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Goods and Services Tax (GST) in India: prospect for states

by Mohd. Azam Khan¹ and Nagma Shadab²
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Abstract: Goods and services tax (GST) is a broad based and a single comprehensive tax levied at every stage of the production and distribution chain with applicable set-off in respect of the tax remitted at previous stages. It is basically a tax on final consumption integrates the union excise duties, custom duties, services tax and state VAT. Presently around 140 countries have adopted the GST pattern, including India. The GST would be beneficial for the consumers as it reduces the final burden of taxation. For Government it leads the reduction of tax compliance efforts and administrative costs and for business units it leads transparency, complete set-off and removal of cascading effect of taxation.

It is in this background that the present paper tries to explain the significance of GST in India and its prospects for states to generate revenue and ensure transparency in tax structure. This paper is organized into seven sections. Section two presents justification for dual structure of GST in India. The third part presents the rate structure under GST work in India. The fourth segment is concerned with the working of GST in India. The fifth part shows the international experiences of GST at state level in India. The seventh and final part is related to conclusion and policy recommendations.

Keywords: Goods and service tax, budgetary revenues, India

JEL Classification: H2, H71

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1. Introduction

The value added tax (VAT) at central and state level has been considered to be a major step – an important breakthrough – in the sphere of indirect tax reform in India. If the VAT is a major improvement over the pre-existing central excise duty at the national level and the sales tax system at the state level, then Goods and Services Tax (GST) will indeed be a further significant improvement in the next logical step towards a comprehensive indirect tax reform in the country. Keeping this objective in view, an announcement was made by the union Finance Minister in the central budget (2007-08), that GST would be introduced with effect from April 1, 2010 and that the Empowered Committee of State Finance Ministers (a Committee formed by the Ministry of State Finance, Government of India to suggest the ways and means for the introduction and implementation of GST in India) on his request, would work with the central government to prepare a road map for introduction of GST in India (Report: Ministry of State Finance Government of India, 2009). GST is a new revolution that is soon to make its appearance in indirect tax regime. The tax was earlier supposed to make its grand entry on April 1, 2010 has now been postponed till April 2013 (Rajkumar, 2009).

Goods and services tax is a broad based and a single comprehensive tax levied at every stage of the production, distribution chain with applicable set-off in respect of the tax remitted at previous stages. It is basically a tax on final consumption. In simple term, GST may be defined as a tax on goods and services, which is levied at each point of sale or provision of services in which at the time of sale of goods or providing the service the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or provide the service (Rajib, 2008). It is the contemporary method of taxation being followed by the many countries in the world. It is a comprehensive tax on goods and services with a continuous chain of set-off benefits. This will benefit the business as these are transparent and a complete chain of set–off, which will result in widening of tax base and better tax compliance.
Effect of this is clear, a lower tax burden at the hand of the consumer by eliminating the cascading effect of taxation. Presently around 140 countries have adopted the GST pattern, including India. All the countries have demonstrated lower tax burden on the consumer as it widens the taxation base. At the outset, this method looks very simple but becomes complicated when input need to be separated from the production cost and also at the time of taxation of sale price, calculating landed costs etc. (Asok, 2010). This system is basically designed to simplify current level indirect tax system. It integrates the union excise duties, custom duties, services tax, and state VAT into a single levy known as GST. GST may be rightly termed as nation level VAT on goods and services with only one difference that, in this system not only goods but also services are involved and the rate of tax on goods and services generally the same. One of the main reasons for the introduction of GST is to avoid cascading effects of taxes in India. For example manufacturing of a product attract Central Value Added Tax (CENVAT), the manufacturer pays CENVAT on goods produced. So that CENVAT element is loaded on the producer.

According to VAT rules, the sales tax is payable on the aggregate selling price which include CENVAT. Here there is no set-off benefits available likewise, there are many situation in nature of cascading effect, for instance, state VAT on CST, entry tax on VAT etc. So in order to overcome from these problems Government decided to implement goods and service tax. India is a federal country where both the centre and the states have been assigned the power to levy and collect the taxes through appropriate legislations. Both the levels of Governments have distinct responsibilities to perform according to the division of power prescribed in the constitution for which they need to raise resources. Keeping in view the report of the joint working group on goods and services tax, the view received from the states and government of India, a dual GST structure with defined functions and responsibilities of the centre and the states is recommended (Sudarshan, 2010).

It is in this background that the present paper tries to explain the significance of GST in India and its prospects for states to generate revenue and ensure transparency in tax structure. This paper is organized into seven sections. Section two presents justification for dual structure of GST in India. The third part presents the rate structure under GST in India. The fourth section describes the working of GST in India. The fifth part
shows the international experiences of GST at state level in India. The sixth part shows the feasibility of GST at state level in India. The seventh and final part is related to conclusion and policy recommendations.

2. Many studies show that GST is positively related to economic growth and development of various sectors such as agriculture, manufacturing industry and trade, poverty reduction and employment in India. But these positive impacts depend on the neutral, rational and less bureaucratic design of GST.

Ravishankar (2010) analyzed in his study that GST not only include more comprehensive indirect central taxes and integrated goods and services tax for the purpose of set-off relief, but may also lead to revenue gain for the centre through widening of the dealer base by capturing value additions in the distributive trade and increased compliance. He argued that GST is not simply VAT plus services tax but an improvement over the previous system of VAT and disjointed services tax, because it removes cascading effects of CENVAT on Services tax. He observed that GST is essential at the state-level because state have additional power of levy of taxation on services and make the system more comprehensive due to set-off relief. Several taxes subsuming of the GST can also remove the burden of CST. GST also increase the possibility of collective gain for industry, trade, agriculture and common consumer as well as for the central government and the state Governments.

Rao (2008) examines in her paper the various issues which make feasible the Goods and Services Tax in India, such like feasible design of GST for India, some unresolved issues and option, and Revenue Neutral Rates of Tax. In the case of feasible design of GST, she discusses the various aspect of previous tax structure, and concluded that GST should be implemented at both the central and the state level. She also says that it is important to clearly specify a regime for taxation of inter-state transactions, and the tax base must be homogenized across the taxes. The other major issue of this paper is rate of the GST, about this issue she says that “A GST regime with acceptable tax rate might provide the scope for moving away from a multi-rate regime to a single rate of regime”.

Vasanthagopal (2011) examines in his paper the positive impact of GST on the various development areas such as agriculture, manufacturing industry, Micro, Small and Medium Enterprises, housing, poverty
reduction, employment, price level, Export and Import, GDP Government revenue etc. He says in his paper that GST could increase the price of agricultural product and this would be a boom to millions of farmers in India, similarly GST also benefits the manufacturing industry. According to him a flawless GST reduces 50% of cost in this sector which will make this sector to compete with their counterparts in west. According to him a flawless GST benefit all the above sectors of the country and a positive impact on direct tax collection which would trigger an increase in the government revenue. He concluded that these positive impacts of GST is dependent on a neutral and rational design of the GST, and also the balancing conflicting interest of various stakeholder, full political commitment for a fundamental tax reform with a constitutional amendment are necessary. In the end he says that the “switchover to ‘flawless GST would be a big leap in the indirect taxation system and also give a new impetus to India’ economic change”.

Alebel Salmman (2011) analyses in his paper two important issues of GST, first the problems which delay the implementation of GST and the effect of implementing GST on the revenue, trade and equity. He divided the problems in two parts, first related to administrator /government and second related to taxpayers. According to him in the case of problems related to administrator it needs advance preparation, adequate investment in tax administration, choosing the rate of tax and exemption, and impact on general price level. In the case of problem related to taxpayers, he point out two important things that tax payers should have for implementing the GST which are accounting records and knowledge about the features of the GST and the procedural requirement before the GST legislation come in force. Without theses will not make an efficient tax. In the case of second important issue he says, that GST has a positive impact of revenue and GST increases both revenue and social welfare. GST also benefits trade and will reduce the cost of exports and encourage foreign importers. In the case of equity, he says that achieving equity is difficult through the implementation of GST in a country that has formal sector.

Agrawal (2011) observes in his paper that, though Goods and services Tax the biggest taxation reform in India along with the proposed GST is not the desired and true form of GST. A single indirect tax cannot be done as India’s federal structure has to be preserved. He also says that
GST is expected to bring many benefits to the Indian economy. All these benefits are based upon the assumption that overall taxation structure is less bureaucratic and cumbersome than the present.

3. Justification for GST in India

Although VAT has shown some sort of progress, but there are certain short-coming in the structure of VAT, both at the central as well as state level. The shortcoming in CENVAT of the government of India lies in non-inclusion of several central taxes in the overall CENVAT such as additional custom duty, surcharges etc. Thus keeping the benefit of comprehensive input tax and services tax set-off out of reach for manufacture/dealer moreover no step has yet been taken to capture the value added chain the distribution trade below the manufacturing level in the existing scheme of CENVAT, therefore GST is one more and very important in Indian tax structure. Moreover the introduction of goods and services tax will create an effect for abolition of taxes such as octroi, central sales tax, state level sales tax, entry tax, stamp duty, telecom license fee, turnover tax, tax on consumption, or sale of electricity, taxes on transportation of goods and services etc. so as to get rid of the cascading effect of multiple layers of taxation.

It is anticipated that the implementation of GST will reduce inefficiency of VAT, compel better compliance, minimize transaction cost and increase the amount of revenue which will result in buoyancy of Indian economy. This piece of legislation would surely contribute to the growth of the economy in the day (Ranjan, 2010).

The existing multiple tax structure can’t construct a conducive environment for accelerated economic development. In the era of globalization when a Multinational company want to do business in India it finds new laws in each state. Not only that but they find so many complicated laws and procedures which reduces their interest to continue their business in India. Therefore the introduction of GST with minimum multiplicity of tax laws will ensure efficiency, equity and simplicity in the tax structure (Mrityunjay, 2010).

The differential multiple tax regimes across sector of production lead to distortion in allocation of resources, thus introducing inefficiencies
in the sector of domestic production. With regard to India’s export this leads to lack of international competitiveness of the sector which would have been relatively efficient under distortion off-set of taxes loaded on to the foreign export prices. The export competitiveness gets negatively impacted even further. Efficient allocation of productive resources and providing full tax offset is expected to result in gain for GDP return to the factors of production and exports of the economy. But the multiplicity of taxes further adds the difficulty in getting full off-set. For this reason the implementation of a comprehensive GST in India is necessary. The GST across goods and services is expected ceteris paribus to provide gains to India’s GDP somewhere within the range of .9 to 1.7 per cent. This value is obtained by the present value of the GST reform induced gain in GDP may be computed as a present value of an additional income stream base on some discount rate. In this case a discount rate as long term real rate of interest at about 3 per cent, gain in export are expected to vary between 3.2 and 6.3% with corresponding absolute value range as INR 246690 Million and INR 486610 Million. Import is expected gain somewhere between 2.4 and 4.7 with corresponding absolute value ranging between INR 311730 Million and INR 615010 Million. The sector with relatively high proportion increase in export includes textile and readymade garments, beverage, industrial machinery for food and textiles transport equipment other railway equipments electrical and electronic machinery chemical products organic and inorganic. Consequently the terms of trade also move in favour of agriculture vis-a-vis manufactured goods within the range of 1.8 to 3.8 per cent.

GST would also lead to efficient allocation of factor of production. The overall price level would go down, it is expected that the real return to the factor of production go up. The efficiency of energy resource use improves the new equilibrium. The introduction of GST would thus be environment friendly (Chadha, 2009).

4. Rate structure under GST

The Empowered Committee of the state finance minister released the first discussion paper on GST in 2009. This paper has specified the features of GST in India.
There will be two kind of GST, for the centre (CGST) and for the state (SGST). The taxes that are merged into GST is given in the following table:

<table>
<thead>
<tr>
<th>Taxes merged under CGST</th>
<th>Taxes merged under SGST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Excise Duty</td>
<td>VAT/State Tax</td>
</tr>
<tr>
<td>Additional Excise Duties</td>
<td>Entertainment tax (unless it is levied by the local bodies)</td>
</tr>
<tr>
<td>The Excise Duty levied under the Medical and Toiletries</td>
<td>Luxury tax</td>
</tr>
<tr>
<td>Preparation Act</td>
<td></td>
</tr>
<tr>
<td>Services Tax</td>
<td>Taxes on lottery, betting and gambling</td>
</tr>
<tr>
<td>Additional Customs Duty, Commonly known as Countervailing</td>
<td>State Cesses and Surcharges in so far as they relate to supply of goods and services</td>
</tr>
<tr>
<td>Duty (CVD)</td>
<td></td>
</tr>
<tr>
<td>Special Additional Duty of Customs-4% (SAD)</td>
<td>Entry tax not in lieu of octroi</td>
</tr>
<tr>
<td>Surcharges and Cesses.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Constructed from the Report Published by the Empowered Committee of State Finance Minister, Government of India (2009)

As the table shows, GST has made a start by merging the various centre and state taxes into CGST and SGST respectively. But the idea of a Pan India tax is still missing. The state also would get to tax services under the GST. Some goods/services taxes are kept in the purview of GST like purchase tax, tax on alcohol, tax on petroleum products (crude, motor, sprit, high speed diesel etc).

A separate accounting system for dual GST business will need to maintain separate account for the two GST.

No inter system input tax credit: there are separate accounts for the two, a business can get input tax credit paid on CGST and can only be utilized for paying output tax on CGST. Likewise, SGST input tax credit can only be adjusted for output tax SGST. There cannot be cross utilization of inputs tax between CGST and SGST.

Inter-state GST: IGST will be introduced to account for interstate sales. The center will collect IGST on the interstate from the exporting state and transfer it to the importing state. The producer and his customer will be eligible for input tax credit on IGST.

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Inter-state GST: IGST will be introduced to account for interstate sales. The center will collect IGST on the interstate from the exporting state and transfer it to the importing state. The producer and his customer will be eligible for input tax credit on IGST.
Taxation rate: there will be two tax rates for SGST, lower rate for necessary and basic importance items and standard rate for all other goods. Further there will be a special rate for precious metal and a list of exempted item. For CGST; also a dual rate structure will be adopted in conformity with the SGST rates. For service there would be one rate for both CGST and SGST.

The governments have not still arrived at GST taxation rate as discussions are still being held amidst members. Finance Commission Task Force estimates the revenue neutral rate (rates at which tax collection will be same in old and new regime) at 12 to 5 per cent for CGST and 7 per cent SGST.

Threshold exemption: this is built to keep small traders out of tax net. It is always difficult to monitor small trader’s costs and high traders for the same. Hence the tax system sets thresholds under which only business above a certain turnover will be taxed. In the VAT system states have adopted their own threshold limits, under GST there is an attempt to harmonization and keep the threshold limits similar across states. The limit being considered is Rs 1 Million for both goods and services. However, for CGST the limit is being considered as Rs15 Million for goods and services to be kept at “appropriately high” levels.

GST council and Dispute settlement Authority: - The 115th amendment bill mentions setting up two constitutional bodies GST council and GST Dispute Settlement authority. GST council will make recommendation on all key matters pertaining to GST like taxation rate under both CGST and SGST, exemption from GST etc. Union finance minister will chair the council with finance minister from states as members. The council members may also elect a vice-chair person of the council from the members. The dispute settlement authority will be responsible for any dispute amidst union/states/member with respect to GST. The authority would have one chairperson and two members. The chairperson should be judge from the Supreme Court or chief justice from the high court and appointment be made by the president of India on the recommendation of chief justice of India. Two other members should be experts from the field of law/economics/public affair on the recommendation of GST council. This has been done to balance the interest of the parties. Overall the GST system is the improvement over the indirect tax system. It merges the central indirect taxes under CGST.
and states indirect taxes under SGST. But still there is a vast scope of improvement as it is still far from a pan India tax system. The tax remains under both states and the centre. Then issues like exemption, dual rate structure remain in the system. It does not meet the harmonized design principle but is still going to be much better than the current system of taxation. The proposed GST system is on the line with the way has been conducting its reform. India has followed the gradual approach in most of its reform where reform is adopted with many of the deficiencies remaining in the system. It is like a skeletal system with just the basics in place. Over a period of time, the flesh is added to the bones to make the reform more comprehensive. The GST is also likely to move in the same direction (Amol, 2011).

5. How will GST work in India?

To understand the working of GST let us take a hypothetical example (with a manufacturer, one wholesaler and one retailer). Let us suppose that GST rate is 10 per cent 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. At 10 per cent GST, the input tax credit (ITC) would be Rs 10 (i.e. tax on purchase value) similarly; GST on output would be Rs 13 (tax on the value of output). The manufacturer will then pay net GST of Rs 3 after subtracting Rs 10 as GST paid on his input (i.e. input tax credit) from gross GST of Rs 13. The manufacturer sells the goods to the wholesaler when the wholesaler sells the same goods after making value addition of (say), Rs 20 he pay net GST of only Rs 2 after setting–off of input tax credit of Rs 13 from 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 Rs 1 after setting–off Rs 15 from his gross GST of Rs 16 paid to wholesaler. Thus, the manufacturer wholesaler and retailer have to pay only Rs 6 (Rs 3 + Rs 2 + Rs 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 following figure. The same illustration will hold in the case of final services provider as well.
Figure 1: Proposed mechanism of GST in India

**Manufacturer**

1.) Purchase Value input INR.-100/
2.) Value addition- INR.-30/

**Step 1**
3.) Value at which supply of goods and services make to next stage-INR.-130/
4.) Rate of GST-10%
5.) GST on output-INR.13/
6.) Input tax credit-INR.10/
7.) Net GST= GST on output- Input tax credit=INR.3/

**Wholesaler**

1.) Purchase Value input INR.-130/
2.) Value addition-INR.-20/

**Step 2**
3.) Value at which supply of goods and services make to next stage-INR.-150/
4.) Rate of GST-10%
5.) GST on output-INR.15/
6.) Input tax credit-INR.13/
7.) Net GST= GST on output- Input tax credit=INR.2/

**Retailer**

1.) Purchase Value input INR.-150/
2.) Value addition- INR.-10/
3.) Value at which supply of goods and services make to next stage-INR.-16/

**Step 3**
4.) Rate of GST-10%
5.) GST on output-INR.16/
6.) Input tax credit-INR.15/
7.) Net GST= GST on output- Input tax credit=INR.1/

Source: Ministry of State Finance Government of India, New Delhi
Net GST = INR. 3 + INR.2 + INR. 1 = INR. 6

Therefore GST would be beneficial for:
Consumers: the final burden of tax would be much less.
Government: reduction of tax compliance efforts and administrative costs.
Business: easier compliances (Thappa, Paravali and Das, 2011).

Now it is evident that working system of GST is very similar to that of the exiting VAT system. However, GST is applicable on both the goods and services; on the other hand VAT is applicable only on goods in India.

6. International experiences of Goods and Services Tax (GST)

More than 140 countries have introduced GST in some form. It has been part of the tax landscape in Europe for the past 50 years and is fast becoming preferred form of indirect tax in Asia Pacific region. It is interesting to note that there are over 40 models of GST currently in force, each with own peculiarities.

For this reasons we discuss international experiences of GST, three countries: New Zealand, Canada and, Australia. We choose these countries because these are federal Countries similar to India.

New Zealand

Goods and Services Tax (GST) was introduced in New Zealand on 1st October 1986 when the tax system had been characterized by a heavy reliance on personal income tax levied at very high marginal rates of up to 66%. Additionally, the income tax system had featured many rebates and deduction as well frequent tax avoidance/evasion owing to high marginal tax rates (Report: Legislative Council Secretariat, Information Note, 2002).

GST makes New Zealand’s main types of tax apart from income tax. It is an indirect tax, which business (including retailers) charge as part of the cost of goods and services that they supply. The current rate is 15%. When a GST registered business buys goods or services from its
suppliers, it can claim a credit for the GST the suppliers charge on these purchases. However end-user consumer cannot claim a deduction for GST in this way. The effect of this is that the final consumer of any product or services pays 15% GST on its cost.

GST is charged virtually all goods and services supplied in New Zealand, except for rental of residential property, financial services such as mortgages, loans and investment, and the sale of a business that is capable of being carried on by the purchaser as a taxable activity (Inland Revenue, 2010).

The introduction of GST was part of a tax reform package aiming to reduce the economic inefficiencies embodied in the “narrow-base, high rate” tax regime. In particular, GST replaced the (WST). Meanwhile, GST was levied at high rate in order to more than offset the shortfall resulting from the abolition of WST. The extra revenue from GST reduces personal income taxes, and helps finance the direct compensation arrangement for low-income groups.

The introduction of GST and the subsequent reduction in personal income tax rates have contributed to reduced reliance on direct taxes. In 2001-02, 25% of total government tax revenue was derived from GST, with an additional 10% from other indirect taxes. In 1985-86, indirect taxes only accounted for 25% of the total government tax revenue.

GST is calculated under a credit-invoice mechanism and charged on the value added at each stage in the production and distribution of goods and services. The Inland Revenue Department is responsible for collecting GST from taxable goods and services. GST is charged at a rate of 12.5% on all goods and services which is not zero rated or tax exempt (Report: Legislative Council Secretariat, Information Note, 2002).

Canada

In 1991, the federal government introduced the GST. The tax replaced the previous federal sales tax, which was imposed directly on
manufacturers and certain licensed wholesaler at a general rate of 13.5% of sales revenues. The federal sales tax remained hidden in the price of goods as the cost of the tax was passed on to retailer and consumer in the price of products manufactured in, or imported into Canada (Butcher and Gaudon, 2009).

The GST is a value-added tax in which each stage of the production/distribution system is assessed. Thus, it is not like a retail tax or a one incident tax that is charged to a consumer when sale is made. There is little exemption under the GST. Under the old tax system or the federal sales tax, all raw materials, parts, components and production were exempt as a Canadian manufactures accounted for the tax when they sold the goods. Finished goods such as food, clothing or services weren’t taxed. Many of these items are now subject to the GST. Tax-exempt status only applied to the following services: Real property, health care, education, childcare legal aid, public sector bodies, financial services and ferry road and bridge tolls.

The GST is a comprehensive VAT. It covers almost all goods and services at all stages of production-distribution process. The tax levied at the rate of 7% on sale price. However, input tax credit is allowed for all purchases in the course of business. Thus, the total amount of tax on goods and services is equal to the final selling price multiplied by the rate of GST.

Technically, the GST is a tax that is levied on the purchaser after the vendor collects the tax; it is the remitted to revenue of Canada. However the tax that the vendor pays the government is the difference between what was collected and tax was paid in the marketing and distribution costs. Hence, the GST is business transfer tax as it flows through the business to the consumer.

\[
\text{GST-GST Paid} = \text{GST Remitted}
\]

At the times a company may find itself in the desirable position to collect a refund, this happens when a company pays more GST then it collects. Most Canadian exporters fall into this category as the GST cannot be charged to a foreign customer (Canadian GST, 2012)
Table no. 1: GST and the Distribution Chain in Canada

<table>
<thead>
<tr>
<th></th>
<th>Manufacture</th>
<th>Wholesaler</th>
<th>Retailer</th>
<th>Final consumer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoice</td>
<td>$3,000</td>
<td>$50.00</td>
<td>$12,000</td>
<td>$17,000</td>
</tr>
<tr>
<td>GST</td>
<td>210</td>
<td>350</td>
<td>840</td>
<td>1190</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Manufacture</th>
<th>Whole seller</th>
<th>Retailer</th>
<th>Final consumer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes on sales</td>
<td>210</td>
<td>350</td>
<td>840</td>
<td>1190</td>
</tr>
<tr>
<td>Less tax on purchases</td>
<td>0</td>
<td>210</td>
<td>350</td>
<td>840</td>
</tr>
<tr>
<td>Tax to Canada</td>
<td>210</td>
<td>140</td>
<td>490</td>
<td>350</td>
</tr>
</tbody>
</table>

Australia

Beginning in the 1930, Australia imposed a national wholesale sales tax on goods. Initially the tax was imposed at a single rate of 2.5%, but by 1998 the wholesale sales tax was imposed at six different rates with a base rate of 22%. The wholesale sales tax was a “robust and stable source of revenue” (Commonwealth of Australia, 1998) for Australia “given the structure of the economy at the time” (Commonwealth of Australia, 1998). However, as the country moved from manufacturing to a service-based markets, then wholesale sales tax become illogical and distorted.

In a 1998 report, the treasurer of Australia outlined the problems with the tax system. The treasurer noted that revenue from indirect taxes had been declining relative to direct taxes. Under the system, the treasurer concluded, Australian wages and salary earners carried a significant share of the tax burden. The treasurer also observed that the wholesale sales tax penalized exports and discouraged investment. Finally the treasurer also observed that income tax complexities impose high compliances costs on business and distorted investment decision-making “by encouraging investments on the basis of tax effect rather than economic merit” (Bird and Gendron, 2009) in essence, the conclusion was that the system was ‘out of date’ unfair, internationally uncompetitive, ineffective and unnecessarily complex” (Bird and Gendron, 2009).
In effort to modernize its entire tax system and address the problems described above, Australia introduced a new indirect tax GST in 2000. The GST replaced the wholesale sales tax as well nine types of state taxes. The GST fully harmonized imposed and administered as a single national tax whose revenues are shared with the states. The GST was lauded as a fairer simple tax system that would provide sound finances for the government, boost business and investment, and promote Australian exporters, the goals of Australia’s tax reform was driven by three broad goals stabilizing, compliance, and improving Australia ‘s global competiveness (Durner, Bui and Sedon,2009).

GST applies to goods and services supplied in Australia and to goods imported into Australia. Some goods such as certain foods, and some services, such as certain health, education and financial fees, are not subject to GST.

The GST is a flat 10% broad–based tax on the private consumption of most goods and services in Australia. The tax is charged and collected by registered entities at each stage in the production chain. The GST is remitted by the registered entity to the ATO on a basis in a form entitled the Business Activity Statement. Each registered entity is entitled to claim a credit for any GST paid. This credit is known as an “input tax credit” and the tax is ultimately borne by the consumer. Each registered entity is required to remit the net amount of GST collected to the Australian Taxation office each month or quarter via the BAS. This all processes we illustrated in Diagram below (Queensland Governmant, 2006).
Diagram no. 1: How the GST Works in Australia

After a brief discussion of GST in three countries we show the impact of GST in these countries. Table provides a brief summary of the main features of the GST in Australia, Canada, and New Zealand.
Table no. 2: Process of GST implementation

<table>
<thead>
<tr>
<th></th>
<th>New Zealand</th>
<th>Canada</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year of introduction</strong></td>
<td>1986</td>
<td>1991</td>
<td>2000</td>
</tr>
<tr>
<td></td>
<td>1989 (raised to 12.5%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Rate(s)</strong></td>
<td>10% initially then 12.5%</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Threshold requirement for registration</strong></td>
<td>$20,000</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Exemptions</strong></td>
<td>Limited</td>
<td>Financial Supplies, Owner-occupied housing</td>
<td>Food Education Health Financial Supplies owner –occupied housing</td>
</tr>
</tbody>
</table>


From the table we see that Canada had the highest effective rate of GST at 15%, New Zealand the second highest rate of GST rate at 12.5% with Australia on the lowest rate at 10%. Moreover, the GST base was widest in New Zealand and the most restrictive in Australia.

The neutrality of any tax instrument between different goods and services, factor of production, and sector of the economy is an important attribute of the instrument. In the field of indirect taxation, neutrality would be achieved by subjecting all goods and services consumed by household to be the same rate of ad valorem taxation.

Each of three countries had their GSTs imposed on a different base: New Zealand had the fewest exemptions; Canada had some exemptions, including food, education, health, financial product and owner-occupied housing. All three countries chose to have a multi-stage VAT with a system of refundable input tax credits as opposed to a RST imposed only at the retail stage.
Table no. 3: Summary of some key Economic Neutrality Impact

<table>
<thead>
<tr>
<th></th>
<th>New Zealand</th>
<th>Canada</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Net Revenue</td>
<td>Revenue Neutral</td>
<td>Slightly revenue contractionary</td>
<td>Slightly revenue expansionary</td>
</tr>
<tr>
<td>Administration Consideration</td>
<td>Low registration threshold</td>
<td>Medium registration threshold</td>
<td>Medium registration threshold</td>
</tr>
<tr>
<td>VAT or RST</td>
<td>VAT</td>
<td>VAT</td>
<td>VAT</td>
</tr>
</tbody>
</table>


New Zealand’s measures were the most neutral economically. From the above table we see that Australia introduced the least neutral GST package, the Canadian GST policy was somewhat more neutral. At the time of New Zealand’s GST introduction all three countries had roughly 4% to 6% annual consumer price inflation rates. In the year following the introduction of the GST in Canada, the average of the three countries had dropped to between 1% and 2%, the average are still low in the year before the introduction of the GST in Australia. According, the observed spike in price level that occurred in all three countries should not be compared directly inter temporally with regards to economic performance since almost all other factors impinging on the rate of inflation were different. However, all three countries did exhibit a spike in price level.
The relative performances of the three countries are shown in fig1. In all three countries the impact was temporary New Zealand had the largest impact Australia the least impact on consumer price inflation, and Canada fell between these two countries. The magnitude of the impact seem to follow the downwards trends in underlying inflation that all three countries have been experiencing during the period of analysis. There is no indication of any subsequent wage price spiral. Figure 2 contains the basic data on economic growth performance in the three countries.
The relative performance of three countries is illustrated in Figure 2. It is immediately apparent that the economic impacts of the GST package were quite varied across countries; the dramatic jump in GDP in 1987 in New Zealand can hardly be attributed to GDP growth since both Australia and Canada experienced a simultaneous boom period. For the same reasons, the Canadian recession could not have been included by the introduction of the GST because it formed part of the global recession.

Revenue effect is widely recognized that one of the key factors that had driven the introduction of the GST was the need to raise additional tax revenue, various factors have been advanced to explained the inability of the previous existing tax regimes to collect sufficient revenue, especially the erosion of the good tax base under the MST and WST and the
increasing service sector share of GDP. As it turned out, the observed revenue that was raised has been substantially greater than was predicted in all three countries concerned.

Figure 3 illustrates the relative fiscal performance of the three countries since 1980. It is evident that there has been significant change in the budget balance of all three countries. At the time of introduction of the GST in each of the three countries there had been a slight net decrease in government revenue as a percentage of GDP. This concurs with observation of relative neutrality of the measures in each of the three countries in that they replaced wholesale sales taxes and introduced income tax change that resulted in approximately balanced revenue impacts. The country with the highest net revenue gain following the introduction of the GST was Canada. Australia had a revenue loss, but still maintained a budget surplus.

**Figure no. 4: General government balance in percent of GDP, (1980-2010)**

![Graph showing general government balance in percent of GDP from 1975 to 2015 for New Zealand, Canada, and Australia.](source: International Monetary Fund, 2010)

From the above we see that impact of the introduction GST is significant in term of growth effect, price effect, and the effect of budget
balance. But these effects because these are highly developed open economy with a high and growing service sector, a change in the tax mix from income to consumption-based taxes is likely to provide a fruitful source of revenue. Thirdly, the aggregate consumption price impact of the introduction of the GST in Australia, Canada, and New Zealand on a macro-economy was both limited and temporary (Bolton and Dollery, 2004).

7. Feasibility of GST in India at state level

India consists of twenty-eight states and seven union territories and these states have their own state parliament (known as legislative assembly) and state government is headed by the chief minister of the state. Similarly, central government has parliament represented by the members elected from all over India. The administrative and legislative powers of states have been governed by the constitution of India and for this reason the design of GST is going to be challenged. Type and design of GST should be feasible at federal level and state should also satisfy this design. Any design based on a central state coordination and harmonization will leave little room for variance in the rate setting by states at least in the near future.

Firstly we will undertake the problem in the existing system of taxation and the problems that can be removed by the comprehensive GST. In the existing state-level structure there are also certain shortcomings. For instance, several taxes which are in the nature of indirect tax on goods and services such as luxury tax, entertainment tax and not yet subsumed in the VAT. Moreover in the present state-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under state VAT and contributing to the extent of cascading effect on account of CENVAT element. This CENVAT loads needs to be removed. Furthermore, any commodity in general is produced on the basis of physical inputs as well as services, and these should be integration of VAT on goods with tax on services at the state level as well. For this reason GST will help in reducing the cascading effects of taxation prevailing at central and state levels. This is the essence of GST and that is why GST is not simply VAT plus services tax but an
improvement on the previous system of VAT and disjoined services tax. However for this GST to be introduced at the state-level it is essential that the states should be given the power to levy taxation of all services. This power to levy service taxes has so long been only with the centre. A constitutional amendment will have to be made for giving this power to states; moreover with the introduction of GST the burden of central sales tax (CST) will also be removed.

The GST at the state-level is therefore justified for:

- Additional power to levy taxation of services for the states.
- System of comprehensive set-off relief, including set-off for cascading burden of CENVAT and service taxes.
- Subsuming of several taxes in the GST and
- Removal of burden of CST (Sukamal and Tamal, 2010).

Due to removal of cascading effect the burden of tax under GST on goods in general will fall. But we see a few state governments have recently indicated their opposition to the implementation of GST at the present juncture. While their objectives need to be carefully examined, it must also be recognized that while implementing of the GST is aimed at being revenue neutral to the states. It will be budget positive to government, this is because government is also larger purchasers in the market for their own consumption, and their cost of procurement will come down significantly with the implementation of GST. Apart from these static benefits, dynamic benefits will be generated in the medium term through more economy, efficient production, improved completion and more importantly greater employment (Kelker, 2009).

The feasibility of GST to states can be further examined with several extra points. While the states will normally not be able deviate from the nationally agreed model for the GST, such constraint's will apply to the center as well. Further the states still have fiscal headroom available. They can impose an additional levy on transmission fuels as well as sumptuary to any goods and the authority to levy temporary cesses and surcharges in case of emergencies. They can also continue to levy user charges for services provided to citizens. Expenditure policy will continue to remain as a powerful fiscal instrument for the strengthening of their fiscal base and will improve their access to capital markets enhancing their borrowing capacity.
The tax base of state governments will significantly increase with the inclusion of the tax on services as well as the tax on manufactures. The tax base of the center on the other hand, will increase only to the extent of tax on sales. Thus it cannot be said that it creates the vertical imbalance will increase in favor of the centre.

State will benefit from the abolition of the cesses and surcharge presently being levied by the centre as the size of the divisible pool will rise. Presently this amount is around 15% of divisible pool.

Tax policy is tax administration, and significant scope exists for improving tax collection efficiency through implementation of GST. The GST grant recommended by this commotion compensates for the seeming limitation in fiscal autonomy by enhancing expenditure autonomy through compensation payments and addition prescribed transfers.

The GST will be a land mark efforts by the states and the union to further strengthen the lines of cooperation in the federal structure with all stake holders contributing to national welfare by accepting its framework (Report: Thirteen Finance Commission, 2009).

Conclusions

The GST is a further significant improvement in the next logical step towards a comprehensive indirect tax reform in India. Indeed, it has the potential to be the single most important initiative in the fiscal history of India. It can pave the way for modernization of tax administration; make it more simple and transparent and a significant enhancement involuntary compliance. However the positive impact of GST only depends on a neutral and rational design of the GST. Likewise, balancing of the conflicting interests of various stakeholders, full political commitment for a fundamental tax reform of the system with a constitutional amendment the switch over to a flawless GST would be a big leap in the indirect taxation system and also given a new impetus to India’s economic change. It should be noted that around 140 countries have already introduced GST in some form or another and is fast becoming the preferred form of indirect tax in Asia Pacific region (Satya and Ehtisham, 2009).

Despite forming a positive step, the discussion paper leaves out some crucial issues. Firstly, a definitive structure for services has not yet
been delineated. Important sectors like real estate, oil and gas have kept out of the scope. Moreover issues continue to underline the integrated goods and services tax in the case of flow of products across multiple states. More over while small traders have been exempted; the criteria to be adopted many differ across state which may again go against the rationale for a harmonious tax system. Also ambiguity exists in the nature of the exempted list. The fact that all states have agreed a uniform system of indirect taxation in principle is a positive step towards its implementation. However it appears that sharp difference continue to exist between states regarding the contours of GST. Some states like Tamil Nadu has proposed a floor rate based system as a measure to introduce flexibility. More over the omission of items in the exempted list and delineated guide lines for services does indicate that consensus still eludes significant facets. Moreover substantial amount of taxes remain outside the GST ambit especial the one’s levied by Municipal Corporation like octroi. The Government should consciously look over these things then only the element of transparency can be achieved in Indian tax structure (Ravishanker, 2010).

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