VAT/GST: A FRIGHTENING BUT FASCINATING FUTUREWORLD….!

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"Once a new technology rolls over you, if you're not part of the steamroller, you're part of the road."

Steward Brand

INTRODUCTION

Taxes are as old as civilization, so the 'Value Added Tax' (VAT), hardly 63 years old, may seem to be relatively young in the history of tax. For India, that embraced this fundamental 'Indirect Tax Reform' in the form of 'Goods and Services Tax' (GST) only in July, 2017, it may even resemble a 'New-born Baby' that has just arrived in the world from the mother's womb!

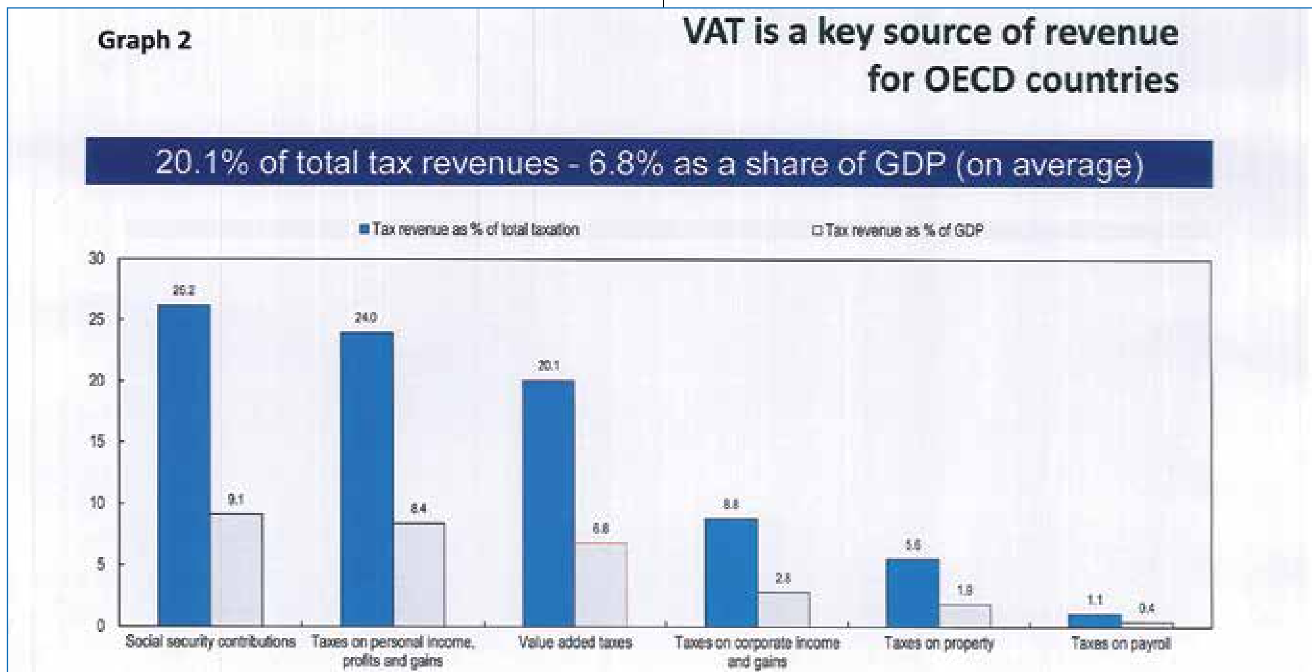
[The words 'VAT' and 'GST' are used synonymously in this article.]

GLOBAL SPREAD OF VAT

The spread of VAT has been the most important development in taxation over the last half-century. Limited to fewer than 10 countries in the late 1960s, VAT/GST is a 'Consumption Tax' of choice of some 170 countries today. Presently, all member countries of the Organization of Economic Cooperation and Development (OECD), except United States, have VAT systems in place [See Graph 1]. Significantly, UAE and Saudi Arabia have also implemented VAT from January 1, 2018, whereas, other Gulf Cooperation Council (GCC) countries – Kuwait, Qatar, Bahrain and Oman – are expected to levy VAT from 2019.

In terms of revenue, VAT is now the largest source of taxes on general consumption in OECD countries on average. Revenues from VAT as a percentage of GDP increased from 6.8% in 2012 to 7.0% in 2014 on average;

and from 20.05% in 2012 to 20.07% in 2014 as a share of total taxation. [See Graph 2].



INDIA'S 'MIDNIGHT TRYST' WITH GST

Finally, GST was launched from the Central Hall of Parliament with much gaiety and fanfare in the midnight of June 30, 2017, marking an opening of a new chapter in the indirect tax history of the country. What was equally significant was the fact that with the introduction of GST, a new era of '**Cooperative Federalism**' was perceived to have begun!

INDIAN GST – FAULT LINES BECOME VISIBLE

However, the fault lines inherent in the design and structure of the country's GST system soon became visible!

Exclusion of several key commodities from GST and resultant distortion of credit chain, significant restrictions placed on the entitlement of Input Tax Credit (ITC) resulting into cascading effect of tax, multiple rates, long list of exemptions, low threshold and ill-conceived business processes are but only a few ills that plagued the Indian GST design from its inception. The biggest 'let-down' turned out to be the GSTN Portal! Multiple and complicated returns, cumbersome Return-filing process, ill-conceived statutory requirements reflecting revenue-oriented, rigid and **'i-don't-trust-you'** attitude coupled with hopelessly ill-prepared GSTN portal have ensured that the GST implementation and compliance by **'more-than-willing**' taxpayers are anything but smooth! The poorly drafted, hastily implemented and badly administered GST laws have only added to the woes of the taxpayers. The situation has reached such an **impasse** that the whole system appears to be running on extensions, promises and assurances!

INDIAN GST DESIGN –WHAT LIES AHEAD?

GST has a potential and the intrinsic characteristics to be 'a **blessing**' – instead of 'a **curse**' as being perceived by many today – provided it is designed and structured intelligently and diligently. The system should be supported by sub-systems such as minimalist number of rates; moderate tax rate; minimum exemption; high exemption threshold; neatly defined key expressions; minimal and clear classification; simple valuation provisions; seamless credit chain; clean and clutter-free business processes; robust, insightful and forward-looking 'dispute redressal machinery' and many more. Anything contrary to this would be a humungous curse for the economy.

TO SUM UP.......

Demonetisation and GST have several common attributes. The most striking one is the discourse of short-term pain and long-term gain. However, the latter can be enjoyed only if one does not succumb to the former. The objective to plug the informal economy – mainly prevalent in MSME Sector – into formal set-up may have benefits. But the cost can outweigh the benefits if done forcefully through radical reforms. Moreover, the decision to grow competitive should be a matter of choice and not compulsion. Presently, lower exemption threshold coupled with cumbersome compliance can prove to be counter-productive and push small businesses towards new ways of tax evasion, thereby breeding corruption.

A mega reform like GST is nothing short of a paradigm shift. Such reforms often gives rise to two broad categories of inconveniences, **foreseen and unforeseen**. Presently, most of the inconveniences were of 'foreseen' category and could have been avoided. Nevertheless, now is not the time to cry over **'what it could have been?'** but, to concentrate on **'what it should be'**.

It is, indeed, heartening to note that the benevolent and responsive GST Council has pro-actively undertaken mid-course corrections. Going by the decisions taken by the Council in last three meetings, the Council appears to be determined to ease the woes, particularly that of compliance load, of the taxpayers and this itself should 'smoothen the ruffled feathers' of the taxpayers, at least, for the time being!

CHANGING GLOBAL TAX HORIZON

Even while the GST Council faces the challenges of finding **'elusive design'** that may fit the bill and the right matrix of the business processes and of building a solid GST structure, the global tax landscape is going through a period of fundamental change. The policy-makers and the tax experts across the world are re-thinking how taxes are or ought to be levied. Changes have been triggered by the unimaginable advancement and rapid spread of technology, digitalisation, new supply chains and an increased scrutiny of multinational tax practices! These changes will certainly have **destabilising** – if not, **devastating** – impact on the taxation across the world including India and will inevitably bring forth its own set of formidable challenges. Obviously, these **changes and challenges** can be ignored by one only at one's own peril!

In the ensuing paragraphs, these technology-driven changes and their likely impact on VAT system are briefly discussed. But before that, it would be advantageous to understand the meaning of 'VAT' and the core principles on which the foundation of VAT rests.

VAT – MEANING AND ITS CORE PRINCIPLES

International Tax Dialogue, 2005 defines '**VAT**' as '*a broad based tax levied at multiple stages of production (and distribution) with – crucially – taxes on inputs credited against taxes on output. That is, while sellers are required to charge the tax on all their sales, they can also claim a credit for taxes that they have been charged on their inputs. The advantage is that revenue is secured by being collected throughout the process of production (unlike a retail sales tax) but without distorting production decisions (as turnover tax does)*'.

In November, 2015, OECD published its 'International VAT/GST Guidelines' (Guidelines). The Guidelines are the culmination of nearly two decades of efforts to provide internationally accepted standard for consumption taxation of cross-border trade, particularly in services and intangibles. The Guidelines aim at the uncertainty and risks of double taxation and unintended non-taxation that result from the inconsistencies in the application of VAT in cross-border context.

The overarching purpose of a VAT is to impose a broad-based tax on consumption, which is understood to mean final consumption by households. A necessary consequence of this fundamental proposition is that the burden of the VAT should not rest on businesses.

The central design feature of a VAT, and the feature from which it derives its name, is that tax is collected through a staged process. This central design feature of the VAT, coupled with the fundamental principle that the burden of the tax should not rest on businesses, requires a mechanism for relieving businesses of the burden of the VAT they pay when they acquire goods, services or intangibles. There are two principal approaches to implementing the staged collection process of VAT, one is **invoice-credit method** (which is a **'transaction-based method')** and other is **subtraction method** (which is **'entity based method')**. Almost all VAT jurisdictions (including India) of the world have adopted the invoice-credit method.

This basic design of the VAT with tax imposed at every stage of the economic process, but with a credit for taxes on purchases by all but the final consumer, gives the VAT "it's essential character in domestic trade as an economically neutral tax". As the introductory chapter to the Guidelines explains:

"The full right to deduct input tax through the supply chain, except by the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain, and the means used for its delivery (e.g. retail stores, physical delivery, internet downloads). As a result of the staged payment system, VAT thereby "flows through the businesses" to tax supplies made to final consumers".

It is, thus, evident that the two core principles on which the VAT system is based are:

- **Neutrality principle**

This is the core principle of VAT design. The Guidelines set forth the following three specific precepts with respect to 'basic neutrality principles' of VAT:

- The burden of VAT themselves should not lie on

taxable businesses except where explicitly provided for in legislation;
• Businesses in similar situations carrying out similar transactions should be subject to similar level of taxation;
• VAT rules should be framed in such a way that they are not the primary influence on business decisions.

- **Destination principle**

This principle seeks to achieve neutrality in cross-border trade.

The Guidelines provides: *"For consumption tax purposes, internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption."*

Keeping the above core principles of VAT system in mind, let us now advert to certain key challenges facing the tax system.

I. TAX CHALLENGES OF THE DIGITAL ECONOMY

On March 16, 2018, OECD released **'Tax Challenges arising from Digitalisation – Interim Report 2018**'. The Interim Report is a follow-up to the work delivered by the OECD in October 2015 under Action 1 of the Base Erosion and Profit Shifting (BEPS) Project, which was focused on addressing the tax challenges of the digital economy.

The Report states that *'Digitalisation is transforming many aspects of our everyday lives, as well as at the macro-level in terms of the way our economy and society is organized and functions. The breadth and speed of change have been often remarked upon, and this is also true when one considers the implications of this digital transformation on tax matters'.* The Report acknowledges the far-reaching implications of digitalisation and its disruptive effects, beyond the international tax rules, on other elements of the modern tax system, bringing forth opportunities and challenges. From the design of the tax system through to tax administration, relevant developments include the rise of business models facilitating the growth of the **'gig'** and **'sharing**' economies as well as an increase in other peer-to-peer (P2P) transactions, the development of technologies such as block chain and growing data collection and matching capacities.

Chapter 7 of the Report titled **"Special feature – Beyond the International Tax Rules"** explores some of these changes including Online platforms and their impact on the formal and informal economy. There is no denying the fact that global e-commerce is becoming increasingly important. The rapid growth of multi-sided online platforms is attributed to digitilisation. The estimates suggests B2C sales of US$ 2 trillion annually and is registering an annual growth of 10 to 15 per cent. Based on an average VAT rate of 15%, this represents US$ 200 billion in tax revenues! (It may be noted that US operates a sales tax and has not embraced VAT as yet). Currently, online shoppers are tagged at 1.6 billion and are estimated to rise to 2.2 billion in 2022. E-Commerce admittedly creates challenges for administrations (VAT and Customs) in terms of collection since non-taxation creates an unlevel playing field.

The Interim Report notes that the opportunities presented by multi-sided platforms as regards taxation are two-fold:

i. Facilitate integration into the formal economy;
ii. Drive growth and increase revenues

The Report then identifies the following issues that must be addressed in order to realise the benefits as well as to address some of the challenges arising from the operation of online platforms:

• Understanding the tax implications of the changing nature of work
• Fostering innovation and ensuring equivalent tax treatment with similar, existing activity
• Improving the effective taxation of activities facilitated by online platforms

In sum, the digital economy has become increasingly entwined with our physical world. The Indian digital economy is expected to be worth about US$ 35 billion and it is growing at a pace of 24-25 per cent a year. Given the high disruption that digital economy has brought about and its blistering growth rate, a few key questions arise – how should the digital ecosystem be taxed? How can governments earn revenue from services that span borders, as some of the world's most valuable enterprises like Google, Facebook and Amazon spread their reach in emerging markets like India? What share of their revenue can the Indian Government look at taxing? Is Indian GST system geared up to address the challenges and seize the opportunities presented by digitisation?

II. BLOCKCHAIN TECHNOLOGY AND ITS IMPACT ON THE TAXWORLD

In early 2016, construction workers in London unearthed hundreds of Roman writing tablets, including some of the earliest known examples of receipts and IOUs. The find reminded all that, essentially, the way in which we record the transactions has barely changed in 2000 years. But will we say the same five or ten years from now?

'Blockchain' – a relatively obscure technology until only a few

years ago – is about to make the step from the theoretical to practical. When it does, it will fundamentally change the way businesses, people and governments operate.

'Blockchain', to put it simply, is a ***'secure distributed ledger that simultaneously records transactions on a large number of computers in a network'***. In this type of secure, shared database, participants have their own copies of the stored data. Strong cryptography ensures that transactions can be initiated only by certified parties, that changes are validated by participants collectively and that the outputs of the system are immediate, accurate and irrevocable.

BLOCKCHAIN AND INDIRECT TAX

Indirect taxes like VAT are 'transaction-based taxes' and often follow chains of transactions and their tax liabilities. Obligations are often "triggered" by key events that need to be documented and recorded securely. These events include the performance of a service or the delivery of goods, the conclusion of a contract, the manufacture of a product and by an act of importing or exporting goods and services.

However, by and large, the indirect tax systems have their foundations in physical transactions and trade. The rise of the sharing economy, digital business and new business models have caused many people to think about the current tax systems. Blockchain has emerged at a time when many in the tax world are speculating about the efficacy and relevance of the current tax system in the modern, digital era. While the financial and business world is naturally excited about Blockchain, 'Tax' is one area where this technology could have a profound impact. Blockchain's core attributes, namely, Transparency, Control, Security, Real-time information and ability to detect fraud and error mean that it has significant potential for use in tax regime. Naturally, the tax administrations around the world - including Indian tax administration – have started considering the adoption of the Blockchain technology.

Some of the likely near-term uses of Blockchain that could have an impact on indirect taxes are:

a. **Blockchain regimes**

VAT and customs administrations could create blockchains for the transmission of tax data and payments between taxpayers and government portals. These blockchains could involve taxpayers in a single jurisdiction or they could cross multiple jurisdictions.

b. **Real-time compliance and reporting**

Tax administrations around the globe are already demanding real-time information from businesses in order to assess and support their VAT liabilities and deductions. Blockchain could greatly increase the speed, accuracy and ease of collecting this data, thereby improving the quality of VAT compliance while reducing the cost of compliance.

c. **Tax Invoices**

Tax invoice is the most critical VAT document. In a Blockchain-based regime, it is likely that for a VAT invoice to be valid, it will require a digital fingerprint, derived through the VAT blockchain consensus process.

The fingerprint would immediately confirm that the block under scrutiny is permanently linked to the previous and subsequent blocks. The entire history of the commercial chain (forward and backward from this transaction) could be followed and scrutinised by a tax official in an office, by a robot or by a customs officer at a border.

d. **Customs documentation**

Customs declarations and export controls depend on various detailed and accurate information, often provided by third parties. The veracity and reliability of this information is vital.

Blockchain can enable the customs officer to verify, with complete accuracy, various information and also the origin and nature of the goods at every stage of the chain.

As this technology would allow them to verify every aspect of a shipment with certainty, they could maintain supply chain security with fewer officers who could target their inspections more accurately.

e. **Supporting refunds, reliefs and rebates and combatting fraud**

The use of immediately verifiable information could allow taxpayers to support claims for VAT deductions (or ITC) and customs rebates and reliefs.

Blockchain technology could also be useful in tracking if and when VAT has been paid and in doing so, reduce VAT fraud. Blockchain could also help to drive behavioural change because of the risks and consequences of non-compliance which may even lead to 'permanent exclusion' from the blockchain network. In these ways, it is likely that blockchain could help reduce the '**tax gap**' to some extent.

f. **Smart audits**

Using blockchain technology, indirect tax administrations could carry out independent risk analysis facilitated by artificial intelligence.

To sum up, Blockchain technology has tremendous potential, not only to transform business, but also the tax regimes across the world. Blockchain has the potential to streamline and accelerate business processes, to improve cybersecurity and to reduce or eliminate the role of trusted intermediaries in industry after industry. The technology has already many real-world applications and many more applications are likely to be adopted in future.

III. 3D PRINTING AND ITS IMPACT ON TAXATION

In 3D printing, we once again have a new technology that could upend supply chains, business models, customer relationships – entrepreneurship itself. 3D printing takes mass distribution and innovation to the next level, while realigning the very geography of work and trade.

Any significant technology that emerges impacts different industries at different times, places and levels of disruption. It also raises tax, legal and policy implications that can trip up corporate leaders and global policymakers alike as they are in full stride toward the future.

3D printing – a process of making solid objects from the instructions in a digital file – has the potential to be every bit as revolutionary as the PC was in the 1980s or even as the factory production line was in the early 20th century. It is also creating unprecedented opportunities to customise products and reduce manufacturing costs.

But 3D printing also presents a minefield of challenges for tax authorities around the world. This is because almost all of the taxable value for a business selling product to be 3D printed is contained within its intellectual property (IP) – namely, the digital file's ownership and authorisation of its use, rather than in its manufacture, transport and point of sale.

a. **Disrupting long-standing business models**

3D printing brings particularly complex global tax challenges because it threatens to bypass long-standing protocols used to set taxes on the movement of goods and supply of services. 3D printing will absolutely disrupt the existing model of taxation of goods and services grounded in the physical movement of things or the provision of services.

The question 'where value is created' lies at the centre of any discussion about the taxation of goods and services. While VAT applies at the point of consumption, in some taxing jurisdictions of the world, taxes are levied on raw materials or intermediate stages where value is created, such as in a factory and on shipment or warehousing.

3D printing disrupts these assumptions by transferring manufacturing from factories to printing devices located nearer the consumer, potentially even in their homes.

b. **Intellectual Property takes centre stage**

If consumers have 3D printers at home, much of the taxable value may migrate there, where the supply chain ends, greatly reducing the potential for supply chain taxes.

IP, as a matter of fact, sets the stage for any discussion of 3D printing and taxation. Any 3D printing tax strategy needs to consider that IP ownership and authorisation will account for much more of a product's value. With the anticipated shrinkage in manufacturing, customer support and sales personnel that will accompany this process, tax authorities' focus on IP is expected to intensify.

c. **Transfer pricing and geographical challenges**

Another tax challenge is the effect of 3D printing on transfer pricing within multinational companies. Every time a company changes its supply chain, it needs to change how it shares costs related to taxable functions. If a local distributor begins printing replacement parts, it could be considered a factory, so the related transfer pricing would change. Under current tax laws, it is unclear how or by how much.

As we enter a new world of 3D printing, there are few comparables in the current world of manufacturing.

d. **Beware of double taxation**

As production costs fall, 3D printing could also affect the percentage of a product's value that resides in any given manufacturing location. In a 3D printing world, the value of a product becomes more intangible than tangible.

So when tax authorities in different geographical locations ask where the base of product's profit is located and who gets the right to tax it, they could come up with very different answers, setting the stage for double taxation.

e. **Global jurisdictional challenges**

Business will also face location-sensitive tax questions related to globally distributed manufacturing via 3D printing

including permanent establishment (PE), exit taxes and "substantial contribution" provisos.

f. 3D printed products can confound customs

Companies and governments often find themselves contesting the value of imports, as products are shipped across borders and through customs controls. Such cross-border calculations could become a whole new equation, as the increasing placement of 3D printers in local markets changes global trade flows. While the raw materials or components used in 3D printers may still cross borders the old-fashioned way, more of a product's value will be defined by the digital blue prints that invisibly traverse the globe.

3D printing could also change the cross-border tax equation for the value of raw materials and components. If the value of raw material declines in relation to parts or products, it could in turn affect customs duties.

The governments will then be looking to replace lost tax revenue, and pressure could mount for a product's digital blue print to become the taxable item.

To sum up, 3D printing, yet another 'disruptive technology' will surely turn the business world upside down and the tax profile of a business inside out!

IV. ROBOTS AND TAXATION

What happens if a new technology causes men to lose their jobs in a short period of time, or what if most companies simply no longer need many human workers? These gloomy prospects loom large because of the advancement and wide-scale spread of 'robotic technology'.

Last year, Bill Gates, the co-founder of Microsoft proposed a tax on robots to fund government expenditure on cushioning the potential dislocation of millions of workers by the widespread introduction of robots, and to limit inequality.

However, the arguments '**for**' and '**against**' the '**Robot Tax**' continue across the world and it is not intended to dwell into the same here.

What one needs to clearly acknowledge is the fact that we appear to be at a technological 'tipping point' in the diffusion of robotic technology across commerce, industry, professions and households. It could spread like wildfire. This could unleash what the economist Joseph Schumpeter apocalyptically described as a 'gale of creative destruction' and set into motion a 'process of industrial mutation that incessantly revolutionises the economic structure from within, incessantly destroying the old one, incessantly creating a new one'.

The pace of automation is accelerating. In 2015, global expenditure on robotics rose to US$ 46 billion. Sales of industrial robots are growing by around 13% a year, meaning that the 'birth rate' of robots is practically doubling every five years.

The widespread introduction of robots could substantially reduce the government's revenues, while simultaneously creating an increased demand for its support for displaced workers until they find alternative employment. The heated debate on 'whether to tax robots or not' revolves around this central issue. However, even while the issue is being debated, it is imperative that as a first step in taxing robots, the legislation clearly defines 'what a robot is?'.

There is currently no clear or agreed definition of what constitutes a 'robot'. The term generally conjures up mental images of mechanical men or even humanoids like the laconic Terminator, as portrayed by Arnold Schwarzenegger in films. But, in practice, it would be challenging to identify robots by sight. As David Poole has noted, 'A robot is not a unit equal to a human. Most are not physical robots, they're software robots. It's no different, really, to a spreadsheet!'.

Given the range and sophistication of robots likely to come into development, the definition needs to be 'form neutral'; i.e. it should include all autonomous robots, bots and similar smart AI machines. Any proposed definition should be tested from not just from legal perspectives, but also from economic, technological and constitutional approaches.

The government, obviously, has a range of possible tax policy options which include:

- Taxing robots
- Increasing the corporation tax rate
- Lumpsum taxes
- Taxing forms on the imputed notional income of their robots
- Robot levy
- Imposing a 'payroll tax' on computers
- Disallowing relief on the acquisition of robotic technology
- Increasing the cost of robots
- Increasing the rate of VAT payable on value added by robots.

To conclude, the governments will be required to urgently develop a legislative definition and ethical-legal framework for robots. They should also take steps to introduce corporate reporting requirements on their deployment, to gather information that would facilitate remedial action like the introduction of new taxes. At present, a palpable lack of leadership in facing up to the substantial risks posed by the

rapid diffusion of robotic technologies is on display across the governments of the world.

VAT: EMERGING GLOBAL TRENDS

Even while the various '**disruptive technologies**' looming large on the horizon gear up to wreak havoc with the tax regimes across the globe, some clear trends or changes are clearly visible or emerging in the global developments of indirect taxation. These emerging trends sweeping the indirect tax landscape are likely to define and reshape the traditional design and structure of VAT system.

Given that over 60 years have elapsed since first VAT, serious deliberations are on amongst the tax experts and policymakers on the need to "reform this revolutionary 'tax reform'", and the contours of such reforms, keeping a close watch on the emerging global trends.

The discussion in the ensuing paragraphs briefly outlines these emerging global trends in the field of VAT. The discussion is based on two independent papers published by two of the Big 4 Accounting firms. [For reference, see 'Acknowledgements']

EMERGING GLOBAL TRENDS IN INDIRECT TAX

Recently, the Global Indirect Tax Leader at EY published an article titled '**Indirect Tax: Five Global Trends**' in the Bloomberg BNA *Indirect Taxes Journal*. The article outlines five key trends sweeping the global indirect tax landscape which are :

1. VAT and GST rates are stabilizing, but remain high

Following the banking crisis of 2008, VAT and GST rates increased globally. The average rate of indirect taxes peaked at 21.5% in the EU and 19% in the OECD. Of late, these increases have slowed down and may even be reversing.

2. Reduced VAT and GST rates and exemptions are making a come back

Related to the post-2008 trend of increased rates, many countries have broadened their VAT or GST base by removing exemptions and restricting reduced rates. However, this trend also seems to be slowing and may be reversing.

3. The global reach of VAT and GST expands

Globally, VAT and GST have rapidly replaced previous-generation single-stage retail sales taxes. Very few countries do not have a VAT or GST.

4. Digital Tax Measures proliferate

Tax administrations are grappling with the problem of how to tax cross-border e-commerce and electronic services, such as, digital downloads, because untaxed online sales distort competition and reduce tax receipts. Governments have responded to the growth of digital commerce by adapting tax laws and using technology to collect tax and monitor tax information.

5. Tax administrations embrace technology

As well as finding new ways to tax the digital economy, tax administrations are applying digital technology to administer indirect taxes more effectively, imposing requirements such as the electronic submission of VAT or GST declarations, mandating the use of e-invoicing, and introducing new reporting standards and real time collection.

While the above trends are, indeed, clearly visible in the VAT/GST systems around the world, a detailed paper titled **"VAT: A pathway to 2025"** published in International Tax Review in November 2017 by Indirect Tax Team of KPMG China, seeks to provide a different perspective and insight in the emerging trends which are likely to sweep indirect taxes beyond what one can already clearly see.

Starting with a quick snapshot of the '**here and now**', the article claims that there has never been a time when there has been a greater certainty about the future global direction of indirect taxes, at least over the next few years. This claim is sought to be buttressed by three propositions:

First, VAT and GST rates throughout the world are at an all-time high, and there is very little pressure being brought to bear to either increase or decrease them. Therefore, any global shift from 'a rates perspective' is unlikely to be seismic, certainly as compared to what took place globally in the period from 2008 to 2015.

Second, from 2016 through to 2018, we will have seen several major economies throughout the world implement a VAT or GST either for the first time or through the expansion or rationalisation of their existing indirect tax systems.

Third, in a global context, the period from 2015 through to 2019 (or thereabouts) will be remembered for the proliferation of digital tax measures – whether they are measures to tax the cross-border provision of services that can occur digitally and without the creation of a permanent establishment, or through a new measure to tax the business-to-consumer (B2C) importation of goods through e-commerce platforms.

However, the article asserts that while the OECD's recommendations were clearly designed with a view to implementation in the EU, when applied to countries in Asia Pacific region, they would be problematic, given certain fundamental and structural weaknesses of the tax systems of the countries of this region.

The article then poses a question – 'Are there bigger changes afoot with indirect taxes as we move into the second quarter of the 21st century?' With a clear intent to prompt discussion and debate and add some colour and controversy, while a pathway to 2025 is lighted, the article posits three key indirect tax trends which are briefly discussed below:

1. **VAT and GST systems will more closely resemble retail sales taxes**

After adverting to the fundamental principles on which VAT systems are intended to operate, the article states that under this system, it is an implicit understanding that in a typical supply chain when there is a flow of goods from say:

a. the manufacturer to the wholesaler;
b. the wholesaler to the retailer; and
c. then from the retailer to the end-consumer,

the only transaction that truly 'matters' from a VAT or GST perspective in the sense that it raises the revenue to which the tax is directed is transaction (c). The process of collecting the tax and allowing input credits in transactions (a) and (b) is merely an administrative mechanism to reinforce the integrity of tax administration throughout the wholesale supply chain.

However, from a tax adviser's perspective, many of the challenges which one confronts each day are focused on the problems when the system breaks down in relation to transactions (a) and (b) – that is, in ensuring the fiscal neutrality of those transactions, leading to inefficiency, non-competitiveness and tax cascading through the supply chain.

The governments may therefore move from VAT system into a tax system that more closely resembles a single stage retail sales tax, mainly for three reasons:

First, technology will enable the settlement of tax obligations between the supplier and the recipient instantaneously, without the need for any real payment, crediting or refund.

Second, with a view to overcome the problems caused by fraud – carousel or 'missing trader' fraud being the most prominent -, the governments have resorted to the reverse charge mechanism in place of VAT and more recently, a number of EU countries have implemented, or propose to implement 'split payment' methods for VAT collection, whereby the recipient diverts the VAT included in the purchase price directly to a bank account held for the benefit of the tax authorities.

The fraud or evasion is often perpetrated in B2B transactions, not B2C transactions. So, if there is a recognition already that by taxing or crediting B2B transactions, the system is prone to fraud or evasion, then, why do it?

Third, the concept of the supplier accounting for output tax and recipient claiming input tax in B2B transactions will be rendered superfluous. What one is left with is a retail sales tax, that is, a single stage tax that applies to transactions with end-consumers only.

The article, however, hastens to add that it is not necessarily suggested that VAT or GST systems will be replaced as a matter of form with retail sales taxes – rather, it is suggested that VAT or GST systems will, as a matter of substance, operate similarly to retail sales taxes.

2. **Indirect Taxes to be managed almost exclusively through technology**

While growing automation of indirect tax determination and administration process, both in government and business, is clearly on display in last few years, the technology developments in the broader economy itself will mean that indirect taxes will be managed exclusively through technology.

Indirect taxes are, by their very nature transaction-based taxes. As more and more transactions occur in the digital world, the logical outcome is that the indirect taxes whose liabilities flow from these transactions will also be managed and administered digitally. [See the discussion on the 'impact of technology on taxation' in the preceding paragraphs].

It is predicted that the role of the indirect tax adviser will, therefore, be akin to the conductor of an orchestra – not playing the instruments, but directing the musicians and ensuring they keep time. The role of the indirect tax adviser will be to maintain a watch over the technology, testing the controls, and addressing problems when they are detected.

The shift to automation will not simply be because the technology will improve to help manage tax compliance, but the tax itself will be adapted to fit the technology. The

automation will be a function of two forces coming together – technological advances to help manage tax compliance, and developments in tax legislation to help the technology apply in a more automated way.

3. **The tax base for indirect taxes will be expanded in ways not previously contemplated**

It is stated that the principles which have, hitherto, defined or shaped the indirect tax structure over the years may not hold in 2025. The following developments which have recently been enacted in China have been cited by the article as leading a pathway for the rest of the world to follow:

a. **The pre-condition of being a 'business' or 'entrepreneur' for VAT/GST registration will no longer apply**

Virtually, all VAT systems (including GST system of India) around the world have a pre-condition for registration and VAT obligations that supplier is engaged in a business or commercial or economic activity or is an entrepreneur. China's VAT system, by contrast, has no such precondition. Instead, China's VAT system imposes registration and payment obligations on 'units' and then imposes different obligations depending upon turnover thresholds.

The question that arises is whether a profit making pursuit, coupled with a *de minimis* exclusion (where the compliance costs would exceed the tax collected) is all that is really needed as a precondition for imposing VAT or GST liabilities. The private consumer/business divide would then become redundant, in favour of a system that more closely resembles what one already sees in China.

b. **VAT/GST systems will even tax consumer-to-consumer (C2C) transactions**

Digital market places now facilitate trade between private individuals. These developments in commerce are commonly labelled as 'sharing economy', 'crowd funding', 'crowd sourcing', and 'ride sharing'.

The central question is, why should the profit or gains derived from these activities fall outside the VAT or GST net? The bigger issue is that VAT or GST systems need to be adapted to tax the value added, irrespective of whether it is by a traditional business or a consumer sitting online.

In China, there is no real distinction drawn between business and non-business activities.

c. **Customs duty will need to find a new tax base**

Customs duties are inherently narrow in their tax base in that they typically apply only to goods, nor services. The question is whether customs duty is at risk of a terminal decline in its tax base unless changes are made. Is it possible that customs duties will be expanded to services, and if so, how would they be collected and administered?

d. **VAT/GST will apply to financial services**

The traditional reasons cited for not taxing financial services under VAT or GST was the inability to apply the tax on a transaction-by-transaction basis. However, that rationale was conceived in an era when margins were the dominant model rather than fee-based services.

Early steps to dismantle this were taken in places like New Zealand (with GST imposed on insurance, through a cash-based tax), in South Africa (with VAT on fee-based services), in Australia (with the introduction of the reduced ITC regime to remove the bias against outsourcing and to achieve a broadly similar tax outcome to exemption), in New Zealand again (with B2B zero rating) and more recently, in China (with a broad-based VAT on financial services with few exemptions).

The experiments in applying VAT to financial services are shown to be largely working.

e. **The tax base for VAT/GST will be expanded in other areas too**

Even the traditionally exempted areas such as healthcare and education could potentially be taxed.

The challenge in this area is in balancing the desire for good policy (which may support the removal of exemptions) with the political realities of doing so (where taxing the necessities of life may be seen as politically unpalatable in some countries).

f. **Taxes like a VAT/GST that are founded in transactions or flows will continue to grow in importance**

The noticeable trend of a decline in the average global corporate tax rate and increase in the average VAT/GST rate may continue. In an era of unprecedented dislocation and disruption to historical business models, what will emerge is taxes that are imposed on 'transactions', or on 'cash flows', and directed to the place where 'consumption' occurs.

While not predicting the demise of corporate taxes, it is predicted that the corporate taxes will transmogrify until

they more closely resemble the features of a VAT or GST.

FINAL THOUGHTS

After more than 60 years, VAT may now be at a turning point in its life. At this juncture, the rapidly changing climate poses serious challenges for the policymakers, lawmakers, economists and the tax experts, including the GST Council in India. The challenge lies in predicting the intersection of two key developments – the first being the profound changes we are witnessing to the economy itself through technological developments that have been labelled as the '**fourth industrial revolution**'; and the second being an increasing reliance on indirect taxes as they mature into a dominant form of taxation in the 21st century.

For Indian GST system, the frequent changes so far made post-introduction of GST indicate that the government is learning by its mistakes. **In the words of Deng Xiaoping, it is 'crossing the river by feeling the stones**'. But let us not lose sight of the above formidable challenges that lie over the taxation horizon even while we shape (or re-shape) our own GST design and structure! The GST Council, led by the Union Finance Minister, seems to be working only on the immediate challenges confronting the system. However, the world is changing in the way and at the speed which we cannot comprehend. What, therefore, is required for the Council is to establish, even while fixing the short-term challenges, a mechanism that starts working on identifying the long-term challenges with the aim of enabling the country's tax systems to keep pace with the seismic-level changes sweeping the taxation landscape.

"We must develop a comprehensive and globally shared view of how technology is affecting our lives and reshaping our economic, social, cultural, and human environments. There has never been a time of greater promise, or greater peril."

Klaus Schwab, Founder and Executive Chairman, World Economic Forum

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