# The complete guide to understanding India’s biggest tax reform – the GST(polity,GS Paper 3,)

India’s biggest indirect tax reform since 1947 looks like it has finally arrived – the Goods and Service Tax.

From its first official mention in 2009 when a discussion paper was introduced by the previous United Progressive Alliance government to the point when the current Modi government tabled the Constitution Amendment Bill in Parliament, building consensus on the GST hasn’t been easy.

The most prominent hurdle in introducing this new tax structure has been the struggle between the states and the Centre on the loss of revenue. It’s taken years to resolve, but even now it is an issue that isn’t completely fixed.

Nonetheless, the introduction of the Constitution Amendment Bill in Parliament seems like the first key step towards bringing in the belated GST reform.

Why does India need the GST?

The GST is being introduced not only to get rid of the current patchwork of indirect taxes that are partial and suffer from infirmities, mainly exemptions and multiple rates, but also to improve tax compliances.

The spread of GST in different countries has been one of the most important developments in taxation over the last six decades.

Owing to its capacity to raise revenue in the most transparent and neutral manner, more than 150 countries have adopted the GST.

With the increase of international trade in services, the GST has become a preferred global standard. All OECD countries, except the US, follow this taxation structure.

## The proposed framework

In India, the unified tax will take the form of a “dual” GST, to be levied concurrently by both the Centre and states. The unified tax will comprise of a Central GST and a State GST, which will be legislated, levied and administered by the respective levels of government. The same taxable base will be subject to both GSTs.

The words “legislate, levy and administer” are key, since the Centre and the state will legislate the respective GST Acts and both will have power to administer the taxes.

The proposed tax system will subsume a variety of central and state levies such as Central Excise Duty, Service Tax and VAT, thereby simplifying the complicated tax structure and reducing compliance costs.

For tackling the complicated issues related to inter-state transactions, an innovative Integrated Goods and Services Tax is also under consideration.

## The fine print

The bill, cleared by the Lok Sabha, has attempted to introduce the definition of GST.

It is defined as any tax on the supply of goods or services that will subsume CENVAT, service tax, central excise duty, additional excise duties, excise duties levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955, service tax, additional customs duty (countervailing duty or CVD), special additional duty of customs (SAD), central surcharges and cesses, State VAT, State sales tax, entertainment tax not levied by local bodies, luxury tax, taxes on lottery, betting, and gambling, tax on advertisements, State cesses and surcharges related to supply of goods and services and entry tax not levied by local bodies.

The primary reason for the bill is to pave the way for the Centre to tax sale of goods and the states to tax provision of services. The bill further proposes that the central government will have the exclusive power to levy GST on imports and inter-state trade.

The bill has also recognised the need to have a GST council. The union finance minister, the union minister of state in charge of revenue or finance, and the minister in charge of finance or taxation or any other minister nominated by each state government would constitute the council to ensure that both the Centre and the states are on an equal footing.

In addition, the bill proposes to set up a Dispute Settlement Authority that would look into disputes between the states and the Centre. Appeals from the authority would directly lie with the Supreme Court.

For the time being, the bill has kept certain goods out of the purview of GST, which have been a point of contention between state governments and the Centre.

These include:

* Petroleum crude
* High speed diesel
* Petrol
* Natural gas
* Aviation turbine fuel
* Alcohol for human consumption.

States shall have the power to levy taxes on these items, except in the case of imports and inter-state trade.

Another important feature of the bill is a proposal to levy additional tax on supply of goods on inter-state trade. The additional tax will not exceed 1% and will be collected by the central government for a period of two years. Finally, the amount so collected will be assigned to the states from where the supply originates.

How does this help you?

A unified GST is an economically efficient solution even for the multinationals, which have to compete with the companies in the unorganised sector, as it simplifies the indirect tax structure to one general rate that can be paid by all companies.

Under the GST structure, every company gets a deduction on the taxes already paid by its suppliers. That results in every buyer ensuring that his supplier has paid his part to claim his deductions.

With the introduction of the bill, the signal that the Modi government seems keen to send is that all the key decisions could well be in the hands of the GST Council. With both representatives from the Centre and states in place, the latter would likely have a say in the implementation of tax laws in their territories.

Moreover, full compensation for the first three years for any kind of revenue loss may work wonders to dilute the initial apprehensions of the states regarding losing income post the introduction of GST.

With the Central government going that extra mile to take care of the interest of the states, one will have to wait and see if the states too return the favour by ratifying similar bills in their assemblies with the much needed two-third majority.

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# Microfinance is no economic

# miracle(GS Paper 3)

It meets consumption needs of the poor. But it is incapable of creating the requisite assets for poverty alleviation

**May 8, 2015:**

The innovation called microfinance is actually an innovation in banking systems and processes to enable lenders to lend to the poor in a sustainable way. Here, the sustainability of the lender and not the borrower is the objective.

Bangladesh’s Muhammad Yunus filled the gaps in existing banking system in innovative ways such as replacing physical capital with social capital, doorstep banking, and weekly repayments to make the poor bankable without compromising on prudent banking rules.

The result was a business model that ensured repayment and approved of reasonable profit. This motivated many lenders to explore the market at the bottom of pyramid — a term that Yunus does not want to be associated with microcredit.

**What’s the effect?**

Various studies on the impact of microfinance have found that there is no transformative change in income and poverty levels despite the availability of credit.

Expecting a change as huge as pulling the poor out of poverty is turning a blind eye to the limitations of market-based solutions — such as microfinance .

Just as the availability of a ₹1 sachet cannot ensure hygiene for the poor in the absence of structural support such as water and sanitation facilities.

Similarly, providing the poor with small sums of credit cannot ensure reduction in poverty in the absence of holistic interventions. FMCG outlets selling these sachets and microfinance institutions (MFIs) are doing business at the bottom of the pyramid. An FMCG cannot and will not focus on substantially changing the hygienic condition of the poor, because that is beyond the scope of its business. Likewise, MFIs cannot necessarily create enabling conditions for growth, because that is none of their business.

MFIs are just commercial lenders (above 75 per cent of micro finance business is done by for profit NBFC MFIs). Financial institutions are not expected to bring about complete development and should not be judged on those criteria.

MFIs can be fairly assessed in their performance as lenders. A closer look at the policies, however, discloses that even as lenders, MFI policies are not designed to create an impact, and commercial considerations prevail over the needs of borrowers.

**Assessing performance**

First of all, the selection criteria for clients are permanent residence in the area, ownership of a *pakka*(brick and cement) house, and the existence of an enterprise for at least a year. Those who have already invested and survived for a year get credit.

Though it makes good business sense to lend to a running unit, the claim of giving loans to the poor for asset creation and income enhancement is not validated.

Most often, clients use the credit as working capital. Not that working capital is not required but since investment is not enhanced, productive capacity is not enhanced; hence there cannot be transformative change.

In addition, this policy leaves out the very poor. Further, this approach limits the number of eligible borrowers. All MFIs target these comparatively fewer numbers of eligible borrowers. This, in turn, leads to client poaching and multiple borrowings.

Moreover, unlike a good lender, the MFI appraisal process does not have a provision for assessing enterprise need.

The present repayment capacity and not the projected income generation of the activity being financed are assessed.

There is no assessment of project cost, raw material or stock cost, gestation period, projected cash flow, prospective buyers, feasibility of project, and capital gap.

Instead, current assets, earnings and working members are recorded to ensure that the client is able to repay from household income.

**Simply not enough**

Since enterprise need is not the focus, MFIs offer only one type of product. This product ranges between ₹10,000 and ₹20,000. The catalogue of MFIs may have a few more products but all clients are given a similar amount with similar repayment period and similar instalment amount.

This could be cost effective for the MFI, but clearly, the financial needs of the micro enterprise are ignored.

Different enterprises may have different needs: for example, the investment needs of a photocopier, a mechanic and a home-based tailor differ substantially, but the MFI will offer the same: ₹12,000 or ₹15,000. This leads the borrower to borrow more from outside sources at high cost or to utilise the money for non-productive purposes thus creating an extra interest burden.

Similarly units at the take-off stage that can grow with proper financial support and generate more employment remain outside the purview of this policy.

Further, the loan amount is too small to create an enduring asset. Barring a few low income-generating activities such as like home-based tailoring, no other investment can be done. Even a buffalo of average quality costs between ₹30,000 and ₹40,000.

Incidentally, this amount is not sufficient even as working capital to cater to a running and growing enterprise. Entrepreneurs have to depend on private sources for peak season work.

MFIs fill the void of formal lenders for a population with a constant cash crunch and as such are welcome.

But their lending policies are aimed at consumption smoothening, and nothing more. This is what all studies have found.

*The writer is the former COO of Friends for Women World Banking*

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