



MAJOR REFORM

# GST BILL A HISTORIC LANDMARK, BUT FORMIDABLE CHALLENGES LIE AHEAD

## EXPERT VIEW

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**B**oth politically and economically, passage of the goods and services tax (GST) bill was a major landmark. But the path from the bill to the implementation of GST is fraught with many challenges.

Getting here has taken us 10 years since P. Chidambaram, as finance minister, announced a 2010 target for introducing a GST in his budget speech of 2006. Sixteen years if we count from prime minister Atal Bihari Vajpayee's establishment of the first empowered committee to design a GST in 2000. This is not surprising because introduction of GST will be a very major tax reform, as far reaching as any of the reforms introduced in 1991. It will completely change the architecture of indirect taxation, significantly restructure the power to tax between Union and state governments, and establish for the first time an integrated common market for the whole country. Moreover, this fundamental reform has also been subject to several conflicts of interest: between the two major political parties, the Congress and the Bharatiya Janata Party (BJP), between the Union and state governments, and between the producing and consuming states, since GST will entail a shift from a production-based tax to the one based on consumption.

A GST can be particularly challenging in a federal system. It is instructive that the US, for instance, has not succeeded in putting such a tax in place even after trying for decades. That we ourselves have got here despite all the conflicts of interest is a remarkable political achievement. Despite all the blocking and jousting inside and outside Parliament, all the political parties could finally come together to serve a larger national interest. Even the All India Anna Dravida Munnetra Kazhagam, the sole exception, did not actually vote against the bill. They simply abstained. While the changing arithmetic of voting power in the Rajya Sabha no doubt helped, credit must be given to both the ruling BJP and the opposition, led by the Congress, for achieving this political landmark.

Economically too, introducing GST will be a landmark reform. GST is a value-added tax (VAT), where sellers of goods and services can take credit for tax already paid on their purchases. It eliminates "cascading," or tax on tax, a characteristic of non-VAT taxes. Normally, elimi-

nating the cascading should reduce the effective rate of taxation. But since the Indian GST system is intended to be revenue-neutral, the effective tax rate may not change much. However, there are several other advantages that can make GST a game changer. It will replace a plethora of indirect taxes, from excise duties to octroi, by a single tax, harmonized across states and the Union government. This rationalization in itself will be a major reform. More importantly, GST will create for the first time a pan-India common market, without differential taxation across states that distort the spatial allocation of resources. It will also enable the free flow of goods and services across the country, without artificial tax barriers. The gains in economic efficiency and economies of scale will be enormous, provided of course that rent seekers do not find new ways of distorting the market to their advantage.

The other major economic advantage of GST arises from the tax information system. Since at each stage of the supply chain sellers can take credit for taxes paid on their purchases, GST will require a tax information system that mirrors the supply chain. A flaw or break at any point in the information system will compromise the tax credit chain for those higher up the supply chain. There is therefore a built-in incentive towards transparency, better compliance, and less revenue loss to the exchequer on account of evasion. However, my colleague Kavita Rao at the National Institute of Public Finance and Policy, an expert who has spent years in back-room efforts to design a revenue-neutral GST, warns that determined tax evaders could potentially design whole chains of unreported transactions from one supplier to the next to game the system. She maintains that successful implementation of GST will depend on whether or not incentives, including ease of compliance, are adequately loaded in favour of compliance as opposed to evasion.

There are several other challenges that make introduction of GST by 1 April 2017 a daunting target. These include rolling out the required IT platform for implementing GST and sorting out the administrative arrangements for a very complex GST system consisting of state GSTs, central GST, and an integrated GST for interstate movement of goods and services. But the most difficult challenge is to complete the remaining legal processes, in-

particular those relating to the tasks of the GST Council.

For rolling out of the required IT platform, called GST Network (GSTN), the National Securities Depository Ltd has to compile the necessary data base for some eight million traders and service providers in collaboration with the Union and state governments, and issue each entity a GST ID number for retrieval of all relevant data similar to an income tax PAN card. This is a formidable task. But quite a bit of the data has already been compiled and verified from the income-tax data base. Additional data regarding nature of business, place of business, bank account details etc. are yet to be compiled. Barring unforeseen developments, rolling out of GSTN by 1 April 2017 will be challenging but feasible.

Setting up the administrative mechanism for implementing a complex dual GST system, which involves overlapping

jurisdictions of Union and state governments, is another daunting challenge. The same tax entity, a trader or service provider, will be paying GST consisting of a state component, a central component, and possibly an integrated component. Who would collect the tax, deal with the tax entity, conduct audits or undertake litigation if required? Neither the Union government nor states would voluntarily give up control of their jurisdictions. This is a complex issue that the GST Council will have to resolve. Rao suggests that the best way forward may be to establish a separate board for administering GST, somewhat like the existing central boards for direct taxes and excise and customs. It could draw its staff from both the central government as well as state governments. Hopefully, the GST Council will consider this proposal.

Completing the legal process, especially the tasks before the GST Council, will be the most challenging of all. Following approval of the Constitution (122nd Amendment) Bill by both houses of Parliament, state legislatures now need to approve the amendment. Assam, Bihar and Jharkhand have already approved the amendment and other states legislatures are scheduling special sessions for the same purpose. Once half the states have approved the amendment, the president can approve the notification amending relevant sections of the Constitution. Within 60 days thereafter, the president also needs to appoint the GST Council. The council will be chaired by the Union

finance minister and include all state finance ministers. Based on the recommendations of the GST Council, Parliament will have to enact two laws to make the central GST and the integrated GST operational. Similarly, each state legislature will have to enact its own state GST law to make the state GSTs operational.

The GST Council will be the core institution of the new GST system. It will determine, among other things:

- (i) the rates, including thresholds and bands, for different classes of goods and services
- (ii) the indirect taxes, cesses and surcharges to be subsumed under GST
- (iii) the goods and services to be exempted from tax
- (iv) the place of supply for application of the tax
- (v) the threshold below which traders and service providers will be exempt from GST
- (vi) the date for extending GST to petroleum, diesel, gas, etc.
- (vii) administrative arrangements for implementing dual GST, and
- (viii) the mechanism for dispute resolution

Reaching consensus on each of these contentious issues, with conflicting interests, will not be easy. The Union government will have 33% voting power in the GST Council, effectively giving it veto powers because decisions will require 75% majority. Reciprocally, states collectively will have 66% voting power in the GST Council, so the Union cannot push through any decision unless most of the states concur.

Clearly, the GST Council will have to work by consensus. Can it possibly take all its decisions in time to enable the subsequent legal steps by 1 April 2017?

Finance minister Arun Jaitley is quite right in holding to the 1 April 2017 timeline for introducing GST, keeping up the pressure on everyone, including himself. However, the challenges outlined above make it quite difficult to meet that deadline. Possibly, the GST roll-out could slip to the 2017 monsoon session of Parliament, or even the winter session. Whenever it happens, it will stand out globally as a remarkable case in tax reform, implementation of GST in a complex, democratic, federal political system.

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### NEXT ESSAY

Montek Singh Ahluwalia

