

Reforming Indirect Taxes in India: Role of Environmental Taxes

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Pre-reform: Indirect Taxes in India (centre)

- Central Government: Customs Duties,
- Union Excise Duties
- Countervailing Duties of Excise,
- Additional Duties of Excise
- Special Excise Duties
- No service tax (high tax burden on goods)
- No. of cesses

Indirect taxes in India: States

- General Sales Tax
- Central Sales Tax
- Sales Tax on Motor Spirit
- State Excise Duties
- Motor Vehicle Tax
- Stamp and Registration Duties
- Entertainment Tax
- Electricity duty
- Passenger and Goods Tax
- Purchase Tax on Sugarcane
- Octroi/entry tax
- Luxury tax

Indirect Taxation: Main Problems

- Cascading
- High and Multiplicity of Tax Rates: tax evasion and avoidance
- Unmanageability and Opacity of Tax Incidence
- Fragmentation of Markets
- Preponderance of Exemptions
- Revenue Loss Due to Inter-State Competition
Extensive Evasion
- Legal Disputes: classification, definitions

Benchmarks from Received Theory

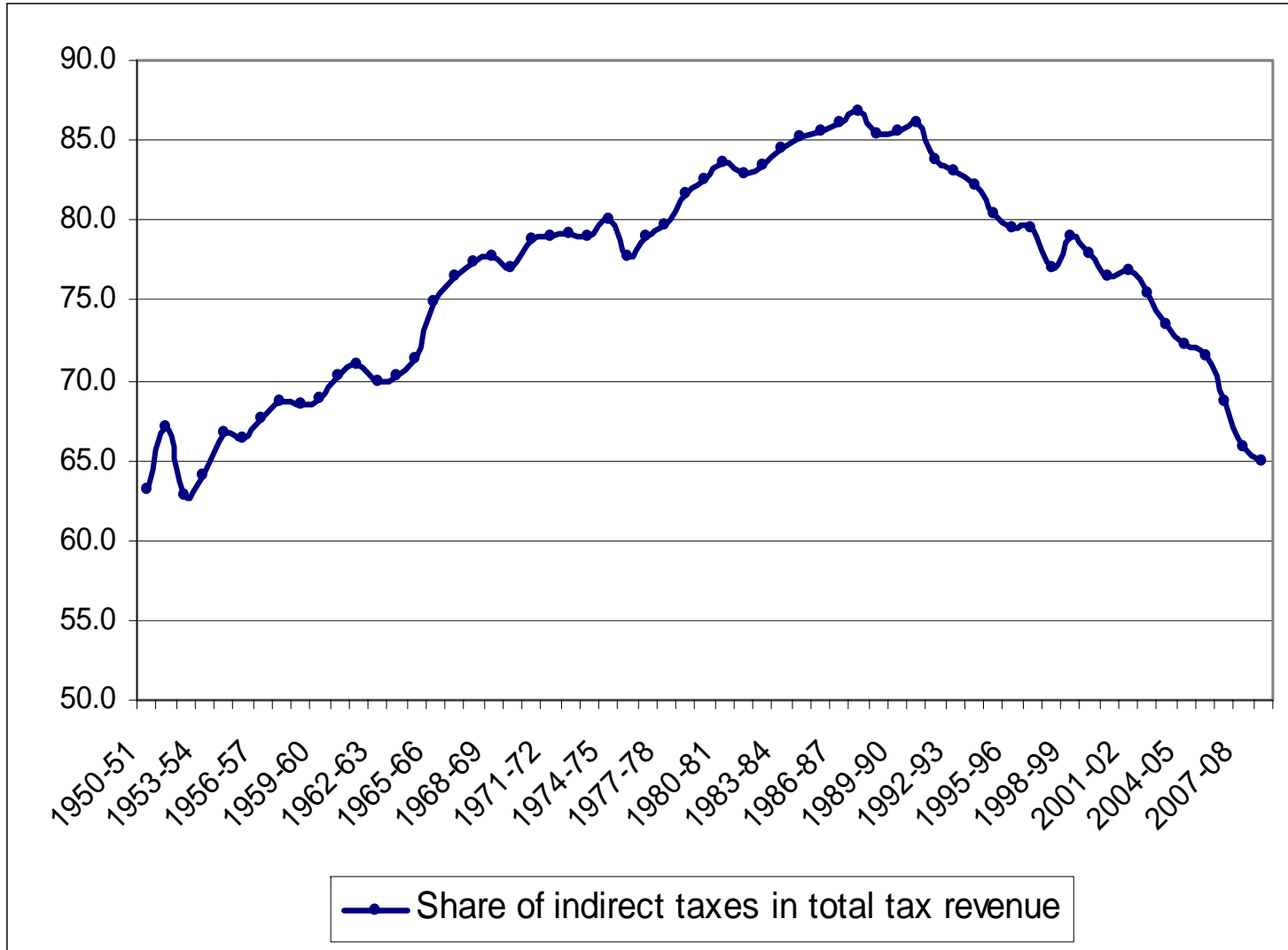
- Optimal taxation
- Inverse-elasticity rule
- Consumption/Destination based taxation
- Zero tax burden on exports
- Common market: no inter-state barrier to trade
- Environmental taxes not fully integrated with mainstream theory (double dividend hypothesis proposed)

Reforms since 1986-87

- Central excise duties
- Modvat, Cenvat
- Central excise continued on Taxation of Petroleum products
- Service tax from (Mid-nineties: coverage and rate progressively increased): allowed some downward adjustment of tax rates on goods
- Customs duty: rates brought down; no. of rates reduced, more ad valorem instead of specific taxes
- Special excise duties, additional excise duty, number of cesses

State taxes

- Sales tax: statevat (2005-2008) all states moved to statevat (value-added taxation principle; rate structure simplified)
- Petroleum products still subject to sales tax
- Inter-state sales tax (rate reduced)
- State excise duties
- Motor vehicle tax
- Entry tax
- Purchase tax on sugarcane



Next Phase of Reforms: Towards GST

- **GST (CGST, SGST): Concurrent base**
- **Three benchmark models: Empowered Committee (First Draft Paper) and TFC Task Force (for reference) and Thirteenth FC (model GST)**
- **Role of Environmental Taxes in each of these models**
- **Green shift in international experience: place of environmental taxes in the GST scheme**

Key Features of Alternative Models

- Broad structure
- Central and state taxes to be merged in GST
- Treatment of inter-state sales
- Rate structure
- Threshold limits
- Place of environmental taxes

Broad Structure: Common Features

- GST to consist of CGST and SGST
- CGST and SGST to be applied to all transactions of goods and services made for a consideration
- CGST and SGST to be paid to central and state accounts; input tax credit (ITC) within CGST and SGST; no cross ITC
- Administration: centre for CGST; states for SGST
- Destination principles: exports and inter-state sales zero-rated

Taxes to be included

- Central taxes
- TFC (and Task Force) : central excise duty, additional excise duty, service tax, additional customs duty (countervailing duty); all surcharges and cesses
- EC: all of the above (also mentions special additional duty of customs (SAD) and excise duty levied under the medicinal and toiletries preparation Act.

State taxes to be merged

- EC: VAT/Sales tax, entertainment tax (unless levied by local bodies), luxury tax, taxes on lottery, betting, and gambling, state cesses and surcharges in so far as they relate to supply of goods and services; entry tax not in lieu of octroi
- TFC: all of above+ entertainment tax, purchase tax, state excise duties, stamp duty, taxes on vehicles, taxes on goods and passengers, taxes and duty on electricity, all state cesses and surcharges, entry tax whether in lieu of octroi or otherwise

State taxes to be merged

- All the taxes listed in the TFC list+ residential and commercial property-entertainment tax levied by local bodies

Inter-state Transactions

- EC: IGST (centre to levy; rate to be equal to CGST+SGST); SGST component to be reimbursed to the states
- Task Force: Modified bank Model
- TFC: any model consistent meeting the condition of zero-rating of exports and inter-state sales

Threshold limits

- EC: SGST: Gross annual turnover of Rs. 10 lakh both for goods and services for all states and UTs. For CGST: Goods Rs.1.5 crore; services Rs. 10 lakh
- Task Force: Turnover net of CGST and SGST Rs. 10 lakh for goods and services
(dealers below this limit can voluntarily register);
dealers in the turnover range of Rs. 10-40 lakh may opt for a compounded levy of 1 percent on turnover)
- TFC same as Task force but does not specify whether turnover net of CGST and SGST

Rate Structure

- Task Force: CGST 5 % SGST 7 %
- TFC CGST 5 % SGST 7 % ('This should be the target')
- EC: SGST: 2 rates lower rate 4-5%, core rate 8-10 per cent

EC: Demerit Goods

- Petroleum products: out of GST; centre to continue to levy excise and states to levy sales tax
- Alcoholic beverages: state excise duty (if already Vatable, then SGST)
- Tobacco products: centre to levy excise and both centre and states to levy CGST and SGST, respectively

Task Force: Sin Goods

- Sin-goods (emission fuels, tobacco products, alcohol) to be subjected to non-rebatable excise; industrial fuels to be subjected to GST
- Taxes under stamp duty, vehicle tax, goods and passenger tax, electricity duty on Sin-goods and any amount collected as tax/fee/charge/cess/user and user charge for supply of Sin goods and services (including environment-polluting goods and services) should not be subsumed under GST: instead consolidate all such taxes to be called Central excises and state excises.

TFC: Eco-taxes

- HSD, MS, and ATF could be charged a non-rebatable additional levy by both the central and state governments over and above CGST, SGST.
- Alcohol and tobacco: non-rebatable additional levy over and above CGST, SGST.
- Also mentions: cesses for emergency and user charges
- Three grants: for forests, grid-connected renewable energy added to grid, and water management

GST and Eco-taxes

- The overall GST logic calls for a single uniform rate for all goods and services, eco taxes call for differentially higher rates for polluting inputs and outputs.
- In a GST, rebate on input taxes will make taxation of polluting inputs ineffective.
- In destination based system producing states do not collect tax to cope with environment damage, loss of minerals, damage to productivity of soil.
- Incidence of pollution is regionally differentiated and states need to have autonomy to levy non-rebatable eco taxes on inputs and outputs

Issues (continued)

- Many polluting inputs/outputs are currently taxed at differentially high rates and a lower common rate would lower the effective rate of taxation on polluting outputs
- Important polluting inputs: coal, electricity, petroleum products subject to a mix of administered prices, subsidies, and taxes: clean-up needed
- Incidence of pollution is regionally differentiated and states need to have autonomy to levy non-rebatable eco taxes on inputs and outputs especially responsible for polluting air, water, and soil in their regions.
- But cannot be done on a large scale to remain consistent with the GST logic

Pollution Patterns in India

- Air Pollution: Two industries account for nearly 2/3rds of air pollution: Cement accounts for 33.4 % and Iron and Steel, 32.2 % of the pollution load (Energy Sector: Coal is very largely responsible for CO₂ emissions)
- Water Pollution: Iron and Steel alone accounts for 87.4 % of water pollution load

Green Tax Shifts: UK Experience

- Fuel Duty Escalator (FDE) was introduced in 1993 and maintained until 1999, with a duty in the range of 3 to 6 percent on fuels
- Simultaneously income tax rates were cut from 25 to 24 percent
- The green tax receipts were not necessarily spent on environmental measures
- The environmental tax revenues made substantial contribution to the overall tax revenues as well as GDP – post 2000 there was clear dip in the contribution of environmental tax revenues

Other Green Tax Initiatives in the U.K.

- Land fill tax: 1996 at standard rate of £7 per tonne of waste, progressively raised; to be raised £40/tonne by 2009; estimated revenue in 2007-08: £900m
- Climate change levy: tax on energy use by business and industry: 2007-08 revenue £700m
- Aggregates levy: on sand, gravel, and rock, 2007-08 revenue £300m
- Motor fuel differentiation: favouring unleaded petrol
- Vehicle excise duty (differentiators: engine size; age)
- Central London Congestion Charge (administered with cameras and electronic readers)

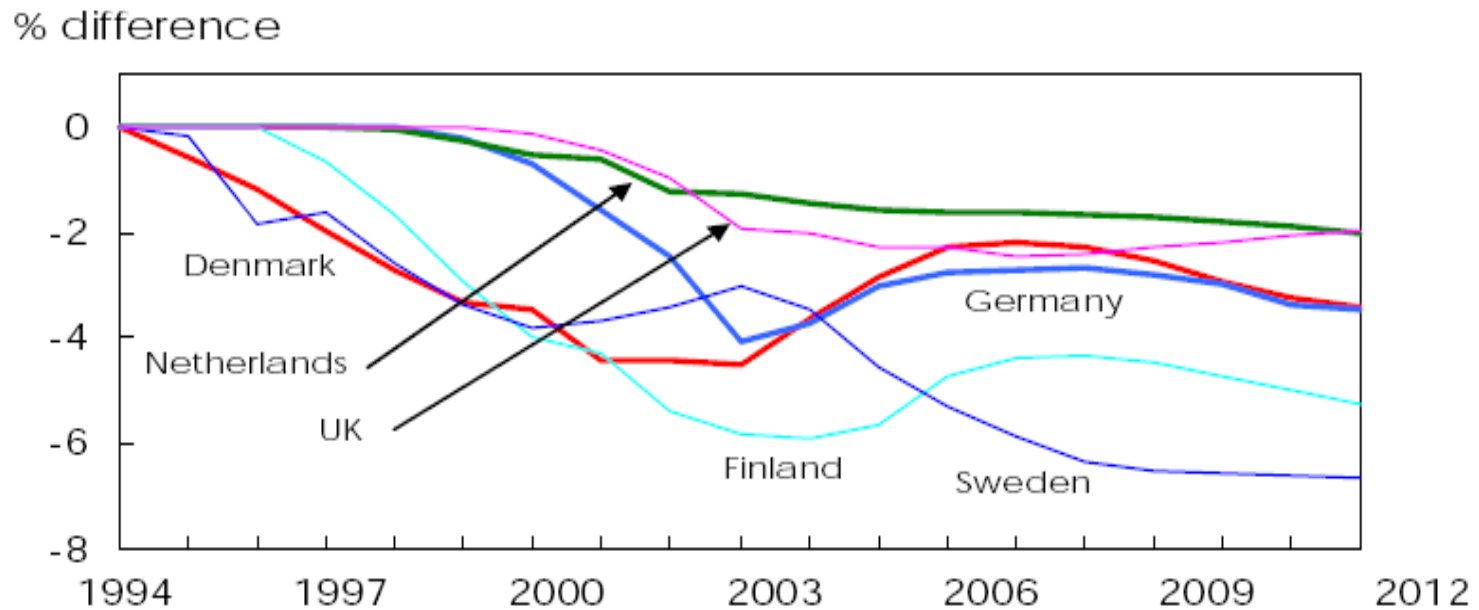
Eco taxes: German Experience

- A set of eco taxes introduced with effect from 1st April 1999 with the aim to make energy and resource consumption more expensive while lowering the cost of labor
- Taxes were introduced in several steps with gradual increases every year
 - Exemptions and reductions were given to particular sectors (e.g., agriculture) that not only received wide criticism, but also reduced the overall tax revenues
- Labor costs were cut simultaneously by reducing the pension contributions
- Bulk of the tax revenues were diverted towards promotion of renewable energy sources

Eco taxes: German Experience (continued)

- Besides taxes, a range of other instruments including, voluntary agreements, financial support programs, innovation support programs, labeling etc. were also used to achieve energy efficiency – as many as 70 individual sectoral and cross-sectoral measures are presently used
- Several indicators of success – low-carbon vehicles, energy-efficient houses, penetration of renewable energy, development of waste management technologies

Effect of Environmental Tax Reforms on Greenhouse Gas Emissions – EU Experience



Note(s) : % difference is the difference between the base case and the counterfactual reference case.

(Source: COMETR, 2007, as cited in GFC Briefing Paper 2, 2009)

Overall Lessons from EU Experience

- Several evaluations by bodies such as EEA, European Commission, Nordic Council, OECD, and GFC clearly suggest that environmental taxes are effective from environmental perspective
 - However, the tax must be set at right level and must be directed at the source of environmental burden to achieve the desired goals
- Environmentally successful green taxes include – Danish energy/carbon taxes, Swedish NOx tax, German energy and transport taxes, UK fuel duty escalator, Finnish, Swedish and UK waste taxes, and the Dutch effluent charge
- Several success stories are accompanied by tax cuts on income or other ‘goods’

Overall Lessons from EU Experience (contd.)

- Most of the taxes have also generated substantial tax revenues
 - Though such revenues have not necessarily been used for environmental considerations
- No evidence on the green taxes with sustainable development goals leading to ‘no-growth’ economy – most country experiences suggest negligible impact on GDP
- Higher taxes would have resulted in more benefits – but feasibility in implementation dominated over the sustainable development aims

Options in the GST Framework

- Pricing and subsidization (petroleum products, fertilizers, coal, electricity) to be simultaneously rationalized
- Environmental taxes: key areas (petroleum products, alcohol, tobacco, electricity through non-rebatable excise duties)
- Non-rebatable excises or cesses and user charges earmarked to industries environment- promoting technologies/processes in the case of other polluting goods.
- Changes in the constitution, the GST rate structure are critical.
- We plan to study the industry perspectives and integrate energy demand, pollution, environmental taxes in an overall growth model