

## Introduction

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The objective of this book is to provide a comprehensive overview of the journey towards introduction of the goods and services tax (GST) in India. The book is based on research carried out at the National Institute of Public Finance and Policy (NIPFP), New Delhi, spanning over a decade. The basic objective of the volume is to highlight the contributions of the chapters in shaping the design and structure of the GST as well as capturing the evolution of the concept of GST in India since the late 1980s. The Indian GST is unique for its structure, design and administrative framework. The country-specific experience discussed in the chapters will help the readers to familiarise themselves with the alternative arrangements available with reference to design, structure and administration of GST from the perspective of a federal country. The concept of GST evolved over time in India and successive tax reform committees played an important role in shaping the Indian indirect tax system that finally culminated in the introduction of GST. Designing a destination-based dual value-added tax (VAT) system for a federal country like India was a challenge and from this perspective the Indian GST is unique. In this volume an attempt is made to capture the historical journey of policy research that was initiated since the inception of the government's interest in a national-level GST for India in the union budget speech of 2006–07. The introductory chapter of the book summarises the recommendations of successive tax reforms committees, constituted since Independence, with specific reference to the indirect tax regime. The recommendations contributed to a clear focus on the removal of the cascading of taxes (building up of taxes) and transition to a destination-based GST regime in India. This volume covers tax reforms carried out both in central and state indirect taxes during the last four decades and provides a background for the introduction of GST.

The chapters were written at different points in time spanning a decade and contributed to the then-on-going discussion on GST. Each chapter of the book is based on rigorous theoretical as well as empirical research. In many countries, GST has been a tax levied by the national government. This has certain advantages. However,

given the constitutional assignment of tax powers in India, with the states having a significant role in indirect taxes, that arrangement was not an option for India in its quest to introduce a regime with lower levels of cascading. The Indian experiment of an alternative model for GST is therefore interesting as a reference point for a discussion on a VAT for federal countries with strong sub-national governments.

The book is divided into three parts – *Genesis and Evolution of the Concept of GST in India*, *Revenue Neutrality of GST* and *GST Administration and the Possible Impact of GST on the Indian Economy*. The first part consists of four chapters and it aims to capture the genesis and evolution of the concept of GST in India.

The introductory chapter documents the evolution of the concept of GST in India by reviewing reports of successive tax reforms committees, constituted since Independence. Removal of cascading of taxes and designing destination-based VAT system are the major criteria adopted in the chapter to evaluate the recommendations of the tax reform committees. Following the recommendations of various tax reforms committees, introduction of reforms at different points in time helped in sequencing tax reforms and also paved the way for a ‘big bang’ tax reform such as GST in India. For a federal country like India, having a fairly decentralised system of fiscal arrangement, sequencing of tax reforms plays an important role in minimising the disruption from major tax reforms such as GST.

In the second chapter, Dr Amaresh Bagchi explores alternative designs of GST for India and, taking a cue from the Canadian QST-GST model, he recommends a dual VAT/GST. The chapter also explores possible arrangements for the administration of GST and opines that mutual trust and coordination between the centre and the states would be crucial for the smooth implementation of GST. Dr Bagchi makes the case for an ‘independent quasi-judicial body to enforce agreements between the centre and the states and among the states.’

Chapter 3 is a criticism of the approach adopted by the Thirteenth Finance Commission (TFC) with reference to GST. Recommendations of the TFC are based on the findings of the study of the Task Force constituted by the TFC. The Thirteenth Finance Commission was required to look into the revenue impact of the introduction of the goods and services tax. Its report, based on the recommendations of a task force constituted to study the issue, recommends a highly uniform and centralised format that does not adequately recognise a tax reform exercise in a multi-level fiscal system that involves compromises and trade-offs. While several flaws can be pointed out in its design, developments that have taken place before and since the report was submitted have to a large extent rendered the commission’s recommendations irrelevant. All this underlines the need for a model that goes beyond uniform rates of tax and allows states to vary beyond a floor, with a fixed classification of commodities and services, so that they can choose an appropriate rate to ensure that their revenue requirements are met.

Chapter 4 discusses the rationale behind moving towards the GST system and provides in-depth analysis of challenges before the introduction of GST. To remove

the cascading effect of taxes and provide a common nation-wide market for goods and services, India is moving towards the introduction of GST. Under the proposed indirect tax reform both central and state governments will have concurrent taxation power to levy tax on supply of goods and services. It is expected that the proposed regime will improve tax collection and minimise leakage, as both central and state tax administrations will monitor and assess the same set of taxpayers. There are several challenges before the introduction of GST and these can be classified into two broad heads: (a) GST design and structure related and (b) GST administration and institutions. On design-related issues, a broad consensus on choice of revenue neutral rates (RNRs), harmonisation of GST rate(s) across states, harmonisation of list of exempted and excluded goods and services and thresholds for mandatory GST registration across states are yet to be reached. Similarly, there are several issues involved in tax administration (between central and state tax administrations and also across state tax administrations) that are yet to be resolved. Taking cognizance of the discussion available in the public domain, this chapter attempts to provide a broad contour of the proposed GST regime and highlights major challenges that require immediate attention of the governments.

The debate on fiscal autonomy versus tax harmonisation is an important issue for a tax reform like GST which involves multiple levels of government with independent taxation power. The evolution of GST in India has had to contend with this issue and therefrom emerge many of the features of the GST regime in place today. These issues are explored in some detail in the first part of the volume. Given that a number of very important taxes were to be subsumed into GST, it was important for all governments concerned that the GST regime be revenue neutral. Some of the issues that impacted the discussion on revenue neutrality are discussed in Part 2. There are three chapters in Part 2. The first two chapters focus on issues related to the revenue neutrality of the tax reform. The third chapter deals with policy alternatives available to include excluded items from GST and show the possible extent of tax cascading that will be retained if major energy sources (like electricity and petroleum products) are kept out of the GST system.

In the discussion on RNR, two alternative estimates are available. The first estimate was the result of the study carried out by the NIPFP. This estimate is presented in Chapter 5. The second estimate is the outcome of the Committee on the Revenue Neutral Rate (RNR) constituted by the Ministry of Finance and headed by the Chief Economic Adviser. This estimate is available in the public domain.

The two estimates differ in their assumptions and Chapter 6 carries out an in-depth analysis of the two estimates and identifies reasons for differences.

The search for revenue neutrality became a contentious issue and research carried out at NIPFP played a pivotal role in shaping a contour for the GST rate. Chapter 7 analyses the impact of keeping crude petroleum, natural gas, motor spirit (gasoline/petrol), high-speed diesel (diesel), aviation turbine fuel and electricity out of the VAT scheme. Specifically, the chapter finds that keeping these items out of the input

tax credit mechanism (either partially or fully) would result in cascading. Through an input–output framework, this study proposes some alternatives to the proposed design of the GST and assesses the implications for cascading and prices. It captures the degree of cascading across 48 sectors under different scenarios and explores alternative policy options to phase out under-recoveries of oil marketing companies on account of sales of diesel and petrol under the administered pricing mechanism.

The third part consists of two chapters. The first chapter explores alternative options for GST administration while the second chapter and the Conclusion provide assessment of the possible impact of GST on the Indian economy and also provide a critical view of the present structure of the GST.

There are uncertainties associated with investment, economic growth and inflation in the post-GST regime and, based on international experiences, possible impacts are highlighted in this book. A simple tax system is desirable from both tax compliance and administration points of view. However, the final design of the GST retains complexities of the previous tax regime and it may raise compliance cost as well as tax evasion.