

National Goods & Services Tax (GST)

The updated reports on roadmap of GST in India indicate that there would be dual GST to be administered both by the Union Government and State Governments simultaneously. If such a taxation system is brought under GST, it will create further complications in as much as the dual authority will result into much paper work and will also create several confusions for an average trader of the Country who is already short of necessary infrastructure even to upgrade his respective business. Under such circumstances, it is strongly advocated that a National GST is the only way to simplify and rationalise the tax structure and will encourage voluntary compliance which is the basic fundamental of a successful taxation regime.

As per an in depth study, the concept of National GST consists of a regime where the two levels of government would combine their levies in the form of a single national GST, with appropriate revenue sharing arrangements among them. The tax could be controlled and administered by the Centre, States, or a separate agency reporting to them. There are several models for such a tax. Australia is the most recent example of a national GST, which is levied and collected by the Centre, but the proceeds of which are allocated entirely to the States.¹³

In China, the VAT law and administration is centralized, but the revenues are shared with the provinces. In going to this model, the Centre had assure the provinces that they would continue to get what they did under the previous arrangement and that changes in revenue shares would be phased in over an extended period of 15 years.

Under the Canadian model of the Harmonized Sales Tax (HST), the tax is levied at a combined federal and provincial rate of 13 percent (5% federal rate, 8% provincial rate) in the three participating provinces. Tax design and collection are controlled by the Centre, but the provinces have some flexibility to vary their tax rate. The revenues from the tax are shared among the participating provinces on the basis of consumer expenditure data for the participating provinces.

In Austria, and Germany, the tax design is controlled by the Centre, but states collect the taxes. This has led to incentive problems, as some of the Lander have begun to use tax administration measures to achieve tax policy goals. In Mexico, the establishment of a VAT at the center replaced state sales taxes, but had to be part of a political-economy compromise that assured the states an automatic share of the revenues generated from all federal taxes.

A single national VAT has great appeal from the perspective of establishment and promotion of a common market in India. However, the States may worry about the loss of control over the tax design and rates. Indeed, some control over tax rates is a critical issue in achieving accountable sub-national go variance and hard budget

constraints. The States may also be apprehensive that the revenue sharing arrangements would over time become subject to social and political considerations, deviating from the benchmark distribution based on the place of final consumption. The Bagchi Report also did not favor this option for the fear that it would lead to too much centralization of taxation powers.

¹The Australian constitutional situation is that both the States and the Commonwealth (the Federal Government) have power to tax supplies of goods and services. The constitution prevents laws interfering with interstate trade (including tax laws) and gives the power to collect Customs and excise taxes exclusively to the Federal Government. It is forbidden for the Commonwealth to tax State Property. To meet this requirement, the GST implementation laws, of which there are 6, simply state that they do not impose tax on State properties and the States accept that view, at least at the moment. The GST was introduced on the pretence that it was a State tax being collected by the Commonwealth in order to (a) secure the States' agreements to abolish some of their preexisting transaction taxes, in particular certain stamp duties, financial institutions duties, etc and (b) to ensure that the States wouldn't start a round of attempts to challenge the constitutional validity of the law (as was done, unsuccessfully, in the past with income tax, which both States and Commonwealth also have power to collect. The current Government has acknowledged that GST is in fact simply a Federal Tax that it uses to make grants to the States and as a result of this acknowledgement, the Auditor General has for the first time since 2000 agreed to approve the Commonwealth accounts.

These concerns can be addressed partially through suitable administrative arrangements and centre-state agreements. The tax design could be made subject to joint control of the Centre and the States. The States would necessarily lose the flexibility of inter-state variation in tax design, but that is also the perceived strength of this option. Given that the Centre does not have the machinery for the administration of such a tax, the States would presumably play a significant role in its administration. The revenue sharing formula could also be mandated to be based on the destination principle, as under the Canadian HST.

The key concerns about this option would thus be political. Notwithstanding the economic merits of a national GST, will it have a damaging impact on the vitality of Indian federalism? With no other major own-source revenues, will individual States become too dependent on collective choices and feel disempowered to act on their priorities? Will it be possible for the governments with such diverse political interests and philosophies to reach a consensus and adhere to it?

While one can have a healthy debate on each of these issues, international experience suggests that discretionary use of broad-based consumption taxes for social, political, or economic policy purposes tends to be limited. The dominant

consideration in their design is their neutrality and efficiency in raising revenues. This is also reflected in the design of the State VATs in India. In spite of vast political and economic differences among them, States have been able to forge a consensus on a common VAT design. A national GST would extend this consensus to the Centre. But participation of the Centre could fundamentally alter the delicate balance of interests that currently prevails in the Empowered Committee and make the consensus harder to achieve.