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Impact of GST on Growth and Development of India Economy

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Research Paper - Economics

ABSTRACT

GST means Goods and Service Tax. It is an indirect tax levied on sale of goods and services. The reformists believe that GST is one of the most awaited law which upon introduced will boost the economic growth in the country. This law if passed by the parliament may come into force from April 2016. As everyone is talking about it now, let's get into the basics of the proposed law in this article.

The Goods and Services Tax was introduced four months ago as a big-bang reform that will transform the Indian economy. What has been its impact, and will it eventually fulfil the country's expectations? How should the GST Council respond to the unfolding situation?

KEYWORDS: GST , Goods, Service Tax

INTRODUCTION:

Introduction of GST would be a very significant step in the field of indirect tax reforms in India. By amalgamating a large number of Central and State taxes into a single tax and allowing set off of prior-stage taxes, it would mitigate the ill effects of cascading and pave the way for a common national market. For the consumers, the biggest gain would be in terms of a reduction in the overall tax burden on goods, which is currently estimated at 25%-30%. Introduction of GST would also make our products competitive in the domestic and international markets. Studies show that this would instantly spur economic growth. There may also be revenue gain for the Centre and the States due to widening of the tax base, increase in trade volumes and improved tax compliance. Last but not the least, this tax, because of its transparent character, would be easier to administer.

Initial Period of Disruption For Businesses

Predictably, GST has set off an initial period of disruption for the businesses. Small and medium enterprises have encountered difficulties with the new tax. Gaps in GST returns filings remain, and the government has been deferring the filing deadlines. Partly, this is a result of glitches in the IT portal and the high compliance requirements set out in the law. Even though the idea behind the invoices matching system to input tax credits is sound, as it helps tackle tax evasion and frauds, it has proven to be a big hurdle to cross every month for many less-tech savvy Indian businesses.

Minimal Initial Impact on Consumers

As of now, the government has been successful in minimising the impact of GST on consumers. Being a broad-based consumption tax, GST can lead to large initial increases in retail prices.

Global experience illustrates this. Several countries have faced higher inflation in the immediate quarter in which GST is implemented (see chart below) which lasted atleast for a year.In some countries such as Australia, the prices started rising even before, in anticipation to GST. In the year of introduction of GST, inflation increased to 4.5 percent in Australia (compared to prevailing 1.5 percent), and 5.6 percent in Canada and as much as 18 percent in New Zealand!

GST exemption given to mass consumption goods and setting of GST rates close to combined excise duty and state VAT/sales tax rates has certainly helped. RBI estimates that only in 5 out of 21 item groups covered in CPI, higher GST rate relative to previous taxes can increase price by more than 1 percent. But for prices to actually remain stable, it is necessary that firms pass-through of benefit of input tax credit to competitiveness of Indian exporters.

Cement - Positive

With GST implementation, we expect the overall tax incidence on the sector to potentially decline. Typically, indirect taxes in the sector are close to 28-30% which would potentially come down post GST implementation to the effective tax rate.

Media and Entertainment - Positive

Media and Entertainment Multiplex- Positive

Multiplexes would be a key beneficiary of GST. At present, multiplexes pay local state taxes like entertainment tax and VAT on overall revenues including food and beverages. In addition, they also pay service tax on projector equipment, utility, security, housekeeping and other cost which are paid to central government. The blended average rate for multiplex players would be ~24-25% across the country which would reduce to ~18%.

Retailing – Positive (especially organised retailers)

Rentals which is one of the major costs for retailers attracts service tax of 14.5%. The retailers cannot set-off this costs like the other industries as the companies trading goods (retailers), which pay VAT, are not allowed to claim credit for the service tax paid on different items since they have no central tax against which this can be set off.

Pharmaceuticals - Neutral

GST for pharma companies likely to remain similar to the current effective tax rate of ~12%. However, as the pharma industry receives area based exemption on indirect taxes, any changes in the exemption or re-negotiation of Memorandum of understanding (MoUs) between the government (state, central) and the companies can have a slight negative impact on the sector. GST will enable pharma companies to rationalize their distribution networks through consolidation of depots/warehouses and better inventory management.

Oil and Gas - Neutral

The Oil and Gas Industry would largely be marginally impacted by the introduction of GST; the reason being that 5 petroleum products (i e crude, natural gas, ATF, diesel and petrol) are excluded from the coverage of GST for the initial years while the remaining

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petroleum products (for e g kerosene, naphtha, LPG etc) are covered within the coverage of GST. As a result, the industry would be required to comply with both the current tax regime as well as the GST regime. So, overall impact is neutral.

Agri-commodities: Tea, Sugar, Cotton – neutral

Most of the agri-commodities have a concessional rate of tax less than 10%. Being essential commodities, it is unlikely the GST rates will be different from the current concessional rates.

Hotels – GST impact will be based on the location

Hotel rooms currently attract Service tax and Luxury tax. While Service tax is levied by the union government and currently stands at 8.7% (taking into account the abatement rate of 40%, Swacch Bharat Cess and Krishi Kalyan Cess), Luxury tax is a state subject. Luxury tax rate currently varies between 5% - 12.5% depending on the state. Therefore, we believe that the impact of GST on hotels will be negative or positive depending on the rate as well as the state in which the property is located. Five star hotels could attract a higher rate of 40% under GST regime, which will be a negative.

CONCLUSION:

The enumeration of benefits casts a welcome setting for GST. Proving GST as a superior and sufficient system depends upon the structure it is designed into and the manner of implementation. While it serves to be beneficial set up for the Industry and the Consumer, it would lead to increase in revenue to Government.

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consumers. Broadly this seems to be occurring as the average post-GST increase in prices of 18 commodities has been merely 0.8 percent. Even for commodities where price rise has been high, the effect is likely to be transitory, as was for countries.

Present system – This can be better explained through an example. Suppose you buy soap for Rs.50 per piece, it includes Excise Duty, VAT or CST, Customs duty on the imported raw materials, etc. So, currently you will have to pay multiple taxes on the same product. Let's take another example; the food you buy at hotels will have VAT as well as Service Tax.

What is tax?

The economic case for GST is straightforward: Income is taxed irrespective of source and use; therefore, consumption should also be taxed on the same principle. GST is one of the widely accepted indirect taxation system prevalent in more than 150 countries across the globe. Globally, GST has been structured as a destination based comprehensive tax levied at a specified rate on sale and consumption of goods and services within a country. GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point up to the retailer's level. It is essentially a tax only on value addition at each stage, and a supplier at each stage is permitted to set-off, through a tax credit mechanism, the GST paid on the purchase of goods and services as available for set-off on the GST to be paid on the supply of goods and services. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

The illustration shown below indicates, in terms of a hypothetical example with a manufacturer, one wholesaler and one retailer, how GST will work. Let us suppose that GST rate is 10%, with the manufacturer making value addition of Rs.30 on his purchases worth Rs.100 of input of goods and services used in the manufacturing process. The manufacturer will then pay net GST of Rs. 3 after setting-off Rs. 10 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 13. The manufacturer sells the goods to the whole seller. When the whole seller sells the same goods after making value addition of (say), Rs. 20, he pays net GST of only Rs. 2, after setting-off of Input Tax Credit of Rs. 13 from the gross GST of Rs. 15 to the manufacturer. Similarly, when a

retailer sells the same goods after a value addition of (say) Rs. 10, he pays net GST of only Re.1, after setting-off Rs.15 from his gross GST of Rs. 16 paid to whole seller. Thus, the manufacturer, whole seller and retailer have to pay only Rs. 6 (= Rs. 3+Rs. 2+Re. 1) as GST on the value addition along the entire value chain from the producer to the retailer, after setting off GST paid at the earlier stages. The overall burden of GST on the goods is thus much less. This is shown in the table below. The same illustration will hold in the case of final service provider as well.

GOODS AND SERVICES TAX

Stage of supply chain	Purchase value of input	Value Addition	Value at Which Supply and Goods Services made to Next services	Rate of GST	GST on Output	Input Tax Credit	Net GST=GST On Output-Input tax Credit
Manufacturer	100	50	150	10%	15	10	15-10=5
Whole Seller	150	30	180	10%	18	15	18-15=3
Retailer	180	20	200	10%	20	18	20-18=2

Impact on India

Prices of goods to decline cost of services to increase, exports to get a boost:

The effective indirect tax incidence is expected to decline post the implementation of GST due to removal of the cascading effect arising from the non-availability of input tax credits across the value chain and between states and removal of tax-on-tax (e g. VAT levied on excise inclusive price). The standard excise duty of 12.5% and VAT of 12.5-15% along with cess, entry taxes and CST take the effective tax rate up to 26-30% in the current system which will drop to a standard rate of 17-18% under the GST. However, the prices of goods that are currently exempt from excise duty or sales tax or are subject to concessional rates are set to increase as the list of exemption under the GST will be lowered. Since GST is a tax on consumption (destination-based), exports would be zero-rated, i.e. export prices would not include any taxes. Currently, exports are reimbursed for central indirect taxes (excise and customs duties) but don't get full offsets for CST and certain state-level taxes such as entry taxes and octroi. Post GST, this non-rebated indirect tax induced distortions would be removed, enhancing