National Agenda for 2019

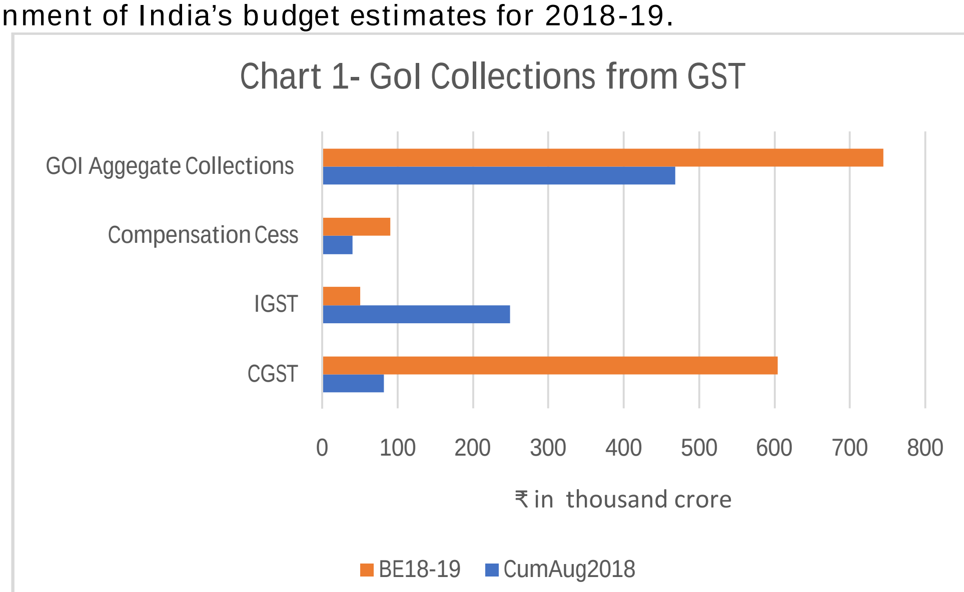
A proposal for the GSTreform

Introduction

The implementation of the Goods and Service Tax inJuly 2017 is a shining example of cooperative fiscal federalism in India. For the first time, since the Indian federation was formed, the Centre and the States, despite having different fiscal perspectives, voluntarily came together to implement the Goods and Service Tax. Such a sharingof the tax base had noteven beenenvisaged by the founding fathers of the Constitution who demarcated mutually exclusive tax bases for the Centre and the States in the Seventh Schedule .

This landmarkagreement was reached after much discussion, negotiation and bargaining. States, who were surrendering a greater proportion of their tax base to the GST than the Centre, were apprehensive of losing their fiscal independence. They needed assurances of revenue generation. To get them onboardrequired compromising on and diluting the structure of the GST. There were two sets of compromises. The first set limitedthe GST design in the Constitutional amendment itself. Petroleumproducts, alcohol,electricity and real estate were excluded from the tax base of the GST. A dual GST with the joint control of the Centre and States on the same base was put in place. The second set of compromises were negotiated into the operational protocols of the GST, its exclusions, rates, treatment of imports and exports, and tax administration.

Chart 1 compares the cumulative GST collections upto August 2018 with the Government of India's budget estimates for 2018-19.



There are significant variations between the budget and actuals even within the five month period April to August 2018. CGST collections have barely reached 15% of the projections. IGST collections for five months are about five times the budget projections for the whole year. Only collections from the compensation cess- which is totally unrelated to GST, seem to be proceeding on track.

It can well be argued that the GST implementation is yet to settle down. The monthlyreturn format has not yet beenfinalised. The invoice matching system has yet to be implemented. The process of the simplification of the rate structure is still ongoing. The GoI has significantly amended the CGST/IGST/Compensation Acts in August 2018 and its impact has yet to be felt . While these assertions are valid, there is a strong case for further simplification of the GST structure so that it can meet its originally envisaged goals. This paper outlines five such measures[1]. The first four can be addressed immediately. The fifth may have to be addressed in the medium term.

Reforming the Integrated Goods and Service Tax (IGST)

The GST model adopted requires that it is levied only on consumption within the tax jurisdiction. It should not be not applied on goods exported from the tax jurisdiction. There are two distinct and separate taxes levied under the GST – the CGST levied by the Centre and SGST levied by the state governments. For the jurisdiction of the CGST, the consumption model requires that no CGST should be levied on exports. However, CGST can be levied across interstate supplies.For the jurisdiction of the SGST, the model requires that no SGST should be levied on inter state supplies as well as exports.

If all interstate supplies were zero rated, sellers will be subject to two different tax rates applied for the same goods depending upon the place of consumption – inside the state or outside the state. The tax rate for intra state supplies would be CGST plus SGST. The tax rate for interstate supplies would be only CGST (since SGST has to be zero). GST rates for interstate supplies would be significantly lower than that for intra state supplies. This may incentivize misreporting between the two categories and open opportunities for tax evasion. Zero rating of SGST interstate supplies also violates the principle of tax neutrality which requires that there be no differential tax treatment of goods depending upon their place of consumption. Tax efficiency considerations demand that as far as feasible, taxes should be neutral[2].

An IGST is therefore levied to address these issues. The IGST should ideally, be only be a substitute for the SGST in the case of inter state supplies. While SGST is levied on intra state supplies, IGST should be levied on interstate supplies. CGST should be levied on both interstate as well as intra state supplies. In such a situation, an intra state supply would be subject to SGST and CGST. An interstate supply would be subject to IGST and CGST. The IGST collected by the exporting state would be transferred to the importing state for adjusting against the SGST collected from the downstream consumer in the importing state. Since both interstate and intra state supplies will face the same tax rate, issues relating to tax evasion, tax neutrality and zero rating will be obviated.

The IGST in place under the GST framework has a more complex structure than outlined above.The IGST is levied only and exclusively on interstate supplies at a rate equal to the sum of the applicable CGST and the SGST. No CGST and SGST is levied on interstate supplies of goods. While it is understandable why SGST cannot be levied on interstate supplies, this is probably for the first time that the levy of a Central Tax has been confined only to intra state transactions and not to supplies across states. This appears to have been done only to make it consistent with the IGST model adopted.

The IGST collected by the selling dealer in the exporting state is credited to the IGST account by the GSTN. The part of the IGST corresponding to the application of the CGST rate is to be transferred immediately by GSTN to the Central Government. The balance amount will be drawn upon by the dealer of the importing state as input tax credit for the supplies he makes in the importing state. Elaborate rules have been drawn up for adjustment of IGST credit available to a dealer. The IGST collected in 18-19 upto August 2018 was ₹2,48,993. This was seen by commentators as the major contributor to the GST revenue. However, of this only half, i.e.₹ 1,24,497 can be seen as the Centre's revenue . The other half- the SGST portion has to be allocated to the importing state as it represents the IGST proceeds collected by the exporting state. As seen, the design of the IGST and its the offset rules are ponderous and cumbersome.

In the model IGST outlined earlier, it is seen as a "compensating" GST levied on interstate supplies which are essentially to be zero rated in a destination based GST. This tax will be distinct from SGST and be levied in addition to the CGST for inter state supplies . Thus a dealer faces a tax on his supplies of either the sum of CGST and SGST or the sum of CGST and IGST which are equivalent, thus nullifying any arbitrage incentives. This simpler model scheme for the IGST comprises three prongs. First, CGST levied by the Central Government will be applicable to both intra state as well as interstate transactions (as it should, befitting a tax levied by the Union). Second, IGST will be levied only on inter state transactions as an alternative tax to the SGST. Both SGST and IGST will be levied at the same rate. Third, Customs duty is so adjusted that the levy of tax on imported goods is equivalent to the sum of SGST and CGST. Since IGST rate is the same as the SGST rate, this requires that the Customs duty should aggregate to CGST and the additional levies warranted by the prevailing import policy.

In this model, the IGST recovered from the selling dealer in the exporting state will be credited to the Central IGST account from which the purchasing dealer in the importing state will draw credit and thus wash out the tax. There is no need to adjust part of the IGST collection to the Central Government account. This will lead to a simpler, more efficient IGST which will have a lower compliance burden.It will also provide a better estimate of GST revenue collection.

Truly Zero rate Exports

In the present economic environment, with increasing oil prices, the growing current account deficit and the falling rupee, strengthening exports is a national priority. Exporters however are facing more problems under the GST than under the earlier VAT regime. The GST Council has adopted a consumption type, destination based GST for India. As per the OECD, " *Under the destination principle, exports are not subject to tax with refund of input taxes (that is "free of VAT" or "zero rated") and imports are taxed on the same basis and at the same rates as domestic supplies*"[3]

This requires that a zero (nil) rate be applied on exports which will enable input tax levied on the components of the exports to be refunded . This is also the practice in New Zealand, Australia and Canada.

Contrary to this practice, the IGST Act requires the levy[4] of IGST on all exports followed by a refund of the same.Levying IGST on exports and providing for subsequent refunds thereafter is in stark contrast to prevailing international practice where exports are charged zero rate of tax i.e. they are not liable to pay any tax whatsoever while being provided credits for input tax levied on components of such exports. While presently the provision for a letter of undertaking to be provided in lieu of payment of IGST ameliorates this stipulation, the levy of tax on exports is inconsistent with a consumption type destination based GST. It also increases the working capital requirements of exporters, increases their compliance burden, increases their turnaround time and makes them dependent on timely refunds.

The GST Council should revert to the pre GST practice of truly zero rating exports .

Removing the e way bill

The e way bill system for interstate trade was introduced as part of the GST from February 2018. An e way bill is an electronic version of a way bill. A way bill is a document mandated by the CGST/SGST/VAT Acts to be carried by person in charge of the vehicle carrying goods. The e way bill is a document generated on the GSTN common portal which contains details of the supplier and recipient, invoice details, description of the goods carried and its value. These particulars have to be entered in the common portal by the supplier before the goods are transferred to the transporter.

The e way bill is different from a transporter's receipt which acknowledges to the supplier the acceptance of goods for onward transportation to the recipient and details the conditions under which they are being transported. This receipt is required to be issued under the various laws in force for carriage of goods[5]. This receipt issued by the transporter has different names depending upon the mode of transport used. For road transport this receipt is called a Lorry Receipt (LR)/ Goods Receipt (GR)[6]. For transport by rail, it is called a Railway Receipt (RR). For transport by sea it is termed a Bill of Lading (BL). For transport by air it is called Airway bill (AB). Each of these receipts has a unique number. It contains details of the supplier and recipient, invoice details, description of the goods carried, its value, and the mode and time of commencement of transportation. It is issued after the goods had been handed over to the transporter. The GR is issued in the format required by Rule 10(4) of the Carriage of Goods Rules 2011 framed under the Carriage by Road Act 2007. One copy of the GR is required to be carried by the person in charge of the vehicle transporting the goods. This requirement of a GR[7] under the Carriage by Road Act has not been diluted with the implementation of the GST. Apart from the GR, two additional documents are now required[8] under the CGST Rules 2017 to be carried by the person in charge of the vehicle- the e way bill and the invoice related to the transaction.

The way bill was introduced at the time when multi point taxes in the form of the general sales tax acts were in force. States were taxing only goods and not services. Road transport operators were out of their tax net. These operators were therefore not accountable to the sales tax departments on whether they were transporting tax paid goods or not. The way bill was conceived as an instrument to indirectly bring the activities of both the transport agencies as well as ' zero business' traders under control by requiring that movement of all tax paid goods must be accompanied by a way bill issued by the sales tax department. Theoretically, this closed opportunities for transport agencies as well as dealers to move tax evaded goods.

The treatment of transport by road in the GST framework is asymmetrical compared to the other forms of transport- sea, air and rail. Services of transportation of goods by road provided by persons in the unorganised sector have thus been excluded from the ambit of GST. Those who provide agency services in transport are liable to pay GST but such liability is cast on the recipients under the Reverse Charge mechanism. All transport by rail, sea and air is liable to GST on forward charge basis without any concessions[9].

The information in the eway bill except for two items is already available in either the invoice or the Goods Receipt which is being carried by the person in charge of the vehicle (the lorry driver in most cases). The two remaining items are vehicle number and the reasons for transportation. The vehicle number, though not specifically required to be included in the carriage of goods rules is invariably included in the GR. The reasons for transportation can be deduced from a scrutiny of the invoice/ delivery challan. Thus, no extra information is provided by the e way bill to the person inspecting the vehicle other than what is already available in the invoice and the goods receipt. Generation of an e way bill appears unnecessarily to add to the compliance burden of the dealer.

The CGST Rules provides sweeping powers to officials to stop and search not only goods transport vehicles but also passenger vehicles and even passenger cars (which are often used to ferry high value low volume items like pharmaceuticals jewelry and gold) This power can be exercised in the same jurisdiction by two different sets of staff- Central Government and State government GST department staff. This provision can create significant inconvenience to not only dealers but also normal road users while simultaneously offering rent seeking opportunities.

The alternative to physical verification lies in invoice matching. The Goods and Services Tax Network provides for matching of invoices reported by the supplier and the buyer in their respective returns. The GSTN formally links the returns of the selling and purchasing dealers ensuring that they report a sales transaction identically.

The e way bill should be discontinued and the compliance burden on trade and industry reduced. This should be done after taking three steps. First, the Goods Receipt/Lorry Receipt issued under the Carriage of Goods Act is recognised as an official document in the GST Act. Second, the invoice matching mechanism in the GSTN is activated. Third, the exemptions given to the road transport sector in the GST framework are withdrawn. This sector should be treated on par with the rail, air and sea freight sectors and the reverse charge mechanism provided exclusively to the road sector withdrawn.

The GST Council Operating Procedure

Article 279(A) of the Constitution provides for the constitution of the GST council and outlinesthe parameters for the conduct meetings including the voting procedure. Thirty meetings of the GST council have been held so far. It isinstructive that in all these meetings, a vote has not been taken even once on any issue. All the decisions taken have been made by consensus. In a widely disparate federal country like India, where states often have competing interests, consensus may not be the best form of decision making for the implementation of national consumption tax. We must guard against the possibility that the efforts for generating a consensus may result in the tyranny of the minority in the GST council proceedings. Such a tyrannycan be responsible for the dilution of the GST design to the least common threshold in an effort to satisfy even unreasonable demands. This stance will then dilute the efficiency of the tax withlittle consequentialbenefit to the either the demanding states or the other stakeholders. It is essential that the deliberations in the GST Council are targeted at only a single goal – increasing the efficiency of the tax, even if this requires the exercise of a vote in the Council.

There are five stakeholders in the GST framework. These are the Centre, the states, the dealers (who collect GST from the consumers on behalf of both the governments) , the manufacturers/traders and the consumers. All these stakeholders have a vital interest in the sustainable functioning of the GST.However, only two stakeholders engage in GST Council affairs. These are the GoI and the state governments. The Centre has multiple roles. It is a stakeholder in GST, a participant in the GST council, a provider of compensation to the states, a setter of the GST council agenda, an agency responsible for the day to day running of the GSTCouncil meetings as well as a record keeper. Its employees man the Council Secretariat. These multiple roles create a conflict of interest for the centre[10].Following the precedent of the UN, WTO, World Bank, IMF, perhaps there is a case for an independent Secretariat for the GST Council headed by a renown public policy/taxation expert who would be designated the Managing Director/Secretary General of the GST Council. He would be responsible for consulting all the five groups of stakeholders, assisting the GST council with independent advice based upon examination of issues, facilitating day to day running of the Council and minutes and conducting research on issues relevant to GST implementation in India.

The GST Council is a constitutional body. Following Parliamentary practice, there is a strong case for following previously agreed procedures for calling of meetings, fixation of agenda, recording of minutes and publishing them[11].There is an equally strong case for making its proceedings public and allowing the press and visitors to attend its meetings.

Medium Term issues

There are five medium term issues which the future independent GST Council Secretariat led by its proposed Secretary General needs to examine carefully and advise the GST council upon. Some of these changes require that the Constitution be amended. These are briefly below.

First, petroleum products should be included in the GST tax base . The GST Council has been empowered to determine when petroleumproducts viz petroleum crude, high speed diesel, motor spirit, natural gas and aviation turbine fuel, will bebrought into the ambit of GST. States are not keen to do so on the ground that it will deny them access to independent sources of revenue. This has created a situation where boththe Centre and the states are managing the excise/VAT rates on the same petroleum products in an uncoordinated fashion[12] to the common detriment.Bringing inpetroleum products into the GST tax base will enable a more coordinated approach to the vexing issue of taxation on these products in a regime of crude oil price increases.

Second, transactions in immovable property should be included in the GST tax base. It accounts for 10% of the GDP and is too large to be kept out. This will also curb the growth of black money. There is adequate international experience in this regard[13]. GST could be applied at the concessional rate after providing for suitable exemptions for sale and lease of domestic housing units. Finalizing the exact model could be left to the GST Council Secretariat. Two points need consideration. First, a number of States earn significant income from the present regime of taxes on immovable property. Adequate comfort needs to be provided to them. Second, significant opposition to this proposal can be expected from a number of quarters for reasons other than economic. These concerns will have to be addressed strategically if this proposal is to fructify.

Third, alcohol for human consumption, which contributes significantly to state revenues. This is also a source of black money. It needs to be included in the GST base for a number of reasons, including significant under-reporting of liquor sales and interstate smuggling arising from rate arbitrage. States, however, have successfully opposed this inclusion. In deference to their views, the definition of GST in Article 366 (12A) specifically excludes alcohol.

Fourth, taxes on consumption or sale of electricity continue to remain in the State List. Such an exclusion limits the GST base and reduces opportunities for catalysing the moribund power sector and moderating power tariffs. This move can contribute significantly to improving competitiveness of the existing power plants which are presently operating at about 50% capacity. This tax should be included in the GST tax base

Fifth, local governments have been historically starved of revenue. More than 50% of the nations GDP is produced in urban areas.The majority of India's poor live in rural areas. The revenue bases of both governments have been precarious for a number of reasons. They need an assured source of income. We need to support local governments in both urban and rural areas by bolstering their revenue base. One way to do this would be to share a portion of GST revenue with local governments. 2% of the GST could be allocated to local government, with the GOI taking a reduced share on the base of an improved GST with a smaller band of rates and limited exemptions. This would also be in consonance with the 73 and 74 amendments to the Constitution which recognised defacto that local governments were the third tier in the Indian federation .

Notes

[1]Some of these proposals have been advocated earlier at other fora. For example IGST reform in "Reforming Integrated GST (IGST): Towards Accelerating Exports" by V Bhaskar and Vijay Kelkar. Policy Brief 2017, Pune International Center. Eway Bill reform in " Reforming the GST: Do we need the e way bill? " by V Bhaskar and Vijay Kelkar. Policy Brief 2018, Pune International Center.

[2] Tax neutrality is supported on the ground that investment decisions should be made purely for economic reasons and not for tax reasons . It is aimed at broadening the tax base so that rates can be kept low. Interestingly, the GST model adopted in India seems to be at variance with such principles. It is not neutral between goods and services. It is not neutral between different types of industry and trade. It is not neutral between the different forms of production. However, it is accepted that governments can and do disregard tax neutrality in the pursuit of specific policy goals.

[3] OECD. International VAT/GST Guidelines 2017.

[4] In lieu of payment, it allows a dealer to a file bond or Letter of Undertaking.However, many exporters are unable to avail this facility

[5] The transporters are governed by the respective laws and rules thereunder. These include 1. The Carriage of Goods by Road 2007, The Railways Act 1989, The Carriage by Air Act 1972, The Bills of Lading Act 1856, the Carriage of Goods by Sea Act 1925 and the Merchant Shipping Act 1958 and the Multimodal Transportation of Goods Act 1993. These Acts and the rules framed under them regulate the form and content of the receipt to be issued by the respective transporter.

[6] The Carriage of Goods Rules 2011 refers to this as a Goods Receipt though it is colloquially called Lorry Receipt. In future discussion in this paper, the abbreviation GR will be used for the goods receipt for transportation by road.

[7] Other acts prescribe the format for the RR, BL and AWB respectively, and these have also to be carried by the person in charge of the vehicle along with the way bill and invoice.

[8] Rule 138A of the CGST Rules 2017.

[9] Forward charge is used to denote the tax payable by the supplier of services to distinguish it from reverse charge where the tax is payable by the receiver of the service.

[10]States have alleged that the 29th GST Council meeting on 4th August 2018 was called for peremptorily and the agenda fixed unilaterally. As per press reports, some states declined to attend and the representative of one state walked out during the meeting

[11]The GST Council website displays minutes only uptoits 24 meeting held on 16 December 2017 http://gstcouncil.gov.in/meetings accessed on 8 October 2018

[12]After a number of states reduced VAT on petroleum products in a staggered fashion, the GoI reduced excise on petrol and diesel by ₹ 2.5 per litre on 3rd October 2018 and invited the remaining states to follow suit.

[13]"The Case for including immovable property in the GST" – V Bhaskar Economic and Political Weekly, 9th August 2014