Use GST Bill breather to set it right

It is important not to implement a bad tax in the eagerness to introduce GST

The past few days have seen intense debate on the GST Bill which has been, to a large extent, not so much on the merits of the Bill but on whether or not it should be sent to Parliament's Standing Committee on Finance. The political gamesmanship on the Bill was only to be expected. After all, when the UPA was in power, the BJP-ruled states did not allow the finalisation of the structure and operational details of the tax in the Empowered Committee. Now, the eagerness to get the Bill passed somehow seems to have overshadowed concerns over whether it will eventually result in a substantially better consumption tax system, broad-based and with reasonable rates, providing a seamless credit mechanism to ensure a nationwide market, with reduced administrative and compliance costs and distortions. Now that the Bill has been sent to the Select Committee of Rajya Sabha, the time is opportune to correct its birth-defects and ensure the fundamentals of the proposed reform are sound.

A careful analysis of the Bill brings out five important issues. First, the Bill provides only a minimalist framework for the levy of GST. This implies that the entire gamut of issues relating to the structure and operation of the levy has to be negotiated and decided upon by the GST Council. These include the taxes to be subsumed, the list of goods and services to be exempted, thresholds for CGST and SGST, the structure of rates, place of supply rules, special arrangement for special category states, model tax law and a deadline for including the tax on petroleum products alcohol and tobacco products, operational details of tax administration including the GST Network and the dates for discontinuing the tax on inter-state supply of goods and services. Second, considering the fact that the GST Council, which will negotiate the structure and operational details of the tax, has 29 states, two UTs with legislatures and the Union government, and also the fact that economic interests of the contending parties are not exactly in harmony, the emerging structure and operational details of the GST will be far from being 'flawless'. Therefore, any speculation that it will be a game-changer is premature. The entire process should be seen as a "work in progress". Third, the Select Committee will do well to review the Bill carefully and remove the defects before it is passed to ensure that the fundamentals of the framework do not violate the basic principles of tax policy. The major shortcomings of the Bill include the 1% tax on the inter-state "supply" of goods and services and the exclusion of petroleum products from the ambit of GST. Fourth, it is important to realise that with the passage of this Bill, the states, even collectively, will lose the autonomy to change the structure and operational details of the tax. That is because, any change would require three-fourths of the votes, and with the Union government being given one-third of the votes, no change is possible without the Union government's approval. Finally, it is too optimistic to expect that the entire process of decision-making in the GST Council will be finalised within the next 10 months. There neither seems to be a clear action-plan nor a time-table announced by the Empowered Committee to assure us of this.

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The important concern, which the Select Committee will have to contend with relates to the major deviation from the recommendations of the last Parliamentary Standing Committee and that relates to the levy of 1% tax on the inter-state supply of goods and services. This was done on the insistence of Gujarat, a major producing state, on the logic that the producing states have to spend on infrastructure and therefore, should be entitled to collect some tax revenue when it is moved out of the state. Curiously, while the exports to another country are relieved of all domestic taxes to make the production competitive, inter-state movement is sought to be taxed. There are two major problems with this. First, the proposal to levy the tax on inter-state supply of goods and services will result in the levy of 1% tax whenever goods and services cross the boundary of a state irrespective of whether it is a sale or simply a transfer. If a good or a service passes through four states before it is consumed, it will be taxed four times and this tax is not creditable. How can the GST in this form ensure a seamless, nationwide market and competitiveness to help Make-in-India? Second, with the 1% tax, GST will no longer be a destination-based tax and that will violate both equity and efficiency. The tax exportation by high-income, producing states to the consumers in poor, consuming states will result in the inequitable invisible transfers.

Referring the GST Bill to the Select Committee provides an opportunity to remove this pernicious provision and hopefully, the Committee will apply its mind in the interest of the nation. The damages from bad reforms were well demonstrated in the past and the most notable of all experiences was the introduction of MODVAT in 1986. The overeager Union finance minister VP Singh, initiated the reform without any preparation, although the recommendation to transform the Excise Duty into a manufacturing stage value added tax (MANVAT) was made by the Jha Committee in 1976. The consequence of this poorly implemented reform was that the revenue from excise duty relative to GDP declined from 4.8% in 1985-86 to 3% in 1998-99 and this happened when customs duty had to be reduced as a part of the opening up of the economy.

Referring the issue to the Select Committee provides some time to rethink on the structure. Hopefully, this will result in getting rid of the 1% levy on inter-state supply and including petroleum products, alcohol and cigarettes in the GST base. It is possible to levy an additional sumptuary excise on petroleum products, cigarettes and alcohol if revenue consideration is the issue. It is also important to undertake capacity building for tax administration and education and information to tax payers. It is important not to implement a bad tax in our eagerness to introduce GST. While the finalisation of the structure and operational details is unlikely to be complete before April 2016, the Union government can go ahead and combine its Union excise duty and service tax to introduce the GST at the manufacturing stage in the next budget itself. This does not require even the Constitutional amendment. This was the recommendation of the Expert Group on Taxation of Services in 2001-02 and at least it can be implemented now as a transitional move towards a full-fledged GST if the Union government is serious about the reform. Ensuring a uniform threshold for excise duty and service taxation will also provide relief to small service providers without much loss of revenue. This will demonstrate the seriousness of the Union government in the GST reform.

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