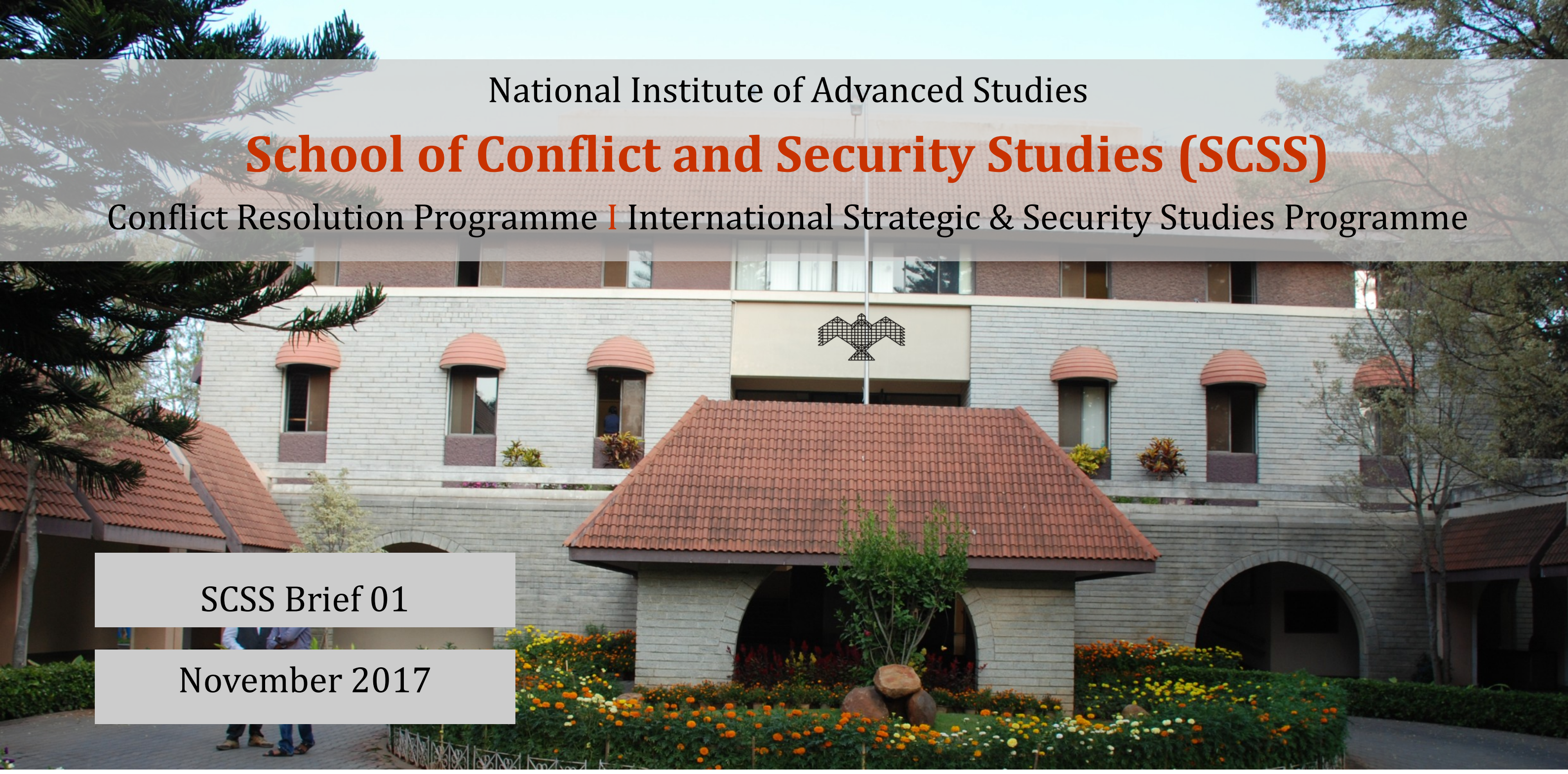

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The Great Indian GST Debate

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The School of Conflict and Security Studies (SCSS) is one of the four Schools at NIAS and consists of two programmes — Conflict Resolution and International Strategic & Security Studies.

The SCSS Brief is a new initiative of the School, focusing on contemporary themes.

The recent reduction in the rates of GST has seen the unusual phenomenon of both the ruling BJP and opposition Congress rushing to claim credit for the decision. Whatever may be the validity of these claims their competitive agreement suggests that the latest changes in the GST are without doubt a good thing. Nothing could be further from the truth. Instead, the cumulative effects of the rush into GST and the selective withdrawal are likely to leave a severe negative impact on an economy that is already seeing depressed growth rates.

In order to see what is really happening we need to move away from the complicated details of GST and go back to the basics. The Goods and Services Tax is based on two economic arguments: the benefits of a Value Added Tax, and the idea of one nation, one tax.

In economic theory the rationale for the Value Added Tax is a very strong one which can be demonstrated by a simple example. Take a product in which a basic material is used to produce an intermediate product which in turn is used to produce the final product. Let us say the value added at each stage is Rs 1000 and the final product is worth Rs 3000. If there is a Value Added Tax of 10 percent on each of the stages, the producer who makes the basic material ready for the intermediate producer will pay Rs 100, the producer of the intermediate product will pay Rs 100 and the producer of the final product will pay Rs 100. The total value added taxes paid will be Rs 300.

When there is no Value Added Tax the producer of the raw material will pay Rs 100 and charge Rs 1100 for his product. The producer of the intermediate product will buy the raw material for Rs 1100 and add his value of Rs 1000. On the total value at this stage of Rs 2100 he will pay 10 percent as tax, that is, Rs 210. The producer of the final good will thus buy the intermediate good at a price of Rs 2310 and add his value of Rs 1000. He will then pay ten percent of Rs 3310, or Rs 331 as tax. The total tax paid across all the stages would then be Rs 100 at the raw material stage plus Rs 210 at the intermediate product stage plus Rs 331 at the final stage, that is, a total of Rs 641.

What is to be done if the purchases that one producer claims he has made has not been recorded by the person who is supposed to have sold it to him?

Since the total Value Added Taxes would only be Rs 300, the tax burden under VAT would reduce by Rs 341. The lower tax burden would also mean lower revenue to the state and central governments. But it is assumed that since the benefit will be passed on to the consumer the prices will decline and this will lead to greater demand and more rapid growth. This in turn will lead to an increase in overall revenue. In addition the method of collection of Value Added Tax is expected to reduce the scope for avoiding taxes. This method requires the tax paid at each stage to include the taxes due at the earlier stages. The taxes on the earlier stages, as reflected in the purchases, are then treated as input credits which he can deduct from his GST. It is then in the interests of the seller of a product to record all his purchases, thereby identifying all his suppliers to the tax authorities. This is expected to spread the tax net wider and further increase revenues.

The strains on this method were evident as soon as it was implemented. As those at the later stages had to pay the tax and then wait for their input credits to come through, it was essential that the input credit could be claimed quickly. The system thus provided for monthly filings of three sets of returns into the system: sales by the 10th of the succeeding month, purchases by the 15th and overall returns by the 20th. This assumed a degree of computer literacy across all involved; something that did not quite exist. And the software too did not quite live up to expectations.

The second and more serious problem was that of mismatches. What is to be done if the purchases that one producer claims he has made has not been recorded by the person who is supposed to have sold it to him? In the current system the producer at the later stage has to pay the tax and wait for the input credit no matter how long that takes. And the problem is not just one of defaulting suppliers. We cannot also be certain that the producer at the later stage is not making a false claim for input credit.

The GST Council's response to this problem has simply been to seek to postpone, and in some cases, withdraw, the Value Added Tax. Since the GST was the result of a Constitutional Amendment this could not be done up front. What has been done is to introduce a series of steps to make the Value Added Tax part of the exercise ineffective. It has been decided that till March 2018 all that will be filed would be the returns on sales. Without filing of returns on purchases there is no question of claiming input credit, let alone receiving them. Thus the Value Added Tax has been postponed for all commodities to March 2018.

The GST Council has also increased the exemptions from Value Added Tax. Under the Composition Scheme of GST those below a certain turnover can pay a flat, and nominal, rate of tax without the hassle of multiple filings. But they would also not be eligible for input credit. The latest changes include raising the turnover limit for the Composition Scheme to Rs 1.5 crores. And in a possible sign of what is to come, the GST Council has, in the case of restaurants, decided to lower the rates and do away with input credit altogether. Without input credit the tax is not restricted to the value added.

With the VAT element on the back foot, if not on the way out, GST is now reduced to primarily a matter of one nation, one tax. Mr Rahul Gandhi has not just supported the reduction in the rates but has also demanded a single rate for the entire country. He, like the Government and the GST Council, is clearly driven by the need to improve the ease of doing business, particularly for foreign investors. A single tax rate would ensure that once a decision is made to invest in India it does not matter, as far as indirect taxes are concerned, where the industry is located or indeed what the product is.

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though, is far from beneficial. To begin with an indirect tax is by nature unequal. Since it is paid by whoever buys the commodity it places the same burden on the richest in the country as it does on the poorest. In practice, the GST Council has been forced to recognize the need to distinguish between commodities that are consumed by the poor and those by the rich and has come up with putting most goods and services under five different slabs of 0, 5, 12, 18, and 28 percent. And all that the latest changes have done is to reduce the number of taxes in the higher brackets.

But the impact of an indirect tax on the poor is not just through those who pay it. The tax can also affect the demand for a good or service. It is quite likely, for instance, that those using a plumber can afford to pay a tax of 18 percent. But as long as there are plumbers available in the informal sector, the users of this service can simply take the tax-free option. Plumbers who register with, say, online service agencies, would then be the losers.

The idea of one rate across a large and diverse country also completely ignores the challenge of regional diversity. There is now increasing evidence of a very substantial proportion of workers in the eastern states like Bihar and Jharkhand getting work for less than six months a year. If these backward states are to try to attract industries they need to be able to offer any concessions they could. GST has ensured that they can no longer offer concessions in indirect taxes.

The strategy of placing the interests of global investors above that of the local economy has been followed before. In the effort to attract foreign capital to our stock markets conditions were created that led to the demise of the regional stock exchanges. The end of local stock exchanges made it more difficult for local industry to tap the capital market and may well have contributed to the current slump in private investment in India.

The course that GST is taking suggests that the next in line to pay the price of wooing foreign capital would be the local economies, particularly in the more backward regions of the country.

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