

ANALYZING INDIRECT TAX REFORMS IN INDIA: A STUDY OF GOODS AND SERVICES TAX

RUKMINI BHATTACHARJEE

ASSISTANT PROFESSOR FROM AMITY UNIVERSITY KOLKATA

Abstract

A tax is a compulsory exaction of money by public authority, for public purpose, enforceable by law and they are not for payment of services provided. Indirect tax is something that a manufacturer pays to the Government of his country. The burden of tax payment is on the end consumer as they are the ones purchasing the products. Indirect tax is a tax that can be passed on to another individual or entity. Indirect tax is generally imposed on suppliers or manufacturers who pass it on to the final consumer. There are many indirect taxes applied by the government of India. Taxes are levied on manufacture, sale, import and even purchases of goods and services. These laws aren't also well-defined Acts from the government, rather orders, circulars and notifications are given out by relevant government bodies to this end. As such, it can be cumbersome trying to understand every feature of indirect taxes in India. Indirect taxes are touted to be streamlined following the introduction of the uniform Goods and Services Tax (GST).

Tax reforms are usually initiated for changing the overall structure of taxation to increase revenue generation and from recurrent taxes on residential property and less from income taxes. Major changes in tax systems of countries with a wide variety of economic systems and levels of development are imperative. The purpose of such reforms may vary from one country to another but emphasis on reforms is widely guided by the development strategy and philosophy of changing times. In many developing countries, the most prominent reason for tax reforms has been the need to enhance revenues to meet impending fiscal crises. As Bird (1993) states, "...fiscal crisis has been proven to be the mother of tax reform". One of the most important reasons for tax reforms in many developing and transitional economies has been to evolve a tax system to meet the requirements of international competition (Rao 1992). The transition from a predominantly centrally planned development strategy to market based resource allocation has changed the perspective of the role of the State in development. The transition from a public sector based, heavy industry dominated, import substituting industrialization strategy to one of allocating resources according to market signals has necessitated systemic changes in the tax system. There have been major changes in tax systems of countries with a wide variety of economic systems and levels of development during the last two decades. The motivation for these reforms has varied from one country to another and the thrust of reforms has differed from time to time depending on the development strategy and philosophy of the times. In many developing countries, the immediate reason for tax reforms, has been the need to enhance revenues to meet impending fiscal crises. As Bird (1993) states, "...fiscal crisis has been proven to be the mother of tax reform".

Goods and Service Taxes (GST) is a significant part of tax reforms in India and has made indirect taxation on business irrespective of size of the business and change the way the economic functions. The Goods and Services Tax was created by the 101st Amendment of the Constitution of India. The Act replaced 7 indirect taxes and duties and 13 cesses created by the Centre and 7 indirect taxes and duties by the states. It promised a common market and displacement of the inspector-raj. GST is IT driven, thus promises transparency and efficiency and curb corruption and leakages. GST Council is the federal dispute resolution body. An amendment was also made to provide compensation to the states for the loss of revenue on account of the GST legislation. The distribution of GST among the Centre and the states is guided by the amended Article 270(1A). Under the amended Article 269A (1), IGST can be levied and collected by the Union and apportioned between the Union and the states as provided by the Parliament by law and based on the recommendations of the GST council. The Centre cannot levy any surcharge on the GST to appropriate it for the Union's purposes. The amended Article 279A provides for the creation of a GST Council. The GST council examines issues related to GST and makes recommendations on parameters like rates, exemptions and threshold limits. The Council functions with the Union Finance Minister as the Chairman with the state Finance Ministers as the members. Every decision of the Council shall be taken by a majority of 75% vote. The Council functioning under Article 279A shall aim to create a harmonized tax structure and common national market. The Council needs to develop a mechanism to adjudicate disputes arising between the governments and on the basis of its recommendations. The GST (Compensation to States) Act, 2017 provides the Parliament may by law on the recommendations of the GST Council may provide compensation to the states for the loss of revenue owing to the imposition of the GST. The financial year 2015-2016 is to be taken as the base year for the calculation of the compensation to the states. The payment to the states is made from the collections in the GST compensation fund.

By 2018, it was reported that of the 193 nations with UN membership, 166 nations including all OECD member countries except the United States of America had implemented the VAT on goods and services in one form or another. Developing countries mostly replaced their cascading domestic trade taxes with the VAT to reduce distortions or as a measure to recoup revenue loss which may result from the reduction in tariffs on joining the WTO. The GST was adopted to function as an appropriate instrument to offset revenue losses from reducing tariffs. In most of the countries the transition to VAT/GST has been relatively smooth because the tax was essentially replaced by the central government. Even in the federal countries like Australia and Germany it was levied at the central level.

Background:

Good and Services Tax (GST) was adopted as a part of the indirect tax reforms in India with the objective to simplify indirect taxation in India. In the pre-GST regime years, a multiplicity of taxes operated in India. The central excise duty and service was levied by the Central Government and VAT and Entry Tax was levied by the state governments. The cascading effect of taxes i.e., tax on tax, at various stages as credit of taxes levied by one government was not available against payment of taxes levied by the other. To simplify the complexities in the imposition and collection taxes to improve the effect of taxation on the economy, GST was introduced. GST was conceived as a comprehensive indirect tax levied by subsuming all central and state levies with a single unified value added tax to transform the nation into one single market and it is likely to have huge impact on both small and big businesses with a substantial impact on the economy. The elimination of the multiplicity of taxes will reduce the compliance cost and will gradually phase out the Central Service Tax (CST).

The idea of national GST in India was originally mooted by the Kelkar Committee in year 2004. The first official pronouncement for the introduction of the national GST was mentioned in the Budget speech on the 28th of April, 2006 by the then Finance Minister and the proposed date to roll out GST was fixed as 1st April, 2010. The Empowered Committee of State Finance Ministers (EC) formulated the design of the state VAT and was also assigned to lay down the roadmap and the structure for the GST. The representatives of the states as well as the Centre constituted the Joint Working Group (JWG) of officials to examine various aspects of the GST and to prepare reports particularly on exemptions and thresholds, taxation of services and taxation of inter-state supplies. On the basis of discussions with the Centre the EC released its First Discussion Paper (FDP) on GST in November of 2009 which laid down the features of the GST and initiated Centre-state discussions at length on them.

The Thirteenth Finance Commission (THFC) was assigned to assess the revenue impact of the introduction of goods and service tax. In its report, based on the recommendations of a task force recommended a highly uniform and centralized structure that does not adequately recognize a tax reform in a multi-level fiscal system. The study was underlined by the need for a model that establishes uniform rates of tax and allows states to vary beyond a floor, with a fixed classification of commodities and services to enable to choose an appropriate rate to ensure that their revenue requirements are met. The report of the task force constituted by the THFC was endorsed in the final report of the THFC (2010-2015).

THFC recommended that “both the Centre and the States should conclude a Grand Bargain to implement the model GST”, which comprise of five elements:

1. There will be a prescribed design for the GST as a consumption-based tax subsuming the bulk of all indirect taxes, which includes stamp duty and state exercises. It will be a single rate regime with few exemptions to have a uniform threshold for the centre and all states, uniform rates of tax across all states, and also would include a proposed design for treatment of interstate transactions.
2. There will be an emphasis on harmonized tax laws and procedures for administration, and common dispute resolution and advance ruling mechanisms as well as simultaneous implementation by all the states.
3. There will be a binding agreement between the centre and the states on the design as well as the rates of tax to be adopted and the conditions under which the rates can be altered. According to the proposed scheme of THFC for decreasing the rates, all states will have to agree, but for increasing them, only two-thirds need agree. The power of veto will be vested in the Centre.
4. In case of any violation of the agreement, disincentives in the form of withholding state-specific grants and GST compensation grants will apply.
5. There will be a phased implementation to provide for the delayed incorporation of real estate transactions into the base and allowing for a two-rate tax in place of one in the initial years of implementation, with an agreement to move forward before 31st December, 2014.

The GST to be adopted as emphasized by the THFC, has to be consistent with all the elements of the “Grand Bargain” as explained above. Otherwise, a compensation package of Rs.50,000 crore proposed by it will not be disbursed.

Primarily the one of the important arguments driving the reforms towards a comprehensive GST in India is to remove all impediments to forming a single common market covering all the states. The previously existing regime with incomplete coverage at the state level in VAT with limitations on input tax credit and source-based taxation of interstate transactions which segmented the market as a result the benefits of economies of scale to producers in the country. This made the regime a necessary one.

The definitions of common market mostly refer to a group of entities, usually nations which eliminate or reduce barriers on the movement of goods and services as well as productive inputs which include capital and labour. The structure of taxes which are introduced to create common markets may have some barriers on the movement of goods and services in a country. For example, in India interstate sales are subject to central sales tax (CST), but consignment transfers were not subject to CST, it was optimal for firms to set up depots in all the states to convert all supplies to the state into consignment transfers and avoid CST.

Constitutional Framework:

The Statement of Objects and Reasons as appended to the Constitutional Amendment Bill states the object of the GST is:

- a) To have common national market;
- b) To avoid cascading effect of taxes.

The introduction of the GST was sought to make India made goods and services more competitive in the domestic and international markets. This will eventually boost economic growth and make the taxation system transparent which will be easier to implement. The Constitutional amendment for the introduction of GST was made on 16th of September, 2016. This amendment of the Constitution gave the Centre and the states concurrent power to levy and collect the GST on both goods and services.

The said amendment to the Constitution of India, inserted Article 366 (2A) defines Goods and Services Tax (GST) to mean to tax on supply of goods or services, or both, except taxes on supply of alcoholic liquor for human consumption. Inter-state stock transfers and branch transfers is to be subjected to GST. New Article 366(26A) defines service to mean anything other than goods.

1st of July, 2017 was fixed as the date from when GST would come into force and to that effect, certain Acts were passed which are as follows:

1. The Central Goods and Service Tax Act, 2017 (CGST).
2. The Integrated Goods and Service Tax Act, 2017 (IGST)
3. The Union Territory Goods and Service Tax Act, 2017 (UTGST)
4. The Goods and Service Tax (Compensation to States) Act, 2017 (Compensation Cess).

These above-mentioned Acts for example the SGST and UTGST were passed by the twenty-eight states excluding the then state of Jammu and Kashmir and the Union Territories with legislature-Delhi and Puducherry by 30th June, 2017. The then state of Jammu and Kashmir passed SGST Act on the 5th of July, 2017. All these Acts were effective from the 1st July of 2017. The CGST and IGST Acts extends to the whole of India except the state of Jammu & Kashmir.

The Constitutional Amendment to implement GST replaced the following taxes which were levied and collected by the Centre:

- a) Central Excise duty
- b) Duties of Excise (Medicinal and Toilet preparations)
- c) Additional Duties of Excise (Goods of special importance)
- d) Additional Duties of Excise (Textiles and Textile products)
- e) Additional Duties of Customs
- f) Special Additional Duty of Customs (SAD)
- g) Service Tax
- h) Central Surcharges and Cesses so far as they relate to supply of goods and services.

State taxes that would be subsumed under the GST are:

- a) State VAT
- b) Central Sales Tax
- c) Luxury Tax
- d) Entry Tax (all forms)
- e) Entertainment and Amusement Tax (except when levied by the local bodies)
- f) Taxes on advertisements
- g) Purchase Tax
- h) Taxes on lotteries, betting and gambling
- i) State Surcharges and Cesses so far as they relate to supply of goods and services.

The GST Council shall make recommendations to the Union and states on the taxes, cesses and surcharges levied by the Centre, the states and the local bodies which were subsumed in the GST. The Council is mandated to be constituted within 60 days of the commencement of the GST. The GST Council should consist of the following -

1. The Union Finance Minister as Chairperson
2. The Union Minister of State in charge of Revenue of Finance
3. The Minister in-charge of Finance, Taxation or any other Minister nominated each state.

The functions of the GST Council are as follows:

1. To make recommendations on the taxes, cesses and surcharges levied by the Union, states and the local bodies that may be subsumed in GST;
2. The Goods and Services that may be subjected or exempted from GST;
3. Model GST laws, principles of levy, apportionment of GST levied on supplies in the course of inter-state trade or commerce, and the principles that govern place of supply;

Besides, these the threshold limit of turnover below which goods and services may be exempted from GST and any special rate or rates for a specified period to raise additional resources natural disasters. A special provision with respect to Arunachal Pradesh, Assam, Jammu & Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh, Uttarakhand and any other matter related to the GST to be take care of the GST Council. The quorum of the meetings of the GST Council is prescribed as half of the total members, and every decision shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting. The Council is also vested with responsibility of establishing a mechanism to adjudicate any dispute between the Union and one or more States, or between the Union and any state or states on one side, and one or more states on the other side, or between two or more states. The GST Council is a permanent body representing the Union and all the states with powers to decide on almost all matters relating to GST administration in the country.

GST: A challenge to Fiscal Federalism in India?

The division of powers between the Central government and provinces was one of the most strongly debated issue during the Constituent Assembly Debates. There were two schools of thought - one favouring a “strong Centre” around which Provinces would revolve while another sought a fairer devolution of powers to the provinces for the purpose of efficiency and effective governance. However, the final Constitution reflected the demands and apprehensions of both the sides which is evident in the creation of three separate legislative lists under Schedule VII and the different realms of legislative powers under Article 246. Historically, the three-fold division of legislative powers were originally proposed in the Government of India Act, 1935. The powers of respective governments to legislate within their jurisdictional scope was secured by providing distinct spheres of taxation. Provisions were also made for the transfer of some taxes from the Centre to the States to support the latter in the performance of their tasks. Despite the recognition of States’ powers there was a greater concentration of powers in the Centre. The Concurrent list consisted of fields that the Centre and States could both legislate upon. However, the repugnancy of Article 254 provided that the laws framed by the Centre were to prevail in case of a conflict. The Concurrent list does not extend any taxation powers, hence the ability of the Centre and states to raise revenues for funding their activities was protected.

Indirect tax reform which has always been constrained by provisions of the Constitution of India which do not allow either the central government or state governments the authority to levy taxes on a comprehensive base of all goods and services and at all stages of production and supply. All indirect tax reform in India need to operate within the constitutional constraints. The literature discussed above referred to three approaches to the design of such a tax, i.e.

- (i) Concurrent Dual GST
- (ii) National GST
- (iii) State level GST (Rangarajan and Srivastava, 2008).

These models were sought to be enforced through Constitutional amendments. The national GST model adopted would closely approximate the Australian case. In this model the entire GST would be collected by the Central government with the result that India would become a unified common market. The logic of the GST requires that it be imposed on a comprehensive tax base of all goods and services and at a single rate. However, governments often violate these principles. In Australia, for example, food is exempt from GST. The institution of a GST in India in any form requires a paradigm change and, hence, a substantial realignment of the taxation powers of the states and the centre (Rao, 2008).

Fiscal Federalism, which refers to the distribution of authorities between the Centre and States for collecting and administering revenue in their respective areas, is an example of how these elements make India quasi-federal in nature. The Indianized GST paradigm, built on the edifice of GST Council and three key pillars of revenue neutrality, tax sharing between the Centre and the States and the provision for GST compensation, has been designed towards fostering cooperative federalism. However, with the roll out of the GST, the states were under the impression that more ground have been ceded to the Union and the freedom that they enjoyed with regard to changing the rates of VAT, the main source of their own tax revenue, has been completely lost. Another concern of the states is the likely revenue loss following the introduction of the GST. It is also pointed by the states that the decision making power of the GST Council is tilted in favour of the Union as it can veto any proposal before the GST Council. Another important concern of the states is the decision of the union government to bring petroleum products under the purview of the GST sooner because VAT on petroleum products is a major source of revenue. The Union also has its share of concerns but it is in favour of cross empowerment but such a policy will result in taxpayers interfacing the multiple agencies. These concerns are based on the institutional vacuum to minimize transitional cost of intergovernmental bargaining and conflict resolution and the GST Council provides an interesting innovation for such a task. This model has prospects of fostering greater understanding between the union and the states as well as among the states.

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