ISAS Brief

No. 487 – 29 May 2017
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Goods and Services Tax in India – Tax Reforms for a Brighter Future?

The Goods and Services Tax (GST) has been hailed as a major tax reform in India to help streamline the indirect tax structure, reducing complications for businesses, apart from widening the tax base and increasing tax revenues. This brief highlights some major attributes of the GST noting a few points which may affect the economic prospects in the short run.

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As one of the leading emerging economies by measures of gross domestic product (GDP) growth in the recent past, India has fared reasonably well when compared to most of the world. In recent times, the government has taken multiple initiatives to improve the country's prospects in attracting investment, facilitating economic growth as well as improve tax administration to widen the tax net while not increasing the burden on any particular segment of the economy.

India's problems with tax evasion, especially for direct taxes like the income tax have been widely noted, along with a long list of indirect taxes which often leave foreign businesses

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puzzled as well as increase ambiguities. In order to reform the tax structure, the government has moved towards streamlining all indirect taxes into one umbrella, naming it the Goods and Services Tax (GST), which will replace multiple indirect taxes collected by the centre and state separately over the years. This will have two main components, namely, the Central GST (CGST) and the State GST (SGST). All interstate transactions will be charged an integrated GST (IGST). While a direct tax always taxes the source (income, inheritance, etc.,), an indirect tax is levied at the end and is paid at the destination of consumption (excise duties, service tax, Value added Tax [VAT], etc.,). The indirect tax structure of India has had a number of components and given its federal structure, interstate duties have in turn created a confusing tax network for business across India as well as for foreign investors who move goods and raw materials across the length and breadth of the country.

The GST Structure

After the GST was suggested for the first time in 2003 by the Kelkar Task Force, successive Indian governments have sought to iron out the differences and complexities of introducing the comprehensive GST, given that both state and central governments will be affected by changes to the indirect tax structure.

At present, the GST council has zeroed in on rates for each commodity with four major tax slabs, namely 5 per cent, 12 per cent, 18 per cent and 28 per cent, and the country is scheduled to adopt the new rates and the structure on 1st July 2017. At one end of the spectrum, there are non-taxable goods which include fresh meat, chicken, eggs, milk, fresh fruits, bread, salt, etc.; while at the other end, the highest tax rate is charged for stays at luxury five-star hotels, automobiles, motor cycles, chewing gum, pan masala etc. Most commodities are placed under the 18 per cent tax rate. The tax is scheduled to be revenue neutral which would give one the impression that it would not change the amount of taxes being paid by the economy. The popular narrative has highlighted a number of benefits that would accrue to the country in response to the successful implementation of the GST with rough estimates indicating a thrust to the GDP of around 1.5 to 2 per cent. Amongst the products which are under the purview of the GST structure but are currently not scheduled to be taxed under the GST are petroleum products and liquor – these will remain under the existing tax structure. Both sectors are sources of high indirect tax revenue. Hence, turbulences caused by any problems in implementation of the GST could have a much larger cascading effect on the economy through these sectors. However, once the GST is appropriately implemented on these sectors, it would have large scale benefits.

Some Concerns

A few areas of concern regarding the implementation of the GST cannot be ignored. The GST, which will replace all indirect taxes, will affect producer and consumer states differently. Given that manufacturing activities in India are distributed amongst a few states, primarily Tamil Nadu, Maharashtra, Gujarat and Andhra Pradesh, the revenues of the state governments in each case are likely to shrink as the GST will be charged at the point of consumption in the consumer states. To protect states against the loss of revenue, the central government has assured reimbursements in the first five years and states which are reluctant to implement the GST have been given the option to decide to join later. It is assumed from the experience of the VAT that the states which are currently reluctant about the GST would decide to join in later. Currently, 23 of the 29 states in India have ratified the GST bill but only eight states have passed a SGST bill, namely: Maharashtra, Bihar, Telangana, Rajasthan, Madhya Pradesh, Uttarakhand, Chhattisgarh and Andhra Pradesh. The GST Council directive would require all states to pass the SGST bills by the end of May 2017.

There are additional concerns with respect to the implementation of the GST system which is totally dependent on the information technology (IT) infrastructure. The central and state governments have registered the Goods and Services Tax Network (GSTN) as a not for profit and non-government company responsible for providing shared IT infrastructure to both the central and state governments as well as tax payers. This will require all businesses to use the IT infrastructure irrespective of their size. India’s production system consists of a large number of small- and medium-sized enterprises (SME) which are a part of India’s large informal sector. The ability, as well as intent of such companies to adapt to the proposed changes through digitisation may be questionable. The short-term impact on these ventures, which employ around a hundred million people, could be significant. The concern is higher when one realises that the system has been envisaged recognising that production activities are organised as a chain of value-added activities, of which both the formal as well as informal sectors are a part, and fluctuations at the source of value chains (comprised of unorganised and informal firms with low or zero IT infrastructure abilities) could have a damaging effect on the final production.

In the case of inter-state transactions, the IGST will be levied and collected by the central government and the exporter and importer will pay taxes adjusting for taxes paid on inputs. This, in turn, requires all parties involved in the transaction to have adequate IT infrastructure to claim the benefits of the system.

Conclusion

In sum, the GST will simplify economic transactions across the economy, converting India into a single market, easing flows of goods and services through the country. However, its strong dependence on a robust digital infrastructure which needs to be used by all tax-paying agents, including businesses in the SME segment (whose current IT usage is negligible), could delay or hinder the envisaged economic progress in the short run. Additionally, as long as all states do not have a SGST to accompany the CGST, the uncertainties resulting from such a structure could harm India's business interests. However, with successful implementation over the longer run, the reform should benefit the economy.

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