



TAX REFORMS AND GST: CHALLENGES FOR FUTURE REFORMS

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ABSTRACT

Since gaining its independence, India has pursued a planned economic development strategy. The primary goal of Indian fiscal policy at first was to ensure that social fairness was maintained as the growth rate was accelerated. Considering this goal, the fiscal policy significantly affected the economy's total growth rate during the period of deliberate economic development. Unfortunately, the economy's total growth rate fell short of projections, and many of the outcomes fell short of what was anticipated. The government of India made a significant effort to plan the Goods and Services Tax for the nation (which is still pending). The only indirect tax that has a direct impact on every sector and area of our economy is the GST. We must all learn it as a result. The goal of the goods and services tax (GST) is to establish a single, integrated market that will be advantageous to businesses and the overall economy. In India, the new Goods and Services Tax (GST) indirect tax system is expected to go into effect. A novel approach to VAT is the goods and services tax, which includes numerous indirect taxes from both the state and federal levels and provides a broad setoff for input tax credits.

KEYWORDS: Fiscal policy, Direct taxes, Indirect taxes, Growth rate, Balance of payment, VAT.

TAX REFORMS

Since 1991, the main focus of fiscal policy has been on comprehensive changes to tax administration and policy. Direct tax changes initially concentrated on streamlining and rationalising the rate structure, cutting high marginal rates and rate categories, and reducing dispersion and tax rates. The tax structure has grown extremely complex as a result of the numerous adjustments made since all of the income and property taxes were first enacted. As a result, efforts were made to reformat the Income Tax Act as a whole. The Direct Taxes Code (DTC), a revised enactment, consolidates all direct tax regulations, including income tax, dividend distribution tax, fringe benefit tax, and wealth tax, in order to create an economically sound, equitable, and effective direct tax system.

When it comes to indirect taxes, measures have been done to simplify the rate structure, minimize the number of rate variations, and make the adoption of the VAT in the union excise duty and sales tax easier. A significant accomplishment has been the implementation of dual-VAT. It aided in

increasing company competition and removing the cascading effect of taxes. But this was simply a temporary change. The original legislation of both income and property taxes saw two amendments, which has resulted in a dual complexity increase in the tax system. As a result, efforts were made to reformat the Income Tax Act as a whole. The Direct Taxes Code (DTC), a revised enactment, consolidates all direct tax regulations, including income tax, dividend distribution tax, fringe benefit tax, and wealth tax, in order to create an economically sound, equitable, and effective direct tax system. In the case of indirect taxes, measures have been done to simplify the rate structure, lessen the number of rates, and make the adoption of the VAT in union excise duty and sales tax easier. A significant accomplishment has been the implementation of dual-VAT. It aided in increasing company competition and removing the cascading effect of taxes.

But this was simply a temporary change. All the flaws in the tax system were not taken into consideration by the dual-VAT. The following shortcomings of dual VAT still exist:

- The CenVAT creates definitional challenges about a commodity's placement in a certain rate group and causes valuation concerns that result in numerous legal disputes.
- The services are taxed by the Centre alone and they are taxed independently of commodity taxes;
- It has a restricted base as a result of which the tax system lacks neutrality and continues to be inefficient. This makes it difficult to tax the items that are provided as part of a lease or composite works contract
- Both sales tax and CenVAT continue to cascade under one another. The central sales tax (CST) is also affected by this.
- The current arrangement favours imports because they do not have to pay the hidden cost of input taxes.
- At both the federal and state levels, tax administration is still incredibly intricate and difficult. Given the aforementioned flaws, it is now being proposed to replace the dual-VAT, service tax, and several other commodity taxes currently imposed by both the Centre and State Governments with a Goods and Services Tax (GST).

DESIGN OF GST

A Joint Working Group (JWG) was established in 2009 by the Empowered Committee of State Finance Ministers (EC) to provide a comprehensive GST framework. The JWG states that the GST for Central Government would include Cen VAT (including union excise duty), additional excise duty countervailing duties (CVD), and other domestic taxes imposed on imports to achieve parity between domestic and imported goods (which are currently classified as customs duty), cesses and surcharges imposed by the Union, and special additional duty of excise on motor spirit and high speed diesel. The GST would include state-VAT, purchase tax, entertainment tax, luxury tax, and entry tax not collected in place of octroi among the State taxes. However, taxes on petroleum crude and its byproducts would not be included in the scope of the GST.

The idea of excluding petroleum crude and its byproducts from the GST is to generate more revenue through cascade-style taxes. In fact, this would result in a larger incidence of tax on inputs, including capital goods, and would ultimately have an impact on how effectively the petroleum industry operates as a whole. Therefore, it is recommended that the whole petroleum sector be brought under the GST framework, with the option of adding extra excise and sales tax levies to increase revenue. It has been suggested that tobacco would be included in the GST base in this situation. To raise more money for its operations, the Centre will impose a special excise duty; the States won't impose any new taxes. This begs the question of why the Center and the States should have different bases.

The proposed GST will have two components: CGST (levied by the Centre) and SGST, regardless of the base that is ultimately adopted by both parties (levied by the States). The revenue implications for the Center and the States, the overall tax burden, and the level of public acceptance of the tax will all be taken into consideration when determining the rates of these two components. In this situation, the EC first recommended that the die rate should be around 15%, with the CGST and SGST each charging a 7% and 8% rate, respectively. This is based on the assumption that the current effective tax rate for state-VAT, CenVAT, and service tax is 13.5% (with some rate categories having lower rates of 5% and some having higher rates than 13.5%).

On the other hand, the Central Government has proposed a three-tiered rate structure for the first year of the adoption of the GST, with 6% for necessities, 8% for services, and 10% as the normal rate. In the second year, the standard rate would drop to 9%, and in the following years, it would drop to 8%. Similar to this, the essentials rate would rise from 6% to 8% in the third year. As a result, GST would have a single rate in the third year. On this matter, the States take different positions. In fact, the EC asserted that since European nations have more than one rate for their VAT regime, why should it be so difficult to have a comparable system in our country where exports would be zero-rated following a recent visit by State Finance Ministers to various foreign countries. It appears that the "Pandora's box of diverse models of inter-State taxation" has been reopened, despite the fact that there has previously been some degree of unanimity on this matter. Under the existing dual-VAT system, interstate trade is subject to origin-based taxation, which the exporting State is responsible for collecting in accordance with the Central Sales Tax (CST) Act of 1956. It is suggested that the current CST system be replaced by a "Integrated GST" that is destination-based because the origin-based CST is incompatible with the GST. There wouldn't be any "tax-exporting" to the importing States as a result. Capital goods and all other inputs would both receive a set-off. Moreover, exports would not be taxed. The "Pandora's box of diverse forms of inter-State taxes" seems to have been reopened, despite the fact that there has previously been some degree of unanimity on this matter. It is unfortunate and has to be resolved.

CONSTITUTIONAL AMENDMENTS AND MAJOR OUTCOME OF SELECT COMMITTEE REPORT

In accordance with the current Constitution's provisions, neither the States nor the Centre are permitted to impose taxes on services, hence the imposition of the GST is contingent upon a modification to the Constitution. In light of this, on March 22, 2011, the Finance Ministry introduced the 115th Amendment Bill in the Lok Sabha. It's important to remember that the EC had already evaluated three draughts of the Constitutional Bill that had been sent by the Union Government to three meetings in August, October, and February of 2010 and 2011, respectively. The following list of substantial complaints from the States to the Bill's provisions:

- First, the proposed Constitutional change calls for the creation of a GST Council that will make recommendations on things like tax rates, exemptions, and threshold limitations. The Bill gives the President the authority to appoint the Union Finance Minister as the Council's Chairman, together with the Union Minister of State for Revenue and the Finance Ministers of every State. Yet, the States believe that they should have equal power over all matters pertaining to the Council. We suggest that the GST Council be established on the model of the current EC, which has a proven track record of revising the tax system for more than ten years, keeping in mind the concerns voiced by the States. The suggested Council should therefore be made up of the Union Finance Minister and the Finance Ministers of all the States and Union Territories. Due to the fact that any change would have an identical impact on the Centre and the States, the income interest of the Centre would automatically be taken care of.

- Secondly, the law calls for the creation of an authority to settle GST disputes. To settle disagreements arising from deviations from the GST Council's recommendations by either the Center or the State Governments, this will have a Chairperson and two members. The States are extremely concerned about the requirement for such a body. Finally, it is necessary to review the decision to exclude petroleum goods from GST coverage. To give the tax a wider base, it is suggested that petroleum products be included in the definition of GST. Even if the GST is not currently applied to these commodities, leaving them out of the Constitution Amendment Bill's definition and coverage of the GST will make the system rigid. In the future, a new constitutional amendment would be needed if the States or the federal government opted to charge GST on these commodities. It would be wise, from a futuristic perspective, to not limit the tax's application to what the Constitution forbids. The Rajya Sabha received the report of the Select Committee established to investigate the Constitution (122nd Amendment) Bill, 2014 on July 22, 2015. The Bill was approved by the Lok Sabha on May 6, 2015, and was then sent to the Rajya Sabha Select Committee for review.
- The Committee suggested that states get compensation for a five-year period.
- The Committee advised that the GST rate for the banking industry should be as low as possible, to ensure global competitiveness. Before, there was a provision in the bill for compensation for periods shorter than five years. If at all possible, financial services might be exempt from GST. The banks contended that because part of the banking industry's services are provided to the general public, they will become more expensive if the GST is raised above 14%, or the current rate of service tax.
- According to the Committee, adding a 1% additional tax will probably result in a cascade of levies. As a result, it was advised that the term "supply" be defined to mean all types of supply made in exchange for consideration. Before, the measure allowed exporting States to impose an additional 1% tax to support manufacturing States, but stock transfers to other branches of the same company in other States were not likely to be excluded.
- The Committee proposed that "bands" be defined to encompass the range of GST rates above the floor rate within which CGST and SGST may be imposed on particular commodities or services or classes of goods or services. Before, the bill did not specify a rate at which GST might be added on top of the floor rate.
- The Committee advised that the revenue sources of Panchayats, Municipalities, etc. be safeguarded in the formulation of state GST laws. As GST includes entry taxes and entertainment taxes, it is important to safeguard these local authorities' revenue sources.
- Members of Parliament issued letters of disagreement, which, in my opinion, were politically driven and adopted a different stance from that expressed by the Empowered Group of State Finance Ministers in its several meetings. The State Finance Ministers' group known as The Empowered Group did a fantastic job bringing the GST to this point.

ADMINISTRATION OF GST

The question of who has the authority to administer the GST has grown complex. According to the Joint Working Group (JWG) on GST, which was appointed by the EC, taxpayers below a specified threshold limit would be responsible to the State authorities for day-to-day administrative matters (including registration, collection, and ITC issues for both CGST and SGST), while taxpayers above the specified turnover would be responsible to both the Central and State authorities. The EC further thought over these suggestions before expressing its opinion in 4 Model and Road Map for GST in India.

As a result, the distribution of administrative activities will be based on the following thresholds for gross turnover of goods or services:

- Gross turnover of goods up to Rs. 1.5 crore was exclusively assigned to the States;
- Gross turnover of services up to Rs. 15 crore was exclusively assigned to the Centre; and
- Gross turnover of above Rs. 15 crore was assigned to both Governments for the administration of CGST to the Centre and for the administration of SGST to the States.

The proposed structure for GST administration would necessitate communication between dealers and tax administration personnel at the federal and state levels of government in addition to involving both tiers of government.

Future GST levy decisions by the states or the federal government would necessitate another constitutional amendment. It would be wise, from a futuristic perspective, to not limit the tax's application to what the Constitution forbids.

It is suggested that rather than involving both Governments in all administrative processes, particular tasks be given to the Center and the States in order to maximise taxpayer convenience and minimise compliance costs.

JUSTIFICATION IN IMPLEMENTATION OF GST

Not with standing VAT's general success, there are still certain issues at both the Central and State levels. There are also certain flaws in the current State-level VAT System. For instance, the VAT scheme has not yet included several taxes that are essentially indirect taxes on products and services, such as entry charges, luxury taxes, entertainment taxes, etc. Nowadays, the Central Government levies Central Excise Tax when commodities are removed from the location of manufacture. Regardless of whether payment has been made for products removed from the location of manufacture, the Central Excise Duty must be deposited. Service tax is assessed on the earlier of the date the services are rendered or the date the money is received. Regardless of whether money has been received for the sale of the goods, the state VAT may be charged at that time. A solution to it will be the implementation of GST. Each transaction involving the sale of commodities, the incorporation of items into a specific contract, the hiring of equipment, the payment of a lease or consultation fee, the rental of any service, the possible transfer of real estate, etc., would be subject to the GST tax.

- The implementation of a single GST would redefine VAT. Since goods and services are now taxed separately, the VAT system might be thought of as an unintegrated version of the GST.
- Manufacturing, "selling of commodities," and "rendering of services" will not be relevant under the GST system as taxable events.
- Long-term reductions in commodity prices are anticipated as retailers lower their pricing to pass along the benefits of lower tax incidence to customers. Dual GST will increase revenue collection for states with higher consumption of goods and services because it is a consumption-based tax.

RECOMMENDED ROAD MAP FOR A RATIONAL ADMINISTRATION OF GST IN INDIA

- The GST department (i.e., the SGST and CGST departments) at both levels needs to be thoroughly re-engineered first. This needs to be done so that each tax department, both at the federal and state levels, can be given clear responsibility, accountability, and authority.
- Secondly, it is suggested that these officers be given special assignments to oversee the CST and SGST operations of numerous dealers due to the small number of authorities at the Central level. The States should be given the daily procedures involving registration, tax payment, and return submission for all dealers (regardless of their size). In other words, the dealers will register with the

State Department in their location and submit their return there. Dealers typically deal with a single tax authority only.

- Third, the registered dealer will pay the tax into the bank account of the relevant Government, with the tax receipts from SGST going into the State Government's account and the tax receipts from CGST going into the Central Government's account.
- Fourth, the new system must increase document cross-verification. Without adequate cross-verification, the sellers evade paying taxes and unfairly credit taxable sales. By establishing offices that resemble the centralized and regional anti-evasion organization in France, tax evasion can be stopped. It is suggested that this function be split between SGST and CGST employees, drawing on the experiences of nations like France. The former should investigate cross-verification issues inside State boundaries, and the later should handle tax matters with implications across State and national lines. Finally, auditing is necessary to minimize the discrepancy between the tax that has been reported and the taxpayer's actual statutory tax due. Hence, a thorough audit plan is required to cover.

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