Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about GST and its significance; Why is GST still a contentious issue?

News: Fifteenth Finance Commission (FFC) chairman N.K. Singh has said GST should be redrafted. Too many changes to GST rules and several items being exempted could be blamed for the Rs. 63,200 crore shortfall in compensation cess for FY20.

What is the Finance Commission saying?

According to data compiled by the Fifteenth Finance Commission, more than 38 changes have been carried out in GST in the two years since it was rolled out. The frequent changes have made the tax unstable and cluttered it too much, making compliance difficult for businesses. The commission has held that the cumbersomeness of compliance and the frequency with which rates have been changed are the important factors for the revenue realization from GST falling short of targets. Therefore, GST should be returned to the drawing board for redrafting from scratch, Singh has said.

What is the root cause of the problems?

In case of revenue shortfalls during the first five years after GST’s introduction, the Centre has guaranteed compensations to states. GST revenue is falling short of the revenue growth of 14% on the FY16 base guaranteed to states under the GST compensation law. The compensation guarantee has created a perverse incentive. States are not sweating to plug leakages, increase compliance or simplify GST. Even states with good growth rates have not seen commensurate growth in GST revenue. Nor have consuming states such as Bihar or Uttar Pradesh made the kind of gains as was expected.

Are integrated GST (IGST) refunds a problem too?
In a pre-budget consultation, states have sought immediate release of arrears of IGST collected on the interstate supply of goods and services and imports. They alleged that the Centre resorted to incorrect accounting for IGST in 2017-18. Earlier, the CAG said devolution of unallocated IGST to states did not happen for 2017-18 according to law.

**What is the way forward on this?**

The best way to tackle revenue shortfalls is by removing all the infirmities in GST. States should get incentives to reduce leakages and compliance burden. **Revenue neutrality** should be a medium-term goal. The Thirteenth Finance Commission and a panel headed by then chief economic adviser Arvind Subramanian had shown the average GST rate ought to be 16-17% to make it revenue neutral. Today, the average is 11.6% because a large number of items are at 0%, although indirect taxes are by definition regressive.

**Should India go for a single-rate GST?**

Given low state capacity, the **best option for India is a single-rate GST. Eighty percent of countries that introduced GST after 1995 opted for a single rate.** If the rate is kept low and exemptions at a minimum, the revenue collection will be good. It will reduce the scope of evasion and leakage. States can impose sin taxes over and above GST on luxury and demerit goods: some may decide to do so for alcohol and others for vehicles that run on fossil fuels.