An unfinished agenda

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(Mains GS 3 : Indian Economy and issues relating to planning, mobilisation of resources, growth, development and employment.)

Context:

> Goods and Services Tax (GST) is a very significant step in the field of indirect tax reforms as it amalgamates a large number of Central and State taxes into a single tax and paves the way for “one nation one tax”.

Landmark reform:

- GST will mitigate ill effects of cascading or double taxation in a major way and pave the way for a common national market.
- GST is expected to improve tax-GDP ratio, end tax cascading, enhance efficiency, competitiveness, growth, and ensure lower prices.
- It is also a watershed in India’s fiscal federalism as the States have forgone a substantial part of their own tax revenue and in turn they were guaranteed a GST compensation assuring 14% growth in their GST revenue during the initial five years.

Biggest Advantages:

- The biggest advantage of GST would be in terms of reduction in the overall tax burden on goods, which is currently estimated to be around 25%-30%.
- It would also imply that the actual burden of indirect taxes on goods and services would be much more transparent to the consumer.

- Introduction of GST would also make Indian products competitive in the domestic and international markets owing to the full neutralization of input taxes across the value chain of production and distribution.
- Studies show that because of its transparent and self-policing character, GST would be easier to administer and also encourage a shift from the informal to formal economy.

The base and pillars

- India's GST architecture is built on the firm foundations of a **GST** Council and the GST Network (GSTN).
- The GST Council is the key decision-making body, chaired by the Union Finance Minister with a Minister of State in charge of Finance and the Finance Ministers of States as members.
- This is envisaged as a due federal process to protect the interests of the States.
- GSTN generates high frequency data and subjects them to analytics for informed policy making.

Key pillars:

- India's GST paradigm stands on two key pillars: revenue neutrality and GST compensation for the States.
- Designed on the principle of destination-based consumption taxation, with seamless provision for input tax credit, GST is applicable to all goods and services except alcohol for human consumption and five specified petroleum products with a common threshold exemption applicable to both CGST and SGST.

Revenue neutrality:

- Even after 50 months in existence, a number of relevant issues, both for policy and action, remain unresolved.
- The assured revenue neutrality remains a mirage and many States have experienced a declining tax-GDP ratio.
- Studies show that in the case of major 18 States, the ratio of own tax revenue to GDP has declined. While the share of the Centre in total GST increased by 6%, that of States put together lagged behind with only a 4.5% increase.
- Stark differences between the Revenue Neutral Rates (RNR) for the producing States and consumption State have been observed.

Complicated situations:

- Revenue neutrality problems were compounded with massive evasion following the dismantling of check posts, and later on fake invoices, that grew by leaps and bounds.
- Further, exemptions and subventions complicated and worsened the situation for example the South African experience illustrates how zero rating and large exemptions have defeated revenue goals.
- In Mexico, although the country relied more on income tax, with a standard rate of 16% they could raise over 4% of GDP from GST.
- Reviewing 30 years of the Canadian experience with GST, it is shown that GST could be improved by limiting zero rating, tax-exemptions and harmonising tax rates.
- The Brazilian experience indicates that transfers through social security or subsidies tend to be more progressive than subventions or exemptions because reduced rates or zero rating do not usually get passed on to target groups or industries as happening in India.

Loss of motivation:

- The States face loss of motivation as they have no taxation powers, their GST revenues are uncertain, the supposed economic benefits seem phantom, and the hypocrisy of 'cooperative federalism' looms large.
- GST in India was possible only because the States surrendered much of their constitutionally inherited indirect taxes.
- While the States collectively forewent 51.8% of their total tax revenue, the Centre surrendered only 28.8%, yet the GST is shared equally between the Centre and States.
- Given the revenue neutrality failure and the host of other issues, many of the States are left with no option except to depend on GST compensation.
- While compensation legitimately has to coexist with GST, even the constitutionally guaranteed compensation for five years has not been implemented in letter and spirit, forcing the States to beg for their entitlement.

Effective use:

- Although IGST is a key source of revenue for many of the States, the clearing house mechanism and the process therein remains *terra incognita*.
- It was pointed out that **GST** is discriminatory to manufacturing States, indicating the need for a revenue sharing formula that duly incentivises exporting States by sharing IGST revenue among three parties instead of two.
- In India, GST operates in an almost information vacuum especially with respect to IGST along with several glitches in the digital architecture.
- GSTN neither makes effective use of the massive and invaluable data being generated nor shares them to enable others to make use of them.

Conclusion:

- Economists and commentators point to the multiple rates structure, high tax slabs and the complexity of tax filings as the problems underpinning India’s GST.
- Thus, India’s grand GST experiment which faces huge challenges needs a radical shift in India’s federal politics along with ‘trust’ and ‘trustworthiness’ between the States and the Centre.