LEGAL AMICUS: INTERNATIONAL JOURNAL OF LAW AND SOCIAL SCIENCES
VOLUME-1, ISSUE-2 ISSN NO- 2456- 1517(online)

GOODS AND SERVICES TAX: INTERNATIONAL EXPERIENCE AND LESSONS FOR INDIA

PAPER CODE-LAJ/V-1/I-2/02

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With 203 votes in favour and none against, the Constitution (122nd Amendment) Bill, 2014 was approved by the Upper House, thereby bringing into force a system of Goods and Services Tax (hereby referred to as GST) in India.[1] A dummy's guide to GST informed me that, it shall replace all indirect taxes which is levied when a consumer purchases a good or service.GST is a tax on value addition that is at each stage of production allowing setting off of credit on tax paid at every purchase in the supply chain, much simpler that the current system where goods are taxed multiple times at different rates. The so called 'one nation, one tax' once implemented, shall remove barriers across state borders by subliming all indirect taxes levied by States as well Centre including service tax, excise tax, value-added tax, entertainment tax and luxury tax. A Dual GST model has been adopted, whereby, GST shall be administered at the Central as well as State level, thus the Parliament and State Legislature shall have Concurrent powers to make laws on GST. Under this Dual System, a sale transaction within the state will have two taxes i.e. State GST that goes to the state and Central GST which goes to the Centre. While a sale transaction from one state to another shall have only one tax levied i.e. the Integrated GST which shall be shared between the Centre and states. The GST Council, shall consist of the Union Finance Minister, Union Minister of State for Revenue, and State Finance Ministers and shall recommend rates of tax, period of levy of additional tax, principles of supply, special provisions to certain states etc. All decisions of the GST Council will be made by a majority of three- fourth of the votes cast; the Centre shall have one-third while the states together shall have two-third of the votes cast.[2]According to Finance Minister Arun Jaitley, if implemented successfully, GST shall add 2 % to India's GDP.The only way to corroborate the previous statement of our honorable Finance Minister is by analyzing the post effect of GST on national growth of those countries that have already implemented a similar tax regime.

ANOMALIES IN THE PRESENT SYSTEM

In the past two decades, Indirect taxes has seen various reforms and is on the verge of another major one. One major feature of any progressive economy is to strike a balance between direct and indirect taxes, keeping in

[1] Shailaja Neelakantani, "Finally, GST Constitutional Amendment Bill passed in Rajya Sabha",The Times of India, August 3 2016.*Available at:* http://timesofindia.indiatimes.com/india/Finally-GST-Constitutional-Amendment-Bill-passed-in-Rajya-Sabha/articleshow/53529041.cms

[2]The Constitution (122nd Amendment) Bill, 2014 (GST), *Available at:http://www.prsindia.org/uploads/media/Constitution%20122nd/Brief--%20GST,%202014.pdf*

mind that a heavy burden on either one could be fatal for the economy. Currently, Value Added Tax (VAT) system is followed to collect indirect tax. VAT can be referred to as a multi-point sales tax on consumption, which is collected in installments at each transaction stage in the production distribution system. Its burden is exclusively borne by the domestic consumer, at each and every point in the series of sales with the set-off tax paid on inputs and previous purchases. States are empowered under the present system to levy various indirect taxes, which also forms a major portion of their revenue. The VAT reform, or as it was called, was brought in to remove the problems of double taxation as well as multiplicity of taxes, however, VAT itself became a liability for the administration. VAT has been accused of being a regressive tax structure, who imposes its liability on the poor who are more likely to spend more on their income than a rich person. Following can be summed up as issues with the current tax regime:

I. Due to the multiplicity of taxes at the State and Central levels, a very complex indirect tax structure has been created. There is no uniformity of tax rates and further prices of goods and services get artificially inflated due to no credit facilities at the stage of manufacturing. One of the main reasons for this complexity of tax structure is existence of exemptions and multiple rates.[3] Ideally there should be a defined tax base with a limited list of exclusions or negative list, which the GST seeks to provide by harmonizing and unifying the tax system and providing a thriving common market, expecting to reduce production cost and inflation and contributing to economic growth.

II. VAT can be criticized for having a narrow tax base. Exclusion of services from being taxed is one of the most major drawbacks of VAT. Due to advancements of IT, goods are now defined to include intangibles e.g. software, copyright etc., but these intangibles are mostly appearing under the service contract. Thus the differences between goods and services have now become archaic. Also, exclusion of services from state taxation under VAT, also affects state tax revenues, a situation which can fixed by the Australian model of sharing central VAT, which included the tax from services.

III. Many times various taxes fall on the taxes which were levied earlier, thereby causing escalation of cost at each stage and resulting in the cascading effect of raising the consumer price. The main cause for tax cascading is partial coverage in Central and State taxes. The effect of cascading on the Indian economy are unknown, but a study of the Canadian manufacturers' sales tax, similar to CENVAT, claimed that this phenomenon accounted for almost one-third of total revenues, it is expected that cascading effect in India would be more given that CENVAT had more restricted input

[3] Pinki, Supriya Kamna, Richa Verma(2014), "Good and Service Tax – Panacea For Indirect Tax System In India", "Tactful Management Research Journal",Vol2, Issue 10, July 2014.

credits and wider exemptions. [4] Tax cascading also puts Indian suppliers at a disadvantage in the international markets, thereby creating a bias in favour of imports.

IV. Though VAT was introduced to simplify the Indian tax structure, it has proved to be burden on it. Administration has become one the most major challenges under the VAT system. Classification of goods and services under different tax schedule is complex system. The lowest rate of 1% is on precious metals and jewellery, while the basic necessities, which one would expect to be at the lowest tax rate, is at a middle rate of 4%.[5]

V. VAT has also been criticized for being an inflationary tax, which favours capital-intensive firms and lacks transparency. VAT is considered inferior to other indirect tax methods in terms of overall economic efficiency. Because of its narrower tax base tax rates are higher than usual.

GST- A SIGNIFICANT WAY FORWARD

Due to various limitations of the VAT structure, the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003 observed that high import tariffs, excises and turnover tax on domestic goods and services has led to cascading effects which have further distorted structure of production, consumption and exports and also resulted in inefficient resource allocation thereby having an adverse impact on GDP growth. The Task Force, therefore suggested a shift in tax burden from trade and production to final consumption, in other words from saving to consumption. Thus, the Task Force recommended an urgent need for a well designed VAT on all goods and services, where only the final product can be taxed, i.e. the GST. GST was designed to fill the incompleteness of both the CENVAT and State VAT. CENVAT does not include chain of value addition in distributive trade below the stage of production which GST model looks to secure by integrating more indirect central taxes for set-off relief. Similarly, with the introduction of GST, the burden of CENVAT would be removed by a continuous chain of set-off from the point of view of the producer, thus alsoeliminating cascading effects. The problem of increased compliance cost and multiplicity of taxes would also have sought to be eliminated by GST. GST in India also aims to expand the tax base through wider coverage of economic activities and reducing the vast list of exemptions prevalent in the current tax regime. Notably, the input tax credit shall also further lead to reducing the cost of goods and services. The issue of transparency, which is prevalent in VAT, would sought to be improved under GST by transactions being recorded in the credit chain leading to improved disclosures of economic transactions and compulsory returns being filed under a common portal of PAN based registration, further having an impact on direct tax as well. GST by nature is very transparent system, with an inbuilt Input Tax credit system and elimination of arbitrage rate between inter-state supplies, thereby equalizing the total rate of tax applicable, unlike the present regime where the

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4 Refrencer on Goods and Services Tax, ICSI, *Available at* : https://www.icsi.edu/Docs/Website/GST_Referencer.pdf

5 Ibid

CST rate is 2% while the normal VAT rate is either 5% or 12.5%.[6] To attract more investments, states often reduce the rate of tax on selected goods, leading to a tax war, which ultimately has an affect on revenues of the state, however the GST bill cures this problem by setting up a GST council which shall recommend the rate of tax to both the centre and the state. The GST council also provides a forum for grievance redressal and dispute settlement. Commissioned by the 13th Finance Commission, National Council of Applied Economic Research (NCAER) stated that the implementation of GST could provide a gain of 0.9 to 1.7 % to India's GDP along with efficient allocation of production and export increase. Dr. Vijay L. Kelkar, Ex-Chairman, Thirteenth Finance Commission in his post-evidence replies stated that GST would help in fiscal consolidation by having a single and low tax rate, thus preventing tax evasion and ensuring a higher compliance rate. According to the same report, GST would help create employment opportunities of about 20 million jobs specially in rural areas, thus helping in improving income levels of households as well as reducing inflation, without impairing the fiscal autonomy of the states. [7]

GST- A BOOST TO GDP?

When our Finance Minister says that GST can add upto 2% to India's GDP, it is pertinent to mention that not all countries which implemented the GST had national growth on the contrary it has had a disastrous effect on the economy due to unwarranted administrative, compliance costs and avoidable economic distortions[8]. Out of more than 150 countries which have implemented GST or VAT, countries like South Africa, Singapore, Australia, New Zealand, Canada have a good GSTs with broad bases as well as uniform structures on the other hand, countries like European Union (EU), Brazil have multiple rates with separate taxation of goods and services. Thus India should be very careful by choosing a transparent and uniform GST, otherwise an ugly GST could cause India upto 2% of National Income, the exact opposite of what our finance minister has predicted.

In his paper Saravanan Venkadasalam, analysed the the effect of the GST on ASEAN countries like Philippines, Singapore and Thailand, through regression analysis conducted using least squares dummy variable model (LSDVM), findings of this paper revealed that not all countries in ASEAN which had implemented GST were experiencing a national growth. The effect differed in countries, Philippines and Thailand showed a negative relationship with their nation's development, while, Singapore showed a positive relationship.[9] The success of GST depends on a neutral and rational design of the GST in such a way that it is simple, transparent and significantly enhances involuntary compliance. [10]

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[6] Ibid

[7] 13th Finance Commission, Chapter 5 on Goods and Service Tax, Finance Commission of India (December, 2009)

[8] Cnossen, S., "Preparing the way for a modern GST in India. International Tax and Public Finance", 20(4), 715–723, 2013.

[9]Venkadasalam, Saravanan "Implementation of Goods and Service Tax (GST): An Analysis on ASEAN States using Least Squares Dummy Variable Model (LSDVM)" , Paper presented at the ICEEH'14, Dec. 10-11, 2014 Bali (Indonesia), 12-14.

[10]Khan, M., & Shadab, N., Goods and Services Tax (GST) in India: prospect for states. Budgetary Research Review, 4(1), 38–64.

GST: AN INTERNATIONAL PERSPECTIVE

It is imperative to analyze the history and post effect of GST on national growth of other countries which have implemented a similar tax regime, in order to understand the effect of GST in India.

Malaysia: Lessons from a newborn GST regime

The roll out of GST in Malaysia in April 2015 was anything but smooth, the first few months were marked by anti-GST protests all over the country. Chaos prevailed in the country since the consumers alleged that the merchants were overcharging them while the merchants complained of a complicated process of computing their value-added.[11]There are two major lessons which the Indian administrators can avoid atleast at the initial stages of GST roll-out, firstly, even though Malaysia's GST was at 6%, one of the lowest in the world, for social reasons various essential commodities were either exempted from GST or were assigned a zero rate. What these exemptions and zero rates tend to do is, establish a complex tax structure, which defeats the whole purpose of GST. Secondly, to ensure that the final consumer benefits from the GST mechanism, a close check should be kept on anti-profiteering law, which according to Satya Poddar, tax partner, policy advisory services, Ernst & Young, is very important for public perception that the roll out of the tax does not result in a broad inflationary impact. Tax experts note that when the effective tax rates are higher than what prevailed before, GST is likely to be inflationary, for instance, when Singapore introduced the tax in 1994, it saw a spike in inflation, as observed by Prasenjit K Basu, head of ASEAN (Association of Southeast Asian Nations) Economics and Malaysia research at Macquarie Capital Securities.[12] Thus it is imperative for Indian administrators to keep a check on inflation post rollout of GST, thereby being GST-ready.

Canada and Brazil: Lessons from Dual GST model.

To understand the Canadian Model of GST is imperative, this is because Canada has dual GST which India seeks to implement.Before 1991, there were two main types of Tax in Canada, the Manufacturer's Tax [also called Federal Sales Tax] imposed at the Federal level and Retail Sales Taxes imposed at the provincial levels, these suffered from a number of deficiencies like missing all stages beyond manufacturing and favouring imports over domestic production. GST was introduced on January 1, 1991 based on invoice credit method VAT replacing a hidden Manufacturers' Sales Tax (MST).Before August 2012, three systems were in operation: the Federal GST; the HST in five states and the QST in the province of Québec, with GST leviable at 5% in all provinces. The QST is actual VAT that applies in Quebec on the GST inclusive price of goods and services. The three provinces of Nova Scotia, New Brunswick and Newfoundland and Labrador and the Government of Canada merged their respective sales taxes into the Harmonized Sales Tax (HST) in 1997 at 13%. HST is is administered by the federal

[11]Sudipto Dey, "GST: Some lessons from Malaysia that India can use", Business Standard, June 13, 2015 *Available at*: http://www.business-standard.com/article/economy-policy/gst-some-lessons-from-malaysia-that-india-can-use-115061300748_1.html

[12]*Ibid*

government, while the participating governments divide the revenues. The three territories of Yukon, Northwest Territories and Nunavut, do not have territorial sales taxes, while Quebec is the only state that administers both the federal GST and the provincial Quebec Sales Tax (QST). Ontario in its 2009 budget had proposed to harmonize its 8% retail sales tax with the GST effective on July 1st, 2010 and in the month British Columbia merged its PST and GST. GST/HST and QST are imposed on consumption on a destination basis and rely on detailed place of supply rules for services to achieve that objective. Traditional retail sales tax [RST], which are not harmonized with the GST/HST or QST, is levied in three provinces and it generally applies to sale or lease of goods and a very limited range of services.

Exclusions from GST base are called tax preferences which refer to preferential treatment to be given to an individual, an organisation or an economic sector to accomplish a non-tax goal. In Canada, the GST model include one, standard exemptions such as on non-profit, charitable activities and public sector activities, secondly reduced rates such as on new housing activities and thirdly zero rated supplies as on agricultural and dairy products, groceries and prescription drugs. This form of taxation seeks to achieve two goals i.e. to raise revenues and simultaneously deliver socially benefiting incentives. As stated above, Canada has had a relatively successful run with GST, one of the main reason being that it has constantly sought to reduce the GST rate, unlike other nations which implemented GST. Various economists have also suggested that the success of Canadian GST in the international market is due to switching towards heavier consumption taxes, thereby helping its economy become more competitive with lower-priced goods. Also, the transparent nature of the GST has kept Canadians aware of their taxation. [13]This is not to say that the Canadian model is perfect.Main lessons that India can draw from the Canadian Model are that:

Firstly, GST credit which is tax-free to assist modest income families to offset the GST they pay should be made more generous to eliminate the adverse distributional impacts of proposals. Secondly, supplier's threshold stands at CAD 50,000 for PNC bodies and for all other persons at CAD 30,000, which many think are too low, and should set atleast where monetary unit of revenue equals the marginal cost of collecting VAT unit, considering all compliance and administrative costs. Thirdly, tax preferences should be eliminated or minimized to achieve desirable economic potential of the GST and would also help in reducing complexity of the GST and therefore generate administrative and compliance cost saving.[14] Also this GST has not been completely effective, as in its initial years on introduction various cases of fraud were reported, where criminals were shown to claim GST input credit for non-existent sales of fictional company.

In Brazil, a system of dual GST is followed with the main State tax being Tax on Circulation of Goods and Services (ICMS) which is due on operations which involve

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[13] Monika Sehrawat, Upasana Dhanda "GST in Inida : A Key Tax Reform", IJR Granthaalayah, 12th December 2015.

[14]Richard Domingue, Jean Soucy "THE GOODS AND SERVICES TAX:10 YEARS LATER" Economics Division,15 June 2000. *Available at : http://publications.gc.ca/Collection-R/LoPBdP/BP/prb0003-e.htm*

circulation of goods as well as on communication and transport services. ICMS is non-cumulative and tax may be offset by credits which allows input tax credits. Export goods are exempted from ICMS.

Federal countries like Brazil and Canada have adopted the Dual GST, whereby the tax can be levied by the centre as well as state governments, thus India have rightly decided to adopt a dual GST of Central Goods and Services Tax (CGST) and a State Goods and Services Tax(SGST). The benefit of dual GST is that it leads to a reduction in number of taxes levied thereby removing the cascading effect of taxes and ensuring higher tax compliance. At the same time, in a country like ours the Constitution requires consideration by the centre while taxing activities of the state, which a dual GST model ensures.

Singapore: Lessons from a near perfect GST model.

On April 1, 1994, GST was introduced in Singapore at 3%, but later increased from 4% in 2003 to 5% in 2004 and 7% in 2007. GST in Singapore is broad-based consumption tax levied on imports as well as goods and services. Beinginspired significantly by New Zealand's model of taxation, consumption tax is levied on all goods and services, including even necessities like health services and basic food, though sales and leases of residential properties and most financial services are exempted while Exports and international services are zero-rated. Also, a business entity with annual turnover less than S$ 1 Million is exempted from registering for GST. The reason of introduction of GST in Singapore was very different to circumstance prevailing in India, Singapore had a significant ageing population, thus with a dying tax base, a shift in reliance from direct to indirect tax was necessary to evenly spread the tax burden.

At four percent, Singapore boasted of the lowest GST rate in the world as well as introduction of GST to offset the loss in revenue due to reduction in direct taxes, however, in his 2007 budget, Singapore's finance minister announced that the rate shall be increased to 7%, which was still moderately low. This rate increase was accompanied by an offset package of about $4 Billion, consisting of direct transfer benefits, cash payouts, CPF top-ups, rebates etc. which acted as a cushion for the population of Singapore as a result of the tax increase.[15]Apart from the offset package the Workfare income supplement which was a wage subsidy also provided a safeguard for lower-income households against the increase in tax-rate.

Thus it can be said that Singapore introduced the GST in a relatively successful manner in a short period of time. The GST's success in Singapore can be attributed to a strong political backing, careful planning, an extensive education program and thus a mass participation. Also the generous package of offsets to reduce the impact of low but steadily increasing GST rate also played a crucial role in the success of the GST. However, this is not to say that the GST has had a smooth ride in Singapore since its implementation. There are various drawbacks in the Singapore model as well. Singapore has reduced the income tax on low-income households and instituted direct transfer payment to these households as well, which has proved to be a nightmare for the middle-class of the country. Thus offsets such

[15]Danial "GST to be raised to 7%: PM Lee" PhraseBase, Monday 2nd of July 2007.

as lower income and property tax, rebates and other tax reliefs and subsidies have ensured that 70% of individuals that used to pay income tax, no longer needed to do so, thereby shifting the tax burden on the rest of the population.[16]According to a recent study, taking into account all direct and indirect taxes, the top 20% of the households account for 53% of the taxes while it is safe to say that the lower income households pay, what could effectively be called a 'negative tax'. On the other hand, the lower income households received transfers amounting to 23% of their income, while the figure for upper income households was only 11%.[17]This tax burden on upper-households, as many argue, will lead to an inevitable rise in GST rate, no matter howmuch fiscal prudence and discipline is applied to it.[18]Another problem the Singapore government faced was not exempting essentials such as healthcare and food from GST, which they argued would actually be more of a help for upper-income households as they spend more on essentials. According to the government exempting essentials from GST would lead to a shortfall of revenue, thereby leading to a rise in GST rate, which shall be borne by the lower-income households and at the same time distorting production and consumption decisions as well as increasing compliance/administration costs to be borne by consumers. Economists have argued that, what many many consider a limitation, is actually the reason for the success of GST in Singapore. By exempting a less number of good and services, the Singapore regime has kept a broad-based, yet a simple GST, which has also provided aid to lower-income households through offsets and subsidies.

However, it is of the utmost importance that a pragmatic GST rate should be adopted by India, this is because to impersonate the Singapore model of tax reliefs and subsidies to offset a very low GST rate, is easier said than done with a population like ours. Even in Singapore there are rumors of a rise in GST rate to 10%, even though the ministry has debunked these rumors. But a PwC report highlights that the increase in tax rate is inevitable due to the increased social spending by the Singapore Government as well as tax burden on upper-income households.

Australia & New Zealand: A Lesson in the importance of GST Rate

The GST was introduced in Australia on 1st July 2000, by replacing Federal wholesale sales tax system as well as the numerous State Government taxes and duties after a long struggle of 15 years. All businesses who had a turnover of $75,000 per annum were required by law to register for GST. Like all other countries which have implemented GST, there are various goods and services which were exempted from paying GST such as food, wages and salaries, real estate, medical and educational services, childcare etc. while others such as, financial services and rental income were input-taxed, i.e., GST can not be charges on the sale of these goods and services but GST paid on it can be claimed as an input tax credit. Transactions related to real property,

[16]Chia-Tern, Huey Min ,"GST in Singapore: Policy Rationale, Implementation Strategy & Technical Design", Singapore Ministry of Finance, October 2004.

[17] Shanmugaratnam, Tharman, "Budget Debate Round-up Speech 2011" Singapore Ministry of Finance, 2nd March 2011.

[18]Staff Reporter, "A GST hike is almost inevitable, warns PwC", Singapore Business Review, 19th November 2015, *Available At*: http://sbr.com.sg/economy/in-focus/gst-hike-almost-inevitable-warns-pwc#sthash.bLUakbUE.dpuf

obligations or rights are chargeable under Division 9 of the *A New Tax System (Goods and Services Tax) Act* 1999.[19]
The Australian model of GST has also been relatively successful, preceding months before GST was implemented, saw the rise of consumptions of various goods, which the Australian public thought would become more expensive, thereby leading to a decline in consumer consumption and thus negative economic growth for the first quarter of 2001.[20] A study by Curtin University of Technology, Perth in 2000, also claimed that GST shall negatively impact the real estate market by increasing the cost of new homes.[21] The small business owners also complained of the additional administrative responsibilities of submitting Business Activity Statements for monitoring of these businesses. However soon all these problems began to disappear, with the consumption levels going back to normal and the economic growth becoming positive again. The tax began to gain widespread acceptance with the GST revenues consistently being ahead the budget projections and the administration being painless. The black economy, according to KPMG's Michael Evans, also started to disappear.[22] Though, the negative impact on the property sector, complexity in financial services as well as inflexibility for foreign buyers have still not disappeared. Furthermore a negative impact on the micro businesses has also been reported, with one report of the Australian Tax Office claiming the penalties and interest of these micro businesses has been $34 million, while the figure for large business remains at $2 million.[23]For the further success of GST in Australia, a research by CPA Australia showed that lifting the GST rate to 10-15% or broadening the tax base would be beneficial for the Australian economy. This report states that the additional GST revenue generated can be used to abolish inefficient state taxes and personal income tax cuts as well as an offset compensation for low-income households. [24]

In New Zealand the situation was a little different, GST was introduced on October 1st, 1986 at 10% and later increased to 12.5% on June 1989.Like the Indian system of GST, even in the New Zealand model of GST, it is the end user who are liable to pay the tax on goods and service directly, while the GST-registered organization pay GST on the difference between GST liable sales and GST liable supplies, which is achieved by reconciling GST received through sales and GST paid through purchase at regular intervals. One major feature of New Zealand's GST is that unlike other countries which have implanted GST, there are very few exemptions, so much so, that even food is taxed at the same rate. The only tax-exempted goods and services being- donations, financial services and rents on residential properties. While exports are zero-rated.

[19] A NEW TAX SYSTEM (GOODS AND SERVICES TAX) ACT 1999. Austlii. Retrieved 8 February 2015.

[20] "Labor says GST has king hit economy". *ABC 7.30 Report*. Retrieved 20 May 2006.

[21]"Background and General Economic Impact of a GST on the Real Estate Industry" (PDF). *Curtin University of Technology, Sydney*. Retrieved 21 May 2006.

[22]" GST 'a success' five years on: KPMG" The Age, June 27, 2005, *Available at* : http://www.theage.com.au/news/Business/GST-a-success-five-years-on-KPMG/2005/06/27/1119724571372.html

[23] Ibid

[24] " GST reform: It's time for a rational debate", CPA Australia, 18th February 2015, *Available at*: https://www.cpaaustralia.com.au/professional-resources/taxation/tax-reform-in-australia/gst-reform-its-time-for-a-rational-debate

According to HSBC Chief Economist of Australia and New Zealand, Paul Bloxham, Australia needs to reduce reliance on income tax and increase its GST rates to raise more revenues, thereby following the New Zealand model. According to Bloxham, this over-reliance on Personal taxation is discouraging workforce participation. According to him, Australia to achieve success in GST, should broaden its GST base, as presently it covers less than half of all consumption, while New Zealand applies to 96% of its spending. Further, too much of the spending was exempted by the Australian GST, which Bloxham regards as a very poor tool for supporting low-income households. The Australian Federal Government published a tax discussion paper where they claimed that richest 20% of the Households got 3.5 times greater exemptions than those received by the low-income households. Thus the New Zealand and Israel model which have wide bases and rates of 15% and 18% respectively are ideal to follow.[25]

Hong Kong: GST which was never meant to be

GST was proposed in Hong Kong in 2006 and ignited a debate amongst lawmakers, politicians, journalists and the citizens and the plan to levy it was dropped by the end of the same year.The reason GST was considered a viable option in Hong Kong was that since it had a narrow tax base, GST would help it broaden the tax base and secure sustainability of tax revenue for Hong Kong to meet its public expenditure. The GST was proposed to be levied at a flat rate of 5%, while replacing or decreasing the effect of other indirect taxes. It was proposed that the GST would have the following relief, for individuals, GST would have provided households with Social Security benefits as well as a universal annual GST credit per household to be used against various rates for the first five-year period. For businesses, GST sought to provide cut in profit-tax rates as well as abolishing capital fee for encouraging more businesses to incorporate. The government also pledged that for the initial five years, revenue generated after deducting administrative costs could be claimed as tax relief. However soon after the proposal, protest against GST implementation started to gain momentum, with over 6500 people participating in them. Thus, on 5th December 2006, Henry Tang Ying-yen withdrew his plan of GST implementation due to lack of public support.[26]

GST: Tax Rate and Tax Base

After analyzing the international scenario of GST, a common observation can be that the success of GST depends upon the GST rate and base, which are yet to be finalized by the GST council. Zero-rating or exemptions are not efficient in achieving its objective of a fair distributions of tax burden, as seen in the case of Australian and Malaysian model of GST, the reason is that it has a significant spillover of benefits to the rich, who spend a larger absolute amount on the exempted essentials. Exemptions also tend to increase the

[25] John Rolfe, "Australia needs to look to New Zealand's tax system and raise the GST", News Corp Australia Network, APRIL 16, 2015, *Available at* : http://www.news.com.au/finance/money/tax/australia-needs-to-look-to-new-zealands-tax-system-and-raise-the-gst/news-story/c6e5a1d7a05f017ba362be97a432f324

[26] "GST looms in Hong Kong", Hong Kong Business, Available at : http://hongkongbusiness.hk/economy/news/gst-looms-in-hong-kong

administration and compliance cost, while making it easier to avoid or evade the tax. Exemptions actually defeat the real purpose of GST, which is to establish a simple tax structure. A study conducted by Satya Poddar and Ehtisham Ahmad, where a comparison of international jurisdictions which had implemented GST, tried to calculate C-efficiency, which is a measure for comprehensiveness of tax base, and it was found that, New Zealand had the highest C-efficiency because of single rate on virtually all goods and services, higher than Canada which zero-rates food and medicines and rebates housing and non-profit sector. Even successful economies of Singapore and Japan had lower C-efficiency than New-Zealand due to exemptions for supplies by non-profit organizations. The experience of countries like New Zealand and Singapore suggest that it is feasible to resist the temptation of exemptions. [27] The GST bill excludes alcoholic liquor from the purview of the tax, further, GST will apply to five petroleum products i.e. (a) petroleum crude, (b) high speed diesel, (c) motor spirit (petrol), (d) natural gas, and (e) aviation turbine fuel at a later date, to be decided by the GST Council. However, the 13th Finance Commission correctly argues that these products are inputs of various other goods and exempting them shall lead to cascading of taxes and distortion of credit chain leading to loss in revenue,all these are limitations of the VAT system for which the GST has been introduced.

[27]Poddar, Satya and Ehtisham Ahmad, GST Reforms and Intergovernmental Considerations in India, Working Paper No.1/2009-DEA, Department of Economic Affairs, Ministry of Finance, March 2009. *Available at : http://finmin.nic.in/workingpaper/gst%20reforms%20and%20intergovernmental%20considerations%20in%20india.pdf*

Thus the 13th Finance Commission and revenue department have suggested that alcohol and petroleum products should be included with GST and if need be, states can levy an additional cost on these products.[28]

For the success of GST, it is also imperative that the perfect GST rate is levied. A high GST rate would encounter consumer resistance especially the retail sector and thus lead to creating for exemptions of necessities. Scandinavian countries are an exception to this economic theory, which has a high standard rate of 25% but still have managed to successfully levy and sustain VAT/GST at this rate. The government has hinted at a comparatively high GST rate of 18-20%, which is far below the current statutory rate of 26.5%. Other countries which have implemented GST, have a relatively moderate rate, for example Singapore's GST rate was introduced at 3% was later increased to 7% and New Zealand introduced GST at 10% with no exemptions except financial services. The same study of Satya Poddar and Ehtisham Ahmad suggested to keep tax rate low, taking the example of New Zealand, Japan and Singapore, especially at inception. [29]

The GST bill states that centre may levy an additional tax of upto 1% on the supply of goods for two years or longer in the course of inter-state trade, which shall be collected by the centre accruing from the states where the supply originates. However, this additional tax will act as a barrier for the creation of national market, by increasing the price of the traded product, which shall also lead to cascading of taxes, thus in the right spirit of the GST bill this provision should be removed.

[28] Supra at 7

[29] Ibid

CONCLUSION

With the Parliament having past the 122nd Amendment Bill, 2014, one of the key challenges which lies with the GST council will be to determine the GST rate, which would have to ratified by three-fourth majority of centre and states. The former finance minister of India, P. Chidambaram, summed up my entire paper in a few words "The heart of the bill is the rate of tax". As mentioned before, the success of GST can be credited to GST rate, thus it is imperative that India chooses a pragmatic rate of levy. While it was a characteristic of older VAT regimes to have complex and high rate structures, newer and successful GST implementing countries have shown a trend of having a single medium or low rate with few or none exemptions, like in the case of New Zealand where even essentials like foods and healthcare come under the purview of the GST, however this is easier done there than in India since New Zealand is not a federation and has population half the size of Delhi. In India, the complexities of our Constitution require that consideration by the union has to be given while taxing activities of the state. Realising the federal structure of India, dual-GST with all its benefits is an ideal option, since if the tax will be centrally administered, then the tax base becomes wide and confusing.

A VAT like the GST has many features which make it a necessary step forward for the Indian tax system, however we should also be ready for the impact it has on the economy. One of the apprehensions in the mind of the people was that GST would lead result in substantial inflation in the economy, however international experience has shown us that if the monetary and wage policies are properly managed then a broad based tax like GST shall not lead to accelerating prices.[30] For example in the case of Singapore, it was anticipated that GST reform would cause inflation rate to increase to 5.5% in 1994 from 2.3% in 1993, however it only increased to 3.1 and in the subsequent year dropped to 1.7%,[31] the government of Singapore had a major hand to prevent this price increase as it assured the public, that inflation attributed from GST would be no more than 3% and was committed to monitor prices to keep in check unfair trade practices for which it established the Committee on Profiteering and Inflation. The Singapore government even compensated households through various offsets. Singapore government's commitment to control inflation can surely be a lesson for the Indian government. The introduction of GST would effect final consumption, thus the impact on the Retail sector would also be interesting to see. Going again by the Singapore example, it was witnessed that for three months subsequent to the levy of GST, retail sales dropped, and in the month of April, May and June of 1994 retail sales indices were 5.6%, 3.9% and 4.1% lower than those for the corresponding months of 1993, however sales picked up in the month of June, thus GST does not have a long-term adverse effect on the retail sector.

A study by Agogo Mawli has found that GST has a severe impact on countries with low income specially on the poor, and if GST has to be implemented the rate should be less than 10%[32], however various other studies like that

[30] Alan A. Tait "Value Added Tax: International Practice and Problems" International Monetary Fund, 15th June 1988.

[31] Singapore Department of Statistics, 1996, Singapore Investment Abroad 1994-95.

[32] Agogo Mawuli "GOODS AND SERVICES TAX: AN APPRAISAL" The National Research Institute PNG

of Ehtisham Ahmed and Satya Poddar (2009), Nitin Kumar (2014) have concluded otherwise, that GST is a positive step for growth of the Indian economy. It is the need of the hour to implement a system which is simpler, transparent and unified, which can only be fulfilled with the implementation of GST. Its implementation will no doubt lead to higher output, more employment opportunities and lowering of prices making it an effective tool for fiscal policy management. However, the success of GST is subject to its rational design which shall determine whether implementation of GST shall overcome various challenges, and make no mistake, there are a lot of challenges. The first challenge is related to Revenue Neutral Rate (RNR), which means the rate of GST which shall have the same level of revenue which is presently collected by state and central governments, the Union government has hinted a RNR of 15% -20% band, which if compared to other countries is very high, this could be problematic as it can lead to incentivizing tax evasion and adversely impacting purchasing power of low income households. Thus it is essential that alcoholic and petroleum products are not exempted from GST, which would lead to enhancing government revenue and tax base. Second challenge which is daunting is the required Information Technology platform where the NSDL will have to compile a data base of almost 8 million service providers and traders, while issuing GST ID number to each one. Another major challenge, would be the dispute resolution and decision making of the GST council. Chaired by the Union Finance Minister, this council shall act as the core institution of the new tax regime, determining everything from tax rate to dispute mechanism to exemptions and tax base, among other things. Despite having a 33% voting power of the centre, the council shall have to work in consensus with other states. The GST bill proposes that the states due to subsuming of state taxes along with cess would be compensated for a period of five years, following the recommendation of the 14th Finance Commission[33], however this humongous compensation could prove disastrous for the economy, having an adverse effect on the manufacturing industry and also leading to a fiscal burden on the centre, which might have a toll on achieving the fiscal target of 3% announced by the Finance Minister in his 2015 budget. The GST bill also states that centre may levy an additional tax of upto 1% on the supply of goods for two years or longer in the course of inter-state trade, which shall be collected by the centre accruing from the states where the supply originates. However, this additional tax will act as a barrier for the creation of national market, by increasing the price of the traded product, which shall also lead to cascading of taxes, thus in the right spirit of the GST bill this provision should be removed. Thus, to build an overall capacity of the administration to implement GST is by itself a formidable task.

Thus the major lesson from other countries with respect to GST is that to achieve success in implanting this tax is to introduce one from the outset. There is no doubt that GST is the next step of VAT. The GST model successfully strikes a balance between fiscal autonomy and harmonization, and coupled by a pragmatic rate, less or no exemptions and a broader base,

Taxation Research and Review Symposium ,29-30th May 2014.

[33] The 14th Finance Commission has recommended that compensation of 5 years should be given to the state for revenue losses, for first three years 100% compensation reduced to 75%and 50% in fourth and fifth year respectively.

it shall lead to better compliance and higher revenues. Thus the Finance Minister is not entirely wrong when he says that GST could add upto 2 % to the Indian GDP, provided the challenges which are outlined above are overcome. Will GST be implemented successfully, only time will tell!