Impact of GST on Indian Eonomy

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GST will act as a major boost to economic efficiency, tax compliance and domestic and foreign investment - Pranab Mukherjee

Goods and services tax (GST) is a comprehensive, destination based scheme of indirect taxation founded on the notion of "one nation, one market, one tax" as it does not differentiate between goods and services and will lead to merger of central and state taxes into a unified system of taxation. The GST is an indirect tax which means that the tax is passed on till the last stage i.e. it is the customer of the goods and services is the one who finally bears the tax. This is true for all indirect taxes in existence today but the difference under the GST is that with structuring of the multiple taxes the final cost to the customer will come out to be lower because of the elimination of double charging in the systemize. GST will lead to the removal of cascading effect (tax that is applied at every stage in the supply chain, without any deduction for the tax paid at earlier stages i.e. as system of tax on tax) by providing a comprehensive input tax credit mechanism. In India, there are different indirect taxes applied on goods and services by central and state government. GST is intended to include all these taxes into one tax charged on both goods and services with seamless Input Tax Credit (ITC).Thus excise duty, VAT,service tax, to name a few will get repealed and will be added into GST. For this, GST will have 3 parts – CGST, SGST and IGST. The central taxes like excise duty will be subsumed into CGST and state taxes like VAT into SGST.

Limitations of Existing tax structure

Until the VAT was passed, the sale of goods were subjected to sales tax and the entry of goods was subject to respective state enactments during which many services were out of taxation system. However, the shift to VAT model did not act as a panacea as it did not end cascading effect as the parliament and state has maintained different models of VAT and also no linkages were provided between them as the credit duties gained under state VAT could not be used to

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offset liabilities in the central VAT. Another major contributing factor to tax cascading is the Central Sales Tax (CST) on inter-state sales, collected by the origin state and for which no credit is allowed by any level of government.Also agriculture, wholesale and retail trade, real estate construction, and range of services remain outside the ambit of the CENVAT and the service tax

levied by the Centre and in many cases were not even allowed to claim the input tax credits.This shows the system suffered from a clear compliance gaps which mandates the implementation of GST which not only increase the volume of tax collection but will also lead to improvement in the international cost competitiveness of Indian goods and services.

GST Structure in In India

India has adopted a dual GST model which means that there are two types of GST in the country i.e. one levied by the centre in the form of CGST and the other by state/union territory in the form of SGST/UTGST as it is consonance with the federal polity as envisioned by our constitution makers. On a single transaction of supply of goods or of services within a state both CGST and SGST will be levied. For example- Mr.A of Uttar Pradesh is selling clothes worth Rs.5000 and assuming the rate of GST to be 18%, 9% of CGST will go to central government while other 9% to the state government.Under the new GST regime inter state exports within the country will attract a new levy known as Intergrated GST (IGST) which is the summation of CGST AND SGST. It is not a new tax but is just a system of tax collection and the exclusive power to levy IGST is on the Centre. The centre will levy and collect the tax and tax revenue is shared by the centre with the state.Being a destination based tax the part of the proceed from the IGST will go to the state where the consumption of goods takes place and also inter country trade (imports) will be treated as inter country trade i.e. it will attract IGST. For e.g.- Suppose dealer ‘X’ from Uttar Pradesh supply goods to a dealer ‘B’ of Bihar. On the invoice raised by ‘X’, he charged IGST on the value of the goods. ‘X’ will then pay the IGST amount to the central government. The proceeds of IGST then will be apportioned between the central govt. and Bihar government (Being the state of purchasing dealer).

Currently, the goods and services are categorized under four slabs- 5, 12, 18 and 28 per cent which has attracted criticism from certain quarters, given that it's not exactly 'one nation, one tax'. But the Finance minister of India clarified that the present structure has been keeping in mind the welfare of the poor as already the indirect tax like GST is a regressive tax system (which makes the rich and poor pay the same tax for a product or service, thus affecting the poor greatly) which makes it unfeasible to have an ideal single GST in a country like India where still 22% of population lives below the poverty line.

Benefits of GST

GST will enable the move from fragmented economy to one market, it will lead to investment and growth – Arvind Subramanian

The implementation of GST will curb the menace of "inspector raj" as there will be minimal human interference because now no manual filing for getting input tax credit is required as all the tax related filings have to be done on the GST network which will lead to less compliance cost and thus giving a boost to ease of doing business. In states other than the special states (like Himachal Pradesh etc) no supplier of goods whose turnover does not exceed 20 lakhs is required to get registered in the GST and thus is not liable to pay any tax which will lead to cheap goods for the consumer, in turn creating more demand that will provide a boost to make in India as it will lead to more jobs,higher GDP with the final result being increased tax base and reduced fiscal deficit.Apart from these benefits the new tax regime will lead to other advantages such as:

- **Black money evasion** – In GST every paisa in transaction is accounted from the source till the last stage of corruption as GST network will be connected to various databases such as income tax,RBI etc which will leave a mandatory paper trail that can be cross referenced to check evasion. Also under GST e-filings would bring an end to the backdating of any document furnishing incomplete information and the usage of PAN and Aadhar will be more frequent, thus assisting the tax department to track transactions. The GSTN will automatically generate an invoice for the purchaser and will grant him the input credit paid by him once the seller upload details of the sales. This linking continues to the consumer who is the last link in the supply chain and if due a supplier fails to upload the details of the sale the purchaser will not get his due input credit which will dissuade the purchaser to enter into transaction with a supplier who is not registered under the GSTN, thus driving them out of the business will act as a self policing system as due to limited ways to outmaneuver law there would be negligible chance of engaging in corruption.

- **Warehousing obsession**–The new tax regime which will integrate India into a single integrated market will bring a uniform tax system irrespective of regional boundaries and thus will make taxation an irrelevant criteria for warehousing obsession. In the pre-GST era, the structure and organization of India's warehousing industry reflected a preoccupation with the multiplicity of tax laws in our country. Implementation of GST will provide the suppliers an opportunity to restructure their logistics and warehousing in terms of locations, size, operations and services as in the old system the suppliers used to maintain warehouse in almost every state so as to cleverly evade central sales tax due to which the end goal was tax optimization and not higher operational efficiency. In the pre-GST era due to the presence of many smaller warehouses, automation of the warehouse did not took place i.e. the sector relied on the manual labour which in turn lead to lower operational efficiency but the new regime will provide an advantage to the companies to undergo merger and acquisitions. The suppliers will be able to establish large warehouses in strategic locations and greater automation will benefit the sector by providing it some protection from rising labor costs in a growing economy and reducing turnaround time to bring it closer to international standards and due to the presence of experienced players in this field the suppliers may outsource their logistics work and may in turn be interested to just focus on their core products. This will not only lead to division of labour and new jobs but also it provides a golden opportunity to extend warehousing services to the MSME industry which will bring them in structured supply chain and enhance export competitiveness of Indian products globally.

- **India as One nation** –

Where the world has not been broken up into fragments by narrow domestic walls. – Rabindranath Tagore

The Indian constitution envisages idea as a federal polity and mentions that trade through out India should be free as they fully realized that economic unity and integration of the country provided the main sustaining force for the stability and progress of the political and cultural unity of the federal polity, and that the country should function as one single

economic unit without barriers on internal trade But in the Independent India free commerce and trade were restricted by the border check posts which were constructed by all the states which not only increased delivery time of goods but also increased their costs due to bribery system and also give rise to environment pollution as trucks queue up for clearance. At present 22 states have abolished the octroi tax system to facilitate seamless flow of goods which will help in bringing the logistics costs down in the country which are as high as about 14 per cent of GDP, while in developed countries they are nine per cent.GST will also help in reducing the rate arbitrage in the country as all states will tax goods and services equally unlike the system in the pre-GST regime. For ex - in the case of luxury cars the state of Maharashtra and Orissa had 12.5% and 14.5% VAT respectively which provide an unfair advantage to the suppliers in the state of Maharashtra as the same car will be cheap in their state, thus attracting buyers from the neighbouring states which lead to loss of revenue to both the supplier and the state where the VAT is more.

- **Zero rated Exports -**

  India is one of the fastest growing economy in the world and so trade is of paramount importance to it. Export of goods has been defined under the IGST Act as taking out of India to a place outside India and supply of service is to be treated as "Export of service" when
- The supplier of service is located in India,
- The recipient of service is located outside India,
- The place of supply of service is outside India,
- The payment for such service has been received by the supplier of service in convertible foreign exchange, and
- The supplier of service and recipient of service are not merely establishments of a distinct person.

In the GST regime supply of goods and services in the course of an import/export is to be treated as inter country supply and thus IGST is applicable on it. Exports are declared to be zero rated which means that the supplier shall be allowed to export the goods/services without charging any tax and can avail the CGST/SGST and IGST credits paid on inputs and input services. If he/she is unable to utilize the credit then, he/she can go for refund of credits. This would serve two objectives simultaneously. On the one hand, the ITC chain through the various dealers will not be broken and on the other hand, the exporter of the finished goods will get the refund of the GST paid on the inputs or on finished goods thereby making the exports actually free from the burden of taxes. As exports are not subjected to any tax liability this will eventually lead to an increase in the global competitiveness of Indian goods by making them cheaper in respect to the goods of other countries and thus giving an impetus to the much needed 'Make in India' initiative. Also the imports will be subjected to Basic custom duty apart from the IGST which is expected to make the imports a little expensive for consumers which will benefit the domestic producers.

- **Compensation Cess**- Being a destination based tax the share of the state in the IGST will be provided to the state where the consumption of goods which is contradiction to the earlier system where the exporter state used to get the tax. This has led to major dissatisfaction among the more developed states like Gujarat which are major exporter of goods within India. So as to compensate these states a compensation cess is applied on certain goods for the first five years so to compensate states for loss of revenue. The cess is applied on the demerit goods including tobacco, pan masala and aerated drinks which will hamper the consumption of these unwanted goods by making it dearer and at the same time will provide the states with much needed extra source of revenue so as to maintain their fiscal autonomy.
- **Electronic way bill** – Tax evasion is going to become more difficult under GST as moving goods worth more than Rs 50,000 will require prior online registration of the consignment and securing an 'e-way bill' that tax officials can inspect anytime during the transit. GST network will generate e-way bill which will be valid for a maximum period of 15 days depending upon the distance to be travelled like 1 day for 100 km and 15 days for 1000 km or more which is to be kept by the transporter with him at all times during the transit. These bills are believed to act as the final nail in the coffin for people dealing

in black market as it is a two way sword because under it the accountability of the tax officer inspecting the vehicle will increase as he will be required to file a final report every inspection of goods in transit within 3 days of inspection and also the e-Way bill will give respite to countless transporters as now any transporter whose vehicle has been intercepted and detained for a period exceeding 30 minutes, he may upload the said information on the GSTN portal which will in turn provide boost to the digital India initiative.

- **A boon for the MSME sector**–The composition scheme is envisioned keeping in mind the unregulated MSME sector which have grown faster than organized peers because of lower cost structures stemming from tax avoidance, and not having to pay social security benefits to employees (such as provident fund and gratuity), and excise duty (if turnover is less than ₹1.5 crore).But under the new tax system the reduction in the threshold for GST exemption to ₹20 lakh from ₹1.5 crore means thousands of unorganized MSMEs will soon be cast into the tax net who unlike the large organizations may not have the resources to fulfill the complex compliance requirements under the new regime. This scheme will help in filling this lacuna by allowing certain taxpayers to file quarterly returns instead of three monthly returns as required to be filed by normal taxpayers. Manufacturers of goods other than notified goods whose annual turnover is less than 75 lakhs are eligible for this scheme and the service sector has been kept out of this scheme with the sole exception being restaurant owners. The dealer registered under composition scheme is not required to maintain detailed records as in the case of a normal taxpayer, thus reducing the compliance cost for the nascent MSME sector.

The GST is expected to reduce the tax burden on the final consumers, thus making the goods and services cheaper but there is a speculation that it will lead to inflation as happened in advanced countries. To check this and also to impart consumer confidence, that prices of goods will not increase ,the government brought in the concept of anti-profiteering in GST. The anti-profiteering provisions provide that 'any reduction in rate of tax of any supply of goods or services due to elimination of cascading effect or the benefit of input tax credit shall be passed on by way of commensurate reduction in prices'. To ensure the implementation of this procedure a National Anti-profiteering Authority (NAA) is to be set up which will not only ensure that the benefits that accrue to entities due to reduction in costs is passed on to the consumers but also that the entities who hike rates inordinately, citing GST as the reason, will be checked by this body. Once an entity that has been identified to be profiting illegally is recognized it can be asked by this body to return to the customer the sum equivalent to the price reduction along with 18 per cent interest from the date the higher sum was collected or can even cancel its registration. For ex – McDonald was served notice by the NAA when it was found that many of its outlet has not passed on the benefit given by the government to the final consumer by way of commensurate reduction in prices and in consequence of this it was asked to submit copies of balance sheets, profit and loss account statements for 2016-17.If the company fails to respond within the stipulated time then the case is liable to be decided ex-parte on the basis of available evidence on the record. This concept of anti-profiteering is based on the principle that

‘Profit is fine, profiteering is not’

Short Term Challenges-

In this world nothing can be said to be certain, except death and taxes – Benjamin Franklin

While many consider GST to be the biggest tax reform of the country which will lead to the further strengthening of the economy, there are some who consider it to be a bane for the country as India has adopted a dual system of GST instead of a single one which has complicated matters as its implementation will be depended on the effective coordination between 29 states and the centre which will definitely lead to political as well as economic issues. Coming to the smaller picture the new tax regime will take its toll on small businesses who will find it extremely difficult to train their employees in the use of new GST compliant softwares which will lead to increase in the operational cost and thus an increase in the final prices for the consumer. Apart from these challenges, the new tax regime will also lead to some other challenges such as:

- **Highest Tax slab rate** – As per the new tax system India will have four tax slab rates: 5%, 12%, 18% and 28% which makes it the country with the highest tax slab rate in the world and the only country which comes near it is Argentina that levies 27% on goods and services. The problem is just not the high tax rate but also who it is going to affect as indirect tax is a regressive system of taxation i.e. the poor and the rich are charged the same amount of tax irrespective of the difference in their income. In a country whose 22% population still lives below the poverty line (India set its official threshold at ₹ 26 a day ($0.43) in rural areas and about ₹ 32 per day ($0.53) in urban areas) these high tax slab rates does not seem justified.

- **Destination based tax** – The new tax regime is different from the early system of taxation as it is a destination based tax. Tax can be of two types -
  1. Origin based tax - it is levied where goods and services are produced
  2. Destination based tax- it is levied where goods and services are consumed.

This means basically that exports are allowed with allowed with zero taxes whereas imports are taxed on par with the domestic production. This interestingly means that the SGST will accrue to the state in whose jurisdiction the consumer of the goods and services reside and not to the state where production takes place (i.e. the producer state gets nothing if goods or services provided are sold outside the state). For ex -If a resident of Bangalore provides IT services and goods to the resident of Bihar, then the SGST component of GST will be claimed by Bihar .This may have a deterrent effect on the more industrialized states which produces more because nothing will accrue to them and in turn they may put restrictions on inter-state movement of goods, thus distorting the dream of one economic India.

- **Exempted Goods**- It is an open secret that the world economy has been developing with oil as its lifeblood. But surprisingly in India these products have been kept outside of the purview of the GST –
  1. Alcohol for human consumption
  2. Petroleum products which include products such as aviation turbine fuel, petroleum crude.
  3. Electricity

The importance of alcohol and petroleum can be understood from the fact that constitutes nearly 45% of Centre’s indirect tax revenue while alcohol constitutes approximately 30% of state's tax revenue. The reason cited for this move is that it has been done to provide fiscal security to the states so as to maintain a minimum guaranteed income under the GST regime. But if the fiscal security is the ultimate goal of the government the same can be achieved by increasing the compensation cess on luxury items like cars and alcohol, instead of increasing the price of a commodity used as inputs in many industries and as they are out of GST input mechanism, it adds to cost of production, making things costly. Also the whole farm sector and thus our food security depends on this commodity. The reason because of which the government does not want to bring petroleum products under GST is because it will hamper their tax revenue as present tax on petroleum products is more than 50% but under GST only 28% tax can be applicable.

- **Fiscal Autonomy of the states**- There is a speculation that the the new tax regime will endanger the principles of federalism which the constitution holds so sacred as all the goods and services will be divided into different categories and the states will not be powerful enough to shift a commodity from a lower to higher tax slab or put it in an exempt category. The rates for both SGST and CGST will be determined by the GST council whose members will be the state finance ministers with union finance minister as the chairman. The voting power of the union and state will be one-third and two–third respectively and any change in the GST regime will warrant three-fourth majority (union and 20 states must agree). Direct tax which constitutes the major source of central government income is outside the purview of the GST but VAT which constitutes the highest to the states revenue will be abolished which in turn will leave the states at the mercy of the 14th finance commission. The commission has suggested the formation of GST compensation fund (cess on certain items like cigarettes) to compensate the loss of revenue to the states with a tapering effect (that the amount of compensation in the present year to be less from the amount of previous year) spanning over 5 years. Any unutilized money in the Compensation Fund at the end of the period of compensation will be distributed among the states in the following manner: (i) 50% of the fund to be shared between the states in proportion to revenues of the states, and (ii) the remaining 50% will be part of the centre's divisible pool of taxes (though the model law was slightly skewed in favour of the states as it stated that 50% of the residual amount in the compensation fund after five years would be devolved between the Centre and states, and the remaining would be given to the states depending on their revenues in the last year of the transition period).

- **Impact on E-commerce**– E commerce market in India is worth $33 US dollars and is expected to hit $200 billion by 2026 according to the report of Morgan Stanley. But despite its growing importance the new tax system has made it more difficult for sellers to sell their product through e-commerce operators (like amazon) because of the introduction of cumbersome compliances for both seller and e-commerce operator. The new system makes it mandatory for e-commerce operators to tax at the rate of two percent as TCS on the net value of sales made by suppliers through e-commerce operators which increases the compliance cost for both the supplier and the operator. The sales reported by the e-commerce operator will then have to be matched with the sales declared by the supplier himself at the end of every month, and in a case of mismatch the difference will be added to the turnover of the supplier and consequently be liable to discharge GST on such additional turnover. Also interestingly the benefits of composition scheme (under which small taxpayers can get rid of tedious GST formalities and pay GST at a fixed rate of turnover) has not been provided to small sellers who sell goods through e-commerce platforms because of which many small retailers may not prefer to work with an e-commerce company, which impacts the booming business of e-commerce operators.
- **Data Privacy Issues**- In 2017 alone data of 100 million customers was compromised (information including names, mobile numbers etc). The UIDAI which claims data security of the highest standard failed to protect its data which was being sold for Rs.500 on whatsapp. Moreover, there have been reports of personal Aadhaar details getting published on websites which compels us to think about the security of the GSTN (private players like ICICI, HDFC own 51% while the govt share is 49%) which not only contains personal details but also financial details of companies which is a gold mine for competitors. India ranks at the 23rd position within 165 countries on Global

Cyber security Index (GCI), released by the International Telecommunication Union (ITU), the UN telecommunications agency. GSTN is expected to yield 5 billion invoices a month and considering the poor performance of Indian agencies in protecting the so called "new gold" a question mark hangs over the integrity of the GSTN network. Apart from the cyber-attacks there is also a question of cyber crashes due to the over whelming rush on the network on the last date of filing the returns which happened during the filing of July 2017 returns when the whole system crashed and deadlines had to be extended and also new forms were introduced because the GSTN failed to deliver the original return forms in time.(GST 3B itself was a creation because GSTN failed to deliver the GSTR 1 and GSTR 3). In such a scenario what happens to the ease of doing business if all the taxpayers are expected to file so many returns on a monthly basis and end up fighting with the GSTN on a daily basis.

Conclusion

The GST induced slowdown has robbed India of its coveted tag of the "world's fastest-growing economy". China which is projected to grow by 6.8% in 2017, has regained the status which it had lost to India in 2015.The government rolled out GST on 1st July which disrupted the economic activity as small businesses found it too complicated to comply with. Exporters too were hit hard as the new tax regime increased their working capital requirement but GST has been already implemented in more than 140 countries which has improved their economy and in a federal country with more than 2 trillion dollars economy, there will be challenges during the initial rollout of a new tax regime. According to the International Monetary Fund goods and services tax would help raise India's medium-term growth to above eight per cent, adding that the reforms are expected to pay off in terms of higher growth in the future as it will subsume most of the indirect taxes which in turn would eliminate their cascading effect, thus turning India into a national market for goods and services as envisioned by our constitution makers.

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