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Decoding the Intricacies of GST Evasion

$10,319,683,940—that is the amount India loses in tax every year to global tax abuse, according to UK-based Tax Justice Network. This $10.3 billion is 0.41% of the country's GDP, or to put it in more relevant terms, considering the current pandemic, this amount is 44.7% of India's healthcare budget or better still, it can pay the salary of 4,230,656 nurses!

Little wonder then that unearthing tax evasion and tax fraud has become a high priority for the Government of India. While on the one hand income tax evasion has come under the scanner, on the other, the noose around GST fraudsters is rapidly tightening. In the last few months of 2020, more than 3,000 cases of GST fraud were reportedly unearthed. The numbers are only increasing by the day. The profile of these GST fraudsters ranges from some dodgy CAs to CFOs and even promoters of companies, and most of these cases are related to furnishing fake invoices for claiming input tax credit.

Let us first decode the modus operandi. Input tax credit related fraud is being carried out in two ways:

- The first and simple way to do it is to obtain an invoice from a fake company, show as if GST has been paid to that company for the 'goods or services' bought (obviously a sham transaction) and claim input tax credit for it.
- The second and a more complex method is sophisticated and has a few advantages. Fraudsters create shell companies, route fake invoices through a series of these companies and transfer input tax credit from one to another in a circular manner. This scam also enables companies to show a higher turnover, which is helpful in securing bank loans, while evading GST at the same time.

How is it that these scamsters went undetected? The primary reason was the lack of due diligence during GST registration. In order to warm up the business world to the idea of GST, the Government made the process hassle free in the initial year. However, the lack of physical verification of companies and strong scrutiny meant that scores of dummy companies were able to get GST registration. Some of these shell companies even used random Aadhaar and PAN numbers to get GST registration.

Apart from this, the lack of data exchange and coordination between the enforcement agencies and banks also helped GST fraudsters get away. However, since November 2020, the Central Board of Indirect Taxes and Customs has embarked on an enforcement drive resulting in many tax evasion cases coming to the fore.

Lastly, when GST was introduced 3 years ago, the checks and balances were implemented in a highly diluted form due to technological constraints. This forced the hand of the GST Council, the apex governing body for the GST regime, to go with a simple form called GSTR 3B, which meant that invoice matching (the practice of cross checking invoices uploaded by the buyer with the ones uploaded by the seller) was done away with to process input tax credit claims.

Implementation of two other forms, the GSTR 2 and GSTR 3 that were supposed to be used for verification of transactional details uploaded by buyers and sellers was also shelved. This helped many evaders claim input tax credit without paying taxes in the absence of any cross verification.

Cut to the present, the extent of this fraud is taking even taxmen by surprise. In December 2020, the Government came up with revised rules for GST verification.

The following are the highlights of the changes.

- **Investigation of New Enrollees**

GST authorities now have the right to physically verify the place of business before granting GST registration in cases where Aadhaar authentication has not been successful, or if they deem fit, to undertake verification in certain cases.

- **Revocation and Suspension**

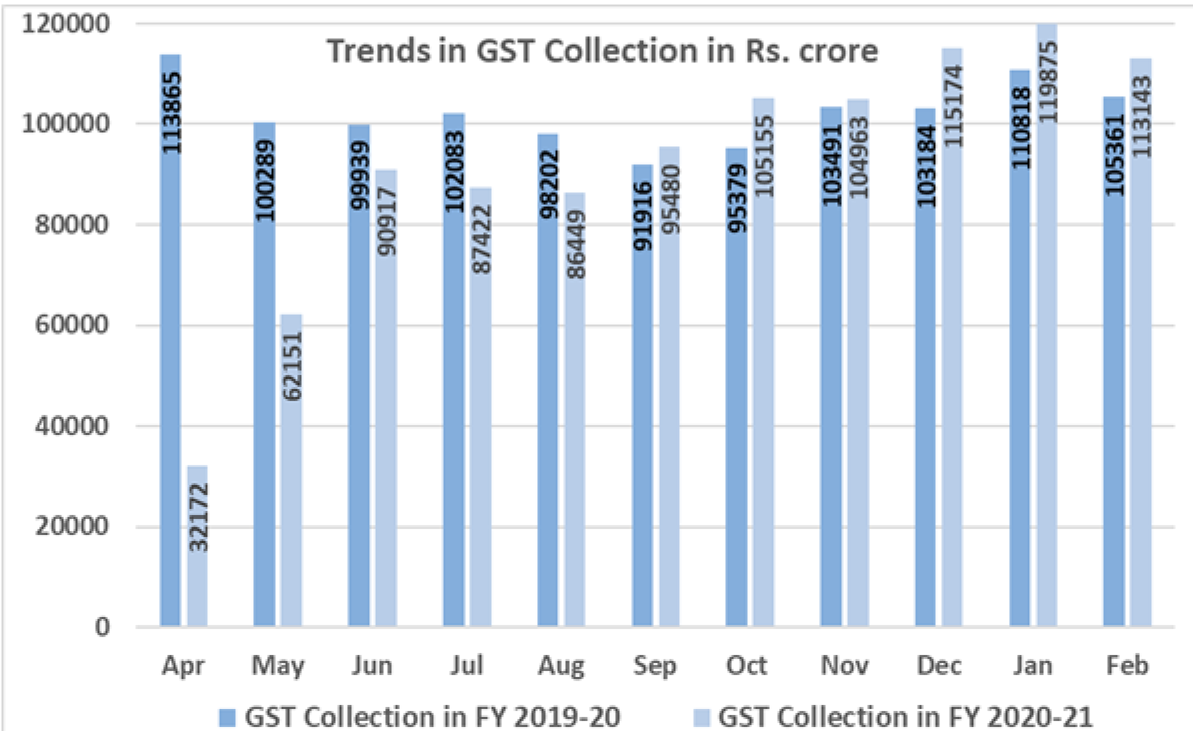
According to a new sub-rule, in case of any discrepancy between a taxpayer's GSTR-3B return and his GSTR-1 and/or GSTR-2B returns which indicate that the taxpayer has violated the provisions of the CGST Act, his registration could be suspended. Following this, he will be issued a notice to explain these differences, failing which the GST registration could be cancelled.

- **Cash Amount**

Another significant change has also been introduced. According to this, businesses whose monthly turnover exceeds Rs. 50 lakh can use input tax credit only up to 99% of output tax liability. The rest has to be paid in cash.

'E-invoicing' or 'electronic invoicing' is also being introduced in a phased manner to report business to business (B2B) invoices to the GST system. Efforts are also on to deploy advanced technology to help compliance. In her Union Budget speech, the Hon. Finance Minister Nirmala Sitharaman said, "Deep data analytics and AI tools are being used to crackdown on GST input tax credit, refund and other frauds and to identify those trying to game the system. Invoice and input tax credit matching is being done wherein returns with mismatch of more than 10% or above a threshold are identified and pursued."

The Government claims that all these initiatives are having a positive effect on compliance, as GST collections are already bouncing back despite a rough year due to the pandemic. As per the Finance Ministry, GST revenue for the month of February 2021 was 7% higher than what it was in the same month last year.



Source: https://pib.gov.in/PressReleseDetail.aspx?PRID=1699562

Even as the Government is doing its part to drive GST compliance, companies are continuing to face the consequences of having done business with those that have not complied. For example, despite being compliant themselves, the consignments of such companies will not move. Their input tax credit will be barred as per the 20% ITC rule. Further, their payment cycle will suffer if their vendor is stuck in any legal proceedings.

Hence, a thorough scrutiny before entering into contracts with vendors can save a lot of trouble further down the road. For starters, cash under GST can simply be manipulated by running a cash-intensive business, where proof of business transactions is not available. To cover the cash flow trail, such vendors may fabricate records of transactions or ask for payments to be made into multiple accounts. In some instances, an entity may be using multiple GSTINs to distribute the inward and outward transactions or the profits among imaginary partners. A vendor switching businesses often is also a red flag. Invoicing practices of vendors also need to be examined for mistakes in product costs, GST rates, or backdated documentation for the transaction.

For instance, in a scam in Uttarakhand unearthed by data analytics deployed by taxmen, there was a network of more than 500 fraudulent entities comprising fake billers, intermediary dealers, distributors, and bogus manufacturers of '*Hawai chappals'* (rubber slippers) to avail and encash fake input tax credit. These fake manufacturers were reportedly supplying to other fictitious entities and retailers in Gujarat, Maharashtra, and Tamil Nadu. The raw material for the *chappals*, known as Ethylene-vinyl acetate attracts 18% GST, whereas ready *chappals* are charged 5% GST, which allowed manufacturers to claim a refund of the inverted duty structure in cash.

Finally, one of the easiest ways to identify a risky vendor would be its non-compliant GST return filing history.

These risks can be mitigated by going digital and keeping records of where the money goes and insisting on proper GST invoices for every single transaction with vendors. Vendors' business continuity also needs to be examined by going into their proof of existence.

Doing these checks and scrutiny is a time consuming process, and not to mention, may not always give a complete picture. Therefore, at **Rubix** we carefully monitor if our customers' counterparties pay their GST and file their returns on time each month; in fact, this is a key part of our Risk Monitoring services. The timely payment of GST is considered to be a key variable in computing the **Rubix Risk Score**. If a firm delays paying its GST and filing its GST returns for some or all the GSTINs associated with it (across states), it implies that the firm is either facing serious cash flow issues or is trying to engage in some kind of evasion. Both scenarios are negative and such delays are therefore tagged as red flags. They will negatively impact the **Rubix Risk Score** of the firm in question which helps our customers to decide whether or not to engage with that entity.

It is clear that the Government is serious about enforcing GST compliance, especially as it desperately needs tax revenues for stimulating the economy during the pandemic. With so many GST evasion cases tumbling out every day, the pressure is only going to mount on companies to ensure that they deal with GST-compliant vendors in the days ahead .

Contact Us

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