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

Prelims and Mains focus: about the key issues to be discussed regarding overhaul of GST; about the composition scheme: eligibility and its merits

News: The Narendra Modi administration and state governments will hold fresh negotiations to overhaul the goods and services tax (GST) after the Union budget is presented on 1 February, said a government official familiar with the development.

Key issues to be discussed

- Finance ministers of central and state governments will discuss restructuring GST slabs and rates as well as ways to handle a revenue shortfall and the GST compensation to states in the year starting 1 April.
- The discussions between the Centre and states will revolve around finding a middle ground to fix the structural flaws that have resulted in a significant shortfall in tax collections.
- The discussions will address the larger question of what should be done when the Centre does not receive enough revenue to compensate states for their GST-related losses, a vital issue on which Centre-state relations and the stability of GST rests.

Challenges

- Tax cuts and exemptions granted in several rounds since the rollout of GST have made it revenue-deficient rather than revenue-neutral, as was originally planned.
- Tax cuts on consumer goods have also led to a situation where businesses are paying more taxes on raw materials than on finished products and subsequently claiming the excess paid as refunds.
- Experts warned that any major change in the GST structure could unsettle the industry. It would be prudent to allow the economy to stabilize before embarking on any changes as businesses would prefer stability and certainty in tax policies when they are grappling with global economic headwinds.
What is on the anvil in next year’s budget?

- The budget is expected to implement the recommendations of the Fifteenth Finance Commission (FFC), which submitted its interim report to President Ram Nath Kovind and finance minister Nirmala Sitharaman earlier this month.
- The report focuses on sharing of tax revenue between Union and state governments. If the tax revenue that the Centre shares with states comes down in FY21 from the present 42% of the revenue pool, it could result in a showdown between the two.
- The Centre is keen that states take a cut in their compensation dues, something states have resisted. The way this issue is settled will have an impact on the final report of FFC for the five years ending FY26. FFC’s suggestions made to the GST Council in September on states taking a cut in compensation did not receive an enthusiastic response from state ministers.

Key takeaways from the GST Council meeting this month

- At the GST Council’s meeting on 18 December, officials made a presentation on revenue trends and suggestions on rejigging tax rates and slabs, but the council decided against taking it up due to the economic slowdown.
- States were not keen on the proposal as it would lead to a rate increase on items in lower slabs, which could impact the common man.
- The council had concluded in its last meeting that raising the rate of cess on items in the highest slab of 28% will not be sufficient to raise revenue to meet the shortfall.
- However, items such as perfumes, cosmetics and vacuum cleaners that were moved from the 28% slab to the 18% slab could become a target of any rate increase in future discussions.
- The decisions taken so far in terms of rate cuts and other relief given to businesses and traders have led to the exchequer forgoing about Rs. 1 trillion a year. These include:
  1. raising the threshold for GST registration from Rs. 20 lakh to Rs. 40 lakh;
  2. raising the limit for composition scheme from Rs. 75 lakh to Rs. 1.5 crore;
  3. and lowering the tax rate under that scheme to producers from 2% to 1%.

What is the composition scheme under GST?

- The composition scheme is an alternative method of tax levy under GST designed to simplify compliance and reduce compliance costs for small
taxpayers.

- The main feature of this scheme is that the business or person who has opted to pay tax under this scheme can pay tax at a flat percentage of turnover every quarter, instead of paying tax at normal rate every month.

**Eligibility for this scheme**

- The composition scheme is applicable to manufacturers or traders whose taxable business turnover is up to Rs.1.5 crore (Rs.75 lakh in case of North-Eastern States). A service provider can opt for the scheme if his taxable turnover is up to Rs. 50 lakh.
- However, businesses with inter-State supplies, manufacturers of ice cream, pan masala and tobacco, and e-commerce players cannot opt for the composition scheme.
- To be eligible for the composition scheme, the registered tax payer must provide a declaration on the GST portal before the beginning of each financial year and not anytime during the year.

**Tax rates under composition scheme**

- The applicable tax rates under the composition scheme are 1 per cent (0.5 per cent Central GST and 0.5 per cent State GST) of turnover in case of manufacturers and traders, 5 per cent in the case of restaurants (not serving alcohol) and 6 per cent for other service providers.
- The tax is to be paid from tax payer’s own pocket without charging it to the customer. The words “composition taxable person, not eligible to collect tax on supplies” should be mentioned at the top of every bill issued by him.

**Why is it important?**

- There are over 63 million Micro, Small and Medium Enterprises (MSMEs) in the country that created 110 million jobs and contributed about 29 per cent of the country’s economic output, as per the National Sample Survey (NSS) 73rd round conducted during 2015-16.

- The composition scheme effectively acknowledges the importance of the MSME sector, by granting relief to it on GST filings, procedures and tax rates. As on October 1, 2018, there were 17,65,684 composition dealers amounting
to about 16 per cent of registered tax payers under GST. The number is expected to go up with the recent increase in the threshold from Rs.1 crore to Rs.1.5 crore and the inclusion of service providers.

- Under the composition scheme, the taxpayer can skip monthly returns and furnish only one return i.e. GSTR-4 on a quarterly basis by 18th of the month following end of the quarter and an annual return in GSTR-9A by December 31 of the next financial year. A dealer registered under the composition scheme is also not required to maintain detailed records.

What about its drawbacks?

- The drawbacks of this scheme are that the taxpayer cannot be involved in inter-State transactions, imports or exports.
- Also, the buyer transacting with a seller registered under composition scheme will not get the benefit of input tax credit, which impact the former’s sales.

What is Input Tax Credit?

Input credit means at the time of paying tax on output, you can reduce the tax you have already paid on inputs.

Say, you are a manufacturer –

- tax payable on output (FINAL PRODUCT) is Rs 450
- tax paid on input (PURCHASES) is Rs 300

You can claim INPUT CREDIT of Rs 300 and you only need to deposit Rs 150 in taxes.