Goods and Services Tax: Challenges and Opportunities

Sankhanath Bandyopadhyay

India has witnessed a number of reforms in indirect taxes over the last two decades with the replacement of State Sales Taxes by Value Added Tax (VAT) in 2005 marking a watershed in this regard. A Modified Value Added tax (MODVAT) was introduced for selected commodities at the Central level in 1986 and subsequently extended to all commodities through Central Value Added Tax (CENVAT). Value Added Tax (VAT) at the State level was introduced in a phased manner during 2003 to 2008. Prior to the implementation of VAT, the indirect tax structure in the country was considered somewhat problematic due to the "cascading effect of taxes" whereby an item is taxed more than once from the production stage to the final retail sales stage. Exporters were also becoming less competitive in the international market due to the relatively higher input costs involved through the earlier sales tax mode (tax burden of a commodity increases when it is taxed repeatedly) – reflected in higher prices of products as compared to global competitors.

To address this problem, VAT was introduced so that taxes are paid on the "value added portion" by each producer and the hurdles of the cascading effect are done away with. But shortcomings have been noticed in the VAT structure as well and efforts have been made to further rationalise the system. For instance, a number of Central taxes like customs duty, surcharge etc. were not included in Central Value Added Tax (CENVAT) while indirect taxes at the State level such as entertainment and luxury taxes were left out of the purview of VAT. While the "White Paper on State-Level Value Added Tax" by the Empowered Committee of State Finance Ministers (ECSFMs), Ministry of Finance, GoI had emphasized that, in general, all the goods would be covered under VAT and would get the input tax credit benefit, still many goods like liquor, lottery tickets, petrol, diesel, aviation turbine fuel, motor spirit etc. were kept outside VAT since their prices are not fully market determined.

The taxation of services was initiated in India on July 1, 1994; it is said to have taken 'giant leaps' over the years both in terms of coverage and increased tax rate. However, over the years, the newer additions to the existing list of services raised issues of overlaps, confusing whether some activities were being taxed for the first time or were already covered under an earlier taxable head. It has been pointed out that there is lack of clarity in existing definitions pertaining to service tax, exposing the tax collection process to avoidable leakages and litigation. Moreover, the hitherto Constitutional provision does not allow both the Central and State Governments to tax both goods and services in an inclusive manner. The government has therefore recognised the need for harmonisation of goods and services tax so that both can be levied in a comprehensive and rational manner in a new taxation regime – namely, Goods and Services Tax (GST).

While presenting the Union Budget for 2007-08, the then Finance Minister P. Chidambaram had announced that GST would be introduced from April 1, 2012, in order to have a tax structure where goods and services tax can be unified in a comprehensive manner. However, since then it has been realized that introducing GST is not an easy task as reflected in the repeated postponement of deadlines of GST implementation. Issues like addressing States' concerns, GST rate structure, taxing specific sectors (like food, petroleum, electricity, land and real estate), and the Constitutional amendment needed have been among the major hurdles.

Country case studies regarding GST reflect that socio-economic conditions of countries differ; hence, a GST framework successful in any particular country may not necessarily be successful in other countries. Though GST has a number of administrative, compliance and other benefits, to what extent such a tax regime would be suitable in the socio-economic context of the Indian economy, is a matter of debate. From country experiences, it can be observed that GST is particularly suitable for countries with homogeneous commercial and demographic features. The socio-economic conditions of the States in India are much different than the countries of the European Union. Hence, it is argued that before implementing GST there should be a clear consensus whether there would be a net benefit for the Indian economy and/or whether Indian economy is ready to absorb the benefits of the GST regime.

For instance, it is argued that a single GST rate is best for administrative efficiency. However, considering both the aspects of fiscal federalism as well as State revenue implications, a single rate is not feasible in India. Given the vertical inequality of State Governments relative to the Central Government and horizontal inequality among State Governments in India (i.e. the inequality in revenue mobilisation capacity), a single rate of GST is difficult to implement in the absence of compensation for States (for revenue loss, if any). However, if the amount of compensation is huge and have to be paid for a long time, it might put fiscal strain on the Centre. Such possibilities should be reviewed carefully. The Vijay Kelkar Task Force suggested to levy GST at two levels - Centre and State, comprising two rate components, viz. Central GST (CGST) and State GST (SGST) respectively. A dual GST module for the country has also been proposed by the Empowered Committee of State Finance Ministers (ECSFM) in their first Discussion Paper on GST. Under this model, GST would have two components viz. the Central GST to be levied and collected by the Centre and the State GST to be levied and collected by the respective States. Central excise duty, additional excise duty, service tax, and additional duty of customs (equivalent to excise), State VAT, entertainment tax, taxes on lotteries, betting and gambling and entry tax (not levied by local bodies) would be subsumed within GST.

New Zealand is an example of a country where GST operates very successfully, but that success was not achieved in a short time; it was a consultative process that took long time to settle considerable issues. In NZ, the GST model comprises a low uniform rate and zero exemptions. It took time to convince economic agents about the necessity of zero exemptions. In the context of the political economy of India, more time should be provided to sort out such issues. Hence, consultative processes pertaining to GST are important even if such processes take time.

[Sankhanath Bandyopadhyay works with Centre for Budget and Governance Accountability (CBGA). The author may be contacted at *sankha.nb@gmail.com*]