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Various Insights into Goods and Services Tax: The Indian case

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Abstract:
This paper provides a comprehensive review of the Indian Tax Policy and the upcoming tax reform. Indian policy makers have proposed a shift of indirect tax regime from complex range of taxes at State and Centre level to Goods and Services Tax. This paper elaborates on this country's current indirect tax structure using a schematic diagram and compares it to the proposed goods and services tax regime along with a theoretical background of economic analysis for the efficiency of such a policy reform. Further, a simple model is developed to establish the regressivity of Goods and Services Tax. This paper also adds substance to the argument for raising the registration threshold in the interest of small enterprises.

Keywords: *Economic welfare, Goods and Services Tax, Indirect tax, Indian Tax Policy, Non-distortionary tax*

1. Introduction

Economic theory explains the importance of achieving Pareto-efficiency which makes it impossible to make any individual better-off without making anyone else worse-off. Here comes the role of welfare economics to choose an allocation from various Pareto-efficient allocations which maximizes the welfare of the economy. Depending on the welfare rankings, there could arise a need of moving the economy from the free market equilibrium to the desired allocation. Such a re-allocation of resources brings to front the need of an optimal taxation policy. Atkinson and Stiglitz (1976) entitle lump-sum tax (direct tax) as the first best solution to the re-distribution problem. But the government faces various difficulties in imposing a lump-sum tax, such as costly and imperfect observation tax base, scope of tax evasion etc. Hence, in most of the cases, the government resorts to the second best solution and attempts to achieve desired redistribution of resources through indirect taxes. Atkinson and Stiglitz in their text Lectures on Public Economics (2015) analyze and quantify the excess burden instigated by indirect taxes. In the light of this trade-off between direct and indirect-taxes, a uniform goods and services tax (GST) solves the dual challenges of ease of administration and minimizing distortions due to tax.

This paper illustrates the non-distortionary nature of GST using a micro-economic consumer choice model in the first section. The second section extends into the review of proposed Indian tax policy reform and clearly states what GST shall replace. In this paper an attempt has been made to sketch a schematic diagram of current complex indirect tax system and proposed GST in India. It must be noted that GST being a consumption tax shall put a heavy toll on those who consume a greater proportion of their income, and might act like a regressive income tax. The third section analyses the extent of regressivity of GST for India. Further, the paper throws light on anticipated benefits from GST and how it serves as catalyst for "Make in India" program. Critical analysis of the registration threshold concerning small and medium enterprises (SMEs) is done in section four. Concluding remarks, in section five, discuss the expected consequences of GST in India based on the current policy draft.

2. Economic Rationale behind Goods and Services Tax

All kinds of taxes transfer resources from individuals to government, so consumers will be worse off undoubtedly. But it must not be ignored that the tax revenue is used in form of government expenditure for the welfare of individuals only. So, the issue of concern is to design a tax policy which minimizes welfare loss for any given amount of revenue raised.

We analyze the welfare impacts of, first, a simple per unit tax on only one good, moving, second, to a distinctive specific tax on various goods, highlighting the resulting excess burden of tax. This analysis then paves way for the rationale of having goods and services tax which is, conceptually, a uniform specific tax on all goods and services.

For keeping the analysis simple it is assumed that the consumer's income is fixed and the tax is fully borne by the consumer. A consumer, given his income, chooses to consume certain quantity of the goods available depending upon the relative prices of the goods. A model of consumer choice with only two goods shall be sufficient for this analysis. Moreover, good 2 is treated as numeraire, and hence the excess burden and/or the tax revenue shall be measured in terms of quantity loss in good 2.

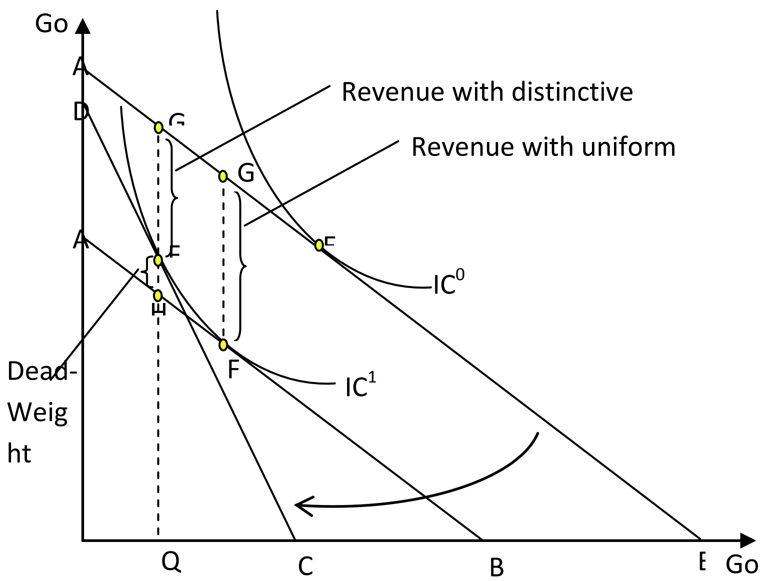

Fig.I.2 Excess burden of distinctive spe

A simple per unit tax on good 1 shall contract consumer's purchasing power and raise the relative price of good 1 in terms of good 2, which is identified as income effect and substitution effect respectively. In Fig. I.1 a per unit tax on good 1 pivots the budget constraint from AB to AC and the consumer shifts his consumption bundle from E to F. Such a tax leads to reduction in consumer welfare as the consumer moves from IC_0 to IC_1 with lower utility. It must be noted that in post tax situation the consumer consumes Q_1 quantity of good 1, for which the reduction in consumption of good 2 due to tax is FG, hence FG is the tax revenue generated from this tax. It must be noted that a lump-sum tax which leaves the consumer with same post-tax utility (by construction) generates revenue GH (equal to G'F'). Hence, FH is the excess burden of a per unit tax on good 1 that is caused by the substitution effect arising from the increase in relative price of good 1 in terms of good 2.

Similarly, having a distinctive specific tax on both the goods shall also contract consumer's purchasing power and alter the relative price of good 1 in terms of good 2. Assuming that tax rate on good 1 is greater than tax rate on good 2, the budget constraint shifts from AB to DC in Figure I.2, and the consumer moves from E to F. Consumer achieves lower utility u_1. Here a comparative analysis can be done with respect to a uniform specific tax wherein both the goods are taxed at the same rate. A uniform specific tax that leaves the consumer with utility u_1 shifts the budget constraint from AB to A'B' and generates revenue equal to GH (equal to G'F') which is greater than GF revenue generated under distinctive specific tax. Hence, a uniform tax eliminates the excess burden of specific taxes by avoiding distortions from substitution effect.

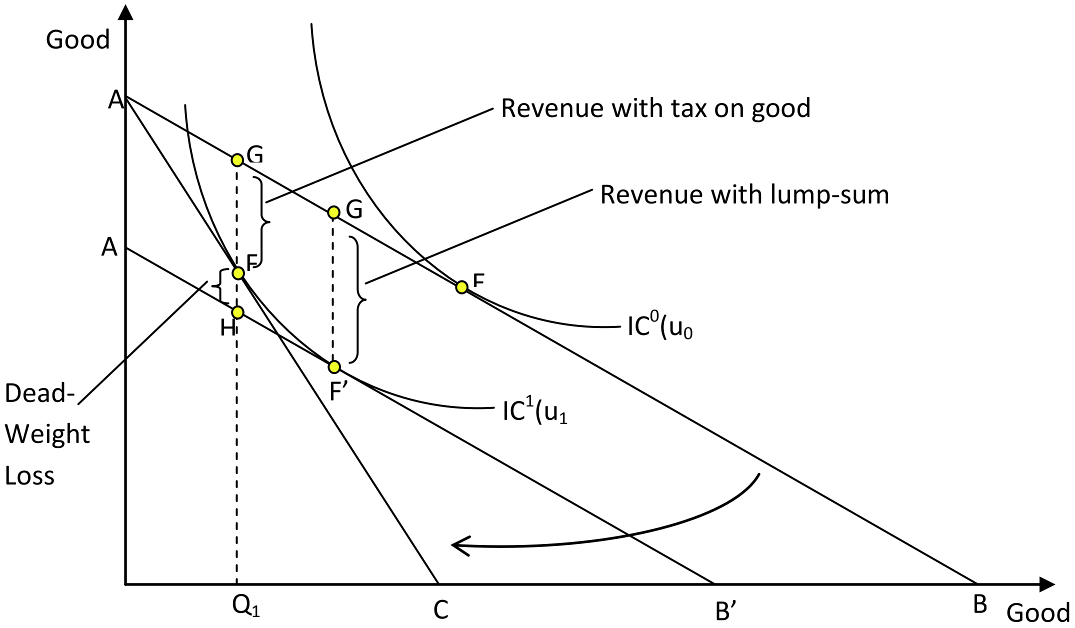

Figure I.1 Excess burden of a simple per unit tax on

Welfare analysis could also be based upon identical tax revenue approach in contrast to this identical utility analysis. Under this approach the two tax regimes could be compared for welfare in terms of reference individual's utility, keeping tax revenue equal. Two scenarios that are compared are, first, differential specific tax on both the goods; second, uniform specific tax on both the goods. By construction, the tax rates adopted would be such that the after tax bundle consumed in first scenario would be affordable in scenario two (with binding budget constraint).

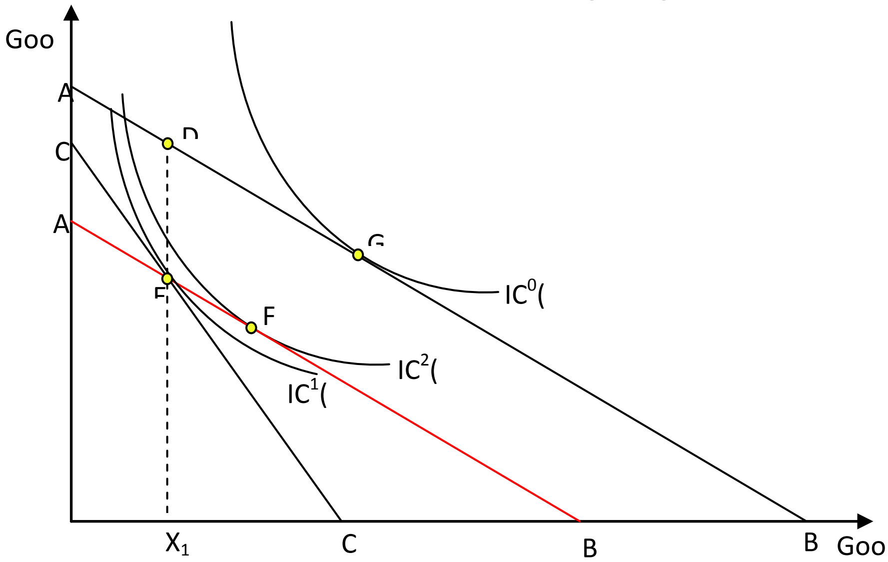

Figure I.3 Welfare analysis keeping tax revenue equal for differential

In figure I.3, CC' is the post-tax budget constraint with distinctive specific tax (assuming tax on good X to be greater than good Y) and the consumer's equilibrium is at point E where he is able to achieve highest possible utility u_1 on indifference curve IC^1. The post tax consumption of good X is X_1 units,

Vol. 4, Issue: 5, July: 2016
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and for this level of good X the reduction in purchasing power of consumer in terms of good Y is equal to DE. Hence, tax revenue is equal to DE. Now, a uniform tax case is hypothesized such that tax revenue is equal to AA' (equal to DE). Under such a tax regime, the consumer's equilibrium is at point F where the consumer is able to achieve utility u_2 on indifference curve IC^2. Clearly, IC^2 is above IC^1, and hence it can be inferred that a uniform tax improves welfare of the individuals, generating same tax revenue for the policy planner.

3. GST: The Indian Tax policy reform

Indian tax policy regime is moving towards the goods and services tax which would be multistage comprehensive Value Added Tax encompassing both goods and services. In India, GST would be a major indirect tax reform as both Centre and State governments will possess rights to tax goods and services at every stage of production and distribution. The central government expects that India's ranking in the World Bank's ease of doing business index would also improve from 142(as on June 2014) out of 189 countries. Major economic motives behind introduction of GST could be, first, additional fiscal space to finance public expenditure, second, overcoming the Constitutional barriers relating taxation by removal of definitional differences between goods and services and that of manufacturing and distribution of goods, third, achieve better fiscal prudence by aligning taxation powers to expenditure commitments/responsibilities under fiscal federalism. (Mukherjee, 2015) GST is a broad-based, comprehensive, single indirect tax which will be levied concurrently on goods and services across India. It will replace most of the Central and State indirect taxes. GST will be levied at every stage of the production and distribution chains by giving the benefit of Input Tax Credit (ITC) of the tax remitted at previous stages; thereby, treating the entire country as one market. (Vaidyanathan, 2016)

3.1 Current tax structure vs. GST

Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas. This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry. Firstly, there is no uniformity of tax rates and structure across States. Secondly, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this 'tax on tax'. (Department of Revenue, Gov. of India)

The introduction of GST would mark a clear departure from the scheme of distribution of fiscal powers envisaged in the Constitution. The proposed dual GST envisages taxation of the same taxable event, i.e., supply of goods and services, simultaneously by both the Centre and the States. Therefore, both Centre and States will be empowered to levy GST across the value chain from the stage of manufacture to consumption. The credit of GST paid on inputs at every stage of value addition would be available, thereby ensuring GST is charged only on the component of value addition at each stage. This would ensure that there is no 'tax on tax' in the country. GST will simplify and harmonize the indirect tax regime in the country. It is expected to reduce cost of production and inflation in the economy, thereby making the Indian trade and industry more competitive, domestically as well as internationally. It is also expected that introduction of GST will foster a common or seamless Indian market and contribute significantly to the growth of the economy. Further, GST will broaden the tax base, and result in better tax compliance due to a robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an inbuilt

Vol. 4, Issue: 5, July: 2016
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mechanism in the design of GST that would incentivize tax compliance by traders. (Department of Revenue, Gov. of India). Figure II.1, II.2 and II.3 illustrate schematic diagram of India's current indirect tax regime and proposed GST regime highlighting the complexity of current indirect tax structure.

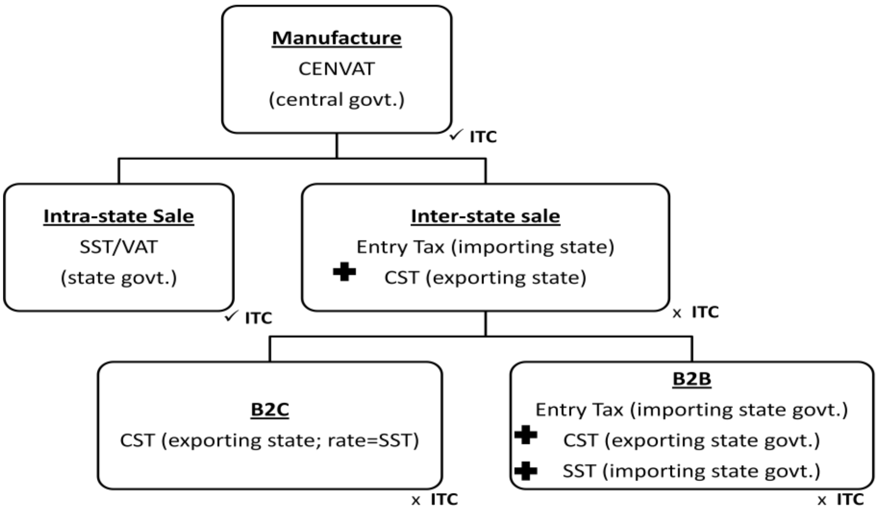

Fig. II.1. Taxation of goods under current system

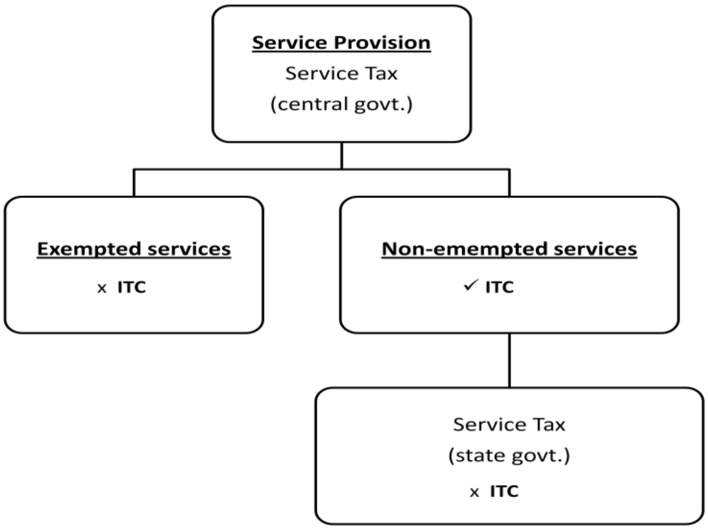

Fig. II.2. Taxation of services under current system

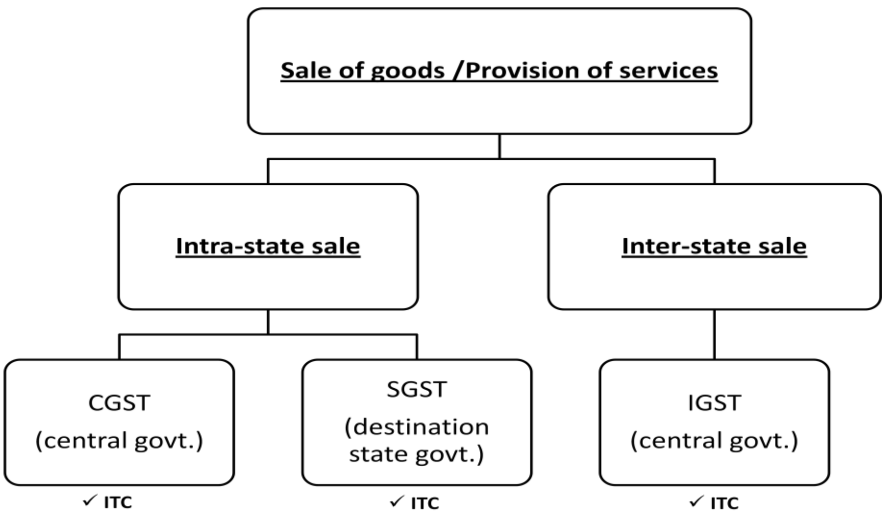

Fig. II.3. Taxation of goods and services under GST regime

3.2 Salient features of proposed GST

1. Dual GST: Both Centre and States will simultaneously levy GST across the value chain. Tax will be levied on every supply of goods and services. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The input tax credit of CGST would be available for discharging the CGST liability on the output at each stage. Similarly, the credit of SGST paid on inputs would be allowed for paying the SGST on output. No cross utilization of credit would be permitted.
2. Inter-State Transactions and the IGST Mechanism: The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. The IGST mechanism has been designed to ensure seamless flow of input tax credit from one State to another. The inter-State seller would pay IGST on the sale of his goods to the Central Government after adjusting credit of IGST, CGST and SGST on his purchases (in that order)
3. Destination-Based Consumption Tax: GST will be a destination-based tax. This implies that all SGST collected will ordinarily accrue to the State where the consumer of the goods or services sold resides.
4. Central Taxes to be subsumed: Central Excise Duty, Additional Excise Duty, The Excise Duty levied under the Medicinal and Toiletries Preparation Act, Service Tax, Additional Customs Duty, commonly known as Countervailing Duty (CVD), Special Additional Duty of Customs-4% (SAD), Cess and surcharges in so far as they relate to supply of goods and services.
5. State Taxes to be subsumed: VAT/Sales Tax, Central Sales Tax (levied by the Centre and collected by the States), Entertainment Tax, Octroi and Entry Tax (all forms), Purchase Tax, Luxury Tax, Taxes on lottery, betting and gambling, State Cess and surcharges in so far as they relate to supply of goods and services.
6. All goods and services, except alcoholic liquor for human consumption, will be brought under the purview of GST. Petroleum and petroleum products have been constitutionally included as 'goods' under GST, but shall not be subject to the levy of GST till notified at a future date on the recommendation of the GST Council. The present taxes levied by the States and the Centre on petroleum and petroleum products, viz. Sales Tax/VAT and CST by the States, and excise duty the Centre, will continue to be levied in the interim period. Taxes on tobacco and tobacco products imposed by the Centre shall continue to be levied over and above GST. In case of alcoholic liquor for human consumption, States would continue to levy the taxes presently being levied, i.e., State Excise Duty and Sales Tax/VAT.
7. Floor rates of GST with band: GST rates will be uniform across the country. However, to give fiscal autonomy to the States and the Centre, there will a provision of a tax band over and above the rate of the floor rates of CGST, SGST and IGST. Initially, the rates of CGST, SGST and IGST are expected to be closely aligned to the Revenue Neutral Rates (RNR) of the Centre and the States. (Department of Revenue, Gov. of India)

3.3 GST Council

In the GST regime, a Goods and Services Tax Council is being created under the Constitution which will be a joint forum of the Centre and the States. This Council would function under the Chairmanship of the Union Finance Minister and will have Minister in charge of Finance/Taxation or Minister nominated by each of the States & UTs with Legislatures, as members. The Council will make recommendations to the Union and the States on important issues like tax rates, exemption list, threshold limits, etc. which will act as benchmark or guidance for them. Every decision of the Council shall be taken by a majority of not less than three-fourths of the weighted votes of the members present. The vote of the Central Government shall have a weightage of one-third the State Governments taken together shall have a weightage of two-thirds of the total votes cast in that meeting. This is to protect the interests of each State and the Centre when the Council takes a decision and is in the spirit of cooperative federalism. (Deptt. Of Revenue, Gov. of India)

Vol. 4, Issue: 5, July: 2016
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3.4 Goods and Services Tax Network

Goods and Services Tax Network (GSTN) is a Section 25 (not for profit), non-Government, private limited company. It was incorporated on March 28, 2013. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions. The Company has been set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of the Goods and Services Tax (GST). (official website www.gstn.org)

3.5 GST and Indian federalism

Two major concerns continue to rankle states as was apparent from the debate in Lok Sabha: loss of revenue and loss of fiscal autonomy. Foremost among continuing worry is loss of revenues, despite assurances that all losses will be compensated. It is the manufacturing states that are more worried than the others. This is because value added tax, or VAT, the current taxation regime in states, is an origin-based tax while the good and services tax (GST) is a destination-based tax. In the origin-based tax system, tax is collected where the supplier of good is located while in the destination based system, tax in collected where the consumer of a product is located. Tamil Nadu, Maharashtra and Gujarat are among the more industrialized states and they fear big losses of revenues on movement of goods made in their states.

The Constitution amendment assures them compensation for losses suffered in the first five years, but some states want to be compensated for ten years. States have been assured 100 per cent compensation for losses suffered in the first three years and 75 per cent in the fourth year and 50 per cent in the fifth year. Consuming states in particular may see their revenues increase with the implementation of GST. To address the fears of revenue loss of manufacturing states, the union government has said additional tax of up to one per cent would be collected on inter-state trade of goods for two years or longer period if the centre-state body, the GST Council, so decides and be transferred to the states in lieu of the central sales tax (CST). Also the Finance ministry expects that revenues generated by states from taxing services will more than make up for losses they suffer when Octroi and entry tax, entertainment tax, luxury tax and other state level taxes are subsumed by GST. The other big concern among states is the loss of fiscal autonomy. States will not be allowed to introduce any new tax at will, change the rate of tax or give exemptions to any class of goods or service provider. They are also not allowed to unilaterally levy Cess or surcharge or increase tax rate to raise resource in the event of a natural calamity. Any change to tax rates will have to be within a narrow band prescribed by the GST Council. Any changes to the tax rate will need to be agreed to with three-fourth majority at the GST Council. While states together have weightage of two-third in any decision and Centre will retain the balance one-third. (Edwin, 2015)

3.6 GST: Impact on States

Fiscal and financial autonomy of the state would no longer be there. Concurrency of GST council would be required for every state decision regarding taxation. Advantageous position enjoyed by certain producing states like (Gujarat, Maharashtra, Tamil Nadu) would be eroded and thus the room enjoyed by them earlier in framing state specific policies/schemes would be compromised. Revenue loss of states would be compensated for only 5 years. Beyond that if states can’t adapt, they will depend on center for financial aid or grants or special category status etc. Relatively more developed, high consumption states would absorb advantages of this destination based tax, which might increase regional disparity. Government of India would have 33% weightage in GST council, giving center a veto power.

4. Regressivity of GST regime

Atkinson and Stiglitz (1976), and more recently Emran and Stiglitz (2007), have meticulously drawn attention to the age-old question of direct versus indirect taxation and the relationship of these taxes to the goals of efficiency and equity. It must be understood that direct taxes are basically taxes on income and indirect taxes on consumption. But it cannot be ignored that consumption has a strong relationship with income. Empirically it has been observed across time and space that relatively poor individuals consume a greater proportion of their income as compared to rich individuals. It can be clearly seen with the help of a simple model, that uniform consumption tax would then be regressive. GST is a uniform consumption tax, where in general, all commodities are taxed equally and all individuals also face identical tax rates.

If c^p and c^r are marginal propensity to consume of poor and rich individuals respectively, then $c^p > c^r$ (1)

Vakil (1973) is one of those rare research works that have empirically tested for the marginal propensity to consume differential between various income groups. Based on their primary surveys they show that marginal propensity to consume falls as income increases, and this effect is more pronounced in urban areas than rural areas. Also the finding is robust for change of base form income to permanent income.

Table 1

VARIATIONS IN THE MARGINAL PROPENSITIES TO CONSUME MEASURED AND PERMANENT INCOME—URBAN AND RURAL INDIA

URBAN INDIA			RURAL INDIA		
Income Group*	MPC_y	MPC_p	Income Group*	MPC_y	MPC_p
< 1,000	1.05	0.96	< 360	1.03	0.98
1,000–1,999	0.90	0.86	361–480	0.98	0.94
2,000–2,999	0.82	0.80	481–600	0.96	0.93
3,000–3,999	0.76	0.77	601–720	0.94	0.91
4,000–5,999	0.72	0.73	721–900	0.93	0.90
6,000–9,999	0.66	0.69	901–1,200	0.91	0.88
10,000–14,999	0.61	0.65	1,201–1,800	0.88	0.86
15,000–24,999	0.56	0.62	1,801–2,400	0.87	0.84
> 25,000	0.49	0.56	2,401–3,600	0.84	0.82
Sample mean	0.80	0.84	3,601–4,800	0.82	0.80
			4,801–7,200	0.80	0.79
			> 7,200	0.76	0.75
			Sample mean	0.87	0.88

[Data source: Vakil (1973)]

Then based on a simple Keynesian consumption function consumption of each type of individual would be:

$$C^P = a + c^pY \quad (2)$$

$$C^R = a + c^rY \quad (3)$$

GST being a uniform specific tax on all goods and services can be treated as a proportional consumption tax, because consumer pays α proportion whenever they consume any good or service. Tax paid by each type of individuals under a uniform consumption tax regime with GST rate α would be:

$$T^P = \alpha C^P = \alpha a + \alpha c^pY \quad (4)$$

$$T^R = \alpha C^R = \alpha a + \alpha c^rY \quad (5)$$

Given (4) and (5), an equivalent direct income tax would have marginal tax rates as follows:

$$\frac{dT^P}{dY} = \alpha c^p$$

$$\frac{dT^R}{dY} = \alpha c^r$$

Given (1), $\frac{dT^P}{dY} > \frac{dT^R}{dY}$, which means that an equivalent direct income tax would be clearly regressive as it taxes individuals with lower level of income at a higher marginal tax rate as compared to rest of the economy. To overcome this issue, Atkinson and Stiglitz (1976) and many other economists suggest that group of commodities need to be identified which are consumed by poor and rich group of individuals. For example, necessities should be taxed at a lower than standard rate and luxuries could be taxed at a higher rate. The proposed Indian GST has taken care of this issue to some extent. It is proposed that food and beverages shall remain exempted from taxes and other processed food shall also fall under the lower rate under the dual-rate plan (Report on revenue neutral rate and structure of rates for the goods and services tax, 2015). Nevertheless, Ahmad and Stern (1991) in their extensive analysis of tax reform in India show that a revenue neutral replacement of excise taxes with uniform VAT is regressive even when cereal is exempted.

5. Boost to Manufacturing Sector

Mukherjee (2015) bring up various ways in which GST could attract investments:

1. Removal of cascading of taxes could release working capital which is currently blocked as unpaid input tax credit.
2. Removal of stranded costs (including transaction costs) involved in inter-state sales of goods will induce investment.
3. If benefits of cascading of taxes are passed on to consumers, it will induce consumer's behavioral changes through price and income effects, and generate additional demand for goods and services. It is also expected that seamless access to market across Indian States will facilitate achieving better efficiency in production and distribution and could minimize costs which will attract larger investment.

Further, it will boost the "Make in India" programme with improvement in ease of doing business, by doing away with multiple taxes and their cascading impact and will also boost employment. In an economy with highly unequal distribution of resources, welfare benefits of such policies cannot be reaped singularly without taking special care of the weaker sections. Till date the tax policy design for medium and small scale enterprises has remained inefficient in terms of providing them a low and affordable compliance cost. Since, the designing of GST is still under process for Indian economy it is a good opportunity to bring attention to medium and small enterprises taxation. Model GST law published in June 2016 provides clear definition of registration requirements. Schedule III prescribes the liability to be registered as follows: Every supplier shall be liable to be registered under this Act in the State from where he makes a taxable supply of goods and/or services if his aggregate turnover in a financial year exceeds rupees 9 lakh (rupees 4 lakh for North-eastern states including Sikkim). Chapter III "Levy of, and Exemption from Tax" prescribes that a person who is required to be registered under Schedule III shall not be considered as a taxable person until his aggregate turnover in a financial year exceeds rupees 10 lakhs (threshold of rupees 5 lakh applies for North-eastern states including Sikkim). Report on the Revenue Neutral Rate and structure of rates for the GST provides data for distribution of taxpayers across turnovers for 2012-13 (Table 2 pp 92 RNR Report).

Table 2: Distribution across Turnover

Turnover	Corporate		Non-Corporate		Total	
	Number of cases	Total Turnover (in Rs. crs)	Number of cases	Total Turnover (in Rs. crs)	Number of cases	Total Turnover (in Rs. crs)
Less than 0	0	0	0	0	0	0
Between 0 and Rs 10 lakh	356036	3186	6077867	81777	6433903	84964
Between Rs 10 lakh and Rs 25 lakh	35152	5898	647707	105854	682859	111751
Between Rs 25 lakh and Rs 40 lakh	21875	7010	304099	96652	325974	103662
Between Rs 40 lakh and Rs 1 crore	51385	34476	616905	412195	668290	446671
Between Rs 1 crore and Rs 2 crore	41455	59682	461638	653155	503093	712837
Between Rs 2 crore and Rs 5 crore	48910	158340	378129	1182874	427039	1341213
Between Rs 5 crore and Rs 10 crore	31696	226691	155235	1081062	186931	1307752
Between Rs 10 crore and Rs 100 crore	60571	1891079	124932	2800947	185503	4692026
Above Rs 100 crore	14130	12579433	4186	1146675	18316	13726108
Total	661210	14965794	8770698	7561190	9431908	22526984

Based on the given data, figures for percentage of taxpayers in each turnover class and percentage of tax revenue generated from each class of tax payers is calculated for further analysis.

Table 3 Distribution of taxpayers by turnover

Range of Turnover (Rs.)	Number of taxpayers	Percentage of total	Total Turnover (Rs. Crore)	Percentage of total
0 to 10 lakh	6433903	68.2%	84964	0.4%
10 to 25 lakh	682859	7.2%	111751	0.5%
25 to 40 lakh	325974	3.5%	103662	0.5%
40 lakh to 1 crore	668290	7.1%	446671	2.0%
1 to 2 crore	503093	5.3%	712837	3.2%
2 to 5 crore	427039	4.5%	1341213	6.0%
5 to 10 crore	186931	2.0%	1307752	5.8%
10 to 100 crore	185503	2.0%	4692026	20.8%
Above 100 crore	18316	0.2%	13726108	60.9%

It can be observed that major portion of tax revenue is generated from firms with turnover above rupees 1 crore (96.6%). Also, the taxpayer distribution is also negatively skewed as 86% of taxpayers fall in the range of rupees 0 to 1 crore turnover. It is clearly evident that increasing the exemption threshold for turnover to rupees 40 lakh or rupees 1 crore shall help additional 10.7% to 17.8% enterprises and shall reduce government's revenue only by 1% to 3% of aggregate revenue. This argument of increasing the exemption threshold is based on the SME (Small and Medium Enterprise) definition based on sales turnover as formulated in Gibson and Vaart (2008). After analyzing the research requirements and available definitions of SMEs they formulated following definition. A SME is a formal enterprise with annual turnover, in US dollar terms, of between 10 and 1000 times the mean per capita gross national income, at purchasing power parity (PPP), of the country in which it operates. Gross National Income Per Capita (GNIPC) for India in constant 2010 US dollar terms is observed to be 1,584.1 for 2013 (World Bank database). Further, OECD statistics provide data for rupee-US dollar exchange rate at PPP for various years, stating that 1 US dollar was worth rupees 14.49 at PPP in 2010. It can be then worked out that GNIPC for India at PPP in 2013 is rupees 22,953.609. Hence, by the above definition a SME is an enterprise having annual turnover between rupees 2,29,536 (2.3 lakh approx.) and rupees 2,29,53,609 (2.3 crore approx.). Based on this characterization of small and medium enterprises, increasing the exemption threshold for annual turnover to rupees 40 lakh or 1 crore would be in line with the government policies aimed at encouraging and boosting SMEs and manufacturing sector as a whole.

Table 4 SME Definition for India

Code	Variable	Details	Year	Source	Value
A	GNIPC	constant 2010 US $	2013	World Bank database	$1,584.10
B	Rupee-US$ exchange rate	PPP	2010	OECD Statistics	1 US$ = Rs. 14.49
C	GNIPC	PPP	2013	(A) X (B)	Rs. 22,953.609
D	Annual Turnover	SME Definition Range	2013	10 - 1000 times of C	2.3 lakh-2.3 crore

6. Conclusion

Presently there is huge diversity in tax administration across governments; hence, this reform in whole indirect taxation system is imperative to smooth and transparent functioning of the economy.

Also it has been examined that current indirect taxation system is too complex and has many problems attached, which can be overcome by introduction of GST. The current GST model devised by Indian government has taken due care of the equity aspect by adapting the standard single tax system to the Indian situation and has devised a dual rate of GST (rather, government has proposed a four-tier GST rate to come over this issue, but this has not been published in any government document yet). But it must be noted that till now all the decisions on GST have been taken without any consultation or opinion from the major stakeholders, i.e. businesses and consumers which may lead to resistance to this tax reform. Hence, the success for the proposed GST system in terms of compliance rests on adequate provision of incentives for tax invoice based transactions. Besides, government should also explore the possibility of joint tax administration to replace current separate tax administration by Centre and State to make GST regime more conducive.

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