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Goods and service tax in India:
Present rates, expected changes and its implications

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Introduction

The need for rationalization of goods and service tax (GST) rate was discussed recently in the 45th GST council meeting held on 17th September 2021 with an objective of simplifying the rate structure and augment GST revenue. In this regard, a group of ministers on rate rationalization is constituted to look in to the following matters (i) review the supply of goods and services exempted under GST with an objective to expand the tax base and to eliminate the breakage of input tax credit (ITC) chain; (ii) recommend suitable rates to eliminate inverted duty structure to minimize the instances of refund due to inverted duty structure[1] and (iii) review the current slab rates and structure and recommend rationalization measures, merger of tax slabs required for a simpler rate structure and recommend changes to augment required resources.

These were also the recommendations of the fifteenth finance commission (15th FC). As per 15th FC report, the revenue neutrality of GST was compromised with multiple downward adjustments of rates from the rates as recommended by Report on the Revenue Neutral Rate (RNR) and Structure of Rates for the Goods and Services Tax, 2015 (RRNR&SRGST). Three rates structure, lower rate, standard rate and demerit rate was recommended by RRNR&SRGST. The lower/merit rates[2] were suggested to be kept at 12 per cent, standard rates varying between 17 and 18 per cent and demerit rates (luxury cars, aerated beverages,

[1] Inverted duty structure occurs when input tax rates are higher than rate of taxes on output supplies. The GST Law permits refund of unutilised ITC under two scenarios, if ITC accumulation is on account of zero rated supplies or on account of inverted duty structure.

[2] Rates on goods having larger share of expenditure of poorer households are known as merit rates. The rates on such goods will either be exempted or be kept at lower rate category according to the Report on the Revenue Neutral Rate (RNR) and Structure of Rates for the Goods and Services Tax (2015). In the report, standard rate is to be applied to all goods and services (majority of the base) whose taxation is not explicitly specified.

paan masala, and tobacco and tobacco products) at about 40 per cent. To restore revenue neutral rate, the fifteenth finance commission recommended (a) a three rate structure of merit, standard and demerit rate; (b) merging of 12 and 18 per cent rates and (c) minimising exemptions. It is also suggested by 15th FC that the inverted duty structure should be resolved by rationalisation of multiple rate structure of GST.

A study by Mukherjee (2021) analysed the revenue implications of GST rates restructuring in India and suggested a three rate structure of 8 per cent, 15 per cent and 30 per cent to restore the revenue neutrality of GST. 15 per cent is the tax slab suggested for the merger of the two slabs, 12 and 18 per cent. According to Mukherjee (2021), merging of rates will result in revenue loss since 18 per cent tax rate comprises of two fifth shares (41%) in total taxable value. To recover this loss, the existing tax rates of 5 per cent and 28 per cent needs to be increased to 8 and 30 per cents respectively. The redesigning of GST structure with three rates will have a serious impact on equity if the goods and services are not assigned carefully under each slab. This paper comments on the equity implication of present GST rates and the likely effect of expected changes in GST rates.

Table1: Present GST structure in India

GST rate slab	No. of items	Percentage share of items under each slab	Major list of items
0	183	15	Agriculture produce
5	308	25	Packaged food items(cooked meals, cooked snacks, baby food),**cooking oil**, **tea, coffee**, **medicine and its salt, diagnostic test kits, kerosene(PDS**), **LPG, match box, clothing, foot wear**[3], cooking spices, airfare, railway fare on AC and first class
12	178	15	Food items (like noodles, butter, ghee, sauce, jam and processed food items) furniture's, **drugs and medicines for personal use, hearing aids, contact lenses, essential items (tooth paste, tooth brush, bucket, umbrella)**
18	517	43	**Essential items soap, hair oil, shampoo, shaving kit, spectacles, electric bulb, tubelight, gas stove burner**, Discs, tapes, Sound recording or reproducing apparatus, **internet expenses**, stainless utensils, electric fan, pressure cooker, **mobile handset**, telephone instrument, computer, cable tv, Sugar confectionary, corn flakes, sports goods, toys
28	28	2	Cars, motor cycle, scooter, camera and photographic equipment, air conditioner, club fees, cement

Source: GST council website, https://gstcouncil.gov.in/
Note: 3% slab consists of gold ornaments, silver, pearls and other semi-precious stones.
0.25% consists of diamond.

Present GST rates and its implication on equity

[3] There will be change in rate on footwear as per the 45th GST council meeting.

The present GST structure as presented in table 1 shows that 18 per cent GST slab comprises of 43 per cent of taxable items which makes it maximum among rest of the other slabs.

5 per cent slab consists of 25 per cent of taxable items, 12 per cent slab has 15 per cent of total taxable items, 28 per cent has 2 per cent of taxable goods and services and 15 per cent taxable items come under 0 per cent slab as per the data provided by the GST council. 18 per cent slab which has maximum taxable items contains major proportion of goods which are essential in nature, like soap, hair oil, shampoo, shaving kit, spectacles, electric bulb, tube light, gas stove burner, discs, sound recording apparatus (which would include educational CD as well), stainless utensils, electric fan, pressure cooker (Table 1). Also this slab contains internet expenses, mobile handset on the one hand and computer, laptop on the other hand. The GST rate for internet expenses and mobile handset does not indicate a rational system particularly since the pandemic 2020 when children are heavily dependent on online classes. This must have taken a heavy toll on the lower income strata with higher burden on the families having more than one child who were compelled to buy mobile handset for continuation of their children's education. Also an analysis of household consumption expenditure from NSSO 68th round shows that the share of expenditure of the bottom quintile of consumption expenditure class in its total expenditure for the items under 18 per cent slab are higher than that for the top quintile indicating a regressive tax rate (Chakravartti and Siddiqui, 2022).

Expected GST rate changes and its implication on equity

With reference to the objectives of 45th GST council meeting, the tax base is likely to increase by reducing the extent of exemptions and the three tax rate-structure is also expected to be implemented soon. Merging of 12 per cent and 18 per cent means the GST structure will have three slab rates like 5 per cent, merged rate and 28 per cent or any other rates in a three slab structure. Whether the new rates are expected to be higher than the existing rates would depend on revenue generation after the construction of merged rate. If the merged rate suggests loss in revenue, then the rates are expected to rise. If the 5 per cent slab rises above its existing rate this would result in taxing the essential items like cooking oil, tea, coffee, medicine and its salt, diagnostic test kits, kerosene (PDS), LPG, match box, clothing, foot wear at a higher rate. The existing 5 per cent slab already indicates a regressive tax rate as per the study by Chakravartti and Siddiqui (2022). Merging rates of 12 per cent and 18 per cent might indicate a rate anywhere between the range from 12 to 18 per cent. If the rate is above

12 per cent and below 18 per cent then it would be a relief for consumers for the items which were taxed at 18 per cent. Lowering the 18 per cent slab shall reflect a reduction in the degree of regressivity in that slab as it is already discussed above. However, increasing the rate above 12 per cent would imply an increase in the standard rates (as per RRNR&SRGST) which consist of essential items like tooth paste, tooth brush, bucket, umbrella, drugs and medicines for personal use, hearing aids, contact lenses.

Undoubtedly, the restructuring will fulfill the objective of revenue enhancing but it will come at the cost of regressive tax rate structure unless effective subsidy programmes and effective targeting comes in place. Increasing the rates from present rates will proportionately increase the burden of GST on every income class without any difference in degree of regressivity between the present tax and the expected tax structure. To reduce the existing degree of regressivity the essential items need to be taken out of GST or is recommended to assign a lower rate. If the exempted items decrease, this will lead to a problem of equity if subsidies are not effectively targeted. Alternatively, implicit subsidy can also be computed to keep the items exempted from GST which will be equivalent to giving a subsidy to poorer income class.

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