

ISAS Brief

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GST Implementation in India:

A Solution with Complications

The resolution of a contentious issue of administrative control over the implementation of Goods and Services Tax (GST) in India, which was accomplished on 16 January 2017, appears to have paved the way for enforcing the measure by 1 July this year. However, several obstacles lie ahead.

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On January 16, the Goods and Services Tax Council, consisting of the Union Finance Minister and the State finance ministers of India, resolved a thorny issue of administrative control over the new taxation architecture.

The Goods and Services Tax (GST) is a very important milestone in the development agenda of India, and has been under consideration for several years. The federal structure envisaged in the Constitution of India has resulted in a large number of State- and Central-taxes, and the GST is an attempt to homogenise the entire indirect tax structure into a national pattern. With

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the GST, it is anticipated that the tax base will be comprehensive, as virtually all goods and services will be taxable, with minimum exemptions.

The GST is expected to be a major reform for the Indian economy by creating a common Indian market and reducing the cascading effect of tax on the cost of goods and services. It would impact the tax structure, tax incidence, tax computation, tax payment, compliance, credit utilization and reporting, leading to a complete overhaul of the current indirect tax system. It would impact the pricing of products and services, supply chain optimization, the required information technology (IT) architecture, accounting, and tax compliance systems.

Introduction of the GST requires the consent of all the States, and changes in the Constitution enabling the States to impose tax on services. The Constitution Amendment Bill for Goods and Services Tax (GST) was approved by The President of India after its passage in the Parliament (Rajya Sabha on 3 August 2016 and Lok Sabha on 8 August 2016) and ratification by more than half the number of State legislatures.

The Central Government was committed to implement the GST by 1 April 2017. However, several difficulties remained after the passage of the Constitution Amendment Bill. Most importantly, there was disagreement between the Centre and the States on the power of administrative control over firms.

Indirect taxes levied by the Central Government are in two forms – excise duties on manufactured goods, and service taxes on services rendered by service industries. At the State level, the levies are in the form of Value Added Taxes which are collected at the point of sale. Administration of the tax collection mechanism has so far been synchronised with the structure of the taxation, with the Centre administering excise and service taxes, and the States administering VAT.

With the prospective advent of the GST and the enabling power of States to levy service taxes, there have been differences between the States and the Centre on administrative control. Under the agreed model now, States will assess 90% of the businesses with an annual turnover of INR 15mn or less for scrutiny and audit, while the Centre will assess the remaining 10%. All businesses with a turnover of more than INR 15mn will be assessed by the Centre and the States at a 50:50 ratio. The integrated GST, which deals with inter-State sales, will be levied and collected by the Centre, but States will also be cross-empowered in the same ratio as above through a special legal provision. The States would also be empowered to levy tax on economic

activity within 12 nautical miles of territorial waters, even though this right vests constitutionally with the Centre.

While a major roadblock has been cleared, there are still a few pending steps before the GST can be implemented, including:

1. Final draft legislation: Changes to draft legislation on Integrated GST (IGST) law, compensation law, State GST (SGST) and Central GST (CGST) laws for the consideration of the GST Council;
2. Approval by legislative bodies: approval of the CGST and the IGST laws at the Centre and the SGST laws by all States; and
3. Fitment of the rates: Each specific good and service needs to be classified into a tax bracket.

There is a long road ahead, but the Finance Minister Arun Jaitley has optimistically promised implementation of the GST by 1 July 2017. However, there are several outstanding concerns.

Firstly, the architecture that has evolved after discussions is very different from the one that was initially envisaged. The GST was initially intended to be a single integrated tax structure, covering all the States and the Centre, with few exceptions and a limited number of tax slabs. A simple pattern of apportionment of the collected taxes was to ensure objective and fair allocation between the Centre and the States.

Instead, what has evolved is a two-tiered structure with a separate State GST and Central GST, a multiplicity of rates, and now, a multiplicity of administrative controls as well. Businesses will have no respite from the audit by a plethora of administrative tax collection departments, as well as a multiplicity of rates. Overlapping jurisdictions, doubts over tax rates for individual items and the final apportionment of the taxes are likely to create significant problems for businesses. The apportionment of administrative jurisdictions over discussions at a table is reminiscent of the carving out of political boundaries in post-war Middle East, without any concern for the difficulties of integration and administration. The percentages of 90% and 50% will be hard to determine and implement. Another worry is that rent-seeking by the tax authorities would not abate under this dispensation, rather, there would be room for greater discretion and corruption.

Second, there is likely to be disparity among the individual State laws and their implementation. Problems of governance between the originating and the end-user States on the interpretation of implementation procedures would need to be sorted out speedily. If this is not done, the GST compliance in the initial years would suffer, with a serious impact on revenues of the States as well as the Centre.

Third, there is an assumption that seamless, nationally integrated IT architecture is ready in all the States that would enable businesses to pay, and receive reimbursements and compliance returns. The recent experience with the demonetisation exercise has demonstrated the weaknesses in IT preparedness even among the banks, which have traditionally been leaders in IT innovation and implementation: the States have much less experience and much fewer skilled personnel.

Fourth, heavy reliance on digital transactions and reconciliations requires strong security features and risk-free implementation. There is little evidence that States, banks, and the tax collection authorities are investing in cyber security measures, or are even trained to detect problems.

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