Anti-Profiteering in GST – The Way Forward

India is going through a transition through one of the biggest post independence tax reforms i.e. Goods & Services Tax (GST Law). However, the implementation of the GST in fellow countries indicated a rise of the inflation in transition period. They have taken various measures to put a check on the inflation and mitigate its effect due to implementation of GST. At the same line in India, the most powerful mechanism i.e. Anti-profiteering to dilute the rise of inflation because of the undue gain due to tax benefit on introduction of GST Law is taking shape. The Indian lawmakers in the GST have restricted the provisions in relation to anti profiteering up to the net benefit due to additional ITC & reduction in tax rate on outward supply. Internationally, Anti-profiteering is a mature concept and has been successfully monitoring and regulating the prices after introduction of GST. The anti profiteering measure in the law is making every enterprise responsible to self check themselves on the prospect of any undue profiteering upon introduction of GST on account of rate change and additional benefit of the ITC claim. Read on to know more…



CA. Ajay Sharma, CA. Vishal Gill and CA. Atul Gupta

(The authors are members of the Institute. They can be reached at atulservicetax@gmail.com.)

The irregularities in price reduction and incidence of unjustified profit have been noticed by every country in which GST has been implemented. India also at the time of implementation of VAT, faced a lot of glitches on this aspect. The revenue authorities displayed a lack of seriousness on fluctuation of prices and failed to establish any mechanism to

detect such issues and to monitor those on prospect of profiteering.

The introduction of Anti profiteering clause in the GST law may be a lesson from the previous deeds but it will attain definite fate only after proper adoption of some international practices and some appropriate hybrid rules suitable for Indian market.

The term profiteering has been evolved from the word "profiteer", the dictionary meaning of which is "Make or seek to make an excessive or unfair profit, especially illegally."

The concept of profiteering under GST can be understood from the following example:

ILLUSTRATION FOR ANTI-PROFITEERING						
	PRE GST		**Profiteering in Post GST**		**Profit Neutral After GST**	
Sale Price	128	-	-	118	-	114.46
Output tax	28	-	-	18	-	17.46
Base Price(Ex Tax)	-	100	-	100	-	97
COGS(After set off of credit)	**A**	30	**A**	29.1	**A**	29.1
Gross profit	-	70	-	70.9	-	-
Staff Cost(Salary)	20	-	20	-	20	-
Rent	12	-	11.3	-	11.3	-
Other overhead	30		28.6	-	28.6	
Indirect Expenses	**B**	62	**B**	59.9	**B**	59.9
Total Cost	**A+B**	92	**A+B**	89	**A+B**	89
Operating profit	-	8	-	11	-	8
Margin (%)	-	8	-	11	-	8.25
CONCLUSION:						
The prices in post GST regime should be reduced to the extent of the reduction in output tax rate and benefit in terms of ITC, then only it will be considered as compliance with Anti profiteering measure under GST law.						
ASSUMPTION:						
1. Rent and other overhead have been considered cheaper (in post GST regime) due to additional allowance of ITC. **2.** All expenses have been considered as net of ITC in pre & post GST regime. **3.** Pre GST rate of tax assumed as 28% & post GST as 18%.						

The prime motive of the GST law is to eliminate the cascading effect of existing taxes; cascading means 'tax on tax'. The mainstay theory of the GST is based on the fact that the tax on any input or input service utilised during the process of manufacturing/ provision of a product or a service would have to be offset against the subsequent output tax paid. The principle of seamless credit system has been formulated keeping the consumer in mind and remove inefficiencies in the supply chain.

But the principle will be defeated if an entity in the supply chain, for instance, a trader, decides to take benefit of a reduced tax rate due to introduction of GST and does not pass on such benefit to a consumer by hiking up his profit. So the anti profiteering is indirectly protecting the core principle of the GST i.e. elimination of cascading effect and seamless flow of credit.

Indian History of Profiteering & Law Under GST

The term anti-profiteering is not new for the Indians as well, although it has been disseminated to the mass for the first time after introduction for the GST. In 1958, West Bengal introduced "The West Bengal Anti-Profiteering Act, 1958" to regulate the prices and supplies of certain specified goods. Further, the act had laid down measures to prevent profiteering in certain articles in daily use at that point of time. However, Anti-profiteering in GST is not regulating the supply; it is only monitoring the price changes due to the reason of introduction of GST.

Features of Indian Law & Mechanism

Indian GST has provided Section 171 in CGST Act, 2017 to govern the anti-profiteering; however, the detailed rules for anti-profiteering are still awaited. However, the lawmakers have formulated the National anti-profiteering Authority to oversee the anti profiteering related issues. The extracts of section 171 are as follows:

> *"(1) Any reduction in rate of tax on any supply of goods or services* ***or*** *the benefit of input tax credit shall be passed on to the recipient by way of commensurate reduction in prices.*
>
> *(2) The Central Government may, on recommendations of the Council, by notification, constitute an Authority, or empower an existing Authority constituted under any law for the time being in force, to examine whether input tax credits availed by any registered person or the reduction in the tax rate have actually resulted in a commensurate reduction in the price of the goods or services or both supplied by him.*
>
> *(3) The Authority referred to in sub-section (2) shall exercise such powers and discharge such functions as may be prescribed"*

It is evident that the Indian law is setting an obligation on the supplier to pass on the commensurate benefit arising out of any reduction in taxes on goods/services and also the benefit of input tax credit. It means that the Indian law is restricting the anti-profiteering measure only up to the additional benefit of the tax credit and additional reduction in taxes. This law is not taking care of the implementation cost and any other cost that raises due to introduction of the GST. Further, the law is also silent on aspect of the definition of the profiteering and profiteer.

Moreover, the GST council has also laid down rules 122 to 137 in the CGST rules, 2017 to constitute an authority to examine whether input tax credit availed by any registered person or the reduction in tax rate have actually resulted in a commensurate reduction in the price of the goods or services or both supplied by him.

In addition, the rules have been framed for the constitution and composition of the members of the National Anti-Profiteering Authority (NAPA). Following are the features of NAPA:

1. NAPA shall be five member committee consisting of a Chairman.
2. The Authority shall cease to exist after the expiry of two years from the date on which the Chairman enters upon his office unless the Council recommends otherwise.
3. The authority has Power to determine methodology and procedure for determination as to whether the reduction in the rate of tax on the supply of goods or services or the benefit of input tax credit has been passed on by the registered person.
4. The authority shall conduct investigation through Director General of safeguards upon recommendations made by the standing committee from the application received by the state level screening committee and collect evidence necessary to determine undue profiteering.
5. The authority shall pass necessary orders.

The flow of application to NAPA can be understood from the following flowchart:

APPLICANT (Suppliers & Recipient of goods & Service)

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STATE LEVEL SCREENING COMMITTEE

constituted in each State by the State Governments, Screening Committee shall forward the case upon satisfaction to the Standing committee on anti profiteering

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STANDING COMMITTEE ON ANTI PROFITEERING

it shall refer the matter to the Director General of Safeguards for a detailed investigation upon satisfaction that there is a *prima facie* evidence against interested parties

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INVESTIGATION By Director General of safeguards

will complete the investigation within a period of three months upon completion of the investigation, furnish to the Authority (NAPA), a report of its findings along with the relevant records.

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Duties of NAPA

To determine whether reduction in prices done, To identify the offender, to order

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ORDER

Reduction in prices, to return the amount with interest, Imposition of fine & Penalty, cancellation of registration

The National Anti-Profiteering Authority is a mechanism devised to ensure that prices remain under check and to ensure that businesses do not pocket all the gains from GST; because profit is fine, but undue profiteering at the expense of the common man is not.

Although a situation of conflict may also arise during the course of investigation due to such silence of law in respect of definition & mechanism of determination of profiteering and the profiteer as well.

Further, the markets in India are highly unorganised at grass roots; in this situation, it will be a task for the authorities to track such cases of profiteering. Though in the initial transition of the GST law, there are high possibilities of the cases of profiteering in each level of industry sector; however, many of these might be cases of unwilling profiteering, reason being lack of availability of mechanism and regulation for identification of profiteering. It means industry (specifically SMEs) is unable to calculate the effect of the benefit due to implementation of GST, because it is a meticulous and difficult exercise to determine the quantum of benefit for small & medium enterprises, specifically in case of B2C supplies. So, there is no exaggeration to say that the market has already profited with benefit due to GST (either knowingly or unknowingly) and more unfortunate is that such benefits are/will be irrecoverable and unidentifiable for authorities.

International Laws, Regulations & Practices

➢ **Overview & Outcome of Australian Law**

Australia introduced GST law on July 1st, 2000 under the New Tax System (NTS) for replacement of number of existing indirect taxes including wholesale sales tax. In Australia, the anti-profiteering monitoring remained instrumental for 3 years, including 2 years post implementation.

The Australian lawmakers introduced a prices oversight regime under the Trade Practices Act, in which the *Australian Competition and Consumer Commission* (ACCC) was entrusted with specific responsibilities to oversee pricing responses to the introduction of NTS (Including GST) during the three year transition period from 8th July 1999 to 30th June 2002. The commission was required to report on quarterly basis during these 3 years to the Minister about its operations in relation to the New Tax System; the reports were also published on the website of ACCC.

The ACCC worked vitally in the implementation of anti-profiteering. By gathering the information of prices and pricing behaviour in the period prior to the introduction of the GST i.e. up to 1st July 2000 and in the months immediately following implementation of GST, it helped the commission to estimate the price movements resulting from the GST implementation, which resulted in the identification of the price exploitation.

The Australian lawmakers laid down the guidelines and various communication strategies for proper compliance with the anti-profiteering. The guidelines were released prior to introduction of the GST, which is not the scenario in India where the industry is still waiting for a set of complete guidelines for the proper mechanism in respect of identification of the profiteer & profiteering.

The glimpses of the guidelines issued by the ACCC are as follows:

- **The ACCC guidelines on price exploitation**
  The Commission's price exploitation guidelines, *"Price exploitation and the New Tax System"*, gave business the basic information needed to comply with the NTS.
  The draft preliminary guidelines were first released in April 1999 and revised guidelines were published in March 2000 to provide greater certainty for business in setting prices.
- **Net Dollar Margin Method:**
  The net dollar margin rule was a fundamental principal of the guidelines for the determination of the price variance & changes respectively. The principle of ***Net dollar or Price margin method*** is that if due to the introduction of GST, incremental taxes and costs of input fall by $1 then prices should also fall by at least $1. If, after taking into account the *cost reductions resulting from* the NTS, the *costs of a business rose* by $1, then prices might rise by no more than that amount.
- **Price margin method**
  Further as per ***price margin method***, prescribed that in any event, the prices charged by the businesses should not rise by more than 10 per cent because of tax changes due to two reasons (ACCC 2000a, 2000d). The reason was that the net cost of inputs/raw materials used by the companies to run their business was not expected to *increase beyond 10 per cent* after consideration of the *claim of an input tax credit for the GST* paid (ACCC 2000d).

However, businesses may adjust their prices to the extent of recouping the compliance costs associated with the GST such as purchase of new accounting software, staff training, and seeking advice specific to GST compliance. However, the capital expenditures (e.g. installation of a new accounting system) incurred by the businesses to comply with GST were allowed to be passed on to prices over several years in line with accounting depreciation rules (ACCC 2000d).

It is pertinent here to notice that these guidelines considered the effect of rise in cost of business due to introduction of GST; comparatively, Indian law only talks about the benefit arisen out of reduction in output tax rate & increase in additional ITC.

- **Price Monitoring by the ACCC**

  The general survey: The general survey involved collecting prices on identical products at different times. The Commission conducted the general survey seven times during the GST transition period: December 1999–January 2000, March, May, August and October 2000, February and May 2001. The size of the survey was substantial.

  Monthly supermarket survey: The Commission conducted monthly surveys of supermarket prices from January 2000 until June 2002, covering more than 300 supermarkets nationwide, with a product basket of over 100 commonly purchased items. The comparisons over time were based on changes between prices averaged over two months.

  Consumer price index: The Commission analysed official statistics produced by the Australian Bureau of Statistics. Particularly data from the CPI (Consumer Price Index) which measures price movements in a basket of goods and services consumed by capital city households.

  General impact of the New Tax System: The results of the Commission's surveys since the September 2000 quarter, together with CPI outcomes, confirmed that the impact on prices occurred mainly in the first quarter of 2000–01. This was consistent with the Commission's estimates. No evidence of significant opportunistic pricing to increase margins was found.

  Industry specific monitoring: The Commission was also active in monitoring price movements within specific industry sectors, particularly in the period leading up to the introduction of the GST on 1st July 2000 and in the subsequent 12 months period.

- **Enforcement of Australian Anti-profiteering:** The price exploitation remained an enforcement priority of ACCC throughout the three years of the transition period. The ACCC has kept their eye specifically on the following issues during the transition period:
  - Either GST charged on GST-free items?
  - Businesses not passing on indirect tax benefits, such as abolition of WST or the reduction in petrol excise, in full.
  - Businesses misrepresenting the total price of goods or services (GST-exclusive price display).
  - Increase in prices which reflected the full impact of the tax changes on the consumer price index (CPI) where the GST also was previously imposed (CPI-based increases may have needed to be discounted for the effect of GST to comply with the Commission's rule that businesses should not increase their net dollar margin as a result of introduction of GST).
  - Charging of GST on contracts that did not provide for the pass through of GST.

TRIVIA

As a result of the meticulous monitoring during the transition period, the Commission investigated approximately **7000** GST-related matters, obtained refunds of around **$21 million** on behalf of approximately two million consumers, instituted court proceedings in **11** GST-related matters & **Accepted 55** court enforceable undertakings.

➢ **The Malaysian Law for anti profiteering**

- The introduction of the GST in Malaysia has also come up with the implications of the anti-profiteering. The law in relation to the anti-profiteering in Malaysia was not specifically mentioned in the GST act, but it was enacted by the Ministry of Domestic Trade and Consumer Affairs. The Malaysian lawmakers introduced *"The Price Control and Anti-Profiteering Act, 2011"* to control price of goods and charge for services and to prohibit unreasonably high profiteering by suppliers. Further, they have also enacted the regulation to determine the profiteering, the regulation was named "The

PCAP Regulations 2014". These regulations specified a time frame (i.e. 2nd Jan 2015 – 30th June 2016), which was subsequently extended to 31st December 2016, in which businesses must not increase their net profit margin. Further, it has been extended on 22nd December 2016 till infinite period as of now, expressly for food & beverages and household goods, the Ministry of Domestic Trade, Co-operatives and Consumerism (KPDNKK) gazetted a new regulation -- PCAP Regulations 2016, which came into effect on 1st January 2017.

Definition and determination of unreasonably high profit:

As the name sounds, the unreasonably high profit was incremental profit after GST from the standard rate of profit prior to the introduction of GST.

The regulation has prescribed the formula for the determination of the unreasonable profit by analysing the net margin/Mark-up in pre & post GST.

In the Malaysian law, if the net profit margin on supply of goods or services under GST regime exceeds the net profit margin as at 1-1-2015 (introduction date of GST), then the supplier is called upon to justify his prices and profits.

Malaysia's anti-profiteering rules were drawn up on a formula-based approach to determine instances of "profiteering" or "unreasonably high" profit. The prescribed formula for determination of net profit margin takes into account factors such as taxes, supplier costs, supply and demand conditions, circumstances of the geographical and product market.

Based on such report, it is also reflecting that such rigorous enforcement of the anti profiteering in Malaysian law has resulted into over-regulation and micro-management of market forces, resultantly enhancing the cost of compliance and choked growth. Such kind of aggressive implementation was criticised widely and proven litigious.

Mechanism provided in the Malaysian Regulation for anti-profiteering

The amended Malaysian regulation has specified following mode for the calculation. It specified that to comply with non-profiteering, the MU% (Mark-up %) or MG %(Margin %) throughout that particular year (i.e. P_B or P_C) shall not be higher than the computed base mark up or margin (P_A). It means if at any point of time the margin & mark up (i.e. P_B or P_C) exceeds the base mark up & margin (i.e. P_A) such situation shall be considered as profiteering.

whereas

$P_A = X_1 + Y$ (Baseline MU% or MG% for the first day of the year)

MU/MG= Mark up/Margin

X_1= MU% & MG& on the on the first day of introduction of GST

Y= Higher of T_1, T_2

T_1= Trend of MU or MG on 1 year preceding to introduction i.e. $X_1 - X_2$

T_2= Trend of MU or MG on 2 year preceding to introduction i.e. $X_2 - X_3$

MU%= Selling price – Cost/Cost x 100

MG%= Selling Price – Cost/Selling Price x 100

Note: As per Malaysian regulation (Amended), If MU% or MG% exceeds its base PA due to cost efficiency, it is not considered as profiteering.

ILLUSTRATION on Malaysian regulation

Step 1: Identify X_1, X_2 and X_3 from past three preceding years from business

Let us assume

X_1 (i.e. margin/or mark-up % beginning of implementation year) = **5.4%**

X_2 (i.e. margin/or mark-up % at second preceding year) = **5.3%**

X_3 (i.e. margin/or mark-up % at Third preceding year) = **5%,**

Step 2: Compute the Y (growth) i.e. higher differential value of mark-up & margin % between 3 years.

$T_1 = X_1 - X_2 = 0.1\%$

$T_2 = X_2 - X_3 = 0.3\%$

Higher of Both will be 0.3%, that means Y=0.3%

Step 3: Compute the base MU% or MG% (i.e. PA) for the implementation year

$P_A = X_1 + Y = 5.4\% + 0.3\% =$ **5.7%**

CONCLUSION

To comply with PCAP Regulations 2016, the selling prices can be increased throughout the year, provided that the, MU% or MG% (i.e. ***PB****) resulting from the change in prices do not exceed the value of PA i.e. 5.7%.*

Complication Arising In Indian Law and Their Hybrid Solution

There are enormous issues, which are coming crossways to the industry while complying with the Anti-Profiteering measure. The industry is in dilemma of getting penalised for the choice of method for determination of the profiteering as the law is silent about the mechanism and formula for the determination. Simultaneous exercise of determination of profiteering clueless law with implementation of GST is overburdening the industry with the fear of non-compliance.

The clarity is also missing about whether the profiteering should be calculated on the business segment basis or individual product basis or contract basis or at the level of overall business. A uniform approach will lead to the absurd results, because the company may gain some penny in an independent agreement or segment, but may have suffered massive losses in overall business due to implementation of GST. The reason for loss directly may not be the tax rates, but the implementation cost and compliance burden that may add some chunks to the cost. Therefore, the wandering giant i.e. anti profiteering measure under GST is making business more complicated as of now. The following are some critical complications, which businesses are facing to comply with anti profiteering measure under Indian GST:

1. The definitions of the profiteer & Profiteering is absent in the law, law is completely non speaking on various issues.
2. The detailed mechanism and criteria for identification of the benefit that arises due to introduction of GST is absent.
3. The all inclusive contracts (AI Contracts) entered in pre GST regime, travelling in GST are difficult to analyse on prospect of profiteering specifically in case of contracts entered with Public Sector Units(PSU's).
4. Industry is unconscious about the concept; awareness to the small industry has not been made, resultantly it is making situation difficult for large units of industry in *Suo Moto* exercise of anti profiteering measure due to non-involvement of bottom line industry.
5. No survey or reports on the price fluctuation in pre & post GST regime.
6. Only the key players of markets are properly analysing the impact of anti profiteering measure that too on a high cost of consultancy and even with a fear of non-compliance due to absence of provision/mechanism.

The solution to all these complications is only one i.e. to follow the hybrid version of the Indian law and international regulations/practices. However, the same will definitely be resulting in the apparent non-compliance, as the Indian law is specific and does not take all other factors occurred due to GST implementation. But, in absence of the available law & regulation, the results arising out of such route shall be at least justifiable to the authority with the contention of the *Bona-fide* believe.

The industry may categorise their impact analysis for anti-profiteering measure in the following three scenarios on the basis of the international law & Indian law as of now:-

1. **Impact as per Section 171 of GST Act 2017:** The amount of net benefit arising out of additional tax credits and reduction in taxes due to introduction of GST.
2. **Impact after considering international practices:**
   a. **Impact as per international practice without considering exceptional items** It will be after consideration of factors in addition to Indian law i.e. recurring implementation cost and additional compliance cost due to introduction of GST etc.
   b. **Impact as per international practice after considering exceptional items:** It will be in addition to the factors cited above; the exceptional factors due to introduction of GST.

So, the hybrid analysis in the above said manner will result in a holistic view of the impact of GST

in prospect of anti profiteering. Such scenarios shall cover all aspects, which will result in healthier compliance and facilitate management to take decision.

Exceptional Item

Apart from the direct attributable cost, industry has also come across various indirect/implicit costs, which were only because of the introduction of the GST. The nature & factor for these costs may be as follows-

1. Increase in the manpower due to rollout of GST
2. Software integration & rollout to new software
3. Blockage of capital into the debtors due to negotiation of contracts
4. Loss of transitional credit due to certain reason

Further, these exceptional items may vary from nature of business & business entities. Internationally, Australian law is considering capital expenditures (e.g. installation of a new accounting system) incurred by the businesses to comply with GST were allowed to passed on to prices over several years in line with accounting depreciation rules.

Prospective & Suggestion for Indian Statutes

It is apparent that India is still working out on how to operate under the GST for profiteering measure. The law is still ambiguous about the concrete mechanism for the determination of the anti profiteering.

International experience indicates that *anti-profiteering* provisions succeed only if there is detailed mechanism and sufficient preparation time to allow the government & other stake holding agencies to monitor and collect data related to prices of various categories of products and services. However, unfortunately India is lagging in each one of these aspects at present. In comparison to countries like Australia, we have delayed in boarding the train for the detection of cases of anti profiteering in transition phase of implementation of GST, but there is still scope of controlling the damage. The time has come for the lawmakers to take immediate initiatives to settle down the lack of clarity of the law on anti profiteering measure. The suggestions based on the international experiences and in accordance with the nature of Indian tax system are-

1. To define all terminology in relation to anti profiteering measure for specification of scope of law.
2. To define mechanism for determination of the profiteering under GST after taking into consideration impact of currency demonetisation, inflation, seasonal price fluctuations while assessing changes in net margin.
3. To specify the assessment of benefit in accordance with anti profiteering measure, the lawmakers should also clarify either to assess independent business vertical/Business unit/ group or individual goods and services.
4. The lawmakers should come with the definite formula based calculation for the profiteering as done in countries like Malaysia & Australia, to avoid the ambiguity and litigation thereafter.
5. To promote and spread awareness to the masses about the concept of anti profiteering measure with mechanism for its identification.
6. To execute market survey for price fluctuation and identify the sector/industry in which profiteering has been reported during the transition period till date.

Just being vigilant will not suffice the purpose of introduction of Anti-Profiteering measure. There needs to be a mechanism to identify profiteering and thorough market report that needs to be created which can conclusively point out an instance of anti-profiteering.

No matter how complex the implementation of the Anti profiteering measure is, as of now it is utmost needed to settle it down to achieve the targeted benefit of the GST law. If GST fails to deliver its promised benefits to the industry and consumers, then it will definitely create a situation of chaos and obstacle and the hard work of more than a decade shall be at a significant stake resultantly. ■