GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF REVENUE

LOK SABHA
UNSTARRED QUESTION NO. 484
TO BE ANSWERED ON FRIDAY, THE 26TH FEBRUARY, 2016
7TH Phalguna, 1937 (SAKA)

ADDITIONAL CENTRAL TAXES

484. SHRI GUTHA SUKENDER REDDY:
SHRI PRABHAKAR REDDY KOTHA:

Will the Minister of FINANCE be pleased to state:

(a) whether the Government has any plan of creation of additional central taxes, if so, the details thereof and if not, the reasons therefor;

(b) whether it is a fact that the Government is deferring any reform until the smooth passage of GST;

(c) the details of the recommendations of the report of Subramanian Committee in this regard; and

(d) the response of the Government in this regard?

ANSWER

MINISTER OF STATE IN THE MINISTRY OF FINANCE
(JAYANT SINHA)

(a) & (b) Proposals regarding levy of additional taxes and reforms if any will be reflected in the Finance Bill, 2016 to be tabled before Parliament by the Finance Minister as part of the Annual Budget speech.

(c) The detailed recommendations of the reports of Subramanian Committee are available on the website of the Ministry of finance at www.finmin.nic.in However highlight of the report of the committee is given as annexure.

(d) The report is under consideration.

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Annexure

Highlights of the Report of the Committee

- Because identifying the exact RNR depends on a number of assumptions and imponderables; because, therefore, this task is as much soft judgement as hard science; and finally also because the prerogative of deciding the precise numbers will be that of the future GST Council, this Committee has chosen to recommend a range for the RNR rather than a specific rate. For the same reason, the Committee has decided to recommend not one but a few conditional rate structures that depend on policy choices made on exemptions, and the taxation of certain commodities such as precious metals.

The summary of recommended options is provided in the table below.

Summary of Recommended Rate Options (in percent)					
RNR	**Rate on precious metals**	**"Low" rate (goods)**		**"Standard" rate (goods and services)**	**"High/Demerit" rateor Non-GST excise (goods)**
Preferred	15	6	12	16.9	40
		4		17.3	
		2		17.7	
Alternative	15.5	6	12	18.0	40
		4		18.4	
		2		18.9	

All rates are the sum of rates at center and states

- On the RNR, the Committee's view is that the range should between 15 percent and 15.5 percent (Centre and states combined) but with a preference for the lower end of that range based on the analysis in this report.
- On structure, in line with growing international practice and with a view to facilitating compliance and administration, India should strive toward a one-rate structure as the medium-term goal.
- Meanwhile, the Committee recommends a two-rate structure. In order to ensure that the standard rate is kept close to the RNR, the maximum possible tax base should be taxed at the standard rate. The Committee would recommend that lower rates be kept around 12 per cent (Centre plus states) with standard rates varying between 17 and 18 per cent.
- It is now growing international practice to levy sin/demerit rates—in the form of excises outside the scope of the GST--on goods and services that create negative externalities for the economy. As currently envisaged, such demerit rates—other than for alcohol and

petroleum (for the states) and tobacco and petroleum (for the Centre)—will have to be provided for within the structure of the GST. The foregone flexibility for the center and the states is balanced by the greater scrutiny that will be required because such taxes have to be done within the GST context and hence subject to discussions in the GST Council. Accordingly, the Committee recommends that this sin/demerit rate be fixed at about 40 percent (Centre plus states) and apply to luxury cars, aerated beverages, paan masala, and tobacco and tobacco products (for the states).

- This historic opportunity of cleaning up the tax system is necessary in itself but also to support GST rates that facilitate rather than burden compliance. Choices that the GST Council makes regarding exemptions/low taxation (for example, on gold and precious metals, and area-based exemptions) will be critical. The more the exemptions that are retained the higher will be the standard rate. There is no getting away from a simple and powerful reality: the broader the scope of exemptions, the less effective the GST will be. For example, if precious metals continues to enjoy highly concessional rates, the rest of the economy will have to pay in the form of higher rates on other goods, including essential ones. As the table shows, very low rates on precious metals would lead to a high standard rate closer to 20 percent, distorting the economy and adding to inflationary pressures. On the other hand, moderately higher taxes on precious metals, which would be consistent with the government's efforts to wean consumers away from gold, could lead to a standard rate closer to 17 percent. This example illustrates that the design of the GST cannot afford to cherry pick—for example, keeping a low RNR while not limiting exemptions--because that will risk undermining the objectives of the GST.
- The GST also represents a historic opportunity to rationalize the tax system that is complicated in terms of rates and structures and has become an "Exemptions Raj," rife with opportunities for selectivity and discretion. Tax policy cannot be overly burdened with achieving industrial, regional, and social policy goals; more targeted instruments should be found to meet such goals, for example, easing the costs of doing business, public investment, and direct benefit transfers, respectively; cesses should be reduced and sparingly used. Another problem with exemptions is that, by breaking up the value-added chain, they lead in practice to a multiplicity of rates that is unpredictable, obscured, and distortionary. A rationalization of exemptions under the GST will complement a similar effort already announced for corporate taxes, making for a much cleaner overall tax system.
- The rationalization of exemptions is especially salient for the center, where exemptions have proliferated. Indeed, revenue neutrality for the center can only be achieved if the base for the center is similar to that of the states (which have fewer exemptions—90 products versus 300 for the center). If policy objectives have to be met, instruments other than tax exemptions such as direct transfers could be deployed.
- The Committee's recommendations on rates summarized in the table above are all national rates, comprising the sum of central and state GST rates. How these combined rates are allocated between the center and states will be determined by the GST Council. This allocation must reflect the revenue requirements of the Centre and states so that revenues are protected. For example, a standard rate of 17% would lead to rates at the Centre and states of say 8 percent and 9 percent, respectively. The Committee considers that there are

sound reasons not to provide for an administration-complicating “band” of rates, especially given the considerable flexibility and autonomy that states will preserve under the GST (including the ability to tax petroleum, alcohol, and other goods and services).

- Implementing the GST will lead to some uncharted waters, especially in relation to services taxation by the states. Preliminary analysis in this report indicates that there should not be large shifts in the tax base in moving to the GST, implying that overall compensation may not be large. Nevertheless, fair, transparent, and credible compensation will create the conditions for effective implementation by the states and for engendering trust between the Centre and states; The GST also represents a historic opportunity to Make in India by Making One India. Eliminating all taxes on inter-state trade (including the 1 percent additional duty) and replacing them by one GST will be critical to achieving this objective;
- Analysis in the report suggests that the proposed structure of tax rates will have minimal inflationary consequences. But careful monitoring and review will be necessary to ensure that implementing the GST does not create the conditions for anti-competitive behavior;
- Complexity and lags in GST implementation require that any evaluation of the GST—and any consequential decisions—should not be undertaken over short horizons (say months) but over longer periods say 1–2 years. For example, if six months into implementation, revenues are seen to be falling a little short, there should not be a hasty decision to raise rates until such time as it becomes clear that the shortfall is not due to implementation issues. Facilitating easy implementation and taxpayer compliance at an early stage—via low rates and without adding to inflationary pressures--will be critical. In the early stages, if that requires raising other taxes or countenancing a slightly higher deficit--that would be worth considering.
- Finally, the report has presented detailed evidence on effective tax burdens on different commodities which highlights that in some cases they are inconsistent with policy objectives. It would be advisable at an early stage in the future, and taking account of the experience of the GST, to consider bringing fully into the scope of the GST commodities that are proposed to be kept outside, either constitutionally or otherwise. Bringing alcohol and real estate within the scope of the GST would further the government’s objectives of improving governance and reducing black money generation without compromising on states’ fiscal autonomy. Bringing electricity and petroleum within the scope of the GST could make Indian manufacturing more competitive; and eliminating the exemptions on health and education would make tax policy more consistent with social policy objectives.

There is a legitimate concern that policy should not be changed easily to suit short term ends. But there are enough checks and balances in the parliamentary system and enough pressures of democratic accountability to ensure that. Moreover, since tax design is profoundly political and contingent, it would be unwise to encumber the Constitution with the minutiae of policy that limits the freedom of the political process in the future: the process must retain the choice on what to include in/exclude from the GST (for example, alcohol) and what rates to levy. The credibility of the macroeconomic system as a whole is undermined by constitutionalising a tax rate or a tax exemption. Setting a tax rate or an exemptions policy in stone for all time, regardless of the circumstances that will arise in future, of the macroeconomic conditions, and of national priorities may not be credible or effective in the medium term. This is the reason India—and most credible polities around the world--do not constitutionalise the specifics of tax policy. The GST should be no different.

The nation is on the cusp of executing one of the most ambitious and remarkable tax reforms in its independent history. Implementing a new tax, encompassing both goods and services, to be implemented by the Centre, 29 States And 2 Union Territories, in a large and complex federal system, via a constitutional amendment requiring broad political consensus, affecting potentially 2-2.5 million tax entities, and marshalling the latest technology to use and improve tax implementation capability, is perhaps unprecedented in modern global tax history. The time is ripe to collectively seize this historic opportunity.