

A study on impact of goods and services tax on Indian economy: A key tax reform

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Abstract

A very significant improvement over the local sales tax system is Goods and Services Tax (GST). GST, one of the biggest taxation reforms in India is all set to assimilate Economies of the State and boost up the overall economic growth. At present businesses pay lot of indirect taxes such as Service Tax, VAT, Sales Tax, Luxury Tax, Octroi and Entertainment Tax. All such indirect taxes would cease to exist just after the implication of GST. Thus, there would be only one tax, at the national level, and that too monitored by Central Government of India. Currently several tax rates are imposed on different goods and services, but after the implication of GST there would be only one tax for every good and services. Assimilation of taxation of goods and services would be a great move by the Indian Government and would also help them in tax collections. The expectations from GST is to create a business-friendly environment, as cost price and henceforth, rate of inflation would fall over a period of time as a uniform tax rate would be applicable. An attempt is made in this paper to study the need of GST in India and the impact of GST on Indian Economy.

Keywords: GST, Indian economy, SMEs, information technology

1. Introduction

Taxes are the only means for financing the public goods because they cannot be priced appropriately in the market. They can only be provided by governments, funded by taxes. It is important the tax regime is designed in such a way that it does not become a source of distortion in the market or result in market failures. The tax laws should be such that they raise a given amount of revenue in an efficient, effective and equitable manner. Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavour to generate tax revenues to support government expenditure on public services and infrastructure development. GST stands for Goods and Services Tax. It is a domestic trade tax that will be levied in the form of a value added tax on all goods and services -in practice with some exemptions. A value added tax exempts all inputs including capital goods. Hence, it becomes a general tax on domestic consumption. It is a convenient and economically efficient way of taxing consumption. If it is levied at a single rate and there are only very few exemptions, it becomes a proportional tax on consumption. In order to ensure that the tax burden is distributed according to the consumption of different individuals, it must be levied on the basis of the principle of destination, that is to say that the tax on a good should go to the state in which the concerned consumer lives. This automatically takes place if the tax is levied at only the central level, or if the state is a unitary one with only one level of taxation. In a federation, there are special problems to be solved if GST is to be levied at the level of the states as well as the federal government.

The goods and services tax (GST) is projected at creating a single, unified market that will benefit both corporate and the

economy. It is an indirect tax that will lead to the abolition of all other taxes such as Octroi, central sales tax, state-level sales tax, excise duty, service tax, and value-added tax (VAT). Both the state and the central governments will impose GST on almost all goods and services produced in India or imported into the country. Direct taxes, such as income tax, corporate tax and capital gains tax will not be affected by GST. It will simplify India's tax structure, broaden the tax base, and create a common market across states. This will lead to increased compliance and increase India's tax-to-gross domestic product ratio. According to a report by the National Council of Applied Economic Research, GST is expected to increase economic growth by between 0.9 per cent and 1.7 per cent. Exports are expected to increase by between 3.2 per cent and 6.3 percent, while imports will likely raise 2.4-4.7 per cent, the study found. The word "tax" is derived from Latin word "taxare" which means to estimate. A tax is an enforced contribution, exacted pursuant to legislative authority. Indian Taxation System comprise of- Direct and Indirect Tax. Goods and Services Tax (GST) is one of the most discussed Indirect Taxation reforms. It is a comprehensive tax regime levied on manufacture, sales and consumption of goods and services. It is expected to bring about 2% incremental GDP growth of the country.

2. Literature Review

Agogo Mawuli (May 2014) ^[2] studied, "Goods and Service Tax-An Appraisal" and found that GST is not good for low-income countries and does not provide broad based growth to poor countries. If still these countries want to implement GST then the rate of GST should be less than 10% for growth.

Dr. R. Vasanthagopal (2011) ^[27] studied, "GST in India: A Big Leap in the Indirect Taxation System" and concluded that switching to seamless GST from current complicated indirect

tax system in India will be a positive step in booming Indian economy. Success of GST will lead to its acceptance by more than 130 countries in world and a new preferred form of indirect tax system in Asia also.

Ehtisham Ahmed and Satya Poddar (2009) [6] studied, “Goods and Service Tax Reforms and Intergovernmental Consideration in India” and found that GST introduction will provide simpler and transparent tax system with increase in output and productivity of economy in India. But the benefits of GST are critically dependent on rational design of GST.

Nitin Kumar (2014) [15] studied, “Goods and Service Tax- A Way Forward” and concluded that implementation of GST in India help in removing economic distortion by current indirect tax system and expected to encourage unbiased tax structure which is indifferent to geographical locations.

Pinki, Supriya Kamma and Richa Verma (July 2014) studied, “Goods and Service Tax- Panacea For Indirect Tax System in India” and concluded that the new NDA government in India is positive towards implementation of GST and it is beneficial for central government, state government and as well as for consumers in long run if its implementation is backed by strong IT infrastructure.

3. Objectives of the study

The main objective of this study is to highlight the needs of Goods and Services Tax in India and to study the impact of GST on Indian Economy.

4. Need of GST in India

The GST is being introduced not only to get rid of the current patchwork of indirect taxes that are partial and suffer from infirmities, mainly exemptions and multiple rates, but also to improve tax compliances. The spread of GST in different countries has been one of the most important developments in taxation over the last six decades, owing to its capacity to raise revenue in the most transparent and neutral manner, more than 150 countries have adopted the GST.

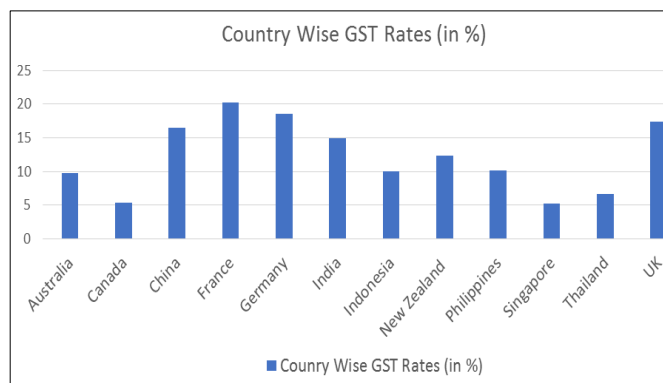
With the increase of international trade in services, the GST has become a preferred global standard. All OECD countries, except the US, follow this taxation structure. The proposed framework In India, the unified tax will take the form of a “dual” GST, to be levied concurrently by both the Centre and States. The unified tax will comprise of a Central GST and a State GST, which will be levied, legislated and administered by the respective levels of government. The words “levy, legislate and administer” are chief, since the Centre and the state will legislate the respective GST Acts and both will have power to administer the taxes.

Finance Minister Arun Jaitley presented the bill in the lower house of the Parliament in 2014. It is defined as any tax on the supply of goods or services that will subsume CENVAT, service tax, additional excise duties, central excise duty, excise duties levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955, service tax, additional customs duty (countervailing duty or CVD), central surcharges special additional duty of customs (SAD) and cesses, State sales tax, entertainment tax, State VAT, not levied by local bodies,

luxury tax, taxes on lottery, betting, and gambling, tax on advertisements, State cesses and surcharges related to supply of goods and services and entry tax not levied by local bodies. The primary reason for the bill is to pave the way for the Centre to tax sale of goods and the states to tax provision of services. The bill later on proposes that only the Central Government will have the exclusive power to levy and administer GST on inter-state trade and imports. The bill has also recognized the need to have a GST council. The union finance minister, the union minister of state in charge of revenue or finance, and the minister in charge of finance or taxation or any other minister nominated by each state government would constitute the council to ensure that both the Centre and the states are on an equal footing.

4.1 GST in other countries

While countries such as Singapore and Canada tax virtually everything at a single rate, In Indonesia tax rate is about 10%. In China, GST applies only to goods and the provision of repairs, replacement and processing services. It is only recoverable on goods used in the production process, and GST on fixed assets is not recoverable. There is a separate business tax in the form of VAT. For example, when the GST was introduced in New Zealand in 1986, it yielded revenues that were 45 per cent higher than anticipated, in large part due to improved compliance. It is more neutral and efficient structure could yield significant dividends to the economy in increased output and productivity. The GST in Canada replaced the federal manufacturers’ sales tax which was then levied at the rate of 60 per cent and was similar in design and structure as the CENVAT in India. It is estimated that this replacement resulted in an increase in potential GDP by 24 per cent, consisting of 12.4 per cent increase in national income from higher factor productivity and 50 per cent increase from a larger capital stock (due to elimination of tax cascading). The Canadian experience is suggestive of the potential benefits to the Indian economy. This means gains of about US\$15 billion annually. This is indeed a staggering sum and suggests the need for energetic action to usher the GST regime at an early date. GST rates of some countries are given below.



Source: <http://www.ey.com/gl/en/services/tax/worldwide-vat--gst-and-sales-tax-guide---rates>

Fig 1

5. Impact of GST

Table 1: Sector Wise Impact of GST

Sector	Change in Tax Rate	Unorganized to Organized	Supply Chain Management	Overall
Auto- Batteries	1	0	2	1
Retail Sector	0	2	0	1
Logistics	0	0	2	1
Multiplex	2	2	0	2
Automobile	2	0	1	1
Metal	0	1	1	1
Pharma	0	0	0	0
Industrial Capital Goods	0	0	0	0
IT	0	0	0	0

Strongly Negative: -2, Negative: -1, Neutral: 0, Positive: 1, Strongly Positive: 2

From table 1 we can conclude that, on one hand the impact of GST on Pharma, Industrial Capital Goods and IT Sector has not effected a bit while on the other hand, Auto-Batteries, Retail Sector, Logistics, Automobile and Metal have a positive impact of GST and Multiplex has strongly positive impact of GST in the Indian Economy.

5.1 Absolute Changes in macro variables over 2008-09

Table 1

S. No.	Sector	Values
Rs. Crore		
1	GDP	49,33,183
2	Export	7,66,935
3	Import	13,05,503
4	Net Export	(5,38,568)
US\$ Million		
1	GDP	1,090,734
2	Export	168,704
3	Import	289,759
4	Net Export	-119,055

The Goods and Service Tax (GST) bill is expected to have wide ranging ramifications for the complicated taxation system in the country. It is likely to improve the country’s tax to GDP ratio and also inhibit inflation. However, the reform is likely to benefit the manufacturing sector but may make things difficult for the services sector. Though there are expectations that the GDP growth is likely to go up by 1 to 2 %, the results can only be analysed after the GST implementation. The response is mixed from countries around the world. While the New Zealand economy had a higher GDP growth, it was lower in case of Canada, Australia and Thailand after the GST was implemented. The one per cent tax that has been proposed as a sop to appease the States for compensating their loss of revenue from the inter-state CST is likely to play a spoil sport. It is probable that it may affect the GDP adversely. The Congress is already opposing the 1 per cent tax. The GS Tax rate is expected to be around 17-18% and can be assumed as a tax neutral rate. This tax rate is not likely to give any incremental tax revenue to the government. The rate will prove beneficial for the manufacturing sector where the tax rate is around 24% at present. The major manufacturing sectors that will benefit the most are FMCG, Auto and Cement. This is because they are currently reeling under 24 to 38 per cent tax. The sector which is going to be adversely affected is the services sector. Already there has been a hike from 12 to 14% from the 1st of

June this year. Another 4 per cent increase will break their backs. The uniformity in the taxation rate is fine but it should not result in disparity for the goods and services sectors. Nobody has thought of the implications it will have in the services sector if the government moots a higher GS Tax rate like 20% or 24%. The higher GST rate will definitely boost the tax to GDP ratio, while giving financial muscle to the government for increasing the capital expenditure. This is likely to spur growth in the economy. There is definitely a silver lining to the whole exercise. The unorganised sector which enjoys the cost advantage equal to the taxation rate can be brought under the GST bill. This will bring a lot of unorganized players in the fields like electrical, paints, hardware etc. under the tax net. It is easier said than done. It will take a lot of meticulous planning in the implementation of the GST reform for capturing the unorganized sector under its ambit. For one it will widen the tax reach and secondly it will benefit the organized players who lose out revenue to the unorganized sector at present. There are still a lot of unchartered territories which need to be looked into through parliamentary discussions in the sessions. This will bring sanctity to the taxation system without hurting any of the sectors adversely. To The Individuals and Companies - With the collection of both the central and state taxes proposed to be made at the point of sale, both components will be charged on the manufacturing costs and the individual will benefit from lowered prices in the process which will subsequently lead to increase in consumption thereby profiting companies. If GST is implemented as per the Chief Economic Adviser (CEA), Arvind Subramanian panel’s report, it will benefit the economy in several ways. Firstly, by removing the net of multiple taxes at multiple phases of production, GST will help harmonize the production activity in the economy. The removal of tax considerations in making business decisions – setting up of warehouses, etc. – will increase efficiency in the system. Secondly, the standard GST rate of 18% is unlikely to be inflationary, as higher prices of services (currently taxed at ~15%) will most likely be offset by lower taxes on goods (currently taxed at ~25%). Further, GST will not only help reduce indirect tax evasion, but will also help to curtail direct tax evasion.

a) Food Industry

The application of GST to food items will have a significant impact on those who are living under the level of subsistence. But at the same time, a complete exemption for food items would drastically shrink the tax base. Food includes grains and

cereals, meat, fish and poultry, milk and dairy products, fruits and vegetables, candy and confectionary, snacks, prepared meals for home consumption, restaurant meals and beverages. Even if the food is within the scope of GST, such sales would largely remain exempt due to small business registration threshold. Given the exemption of food from CENVAT and 4% VAT on food item, the GST under a single rate would lead to a doubling of tax burden on food.

b) Housing and Construction Industry

In India, construction and Housing sector need to be included in the GST tax base because

construction sector is a significant contributor to the national economy. GST could play a major role in bringing transparency in the real estate sector. It could possibly reduce cost of home ownership especially if, GST rate is lower than current rates put together. GST could also lead to lower compliance and input cost for builders.

c) FMCG Sector

Despite of the economic slowdown, India's Fast Moving Consumer Goods (FMCG) has grown consistently during the past three – four years reaching to \$25 billion at retail sales in 2008. Implementation of proposed GST and opening of Foreign Direct Investment (F.D.I.) are expected to fuel the growth and raise industry's size to \$95 Billion by 201835.

d) Rail Sector

There have been suggestions for including the rail sector under the GST umbrella to bring about significant tax gains and widen the tax net so as to keep overall GST rate low. This will have the added benefit of ensuring that all inter – state transportation of goods can be tracked through the proposed Information technology (IT) network.

e) Financial Services

In most of the countries GST is not charged on the financial services. Example, In New Zealand most of the services covered except financial services as GST. Under the service tax, India has followed the approach of bringing virtually all financial services within the ambit of tax where consideration for them is in the form of an explicit fee. GST also include financial services on the above grounds only.

f) Information Technology enabled services

To be in sync with the best International practices, domestic supply of software should also attract G.S.T. on the basis of mode of transaction. Hence if the software is transferred through electronic form, it should be considered as Intellectual Property and regarded as a service. And If the software is transmitted on media or any other tangible property, then it should be treated as goods and subject to G.S.T.

g) Impact on Small Enterprises

There will be three categories of Small Enterprises in the GST regime.

- Those below threshold need not register for the GST
- Those between the threshold and composition turnovers will have the option to pay a turnover based tax or opt to join the GST regime.
- Those above threshold limit will need to be within framework of GST

Possible downward changes in the threshold in some States consequent to the introduction of GST may result in obligation being created for some dealers. In this case, considerable assistance is desired.

In respect of Central GST, the position is slightly more complex. Small scale units manufacturing specified goods are allowed exemptions of excise upto Rs. 1.5 Crores. These units may be required to register for payment of GST, may see this as an additional cost.

6. Conclusion

India's biggest indirect tax reform since 1947 looks like it has finally arrived – the Goods and Service Tax. From its first official mention in 2009 when a discussion paper was introduced by the previous United Progressive Alliance government to the point when the current Modi government tabled the Constitution Amendment Bill in Parliament, building consensus on the GST hasn't been easy. The most prominent hurdle in introducing this new tax structure has been the struggle between the states and the Centre on the loss of revenue. It's taken years to resolve, but even now it is an issue that isn't completely fixed. Nonetheless, the introduction of the Constitution Amendment Bill in Parliament seems like the first key step towards bringing in the belated GST reform. In India, the unified tax will take the form of a "dual" GST, to be levied concurrently by both the Centre and states. The unified tax will comprise of a Central GST and a State GST, which will be legislated, levied and administered by the respective levels of government. The same taxable base will be subject to both GSTs. Overall GST is helpful for the development of Indian economy as well it will be very much helpful in improving the gross domestic product of the country more than two percent. Now the government of India should take final step to pass the GST bill in parliament with removing all hurdles.

Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavour to generate tax revenues to support government expenditure on public services and infrastructure development. The ongoing tax reforms on moving to a goods and services tax would impact the national economy, International trade, firms and the consumers There has been a good deal of criticism as well as appraisal of the proposed Goods and Services Tax regime. It is considered to be a major improvement over the pre-existing central excise duty at the national level and the sales tax system at the state level, the new tax will be a further significant breakthrough and the next logical step towards a comprehensive indirect tax reform in the country. GST is not simply VAT plus service tax, but a major improvement over the previous system of VAT and disjointed services tax – a justified step forward. A single rate would help maintain simplicity and transparency by treating all goods and services as equal without giving special treatment to some 'special' goods and/or services. This will reduce litigation on classification issues. It is also expected that implementation of GST in the Indian framework will lead to commercial benefits which were untouched by the VAT system and would essentially lead to economic development. Hence GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the Central Government and the State Government. Sooner or later, the GST will surely knock the doors of India. And when that

happens, we as future torch bearers of the profession are required to be prepared and fully equipped with our knowledge regarding GST. Forewarned is forearmed. Thus, we must be ready to deal with GST and many other changes that are going to take place in India. Slowly, India shall move to join the world-wide standards in taxation, corporate laws and managerial practices and be among the leaders in these fields.

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