Ratings for GST Compliance: A Novel Idea, Indeed

As **Prabhanjan Halgeri** explains, the planned GST compliance ratings will be a boon in many ways, but there are also several challenges to look out for

For better or worse, students get rated on their academic achievement, products on their energy efficiency, and businesses on a whole host of parameters, including credit-worthiness. Starting shortly, the Indian government will start to rate companies on their 'GST compliance'. The eventual aim is to incentive good behaviour through expedited tax credits and refunds. It remains to be seen whether, and to what extent, this actually pans out, but in theory, the idea is most sound.

> GST compliance ratings will incentive 'good' behaviour, and managed well, will be a positive for businesses

How GST ratings would work...

The new ratings methodology will measure how compliant businesses are with reference to their GST obligations. It will be a points-based system that rates firms on a 1 (worst) to 10 (best) score. The scores will be made public on the GST Network (GSTN), hopefully giving a boost to transparency, and encouraging the non-compliant to change their behaviour. The underlying objective is to nudge India's business culture away from evasion and avoidance, and towards willing compliance. Over time, a rating of 10 may come to symbolise public credibility, at least on this one front.

While the rating parameters are yet to be notified, indications are that they will include the timely completion of:

- Tax payments
- Filing of returns
- Reconciliations between buyer- and seller-reported data on the GSTN
- Uploading of invoices

- Submission of GST audit reports

Additionally, ratings will take into account the timeliness with which businesses adhere to other provisions of the GST Act, and how quickly they respond to the GST authorities.

...and how they would benefit the compliant...

As envisaged, the system will allow several benefits to flow to the more compliant tax filers. Highly-rated purchasers, for instance, may receive immediate input tax credits, helping them better manage their working capital. (At the moment, unreconciled transactions tend to delay tax credits, putting a strain on finances.) The better-rated companies – anyone, say, with a score of 5 or higher – may also become eligible for quicker refunds. This would be a welcome development, in particular, for export-driven businesses, because the input credit would effectively become a refund claim. Meanwhile, sellers with high ratings will command a higher standing in B2B transactions, and hence attract more business. Clearly, this would need to be validated empirically, given that the economy as a whole is undergoing a transformational shift away from non-compliance but in principle, this step towards creating a merit-based system is a good thing in every way. There is also the possibility of the government offering ratings-linked tax rebates – such as a 5 per cent rebate for a specified period for those rated 8 or higher. Companies with high compliance ratings will also be able to disclose this information in their financial statements, attracting investment and enhancing shareholder value. Finally, they will presumably see fewer tax disputes and less litigation.

...and the government

For the government, an obvious benefit of such a system – or rather, the behaviour it might encourage – is higher and timely tax collections. Additionally, if ratings feed into a system of exceptions-based scrutiny, it would reduce the quantum of time and effort required of the Tax Department. For example, it might be prescribed that vendors with ratings of 8 or higher be subject to GST departmental audits every 3 years, while those rated between 1 and 5 may have to face annual audits..

Firms - and the government - will need to avoid pitfalls such as poor ratings stemming from initial non-compliance, and unilateral action by creditors

Punishing the non-compliant

A corollary of the new ratings system is that it will allow a 'blacklisting' of the chronically non-compliant. Again, it is not yet clear what parameters will be used to assess this, but they could include non-filing of tax returns or falling short on tax dues for 3 months in a row, or failing to respond in a timely manner to the GST authorities 3 or more times. The blacklisted names will get displayed on the GSTN website, and in extreme cases – say, if someone on the list fails to become fully compliant within a period of 6 months – it could lead to de-registration.

Some possible pitfalls

Expectedly, there will be certain issues with any ratings system like this. For one, bigger companies will be at an advantage, adapting faster than their smaller rivals, who may not be able to afford to engage consultants or dedicate the kind of resources needed to ensure compliance. Second, in the initial stages of GST implementation, businesses will be more prone than usual to errors and delays, which will impact their ratings. Third, there may be unintended consequences of a low compliance score. For instance, banks may unilaterally decide to reduce the credit limit for poorly-rated borrowers, setting off a vicious spiral of sorts. Finally, other stakeholders will need to be extremely cautious about not dealing with blacklisted vendors, because they may not be able to claim input tax credit for such transactions.

Summing up

On the whole, GST compliance ratings are very welcome at a conceptual level, even as it is still early days for GST implementation. The modalities of the new system are awaited, but chances are that – by making tax-compliance information public – it will prove to be a path-breaking move along India's journey to transparency and compliance. Hopefully, it will give a boost to India's tax-to-GDP ratio – a lowly 17 per cent today – as well its credit and 'ease of business' ratings. To drive this forward, the government should consider incentivising compliance, such as through a steeply-progressive scale of GST duty drawbacks or refunds. (For example, those with a rating of 10 may be eligible for a 10 per cent drawback; those with 9, 7.5 per cent; and companies with 8, a lower 5 per cent.) Doing so would be a real shot in the arm for the new system. ■

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