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INDIA'S GOODS AND SERVICE TAX – A PRIMER

India's Goods and Service Tax (GST) was rolled out in July 2017, over a decade after its conception, in what was the **biggest change to the country's tax system since independence**. It replaced the jumble of more than a dozen state taxes, including the central excise duty, the services tax, additional customs duties and state-level VAT with a single national sales tax. There are four separate tiers of the GST, set at 5%, 12%, 18% and 28%. Essential goods, including most healthcare products, are taxed at the lowest rate, while luxury goods and tobacco products are taxed at the highest rate. Some industries and products were exempted by the government and remain untaxed under the GST, including dairy products, fresh fruit, vegetables and meat products, but **most goods fall into the 18% tax band**.

The GST was introduced because of the significant long-run benefits to the economy that it would bring, despite expectations of some initial disruption due to the enormity of the change to the tax system. By subsuming various indirect taxes such as excise, sales and services levies, **the tax system of the country has become less complex, and the business environment has improved**. This will boost inter-state trade over time. The simplified tax system **will also help to increase tax revenues**, which as a share of GDP are amongst the lowest in EM. As an illustration, general government (i.e. central government plus the states) tax revenue is around 11% of GDP in India, as compared to 13-16% for many EM peers.

Because of the disruption caused by covid, it has taken longer for these benefits to play out. However, there are some indications that they are beginning to feed through. For example, the GST take is projected to be 3.1% of GDP in FY22/23, up from 2.8% over the last couple of years.

In the manufacturing sector, the GST has had a positive impact by removing the cascading effect of taxes, resulting in the **reduction of manufacturing costs**. Before GST implementation, for example, certain taxes paid by manufacturers on procurements were non-creditable. Being costs to the business, manufacturers generally had no option but to factor in such costs into their sales prices. Now, with the restriction on credits being removed, costs have been reduced. On the output side, manufacturing and sale of goods attracted both excise duty and a VAT/central sales tax, with the former levied at 12.5% and the latter also often at 12.5%. Now, with the exception of mostly luxury items, the majority of goods are taxed under the lower 12% or 18% brackets. This simplification of the tax system may have contributed to the **increase in formal company creation** seen over recent years, with the number of active registered companies rising notably from below 1.2mn in FY19/20 to well over 1.4mn in FY22/23.

Firms have also benefitted from a reduction in the administrative burden, as they are no longer required to file multiple returns, for assessment at multiple tax authorities. A simplified system coupled with electronic invoicing and other automation has increased tax compliance, which is gradually filtering through to revenue collection. Increased automation means that it is easier to trace the transaction chain right from the supply of raw materials all the way through to final sales, making tax evasion harder. The introduction of data analytics also helps in identifying false tax credit claims. As a result, **the tax base has grown**. Separately, there has also probably been a boost to economic growth as the elimination of interstate restrictions and removal of checkpoints and entrance tax barriers at state borders has **increased efficiency and decreased logistical costs**. This is expected to stimulate economic activity and contribute to a **higher GDP growth trend over time**, especially now that the covid distortions have subsided.

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