Editorial

Goods and service tax (GST): how and why

Governments, like other organizations, need resources (revenue) for their proper functioning. The world over the major sources of revenue for them are different types of taxes. Broadly, the taxes are classified as direct and indirect. Direct taxes are paid, as the name suggests, directly by the residents of the country as a defined part of their income. The residents may be physical persons or legal entities, such as business firms and other organizations. In common parlance, what individuals pay is termed as income tax and what corporate firms pay is known as corporate tax.

The other tax is indirect. This tax is paid on the expenditure that an individual makes for buying goods for consumption and/or for receiving services. The tax is known as indirect since it is not paid directly by a payer to the government but through the economic agent from whom the goods are purchased or services are received. The goods and/or services reach a consumer by a series of processing through a complex supply chain. Therefore, the levy of this tax is much more complex than a direct tax, levied on the income of the payer.

Different countries have experimented different methods of levying indirect taxes. But, gradually, the most common format that the governments, the world over, have been zeroing in on is known as value added tax. Goods and services tax (GST) is another name for this.

France introduced this tax quite some time back, namely, in mid-50s. Other countries did so at different times. For example, New Zealand introduced it in 80s, Canada in early 1990s, Singapore in mid-1990s, Australia in the year 2000, Malaysia a couple of years back and so on. All these countries and others have had reasons to do so. Some of these reasons are: to reduce tax evasion, to reduce compliance and administrate costs, to reduce price distortions, to reduce the cost of doing business, etc. Above all, it is also meant to bring about transparency and elimination/reduction of uncertainty in the tax system.

India has introduced GST very recently, that is, in July 2017. It is expected to increase the efficiency of tax collection, reduce corruption and make it easy for inter-state movement of goods. It seeks to make India a single market in terms of tax for any good or service. It has been rightly said that it would lead to one-nation, one-tax. Since India is the latest country to introduce this form of indirect tax, let us look at its relevant aspects.

India has a federal structure of governance where there is a central government and there are several state governments. The GST is meant to be levied as a combination of central GST and state GST. The concept of GST is that it is levied at all stages of manufacturing or value addition until the final stage of consumption. Only value added is taxed at each stage along the supply chain. Though it is levied at each stage of supply chain, the tax, itself, does not become part of the cost of the product or the service since a credit for it is taken at each subsequent stage. Finally, only consumer of the good or the services bears the burden of the tax. Thus, it facilitates a seamless credit structure, irrespective of the number of stages until the purchase is made by the final consumer in the chain.

It is a major reform in tax structure of any country and much more so where the issue of transparency in transactions is important. India has been debating this reform nearly for one-and-half decade before it could bring in the same through a multi-step legislative process, involving the necessary changes in the constitution of the country and enactment of appropriate laws at the central level as well as at the level of states. Such a major reform required not only wading through a complexity of technical issues but also dexterous

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handling of negotiations at the political level since not all governments at the centre and in the states share the same political ideology.

The GST law in India is unique in many ways, though it cannot be entirely different from the provisions in vogue in other countries. The GST has subsumed various taxes and levies such as excise duty, service tax, sales tax, octroi tax, luxury tax, etc. The taxes on activities such as lottery, betting and gambling have all been subsumed in the GST. This tax is levied almost on all goods with few exceptions such as petroleum product, which may be brought under this tax some time later. Certain states may stand to lose their revenues. So they will be compensated for this loss for a period of five years. The GST law seeks to work on the federal principle, through a body, known as the GST council. This is an empowered body that includes the finance ministers of all states, with the central finance minister as its chairman. This body has power and responsibility to decide the tax rates, exemptions of items and other related matters. Its decisions are expected to be based on consensus. Yet, there is a provision for decisions, which may be based on voting. The center has a weight of one-third, while all the states, taken together, have a weight of two-third of total votes cast. In the absence of consensus, a decision will be considered valid if 75 percent of weighted votes are cast in its favor. This federal form of operation of the GST law means that the center and all the states lose their fiscal autonomy considerably in favor of a joint decision-making process.

Be that as it may, the success of this tax will depend on the factors like technology in terms of quality software, the readiness of industry to adopt it quickly, the capacity of officials to do trouble shooting as and when the problems arise, and above all, a continuous process of political consensus building.

Nowadays, India and China are talking points in business circles everywhere. The world business community watches any steps that are taken at policy level closely in terms of their potential to increase the ease of doing business. Needless to say, this reform too will be scrutinized for its consequences.

As the time passes, more data will become available for the purpose of analysis. The researchers can look forward to analyzing the consequences of this major tax reform.

Its effect can be examined on the following economic variables, among others: inflation, GDP growth, integration of national market, improvement in tax compliance, better revenue inflows for both, the center and the states, economic and psychological impact on producers as well as consumers, benefits in terms of tax administration for government as well as tax payer, visibility of transparency in transactions and so on.

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