

GST: Brazing for the reform

The competition between the central and state tax administrations to expand territory doesn't bode well

After the 101st Constitutional Amendment enabled both the Union and the state governments to levy the Goods and Services Tax (GST), there has been a sense of urgency in implementation. I had characterised the GST reform as a bullock-cart stuck in the mud, going neither forward nor backward. It seems the mud has dried, the bullocks have gained stamina and the cart has been oiled well to go forward. The government is pushing up the pace to roll out the reform from April 1, 2017, and that entails a flurry of activities leading up to its implementation. A number of issues, some of them contentious, will have to be resolved and decisions taken within a short span of time.

The amendment, with the insertion of Article 246A, enables both Parliament and state legislatures to levy GST on intra-state transactions concurrently. The insertion of Article 269A empowers the Centre to levy and collect the tax on inter-state trade and share it with the states as per the recommendation of the GST Council. Article 279A requires the President to appoint the GST Council with the Union finance minister as the chairperson and all the state finance ministers as members. The Centre will have one-third votes and the states together command two-thirds. Each state will have one vote. The decisions to be taken in the council require three-fourths of the votes. This implies that, if it so desires, the Union government can veto any decision even if all the states desire it. Similarly, the Union government will have to gain the support of at least 19 states to carry out any change it desires.

The President has duly constituted the GST Council and there have been two meetings already and the third is scheduled on October 17. The two meetings have seen decisions on a number of issues. These relate to thresholds and having a single tax administration in respect of small producers and service tax assesses. In the second meeting, issues relating to ad-

ministration such as registration, mechanism to deal with area-based exemptions by collecting the tax and paying refunds have been decided.

In the first meeting of the Council, decisions were taken on the thresholds for the GST and arrangements to avoid dual administration for the producers with a turnover of less than ₹1.5 crore and service tax payers. The decision by the GST Council was to fix ₹20 lakh as the annual turnover threshold for GST in general category states and at ₹10 lakh in the north-eastern and hill states. This is a welcome development for the threshold suggested earlier at ₹10 lakh and ₹5 lakh, respectively, for the two categories of states was too low. By excluding those with less than ₹20 lakh turnover (and ₹10 lakh turnover in north-eastern states), the Council has considerably reduced both administrative and compliance costs without much loss of revenue. The decision to introduce simplified (compounding) tax for taxpayers up to ₹50 lakh turnover, too, is a welcome step as it will facilitate small businessmen in keeping simplified accounts and furnish simplified returns. Although the tax paid by such dealers is not eligible for input tax credit, those who are dealing with basic inputs can still voluntarily register and pay the tax as regular dealers.

The decision to subject the taxpayers with less than ₹1.5 crore turnovers solely by the state tax administrations and the service tax payers entirely by the Central tax administration is essentially to avoid subjecting them to dual tax administration. The states have been concerned about the possi-



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ble disaffection on account of dual tax administrations by these taxpayers. The threshold for excise duty is ₹1.5 crore, and producers falling below the threshold have been paying only the sales taxes to the states. The states have been demanding that these taxpayers will be administered only by the states in regard to both state GST (SGST), central GST (CGST) and inter-state GST (IGST).

The issue of avoiding dual tax administration of service tax, although has been resolved in favour of the central administration in the first meeting, was not agreed to by some of the states in the second meeting, ostensibly on the ground that they have been levying taxes on hotels and restaurants. In my view, the arrangement to separate service tax payers is conceptually flawed as

once GST is levied, it is inappropriate to think in terms of goods and services separately. Ideally, one would have preferred to have one tax administration for administering the entire GST as the technology enables centralised collection of CGST, SGST and IGST. However, once it is decided that there will be two administrations, it will be inappropriate in a GST regime to separate goods and services and subject them to different administrations. Perhaps, the arrangement reflects the competition between central and state tax administrations to expand their relevance, and that does not bode well. What is required is a harmonised administration and enforcement of the tax.

The October 17 meeting of the Council will be looked forward to with much expectation. The meeting is supposed to resolve one of the most con-

tentious issues, of deciding on the exemptions and the rate structure. As the decision has already been taken on merging the cesses and surcharges with the basic levy, the issue of rate assumes significance. While the Centre has promised to keep the rates low, it cannot afford to lose revenue from the reform. Besides absorbing the revenue impact of the cesses, it will have to pay compensation for any revenue loss to the states. Even the revenue neutral rate structure will result in substantial outgo for the Centre, given the states which gain will not share with the losers and those that lose will have to be compensated. At the same time, a majority of the states will insist on levying the tax at high rate for the fear of losing revenue after five years when the compensation mechanism expires.

There is a question of the number of rates. After reviewing three different methods used to calculate revenue neutral rate, the committee chaired by the chief economic adviser has suggested three rates besides exemption (four rates if bullion and spices have to be taxed at lower rate). The general rate suggested is 18%. There are methodological questions on these estimates and it is not going to be easy to convince the states and get an agreement on the issue.

Once there is an agreement on the structure of the tax, a major milestone will be crossed. Indeed, there will be many more hurdles such as finalising the place of supply rules. There are considerable differences among the states in terms of preparedness, and businesses would require at least 4-6 months of preparatory time after the structure is finalised as the new tax involves major changes in the ways of transacting businesses and supply chain management. The next few months will be action-packed, and we will see exciting times on this important reform.

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