JOURNAL OF NATIONAL DEVELOPMENT
PEER REVIEWED, INDEXED & REFEREED Bi-ANNUAL INTERNATIONAL JOURNAL
ISSN 0972-8309
https://www.jndmeerut.org
[Vol. 37, No. 2 (Winter), 2024]
https://doi.org/10.62047/JND.2024.12.31.94

Policy Gaps in GST for the Manufacturing Sector: A Study

Nitin Kumar Bidla* and Tarun Jain**

*Research Scholar, Department of Commerce, D. J. College, Baraut, Baghpat, Uttar Pradesh (India) E-mail:<birla.nitin181@gmail.com>

**Assistant Professor, Department of Commerce, D. J. College, Baraut, Baghpat, Uttar Pradesh (India) E-mail:<drtarun04@gmail.com>

Abstract

The introduction of the Goods and Services Tax (GST) in India marked a paradigm shift in the country's indirect taxation system, aiming to streamline taxation and boost the manufacturing sector. However, several policy gaps continue to hinder its full potential. This study identifies key gaps in GST policies impacting the manufacturing sector, such as compliance burdens, input tax credit (ITC) restrictions, and classification ambiguities. Through a literature review and analysis of manufacturing sector data, this paper suggests reforms to address these issues, emphasizing simplification, transparency, and inclusiveness. The recommendations aim to enhance operational efficiency, competitiveness, and economic growth.

Keywords

GST, Manufacturing sector, Policy gaps, Input tax credit, Tax reforms, India.

Centre For Studies of National Development, Meerut
Editorial Office : D-59, Shastri Nagar, Meerut - 250 004 (INDIA)
Ph. : 0121-2763765, +91-9997771669, +91-9412200765

8

Policy Gaps in GST for the Manufacturing Sector: A Study

1. Introduction

The introduction of the Goods and Services Tax (GST) in India on July 1, 2017, represented a watershed moment in the country's economic history. GST replaced a complex and fragmented system of indirect taxes, including excise duty, service tax, value-added tax (VAT), and several state-level taxes, with a unified framework. This reform aimed to simplify tax compliance, enhance transparency, and promote ease of doing business across sectors. For the manufacturing sector, a critical contributor to India's Gross Domestic Product (GDP) and a major source of employment, GST was hailed as a transformative measure to streamline operations, reduce cascading taxes, and improve supply chain efficiency.

Despite its ambitious objectives, the GST regime has encountered several challenges, particularly in the manufacturing sector. While the system has succeeded in reducing logistical bottlenecks and creating a common national market, policy gaps have emerged that hinder the sector's ability to fully leverage the benefits of GST. These gaps manifest in various forms, such as the complexity of compliance processes, restrictions on input tax credit (ITC), ambiguities in the classification of goods, and the inverted duty structure in certain industries.

The compliance burden under GST remains a significant issue, particularly for small and medium enterprises (SMEs) in the manufacturing sector. Frequent changes in regulations, coupled with technical glitches in the GST portal, have further complicated tax filing processes. Similarly, restrictions on ITC for expenses such as capital goods and certain services create liquidity challenges for manufacturers, affecting their working capital and financial health. The inverted duty structure, where the tax rate on inputs exceeds that on finished goods, continues to plague industries like textiles, footwear, and renewable energy, leading to unutilized credits and increased costs.

Another critical issue lies in the classification of goods and services. The existence of multiple tax slabs under GST has resulted in classification disputes, with manufacturers often facing litigation due to differing interpretations of tax rates. Moreover, the lack of sector-specific provisions within GST fails to address the unique requirements of different manufacturing industries, from traditional sectors like textiles and steel to emerging fields such as electric vehicles and green manufacturing.

Given the manufacturing sector's pivotal role in India's economic ambitions, including its potential to generate jobs and drive exports, addressing these policy gaps is essential. Initiatives like "Make in India" and "Aatmanirbhar Bharat" envision a globally competitive manufacturing ecosystem, which can only be achieved by resolving existing challenges within the GST framework. This necessitates a more inclusive, transparent, and simplified taxation system that supports the diverse and dynamic needs of manufacturers.

This paper delves into the critical policy gaps in GST that impact the manufacturing sector, analysing their implications on operations, competitiveness, and growth. Through a comprehensive examination of these issues, the study proposes actionable reforms aimed at fostering a more conducive tax environment. By addressing these gaps, the government can unlock the full potential of the manufacturing sector, ensuring its alignment with broader economic goals and enhancing its contribution to India's growth story.

2. Literature Review

The implementation of the Goods and Services Tax (GST) in India has been a significant reform in the country's tax structure, with widespread implications for the manufacturing sector. While the new tax regime has simplified several aspects of taxation, it has also introduced new challenges. This literature review explores various studies and reports analysing the impact of GST on the manufacturing sector, focusing on compliance challenges, input tax credit (ITC) issues, classification ambiguities, and the inverted duty structure.

Kumar and Singh (2018) examined the compliance burden of GST on small and medium enterprises (SMEs) in the manufacturing sector. Their study highlighted that the multi-tier filing system, which includes GSTR-1, GSTR-2, and GSTR-3, imposes a significant administrative burden on businesses. Frequent changes in GST rules and technical issues with the GST portal exacerbate these challenges. Similarly, Aggarwal (2019) emphasized the disparity in compliance requirements between large manufacturers and SMEs, arguing that the one-size-fits-all approach under GST disproportionately impacts smaller businesses.

The availability of ITC is a critical factor affecting the liquidity and working capital of manufacturers. Sharma et al. (2020) noted that restrictions on ITC for specific expenses, such as goods used for employee welfare and capital investments, create liquidity challenges. Their study also highlighted delays in ITC refunds, particularly for exporters, which adversely impact cash flow. Mehta and Joshi (2021) expanded on these findings by analyzing the impact of ITC mismatches, emphasizing the need for automated systems to minimize manual errors and ensure timely refunds.

The GST regime's reliance on multiple tax slabs has led to classification disputes, which have a direct impact on the manufacturing sector. Gupta and Rao (2020) explored classification issues, highlighting instances where similar products were taxed under different rates due to ambiguous guidelines. For example, products such as confectioneries and snacks often face disputes over whether they should be taxed as processed foods or luxury items. Rana et al. (2021) argued that these ambiguities result in increased litigation and compliance costs, thereby hindering business operations.

Several studies have identified the inverted duty structure as a significant issue under GST. Verma and Singh (2019) analysed the impact of this structure on sectors such as textiles, footwear, and renewable energy. Their research revealed that higher tax rates on inputs compared to outputs lead to unutilized ITC, increasing the financial burden on manufacturers. Das et al. (2021) suggested that rationalizing input and output tax rates could address this issue, enabling manufacturers to utilize ITC more effectively.

The manufacturing sector encompasses diverse industries with unique needs. Jain and Kapoor (2022) observed that the "one-size-fits-all" approach of GST fails to accommodate these variations. For instance, emerging industries like electric vehicles and renewable energy require customized tax policies to foster growth, but such provisions are largely absent under GST.

3. Methodology

This research paper employs a qualitative approach to investigate the policy gaps in the Goods and Services Tax (GST) framework as they pertain to the manufacturing sector. The methodology involves secondary data analysis, stakeholder consultations, and case studies to identify, analyze, and propose actionable reforms for addressing these gaps.

4. Policy Gaps in GST for the Manufacturing Sector

The implementation of the Goods and Services Tax (GST) in India was expected to simplify indirect taxation, streamline processes, and enhance ease of doing business. However, certain policy gaps within the GST framework have created challenges for the manufacturing sector, impeding its growth and efficiency. These key policy gaps include:

4·1 Complex Compliance Framework

- **Multiple Returns Filing :** Manufacturers, especially small and medium enterprises (SMEs), face difficulties in managing the compliance requirements of filing multiple returns, including GSTR-1, GSTR-3B, and annual returns.
- **Frequent Rule Changes :** The continuous amendments in GST rules create confusion, increasing administrative burdens for businesses.
- **Technical Issues with GSTN Portal :** Technical glitches in the GST Network (GSTN) portal disrupt timely filing of returns and hinder smooth compliance, especially during peak periods.

4·2 Input Tax Credit (ITC) Restrictions

- **Blocked Credits :** Certain expenses, such as employee welfare and capital goods, are ineligible for ITC, creating liquidity issues for manufacturers.
- **ITC Mismatches :** Mismatches between supplier invoices and buyer claims lead to ITC denials, impacting working capital.
- **Refund Delays :** Delays in ITC refunds, particularly for exporters and industries facing the inverted duty structure, affect cash flow and operational efficiency.

4·3 Inverted Duty Structure

- **Higher Input Taxes :** In industries like textiles, footwear, and renewable energy, the tax on raw materials often exceeds the tax on finished goods.
- **Unutilized ITC :** The inverted duty structure results in the accumulation of unutilized ITC, increasing the cost of production. Despite refund provisions, delays in processing refunds exacerbate the issue.

4·4 Ambiguities in Classification and Tax Rates

- **Multiple Tax Slabs :** The GST framework includes multiple tax rates (0%, 5%, 12%, 18%, and 28%), leading to confusion in classifying goods and services.
- **Classification Disputes :** Manufacturers often face disputes over the classification of goods, such as whether a product qualifies as essential or luxury, resulting in increased litigation and compliance costs.
- **Lack of Clarity for Emerging Sectors :** Industries like electric vehicles and renewable energy struggle with ambiguous classification and inconsistent tax rates, limiting their growth potential.

4·5 Compliance Costs for SMEs

- **Disproportionate Impact :** Small and medium manufacturers face challenges in hiring skilled personnel for GST compliance, given the complexity and costs involved.
- **Threshold Concerns :** The turnover threshold for GST registration, though aimed at excluding micro-businesses, sometimes creates an uneven playing field for SMEs competing with larger players.

4·6 Limited Focus on Sector-Specific Needs

- **One-Size-Fits-All Approach :** The GST framework lacks tailored provisions for different sectors within manufacturing. Traditional industries like textiles and new-age sectors like electronics have unique needs that are not adequately addressed.

- **Export-Oriented Units :** Exporters in the manufacturing sector face refund delays and compliance complexities, undermining their competitiveness in global markets.

4·7 High Tax Burden on Capital Goods

- **Tax on Capital Goods :** High GST rates on machinery and capital goods increase the cost of setting up and expanding manufacturing facilities.
- **Delayed Credit Utilization :** Restrictions on claiming full ITC on capital goods further strain the financial resources of manufacturers.

4·8 Limited Automation in Processes

- **Manual Errors in Reconciliation :** The reliance on manual processes for ITC reconciliation and tax filing increases the chances of errors, resulting in penalties and delays.
- **Underutilization of Technology :** Despite advancements, the adoption of automation in GST processes remains limited, especially among SMEs, due to cost constraints and lack of awareness.

4·9 Cross-State Variations in Compliance

- **State-Level Interpretations :** Though GST aims to create a unified tax regime, differences in state-level implementations and interpretations lead to operational complexities.
- **Logistical Challenges :** Manufacturers with interstate operations face compliance burdens related to e-way bills and state-specific requirements.

5. Suggestions for Reform

5·1 Simplification of Compliance

- Introduce a simplified compliance framework for SMEs, with quarterly filing options and fewer documentation requirements.
- Enhance the GST portal's user interface to improve accessibility and minimize technical glitches.

5·2 Revamp ITC Mechanism

- Allow ITC on all legitimate business expenses, including capital goods and employee welfare.

- Ensure timely ITC refunds through automated systems, reducing dependency on manual verifications.

5·3 Resolve Classification Ambiguities

- Establish a centralized classification authority to provide binding rulings on tax rates and product classifications.
- Adopt uniform rates across closely related products to reduce disputes.

5·4 Address Inverted Duty Structure

- Rationalize input and output tax rates to eliminate the inverted duty structure.
- Introduce specific refund mechanisms for industries affected by this structure.

5·5 Sector-Specific Incentives

- Provide tax incentives and exemptions for emerging sectors like green manufacturing, electric vehicles, and renewable energy.
- Develop industry-specific GST guidelines to address unique challenges.

5·6 Strengthen Policy Dialogue

Foster regular consultations between policymakers and industry stakeholders to address evolving challenges.

Create grievance redressal mechanisms for resolving compliance and classification disputes efficiently.

6. Conclusion

While GST has significantly transformed India's tax landscape, the manufacturing sector continues to grapple with compliance burdens, ITC restrictions, and rate ambiguities. By addressing these policy gaps, the government can foster a more conducive environment for manufacturing, aligning with India's vision of becoming a global manufacturing hub.

This paper highlights actionable reforms to simplify compliance, enhance transparency, and ensure sector-specific inclusiveness, ultimately boosting competitiveness and economic growth. A collaborative approach between policymakers, industry stakeholders, and tax authorities is essential for realizing GST's full potential in the manufacturing sector.

References

Aggarwal, R., "Compliance Challenges for SMEs under GST in India", ***International Journal of Business and Management Studies***, 6(3), 2019, 45-62.

Das, A., Roy, K., & Chakraborty, P., "Rationalizing the Inverted Duty Structure: Impact on India's Manufacturing Sector", ***Economic and Political Weekly***, 56(12), 2021, 27-33.

Government of India, Ministry of Finance, ***GST Annual Report 2021-2022***, (2022). Retrieved from https://gst.gov.in, pp. 12-35.

Gupta, A., & Rao, S., "Classification Ambiguities in Goods and Services Tax: Implications for Indian Manufacturers", ***Journal of Tax Policy and Research***, 9(4), 2020, 201-217.

Jain, P., & Kapoor, N., "Sectoral Challenges under GST: A Study on Manufacturing Industries", ***Indian Journal of Economic Policy***, 14(2),2022, 79-98.

Kumar, M., & Singh, R., "Understanding the GST Compliance Burden on Small and Medium Enterprises in India", ***Asian Journal of Business and Economics***, 5(2), 2018, 89-105.

Mehta, S., & Joshi, D., "Input Tax Credit Mechanism under GST: A Critical Analysis", ***Indian Taxation Journal***, 11(1), 2021, 112-129.

Rana, V., Mishra, T., & Sharma, A., "Litigation Trends in GST Classification Disputes", ***Indian Journal of Law and Policy***, 8(3), 2021, 131-147.

Sharma, P., Yadav, A., & Saxena, R., "Impact of ITC Delays on Export-Oriented Manufacturing Units in India", ***Global Business Review***, 21(5), 2020, 678-692.

Verma, N., & Singh, A., "Inverted Duty Structure: Analyzing Its Implications for the Indian Textile Industry", ***Journal of Economic Studies***, 8(2), 2019, 55-68. ★

Article Received on November 10, 2024; Accepted on December 06, 2024