GST FRAUD: UNVEILING THE MODUS OPERANDI OF INPUT TAX CREDIT FRAUD SCHEMES.

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Abstract

Goods and Services Tax (GST) is an effective way of raising revenue for the Government, but it also faces the problem of GST Input Tax Credit (ITC) fraud. Input tax credit is a crucial component of the indirect tax system, but it can be misused by fraudsters to evade taxes and cause a huge loss of government tax revenue. This paper studies the GST fraud modus operandi based on newspapers articles. It reveals that fraudsters have devised a unique scheme of fake billing and input tax credit fraud, involving the creation of shell companies. GST fraud poses a challenge for the GST department in India, as fraudsters exploit the loopholes in the GST system. To curb GST fraud and minimize its impact, it is important to understand the GST fraud modus operandi and its types. This paper presents two modus operandi that illustrate how GST frauds are committed by fraudsters.

Keywords: GST fraud, Input tax credit, Modus operandi, Shell companies, Fake billing

INTRODUCTION

There are two types of taxes: **Direct tax and Indirect tax**. Direct tax is collected from **individuals and companies**. Income tax, Corporate Tax and Gift tax are some examples of Direct tax. Indirect tax is imposed on the Goods & Services consumed. Indirect tax is collected from the consumers by a third party, so consumers have the burden of tax payment. Goods and Services Tax is an Indirect tax. **Most developing nations collect indirect tax from the consumers.** The motive of developing countries is that **they are still developing, and they want to increase their tax base by collecting taxes like Goods and Services Tax.** The main motive of Indirect tax is to govern the point of levy. Levy is **a** charge such as tax, duty, fine, or other fees that is imposed on something. **A** developing country has a big market of **informal activity (a type of activity that has a market value but is not formally registered)** at the consumption level. **This leads to a parallel economy by keeping a huge part of the value chain outside the regulatory authority's watch** (Mehta et al., 2019)**.** To handle this problem, they follow a multipoint taxation system like Value-Added Tax **(a tax that is charged on the goods and services levied at each stage of the supply chain**) and Goods and Services Tax. T**he Government of India implemented GST on 1st July 2017. GST replaced many indirect taxes (Value Added Tax, Excise Duty, Service tax, etc) that previously existed in India.**
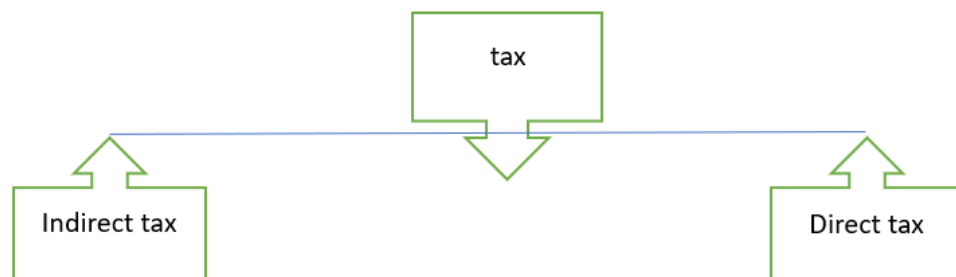
(Figure:1 Types of Taxes)

Goods and services tax (GST) is a successful method of raising government revenue, but this indirect tax is susceptible to fraud and is frequently exploited by taxpayers, depleting the government tax revenue. The Goods and Services Tax (GST) was implemented in India as a historic reform with the goal of streamlining the nation's tax system and fostering economic expansion. The prevalence of fraud has been one of the GST system's biggest challenges. The GST system is vulnerable to manipulation by dishonest enterprises because it mainly relies on self-assessment.

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As per the public disclosure in parliament by finance ministry, from July 2017 to February 2023, there was close to Rs. 3.08 lakh crore in GST evasion reported of which more over 1.03 lakh crore was recovered. The GST officials detained 1,402 offenders from July 2017 to February 2023 for tax evasion (The Economic Times 2023). In 2023-24 only GST evasion of ₹ 1.51 lakh crore have been detected by GST department (The Indian Express, 2023).
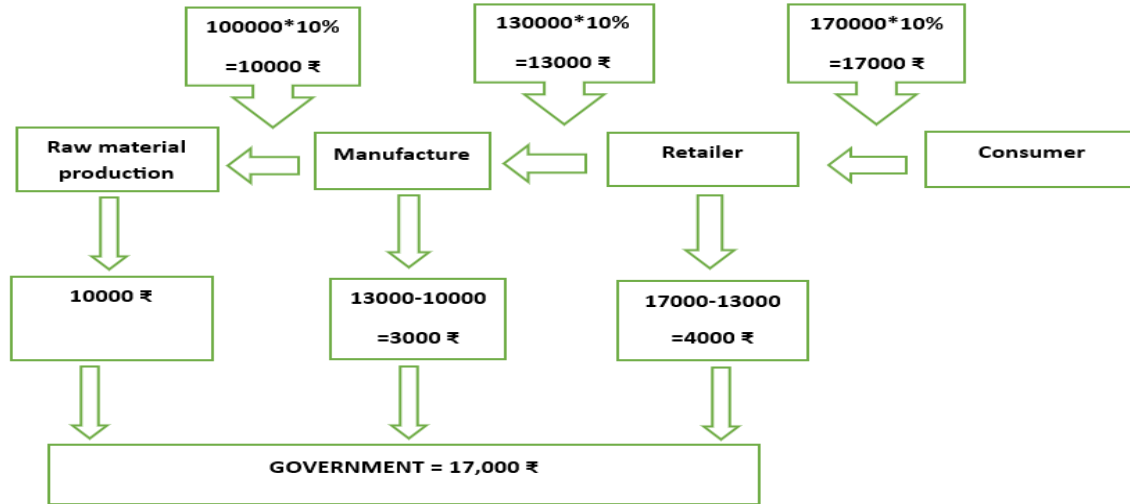

(Figure:2 flow chart of GST collection by Government through GST)
(Source: Mehta et al., 2019)

In the above example, as we can see in the above given chart the manufacture purchases some raw material of ₹ 1,00,000, tax rate is 10%. So, they are paying ₹ 10,000 as a tax of raw materials manufacturers. Raw material manufacturer dealers remits to the Government the tax amount the has been collected. Then the retailer purchases the processed goods from manufacturer of ₹ 1,30,000. An amount of ₹ 13,000 is then paid as tax. The manufacturer pays to the government the difference between the tax that the manufacturer collected from the retailor (₹ 13,000 - ₹ 10,000) ₹ 3,000. The consumers then buy the finished goods from the retailer. The retailor for ₹ 1,70,000 by paying tax of ₹ 17,000 by following the same system given in the previous steps the retailor pays (₹ 17,000 - ₹ 13,000) ₹ 4,000 to the Government. So, the total tax Government get is ₹ 17,000 which is paid by the consumer of the goods in indirect way. Raw Material dealer manufactures and retailers are representative of the Government to collect the tax (Mehta et al., 2019).

CIRCULAR TRADING IN GOODS AND SERVICES TAX

Circular trading, also known as carousel fraud or chain trading, is a type of fraudulent activity where goods or services are continuously bought and sold among a group of companies or individuals to fraudulently claim input tax credit (ITC) or value-added tax (VAT) refunds. In most tax evasion in GST cases, commercial dealers, in their regular tax-returns, intentionally manipulate their actual business transactions interested by the amount of profit gained by evading tax. In the context of Goods and Services Tax (GST) and Value Added Tax (VAT), circular trading typically involves a series of transactions that create an artificial chain of supply. This is done to create the appearance of legitimate business activity and claim tax benefits, such as ITC or VAT credits.
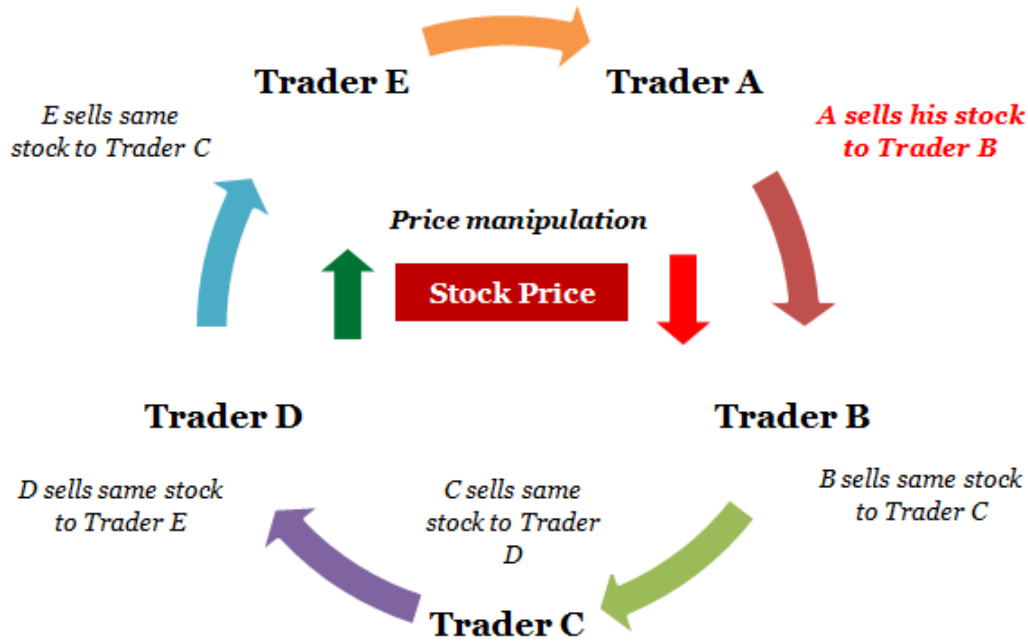
(Figure: 3

(Source: Author's own work)

a)   A group of companies or individuals form a network where they create fictitious invoices for the sale and purchase of goods or services.

b)   The first Trader in the chain (Trader A) purchases goods or services from another member of the group (Trader B) and receives an invoice with tax included. c) Trader A then sells the same goods or services to another member of the group (Trader C), charging tax once again. d) This process continues with subsequent members of the group, each selling the goods or services to another member, adding tax, until it completes a full circle and returns to the original Trader (Trader A).

c)   Trader A then sells the same goods or services to another member of the group (Trader C), charging tax once again.

d)   This process continues with subsequent members of the group, each selling the goods or services to another member, adding tax, until it completes a full circle and returns to the original Trader (Trader A).

e)   Throughout this circular chain, the participants fraudulently claim and receive ITC or VAT refunds based on the taxes paid in the previous transactions. They present these invoices to tax authorities as evidence of legitimate business transactions and reclaim the tax credits or refunds.

Circular trading is a form of tax evasion because the goods or services involved often do not physically move or have any real economic purpose. It is solely done to create a chain of transactions, generate fake invoices, and fraudulently claim tax benefits. Tax authorities worldwide have implemented various measures to detect and prevent circular trading, including data analytics, verification procedures, and regulatory frameworks. These efforts aim to detect suspicious patterns, cross-check invoices, and track the movement of goods or services to identify potentially fraudulent activities and take appropriate legal actions against the perpetrators.

MODUS OPERANDI OF INPUT TAX CREDIT FRAUD SCHEMES

In India many GST fraud cases have been reported but here two modus operandi of GST fraud has been included.

1.   Madhav Copper Bhavnagar GST Fraud Case

Gujarat has witnessed one of the biggest GST frauds which happened in Bhavnagar involving fake billing of Rs 5000 crore. According to GST enforcement probe (case under investigation) the fraudster made a gang in which they offered providing Government support and change phone number in Aadhaar card. Then based on Aadhaar card fraudster used to get PAN numbers and then get GST registrations for the creation of Shell Companies. Biggest breakthrough related to the Bhavnagar fake billing scandal, where individuals manipulated Aadhaar information unlawfully to acquire GST registrations under unsuspecting people's names, it has been revealed that approximately one-fourth of the estimated Rs 20,000 crore in fraudulent billing occurred in the state of Gujarat. Then based on Aadhaar card fraudster used to get PAN numbers and then get GST registrations for the creation of Shell Companies. During inspections carried out at Aadhaar centres by SGST officials, it came to light that approximately 2,800 Aadhaar cards had their associated mobile numbers altered. In the initial chargesheet recently submitted by the special investigation team (SIT) tasked with investigating the scam, they've identified 461 fictitious companies. In a related development, Mohammad Tata, who is allegedly the mastermind of another

fraudulent billing scheme amounting to Rs 739 crore involving Madhav Copper Limited, has been relocated from Sabarmati Jail in Ahmedabad to Bhavnagar for further investigation into his potential involvement in the Aadhaar-GST fake billing scam. Among these entities, 236 have already undergone scrutiny, but sources suggest that the actual number of such dummy corporations could extend into the thousands.

The deduction process unfolded as follows: According to sources who informed The Times of India, in February 2023, the SGST initiated a comprehensive on-the-spot verification campaign across several cities, including Ahmedabad, Surat, Rajkot, Bhavnagar, and Anand. Of the approximately 100 companies subjected to raids during this operation, 61 in Surat and 13 in Ahmedabad were identified as fraudulent entities. Notably, during a spot verification at a specific location in Surat, the Aadhaar cards associated with the GST registrations of these shell companies revealed addresses in various places, such as Bhavnagar, Palitana, Amreli, Ahmedabad, and Anand.

The residents of Palitana, who possessed Aadhaar cards, claimed they were unaware of PAN numbers registered under their names. Subsequently, investigative efforts revealed a disturbing fact: the mobile numbers linked to these Aadhaar cards had been altered. In response, SGST officials conducted searches at around 50 Aadhaar facilitation centers in Bhavnagar and Palitana, uncovering discrepancies in the mobile numbers connected to approximately 2,800 Aadhaar cards. This raised concerns about the legitimacy of the associated GST registrations. Recent findings indicate that individuals, not limited to Gujarat, fraudulently secured GST registrations by manipulating Aadhaar cards, extending their operations to multiple states, including Maharashtra, Madhya Pradesh, Delhi, Uttar Pradesh, Tamil Nadu, and regions in the Northeast.

The investigative team achieved a significant breakthrough when they identified a novel modus operandi: manipulating Aadhaar data to obtain PAN cards and GST registrations. The use of altered Aadhaar data for GST registrations has been confirmed in various significant states across the country, as disclosed by an insider. The SGST department has taken proactive measures to inform relevant authorities in other states, urging them to investigate these GST numbers for potential cases of fraudulent billing and tax evasion. Thus far, the investigation has led to the arrest of at least 24 individuals with connections to the case.

2. Delhi Fake Billing Scam

A comprehensive, multi-agency investigation launched by the Central government is currently underway to probe the Noida police's assertions of dismantling a significant GST fraud operation, which is estimated to have involved an astounding sum of Rs 10,000 crore. Disturbingly, the probe has uncovered that a network of around 3,000 shell companies was established using fabricated Aadhaar and PAN details.

The Directorate General of GST Intelligence (DGGI) recently made a notable arrest in connection with this case. Sanjay Dhingra, the owner of Good Health Industries Pvt Ltd, based in Rajouri Garden, Delhi, and known for producing the 'Dairy Best' brand of desi ghee, was apprehended. This company operates manufacturing facilities in Mewat, Haryana, and Saharanpur, Uttar Pradesh. During questioning, Dhingra disclosed to DGGI officials that the syndicate behind this fraudulent scheme had successfully registered approximately 3,000 companies, with around 1,000 of them actively participating in illicit activities such as issuing fake e-way bills and fraudulently claiming input tax credits amounting to hundreds of crores. As of now, the investigative agency has identified tax evasion exceeding Rs 700 crore attributed to these entities.

The Central government has taken the initiative to collaborate with various intelligence agencies to trace and apprehend the individuals involved in this expansive syndicate, which has a presence across multiple states and has skillfully created numerous fake companies.

The Directorate General of Goods and Services Tax Intelligence (DGGI) has assembled specialized teams for a thorough investigation. An examination of the records has unveiled that a staggering 1,000 shell companies have managed to evade Goods and Services Tax (GST) amounting to over Rs 700 crore.

The perpetrators of these fraudulent GST activities were traced across the entire country because of a comprehensive search and seizure operation. The DGGI's Ghaziabad unit is currently investigating Dhingra's manufacturing facilities in Mewat and Saharanpur, suspecting their involvement in evading over Rs 63 crore in GST payments. Dhingra has faced previous arrests related to GST fraud and is concurrently under scrutiny by other federal agencies for potential involvement in bank fraud cases.

During the initial investigation, it was found that the syndicate's modus operandi involved the creation of sham companies using falsified documents. These companies then appointed fictitious directors to shield the true mastermind behind these illicit operations.

CONCLUSION

GST fraud has become increasingly audacious in India, necessitating a deeper understanding of its mechanisms to minimize its impact. When individuals plan for GST fraud, comprehending the modus operandi becomes crucial for swift investigations and effective law enforcement. This study sheds light on two significant GST frauds that occurred in Gujarat and Delhi, involving the use of fake invoices and manipulation of Aadhaar card details of local residents. Analyzing the data, the study found that despite GST implementation in 2017, some fraudsters continue to exploit loopholes, resulting in reduced tax payments and subsequent losses for the government. To

prevent GST fraud, it is suggested that the government focus on addressing the fake invoice billing scam and Aadhaar card misuse. In summary, understanding the tactics employed by fraudsters and implementing robust measures can help curb GST fraud and ensure a fair and transparent tax system for all. The Enforcement wing of GST department should invest Artificial Intelligence, Machine Learning, and fraud analytics tools to identify GST frauds at early stages. For better results GST department can give internship opportunities to students of Business Analytics and Intelligence, Forensic Accounting and Fraud Investigation and Cyber Security Management students for preventive fraud vigilance.

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