ONE-STOP DESTINATION FOR TAXMAN AND TAXPAYER

Let's Talk About Growth-Tonic called GST

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INDIA continues to be in the thick of black money issues. Even before the UPA Government could re-trace its feet to stand and reassure the industry captains of policy reforms in the offing, news-making NGO India Against Corruption released a list of names of industrialists and politicians having accounts in HSBC bank's Swiss branch. They dared to name a few and alleged that the Government has been playing possum over a huge list obtained from the French Revenue authorities. As expected all the accused denied the veracity of the news, and the North Block came out with a predictable statement that the investigation has been going on, and the names cannot be disclosed because of the secrecy clause as per the provisions of the Double Taxation Avoidance Agreement. In other words, by issuing such a statement the Government managed **to cork the genie** of fresh political storms in the bottle!

Let's now go back to two significant events of the last week. One is relating to the proposed GST in India, and the other is with respect to the OECD efforts to develop a standard guidelines for **levying VAT/GST on Services and intangibles** in cross-border trade. As regards the Indian GST, the Union Finance Minister, Mr P Chidambaram, seems to have not lost all hope. And, how can he, when the credit for taking the GST initiative goes back to his Budget Speech in 2006. Although GST close watchers may find his demeanour not too enthusiastic, that is because of his preoccupation with the immediate task of manoeuvring the growth trajectory and the ballooning fiscal deficit but he is hopeful of realising some of the milestones for the GST roll-out. After his meeting with the Chairman of the Empowered Committee of State Finance Ministers, he ordered the constitution of two key committees - one for working out the CST compensation package, and the other for fleshing out the **DESIGN** of the GST legislation. The CST Committee is being manned by the Revenue Headquarters, and the other has gone to the CBEC, which is expected to improve on the design provided by the Gautam Ray Committee.

Whether setting up of these two panels really amounts to a significant step forward would remain a debatable issue but there can be no two views on the fact that the attitude in the North Block continues to be positive towards GST. The Government is also hopeful that the Parliamentary Panel looking into the Constitutional Amendment Bill may come out with its Report, which can be debated in the House. Other components of the GST system can be rolled out only after this primary bill of amending the Constitution is passed. Once this Bill is passed by the Parliament during the Winter or Budget Sessions, it would require vetting by two-third of State Assemblies to approve the same. This amendment will empower the States to levy **tax on services**, and the Centre **to collect tax from sale of goods**. Till the time this Bill is passed, let's not be too optimistic about any of the possible deadlines.

Let's now talk about the landmark initiative taken by the OECD, which hosted the first meeting of the Global Forum on VAT/GST in Paris last week. As many as 90 representatives from 80 countries, including India, participated in this event. And all the countries agreed on the view to urgently develop a global framework for the application of Value Added Taxes (VAT) to international trade, particularly in services and intangibles. The OECD has been working on International VAT/GST Guidelines to address issues of double taxation and unintended double non-taxation of cross-border trade. Although the value of global services exports increased only by 11% in 2011 to USD 4.2 trillion, and India accounted for only 4% growth to USD 137 bn last fiscal, the levy of VAT/GST on import of services is going to be a critical factor for the global trade growth in the future. With the VAT/GST becoming increasingly popular with as many as 150 countries operating it today, twice the number in 1992, its uniform application to services exports and intangibles is going to be indeed of tremendous significance.

Going by the fiscal consolidation strategy being adopted by the developed and developing countries alike, there has been a rise in the VAT/GST rate across the globe. Between 2009 and 2012, 16 OECD countries increased their VAT rates. Six more increased their VAT rates later. This has raised the OECD average standard **VAT rate to 19% today** from 17.7% in 2008. This is after registering no hike for about a decade before 2008. Similarly, developing countries have also hiked the VAT/GST or indirect taxes rates during this period. With the government finances being under strangulating strain, India has also hiked the central excise and service tax rates. Since withdrawing exemptions granted to many essential items is a political impossibility in many countries, for most governments, including India, raising the VAT/GST or indirect taxes rates is perhaps the **Hobson's choice**. Unless tax frauds are checked to a reasonable percentage, this is another challenge to the fiscal consolidation strategy of governments worldwide. As per studies, tax frauds and aggressive tax planning account for revenue leakage ranging between 10% to 30% - former in the developed economies and the latter in the developing countries. India also suffers from the same malaise. The tax frauds in Central taxes like Central Excise and Service tax and State taxes like VAT and State Excise are believed to be huge. Since no comprehensive data or study has ever been attempted to quantify the loss of revenue because of tax evasion, it is guesstimated to be **about 25% of the revenue potential**. Then comes the major handicap of political compulsion to continue with the mega tax shelter schemes on both indirect as well as direct tax fronts. This restricts the growth of taxbase, which again pushes the tax rates upward. Higher tax rates coupled with complex laws and procedures again constitute a Vicious Cycle, which in turn **works against voluntary tax compliance.**

Keeping in mind that the VAT/GST hikes account for more than 20% of the global tax revenues, the OECD has launched its Global Forum on VAT as a platform for policy dialogue and consensus building around best practice principles, particularly in the context of international trade. At the last week meeting, the Global Forum looked at a range of design issues, considering how rising household income inequality may affect VAT policy and discussing options for improving VAT compliance. Country experts also exchanged views on counter-measures to reduce VAT losses due to fraud and, in this context, expressed a strong need for enhanced administrative co-operation, including through the exchange of information. In contrast with the taxation of income (where there is the OECD Model Convention) there is **no internationally agreed framework for the application of VAT** to cross-border trade. This is especially problematic in the context of the strong growth in services and intangibles. Services cannot be subject to border controls in the same way as goods, so administrative procedures for ensuring that the right amount of tax is paid in the right place are more complex, notes the OECD Report. From a government's viewpoint there is a risk of under-taxation and loss of revenue, or distorting trade through double taxation. From a business viewpoint, there are large revenue risks and high compliance costs. Work on the VAT/GST Guidelines will now continue under an ambitious work programme to complete these Guidelines by 2014, in co-operation with Global Forum participants. A comprehensive set of Guidelines will be presented for endorsement by the Global Forum on VAT at its next meeting early 2014.

In his closing remarks OECD Secretary General Angel Gurría said," ...
between 2000 and 2008, the services flows have doubled, with growth rates in the emerging market economies even greater than in the OECD area, reaching a scale to have material effects on government revenues and economic growth."

In this backdrop of global development and future projections of growth in exports of services and intangibles, it is important for India to roll out the GST if not in 2013, at least in 2014 or 2015 and make it co-terminus with the OECD's International Standard Guidelines to be released in 2014. Given the fact that India's growth has receded and exports has also suffered crippling setback, including the exports of services, it would be highly desirable to persuade the States for immediate GST roll-out, which alone can jack up our economic growth by at least 1% if we go by the opinions of the experts. For higher and sustainable economic growth it has become imperative for India to remove all the barriers and let India be a one and unified market for the trade and industry. Even for the USA, which has a complex architecture of federalism, such barriers do not exist, and it has hugely contributed to their prosperity and higher growth cycle. Merely because the hike in the indirect taxes is a **lesser evil** as it does not directly impact the economic decisions of households or the business and also **does not hurt the savings and investment cycles** in the economy, the Indian States and the Union Government should not delay the implementation of six-year-old GST proposal. GST has become a necessity for the sustainable growth cycle of the Indian economy, and our political parties should stop playing narrower politics with the Exchequer's interests as well as the overall economic prosperity of India.