India-related Legal Services at Our Office（８）

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Introduction of Goods and Services Tax (GST)

I. Introduction

Among all the economic reforms by the Modi government, the most outstanding is Goods and Services Tax (GST) introduced in July 2017. This was strongly wished for, not only by the Indian economic community, but also by foreign economic communities. In August 2016, the constitution was amended to introduce GST, which actually commenced in July 2017. GST is aimed at integrating complex indirect taxes both at national and local levels, and expected to realize one common market in India, while broadening the tax base and ensuring compliance regarding tax payment[1].

II. Significance of GST

GST, put into force in July 1, 2017, was designed to bunch up 17 taxes from the central government and the state governments, so that the complicated tax structure becomes simplified and the tax rates all over India become uniformed: GST is a huge step towards materializing a common domestic market. Also, from the view point of consumers, it is beneficial, reducing tax burdens which previously covered 25% - 30 % of goods prices. According to the estimate by National Council of Applied Economic Research (NCAER), the Indian leading think tank, the GST will increase GDP growth by 0.9% - 1.7%.

The GST introduction required amending the constitution, thus it was very difficult to be achieved. To begin with, the constitution stipulated that the right to tax goods and services belonged to the central government; the right to tax sales to the respective state governments; and the right to tax inter-

[1]Makoto Kojima, *"The Introduction of GST and the prospect of the Indian economy," Contemporary India Forum, 2018 winter*, Japan India Association. (original title)小島眞「GST の導入とインド経済の展望」、『現代インド・フォーラム 2018 年冬季号』所収、日印協会。

state sales to the central government, although its collection was entrusted to the state of good's origin; moreover, as for imported goods, on top of the basic customs duty, the central government imposed additional customs tax equivalent to goods tax, sales tax and state's value-added tax (VAT).

Based on the constitutional amendments, GST has become the tax of common and exclusive competency of the central government and the state governments. Therefore, both the central government and the state governments shall collect GST on the common basis, respectively as Central GST (GGST) and State GST (SGST). Also, Integrated GST (IGST) shall be imposed upon the interstate supply of goods and services and collected by the central government, and IGST shall be levied on imported goods as additional taxation. Furthermore, any decrease in a state's tax revenue would be compensated for five years by the central government, while assuming the tax revenue will increase by 14% annually in comparison to the revenue of the fiscal year 2015.

Under GST, the same good will be taxed at the uniform rate all over India. And the rates were set for each good at one of the four rates (5%, 12%, 18%, or 28%) by the National Conference for GST, comprised of the financial minister of the central government as the chairperson and the financial ministers of every state.

VAT, equivalence to GST, is adopted in approximately 160 countries in the worlds. Still, Indian GST is a very ambitious scheme. It is a clean double-layered structure based on cooperative federalism, minimizing the defects of centralized VAT and independent VAT, and aimed at facilitating the administration and compliance of tax by way of the common tax basis and the similar tax rates and at making interstate transactions easier.

Additionally, in order to apply for a tax refund regarding transactions in a supply chain, the records of both sellers and buyers need collating online; such an online platform for running GST has been made and is being used as GST Network (GSTN), which has already registered over 5 million companies. According to Dr. Makoto Kojima, the professor emeritus at Takushoku University, the introduction of GST after invalidating large denomination bills created great momentum towards digitalizing the economy in India[2].

III. Benefits brought by GST

(1) Reduction of costs in logistics

The conventional tax structure segments the domestic market and cuts India into pieces. For instance, on transporting goods from Delhi to Mumbai, one needs to pay, besides the central sales tax, border entry tax at a state border and Octroi tax in entering Mumbai; and the total can be as much as customs duty on imported goods in some cases. The 2% central sales tax imposed on interstate goods, in particular, hinders streamlined supply chains and promotes geographical segmentation of production. This way, producers' efforts to evade the central sales tax by moving branches and warehouses are in the end offset by the increase in logistics costs.

Logistics' impacts on manufacturers are stronger than the direct cost of transportation. In India, road transportation accounts for 60% of all transportation and especially troubling is the length of transportation time and uncertainty regarding this type of transport.

Reasons for delay in transportation include, besides the situation of road networks, the troublesome regulations at check points along state borders. Since the introduction of GST, the checking posts have already been abolished in 24 states and it is expected to contribute significantly to trading between states. In fact, driving hours only accounts for about 40% of all transporting hours, while a quarter of the time is spent at checking posts and for other regulations.

(2) Enlarging tax basis

With the invalidation of large denomination bills in force, the Indian government has been grappling with the task of containing black money, supplemented by GST having a built-in incentive to contain black money.

[2] Kojima, *op. cit.*

Under the GST system, one can apply for tax refund of purchases to be resold in order to prevent double taxation. For the application, invoices from companies in the downstream industry in the added value chain should be submitted to GST Network (GSTN) on line. GSTN is a nonprofit organization established in 2013. The stocks are owned by the central government and the state governments with 24.5% respectively and the rest (51%) is owned by five financial companies.

GSTN is for companies with the sales of 2 million Rupees or more per year. Such companies are required to hand in three types of monthly reports and annual reports. And, companies with the annual sales of 7.5 million Rupees or less (changed to 15 million Rupees or less last November) have another option to pay not VAT but a certain percentage of sales (the rates are 1% for merchants, 2% for manufacturers, and 5% for restaurant managers.), in which case they need to submit, besides annual reports, quarterly reports only, but cannot receive the benefit of tax refund.

VI. Challenges

As early as a few months after the introduction, the GST system faced various problems that cannot be overlooked. As the ongoing challenges to running the system, three can be pointed out as follow:

First is the issue of tax payment compliance. GST, since its start, has been forcing taxpayers to submit many reports and to go through cumbersome procedures, which is a huge burden especially for small and medium sized enterprises. Companies not registered in GST usually do not issue invoices, and in the case that purchases from such unregistered companies reaches a certain amount, registered legal entities need to make invoices and pay the price minus GST to the unregistered companies.

Second is tax rate. Regarding the setting of tax rates, various demands came from both producers and consumers to the National Conference for GST, who released new rates for more than 200 items in November 2017. Especially the rate of 28% is criticized severely by the business community for being arbitrary in setting and for distorting the range and spirit of GST.

It is foreseen that the rate will be duly changed if necessary in the future.

The third issue is a technical one, as to how GSTN can cope well with enormous amounts of data. The establishment and maintenance of the GST system are taken care of by the second largest IT company in India, Infosys, which, in September 2017 after the introduction of GST, experienced system trouble due to concentrated uploading right before the reporting deadline.

VI. Conclusion

The key to the success of GST is in the Prime Minister, Modi, and his formidable ability to lead. His power can be observed, for example, in the fact that he was able to bravely invalidate large denomination bills which would cause people a great inconvenience. Also, shown in his perseverance through the hardship that GST needed to receive the constitutional amendment, which required two thirds affirmative votes in both the Upper and the Lower House respectively, while the ruling party BJP was in the minority in the Upper House. In the end the ruling party and opposition parties reached an agreement through Modi's overwhelming leadership. GST will successfully take root in India and bring further growth in the economy and better environment for investment.