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GOODS AND SERVICES TAX AS AN UNFINISHED AGENDA

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

GST, or Goods and Services Tax, an institutional tax innovation intensively marketed in many countries by the International Monetary Fund and the World Bank, was wrapped in a “one nation one tax” package, and was accepted by India on the midnight of July 1, 2017. Despite the alleged haste in its launching by the central government, there were adaptations to make it to suit the Indian context.

Hailed as a landmark reform in India’s tax history, it was expected to improve tax-GDP ratio, end tax cascading, enhance efficiency, competitiveness, growth, and ensure lower prices. It was also projected as a watershed in India’s fiscal federalism. While the States have forgone a substantial part of their own tax revenue, they were in turn guaranteed a GST compensation assuring 14% growth in their GST revenue during the initial five years. Many exemptions, along with different tax rates, as against the single rate in many countries, have been accommodated to protect the interests of different stakeholders.

Even after 50 months in existence, a number of relevant issues, both for policy and action, remain unresolved. A recently held international seminar on GST, organised by the Gulati Institute of Finance and Taxation that brought together experts from India and select countries (Malaysia, New Zealand, Australia, South Africa, Brazil, Mexico and Canada), was the venue for a *suigeneris* policy debate focusing on India’s GST experience. We, as participant observers, cherry-pick some of the observations that were made for reflection by policymakers and the wider public.

India’s GST architecture is built on the firm foundations of a GST Council and the GST Network (GSTN). The first is the key decision-making body, chaired by the Union Finance Minister with a Minister of State in charge of Finance and the Finance Ministers of States as members. This is envisaged as a due federal process to protect the interests of the States. GSTN generates high frequency data and subjects them to analytics for informed policy making. Built on this foundation, India’s GST paradigm stands on two key pillars: revenue neutrality and GST compensation for the States. Designed on the principle of destination-based consumption taxation, with seamless provision for input tax credit with CGST levied by the Centre, SGST by the States, UTGST by the Union Territories, and IGST levied on inter-State supply including imports, GST is applicable to all goods and services except alcohol for human consumption and five specified petroleum products with a common threshold exemption applicable to both CGST and SGST.

The assured revenue neutrality remains a mirage and many States have experienced a declining tax-GDP ratio. Studies show that in the case of major 18 States, the ratio of own tax revenue to GDP has declined. While the share of the Centre in total GST increased by 6%, that of States put together lagged behind with only a 4.5% increase. Stark differences between the Revenue Neutral Rates (RNR) for the producing States and consumption State have been observed. States producing exempted food grains also lost out.

Since the rates were lower under GST *vis-à-vis* the VAT regime, revenue neutrality was not adhered *ab initio*. The problems were compounded with massive evasion following the dismantling of check posts, and later on fake invoices, that grew by leaps and bounds.

Exemptions and subventions complicated and worsened the situation. The South African experience illustrates how zero rating and large exemptions have defeated revenue goals. In Mexico, although the country relied more on income tax, with a standard rate of 16% they could raise over 4% of GDP from GST.

Reviewing 30 years of the Canadian experience with GST, it is shown that GST could be improved by limiting zero rating, tax-exemptions and harmonising tax rates. The Brazilian experience indicates that transfers through social security or subsides tend to be more progressive than subventions or exemptions because reduced rates or zero rating do not usually get passed on to target groups or industries as happening in India. The resilience of the economy at the time of rolling out of GST is critical for its wider reception as the Australian experience shows. However, India was in the reverse gear given the downturn following demonetisation.

GST in India was possible only because the States surrendered much of their constitutionally inherited indirect taxes. While the States collectively forewent 51.8% of their total tax revenue, the Centre surrendered only 28.8%. Yet, GST is shared equally between the Centre and States despite two expert committees recommended for a higher share for the States. Given the revenue neutrality failure and the host of other issues, many of the States are left with no option except to depend on GST compensation. While compensation legitimately has to coexist with GST, even the constitutionally guaranteed compensation for five years has not been implemented in letter and spirit, forcing the States to beg for their entitlement. This is not conducive to sustainable co-operative federalism.

Although IGST is a key source of revenue for many of the States, the clearing house mechanism and the process therein remains *terra incognita*. It was pointed out that GST is discriminatory to manufacturing States, indicating the need for a revenue sharing formula that duly incentivises exporting States by sharing IGST revenue among three parties instead of two. The Malaysian experience demonstrates the need for swift and transparent functioning of the input tax credit system through a flawless IT infrastructure. Malaysia ended up abandoning GST owing to these woes. We operate in an almost information vacuum especially with respect to IGST along with several glitches in the digital architecture. GSTN is now in the doldrums. It neither makes effective use of the massive and invaluable data being generated nor shares them to enable others to make use of them. Such practice in “data monopoly” was a fact of history in India’s statistical system and has to go sooner rather than later.

Australia, having several similarities with India, in terms of Centre and the subnational units, and destination-based, multi-stage tax with input credit provisions, has not been revenue-buoyant. The GST revenue of Australia has fallen relative to GDP from 3.85% in 2003-04 to 3.28% in 2018-19. It is a matter for consideration whether such adventures such as widening exemptions and the replacing of income-tax by GST in the case of small and medium enterprises are advisable measures in the Indian context.

GST should be seen purely from a revenue point of view and as a fiscal policy tool for efficiency, competitiveness and growth. Even by this standard, India’s GST is still on a rocky road, with several of the assumptions falling flat while expectations stand belied. Neither the States nor the consumers seem to have benefited since the rate reductions are not translated into prices due to profiteering and cascading. Despite many years of efforts in evolving an Indianised GST system and over 50 months of adjustments with over a thousand notifications, with accompanying uncertainties in the first year and the novel coronavirus pandemic and the lockdown still in the saddle, GST continues to be an unfinished agenda. But how far and how long?

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