We need to get GST right for revenue neutrality

P C JHA

The existence of grey markets is a matter of serious concern for any economy. They hurt trade, foreign investment, government revenue, employment, innovation, crime control, national security and the health of the people. India is on the cusp of a major growth phase, but this has also opened up avenues for the growth of a parallel economy and large grey markets.

A study by Ficci CASCADE reveals that the supply of unaccounted and untaxed goods in India increased by 44.4 per cent in just two years (between 2012 and 2014) in sectors such as alcoholic beverages, auto components, computer hardware, package foods, personal goods, mobile phones and tobacco. Genuine producers collectively suffered an annual sales loss of ₹32,412 crore, while the government's loss in tax revenue went up by ₹13,049 crore. The maximum loss was suffered by the tobacco sector — a staggering ₹9,139 crore, with the share of the grey market in tobacco products growing from 15.7 per cent to 20.2 per cent in these two years.

An important factor that results in rapid growth in the grey market for any product is a high tax rate. However, this point does not get adequate attention from policy makers in the government. The loopholes in central and state government taxation policy encourage availability of tax-evaded, substandard, fake and smuggled goods in huge quantities. Attaining the right balance between tax revenue targets and consumer interests is imperative for any country. The Goods and Service Tax (GST) will have to rectify this anomaly in taxation policy and set this imbalance right.

High tax rates fuel the growth of the grey market. Attaining the right balance between tax revenue targets and consumer interests is imperative. GST will have to rectify this anomaly in taxation policy

Globally, most countries have adopted a single tax rate while implementing GST. Singapore has a GST rate of seven per cent, while in Australia it is 10 per cent. However, in India, the GST Council has decided on four slabs ranging from five to 28 per cent. It has also decided to impose cess over and above the highest rate of 28 per cent on demerit and luxury goods such as luxury cars, aerated drinks, *pan masala* and tobacco products. Collections from the cess will be put into a separate fund, from which the Centre will compensate states for any revenue loss for a period of five years resulting from the switch-over to GST.

Multiple tax slabs will in all probability lead to a resurfacing of classification disputes that had settled down as a result of a single Cenvat rate. However, there is also substance in the view that a single tax slab is unworkable in India, given its complexity, income disparity, federal system and the likely inflationary impact of this major change. It is the latter which seems to have prevailed and under the circumstances, the decision taken is no doubt an expedient one.

Items such as petroleum, luxury watches, luxury pens, luxury bags and tobacco are challenges for the government. In the petroleum category, kerosene, naphtha and LPG will be under GST but crude oil, petrol, diesel, natural gas and aviation fuel will be outside its ambit during the initial years. This dual tax regime for petroleum will make compliance difficult. Taking tax credit will be another issue. Besides, there will be non-creditable tax costs.

Cigarette-centric tobacco taxation results in double jeopardy; it undermines both health and revenue objectives. This is clear from the fact that while tobacco consumption increased by 38 per cent between 1981-82 and 2014-15 (from 406 million kg to 562 million kg), cigarette consumption declined from 21 per cent to 11 per cent during the same period. The loss of revenue is due to rampant tax evasion.

The current policy stance on cigarette taxation exposes consumers, particularly of the lower socio-economic strata, to substandard and unhygienic tobacco products. GST will be a game-changer if it can factor in the need to remove distortions in the current tobacco taxation policy. Equitable taxation structuring on tobacco will not only ensure sustainable revenue buoyancy but also, more importantly, address the bigger concern of large-scale use of chewing tobacco — a more serious health hazard than cigarettes. The way forward may be levy of GST on all unmanufactured tobacco at the standard rates, with input tax credit at every stage of value addition.

In taxing cigarettes the government has to be careful, as higher tax arbitrage in the past has invariably resulted in litigation and evasion of government revenue in a big way. It is only after 1987, when a specific duty structure was introduced, that there has been stability and revenue buoyancy with a litigation-free environment in respect of tobacco products. This has resulted in mutual trust between the government and the industry. With the introduction of VAT, there has been a surge in the illicit trade in this segment.

According to media reports, cigarettes will be in the 28 per cent slab under the GST regime, with an additional cess likely to be imposed. Twenty-eight per cent GST would amount to a 16 per cent increase on the current weighted average of VAT. This would further push up the prices of this product unless the concept of revenue neutrality is applied. Government is expected to ensure seamless transition to GST, maintaining revenue neutrality. The existing structure of specific slabs is time-tested and working well. It ensures no undervaluation, is litigation-free, simple to administer and will not cause disruption for any stakeholder.

Legislations such as the GST come once in many decades. It is critical that the concerns of various stakeholders are judiciously addressed.

The writer is Advisor, Ficci CASCADE, and former Chairman, CBEC