DEMONETISATION AND GST

DEMONETISATION

Concept

Demonetisation is a situation where the Central Bank of the country (Reserve Bank in India) withdraws the old currency notes of certain denomination as an official mode of payment.

Demonetisation has been done in various countries of the world in context of hyperinflation, wars or political upheavals. Countries like Nigeria, Zimbabwe, Australia, Myanmar etc. have initiated the move in order to curb excess money supply with respect to black money.

After demonetising bank notes on two previous occasions i.e. in the year 1946 and 1978 the Government of India decided to do so again on November 8, 2016, wherein, higher denomination currency notes of `500 and `1,000 (together comprising nearly 86% of the currency in circulation) ceased to be legal tender except for a few specified purposes. This currency was to be deposited in the banks by December 30, 2016, while restrictions were placed on cash withdrawals.

Aim of Demonetisation

India's economy is relatively cash-dependent and where cash holdings are used for majority of transactions the chances of cash not being used for legitimate transactions, but perhaps for other activities such as corruption are high. The recent move of demonetisation by the Government of India aimed at achieving the following objectives:

• To curb corruption and penalise illicit activities and wealth acquired from it.

• To pave way for digitalisation by shifting transactions out of the cash economy and into the formal payments system.

• To curtail circulation of counterfeit currency (fake currency).

• To tax unaccounted private wealth maintained in the form of cash. Ensure greater transparency and reduction in tax evasion by restricting cash transactions and giving a boost to digital transactions.

• To reduce informal savings and channelize them through formal banking system. The money deposited in banks could provide a base for giving more loans, at lower interest rates.

Impact of Demonetisation

Some of the notable short term impacts of demonetisation are discussed below.

• A slowdown in the growth process was witnessed as demonetisation reduced both, demand and supply in the market due to lack of liquidity, reduced working capital availability and increased uncertainty with a major impact on cash intensive sectors like agriculture, real estate, jewellery etc.

• A decline in the stock of black money could be seen as some holders came into the tax net.

• There was a sharp rise in the bank deposits and financial system savings.

• Government's revenue from taxes increased because of increased disclosure. Payments to local bodies increased as demonetised notes remained legal tender for tax payments/clearance of arrears.

• There has been a decline in the indirect and corporate taxes, to the extent of slowdown in the growth process. However, in the long run, taxes are expected to increase as formalization expands and compliance improves.

Demonetisation is an effective tax administration measure as black money holders are not left with any choice but to declare their wealth and pay taxes as penalty. Through this measure the government seeks to communicate that tax evasion shall not be accepted and allowed any further. However, it involves huge cost in the process of withdrawal of old currency circulating in the economy and printing of new currency notes. The long term benefits of demonetisation can be reaped only if it is followed with fast, demand-driven remonitisation, digitalization and growth oriented tax reforms.

GOODS AND SERVICES TAX (GST)

Concept

The Goods and Services Tax (GST) is an indirect tax levied on the supply of goods and services. GST Act was passed in the Parliament on 24th March, 2017 and it came into effect from 1st July 2017.

Goods & Services Tax is a comprehensive, multi-stage, destination-based tax (place where consumption of the goods or services takes place) that is levied on every value addition (monetary worth added at each stage) by the Central and State governments. Before the implementation of Goods and Services Tax (GST), various central, state and local area taxes were levied in India. These indirect taxes have now been subsumed under GST which is based on the principle of 'One Nation One Tax'.

Features of GST

(i) GST is a comprehensive tax as various indirect taxes have been merged in this single tax except Customs duty, taxes on petroleum products, alcoholic drinks and taxes levied by local bodies.

(ii) (ii) GST is a multi-stage tax because it is proposed to be levied at all stages starting from production up to final consumption with a provision of set off of taxes paid at previous stages.

(iii) GST is a Value Added tax because it is levied on value addition at each stage of the supply chain (from manufacturer to wholesaler to retailer and to the final consumer).

(iv) (iv) GST is a destination-based tax as the tax would accrue to the taxing authority which has jurisdiction over the place of consumption. For example, if goods are manufactured in State A and sold to final consumer in State B, the tax revenue from GST will be collected by the State B and not State A.

Taxes that have been subsumed under the GST are summarized here:

i) Central Level Taxes: Central Excise duty, Service Tax, Central Sales Tax

ii) State Level Taxes: Entertainment Tax, VAT, Octroi and Entry Tax, Purchase Tax, Taxes on Lotteries

GST structure in India

India has adopted dual GST structure wherein taxes are levied and collected both by the Union and the States. There are three taxes applicable under GST:

• Central GST (CGST): Where the tax revenue will be collected by the central government.

• State GST (SGST) or Union Territory GST (UTGST): Where the tax revenue will be collected by the state governments for intra-state sales i.e. within the same state.

• IGST: Where the tax revenue will be collected by the central government for inter-state sales i.e. sale from one state to another.

The tax rates, rules and regulations are governed by the GST Council which consists of the finance ministers of the centre and the states. Goods and services are divided into following tax slabs for collection of tax namely, 0% (on essential items including food), 5%, 12%, 18% and 28% (on luxury items and tobacco).

Advantages of GST

The GST has been widely heralded for many things, especially its potential to create one Indian market. Various benefits that shall accrue with the introduction of GST are discussed below:

• Foster Economic Growth: The subsuming of major Central and State taxes in GST will reduce the cost of locally manufactured goods and services and increase their competitiveness in the international market thereby giving boost to Indian exports. An increase in economic activities will also help in increasing the country's GDP and generating employment.

• Ease of doing business: In pre GST regime there were multiple indirect taxes and the firm was required to register itself separately under each such Act. Introduction of a single tax and automated procedures for registration etc. has led to ease of doing business for the enterprises.

• Attracting Foreign Investment: Introduction of GST has given a boost to foreign investment and "Make in India" campaign by harmonising the tax base and administration procedures across the nation.

• Ensure better tax compliance: The transparent and complete chain of set-offs will result in widening of tax base and better tax compliance.

• Reduction in the cost of goods: Implementation of GST will prevent cascading of taxes (i.e. tax on tax) which resulted due to multiplicity of taxes on goods and services. This will make products cheaper and would benefit the consumers and increase aggregate demand in the economy