



THE HINDU CENTRE

for

Politics and Public Policy

The Arena << Current Issues



Interview

Goods and Services Tax may not really be the biggest tax reform: Parthasarathi Shome

S. Rajendran

May 19, 2017



The Hindu Union Finance Minister, Arun Jaitley, chairing the First Meeting of the GST Council, with Minister of State for Finance, Santosh Kumar Gangwar (right) and Hasmukh Adhia (left), Revenue Secretary, at Vigyan Bhavan in New Delhi on September 22, 2016. File photo: Shanker Chakravarty

The Goods and Services Tax (GST) is regarded as one of the biggest tax reforms since Independence (1947). Do you concur with this claim made by the authorities including a section of the political parties?

If the proposed GST structure was closer to the ideal, it would comprise fundamental tax reform. If however, one examines the proposed structure of the GST, it becomes difficult to view it as one of the biggest tax reforms since independence. In earlier periods, in 1996-97, the income tax structure was fundamentally altered with a significant cutback in the rate structure to 30, 20 and 10 per cent which encouraged work effort and improved revenue intake. A decade later, the value added tax (VAT) was introduced at the level of the States as a prime example of Centre-State fiscal cooperation. This radically altered the earlier State-level Sales Taxes. Again revenue intake shot up while providing impetus to business.



In that context, if one is calling the new tax a GST, it should not have differentiated between goods and services; yet that differentiation will continue as before with concomitant adverse impact on litigation. Second, an administrative requirement will make it essential for inter-State dealers to register in every State they trade in. This goes against the common market principle that GST was supposed to usher in. Importantly, third, it also means that a trader can be picked up for audit in any of these States thus making tax compliance difficult if not impossible for taxpayers. Fourth, the Centre and the States have brought under their respective control the same taxpayers even at lower turnover levels thus implying an increased compliance burden on taxpayers with tax administrations at both levels to deal with. Thus the various tax administrations—horizontally across States and vertically between the Centre and States—are increasing their power with little perceptible increase in their own accountability. The list goes on.

I would not like to comment on political parties though the question that comes to mind is that, irrespective of politics, it is crucial that the fear of tax terrorism should not be set in motion if GST is to be a success or if tax reform across the board is to

take hold.

With the GST a reality, is there not a need to reform the Income Tax structure (direct taxes)? Reforms and rationalisation of income taxes will translate into comprehensive changes in the tax structure as a whole and will go a long way in curbing unaccounted money.

A Direct Tax Code (DTC) had been carefully developed and completed in 2009, revised in 2010, finalised in 2013, examined by the Parliamentary Committee on Finance whose comments were addressed meticulously, was cleared by line Ministries, and ready to go to Cabinet in 2015, got delayed, and then general elections took place. The incoming policymakers declared that the DTC would be set aside since most matters therein had already been addressed. The reality is that there is a vast area of income tax policy improvement that remains incomplete. Indeed, the authorities are increasing their administrative powers for example on search and seizure. They appear to be at

variance with the Supreme Court's opinion that explanation should be provided to the taxpayer after a case is completed as to the reason for why such a drastic step was taken against them. By the way, India uses such draconian methods much more so than comparable countries.

At the same time, in terms of the Income Tax structure, new activities are being given tax incentives where investments protect the rich from high tax rates. Inequity is built into the tax structure, another example being the exemption of one residence irrespective of its value while a lower middle class person has to pay presumptive tax on even a small second home that may have been acquired towards the end of a professional career. And changes in the colour of successive administrations have not resulted in corrective steps in such aspects of the Income Tax law. Thus claims of equity within the income tax structure are unfounded. The only solution is to revisit the 2009 DTC and undertake measures proposed in it.

Will the new GST lead to an increase in the incidence of taxes? The common people including the trading community have no clarity on this matter.

The GST is being introduced hopefully on a revenue neutral basis for the structure as a whole. But there are bound to be winners and losers among States' revenue authorities, among producers and dealers, and among consumers. So there is bound to be some dissatisfaction though the authorities cannot be blamed on this account. What is important however is to install mechanisms to monitor egregious malpractice that could occur in particular during the early implementation period. Thus it is important to put in place a Monitoring Cell (MC) to check if excessive prices are not being charged by retailers and many such challenges that are likely to appear. This is not unknown internationally when a GST is introduced for example in South Africa where such a MC played a crucial role in checking the immediate ramifications of the new tax. Yet in India an MC was there in the first draft of a GST Bill but for some unknown reason was later removed.

Incidence of taxes can also be affected adversely by administrative practice. In its newest move, the CBEC has reiterated its refusal to issue refunds to business taxpayers until unjust enrichment is disproved by them. This would imply that before obtaining any refund when the tax is reduced, they would have to prove that they have reimbursed the associated tax benefit to all their customers in full. This is an impossible task even as argued by several ex-high officials of the Department. It is therefore noteworthy that, in retirement, many officials proffer views in opposition to the current official position. The point here is that instead of modernising tax administration practices, field experience in some areas seems to reveal movement away from administrative modernisation.

It is envisaged that the GST will be one indirect tax to be implemented across the country and that the country will emerge as one unified market. There are serious doubts over this claim following the pressure being exerted by the State Governments on the Centre. May we have your views?

It is difficult to visualise a unified market when States will continue with overlapping and cross-cutting administrative powers, for example through registration by taxpayers in every trading State and, relatedly, the possibility of audit. This likelihood had been well known and for many years the Centre had resisted demands from the States to put in place a splintered structure. However, it is obvious that the Centre finally succumbed to the States in introducing a tax full of administrative excesses. This is unlikely to command acceptance internationally. Businesses will continue to face truncated markets and have to differentiate each production activity from another, thereby making the processes of production and distribution more complex in the name of transparent tax administration. This fallacy will be experienced after the GST is introduced.

Finally, a reformed tax is not meant for the authorities. Whether the Centre or the States, the GST is not for garnering revenue through rates or administrative constraints on economic productivity. A reformed tax is one which reduces production distortions and administrative hurdles, thus clearing the way for higher productivity of goods and services. That, in turn, will produce more and add up to a higher GDP which should then generate more revenue for the authorities. In the way GST is being structured, however, it appears that capturing revenue is the first goal of the authorities. In this, the very objective and the tools to support it are flawed.

It is strange that petroleum products, alcohol etc are kept out of the purview of the GST although these are very important products and the multiple taxes on them result in a huge burden on their consumers. One of the latest is the drought cess on petroleum products imposed by the State of Maharashtra. The State of Karnataka imposed a one per cent cess on petroleum products (over two decades ago) to raise money for the implementation of a mass rapid transit system in Bengaluru and this cess is yet to be withdrawn despite the commissioning of the metro rail. Are not all these improper and unethical given the stand in favour of a unified market?

Petroleum and electricity are essential inputs in the supply—production and distribution—chain. By keeping these out, both upstream and downstream cascading will occur. Let me explain. First, there will be a tax on petroleum in every State though it will not be under GST. Therefore the tax paid cannot be credited out by businesses who pay the tax when they buy and use petroleum products. Second, petroleum being outside GST, petroleum companies themselves—since they are excluded from GST—are unlikely to get any credit for the GST that they will have paid on their own inputs. Thus petroleum companies will add the tax they will pay on inputs into their product price; and businesses that purchase petroleum will build in the tax they pay on their petroleum input into the sale price of their product.

Thus there will be double cascading. The same double cascading will occur for all excluded inputs, in effect continuing the cascading of taxes as at present, with concomitant distortionary production decisions and, therefore, the pricing of products. Those products that use more excluded inputs will set prices relatively highly vis a vis those products that use less excluded inputs. Consequently, the structure of relative prices that emerges will not reflect consumer preferences that should ideally determine all product prices.

As far as alcohol is concerned, its exclusion reflects political expediency at the State level for any revenue from it can be used in whatever way they wish with little monitoring and evaluation. In the ultimate analysis, it also reflects the Centre's inability to reign in malpractices.

What proportion of transactions does the GST regime cover, is it comprehensive enough?

If one considers the exclusion of real estate from GST and all other inputs and exemptions, some estimates show an exclusion of 60 per cent of GDP from the GST base. If we ignore real estate, we could perhaps work with a figure between 40-50 per cent. In any event, a large portion of GDP is being excluded. Even if we opt for a lower number, it implies that indirect taxes paid by this excluded portion will not be credited out in the supply chain and, instead, will be embedded multiple times as the production-distribution chain moves downstream. The ultimate outcome will be continuing distortions in price determination in the economy.

Are so many rates of GST advisable, is the rate structure agreed to by the GST Council ideal?

Ideally there should be two rates—a general rate and a lower rate for popular consumption items. We are moving away from it. I can imagine that the States disagreed and finally the Centre agreed. But the Centre's resolve should not have been compromised merely for the sake of having a GST.

The adverse consequences of having so many rates are many. To begin, businesses would want to be classified into a lower rated item wherever this is feasible; the administration will not agree; so such cases will end up in the courts. Second, it is not impossible that some lower-taxed items will accumulate excess input tax credit (ITC) when their inputs are taxed at higher rates. The same will be the case with exempted items that will not receive ITC. Excess ITC could remain unutilised and their refund could be severely constrained by the tax administration as is the prevailing situation. Again, improvement in business productivity or scaling back of administrative excesses under GST is unlikely to compare well with other countries when they undertook similar tax reform. India's GST cannot therefore be benchmarked successfully.

Will the GST help the country in attracting foreign investments in a big way?

Despite all the challenges mentioned above, if the GST is able to improve the ease of paying taxes, then foreign investment should receive an impetus. The fact is that for 2015-16, India has been ranked by the World Bank at 172 out of 190 countries (for ease of paying taxes including post-tax payment activities such as audit) for the income tax. However, tax matters are not the only constraint for foreign investment. Many non-tax parameters also play a role. Nevertheless, it is also true that if the tax administration is rudimentary, then its adverse importance of the tax aspect rises in the list of determining factors.

Even today, by and large, foreign investors continue to be dissatisfied with Indian tax administration practices at the field level. This needs to change so that business confidence returns. GST will be an important test to check if the corner has been turned and the business community experiences a perceptible improvement in the ease of paying taxes. The tax authorities both at the central and state levels have to be given the opportunity to work on this and achieve success.

What will be the direct benefit to the end consumer? Will GST result in reduction in costs at least in the prices of essential commodities and consumer goods?

Reduction in prices can occur only if the supply of goods and services increases after GST is put in place. That will occur if GST reduces economic distortions compared to the mix of taxes it replaces—excises, service tax, VAT, the taxes on imports, smaller State taxes, local levies and so on—and certainly the potential for improvement is there. However I can visualise the various tax administrations becoming overzealous and consequently the advances suffering setbacks.

If however the supply chain yields a better—demand driven—mix and a higher quantum of goods and services, inflation across the board should be less. That would certainly benefit consumers. Even if demand keeps increasing, as long as supply increases faster, inflation should remain under control.

The State Governments have jointly registered Goods and Services Tax Network (GSTN) as a not-for-profit, non-Government Company to provide shared IT infrastructure and services to Central and State Governments, tax payers and other stakeholders. The GSTN is working on developing a state-of-the-art comprehensive IT infrastructure including the common GST portal providing frontend services of registration, returns and payments to all taxpayers, as well as the backend IT modules for certain States that include processing of returns, registrations, audits, assessments, appeals, etc. How do you view this shared IT network since all GST transactions have to be necessarily online.

The shared IT network is a good feature. First, the Centre and States are sharing the same platform. Second, the public and private sectors are sharing the responsibility to deliver efficient processes. In the income tax area, it already exists, for example at the Centralised Processing Centre (CPC) for income tax returns in Bangalore, as well as in Vaishali near New Delhi. These programmes have gone well.

The challenge in the case of GSTN is of course deeper since both States and the Centre are involved and revenue intake has to be correctly released to all of them. Further, all the administrative procedures that are mentioned in this question have to be successfully completed. However, from all reports, the preparations are going well since the private sector will be observed and tested with an eagle eye by Government. Some have complained that the involvement of the private sector will cost the Government considerable financial resources. But, if past experience is to be relied on, this argument has to be set aside in order to achieve uncompromising success.

The common belief is that the GST will bring down the high level of corruption in the department of commercial taxes. The high incidence of corruption, visible even at Sales Tax checkposts on the National and State Highways, has a cascading effect on the high cost of goods and services.

Unfortunately, corruption flows through the veins and arteries of India as reported relentlessly by both Indians and foreigners. I have maintained that corruption is a double-edged sword; it cannot occur from one side only. The acquiescence of the general public to corruption in order to take the short cut has vitiated society. That has enabled corruption. As corruption spreads, it becomes more acceptable, thus fuelling the fire even further. Fearfully, the most powerful are most corrupt, its obverse side being the spread of extreme poverty. Poverty has become a political tool and we Indians shamelessly accept it as inevitable. Foreign well-wishers cannot comprehend this aspect of our society though they may love India just like we do.

Thus I believe that the GST by itself will have little impact on corruption. We have an impeccable ability to subvert procedures. Even a measure such as demonetisation was being successfully subverted immediately after it was set in motion. Nevertheless, inasmuch as computerised processes "successfully" replace many face to face transactions under the GST, corruption should be checked somewhat within this narrow sphere. That would comprise a good beginning. But a comprehensive solution to corruption lies elsewhere.

In terms of India's political framework, and as Prof. Prabhat Patnaik points out, the constitution's "basic structure", does not the GST run counter to federalism, notwithstanding constructs such as 'cooperative federalism'".

The GST structure cannot be changed by the Centre alone. States have to participate in the GST Council to make any change. In this, the framework has achieved a workable balance between the powers of the Centre and States. In fact the GST is better than the Central Sales Tax (CST)—which will be replaced—where the Centre set the rates of tax on inter-State trade and the States collected and retained the revenue. In the case of GST, the Centre cannot any longer carry out any change unilaterally. Thus there is give and take on both sides and the emerging balance is an acceptable one. I do not believe that the GST amounts to States ceding for perpetuity substantial taxation powers to the Centre. Instead, if all goes well, I would not be surprised to find a steady emergence and growth in fiscal responsibility on both sides.

Rather, my question is whether all the time and resources spent to decide matters between the Centre and States be justified in the form of improvements for businesses, their productivity, the impact on GDP, on resultant tax revenue, and comparability and benchmarking of India with the rest of the world. Or are we going to be unable to change the truncated, autarkic economic environment that we essentially have irrespective of the colour of administrations that come and go. If the GST can assist in garnering foreign and domestic investment and generate economic growth while containing inflation, it would have gone a long way. I hope so, despite the many faultlines in its structure and probable gaps in its administration.