Multiple state GST rates – politics overtaking economics? – Sept 23, 2009

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AS per media reports, the Revenue Secretary of the Government of India has said that a consensus had been reached among states on the rolling out of Goods and Services Tax (GST) from April 1, 2010, with most of them approving to have a common tax rate. The Revenue Secretary had made these comments while speaking at a CII function, as per the press reports. The Secretary had also mentioned that most states have agreed to a common GST rate which would have two components – Central and the state GST and that on the state GST, states have agreed to have a single tax rate, unlike VAT where different states have different rates. The national daily, which had carried this story on July 16, 2009, had also commented that this development had removed a major roadblock and would considerably help the government's commitment in implementing GST from April 1, 2010.

One is therefore shocked to see press reports which have appeared last week. It would seem the efforts to stitch together a common market in India through the introduction of a single goods and services tax (GST) by 1 April, 2010 have suffered a serious jolt on September 16, after 35 states and Union territories have agreed on three GST rates for sale of goods. It has been reported that the states have proposed a lower GST rate for items of mass consumption, a regular rate for other goods and a nominal charge of 1% on precious metals. The States also want small list of goods exempted from this tax.

A single GST rate is a sine qua non to replace a tangled web of national, state and local taxes and would have been the culmination of a long process of indirect tax reforms that began way back in 1991. The whole concept of GST in its original form is a great economic model followed worldwide, to help firms produce more efficiently and give consumers more clarity about the taxes they paid on goods and services. These hopes would now seem to have been dashed, with the decision of the Empowered Committee of the State Finance Ministers, to go in for multiple state GST rates, which is seen more of a political decision than an economic decision.

We can now expect that the State GST would be administered in a manner very similar to the way, the Value Added Tax regime is being managed (or mismanaged) by the States. Hailed as a great move to unify the taxes levied at the State level, we have seen that over the last four years since VAT was introduced in most States, dealers have been subjected to much more complications and uncertainties, as compared to the simple Sales Tax Acts that had been in vogue for about five decades earlier. Except for the extension of the input tax credit, the VAT regime has not contributed in any measure to reduce the difficulties for the dealers. The States do not have common VAT provisions even on fundamental issues like the definition of the tax period or for that matter, on the treatment of taxes paid by SEZ Developers and Units. In a State like Karnataka, with the tax period being defined as the calendar month, the magnitude of the problems faced by dealers are manifold, as compared to life under the erstwhile Karnataka Sales Tax Act, where the tax period was the financial year.

It has been reported that the states want multiple rates to stem revenue losses as well to hold the price line of some goods, especially, the mass consumption goods. There have also been reports that the normal state GST rate is likely to be around 5% while the standard rate could be anything between 8% and 12.5%. If we add the central GST rate of about 8%, for most commodities, the effective GST rate would work out to anything between 16% and 20.5%. That's a lot of taxes, Sir. Especially, for the pure services sector, this is only paying around a 10% service tax now. Though it has been reported that States are open to charge 8% on services, the overall GST rate could work out to about 16%, which is a good 60% increase in the output tax rates.

We should not also downplay the fact that, there is a lack of consistency in terms of classification of goods, amongst the States, given the fact that, there are three schedules for the tax rates, viz. 1%, 4% and 12.5%. With multiple state GST rates which would not be uniform between the States, we must be prepared to have continued uncertainties on the tax rates, which is not desirable at all.

One does not understand the need for the States for insist on multiple state GST rates, when the Central Government has already promised to reimburse the revenue losses, if any, arising out of the implementation of the GST regime.

There are several issues vis-a-vis the States which are yet to be addressed. Apart from the tax rates, the GST regime would also need to ensure that the legislations of the States governing the GST levies, are uniform across the country. The statutory provisions for appeals, penalties, etc. have got to be uniform, as between the central GST and the state GST levying mechanism and also, as between the states' legislations. Then only, can we progress towards a true nationwide levy and meet the original objective.

But, with the decision to go in for multiple state GST rates, it would seem that the historic opportunity to move towards a nationwide levy has been severely tested.

It has been reported that the FM is scheduled to meet the Finance Ministers in October 2009. With the Congress Party in comfortable working majority in the Parliament and ruling in several states, one hopes that the Government would not let the historic opportunity of introducing a GST regime, slip thro' its hands. As such, even the BJP would not seem to be against the GST, having included the topic in its election manifesto during the 2009 general elections. With hardly any time left for the GST implementation, the Government would need to move faster, given the fact that a lot needs to be done, including the constitutional amendment and the release of the draft laws, etc.

The Central Government should definitely assume the leadership role, for sure and not let politics overtake economics.

Before concluding…….
As of date, we do not even have a list of the duties and taxes, which are to be 'subsumed' within the GST rates. This is of a great concern, especially, in respect of the taxes and duties that would constitute the state GST rate. There are reports that the States want the stamp duties out of the state GST rate. In terms of the impact of the GST on the Realty Sector, the exclusion of the stamp duty from the state GST, would be a major dampener, for sure