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# Let's make GST a good and simple tax

M Govinda Rao writes: Existing rate structure needs to be rationalised. There should be only two rates

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The introduction of the value-added tax (VAT) has been perhaps the most important tax reform seen across countries in the last three decades. As of 2018, as many as 166 out of the 193 countries that are members of the UN had implemented the VAT in one form or another. In India, it has been a remarkable achievement and a unique experiment in cooperative federalism. In this, both the Union and the state governments gave up their tax autonomy in favour of harmonising domestic trade taxes. The objective of the reform was to simplify the indirect tax system, make the system competitive by reducing cascading effects and increase revenue productivity. Building a consensus to implement GST by combining 11 different domestic indirect taxes levied by the Centre, states and Union territories with legislatures took considerable time and involved several compromises in the structure and operational details. Not surprisingly, some bad features entered into the structure of the tax to get it accepted. It has now become extremely difficult to remove them.

One of the most important shortcomings in the structure of GST is multiple rates. The committee headed by the Chief Economic Adviser estimated the tax rate at 15-15.5 per cent. It further recommended that in keeping with growing international practice, India should strive towards a single rate in the medium-term to facilitate administrative simplicity and compliance, but in the immediate context, it should have a three-tier structure (excluding zero), comprising of a lower rate of 12 per cent, a standard rate varying between 17 to 18 per cent and a very high rate of 40 per cent on "demerit" goods. The structure finally adopted was to have four rates of 5, 12, 18, and 28 per cent besides zero, though almost 75 per cent of the revenues accrue from the 12 and 18 per cent slabs.

The reasons for adopting a single rate structure in most countries are to have a simple tax system, prevent misclassifications and litigations arising therefrom, and to avoid an inverted duty structure of taxes on inputs exceeding those on outputs requiring detailed scrutiny and refunds. In India, items like electrical transformers, railway wagons, some textile products, plastic bags, and solar modules are examples that have inverted duty structures. The main reason for rate differentiation is equity. But it is argued that this is an inefficient way of targeting benefits for the poor. Although the exempted and low-rated items are consumed relatively more by the poor, in absolute terms, the consumption may be more by the rich. Furthermore, the ideal way of targeting the benefits to the poor is on the expenditure side, through targeted cash transfers to vulnerable groups and providing quality education and healthcare. Of course, unprocessed food items have to be exempted for reasons of administrative difficulty, but the list should be kept small. The rate structure that has been adopted in India is chaotic and in need of urgent reform.

Now, in fact, is the opportune time to rationalise the rate structure. The economy is in recovery mode and more importantly, GST revenues have shown reasonably high buoyancy with collections of over Rs 1 lakh crore in the last 10 months and touching a record of Rs 1.68 lakh crore in April 2022. What is important is that the revenue increase has not come about only due to the economic recovery. The more important reason seems to be that at last, the GSTN has been able to stabilise the technology platform. Mandating the issue of e-invoicing for all businesses above Rs 100 crore has enabled better invoice matching and detection of fake invoices that were used to claim the input tax credit. This has helped to improve tax compliance and has also enabled better enforcement. With time, the GSTN should be able to enforce e-invoice requirements on all businesses above Rs 10 crore, which will cover more than 95 per cent of taxpayers. With this development, we can expect high revenue buoyancy, which should provide sufficient compulsion to comply with the tax.

Of course, the GST council is concerned about the problems arising from excessive rate differentiation and has set up a seven-member ministerial panel chaired by the chief minister of Karnataka. The panel's report is awaited. But it has been widely reported that the committee is thinking of increasing the lower tax rate from 5 per cent to 8 per cent and moving some essential items from the 5 per cent category to the 3 per cent slab. This will be retrograde because a rate category will be added. The need of the hour is to reduce the rate categories.

Ideally, it would be desirable to have a single rate of tax besides exemptions on unprocessed food items. That will avoid not only the problems arising from multiple tax rates but also put an end to lobbying by manufacturers for placing their products in the low tax rate category. However, moving over to a single rate structure may not be implementable at this stage due to political economy considerations. It would be preferable to merge the 12 per cent and 18 per cent categories into a 15-16 per cent slab and move the items in the 5 per cent category to the 8 per cent slab and remove the 28 per cent category altogether. That will result in the GST structure with two rates and as the cesses will cease after 2026 when the compensation requirement is over, it will really become a "good and simple tax".

This column first appeared in the print edition on May 6, 2022, under the title 'Make GST good and simple'. The writer is chief economic advisor, Brickwork Ratings. He was member, 14th Finance Commission and former director, NIPFP. Views are personal