**Present State of Goods and Services Tax (GST) Reform in India**

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Indirect tax system in India has gone through several reforms in the last two decades (Rao and Rao, 2005). At the Central level, introduction of Central Value Added Tax (CENVAT) in 2000-01 and Service Tax in 1994 are the major ones. Introduction of VAT could be termed as the first coordinated tax reform initiative ever carried out in India since independence and it achieved many milestones. There are four major taxes on domestically produced goods in India. First, the Central Excise (or CENVAT) duty is a Value Added Tax (VAT) at the central level levied and collected by the Central Government on the manufacture of goods. CENVAT duty is uniform across States and due input tax credits (CENVAT Credit) are allowed against Central Excise Duty, service tax (since 2004), and Countervailing Duty (CVD) and cesses thereof (for imported goods/ inputs). Among other three taxes, State sales tax or VAT and Entry Tax (in lieu of Octroi) are levied by the States and also collected and retained by the State Governments.13 The Central Sales Tax (CST) is levied by the Central Government on inter-State sales of goods but it is collected and retained by the exporting States. The rates of State taxes vary across States and the rules and regulations to allow input tax credits. Entry tax rates vary across States and commodity.

The key features of the proposed GST regime are briefly summarized as follows:

* The tax is to cover all goods and services; it is however, proposed that there would be a small negative list of goods and services which will not be taxed under GST. All other supplies of goods and services would be subject to tax.
* Dual GST: there will be two taxes levied on each such supply – one as a part of the Central GST and the other as a part of the State GST.
* It is proposed that the GST regime would have two rates of tax, a lower rate for supply of specially identified goods and services and the rest of the supplies would be taxable at a standard rate.
* On inter-state supplies, it is proposed that the Centre will levy and collect Integrated GST (IGST) – the importing dealer can claim input tax credit for IGST paid on these goods against taxes payable on subsequent transactions.
* It is proposed that for the standard rate there would be a band which allows the states some flexibility in fixing rates.
* In order to protect the states from any loss of revenue in the process of reform, Central government has proposed to compensate for any loss of revenue.

**Challenges in Designing and Administration of GST**

The benefits of the proposed GST system could only be reaped if certain challenges related to design and structure of GST, are addressed by the governments.

* Estimation of correct tax base for GST is important to understand the tax potential and estimation of tax rate(s) to achieve revenue neutrality. Estimation of GST base depends on several structural features of GST design and the most important are - a) whether proposed GST would be origin (production) or destination (consumption) based, b) whether income or consumption type, c) whether implemented with credit (input tax) invoice based subtraction method or formula based (ad hoc) subtraction method for allowance of credit against input taxes and d) having many or a few exemptions.
* Estimation of revenue neutral rate for GST is a complex issue and given the complexity in the design of GST, it would be difficult to estimate RNRs without any revenue implications. The proposed tax system will subsume both Central and State indirect taxes and levies. On the combined tax base dual GST (CGST, SGST and IGST) will be levied.
* An attempt is made to estimate the tax rate for the proposed GST in India. This estimate is based on average 'C-efficiency' of lower middle-income countries and that of Asia/ Pacific region. 'C-efficiency' is a measure to assess the performance of VAT (Keen, 2013). Keen (2013) defines 'C-efficiency' as "an indicator of the departure of the VAT from a perfectly enforced tax levied at a uniform rate on all consumption". Apart from 'C-efficiency', depending on differentiation in tax rates across goods and services and exemptions, tax collection under VAT varies. 'C-efficiency' is defined as:

C-efficiency = (VAT Revenue) / (Tax Rate \* Consumption Expenditure)

Tax Rate = (VAT Revenue)/ (C-efficiency\* Consumption Expenditure)

* The proposed design of GST does not include a) alcoholic liquor for human consumptions, b) electricity, and c) real estate. In addition to these, inclusions of petroleum products and natural gas have been postponed to an unspecified future date that would be decided by the GST Council. By non-including electricity and some other sources of fossil fuels the proposed GST system will retain substantial cascading of taxes which will be detrimental for achieving export competitiveness of Indian industries in the international markets.

There are some misconceptions regarding GST which required clarifications.

* First, many people think that introduction of GST will widen the tax base by expansion of coverage of economic activities under the tax net and by reducing the list of exemptions. However, most economic activities are presently taxed either by Central and/ or State Governments and there is not much scope for further expanding the tax base by bringing more goods and services under the purview of GST unless we reduce the list of goods and services that kept under the exemption list.
* Secondly, it is common perception that mitigation of cascading and double (multiple) taxation and lower tax burden under GST would induce better tax compliance. Even under the proposed design of GST with exclusion of goods like electricity and petroleum products, cascading of taxes would be retained. Tax payers who faced with single tax administration (e.g. retailers, service providers) would face two tax administrations and complying with different tax authorities for single transaction could enhance the compliance costs and this could work against voluntary compliance. Therefore, the argument on possibility of “lowering of overall tax burden on goods and services” does not have any basis.
* Thirdly, it is envisaged that competitiveness of domestic industries in international market will improve as the system will remove latent and embedded taxes. However, by keeping major revenue earning as well as major energy sources like electricity, petroleum products (petrol, diesel and ATF), natural gas, crude petroleum out of the GST, the removal of cascading will be limited and therefore the impact on export competitiveness of Indian industries would be limited.
* Fourthly, it assumes that GST will provide common national market for goods and services by unifying the tax structure across States.

**Consequences of GST on Inequality**

Impact of GST on different strata of the society will be different depending on composition of their consumption basket by having an immediate impact on prices of goods and services and it will induce behavioural changes among consumers, provided the benefits of removal of cascading of taxes and/or costs of additional tax burden are passed on to consumers. Different group of consumers will have different response to changes in prices and in the long run it is expected that inflationary pressure will subside due to removal of cascading of taxes under GST.

Given the large informal sector that escapes tax net and substantial cash-based (without invoice) transactions, opportunity cost of being under the tax system cannot always outweigh the benefits. The presence of informal credit and labour markets and large domestic demand for locally produced goods and services often lead to unaccounted incomes and avoid taxes. For successful adoption of GST framework in India, establishment of GST institutions is very important. Given federal structure of India, the character of the institutions should be neutral and both Centre and State government should have equal space (opportunities) in these institutions to propagate the spirit of cooperative federalism.

**Conclusions**

Till now all decisions on GST have been taken without consultation of major stakeholders like businesses and citizens (consumers). All the decisions taken by the Empower Committee of State Finance Ministers and the Central Government are not available in the public domain and therefore it is difficult to get clarity on various aspects of GST. Since businesses are not consulted, their views on the present design and structure of GST are not clear. This may lead to resistance to the tax reform and/or negotiated tax environment which are not conducive for a modern rule-based tax system. Keeping major stakeholders out of the discussions on GST is not a good sign for any tax reform as decisions taken by the governments will influence their day-to-day decisions. It is desirable that more transparent approach would be followed to disseminate the decisions among stakeholders and considering their views in policy designs.

Reform in tax administration is as important as tax policy for mobilization of revenue, given the present state of diversities in tax administration across governments, it is expected that tax administration reforms will be taken up sooner than later to enable tax officials to administer the GST efficiently. By moving towards GST, it would be difficult for individual States to deviate from harmonized structure of GST and it will further enhance the importance of tax administration to achieve revenue objectives of the State Governments. The present state of investment in tax administration is miniscule. Large scale vacancies in tax departments, limited availability of infrastructure are major constraints which influence tax efficiency. A large section of tax officials is engaged in carrying out routine works, there is hardly any scope for skill development and specialization in tax administration. Modernization of tax administrations by investing in manpower and infrastructure along with continuous research and training could inculcate the desires for specialization in various aspects of tax administration.

At last, the success of the proposed GST system in terms of compliance and revenue mobilization will largely depend on – a) provision of incentives for tax invoice-based transactions and b) simplification of tax administration. A large part of transactions (both in goods and services) remain outside the tax net. Even there is no mechanism to verify the originality of the tax invoice issued by the vendors or service providers. Prevailing system of without-invoice transactions results in generation of unaccounted income as it escapes tax nets of both direct and indirect taxes. The present system of separate tax administrations by Centre and States is not conducive for GST like tax system and it will increase both compliance and administrative costs. Therefore, options for joint tax administration may be explored.