A critical Appraisal of GST in India

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Abstract

The introduction of Goods and Services Tax (GST) is one of the biggest tax reforms for India. GST is not just a tax change but it will benefit the economy as a whole and have far-reaching impact on businesses. GST is a value added tax (VAT) on both goods and services, as against the prevailing VAT on only goods. The important gains from the GST reform are that it is expected to broaden the tax base, reduce distortions in the economy through a more comprehensive input tax credit, enhance export competitiveness by comprehensively relieving domestic consumption taxes on exports, ensure greater regional equity by getting rid of inter-state sales tax and having a destination-based tax, and help create a seamless national market by removing inter-state trade barriers. It is hoped that the reform will significantly reduce the compliance cost for taxpayers by simplifying and harmonizing the tax structure and by making the administration uniform across states. While the desirability of the reform is not in doubt, making a transition to GST involves not only considerable work but also formidable challenges. Unlike in many other countries where GST is a centralized tax, in India it is leviable by both central and state governments, according to the proposals. This implies that both the structure and administration of the levy will have to emerge after detailed negotiations and bargaining between the centre, 29 states and the two Union Territories with legislatures. This paper is about critical appraisal GST in India.
Key Words: Tax, Direct and Indirect taxes, Goods and Services Taxes,

Introduction

Goods and Services Tax is a tax on goods and services, which will be levied 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 can claim the input credit of tax which he has paid while purchasing the goods or procuring the service. The GST aims to simplify the indirect tax regime with a single tax on manufacture, sale and consumption of goods and service at a national level. A study by the National Council of Applied Economic Research (NCAER) had estimated that roll out of GST would boost the India's GDP growth by 1% to 2%. CRISIL had also reported that GST is best way to mobilize revenue and reduce the fiscal deficit. GST has been commonly accepted by world and more than 140 countries in the World. Looking to the magnitude, GST is going to impact all sections of the Society — from a small time businessman to a huge conglomerate and from a tiny State to a developed State in this Country. The implementation of GST is not only going to give boost to the growth engine pursued by the Government but it is also as important as it is going to switch over from the existing Indirect taxation system in the Country.

Critical points of GST

GST is being sold to the masses and the media as a "Sarva Vyaadhi Nivaarini" (a medicine for all evils). But the extent of this medication is conditional and exceptionally ad-hoc .But there are some bottlenecks in the path of success of GST in India. There are a number of issues on which negotiations are necessary to reach a consensus between the centre and the states and among the states themselves. It would be unrealistic to expect a "flawless" GST. In fact, such a GST structure does not exist in any country where both the centre and states are empowered to levy the tax (Bird and Gendron 2010). Every country has to adopt the structure it can administer. It is neither a gorilla, nor a chimpanzee, but a genus-like primate (Rao 2010). Issues like addressing States' concerns, GST rate structure, taxing specific sectors (like food, petroleum, electricity, land and real estate), and the Constitutional amendment needed have been among the major hurdles.

Country case studies regarding GST reflect that socio-economic conditions of countries differ; hence, a GST framework successful in any particular country may not necessarily be successful in other countries. Though GST has a number of administrative, compliance and other benefits, to what extent such a tax regime would be suitable in the socio-economic context of the Indian economy, is a matter of debate. From country experiences, it can be observed that GST is particularly suitable for countries with homogeneous commercial and demographic features. The socio-economic conditions of the States in India are much different than the countries of the European Union. Hence, it is argued that before implementing GST there should be a clear consensus whether there would be a net benefit for the Indian economy and/or whether Indian economy is ready to absorb the benefits of the GST regime.

For instance, it is argued that a single GST rate is best for **administrative efficiency**. However, considering both the aspects of fiscal federalism as well as State revenue implications, a single rate is not feasible in India. Given the vertical inequality of State Governments relative to the Central Government and horizontal inequality among State Governments in India (i.e. the inequality in revenue mobilization capacity), a single rate of GST is difficult to implement in the absence of compensation for States (for revenue loss, if any). However, if the amount of compensation is huge and have to be paid for a long time, it might put fiscal strain on the Centre. Such possibilities should be reviewed carefully.

The Vijay Kelkar Task Force suggested levying GST at two levels - Centre and State, comprising two rate components, viz. Central GST (CGST) and State GST (SGST) respectively. A dual GST module for the country has also been proposed by the Empowered Committee of State Finance Ministers (ECSFM) in their first Discussion Paper on GST. Under this model, GST would have two components viz. the Central GST to be levied and collected by the Centre and the State GST to be levied and collected by the respective States. Central excise duty, additional excise duty, service tax, and additional duty of customs (equivalent to excise), State VAT, entertainment tax, taxes on lotteries, betting and gambling and entry tax (not levied by local bodies) would be subsumed within GST.

New Zealand is an example of a country where GST operates very successfully, but that success was not achieved in a short time; it was a consultative process that took long time to settle considerable issues. In NZ, the GST model comprises a low uniform rate and zero exemptions. It took time to convince economic agents about the necessity of zero exemptions. In the context of the political economy of India, more time should be provided to sort out such issues. Hence, consultative processes pertaining to GST are important even if such processes take time.

In India, a merger between two government agencies is very difficult. Integrating the revenue collection services of 28 odd states and an extremely powerful Central Service into one GST collection agent is will be very difficult task. This would either mean disbanding the State Sales Departments of the states or winding up the Indian Revenue Service (Customs and Central Excise), both of which are plain impossible. So the erudite officers of the North Block have come up with the concept of a Dual GST. The states shall collect SGST (State GST) and the Centre shall collect the CGST(Central GST).

They say that SGST would give the states leverage to vary taxes within a spectrum of acceptability, ensuring some credible degree of autonomy. But once tax slabs start varying, the image of a unified market dissolves into thin air. Central Excise has a taxpayer base of around 5 lakh right now. Service Tax has an assessee base of another 10 lakhs and it is increasing daily (by geometric progression after the introduction of the negative list). The manpower and the IT infrastructure have not kept up with the rising tax payer number or the increased documentation. Even today, the indirect tax administration faces several problems regarding tax collection, record maintenance, document management, logistics, recovery of arrears, litigation, an aging workforce, information technology lacunae and a general apathy towards the population, with its limited assessee base. This base is supposed to swell into an excess over 50 lakhs if GST becomes operational. Staff shortages have made life a misery already in Central Excise. With GST, the department would immediately implode.

. Items are being thrown in and out of the GST basket at fancy. Petroleum (which constitutes a major chunk of the import and manufacturing and consequentially a large part of Customs, Central Excise and Sales Tax) was very vehemently kept out of the ambit of GST until recently. Now Oil companies, sensing the chance of availing extensive tax credits have managed to bring it in. Alcohol is still kept out of the purview, and the states whose subsistence is dependent on incomes from liquor will never give up control over Abkari. Petroleum and alcohol would have been the first to be taxed via GST if fiscal prudence and economic common sense was the priority. But the attitude of the establishment towards these key items indicates that GST is a mere tax of convenience rather than being a tax of rationalization. No one wants to share their pie. Tobacco is also kept out of the GST list with a brand of a “demerit item”. I don’t care if it is merit or otherwise. I say that if there is manufacture or value addition, it should be brought under the GST regime. But it hasn’t been. The only plausible explanation is that Central Excise is reluctant to give up lucrative revenues from the Compounded Levy and Physical Control schemes. Federal structure is one of the basic structures of the Indian constitution. The Supreme Court has held the view, in the case of Minerva Mills vs. Union of India that the power of the Parliament to amend the Constitution is not the same as the power to destroy.

If the Centre insists that the states should follow its taxation policy and tariffs or orders that the proceeds from taxes (within the state list) are poured into the North Block Exchequers, it is equal to enslaving the states and making them dependent upon the Central sharing formulae. The GST would result in another un-understandable and much abused formula of sharing between the Centre and the states like the Gadgil-Mukherjee formula. And the possibility of richer states, which are contributing a larger chunk to indirect taxation (which previously would have gone into their state kitties), opposing doles and special payments out of the GST collections to specific states is distinct and would also be a valid objection.

The autonomy of a state to face an economic challenge (a drought, a flood or a crop failure) or initiate a new social welfare scheme (Arogyasri, Mid-Day Meals, special sub-plans for weaker and scheduled sections) will be severely strained under a GST regime. The states have been clamoring for compensation for any CST losses that they might incur in the first few years of GST implementation and want the Centre to compensate them. They have recently agreed on a figure as well which would be dispersed in three staggered payments. But none of these states have come forward with even an inkling of compensation towards the local bodies. Municipal Corporations and Panchayats are also going to be divested of their powers to collect taxes as GST intends to subsume Octroi, Entry Taxes, Betting tax, Cesses and surcharges.

The GST's biggest downside is that it hits poor people hardest because it takes a higher percentage of low incomes than of high incomes. Any proposal to lift the GST would be deemed grossly unfair unless accompanied by compensation. That means the revenue and efficiency benefits of the GST are eroded to some extent by the volume of compensation and related compliance costs. Grattan Institute chief John Daley says governments "probably have to overcompensate" households if they are ever to win support for changes to the GST. Baird's proposal illustrates this. Under his plan, about half the extra $36 billion raised by a 15 per cent GST annually by 2019-10 would be handed back to middle- and low-income households as compensation. The need for GST compensation introduces another potential disadvantage that receives less attention that it deserves. Targeted payments to those who need them most, such as family tax benefits, can create disincentives to work. This affects many part-time working mothers who want to increase the number of hours or days they work. For them, the financial rewards of doing more work may be cancelled out by the loss of welfare benefits and additional childcare costs.

GST has to be implemented simultaneously by the Central & State Government. And, here Central govt can only provide the proverbial carrot but doesn't have the stick since it doesn't have constitutional authority to levy the tax without States acceptance, and hence its pretty much at the individual State's mercy to implement. And, forming a consensus between all 28 states having different political parties & their own agendas isn't that easy. The taxes would be levied on the basis of Destination Principle (i.e. taxed in state where goods/service is sold/rendered) and State govts are fearful of losing money. Though Central government has put forward a tax revenue sharing program, but States aren't entirely convinced about it.

Impact of Goods and Service Tax

1. Food Industry: The application of GST to food items will have a significant impact on those who are living under subsistence level. But at the same time, a complete exemption for food items would drastically shink the tax base. Food includes grains and cereals, meat, fish and poultry, milk and dairy products, fruits and vegetables, candy and confectionary, snacks, prepared meals for home consumption, restaurant meals and beverages. Even if the food is within the scope of GST, such sales would largely remain exempt due to small business registration threshold. Given the exemption of food from CENVAT and 4% VAT on food item, the GST under a single rate would lead to a doubling of tax burden on food.
2. Housing and Construction Industry: In India, construction and Housing sector need to be included in the GST tax base because construction sector is a significant contributor to the national economy.
3. FMCG Sector: Despite of the economic slowdown, India's Fast Moving Consumer Goods (FMCG) has grown consistently during the past three – four years reaching to $25 billion at retail sales in 2008. Implementation of proposed GST and opening of Foreign Direct Investment (F.D.I.) are expected to fuel the growth and raise industry's size to $95 Billion by 201835 .
4. Rail Sector: There have been suggestions for including the rail sector under the GST umbrella to bring about significant tax gains and widen the tax net so as to keep overall GST rate low. This will have the added benefit of ensuring that all inter – state transportation of goods can be tracked through the proposed Information technology (IT) network.
5. Financial Services: In most of the countries GST is not charged on the financial services. Example, In New Zealand most of the services covered except financial services as GST. Under the service tax, India has followed the approach of bringing virtually all financial services within the ambit of tax where consideration for them is in the form of an explicit fee. GST also include financial services on the above grounds only.
6. Information Technology enabled services: To be in sync with the best International practices, domestic supply of software should also attract G.S.T. on the basis of mode of transaction. Hence if the software is transferred through electronic form, it should be considered as Intellectual Property and regarded as a service. And If the software is transmitted on media or any other tangible property, then it should be treated as goods and subject to G.S.T. According to a FICCI – Technopak Report. Implemtayion of GST will also help in uniform, simplified and single point Taxation and thereby reduced prices.
7. Impact on Small Enterprises
There will be three categories of Small Enterprises in the GST regime.

- Those below threshold need not register for the GST
- Those between the threshold and composition turnovers will have the option to pay a
- turnover based tax or opt to join the GST regime.

Comparison of GST of India with other courtiers

In India there is no an ideal VAT. In central, central VAT id followed while in state, state level VAT is followed. Same is the case with GST. There is no ideal GST which all indirect taxes will be subsumed in to one. Central sales tax which the central imposed on the sale of goods from one state to another will continue in the different form called Integrated GST. So central government levies 1% IGST for two years (as per present information) from the date of implementation of GST. This duration could be changed based on the prescription of GST council. There could be possibility to extend this period of two years. This contradict the very purpose of GST.
There are some items exempted from GST at present. The major items exempted from GST are Alcoholic liquor for human consumption, Aviation turbine fuel, Diesel, Petrol etc. In other words, GST council has to decide when those items should be covered under GST. If those items excluded from GST, again the purpose of GST is defeated. Because, state government gets 40% revenue from these items. So we can call this GST as Indian GST, as it differs from GST of other countries. These are some issues related to GST.

A constitutional amendment required to give concurrent power to both state and central to make laws for the taxation of GST. In Indian case, there will be a dual GST. Central GST comes under central and State level GST comes under each state of India. The central level VAT comes under central GST and state level VAT comes under state GST and will also have integrated GST. GST rates of some countries are given below.

Country	Rate of GST
Australia	10%
France	19.6%
Canada	5%
Germany	19%
Japan	5%
Singapore	7%
Sweden	25%
India	27%
New Zealand	15%
Pakistan	18%
Malaysia	6%
Denmark	25%

Proposal but Arun Jaitley in lok sabha said that 27% will be too high the actual figure will decided by GST council and it should around 18% (source-wikipedia)

Conclusion

Based on the experience of tax reform and the complexities involved, it is important to underline three important issues. First, given that there are 32 actors in the negotiations (29 states, two Union Territories with legislatures and the central government), it would take considerable time to finalize the structure and operational aspects of the tax. The structure that would emerge would be based on the consensus reached and it is necessary to ensure that the fundamental, sound features of the tax are not compromised. In fact, the introduction of GST is only the next stage of reform. In that sense, the introduction of GST will not be a silver bullet and we should keep expectations at a realistic level.

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