

Likely this budget, biggest tax reform in years

Given the amount of work done in terms of the IT backbone, or the GST Network, it looks likely that implementing Goods and Service Tax (GST) will be this Budget's boldest reform. Indeed, since compensation for removing Central Sales Tax was the biggest sticking point, once finance minister Jaitley gets past this hurdle, the Budget can announce an implementation date for GST, India's biggest tax reform in years, given how it will reduce transaction costs dramatically, usher in a unified pan-Indian market and remove cascading of taxes—estimates are it will add between 0.9% and 1.7% to GDP each year. Apart from the obviously political opposition from the key BJP ones, states were worried they would lose out on tax buoyancy. This was easily resolved by promising to compensate them—the 13th Finance Commission had recommended putting aside R50,000 crore for this—but the problem was the Centre was too cash-strapped to do so. Which is why, when Pranab Mukherjee was finance minister, he simply refused to compensate states beyond a point; P Chidambaram got states to the discussion table by agreeing to a compensation figure of R34,000 crore; a provision of R9,300 crore was even made in the FY14 budget as a first instalment, but just R1,940 crore was released.

In which case, the Jaitley budget will have to ensure funds for GST compensation, and ensure that this is given out quickly. The current Finance Commission will be coming out with its recommendation on compensation, and one way out is to increase the share of Central taxes automatically transferred to states. In addition, the Centre has to convince the states that it makes sense for them to include petroleum in the GST. While states will be free to add an extra carbon tax to compensate for any loss in their revenues—in any case, this is supposed to be made good by the Centre—including this in the GST will mean units in each state will be able to get some input credit for petroleum taxes. Even if petroleum is to be excluded, it must not be put in the Constitutional Amendment Bill, as this will make it difficult to include this at a later date. Some relaxation in terms of the powers of the GST Council will also be called for as the states are wary of changes being thrust down their throats. As prime minister-aspirant, and later when he got the job, cooperative federalism has been one of Modi's calling cards. GST is all about cooperative federalism.