Recently Union Finance Minister Arun Jaitley who is also the Chairman of the Goods and Services Tax Council, the all-powerful body set up under the Constitution Amendment Act to determine the new tax structure and the rates under it, was confronted with a question as to why India cannot have one or two rates in consonance with the global practice. Jaitley's answer was that for India with wide disparities in incomes and majority of its people living below the poverty line, "the tax on an item like *chappal* (mostly used by the poor) cannot be the same as on a luxury car which is the privilege of a rich person". Yet, he did not rule out moving to the desired goal in future.

◆ **By Uttam Gupta**

Finance Minister Arun Jaitley hitting the 'GST Bell' at a Conclave on GST held in New Delhi

GST – cooperative federalism, at what cost?

Finance Minister Arun Jaitley's argument here is self-defeating. If, in view of the reasons cited by him, it is not possible to achieve the desired goal today, then how will it be possible in the future? Will those reasons cease to exist, say, five years from now?

Jaitley is well aware that income disparities and poverty won't go away though under the Narendra Modi Government (given its huge pro-poor bias in the formulation of its policies, development plans and welfare schemes) one can look forward to some reduction. The real reason for putting together a GST architecture that is far removed from an ideal stuff is the compulsions of a federal polity.

Be it in the Empowered Group of Finance Ministers which discussed the contours of the Constitution Amendment Bill or in the GST Council mandated to carve out the fine details, Jaitley has ever been keen to take all States on board. He has accommodated most of their demands and ended up with a tax structure that is a mere rehash of the subsisting dispensation.

There are five broad rate categories, viz, zero, 5%, 12%, 18% and 28% besides a number of cesses imposed on demerit items falling in the highest slab of 28%. The ball does not stop here.

THE RATE VARIES

For any given item, the applicable rate varies depending on its value.

For instance, a footwear item valuing less than Rs 500 attracts 5% GST whereas the same item costing more than this amount will attract an 18% tax. Likewise, an apparel costing less than Rs 1,000 attracts 5% whereas for the purchase of an apparel above this threshold, the customer will pay an 18% tax. Then, there are a host of other distinctions such as a branded food item versus an unbranded one, an AC restaurant versus a non-AC restaurant and the economy versus the executive class. The rates will be different depending on the class.

Such a highly differentiated GST structure gives too much discretion to bureaucrats. In such a regime, corruption and nepotism are inevitable since a business entities lobby may think of getting a particular product of its interest included in the low rate category. This is out of sync with Modi's philosophy of zero tolerance for corruption.

The real reason for putting together a GST architecture that is far removed from an ideal stuff is the compulsions of a federal polity.

The desire to take all decisions by consensus and take every State Government on board (rendering even the voting clause redundant) has also led to a host of other collateral damages. Thus, the Union Government has acceded to granting the States full compensation for the loss of revenue vis-à-vis what they would be getting under the extant dispensation. Such a demand shows the lack of faith in the capability of the new Central regime to deliver. What makes things worse is the levy of a cess on demerit items (those attracting 28% GST). This could have been avoided if there was no obligation on the Union Government to compensate the States.

GST COUNCIL'S OPENNESS

The Union Finance Minister has also alluded to the openness of the GST Council to consider changes in the tax rates and their classification or any other issues that are brought to its attention or even suo motu. While, there can be no disagreement on addressing implementation issues, it would be inappropriate for the Council to alter the rate structure or classification of items. Doing so amounts to injecting an element of "unpredictability" and "instability" in the system.

For instance, in respect of sports utility vehicles (SUVs), initially the Council decided to levy a 15% cess which together with the basic rate of 28% GST adds up to an effective rate of 43%. Now, it has increased the cess to 25% which comes translates into an effective rate of 53%. This has caused consternation among the makers of SUVs (mostly MNCs) who have termed it – rightly so – a retrograde step. Some of the MNCs have gone a step ahead to revise their plans for investment in India.

Ironically, the Council has not addressed anomalies that had crept in the GST architecture in the very first place. Thus, it had "virtually" excluded crude, gas, petrol and diesel (included but keeping them zero rated). This meant that even as oil and gas companies continue to charge excise duty and VAT – plus other local levies under the existing dispensation – they won't get credit for duty paid on the purchase of their inputs, including equipment and machinery. This goes against the very philosophy of the GST requiring a seamless input credit chain.

The uncovered input tax credit would result in a staggering loss (estimated to be about Rs 25,000 crore) to the Oil and Natural Gas Corporation, Oil India Limited, Indian Oil Corporation, Bharat Petroleum Corporation and Hindustan Petroleum Corporation. Since these undertakings are the lifeline of the Indian economy, the Government cannot simply afford their getting haemorrhaged.

JAITLEY'S PROMISE

Following a representation from these oil PSUs, Jaitley had promised to take up the inclusion of gas "only" (crude, diesel and petrol are not even on his radar). Even this has not happened so far.

Electricity has also been excluded from the GST ambit. Consequently, power generation and distribution companies won't get credit for taxes paid on inputs used by them. The excise duty or State VAT paid on gas that goes into electricity generation as also the tax paid on equipment and stores get embedded in the cost of the end product (*read* electricity). This anomaly too needs to be urgently removed. But, the Council seems to be in no mood to take it forward.

The Council should stop fiddling with the GST architecture forthwith. Instead, it needs to focus on removing anomalies, viz. the exclusion of oil and gas products, electricity, alcohol and real estate. Going forward, it should aim at a 3-tier structure – as recommended by the Dr Arvind Subramanian Committee – in the interim and a single GST in the long run as recommended by a committee set up by the 12th Finance Commission under Dr Vijay Kelkar. ■

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