

## ● GOODS AND SERVICES TAX

WHAT IS BEING PROPOSED IS A HIGHLY COMPLICATED STRUCTURE WITH FOUR TAX RATES, IN ADDITION TO EXEMPTION, A LOW RATE ON BULLION AND CESSSES ON DEMERIT GOODS

# The stage is set for implementation

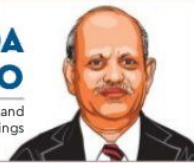
**T**HE PASSAGE OF four GST Bills on March 29 after a seven-hour debate in the Lok Sabha has been described as historic and game-changing. The passage of CGST, IGST, UTGST and GST (compensation to states) Bills sets the reform in motion and provides the legal framework for implementation. Once the states pass the SGST Bills, the reforms will be ready to be rolled out. Since the SGST Bill has been whetted and approved by the GST Council after considerable deliberations, it is only a matter of time before the Bill is passed for implementation. With this the reform is truly under-way and the process needs to be completed before September this year when the prevailing excise duty, service tax and sales tax acts cease to be operational, according to the 122nd Constitutional amendment.

This is a reform which is beneficial to both the Union and the states and the economy as a whole and yet, it has taken more than 10 years of negotiation and bargaining to arrive at the consensus on the broad contours. From the progress achieved so far, it would be too optimistic to claim that the promised gains from the reform would accrue. It was hoped that the reform will result in a simpler tax system, pave the way for a nationwide market, evolve a destination based tax to avoid inter-state tax exportation, provide comprehensive input tax credit to eliminate cascading, provide complete indirect tax relief on exports to bring in export competitiveness and ensure better compliance of the tax through self-policing. Indeed, the seeding of the PAN numbers in the GST registration is expected to bring in significant revenue gains from the income tax as well.

However, the broad contours of reform so far do not give the confidence that the promised gains will accrue and, therefore, it would be advisable to be cautious. The final shape of the GST as it is being evolved is very different from what should have been. Of course, in a major tax reform and harmonisation exercise involving both the

**M GOVINDA  
RAO**

The author is emeritus professor, NIPFP, and chief economic adviser, Brickwork Ratings



Union and state governments, compromises are inevitable and often some imperfections may have to be accommodated to get the reform implemented. However, what is being proposed is a highly complicated structure with four tax rates, in addition to exemption, a low rate on bullion and cesses on demerit goods. In most countries that have implemented GST successfully, there are no more than two rates and that is what most experts too advocate. In fact, even at present, the states levy the value added tax at two rates in addition to exemption and a low rate on bullion, and in that sense, having a high demerit rate and cesses are clearly retrograde. The recommendation for the high rate came from the report of the chief economic advisor which seems to be unsure of collection being revenue neutral at the 18% general rate.

Multiple rates will create several problems. There will be many classification problems and disputes. It is not sure whether all the states will agree to an identical classification. (Kerala, for example, will consider coconut oil as edible oil whereas many other states may consider it a cosmetic). In a system where input tax credit has to be given, it is quite possible that there will be inverted structures (input tax deduction being more than the tax payable on final output). There will be a lot of special interest group activity seeking to be placed under lower rates. Multiple rates increase both administrative and compliance costs and these costs multiply with the number of rates.

Another major issue is the exclusion of petroleum products and alcohol in the GST. It is estimated that revenue collec-

tions from petroleum products and alcohol constitute over 45% of the excise duty at the Centre and sales tax at the state level. When these are outside the ambit of GST regime, cascading will continue to permeate. Take the case of transportation. The transporters will have to pay the GST, but they cannot claim input credit on the taxes paid on high-speed diesel, petrol or aviation turbine fuel. To the extent that these are outside the ambit of GST, all the advantages claimed, like the efficiency gains and competitiveness of the economy, get drastically reduced. Cascading will continue in respect of 45% of these taxes which cannot get input tax relief.

We have already seen considerable turf war between central and state tax administrations. The temporary truce that has been brought about is to have a fractured administrative arrangement in regard to the taxpayers with turnovers up to ₹1.5 crore. The states' administrations are supposed to administer 90% of them, and the central tax administration, the remaining 10%. The central tax administration is reportedly not happy with the truce. Dividing the administrative responsibility will continue to fuel a turf war. The ideal process should have been to raise the threshold for GST registration itself to ₹50 lakh. These entities constitute a large number of taxpayers that contribute less than 5% of the tax paid.

We should welcome the reform in principle, but should consider it as a process

rather than an event. Overly optimistic estimate of the gains from the reform will only lead to disappointments. It has been repeatedly stated that the GDP will increase by 2% because of GST, even before the rate structure and administrative mechanism were finalised. There is no scientific basis for such an estimate and with the complicated tax structure chosen and the attendant administrative complexities, it will be realistic to moderate the expectations. A complex tax system is an administrative nightmare, and even as GSTN, the technology company, gets ready to roll out the technology, tracking crores of invoices with multiple tax rates for ensuring that the tax credit has been claimed correctly and interstate transactions traced properly will pose serious challenges. Another important issue is to work out the transitional matters to ensure soft-landing. Initial glitches can

create a lot of disaffection. It is important that both the industry and tax administration should be adequately prepared. The former can prepare itself only when the final decisions are taken and the structure is known. As of now, it is not clear which items fall into which tax rate category as these decisions

are scheduled to be taken in May. Fitting of goods and services under various rates is not likely to be a smooth affair.

This reform is important, but should be taken as the next stage of consumption tax reform in the country. In this connection, three important issues must be noted. First, let us be realistic in our expectation from the reform. Second, it is important to prepare ourselves well—both tax collectors and taxpayers—before taking the plunge and it would be advisable to work out a detailed plan according to prescribed schedule of various activities to roll it out in September. Finally, it is necessary to take adequate care to ensure a smooth transition because that is the most important advertisement for the reform.

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