Impact of GST on Karnataka State Economy: will be a boon or bane?

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Abstract: We all know that India has been one nation with multiple taxes. All this will come to an end with the country becoming a clutter free highway for transparent, simple, efficient, one nation indirect tax system. The GST will replace all indirect taxes levied on goods and services by both central and state governments. The basic idea of GST is to create a single cooperative and undivided market to make our economy stronger and powerful. Hence, it will be one of the biggest taxation reforms after India’s independence. Present paper emphasized on some critical observations with respect to center-state relations for sharing the tax revenue, tax impact on manufacturers and ultimate consumers, impact on financial federalism of our country, and impact on vibrant automobile, agro, aerospace, textile & garment, biotech and heavy engineering industries states like Karnataka.

Keywords: indirect tax, consumption, manufacturing, goods, services.

I. Introduction:

Goods and Service Tax (GST) is an indirect tax system introduced in our country from July 1, 2017. It is applicable throughout India which replaced multiple cascading taxes levied by the central and state governments. It was introduced as the Constitution (One Hundred and First Amendment) Act 2017, following the passage of Constitution 122nd Amendment Act Bill. “Goods and Service Tax” would be comprehensive indirect tax on manufacture, sale and consumption of goods and services throughout India, to replace taxes levied by the Central and State governments. GST would be levied and collected at each stage of sale or purchase of goods or services based on the input tax credit method, irrespective of state. The taxable goods and services are not distinguished from one another and are taxed at a single rate in a supply chain till the goods or services reach the consumer. Administrative responsibility would generally rest with a single authority to levy tax on goods and services. Exports would be zero-rated and imports would be levied the same taxes as domestic goods and services adhering to the destination principle.

The introduction of Goods and Service Tax (GST) would be a significant step in the reform of indirect taxation in India. Amalgamating several Central and State taxes into a single tax would mitigate cascading or double taxation, facilitating a common national market. As our country is a Federal republic GST would be implemented concurrently by the central government and by state governments.’

Present indirect tax structure has a dual tax system for taxation of Goods and Service. The tax system is described by Central Taxes and State Taxes, which may be further subdivided into Excise Duty, Service Tax, VAT and Customs Duty. In 2005 VAT was introduced for intra-state transactions, Karnataka has passed the Karnataka Value Added Tax Act 2003 in January 2005 and followed the same up with amendment in February 2005 and have been made applicable from 1st of April 2005.

GST is one of the most significant fiscal reforms of independent India. GST is expected to result in major rationalization and simplification of the consumption tax structure at both Centre and State levels. It is expected to replace all indirect taxes, thus avoiding multiple layers of taxation that currently exist in India. Depending on the final GST base and rate, there will be significant redistribution of tax across different goods and services. Goods currently subject to both Centre and State taxes should experience a net reduction in tax, with positive impact on consumer demand. Besides simplifying the current system and lowering the costs of doing business, GST will call for a fundamental redesign of supply chains. It will affect how the companies operate their businesses, presenting significant opportunities for long-term revenues and margin improvement. For instance, under the current tax structure, supply chains are invariably designed to minimize the burden of the...
Central Sales Tax, with distribution centers located in individual states where the consumers are located. They are sub optimal from a strategic and economic perspective. The elimination of the central sales tax will provide an opportunity to optimize supply chains, enabling companies to re-evaluate existing procurement patterns, and distribution and warehousing arrangements.

Objectives of the GST are

i. Ensuring availability of input credit across value chain
ii. Minimizing cascading effect of taxation
iii. Simplification of tax administration and compliance
iv. Harmonization of tax base, laws and administrative procedures across the country
v. Minimizing the tax rate slabs to avoid classification issues
vi. Prevention of unhealthy competition among states
vii. Increasing the tax base and raising compliance.

GST is also expected to result in a reduction in inventory costs. Dealers would be able to claim a credit for the tax paid on their inventories, leading to improved cash flows. GST has been envisaged as a more efficient tax system, neutral in its application distributional attractive. The benefits of the GST are

- Wider tax base necessary for lowering the tax rates and eliminating classification and disputes.
- Elimination of multiplicity of taxes and their cascading effects.
- Rationalization of tax structures and simplification of compliance procedures
- Harmonization of Centre and State tax administration, which would reduce duplication and compliance costs.

II. Research Methodology:

The paper is based on secondary data. The data has been collected from internet, articles newspapers etc. Graph and percentile method has been used to analyze the data.

III.A. As per the proposed Goods and Service Tax the major concern is

Both the Central and State governments will have to face many challenges in implementing such a historic reform for the first time in independent India. About the revenue of the state govt. whether it is a addition in revenue or any decrease in revenue from the existing tax structures and the powers of the state or central in levying the different rate of taxes for different commodities. But the traders are not at all concerned with this.

There are two aspects to it. One, from 2003, VAT started replacing the sales tax. Now to reduce the distortion in trade, we have the central sales tax, i.e. when goods move from one state to the other. Now that is not creditable. That's a cost. The central government said, progressively we will bring down Central CST (i.e. the revenue which goes to the originating state at the time of sale). And they assured states to compensate them for whatever revenue they stood to lose on account of the CST coming down. Accordingly, states reduced the rate from 4, to 3, and finally to 2 per cent. But that compensation to the states was not initially paid by the centre. Therefore, they had misgivings about GST when they learned that the originating states will lose their right to tax goods because taxation is going to be destination based. On the other hand, today in a producing state everything is paid at the state of origin. They wondered about losses, having given facilities to set up factory, production, employment, etc. But when the Centre said it will compensate them, the states didn't have the faith because they didn't have a good experience on the CST compensation front. That is why it took so long. Also, states needed some leeway to fund for emergencies like famine, flood, or outbreak of some disease. For example in North Karnataka, we had a flood some four years ago. That time the VAT rate was increased to fund the relief operations. Now if you tell the states that they will lose the leeway to increase the VAT, how are they going to be compensated? That's the concern (VAT rates were initially uniform at 12 per cent, but it is now at 14.5 per cent almost everywhere).

B. Is it losing proposition for the states?

The Goods and Services Tax (Compensation to States) Bill, 2017 was introduced in Lok Sabha on March 27, 2017. The Bill provides for compensation to states for any loss in revenue due to the implementation of GST. Period of compensation: Compensation will be provided to a state for a period of five years from the date on which the state brings its State GST Act into force. Projected growth rate and base year: For the purpose of calculating the compensation amount in any financial year, year 2015-16 will be assumed to be the base year, from revenue will be projected. The growth rate of revenue for a state during the five-year period is assumed be 14% per annum. Base year revenue: The base year tax revenue consists of the states’ tax revenues from: (i) state Value Added Tax (VAT), (ii) central sales tax, (iii) entry tax, octroi, local body tax, (iv) taxes on luxuries, (v) taxes on advertisements, etc. However, any revenue among these taxes arising related to supply of
(i) alcohol for human consumption, and (ii) certain petroleum products, will not be accounted as part of the base year revenue.

Calculation and release of compensation: The compensation payable to a state has to be provisionally calculated and released at the end of every two months. Further, an annual calculation of the total revenue will be undertaken, which will be audited by the Comptroller and Auditor General of India.

Levy and compensation of GST compensation cess: A GST Compensation Cess may be levied on the supply of certain goods and services, as recommended by the GST Council. The receipts from the cess will be deposited to a GST Compensation Fund. The receipts will be used for compensating states for any loss due to the implementation of GST. The cess will be capped at: (i) 135% for pan masala, (ii) Rs 400 per tonne for coal, (iii) Rs 4,170 + 290% per 1,000 sticks of tobacco, and (iv) 15% for all other goods and services including motor cars and aerated water.

Any unutilised money in the Compensation Fund at the end of the compensation period will be distributed in the following manner: (i) 50% of the fund to be shared between the states in proportion to revenues of the states, and (ii) the remaining 50% will be part of the centre’s divisible pool of taxes.

However, the provisions of the Bill give an impression that the proportion will be decided by the GST Council. The question then arises as to how the calculations provide 100% compensation for the first five years, 75% for the fourth year and 50% compensation for loss of revenue for the fifth year. Taking the authoritative challenges as constant, there is no light of reference as to what will happen if the loss of revenue continues after five years of which susceptibility is equally probable as is otherwise.

However, as Kavita Rao, professor at the National Institute of Public Finance and Policy (NIPFP) and member of one of the Working Groups constituted on GST by the Empowered Committee of State Finance Ministers, points out, when you move to a GST regime in a federal set-up, some curtailment of the State’s freedom is inevitable. “All goods and services will be divided into certain categories. The rates will be fixed by category, and if I am a state, I cannot shift a commodity from a lower to a higher rate, or put it in the exempt category.”

This is not the only limitation. The rates for both, the CGST and the SGST, will be fixed by the GST Council, whose members will be State finance/revenue ministers and chairman will be the Union finance minister. Once the rates are set by the GST Council, individual States will lose their right to tax whichever commodities they want at the rates they want.

This development needs to be viewed in the context of steady erosion in the states’ freedom to decide on taxes and tax rates. The economist Prabhat Patnaik points out, “According to the Constitution, the States have complete autonomy over levy of sales taxes, which, on average, accounted for 80 per cent of their revenue. An attempt was made to curtail this autonomy with the introduction of VAT. But it did not totally succeed because the VAT still had four different rates that states could play with. But with the GST, which mandates a uniform rate, even this limited autonomy would be gone.” In other words, while the loss in revenue of the States may well be compensated by the Centre (as provided for in the GST Bill), how does one make good a State’s loss of the political right to fix its own tax rates? Ms. Rao believes this is not necessarily a bad thing. “Individual States are always catering to some interest group or another. By placing limits on what they can do, we are effectively empowering them to resist interest group politics, where someone or other is always lobbying for concessions or exemptions.” But this is a problematic argument. “The underlying assumption here,” says Mr. Patnaik, “is that political representative bodies are irresponsible. So give them less power, less discretion. This is a fundamentally anti-democratic vision of development.”

Moreover, the restrictions imposed by a uniform tax regime could adversely impact States that may be more committed to welfare expenditures. “The AIADMK or the Left Front or Mamata Banerjee may have their own development philosophies,” says Mr. Patnaik. “In order to express these philosophies, you have to be able to control your tax revenue. Why should I give up this right which I already have — and be sitting in some Council where I will be ouvoted by other states or the Centre telling me what I can or cannot do?” Perhaps it is to allay this concern that the draft GST bill speaks of the GST Council fixing not just rates but “rates including floor rates with bands”. A band would, at least on paper, give some room for states to vary their rates depending on their need. A floor-rate-with-band model (as opposed to a uniform rate) of GST is also what Ms. Rao is rooting for. “To my mind, it is the procedures, definitions, and credit rules that should be uniform for a harmonised tax regime. We should let the States figure out what rates they want.” However, a GST regime where each State has a different tax rate for different goods and services doesn’t sit well with the industry demand for a single national market with a uniform tax regime. Besides, if rates will be different, the taxes will be dual, and the dual taxes will be administered independently by the States and the Centre, why not just streamline the existing tax architecture instead of erecting a new one?

However, even though, critics some experts say that GST is likely to improve tax collections and Boost India’s economic development by breaking tax barriers between States and integrating India through a uniform tax rate. Under GST, the taxation burden will be divided equitably between manufacturing and services, through
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a lower tax rate by increasing the tax base and minimizing exemptions. The rationale behind GST is that it simplifies the indirect tax regime with a single tax. A study by the National Council of Applied Economic Research estimated that roll out of the tax would boost the GDP growth by anywhere between 0.9-1.7 per cent. A Crisil report had also said GST was the best way to mobilise revenue and reduce the fiscal deficit. Removal of cascading taxes makes the manufacturing sector more competitive and cut down on the tax compliance burden, thereby flourishing the whole scale of industries in India.

C. GST levied in the 3 different forms

Under GST, a Central GST as well as a state GST is expected to apply on every intrastate supply of goods and services in India. Further, an integrated GST or IGST, which is a combination of Central GST and State GST, is expected to apply on cross-border supply of goods and services into India (i.e., imports) and within India (i.e. inter-state supplies). GST essentially seeks to replace an origin-based tax levy currently prevailing in India, with a destination-based tax levy. Under the current system of taxation, goods manufactured in a factory in Karnataka and sold to a customer in Tamil Nadu shall require payment of central sales tax on the sale in the state of Karnataka. Under GST, it is expected that, IGST shall apply on the sale with the state GST revenue accruing to the state of Tamil Nadu. Further, as against central sales tax, which is non-creditable and, therefore, a cost in the supply chain, full credit is expected to be available in respect of GST paid on inter-state sales.

CGST: Central Goods and Service Tax

SGST: State Goods and Service Tax

IGST: The scope of IGST Model is that centre would levy IGST which would be CGST plus SGST on all inter-state transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. IGST will be combination of CGST and SGST and the same will be collected by the Centre in the Origin State.

Goods which have not been covered under GST purview: Petroleum products, Entertainment and Amusement tax levied and collected by Panchayat/ Municipality/ District council, tax on Alcohol consumption, Stamp Duty, Customs Duty, tax on consumption and sale of Electricity.

D. Impact to the Karnataka State Economy:

The Constitutional amendment stipulates that all states must pass the respective SGST bill, failing which they will lose their taxation power. In that way the legislative assembly passed Karnataka Goods and Service Tax bill 2017 with effect from July 1 2017. The manufacturing and service providing state like Karnataka is set the stage for the rollout of the new indirect tax system GST, which is come into effect from July 2017. Based on the following data and information on the tax revenue for the state of Karnataka, the impact of GST is analyzed.

Table # 1

<table>
<thead>
<tr>
<th>Taxes levied by Central government which would be subsumed in CGST</th>
<th>Taxes levied by State government which would be subsumed in SGST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Excise duty</td>
<td>Vat/Sales Tax</td>
</tr>
<tr>
<td>Excise duty levied under the Medicinal and Toilettries</td>
<td>Entertainment Tax</td>
</tr>
<tr>
<td>Preparation Act</td>
<td></td>
</tr>
<tr>
<td>Service tax</td>
<td>Luxury Tax</td>
</tr>
<tr>
<td>Surcharges</td>
<td>Taxes on lottery, gambling</td>
</tr>
<tr>
<td>Cesses</td>
<td>State cesses and surcharges relate to supply of goods and services</td>
</tr>
<tr>
<td></td>
<td>Entry tax</td>
</tr>
</tbody>
</table>

Table # 2

Consolidated Fund of Karnataka from Taxes on Commodities and Services

<table>
<thead>
<tr>
<th>TAX REVENUE</th>
<th>2013-14</th>
<th>2014-15</th>
<th>2015-16</th>
<th>2016-17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs</td>
<td>225290.00</td>
<td>267585.00</td>
<td>381069.00</td>
<td>406297.00</td>
</tr>
<tr>
<td>Union Excise Duties</td>
<td>159116.00</td>
<td>188409.00</td>
<td>247834.00</td>
<td>448934.00</td>
</tr>
<tr>
<td>State Excise</td>
<td>1282835.96</td>
<td>1443000.00</td>
<td>1520000.00</td>
<td>1651000.00</td>
</tr>
<tr>
<td>Taxes on Sales, Trade etc</td>
<td>3371934.65</td>
<td>3725000.00</td>
<td>4132900.00</td>
<td>4560209.68</td>
</tr>
<tr>
<td>Taxes on Vehicles</td>
<td>391150.38</td>
<td>435000.00</td>
<td>480000.00</td>
<td>545000.00</td>
</tr>
<tr>
<td>Taxes on Goods and Passengers</td>
<td>262565.96</td>
<td>289000.00</td>
<td>310100.00</td>
<td>332823.63</td>
</tr>
<tr>
<td>Taxes and Duties on Electricity</td>
<td>89658.46</td>
<td>93500.00</td>
<td>115074.00</td>
<td>123588.06</td>
</tr>
<tr>
<td>Service Tax</td>
<td>224993.00</td>
<td>270588.00</td>
<td>422984.00</td>
<td>472221.00</td>
</tr>
<tr>
<td>Other Taxes &amp; Duties on Commodities and Services</td>
<td>141953.78</td>
<td>135900.00</td>
<td>143499.00</td>
<td>123698.50</td>
</tr>
<tr>
<td>Total</td>
<td>6149494.00</td>
<td>6847982.00</td>
<td>7753460.00</td>
<td>8664231.87</td>
</tr>
</tbody>
</table>

Source: Karnataka Annual Financial Statement 2015-16 and 2017-18
It shows the Revenue from Taxes on Commodities and Services of Karnataka for the year 2013-14 to 2015-16 fiscal years. During 2013-14 an amount of Rs. 6149494 lakhs was collected. For the year 2014-15 an amount of Rs. 6847982 lakhs was collected. For the year 2015-16 an amount of Rs. 7753460 laksh has been collected and for the fiscal year 2016-17 it has raised to Rs 8664231.87 under Customs, Union Excise Duties, State Excise, Taxes on Sales, Trade etc. Taxes on Vehicles, Taxes on Goods and Passengers, Taxes and Duties on Electricity, Service Tax and Other Taxes & Duties on Commodities and Services.

**Figure :1 Composition of Karnataka Tax revenue in 2017-18**

*Source: Karnataka State Budget Documents 2017-18*

**Figure # 2**
*Receipts of Karnataka- How the Rupee comes from different revenue source*

It shows the Receipts of Karnataka how the rupees come from for the year 2015-16. During the year receipts from Public Account is 2%, States Tax Revenue is 54%, Borrowing is 16%, Grants from Central Government is 7%, Share of Central Taxes is 17% and State Non Tax Revenue is 4% only was collected for the
year 2015-16 fiscal year. From the above chart, it says that State Tax Revenue (54%) and Share of Central Taxes (17%) is the major contributor for receipts of Karnataka state in the fiscal year.

GST would replace most indirect tax currently in place such as
- The Karnataka Sales Tax Act, 1957
- The Karnataka Tax on Professions, Trades, Callings and Employments Act, 1976.

Amalgamating the above mentioned taxes between Centre and State into a single tax would mitigate cascading or double taxation, facilitating a common national market. The simplicity of the tax should lead to easier administration and enforcement. All states have been instructed to pass legislation on GST. So far, 25 states have passed this and Karnataka will be the 26th, but many states have raised certain concerns regarding the structure of the proposed tax as well as transitory compensation management. Karnataka has raised objections on three main accounts, including the loss of revenues or compensation formula, protection of state government’s sovereignty with respect to the levy of tax on certain commodities and thirdly, charging the highest tax rate. There are going to be gainers and losers in GST, hence Full Compensation for five years for any revenue loss to states, as against the current progressive declining compensation, starting with full offsetting of the losses in the first three years. The GST structure results in very little elbow room for states to raise additional resources. Further, the state has suggested that the GST Council be the body to implement and monitor the compensation to states. Necessary changes in the draft bill may be made to expand the scope of work of the GST Council to include this item of work. The Karnataka government has already strongly urged the Empowered Committee not to give in to the recommendations by the Centre to include petroleum products under GST. It will have a disastrous impact on the states. The state has also opposed the continuance of the concept of declared goods under GST.

Even the World Bank has acknowledged Karnataka as the most progressive states in implementing tax reforms. Karnataka state government had sponsored a study in 2011 by the National Institute of Public Finance and Policy about the implications of GST on Karnataka. GST will come exactly 10 years after VAT was introduced in 2005. It has made it clear that since Karnataka was the first state to implement VAT in 2005, it should also be the pioneer when it comes to implementing better tax system. Meanwhile, the state government has installed a robust IT backbone and computers in most offices. The preparedness to implement GST is almost 95 per cent compared to many other states which are still to catch up on the IT infrastructure. The Karnataka government has already spent about Rs 1,800 crore on setting up the relevant infrastructure.

The prices of commodities are expected to come down in the long run as dealers pass on the benefits of reduced tax incidence to consumers by slashing the prices of goods. Being consumption based tax, dual GST will result in better revenue collection for states with higher consumption of goods and services. This is been explained with an example.

<table>
<thead>
<tr>
<th>Under old tax system (Rs.)</th>
<th>Under GST (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price of a product sold from Pune to Jaipur = Rs.1,000</td>
<td>Price of a product sold from Pune to Jaipur = Rs.1,000</td>
</tr>
<tr>
<td>VAT @ 10% = Rs.100</td>
<td>CGST @ 5% = Rs.50 + SGST @ 5% = Rs.50</td>
</tr>
<tr>
<td>Cost of a product sold from Pune to Jaipur = Rs.1,100</td>
<td>Cost of a product sold from Pune to Jaipur = Rs.1,100</td>
</tr>
<tr>
<td>Profit = Rs.1,000</td>
<td>Profit = Rs.1,000</td>
</tr>
<tr>
<td>Selling Price = Rs.2,100</td>
<td>Selling Price = Rs.2,100</td>
</tr>
<tr>
<td>CST @ 10% = Rs.210</td>
<td>IGST @ 10% = Rs.110</td>
</tr>
<tr>
<td>Total cost of the product = Rs.2,310</td>
<td>Total cost of the product = Rs.2,210</td>
</tr>
</tbody>
</table>

It is evident from the above example that due to multiplicity of taxes and due to non-availability of input tax credit across the board the final price to the consumer is much higher not only due to tax component but due to cascading affect also.
E. There are number of issues on which negotiations are necessary to reach a hassle free business environments between Centre and Karnataka State, those are:

- Reforms have to take in the field of Taxation to adopt the best practices in line with the implementation of GST i.e., adoption of Negative list, Building up of IT infrastructure, Development of GST network, Convergence to a Common Rate under Service Tax and Central Excise, Place of Supply Rules under Service Tax etc.
- Setting up an Administrative system of GST and working out the transitional arrangements.
- GST rates should be reasonable and moderate to protect consumers from unfair burden and that’s why GST Council should have a ceiling of 18 percent.
- Full compensation for five years for any revenue loss to states.
- The share of states in voting in the GST Council should be 75 percent and Centre should be 25 percent in the interest of cooperative federalism.
- There should be an independent dispute redressal mechanism.
- Source of revenue for panchayats and municipalities must be protected and these bodies too should get a share from expected buoyancy in tax collections.

Only time will tell whether the GST will be a boon or bane to Karnataka state economy, but it is important the GST reform as a process rather than an event. Once the basic features of the tax are implemented, it would be necessary to improve the structure and operational aspects of the tax over time. In fact, the introduction of GST is only the next stage of reform. In that sense, the introduction of GST will not be a silver bullet and we should keep expectations at a realistic level.

III. Conclusion:

Goods Service Tax as the new indirect tax regime seeks to reinstitutionalize the present arrangement of indirect taxes. GST is not a political issue, but it is linked to the spirit of federalism as enshrined in our constitution and hence, it is to be conversed in terms of Centre vs. State establishment. Many States including Karnataka’s major concern about the revenue of the state govt. whether it is a addition in revenue or any decrease in revenue from the existing tax structures and the powers of the state or central in levying the different rate of taxes for different commodities. There are many issues on which negotiations are necessary to reach a hassle free business environments between centre and states. Centre has to address the concerns of states and their rights preserved then only it is a significant fiscal reform of independent India. Hence, only time will tell whether the GST will be a boon or bane to states economy like Karnataka.

Reference:


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