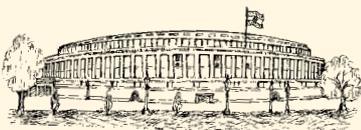


# Issues for Parliamentarians

To facilitate informed discussions among Indian Parliamentarians on key economic policy issues

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**Parliamentarians' Forum on Economic  
Policy Issues (PAR-FORE)**

## Goods and Services Tax *A Key Instrument for Improving Economic Governance in India*

The concept of Goods and Services Tax was first presented during 2007-2008 budget session by the then Union Finance Minister, P Chidambaram. It was presumed that GST will be a significant breakthrough towards initiating a comprehensive indirect tax regime, and if implemented, would be termed as single biggest tax reforms in India. This Issue Note for our parliamentarians, legislatures and the polity at large including non-state actors deals with the concept and importance of GST, summarises some key issues regarding its implementation, and offers some important points for discussion.

### INTRODUCTION

Among the major changes expected from the rollout of GST is to reduce the indirect tax burden. Other federal countries, such as Australia have around 30.2 per cent share of indirect tax in total tax revenue and in Brazil it is around 40 per cent. Over the years, India has witnessed a fall in the share of indirect tax in total tax revenue but it still remains around 43 per cent.

Furthermore, the implementation of the GST would allow the Central as well as State governments to avoid multiple layers of taxation that currently exists in India leading to the creation of a single Indian market. The system will facilitate abolition of taxes such as octroi, central sales tax, state-level sales tax, entry tax, stamp duty, turnover tax, tax on consumption or sale of electricity, taxes on transportation of goods and services, etc.

After missing two earlier deadlines, the plan is to start operationalizing the GST by August 2012, but as the Centre and States have not been able to arrive at a consensus on various issues, it is expected to take some more time. States fear that the implementation of GST might impinge on their financial autonomy as they would not be in a position to tax goods and services directly.

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While taking into consideration the current situation, fresh initiatives are required on the part of both the Centre and the States. States need to realise the importance of GST for the Indian economy as it will provide competitive edge to India in internal and international trade. It is highly recommended for States to come forward and support the proposed tax regime that will result into the creation of a single market.

***A study done by the National Council of Applied Economic Research estimates that the revenue-neutral GST rate for goods and services across the country should be between 6.2 and 9.2 per cent.***

On the other hand, the Centre should build consensus among States for effective implementation of GST. It is required to develop a transparent system that leaves no doubt in the mind of States regarding possible fall in their tax revenue once GST is implemented. Sharing mechanism under the proposed centralised tax system should be dealt with utmost care leaving no space for discrepancies.

It is obvious that GST will be a big tax reform and in a federal economy like India, it would take some time before the Centre and the States arrive at a consensus.

Some key issues regarding the implementation of GST are as follows.

### **REVENUE NEUTRALITY**

One of the major concerns is revenue neutrality. States which are generating high tax revenue have shown apprehension against the possibility of suffering revenue losses after the implementation of GST. In order to address their concerns, the Centre should take decision on incorporating various existing Central and State taxes into GST as States will lose their power to tax goods directly. The tax will be collected at the Central level and shared between States. Developing infrastructure for collection of taxes without any pilferage is required to avoid reduction in tax revenue.

States have also given suggestion to the Centre for addressing issues related to revenue neutrality. They have requested the Centre to frame an objective compensation mechanism for revenue loss. Also, it is very important for the Centre and the States to devise a proper framework that will ensure equitable distribution of tax revenue among the Centre and the States and also mitigate any chance of fall in tax revenue for the States.

A study done by the National Council of Applied Economic Research estimates that the revenue-neutral GST rate for goods and services across the country should be between 6.2 and 9.2 per cent. Another study done by the Task Force on GST set up by the 13<sup>th</sup> Finance Commission has recommended five per cent GST at the central level and seven per cent at the state level.

The 13<sup>th</sup> Finance Commission also recommended that States should be sanctioned with a grant of Rs. 50,000 Crore between 2010-11 and 2014-15 to compensate them on account of possible revenue losses after the implementation of GST.

### **COMPENSATION TO STATES**

Compensation to States against the gradual phase-out of Central Sales Tax has become a major bone of contention between the Centre and States, and is threatening to derail the plan to introduce GST. Many States have shown their dissent over the decision of the Central Government to distribute Rs. 300 Crore as CST compensation as against Rs. 19,000 Crore demanded by States for lowering their CST rates from four to two per cent.

According to the States, gradual lowering of CST rates have led to a fall in their tax revenue during the past few years and it should be the responsibility of the Central Government to compensate them on account of revenue loss and that they should

continue compensating till the time GST is fully implemented. According to some of them, if the Central Government is not willing to provide compensation as per their calculation, they might consider restoring the CST rate to its original level of four per cent.

The Centre should review its position on compensation to States as funds are required to implement various state-level schemes. At the same time, States should reconsider their threat to roll back the CST rate to four per cent as it would be a regressive step toward the idea of establishing a common Indian market.

### DISPUTE SETTLEMENT

Introduction of the GST is one of the top priorities of the Government. Owing to lack of communication between the Centre and the States, the initiative that could have been the biggest tax reforms in independent India, is still hanging.

The reason behind the delay in the implementation of GST has been the concerns raised by States over the issues of fiscal autonomy, revenue loss, extent of compensation, etc.

In order to redress these issues which may lead to disputes between the Centre and the States, the Constitution Amendment Bill, 2011 has proposed the creation of a GST Dispute Settlement Authority. On the other hand, the Empowered Committee of State Finance Ministers on GST has argued against the creation of such an authority. According to this Committee, the proposed GST Council headed by the Union Finance Minister with one representative from the Centre and rest from the States should be assigned with dispute settlement powers and not the Authority as mentioned.

Both the Centre and the States may have their own mandate over the creation of a body that will have power to intervene between the Centre and States to resolve disputes that may arise from various issues regarding the implementation of GST.

The Centre and the States should sit together to arrive at a consensus over the creation of this dispute settlement body and also to settle other issues. Already too much time has been spent in finalising the structure of the GST and any further delay in its implementation will have a negative effect on the Indian economy.

### NEGATIVE LIST

Negative list is defined as that which includes goods and services that the Government intends to exempt from the ambit of the GST. In January 2012, the Empowered Committee of State Finance Ministers on GST has approved a Negative List. However, still there are issues pertaining to the definition of goods and services to be included in this List.

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### TECHNICAL ASSISTANCE AND CAPACITY BUILDING OF STATES

For successful implementation of GST, it is an imperative to iron out operational bottlenecks. The most important task is to build adequate infrastructure (administrative as well as information technology enabled services) that will cater to the requirements

of collection of the GST. Without a well-designed infrastructure across the country, the benefits of the GST will remain elusive. The Central Government should arrive at a consensus with the States on developing such infrastructure within an earliest possible timeframe.

It is also important to provide technical assistance and capacity building at the state level so as to ensure an effective implementation of the GST. Technical assistance to States would help in developing and benchmarking good practices, which will help enhancing GST collections at the State level. Capacity building programmes for government officials and other relevant stakeholders on technicalities related to GST would help in increasing their efficiency.

The Central Government should gather good practices from other countries having the experience of successful implementation of GST-like indirect tax regime.

### IN LIEU OF A CONCLUSION

The motive behind the implementation of the GST is to create a single and unified Indian market. Its implementation will result in a comprehensive indirect tax regime in India, covering manufacturing, sale and consumption of goods and services. GST will improve tax collections by removing barriers and other discrepancies of doing inter-state trade and will integrate the Indian market which is expected to improve our economic growth.

Following are few immediate benefits once the GST regime is implemented in India:

- Broadening of the indirect tax base
- Enhancement of gross domestic product by about one to two per cent
- Help in promoting inter-state trade, exports, raising employment opportunity and boosting overall economic growth
- GST will be charged only at the destination point, minimizing the chances of irregularities in tax collection; thus, will ensure a more transparent system of economic governance in India.

### ISSUES FOR DISCUSSION

- ◆ How to ensure effective communication between government officials and other stakeholders on political and economic rationale behind indirect tax reforms in India through the introduction of a Goods and Services Tax?
- ◆ Should “essential commodities and services” be exempted from the ambit of the GST?
- ◆ How to ensure a better Centre-State fiscal/financial relation through the introduction of the GST?
- ◆ How to monitor the implementation of the GST regime in respect to inter-state trade facilitation, employment generation and overall growth of the Indian economy?

***GST will improve tax collections by removing barriers and other discrepancies of doing inter-state trade and will integrate the Indian market which is expected to improve our economic growth.***

For further information, please contact

**CUTS**<sup>®</sup>  
International

D-217, Bhaskar Marg, Bani Park, Jaipur 302016, India.  
Ph: 91.141.2282821  
Fx: 91.141.2282485  
E-mail: cuts@cuts.org  
Website:  
www.cuts-international.org

To post comments, please write to:  
PAR-FORE@yahoo.com