Transition to Goods and Services Tax (GST) Regime: 
Rationale and Impasse

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Abstract

The paper throws light on different aspects of the proposed Goods and Services Tax (GST) in India – its principles and objectives; its modus operandi, and its implications for governments, industries and consumers. The papers also examines light on why the GST bill is still pending in the parliament and throws light on genuine concerns of the state governments in this government. The author contends that flawless GST is one of the most important reform agenda which can provide a new impetus to economy of the country and attain inclusive growth. The paper calls for the Central government and the all political parties to come together to find an agreeable solution to end the logjam.

Introduction

Presently almost 150 countries in the world have introduced Goods and Services Tax (GST) in one or the other form till now. France was the first country to introduce it. The idea of launching GST in India was first initiated by Government of India in 2000 under the leadership of Atal Behari Vajpayee, the then Prime Minister of India. An Empowered Committee of State Finance Ministers headed by Dr Asim Dasgupta, the then finance minister of West Bengal was constituted to design the model of GST and inspect the preparation of IT infrastructure for its roll-out. In 2011 Government of India introduced a Constitution Amendment

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Bill (115th) to facilitate the introduction of GST in the Lok Sabha. However, the Bill lapsed with the dissolution of the 15th Lok Sabha. Later on, the Constitution Amendment (122nd) Bill 2014 on GST was introduced in the Lok Sabha on December 19, 2014 and it was passed in the Lok Sabha on May 6th 2015. The Constitution Amendment (122nd) Bill 2014 (CAB) was referred to the Select committee of Rajya Sabha on May 14, 2015. On July 22nd 2015, the Select Committee has submitted its report with appropriate modifications and some recommendations for incorporation. Now the CAB awaits the approval in the Rajya Sabha.

GST is a value added tax levied across goods and services. The GST regime intends to subsume most indirect taxes under a single taxation regime. The broad objectives of GST are to widen the tax base, eliminate cascading of taxes, increase compliance through lowering of overall tax burden on the goods and services and reduce economic distortions caused by inter-state variations in taxes. ‘By doing away with latent or embedded taxes, it would provide leeway for the competitiveness of domestic industry vis-à-vis imports and in international markets. Unifying the tax structure across States, the new scheme of tax regime would pave way for a common national market for goods and services’ (Select Committee Report, 2015). According to the Report of Task Force on GST, the GST should be structured on the destination principle. As a result, the tax base will shift from production to consumption whereby imports will be liable to tax and exports will be relieved of the burden of goods and service tax. Given the above the present paper seeks to highlight the rationale of the GST in India, gauge the real beneficiaries and pinpoint salient features of the Constitution Amendment (122nd) Bill, 2014 called CAB passed in Lok Sabha, draw out a comparison between current indirect system and proposed GST and point out the bargaining issues that still act as impasse for the passage of the CAB in the Rajya Sabha and its implementation in the country. The present paper is based on the secondary sources mainly the published Reports of Task force, first discussion paper of empowered committee of state finance ministers, reports of finance
commission, constitution amendment bill(s), working papers and various articles published in esteemed newspapers etc.

**Justification of GST**

In the existing framework of Indian Constitution, the authority to levy both direct and indirect taxes is divided between central government and state governments. Central government levies indirect taxes such as custom duty on import on goods, excise duties on manufacture of goods, central sales tax on interstate transactions and service tax on provision of specified services, etc., while the state governments levy Value Added Tax (VAT), state excise, luxury taxes on hotel, entry tax/octroi on the entry of goods in specified areas, ancillary taxes like entertainment taxes etc. Although indirect tax structure has gone through several reforms since 1991 like introduction of service tax in 1994 and central value added tax (CENVAT) in 2001 by central government and introduction of VAT in 2005-06 by state government replacing sales tax etc., emphasis on moving towards a neutral or uniform tax structure is below par the desired level. A fundamental flaw of the present indirect structure is the multiple taxes levied by central government and state government at different levels of supply chain.

This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country. First, there is no uniformity of tax rates and structure across states. Second, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice-versa. Further, no credit of state taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this 'tax on tax'. Present structure has cascading impact on cost of indigenous manufacture of goods and services affecting the competitiveness of Indian industry. For example VAT is levied on sale value of product, which includes excise duty element. Thus VAT is also charged
on excised duty element, and vice versa. Similarly, service tax is levied on services and central sales tax is levied on inter-state sale of goods evincing cascading of taxes at each stage in supply chain. On the other hand, such multiple taxes with different rates and different tax bases not only make tax structure highly complicated, but also make it difficult to comply and administer resulting in high compliance cost, tax arbitrage, and wastage of time and efforts. Complexity discourages tax compliance and retards investment and economic growth. In true sense, multiple taxes provide incentives for tax evasion and undermine efficiency. Tax inefficiencies in domestic tax structure compel government to continue policy of high custom duty to protect domestic industries making India high cost economy and exports less competitive (Kothari, 2011). All these warrant replacing the present regime by efficient, rational Goods and Services Tax structure, which would be buoyant too, without disturbing the country’s federal structure.

In the present State-level VAT scheme, CENVAT load on the goods has not yet been removed and the cascading effect of that part of tax burden still continues. Moreover, several taxes of the States, such as, Luxury Tax, Entertainment Tax, etc., which have yet not been subsumed in the VAT would be comprehensively removed with the introduction of GST. It is held that the introduction of GST will not only include comprehensively more indirect central taxes and integrate goods and services taxes for set-off relief, but may also lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade and increased compliance (Dasgupta, 2009). A continuous chain of set-off from the original producer’s point and service provider’s point up to the retailer’s level would be established removing the burden of all cascading effects, including the burden of CENVAT and service tax. This is the essence of GST. Once the new tax system comes into force, there will be three indirect taxes namely Central GST (CGST), State GST (SGST) and Integrated GST (IGST) apart from the customs duty which is levied only on imported goods. Thus GST is not simply VAT plus service tax, but a major improvement
over the previous system of VAT and disjointed services tax – a justified step forward (Lok Sabha Secretariat, 2014). The ‘flawless or Ideal GST’ (meaning single rate and minimum exemptions) as recommended by Task force includes the following elements:

1) The GST will be a dual levy imposed concurrently by the Centre and the States, but independently. It will have two components: one levied by the Centre (hereinafter referred to as CGST), and the other levied by the States and Union Territories (UTs) [hereinafter referred to as SGST].

2) Both the CGST and SGST will operate over a common base. i.e.; the base will be identical.

3) There should be no distinction between raw materials and capital goods in allowing input tax credit.

4) There should be no classification between goods and services in law so as to ensure that there is no classification dispute.

5) The computation of the CGST and SGST liability should be based on the invoice credit method i.e., allow credit for tax paid on all intermediate goods or services on the basis of invoices issued by the supplier. As a result, all different stages of production and distribution can be interpreted as a mere tax pass-through, and the tax will effectively ‘stick’ on final consumption within the taxing jurisdiction. This will facilitate elimination of the cascading effect at various stages of production and distribution.

The proposed switchover to the ‘flawless’ GST should, therefore, be viewed as pro-poor and not regressive (Task Force, 2009). GST will simplify and harmonize the indirect tax regime in the country. The changeover to the Goods and Service Tax (GST) will be a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues and acceleration of growth, as well as generate many positive externalities (Finance Commission, 2009). ‘It can pave the way for modernization of
tax administration - make it simpler and more transparent – and significant enhancement in voluntary compliance’ (Poddar and Ahmad, 2009). Fourteenth Finance Commission also proposed the universal application of GST regime. The Finance Commission felt that a broad based tax like GST would help develop a common market and, in turn, would help increase economic growth and revenue outcome. In the long run, all goods and services should be brought under the ambit of GST’ (Finance Commission, 2015). According to the report of Union Bank of Switzerland (UBS), “GST will be a game-changing reform. It will likely result in higher tax revenues (over 1 per cent of GDP), which is critical given India’s high fiscal deficit (The Economic Times, 2014). All these amply justify that the introduction of GST in India would help in building a more harmonized tax structure and minimize distortions.

Realistic beneficiary

The above discourse shows that GST is beneficial to the Centre, States, industry, manufacturers, the common man and the country at large since it will bring more transparency and better compliance besides faster GDP growth and revenue collection. However the present study highlights the positive impacts on macro-economy, manufacturers and consumers only.

a) Impact on Macro-economy: GST will boost economic growth and increase government revenue by widening tax base. GST will reduce the overall incidence of indirect taxation by removing the many distortions in the present indirect tax system. Flawless GST will, amongst others, increase productivity of all factors of production and hence enhance GDP and it will also cause poverty reduction. ‘Implementation of GST across goods and services is expected, ceteris paribus, to provide gains to India’s GDP somewhere within a range of 0.9 to 1.7 per cent. The corresponding change in absolute values of GDP over 2008-09 is expected to be between Rs. 42,789 crore and Rs. 83,899 crore respectively (Task Force,
It is argued that ‘implementation of a comprehensive GST in India is expected to lead to efficient allocation of factors of production thus leading to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital’ (NCAER, 2009). The differential multiple tax regimes across sectors of production are leading to distortions in the allocation of resources as well as production inefficiencies. Complete offsets of taxes are not being provided to exports, thus affecting their competitiveness. It is estimated that ‘the gain in exports is to vary between 3.2 and 6.3 per cent with corresponding absolute value range as Rs. 24,669 crore and Rs. 48,661 crore while imports are expected to gain between 2.4 per cent and 4.7 per cent, thus improving the trade balance’ (Task Force, 2009). Available information also indicates that ‘India will gain 15 billion dollar a year if GST gets implemented. It will divide the burden of tax between manufacturing and services’ (Phukan, 2015). In a nutshell it may be mentioned that impact of GST on the whole economy is multidimensional.

b) **Benefits for Manufacturers:** The proposed GST bill is likely to reduce manufacturing cost. With the elimination of multiple tax structure at central and state levels, manufacturing sector would be viable and globally competitive. According to one expert, even a two per cent reduction in production cost may help profits to rise by 20% giving enough space for reducing prices and benefitting the end-users (Raj). If GST is introduced, the companies that face stiff competition from the unorganized sector now would gain immensely. According to UBS Report the biggest beneficiaries would be the sectors having a high percentage of the market occupied by unorganized participants. Under the existing framework of GST, a company having a turnover more than Rs. 10 lakh would be liable to pay tax against Rs 1.5 crore under the existing excise duty structure. Thus GST will render
more companies from the unorganized sector into the tax net resulting in higher revenue to government as well as providing better space for the organized players in competition as cost and taxes for the unorganized sector will increase. The key beneficiaries of GST will be sectors such as batteries, footwear, plywood, electrical appliance, ceramics, adhesives, fast moving consumer goods, textile industries and paints, where the unorganized sector accounts for 35% to 70% of total market size. For instance, the replacement battery segment in India has a total turnover of about Rs 4,800 crore -- nearly 50% of this is contributed by companies in the unorganized sector (Ashutosh and Suraj, 2014). Other big beneficiaries would be logistics companies. ‘The GST regime will make sure that companies consolidate their warehouses into four or five big ones rather than keeping one in every state to save on Central Sales Tax. The retail industry will gain too. The rollout of GST will help free movement of goods across states’ (Chatterjee and Pinto, 2014). Since tax paid in a previous state is treated as input credit, it will facilitate the easy movement of goods anywhere in the country without a tax burden. Besides transport services, GST will also improve the profitability of power sector as well. According to tax experts, the entertainment and telecom sectors would be big beneficiaries as the GST would eliminate a multiplicity of taxes–entertainment tax, luxury tax, VAT and service tax.

c) Impact on Consumers: Under GST, several taxes would be subsumed and this would eliminate the impact of double taxation resulting in fall in prices and consequent relief for the consumers. For example, cost of manufactured goods/excisable goods will be cheaper given the fact the current regime of excise duty and VAT stands withdrawn (Dasgupta, 2009). The prices of many other consumer goods such as sugar; beverages; cotton textiles; wool, silk and synthetic fibre textiles; and textile products and wearing apparel, etc., are likely to decline (NCAER, 2009). The implementation of
the GST will result in a sharp decline in the prices of cotton textiles (by 6.44 percent), wool, silk & synthetic fibre textiles (by 11.4 percent), and textile products including wearing apparel (by 17.45 percent) (Task Force, 2009). All food items covered under the public distribution system are proposed to be exempt from GST. As a result primary food articles like rice and wheat would be exempt from GST. Like food, basic health and education services are also intended to be fully exempt. Cost of housing will be cheaper. The prices of goods will automatically come down when the companies pass on the benefits to the consumers. However, the actual quantum of benefit to the consumers can be gauged only when GST design and RNR etc become explicit.

Salient features of the Constitution Amendment (122nd) Bill, 2014 (CAB) on GST

The salient features of the CAB as introduced in the Lok Sabha are as follows:-

(a) Subsuming of various Central indirect taxes and levies such as Central Excise Duty, Additional Excise Duties, Excise Duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955, Service Tax, Additional Customs Duty commonly known as Countervailing Duty, Special Additional Duty of Customs, and Central Surcharges and Cesses that relate to the supply of goods and services;

(b) Subsuming of State Value Added Tax, Sales Tax, Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States), Octroi and Entry tax, Purchase Tax, Luxury tax, Taxes on lottery, betting and gambling; and State cesses and surcharges relating to supply of goods and services;

(c) Dispensing with the concept of ‘declared goods of special importance’ under the Constitution;
(d) Imposing Integrated Goods and Services Tax (IGST) on inter-State transactions of goods and services; Only the centre may levy and collect GST on supplies in the course of inter-state trade or commerce. The tax collected would be divided between the centre and the states in a manner to be provided by Parliament, by law, on the recommendations of the GST Council;

(f) Conferring concurrent power upon Parliament and the State Legislatures to make laws governing goods and services tax;

(g) Coverage of all goods and services, except alcoholic liquor for human consumption, for the levy of goods and services tax. In case of petroleum and petroleum products, it has been provided that these goods shall not be subject to the levy of Goods and Services Tax till a date notified on the recommendation of the GST Council.

(h) Compensation to the States for loss of revenue arising on account of implementation of the Goods and Services Tax for a period which may extend to five years;

(i) An additional tax of 1% on the supply of goods may be imposed by centre in course of interstate sales or trade accruing to states from where the supply originates;

(j) Formation of GST Council for examining issues relating to goods and services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits, rates of GST, model GST laws, principles of levy, apportionment of IGST and principles related to place of supply and special provisions in respect of the eight north eastern states, Himachal Pradesh, Jammu and Kashmir, and Uttarakhand;

(k) The GST Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with
the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government;

(l) The structure of GST Council follows the federal nature of governance in this country;

This provision may have been adopted to ensure the federal balance in the functioning of the GST Council, and also to improve co-operative federalism. All decisions in the GST would be taken with three-fourth majority of the votes cast of which the centre shall have one-third of the votes cast, and the states together shall have two-third of the votes cast. Thus, neither the States nor the Centre alone can take a decision in the Council. With the introduction of GST Taxes would be coming down and tax would be only paid on the additional value addition part only. This will encourage voluntary compliance as a person in the supply chain gets credit only when tax is paid by previous person. On the other hand as Single tax is applied for both goods and services, hence distinguishing between the two is not necessary.

Impasse

At the very outset it may be mentioned that a majority of the States was in broad agreement with the suggestions, views, opinions and recommendations of the Empowered Committee as placed before the Finance Commission (Finance Commission, 2015). All of them reiterated their concerns on the revenue loss and raised the issue of some other taxes likely to be subsumed under the proposed GST. They also raised the issue of keeping some of the goods like petroleum products, alcohol for human consumption, and tobacco out of the purview of GST. State-specific concerns were raised on the issue of entry tax in lieu of octroi, compensation package, a separate and independent compensation fund under the administrative control of the GST Council, automatic compensation mechanism and the quantum of compensation.
It may be mentioned that although the CAB has been cleared by the Select Committee by supporting the larger points proposed by the Government along with some recommendations, the passage of the CAB in the Rajya Sabha is uncertain because the Government may lack the required support of two-third majority. Given the hurdles of number in current strength of 245-member Rajya Sabha, the party in power which is having 65 MPs on their side has been facing stiff resistance regarding the passage of the bill, warranting a crafty role on the part of Central Government in this regard. As the CAB had been not passed in Monsoon session concluded in August 2015, April 2016 deadline fixed for its implementation would be too ambitious to think and thus the approval of CAB is postponed till the Winter session.

**Opposition Arguments**

The points of concern or main objections that the opposition parties persist are as follows:

1. With a view to protecting the poor consumers from the unfair burden of GST and skirting the power of GST council from fixing any higher rate, main opposition party has proposed a ceiling rate or cap of 18% GST in the constitution itself (Article 246A). It may be mentioned that the sub-panel of the empowered committee of State Finance Ministers had recommended a Revenue Neutral Rate (RNR) of 27%, which currently is being looked into by a committee headed by Chief Economic Advisor. Globally, the GST rate ranges from 16% to 20%, even though in countries such as Australia it is as low as 10% and, in Japan, 8%. Thus the RNR is really a bone of contention. ‘The bill provides only a minimalist framework and leaves the structure and operational details to the GST Council. This implies that the entire gamut of issues relating to the structure and operation of the levy has to be negotiated and decided on by the council’ (Rangarajan and Rao, 2015). The council will have to consider the RNR of tax estimated by an expert body. Thus the matter is not so easy.
2. Compensation for revenue loss due to the introduction of GST should be deposited in a GST Compensation Fund, under the administrative control of the GST Council, as proposed by the Standing Committee on Finance is another disagreement issue.

3. The provisions of the GST bill do not fully conform to an ideal GST regime. Deferring the levy of GST on five petroleum products may cause cascading of taxes.

4. In the interests of true “cooperative federalism”, the share of the States in voting in the GST Council needs to be enhanced to 75% and the share of the Centre be brought down to 25%. Some state governments have also given same opinion on the issue. With the Union government having two-thirds of the vote, no decision can be carried without its approval, even if it is desired by all the state governments.

5. The CAB can’t be supported because it contravenes the elementary principle of law that parties to a dispute should not be judges in their own cause. The failure to incorporate a GST Disputes Settlement Authority, as was provided for in the 2011 Bill, is a serious lacuna that must be filled and needs to be accommodated in the CAB.

6. The sources of revenue of the Panchayats and Municipalities, as provided for in Parts IX and IXA of the Constitution, must be safeguarded and they must be assured of their due share in the revenue buoyancy that is expected to arise from the enactment and implementation of the GST.

7. Another bone of contention relates to inclusion of purchase taxes on food grain, in lieu octroi or entry tax. The food grain surplus states which have been levying the purchase tax would incur revenue loss once such taxes are subsumed in GST.

8. Some argued that GST Council as a constitutional body impinges on the legislative sovereignty of both Parliament and the State Legislatures. It also completely jeopardizes the
autonomy of the States in fiscal matters. Ideally it should not exist. The existing mechanism of the Empowered Committee of State Ministers which dealt with VAT issues is adequate. Thus formation of statutory GST Council is also even questioned.

9. Bringing Petroleum and Petroleum products under the ambit of GST will entail huge revenue loss to the States as Input Tax Credit will have to be provided eventually. The states are reluctant to bring motor spirit and high speed diesel within the ambit as presently the tax is levied at a floor rate of 20% and the states derive about 35% of their sales tax collections from these petroleum products. Once the rates for CGST and SGST would be fixed by the GST council, individual states will lose the right to shift a commodity from lower to higher rate and even the states will lose the right to tax the whichever commodities they want at rates they want.

10. Tobacco and tobacco products, alcohol for human consumption and electricity supply and consumption must be brought within the purview of GST within five years. Once GST becomes operational, the States cannot levy taxes on tobacco. State excise duty is not subsumed in GST, yet, the States lose revenue, if alcohol is included is included in GST.

11. With respect to services such as transportation of passengers or goods in railways or telecom, the place of sale and payment and the place of consumption may not coincide and allocation of revenue will have to be negotiated and settled. Clearly defined principles and rules for the allocation of revenue from transactions in such services are needed.

Present Status of GST Bill

Current scenario indicate that roll out of the national GST is all set to miss the April 1 deadline because the CAB is still pending in Rajya Sabha. According to official sources, the implementation
of GST will take at least two more sessions in Parliament if it is passed by Rajya Sabha in coming winter session. Once the CAB is approved in the Rajya Sabha and it receives the President’s assent it will have to be ratified by 50% of the state legislative assemblies. With the ratification of GST Bill, a GST council with the Union finance minister and finance ministers of all states will be constituted to take a final call on the design of GST, including the revenue threshold level beyond which the tax will be applicable and the tax rate under the indirect tax regime.

Till now emphasis are given on the steps initiated by the Central Government to make GST operational but now the time has come for the state governments to start acting on the GST (Ghosh, 2015). It includes drafting the respective state GST legislation, attainment of alignment with the corresponding provision of the central legislation, the place of supply of rules etc. Besides, the technology platform which the government has been working needs to be implemented, and last but not the least is the release of GST draft legislation for discussion with all stakeholders and allowing sometime to the stakeholders for preparedness to switch over.

Conclusion

To conclude, it may be mentioned that GST is proven to be better tax structure because it is buoyant, elastic and efficient. GST is buoyant because tax revenue as a proportion of GDP will register an upward trend. It is elastic because the tax revenue will increase due to variation in coverage and rate of taxation. It is seen as efficient because cost of collection will be less and economic distortions will be minimum. Although the implementation of GST has been referred by various expert committees such as Empowered committee of State Finance Ministers, Task force on GST, Finance Commission of India, Select Committee of Rajya Sabha, etc., and almost all the states are broadly in agreement for the introduction of GST, the jinx is yet not broken and switchover to GST regime is awaited. Lack of adequate political support is the stumbling block
for a neutral and rational GST design. The impasses discussed in the paper are neither trivial, nor technical. Rather they represent conflicting interests of stakeholders. With a view to arriving at consensus on the design of GST, the final rate structure particularly RNR and other key issues, the Central government needs to speed up the process and assure commensurate compensation of revenue loss to the States due to introduction of GST. It is not an exaggeration that the ‘flawless’ GST is one of the most important reform agenda which can provide a new impetus to economy of the country and attain inclusive growth. But the need of the hour is that the Central government and the all political parties should come together shunning their political compulsions and take proactive roles for an agreeable solution so that logjam/stalemate in Rajya Sabha may be overcome soon and enable the government to implement a ‘flawless GST’ in India, a win–win proposition for all.

Note

A tax is said to be buoyant if tax revenue increases more than proportionately in response to rise in national income. A buoyant tax has an inherent tendency to yield greater revenue with the growth of its base.

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