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The Goods and Services Tax in India: Impressions and Realities

India's indirect taxation will experience a remarkable change with effect from 1 July 2017 with the introduction of the Goods and Services Tax (GST). This paper attempts to correct some misperceptions about the GST, including its coverage and structure. It also highlights the possibility of a temporary slowdown in economic growth as the country adjusts to the implementation of the GST.

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As India shifts to the Goods and Services Tax (GST) with effect from 1 July 2017, there are several impressions influencing businesses, tax experts and ordinary people in terms of what the GST is going to usher in. Some of these impressions might be inaccurate, given that the GST's evolution over the last one year has been accompanied by a flurry of writings and comments from numerous experts in the media on its likely impact. The torrent of opinions and analyses can leave many confused about what the producers and consumers in India will encounter from now on in their daily use and transactions of goods and services. This paper addresses some of these impressions.

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Same, Not Single Tax

There is an erroneous perception on the part of some that, with the GST ushering in a 'common' market for goods and services, there will be a common single rate of tax on all goods and services across the country. This is not the case. There will be different tax rates for different goods and services. There are four rates – 5, 12, 18 and 28 per cent – at which different goods and services will be taxed. The 'common' character of the GST comes in through the same good (or service) being taxed at the same rate across the whole country. For example, coffee (roasted or decaffeinated) and tea (flavoured or otherwise) will be subject to a GST of five per cent wherever they are sold in India, as will dining in air-conditioned restaurants of five-star (or higher-rated) hotels in the country, which will now be taxed at 28 per cent. Earlier, these rates were different across India due to the multiple central, state and local taxes that went into the final retail prices paid by the consumers. The uniformity of product-specific rates across the country does not mean that coffee and tea will be taxed the same rate as, say, refined sugar (18 per cent) or economy class air travel (five per cent) is taxed the same rate as high-end dining.

Not on All

The GST, at least for the time being, will not apply to all goods and services. The notable exceptions are petroleum products, alcohol for human consumption and electricity. The petroleum product industry will experience two different systems of indirect taxes. While kerosene, naphtha and liquefied petroleum gas will be subjected to the GST, five major petroleum products – crude oil, natural gas, aviation turbine fuel, high-speed diesel and petrol – will be excluded from the GST. These items will continue to attract the taxes which they currently do even after the country transitions to the GST system. The states will, therefore, be free to impose the value added taxes (VAT) on these products at the rates of their choice. Similarly, alcohol for human consumption will continue to be taxed by the states in the way it currently is. Electricity too will continue to be taxed by the states at the same rates as now.

The ostensible reason for keeping these items away from the GST regime is to allow the states the freedom to impose taxes on these 'revenue-fetching' products. These will, therefore, be the goods and services whose prices will be different across the country as the various states will levy diverse rates of taxes. Petrol prices, for example, that show large variations across the country right now, will continue to do so even after the implementation of the GST.

Streamlining Taxes, Not Slashing

The most common misperception about the GST perhaps is the notion that it will bring down tax burdens. The GST was never intended to do so. The main objective of the GST is to streamline multiple indirect taxes levied on goods and services by consolidating them into a few composite rates. The GST subsumes, in itself, a large number of the current taxes such as the central and state excise duties, sales tax, VAT, service tax, various central and state surcharges and cess, entertainment tax (except those imposed by local bodies), luxury tax and entry tax.[2] Earlier, the effective rate of taxation on goods and services was the total of all these central and state taxes. The GST will now replace all these taxes but this will not make a significant impact on the effective rate of taxation, except at the margin.

Various goods and services have been brought under the four tax slabs of the GST by taking into account their effective taxation rates, and the new rates have been kept as close as possible to the old rates. In essence, the GST has simplified and streamlined the messy indirect tax system of the Indian federation but it will not, necessarily, reduce the incidence of taxes.

Economically Robust?

Contrary to some expectations, the GST might initially act as a dampener on economic activity, rather than being an accelerator. All economic actors – businesses, institutions and state administrations – will need time to adjust to the new technologically-driven system of indirect taxes. There are nagging doubts over the time that these agencies will take to refund input taxes as well as overcome their hesitations over how efficiently banks and other institutions will administer the GST. For the first few months, there will also be a substantive information asymmetry between the framework and its users.

[2] The customs duties will continue after the implementation of the GST.

All these will act as a dampener on economic activity as producers are likely to refrain from adding fresh capacity and new investments. These difficulties, however, should be overcome over the next couple of quarters. This will be a period during which foreign investors will also be closely watching the implementation of the GST and will particularly be looking out for states that do it better than the others. The upshot might be a reduction in the expected rate of overall gross domestic product growth for the next couple of quarters.

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