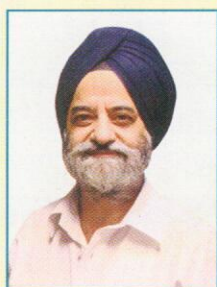


CTRFPF

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Centre for Training and Research in Public Finance and Policy

From the Finance Secretary ...



It gives me great pleasure to know about the unveiling of the first edition of the half-yearly Newsletter on the activities of the CTRPFP. The Unit, which opened on 31st March, 2011, has been established to promote effective fiscal and taxation policies through better understanding of their impact on individuals, families, businesses and the government's finances, disseminate research effectively thereby maximizing their impact on policy both directly and also through public debate to a wide range of audiences thereby establishing itself as the authoritative commentators on fiscal policies particularly with respect to taxation.

This Newsletter will serve as a knowledge-sharing platform, addressing issues of a global and common nature, and providing the opportunity for stakeholders to express their own perspectives, identify best practices and share experiences gained.

I hope that you will find this Newsletter useful in keeping you informed on pressing matters of public finance, tax and welfare policy.

I extend my heartfelt warm wishes to the CTRPFP on this occasion.

(R.S. Gujral)

From the Director ...



Centre for Training and Research in Public Finance and Policy (CTRFPF) is a unique endeavor of the Centre for Studies in Social Sciences (CSSSCalcutta) sponsored by a corpus grant from the Union Ministry of Finance, Government of India to foster cutting edge training and research in all aspects of public finance and policy. Although the initiative is quite fresh we have started various projects on GST, revenue generation at the Central and State levels and other aspects of public economics. Apart from the internal faculty members of the Economics group, we have been able to host excellent foreign and national research visitors from USA and Australia. CTRFPF is also open to collaborative links with national institutions and scholars. With CSSSC ranked as among the top three institutions of the country in Economics research and hosting two of the top five economists of the nation, CTRFPF is all set to make an impact in the national public policy domain in near future. This Newsletter provides an active forum of policy dialogue in public finance with contemporary flavor along with summary of the activities of the CTRFPF.

(Sugata Marjit)

News & Events ...

- Prof Avik Chakrabarti- University of Wisconsin-Milwaukee, Prof Robert Breunig- Australian National University, Smt Shyama Nair-GIFT, Trivandrum have been Visitors to the CTRPFP in the year 2011-12.
- International conference on "Emerging Issues in Public Finance Public Policy" organized by the RBI Endowment and Centre for Training and Research in Public Finance and Policy, at the CSSSC on 23rd and 24th of February 2012. Conference is open to public.
- Call for research proposals - CTRFPF invites small grant proposals from practitioners and academics related to current issues in public finance and policy. Please contact CTRFPF Program Coordinator (ctrfpf@cssscal.org) for details.
- Visiting faculty openings- CTRFPF invites practitioners and academics to apply.
- Advertisement for faculty positions will be announced in future. Please visit website www.cssscal.org for details.

VAT and GST – An Overview

Punarjit Roychowdhury

"All [state] activities depend first on the Treasury. Therefore, a King shall devote his best attention to it."

Kautiliya: The Arthashastra [2. 8. 1, 2]

■ Optimization of equity and efficiency in the system of taxation is a pre-requisite of social and financial growth. However, models of taxation of goods and services followed in India since independence was unfortunately characterised by cascading and distortionary tax on production that lead to misallocation of resources and hindered economic growth. Voluntary compliance was also missing in the system. Such cascading effects ultimately had a negative effect on the size of tax base thereby dampening the process of revenue generation and resource mobilisation of the government. To address these major pitfalls of the prevailing taxation-system, Central Value added tax (CENVAT) was introduced in early years of the new millennium and states started implementing VAT from 2005. It was held that VAT would address the problems of the existing system of taxes and was seen as an important break through in the sphere of indirect tax reform in India.

In case of VAT, a deduction on taxes is made on the inputs used on which taxes have already been paid thus removing the problem of double taxation. Moreover since set offs are given only if taxes on inputs are paid, VAT essentially ensures a built-in check in tax compliance in Centre as well as in the States. With introduction of VAT the system of taxation has not only become more transparent, tax compliance has also increased to a great deal. The rate of growth of Tax Revenue has nearly doubled from the average annual rate of growth the pre-VAT five year period after the introduction of VAT.

However, the system of VAT has quite a number of shortcomings. For instance, non-inclusion of several Central taxes in the overall framework of CENVAT, such as additional customs duty, surcharges, etc., thus keeps the benefits of comprehensive input tax and service tax set-off out of reach for manufacturers/dealers. In the existing State-level VAT structure there are also certain shortcomings: there are, for instance, even now, several taxes which are in the nature of indirect tax on goods and services, such as luxury tax, entertainment tax, etc., and yet not subsumed in the VAT. Moreover, in the present system of State-level VAT, CENVAT load remains included in the value of goods to be taxed under State VAT. This further compounds the cascading effect of value added taxes. Thus, removal of the CENVAT load is utmost important so as to increase the efficiency of the tax system. Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be integration of VAT on goods with tax on services at the State level as well, and at the same time there should also be removal of cascading effect of service tax. The transition from VAT to Goods and Services Taxes essentially is motivated by the urge to remove these shortcomings (see Poddar and Ahmed, 2009).

Perceived as the 'biggest tax overhaul since independence', introduction of GST at the Central level is expected not only to include comprehensively more indirect Central taxes and integrate goods and service taxes for the purpose of set-off relief, but also lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade and increased compliance. Apart from this, in the GST, both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point up to the

retailer's level is established which reduces the burden of all cascading effects (First Discussion Paper on GST, 2009). This is the essence of GST, and this is why GST is not simply VAT plus service tax but an improvement over the previous system of VAT. GST at the State-level is also expected to improve the overall revenue scenario as it gives additional power of levy of taxation of services for the States, encourage a system of comprehensive set-off relief, including set-off for cascading burden of CENVAT and service taxes and also remove the burden of Central Sales Tax. Because of the removal of cascading effect, the burden of tax under GST on goods will, in general, fall (see CII-KPMG survey 2010, Report of the Task Force on GST 2009 etc.).

The GST at the Central and at the State level when introduced will thus give more relief to producers and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, subsuming of several taxes in the GST. With the GST being properly formulated, it is expected that there will be revenue/ resource gain for both the Centre and the States, primarily through widening of tax base and possibility of a significant improvement in tax-compliance.

Seminar at CTRFPF on the Goods and Services Tax

A report by Professor *Indraneel Dasgupta*

■ A seminar was presented by Smt. Shyama Nair, of the Gulati Institute of Taxation and Finance, at CTRFPF on September 22, 2011. Smt. Nair spoke on various aspects of the proposed Goods and Services Tax (GST). She clarified at length the key features of GST, including its economic and administrative rationale, legal framework, implications for fiscal and revenue devolution to the states, and present legislative status.

In course of the ensuing discussion between the speaker and members of the audience, a number of open issues and research agenda were identified and elaborated. It was pointed out that the standard methodologies for estimating tax rates that would imply states' revenue-neutrality, relative to the present fiscal system, might all suffer from fundamental conceptual difficulties. They take inadequate account of the possible responses of firms and individuals to the introduction of the new system: in effect, the standard methods implicitly adopt a short run and partial equilibrium approach. Consequently, the estimates they generate may turn out to be quite inappropriate. It was pointed out that a computable general equilibrium framework appeared to be the most appropriate for deriving the relevant revenue estimates. The discussion also focused on the presumption that a goods and services tax would reduce commodity prices. It was argued that the impact on prices is likely to depend largely on the market structure, and therefore further examination of this question on the basis of detailed information regarding the degree of competition in different sectors and industries would be in order. Problems pertaining to service taxation, and the consequences of taxing at the point of sale rather than at the point of origin, in terms of the impact on states' revenue generation, were also discussed at length.

The seminar was well-attended. The lively discussion was enriched by the presence and participation of a number of policy practitioners from the relevant departments of the Government of India, in addition to that of academics from CSSSC. This mixed nature of the audience led to a fruitful exchange of views on aspects of the proposed Goods and Services Tax that are of immediate and direct policy concern, including practical administrative difficulties with its implementation, as well as aspects that are more theoretical and thus foundational.



“GST is an improved version of VAT with services being also a part of it”

Smt. Shyama Nair of Gulati Institute of Finance and Taxation, Kerala in a conversation with Punarjit Roychowdhury shares her view on yet-to-be-implemented GST

■ How would you define GST in one line? Is it just an extension of Value Added Tax or is it something more than that?

GST is a tax on goods and services with comprehensive set-off benefits from the manufacturer's and service provider's point up to the retailer level. It is not just an extension of VAT but an improved version of VAT with services also being a part of it. It is a multi point tax on supply of goods and services or both and is aimed to be a simple, nation-wide, transparent and efficient system of indirect taxation. In a GST regime all Goods and services are subject to tax unless specifically exempted unlike in the present system where we have a negative list of goods and a positive list of services. In the new scenario there will be no differentiation between goods and services. The Centre has proposed a negative list of services which includes 22 sub groups of services which are going to be exempted from tax. All other service categories outside the list will fall under the tax net.

According to you what are the main points of concern regarding GST?

The main issue is defining the place of supply or consumption especially in the case of inter-state transactions and the mechanism of seamless input set off. Protecting and balancing the present and future revenues of the Centre and the States need to be worked out very carefully. Estimation of the service sector tax base of the states and the revenue neutral rates of GST are areas where there is still no consensus among the states. Automation of the Central and State departments to ensure smooth implementation of the new system poses a big challenge. Complete digitization of the concerned departments of the states and the Centre is essential for a flawless credit mechanism to work. This is an issue which requires priority attention.

...And what are the perceived benefits?

GST will bring about harmonization of the tax base, tax rates, tax laws and procedures. Rationalization of the tax system will make the nation a common market. The cascading effects of taxation will be removed as full credit is provided for the total amount of tax paid on inputs. The cost of collection and the compliance cost can be brought down considerably. GST will lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade and increased compliance. As it covers all the goods and services, tax administration becomes easy.

Mr. Sumit Dutt Majumder, chairman of the Central Board of Excise and Customs (CBEC) in a recent interview has said that GST should be in place by June 2012. What is your take on this? Is India ready for the 'biggest tax overhaul' since Independence?

India would have been ready for the take off in 2012 had we done the home work by now, for its implementation. We have not got the constitutional amendment bill and the Model GST Act passed. Tax payer education or public awareness programmes are not yet on. Public workshops, seminars and training on GST need to be conducted at all states. The required Manuals are not in place. States have not worked out their revenue implications and compensation package. The revenue neutral rates are not calculated. As mentioned earlier complete automation of the departments of the states and the Centre should be executed at the earliest linking all the states and digitizing all its departments. Once these issues are sorted out, then we can ensure a smooth transition to GST.