A good and simple tax: a major step forward for India

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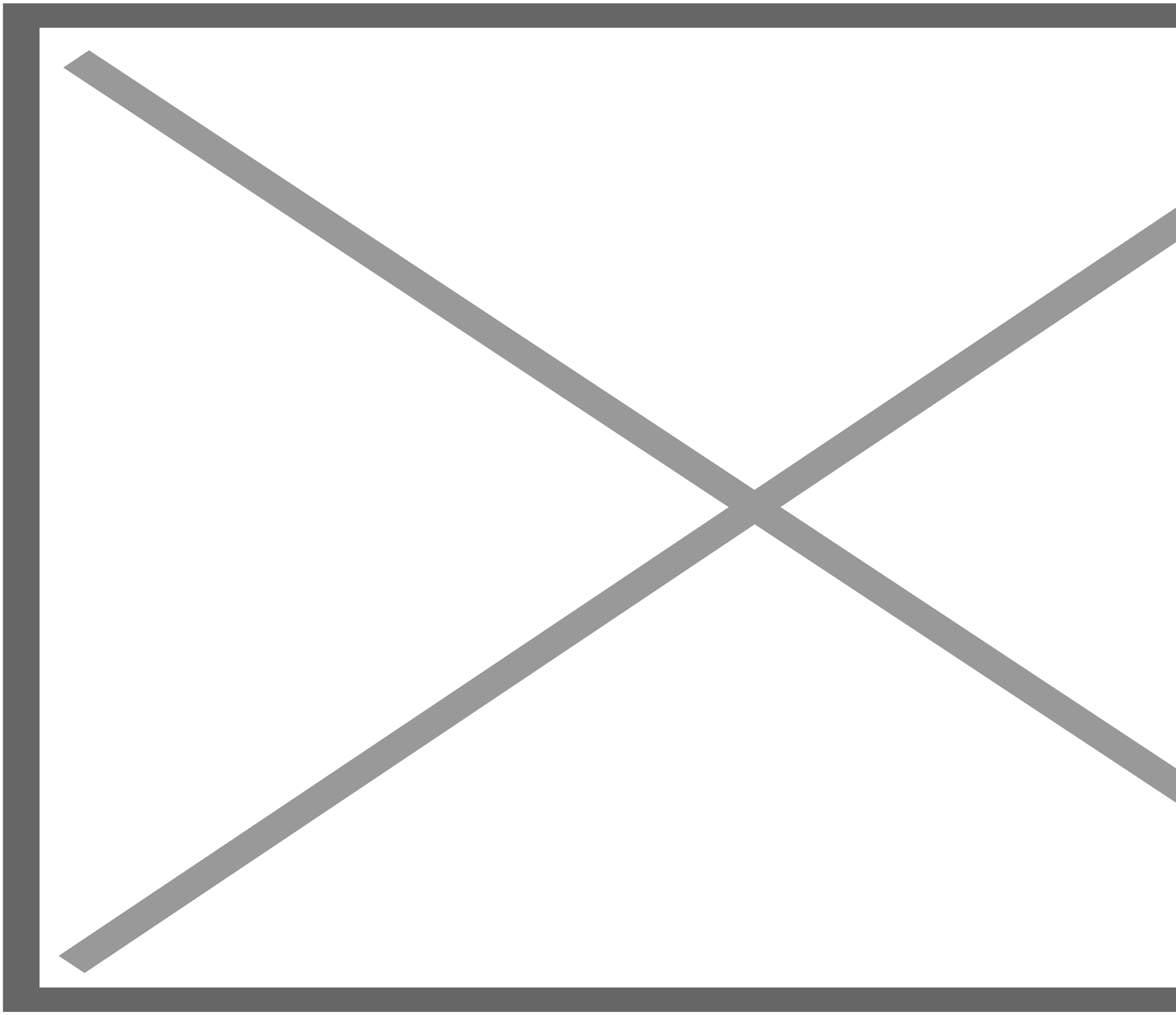

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Ram Iyer outlines the good and simple tax: India’s New GST Law

Introduction

In the last four years, India has seen a revolution in legislation, through the introduction of a new Companies Act, the Real Estate Regulation Act (RERA), the Insolvency and Bankruptcy Code (IBC), the Benami Transactions Act (to regulate proxy property purchases), demonetisation of high-value currency notes and the Goods and Services Tax (GST). In this article, we will see the impact of GST.

On 30 June 2017, India had separate VAT laws in each of the 29 states and seven union territories. In addition, there was the nationally administered Service Tax, Excise Duty and Central Sales Tax (CST) and locally administered Entry Tax and Entertainment Tax, among others. All of these involved multiple compliances, returns, payments, refunds, assessments, litigation, etc.

Complexity arose in other ways too. Input VAT credit was not available in several states. Excise Duty was an output tax on manufacture, i.e. even before the product left the factory. CST, an inter-state tax, was not available as an input credit. There were disputes between states demanding jurisdiction on transactions and re-interpreting “intra-state” and “inter-state". Inter-state goods movement was hampered by check post delays and entry tax.

On 1 July 2017, all of the above indirect tax laws were replaced by a single nation-wide GST law that even subsumed additional customs duties on imports (i.e. duties on top of basic customs duty). The Indian Prime Minister, Narendra Modi, catchily described GST as a “*Good and Simple Tax*”. In its very short history, it has gone through quite a few pain points, some of which we will see later in this article. However, considering what Indian businesses had been through earlier, GST has been quite a transformation.

Highlights of the law

The basic structure of GST is simple and similar to GST and VAT in other countries. Every business in the supply chain pays input GST and adjusts it against its output GST, effectively paying tax only on the value addition. As with any indirect tax, the final retail consumer bears the full GST cost.

India has a federal structure, where power is allocated between the centre and the states. As such, GST is broken up into components, to address the treasury needs of the centre and the states. An intra-state transaction (say, within the state of Maharashtra) would be subject to State GST (SGST) and Central GST (CGST), split in equal percentages, so that the tax is shared accordingly. An inter-state transaction (say, between Maharashtra and Kerala) would attract only Integrated GST (IGST), but in the government’s internal ledger, even this IGST would be split and shared. For example, the sale of toothpaste within the state would attract 18% GST (9% each of SGST and CGST), whereas an inter-state sale would attract 18% IGST.

Depending on their turnover, small businesses are either exempt from GST registration or can opt for a composition scheme, which significantly simplifies compliance. For instance, a small retail store opting for composition, would pay a flat 1% on all sales, would not be entitled to input tax credit and cannot charge the tax separately on its sale invoice. For this store, even the return filing requirements are much simpler.

The government set-out with the aim of limiting the number of tax slabs, with the long-term aim of having just one or two rates. At present, there is exempt, zero-rated, 5%, 12%, 18% and 28%, with an option to add cess on top, in limited circumstances. Broadly, certain essential sectors like agriculture, education and healthcare are exempt. Also exempt is interest on loans. Basic, unbranded grain supplies are zero-rated, basic consumer products are at 5%, most packaged products and manufactured goods are at 12% or 18%, most services at 18%

and lastly, certain high-end products and the so-called “sin” or “de-merit” items like tobacco and luxury cars are at 28%, with an option to add cess. Petroleum, land and electricity are currently out of scope.

The key driver

As with several other examples in India (like a unique digital ID for every Indian, electronic voting machines and online tax return filing), the key driver of GST is technology. The GST Network (GSTN) is, in fact, the backbone of the entire law. Through various individual filings related to outputs, inputs, summaries, etc, buyers and sellers will report all transaction details into the GSTN, which will then match the data.

The implications

The GST Network is forcing previously non-compliant businesses to report their transactions, since someone else in the chain is doing it! This will particularly affect unregulated sectors and businesses that try to evade taxes. The GST Network will likely be a major catalyst in re-drawing India’s compliance map and enhancing tax collection.

In general, businesses have found the new law quite good, as it reduces the compliance burden, gets rid of paperwork, allows for smooth inter-state goods movement, reduces the cost of holding inventory in different states and above all, reduces the basic cost of goods (since tax cascading is eliminated).

Inevitably, some sectors benefitted more from GST than others. For example, the automobile and cement sectors saw the tax incidence going down, while in general, the rates are higher in discretionary segments like processed foods and personal care.

The government was probably too ambitious in expecting every transaction to be perfectly reported and to find a perfect online match between the data of two reporting parties. Reality has proved to be quite different and several businesses have been unable to claim input tax credits due to mismatches. To resolve this, particularly for small businesses, the government increased the turnover band for the composition scheme, extended the filing deadlines and simplified some of the returns.

Also, to mitigate the impact on certain sectors, several initially determined rates were recalibrated.

Overall, the government has been quite pro-active in addressing stakeholder concerns.

An unexpected, but pleasant, surprise has been the exceptional co-operation between the various state government finance ministers and the centre, all represented by different political ideologies. They came together as a GST Council, in drafting the law, and remain together in the maintenance phase too. This has resulted in a model for “co-operative” federalism.

Comparison with other countries

India appears to have some of the highest GST rates and likely has more rate bands and other tweaks than any other country. However, considering the size and complexity of the country, it could fairly be called a “good and simple tax”.

Conclusion

Operationally, there is much more to happen as this law evolves. However, this is one of the most path-breaking laws in India. It will even serve as a major tax case study globally on how a huge country can use technology and federal teamwork to transform the business ecosystem.