

**Special Address at**  
**3<sup>rd</sup> National Conference on**  
**GST for Accelerated Economic Growth**  
**and Competitiveness**

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**Speech by Dr. Vijay Kelkar, Chairman, Finance Commission  
on the occasion of the ASSOCHAM 3<sup>rd</sup> National Conference on  
“GST for Accelerated Economic Growth and Competitiveness”**

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## **Introduction**

1. It is indeed a privilege to be present at this seminar on “GST for Accelerated Economic Growth and Competitiveness” and share some thoughts on the Goods and Service Tax.

2. Over the past fifteen months, in my capacity as Chairman of the Finance Commission, I have had the privilege of visiting twenty five States in our country and discussing with the respective State governments their views on our Terms of Reference and how the Commission should go about its work. One important item in our Terms of Reference relates to consideration of *“the impact of the proposed implementation of the goods and service tax with effect from 1<sup>st</sup> April 2010 including its impact on the country’s foreign trade.”* A number of State governments have expressed their views on the GST to us while voicing their own concerns. Independently, a number of economists, practitioners and financial journalists have raised issues and suggested options relating to the implementation of GST. I am aware that the GST debate has so far been dominated by the concerns of two of the three major players in this policy triangle – the Central government on the one hand and the different State governments on the other. The third group of stakeholders – trade and industry should proactively seek to influence this debate so that their concerns, needs and aspirations can be incorporated into the GST design as well as the implementation protocols. I therefore congratulate ASSOCHAM for organizing this seminar which will be addressed by important policy makers and implementers. I am confident that this seminar would result in a set of concrete recommendations that can be forwarded both to the Government of India as well as the Empowered Committee of the State Finance Ministers for their consideration. As you will all agree, policy can be best influenced when it is still malleable and I urge not only ASSOCHAM but also all the other trade associations to closely study all possible ways in which the GST will impact their membership and put forward their views on

the various issues as early as possible in anticipation of, rather than consequent to a draft GST law which may be put up for discussion.

3. Much can and has been said on the merits of the GST. It will bring about a phase change on the tax firmament by redistributing the burden of taxation equitably between manufacturing and services. It will lower the tax rate by broadening the tax base and minimizing exemptions. It will reduce distortions by completely switching to the destination principle. It will foster a common market across the country and reduce compliance costs. It can provide a fiscal base for local bodies to enable them to fulfill their obligations. It will facilitate investment decisions being made on purely economic concerns, independent of tax considerations. It will promote exports. A recent study on the impact of GST on foreign trade indicates that the rate of growth of exports will be significantly higher than that for imports. GST will also promote employment. Perhaps, most importantly, it will spur growth. As I have mentioned elsewhere, it has been estimated that the GST implementation increased Canadian GDP by 1.4 percent. In India, we can expect a similar kind of positive impact. This means gains of about 15 billion dollars annually. Discounting these flows at a modest 3 percent per annum, the present value of the GST works out to about half a trillion dollars. This is indeed a staggering sum and suggests the need for energetic action to usher the GST regime at an early date. I will attempt to address important questions relating to effective implementation of the GST regime.

### **Concerns relating to GST**

4. Most concerns expressed about the implementation of GST can broadly be divided into three categories -

- a. Design issues
- b. Operational issues.
- c. Infrastructure issues.

I shall take these up one by one.

## **Design issues:**

5. What should be the design of the GST ? The broad framework of GST is now clear. This is on the lines of the model approved by the Empowered Committee of the State Finance Ministers. The GST will be a dual tax with both central and State GST component levied on the same base. Thus, all goods and services barring a few exceptions will be brought into the GST base. Importantly, there will be no distinction between goods and services for the purpose of the tax with a common legislation applicable to both.

6. However a number of issues remain to be resolved. These are presently under the consideration of the Empowered Committee under the Chairmanship of Dr Asim Dasgupta, the distinguished Finance Minister of West Bengal. These issues include :

### ***The rate structure and value***

7. The primary concern of all State governments is protection as well as enhancement of existing revenue streams. There are three parameters which need to be balanced here – one is the range of taxes presently being levied which will be subsumed into the GST. This will determine the tax base of the GST. The other two parameters are the number of rates and the numerical value of these rates which will be applied to this base .

8. All indirect taxes on the supply of goods and services would need to be subsumed into the GST. The Empowered Committee in its road map of Dec 2008 has indicated which taxes which will qualify. The Finance Commission has appointed a Task Force to advise the Commission on the implementation of GST. For the purpose of computing the Revenue Neutral Rate the Task Force assumed that apart from VAT, stamp duty, vehicle tax, taxes on goods and passengers, taxes and duties on electricity, entertainment tax, entry tax, luxury tax, taxes on lotteries, betting and gambling, purchase tax as well as all State cesses and surcharges will be subsumed into the State GST. Central Sales tax will stand abolished. From the government of India side, Central excise, additional excise duties, service tax, Additional Customs duty (CVD), and all cesses and surcharges (other than educational cess) will be subsumed into the Central GST.

9. There appears to be agreement that the best option would be a bare minimum number of rates, at best two, preferably one. We assume that a single rate structure will find favour with a very limited set of exemptions available for basic foodgrains as well as basic education and health services. This single rate will ensure low compliance costs, obviate classification disputes, and ensure uniformity of approach amongst all players. But to be attractive, a single rate cannot be too high. At the same time, the rate must be high enough to address the concerns of States regarding revenue neutrality.

10. Using data from about 18.25 lakh business entities for the year 2007-08, the Task Force has generated very interesting data relating to the GST rate which will maintain the same level of income for the centre and States respectively in a minimal exemption regime. Their preliminary calculations suggest that Revenue Neutral Rate will be substantially below the combined Central and State rates. It is necessary that these and similar calculations which may have been made by other stakeholders be published for debate and examination. States also need to satisfy themselves that not only will the GST rate applied be revenue neutral nationally but also individually and wherever this is not initially so, adequate compensation provisions are made. This public scrutiny will thus ensure that a reasoned view is taken on the rate to be applied as well as on the exemption regime which should be adopted. The report of our Task Force will be published on the Finance Commission's website shortly and I hope that that this will contribute to better awareness and constructive policy dialogue.

### ***Rules of Supply for goods and services***

11. While CST will be abolished in the GST regime, the treatment of inter state sales will need to be carefully thought through. It would be necessary to guard against tax arbitrage where local sales which will be taxed could be shown as inter state sales which will not. The CST Act provided for documentation to attest the interstate nature of the sales. A number of models are being examined by the Empowered Committee which will serve as alternatives. Since the final model adopted would have a direct bearing on the ease of inter state trade transactions as well as the compliance cost, I would urge that all trade and industry associations involve themselves in this choice through voluntary submissions of their views to the Empowered Committee.

12. Putting in place the Rules of Supply for the inter state provision of services will be demanding. Services produced and consumed within the same State would not pose a problem as far as the appropriation of taxation proceeds is concerned. However, some services may be supplied from one State, consumed in another and paid for in a third State. A set of rules to determine the taxation jurisdiction and appropriation would need to be worked out. There is adequate international precedent for this but here again, trade and industry associations could take proactive steps to suggest possible options.

### ***The framework for exemptions, thresholds and composition***

13. The existing sales turnover thresholds for VAT taxation vary widely across States. Some small States have specified a threshold turnover of Rs 2 lakhs per annum. Larger States have stipulated Rs 40 lakhs per annum. The turnover range for composition eligibility is equally diverse. The list of exempted goods also differs across States. To allow for uniform treatment of inter state transactions nationally, it may be necessary that these variations be bridged so that tax cascading is eliminated. However, the concerns of smaller States need to be kept in mind. For this reason, perhaps such convergence could be targeted over a certain period of time rather than immediately.

### **Operational Issues**

#### ***Common Approach***

14. For GST to be successful, all States and the Centre should implement it in a similar fashion. Only this will bring about the national common market which is one of its goals. This will be possible when there will be a common law, a common assessment procedure and perhaps even a common return. The Empowered Committee can provide the required leadership to engender this uniformity of approach between all the States amongst themselves and also with the Union government.

#### ***Sharing of information***

15. Recent experience relating to revenue collections from the Central Sales Tax have raised the issues relating to tax arbitrage. It appears that local sales under the VAT regime are being shown as lower taxed CST sales leading to

revenue loss. Some States have expressed concerns and referred to tax evasion in developed countries which have a VAT in place. They have sought reassurance that revenue leakage would be effectively checked in the GST system. Apart from putting in place a comprehensive IT network, sharing of tax related information and coordination amongst all the States will be crucial for this. Perhaps the Empowered Committee could set up a coordination mechanism to address such concerns. Trade and industry bodies also have a strong role to play in curbing such malpractices.

## **Infrastructural Issues**

### ***IT infrastructure***

16. A simple system for inter-state verification of dealers and transactions is essential to ensure tax compliance and check avoidance. It will also be essential for enforcing the rules of supply discussed earlier. Given the volume of such transactions, this system necessarily has to be IT based. The present system Tax Information Exchange System ( TINXSYS) does not appear to be fully operational across all States. There are asymmetric benefits to States in putting in place such infrastructure and this appears to be affecting their incentives to do so. We need to put in place a system which will uniformly incentivize all States to participate in and contribute to the verification system. Or alternatively, one central agency could be charged with maintaining this system. Both the alternatives available are challenging, but this needs to be done.

### ***Checkposts***

17. Most States have put in place a system of checkposts on its road borders. Apart from other verifications which may take place, these checkposts verify and document inter-state sales of goods carried by the vehicles which cross these borders. These details are then cross verified with the VAT returns of the importing dealers. The need for such an arrangement to continue in the GST regime has been emphasized, especially in view of the abolition of CST and the possibility of tax arbitrage. However, the fact remains that such checkposts by the very nature of their operations, generate enormous delays in road traffic, sometimes upto three hours per checkpost. A freight truck travelling by road between Delhi and Chennai will need to cross five State borders and ten checkposts. Delivery times for goods may be extended significantly because of delays at checkposts. The arrangement also encourages rent seeking behavior.



18. It may be difficult to eliminate checkpoints given the valid concerns of State governments which may extend beyond collection of taxes and movement of goods to vehicle fitness examination, prevention of trafficking, collection of local cesses, etc. But what appears to be egregious is that the same vehicle has to pass through two checkpoints while crossing one border – the exporting States checkpoint and the importing States checkpoint. Both these checkpoints are often located within a couple of kilometers of each other and a vehicle driver has to spend considerable time in both. Perhaps, it may be possible for both the States to put up a combined checkpoint. Officials of both States could sit together and conduct their verifications in one checkpoint. Or one State could handle traffic on one direction and the other State in the other direction. But essentially there would be only one check per border for a goods vehicle. Such an arrangement will significantly reduce travel time. The Finance Commission is prepared to support creation of such checkpoints if the respective State governments are willing to operate jointly.

### ***Impact on Small Enterprises***

19. The impact of GST on small enterprises is often cited a concern. On the State GST component, the position will be exactly the same as under the present VAT regime. There will be three categories of small enterprises in the GST regime. Those below the threshold need not register for the GST. Those between the threshold and composition turnovers will have the option to pay a turnover based tax or opt to join the GST regime. Given the possibilities of input tax credit, not all small enterprise may seek the turnover tax option. The third category of small enterprises above the turnover threshold will need to be within the GST framework. Possible downward changes in the threshold in some States consequent to the introduction of GST may result in obligations being created for some dealers. In such cases suitable provisions could be made to provide direct assistance to the affected small enterprises if considered desirable.

20. In respect of Central GST, the position is slightly more complex. Small scale units manufacturing specified goods are allowed exemption of excise upto a turnover of Rs 1.5 crores. These units, which may be required to register for payment of GST, may see this as an additional cost. We welcome suggestions from trade bodies on how this issue can be addressed.



## **A “Flawless” GST**

21. Ideally the GST would subsume all the major State Level taxes, use a single rate, allow for only essential exemptions and eliminate all barriers to trade. This flawless GST will feature the following characteristics.

### **Harmonisation**

22. For GST to be effective, there should be identical GST laws across States as well as at the Centre. I propose that not only the law but also the methodology relating to levy, assessment, collection and appropriation of the GST should be similar across States and the centre. Such a unified approach will simplify procedures, eliminate bottlenecks and drastically reduce transaction costs for dealers, enabling them to leverage cost and time gains from the new taxation system. Necessarily, such an approach requires that tax rates for most goods and services be common across the country as should be the list of exemptions and thresholds. These considerations would need to be kept in mind while considering fiscal autonomy of States. Some States have proposed a mechanism which ensures that in future, changes in the essential elements of GST are made only with the concurrence of all States and the center. Such a mechanism will provide stability of the taxation regime and suggestions from trade and industry would be welcome on how to move forward on such a proposal.

### **Common Procedure- levy, assessment, collection, appropriation**

23. For industry to reduce its transaction and compliance costs, it is necessary that apart from a common law, the implementation of the law be also similar across States. All stages of the taxation chain from the levy of the tax to its assessment collection and appropriation should be similar. This would involve similar rules across States dealing not only with assessments, audit, refunds but also more basic issues like registration, filing of returns, treatment of transportation of goods etc. A common dispute resolution mechanism as well as a mechanism for giving advance rulings would further facilitate trade and industry. Here too, associations can play a very useful role by providing advice and suggestions on the modalities to be followed.

## **Expanding the envelope**

24. The broader the tax base, the lower will be the GST rate. I therefore return to an issue raised in the 2003 FRBM Task Force report – the taxation of real estate. The construction sector is a significant contributor to the national economy. Housing expenditure dominates personal consumption expenditure. Further, the present piece meal taxation of this sector encourages perverse incentives. Raw material is charged CENVAT, the works contract is charged VAT and stamp duty is levied on the sale. With no provision of input tax credit in place, there is little incentive to record such transactions either at the construction stage or at the sale stage at their correct value. This leads to substantial loss of tax revenue and fuels the parallel economy. I am aware that the present discussions on the GST configuration do not consider the inclusion of this sector. However, given the potential long term benefits to the economy and to a successful GST, I would urge that the construction and housing sectors be included in the GST tax base, either immediately or during a subsequent phase.

25. Another possible step to expand the GST tax base will be the inclusion of the rail sector. This will be necessary if a level playing field is to be provided to the road and air transportation sectors which will be subject to this tax. This inclusion will also ensure that all inter state transportation of goods can be tracked through the proposed IT network. The railways themselves will benefit from this by availing input tax credit on the significant purchases made by them .

## **Benefits to State Government**

26. A few State governments have recently indicated their opposition to the implementation of GST at the present juncture. While their objections need to be carefully examined, it must also be recognized that while implementation of the GST is aimed at being revenue neutral to the States, it will be budget positive for the government. This is because governments are large purchasers in the market for their own consumption and their cost of procurement will come down significantly with the implementation of GST. Apart from these static benefits, dynamic benefits will be generated in the medium term through more economically efficient production, improved competition and more importantly greater employment.

## **Role of the Finance Commission**

27. It is possible that some States may want assurances that existing revenues will be protected when they implement GST. The Commission is willing to consider providing for compensation in order to advance the implementation of a “flawless” GST.

## **Next Steps**

28. I have shared with you my views on what should be some of the goals of the Goods and Services Tax. I am acutely aware that there has been as yet no agreement on which of these goals will be adopted and how then will we reach the selected goals. The two major players – the Empowered Committee and the Government of India are discussing these issues. As I mentioned earlier, the policy on GST is still malleable and industry and trade associations can play a valuable role in forging it. I would urge that ASSOCHAM and all similar promotional bodies study some of the issues highlighted above and present their suggestions to the Empowered Committee and the State governments. In particular, they could work on the appropriate treatment of inter state sales of goods and services; the thresholds, composition and exemption regime which should be adopted; the treatment of small industry; the assessment and audit regime to be adopted; the inclusion of real estate in the tax base and even a draft GST law.

## **Conclusion**

29. During his recent interaction with State Finance Ministers, the Finance Minister has encouraged State Governments to implement GST from 1<sup>st</sup> April 2010 noting that this was a critical part of the government’s economic reforms program. This is a strong signal. The agenda is vast. All stakeholders need to and must contribute to the present debate. Once GST is introduced, outreach efforts by all agencies will be equally important.

30. I would like to conclude by thanking ASSOCHAM for giving me this opportunity to share some of my thoughts on such an important subject with you.

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