A Research Paper on Impact of Goods and Service Tax (GST) on Indian Gross Domestic Product (GDP)

***Dr.Ashalakshmi R K**

*Associate Professor, Dept.of Management Studies, MACFAST, Tiruvalla

Abstract

This paper is an analysis of what the impact of GST (Goods and Services Tax) will be on Indian Gross Domestic Product (GDP). GST also known as the Goods and Services Tax is defined as the giant indirect tax structure designed to support and enhances the economic growth of a country. There will be one tax rate for all which will create a unified market in terms of tax implementation and the transaction of goods and services will be seamless across the states. It is expected that it will be helpful in increasing production and the purchasing power of the buyer which may increase the GDP by 1% to 3%. Recently, India accounted 7.1 percent growth for the financial year of 2016-17 while for the march quarter, it was behind the china at 6.1 percent in front of 6.9 percent of china's statistics. More than 150 countries have implemented GST so far. A reformed tax is one which reduces production distortions and administrative hurdles, thus clearing the way for higher productivity of goods and services. That, in turn, will produce more and add up to a higher GDP which should then generate more revenue for the authorities. In the way GST is being structured, however, it appears that capturing revenue is the first goal of the authorities. In this, the very objective and the tools to support it are inconsistent.

Key words: GST, GDP, Indian economy

I. Introduction

The Goods and Services Tax (GST) is regarded as one of the biggest tax reforms since Independence (1947). The biggest taxation amendment which comes after independence of India is going to change the whole scenario of taxation that was followed from last several years. It had many phases of taxation or we say it is the combination of various taxes and various method. It is going to smooth the part of indirect tax. It will come with many new rules and regulation, many aspect of taxation, many big implementations. It will create the whole taxation part transparent without any manipulation. The 122nd amendment of constitution i.e. goods and service tax is closer to the ideal, it would comprise fundamental tax reform. If however, one examines the proposed structure of the GST, it becomes difficult to view it as one of the biggest tax reforms since independence.

In 2005-06 the value added tax (VAT) was introduced at the level of the States as a prime example of Centre-State fiscal cooperation. This radically altered the earlier State-level Sales Taxes. Again revenue intake shot up while providing momentum to business. Goods and Service Tax (GST) is a new indirect tax scheme which is a consumption based tax. It will replace all the indirect taxes. It is biggest tax reform that will bring India in competition with other countries in respect to the indirect taxation platform.

Adi Godrej, the most forceful proponent of GST, thinks that the GDP growth rate will soon be in double digit with the unified tax system. A study done by NCAER that explores the impact on growth due to reduction in direct cost and cost reduction on capital inputs pegged the improvement in growth rates between 2 and 2.5 per cent. Others have estimated the Indian economic growth between 1.5 and 2 per cent faster under the new tax regime.

While these projections can come true over the long-term, it is doubtful if there will be an immediate improvement in the growth rate of the economy. In fact, growth can slow down in the initial phase of the GST roll-out before the longer term benefits kick-in.

Negative impact in the short term

The primary reason why growth can be affected, at least in the first year, will be because the tax on services that account for around 60 per cent of the GDP is expected to increase under GST while taxes on manufactured products that make up 17 per cent of the GDP can move lower. There is a typical tendency to prepone consumption if taxes are expected to move higher. But in this case, since most services are non-discretionary and since tax rates on goods can move lower, output can contract slightly following the roll-out.

A panel regression analysis done by Sonal Verma and Neha Saraf of Nomura on 11 countries for the period between 1961-2015 to study the impact of change in effective tax rate shows that for countries where tax rates moved higher, GDP growth picks up in the year prior to the GST implementation (year T-1), likely reflecting pre-ponement of consumption in anticipation of higher prices. "This is followed by a temporary (though insignificant) negative impact on GDP growth due to weaker consumption in the year T, as firms pass on tax increases into higher output prices. Beyond that, growth does rebound, perhaps due to efficiency gains from a more streamlined tax structure and better tax compliance."

However, there is a consensus among most economists that the GST will be positive for the economy over the longer term as it simplifies the tax structure, increasing compliance, reduces tax evasion, expands tax base and significantly improves the functioning of the logistics network.

Expansion of tax base

The GST regime ensures that the tax base for indirect taxes grows through two ways. One, it sets up a system of taking credit for taxes on inputs only if it has been declared and paid by the input manufacturer. This sets up a system of self-policing as it is in the interest of the producer to ensure that he sources goods only from those suppliers who are tax-compliant. Many companies in the unorganised sector who are currently not paying tax are thus expected to fall within the tax net.

Two, the committee set up to recommend the Revenue Neutral Rate (RNR) under Arvind Subramaniam, recommended an exemption threshold of Rs. 25 lakh for goods. Currently, goods producers with turnover less than Rs. 1.5 crore are exempted from paying central excise duties; at the state level, the exemption limit for goods varies between Rs. 5 lakh and Rs. 10 lakh. Decreasing the threshold for GST will therefore make many small manufacturers liable to pay tax on their products. Corporate tax data shows that entities recording revenue between Rs. 25 lakh and Rs. 40 lakh are paying a very small proportion of tax, though they are large in number. The threshold for services will however increase from the current limit of Rs. 10 lakh to Rs. 25 lakh.

GST will have a direct effect on cost reduction and it will reduce capital cost also after coming into actualization. As there will be **no double taxation of goods and services** after implementation of GST with the elimination of cascading effect on the taxation as there was a tax on tax system in the previous regime. As proposed earlier, there will be a single rate of tax applicable to particular goods and services across the nation under the GST scheme. This will also bring about a reduction in compliance cost also which will ultimately increase profit percentage. In fact reduction of cost of 1% will bring about 9-10% increase in profit and that is the power of new tax scheme.

The biggest tax reform is on its way and very soon Goods and Services Tax will be the part of Indian Economy. A new and unified tax structure will be followed for indirect taxation on the place of various existing tax laws like Excise duty, Service Tax, VAT, CST etc. and for sure the new tax regime will eliminate the cascading effect of tax on transaction of products and services, and it will result in availability of product and services to consumers at lower price. All these have a direct impact on India's Gross Domestic Product (GDP).This unified indirect tax structure will attract the new investors in India because of its lenient taxation procedures.

Thus increase in investment will bring about the more business units in India. This will ultimately result in increasing the tax collection to the Government and this will increase the Government revenue.

Cascading effect will be eliminated under GST and it will bring around growth prospects in our country. When it comes to the impact of GST on revenue of state governments, there comes a negative and positive both type of impact on State Government revenue. As for example, revenue from Value added tax was collection only for the State governments but after GST the VAT will be subsumed. And collection will be bifurcated under both CGST and SGST so in this case, it will have a negative impact on State Revenue.

On the other hand central taxes like Service tax, excise etc. will also get subsumed under GST and there will again a bifurcation between SGST and CGST. SGST will be a share of state government and CGST will be a share of Central Government so, in this way state government will get the share in tax revenue. In spite of that, there is a provision of Compensation Cess also under GST regime. Compensation Cess is a levy which will be used to compensate to the states for the loss of tax revenue which will, in any case, make some neutral impact on the revenues.

Goods and Service Tax: An Outline

Existing Indirect Tax Structure in India

Central Taxes	State Taxes
Central Excise duty	State VAT / Sales Tax
Additional duties of excise	• Central Sales Tax
Excise duty levied under Medicinal & Toiletries Preparation Act	• Purchase Tax
Additional duties of customs (CVD & SAD)	• Entertainment Tax (other than those levied by local bodies)
Service Tax	• Luxury Tax
	• Entry Tax (All forms)
	• Taxes on lottery, betting & gambling
	• Surcharges & Cesses

CGST, SGST, UTGST & IGST

The assignment of concurrent jurisdiction to the Centre and the States for the levy of GST would require a unique institutional mechanism that would ensure that decisions about the structure, design and operation of GST are taken jointly by the two. For it to be effective, such a mechanism also needs to have Constitutional force. To address all these and other issues, the Constitution (122ndAmendment) Bill was introduced in the 16thLok Sabha on 19.12.2014. The Bill provides for a levy of GST on supply of all goods or services except for Alcohol for human consumption.

The tax shall be levied as Dual GST separately but concurrently by the Union (central tax - CGST) and the States (including Union Territories with legislatures) (State tax - SGST) / Union territories without legislatures (Union territory tax- UTGST). The Parliament would have exclusive power to levy GST (integrated tax - IGST) on inter-State trade or commerce (including imports) in goods or services. The Central Government will have the power to levy excise duty in addition to the GST on tobacco and tobacco products. The tax on supply of five specified petroleum products namely crude, high speed diesel, petrol, ATF and natural gas would be levied from a later date on the recommendation of GST Council.

Why GST: Advantages

To Trade	To Consumers
Reduction in multiplicity of taxes	Simpler Tax system
Mitigation of cascading/ double taxation	Reduction in prices of goods & services due to elimination of cascading
More efficient neutralization of taxes especially for exports	Uniform prices throughout the country
Development of common national market	Transparency in taxation system
Simpler tax regime	Increase in employment opportunities
Fewer rates and exemptions	
Distinction between Goods & Services no longer required	

II. Objectives of the study

- To understand the concept of goods and service tax and its benefits
- To understand how GST will work in India and its implications to Indian Gross Domestic Product (GDP)
- To learn about the future GST regime

IV. Research Methods

Primary data used in the study includes discussion and interview with officials of Central Board of Excise and Customs. The study is poised towards analysis of Secondary data collected from various books, National & international Journals, reports of Central Board of Excise and Customs, Income Tax Authority, government reports, publications from various websites which focused on all relevant aspects of Goods and Service tax.

V. Goods and Service Tax: Implications on GDP: An Analysis

Investments-Promoter

The RNR report submitted in December 2015 makes the point that investments in the economy will improve "with a more seamless and efficient crediting of taxes paid on capital goods." Currently, companies sourcing capital goods for capacity expansion cannot claim tax credit on capital goods purchased; this will change with the GST regime. The report says that capital goods prices would become effectively 12-14 per cent cheaper as companies avail tax credit. This is likely to increase investments and help growth. The report says that this could lead to incremental GDP of 0.5 per cent. There will be one tax rate for all which will create a unified market in terms of tax implementation and the transaction of goods and services will be seamless across the states.

The same will reduce the cost of transaction. In a survey, it was found that 10-11 types of taxes stated in the above table, levied on the road transport businesses. So the GST will be helpful to reduce transportation cost by eliminating other taxes. After GST implementation the export of goods and services will became competitive because of nil effect of cascading of taxes on goods and products. In a research done by National Council for Economic Research it was suggested that GST would be the key revolution in Indian Economy and it could increase the GDP by 0.9 to 1.7 percent. As speculated earlier, the tax experts can now assume that the growth will be around 1 to 2 percent after the implementation of the GST.

GST will be more transparent in comparison to the existing law provision so it will generate more revenue to the Government and will be more effective in reducing corruption at the same time. Overall GST will improve the tax Compliances. In a report issued by the Finance Ministry, it was mentioned that Make in India programme will be more benefited by the GST structure due to the availability of input tax credit on capital goods. As the GST will subsume all other taxes, the exemption available for manufacturers in regards of excise duty will be taken off which will be an addition to Government revenue and it could result in an increase in GDP.

The GST regime has although a very powerful impact on many things including the GDP also. The Gross Domestic Product has the tendency to come into view on the shoulders of revenue generated by the economy in a year. Still, a worthwhile point includes that the GST has the capability to extend the GDP by a total of 2 percent in order to complete the ultimate goal of increasing the per-capita income of every individual. Also, the scheme will certainly improve the indirect revenues to the government as the tax compliance will be further enhanced and rigid, extending the taxpaying base which will add to the revenue. The increased income of the government will redirected towards the developmental projects and urban financing creating an overall implied scenario.

Welfare of the Nation: GST will raise overall Indian welfare and is an inclusive policy in that it would be welfare improving all Indian states. GST would lead to real GDP growth of 4.2% in the long term under the baseline assumption of surge in the factory production. It will prevent cascading of taxes as Input Tax Credit will be available across goods and services at every stage of supply. Synchronisation of laws, procedures and rates of tax will ultimately help in poverty eradication by generating more employment and more financial resources. More efficient neutralization of taxes especially for exports thereby making our products more competitive in the international market and give boost to Indian Exports.

GST will improve the overall investment climate in the country which will naturally benefit the development in the states. Uniform SGST and IGST rates will reduce the incentive for evasion by eliminating rate arbitrage between neighbouring States and that between intra and inter-state sales. Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption, which in turn means more production thereby helping in the growth of the industries . This will create India as a ” Manufacturing hub”.

Increase in domestic and international trade and investment: If the GST is able to improve the ease of paying taxes, then foreign investment should receive a momentum. The fact is that for 2015-16, India has been ranked by the World Bank at 172 out of 190 countries for the income tax. However, tax matters are not the only constraint for foreign investment. Many non-tax parameters also play a role. Nevertheless, it is also true that if the tax administration is elementary, then its adverse importance of the tax aspect rises in the list of determining factors.

Even today, by and large, foreign investors continue to be dissatisfied with Indian tax administration practices at the ground level. This needs to change so that to gain foreign investors confidence. GST will be an important test to check if the corner has been turned and the business community experiences a visible improvement in the ease of paying taxes. The tax authorities both at the central and state levels have to be given the opportunity to work on this and achieve success.

Increase in international competitiveness: GST will help the country expand external trade by 32%. It will boost export and manufacturing activity, generate more employment and thus increase GDP with gainful employment leading to substantive economic growth.

- **Make in India**: Unified tax system Will help to create a unified common national market for India, giving a boost to Foreign investment and "Make in India" campaign

- **Ease of Doing Business**: Simpler tax regime with fewer exemption, reductions in the multiplicity of taxes that are at present governing our indirect tax system leading to simplification and uniformity, reduction in compliance costs - No multiple record keeping for a variety of taxes - so lesser investment of resources and manpower in maintaining records, simplified and automated procedures for various processes such as registration, returns, refunds, tax payments, etc, all interaction to be through the common GSTN portal- so less public interface between the taxpayer and the tax administration, improvement in environment of compliance as all returns to be filed online, input credits to be verified online, encouraging more paper trail of transactions, Common procedures for registration of taxpayers, refund of taxes, uniform formats of tax return, common tax base, common system of classification of goods and services will lend greater certainty to taxation system, electronic matching of input tax credits all-across India thus making the process more transparent and accountable.

Tax Calculation for Inter-state Sales

A new concept of IGST has been introduced under the GST law which will ease interstate sale of goods and services. Earlier CST was charged over and above VAT and the excise duty for movement of goods between two states, whereas IGST will be a single tax levied on the goods moving across state borders. Let us understand IGST with the help of this example:

Particulars	Under current tax laws	Under GST
Value to Retailer		
Cost of goods	100000	100000
Add VAT @12.5%	12500	
Add IGST @12%		12000
Add CST @2%	2250	
Total Value to retailer	114500	112000

***IGST rate has been assumed at 12% for the purpose of this example**.
There is an advantage of Rs. 2500 for a sale of goods and service worth Rs. 10000.

- **Benefit to Consumers**: Final price of goods is expected to be lower due to seamless flow of input tax credit between the manufacturer, retailer and service supplier. Surge in factory production necessarily provide advantages of economies of scale to the manufacturer and thereby reduced price to the end customer. It is expected that a relatively large segment of small retailers (turnover less than 20 lakhs in a year) will be either exempted from tax or will suffer very low tax rates under a compounding scheme- purchases from such entities will cost less for the consumers.

Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption. Reduction in prices can occur only if the supply of goods and services increases after GST is put in place. That will occur if GST reduces economic distortions compared to the mix of taxes it replaces—excises, service tax, VAT, the taxes on imports, smaller State taxes, local levies and so on—and certainly the potential for improvement is there. Higher quantum of goods and services results in lower inflation rate in the country that would certainly benefit consumers. Even if demand keeps increasing, as long as supply increases faster, inflation should remain under control.

As many positive of GST is listed above, it is not free from adversities to the Indian economy. As we know Real Estate also plays an important role in Indian economy but some expert thinks that GST will impact the Real Estate business negatively as it will add up the additional 8 to 10 percent to the cost and reduce the demand about 12 percent. GST will applicable in the form of IGST, CGST AND SGST on the Integrated(Centre and State Government) but some economists say that there is nothing new in the form of GST although these are the new names of Central Excise, VAT, CST and Service Tax etc.

If one considers the exclusion of real estate from GST and all other inputs and exemptions, some estimates show an exclusion of 60 per cent of GDP from the GST base. If we ignore real estate, we could perhaps work with a figure between 40-50 per cent. In any event, a large portion of GDP is being excluded. The ultimate outcome will be continuing distortions in price determination in the economy.

Petroleum and electricity are essential inputs in the supply—production and distribution—chain.. First, there will be a tax on petroleum in every State though it will not be under GST. Therefore the tax paid cannot be credited out by businesses that pay the tax, when they buy and use petroleum products. Second, petroleum being outside GST, petroleum companies themselves—since they are excluded from GST—are unlikely to get any credit for the GST that they will have paid on their own inputs. Thus petroleum companies will add the tax they will pay on inputs into their product price; and businesses that purchase petroleum will build in the tax they pay on their petroleum input into the sale price of their product.

Consequently, the structure of relative prices that emerges will not reflect consumer preferences that should ideally determine all product prices. As far as alcohol is concerned, its exclusion reflects political expediency at the State level for any revenue from it can be used in whatever way they wish with little monitoring and evaluation. In the ultimate analysis, it also reflects the Centre’s inability to reign in malpractices.

Conclusion

Manufacturers/ Retailers/ Dealers would see reduced cost of the goods sold within the state or intra-state under GST. But the sectors which contribute to the Gross Domestic Product of a nation viz. petroleum, alcohol, real estate etc are still standing outside the GST. The ultimate outcome will be continuing distortions in price determination in the economy. There is a long way to go and many hurdles to surpass before the GST becomes a success. The final standard GST rate, exemptions granted, compensations to States etc will determine the actual benefit to the economy. Apart from all shortcomings it has been concluded that the new tax scheme will bring a few revenue generation and overall **synchronization of taxes** in the government.

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