MONOGRAPH 43/2019

THE EVOLVING GST

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February 2019

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Rs.200/-

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This monograph reproduces the Chelliah Memorial Lecture delivered by the author at the Madras School of Economics on 28 February 2019. The author wishes to place on record her thanks to the Chairman and Director of the Madras School of Economics, and the sponsors of the lecture.

Introduction

Chairman Dr. Rangarajan, Mrs. Chelliah and members of the family, Director, faculty and students of the Madras School of Economics, President of the SICCI, distinguished ladies and gentlemen.

It is indeed a proud privilege for me to be delivering this lecture in memory of Dr. Raja J. Chelliah, the most powerfully influential fiscal economist of our country, who shaped the taxation structure to his vision of what would serve rather than retard the efficiency of the national economy, with ease of compliance.

When in July 1991, the government of India headed by Prime Minister P.V. Narasimha Rao, with Dr. Manmohan Singh as Finance Minister, launched a broad spectrum programme of economic reforms, it was Dr. Chelliah they turned to for the fiscal plank of those reforms. A tax reforms committee was constituted with him as Chairman, which issued its interim report in December 1991, and a final report in two parts over 1992-93.[1]

There have been many tax reform committees in independent India, but none has had the impact of what is commonly known as the Chelliah committee. It was the first official document to recommend a move to an integrated indirect tax for India, offering input tax credit across both goods and services.

The message of the committee covering the whole gamut of taxation including direct taxes was immediately accepted although, as stated in the quote below from the 1993-94 budget speech of Finance Minister Manmohan Singh, the recommendation for a nationwide value added tax, could not be immediately implemented.

> "I accept the broad thrust of the Chelliah Committee's recommendations on both direct and indirect taxes. We must move as rapidly as possible to a regime of moderate tax rates in direct taxation, which will encourage better compliance, especially if supplemented by efforts at broadening of the tax base…..and our long-term aim should be to move to a Value Added Tax System. However, a nationwide value added tax system cannot be introduced overnight. There has

[1] Government of India, Tax Reforms Committee, Interim Report, and Final Report Parts I and II (Delhi, India: Department of Revenue, Ministry of Finance, December 1991, August 1992, and January 1993).

to be a broad agreement among the Centre and the States on the design of such a system."

Budget Speech 1993-94, Part B, para 52[2]

In their commentary as editors of Volume IV of the collected works of Manmohan Singh published in December 2018, covering his post-reform budget speeches, Nicholas Stern and Shantanu Singh, have this to say: "The biggest reform in these Budgets, however, were seen in the implementation of the Chelliah Committee's recommendations for tax reform." [3]

A national value added tax system called for amending the Constitution, to eliminate the divide between the tax bases of Centre and states. A first amendment attempt moved in 2011 lapsed in 2014, at the end of the term of the government moving it; a second attempt succeeded.[4] The amendment was notified in the Gazette of India on 8 September 2016, 24 years after the Chelliah report.

The GST Council was notified on 12 September and the other provisions governing the GST on 16 September 2016.

The Profile of the GST

I have titled this lecture "The Evolving GST" because the initial design of the tax carried many defects and had to be corrected. The manner of its correction, in a slow dribble over the months, was in itself almost as much of a problem as the initial defects, because it meant constant re-adjustment of the parameters governing the tax.

A tax which was supposed to carry appeal to taxpayers by virtue of its simplicity and the offer of input tax credit, did not appeal to taxpayers in the form rolled out on 1 July 2017. It incurred, on the contrary, the wrath of taxpayers.

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[2] http://indiabudget.nic.in/bspeech/bs199394.pdf, accessed 30 January 2019.

[3] Singh Manmohan, 2018, Changing India, Vol IV: Economic Reforms – 1991 and Beyond, ed. Nicholas Stern and Shantanu Singh (New Delhi: Oxford University Press): p.xxvi.

[4] However, the comments of the Standing Committee on the earlier bill influenced the shape that the amendment finally took (see References). The 122nd Constitutional Amendment Bill No. 192 placed in Parliament on 19 December 2014 was passed by the Lok Sabha on 6 May 2015, but further amended during its subsequent passage through the Rajya Sabha before final enactment as the Constitution (101st Amendment) on 8 September 2016.

The goods and services tax is a nation-wide destination based value added tax on final consumption, after the Constitutional amendment enabled dual taxation by the Centre and states on the same tax base. Some of the initial defects now stand corrected, with the GST Council showing commendable responsiveness to the negative effects of the initial design. The evolution of the design of the GST will be dealt with in what follows, after a brief description in this section of the boundaries of the tax as it was enacted.

The GST does not have "value added" in its name because there was already a VAT levied at state-level starting in 2005. The state VAT was limited by the constitutional division of powers to sale of goods alone. The value added principle had been worked into the value chain of the Central excise on manufactured goods starting even earlier in 1986, with the Central service tax also worked in later for input credit within that chain. The name of the GST emphasises the merger of goods and services into a single tax levied dually by Centre and states on a common base across the initial Constitutional divide, which was what distinguished the tax and gave it its identity.

The fundamental appeal of value added taxation, which has led to its adoption in 160 countries at last count, has to do with its offer of input tax credit at every stage of the value chain. This makes the product price at the final destination point, exclusive of the final GST levy, reflect the pure input cost[5] of producing it, without being contaminated by taxes levied along the way. When consumer choices are shaped by the relative resource cost of products, and when producer choices are likewise not distorted by levies on inputs, resources are directed into their best uses. It is this efficiency property of value added taxation that is its principal virtue.

Input tax credit, aside from the efficiency property noted above, also has an in-built compliance incentive. The producer who has paid tax on his inputs is keen to collect taxes from his buyer, so that he can credit input tax paid against the tax he collects. In this way, he becomes a partner of the tax collecting authority, rather than an adversary. His incentive is aligned with that of the tax collector. That was the textbook picture of a value added tax.

Aside from its textbook advantages, the success with the value added principle within the central and state tax domains in India, in terms of both revenue and

[5] Input prices may however carry other non-tax structural distortions.

acceptance by taxpayers, laid the ground for acceptance of the GST across the political spectrum. The idea of the GST was endorsed by a number of committees subsequent to the Chelliah committee.

The "broad agreement between Centre and states" articulated by Finance Minister Manmohan Singh took shape slowly over time, as the revenue success of the state-level VAT began to be visible five years after its adoption by most states in 2005. A study conducted over 1993-2009 found no incremental revenue impact from the VAT.[6] By 2014–15 however, aggregate state revenue had risen to 6.8 percent of GDP, higher by one percentage point than in the pre-VAT year 2004–05.[7]

The Constitutional amendment established a GST Council, which has Finance Ministers of the Centre, all states, and two Union Territories with legislatures[8] as members, with full autonomy to set rules and rates.

Although the GST was comprehensive in the sense of spanning both goods and services and thereby all types of inputs, the Constitutional amendment kept some goods outside the GST, which were retained in the tax domains of the Centre and/or states. They are listed below in categories which could justify their exclusion, with the tax domain shown in parentheses. Taxes on those items become non-rebatable levies within the GST chain.

1. sin taxes - **alcohol** for human consumption (within-state sales tax and excise); **tobacco** (Central excise);
2. climate change externalities - **electricity** (within-state duty); **petroleum products** (both Central excise and within-state sales tax)

Petroleum products are mentioned in the Constitutional amendment as potentially includable within the GST, if so decided by the GST Council. At present petroleum products remain outside. The Constitutional amendment does not touch on the issue of taxation of real estate. At present, stamp duty on sale and purchase of land are leviable by states. Moving real estate to the jurisdiction of the GST should therefore require yet another amendment of the Constitution since it is tantamount to encroachment of states' tax base by the Centre, although an alternative opinion holds

[6] Das-Gupta, 2012.

[7] Rajaraman, 2019.

[8] As stated in Parliament on 28 July 2017 in response to Lok Sabha question number 2298 (www.parliamentofindia.nic.in).

that as long as GST is an add-on to a non-rebatable stamp duty, the Constitution need not be amended.

Value added taxes are efficient and naturally compliance inducing, but both properties are argued by economists to be advanced when the GST is levied at a single rate. In a Chelliah Memorial Lecture in 2012, Michael Keen developed a model showing that the regressivity of such a tax can be more than offset by using the revenue to offer free services favouring the poor,[9] but these models fail to take on board the immense difficulties of targeting, and the impossibility of ensuring equal access and equal quality for the poor in a spatially dispersed country like India.

In the report of the Thirteenth Finance Commission, a case was made for an "ideal" a single rate GST at 12 percent, on a wide tax base including real estate, incentivised by a grant of Rs. 50,000 crore to be made available to states over the 2010-15 horizon of the Commission, if they were to accept such a tax. Needless to say, such a single-rate GST did not come to pass.

It was inevitable that distributive justice would dictate a multiple rate structure, where the lower rates for goods commonly consumed by the poor would necessarily have to be offset by high rates on high-end consumption. The five-rate structure finally agreed upon was 0, 5, 12, 18 and 28.[10] The multiple rate structure in and of itself was not a violation of any of the key attributes of a value added tax, but what did become problematic was the assignment of goods and services to these five rate categories.
The GST was, and remains, a fully online tax system.

The sections following on the problematic features of the initial design of the GST and the subsequent correction of some though not all aspects, has a selective focus on the filing frequency, and the pattern of assignment of products to the five rates. There are many other features of the design and their changes over time, which are not covered in this lecture for lack of time. These include the turnover threshold for registration, the reverse charge mechanism for dealings between counterparties across

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[9] See Keen 2014, which is the published version of the 2012 Chelliah Memorial Lecture at the National Institute of Public Finance and Policy.

[10] Nil is an exemption, not a zero rate. The rate structure was decided at the 14th meeting of the GST Council on 18 May 2017, http://pib.nic.in/newsite/PrintRelease.aspx?relid=161947. There were also rates of 3 percent and 0.25 percent, and exports were zero rated.

the registration threshold, the composition scheme, and the appellate tribunal for dispute resolution.

The focus on filing and rate assignment is dictated by these features having robbed the GST implemented of some key attributes of value added taxation.

The Initial Filing Burden And Its Subsequent Correction

As initially introduced the GST called for monthly filing of four forms, [11] listed below, each with a separate filing deadline, with a penalty for every day by which the deadline was crossed.

GSTR 1, with invoice details, of outward supplies
GSTR 2, with invoice details, of inward supplies
GSTR 3B, a summary unverified submission, with an interim tax payment
GSTR 3, the final claim, with input tax credit validated through invoice matching of the filings of counterparties.

The problem was the attempt to override the natural incentive for "forward compliance" – collecting the levy from buyers against which to set off input tax credit – by requiring invoice details of all outward supplies, in a bid to track those buyers further for whether they were levying the GST on their buyers.

Likewise, the information asked on the entire cost structure of the company in GSTR2 was an attempt to check backward compliance, for whether inputs were coming from within the GST net, instead of leaving the natural incentive to work with those sellers.

The initial GST design repelled taxpayers, rather than inducing them to join, which is one of its textbook properties. The burden of monthly filing of invoice details more than outweighed the attraction of input tax credit for businesses, especially at the small end of the scale spectrum. However, they became traceable from the GSTR1 details of any large seller they might buy inputs from - say steel for manufacture of kitchen utensils. The only recourse for the utensil maker not wanting to enter the GST

[11] There was a composition scheme offering a low tax rate on turnover below an eligibility threshold, without input tax credit and no obligation to issue sale vouchers, which had a separate form, GSTR 4.

system with its onerous reporting burden was to slip under the turnover threshold for taxability, splitting his unit into two or more as required.

On top of the filing burden, the GST Network (GSTN) portal failed to perform the invoice matching function necessary for validating input tax claims in the final claim form GSTR3. This was an operational rather than design failure, but it resulted in rejection of input tax credit claims that were perfectly valid. Uncertainty about input tax credit meant that businesses continued to price their products at the tax-included price of inputs. This robbed the GST of its principal efficiency property, of eliminating tax cascading.[12]

The GST Council recognised the compliance problem at the 21st meeting of the GST Council, on 9 September 2017, and the deadlines for July 2017 were variously extended to October/November. But the initial filing system with multiple forms remained in place for the first three months.

At the 22nd meeting of the GST Council in October 2017, the filing (and payment) frequency was reduced to quarterly below a turnover of Rs. 1.5 crore, accounting for 85 per cent of total filers and a mere 6 per cent of total revenue.

At the 23rd meeting of the Council in November 2017, the number of forms was finally reduced to GSTR1 on outward supplies, and GSTR3B, with tax credits as self-declared in the latter to be honoured. With the dropping of GSTR2, invoice matching as a pre-condition was dispensed with.[13] But for quarterly filers below the turnover threshold, GSTR3B along with an interim payment was made payable monthly.

The turnover threshold for quarterly reporting was further raised at the 28th meeting of the Council in July 2018 to Rs 5 crore, covering an estimated 93 per cent of taxpayers.[14]

In addition to the monthly forms, there were also three forms to be filed annually: forms 9, 9A and 9C. An indicator of the poor compliance with this requirement

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[12] Since, as will be seen further below, the GST rates were already "fitted" to the pre-GST cascaded incidence of levy at the four-digit level, this meant a cascaded incidence levied on a further inclusion of input taxes.

[13] I am indebted to Najib Shah for pointing out that sections 42 and 43 of the CGST Act still call for invoice matching, so that it has merely been suspended rather than actually eliminated.

[14] In a further nod to the compliance difficulties faced by small business, the 32nd meeting on 10 January 2019, announced that free accounting and billing software would be provided to small taxpayers by GSTN.

was the decision taken at the 31st meeting of the GST Council on 22 December 2018, to extend the deadline for unfiled annual returns pertaining to the financial year 2017-18, to 30 June 2019.

The excessive pursuit of compliance in the original design reflected the revenue anxiety of the Centre, which was left holding the revenue risk resulting from a shortfall cover guarantee to states for five years actually built into the Constitutional amendment. This was quantified as a guaranteed 14 percent annual increase year on year at the seventh meeting of the GST Council in December 2016, followed by a formal enactment[15] simultaneously empowering the Centre to levy a cess to fund the compensation due.

Despite the successful revenue experience of states with VAT, they were mindful of the fact that it had taken five years for the incremental revenue from VAT to become visible, and therefore compensation to states for five years was actually built into the arrangement, clearly leaving the Centre holding the revenue risk from the GST.

Even though the Ministry of Finance stated formally in the Lok Sabha that all decisions taken by the GST Council were unanimous,[16] the revenue assurance clearly disincentivised the states from looking at the design too closely. The process seems to have been driven by the Centre, justified by its assumption of the revenue risk.

The interim design introduced over October-November 2017, which grants tax credits as reported without invoice matching, continues to remain in place till today. Monthly filing applies only to taxpayers with a turnover over Rs. 5 crore, who are 7 percent of all registered GST dealers. Those with turnover less than Rs. 5 crore file quarterly, but make an interim payment monthly.

At the 27th meeting of the GST Council on 4 May 2018, a final design to replace the interim system, calling for monthly payment and filing of GSTR1 with uploaded vouchers on all B2B transactions, confined to outward supplies, and input credit automatically generated by the GSTN portal, was approved. At that meeting, it was to have run in parallel with the interim system from November 2018, and to replace the interim system altogether from April 2019. The start was postponed.

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[15] The Goods and Services Tax (Compensation to States) Act 2017, notified on 12 April 2017, which enabled levy by the Centre of a cess to fund the compensation; see http://www.cbec.gov.in/resources/htdocs-cbec/gst/gst-compensationcess-rates-18.05.2017.pdf

[16] In response to question No. 2298 answered on 28 July 2017.

The latest date for the start of the final system is 1 April 2019 on a trial basis and 1 July 2019 on a mandatory basis, as decided at the 31st meeting of the GST Council on 22 December 2018.

If an autopopulating role for the GSTN portal is intended for the final design, it is important to keep in mind that the malfunctioning of the portal in conjunction with invoice matching in the initial design was what robbed the GST of its key property, since uncertainty over receipt of input tax credit made businesses continue to price their products inclusive of input taxes. If quarterly filing for those below a turnover threshold of Rs. 5 crore will continue to remain in place, there will be a problem with counterparties across the threshold divide.

The Revenue Performance

Monthly GST revenue collections in aggregate are shown in the chart below. These are for collection months, pertaining to the revenue month preceding, whose payment deadlines fall in the month indicated.[17] The GST monthly time series carries quarterly spikes in the months of July, October, January and April, corresponding to the revenue months marking the end of each quarter (June, September, December and March). This is because of quarterly composition scheme filing, reinforced after October 2017, when a quarterly filing option was given even to regular filers below a turnover threshold.[18]

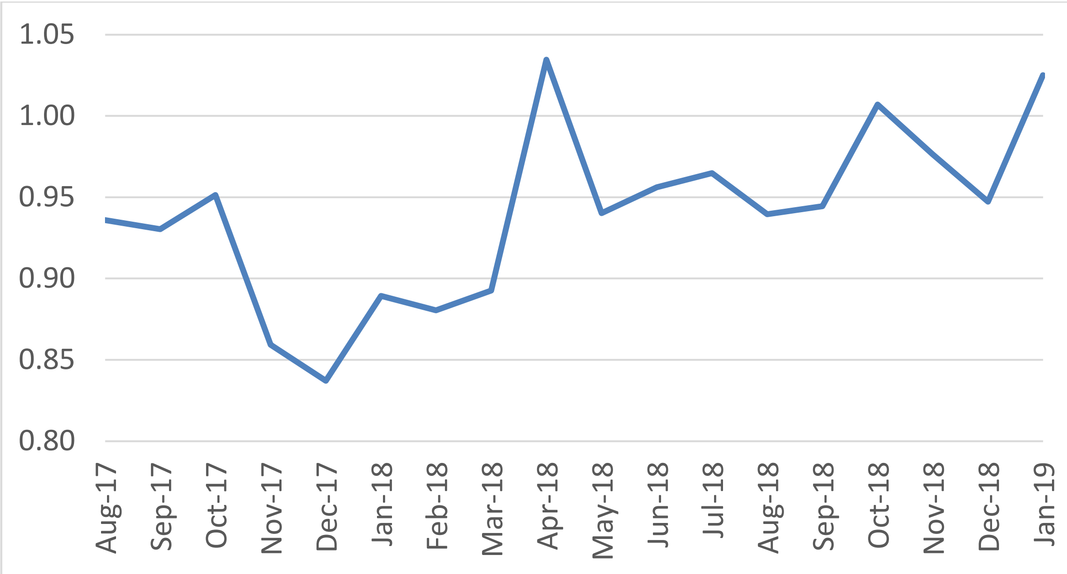
The drop in collections in November 2017, for the revenue month October, is because of both the (newly offered) quarterly filing option, as well as the first round of rate reductions announced in September 2017, which became effective in October, visible in November collections.[19] The further fall in December collections reflects the second round of rate reductions which became effective in mid-November 2017. There must also have been the delayed recognition of input tax credit on account of the extension of filing deadlines for the early months, being paid out in October and November.

[17] GST on imports is collected concurrently in the revenue month. The convention adopted aggregates the filed revenue pertaining to the previous month, with concurrent collections from imports in the collection month. The monthly figures for the eight collection months August to March in 2017-18 (Press Information Bureau, 2 April 2018) worked out to a monthly average of Rs. 89704 crore, close to the figure given in the Union Budget speech 2019. However, a later release (Press Information Bureau, 27 April 2018), reported a monthly average for those eight months of Rs. 89885 crore, explicitly stating that the concurrent collection in the first month of July 2017 was excluded. These discrepancies are unfortunate, but not major.

[18] Although those below the turnover threshold do an interim monthly payment until the quarterly filing month.

[19] The rates were notified on 22 September 2017, effective in the month of October.

Chart 1: GST revenue collections (Rs. Lakh Crore)



Source: Monthly releases from the Ministry of Finance through the Press Information Bureau, shown by collection month (pertaining to the revenue month preceding). Thus the collection reported in August 2017 pertains to revenue due for the month of July 2017, the first month of operation. See also footnote 17.

There is a distinct shift upward visible in the collections from May 2018, relative to the eight months preceding April 2018, which might have been on account of the e-way bill introduced on 1 April 2018, a supplementary fraud-checking mechanism mandated for all cargo consignments by road or rail above a certain threshold size. The e-way bill carries a unique electronic number which can be used only once, thus preventing the same input purchase from being cited for credit multiple times. However, it would appear that the e-way bill is only now in the process of being formally incorporated into the GST reporting system.[20]

The smooth functioning of the e-way portal, handled by the National Informatics Centre has made this a success story of the evolving GST. Initially introduced only for inter-state transport of goods, where the possibilities for fraud are greatest, it had

[20] I am indebted to Najib Shah for alerting me to this. In the pre-GST system, excise on factory output imposed inspection and documentation before outward movement of goods from the factory gate. Post-GST, goods not levied to GST at the point of the factory, could freely move downstream in the value chain carrying no incentive for forward compliance. But it is only when the e-way bill is linked to GSTR1 that its full potential for checking fraud will be reaped.

succeeded so well that by June 2018 it had been adopted by all 29 states for intra-state transport of goods as well.

The Finance Minister in his Union Budget 2019 speech said of the improvement in GST revenue performance (para 65): "The average monthly tax collection in the current year is Rs. 97,100 crore per month as compared to Rs. 89,700 crore per month in the first year." However, since the April 2018 spike includes the quarterly filing for January to March 2018, and deadline extensions for monthly filing due to compliance difficulties, the April figure should properly be included in the average for 2017-18. With April included, the average for 2017-18 works out to Rs. 91,233 crore. The average for the nine months May 2018 to January 2019 is Rs. 96,676 crore. With April included, the average for the current year moves up to Rs. 97,355 crore, crossing the estimate in the budget speech.

For now, it is enough to note that the GST revenue level has settled at a level of a little under Rs. I lakh crore a month, and that there can be a stable expectation of revenues remaining at least at that level going forward. In that sense, the GST can be termed a revenue success, although perhaps it failed the high expectation in Union budgets for both 2018-19 and 2019-20.

The Fitment of Rates to Goods and Services

The initial assignment of products to rates in the GST was decided at the fourteenth and fifteenth meetings of the GST Council on 18 May and 3 June 2017.[21]

The rate assignment was the work of a fitment committee constituted by the GST Council, which sought to achieve revenue neutrality at the four-digit level of product classification, instead of seeking revenue neutrality in aggregate across products. The Finance Minister stated this officially in Parliament in response to Lok Sabha question number 3390 on 4 August 2017: "The GST rates on supply of goods and services have been fixed, inter alia, at the total indirect tax incidence in the pre-GST regime, including cascading of taxes."

[21] http://www.cbec.gov.in/resources/ htdocs-cbec/gst/chapter-wise-rate-wise-gst-schedule-18.05.2017.pdf and http://www.cbec.gov.in/resources//htdocs-cbec/gst/chapter-wiserate-wise-gst-schedule 03.06.2017.pdf; accessed February 2018.

This violated the very principle underlying GST, whose purpose was to get away from the distortions introduced by tax cascading. It also added hugely to the work burden of the fitment committee, faced as it was with the task of working out the pre-GST cascaded rate of incidence after taking on board Central excise and service taxes, and VAT rates in 29 states.

In order to highlight the problems with the extreme rate differentiation introduced in the initial rate structure, here are a few examples. They are taken from the rate list as per decisions taken at the GST Council meeting on 18 May 2017. If corrected subsequently, the nature of the correction is also shown.

The problem was much worse than differentiation of rates at the four-digit level. A structure where each 4-digit level mapped uniquely onto one of the five rates, while distortionary, would at least have enabled GSTR1 forms with rates shown corresponding to each four-digit category.

There was also differentiation ***within*** four-digit categories by type of product or type of use. What was even more disappointing was that the rate corrections recommended at the 21st meeting of the Council on 9 September 2017, seemed more focused on bringing down the number of items at the 28 percent rate, rather than on rationalising the rate structure.

Some examples are given below, where the corrected rate structure introduced in September 2017 was actually less rational than the initial rate structure.

Quite independently of these examples, individual products or services were assigned to lower rates on turnover without input tax credit (certain types of restaurants to a 5 percent rate at the 23rd meeting in November 2017), or diamonds and precious stones from 3 percent to 0.25 percent at the 28th meeting in January 2018.

The examples below are very selective, and most of all, should not be taken as indicative that rate correction happened only at the 21st meeting in September 2017. At the next meeting in October, an Approach Paper was approved which tried to move away from the initial basis of fitment to pre-GST rates. Based on the approach paper, wide-ranging rate revisions were approved at the 23rd meeting in November 2017, largely focused on reducing the number of products taxed at 28 percent. However, neither the

Approach paper, nor the subsequent rate reductions at the 25th, 31st and 32nd meetings, did more than tinker at the margins of the structure adopted at the outset.

i) **Differentiation within 4-digit categories by type of product**:

Let me take an example from the food group. This illustrates both differentiation between closely related four-digit heads, as well as differentiation within a four-digit head.

4-digit head	Description	Initial GST rate	Correction 21st meeting Sep 2017
0801	Coconuts, fresh or dried	Nil	
0802	All other nuts, fresh	Nil	
0802	Areca nuts dried	5 percent	5 percent (only walnuts)
0802	Dried nuts other than areca, whether or not shelled or peeled	12 percent	

Source: http://www.cbec.gov.in/resources/htdocs-cbec/gst/chapter-wise-rate-wise-gst-schedule-18.05.2017.pdf and http://www.cbec.gov.in/resources//htdocs-cbec/gst/chapter-wiserate-wise-gst-schedule 03.06.2017.pdf; accessed February 2018. Rate change from Press Information Bureau, Ministry of Finance press note dated 9 September 2017.

The possible distributive justice in having coconuts at a nil rate in all forms, fresh or dried, while other nuts are taxed at positive rates may be dimly visible, since the latter command a higher price and are consumed at higher income slabs. However, to single out walnuts alone for reduction from 12 percent to 5 percent at the first major round of rate reductions recommended by the GST Council at its 21st meeting on 9 September 2017, is completely inexplicable. The change actually made the rate structure less rational than it was before. From the minutes of the meeting, the change was suggested by the finance minister of a particular state for fear that domestic production was suffering from import competition. The fear was not valid unless walnuts are being smuggled into the country in large quantities, escaping both import tariff and GST on imports. In any case, the GST rate structure cannot and should not be tampered with to handle an extraneous issue like smuggling, which has to be tackled independently.

ii) Differentiation within four-digit categories by type of use:

Here is an example from four-digit heads 2304, 2305, 2306, covering de-oiled cakes.

4-digit head	Description	Initial GST rate	Correction 21st meeting Sep 2017
2304, 2305, 2306	De-oiled cakes	Nil	Nil only for cattle feed
			5 percent for all other uses

Source: See source to previous table.

Differentiation by use is impossible to monitor. Aside from the enforcement issue, the GST is a levy on a product. Different rates by usage introduce a distortion which runs contrary to the efficiency property of the tax.

iii) **<u>Differentiation within four-digit categories by price of product</u>**

In this example, the September 2017 correction actually introduced an additional rate of 5 percent within the four-digit head 9404, where only three rates had previously existed. It introduces differentiation by price for the same product (cotton quilts), which is virtually impossible to enforce.

4-digit head	Description	Initial GST rate	Correction 21st meeting Sep 2017
9404	Coir products excl mattresses, quilted textiles	12 percent	
	Coir mattresses, cotton quilts	18 percent	12 percent cotton quilts > Rs. 1000 per piece; 5 percent price <Rs.1000 per piece
	Mattresses with spring, rubber or plastic	28 percent	

Source: See source to previous tables.

In one of his budget speeches, Finance Minister Manmohan Singh said:

> "Over the years, our indirect tax structure has grown into a complex maze of high and multiple rates, with numerous exemptions and different rates being applicable for the same product for different uses and users. This has resulted in unnecessary complexity leading to administrative abuse, mounting litigation and uncertain economic impact. All this has effectively eroded the tax base and buoyancy of the system and created economic distortions."
>
> Budget Speech 1994-95, Part B, para 55[22]

The examples given above show how the fundamental idea of the GST was violated by the approach to rate fitment. The description of the pre-reform indirect tax structure sounds dangerously similar to the "complex maze of multiple rates" which characterises the GST as it exists today.

[22] http://indiabudget.nic.in/bspeech/bs199495.pdf, accessed 30 January 2019.

The final example has to do with the structure of taxation of the construction sector (four-digit head 9954), which has had far-reaching real and financial sector impacts.

In the earlier funding model for construction of housing, housing companies obtained working capital through sale of apartments before construction was even begun. This had the property of getting consumer commitment before start of the project (although there were also many cases of fraud, where unscrupulous companies took the money and disappeared). Clearly, the taxation of pre-construction purchase at 18 percent with simultaneous exemption of completed housing implied intent to shatter that financing model, perhaps to squeeze out use of untaxed cash ("black money") in the construction sector. Post-GST, the construction sector turned for funding to non-bank finance companies, which had already received investible funds after de-monetisation flooded banks with cash in November 2016, followed subsequently by financing from mutual funds.

4-digit head	Description	GST rate	Exception
9954	Unfinished structures sold before completion or occupation	18 percent	Nil if sold after completion or occupation
	Works contracts (except below)	18 percent	
	Works contracts to governments, as defined under clause (119) of section 2 of the Central Goods and Services Tax Act, 2017 (including affordable housing)	12 percent	5 percent if supplied by a sub-contractor

Source: Notification No. 11/2017-Central Tax (Rate) dated 28 June 2017, as amended upto 27 July 2018. An abatement of one-third for land value meant that statutory rates of 18 percent and 12 percent (on unfinished affordable housing) mapped onto effective rates of 12 percent and 8 percent respectively. These were the rates prevailing until the decision of the GST council on 24 February 2019 (see text), which will be notified to go into effect from 1 April 2019.

The impact of this avenue of funding replacement in conjunction with uneven diligence by non-bank finance companies, and credit rating failure, was among the many factors leading to the serial defaults by the Infrastructure Leasing and Finance Company (IL&FS) in September 2018, and the contagion impact on non-bank finance companies thereafter. There is also presently a huge build-up of unsold inventories of housing units.

The distortion in the GST rate structure on housing was recognised in the Union Budget speech for 2019-20 (para 63). Following that, it was announced on 9 February 2019 that a panel had approved lowering the rate on under-construction properties to 5 percent without credit for taxes paid on raw materials (rather like a composition rate). This proposal was approved by the GST Council at its meeting on 24 February 2019, with a further reduction of the GST levy to 1 percent for affordable under-construction properties, and an enhancement of the perimeters of affordability in terms of value and space.

Going Forward Where Should the GST Head?

From the preceding sections, it is clear that although the GST has indeed evolved towards greater efficiency after alteration of some features of its initial design, a great deal of distortionary content still remains in it which needs to be corrected going forward. I have eight recommendations on future policy directions for the GST.

1. Revenue anxiety about GST is no longer justified, but there should be no excessive loading of revenue expectations onto budget projections.
2. The focus on revenue should be replaced by back office analysis of filing data which will help develop sectoral benchmarks for auditing of claims (a new Analysis and Risk Management wing within the Central Board for Indirect Taxes and Customs is a promising new institutional initiative within which such work could be done).
3. The interim filing system is working well in conjunction with the e-way bill. The final filing system proposed from 1 July 2019, will bring back invoice matching through the back door, with the GSTN portal required to autopopulate input tax credits. If quarterly filing below the Rs. 5 crore turnover threshold continues, there will be delays in autopopulating returns across the divide. There is no urgent need to bring in the final system before these matters are sorted out.
4. The success of the National Informatics Centre portal for the e-way bill was a contrast to the failure of the outsourced agency handling the GSTN portal. The NIC should be entrusted with responsibility for the GSTN portal.
5. The harmonised product classification is designed to differentiate between goods at the four-digit level. That does not mean that GST rates must also necessarily differ at the four-digit level.
6. All rate differences within four-digit categories need to be done away with, whether by type of product, type of use, or price of product. These are examples of the "different rates being applicable for the same product for

different uses and users" that the process of tax reform was meant to do away with.

7. Rate changes made in a slow dribble are problematic in themselves. A single revision needs to be done of all the changes needed to make the rate structure such that it serves the original intent of the GST.
8. Forward compliance can be reinforced if registered units can gain access to bank credit from GST tax records of sales substituting for collateral. However, this is an issue falling within the jurisdiction of the banking regulator.

Concluding Tribute to Raja Chelliah

Although the GST as introduced on 1 July 2017 was defective, its evolution and revenue delivery, currently running at a little under Rs. 1 lakh crore a month, has set in process Dr. Chelliah's dream of an efficient nation-wide tax with ease of compliance.

I have not referred to his other contributions, foremost among which are the two institutions he founded, which thrive today – the National Institute of Public Finance and Policy and the Madras School of Economics. I had the good fortune of being a faculty member of one of them for thirteen years, and have the good fortune of addressing the faculty and students of one of them today.

Underlying the success of an institution are some essential qualities that any founder must have. Raja Chelliah was keenly aware of the kinds of pressures that can lead to the downfall of an institution over time.

He ensured that whenever he appointed any scholar, whether to his own institutions or as an external expert in selection committees of other institutions like the Delhi School of Economics, he read every word of the principal published research papers of the applicants. It was that kind of painstaking care which led to his being his own master, and not a slave to narratives spun by powerful opinion makers.

He knew better than anyone else that once an institution is founded, it could become the personal fiefdom of a particular individual or a particular regional group. The country is littered with the wreckage of institutions which fell victim to exactly such pressures.

I hope the Madras School of Economics will always cherish the vision of its founder.

Thank you.

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