

Some Concerns Regarding the Goods and Services Tax

Surajit Das

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Part-B- Unit – 2 Goods and Services Tax

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The Goods and Services Tax (GST), is considered to be one of the most profound reform in India's indirect taxation system. The main expectation from GST is to remove all indirect taxes and its cascading effect and only GST be levied. It is unified system of taxation which is expected to move the economy in upward direction.

The following main claims have been made by the present and past central governments of National Democratic Alliance (NDA) and United Progressive Alliance (UPA) regarding the GST. It is to:

- (i) enhance growth and reduce inflation,
- (ii) shift the tax burden from producers and suppliers to the final consumers,
- (iii) integrate the national market,
- (iv) improve tax compliance,
- (v) mitigate the cascading effect of taxation,
- (vi) be a win-win situation in terms of revenue for both centre and the states,
- (vii) be good for both producers and consumers,
- (viii) be beneficial for both tax payers and the tax administration,
- (ix) make for a simpler and more transparent tax system and so on.

Inequality-GST trade off:

Although the objective of the GST is commendable but in reality, there is a trade-off between inequality and tax-GDP ratio. The more increase in GST tax-GDP ratio will lead to higher inequality. As the tax rate is same, the incidence of tax would be higher on the poor as the poor consume more in proportion to their income suggested by Kalecki (1943). This nature of disproportionate incidence of tax makes this tax a regressive one. If because of the better compliance or higher GST rate the tax-GDP collection will increase then inequality in the economy will increase and if

the collection will be low then due FRBM Act there will be also low government's expenditure-GDP.

State's Autonomy-GST trade off:

Another trade off is the fiscal autonomy and GST. GST council which is a central body will decide regarding the revenue collection. Though the states have some say but they don't have the freedom to decide a different tax rate. If the entry tax is abolished the state will merely be a tax collecting agent.

In spite of having a uniform tax across states, the price of the commodity will vary from state to state and from rural to urban. The price of a particular commodity depends upon the cost of production, transportation, marketing etc. The variation in tax rates only explains a small fraction of the total price variation. So, to suggest one uniform tax rate is not a viable option.

Given the strong sub-national identities and autonomy of the states there is a need to have a differentiated tax rate that can be decided by the state, as Amresh Bagchi (2006) has argued that the essence of taxing power lies in the power to fix rate or else the fiscal autonomy of the state will be compromised forever.

Shifting Tax burden from Producers to Consumers

General Public Finance textbook understanding suggest that any kind of tax is shared by both the producer and consumer. The elasticity of supply and demand curve basically will decide both the consumer and producer behaviour given the tax incidence. So, it is not necessary that the incidence of tax will be lesser for producer in GST case.

Growth and Inflation under the GST Regime

Given our microeconomics understanding if the GST rate is higher than the revenue neutral rate (RNR)¹, the real disposable income of people would go down. This in turn, may further shift the demand curve to downwards to the left. This will lead to a reduction in equilibrium output. From macroeconomics standpoint there will be a reduction in aggregate propensity to consume followed by the redistribution of real income (Kalecki 1943). The multiplier (Keynes-Kahn) would be weakened and will result in relatively less in aggregate output and employment, autonomous investment demand or export demand or government expenditure. The absence of sufficient aggregate demand will hardly induce the investor to enhance the aggregate output and employment. To ensure no losses in revenue the centre has to

¹ The Revenue Neutral Rate is a rate of GST at which the amount of taxes collected currently by the government and the expected amount to be collected after the implementation of GST remains the same. This rate is known as revenue neutral rate.

compensate the states which means the combined tax rate has to go up, which does not ensure higher growth or lower inflation.

Compliance under the GST Regime

Compliance is defined as the ratio of the actual tax collection to potential tax collection, given the tax rate and tax base. This compliance is typically dependent on the efficiency of tax administration, the tax information network and on the degree of corruption. The government claims that at least in long run there will be better compliance. But the author suggest that introduction of GST is neither a necessary nor a sufficient condition for improvement of tax compliance. He suggests if the corruption decreases, the efficiency of tax administration improves and the tax information network expands, the compliance may improve even without the introduction of GST. If there is no improvement in these factors, the compliance may even deteriorate after the introduction of GST.

Controversy Regarding Revenue Neutral Rates

Revenue neutral Rate is the most important consideration as no government would like face revenue loss due to tax reform. However, there is no consensus regarding the calculation of RNRs, which is of utmost importance. Bhaskar and Nath (2015) mention that the report of the National Institute of Public Finance and Policy (NIPFP) has preliminarily determined the RNR as 27%. Following the format in the Report of the 13th Finance Commission, Kavita Rao (2010) opined that if India is at the lower end, the base for the tax would be about ₹15 lakh crore and not ₹21 lakh crore as cited, and the corresponding RNR will be more than 23%. The Ministry of Finance (2015d) says that the RNR for the centre and the state is estimated to be 5.64% and 6.34% respectively. The combined RNR is determined at 11.98%. The latest estimate of combined GST by the committee of the Ministry of Finance headed by the chief economic advisor (CEA) is 19%, and that by Kavita Rao of the NIPFP is around 23% based on different assumptions (Kavita Rao 2016). Therefore, there is a huge confusion regarding the RNR. There is no question of the average combined RNR being less than 20%. If the actual GST rate is less than the RNR, the combined indirect tax revenue of the centre and the states would come down as a proportion of GDP and if the actual rate is higher than the RNR, there would be revenue gain but it would be, *ceteris paribus*, inflationary and detrimental to inequality and growth.

Conclusions and Policy Implications

The major concern confronted here is about the future of Indian fiscal federalism and the degree of inequality. So the government needs to seriously consider beyond the cost-benefit analysis while undertaking the tax reform. The GST should be carefully structured keeping in mind all the possible trade-offs.

Government should focus more on improving direct tax-GDP ratio for arresting the inequality. Each state should be able to set their own SGST. The calculation of RNR for central government should be done separately for determining the CGST rate, which would be uniform across the states. Government also needs enhance growth rate keeping in check the inflation as well as improve the compliance rate also by reducing corruption and improving efficiency in administration.