GST: A high standard rate would impact prices and hamper acceptance

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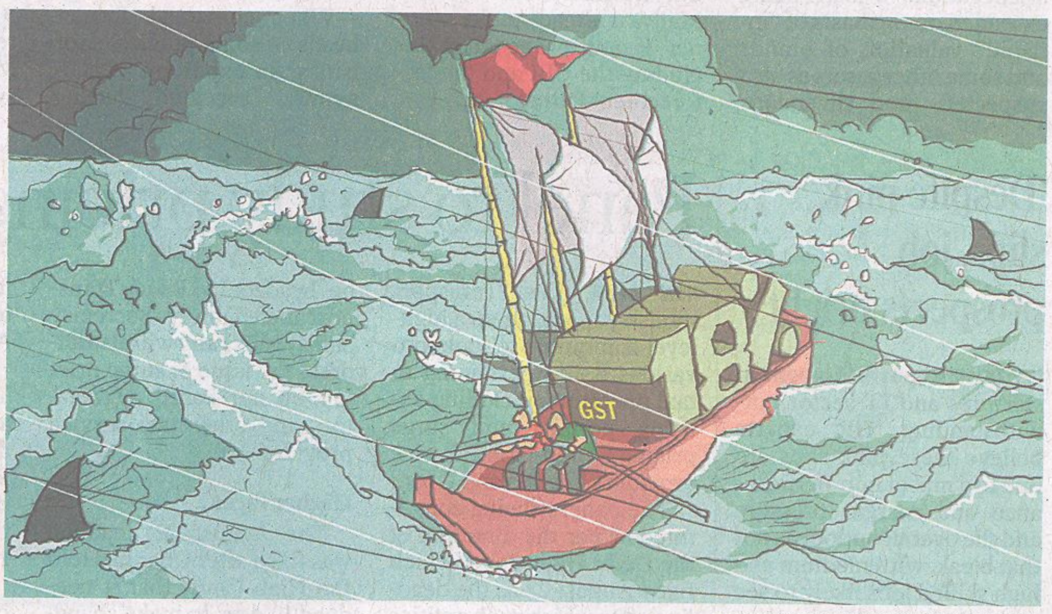

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In a historical move for the country, the 122nd Constitutional Amendment Bill to introduce the Goods and Services Tax (GST) was unanimously passed by Parliament this session. Widely believed to be the most important tax reform since 1991, the GST will transform India into a unitary market, lower transaction and logistics costs, spread the tax net wider and propel investments and growth.

Given the multiplicity of taxes at the Central and State Government levels, evolving a single indirect tax was a challenge; but all political parties came together in a paradigm of cooperation and consensus to make it a reality. The measure reiterated the country's strong commitment to an inclusionary, consensual and sustainable reforms process.

As the Prime Minister said in his speech in the Lok Sabha, "It is the strength of our democracy that most of the states and political parties now support this Bill." We in industry wholeheartedly concur and compliment the government for steering this critical legislation through the Parliamentary process. CII believes that the GST legislation marks a turning point in the nation's reform journey which will go from strength to strength from here on.

Not easy

The journey ahead for introducing the GST will not be easy as a number of steps are required from different stakeholders. For industry too, conforming to the new administrative processes within a compressed time-frame will be challenging.

One of the first tasks for the new GST Council proposed to be set up under the Bill would be to decide on the applicable tax rate. This rate will be central to the success of the endeavour as it would impact India's macroeconomic indicators, including GDP growth rate, inflation, the fiscal condition of the Central and State governments, and so on. It would also impact the common man's daily life, employment creation and external trade as well as the competitiveness of industry in a difficult global environment.

The Report on the Revenue Neutral Rate and Structure of Rates for the Goods and Services Tax (GST) brought out in December 2015 by a Committee headed by Arvind Subramanian, Chief Economic Adviser, studied different approaches to the taxation rate that would protect the revenues of the Centre and the States, or revenue neutral rate (RNR).

As per these approaches, the RNR ranged from 11.6 per cent to 17.7 per cent. The committee, after a detailed study, recommended a reasonable RNR of 15-15.5 per cent which would determine the standard rate of 17-18 per cent and a lower rate of 12 per cent for essential goods.

CII broadly concurs with this standard rate plus a merit and demerit rate for identified goods and services. There are several compelling reasons for keeping the standard rate at around 18 per cent.

For one, the standard rate of 18 per cent ensures that the tax revenues of the Centre and States would not be adversely impacted by the introduction of GST.

> A standard rate of 18 per cent ensures that the tax revenue would not be adversely impacted

The Centre has also assured the States of full compensation for five years.

Second, the key impact of a higher rate would be on prices which would create an adverse consumer mindset and would hamper buy-in. For example, the tax on services is currently set at 15 per cent including cesses, and a sudden increase beyond an acceptable standard rate of 18 per cent would lead to lack of confidence in the GST as a beneficial tax reform.

This, in turn, might negatively affect compliance. Although the administration of the tax would offer benefits for all players in the supply chain, the incentives for non-compliance in the case of a higher tax rate would be that much higher.

Consumer incomes

Third, the impact on inflation arising from a tax rate that is set too high would be inimical to the entire economy. We have just emerged from a period of high inflation which was addressed by raising interest rates, which, in turn, impacted investments. A reasonable standard tax rate of 18 per cent would not only deter inflation build-up, but would also protect the consumer's incomes and interests. The Subramanian Committee estimated the impact of a standard rate of 22 per cent on inflation as 0.3-0.7 per cent and stated that a lower RNR would ensure consumer buy-in, as also be less regressive relative to direct income taxes.

For industry, which seeks to be competitive in the global marketplace, a standard rate of 18 per cent will be advantageous. As pointed out in the Report, the average standard rate of value-added tax in high income countries is 16.8 per cent, while that in emerging market economies is 14.1 per cent, although rates in countries like China and Mexico are a little higher than this. India should position itself correctly in order to boost exports and generate employment. GST is a game-changer for India. To enable it to have the maximal impact on growth, employment and incomes, the standard tax rate should be maintained at a reasonable level. The industry looks forward to the successful roll-out of the GST.

The author is Director General, Confederation of Indian Industry