GST Rate Structure - Demerit Goods - Politics of Cess would not work!

TIOL - COB(WEB) - 524
OCTOBER 20, 2016

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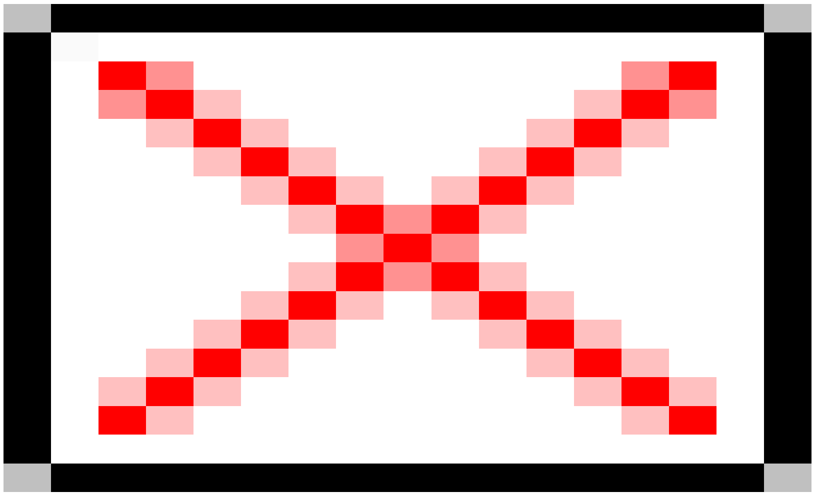

IT is Diwali time in India. And Diwali means fulsome shopping by all persons irrespective of one's political or economic status. And this is what probably prompted the GST Council Members to truncate the three-day meeting to two-day. Another indirect reason to push the GST rate structure issue to the next meeting could be that any decision taken prior to Diwali may have spelt bad time for certain products. But, going by the Union Finance Minister's statement that the Council has 'converged' towards consensus on the issue of GST rate structure, one may draw the conclusion that there were extensive and fruitful deliberations on this issue.

The Union of India has proposed FOUR-RATE structure - 6%, 12%, 18% & 26%. Gold is likely to be a loner with 4% rate. These rates have evidently been well thought out as goods are going to be bracketed to the nearest rate. A good number of goods used by the common man today attracts 5% VAT and either zero Central Excise duty or 6% duty. All such goods can now be bracketed in the 6% slab. In other words, all items which today fall in the category of 3% to 9% of either VAT or Central Excise Duty would be put in the 6% basket. Similarly, a good chunk of goods would be in the baskets of two Standard Rates of 12% and 18%. For a major chunk of goods the standard rate is going to be 18%. Going by the global wisdom, the standard rate for goods and services both, a common base, is going to be 18%. The higher rate of 26% is only for a few items such as tobacco, SUV, aerated drinks, environment-unfriendly and luxury goods. These goods have been bracketed as demerit or sin goods.

Now, the larger question is - what really prevented the GST Council Members from evolving a consensus at its third meeting. And the villain of the piece was quite predictable - the proposal to levy CESS over and above the peak rate of 26%. So far as the concern of the Union of India goes, it is quite justifiable that it needs extra revenue in its kitty to compensate the States, particularly the 11 Special Provision States which are expected to suffer serious dent into their revenue collections because of high exemption threshold as well as dismantling of exemption-raj. But the State Finance Ministers could clearly see the design to deprive them of their share of revenue by imposing CESS over the GST rate for goods. If the States allow the Centre to do so, it cannot claim any share in the Cess kitty.

Let's now take a closer look at the fiscal economics to understand this issue. If the States do not allow the Union of India to levy CESS over the GST peak rate and insist on spiking the peak GST rate to 30% or even 35% on items like SUV and tobacco, the States would gain **50% of the extra revenue** from the higher rate in addition to **42% share** from the revenue pool as accepted by the Centre on the basis of the Finance Commission Report. As per theseeconomics, the State would end up garnering revenue to the tune of **72% of the duty collected** from demerit goods. But the biggest problem in this model is - the Centre needs extra revenue to compensate States losing revenue because of the present model of GST.

So, where does the solution lie? Most probably, the Union of India will be forced by the States at its fourth meeting on November 3 & 4 to forget about the **politics of Cess over and above the GST rate and go back to the Entry 97** of the Union List of the Seventh Schedule of the Constitution and levy either CESS or even Central Excise duty on certain items as this omnibus Entry vests unlimited power in the Union of India to levy new tax by any new name. So, by designing new CESSES or even Central Excise duty on certain products the Centre would garner extra revenue to meet its statutory requirements. In this bargain, the two products which may suffer most are the widely accepted sin goods - tobacco and SUV. They might be subjected to more than 36% final incidence of duty. As against the present incidence of tax above 35%, it might get some relief as its rate may be kept close to 32%. Other luxury items may be subjected to 4% to 6% extra duty over and above the peak rate.

The second important issue which has been successfully settled by the Council is the issue of compensation. So far as the issue of base year goes it was decided to be 2015-16 at the second meeting itself. The only contentious issue was the projected revenue growth and it has thankfully been decided to be a secular rate of 14% which has now become the Revenue Neutral Rate (RNR). At this growth rate, the States are unlikely to suffer any revenue loss as compared to what they collect today. They had collected close to Rs nine lakh crore last fiscal. With the GST revenue collections likely to be above 22% in the first few years, it is expected to be a win-win scenario for both the Centre and the States. Another major component of the compensation issue was the CST rate. The States predictably asked for compensation to be calculated at the rate of 4% CST rate but they were reminded that because of this demand the UPA-II could not muster courage to implement GST in 2011 and it may derail the entire process. And thus, they finally settled for 2% CST rate which is going to be about 50,000 Crore.

This brings us to the third most important issue of cross-empowerment of the dual authorities for CGST and SGST. Before addressing the larger issues, a consensus was achieved over the issue of one-assessee-one-authority doctrine. In other words, so far as the taxpayers go, they would not be forced to interact with two different authorities for both the CGST and the SGST. However, it is indeed a ticklish issue and it entails leaving constitutional space for each other. One area where it is badly required is the AUDIT. Even as the States are trying to corner an exclusive zone for assessees below Rs 1.5 Crore, the Centre is keen to have its own share. A solution may be found if the Centre agrees to one per cent of the creamy layer of such small assessees for audit purpose. Similarly, some formula can be developed for large assessees so that multiple audits could be avoided. And a healthy protocol in this regardmay help both in avoiding any inconvenience to the taxpayers. So far as enforcement is concerned, it would be ideal to handover the entire chain of value addition as it is going to be largely intelligence-based or part of data mining and can be done by the GST Network.

Although the Union Finance Minister yesterday said that once the consensus is achieved over the GST rate structure, the next major issue to be taken up at the next meeting on November 9 & 10 is going to be the Model GST Law but the issue of retention of services remains unsolved and has also assumed serious proportions with VAT officials and Central Excise officials preferring to come out on the streets. Since concurrent powers exist for both to tax services, a solution may be found lying with the GST Network which may provide a backend solution behind the front-end screen. So far as audit is concerned, a formula can be developed and the same can be bifurcated by the GSTN behind the screen based on the returns filed.

Even as the debate over some of these issues may continue till the formal announcements are made by the GST Council Chairman i.e. the Union Finance Minster, one needs to congratulate Mr Arun Jaitley and all the State Finance Ministers for finding a solution by consensus rather than voting. Once the GST rate structure is finalised, there is hardly going to be any need to resort to voting for any other issue in the near future. For this, even the GST Council officials need to be appreciated for their adroit handling of the Council's proceedings. Even VAT Commissioners who are a part of the technical committees deserve equal amount of appreciation for making the thorny path of decision-making a smooth ride for the Nation. Let's wait and watch for the final outcomeof the Fourth and Fifth Meetings of the Council. But what is surprising for the Nation is that the GST Council is **yet to release the signed minutes of the First and Second Meeting** which the Nation would like to peer through to fathom the making of a new fiscal history in India.