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ANALYSIS OF GST ON CORPORATE GOVERNANCE IN INDIA

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ABSTRACT

Taxation system is as old as the human civilisation. This has evolved over the ages and Chanakya's Arthashastra is the famous treatise on the subject of the ancient times. However, with the regular evolution of the economic activities combined with adoption of different forms of administration the taxation systems were bound to change. The further evolution came with the scientific discoveries, expansion of economic activities, growth of population, improvisation of production systems among others. The present paper aspires to look into the acceptance and success of the GST system. It tries to look into the different factors which are bound to judge the effects that try to mould the overall GST implementation mechanisms. The most awaited frontier GST viz. Goods and Services Tax has finally arrived. Nevertheless the pitch work is still in early stages and the final landing is proposed effectively from 1st April 2017. There is a lot of ground work which has to be done, so that the teething troubles can be minimized and the GST can be implemented with full punch. Earlier, distinct taxes or duties were imposed on the basis of various mind-numbing concepts of manufacturing cost, value addition/subtraction, origin, territorial issues etc. There have been umpteen committees, commissions, amendments etc. in the pre as well as post-independence era of Indian taxation system. With deep plunging into the intricacies of various provisions of different taxation, the GST has ultimately emerged as an umbrella tax, which will embrace mostly all the taxes and duties and be charged as a single unified tax. This study attempts to enlighten on various issues in reference to the origin, evolution and the probable implications of GST regime on corporate governance in general and Indian corporates in specific.

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INTRODUCTION

Definition: Corporate governance is a system by which corporates are directed and controlled. The Board of Directors have a fiduciary duty to the shareholders, and thereby are responsible for overseeing the operations and activities of the company. Corporate governance also provides the framework for the attainment of a company's objectives. The main focus is to make the business function in a highly effective manner so as to achieve positive results and thereby maximise the returns of the stakeholders.

Overview: Given the passage of the Constitution (122nd) Amendment Bill, 2014 for Goods and Services Tax (GST) in the LokSabha on 6th May, 2015, the Government of India seems committed to replace all the different kind of indirect taxes levied on goods and services by the Centre and States which is proposed to be implement by 1st April, 2016 (Budget Speech 2015 by Mr.ArunJaitley, Former Finance Minister, Government of India). Goods and Service Tax is a destination-based tax collected in a multi-point of production, sales and rendering of services at uniform manner with a facility of claiming an input tax credit on output tax. In simple terms, GST may be defined as a tax on goods and services, which is liveable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or procuring the service. It is basically a tax on final consumption. In a GST regime it is anticipated that the tax base will be comprehensive, as virtually all goods and services will be taxable, with minimum exemptions. GST will be a game changing reform for Indian economy by developing a common Indian market and reducing the cascading effect of tax on the cost of goods and services (Kumar, 2014). It will impact the Tax Structure, Tax Incidence, Tax Computation, Tax Payment, Compliance, Credit

Utilization and Reporting leading to a complete overhaul of the current indirect tax system. India is going to implement the duel GST model for levy and collection of taxes. Where both Centre and States will simultaneously levy GST across the value chain. Tax will be levied on every supply of goods and services. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The input tax credit of CGST would be available for discharging the CGST liability on the output at each stage. Similarly, the credit of SGST paid on inputs would be allowed for paying the SGST on output. The Indian Constitution allocates taxation powers between centre and states. Be it the state of the centre, both kinds of government have some exclusive areas, where they can levy tax. Income tax, which includes tax on company profits, is the exclusive domain of central government. These taxes are termed as the direct taxes. On the other hand the indirect taxes are taxes levied on manufacture of goods, provision of services and consumption. In India, generally speaking, indirect taxes levied on manufacture of goods or provision of services are the exclusive domain of central government. Taxes on consumption are the exclusive domain of state governments.

There are two important problems with the current arrangement. First, keep in mind that some good such as a shirt has to first be manufactured before it is consumed. The central government, therefore, levies its indirect tax called central excise at the factory gate. Subsequently, a shirt reaches a retail outlet and is bought by a consumer. The state government, at this stage, levies a tax on consumption dubbed value added tax (VAT). So, we have a tax at the factory gate which adds to the cost of the shirt and another tax on the final price. Since states have their exclusive domain on consumption tax within their borders, they treat goods coming from other states as "imports." For example, if a shirt maker in Uttar Pradesh buys dye in Bihar, he would have paid central excise and Bihar's state taxes on the product. On this cost, Uttar Pradesh government would levy its tax if the shirt is sold in the state. If the shirt is sent across Uttar Pradesh's border and sold in Delhi, an "export" tax called central sales tax is collected by UP. As the example suggests, India is politically one country, but economically it is fragmented. There are multiple taxes when there is commerce across state borders. Consequently, it increases costs for everyone and makes economic activity within India for Indians complicated. The RajyaSabha had finally consented to debate a constitutional amendment to bring about a system of Goods and Services Tax (GST) in India. And inarguably, the motion is passed with majority. It is perhaps the most important economic reform item on the NarendraModi government's agenda. This is one reform which affects all of us.

GST INSPECTIONS & CORPORATE GOVERNANCE: INDIA GOVT. CLAMP DOWN

Taxmen allege GST fraud by Multinational Giants

Background	The Law	Penalties for Non-Compliance
The government had reduced GST to 18 % from 28 %, and to 5 % from 12 % on many products The government also exempted some goods that had earlier been taxed	Companies were required to pass on GST benefits to customers, in the form of reduced prices	The report states that P&G has been issued a show-cause notice and is required to submit its reply on April 29 2019 The final order is expected to be passed in the next 3 months

Tax authorities have alleged GST non-compliance by several multinational companies. As per reports in the Business Standard, the said companies which include big corporates Procter & Gamble, Johnson &Johnson and Samsung, are said to have not passed on benefits from the GST tax cut to customers. Officials allege that Procter and Gamble failed to pass on more than $35 million in tax benefits.

The National Anti-Profiteering Authority has reported that Procter & Gamble had not reduced prices on many products despite a tax-cuts. However, P&G, Samsung and J&J have denied any wrongdoing, and stated that they are committed to compliance.

Corporate Governance: MCA Action against Directors & Promoters Forensic audits of more than 200 companies facing insolvency resolutions under the Insolvency and Bankruptcy Code (IBC) have exposed major financial irregularities. The offences include siphoning of funds for illegal transactions with related parties, including illegal involvement of banks, as per reports in the Times of India.

The Ministry of Corporate Affairs is expected to initiate action against the promoters, directors as well as auditors of the said companies. A separate probe into the irregularities led by the Serious Frauds Investigation Office (SFIO) is parallelly underway.

PRINCIPLES OF CORPORATE GOVERNANCE

Transparency: The more informed you are, the more certain you are. This is the mantra that the stakeholders firmly believe in. Transparency, in the business world, also pays dividends. Companies that are upfront about the goings-on in the operations and with regard to their financials earn the public trust, something that is immeasurable. Transparency is an essential component at all levels of operation in a business entity; especially at the top management level, where major decisions are made and where major plans are formulated. Keeping the investors and other stakeholders informed helps build a relationship of trust and solidarity that results in the rewards of a higher valuation and easy access to funding.

Accountability: Accountability, in essence, means a willingness or an obligation to accept responsibility for one's actions. Accountability is generally looked at from a negative viewpoint and misconstrued by many who think it is associated with the traditional "Blame Game". In reality, accountability answers more questions than just the one regarding who the responsible person is. It has to be looked at from a positive standpoint as well because it recognises accomplishments too. Accountability gives the shareholders confidence in the business that, in any case, that leads to an unfavourable situation in the company, the ones responsible are dealt with in an appropriate manner. Accountability establishes a system in place where everyone is held accountable for their respective work and associated duties. Accountability holds two main things firmly in place:-

Ensures that the management is accountable to the Board. Ensures that the Board is accountable to the shareholders.

Independence: The ability to make decisions while being free from any sort of constraint or without any influence is what independence is. And this is something that has proven to be crucial to the smooth operation of businesses as well. Independence is

- The ability to stand firm in the face of inappropriate influences.
- The ability to make unadulterated, firm decisions on any given issue
- The ability to adhere to professionalism and do right by the company
- It allows the person to act with integrity and make decisions and form judgments bearing in mind the best interests of the stakeholders. This is the reason companies appoint independent directors, so as to ensure that there is no force of hand being used or that the director does not have any personal interests with the company thereby hampering his ability to make decisions freely.

Advantages of Corporate Governance: Good corporate governance can turn a good company into a great one. The leaders in any industry are at the helm of their respective industries, mainly because of outstanding corporate governance practices.

- **Compliance with laws:**With corporate governance in place, compliance with various laws is taken care of easily, as corporate governance includes the rules, regulations and policies that enable a business to stay compliant throughout and function without any hassle or legal inconveniences whatsoever.
- **Lesser fines and penalties:**Since the legal compliance aspect is taken care of credit to the corporate governance practices, companies are able to save a fortune on unnecessary fines and compliances and possibly redirect those funds towards business objectives to achieve greater heights.
- **Better management:**Since there is a structure in place with regard to how the entity operates, its day-to-day functioning, managing the activities and achieving targets becomes a whole lot easier. The work atmosphere also takes care of itself under good principles of corporate governance fostering teamwork, unity, efficiency and a drive for success.
- **Reputation and relationships:**Companies with good corporate governance are able to attract investors and external financiers with relative ease, going by their sterling reputation and brand image. One of the pillars of corporate governance is transparency, which is the practice of sharing key internal information with the stakeholders. This improves the relationship of the entity with its stakeholders and sows the seeds of trust between the company and society at large.
- **Lesser conflicts and frauds:**The rules instilled in the workplace encourage the employees to be morally conscious in every situation that they encounter, thus eliminating the possibility of fraud and conflict between employees.

Disadvantages of Corporate Governance: When it comes to the matter of smaller corporations, there might be a bit of hassle where the shareholders may serve as the directors and managers, having no segregation as such. Bearing this in mind, it gives rise to

- **The burden of staying legally compliant:** Corporates generally have loads of compliance that have to be followed, attracting different laws based on their industry. Corporate governance ensures legal compliance, but it does come at a very hefty price.
- **Increased costs:** Administrative costs for companies with corporate governance are pretty exorbitant, considering all the requirements to be met. Here are a few documents to be maintained:-
  - Stock sales and purchases.
  - Legal compliance records.
  - Annual registration.

Maintenance of segregation: Irrespective of the size of the corporation, the adherence to all formalities and requirements must be met without any exceptions. Failure to comply with these rules leaves the company with huge exposure such as "piercing of the corporate veil", where the separate legal entity status of the corporation is ignored in order to understand the goings-on behind the closed doors.

The conflict between the principal and the agent: Large corporations have made it a common practice to appoint a well-known manager, one with a good track record to manage the day to day operations of the business. Unfortunately, this gives rises to a conflict between the shareholders and the managers as they both may have very different objectives and perspectives. This often leads to a clash between the two, thus affecting the overall ability of the business to run its operations in a smooth and efficient manner.

METHODOLOGY

The multiple regression statistical analysis is used to determine the nature of relationship between the corporate governance and operating performance variables during and after (2015 & 2016) GST implementation period. The 265 Indian listed firms are selected based on their record of market capitalization. The data of these firms collected from the audited annual report during and after GST implementation accessed from Bursa India website. This paper utilized ordinary leased squares (OLS) regression to determine the relationship between the operating performance (SG and CR) with the corporate governance (BS, BI, WD, CA, CTY). The sales growth is one of profitability analysis that highlights on sales trend. The current ratio measures the short-term debt-paying ability. [5] study propose to use SG and CR as the dependable variables to represent operating performance to determine the relationship with corporate governance during GST implementation. Basically, this paper shall determine the effectiveness of the 5 corporate governance variables in maintaining the sales trend and liquidity position during and after GST implementation period. Thus, the two regression models are developed for Operating Performance Profitability (OPP) measured by sales growth (SG) and Operating Performance- Liquidity (OPL) measured by current ratio (CR). The regression models are as follows:

$SGit = \beta0 + \beta1\ BSit + \beta2\ BIit + \beta3\ WDit + \beta4\ CAit + \beta5\ CTYit + \beta6\ FSit + \beta7\ FAit + \beta8LEVit + eit$ (Model 1)

$CRit = \beta0 + \beta1\ BSit + \beta2\ BIit + \beta3\ WDit + \beta4\ CAit + \beta5\ CTYit + \beta6\ FSit + \beta7\ FAit + \beta8LEVit + eit$ (Model 2)

Where:

Code	Description	Measurement
Dependent Variables		
OPP		Operating Performance Profitability
SG	Sales growth	Dividing year-end sales by beginning of the year sales
OPL		Operating Performance Liquidity
CR	Current ratio	Current assets/current liabilities
Independent Variables		
BS	Board size	Natural log of board size
BI	Board independent	Percentage of independent and nonexecutive directors to total number of directors
WD	Women director	Number of women directors divided by total board members
CA	CEO age	CEO age
CTY	CEO Type	Family CEO code as 1, otherwise is zero for outside (nonfamily) CEO
Control Variables		
FS	Firm size	Total assets, natural log total assets value
FA	Firm age	Number of years firm incorporation, log firm age
LEV	Number of years firm incorporation, log firm age	Book value of total debt over total assets
e	Error term	

RESULTS AND ANALYSIS

A list of items is selected from the supply chain of Goods and services on the basis of previous tax rate and GST rate to find out the growth and fall in the taxation of the selected items. As per the objective following tools are used:

- Correlation analysis- to find out the relationship between previous tax rate and present tax rate.
- Regression analysis- to find out the best straight line for interpretation
- Sign Test- to test the impact of GST on the supply chain after its implementation.

- Implication of GST on suppliers and the government: A correlation analysis

Table1. Impact Few Services Which will also come under GST (GST rate and Previous rate)

Items	GST Rate (%)	Previous Rate (%)
Insurance/Loans	18	15
App-Based Cabs	6	5
Online Movie tickets (>Rs100)	28	0-50

Table 2. Implication of GST on suppliers and the government: A correlation analysis

Impact on consumer	Impact to Industrial Sector	Impact on consumer Discretionary & services	Few Services come with GST
r=0.4427	r= 0.5319	r=0.8607	r=0.9349

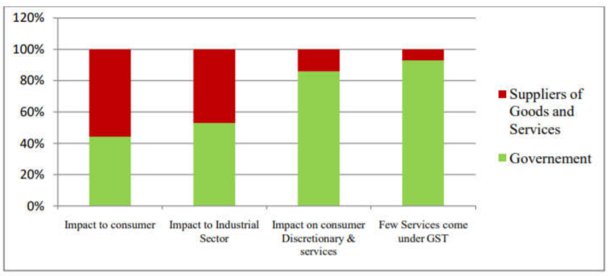
A positive impact of GST upon Suppliers of Goods and services and the Government (Central and State) – A Graphical Presentation. The following Table 3 and Table 4 presents the Pearson correlation results of independent and control variables with the dependent variables namely sales growth (SG) and current ratio (CR). Basically the coefficient results is less than 0.8, which indicates no multicollinearity issues between independent variables

Table 3. Sales growth correlation results

	SG	BS	BI	WD	CA	CTY	FS	FA	LEV
SG	1.00								
BS	-0.09**	1.00							
BI	0.08*	-0.04	1.00						
WD	0.04	-0.07*	0.16***	1.00					
CA	0.10**	-0.07*	-0.05	-0.16***	1.00				
CTY	-0.09**	-0.07*	-0.04	-0.03	0.04	1.00			
FS	-0.09**	0.16***	0.14***	0.02	-0.11***	-0.02	1.00		
FA	-0.04	0.04	-0.08**	-0.06	0.03	0.02	0.17***	1.00	
LEV	0.00	0.06	-0.01	0.08*	0.05	-0.07*	0.09**	-0.02	1.00

Table 4. Current ratio correlation results

	CR	BS	BI	WD	CA	CTY	FS	FA	LEV
CR	1.00								
BS	-0.05	1.00							
BI	-0.04	-0.04	1.00						
WD	0.00	-0.07*	0.16***	1.00					
CA	0.20***	-0.07*	-0.05	-0.16***	1.00				
CTY	0.14***	-0.07*	-0.04	-0.03	0.04	1.00			
FS	-0.21***	0.16***	0.14***	0.02	-0.11***	-0.02	1.00		
FA	0.01	0.04	-0.08**	-0.06	0.03	0.02	0.17***	1.00	
LEV	-0.05	0.06	-0.01	0.08*	0.05	-0.07*	0.09**	-0.02	1.00

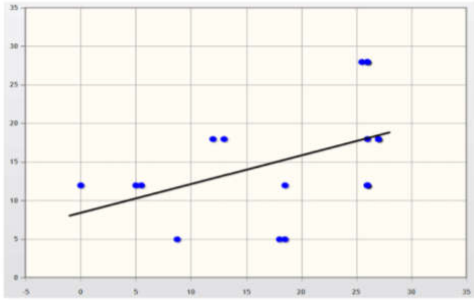


Graph 1.

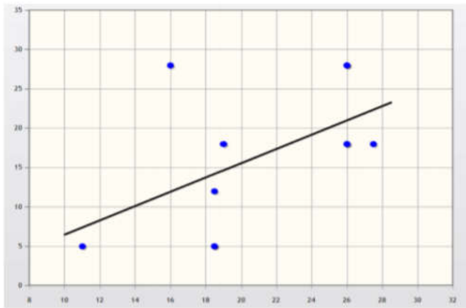
Interpretation:

- The correlation between the old effective tax rate and the newly introduced GST on consumer goods is found as 0.443.
- Similarly, the correlation between the old effective tax rate and the newly GST on Industrial product is found as 0.532.
- The correlation between the old effective tax rate and newly introduced GST on consumer durables is found as 0.861, it implies that 86% benefit goes to the government while 14% benefit would be to the suppliers of consumer durables.
- Finally, the correlation between the old effective indirect Tax rate and newly introduced GST on insurance/loans, App-Based services, and online Tickets are found as 0.935. Thus; it implies that the newly GST gives maximum benefit to the government on these three specialized services.

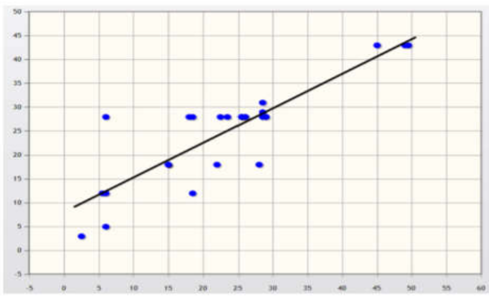
The regression line for all four different categories



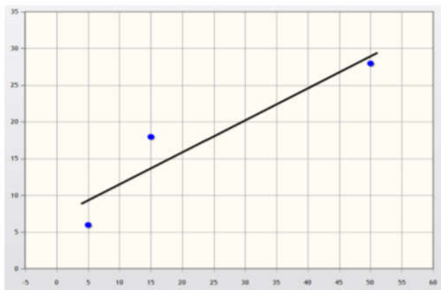
Graph 2. Impact to consumer



Graph 3. Impact to Industrial



Graph 4. Impact on consumer Discretionary



Graph 5. Few Services come under GST

Interpretation

- From above analysis, it is clear that the impact of GST on consumer goods is highly beneficial to the consumers and less benefit to the government as we can see fixed value is high with less variable value.
- Followed by the impact of GST on Industrial goods it shows a negative fixed value but a positive high variable value which shows a balanced impact for both suppliers and government.
- As per the result of Consumer durable goods, it is clear that fixed and variable value are much higher which can be concluded that government is going to earn the highest rate of tax and give less benefit to suppliers of goods and services.
- Other services or web-based services shows a high and positive fixed and variable value which can easily be concluded that it gives a high result on Government benefit with regards to suppliers.

CONCLUSION

The concept of one nation and one tax made the taxation system simple and transparent by considering all goods and services as equal without any special attention to any goods and services. It can be concluded that introduction of GST brought a great relief to consumer, industrial and producers by giving a wide coverage of indirect tax under than one platform. From the analysis, it is observed that GST has a positive effect on several firms and sectors. But the introduction of GST requires a due care by Central and State Government, firms and companies to educate every bottom level people who are the end users of such goods and services. The regression results explicitly show that effective corporate governance namely small/ideal board size, board independent, more senior CEO and family CEO contribute to positive sales growth (profitability position). Further, on the positive side to achieve an exceptional working capital position (measured by current ratio) can be of great value by having senior and family CEO. Besides corporate governance role renowned for monitoring mechanism, the results provide evidence on corporate governance involvement in financial and operational matters for firm value creation. The findings of study contribute to internal and external stakeholders on the corporate governance challenges for ensuring an effective firm operation during and after GST implementation.

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