Transcript of a Panel Discussion on Goods and Services Tax – A Game Changer

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Dr. Chaturvedi: Good morning. We do have challenges with GST implementation with GST being just 19 days old and as my colleague Dr. Mishra was saying it is similar to the unification of princely states. But this is a great opportunity for the MBA students to see the whole economy, society, polity from the prism of GST. There is immense scope for MBA students-they can do research, undertake projects, go to field, and they can find out what is happening on the economy, society, business. There are certain sectors which are adversely affected because of tax rates, for example GST levy has been imposed for the first time on the outsourced hostel food. There is a principle in management that you should do whatever is your core strength and you should not do whatever is not your core strength. In 2009, we were running this mess through contractors and then we thought we should manage it in house and now we have saved all of you from 18% levy because it is not outsourced. But GST is increasing the cost of higher education to be borne by students, parents, faculty and staff. On 7th August, all college, universities will be sending Twitter messages to PM to withdraw levy on outsourced services of higher education institute. I would now like to conclude that if you want to update your knowledge on social, political and economic issue, everyday morning spend half an hour on TheWire.in – upcoming news portal led by MK Venu , Siddharth Varadarajan- founder editors, Nandan Nilekani-one of investors.

Prof Krishnan: Good morning everyone. It's a great privilege to have Mr Venu. We had a great discussion six months back on Demonetization. Now I have a good opportunity to be with him today, it's a great privilege sir. We are waiting for the taxation expert and well known authority on taxation-Mr Bhutani. My target population, that is, the students, they have two concerns- what will be the impact of GST on their restaurant bill and on their use of mobile phones. I am sure we will be able to get an authentic explanation on this matter.

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Mr. MK Venu: Actually, I don't have any calculations as such but I think Mr Bhutani must be having some specific numbers about this, But my sense is that as Mr Chaturvedi said, there are a lot of areas where service tax was not imposed and now we have 18% so for students who are doing higher education in colleges/universities where food services are outsourced, will end up paying more. Even when we go outside, we have confusing categories of restaurants - with AC have different rates than restaurants without ACs. In a sense we still don't have a one nation-one commodity-one tax because within the commodity there are different narrations- restaurants without AC, with a bar, with AC with a bar or 5 star; in 5 star accommodation there are categories like rentals below 2000 have a certain rate which are different from categories of rentals between 2000 and 5000 and rentals above 5000. So, there are issues over there. As far as your mobile services are concerned, my sense is that you will end up paying a little more than before because the service tax earlier was 14% and now everything goes up by 4%. All a=the services that were taxed at 14% are now taxed at 18%, so you end up paying 4% extra. Thus, across the board, whether its mobile services or any services that you access outside which were earlier 14%, now we have to pay 4% more.

Prof Krishnan: Thank you Sir. Finance Minister when introduced this tax system said it's a Good Simple Tax, then why has it created so much confusion. Obviously, we know it's still work-in-progress and it's not easy to bring all these multi layered taxes into one but the promise made was that it would help in ease of doing business and the cost of doing business. So sir on these two counts, what's your take?

Mr. MK Venu: Well to begin with, it was Prime Minister Narendra Modi to use the term Good and Simple Tax for GST in the mid night parliament session. My sense is that it is not a simple tax in the way it is implemented. The idea of a single tax which can unify markets among various states can be a game changer. I think there has been a very big compromise on the idea that's why the government itself is saying that's it's a work in progress and they are trying it to make it more refined over the next one or two years . So there is an inherent admission in that statement that its implementation at the moment is not optimal and I am not saying this, there's an article in Indian Express by Mr. Arvind Subramanian, the advisor to Finance Minister Mr. Jaitley where very clearly he says that this is not an optimal GST and the 28% slab could have been done away with, In fact, in the article, he urges the government and the Finance Minister to remove the 28% slab and collapse it with the 18% slab to make it a 20% slab and keep 20% as the peak rate because no nation in the world has GST of 20%- Germany, has 19%, lot of East Asian countries have 10-12% , In my view, GST rates of 0 5 18 or 0 5 20 would have been perfect and optimal. But, we have complicated it and the Centre says that we have done it because the State revenue was going down so states will be allowed to have higher rates. Subramanian also says that initially, very few items were there in 28% slab – less than 5% of the 1200 items, But as the thing as turned out, large number of items have appeared on 28% slab. So, I don't know where the weighted average rates would be. So it's very messy at the moment and I think there is a view that going forward 28% slab should be streamlined further. But we will have to wait and see whether that happens and the other big flaw in the GST is that 3 sectors have been kept out- Petroleum, Energy and liquor and Real Estate and these 3 at the moment bring about 45% of the revenue for the government and its the government's claim that these sectors are the biggest generators of black money. I don't understand that why these big generators of black money have been kept

Prof Krishnan: Thank you Sir. One issue that has been debated is the Constitutionality of GST, that is, the power to tax vests with the Parliament. Now some part of it has been taken over by the GST Council. So, would this be challenged over any period of time or is it accepted and taken a part of good administration, What about the states feeling hurt about this center state tax division, the producer state and the consumer state? Has the balance shifted?

Mr. MK Venu: First of all, the Constitutional position is that even today the States and the Center have pooled their powers in the GST Council, but it's voluntarily. Even today, as per the Constitution, a state has the right to vanish on their commitment and they can go back to their own compact way until some emergency situation. Essentially, the success of this GST Council and this whole GST framework would depend on how the Centre and the States work together. Therefore, there is a mechanism for resolving disputes. Also, states have 75% voting rights and the Centre has Veto. Going forward, we would have to see how the revenues come and the economy eventually functions, I find that when VAT was introduced, it did very well in year 2000, there was boom period because all states had experienced big jump in revenues, so they were very happy with VAT. The economy was consistently growing up. But my fear is that, today GST is being implemented at a time when GDP growth is very stagnant and actually declining a bit especially post demonetization. Revenues are function of the economic growth. So, I don't know if revenues don't grow at the pace at which the States expect, there could be particular complications but still I support this experiment. It's a great experiment for both Centre and States to pool their powers towards a common objective, so let's see it turn out.

Prof Krishnan: Thank you Sir. The other issue is the cess on products like cigarettes, alcohol will be kept for 5 years, Does this, in any way, reduce the revenue that is likely to be generated from these industries?

Mr. MK Venu: As far as cess is concerned, at the moment there are very clearly defined sin tax categories. They have kept petroleum, which gives 30% of revenues, out of GST. Petroleum is easily adjustable. At the moment if you add Centre and State taxes for petroleum, petroleum gives 45% tax revenues. So, petroleum today effectively comes in sin tax category. So they can keep adjusting it when they find revenues from sin categories products falling. In my view, this is not a good policy. I think they should bring petroleum in GST.

Prof Krishnan: One question for Mr Bhutani is about the students. How GST will impact our students? When they go out and eat at restaurants, how will GST impact their bills? Also, they are great users of mobile phones. So how GST would impact their mobile phone bills?

Mr. Mukesh Bhutani: If you look at the erstwhile law, VAT was charged. In addition to that, consumption of alcohol at restaurants would also have additional charges. So now, under the new law, everything is common, you have an 18% VAT unless you go to a restaurant which is non AC. If you go to a non AC restraint then the VAT is less and the VAT is slit 50-50 between the State and the Center government. Assuming you go to an AC restaurant, you pay 18% VAT on food and then you pay a slightly higher rate if you consume alcohol. So you must be careful of how much alcohol you consume because that will eventually determine how much tax you pay under the new GST law On mobile phones, I think it's a very interesting question, because of the services segment. The 3 services that are immediately impacted (impact on the pocket) are telecom services, insurance and banking services. You all know that all the services were taxed by the Central government under the Service Tax law. It was 12% and then it was raised to 15% and it never got raised to 18%. But, logically for people who follow the GST policy, there has to be same rate of tax for goods and services. So, if the goods rate of tax is 18% which is the revenue mutual rate so the services tax rate would also be 18%. Surprisingly, at the last moment, contradicting the belief that there could be multiple rates of tax for goods, they had multiple rates for services as well. So, telecom, banking and financial services are at 18%. Prima facie, it seems that from 15%, you have moved to 18%, however, the telecom companies over period of time will benefit from input services. Let me just give you an example of what are those input services. For example if a telecom company acquires a capital asset for setting up towers , depending on whether its imported or acquired from within India, the counter veiling duty that you pay, the GST that you pay on those capital goods that comes into the credit basket. Similarly, with the telecom companies that provide you services avail services from others and they pay GST on services which are also available as inputs. So most people believe that over a period of time, telecom tariffs could go down but I want to add an important rider here, that is, provided they see that the input credit mechanism under the GST law is working in a manner where they can pass on the benefit of the tax on the consumer,. But eventually, 18% will remain. That rate is sacrosanct. So when you see your telecom bill, that rate won't change.

Prof Krishnan: Do you think when GST is in full flow, will it affect the flow of revenues? Will the States be better off?

Mr. Mukesh Bhutani: So we are talking about two independent issues. The first issue is that what the Recommendations of 13th Finance commission were in so far as split of revenues between the State and the Central government is concerned? The larger object of the 13th Finance commission by which greater degree of revenues evolved on the State was more from allocation view point and that was in order for the government to propel what they call as cooperative federalism where states are more powered. It was always there in the earlier regime as well but is far more pronounced in the new administration when Mr. Modi came out with this concept called cooperative federalism. But that doesn't in any manner get impacted so far as GST law is concerned. Having said that, as you all know that, it took us a while to get past the Constitutional Amendment of Sept 2016 and really the issues before the States were in two baskets. One was clearly a political issue as to how much empowerment will they continue to exercise in administering the law because under the earlier laws, sales tax or a VAT or entertainment tax- all of these were administered by the State. So they had a State revenue official who was looking after the administration of laws. So that was a very big issue on the empowerment. The second and most important issue was the financial autonomy. If under the GST law, it is the GST Council which is the final authority on setting out the rates and not the State Legislative Assembly, will it result in loss of revenues for the State? I will explain it in very simple terms. Under the old law, sales tax was paid and the excise duty was paid at the port of sale. GST is a consumption destination based tax which means there was a fear of many states which were producing states and not the consuming states that the revenues will move. Hence you saw some of the large manufacturing states such as Maharashtra, Gujarat, Haryana, Tamil Nadu objecting to that which was a very valid and logical objective and that's a reason even on the earlier version of GST they started talking about what we call as the compensation formula. So now the final compensation formula that has been agreed is that the government will take every state's revenue of 2015-16 financial year as the base and they will assume that there is a 14% year on year growth on the 2015-16 finance. If the states are unable to collect as much as has been estimated then it's like the Central government will cut out the cheque and give it to the State. Otherwise there was no way; they could have all states unanimously propose. Sorry for the long explanation.

Prof Krishnan (to Mr. MK Venu); Sir, your take on the 13th Finance Commission. There are other aspects also here and not just the financial aspects.

Mr. MK Venu: See, What does the Finance Commission do? There's a formula based on which the central taxes are pooled and shared with the states. So in some way, GST will get superimposed on that because GST is also about pooling various taxes and then eventually pooling it between the center and the state. So, in my view, I think the next finance commission will have to take GST into account. I remember Chairman of the previous finance commission Dir. Reddy had written to me. I remember Chairman of the previous finance commission Dr. Reddy, when he was trying to evolve a formula for sharing of revenues, had written to me that please tell me your GST implementation schedule so that I can factor that into the Finance commission formula that I am arriving at. So, I think that will happen in the next Finance Commission proceedings. They will have to take GST as a factor and then adjust the sharing of revenues as per the impact of GST. I mean, that's common sense, pretty logical.

Mr Mukesh Bhutani: Yeah, I agree with you. I don't rule out the possibility of the next finance commission reviewing I would say, not changing, the basis. But I feel that the cooperative federalism philosophy of the government, where the states are seen and known to be in power, will continue. As a matter of fact, I feel that in GST where state governments felt insecure because the Centre was assuming an important role to the GST Council in terms setting up the rates that Centre would be more than forthcoming to the states because at the end of the day the growth and development and how you allocate funds are largely state level decisions. So it's speculative at this point of time but I feel that the government will promote the cooperative federalism in a much speedier manner that it has done in the past.

Mr. MK Venu: Finance Commission recommendations are actually only recommendations right. In fact I feel next finance commission will not go so much into how to share revenues, which the GST Council is already looking at. They will be focusing more on grants, benefit of scheme players, and all those similar things they will look at.

Prof Krishnan: So, they say that good politics is good economics. Is that the reason why the states which were ideologically not in sync with the Center were keen on accepting it?

Mr. MK Venu: I don't think there was any ideological consideration. The left looked at it purely as a fiscal federalism issue within the Constitution. Their key concern was whether the fiscal powers are being compromised or not. So, I think they came on board on these very pragmatic conditions. But, I must say, Mukesh even the Constitutional law is saying that GST Council is actually working on the basis of consensus. If the states decide, they can voluntarily move away from it. They are doing it under collective pressure right?

Mr. Mukesh Bhutani: So, what did the 101th Amendment in the Constitution say in 2006? It basically said the Constitution is amended and through the amended constitution state and center both assume the right to tax goods and services. It also said the states loose the right-exclusive right-for movement of goods, which is what the states assumed the erstwhile VAT era.As the constitution said, there is a one year period, which is the transition period which means that on Sept. 2017, the states will have no right. So the states had no option, but to join the GST bandwagon. This was number one. I think, what the states was their fair share of power and this is the reason why it took a while for the compensation bill to agree. But I think the most important compromise in my view that the central government has made was after the Constitutional Amendment, if you recall, that in the first two-three meetings of the GST Council, the States were trying to take a view that the administration of the law should be shared more in the favor of states. So, the first offer from the Center was that any provider of goods and services that is less than Rs 1.5 Crores, states can it, any provider with more than Rs 1.5 Crore, the Center will do it. What eventually turned out, which I term as a grand bargain, because the Centre government just couldn't get its point across in the GST

Council, was that for 90% of the tax payers falling in net of Rs 1.5 Crore , it was the state government, for rest 10% it will be the center government. 50% of the payers falling in the more than Rs 1.5 crore will be taken by the state government and rest 50% by the center government. Now, this is fine because this is what is agreed.

Mr. MK Venu: How will they allocate?

Mr. Mukesh Bhutani: Exactly. So that's the dilemma that the tax payers have today. So, suppose I am a bank. My registered office is in Delhi. I provide nationwide services. One, I have multiple cities as filling requirements in so far as banking services are concerned. I do not know at this point of time, which is going to assess me. Is it state or center or both?

Prof Krishnan: So, its work in progress. There's a talk of 1% cess, which is creating bit of waves. Sir (to Mr. Bhutani), could you clarify on that?

Mr Mukesh Bhutani: I thought that the 1% cess proposal was taken off. Yeah because that 1% cess was maybe an avenue to mobilize revenue to be able to compensate the states. But that 1% cess was not creditable. It went against the grains of the GST law which provides the flow of seamless credit in the entire chain. So, that's why that proposal was taken off.

Prof Krishnan The second issue that has been noted in the press is the reverse charges. Because of those who are not registered, their charges are being reversed and we are told that many of the smaller firms are being pushed out of the supply chain. So your take on both these issues.

Mr. Mukesh Bhutani: Well, I think there are 2-3 aspects on this reverse charge mechanism. So, I am providing a service and for that I am supposed to be charging a GST on my services. Assuming that I am a small time service provider, the recipient of the services, under the reverse charge mechanism, will pay GST on services. Now that can happen in 2-3 scenarios. Scenario 1 would be the service provider is below the threshold. Scenario 2 would be it is within threshold bur it has opted for what is called as a Composite Scheme. It means that he is small time service provider and he chooses to be taxed at a particular rate. So, if you do it under Composite Scheme, the credit is not available. The third category would be where the service provider isn't registered at all. Now, that is a tricky one, because in this case, when the service provider is not registered, the liability of GST falls on the recipient. I think the game pan of the government seems to be very clear that these ti e service provider come in to the net og GST and eventually come to the income tax net, which most policymakers believe are not compliant with the law.

Mr. MK Venu: The way GST is being implemented, the small business: small shopkeepers, traders. In my view, this is the most difficult part in implementation because most of the shopkeepers have a turnover of around Rs. 20 Lakhs. There's a piece of NSS data which says, there are 5-6 crores of small traders in India. So, 60-70% of them are still at loss as how to come into the system, how to register and similar range of problems. Actually, this is still unaddressed. Mukesh even told me when we were in NDTV discussion. He visited Amritsar and all the small businesses there. You see what is happening in Surat-all the kapda vyaparis are on the roads. And remember, as I was reading today in Indian Express, Rs 135 crores was the value of production every day. 40 million of meters of saree, the quality of saree which is considered poor: Rs 100-150 saree-was supplied all over the country. It says that, under GST the cost of this business would go by 30-40%. So, I don't know how things will play out in terms of inflation and similarly for the items of the poor consumer.

Prof Krishnan: I think France was the first country to impose GST. In UK it is being done successfully. Is there any European or Asian countries or Thailand or comparable economies for GST implementation?

Mr. Mukesh Bhutani: France is considered as a mother country for VAT. It was the first country in Europe, much before EU was set up, to implement VAT and many countries in EU replicated the bench model. I think our GST law is very different leave aside debate on the fact that we don't have petroleum, alcohol products in GST, we don't electricity tax, we don't have stamp duties. All of these taxes, internationally, are subsumed in GST or VAT. We have one very unique aspect of our GST law- the center state divide which means we become comparable to Canada. How many of you have been to Canada? If you go there and avail any good or service, you will see an invoice which looks similar to what we see in India as well which is half of it is the provincial GST and half is the federal GST. So, I think India is unique in that sense. India is an experiment for such GST, for many parts of the world. Not that there are many countries left to roll out GST, but I think the other big roll out of GST that has been happening is in United Arab Emirates, which is the other big country that is getting into GST and that will set the tone for many other countries in the Middle Eastern region in the years to come. The recent experiences of GST roll out are that of Malaysia which is comparable to India as an emerging market, though the Malaysian GDP is far higher than the Indian one. I think they had several hiccups, despite the fact that the Malaysian GST is far relatively simple than the Indian GST. As a matter of fact, even in a small country like Malaysia we have seen, that the general disruption at a common ma's level is far higher. So there's nothing new about it except the fact that in India, the smallest news makes it to the biggest news because our media is very active. So, I think that disruption is a part of it and as a matter of fact one of the economist from Asia-Pacific was telling me that the disruption in some of the initial countries in the roll out of GST were far more great. We need to consider that we are 1.3 billion economies with complex state-federal system. Beyond that we have local taxes, octroi, etc. He said that overall you seem to have done a great job because the administration has gone more than the call of the duty, you have GST credits, highest levels of bureaucrats and policymakers are talking to citizens, engaging themselves. My overall assessment is that yes there are apprehensions, when we were in the panel few days before the roll out of the GST anticipating problems, but it has gone out very smoothly. It is not an easy system to work with. I think all of the issues will arrive and ease out as you go about and now the ball will be in the government's court as to how fast they are able to respond. So, we have an administration that is responsive and I think the ability of the administration would be how fast it can respond. I also feel, and this is what I keep talking to my friends in civil services who are mandated the task of roll out of GST is that classification issues will be profound. I give you a classic example. I was with a very large Fortune 500 company. They manufacture eyeliners. All the female colleagues use eyeliners, right? Now, there is one more Fortune 500 company that calls its eyeliners as kajal and the kajal is exempted from GST whereas the eyeliner is not. There is an international harmonized classification code. It is there for kajal. Kajal is recognized.

Mr. MK Venu: But, the brand is not recognized.

Mr. Mukesh Bhutani: Well, I think the debate with the client was it clearly sounds like someone who can take an interpretive issue and lead to dispute. So this is what I call as a classic classification dispute-Are you having an ice cream or are you having a frozen dessert? Are you a bread or are you having a cake?-because the classification is all things are classified separately

Now there are 2-3 ways to resolve such issues. One is, what we lawyers call as, dispute avoidance mechanism. Rather than some the cases going in disputes, going on a trial, because the moment a civil servant or revenue officer look at this classification, he is not going to give a benefit of doubt. So, what is that the government tells you? The government lays out the mechanism to address this.

Mr. MK Venu: Can I add to what he said? I agree with Mukesh that the implementation is so far very smooth but I would like to add a rider Mukesh. That is also partly because the enforcement has begun yet. So it's like the college is open but the classes haven't started yet. So, the enforcement mechanism as of now, as Mukesh pointed out, is very discretionary. I read about a very worrying news item today that IT officials are going and asking for invoices. I think they need to evolve, certain advanced systems to tackle the disputes. I think with full enforcement of GST, these things will become cleat.

Mr Mukesh Bhutani: I think Venu is making a valid point. We still need to see the proof of the pulling. I think there is one aspect at which we are not good at-not just as administration but also as Indians. It is what we call as the speed and ease of implementation. We make great plans but our implementation is short. But I would like to add in defense that GST network is really the backbone, not just from the IT or infrastructure point of view but this network will house in every possible purchase that you and I make. Not just the transaction between you and the establishment but how it has flown to the establishment with whom you are transacting. Now, this system has to be stabilized because that's the key. Once the system stabilizes, you will have a dashboard before the administration as to how this transaction has happened. Once that dashboard is available, it will not have the assessment features. So you will be having more and more self-assessment features.

Prof Krishnan: I know students; you all are very keen on asking questions from our esteemed panelists. We are soon going to move to that. Before that, I have one small technical question- what is anti-profiteering clause?

The anti-profiteering clause is common for GST roll outs. We have seen that in Australia. Australia actually is one of the countries who pioneered the anti-profiteering clause. The objective is similar to the objective purpose in India. But India has a slight history of anti-profiteering clause. You know I the good old days of the 60s and the 70s we used to disputes of the tier companies, the tobacco companies and at that point of time, Supreme Court came out with the principle called the principle of unjust enrichment. Under this principle, what the Supreme Court said is that , if you collected more taxes or if you sold your goods to the customer in anticipation of more taxes then you dispute it to us and finally win that in the battle of law, You have no right to keep that money because that is the consumers; money . Now there is no way also to return that money back. So, I think the Supreme Court at that time came very hard and said that principle of unjust enrichment demands that you don't collect taxes in the name of the guide. That to some extent is getting transferred to the anti-profiteering laws as clearly we can see some products of coming in the 5% and 0% category which are otherwise taxed then you have products like oil and detergents also coming down. So, the idea is that all of this benefit should go and I think many of the entrepreneurs are advertising that the benefit should pass on to the customer.

The objective of the anti-profiteering law is supposed to be working on this manner. The government still has to come up with enabling legislation and administrative clarification.

Prof Krishnan: Thank you Mr Bhutani. So now, we are open to questions.

Student 1: Good morning everyone. My name is Vrinda Bhatia from PGDM. I want to ask that what is the impact of GST on import and export as the various custom duties remain the same. So how this is going to be enacted?

Mr Mukesh Bhutani: So, under the earlier law, if you import anything, you will pay the Basic Custom Duty (BCD) and Counter Veiling Duty (CVD) and special additional CVD. Now what will happen is that only BCD will apply and if at all if you land up paying special additional duty then you will get credit which you were earlier getting under the law so the landed cost of an imported good will is less than what you had. What will be the rate that will depend on the customs and they will look at the category at which the goods will fall in.

Mr MK Venu: What GST also does is earlier there wasn't any level playing field because for a local manufacturer, suppose an item is being imported and the local manufacturer is producing the same item. He will be at disadvantage because the local taxes are not getting counter-veiled so he wasn't competitive. But now I think the level playing has been restored with GST. The local taxes have been collapsed to the GST

Student-2: Good afternoon sir, as you correctly pointed out about similar brands-the kajal and eye liner, my question is regarding the premium and nutritious dry fruit market. Almonds are under the tax slab of 12% whereas cashews are under 5%. So what are the implications on that? Also second question is that current inflation rate in India is about 2% and when we look at GST implementation in many countries like in France and other European countries, inflation has got a spike and has been a successive growth over past few years so what will be the expected inflation in India and will it be feasible for us?

Mr Mukesh Bhutani: I was talking to one of the clients and they are into manufacturing of milk products but fall in 28% category. They feel like it's a health product, there should be no tax on it, so all of these things will continue. I think the ball of this is in court of GST Council because any change in rates need to be exercised.