India's biggest tax reform since its independence still need tweaks

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Despite a raft of changes to India's new goods and services tax (GST), economists and businesses say further amendments to the taxation regime are needed as companies continue to grapple with the biggest tax reform since the South Asian nation gained independence in 1947.

India's GST Council, the government tax body, this month cut the GST rates on 27 items and eased the rules for small and medium-sized (SME) businesses and exporters. The move comes on the back of a slow down in the Indian economy, which has mounted pressure on New Delhi to take steps to boost growth.

India's long-awaited GST, introduced on July 1, is designed to replace a myriad of taxes across the different states with a single tax regime. Under the new system, products in different categories, fall in under different slabs, but are taxed at the same rate across the country.

“While implementing this, the government has learned that in the next one year there are a lot of reforms required under the GST regime,” says Vineet Gupta, the director of finance at software company CRMNext, adding that changes are needed to overcome the difficulties faced by the businesses and to stabilise the IT infrastructure as well.

Softer economic conditions were among the reasons the council was forced to make amendments including lowering the tax rates on items ranging from stationery and diesel engine parts - both reduced from 28 per cent to 18 per cent - to dried mango, which was slashed from 12 per cent to 5 per cent.

SMEs can now submit quarterly returns instead of monthly filings and exporters have also received some relief.

India's GDP growth slowed to a three-year low of 5.7 per cent in April-June quarter this year, compared with 7.9 per cent for the corresponding three-month period a year earlier.

The IMF this week lowered its growth forecast for 2017 to 6.7 per cent from 7.2 per cent, citing the “uncertainty” and “transition costs” related to the introduction of GST as a factor.

“GST is good for the economy but the rates are not rationalised,” says SP Sharma, the chief economist at PHD Chamber of Commerce and Industry. The basic purpose of GST, according to him, was to streamline the already high tax rates, but a 28 per cent levy under the new regime in some cases would likely inspire tax evasion.

The current rates of GST should be reduced further, he says. “We hope that the government will do more.”

“These reforms are appreciated, but there's still a long way to go to refuel the economic activity.”

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Rahul Garg, the chief executive and founder of an e-commerce platform Moglix, advocates ongoing simplification of the new tax regime.

"The need is to continuously simplify GST ... also compliance for SMEs," he says, adding that SMEs and their GST advisors or chartered accountants are far from ready to deal with the new tax.

Small businesses are facing other challenges including the high cost of compliance to the technology-driven GST regime, he adds.

India's government has suggested that further changes to GST could be on the way.

The finance minister Arun Jaitley has said the council will also consider reducing the taxation rate of 18 per cent for air-conditioned restaurants. On the other hand, the real estate sector – where there is a high level of tax evasion - could be brought under the GST umbrella. This will be examined at the next GST meeting, which is due to take place next month, Mr Jaitley said.

With important state elections to be held in the state of Gujarat in western India at the end of this year, there are also political factors at work behind the changes to the taxation system, some analysts note. .

“A number of recent tweaks to the new GST appear to be attempts to shore up support for the BJP [the ruling party] ahead of the upcoming state election in Gujarat rather than attempts to improve the tax system,” Shilan Shah, the India economist at Capital Economics, says in a research note. “This willingness to use the GST as a political tool could undercut some of the economic benefits that the GST could in principle bring.”

But others are less sceptical about the motivations behind the steps New Delhi is taking.

"The changes proposed by the GST council’s recent meeting evidently suggests that the government is receptive to feedback and to make requisite course correction in the implementation of GST – a watershed economic reform," says Ranjeet Mahtani, a partner at Economic Laws Practice, a law firm based in Mumbai.

"It is absolutely clear that the government think tank acknowledges that GST is an enormous tax reform, more so in the context of a country like India. It has, Nikhil Salvi, the senior manager of the investment research and analytics at Aranca, says "there will be implementation issues is the beginning, but in the long term this will smooth out".

The main driving factor behind the changes, he says, was to provide some relief and concession to SMEs and exporters.

"I think the government was looking at its own assessment of how the economy was shaping up and how the government can step in to support specific sectors that were suffering, more so that they could contribute to the economy."

New Delhi, however, is unlikely to simply be swayed by pressure from different sectors in future to reduce rates, unless there is a dire need of support.

"Very frankly speaking, businesses always demand more concessions all the time, it doesn't matter which regime is there," Mr Salvi says. "The government has taken its own course in terms of which industries to help out by changing the rates and policies."

The impact of the recent changes on federal finances remains unclear at this stage, he says.

"We don't foresee any reduction in government finances," says Shailesh Agrawal, the director of GSTSTAR, a GST solutions company. "Even with the reduction of rates, the volume of taxpayers is huge."

The consensus is that, although businesses are struggling to adapt to GST in the short-term, given its complexity , the system will eventually settle down as the government and companies get comfortable with implementation procedures.

The IMF says while the the new tax regime may be having a negative impact now, the longer-term effects will be positive.

It says GST, which "promises the unification of India's vast domestic market", is among several key structural reforms under implementation that are expected to help push growth above 8 per cent in the medium term.

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