GOODS AND SERVICES TAX - ECONOMY

The central government has proposed simplifying India's GST by reducing its five-slab system to a two-rate structure. This reform aims to ease compliance but faces challenges like potential revenue loss for states and concerns over tax equity.

Background - The Goods and Services Tax (GST)

Introduction and Aim - Launched in July 2017, the GST is India's most significant indirect tax reform. Its primary objective was to replace a complex web of multiple indirect taxes (like VAT, excise duty, service tax, etc.) with a single, unified system under the motto "One Nation, One Tax."

Current Multi-Slab Structure - The GST framework currently operates with a multi-tiered rate structure, designed to tax goods and services based on their nature and necessity. The slabs are:

1. **0%**: Applied to essential items and food grains to keep them affordable for everyone.
2. **5%**: Covers items of mass consumption.
3. **12%**: A standard rate for various goods and services.
4. **18%**: The major and most common slab, covering the bulk of goods and services in the country.
5. **28%**: Applied to luxury items (like high-end electronics) and "sin" goods (like tobacco and aerated drinks). An additional cess is also levied on certain items in this category, such as luxury cars, to generate extra revenue.

The Current Reform Proposal

Core Idea - The central government has proposed a major simplification of the GST by removing the 12% and 28% slabs. This would consolidate the current system into a more streamlined two-rate structure, likely consisting of the 5% and 18% slabs.

Role of the Group of Ministers (GoM) - The GoM on Rate Rationalisation, currently headed by Bihar's Deputy Chief Minister Samrat Choudhary, has reviewed and approved the Centre's proposal. This endorsement is a critical first step.

Next Step - The GST Council - The GoM's recommendation has been forwarded to the GST Council for the final decision. This apex body, headed by the Union Finance Minister and comprising Finance Ministers from all states, will deliberate and vote on the proposal.

Rationale for a Two-Rate GST System

Simplification - The existing five-slab system is considered complex and often leads to classification disputes, where businesses are unsure which tax rate applies to a particular product. A simpler structure would reduce such ambiguities.

Ease of Compliance - A simplified tax regime makes it easier for businesses, especially Micro, Small, and Medium Enterprises (MSMEs), to manage invoicing, file returns, and comply with tax laws, reducing their administrative burden.

Enhanced Transparency - With fewer slabs, there is less room for industries to lobby for their products to be placed in a lower tax bracket, leading to a more transparent and less manipulable system.

Alignment with International Practice - Most countries that have a VAT or GST system operate with one or two standard rates. India's current multi-slab structure is an exception to this global norm.

Concerns Highlighted by the Proposal

Potential Revenue Loss for States - The primary concern, especially for states, is the potential loss of income if the high-revenue 28% slab is removed. Kerala's Finance Minister, K.N. Balagopal, has already emphasized that states must be compensated for any resulting revenue shortfall.

Impact on Luxury & Sin Goods - Currently, these items are taxed at 28% plus a cess to discourage consumption and generate higher revenue. If they are merged into an 18% slab without a significant cess, it could lead to a drop in revenue and an increase in demand as these goods become more affordable.

Equity and Progressivity Concerns: A "flatter" tax structure risks being less progressive. Taxing essential goods and luxury items at closer rates could place a proportionally higher burden on lower-income households compared to the wealthy.

Implications of the Reform

For Consumers - Prices of everyday goods may see minor adjustments depending on how they are reclassified into the new slabs.Luxury goods could become significantly cheaper if the 28% slab is eliminated without a corresponding increase in cess.

For Businesses - The reform would lead to easier invoicing, simplified accounting, and fewer classification-related legal disputes.It is expected to encourage the **formalization of MSMEs** by lowering the barrier to GST compliance.

For the Government - A simplified structure promises better compliance and reduced litigation costs. However, the government faces the critical challenge of balancing **revenue neutrality** (ensuring no loss of overall tax income) with consumer affordability and economic stability.

Larger Economic Context

Timing for GST 2.0 Reforms - This proposal is part of the broader **"GST 2.0"** reform agenda. The timing is considered opportune for several reasons - The **compensation cess regime**, which was in place to cover state revenue losses after GST implementation, ended in **June 2022**. GST collections have stabilized and are now averaging **₹1.6 to ₹1.7 lakh crore per month**, suggesting a stable revenue base that can absorb reforms.

Long-Term Vision - The move to a two-rate structure is seen as a transitional step. The ultimate long-term goal for many policymakers is to eventually move to a **"three-rate GST"** system -

1. A **0% rate** for essential goods.
2. **One standard rate** for most goods and services.
3. **One higher rate** specifically for sin and luxury goods.

Challenges Ahead

Political Consensus in the GST Council - Achieving consensus is the biggest hurdle. The reform requires the support of a majority of states, and the priorities of manufacturing-heavy states, consumption-heavy states, and richer vs. poorer states often diverge.

Demand for Compensation - States like Kerala and Punjab, which are concerned about revenue loss, are likely to insist on a new, guaranteed compensation formula before agreeing to the changes.

Inflation Risk - If the restructuring requires raising the tax rate on some mass consumption items to offset the revenue loss from scrapping the 28% slab, it could trigger inflationary pressure on the economy.

The Way Forward: Recommendations for a Smooth Transition

1. **Establish a Revenue-Neutral Rate (RNR)** - A new standard rate must be carefully calculated to ensure that the total tax revenue collected by the Centre and the states remains the same post-reform.
2. **Retain a Sin/Luxury Cess** - To maintain higher taxes on demerit goods, a separate cess can be retained on items like tobacco, luxury cars, etc., even if they are moved out of the 28% slab.
3. **Leverage Technology for Compliance** - Use AI-driven analytics within the GST Network (GSTN) to identify tax evasion and improve compliance. Higher compliance reduces the need for higher tax slabs to meet revenue targets.
4. **Implement in Phases** - A gradual approach is recommended. The government could start by merging the 12% slab into the 18% slab first, and then address the more contentious 28% slab at a later stage.

Source: https://www.thehindu.com/business/Economy/how-is-the-gst-structure-being-simplified-explained/article69969308.ece