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GST

Customs
Union Excise Duties
Service Tax
Tax on Income
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GOODS & SERVICE TAX

Happy New Year 2016

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CONTENTS

► **President Page** 03

► **Editorial Page** 05
Conditions for Smart Cities

► **Global Economic Monitor** 10
Global Trade and Investment Trends
- Dr. Prakash Hebalkar

► **Goods and Services Tax (GST)**

- Goods and Services Tax (GST) 13
  - Mr. Dilip Save
- Goods and Services Tax (GST) 16
  - Capt. Pramod Salvi
- Goods and Services Tax in Canada 18
  - MEDC Research Team
- Goods and Services Tax in Australia - Implications and Impact 20
  - MEDC Research Team
- VAT : The European Experience 23
  - MEDC Research Team
- Philippines Experience with VAT 28
  - MEDC Research Team
- The Rise of Disruptive MSMEs 32
  - Ms. Bindi Patel

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From the President's Desk

Dear readers, MEDC members and all our associates wish you a happy and prosperous 2016 !

The year 2015, ended on a very happy note from the farming front. The government of India ministry of agriculture released a report on district wise statistics on horticulture. You can improve only that, which you can measure. I must add here that this report came soon after my participation in the AGRO –vision 2015 in Nagpur. It was attended by close to 5 Lakh farmers and had conducted 42 workshops for farmers which were very well attended. it can be seen that consistent efforts and events such as this do result in spectacular increase, in motivating farmers and growth of technology assimilation and thus in consequent growth in agricultural production. It is encouraging to note that as of 2012-13, India produces (14%) of world's vegetables and has an exports share of (15%) of worlds vegetable exports. Our performance on fruits, where we produce (12.6%) of the global production is even better as we export almost a quarter of the worlds processed fruits and vegetables. To my mind an agrigarian nation such as ours should focus itself on our abundant resources of land, water, sunshine and a very large population of farmers. it is evident that efforts put in by the National Horticulture Mission (NHM), Indian Agriculture Research Institute (IARI), Indian Council For Agriculture Research (ICAR), National Horticultural Board (NHB), are now barring visible fruits .

This reminds me of an article in The Time magazine in late 90's when the United States published a report called 'Global 2000'. The notable part was that India had the lowest energy inputs in every tone of food production. The traditional farmers technique of using animal power for ploughing and other farming activities is more cost effective then large scale mechanized farming . Needless to say that even though our productivity measured in metric tons per hectare is roughly half of that of the toppers, our minimal input costs in the form of hydro carbons, chemical fertilizers and pesticides should provide us with far superior cost advantage and earning potential. The fringe benefits of reduced carbon footprint is an added advantage Maharashtra has done well in topping the chart among the fruits producing states in the country. Agreeably the state has much to do to gain its rightful position in vegetable and food-grain production. The newer initiatives of the government of Maharashtra such as "Jalayukta Shivar Yojana" and the target of five lakh solar powered pumps will definitely result in taking us to the top of food production cost efficiency and quantity.

Let me express my feelings on an effect of e-business. I was sad to note that an iconic establishment like "The Rhythm House" at Kala Ghoda, is shutting down by end February this year. This is the most serious indicator of way old businesses will fall due to e-trading. Much against our desire loss of such iconic institutions may erode our cultural base and change our social ethos, but such is the call of time. Change is inevitable perform, adapt, or perish.

This issue of the digest is on the GST. Needless to say that GST is one of the largest economic measures in our national interest. One can only hope that our political parties rise above showmanship, faulty floor management in both houses of the parliament and ensure that electoral ambition for the next general election does not hamper the economic progress of the nation. Let us all hope that 2016 ushers in an era of greater wisdom, vision and of putting our national interest above the compulsions of electoral petty politics

Cdr. Dipak Naik, President

Conditions for Smart Cities

Mr. Chandrashekhar Prabhu
Chairman, Editorial Board &
Consulting Editor

Ten different cities in Maharashtra and over 90 in the country passed resolutions, some of them conditional, stating their versions of a smart city and sent them to New Delhi for approval. The smart city proposals were discussed at different levels in Mumbai, as well as in other cities in Maharashtra, and they were severely criticized, not just by the opposition benches, but members and supporters of the ruling parties as well.

The first question commonly asked was "What is meant by a smart city". The answer given in the document circulated by the Government of India was- "There is no universally accepted definition of a Smart City. It means different things to different people. The conceptualisation of Smart City, therefore, varies from city to city and country to country, depending on the level of development, willingness to change and reform, resources and aspirations of the city residents. A Smart City would have a different connotation in India than, say, Europe. Even in India, there is no one way of defining a Smart City".

With this definition, the government admitted that the term 'smart' is relative and hence smart city cannot be defined as it means different things to different people. It was expected that the government, in its own wisdom, would attempt to categorise urban India and attempt to define smartness, as applicable to local conditions.. However the document fell short of admitting that the choice of the word was indeed wrong and that it could have been replaced with other words including "livable cities" or "Infrastructural upgradation" or" upliftment of cities', or similar 'Doable' definitions.

"Some definitional boundaries are required to guide cities in the Mission. In the imagination of any city dweller in India, the picture of a Smart City contains a wish list of infrastructure and services that describes his or her level of aspiration. To provide for the aspirations and needs of the citizens, urban planners ideally aim at developing the entire urban eco-system, which is represented by the four pillars of comprehensive development — institutional, physical, social and economic infrastructure. This can be a long term goal and cities can work towards developing such comprehensive infrastructure incrementally, adding on layers of 'smartness'."…. The document goes on…

With a please all agenda, little did they realize that the hopes, expectations and aspirations were raised to such levels that they would be very difficult to fulfill.

"In the approach to the Smart Cities Mission, the objective is to promote cities that provide core infrastructure and give a decent quality of life to its citizens, a clean and sustainable environment and application of 'Smart' Solutions. The focus is on sustainable and inclusive development and the idea is to look at compact areas, create a **replicable model which will act like a light house to other aspiring cities**. The Smart Cities Mission of the Government is a bold, new initiative. It is meant to set examples that can be replicated both within and outside the Smart City, catalysing the creation of similar Smart Cities in various regions and parts of the country". says the document. Let us therefore analyse the core infrastructure elements, as stated in the document, that a Smart City would try to improve:

Adequate water supply,- Mumbai has half its population staying in slums. They have been assured adequate water supply in every elections. However the ground reality is that more than 100 persons share a tap in the ideal situation. In other slums, the situation can be much worse. 24 hour water supply has been given to some areas on an experimental basis, but for slumdwellers, unless there is a security of tenure, right to take proper decisions without fear or favour, access to properly constructed houses, upgrading

the dwellings from the informal sector to the formal one with adequate social infrastructure including health facilities, maintaining of affordable levels of outgoings,the whole exercise would be fruitless. Mere constant flow of water in the common taps may not alter the quality of life even partially.

Assured electricity supply,-On this ground, Mumbai scores over the rest of the cities as the supply is by and large available. The councilors who participated in the discussion were at loss to understand what more needs to be done in Mumbai to fulfill this assurance. There were suggestions to make electricity more affordable especially since the residents of the island city have to pay more to offset the losses of the transportation wing of the BEST. The document however does not mention the affordability of either electricity, water or any of the core infrastructural facilities.

Sanitation, including solid waste management. -It is common knowledge that solid waste has to be carried to far off places and there is huge resistance to the placement policy for dumping grounds. Sewage is randomly dumped in the sea and creeks without proper and adequate treatment. It is also known that the lobby of contractors engaged in the transportation of the solid waste is powerful and allegation of malpractices, corruption and cheating have been surfacing time and again. Solutions are available, but paucity of land and vested interests of those involved in sharing the loot have thwarted efforts to implement them.

Efficient urban mobility and public transport,- The lifeline for Mumbai is indeed its railways. More than 60 accidents take place daily and several of these resulting in death and disabilities, cause unexplainable hardships to the 8 million commuters. A minimum of Rs 50 thousand crores would be required to make a noticeable difference to their travel blues. More than 200 AC busses are lying unused in various depots and the BEST is finding it difficult to maintain them. The numbers of bus commuters have been decreasing despite the service being better than what is available to most cities in the country, as the commuter finds the fares unaffordable, and the travel inconvenient if compared to the available alternatives.

Affordable housing, especially for the poor,- We have been writing about this issue time and again and would not repeat the solutions. However we would be failing in our duties if we do not say that the housing stock available in Mumbai is not affordable to 99 per cent of the population.

Robust IT connectivity and digitalization,- With almost 90%of the population living in inadequate shelter, by all definitions, and all of them are struggling to find resources to maintain their existing homes, could they afford the cost of getting connected digitally? This question was asked by the corporators and decision makers during the debates.

Good governance, especially e-Governance and citizen participation, - Most redevelopment schemes result in eviction of those for whom the schemes were ostensibly conceived. Citizens have been demanding alternative schemes for the redevelopment of their residences, both in dilapidated buildings and in slums, but they have received no response. Corruption is on the rise at all levels. If standard levels of governance do not accommodate these modest requests, good governance is far away.

Sustainable environment,- We assume that this point has been included only because it is fashionable to do so. The levels of pollution have been increasing day by day and nothing is being done to check or control it.

Safety and security of citizens, particularly women, children and the elderly,- Crimes against women and children are on the rise and there are hardly any footpaths on most roads and even the ones who have them are unsafe for the women, children and the elderly.

Health and education.- It is virtually impossible to get admission to good educational institutions and the condition of the public hospitals is pathetic due to the large number of patients, while the private health services are unaffordable.

The project presently allocates a hundred crores per annum, for converting Mumbai into a Smart City!!!. It would therefore be clear to all that the "core infrastructural elements" have been enlisted only because they could not have been left out.

Some typical features of comprehensive development in Smart Cities are described in the document.- The corporators read them one by one and they came in for ridicule, to say the least. Let us therefore read those features carefully and analyse some of them.-

"Promoting mixed land use in area-based developments — planning for 'unplanned areas' containing a range of compatible activities and land uses close to one another in order to make land use more efficient. The States will enable some flexibility in land use and building bye-laws to adapt to change".-The MCGM has been filing criminal cases against those who do petty commercial activity in the residential zones. This is one of the major sources of corruption. If the aim is indeed to encourage mix users and permit change in use, the cases could be withdrawn saving not just harassment to the victims, but also crores of taxpayers' money. Mixed use has its own problems, and to suggest this as a blanket solution shows, amongst other things, non application of mind.

"Housing and inclusiveness — expand housing opportunities for all"- As mentioned earlier, the issue is not of opportunities but of affordability.

"Creating walkable localities — reduce congestion, air pollution and resource depletion, boost local economy, promote interactions and ensure security. The road network is created or refurbished not only for vehicles and public transport, but also for pedestrians and cyclists, and necessary administrative services are offered within walking or cycling distance".- The corporators echoed the sentiments of the citizen when they spoke of the appalling conditions of the footpaths and the increasing pollution.

"Preserving and developing open spaces — parks, playgrounds, and recreational spaces in order to enhance the quality of life of citizens, reduce the urban heat effects in Areas and generally promote eco-balance"- We have dealt with the issue of open spaces in our earlier editorials and found that the corporators agreed with our views and quoted from them.

"Promoting a variety of transport options — Transit Oriented Development (TOD), public transport and last mile para-transport connectivity"-We have seen that under the garb of encouraging transit oriented development, the proposed development plan had permitted 8 FSI in and around select railway stations. It is only when there was a uproar in the masses that the proposals were forced to be withdrawn.

"Making governance citizen-friendly and cost effective — increasingly rely on online services to bring about accountability and transparency, especially using mobiles to reduce cost of services and providing services without having to go to municipal offices; form e-groups to listen to people and obtain feedback and use online monitoring of programs and activities with the aid of cyber tour of worksites"- The corporators felt that despite total computerization, the services have neither become citizen friendly nor affordable.

"Giving an identity to the city — based on its main economic activity, such as local cuisine, health, education, arts and craft, culture, sports goods, furniture, hosiery, textile, dairy, etc" –

We have given a proposal to the government to utilize idle built space for promotion of ethnic cuisine and culture of different states by making it follow the Mini India concept, which Mumbai really represents. The proposal has not yet received the expected response.

"Applying Smart Solutions to infrastructure and services in area-based development in order to make them better. For example, making Areas less vulnerable to disasters, using fewer resources, and providing cheaper services"- The decision makers reminded and discussed the casualties caused by the flooding every year due to incessant rains.

The strategies suggested in the guidelines on smart cities were carefully read by the decision makers who lucidly commented on them.

We reproduce the strategies and the reaction.-

"**Retrofitting** will introduce planning in an existing built-up area to achieve Smart City objectives, along with other objectives, to make the existing area more efficient and liveable. In retrofitting, an area consisting of more than 500 acres will be identified by the city in consultation with citizens. Depending on the existing level of infrastructure services in the identified area and the vision of the residents, the cities will prepare a strategy to become smart. Since existing structures are largely to remain intact in this model, it is expected that more intensive infrastructure service levels and a large number of smart applications will be packed into the retrofitted Smart City. This strategy may also be completed in a shorter time frame, leading to its replication in another part of the city".- Inspired by this strategy the MCGM proposed the Lower Parel area for retrofitting . The

proposal was received with anger and disgust from all including the Mayor of Mumbai who represents the area. The MCGM was asked to withdraw the proposal. Finally it was suggested that the Lower Parel proposal be treated as an example which need not be the ultimate choice.

"**Redevelopment** will effect a replacement of the existing built-up environment and enable co-creation of a new layout with enhanced infrastructure using mixed land use and increased density. Redevelopment envisages an area of more than 50 acres, identified by Urban Local Bodies (ULBs) in consultation with citizens. For instance, a new layout plan of the identified area will be prepared with mixed land-use, higher FSI and high ground coverage. Two examples of the redevelopment model are the Saifee Burhani Upliftment Project in Mumbai (also called the Bhendi Bazaar Project) and the redevelopment of East Kidwai Nagar in New Delhi being undertaken by the National Building Construction Corporation"

Mumbai has horrible experiences of redevelopment and the elected representatives were vocal in their opposition to the existing schemes, about which we have written earlier in our editorials.

"**Greenfield** development will introduce most of the Smart Solutions in a previously vacant area (more than 250 acres) using innovative planning, plan financing and plan implementation tools (e.g. land pooling/ land reconstitution) with provision for affordable housing, especially for the poor. Greenfield developments are required around cities in order to address the needs of the expanding population. One well known example is the GIFT City in Gujarat. Unlike retrofitting and redevelopment, greenfield developments could be located either within the limits of the ULB or within the limits of the local Urban Development Authority (UDA)".-

This strategy is perhaps the only one which may succeed if sufficient funds are allotted to it. In Mumbai however, there are no vacant lands available for development. The NAINA area around the proposed new International Airport may provide enough opportunities for such projects. The coastline stretching fron Gujarat to Goa provides tremendous opportunities for a chain of cities along the coast with connecting transportation links by rail, road, and waterways. The elected representatives were virtually unanimous in their view that the funds available to Mumbai may be better spent in the NAINA area.

"**Pan-city** development envisages application of selected Smart Solutions to the existing city-wide infrastructure. Application of Smart Solutions will involve the use of technology, information and data to make infrastructure and services better. For example, applying Smart Solutions in the transport sector (intelligent traffic management system) and reducing average commute time or cost to citizens will have positive effects on productivity and quality of life of citizens. Another example can be waste water recycling and smart metering which can make a substantial contribution to better water management in the city".- These are indeed suggestions to make the city more efficient. The decision makers had serious doubts whether these would make the city smarter, since most of them were already considered by them for Mumbai, and some have been approved and are in the process of being implemented.

"The Smart City proposal of each shortlisted city is expected to encapsulate either a retrofitting **or** redevelopment **or** greenfield development model, **or** a mix thereof and a Pan-city feature with Smart Solution(s). It is important to note that pan-city is an **additional** feature to be provided. Since Smart City is taking a compact area approach, it is necessary that **all the city residents feel there is something in it for them also.** Therefore, the additional requirement of some (at least one) city-wide smart solution has been put in the scheme to make it inclusive".

This issue was discussed the words "it is necessary that **all the city residents feel there is something in it for them also"** came for sharp criticism. The critics felt that this line itself confirms that the whole exercise is conceived to cater to the vested interests, and the effort was to make the residents feel that they also have got something. Introducing of WIFi throughout the city was proposed by all. The ruling party members felt that they had proposed this much before the smart city guidelines were proposed. However the administration did not act due to some flimsy grounds cited at that time.

There was heated discussion and debate and since it was the last date for submitting the proposal,

several conditions were insisted upon. There was anger also because the SPV which was to implement the project was to be controlled only by officials and the proposal also provided for private participation in decision making. The fear was that the Centre would interfere in the ULBs affairs, developers and vested interests would be involved in the decision making processes, and that the powers of elected representatives would be seriously curtailed. The commissioner, and the officials requested that the proposal be sent to the centre and if the elected representatives had reservations, they could put conditions making it a conditional proposal. Conditions were then enlisted, discussed and placed on record.

We would like to reproduce the conditions for the benefit of our readers. It was made clear that unless the centre amended the scheme and accepted these conditions, the Smart City project was not acceptable..-

1) Municipal Corporation of Greater Mumbai (MCGM) is not averse to the idea of Smart City as a new urban identity however has serious reservation to the Smart City – SPV concept proposed by Municipal Commissioner as this special purpose vehicle undermines, diminishes and weakens the Constitutional Right of Urban Local Body i.e. MGCM as enshrined in the letter and spirit of 74th Constitutional Amendment of India.

2) Municipal Corporation of Greater Mumbai (MCGM) will have the unequivocal right to select the location and area of project. Site location of Lower Parel is for illustrative purpose only and Municipal Corporation of Greater Mumbai (MCGM) has serious reservations to this selection. Municipal Corporation of Greater Mumbai (MCGM) believes that there are several other areas/hubs which are more appropriate for Smart City Project.

3) Municipal Corporation of Greater Mumbai (MCGM) has serious doubt of the 60 lakh job creation claim purported by Municipal Commissioner which is nearly half the current population of Greater Mumbai. However 85% of all jobs created in the project area will be reserved for local residents of that locality in Mumbai.

4) Equity in the Smart City SPV in Mumbai will be limited to 50% to the Government of Maharashtra and 50% to Municipal Corporation of Greater Mumbai (MCGM). No private equity will be permitted in Smart City SPV in Mumbai.

5) Smart City SPV in Mumbai will not levy any user charges or additional taxes, debt, surcharges etc. in lieu of the development.

6) 50 % of Board of Directors will be appointed by Municipal Corporation of Greater Mumbai (MCGM) from its elected representatives and 50% from State Government. No independent directors shall be appointed on the board of the Smart City SPV in Mumbai.

7) Chairman of the Board position of the SPV shall be always reserved for Mayor Mumbai. Chairman (Mayor Mumbai) and the house will reserve a right to veto and Golden vote to any decision taken by the board of Smart City SPV in Mumbai.

8) Chief Executive Officer will be appointed solely by Municipal Corporation of Greater Mumbai (MCGM).

9) All financial matters of the Smart City SPV in Mumbai shall be with prior sanction of Municipal Corporation of Greater Mumbai (MCGM).

10) Any modification to the above conditions shall be reverted back to Municipal Corporation of Greater Mumbai (MCGM).

11) Necessary modification shall be made to the Smart City Mission Statement and Guidelines promulgated by the Ministry of Urban Development and will be submitted to Municipal Corporation of Greater Mumbai (MCGM) for prior approval.

12) Notwithstanding what is stated hereinabove any act, or resolution or directive or direction or proposal not in consonance or in any way violating the letter and spirit of the74th Constitutional Amendment shall be treated as inapplicable and hence rendering this resolution null and void.

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Dr. Prakash Hebalkar

Global Trade and Investment Trends...

This column focuses on trends in trade and investments in the past month.

The much talked about Grexit, Brexit - will we now see a Finexit? The economic turmoil and the feeling of helplessness among the weaker economies continues to spread from Greece and Portugal and Spain now moving northwards to Finland.

Without the option of currency devaluation, the government has calculated that Finland needs to lower its labor costs as much as 15 percent to catch up with its main trade partners, Sweden and Germany.

Finland's economy has shrunk for the past three years and Nordea, the biggest Nordic bank, predicts further contraction in 2015. Finland will be the weakest EU economy by 2017, when it will grow at less than half the pace of Greece, according to the European Commission.

Source: Bloomberg - Finland Should Never Have Joined Euro, Foreign Minister Says

The European Union faces a potential existential threat. This time it arises not from the continuing financial crisis which has divided it into the Northern and the Mediterranean countries, but from group-think on Syrian immigration at the top level but huge dissonance at the individual country level as voiced already in Hungary by its President. More recently, the fears have spread to the strongest European country, Germany.

German business leaders fear that deep divisions over how to handle the refugee crisis and growing nationalism among member states could break up the European Union, according to five of the country's biggest industry bodies.

The arrival of hundreds of thousands of people fleeing war and poverty in countries such as Syria and Iraq in Europe this year has frayed ties between European nations that were already strained by the euro zone financial crisis.

Added to that, rising nationalism could endanger Europe's wealth, economic success and security, the presidents of Germany's most prominent business groups told Reuters.

"Next year will be a crucial year for Europe," BDI industry association leader, Ulrich Grillo, said. "I'm very worried about the future of the European Union."

http://uk.reuters.com/article/uk-europe-migrants-germany-business-idUKKBN0U907Z20151226

The US presidential election of 2016 is bringing to light the political turmoil in the white majority (still the majority for now) population. Three articles have brought out the sharp income inequalities in this population, the hopelessness that pervades their mindset since the 2000's and the direction in which solutions are being sought. **All of these have an impact on the way trade, investment, immigration and foreign relations will develop in the next couple of decades and so are as important trends to US economic and foreign policy as the rise of China, the hoped-for rise of India and the rise of the Caliphate.**

The republican revolt :

The angriest and most pessimistic people in America aren't the hipster protesters who flitted in and out of Occupy Wall Street. They aren't the hashtavists[1] of #BlackLivesMatter. They aren't the remnants of the American labor movement or the savvy young dreamers who confront politicians with their American accents and un-American legal status.

The angriest and most pessimistic people in America are the people we used to call Middle Americans. Middle-class and middle-aged; not rich and not poor; people who are irked when asked to press 1

1 Hash-tag activists

for English, and who wonder how "white male" became an accusation rather than a description.

You can measure their pessimism in polls that ask about their expectations for their lives—and for those of their children. On both counts, whites without a college degree express the bleakest view. You can see the effects of their despair in the new statistics describing horrifying rates of suicide and substance-abuse fatality among this same group, in middle age.

White Middle Americans express heavy mistrust of every institution in American society: not only government, but corporations, unions, even the political party they typically vote for—the Republican Party of Romney, Ryan, and McConnell, which they despise as a sad crew of weaklings and sellouts. They are pissed off. And when Donald Trump came along, they were the people who told the pollsters, "That's my guy."

http://www.theatlantic.com/magazine/archive/2016/01/the-great-republican-revolt/419118/

Why America is turning left:

If the lesson of the Reagan era had been that Democrats should give a Republican president his due, the lesson of the Bush era was that doing so brought disaster. In the Senate, Bush's 2001 tax cut passed with 12 Democratic votes; the Iraq War was authorized with 29. As the calamitous consequences of these votes became clear, the revolt against them destroyed the Democratic Party's centrist wing. "What I want to know," declared an obscure Vermont governor named Howard Dean in February 2003, "is why in the world the Democratic Party leadership is supporting the president's unilateral attack on Iraq. What I want to know is, why are Democratic Party leaders supporting tax cuts?" By year's end, Dean—running for president against a host of Washington Democrats who had supported the war—was the clear front-runner for his party's nomination.

That's what happened to **Occupy Wall Street. The movement may have burned out, but it injected economic inequality into the American political debate.** (In the weeks following the takeover of Zuccotti Park, media references to the subject rose fivefold.) ...And without Occupy, it's impossible to understand why a curmudgeonly Democratic Socialist from Vermont is seriously challenging Hillary Clinton in the early primary states. The day Bernie Sanders announced his candidacy, a group of Occupy veterans offered their endorsement.

Arguably more significant than the Sanders campaign itself is the way Democratic elites have responded to it. In the late 1980s and the '90s, they would have savaged him. **For the Democratic Leadership Council, which sought to make the party more business-friendly, an avowed Socialist would have been the perfect foil. Today, in a Democratic Party whose guiding ethos is "no enemies to the left,"** Sanders has met with little ideological resistance. That's true not only among intellectuals and activists but among many donors. Journalists often assume that Democrats who write big checks oppose a progressive agenda, at least when it comes to economics. And some do. But as John Judis has reported in National Journal, **the Democracy Alliance, the party's most influential donor club, which includes mega-funders such as George Soros and Tom Steyer, has itself shifted leftward during the Obama years.** In 2014, it gave Warren a rapturous welcome when she spoke at the group's annual winter meeting. Last spring it announced that it was making economic inequality its top priority.

Moreover, the Occupy-Warren-Sanders axis has influenced **Clinton's own economic agenda, which is significantly further left than the one she ran on in 2008.** She has called for tougher regulation of the financial industry, mused about raising Social Security taxes on the wealthy (something she opposed in 2008), and **criticized the Trans-Pacific Partnership (a trade agreement she once gushed about)**. Overall, Vox's Matthew Yglesias has written, **Clinton appears "less inclined to favor a market-oriented approach than a left-wing**

approach, a real change from the past quarter century of Democratic Party economic policymaking." Her "move to the left," notes Kira Lerner of Think Progress, "distances her policies from those of her husband and Obama." Peter Beinart[2] in the Atlantic Magazine

The Inequalities in Education: The truth is that the meritocracy was never more than partial. Visit any elite campus across our great nation, and you can thrill to the heart-warming spectacle of the children of white businesspeople and professionals studying and playing alongside the children of black, Asian, and Latino businesspeople and professionals. Kids at schools like Stanford think that their environment is diverse if one comes from Missouri and another from Pakistan, or if one plays the cello and the other lacrosse. Never mind that all of their parents are doctors or bankers.

That doesn't mean there aren't a few exceptions, but that is all they are. In fact, the group that is most disadvantaged by our current admissions policies are working-class and rural whites, who are hardly present on selective campuses at all. The only way to think these places are diverse is if that's all you've ever seen.

Let's not kid ourselves: The college admissions game is not primarily about the lower and middle classes seeking to rise, or even about the upper-middle class attempting to maintain its position. It is about determining the exact hierarchy of status within the upper-middle class itself.

This system is exacerbating inequality, retarding social mobility, perpetuating privilege, and creating an elite that is isolated from the society that it's supposed to lead. The numbers are undeniable. In 1985, 46 percent of incoming freshmen at the 250 most selective colleges came from the top quarter of the income distribution. By 2000, it was 55 percent. As of 2006, only about 15 percent of students at the most competitive schools came from the bottom half. The more prestigious the school, the more unequal its student body is apt to be. And public institutions are not much better than private ones. **As of 2004, 40 percent of first-year students at the most selective state campuses came from families with incomes of more than $100,000, up from 32 percent just five years earlier.** More broadly, they need to rethink their conception of merit. If schools are going to train a better class of leaders than the ones we have today, they're going to have to ask themselves what kinds of qualities they need to promote.

The changes must go deeper, though, than **reforming the admissions process. That might address the problem of mediocrity, but it won't address the greater one of inequality**. The problem is the Ivy League itself. We have contracted the training of our leadership class to a set of private institutions. However much they claim to act for the common good, they will always place their interests first.

High-quality public education, financed with public money, for the benefit of all: the exact commitment that drove the growth of public higher education in the postwar years. Everybody gets an equal chance to go as far as their hard work and talent will take them—you know, the American dream. Everyone who wants it gets to have the kind of mind-expanding, soul-enriching experience that a liberal arts education provides. We recognise that free, quality K–12 education is a right of citizenship. We also need to recognise—as we once did and as many countries still do—that the same is true of higher education. **We have tried aristocracy. We have tried meritocracy. Now it's time to try democracy.**

Don't Send Your Kid to the Ivy League

The nation's top colleges are turning our kids into zombies

BY WILLIAM DERESIEWICZ – ex professor at Yale University

The New Republic, July 22, 2014

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Goods and Services Tax (GST)

Mr. Dilip Save

The proposed Goods and Services Tax ("GST" for short) is one of the key activity on the reform agenda. There will be a paradigm shift in the manner indirect taxes have been administered and collected. GST will subsume very many central and state indirect taxes to deliver a simple, equitable and comprehensive indirect tax structure for the country, and more importantly, integrate India into a common unified market.

Introducing value added tax in a large federal structure, like India, is fraught with challenges. It is not about the political process, but the platform of scheme and structure that would deliver the expected results and more importantly, getting it first time right. In the past few years, there has been a meaningful engagement between the stakeholders involving a lot of application of mind and thought. The result: evolution of a unique federal GST structure, a win-win proposition for all.

In the Indian context, GST would mean sharing a common tax base. Both the centre and the sates will be entitled to levy value added tax on goods and services. Such a change therefore demands amendment to the constitution. Apart from common tax base, the GST format proposes to adopt uniform law and structure for classification, levy, collection, input credit and administration.

Therefore, how do things change for the business going forward ? The answer simply stated : Logic, not tax, will guide the business decisions.

Why GST:

The present tax structure, as it evolved over the past sixty five years, has too many shortcomings: small tax base, multiple taxes and rates, high cost of administration, cascading effect of taxes and, above all, certain taxes (like, CST, Purchase tax) contrary to the very basic tenet of destination principle. GST is expected to address all the stated shortcomings by widening the tax base, providing dual tax structure, introduction of two rate structure (with minimum exemptions / concessions), removal of cascading effect of tax, ease of administration and compliance. Outcome: A level playing field for all, optimization of resources and integration of India into a common unified market.

GST framework and structure:

The scheme and structure of GST is expected to be simple. This coupled with effective administration and reasonable rates of tax (expected to be on par with most developing economies) will drive better compliance and higher revenue collection for both the centre and the states.

The taxable event in GST is "sale" or 'supply' of goods or service with tax finally flowing to the destination where the goods and service is finally consumed. The concept of 'supply' is unique and is expected to include all stock transfers, goods issued for processing/job-work, free issue for sampling, etc. Taxing of supplies under GST should be welcome for obvious reasons: ease of transfer of input tax credit to the destination state, no reversal or adjustment to input tax credit towards free goods or service and no obligation to maintain separate

books of account for tax free goods.

As such, there would be no difference between 'goods' and 'service' under GST. The Harmonized System of Nomenclature (HSN) adopted for classification of goods under the present Central Excise and Customs law will be adopted for classification under GST as well. The definition of service is sought to be kept simple. What are not goods is defined to be a service, subject to certain exceptions. With minimal exemptions, disputes on classification would be substantially lower, if not avoided altogether. Alcohol beverages are sought to be kept out of GST. Petroleum and tobacco products will stand covered by GST two years down the line after GST is implemented and will attract additional 'sin' tax.

The scheme proposes a duel tax structure: Central GST (CGST) and State GST (SGST) that would apply on every transaction of sale or supply. The CGST accruing to the Central Government and the CGST accruing to the State Government in which the consumption takes place. A separate mechanism is proposed to deal with interstate transactions. The interstate transactions will attract Interstate GST ('IGST' for short), a combination of CGST + SGST with mechanism to transfer tax to the central and state authority through a specially setup nodal agency.

The levels of income and consequent consumption will decide the revenue earnings of the states. With the states enjoying right to tax services, the tax base for the states should grow significantly. However, such a scenario, still raises concerns for the states in the North East, state of Punjab and Haryana, which will be addressed by the Central Government separately with suitable compensation package.

Value addition at every stage is proposed to be taxed and 'Transaction Value' will be the basis of valuation under CGST and SGST. Where transaction value is not available, the valuation rules, similar to those under the central excise, will facilitate valuation. 'MRP' as a basis will be irrelevant for valuation under GST. Nonetheless, the transaction value will be derived from GST for all such goods bearing MRP. Multiple price list based on the stage of value addition therefore appears to be an option worth examining.

The biggest benefit that GST offers is neutralization of input taxes, save and except those suffered on certain employee related expenses. The present Indirect tax structure results in a cascading impact of tax estimated to be around 5 - 7%. The effective tax impact is therefore far greater that the cumulative taxes the goods or service suffer. While this casts a huge burden on the consumers, it also severely impacts competitiveness of Indian exports.

Challenges for Business:

For the business, GST poses several challenges. These concerns if addressed effectively is sure to provide a business and competitive advantage.

The primary challenge for any business will always be continuity (of business)

and compliance. This twin objective is non-negotiable and has to be ensured at any cost. The rest relate to financial gains accruing from tax rationalization, full input tax credit and better cost management resulting from re-engineered supply chain and business processes.

Every sector / industry will have some specific concerns arising from GST. Identifying and escalating them to the policy makers through the trade bodies need not be stressed. It is a common experience that engagement in the preparatory stage is always better and a neater option of redressal.

Change Management :

GST will demand paradigm shift in the manner business is conducted and managed. Every business process would need review and re-engineering for the simple reason that there is a huge opportunity to leverage GST for business and competitive advantage.

The process of change management must be driven from the top and through formation of a cross functional team. The process will involve understanding and analyzing business impact, operational and financial, and redefine strategy across the supply chain starting from sourcing, to manufacture, distribution and sales. The supply chain shall also include the 'back-end' (the feedstock suppliers to the suppliers) and the 'front-end' (distributors / stockists / sole selling agents). Unless the front-end and back-end are roped in and aligned, business continuity and benefits cannot be guaranteed.

Journey so far:

The journey so far has been of hope and despair. A lot of preparatory work has happened. The Constitution [122nd Amendment] Bill, 2014 has been passed by the Lok Sabha and now before the Rajya Sabha. After Rajya Sabha passes the Bill by 2/3 majority, the Bill will have to be ratified by 50% of the states. With logjam in Rajya Sabha, 1 June, 2016 also appears to be difficult.

Every delay is a missed opportunity. There is sufficient information on the public domain for businesses to get started and get into readiness to embrace GST as and when it comes.

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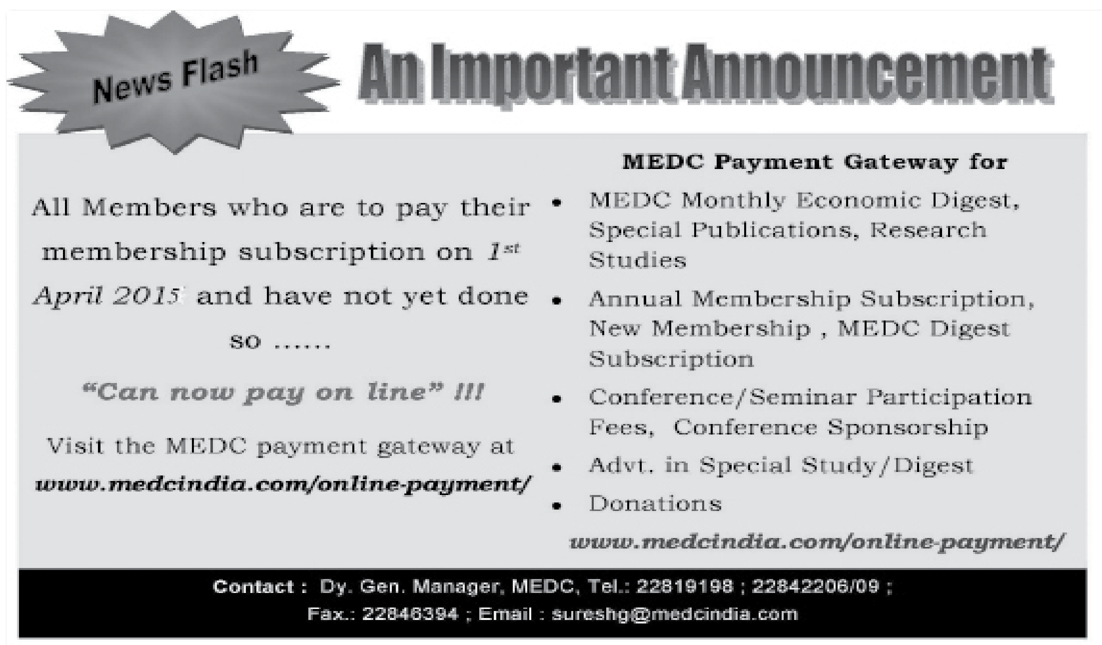

Goods and Services Tax (GST)

Capt. Pramod Salvi

Honourable President of MEDC has rightly expressed his views and reservations about GST in his resent "From President's Desk-December 2015".

Unfortunately "GST bill" is heading towards watering down it's very purpose through riders on some existing important taxes.

Background:

The world's governments have relied most heavily on indirect taxes for extra revenue. France was the first country to introduce GST in 1954. Worldwide, Almost 150 countries have introduced GST in one or the other form till now.

Most of the countries have a unified GST system.

In India, GST was to have been in place five years ago which was initiated by earlier Finance Minister Mr. Chidambaram . The Constitution (One Hundred and Twenty Second Amendment) Bill, 2014, conferring concurrent taxing powers on the Union as well as the States was rolled out in December 2014 and approved in the Lok Sabha in May 2015.

Brazil and Canada follow a dual system. In China, GST applies only to goods and the provision of repairs, replacement and processing services. GST rates in Australia is 10%, France 19.6%, Canada 5%, Germany 19%, Japan 5%,Singapore 7% and New Zealand 15%.

Indian government is considering pegging the rate of GST from 20% to 23% that is well above the global average rate of 16.4% for similar taxes,

The benefits of GST would be more for the manufacturing sector. However, going by experience of other countries, there will be short term impact of GST. GST triggered inflation for few years in some of the countries.

GST is a centralized tax:

GST bill, when passed, will become the single most important tax reform after 1947, wherein the Centre and the State will jointly put in a system of near perfect modern Indirect Tax collection.

Originally GST was supposed to replace all these taxes. In other words only one tax, only at the national level by the central government. GST is levied at the final point of consumption and not at the manufacturing stage. At present, separate tax rates are applied to goods and services. GST will replace Central taxes like, Central Excise duty, Additional Excise duty, Service tax, Additional Custom duty and Special Additional duty and State level taxes like, VAT or sales tax, Central Sales tax, Entertainment tax, Entry tax, Purchase tax, Luxury tax and Octroi.

GST would bring in more revenue to the government. Currently, there are a lot of slippages in taxes. With just one authority managing the tax, collections are supposed go up. Since the tax would be charged on a consumption basis and not on manufacturing, states poor in manufacturing would benefit.GST will be reform for Indian economy by developing a common Indian market and reducing the cascading effect of tax on the cost of goods and services.

The power to make laws in respect of supplies in the course of inter-State trade or commerce will be vested only in the Union government. States will have the right to levy GST on intra-State transactions including on services. Members of GST Council comprised of the Central and State ministers in charge of the finance portfolio. Administration of GST will be the responsibility of the GST Council, which will be the apex policy making body for GST.

Centre will levy IGST on inter-State supply of goods and services. Import of goods will be subject to basic customs duty and IGST.

Fractured GST BILL

In original form GST was to completely change indirect taxation.

However in present proposed format :

1) It does not include taxes on alcohol for human consumption. Unlike Petroleum products there is no scope for liquor, bringing it into the GST. It will need another constitutional amendment with two-thirds majority in Parliament and ratification by states. It could be said that

wasted interest of all involved have made sure that this important tax remains out side GST and outside Central's control as if India is divided in to 29 plus (states plus union territories) independent countries.

2) GST will not affect taxes on Petroleum and petroleum products i.e. crude, high speed diesel, motor spirit, aviation turbine fuel and natural gas till further changes are as and when are made by GST council. The Bill says petroleum can be brought under the GST should the proposed GST Council agree.

3) There could be 1% origin based additional tax which could be levied on inter-State supply of goods. The revenue from this tax is to be assigned to the Origin State. This tax is proposed to be levied for initial such period as recommended by the GST Council. The bill provides for 1 percentage point extra tax on goods for at least two years. This extra revenue will go to the state from which the goods originated, or where it was manufactured.

4) There is Provision (not firm commitment) for removing imposition of entry tax / Octroi across India.

   Taxes charged by states namely: Entertainment tax on movie and theatre are proposed to be replaced by GST. However taxes on entertainment at panchayat, municipality or district level to continue.

5) GST may be levied on the sale of newspapers and advertisements.

6) Stamp duties, will be levied by the States.

Some states may lose some revenue because of the introduction of GST. The bill allows for compensation for revenue loss to states for a period of 5 years. GST will be levied on buyers of goods and services, or where the service is consumed. This means big consumer states such as Uttar Pradesh, West Bengal and Kerala will get a high share of the taxes. Manufacturing states such as Maharashtra, Tamil Nadu and Gujarat will lose out on revenues.

Liquor has been kept out of GST by states because it contributes over Rs 90,000 crore to state governments' revenue. States want to maintain control over taxability of alcoholic beverages. The liquor industry is the second largest contributor to State government exchequers, contributing more than 90,000 crore in taxes per annum. Not having uniformity in the regulations of different States makes it difficult for the manufacturer and seller to work with complex system. The credit of various duties/taxes paid by the manufacturer is not available as a set-off from excise duty which adds to the cost of the manufacturer. The same is true for discharge of VAT liability, wherein the excise duty is not eligible for set-off. This leads to the tax cost being the major component of the final cost to the consumer.

Disparity of state excise duty rates is very big loss to the state of Maharashtra through illegal cross border trade. Excise duty of liquor in neighboring states and union territories such as Goa, Daman and Diu are very low than that of Maharashtra. (If you divide number of liquor bottles produced in Goa by population of Goa it comes in "bottles" per capita consumption per day).

International best practices support taxation of Alcoholic Beverages under GST. GST will also substantially reduce illicit liquor and illegal production by establishing controls on manufacture and movement. If GST subsumes state excise duty, there will be uniform tax all over country and Maharashtra and other states and country will stand to gain. The economic distortion caused due to varied taxes on alcohol can be removed by a comprehensive tax system, paving the way for an efficient and effective tax administration. GST will also substantially reduce illicit liquor and counterfeiting by establishing stringent controls on manufacture and movement.

Summary :

Proposed model of GST is not the best we could have had.

However the fact remains that we should not remain with outdated complicated system of indirect taxation we have been working with it since our independence.

We should go ahead with even the compromised GST and work towards further refining of GST by taking 29 plus states in confidence and making them understand that what is in interest of nation will also be in interest of states in longer term. With GST in place over the period we will reach better GDP growth with better prosperity for all involved. GST council should further reform and bring all the taxes under it's umbrella in time bound manner for stronger India.

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Goods and Services Tax in Canada

- MEDC Research Team

INTRODUCTION

Many countries in the world have a single tax applicable throughout the country. However, the federal countries like Canada, a dual GST system is prevalent whereby GST is levied by both the federal and state or provincial government .Taxation is a mechanism used by all levels of government in Canada to collect revenue in order to finance government programs and services. Taxation is a compulsory payment imposed on individuals, businesses, organizations, and property. The GST is a sales tax which applies to final consumption at a fixed rate of 7%. Whereas the former FST was a hidden tax on the manufacture of goods, including those exported for foreign consumption, the GST is a visible tax on the value added at each stage of production and distribution of goods and services– which makes it a multistage tax– and applies only to consumption within Canada.

APPLICATION OF GST IN CANADA

The GST is applied to most goods and services exchanging hands between individuals, businesses, and organizations. However, some things are excluded (or partially excluded) from the GST's application. These exclusions usually involve goods and services that governments desire to keep cheaper for lower income individuals and families.

There are two types of GST exclusions: tax-free and tax-exempt

"Tax-free" exclusions include goods and services where no GST is assessed throughout the life of the product. Final consumers are not charged GST when they purchase these products from distributors. Moreover, vendors are entitled to Input Tax Credits at the production and distribution stages. As a result, the good or service is completely free taxation, at least with respect to the GST. Examples of tax-free exclusions include basic groceries, prescription drugs, and medical devices.

"Tax-exempt" exclusions include goods and services where the GST is charged at the production and distribution stages, but not at the final retail stage. In other words, final consumers of products are not charged GST on their purchases. Manufacturers, wholesalers, and retailers. However, are assessed GST in their production and distribution of the good or service, and are prohibited from claiming an Input Tax Credit. As such, some GST is embedded in the final price of the good or service; However, it is lower than it would otherwise be under the regular GST regime. Examples of tax exempt exclusions include residential rents, health and dental care, and educational services.

Finally, lower income individuals and families are entitled to some GST relief on goods and services that are normally taxed under the GST. These people can claim a refundable tax credit on some of the GST they paid over the course of the year. This tax credit is given to people when they submit their personal income taxes, and is based on their annual earnings.

BASIC STRUCTURE OF GSTs

GST is sales tax, meaning that it is a charge on the exchange (or "sale") of goods and services between individuals, business, and organizations. As a sales tax, there are several basic elements that characterize the GST.

First, the GST is aconsumption sales tax, meaning that the party purchasing the product (the consumer) is responsible for paying the tax, as opposed to the "seller" of the product. If you purchase a book from a bookstore, for example, you (as the consumer) are charged the GST in that particular transaction. This principle operates at all stages of production and distribution. Whenever a transaction occurs, be it at the manufacturing, distribution or retail stage, the party purchasing the good or service is required to pay the GST.

Second, the GST is apercentage consumption tax, meaning that the amount of tax you pay is based on a certain percentage of the sale cost (before taxes) of the good or service you have purchased. As of June 2007, the GST was a six percent tax;Meaning that consumers were required to pay a tax of six percent of the sale cost of the good or service they purchased.

Third, the consumer pays theGST, while the seller or vendor is responsible for collecting andremitting the GST to the government. The consumer who purchases the book pays the GST to the bookstore and the bookstore remits it to the government at a later date. Over the course of the tax year, vendors in Canada are responsible for keeping track of how much GST they have collected and then sending that amount to the government.

GST TO OVERCOME THE TAX REGIME DIFFICULTIES

The very notion of the GSTsparked instant controversy across the country. Much of the controversy centred on perceptions the GST was tax grab by government, and that it would be a regressive form of taxation, meaning that it would hit lower income individuals and families harder than wealthier ones. While,The GST is a special sort of sales tax, commonly referred to as a valueaddedsales tax. This type is distinctive in that it only taxes the monetary value added to a product at different stages of the production process. This is significant in that it

overcomes the problem of cascading taxation that can plague other sorts of sales tax. What exactly is cascading taxation? Consider a sales tax that is applied whenever a good or service exchanges hands. As such, a situation would occur in which the tax is applied multiple times in a product's life. Take, for example, a television. Firstly, the television must be made bya manufacturer, who purchases a number of inputs during the production process, such as raw materials and equipment. In purchasing these inputs, the manufacturer must pay a sales tax. This process continues through the wholesaling and retail stages. When a wholesaler purchases the television from the manufacturer, they have to pay tax in that transaction. When the retailer purchases the television from the wholesaler, another tax charge is applied. Finally, when you purchase the television from your local retailer, you again are charged a tax. This layering of sales tax can significantly increase the final sales price of a good or service, as each party in the cycle (manufacturer, wholesaler, and retailer) must increase the price of the product to recoup the tax they paid. Making matters even worse, tax is being paid on tax. This process of paying tax on tax is repeated when the retailer purchases the product from the wholesaler, and again when the final consumer purchases it from the retailer.

Valueadded taxes, such as theGST, overcome this problem of cascading taxation through a system of Input Tax Credits. Under this system, sellers or vendors of goods and services are provided with tax credits equalling the amount of GSTthey paid during their normal business. Manufacturers, for example, receives a tax credit for all the GST they paid when purchasing inputs in the manufacturing process. Wholesalers and retailers, similarly, receive tax credits for all the GST they paid when purchasing their stock. The only group that does not receive a tax credit is the final consumer, who purchases the product for consumption as opposed to using it as input for production or distribution.As a result of this Input Tax Credit, there is no layering ofGST. Manufacturers, for example, are able to recoup theGST they paid in the production process through the system of Input Tax Credits. As such, they are not forced to increase the price of their product when selling to wholesalers. Similarly, wholesalers do not need to increase their price when selling to retailers, or retailers when selling to the final consumer.

GST IN INDIA, IMPACT ON INDIA'S INTERNATIONAL TRADE

Traditionally India's tax regime relied heavily on indirect taxes including customs and excise. Revenue from indirect taxes was the major source of tax revenue till tax reforms were undertaken during nineties. The major argument put forth for heavy reliance on indirect taxes was that the India's majority of population was poor and thus widening base of direct taxes had inherent limitations. Another argument for reliance on indirect taxes was that agricultural income was not subjected. The ongoing tax reforms on moving to a goods and services tax would impact the national economy, international trade, firms and the consumers. However, there has not been much work on the impact of tax reforms on India's international trade. The impact of introducing comprehensive goods and services tax (GST) on economic growth and international trade; changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectorial level to central income tax and there were administrative difficulties.Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavour to generate tax revenues to support government expenditure on public services and infrastructure development. Cascading tax revenues have differential impacts on firms in the economy with relatively high burden on those not getting full offsets. Such domestic and international factors lead to inefficient allocation of productive resources in the economy. This results in loss of income and welfare of the affected economy. For a developing economy like India it is desirable to become more competitive and efficient in its resource usage. Apart from various other policy instruments, India must pursue taxation policies that would maximise its economic efficiency and minimise distortions and impediments to efficient allocation of resources, specialisation, capital formation and international trade.

CONCLUSION

Canada could offer a good model for India, which needed to overhaul its tax regime. The current system of revenue collection in India, a legacy of the post-Independence period, is not working, and there are enormous gaps between where India needs to be and where it is right now. Even though, Canada and India approach GST as a measure to improve the competitiveness of the economy/ exports, there is a stronger case for India to rationalize its multiple and uncoordinated taxes. Canada with a unitary system of tax collection lends itself to variations in the rates of taxes. Multiple agencies in India call for a unitary data base and unified tax rate. India therefore has to achieve a synchronous shift to GST unlike Canada which is doing it incrementally. GST is expected to yield significant tax buoyancy for India despite lower incidence of tax, on account of higher compliance, which was not the case with Canada. Both Canadian and Indian models are far from being elegant at present. Origin based taxes introduce an additional contentious issue for India.

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Goods and Services Tax in Australia – Implications and Impact

- MEDC Research Team

The implementation of the much-talked-about Goods and Services Tax a comprehensive tax on manufacture, sale and consumption of goods and services at national level in India has failed due to Parliament logjam and political failure to pass GST Bill 2015. This political failure was due to Congress's obstructions because the BJP too took the obstructionist path when UPA was in power, including on the critical GST Bill, so it is being paid back in the same coin.

The spread of Value Added Tax (VAT) or Goods and Services Tax (GST) system of Indirect taxes across the globe is showing an increasing trend with more than 160 countries, including 33 of the 34 member countries of Organization for Economic Co-operation and Development (OECD), employing VAT as the preferred form of consumption tax. The international scenario also does not show a smooth sailing in implementation of this indirect tax reform. Implementation of New Tax System package in Australia including New Tax System (Goods and Services Tax) Act, 1999 is considered as a landmark change to the Australian tax system.

General Political rationale for introducing Goods and service tax in Australia:

The goods and services tax (GST) in Australia is a value added tax of 10% on most goods and services sales. GST is levied on most transactions in the production process, but is refunded to all parties in the chain of production other than the final consumer.

The tax was introduced by the Howard Government and commenced on 1 July 2000, replacing the previous federal wholesale sales tax system and designed to phase out a number of various State and Territory Government taxes, duties and levies such as banking taxes and stamp duty.

The idea for a broad-based consumption tax was first proposed by then federal treasurer Paul Keating at the 1985 Tax Summit but was dropped at the behest of then Labor Prime Minister Bob Hawke after pressure from the ACTU, welfare groups and business, which did not like its association with proposals for capital gains and fringe benefits taxes.

The idea was revived in 1991 by the opposition Liberal-National Coalition led by Dr John Hewson, and a GST was the centerpiece of the opposition's "Fightback!" platform at the 1993 election. The opposition had difficulty explaining the policy, as exemplified by Hewson's famous Birthday Cake Interview, and Labor prime minister Paul Keating's campaign exploited public distrust of a GST, which was considered a factor in the opposition's surprise loss of the "unloseable" 1993 election. In 1994 the Liberals decided to discard the remnants of "Fightback!" and Alexander Downer replaced Hewson as Liberal leader.

Politics and process of Implementing Goods and Service Tax in Australia:

John Howard was re-elected leader of the Liberal party in 1995, and pledged "never, ever" to introduce the GST. Howard led the Liberal-National Coalition to a large victory in the 1996 federal election. However, before the 1998 election, Howard proposed a GST that would replace all existing sales taxes, as well as applying to all goods and services. At the election, the Howard Government suffered a swing against it of 4.61% at the election, achieving a two-party-preferred vote of only 49.02%, compared with Labor on 50.98%. Nevertheless, the incumbent government retained a majority of seats in the lower house and Howard described the election win as a "mandate for the GST". Lacking a Senate majority, and with Labor opposed to the introduction of the GST, the government turned to the minor parties such as the Australian Democrats to gain the necessary support to get the necessary legislation through the Senate.

A prominent selling point of the legislation was that all the revenue raised by the GST would be distributed to the states. In 1999 an agreement was reached with the state and territory governments that their various duties, levies and taxes on consumption would be removed over time, with the consequent budget shortfall being replaced by GST income distributed by the Commonwealth Grants Commission. Furthermore, federally-levied personal income tax and company tax was reduced to offset the GST.

During the 1998 election campaign, the leader of the Australian Democrats, Meg Lees, stated that her party was opposed to a GST unless food, books and tourism packages sold offshore were exempt, and other compensating tax measures were implemented. The government initially stated that exemptions to the GST were not possible, and looked most likely to pass the GST legislation with the support of independent Senator Brian Harradine. However a compromise was eventually reached with Lees, involving most basic food items being exempt from the GST, the GST on library purchases of books being refunded, a temporary 8% refund on

school textbooks, increases to welfare payments, and greater powers to the ACCC to oversee the implementation of the new tax regime. A proposal to exempt tampons from the GST was dismissed by Howard. The legislation was passed on 28 June 1999 as A New Tax System (Goods and Services Tax) Act 1999. It gained assent on 8 July 1999 and came into operation on 1 July 2000.

John Howard had said that the "GST would never become part of Liberal Party policy", but his change of heart would become apparent in the lead-up to the 1998 campaign. It was passed by the Senate in June 1999 in a heavily amended form. The Leader of the Democrats, Meg Lees, viewed the dilution of the GST legislation as a success, but the issue split the Democrats, with Senators Natasha Stott Despoja and Andrew Bartlett voting against the GST. The move triggered infighting amongst the Democrats, and while the Democrats performed reasonably well in the 2001 federal election when Stott Despoja was party leader, the infighting worsened, resulting in Stott Despoja being forced out of the leadership and the loss, at the 2004 federal election, of the balance of power they once held in the Senate. The annihilation of the Democrats was completed at the following election in 2007 when they lost all their remaining seats, with the Australian Greens becoming the major third party.

Australian Labor Party leader Kim Beazley continued to oppose it during the Howard government's second term. During the2001 election campaign, Labor made a 'GST rollback' a centerpiece of its election platform. Labor attempted to reprise the effects of the birthday cake interview by deriding the application of GST to cooked and uncooked chickens, but failed to ignite public response to the limited scope of the rollbacks applying only to gas and electricity bills. Labor lost the election, and though the 11 September attacks and the so-called Tampa affair dominated the campaign, the loss would effectively end all serious opposition to the GST.

In early 2006, the New South Wales State Government and the Federal Treasurer Peter Costello launched adversarial advertising campaigns concerning distribution of the GST to the states. New South Wales Treasurer Michael Costa argued in full-page newspaper advertisements and on televised commercials that New South Wales consumers paid A$13 billion in GST but received only A$10 billion back from the Commonwealth Grants Commission, and therefore New South Wales was subsidizing resource rich states like Queensland and Western Australia. A Bill was introduced that gave the federal government no obligation to hand back revenue earned by that state to be divided to other non-performing states. Unlike the GST, sales tax revenue went back to the State that generated the sales tax.

The federal government counteracted with its own advertising campaign which claimed that New South Wales had breached its contractual obligations under the 1999 GST Agreement by continuing to charge unfair stamp duties and land taxes, which were supposed to have been abolished. After weeks of intense media and public pressure, the New South Wales State Government announced in its budget that it would reduce stamp duty and land tax, but critics argued that the State Government did not go far enough with much broader tax reform in New South Wales required to help encourage investment and business that had been forced elsewhere due to an unfavorable New South Wales business environment. This was in response to the Commonwealth allowing another A$72 million in grants to New South Wales, in addition to existing annual increases.

Difficulties in implementation of GST in Australia:

Critics have argued that the GST is a regressive tax, which has a more pronounced effect on lower income earners, meaning that the tax consumes a higher proportion of their income, compared to those earning large incomes. However, due to the corresponding reductions in personal income taxes, state banking taxes, federal wholesale taxes and some fuel taxes that were implemented when the GST was introduced, former Treasurer Peter Costello claimed that people were effectively paying no extra tax.

The preceding months before the GST became active saw a spike in consumption as consumers rushed to purchase goods that they perceived would be substantially more expensive with the GST. Once the tax came into effect, consumer consumption and economic growth declined such that by the first fiscal quarter of 2001, the Australian economy recorded negative economic growth for the first time in more than 10 years. Consumption soon returned to normal however. The Government was criticized by small business owners over the increased administrative responsibilities of submitting Business Activity Statements (BAS) on a quarterly basis to the Australian Taxation Office.

A study commissioned by the Curtin University of Technology, Perth in 2000 argued that the introduction of the GST would negatively impact the real estate market as it would add up to 8 percent to the cost of new homes and reduce demand by about 12 percent. The real estate market returned to boom between 2002 and 2004 where property prices and demand increased dramatically, particularly in Sydney and Melbourne. During the 2004-2006 period Perth also witnessed a sharp climb in real estate prices and demand.

The Australian GST: Current scenario:

The Australian economy has one of the lowest GST rates and one of the highest dependencies on income taxes in the OECD. Further, a significant proportion of the goods and services in Australia are GST-free (including food, health and education). This means that there is the capacity to broaden the GST base and/ or lift the tax rate, and use the additional

GST revenue to fund the removal of other, more inefficient taxes. The ongoing structural and demographic changes in the Australian economy are leading to a decline in the income tax revenue base. This suggests the need for a shift from a reliance on direct (income) taxes to a greater focus on indirect (consumption) taxes. A more sustainable revenue base will provide more fiscal headroom for financing the cost of an ageing population and for funding compensation for households that may face additional costs under the reform.

The potential impacts on the economy of the following four GST scenarios are examined:

1. 10% GST on a broader base – extending the GST coverage to include fresh food, health and education. In 2015-16, this is estimated to raise an additional $12.1 billion in GST revenue. This additional revenue is used to abolish insurance taxes, stamp duty on motor vehicles and a small proportion (9 per cent) of conveyancing stamp duty. Any remaining additional GST revenue is returned to households through personal income tax cuts and welfare payments.
2. 15% GST with current exemptions – increasing the statutory rate of GST to 15 per cent. In 2015-16, this is estimated to raise an additional $26.0 billion in GST revenue. This additional revenue is used to abolish insurance taxes, stamp duty on motor vehicles and 80 per cent of conveyancing stamp duty. Any remaining additional GST revenue is returned to households through personal income tax cuts and welfare payments.
3. 15% GST and applied to health and education – increasing the statutory rate of GST to 15 per cent and extending the GST coverage to include health and education. In 2015-16, this is estimated to raise an additional $36.8 billion in GST revenue. This additional revenue is used to abolish insurance taxes, stamp duty on motor vehicles and all conveyancing stamp duty. Any remaining additional GST revenue is returned to households through personal income tax cuts and welfare payments.
4. 15% GST on a broader base – increasing the statutory rate of GST to 15 per cent and extending the coverage to include fresh food, health and education. In 2015-16, this is estimated to raise an additional $42.9 billion in GST revenue. This additional revenue is used to abolish insurance taxes, stamp duty on motor vehicles and all conveyancing stamp duty. Any remaining additional GST revenue is returned to households through personal income tax cuts and welfare payments.

While these scenarios show that there are potential benefits associated with GST-led tax reform, it is acknowledged that the final design of tax reform must take into consideration many other factors. These would include, but not be limited to, assessment of other options around tax mix switches, welfare impacts across different socio-economic groups, fiscal implications at all levels of government (including the implications on horizontal and vertical equalization), and implementation issues such as grandfathering, and compliance costs.

Relevance of the Australian experience in GST to the situation in India

India's current taxation system is complicated and difficult to administer. For example, the central government has the ability to tax the final consumption of services, but not goods. States have the ability to tax the final consumption of goods, but not services. While the central government has the legal ability to levy taxes on interstate transactions, the home State can collect and retain the tax revenue.

The Indian Government recognizes some of the problems in the taxation system and has plans to reform aspects of it with the Direct Tax Code and the introduction of a goods and services tax. However, the Indian experience with tax reform, like Australia's, is not a straightforward one and negotiations are still underway. Over a long term there are improvements across the macroeconomic variables but there were short term glitches. Inflation did seem to rise in the years of introduction but was mainly blamed on the administration for the same. The impact on revenue and current account has been very impressive with sharp gains seen in all the three economies. In Australia there was a more dramatic impact of GST on the economy. Before GST's implementation, consumers rushed to purchase goods that they perceived would be substantially more expensive post-GST. After the tax, consumer consumption and economic growth declined sharply initially. In Q1 2000, Australian economy recorded negative economic growth for the first time in more than 10 years. Consumption and growth soon returned to normal. There was some negative impact on price of real estate as well but the market rose and property prices and demand increased sharply in 2002-04.

Conclusion

To meet its changing needs, the Australian government is keenly looking at tax reform to shore up its revenue model. There seems to be an inevitability that the Goods and Services Tax (GST) will increase from 10% to 15%, but the application of the increased revenue divides the two side of politics. While Labor would like the funds to go towards education and health, the Coalition prefers the monies be spent on decreasing personal taxes. While the debate rages on and keeping in view the rolling out of GST in India a group of State Finance Ministers from India visited Australia recently to study the GST system of Australia. Their main interest was the sharing of the revenue model between the Central and State governments. In this connection, a delegation of 13 State Finance Ministers and their representatives including those from Maharashtra, Tamil Nadu, Kerala, West Bengal, UP, Andhra Pradesh visited

cont...on page no.31

VAT : The European Experience

- MEDC Research Team

BACKGROUD:

The tradition of tax system similar to VAT known as turn-over taxes has long been persistent in Europe the only difference is turn-over taxes, taxes intermediate especially capital goods. Dating back to the tax system imposed by the Greeks in the 5th century. General fees on stamps on goods and services were particularly more popular in Spain, France and Germany. In 1918 a German industrialist "Wilhelm von Siemens proposed a very early structure of modern VAT allowing certain deductions from the gross turnover taxes. His idea of VAT went unnoticed for almost 30 years. All European taxes in the inter-war period were levied on the traditional system of taxation. Due to its serious disadvantage i.e. Burden of taxes on the commodity depends on number of production process through which it is passed, the vat proposal of Wilhelm von Siemens was reconsidered. In 1954 France became the first country to introduce VAT popularly known as Taxe Sur La Valeur Ajoutée. With passing years the harmonization of turn-over taxes i.e. the tax types, tax bases and tax rates, was put on European agenda.

Tax Harmonization in EU:

Tax harmonization has been one of the very difficult issues in EU. Tax harmonization as the name suggests is the agreement and application of common rules for taxation across the entire Europe union. Tax matters have been very well explained in the treaties since the beginning of the Union but the provisions have been closely linked to member states and protected according to the requirement and legislative procedure which keeps tax matters closely under the control of council. In EU each member state had the freedom to decide its own tax rates while trading

The development of community-wide taxation of international commodity dates back to the times of ECSC treaty of 1951. The major drawback of this treaty was that it excluded the question of border taxes and vaguely talked about removing tax barriers and therefore the high-authority of EU appointed a panel of experts to inquire into the consequences of taxing the intra-community trade

Taxes can act as tariff barriers in international trade they are not only influenced by technical trade barriers but also commodity taxation and therefore a legal framework for harmonization of tax was required smooth functioning of custom union. The fact that un-uniform tax rates leads to difficulties in intra-community trade was recognized well before in European integration the Tinbergen community was the very first expert committee to handle the unresolved issues of commodity taxation. Particularly on different turn-over tax system applied within the common market. And one of its mandates was to assess the effects of two taxation principle namely The Destination Principle and the origin-principle

Under the destination principle commodities are taxed in the country consumed Exports are free of taxes and imported goods are subject to sales taxation once they cross the border. The origin principle, in contrast, taxes goods and services in the country of production, and the revenues are distributed according to the value added in each country. Commodities produced in one Member State would bear the same tax burden within the EU, irrespective where they are consumed. Under this principle, no border adjustments are needed, making it more consistent with the operation of a common market

Tinbergen arrived at the conclusion that both the principles are equivalent under certain conditions provided that tax is applied to all the products at uniform rate and same tax principle is adopted by all the industries i.e. In case of general taxes the origin principle may have the same effect as that of destination of principle and, the only difference would be exchange rate. Since exchange rates were not flexible Germany was reluctant to introduce VAT. While the report recommended abolition of border tax for the steel sector only. However the recommendations of report were accepted and Germany had to surrender.

Treaty of ROME:

The treaty of Rome founded the European Economic Community in 1957 here the application of gross turn-over taxes in all the EU-member states except France became a major problem in determining the tax rebated under destination principle. In 1960 the EEC commission appointed fiscal and financial committee under the chairmanship of Fritz Neumark to study the differences in the member states tax system and make harmonization proposal if necessary. The committee recommended replacing the gross-turnover tax existing in Germany Italy and other member countries by VAT. At EEC inception there were four types of turn-over taxes one was multi-stage cascade system prevalent in Germany, Luxemburg and Netherlands where tax was levied on gross value of commodity at each stage of production without any rebate, VAT prevalent in France levied at each stage of production third was mixed system prevalent in Belgium and Italy and fourth

was purchase tax prevalent in UK. Although this system had a common treatment of trade, with no tax paid on exports and tax levied on imports at point of entry. This cumulative system involved distortions.

Creating the European VAT:

The after effect of the treaty of Rome is rather fair. Due to the intentionally unclear formulations in the legal text, many questions were left unanswered. For e.g., the rather arbitrary determination of border tax adjustment rates in countries with cascade (gross-)turn-over taxes opened ample possibilities of discrimination: a true tax content on a commodity below this rate caused an export subsidy or import discrimination. In the years following the treaty of Rome, some countries, especially Italy and Belgium, made extensive use of cunning possibilities almost certain to happen; the questions of common turn-over tax system became the focus of interest.

Persistent quarrel about the turn-over tax in the end of 1950's made the EEC commission think seriously about the final solution about the problem. The commissioner on affairs of trade issues, 'Von Der Groeben," appointed a fiscal and financial affair committee", which was chaired by German economist Fritz Neumark. There group of economist was suppose to clarify the basic questions of unified turnover tax law for Europe. In addition to the committee, a task force of three sub-group (A, B and C), with experts and practitioners from national administrations was established.

This Fiscal and Financial Affairs Committees report popularly referred to as Neumark report is a landmark in European tax harmonization history. It established the idea that the European tax integration should be understood as continuous process in accordance with the general growing up of the member states, i.e. should not be a one-time undertaking. Consequently, the Neumark report developed a step-by-step plan in which the necessary measures were ranked in order of priority. The first and most important step was that none of the member states the EEC maintains a cascade system of gross -turn-over tax ". All EEC members should introduce vat as already existed in France.

There was abroad agreement in favor of an all stage, non- progressive turn-over tax. Possible alternative such as one-stage retail tax a wholesale tax were without opposition rejected by members of Neumark committee. A much more controversial discussion aroused about which was the most practicable and theoretical superior method of calculating tax liabilities. The basic choice was between the credit of invoice method on the one hand and the subtraction method on other. Under the former, each taxable firm may deduct the tax paid on its purchase of intermediate and investment goods from the tax that is due on its sales. Under the subtraction method, the firm deducts its outlays from its sale and applies the tax rate to the difference

The Neumark committee itself consisting almost renowned group of academics, favored the subtraction method it was argued that only this method would lead neither to tax revenue shifts nor to trade distortions one to the origin principle had been introduced. Task force subgroup C, however, composed of tax experts from member states and the commission, was in favor of credit method.

The supporters of the subtraction method in the Neumark committee build their arguments on two fairly unrealistic assumptions. First, the pre-supposed a far- reaching harmonization of tax rate within the EEC. Second, they believed that the origin- principle would be realized shortly. The practioners in sub- group C may have realized that an immediate transition to the origin-principle was not a very realistic prospect in view of strong prevailing national interest(especially the fear of revenue losses)more-over, they were well aware of the reservations over rate harmonization between member states. In their view, the credit- method was the superior method of tax calculation under the destination principle, especially because correct border tax adjustments were possible even if the tax rates were differentiated within and between countries. As is well known, the EEC committee decided in favor of credit method. As they believed that this decision was more correct and was far-sighted

Based on the findings of Neumark report and the joint report of ABC subgroup, the EEC commission in November 1962 proposed a three stage procedure for harmonizing of turn-over taxes. During the first stage, member states would replace their gross- turn-over tax with Vat during the Second Stage a Common vat would be introduced. Finally in the third stage the abolitions of fiscal frontiers were at stake. After intensive discussion in European parliament and the council of ministers, the later adopted First and the Second Directive both dated April 11 1967

The First Directive required all member states except France to replace their existing tax with vat not later Jan 1 1970. The second directive gave a more detailed, specifying the technical details of EU Vat System, utilizing the credit method and destination principle For good reasons the introduction of this two vat directives was celebrated as a great success of European integration. the first countries to comply with France and Germany in the case of France the change in tax system was less dramatic and required little adjustments although Luxemburg and Netherlands introduced their vat in 1969, i.e. within the appointed time, Belgium and Italy were rather reluctant to introduce new tax. They complied only after several postponements. By 1973 all EEC member states including the new

entrants i.e. demark Ireland and United Kingdom's introduced VAT

VAT treatment of agriculture, the deduction of import taxes, the existence of exemptions and the taxation of services across the frontiers were the most obvious problem areas, requiring the further harmonization efforts. But there was another, perhaps more crucial reason to achieve closer harmonization of national vat laws which was initiated in 1970's in which the council decided to rely on its own resources rather than rely on financial contributions from the member states. From 1975 on, the EEC budget would comprise agricultural levies, custom duties, and a 1% levy on a VAT tax basis, determined in a uniform manner for all member states.

Against this background, the Sixth Vat Directive of May 17, 1977 was a further landmark on Europe's way to a universal VAT which proposed common basis for assessment of VAT; it had been approved by the council in 1977 and has been implemented in all member states in 1977. Furthermore the Sixth Directive provided special provisions for farmers, travel agencies and second hand sales and listed allowable exemptions including postal's, medical, social, educational and cultural services. In the following years around 15 more directives were submitted to the council of ministers of which some have been adopted and some struggled with minor issues in detailing. The twentieth directive however, authorized Germany to compensate its farmers by which higher Vat credits for income losses from agricultural policy.

The Ongoing Debate since 1985:

1980 was seen as the beginning of new- European era. it was a time when the frontiers between France Germany and Italy were blocked by long distance lorry drivers for many days and week making it clear that border controls were still present and obstructing the trade within the community . European commission under the new president Jacques Delores published a white paper which lays out the necessary measures to remove physical barriers, technical barriers and tax barriers which was adopted by the council and enacted by parliament. In 1986 EEC treaty was revisited Legal basis for creating internal market was laid changes made were aimed to increase the community power in the field of indirect taxation and the measures adopted required the commission to complete the work by December 1992. Harmonization of indirect tax was seen as a pre-requisite for functioning of single market the commission considered the harmonization of indirect tax as one of the key to the completion of internal market.

In 1987 commission issued a proposal in describing the clearing system in great detail under this system the trader has to maintain a record of both VAT paid on his imports from other members and charged on his exports and collected in domestic currency And made clear with what needs to be done in this field. with its courageous program for the single –market, the commission had added speed to European Union integration, the setting of a deadline for removal of border controls.

Problems relating to legal construction of vat system. Changes were needed once these physical borders were eliminated. The conditions that tax system in countries should be same in terms of base, rules and rates should be balanced, in absence of these situations the original and destination principle will lead uneven distribution of tax burden. Maintain destination principle requires border tax adjustments without frontiers control required to shift to origin-principle. In absence of equivalence conditions both systems involve potential jurisdiction and distortions problem. The EEC decided to use the destination principle for purchases for the transitional period of four years and at the same time physical border controls were abolished by 1993, allowing un restricted cross-border transactions. In 1991 council already decided an appropriate VAT rate structure and level in community. Here too commission has given up its original goals. According to the council compromise member states have to apply a minimum standard rate of 15%. They however require minimum reduced rate 5% to a limited list of goods and services. Countries with lower reduces rates including zero-rates may retain these. This tax rate diversity seemed tolerable because the transitional system largely maintained the destination principle. Rate adjustments in order to prevent trade distortions were not considered to be as urgent as under origin principle.

VAT Rate Structure Debate:

European Union has still long way to go to implement the Vat structure drafted in the White Paper all countries respect the standard rates. However lower rates vary from 0-10%. With majority of the countries working at multiple- VAT rate and long list of exemptions make the compilation more difficult. The extent to which there is variations in the rates represent problems regarding the cross-border transactions. Evidence suggest that its magnitude diminishes rapidly with distance .similarly abolitions of border controls have not bring about much needed change to the problems of cross-border transactions. In fact UK had argued that multiple rates lead to problem in compilation of VAT. The suggestions for controlling this problem differ from tightening up administrative arrangements to altering the VAT principle. The analyses leads to the conclusion that harmonization of tax rates should enable the smooth move to the origin-principle

UK AND VAT

In July 1961 United Kingdom's opened its membership negotiations but was rejected membership twice in

1963 and 1967 by the French prime-minister De-Gaulle, who was of the view that UK was economically too weak to be considered as a member state of union. Finally with Georges Pompidou coming to power at in 1968 UK made an attempt for the membership and finally the rejections were lifted and UK was admitted to union in 1973 along with Denmark and Ireland.

EU membership and UK politics:

Though it is true that UK advocated the integration of the European continent but, it then never intended to join the union. European integration was supported by many important British voices and one of them was Winston Churchill who was one of the early aspirer of the European union but Britain just being linked and not absorbed. The reservations were less economical and more political. Thus the American relationship, the common wealth nations and the domestic policies were the pre-conditions for Britain to join EU.

The Suez crisis of 1956 became the eye-opener to British-US soured relationship which happened to be the major loss for UK. Joining EC then seemed to be the only possible solution to improve its relationship with US. The reason which Britain has cited for not joining EC. The relationship developed into the prime reason to favor its entry into EC . It joined EFTA(European Free Trade Association) in 1960. The only difference between EFTA and EEC was absence of common external tariff Initially the trade was undergoing a noticeable shift in position. UK received cheap food and raw material and common wealth nation received industrial goods but it was difficult to trade outside area because it they had to change currencies and had much less control. Britain has more trade with common wealth nations than its European counterparts which became the major reason of economic problems in Britain. In 1960 Britain had worst balance of payment for decades and to top it off was the major sterling crisis of 1961. Many saw the solution to the British economic crisis in her entry. Which would provide necessary support in the form of economies of scale, technological co-operations and an increased market. The common wealth nations further became the political motivators of the Britain to join EC. With the Suez crisis the influence of Britain in common-wealth nations began to deteriorate. Members of common wealth nations were consulted before application was made their interests were dealt with the negotiations.

In 1961 United Kingdom opened its membership negotiations with EU but however was denied membership by the French prime-minister De-Gaulle in 1963 as he was of the view that UK was economically too weak to join EU which came as a devastating blow to Harold Macmillan the then prime-minister of UK. UK was by now had faced many economic and political debacle. In 1968 Georges Pompidou came to the power and the veto were lifted against UK and was welcomed as the member state in 1973 under the conservative government headed by Edward Health along with Denmark and Ireland.

EU's membership was not the whole-hearted move for the British. Though parties agreed initially to the common-market. But the effects of membership are complex. At one point integration into the continental legal framework of EU stands as a major challenge to parliamentary sovereignty. Even though some leaders or political thinkers within the parties didn't mind exposing Britain to the culture of the treaties but not all were ready to sacrifice the sovereignty that followed therefore the question of sovereignty raised its head initially when UK joined.

BACKGROUND OF VAT IN UK:

VAT came into force in 1973, introduced by Lord Barber, the chancellor under Sir Edward Health as one of the condition to join EU. VAT replaced Purchase Tax which was a form of consumption tax in UK since 1940. Purchase Tax is levied at different rates depending upon the "Luxuriousness of goods" and initially applied at the wholesale stage at the rate of 331/3% and then was increased to double at the rate of 661/3% and then shot up to 100% before reverting back to 331/3%. Unlike VAT Purchase Tax was levied at manufacturing and distribution point rather than at the point of sale. The major drawback of this tax system was that it had narrow based and many goods were excluded from its coverage

As each EU member state can introduce its own VAT states UK has 3 rates namely, Standard Rate, Reduced Rate and Zero-Rated Rate. Standard rate is applied to most of goods brought from the business. Reduced rate is applied to children's car seats, gas and electricity for home and goods that are not subjected to VAT come under the categories of Zero-Rated Tax.

Initially VAT was introduced at rate of 10%. With exception on petrol and electrical appliances which was subjected to 25%. The wide difference between the two rates created a range of difficulties in administration f tax revenue. It was reduced to 12.5% in 1976. With difficulties still persistent with the administration the therefore in 1979 the chancellor of conservative government "Geoffrey Howe" abolished higher rate and merged the two rates into one single rate of 15%. This rate remained unchanged until 1991 and then it was increased to 17.5%

During 1992 the conservative government in power announced domestic fuel and power which were previously zero-rated and tax levied would be 8% till 1994 and than the standard rate of 17.5% will be applied from 1995. But however this

increase didn't materialize as govt lost vote in parliament.

In 1997 general elections one of the intentions of the labor party government was to reduce the VAT rate on power and fuel from 8% to 5%. The tax base of the VAT has also been increased since 1973. The difficulties subjected to goods and services to VAT continued to cause problems and another major change was imported services became taxable since 1978. Another issues which was quiet noticeable was meals eaten at restaurants were charged VAT and take-away meals were not which included British staple fish and chips. The result was a significant shift from restaurants to take- away services and VAT was then extended to take-away meals from 1984. VAT has now been in uk for almost two decades and raises almost 1/5th of total revenue of all governments.

Reasons for Introduction of VAT:

In the UK, the Government announced its intention to introduce a VAT some two years before it was to be operational. A Green Paper was published setting out detail of the proposals so that consultation could take place with those who would be affected by the new tax. The reasons put forward for introduction of VAT were:

- Its broad base
- Levied on consumption
- Promoted harmonization
- contribution to the bop policy
- Was self enforcing

This was considered to be the general consensus of VAT within the government. historically, indirect taxation developed as a taxation for goods rather than services for the most obvious reasons in less developed economies goods were more visible than services and service sector in such economies was comparatively less developed as those of in advanced economy. In UK goods were subjected to purchase TAX but over the period of time goods as a proportion of economic output declined with its tax base. With passing of time taxation on goods and not on services became an obvious reason for debate as service sector expanded rapidly so to bring a balance in UK this lead to introduction of Selective Employment Tax by which the payrolls of the employees were taxed, which were then used to refund the manufacturing industry. Therefore the green paper proposal was a signal by the government for more non-discriminatory form of tax. Therefore VAT was seen more as a solution to distortions to multiple tax rates for different economic activity.

Though initially vat did not met the political acceptability many concessions were made either by exempting items from vat or by subjecting them to Zero-rate of VAT . The effects of VAT on the distribution of income turned out to be less adverse than some had thought of . Much of this was a result of ensuring that certain items such as food were free of tax whereas tax was levied on many forms of consumption that tended to be more the exclusive of those on higher incomes.

Arguments against VAT :

There were two main arguments against introduction of vat in UK one was possible effects on prices and wages and second was compliance and administration cost of vat was higher than those of purchase tax and SET tax

The experience of VAT currently is that the prices and wages issue does not have the significance it once had. This is partly understandable since the impact of a new tax is likely to be very different from one that has been established for over three decades. Furthermore, there has been a shift in the prevailing view regarding economic policy on these matters. In the period up to the introduction of VAT it was commonly thought that government could and should influence such variables as prices and income but the failures of such policies contributed to a more market-based philosophy and a much lighter hand of government in these matters. The Second argument - the higher administrative and compliance costs proved to be correct but in the longer run these costs did not turn out to be as high as some had predicted. Replacing Purchase Tax and SET with VAT led to an increase in the number of taxpayers from 74,000 to 1.4 million and an increase in the number involved with the administration of these taxes from 2,000 to 12,500. In terms of the arguments originally put forward for the introduction of VAT the outcome has been to certain extent successful. Although limited, the tax was broadly based without some of the problems associated with its tax system earlier. Furthermore the disadvantages have not proved as bad as some had claimed. VAT has proved to be a useful and robust tax and is one of the biggest sources of tax revenue in the UK.

Lesson to learn for INDIA:

THE trends of shifting to vat is prevalent globally therefore When introducing a VAT regime, policymakers should find a balance between the interests of government, businesses (the unpaid tax collectors), and citizens. The EU VAT system has much strength and meets best practice standards regarding the definition of taxable person, the scope of application of VAT to all transactions, and the place of taxation. It also results in high tax revenue to governments, but revenue isn't maximized. Therefore India should take these developments into considerations when introducing GST

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Philippines Experience with VAT

- MEDC Research Team

Goods and Service Tax (GST) or in some countries also known as Value Added Tax (VAT) is a common, stable, flexible and modern tax. It is a multi-stage consumption tax with credit facilities. It is undeniable that countries implying GST always encounter growth. Nevertheless, the extent of the impact varies depending on the governance, compliance cost and economic distortion. Most countries that impose VAT have experienced raise on the average of about 25% in their tax revenue. VAT was one of the most important fiscal innovations of the second half of the 20th century.

Not all countries have experienced a national growth after implementing the GST. There are studies which show that implementing GST will induce the Gross Domestic Product (GDP), provides revenue to the Government and ensures liquidity of the treasury. But not all countries implementing the GST are able to generate revenue. Instead, it cost losses to the National Income due to unwarranted administrative compliance costs and avoidable distortions.

In Philippines, it is a form of multi-stage sales tax on consumption levied on the sale, barter or exchange and/or lease of goods or properties and services in the Philippines and on importation of goods into the country. With the advent of the value-added tax (VAT) in 1988, a massive campaign program aimed to promote and encourage compliance with the requirements of the VAT was launched. The adoption of the VAT system was one of the structural reforms provided for in the 1986 Tax Reform Program, which was designed to simplify tax administration and make the tax system more equitable. It was also in 1988 that the Revenue Information Systems Services Inc. (RISSI) was abolished and transferred back to the BIR by virtue of a Memorandum Order from the Office of the President dated May 24, 1988. This transfer had implications on the delivery of the computerization requirements of the Bureau in relation to its functions of tax assessment and collection.

Tax effort has always been dismally low in the Philippines. It had been practically flat at around 11.1 percent in the first half of the 1980s. After the overthrow of the Marcos dictatorship, the Aquino government implemented a tax reform program in 1986. Some 29 tax measures were introduced including:

- The introduction of a 10% Value Added Tax (VAT) in place of various sales taxes;
- An additional 20% VAT imposed on luxury goods;
- A unified tax schedule for compensation and professional income;
- Personal exemptions were increased to spare those below the poverty line;
- The dual rate of 25 and 35 percent tax on corporate income was replaced by a uniform rate of 35 percent;
- New taxes on franchisees

The value added tax replaced the following taxes

- Annual fixed taxes
- Original sales tax on manufacturers and producers
- Turnover tax on subsequent sellers
- Advanced sales tax
- Compensating tax on importation of goods
- Miller tax
- Percentage tax on contractors, brokers, leasers of personal property/ cinematographic films
- Excise tax on certain articles.

Studies have shown that VAT collections were consistently higher than that which would have been collected in other percentage tax system. For the period of 1988-2003 VAT collection was PHP 98 billion higher than the old sales tax (percentage tax). The passage of Value Added Tax Law amended 21 sections of National Internal revenue code of 1997, these amendments involved expanded coverage of VAT that resulted in lifting the exemption for some professionals, natural gas, coal, petroleum products, and increased the VAT rate by 2% from February 2006, under certain conditions. If collected, it expected to add additional revenue of 0.5 of GDP for 2005 and about 1.7% of GDP on a full basis in 2006.

From 1996 to 2005, the following were the revisions to the law:

- 1996: R.A. 7716 – Expanded VAT (EVAT) Law (inclusion of sales, barter, exchange or lease of intangible and real properties; and sale of services in the Philippines by a non-resident person)
- 1997: R.A. 8241 – Improved VAT (IVAT) Law(restoration of certain operators under the coverage of the common carrier's tax)
- 1998: R.A. 8424 – Tax Reform Act of 1997
- 2005: R.A. 9337 – Expanded VAT Act of 2005(expands the coverage of the VAT to include previously exempt services and commodities such as electricity and petroleum products at a time of skyrocketing oil prices. It also limits the input VAT credit to 70 percent of the output VAT and increased the VAT rate by from 10 to 12 percent in January 2006. It also temporarily raised the corporate income tax rate to 35)

On September 1, 2005, the Supreme Court declared Republic Act (R.A.) No. 9337 (the new value added tax or VAT law) as valid and constitutional. R.A. No. 9337 is projected to generate, for the government, additional revenues of PHP 64.3 billion annually.

This Act which is a consolidation of House Bill No. 3555, House Bill No. 3705 and Senate Bill No. 1950 was finally passed by the House of Representatives and the Senate on May

11, 2005 and May 10, 2005, respectively. But it was imposed a temporary suspension by the Supreme Court a few hours after it went into effect on July 1 because of a petition from opposition lawmakers questioning its legality.

As a response to this allegation, Bunye emphasized that the measure "underwent rigorous and tight scrutiny in the House (of Representatives) and in the Senate" before it was finally enacted and signed by President Gloria Macapagal-Arroyo into law as Republic Act No. 9337 last May 24.

The suspension, however, was considered as a victim of the rift between the administration and the political opposition over the corruption and election fraud charges against President Arroyo.

This delay in the EVAT Law, according to a Business World Research article, worsened the budget deficit; foregone revenues are estimated to be around P5 billion. Aside from the lost revenues, it also resulted in a credit rating downgrade from agencies such as Moody's, S&P, and Fitch.

Following almost four-hour deliberations, the highest tribunal released the decision around 2 p.m. of October 18, 2005 after months of suspension, allowing President Gloria Macapagal-Arroyo to raise the sales tax rate from 10 percent to 12 percent revenue-increase measure.

The law was enforced on November 1, 2005. To increase awareness on the law tax campaigns and other events were organized in different parts of the country. Bacolod EVAT awareness road-show was kicked off in January 13, 2006. Finance Secretary Margarito B. Teves led top government officials from various government agencies in explaining features of EVAT and its impact on the prices of basic commodities

The Expanded value-added tax (E-VAT) law was instituted as a measure to bridle the rising foreign debt of the Philippines and to improve government services such as education, health care, social security, and transportation. It forms part of the package of measures Malacañang had endorsed to help shore up the government's fiscal position and reverse the credit rating downgrade certain rating agencies had given the Philippines.

This law was made on account that the more taxed a government can collect, the more services and programs of the government can be implemented as infrastructure projects. The EVAT law granted President Arroyo the stand-by authority to raise the tax from the current 10 percent to 12 percent under certain conditions. This would help in increasing government funds and helps alleviate government deficit so that an inflation rate and unemployment can be overcome. The president stated that the P120 billion expected to be generated a year by the measure represents an unprecedented revenue increase in the country's fiscal history.

President Gloria Macapagal Arroyo stressed that this law may entail sacrifices in the short term due to the tax increase imposed on sectors of society but its long-term benefits for the country and the Filipino people will be immeasurable and far-reaching in the form of more jobs and livelihood opportunities, better social services, more infrastructures, less debt, and more and better financing for rural programs. This is part of the steps undertaken by the Arroyo government to pave the way to for the plan to build a strong Republic "that will make the Philippines a first world country in 20 years with a permanent environment conducive to sustain wealth creation."

The new tax measure was expected to bring the government an extra 2 billion-3 billion pesos (36 million to 54 million US dollars) in monthly revenues in 2004, which can ease the deteriorating budget deficit and national debts dragged by rising oil price and consistent political turbulence. The government expects at least 80 billion pesos to be resulted from the law the succeeding year, helping reduce the country's budget deficit to 125 billion pesos, or 2.1 percent of the gross domestic product.

In the five cases separately filed before the Supreme Court, petitioners claimed that R.A. No. 9337 is unconstitutional because of Breach of constitutional procedures by the bicameral conference (Bicam) committee. The Supreme Court dismissed the petition and upheld the constitutionality of R.A. No. 9337.

The SC ruled that the 12% VAT rate does not impose an unfair and unnecessary additional tax burden because the alternative conditions therefore are anchored on the principle of fiscal adequacy.

The implementation of the reform VAT law (R.A. 9337), helped the government to simplify tax administration and promote efficient tax collection and monitoring of tax payments by the Bureau of Internal Revenue (BIR) through the VAT sales invoice or VAT official receipts. The government expected to foster honesty in tax payment for businessmen would demand receipts from sellers to accumulate more input tax (the tax payed by a person passed on to him or her by the seller, when the person buys the goods) that can be credited against output tax (tax due from the person when he or she sells goods) payable.

The Philippine government has signaled a strong commitment to fiscal consolidation by developing medium-term fiscal framework supported by submission and passage of a comprehensive new revenue bill, while pursuing continues expenditure management. The reform Value added Tax Act 2005 raising the tax rate from 10% to 12% and removing some exemptions has already been put in effect. Some individuals or groups continue to call for major amendments or even outright abolition of the reform VAT law. But looking into its advantages, there are good reasons why the government prefers this tax for revenue generation.

The VAT reform itself is found to be generally progressive and well targeted. The tax mitigating measures were successful at alleviating the effect of the reform on households in general, but a large amount of the benefits accrued to high income groups. The planned

social spending increases are likely to be more successful in reaching the poor, depending on their exact composition.

A study on the relation between GDP and the household final consumption expenditure, general government consumption expenditure and the consequences of implementing GST in Philippines, Singapore and Thailand states, a percentage change of increase in household final consumption expenditure will increase the GDP by 0.549176% and a percentage of increase in general government consumption expenditure will result in an increment of GDP by 0.484865%. The study further states that if all other variables are fixed, the GDP in the Philippines was reduced by 16.4259% after implementing the GST. The post-GST monthly inflation rate in Philippines did not recede to its pre-GST level until September 1992.

The urgency of the fiscal crisis in 2004 was used to justify the reformed VAT law rather than push for a decisive policy on dealing with the debt overhang and eliminating redundant fiscal incentives because the latter were considered politically untenable. The VAT reform, including the mitigating measures, is expected to bring about 1.3 percentage points of GDP in additional revenues annually

Prior to the 2005 VAT reform, the Philippines VAT was levied at a standard rate of 10 percent. Zero-rating and exemptions were limited with a number of important exceptions. In addition to a standard zero-rating of exports, a zero VAT rate was also applied to services paid in foreign currency and the supplying of goods and services to exporters. The economic sector that benefited most from the VAT exemptions was agriculture, broadly in line with its tax treatment in other developing countries. Non-standard VAT exemptions included petroleum products and raw materials; power generated by electric cooperatives; sales by cooperatives other than agriculture, electric, or credit cooperatives; sales by artists of their works; and vessels of more than 5,000 tons and spare parts thereof. VAT receipts were low, both compared to the potential and to collections in other countries in the region. VAT productivity, measured as the ratio of VAT revenues to GDP divided by the standard rate, was only 31 percent, compared to a 40 percent unweighted average in the Asia-Pacific Region (Table 4). The low productivity partly reflected the importance of the VAT-exempt agriculture in the Philippines, but also problems with tax administration, and the exclusion of other important sectors, such as the energy sector, from the VAT base.

The VAT reform reduced poor households' income by a moderate amount and was slightly progressive. The average gross reduction in household consumption was estimated at 2.5 percent. Households in the bottom quintile incurred a 2.4 percent reduction in real consumption, while households in the top quintile lost 2.7 percent. This finding is consistent with the consumption patterns of poor households, who tend to rely more on unprocessed agricultural products that are exempt from the VAT.

The reforms raised the tax-to-GDP ratio from 12.4% in 2002 to 14% in 2007 was brought down from 72.5% of GDP to 55.8% over the same period. The better fiscal position gave room for the stimulus package to mitigate the crisis impacts since 2008. The economy has shown a strong recovery and the GDP growth rate reached 7.3% in 2010, the highest in the last 34 years. However, the impact of the 2005/06 VAT reforms was short-lived, as the tax-to-GDP ratio has begun to decline and fiscal pressure has been growing since 2009. While the stimulus spending and post-calamity restructuring expenses after tropical storm Ondoy in 2009 contributed to the larger deficit, an aggravating factor lies in the country's weak revenue mobilization capacity. The combination of accelerating spending and weak revenue collection drove the fiscal deficit to 3.9% of GDP with a debt-to-GDP ratio of 57.3% in 2009. Tax revenues were eroded to 12.8% of GDP in 2009, the lowest since the 2005/2006 tax reforms.

Philippines and India are actually comparable in many ways. They have a fair share of their own similarities that include having a relatively overpopulated country, low GDP per capita, and low rates of development. For the past decades, both of these tax systems underwent thorough changes and reforms in attempt to fix their respective structure and systems.

Such changes include widening the tax base, increasing or decreasing tax income tax rates, providing tax incentives and many more. The tax systems of both countries are bounded by their countries respective constitutions and laws. The Philippine tax law is based on the National Revenue Law with its latest version is manifested in the Republic Act No. 8424 or the Tax Reform Act of 1997 (Bureau of Internal Revenue, n.d.). The tax law of India is bounded by its Constitution. Both the Philippines and India have similar governing body which overlooks the tax system of both countries. For the Philippines, the Bureau of Internal Revenue or BIR under the Department of Finance is the main responsible for the tax collection of the country. The Indian counterpart of BIR is the Department of Revenue under the Ministry of Finance.

There is considerable expectation in India that the new government at the centre would activate the reform process to introduce the goods and services tax (GST). GST is a value added tax (VAT) on both goods and services, as against the prevailing VAT on only goods. The important gains from the GST reform are that it is expected to broaden the tax base, reduce distortions in the economy through a more comprehensive input tax credit, enhance export competitiveness by comprehensively relieving domestic consumption taxes on exports, ensure greater regional equity by getting rid of inter-state sales tax and having a destination-based tax, and help create a seamless national market by removing inter-state trade barriers.

The dual GST proposed to be introduced is expected to expand the

tax bases and simplify and harmonise the conception tax systems presently levied at both central and state levels. Given the federal structure of India and the fact that taxation powers have been constitutionally assigned to different governments, the introduction of a GST would be a major indirect tax reform since independence. Both the federal and state governments will have concurrent taxation rights at every stage of production and distribution.

A GST would be an improvement as it would reduce cascading of taxes — that is, tax being applied on top of other taxes at every stage of the production process — and transaction costs associated with interstate sales of goods. This could facilitate achieving a seamless common market. As a result, a GST would enhance economic growth by attracting investment and releasing working capital.

If international experience is anything to go by, it is unlikely that a faultless GST will be designed and rolled out in India as a single event. But some structural faults could easily be addressed and rectified. Given the diversity involved in design and administration, an Indian GST will be unique. How successful it is in terms of compliance and revenue mobilisation will largely depend on the provision of incentives for tax invoice based transactions and the simplification of tax administration.

Implementation of a comprehensive GST across goods and services is expected, ceteris paribus, to increase India's GDP somewhere within a range of 0.9 per cent to 1.7 per cent. The corresponding changes in absolute values of GDP over 2008-09 is expected to be between Rs. 42,789 crore and Rs. 83,899 crore, respectively. The comparable dollar value increment is estimated to be between $9,461 million and $18,550 million, respectively. The additional gain in GDP, originating from the GST reform, would be earned during all years in future over and above the growth in GDP which would have been achieved otherwise. The present value of the GST-reform induced gains in GDP may be computed as the present value of additional income stream based on some discount rate. We assume a discount rate as the long-term real rate of interest at about 3 per cent. The present value of total gain in GDP has been computed as between Rs. 1,469 thousand crores and 2,881 thousand crores. The corresponding dollar values are $325 billion and $637 billion. Gains in exports are expected to vary between 3.2 and 6.3 per cent with corresponding absolute value range as Rs. 24,669 crore and Rs. 48,661 crore. The comparable dollar value increment is estimated to be between $5,427 million and $10,704 million, respectively. Imports are expected to gain somewhere between 2.4 and 4.7 per cent with corresponding absolute values ranging between Rs. 31,173 crore and Rs. 61,501 crore. The comparable dollar value increment is estimated to be between $6,871 million and $13,556 million, respectively.

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contd..from page no. 22

Sydney. They met Premier Mike Baird, Treasurer Gladys Berejiklian and Minister for Trade Stuart Ayres. The delegation was also briefed on GST by Blair Comely, Secretary Department of Premier and Cabinet, and Dr Ken Henry, former Secretary to the Treasury. They also met other senior officials in Canberra. They were of the view that the GST framework is a very important reform for the country as it will take away a lot of inefficiencies in the system. They believe it will make the tax procedures fairer, and more transparent and efficient for producers and administrators.

From what they have learned from interactions with the Australian think tanks on how they implemented their GST here, the education of the public is very important. Another important takeaway is that Australia studied very closely the impact of their GST on the price index of various commodities. They made the expected price changes public and in turn had a regulator who could monitor this price impact and ensure if there were any savings that they were passed on to the consumer. That is an important learning for India. Goods and Service Tax is easily the biggest taxation reform in the country along with the proposed Direct Tax Code. In terms of macroeconomic reforms too, it will be at tops with the various reforms taken since 1990s. It will also serve as a useful case study for other economies which are contemplating to implement GST. The sheer scale of GST project to bring all indirect taxes in India under one fold is a major achievement and needs to be commended. The proposed GST is not the desired and true form of GST. But a single indirect tax cannot be done as India's federal structure has to be preserved. GST is also expected to bring many benefits to the Indian economy. Though, all these benefits are based on the assumption that overall taxation structure is less bureaucratic and cumbersome than present. The implementation is going to be crucial so that the promised benefits are realized. The Government also needs to be weary of inflation spurts in initial implementation phase of GST as pointed by experiences from international economies. Ideally, one should be first easing all these state-wide inefficiencies and then implement GST. However given the challenges in India, the policymakers are hoping GST will help ease these inefficiencies and eliminate them over a period of time.

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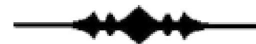

Consumption Taxes – The Logical Basis

Ms. Bindi Patel

Taxes form an important lifeline in any economy, since the principal revenue of any government comes from taxes. One may define taxes as, "Taxes are generally an involuntary fee levied on individuals or corporations that is enforced by a government entity, whether local, regional or national, in order to finance government activities. In economics, taxes fall on whomever pays the burden of the tax, whether this is the entity being taxed, like a business or the end consumers of the business's goods"- (Investopedia)

The classical economists were of the view that raising government revenue was the only objective of taxation, but however in the current scenario, the objective of taxation is changed. Apart from being the main source of revenue for the government taxes are levied to affect consumption, production and distribution with a view to ensuring the social welfare through economic development of a country. For example, taxes can be utilised for the economic development of a country in the following manner:

1. **Optimum allocation of resources :** Since taxes are an important source of public revenue, the imposition of tax leads to diversion of resources from the taxed to the non-taxed sector. The revenue is then allocated on various productive sectors in the country with a view to increasing the overall growth of the economy and therefore tax revenues may be used for development activities.
2. **Raising Government Revenue :** In the current scenario, the aim of raising revenues is not only for the purpose of meeting the administrative expenses of the government but also for ensuring social welfare. A part of tax revenue is utilized for social development activities such as healthcare, education etc.
3. **Reduction of Inequalities of Income & Wealth :** Most of the taxation policies follow the principal of equity. Most of the direct taxes are progressive in nature and some of the indirect taxes such as taxes on luxury goods are also progressive in nature. This means the wealthier the person the higher tax rate he pays, on the other hand the lower income group is either exempted from paying direct tax or has to pay lower rate of duty (indirect taxes) on goods and services consumed by masses. Thus taxation, helps to reduce inequalities of income and wealth
4. **Control Inflation :** Taxation may be used as a tool to control inflation. For example: If inflation is due to high prices in essential items, then the government may reduce the rate of indirect taxes. Subsequently, if inflation is due to increase in demand, the government may try to cut down effective demand by increasing the tax rate. Increase in the tax rate, may restrict consumption, which in turn may reduce demand and consequently inflation may be controlled

There are mainly 2 type of taxes, **Direct taxes & Indirect taxes.**

Now-a-days more countries are relying on indirect taxes for development. For most of the countries, indirect taxes form the main stream of revenue. Many developing economies, who have adopted economic planning utilize indirect taxes as their primary source of funding. There are different types of indirect taxes for example : service tax, excise duty, VAT, customs duty etc.

One of the indirect tax I would like to discuss about in this article is Consumption Tax.

A Consumption tax is a tax on purchase on goods and services. Consumption taxes can take the form of **sales taxes, tariffs, excise, VAT** and other taxes on consumed goods and services. Generally, consumption taxes are imposed on the buyer and paid to the seller of the product, which acts as a collecting agent on behalf of the taxing authority.

The main difference between a consumption tax and an income tax is that a consumption tax is charged on the goods and services that are consumed, whereas on the other hand, income tax is a tax that is levied on the income earned from either capital or labour.

Let's take an example: If a tax payer has gross wages of say Rs. 80,000 and he saves Rs. 20,000, then the taxpayer pays the consumption tax on only Rs. 60,000 whereas the taxpayer is taxed on the entire Rs. 80,000 in an income tax system.

While, there might be a debate on the fairness of each system, this article examines the merits and demerits of implementing consumption tax. Furthermore the article seeks to examine the effects of consumption tax in an economy and consequently briefly compare consumption tax with the income tax system.

To start off, let us first examine the pros and cons of the consumption tax system.

One of the significant advantages of the consumption tax system is that it encourages economic growth. By

allowing individuals and businesses to save money, the system encourages immediate investment which in turn becomes a catalyst for economic growth. Another advantage of the consumption tax system is, workers who are willing to work overtime wouldn't be taxed on the additional income they earn (unless the income is spent) and consequently the workers will be willing to work for more hours since the incentive offered to engage in additional labour is sufficient to compensate the loss of leisure.

It can also be argued that the consumption system would be considered equitable in comparison with the income tax system, since everyone would be paying the same amount of tax for any good or service that is consumed.

Consumption taxes also have economic advantages. First, it would not distort the consumer choice between present and future consumption. Second, it would probably increase saving, which in turn would increase investment, productivity and growth. Implementation of a consumption tax would also affect individual behaviour.

However given the advantages of implementing consumption tax there are some downsides with respect to such a system.

Firstly an excessive consumption tax affects an economy in the following ways. 1) Consumption tax discourages consumer spending 2) decreases business revenues and 3) by lowering the amount of tax that can be collected when economic activity decreases.

Another major disadvantage with the consumption tax system is the lack of progressivity. Since all the tax payers pay the same amount for the goods and services consumed, the percentage of the total budget compromised of tax will be less for wealthier individuals than for individuals belonging to the lower income households. Since tax would be only paid on the goods and services consumed, a situation could arise where the rich save all their income and land up paying no tax, whereas the poor families are forced to pay consumption taxes to fulfil their basic needs and therefore the tax would be more regressive in nature. Similarly, because only consumption is taxed there might be a possibility that the revenues from tax collections could become volatile in nature and wealthy taxpayers could essentially choose not to pay and save all their income. By adopting such a system, there are chances that the tax payers have greater control in the amount of tax they pay.

One of the other potential disadvantage of the consumption tax is that certain goods and services may be taxed at an exorbitant rate discouraging the consumer from purchasing the product. Furthermore the product might be abused in the market space consequently undermining a particular industry or a company. (Trends In State Taxation: Consumption Tax versus Income Tax- A Deloitte Report)

Now that we are given an overview of the various advantages and disadvantages of the consumption tax system & how it affects the economy, we will discuss a brief overview of the consumption tax system over the income tax system.

In the consumption tax system, people would be required to pay taxes on goods and services they consume. While this might seem a good idea in regard to tax evaders, those who make money through illegal means or who are paid under the table would no longer have a tax advantage, since they too would have to pay tax each time for any goods or service that they purchase. This helps in creating transparency in the system which is unlikely to happen with the income tax system, thereby creating a huge advantage.

Another perceived advantage to implementing a consumption tax rather than a tax on earnings is that it does not tax savings, it only applies to the money that is spent. However it creates a problem when people think of saving more instead of spending and putting the money into the economy. It might create problem for the government to get enough money when consumers save more of their cash in order to lessen the amount of taxes that they have to bear. Consequently, the rate of taxation might have to be raised in order to make up for the losses. (The Advantages & Disadvantages Of a Consumption Tax- www.wisegeek.org)

Another important aspect would be 1) getting people to save more and 2) getting people to work more so that when the younger population grows older they don't drop out of labour force. So if one is not taxing savings, then inevitably the tax burden increases on the labour. So if there is labour and capital and if capital is exempt consequently the tax on earnings has to go up and thereby switching to a consumption tax would ultimately penalize working.

And hence in the real world consumption taxes do not turn out to be much of a practical solution or rather shouldn't replace income tax.

Given the arguments of the various merits and demerits of consumption taxes over income taxes, a lot of thought needs to be given for the Goods & service Tax Bill to be implemented in India. Since the GST bill would not only have a significant impact on the economy but also on the entire workforce and given that 96% of the Indian population works in the unorganized sector all factors need to be taken into consideration before finally rolling out GST.

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