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GST Reforms in India: Challenges of Rationalising

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Abstract: *Direct and Indirect taxes are the main sources for any government to manage its revenues and expenditure. In an economy which is transparent and citizen friendly tax reforms and its rationalization will be much easier compared a coercive government. In case of India, where the tax evasion is still high, government will have to find the resources to match its expenditure through levying taxes in a way that does not hurt its citizens. Rather than increasing the tax rates in the given context the governments will prefer to opt for consolidation of the taxes levied in different ways. Increasing the tax base and bringing more business under taxation thus prompts the governments to look for efficient alternatives of tax regimes.*
GST is right move in this direction – this move not only has avoided an increase in tax rates, but has initiated a comprehensive tax reform coupled with rationalization of subsidies and government expenditure to curb fiscal deficit. This paper is an attempt to understand this process of rationalization of taxation made by the fiscal authority to change the pre-existing ad-hoc pattern of taxation into one which is based on a set of published rules after simultaneous research and practical observation. The aim and purpose of rationalization of tax system is to bring about efficiency, coordination and control of the tax collecting procedure. This paper is a review of the same and runs to around 8 pages with nearly a 2000 word descriptive content.

Keywords *: GST, Rationalising, Law making.*

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I. Introduction

"It was only for the good of his subjects that the kings collected taxes from his subjects, just as the Sun draws moisture from the Earth to give it back a thousand fold" – (Kautilya'sArthashastra)

Tax is said to be a mandatory liability for every citizen of the country. There are two types of tax in India i.e. direct and indirect. Taxation in India is rooted from the period of *Manu Smriti and Arthasastra.* Present Indian tax system is based on this ancient tax system which was based on the theory of maximum social welfare.

Prior to the liberalization of Economy, India's tax regime suffered numerous problems. These problems which were in vogue in 1960s and 1970s had a high degree of progressiveness (rich needed to pay exorbitant taxes). On the other hand, tax collection efficiency was very weak and biased. There was large number of exemptions, which eroded the already narrow tax base in the country. In terms of corporation tax, there were numerous discriminations and a sort of crony capitalism existed then too but without much understanding of these biases in the minds of the ordinary people.

In terms of Indirect taxes, the high rates of custom / excise duties were prevalent. There was no VAT; there was no service sector within the purview. The efforts to reform India's tax system to be precise began in mid 1980s when the government announced a Long Term Fiscal Policy in 1985. This policy recognized that the fiscal position of the country is going downhill and there was a need to make changes in the taxation system. In that review and rationalization of the tax system in India became the central theme with the central excise duties established leading to introduction of Modified System of Value-Added Tax (MODVAT) in 1986. This was further rationalized and harmonized with the coming of GST with the classification of goods and service tax system.

II. Objectives

- To understand the nature and efficiency of Indian Tax reform
- To measure the efficacy of the proposed tax reforms in the Indian tax eco system
- To understand the rationale and capability of the GST as a reform tool

III. Methodology

The current paper is written using descriptive and analytical methods supported by secondary sources. Analytical writing in this paper not only gives information, but helps in reorganizing the subject content into categories and parts for a better understanding of the arguments placed.

Secondary Data: The analysis of the paper thoroughly depends upon the secondary data collected from Investopedia, and RBI websites.

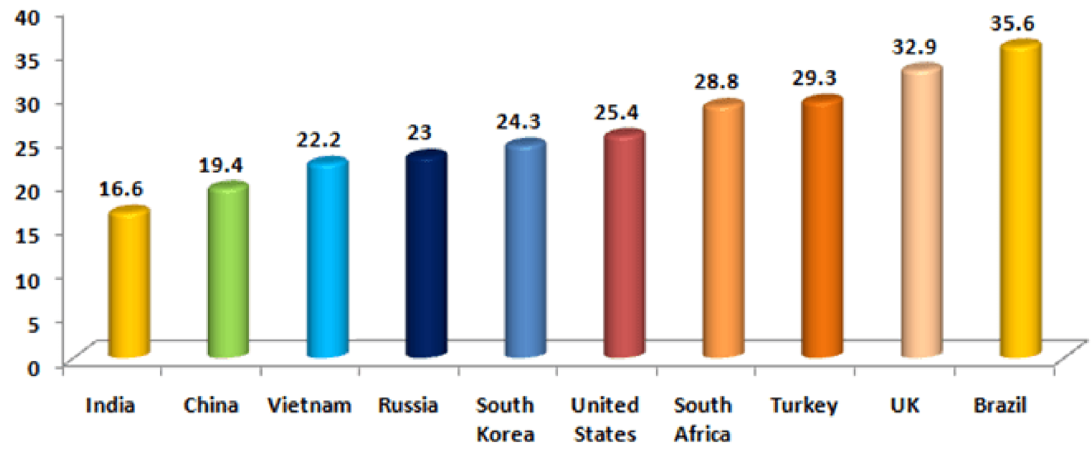
Analysis : Simple Descriptive statistical measures like Bar charts, percentages, averages have been used to analyse the tax related data.

Need for rationalizing

India's modern tax reform agenda was defined by the reports of two celebrated task forces, both chaired by Vijay Kelkar. This was during the previous NDA regime of Prime Minister Vajpayee. Those reports, on direct and indirect taxes, are still refreshingly relevant. The main thrust of the reforms was to have low tax rates, simplification of the code, very few exemptions and a wide tax net. The proposals also included substantial administrative reforms, including service orientation of the tax department, removal of discretion, comprehensive use of PAN, reducing scope for litigation and focus on the citizen as a "customer" of government services.

IV. Discussion

Modern societies need taxes to provide for public goods, including law and order, defence and quality primary education, health, and to redistribute income. To achieve this, the tax to GDP ratio for most developed economies in the OECD and others like Brazil and Argentina is more than 35 per cent. For the USA it is 27 per cent. For India, inclusive of state and local taxes, the ratio is 17 per cent, among the lowest in comparison to its peers.



Source : Investopedia

The grand agreement on taxes between citizens and the government is based on the trust that services will commensurate with taxes paid. For instance, in many Scandinavian countries the tax to GDP ratio is much higher, but citizens are not fleeing those high tax jurisdictions merely because of the ease of living and the comforts they get as citizens starting from a comfortable pot hole free road down to his/her everyday needs including his/her social security. As a result of this they perceive that their tax money is spent wisely and that it is returning to them in the form of services, public goods and social stability.

Classification	Jurisdiction	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Medium	India	100	130	130	142	134	132	132	134	133	122	120	134	116

Source : Wikipedia

India recently jumped up 30 ranks in World Bank's Ease of Doing Business rankings. One of the metrics that goes into this measurement is called "paying taxes" which stands for the ease, fairness, and transparency of the tax system. India's rank jumped up before the rollout of the Goods and Services Tax (GST) is a noteworthy point for discussion.

This is a landmark tax reform which unifies the country into one indirect tax zone, and removes several frictions of interstate and taxes. Its key strength is near complete computerization and interlocking incentives for compliance. Nobody gets a tax refund unless one produces a proof that one has paid one's taxes.

Criticism that the implementation of the GST has been messy may be partly true, but as a political decision taxation India must be given a margin of go by as this mess of introducing GST partly reflects compromises made by the political leadership of the country to reach a consensus within the GST council, and partly because the rates were kept too high, fearing tax revenue losses. All this being addressed quickly hopes to cover and converge two or three rate slabs, low rates and wide tax coverage, including the hitherto excluded items like electricity, petrol, diesel and real estate.

Job half done

But even a well-crafted and implemented GST is only a job half done for tax reforms. The other half comes from the second report of the Kelkar Task Force, i.e. on direct taxes. India's income tax Act is perhaps slightly more than 56 years old. Every year it undergoes amendments that are part of the Union Budget, or rather the Finance Bill. Cumulatively over the years the changes to the direct tax statute constitutes some kind of reform. Thus, it is true that tax rates have come down, and anomalies have been ironed out. In spite of these annual changes there is a considerable amount of consistency in the present status of direct taxes. Yet this piecemeal approach cannot ever make up for a genuine comprehensive overhaul, or true tax reform.

The 'fixes' done every year are part of a giant patchwork which keep the income tax statute together. But we do need a new direct tax code (DTC), which will be the true reform complement to GST. This new DTC would start afresh, and crystallize the blueprint laid out in the 2002 Kelkar committee report. Basically it would tax income, no matter what the source. It would have low tax rates with minimal exemptions, and would widen the tax net to the maximum extent possible. It would leave very little room for tax officer discretion and income holidays. To me as a researcher this is the crux of a good reform. It is my desire that along this path a slow and study erosion of the subsidies of all sorts in India must also go including the subsidies for education based on caste and creed. If for the argument sake and the concern for the farmer's issues these subsidies must be maintained as a positive one for the farming and peasant class.

Recently the chairman to the prime minister's Economic Advisory Council said that if exemptions are removed, India's tax to GDP ratio can rise from 17 to 22 per cent is thus a notable comment(https://www.financialexpress.com/economy/ending-exemptions-can-take-tax-to-gdp-ratio-to-22-pct-says-narendra-modis-chief-economy-advisor-bibek-debroy/966438/). That's a huge jump. This is so because as of now the complicated structure of exemptions are benefitting only large corporations who can have an army of tax experts to advise them on "tax planning". High exemptions also act as a barrier to lowering overall tax rates, since exemptions represent tax leakage. Removing exemptions would also mean looking at large loopholes like exemptions for capital gains in stock markets. Income tax is imposed on middle class earnings of human beings, not inanimate objects like companies.

So while we cannot completely do away with corporate income tax, we should move to lower taxes on companies and instead focus on imposing taxes on humans, i.e. shareholders. By this we will be rationalizing the tax rationale in India.

The Challenge

The challenge in a scenario like the one mentioned above is that – the tax in this context is for the income and not the savings. But if those savings generate more income, that income too should be subject to tax. In a way through this method we will aiming to encourage long-term savings, but that does not mean we violate this basic principle of taxing income whatever its source. Often the salaried class feels unfairly targeted because that is the only class whose tax is cut, even before they see their paycheck. Thus income from capital and labour has to be taxed with fair treatment. A new DTC was proposed in 2010, and a draft was ready to be passed by the Parliament in 2013. Unfortunately it lapsed with the 15th Lok Sabha. Its demise may be a blessing in disguise, because the final version had too many elements of compromise which had diluted the reformist features.

Role of Law making

It is said that the 'Indian lawmakers have the genius of doing the right thing, after trying out everything else!'

It is good that the current government has a new panel formed headed by tax veteran Arbind Modi, a member of the original Kelkar Task Forces who also helped draft the DTC which lapsed in 2013. We hope that under the guidance of this committee, the panel will propose a bolder, simpler, fairer and a comprehensive direct tax code with minimal exemptions, which is friendly to the taxpayer.

Chief Economic Advisor (CEA) Arvind Subramanian recently stated that the implementation of the goods and services tax (GST) will reduce disparities among the states. In this context he was referring to the idea of "convergence" of a federal India. He also stated further that the people in the country have not fully understood GST. In his reference to GST he said that under GST regime, no state can offer incentives to attract investments. GST will be placing some restriction on states in placing incentives to industries. This in his view would actually promote convergence and reduce divergence among states.

Early Conclusion

Thus from the above arguments and facts it can deduced that tax reforms are likely to stay on and that they are here to expand revenue base in fast growing economies like India but they will be most effective when accompanied by lowering of fiscal deficit and effective management of expenditure – which is in other words the rationalizing of the taxes – it is this step that was appreciated by the Moody's Investors Service recently.

In their statement the Moody's said that while most sovereigns have embarked on tax administration and compliance reforms, especially through the centralization of multiple agencies and increased usage of technology. "We believe that tax administration and compliance is likely to be most effective in India apart from other south Asian countries.

It is true that a good tax reforms is likely to expand revenue bases in fast-growing economies strengthening expenditure and debt management however it must be remembered that such a move has to be stabilized with adequate measures of tax administration. Thus mere broadening the tax base are unlikely to boost fiscal strength unless accompanied by enhanced tax administration and measures that effectively manage expenditure growth.

V. Conclusion

No discussion on tax reforms in India or its rationalizing is complete without understanding of its valid criticisms. In the recent past the World Bank has quite rightly criticized the complicated goods and services tax (GST) introduced in India. It said that there are four rates—plus many items that are exempt from the tax; there is a special rate for gold; key products such as petroleum, electricity and real estate are not under the GST regime; and there is also a cess. The top GST slab in India is the second highest in the world. None of these criticisms are invalid. In fact high GST rates are a problem because such indirect taxes are regressive. The complicated rate structure limits efficiency gains. However what is important in tax reforms In Indian context – especially of the challenges of rationalizing it is the ability of the Indian government be it of any party is their willingness to listen to criticism and respond to it positively.

It is good that the GST Council in India has eyes and ears and has been trying in its recent meetings to address these problems. In this paper I argue that India should ideally have most economic activity taxed at a single rate, with a small list of essentials that attract no tax as well as a small list of demerit goods that should be taxed at a high rate. Additionally, the best way to bring down GST rates is by raising more direct taxes. In other words, direct tax reforms are the key to lower indirect tax rates.

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