A Road Map for Implementing the Goods and Services Tax

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This paper examines the current steps being taken to implement the Goods and Services Tax in India. It analyses the provisions of the 115th Constitutional Amendment Bill and the Finance Act 2012 relating to service tax and notes the need for changes if the policy goals of the GST are to be met. It proposes steps to be taken for speedy implementation of GST. These include five changes to the Bill and five steps the Government of India needs to take to bridge the present "GST trust deficit" between it and the states.

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1 Introduction

The Goods and Services Tax (GST) tax will contribute to removing market distortions and spur the growth of the economy. A National Council of Applied Economic Research study (NCAER 2009) has documented the misalignment in the allocation of resources as well as production inefficiencies caused by the present taxation regime. It has estimated that the implementation of a comprehensive GST across goods and services will increase gross domestic product (GDP) growth by between 0.9% and 1.7% while making industry more competitive.

The White Paper on Black Money (Ministry of Finance 2012a) recognises the need to control this scourge and foster the growth of the legitimate economy. At five different places, in different contexts, this paper underlines the importance of implementing GST promptly and efficiently. These include building up of data bases and their integration, preventing the generation of black money and monitoring specific sectors susceptible to the ingress of black money.

While the Government of India (GOI) clearly recognises the importance of putting in place a GST as early as possible, it is often felt that adequate and coherent efforts are not being made to achieve this end. This paper will examine these efforts and suggest steps which need to be taken if these efforts are to fructify promptly. It is divided into eight sections. Section 2 summarises the steps which have been taken so far for implementing GST. Section 3 analyses the provisions of the 115th Constitutional Amendment Bill introduced in Parliament in April 2011 to enable the GST and suggests changes which may be required. Section 4 attempts to outline a philosophy for the proposed Constitutional Amendment Bill based upon which its provisions should be drawn up. Section 5 looks at the service tax provisions in the Finance Bill 2012 and notes that some of them anticipate the passage of the Bill and may not be consistent with the allocations in the Seventh Schedule. Section 6 looks at the political economy considerations and Section 7 analyses the role of the GOI and suggests five steps the centre should take to demonstrate its firm commitment to the GST and strengthen the conviction of the states on the need to do so. Section 8, the conclusion, while bringing together the recommendations made in the paper proposes a road map for the implementation of the GST.

2 Present Position

There has been significant progress on the Indian tax firmament since the modified value added tax (MODVAT) was introduced in 1986. Value added tax (VAT) was introduced by state

governments in a staggered manner between April 2003 and January 2008. Encouraged by the successful implementation of VAT, the Government of India in February 2007 ambitiously indicated that GST would be implemented nationally by 1 April 2010. Concomitantly, the need to eliminate the origin-based central sales tax (CST) was recognised. It was reduced from 4% to 2% in two steps but has not yet been brought down to zero.

The Thirteenth Finance Commissions (THFC) in its report (2009) recognised the critical role GST could play in spurring the growth of the economy. It attempted to incentivise state governments to implement a "flawless" GST by earmarking Rs 50,000 crore to fund possible losses incurred by states over a period of five years. The "flawless" GST defined by the THFC includes four broad characteristics:

- Subsumation of all indirect taxes, cesses and surcharges levied by the centre as well as the states into the GST.
- No distinction being made between goods and services which would be subject to a single rate.
- A minimal list of exemptions and a common threshold criterion for the centre and the states.
- To maintain revenue neutrality, a special provision to allow for petroleum products to be subject to an additional levy, apart from GST.

These recommendations did not find favour with either the centre or the states mainly for the following reasons:

- The levy of a single rate (though effectively the THFC was willing to accept two rates) was seen as both unrealistic as well as an attempt to crimp the fiscal autonomy of the states.
- The inclusion of the real estate sector and the railways in the GST tax base was seen as not pragmatic.

Both the states and centre were chary of the recommendation to put in place a binding agreement between the centre and states to prevent deviations and to penalise non-compliance.

Based upon subsequent discussions in the Empowered Committee (EC), the GOI introduced the 115th Constitutional Amendment Act in Parliament. It also proposed a negative list-based approach for the levy of service tax in the Finance Bill of 2012. The consistency of these two initiatives with the stated objective of putting in place a GST framework is reviewed below.

3 The Constitutional (115th Amendment Bill) 2011

This Constitutional Amendment Bill (Bill) was introduced in the Lok Sabha by the finance minister in March 2011 (Ministry of Finance 2011). The Bill seeks to amend the Constitution to authorise the levy, collection and appropriation of the GST by both the centre and the states.

The statement of objects and reasons of the Bill is unimpeachable and reads as:

- The GST would replace a number of indirect taxes presently being levied by the central government and the state governments and is intended to remove cascading of taxes and provide a common national market for goods and services.
- The proposed central and state GST would be levied on all transactions involving supply of goods and services except those that are exempt or kept out of the purview of the GST.

The Bill is presently being considered by the Parliamentary Standing Committee on Finance. A preliminary reading of the Bill raises a number of concerns on whether the Bill as drafted would fully meet its declared objects and reasons including its primary purpose of providing a common national market for goods and services.

It also does not appear that approval of the constitutional amendment will pave the way for quick implementation of GST. Some of these concerns are outlined here.

3.1 Definition of GST

Article 366 is the definitional Article of the Constitution. The Bill seeks to insert clause 12 A in this Article to define the GST as "any tax on the supply of goods or services or both except the taxes on the supply of the following goods (hereinafter called specified goods in this paper) namely: (i) Petroleum crude, (ii) high speed diesel, (iii) motor spirit (petrol), (iv) natural gas, (v) aviation turbine fuel (ATF), and (vi) alcoholic liquor for human consumption."

The outcome of accepting such a definition of GST appears to be: (i) This definition of the GST can be changed only through another constitutional amendment. (ii) All items not in this of excluded goods list will be subject to the GST.

This specific stance adopted on the definition of GST must be consistent with the stance adopted regarding the subsumation of the corresponding taxes into the GST by the centre and the states, respectively. For example, as the six goods specified above are exempt from GST, the Bill proposes simultaneous amendments to Entry 84 of the Union List and Entry 54 of the State List to empower the centre and the states to independently tax the manufacture and sale respectively of these six goods only while allowing for the subsumation of the excise/sales taxes of the remaining goods into the GST.

However, such a consistency in approach does not appear to have been adopted universally to allow for integration of all taxes which could possibly be subsumed into GST in the future. For example, the inclusion of real estate into GST. The White Paper on Black Money recognises that the real estate sector which comprises 11% of the GDP is a favoured avenue for "parking unaccounted money and a larger number of transactions in the real estate sector are not reported or underreported". Despite such an explicit acknowledgement, the Bill does not provide the headroom for enfolding the real estate sector into the gross state domestic product (GSDP) even at a later date, if not immediately. This could have been achieved by making suitable changes to the proposed definition as well as amending Entry 63 in List II and Entry 44 in List III which empower the state and central governments in matters relating to stamp duty.

Similarly, recent events sparked by the Supreme Court's views on the auction of natural resources will put upward pressure on the price of coal in India. This would have been the right time to recognise the need to enfold electricity duty into GST by suitably accommodating this contingency in the definition of GST and in Entry 53 of List II. This would provide significant relief to power producers who would then be able to set off their input tax, making power costs more competitive.

The proposed amendment to Entry 84 of the Union List, seeks to empower the centre to continue to levy excise on petroleum crude, high speed diesel, motor spirit, natural gas, ATF and tobacco products. Comparing this to the exclusion list proposed for Article 366, it is seen that tobacco has been included in Entry 84 but not excluded from the purview of GST as defined in the proposed clause 12 A of Article 366. Thus, the Bill envisages that tobacco will be included in the GST base, but simultaneously subject to an excise by the GOI.

Correspondingly, the proposed amendment to Article 54 of the State List empowers the states to levy sales tax on the same list of goods with the notable exception that tobacco is replaced by alcohol for human consumption. Thus in this part of the Bill, it is envisaged that alcohol for human consumption will be excluded from the GST base but subject to levy of tax on sales by the state government.

Both tobacco and alcohol, seen as luxury goods, need to be treated symmetrically in the proposed GST. The Bill does not do so. Tobacco is kept within the GST but subject to a central levy. Alcohol is kept outside GST, similar to the other specified goods, except that in its case, both excise and sales taxes will be levied by the states. Such a framework seems to be part of a sharing arrangement worked out between GOI and the states where GOI gets to levy additional excise on tobacco in return for states being allowed to continue levying both excise and sales tax on alcohol for human consumption after GST is implemented.

This arrangement, where excises continue to be levied outside GST which cannot be set off against tax paid dilutes the very raison d'être of the GST. The THFC had recommended that all the specified goods be brought into the ambit of GST and to maintain revenue neutrality, a special levy imposed wherever required. Such an arrangement has been envisaged for tobacco in the Bill. It is a pity that this framework was not extended to all the other six specified goods. Most states derive more than half their VAT revenue from the specified goods and keeping them out from the GST base ignores the valid and felt needs of industry. Such a holistic approach would have ensured a broader based GST and continuity in the GST chain for a larger range of goods resulting in industry becoming more competitive.

Thus, for reasons outlined above, there is a strong case for revisiting the definition of GST.

3.2 Insertion of Article 269(A)

Article 269 as it stands allows for the levy of taxes on the sale and purchase of goods and on the consignment of goods by the centre during the course of interstate trade. It is the basis on which the central sales tax is levied. The CST being an origin-based tax will need to be abolished with the implementation of GST.

The Bill proposes to introduce Article 269(A) which will specifically empower the GOI to levy and collect GST in the course of interstate trade subject to apportionment as may be decided by Parliament. The fact that Article 269 is proposed to be retained without substantive amendment seems to point to a development of a framework which may allow for the existing CST regime to coexist in the future in the GST regime. CST being an origin-based tax and GST being consumption-based tax, this dichotomous approach is comprehensible if a partial rollout of GST in some states is being considered. Whether a partial rollout of GST would be feasible, much less desirable, is a moot point. Another explanation could be the possibility of allowing for a zero rated CST to prevail even in the GST regime, to prevent arbitrage between interstate and intra-state sales. Whatever the problem it seeks to address, the proposed solution, allowing an origin-based tax to coexist in the GST regime, may not be the desirable solution.

The Bill proposes that the interstate GST (IGST) collected during the course of interstate trade should be apportioned between union and the states as prescribed by Parliament after it also determines what constitutes interstate trade. However, the procedure for allocation of proceeds and the modalities of collection of the IGST does not find specific mention in the terms of reference of the Goods and Services Tax Council (the proposed Article 279(A) discussed in Section 3.5 below) even though such items are of extreme concern to all the states who are members of the proposed council.

Further, the tax on consignment of goods which has never been levied since it was introduced by the 46th Amendment, and which is totally irrelevant in a GST framework has not been proposed for deletion in Article 269.

3.3 State List-Entry 52

The proposed amendment to Entry 52 allows for taxes to be levied and collected by a panchayat or a municipality on entry of goods into a local area for consumption use or sale therein. Thus effectively, in a GST regime, local bodies can continue to levy Entry Tax. The spirit of this proposal while being eminently consistent with the 73rd and 74th amendments may actually result in physically hindering the free movement of goods and hamper trade. The exercise of this power by local bodies may result in every panchayat/municipality within which major highways are located, setting up check posts for verification of goods passing through their jurisdiction for collection of entry taxes, wherever appropriate. This would cause significant delays to the movement of goods traffic and would militate against the declared objective of the Bill to provide a common national market for goods and services. The THFC had proposed subsumation of all taxes into the GST including the entry tax. Recognising that this recommendation may result in lowering revenue for local bodies, the THFC had significantly raised devolution to these bodies, making them eligible for up to 2.5% of the divisible pool. Keeping these two factors in mind, all entry tax should be subsumed into GST and this proposal to amend Entry 52 reviewed.

3.4 State List-Entry 62

The proposed amendment to Entry 62 permits taxes on entertainment and amusements to the extent levied and collected by panchayat, municipality, regional council or district council. These taxes will be outside the GST base and it is proposed that input tax paid cannot be set off against them. Entertainment today is big business requiring significant investment in

multiplexes, theme parks, golf courses, and the like. Due to the high cost of land, a number of such centres are located outside city areas within the jurisdiction of panchayats. To compensate for their large investments, entertainment facility owners are entitled to avail of input tax on goods purchased by them for setting up their facilities. Keeping entertainment tax levied by local bodies outside GST may not be desirable, even though the motive to strengthen local government revenue is laudable.

3.5 Creation of Goods and Services Tax Council

The Empowered Committee of State Finance Ministers was set up in July 2000 to provide a forum for states to forge a consensus on indirect tax-related issues. The committee was registered as a society in 2004 under the Societies Registration Act. However, it still does not have any formal status nor do its recommendations carry any force of authority. Its recommendations, derived by consensus, have so far had to be converted to legislation by the respective state governments as well as by the centre. This was the procedure followed when VAT was implemented. Based upon the recommendations of the EC, each state enacted VAT acts in their respective assemblies. Some states did not completely comply with the recommendations of the EC, either at the time of enacting their VAT acts or subsequently. This laissez-faire approach which has been unwittingly tolerated by the EC has resulted in dilution of the VAT framework in the country in the recent past.

If GST is to be a success, there should be uniformity of approach across all states as well as strong disincentives for non-compliance with the agreed framework. This stance was supported by the THFC, which recommended that the constitutional status be provided to the EC through creation of a GST council so that its recommendations would have the force of authority. The Bill ostensibly seeks to implement this recommendation.

The proposed Article 279(A) provides for the creation of the council. It will be chaired by the union finance minister with all state finance ministers as members. The state finance ministers are required to elect from amongst themselves a vice chairman.

The council is required to make recommendations (sic) to the union and the states on: (i) the taxes, cesses, surcharges levied by centre, state and local bodies which may be subsumed in the GST, (ii) the goods and services which may be exempted from the GST, (iii) the threshold limit of turnover below which GST will be exempted, and (iv) the rates of GST.

Though the above four are important issues, all important issues relating to GST have not been included in the terms of reference. For, e g, the modalities of levy, collection and appropriation of IGST do not find specific mention above. However, the umbrella provision that the council can consider "any other matter relating to GST as the council may decide" may be seen as suitable empowering the council. To what extent the council's views will prevail if Parliament, which will be empowered to enact on IGST by the proposed Article 269(A), sees otherwise, is not clear.

Since the proposed council would have ministerial representation from both the centre and the states (unlike the present EC), the intention of the THFC clearly was to provide statutory backing to its recommendations on all critically important parameters of the GST. Unfortunately, the Bill while providing a statutory status to the structure of the council per se provides no legal backing to its deliberations. The Bill envisages that it can make only recommendations (sic) to the union and the states. The deliberations of the council can culminate only in recommendations which presumably may or may not be accepted and implemented by either the GOI or the state governments. This detracts from the credibility of the council.

"Further, Item (a) in Para 27 above, the council is empowered to recommend the taxes, cesses, surcharges levied by centre, state and local bodies which may be subsumed in the GST". This proposal appears to be at variance with the proposed amendment to Article 366 which already specifies which goods are proposed to be kept out of the purview of the GST. It appears that anticipating the wisdom of the GST council, the primary decision to exclude the specified goods from GST has already been taken. While admittedly this may have been done after consultation with the EC, there is a possibility that the GST council may review this stance in line with the recommendations on the THFC that the specified goods be included in the GST tax base – as has been discussed above, while maintaining revenue neutrality through additional taxes levied by both GOI and state governments. Such additional levies will be outside the purview of the GST and no input credit would be available. This option is a preferable option as it would widen the GST tax base and provide continuity in the VAT chain. However, if and when the GST council agrees to such a stance, this would be impossible to implement without another constitutional amendment as the framework of the GST appears to have already been defined by the Bill.

3.6 Dispute Settlement Authority

The GST council is empowered to make only recommendations to the union and states for consideration. As mentioned above, this implies that these recommendations will not be binding on either the centre or the states, who will have the option to accept or reject any (or all?) recommendation. However, the proposed Article 279(B) provides for the setting up of a tax dispute settlement authority to adjudicate disputes/complaints arising out of deviations from recommendations of the council. It is not clear how mere recommendations of the council will be deemed to acquire finality based upon which the grounds for a dispute between states inter se or between the centre and states can be articulated and prosecuted before the dispute settlement authority.

3.7 Empowering Parliament to Legislate Independently on GST

Article 249 presently empowers Parliament to legislate with respect to a matter in the State List in the national interest. The Bill seeks to empower Parliament to make laws with respect to goods and services tax in the national interest even though GST is not in the State List. This seeks to give Parliament a power independent of the proposed Article 246(A) to levy GST without the need to consult the states if it is deemed

in the national interest. Such a proposal would be viewed with extreme circumspection by the states. Similarly, it is proposed to amend Article 250 which presently empowers Parliament to legislate on matters in the state list during the period of proclamation of emergency. The amendment seeks to enable Parliament to legislate on GST also during the period of an emergency. These two proposed amendments are not essential for the implementation of the GST. These proposals may be seen to be at variance with the professed intention of the GOI to adopt a consensus-driven approach to the implementation of GST in the country and may be interpreted as a lack of commitment to take the states on board.

3.8 Basic Structure

The Constitution presently mandates exclusive tax jurisdictions to both the centre and the states through the mechanism of Article 246 and the Union and State Lists in the Seventh Schedule. It does not allow for concurrent jurisdiction for both the centre and the states over any tax base. The GST necessarily requires a concurrent jurisdiction to enable both the centre and states to simultaneously levy taxes on the supply of goods and services. There are a number of options available to enable states/centre to levy GST through constitutional amendments. The Bill seeks to achieve this by inserting a new Article 246(A) which will specifically empower Parliament and state legislatures to make laws with respect to taxes on goods and services imposed by the union and states respectively. The Bill proposes that Parliament retain the exclusive power to make laws in respect of taxes on goods and services involved in interstate trade.

A more direct option is amending the Seventh Schedule to include the items comprising the GST tax base in the concurrent list while removing them from the union and state lists. This option was reportedly considered but opposed by the states on the grounds that if placed in the concurrent list, the provisions of Article 254 would ensure the dominance of the GOI in this tax field. This situation, it was apprehended, would result in constraining the fiscal autonomy of the states. Such apprehensions are without basis for two reasons. First, all GST-related law will have to be approved by the GST council. The balance of power in the council is totally asymmetric in favour of the states. The GOI has only two members. The states have 28 (excluding the three union territories with legislatures). States can effectively shoot down any proposal of GOI aimed at fiscal hegemony. Second, a number of sensitive subjects are already in the Concurrent List like education, electricity and labour. It can be nobody's case that the GOI has sought to dominate the states in these fields.

Despite the states' apprehensions being groundless, the option of including GST in the concurrent list was discarded and the option of insertion of Article 246(A) favoured. It could be argued that Article 246 and the Seventh Schedule of the Constitution as they stand, are part of the basic features of the Constitution and introduction of an Article 246(A) as a specific provision for levy of goods and services tax, will dilute the import of Article 246 and hence the basic structure of the Constitution. This option needs to be validated with reference to its consistency with the Constitution if the Bill as it stands is to be proceeded upon. It would be extremely desirable if a presidential reference is made under Article 143 of the Constitution, to the Supreme Court, on this important issue which has the potential to hamstring the proposed constitutional amendment.

4 Philosophy of Constitutional Amendment

As seen from the eight issues raised in Section 3, the Bill does not appear to be driven by a broad philosophy on the modalities of implementation of the GST. Measured against Occam's razor, the Bill is neither succinct nor comprehensive. It is "over specific" in some sections like the definition of GST and not specific enough in other sections like the powers of the GST council. It neither fully determines the contours of GST nor does it adequately empower the GST council to do so. Admittedly, this Bill seeks to find the middle ground between different state contentions and GOI's views, but in seeking to do so, it has not identified the policy goals to be achieved for implementing the GST. Ideally, the Bill should enable the policy goal of the GST to be implemented. Only then can the full benefit of this tax reform be leveraged. The Bill should simultaneously empower the GST council to suitably moderate the path to this goal depending upon political and administrative constraints. Unfortunately, the Bill reverses the sequencing of these steps. The dominant political and administrative constraints have first shaped the Bill. The GST council is subsequently then expected to achieve the policy goals. This appears to be an unreasonable expectation, given that the same political and administrative constraints will continue to apply to the working of the council also. There is thus a possibility that this will lead to a suboptimal GST.

Further, it is noteworthy that the passage of the Bill as it stands is not sufficient for the implementation of the GST. More work will need to be done by the council which may result in the need for another constitutional amendment. At best, this Bill can be described as a job half done. Ideally, as mentioned above, the Bill should have only enabled the implementation of GST while delegating the modalities of implementation to the GST council. The Bill should have enabled the policy goal – the "flawless" GST as defined by the THFC being reached and adequately empowered the GST council to determine the road map to achieve this goal. In view of the lack of consensus on some issues amongst states and the centre, the road map could involve a multistage journey. Thus even if a hybrid GST has to be adopted in the first instance by the council, it could later be improved upon without recourse to another constitutional amendment.

5 Service Tax

A necessary and complementary approach to the GST is the treatment of service tax of which the GST is an indelible part. After a significant debate the centre has accepted the need to adopt a negative list approach to the taxation of services and proposed suitable amendments in Chapter V of the Finance Bill

2012 (Ministry of Finance 2012b). The concept of negative list is delineated by three sections of the Finance Bill 2012. These are: (i) 66(B) which is the charging Section; (ii) 66(D) which lists the services to be placed in the negative list; and (iii) 66(E) which specifically identifies services which have been declared as services.

The first three items on the negative list of services exempt providers (Government of India; RBI and foreign embassies) for all the category of services they render. The other items deal with activities which are exempt like agriculture, farm labour, trading of goods, etc. A number of questions have arisen with respect to the negative list. Using the "dominant position of transaction" test, it has been argued that some of the activities declared as services in the new Section 66(E) and which are proposed to be taxed by the centre are in fact well within the legislative purview of the states. Some specific instances are:

- Renting of Immovable Property: The centre assuming the right to tax renting of immovable property may be seen as negating the state's rights to tax land and buildings under Entry 49 of List II. It can be argued that any activity ancillary to ownership of land and buildings and concomitant to it lies within the legislative competence of the states. In the past, courts have supported a limited exercise of this right by the centre "as long as it is associated with business or commercial use". But this caveat is absent from Section 66(E) of the Finance Bill 2012 which deems renting of immovable property to be a declared service, with a specific exception being provided in the negative list for residential buildings. Section 66(E) assumes a general power to tax renting of immovable property with a specific exemption instead of a specific power being presently recognised by the courts.
- Taxes on Hire Purchase: Entry 54 of List II grants states the power to levy taxes on intra-state sale or purchase of goods. The term sale or purchase is defined in Article 366, Section 29(A)(c) to include "a tax on the delivery of goods by hire purchase or any system of payment by installments". Thus taxes on the intra-state sales of goods by hire purchase lie squarely within the domain of the state governments. However, vide 66(E)(g) of the Finance Act 2012, "activities in relation to delivery of goods on hire purchase or any system of payment by installments" are deemed to be declared services. The finance minister's assurance in Parliament during the discussion on the Finance Bill that he would exclude activities specified as deemed sales from the purview of service tax may, however, address this problem.
- Taxes on Luxuries: Under Entry 62 the states are empowered to levy taxes on luxuries, including taxes on entertainment, amusements, betting and gambling. Most states have in place a luxury tax act, some more exhaustive than the others. Despite this, the union has been levying service taxes on activities like beauty parlours, health and fitness centres, which are patently luxuries within the legislative competence of the states. However the negative list in 66(D) does not use the word luxuries in clauses (i) and (j). These clauses merely restrict themselves to excluding betting gambling, or lottery and admission to entertainment events or access to amusement facilities.
- Missing Services: Apart from what is included, another aspect of concern in the negative list is what is excluded. There are negative lists nested within the negative list in respect of three clauses. Under clause (o), the service of transportation of passengers with or without accompanying belongings by stage carriage and railways excluding those travelling by first class or air-conditioned coach are included in the negative list. Effectively, service tax is leviable on the railways only for first class and AC class passengers. In regards to goods transported by the railways, they are ostensibly included in the tax base as they are not specifically excluded in the negative list. However, when and in what manner the centre will collect service tax on railways remains to be seen. Service tax on railways was originally proposed during the 2009-10 budgets, but was exempted in September 2009. This exemption was to be withdrawn in 2010-11 after providing an abatement of 70% – but this too was not made effective. Presently, the exemption from levy of service tax on freight continues till 30 June 2012. Thus, except for travel in first or AC class, all other railway services are presently exempt from service tax. The gross traffic receipts of the railways are projected to be Rs 1,32,552 crore for 2012-13. Given their significant tax paid purchases which will be eligible for input tax credit, the service tax payable by the railways may not be as significant as it immediately appears. Despite this, no concerted effort has been made to enfold the railways into the GST. Excluding it from the GST the tax base by providing them abatement may weaken the overall impact of GST.

As discussed above, the service tax provisions in the Finance Bill 2012 seem to anticipate the passage of the 115 Constitutional Amendment Bill which may not take place in the immediate future. The validity of some of these provisions could therefore be called into question.

6 Political Economy Considerations

All reform is driven and incentivised by political economy considerations. The ongoing opposition to GST is ostensibly driven by economic considerations. These are often vocalised by states which have a poor consumption base and who stand to lose on origin-based taxation of resources which they presently receive based on export to other states. It is undeniable that there will be some losers immediately upon the implementation of the GST. It is therefore imperative that the centre come forward with a broad assurance for the provision of compensation for losing states for a period of five years as suggested by the THFC.

The issue of dilution of fiscal autonomy of states has to be examined in a holistic manner. There are a number of issues which need to be considered. First, if a floor approach is adopted instead of a fixed rate, then states, which will then have the freedom to levy taxes above the floor may be less vocal in their opposition. Second, it must be recognised that the centre is equally giving up its fiscal autonomy in respect of indirect taxes. Third, the GST will bring with it the merger of

all cesses and surcharges levied by the centre. This will expand the size of the divisible pool increasing tax devolution to the states. Fourth, the tax base of the states will significantly increase with the inclusion of manufacture and services. The centre's tax base on the other hand may not increase as significantly with the inclusion of only sales in its tax base.

These and other issues relating to GST implementation need to be adequately addressed in the GST council which should be fully empowered to take and enforce decisions rather than merely make recommendations. This would require that both the centre and the states repose commensurate trust in the GST council and be willing to take a leap of faith by accepting its suzerainty.

7 Role of the Central Government

In the "flawless" GST which will be the ideal policy goal, only excise and service tax, as well as present cesses and surcharges will form part of the central contribution to the GST pool. On the other hand, all the state taxes are seen as part of the pool. The stakes of the centre and the states in the GST pool based upon the accounts for 2009-10 are in Table 1. Proceeds of taxes transferred to the states by finance commission devolutions have been excluded from this pool (30.5% during 2009-10). Of the total GST pool of Rs 4,75,242 crore, the GOI will contribute 24%. States will contribute as much as 76%.

States have more than three times the financial stake of the GOI in the GST. The centre with its buoyant income tax and customs duties, outside GST, has other tax opportunities which the states do not have. The GOI therefore should be more accommodating than the states. It needs to be proactive and take steps to build trust and confidence.

Table 1: Pool of Resources for GST (Rs crore)

No	Type of Tax	2009-10 (Accounts)	After Deducting 30.5% Devolution for Items 1 and 2	% of Total
1	Excise	1,02,991	71,579	15
2	Service tax	58,422	40,603	9
3	Sales tax/VAT	2,20,640	2,20,640	46
4	Other state/local taxes	1,42,420	1,42,420	30
	Total	5,24,473	4,75,242	100

Source: GoI Budget Documents 2011-12 and RBI State Finances: Review of State Budgets 2011-12.

It is because of the proactive stance of the centre that states successively took the leap of faith and implemented VAT between 2005 and 2008. The firm assurance provided by GOI about compensating possible revenue losses during implementation was the bedrock of this faith. States expect a similar approach to compensation while implementing the GST. Unfortunately, such an assurance has not been forthcoming so far. Further, the payment of compensation on account of reduction of CST is not being settled to the full satisfaction of the states and this has led to the emergence of a trust deficit between the centre and the states.

CST is an origin-based tax and is incompatible with GST a destination based tax. Hence it was agreed by the Empowered Committee as well as the GOI that this tax would be phased out with effect from 1 April 2007 over a period of three years. Compensation package guidelines were issued in October 2007. This package envisaged the transfer of identified services for levy, collection and appropriation of tax by the state governments. It also recommended raising the lower VAT rate from 4% to 5 % and levying tax on sugar and textiles. The first step – reduction from 4% to 3% – was effected on 1 April 2007. Subsequently, since all the components of the compensation package could not be implemented, a revised package which included a watered-down compensation formula based on proportionate loss rather than the expected growth of CST was accepted by the states. CST was then reduced from 3% to 2% with effect from 1 June 2008. Subsequently, the payment of compensation by the centre to the state governments has become controversial. Claims from the states aggregating Rs 12,666 crore for 2010-11 are pending. The centre insists that the revenue from the increase in the VAT rate from 4% to 5%, and deduction on account of abolition of D Form be set off from the compensation payable. States contest this claim on the ground that these elements were not included in the revised compensation package. GOI made a budget provision of Rs 12,000 crore in 2011-12 for payment of CST-related compensation, but paid only Rs 4,172 crore. For 2012-13, only Rs 300 crore has been provided in the GOI budget. These allocations and disbursements appear to reflect the view that GOI does not appear sanguine about either the validity of the compensation claims of the states or the prospect of implementation of GST in the near future.

In the 2012-13 budget speech, the only date relating to GST mentioned is August 2012 which refers to the projected operationalisation of the GST network. No time line or commitment with respect to the implementation of GST has been made. As mentioned above, even if the Bill is enacted, substantial further work needs to be done before the GST framework can be firmed up. Therefore, it is often inferred that the GOI feels that states are responsible for the delay in the implementation of the GST and has therefore determined not to pay compensation during 2012-13 and possibly in the future. These instances reflect to some extent the growing trust deficit between the centre and the states on the issue of CST and GST. This is showing the movement towards the GST.

The centre could take five steps to bridge its trust deficit with the states and underline its commitment to implementing a GST as quickly as possible. These are:

- The centre should settle the CST compensation dispute with the states immediately.
- The centre should provide a firm assurance upfront to states that they will provide compensation to states for possible losses in implementation of GST for a period of at least five years as suggested by the ThFC.
- The centre should suo motu put in place a central GST within the present framework by merging the excise and service tax levies and replacing it with a single GST.
- The centre should delegate collection of central GST up to an agreed turnover limit to the states. This will bring into place a single tax window for relatively low turnover accounts – a much expressed desire of trade and industry which will also reduce compliance cost and improve collection.

• The centre should review the proposed amendments to Articles 249 and 250 which seek to give overriding powers to Parliament to legislate on GST without the consent of the states.

If the centre takes all five steps outlined above, it would demonstrate its firm commitment to the implementation of GST and strengthen the conviction of states on the need to do so, despite their present apprehensions.

8 A Road Map for an Acceptable GST Framework

There are fundamentally two broad policy approaches available for the implementation of the GST – the incremental approach and the transformational approach.

The incremental approach is what is presently being considered by the centre. The proposed hybrid GST which excludes the specified goods (about half the VAT revenue of some states is derived from these specified goods), as well as important sectors like the railways and real estate may do little to make our industry more competitive and catalyse the economy. It does not put in place a mechanism to ensure compliance of the states with the GST framework and thus does not deter the competitive "race to the bottom" indulged in by some states.

The transformational approach recognises the paradigm shift which will be brought by the GST and seeks to enfold into it all taxes and levies while maintaining revenue neutrality. It seeks to amend the Constitution only on broad terms while leaving the nitty-gritty to the GST council. It will allow for the inclusion of the railways and the real estate sector into the GST making it truly comprehensive and "flawless". It will penalise wayward states for non-compliance and put India truly on the road to a national market.

Unfortunately, we seem to be displaying our path dependence by opting to go in for an incremental approach, despite the fact that this may not be a good idea insofar as implementation of GST is concerned. It is necessary that all stakeholders accept and recognise that the destination – a flawless GST is not negotiable but the path to such a GST could be as non-disruptive as possible. For this it is suggested that the following five steps be taken in addition to the five steps outlined above to be taken by the centre.

(i) The Bill is amended to allow for a broader definition of GST in respect of the taxes to be subsumed while leaving the final details of the GST to the determination of the council, (ii) The Bill should enable the GST tax base to be broadened as and when consensus is achieved between stakeholders without recourse to another constitutional amendment. Special emphasis should be placed on possibility of including the real estate sector and the railways in the tax base, (iii) petroleum crude, high speed diesel, motor spirit, ATF, natural gas, alcohol for human consumption and tobacco should be included in the GST tax base. To maintain revenue neutrality, they could also be subject to an additional levy against which input tax credit need not be provided, (iv) the Bill should adequately empower the GST council so that its recommendations have finality and are enforceable, and (v) the proposed amendments permitting local bodies to levy entry tax and entertainment tax should be reviewed.

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