

GOODS AND SERVICES TAX (GST): LESSONS FOR INDIA FROM CHINA AND JAPAN

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Abstract: *Subsuming majority of indirect taxes and cesses levied at the central and state government levels Goods and Services Tax (GST) has finally been implemented in India from 1 July 2017. GST has put an end to the complex and cascading nature of the multiple tier indirect taxation system in India. Since majority of the countries around the world have already implemented value added taxation system in one form or the other, there is a lot which India can learn from their experiences. In this paper an attempt has been made to study the functioning of VAT/GST of two Asian countries namely China and Japan and to draw lessons for India from their experiences. In case of Japan, better administration and special measures taken to reduce the compliance costs for small scale businesses led to an increase in indirect tax revenues and smooth implementation of GST/VAT. But uniform rate of VAT with very few exemptions and no compensatory packages has made the Japanese consumption tax highly regressive and dampened the consumption demand. On the other hand China although saw an increase in their indirect tax revenues post implementation of VAT but encountered administrative and compliance problems. India should be wary of problems faced by them and initiate special programmes as undertaken by these countries to resolve economic/sector specific issues and to improve tax compliance and administration.*

Key Words: *Goods and Services tax, Value Added Tax, Consumption Tax, Administration and Compliance.*

1. INTRODUCTION:

The concept of VAT in the world is more than half a century old. France pioneered in implementing VAT in 1954 on the recommendation of the French Taxman Apparatchik Maurice Laure. The tax was designed as a 'consumption tax' such that the burden is borne by the final consumer. Since then VAT also recognized as Goods and Services Tax (GST) in several countries, has been a widely discussed topic in the field of public finance and has become an important source of indirect taxation around the world.

So far more than 160 countries including European Union, Australia, Canada, Japan, Singapore, China, etc. have already implemented GST/VAT in one form or the other. The recent countries to implement GST in the year 2015 are Malaysia and Bahamas. The latest global Indirect tax rate study made by KPMG international has found out that the Europe's indirect taxes are the highest in the world. Goods and Services Tax (GST) or Value added Tax (VAT) rates in the countries of European Union average 20.1 percent, compared with 12.73 percent in Asia, 13.08 percent in Latin America, 19.16 percent in the OECD and 15.69% global average. The world's highest indirect taxes are found in Denmark (25%) and Hungary (27%). The lowest GST is charged in countries like Canada at 5%, Malaysia at 6%, Thailand and Singapore at 7% and Japan at 8%. In India GST is implemented effective from 1 July 2017 with a standard rate of 18% (with major commodities falling under this rate) which is the highest in comparison with other major emerging market economies. (Refer Graph 1).

Since VAT can be levied on both goods and services it has also been termed as 'Goods and Services Tax' popularly known as 'GST.' In some countries GST is known as VAT or HST, but the core idea of GST remains unchanged.

It is a destination based comprehensive value added tax levied at each stage in the supply chain on the sale and consumption of goods and services within a country with the benefit of the credit of tax paid by the taxpayer on the previous purchases thereby enabling flow of seamless credit across the supply chain. Each business pays tax on its 'value added' which is simply its total sales minus the cost of inputs it purchases from other businesses.

Since VAT/GST is a destination based tax, imports are subject to VAT/GST on the same basis as domestic goods and services while exports are not. Exports are zero rated with a prior deduction of input VAT.

India, after a decade long struggle, has finally implemented Goods and Services Tax, from 1 July 2017. It has simplified the indirect tax structure of India and reduced the cascading effect of multiple-layer of taxes by subsuming 17 central and state indirect taxes and around 23 surcharges. GST is a nationwide tax levied on supply of goods and services in India. GST is expected to bring a basket of benefits for the Indian economy in terms of buoyant revenues, GDP growth, employment, lower logistics costs and increased exports. However, these benefits are contingent upon the manner of its implementation. In India, both the policy makers and the public have a lot of expectations from GST

in terms of resolving loopholes in the pre-existing Indirect tax structure. In this context, this paper attempts to study the functioning of VAT/GST of two Asian countries namely China and Japan and to draw lessons for India from their experiences. The rationale behind selecting China is that it is becoming more economically integrated with India in terms of trade and investment. Both in China and India, income tax is small and poorly distributed, while indirect tax is well established and has emerged as an important source of revenue over the direct taxes. The rationale for choosing Japan is the importance of small scale businesses in Japan. To quell the compliance concerns of broad based value added tax on SMEs, the Japanese consumption tax contains special features to minimise its impact on small businesses. Since in India, majority of businesses are small scale, this paper aims to explore whether India can draw any lessons from the Japanese experience.

2. RESEARCH METHODOLOGY:

This paper is based on exploratory research. It aims to gain familiarity and acquire new insights on GST in selected Asian countries under the study. The research design employed for the study is descriptive in nature. Available secondary data was extensively used for the study. Different news articles, national and international journals, books and websites which focused on various aspects of GST were used for the study.

3. OBJECTIVES OF THE STUDY:

Following are the objectives of the study:

- To study the functioning of VAT/GST of two Asian countries such as Japan and China.
- To draw lessons for India from the experience of selected Asian countries under the study to make Indian GST more efficient and administratively smooth.

4. LITERATURE REVIEW:

Tajika (1995) examined the VAT in Japan. Author pointed out the effects of exemptions granted to the small and medium businesses in Japan in order to make the VAT acceptable to them. Granting voluntary surcharges on part of VAT exempt firms and providing subsidies to the bigger firms for procuring goods from small businesses seemed to be too much of compromises. Author suggested the use of invoice method as against the current deduction/accounting method for calculating the consumption tax liability to make the business accounts more transparent. Author also pointed out the regressive nature of single VAT rate in Japan levied on all goods and services uniformly including food and basic necessities. The proportion of VAT liability to income ranged from 1.85% of the lowest income group to 1.41% of the highest income. Author suggested deduction for personal income tax or zero rating/exemption of basic necessities to overcome regressivity.

Nie, Fang & Li (2010) and Chai & Harrison (2011) investigated the impact of 2004 VAT pilot reform in China which permitted eligible taxpayers to subtract expenditure of fixed assets and equipments from VAT base in selected industries in 3 north-eastern provinces in China. Nie, Fang & Li (2010) used the Differences in differences method to study the impact of the reform on firms' fixed asset investment, employment, innovative activities and productivity. They found that the reform significantly led to an increase in firm's fixed asset investment, capital-labour ratio and productivity but led to a decline in employment. On the other hand results of Chai & Harrison (2011) differ in significant ways. They explored the impact of the VAT reform on firm employment, investment, profits, productivity and exports. Their results suggested that while the reform was effective in reducing the value-added tax paid by firms, but the policy significantly reduced firms' total number of employees for both domestic and foreign firms. Also the impact of the tax reduction on firm productive investment was limited: while there is some evidence that SOEs increased their investment, the impact was not significant for most other types of enterprises. Finally, the tax reform did not have any significant effect on firm productivity for all types of firms, and it decreased export intensity for most types of firms.

Ainsworth (2013) pointed out the problem of regressivity caused by the single rated consumption tax levied on all goods and services in Japan including food and other necessities. Continued fiscal deficit has forced the Japanese Government to increase the consumption tax rate which will further add on to the burden of tax on poor. Author has argued that mitigation of regressivity by exempting or reducing the rate for everyone on the purchase of necessities is overly broad. He suggested a better approach to resolve the regressivity by using modern technology i.e. to identify individuals in need and not the goods they frequently purchase and then to devise a method for granting surgical relief to these individuals alone. He said that modern technology in Japan can make this happen.

Wang and Fan (2014) studied empirically the impact of VAT on government size in China. To investigate the impact of VAT on government size, growth of VAT rate was taken as the dependent variable and the ratio of government expenditure to GDP was taken as an indicator of the government size being an independent variable. Based on data from 1985 to 2011 their study concluded that VAT acted as a significant factor in government's expansion. Over this time period income from VAT grew rapidly from merely 14.77 billion RMB in 1985 to 2426.663 billion RMB in 2011. Also government expenditure as a percentage of GDP increased from 11.22% in 1995 to 23.1%

in 2011. The continuous increase in expenditure was a result of the rapid increase in government financial income arising from VAT being the highest contributory to the total taxation income.

5. FUNCTIONING AND EXPERIENCE OF GST/VAT IN THE SELECTED ASIAN COUNTRIES CONSUMPTION TAX IN JAPAN:

Japan's consumption tax is popular internationally for its simplistic structure but is still unpopular and controversial at home even after a decade of its implementation because of the perception that it has fuelled the recessionary situation in Japan by undermining household consumption demand over the years.

The path towards the introduction of a broad based value added tax was not easy because of the unpopularity of the 'concept of taxation' among masses in Japan. It required a decade long struggle of several Prime Ministers and bureaucrats to finally craft a simplistic VAT structure that was acceptable to the public especially small scale businesses. Prior to the introduction of consumption tax, Japan was heavily dependent on highly progressive individual and corporate income taxes which were a burden on middle and upper middle class wage earners. Also the indirect tax system relied mainly on selective excise taxes which had many loopholes such as extremely narrow base with high rates which caused distortions in consumer choices. Other indirect taxes were outdated with only few services being taxed despite being a service oriented economy. Indirect taxes failed to generate adequate revenues. The necessity of a broad based consumption type tax arose in 1970s when the oil shocks of 1973 slowed down the Japanese economy leading to high fiscal deficits. Later on more stress was placed on reducing the dependence on the income tax due to rapidly ageing population of Japan. Prime Minister Ohhira proposed "the General Consumption tax in 1979 but it never became a law because of opposition from the small business sector considering it both inequitable and unnecessary. In January 1987 Prime Minister Nakasone proposed his version of the VAT called "the Sales Tax" but it again did not come into being amid public opposition because of its regressive nature. Finally in December 1988, Prime Minister Takeshita got the approval of two houses and this time the VAT was named as "the Consumption Tax." Consumption tax was ultimately adopted and came into effect from 1 April 1989 as a broad based consumption tax levied on sale of goods and services in Japan with only few exemptions at a single rate of 3% using simplified calculation and reporting methods to minimise the compliance cost of businesses. The main exemptions retained were for only few items such as education, healthcare and welfare programmes. An exemption for food was mainly restricted due to difficult definitional issues. The resultant regressivity of the tax was offset by reduction in the income and corporate tax rates and increase in personal income tax threshold.

Considering the importance of small businesses in Japan and to quell their concerns regarding the consumption tax, some special features were incorporated in the consumption tax laws. Some of them were:

- High initial threshold: initially any firm with an annual taxable turnover of less than 30 million Yen was completely outside the scope of the consumption tax system.
- Tax exempt firms may voluntarily shift 3% surcharge on their sales price and collect it in their without contributing to the treasury. They may even not be punished by law to demand it from customers as a consumption tax.
- Simplified scheme: when consumption tax was introduced, firms whose annual taxable turnover was larger than 30 million Yen but smaller than 500 million Yen were allowed to opt a simplified method of computing the tax with a view to reduce the compliance costs. Instead of calculating the total value of purchases certain fixed percentage (10% for wholesalers and 20% for other businesses) was multiplied by total sales value and the result subjected to the consumption tax rate.
- Larger returns and tax collection periods: businesses whose tax payable in the previous year was equal to or less than 6,00,000 Yen were required to pay the tax only once a year. Larger businesses were required to pay tax twice a year. Tax returns were to be filled annually.
- Absence of tax invoices: in order to overcome the opposition of small businesses regarding the requirement of sophisticated record keeping under the VAT system, the Consumption tax was structured in a manner that there is no reliance on invoices to input tax credit. This a departure from the European model which requires maintaining proper tax invoices to claim the input tax credit. Japan has adopted the simplified accounts method also known as subtraction method for claiming input tax credit. This method reduces the compliance burden as it requires that the same type of financial records to be kept as required by the corporate and income taxes. Under this method the value added that each firm generates is calculated by subtracting the taxable purchases shown in the taxpayer's books of accounts (including capital investments) from taxable sales shown in the taxpayer's books of accounts.

Value added = sales (exclusive of consumption tax) – purchases (exclusive of consumption tax)

Consumption tax liability = value added * consumption tax rate

Invoice and subtraction methods are identical under the single rate system. Subtraction method does not apply when VAT rates differ from one good to another. This method permits businesses to claim deductions even for purchases that were made from an exempt business and no tax was actually paid.

However over the years many aspects of simplification had to be removed to rectify the problems caused by various compromises. Some of the changes were:

- Reduction of the threshold for application of simplified scheme from annual sales of 500 million Yen to 400 million Yen in 1991 which further reduced to 200 million yen
- Expansion of exemptions under consumption tax
- Strengthening of requirements to claim input tax credit by requiring the business to retain bills, receipts, invoices and other documents supporting any purchases.
- Quarterly filling of returns and payments of consumption tax

Consumption tax rate was increased from 3% to 5% effective from 1 April 1997. The rate was further increased to 8% effective from 1 April 2014. Gradual amendments to the tax are typical of Japanese consumption taxation. The tax was enacted at the lowest possible rate and with a no. of simplification features and exemptions for small businesses. Overtime those have been gently tightened with the threshold for special treatment falling.

6. IMPACT OF CONSUMPTION TAX ON THE JAPANESE ECONOMY:

Consumption tax had a positive impact on the revenues. Revenues raised by the Japanese consumption tax continued to increase during 1990s despite difficult economic conditions in Japan (Dabner, 2002). Since the introduction of CT in 1989, its tax revenue has increased steadily and now account for about 12% of the total national tax revenue and is considered as one of the major taxes in the present tax system (OECD, Revenue Statistics, 2016).

In all countries, the public and the government anticipate an increase in retail prices post VAT introduction. Japan was not an exceptional case. The consumer price index in total rose by 2.9% in fiscal 1989 which was substantially higher than 0.8% in fiscal 1988. Price hikes continued at a reasonable level until the end of 1989. But later on CT had a little impact on prices due to the guidance of government on prices and official monitoring (Ishi, 1992). The 1997 rate hike had a negative impact on consumer spending in Japan. Beyer (2000) reported that consumer spending dropped after the rate increase. However, overtime the situation corrected itself. The rate hike of 1997, fuelled the argument among veterans that consumption tax contributed to the Japanese economic slump and contributed to the negative growth in 1997. The real economic growth in Japan in the fiscal year 1997 was -0.7%, the first negative rate since the oil shocks (Fumitoshi, 1999). Also, the effects of the tax hike in April 2014, were felt immediately. In the 2nd quarter of the year from 1 April to June 30, the economy contracted at an annualised rate of 7.3% which further contracted by 1.6% in the 3rd quarter technically falling into a recession. Private consumption demand fell around 1.5% points of GDP immediately after the consumption tax hike and hasn't recovered yet.

Horioka and Sekita (2004) found that Japan's consumption tax structure was problematic from the efficiency and equity's point of view. Single rate levied on all goods and services including food and luxury items make the consumption tax regressive in nature and inequitable. Food is one item that has not yet been exempted or zero rated despite of hard lobbying. Therefore, even after more than two decades of its implementation CT has not gained public acceptance.

Special concessions provided to the small and medium enterprises also posed problems. A particular problem with exempt status is that CT does not require exempt taxpayers to advertise their exempt status. This makes it possible for them to charge the tax from consumers and pocket the money (Beyer and Ishimura, 1993). Annualised filling of returns was also criticized as the infrequency of the return left the collected tax in the hands of the taxpayers who then attempted to invest the funds. So effective 1 October 1991, tax returns were filled quarterly by all taxpayers whose annual CT liability for the previous year exceeded 5 million Yen. Also the subtraction/deduction method is distortionary as it is difficult to detect tax evasion. It is so imprecise that it is impossible to even speculate as to its inefficiency or the amount of revenue it is failing to bring in (Beyer and Ishimura, 1993). This method provides avoidance opportunities and makes enforcement difficult. An audit trail cannot be traced to tax invoice, only the accuracy of the accounts must be relied upon. Lack of tax invoice also makes it difficult to distinguish between goods on which tax was paid and goods that are tax free. This provides an opportunity to claim credit on purchases from exempt small businesses (Dabner, 2002).

On a positive side, despite prevalent fears in advance, the implementation of VAT was much smoother than anticipated. Both traders and consumers behaved well and cooperated with tax authorities, although anti-VAT sentiments still retained strong among the public.

Japan is now planning to increase the consumption tax rate from 8% to 10% effective from 1 October 2019. To alleviate the burden for low income earners, when consumption tax rate will be raised to 10%, the current rate of 8% will be retained for certain goods. The lower rate would be applied to the purchases of food and drinks (excluding alcoholic beverages and dining out) as well as to subscription of newspapers. Followed by the multiple tax rate, a new invoicing system will be introduced on 1 October 2023. Until then a simpler method will be used.

7. VALUE ADDED TAX IN CHINA:

In China, the era of reforms and transition from centrally planned to a market oriented economy began from late 1978 to lift the economy and to boost the economic development. Taxation was considered as a significant fiscal tool to facilitate economic development and improve resource allocation (Xu, 2012).

For a long time turnover tax was the major form of taxation levied on enterprises. As a part of indirect tax transformation, Chinese government began experimenting with the pilot value added tax program in 1979 that applied only to two industries namely machinery and agricultural tools and three products- bicycles, sewing machines and electric fans in two cities namely Shanghai and Xian. In 1984, China expanded VAT to 24 categories of goods. VAT was levied only till the wholesale stage. VAT coexisted with other turnover taxes like Business Tax and Product tax which were imposed on gross sales value without allowing for deduction of tax already paid on purchases/inputs. The turnover nature of the Business and Product taxes and simultaneous levy Value Added Tax and product tax on the same base created a cascading effect throughout the business chain. Unduly complicated sales tax system led to high administration and compliance costs leading to rapid erosion of revenues collected by the government and caused excessive burden on enterprises.

In 1994, after considering the domestic fiscal needs, the People's Republic of China responded with the introduction of a Production/GDP type VAT to be levied on sale of goods (except for intangible and immovable goods) and provision of few services in China and also on import of goods into China. The input tax paid on purchases of fixed asset was not credible against the payment of output tax. VAT was supplemented by two other turnover taxes namely business tax and consumption tax. Business tax applied to most of services and was levied and collected by the local governments. Consumption tax applied to luxury and sin goods such as expensive jewellery, wine and cigarettes in addition to the VAT. The imposition of VAT and BT was mutually exclusive and were administered and collected by the central government.

VAT was considered as a laudable improvement in terms of removing tax distortions and providing stable source of revenue to the central government.

China's VAT is administered by the State Administration of Taxation (SAT), and the tax regulations and rules are uniformly applied across the country. VAT revenues collected are split 75/25 between the central and local governments. Until 2012 VAT reforms, there were two VAT rates in China. The VAT applied at a standard rate of 17% on sale of majority of taxable goods in China, imported goods and provision of services. The reduced VAT rate of 13 percent applied to a range of goods, including basic staples or household necessities such as food, fuel, electricity, books, newspapers and magazines, and agricultural products. The zero rate applied to export of goods. There are two types of taxable persons in the VAT law based on annual sales volume. The first category includes, "general taxpayers," whose annual sales reached CNY 1 million or more (production type) or CNY 1.8 million (non-production type) and who have a sound accounting system to enable tax officials to ascertain the output and input VAT. The second category, "small-scale taxpayers," are those whose revenue are below the above levels and maintain incomplete accounting records. They are levied based on a simple computation with no right to deduct the input VAT (general taxpayers have the right to deduct). Above threshold limits have been revised post 2009 and 2012 reforms.

There are two types of VAT invoices in China- the General VAT Invoice and the Special VAT Invoice (SVI). VAT General Invoices are issued by the small taxpayers. It cannot be used to calculate the input tax credit. Small taxpayers are prohibited from using the VAT Special Invoice. On the other hand the VAT Special Invoices are issued by the general taxpayers. It shows the purchase price and the VAT amount payable separately so that the purchaser can use this invoice to claim input tax credit while paying the output tax. Even general taxpayers are not allowed to issue special VAT invoices in final consumer transactions or in VAT exempt transactions. They must issue general invoices in such situations. The SVIs are wholly controlled by the SAT. All taxpayers must purchase the tax invoices from a relevant local tax bureau. Although the new VAT established the uniform standard rate of tax, expanded the base and increased the revenue but it was still considered as impure compared to the classical VAT because of production or GDP type of VAT with tax on purchase of capital goods not allowed as deductions from output tax; frequent adjustment of rates at which input taxes are rebated on exports making the VAT on exports non-neutral and an instrument of trade policy; lack of integration of VAT and BT and administrative problems produced by the invoice based VAT system. There was a bias against capital-intensive and labour incentive industries as the former borne a comparatively higher burden.

In 2004, China's Ministry of Finance and SAT jointly issued a document "the provision of extending reduction base of VAT in North-eastern region" which permitted certain general taxpayers to deduct expenditure of fixed assets from VAT base in 8 industries like equipment machinery, petrochemical etc. in 3 north-eastern provinces of Hielongjiang, Jilin and Liaoning. In addition from 1 July 2007 the pilot program was put into practice in 26 cities of central China and was further extended to other regions from 1 July 2008. Finally, on 1 January 2009 the VAT reform was implemented nationwide in all industries in the backdrop of global financial crisis (GFC). This reform allowed the firms to claim VAT credits on purchases of fixed investment up to the amount of current VAT liability and carry forward to future years any remaining credits. This provided immediate cash flow benefits to enterprises in China

during a time of financial turmoil, and in the long term facilitated development of capital-intensive industries and a platform for upgrading technology.

Even after the 2009 reform, VAT was distortionary because the right to deduct input VAT on the purchase of fixed assets was not applicable to real and intangible property. Simultaneous existence of turnover tax i.e. BT which was not credible against VAT was causing cascading effect. Also there were problems associated with the hybrid VAT invoice system.

So in order to resolve the problems of double taxation, to make improvements and to support the development of modern service industry government proposed “the Business Tax to VAT Transformation Pilot Program” to broaden the scope of VAT by adjusting and reducing Business Tax. From 1 January 2012 onwards, government launched a VAT pilot program in Shanghai which involved replacing the BT with VAT on transportation services (except railways) and some modern service industries like R&D, IT, cultural and logistics among others. This program was then extended to 8 municipalities and provinces in August 2012. The new VAT rates of 6% and 11% were introduced and added to the existing rates of 13% and 17%. The MOF and SAT extended the VAT for the above services to the entire nation in August 2013. In June 2014 the VAT was further broadened to cover telecommunication services in all provinces of China. As of January 1, 2015, the upgraded VAT Invoice Processing System was put into use that can effectively identify and prevent tax evasion and tax frauds related to tax invoice. Effective 1 May 2016, the major industries which were still under BT such as construction, finance, real estate and lifestyle were included in the VAT eliminating BT from China’s tax system.

8. IMPACT OF VAT ON THE CHINESE ECONOMY:

VAT was regarded as a laudable improvement in terms of removing tax distortion and providing stable source of revenue for the central government. Since 1994, VAT became the biggest tax in China providing revenues of around 221.26 billion Yuan that year accounting for 43.3% of total tax revenue. In 2005 the revenue from VAT was 1079.21 billion Yuan. Although from 1994 to 2005 the share of VAT in total revenue declined from 45% to 37.5% but still the share of revenue from VAT was much higher than any other tax (Lin, 2007).

In 2009 when global financial crisis affected China’s economy, VAT revenue still contributed 31% to the total tax revenue (Yan, 2010). However government estimated a loss of revenue of CNY 120 billion in 2009 from the changes (Yan, 2010). In 2011 after 2009 reforms the VAT income was 2.436663 trillion Yuan, accounting for 27.04% of total revenue. This was consistent with the study done by Ahmad et al. (2004) which stated that such a reform would result in losses to the government.

In the year 2015, share of VAT in the total tax revenue of the government was 24.9% (China Statistical Year Book 2016) making it the largest source of revenue for the government.

The 2004-09 reform significantly led to an increase in firm’s fixed asset investment, capital- labour ratio and productivity but led to a decline in employment indicating the uncertainty of the VAT reform on social welfare (Nie, Fang & Li ,2010). Also there was strong heterogeneity in firm response to the investment tax credit. Only smaller firms and firms with larger cash-flow ratios experienced significant increases in investment following the VAT reform; large firms and firms with small cash-flow ratios were not responsive (Chen, He & Zhang 2015). Although VAT in China achieved certain successes in terms of generating revenues and increasing fixed investments but faced serious problems regarding VAT evasion and fraud because of impure, non neutral and partially consumption and partially production based VAT system. The use of invoice credit method is very problematic due to discriminatory rules which apply to small scale taxpayers and general taxpayers, to sale of taxable goods and services and non-taxable services. Also lack of sound accounting systems and effective IT systems for VAT administration for government limited addressing fraud and evasion problems. Simplified VAT reporting was also troublesome as over 80% of all VAT taxpayers are small scale taxpayers who could not claim input tax credit because they were subject to the simplified low rate turnover tax. (Cui and Wu, 2011).

Studies estimated that about 55% of VAT revenue was lost due to tax evasion and deficiencies in tax administration. Forged VAT invoices, invoices for fictitious transactions, illegally selling or purchasing SVIs, and the failure to report the VAT by not issuing invoices to purchasers are common means of evading the tax. China’s tax administration has long relied on manual operations for tax collection, refund, and audit. The tax administration lacks efficiency and accuracy in monitoring tax payments.

On the positive side, the 2016 reform led to remarkable achievements, as more than 570 billion Yuan (\$82.8 billion) in taxes were reduced for companies in all sectors and The Wall Street Journal regarded it as China’s greatest tax reform in 30 years. Replacing the business tax with value-added tax (VAT), which helped reduce tax burdens on enterprises and industries, has brought many positive effects to China’s macro economy. The reform has boosted industries to be more specialized and professional, and improved productivity standards nationwide. It helped optimize the industrial structure by including modern services, finance and productive services in the reform.

China’s tax authorities have confirmed proposals to reduce the number of VAT rates from 4 to 3. Goods such as farm produce, water, coal and gas will be reclassified from 13% to 11%. The new three-rate band – 17%, 11% and 6% –

will come into effect on 1 July 2017. The annual VAT registration threshold will also rise to Yuan 500,000 from the current Yuan 300,000. The Chinese tax authority has granted the right for small tax payers in key sectors to the right to issue sales invoices without seeking prior approval via the Golden invoice regime. The new easement of the invoicing requirements will apply to companies with annual sales below CNY 90,000 per quarter.

Although China has improved its compliance, tax evasion and administrative issues prevalent earlier but improvement in the management system, up gradation of data processing capabilities & IT system and educating the public regarding their tax obligation is necessary for smooth transition. Also issues relating to lack of input tax credit on the purchase of real and intangible still needs to be resolved. In future China should work on making the VAT structure more neutral and simple, reform its hybrid invoice credit mechanism to improve compliance and reduce tax evasion and increase the efficiency of tax administration.

9. LESSONS FOR INDIA:

Based on the analysis of the VAT/GST structure of China and Japan and the impact of the tax on their economy, certain lessons can be drawn for India. Some of the lessons are as follows:

- Notwithstanding some limitations of the Japanese compromise, their focus on minimizing the compliance burden on small taxpayers are lessons that India might take to resolve the increased compliance burden and cost under GST for small scale businesses in India. One of the measures which can be adopted includes permitting small businesses to file quarterly returns instead of requiring them to file monthly returns.
- The introduction of the consumption tax in Japan was politically charged and had a number of false starts. One of the most important lessons from the Japanese experience is the need for an intense public relations campaign preceding the introduction of a VAT.
- Another lesson which can be drawn from Japanese experience is that in case of recessionary situation in an economy it is not advisable to increase the rate of a broad based value added tax especially when the VAT structure is highly regressive as it reduces the consumption demand and further worsen the recessionary situation.
- China's experience illustrates that VAT should be designed to be simple, neutral and as clear as possible avoiding excessive exemptions and derogations. Otherwise the administrative and compliance cost will be high and tax evasion will be more difficult to control. In case of India, although GST is an improvement over the pre-existing VAT and other central indirect taxes but multiple slab GST rate system, large exemptions, provision of monthly returns and dual administration are likely to complicate the GST regime and add to the compliance cost of the taxpayers and administrative problems for the authorities. So India should learn from China's poor experience with respect to tax compliance and administration and should prepare well in order to ensure smooth implementation of GST.
- Another lesson which can be drawn from China is that, to prevent possible VAT evasion, a sound accounting and an advanced information management system is a must along with the effective governmental regulation which lacked in China prior to 2012 reforms. Although India has developed a large IT system known as Goods and Services Tax Network (GSTN) with an inbuilt invoice matching system but its soundness would be known after it comes into practice post GST implementation.
- China's tax authorities have confirmed to the proposals for reducing the number of VAT rates from 4 to 3. Goods such as farm produce, water, coal and gas will be reclassified from 13% to 11%. The new three-rate band – 17%, 11% and 6% – will come into effect on 1 July 2017. India should also focus on gradually reducing the number of GST rates from 4 to 2 or 3 in the long term to improve administration and compliance and avoid classification disputes.

10. CONCLUSION:

Tax administration plays a crucial role in ensuring the effectiveness of a tax policy. However, implementation of VAT and its compliance is not an easy task especially for developing countries which lack sufficient resources and information technology required for administration and improved compliance of a broad based value added tax. This is evidenced from the analysis of this study. In case of Japan which is a developed country, better administration led to an increase in indirect tax revenues and smooth implementation of GST/VAT. But uniform rate of VAT with very few exemptions with no compensatory packages has made the Japanese consumption tax highly regressive in nature. It has fuelled the recessionary situation in Japan by undermining household consumption demand over the years.

On the other hand, developing country like China, although saw an increase in their indirect tax revenues but encountered administrative and compliance problems (especially for small and medium scale businesses for whom compliance costs increased in higher proportion than their larger counterparts) post GST/VAT implementation. Administration of the dual GST model is the biggest challenge facing India. India should learn from both the pitfalls in administration & application of law in China and successful administrative strategies of Japan. Administrative structure should be such that it does not undermine the administrative independence of the central and state

governments' tax departments and yet should provide simplification and harmonization for taxpayers across the country to avoid dual control otherwise it will lead to failure of tax compliance. There is a need for proper audit plan (to minimize the gap between the reported and actual statutory tax liability of the taxpayer) to cover different economic activities and large variety of taxpayers. In order to reduce the compliance burden businesses should establish an effective work plan to migrate from the pre-existing indirect tax regime to the GST. They should test and revise their accounting system for GST, review and revise staff profile and ensure that they must have adequate manpower to handle GST. For small and medium scale businesses who do not have sufficient resources and technological know-how and have low profit margins, government should allow them to file quarterly returns instead of requiring them to file monthly returns. Apart from this adequate training is necessary for both taxpayers and enforcers.

Indian government should also be wary of the spike in inflation due to GST as happened in Japan. India should learn from the effective anti-profiteering measures taken by Japan to mitigate price hike in the long run. Although India has opted for a two-pronged solution to make sure this doesn't happen- a multi-rate GST structure and a proposed anti profiteering agency, but its success will entirely depend upon efficient administration.

We hope that all the issues and challenges emerging post GST implementation are resolved expeditiously and India learns from the from the experience of other countries so that India is wary of problems faced by them and initiate special programmes as undertaken by these countries to resolve economic/sector specific issues and to improve tax compliance and administration which is key to success for a broad based value added tax.

11. LIMITATIONS OF THE STUDY:

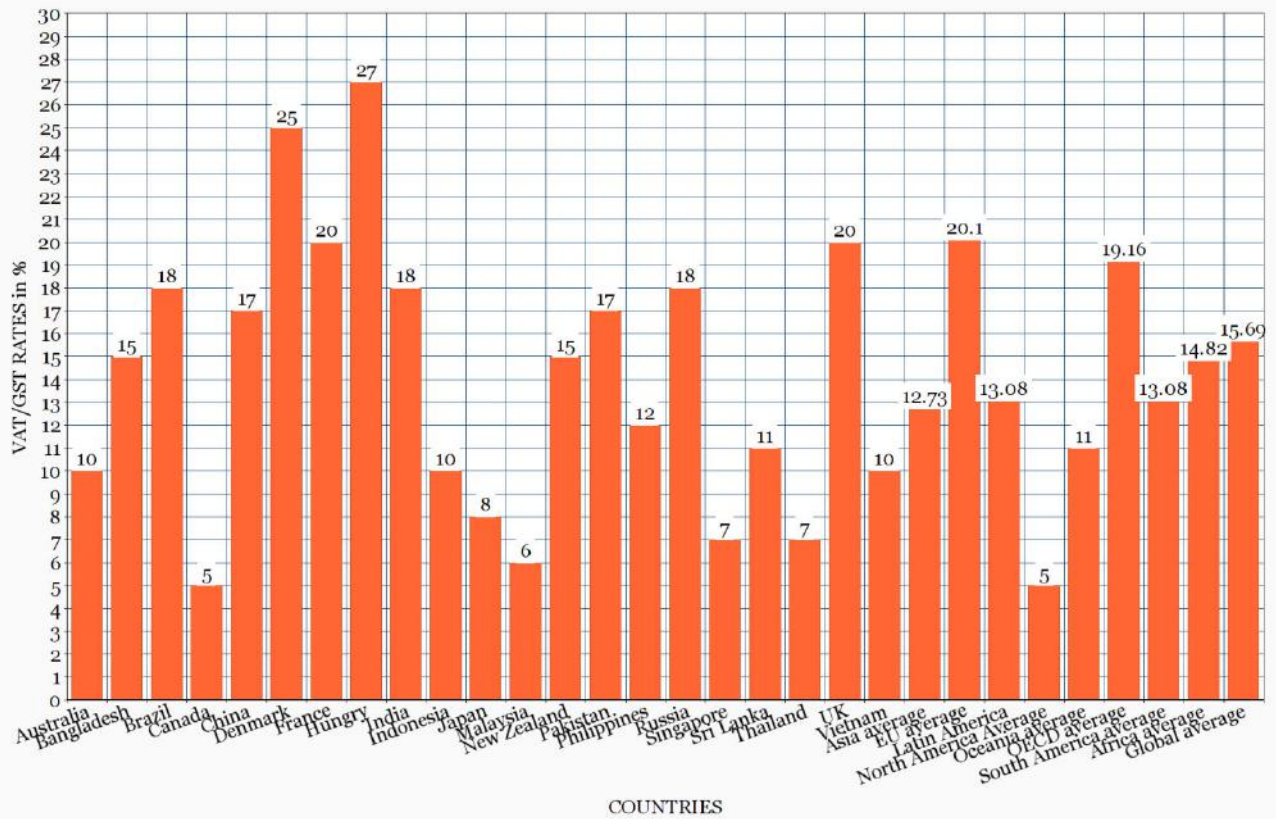
Findings and conclusions of this study have been drawn by reviewing mostly the papers from only 2 Asian countries. Therefore more papers from a wide range of developing and developed countries across the different regions of the world could be reviewed to enhance the quality of the study and make the findings of the study more reliable for policy makers.

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APPENDIX:

GRAPH 1: VAT/GST RATES OF SELECTED COUNTRIES AS OF JULY 2017



Source: KPMG’s indirect tax table and author's own.