
BETWEEN BREAD AND DIAMONDS: A CRITICAL STUDY OF TAXATION ON ESSENTIALS AND LUXURY GOODS IN INDIA

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*“The measure of a society is how it treats those at the bottom, even when
taxing those at the top.”*

ABSTRACT

The GST in India was a grandiose concept which is a single unified market wherein social equity and fiscal efficiency are both considered. It is structured in a multi-slab form with zero taxes of the basic needs such as unbranded food grains and medicines to 28 per cent tax of high luxuries such as luxury cars and jewellery and high-quality electronics with the aim of taxing according to the available income. But, practically, the system is generally ripped apart on the question of equity versus simplicity. Goods that are borderline such as packaged bread, brand milk, a herbal health drink or a mid-price personal care product go through a grey area of a necessity and a luxury. Such ambiguity creates conflicts, courtroom contests and governmental bureaucracy and prompts companies to re-invent products or find favourable labels. These issues are severely debated in the paper, and the paper looks into how various slabs can accidentally result in retrogressive outcomes, contribute to compliance price, and distort market behaviour. It is also comparable to the European Union, Australia and Canada where the stringent exemptions and clear classification regulations reduce controversies and safeguard necessities. The study promotes a less complicated system of GST founded on values, which involves a limited set of zero necessity, predictable expenses, and select social security. India can now move a step closer by ensuring that democracy and equity are an inherent constituent of its taxation regime so that diamonds can indeed be taxed and bread retained affordable, the constitutional promise of equity and efficiency and one national market.

Keywords: Goods and Services Tax (GST), indirect taxation, essential goods, luxury goods, tax equity,

Introduction:

In 2017, India came up with Goods and Services Tax (GST) and the promise was not just a new source of revenue. It would be a tax revolution, one country, one market, one tax, an attempt to wipe away a mottled array of state and national taxes and in their place introduce a less complex more comprehensible system. GST was meant to make life easier and drive upwards to both businesses and consumers. But, like most general reforms, the devil lurks in the details. Not all the things in our shopping cart do not have equal weight in our lives. Essential needs are met with rice, fundamental medicines and school textbooks. Pre-eminence and wealth are indicated by luxury cars, necklaces made of diamond, and high-quality whiskey. It would be unfair to tax them the same because that would neglect the fundamental rule of fairness; which is the notion that one should contribute more, when they have the means of doing it. A solution to this has been an Indian tiered GST system, ranging at zero rate on most staples, up to 28 percent on luxuries and sin tax products.¹ This paper poses a question of whether or not that well-stratified system is effective in any way. What is meant by the terms essential and luxury even in a diverse country like India? Will existing GST rates relieve average households or create new problems? With a combination of legal discourse, economic rationale and a peep into the approach taken by other nations to the same conundrum, this paper will seek to examine whether the taxation of bread and diamonds in India is indeed a demonstration of social justice- or it is merely full of good intent and cracks in the background.

Research Objective:

This research is guided by the following key objectives:

1. Examine the GST Framework

To examine the constitutional and statutory foundation of India on the concept of Goods and Services Tax, with emphasis on how rate slabs are set on essential commodities and luxury goods.

2. Understand Classification Principles

To investigate the factors and criteria that law legislators and the GST Council apply

¹ Notification No. 1/2017-Central Tax (Rate), Ministry of Finance, Dep't of Revenue (India), June 28, 2017, <https://cbic-gst.gov.in/gst-goods-services-rates.html>.

to define certain commodities as necessities and others as luxuries, as well as to find loopholes where there is a dispute or confusion about the classification.

3. Evaluate Fairness and Equity

To evaluate the effectiveness of the existing GST structure according to the principles of distributive justice and ability-to-pay, taking into account its effects on the various income groups and patterns of consumption.

4. Identify Implementation Challenges

To examine the administrative challenges, non-compliance and market warping caused by the presence of a multi-tax slab and unclear product lines.

5. Draw Comparative Insights

In order to examine the ways in which other jurisdictions like the European Union, Australia and Canada strike a balance between taxing basic needs and luxury goods and what India can learn about such approaches.

6. Recommend Policy Reforms

To recommend the steps that may improve the Indian indirect tax system to be more transparent, efficient, and socially fair.

Research Question:

- How does the GST regime of India provide definitions and distinctions between essential and luxury goods, and what are the constitutional or economic principles involved in the distinction?
- How well does the existing GST rate scheme bring fairness and distributive fairness, especially to low- and middle-income families?
- What can India learn out of the experience of other countries in their indirect tax systems to restructure the GST classification and have a more transparent and equitable way of taxing necessities and luxuries?

Research Methodology:

In this paper, the approach to the study is a qualitative, doctrinal one to analyse the way of how GST in India differentiates of essential and luxury products. It relies on provisions of the constitution, GST Acts, Council notifications and provides major judicial rulings with the aid of government reports and scholarly literature. The content analysis of statutory texts and case law is conducted in terms of thematic fairness and equity in existing tax slabs. International context is given by comparing the EU, Australia and Canada experience. The study is based on legal and policy research with no field surveys or econometric modelling and addresses the progress proving the introduction of GST in 2017 through to 2021.

GST Framework In India:

Goods and Services Tax (GST) in India has a good constitution and statutory framework that reflects the federal system in the country and the need to have one national market. The 101st Constitutional Amendment Act, 2016 transformed the paradigm in terms of how the indirect taxation and the means of its administration would take place in the country. This historic amendment incorporated the Article 246A that vested the powers simultaneously on both the parliament and the State Legislatures in enacting laws on GST in supply of goods and services. This shared jurisdiction is also wonder to note: the two levels of government are given the opportunity to participate in the policy formulation and collection of tax as a sign of cooperative federalism of India. Besides this, Article 269A² also empowers the Union Government to impose or collect the Integrated GST (IGST) on inter-State Supplies of goods and services and also specifies how such revenue should be distributed between the Centre and the States. In addition to these provisions, the amendment also formed the GST Council in Article 279A³, a constitutional body, consisting of Union representatives in addition to all States.

The Council has the mandate of coming up with important recommendations on important factors like the tax rates, exemptions, the threshold limits, and model laws thus acting as the nerve centre to harmonisation of fiscal policy in the diverse economic environment of India. It is based on this constitutional requirement that a series of laws were passed by Parliament which may be regarded as the working core to the GST regime. The levy and collection of tax on intra-State Supplies is controlled by the Central Goods and Services tax Act, 2017 (CGST

² INDIA CONST. art. 269A.

³ INDIA CONST. art. 279A.

Act)⁴, whereas taxation of the inter-State transactions and imports is controlled by the Integrated GST Act, 2017 (IGST Act). In order to ensure that the system is smooth between jurisdictions, Complementary State GST Acts (SGST) were created to allow an individual State to manage their portion of intra-State supplies. In the case of the Union Territories that lack legislatures, the Union Territory GST Act, 2017 (UTGST Act)⁵ is a similar act. Combined with other statutes, including those rules and notifications, these statutes operationalise the constitutional outlook of one, destination-based tax on consumption. The main feature of the Indian GST is a multi-slab rate, indicating an effort to balance two goals of revenue and social justice in a large, heterogeneous economy. Goods and services are divided into five major rate bands, 0, 5, 12, 18 and 28 percent with an extra compensation cess being charged on particular products like tobacco, carbonated drinks and luxury automobiles, popularly known as sin or luxurious goods.

The design is meant to ensure the necessary commodities are affordable to the ordinary consumer and tax luxury and unnecessary commodities at increased rates to increase revenue and deter conspicuous consumption. In case of food grains, fresh vegetables, milk and most life saving medicines which are necessities are either zero rated or under the concessional 5 percent slab. Meanwhile, those items perceived as luxurious or harmful to the environment such as high technology electronics, high-end motor vehicles or even some types of jewellery are put in the highest 28 per cent slab, usually with a compensation cess set aside to counteract any loss of revenue to the States. These rates are periodically discussed and revised in the GST Council, but the process of decision-making is hardly a thoroughly technocratic process. Rather it is a well bargained compromise between economic factors, revenue factors and necessity of political agreement among States that have different fiscal priorities. The GST was not reached easily.

The situation in the indirect tax environment in India was decades of fragmentation and cascading levies that resulted in inefficiency and hindered development. Until 2017 the country was governed through a diffuse system of central and state taxes, including central excise duty, service tax, countervailing duty, special additional duty and a range of state taxes including Value Added Tax (VAT), entry tax, purchase tax and luxury tax. This patchwork resulted in tax-on-tax impacts also referred to as cascading where input taxes paid at one point could not be

⁴ Central Goods and Services Tax Act, 2017, No. 12 of 2017, INDIA CODE (2017).

⁵ Union Territory Goods and Services Tax Act, 2017, No. 14 of 2017, INDIA CODE (2017).

fully offset against the taxes owed at a later point. Besides, the variety of levies and non-uniformity among States created a large inter-State trade barriers to business such that companies were forced to have different warehouses and compliance systems in various jurisdictions merely to maximise taxes. The GST came into practice in July 2017 thus an Indian fiscal watershed reforms.

Essentials vs. Luxury Goods: Classification and Challenges

Goods and services Tax (GST) system in India has a number of different tax slabs based on the effort by the government to discern between a basic need and non-essential luxurious goods and services. This category aims at the balanced consideration of two goals: social equity and income collection. Basic commodities such as unbranded food grains, fresh vegetable and pulse, milk, life saving drugs and simple education materials are usually under the zero percent or five percent tax bracket⁶. Such preferential treatment is aimed at achieving affordability to the low and middle income households hence narrowing the regressive effect of consumption taxes.

The system aims at preserving the economic wellbeing of the general population as well as the overall revenue neutrality by ensuring that the prices of basic commodities remain low. At the other extreme, luxury and non-essential goods such as high-end automobiles, high-end electronic products, branded jewellery, alcoholic beverages and other luxurious products attract the highest slab of 28 percent tax with an extra sin or compensatory tax⁷. These excess rates are not only useful in increasing revenue for the government, they also put off-put potential buyers of products with negative externalities (such as tobacco and alcohol) and also contribute to the progressive nature of the indirect taxation.

Nevertheless, despite these obvious plans, the real working out of this classification system is not without certain problems. Many products are in the grey area and thus it is hard to come up with specific boundaries between necessities and luxuries. An example is whether or not packaged bread or ready-to-eat cereals are a staple or processed convenience food? Would branded clothing which functions as a basic need to which clothing serves should be taxed as a need, or a luxury lifestyle item? Equally, cosmetic and personal care products typically fall somewhere in between daily need and luxurious indulgence. These uncertainties are further

⁶ Central Goods and Services Tax Act, 2017, No. 12 of 2017, INDIA CODE (2017).

⁷ Goods and Services Tax (Compensation to States) Act, 2017, No. 15 of 2017, INDIA CODE (2017).

complicated by the fact that GST council constantly varies the tax rates and exemptions and in many cases this is being influenced by the industry lobby groups, the political force or a shift in consumption trend in various states. The result is the dynamic terrain that adds to the taxpayers and administrators even further. The impacts of this grey line are doubled. There is also classification battle where businesses strive to be placed in lower tax bracket in order to pay less in terms of taxes. Conversely, the tax agencies are accused of having the responsibility of placing rates that are open to interpretation which leads to court cases and protracted adjudication processes. This not only increases the administrative expenses, but it also creates the opportunity to evade taxation as companies will take this as an opportunity to make their profits at the expense of others by exploiting any loopholes. It also interferes with the predictability and fairness of the system to the taxpayer confidence of the predictability and fairness of the system, which is part and parcel of voluntary compliance.

To solve these problems, academics and policy researchers have highlighted the necessity of a more open and principle-oriented approach to the classification⁸. This method may be based on pre-determined standards, like the principle of ability-to-pay, which tax structures individuals and organizations based on their economic potential, and an evaluation of real social need, which objectively determines things that are necessary as the basic standards of living. Through strict, uniform and well clarified rules, the GST system may lead to less ambiguity as well as litigation as well as ensuring that in the process of making the key items affordable, luxury and non-essential items provide the necessary contribution to the government revenues. Formal structuring would also enable a rational response of the system to the socio-economic changes, technological advances, and customer behaviour changes without compromising clarity and fairness. Essentially, the classification dilemma indicates a fundamental wrangle in the design of the GST in India the willingness to shield the common consumer against high indirect taxes, and the willingness to tax discretionary consumption to finance the revenue requirement. To resolve this tension, it is necessary not only to take careful decisions but also to design objective and principle-driven rules that are unlikely to be threatened by political and business interests, and this will result in an effective and fair system not only in the long term.

⁸M. Govinda Rao, Goods and Services Tax in India: A Work in Progress, NIPFP Working Paper (2019).

Ethical, Social, and Economic Implications

The tiered nature of the GST has a direct effect on the distribution of the tax burden among income groups.⁹ Progressive and regressive effects are one of the major issues: since GST is a consumption tax everyone will pay the same rate on a given product, however low income families will use higher proportions of their income on consumption. To compensate this regressivity, zero-rating or taxing necessities such as basic food and medicine at 05 percent can be used, with higher rates on luxuries and so-called sin taxes, to make the system more progressive.¹⁰ Nevertheless, even when borderline goods like packaged foods or branded clothing fall under a higher slab, the poor would still be left paying a bigger portion.¹¹ Socially-justice wise, even-handed taxation is indicative of the principle of ability-to-pay. Securing necessities means that individuals are not required to spend beyond their financial means on meeting basic needs, whereas the luxury items taxed greater are those that are already considered discretionary spending and can be used to provide redistribution through governmental services¹². Clear categorizations and uniform implementation cannot, therefore, be only technical specifications but also ethical requirements. In the economic arena, GST rates influence the behaviour of the market and market efficiency.¹³ To reduce demand in luxury goods or stimulate the black-market, high taxes on luxuries can be implemented and low or no taxes on necessities can be implemented to retain buying power and stabilize prices. A balanced framework may facilitate an effective distribution of resources, but the unpredictability of a frequent change of rates, or vague classifications, foster uncertainty, raise compliance expenses, and deter investment. To the point, the moral and social justification of differentiation of the GST rates should correspond to the rational economic incentives in order to attain equity and growth.

Comparative Perspectives and Relevant Indian Case Law

The GST classification in India has led to a lot of judicial review, as there is always a challenge in separating necessities and discretionary luxuries. A number of high-profile cases

⁹ Central Goods and Services Tax Act, 2017, No. 12 of 2017, INDIA CODE (2017).

¹⁰ GST Council, Rate Structure, <https://gstcouncil.gov.in/gst-rates>.

¹¹ Press Release, GST Council, Decisions on Rate Rationalisation (Dec. 2023), <https://pib.gov.in/PressReleasePage.aspx?PRID=1998772>.

¹² R. Avi-Yonah, The Three Goals of Taxation, 60 Tax L. Rev. 1, 7–12 (2007), <https://repository.law.umich.edu/articles/1234>.

¹³ Organisation for Economic Co-operation & Development (OECD), Consumption Tax Trends 2024, at 45–49, <https://www.oecd.org/tax/consumption-tax-trends-20725124.htm>.

demonstrate how hard it is to make a distinct line between these categories in real life. In *Union of India v. The Court (Mohit Minerals Pvt. Ltd. 2022, Supreme Court)*¹⁴, however, confirmed that GST Council has a very important advisory role in advising Parliament or State Legislatures on rates and classifications, but its advice is not binding, which is indicative of the federal flexibility of the GST framework. Though it does not directly deal with the issue of necessities versus luxuries, the ruling highlights the ability of states and the Centre to reexamine rate structures on their own, which adds to inconsistency and possible conflicts.

In addition to this, such cases as *Dabur India Ltd. v. Commissioner of GST*¹⁵ and *CE (2022, CESTAT)* and *Girnar Food and Beverages (P) Ltd. v. Union of India (2021, Delhi HC)*¹⁶ raise the awareness of the cases involving classification with direct references to essential goods. In *Dabur*, the tribunal was to decide whether some of the ayurvedic health beverages would be classified as medicaments and charged at a lower rate or beverages and charged at a higher rate, but in the long term, the tribunal ruled in favour of the former and at the expense of the fine distinction between health-oriented consumables and luxury products. Equally, the Delhi High Court in *Girnar Case* determined whether flavoured milk should be taxed as milk, a main food at subsidized rates, or a beverage, which is a higher tax, and ruled in favour of the former, that is taxed as milk at 5%. These rulings indicate the judicial awareness of the ordinary consumer goods and the need to interpret GST in a way that safeguards affordability.

The other educative case is *Nestle India Ltd. vs. Commissioner of CGST (2021, CESTAT)*¹⁷ whereby the case was whether to fit KitKat in the fold of wafer cookie or chocolate, which was taxed differently. The tribunal has laid stress on the inflexibility of the application of tariff headings, and the need to possess objective criteria in classification, and justify that indistinctness of the groups of products may impose administrative as well as controversial loads. Combined, these cases reveal the challenges of the multi-slab system of the GST: even though low rates can be used in protecting needs and high rates are used in protecting wants, the multi-slab system has proved to contribute to the high number of law suits, grey areas, and inconsistent application that need more transparency and classification on principles. India can

¹⁴ *Union of India v. Mohit Minerals Pvt. Ltd.*, (Sup. Ct. India 2022), <https://indiankanoon.org/doc/183869429/>.

¹⁵ *Dabur India Ltd. v. Commissioner of GST & CE*, (CESTAT 2022), <https://www.casemine.com/judgement/in/665f36b0445ee2217bfa40aa>.

¹⁶ *Girnar Food & Beverages (P) Ltd. v. Union of India*, (Delhi HC 2021), <https://indiankanoon.org/doc/173862104/>.

¹⁷ *Nestlé India Ltd. v. Comm'r of C.G.S.T.*, 2021 (52) G.S.T.L. 512 (C.E.S.T.A.T.), <https://www.casemine.com/judgement/in/61f3adfc50db91749ec3ff2>.

learn some lessons about comparative international experience. European Union has a standard VAT but is offering better rates on basic commodities such as food and books with minimal list of exemptions which is designed to keep it very simple and not controversially so. Australia has a comprehensive 10 percent GST with exemptions on basic food, health and education services, which itself is an indication that having a unified standard rate does not imply any lack of carve-outs (of necessities). Similarly, Canada has a dual GST/HST system of basic groceries that will not be taxed, luxury items with high tax rates, which will lead to an effective model of relief.

Combined, Indian judicial experience and foreign experience demonstrate that even though GST is aimed at safeguarding important goods by reduced rates and tax discretionary consumption by increased rates, absence of definite statutory definitions and principle-based classifications still creates uncertainties. Enhancement of legal and administrative framework by providing clear guidelines, standard criteria and visibility of policies would help to increase efficiency, equity and trustworthiness of taxpayers towards the GST system in India.

Critical Analysis:

The concept of multi-slab GST in India was conceived with a good purpose: to make luxuries expensive and leave the necessities of life affordable to people. Theoretically, it reflects the ability-to-pay principle, i.e. those richest will carry a higher proportion of taxes, whereas common households are not subjected to unnecessary pressure. As a matter of fact, though, the system has a way of stumbling under its own weight. The five rate system, 0, 5, 12, 18 and 28, has resulted in a maze of rules and exceptions where not only the taxpayers but also the administrators are trapped in a maze of confusion. The issue is in determining what constitutes necessities.

The borderline goods such as packaged breads, fortified health drinks, branded milk or even some of the hygienic goods such as imported soaps denude the distinction between necessity and indulgence. As an example; a standard packaged bread loaf in a metro city turns out to be taxed 12% and unbranded staples are not taxed or taxed at 5%. In the same line, a herbal energy drink can be categorized as a beverage and have a higher rate though it is taken everyday by the working-class families due to health-related benefits.

Slabs also increase the compliance cost, as well as distort the market behaviour, economically.

There is no better way than taking up tax categories and bending over backwards to ensure that companies are treated favourably than the time companies are actually improving their products or tapping into new markets. The other bakeries, which shift their ingredients or packaging to get the 5 percent slab, or beverage companies can alter the labelling as such in order to avoid the high tax, where taxation has never been a genetic economic means but rather a game. The uncertainty is further heightened by the regular amendments that are being made by the GST Council, sometimes not out of the economic reasons but rather as a result of the political trading. The supply chains become feeble, the process of planning is disrupted and innovation is placed on the backburner. The implication of these problems is that the less-is-more. Tiering simplified (single standard rate on most products, and a few and clearly defined zero rated essentials) can help cut disputes, litigation, and administration costs by a significant margin. There are the proponents of two-tier system; low rate on the necessities and equal high rate on all the other items. This would be supplemented with focused subsidies or cash transfers to maintain the buying power of low-income families without expanding the tax code with exceptions.

Policy change must be made to be clear, transparent, and predictable. The GST Council can make publicly available principle-based criteria of classification on a more or less regular basis. The fact that the ability-to-pay principle is not an ideal but was incorporated into the law would give the courts a more tangible guide to be followed in the case of conflict and would reduce the amount of litigation in a court and would instill more trust in the citizens. There is a lesson to be learnt throughout the world experience. The very narrow list of exemptions of essentials that is highly restrictive in the EU and the broad-based GST with narrow carve-outs in Australia indicate that a system of taxation can be both simple, predictable, and socially protective. Primarily, the GST in India has a spectacular vision an integrated market that imposes so heavily on luxury spending and guards the need. However, the current system of twists and turns of slabs and exemptions replaces fairness and effectiveness and turns a system that is supposed to be progressive into a bewildered web on paper. At last, however, making GST leaner and more principle based, i.e. a framework that is not complex but focussed in its social protection, would imply that GST will ultimately have a chance to implement the constitutional promise of fairness, transparency, and seeing basic goods like bread, milk, and medicine affordable in the hands of the millions of households that need them on a daily basis.

Conclusion

This paper aimed to discuss whether the Indian GST system actually addresses the two objectives of revenue collection and social justice. The results indicate that though the multi-slab system theoretically secures the necessities by levying low taxes and the luxuries by increasing the rates, the truth is to the contrary. The grey categories such as the distinction between health drink and medicament, or the drink and non-drink categories, are easily controversial, impose administrative overheads, and occasionally propel those semi-necessity items into the high tax bracket, which is not equitable. The economic impact of a number of slabs is compliance costs and market distortion which encourages lobbying and product reclassification rather than efficiency. The cross-country comparisons have shown that simpler models such as the broad-based GST in Australia with few exemptions or the lower rates in the EU are a lot more effective and their protection mechanisms are simpler to satisfy the needs and to curb distortions. Having a balance between revenue and equity therefore necessitates a shift to a more principle-based structure which is lean. A two-rate or single-rate GST, with a strictly sparse zero-rate list and conditional subsidies or direct transfers would not only cushion the households with low incomes, but would also ensure revenue stability. Open principles in the law, and in keeping pace with the experience of other courts, would bring India near to the constitutional ideal of a just and rational tax regime that will enable bread to be affordable and reduce the tax evasion of the tax by diamonds.