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The Goods and Services Tax: A New Chapter in Indian Public Finance

India's impending transition to an indirect tax structure based on the Goods and Services Tax (GST) marks the beginning of a new era of fiscal federalism in India. This paper discusses the progress on the GST and some key aspects of its framework, and highlights the major role that states would henceforth play in determining indirect taxes in the country.

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India is on its way to introduce the Goods and Services Tax (GST) from 1 July 2017. Several GST rules are now in the public domain, including those on composition, valuation, refund, registration and invoicing[2]. The GST framework would comprise the Central GST, state GSTs and the Integrated GST that would be imposed on inter-state sale of goods and services.

The GST Council constituted on 12 September 2016 has been meeting regularly since to decide on various issues. The GST would have four rates– five per cent, 12 per cent, 18 per cent and 28 per cent. In one of its latest meetings, the Council decided to have the flexibility

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2 Central Board of Excise and Customs, Department of Revenue, Ministry of Finance, Government of India. http://www.cbec.gov.in/htdocs-cbec/gst/index#. Accessed on 26 April 2017

of increasing the peak rate of 28 per cent to 40 per cent as an enabling provision to address economic exigencies.[3] The Council is yet to decide the rates at which items would be taxed. Most goods, however, are expected to be taxed at five per cent, 12 per cent and 18 per cent with ‘demerit’ or ‘sin’ goods like luxury cars, tobacco, aerated drinks and coal being taxed at the highest rate of 28 per cent. The Council would be looking at current effective taxes (sum of various central and state indirect taxes) of various goods and services to decide the GST rate at which they would be taxed. Minimising inflationary impact would be an important criteria in deciding the rates.

Cleaning up Indirect Taxes

The introduction of the GST is an important move towards cleaning up India’s indirect tax structure. India has too many indirect taxes now imposed by both the Centre and states. Central taxes include customs duty (including additional customs duties like countervailing duty and special additional duty), central excise duty (including additional excise duties), service tax and various cesses levied for raising revenues for specific purposes (for example, Krishi Kalyan and Swachch Bharat cess of 0.5 per cent each). Indirect taxes imposed by the states include Value Added Tax (VAT), Central Sales Tax ([CST] which is imposed by the Centre but collected by states), purchase tax, entry tax, luxury tax, entertainment tax and taxes on lottery. The GST would subsume all these taxes except customs duties levied by the Centre and entertainment taxes imposed by local bodies (for example, municipalities) in states. Needless to say, post-GST, India’s indirect tax structure would be much simpler to understand enabling businesses to better comprehend their tax liabilities.

Creating an Uniform Market

The effective indirect tax rates for businesses are different across India. This is due to the differential rates of various taxes imposed by states on sales of goods and services within their territories. The differences largely arise from dissimilar rates of entry, luxury and entertainment taxes among states leading to variations in prices that consumers pay for

[3] ‘GST draft bills tabled in Parliament, maximum rate at 40%’, DNA, 27 March 2017; http://www.dnaindia.com/money/report-gst-draft-bills-tabled-in-parliament-peg-peak-rate-at-40-2370637. Accessed on 26 April 2017.

various goods and services and the tax liabilities of producers. Absorption of these taxes within the GST would eliminate many of these variations, making the Indian federation a more homogeneous market with respect to indirect taxes. It would also reduce incentives for businesses to discriminate between states and locations on the basis of their tax attractiveness.

More Empowerment for States

The most challenging and unique aspect of India's GST is the sharing of responsibility it envisages between the Centre and states. The Constitution of India provided proportionally greater power to the Centre for raising revenues than to the states. The Centre could impose excise duties on manufactured products, service tax on services and the CST on inter-state sales of goods. The states were empowered to tax goods and services within their territories through the VAT and sales taxes, and impose luxury, entertainment and purchase taxes in addition to entry taxes. The GST required amending the Constitution for giving Centre and states concurrent powers to tax manufactured products and services. This was done through the 101^{st} amendment of the Constitution on 8 September 2016.

The significance of the amendment is unique as it empowers the Centre and states to not only impose but also collect taxes on various goods and services. Internationally, the GST and the VAT in most countries are collected by the federal government and distributed to provinces according to their revenue requirements. India's GST would be a major departure in this respect, making states much larger actors in the running of the country's public finances. The pronounced role that states would play in the administration of the GST is also evident from the composition of the GST Council, where the states have two-third weightage in votes cast for taking decisions, as opposed to one-third weightage for the Centre. The states have also been assured by the Centre for compensation of losses in their revenues (if any) after the transition to the GST. The compensation would come from a pool of fund accruing from cess imposed on goods attracting the highest tax rate of 28 per cent.

New Challenges

While the above marks the beginning of a significant shift in the financial functioning of the Indian federation by empowering states, it creates more challenges for states also. State tax administrations would now need to overhaul themselves by taking on much greater responsibilities in collection and auditing, including speedy disposal of refunds. The issue of state capacities in this respect becomes more significant given that the GST rules specify 90 per cent of taxpayers with turnovers of less than INR1.5 crore (INR 150 million) would be assessed and monitored by states. Along with administrative capacities pertaining to abilities of the state tax officials to assess and monitor large numbers of taxpayers, upgrading technological capacities of states for handling electronic transactions and working seamlessly with the GST Network – the common 'pass through' portal for taxpayers – become critical challenges.

Exemptions and States

Alcohol for human consumption and five refined petroleum products (crude oil, diesel, petrol, natural gas and aviation turbine fuel) have been kept outside the purview of the GST framework. The states have the power to continue to tax the former at their chosen rates, as they do now. The GST Council would decide when the petroleum products would be subjected to GST. The views of the states have been important in deciding the exemptions. Excise collections from the sale of alcohol and revenue collected from the VAT on refined petroleum products are major sources of revenue for Indian states. The states, ostensibly, would not like to give up control on these revenues, at least not for the time being, by shifting to an integrated GST framework, which would confine the flexibility of individual states to amend taxes to only specified rates.

The GST would be a game-changer for India's indirect tax structure in the authority it imparts to the states to raise revenues. Indian states have never had the chance to play as big a role in determining revenues as they would have now. In this respect, the GST signals the beginning of a new era of fiscal federalism in India.

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