

Invoke Cooperative Federalism to Check Tax Uncertainty

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INDIA'S

growing tax revenue uncertainty is cause for deep worry for three major reasons – 1) Demonetization 2) Its dark shadow over introduction of long-delayed Goods and Service Tax (GST) on 1st April 2017 & 3) Adverse impact of Centre's unilateral macro-economic decisions on State finances.

Amidst the growing Tsunami of reduced GDP estimates worked by different entities post demonetization, one conclusion is unmistakable: Both Central and State tax revenues would get dented due to cash shortage-driven slump in demand & economic activities.

The spurt in payment of pending tax dues such as property tax with demonetized Rs. 500 & 1000 notes created irrational exuberance among demonetization votaries. This trend would peter out by December-end.

As it is, decline in VAT receipts in certain States has rattled revenue authorities. Telangana has tentatively projected demonetization-triggered reduction in its tax receipts at Rs. 3,000 crore for the balance period of 2016-17. It is monitoring tax collections on daily basis.

Kerala says it is struggling to fund its expenditure on various activities. It has reportedly suffered revenue loss of more than Rs. 2,000 crore, which is expected to increase in the next four months.

Uttarakhand has formed a high-level committee to study impact of demonetization on its tax receipts. Its Chief Minister Harish Rawat has already written a letter to Union Finance Minister Arun Jaitley, seeking help to tide over the impact of demonetisation on tourism, agriculture and overall tax receipts.

Mr. Rawat reportedly wrote:

"Demonetisation is weighing heavy on a state already battling the losses caused by the recommendations of the 14th Finance Commission."

Karnataka too has raised concern over tax revenue uncertainty. The final stamp on States' concern on this count has been emphatically delivered by Amit Mitra, West Bengal Finance Minister and Chairman of Empowered Committee of State Finance Ministers.

In an interview to a TV channel, he reportedly stated that post-demonetization, GST has become a "double whammy" for states. Mr. Mitra said he would consult his counterparts in other States to reconsider GST roll-out timing.

Mr. Mitra pointed out that states are losing more money post demonetization, which is expected to reduce GDP growth by 2%. Noting that all leading economist have disapproved demonetization, he said: ***"The government needs to redo its arithmetic."***

Yes, every stakeholder in the economy right from daily wage earner to mighty MNCs and all-mighty Union Government are already assessing the impact of demonetization.

The Union Government ought to be more transparent and pragmatic in taking into confidence not only States but the entire nation on its strategy to minimize the impact on economy.

The Union Finance Ministry should get into damage-control mode. And the first step it should take in this regard is to set up a joint Committee of Centre and States to assess all revenue losses. The Committee should recommend measures to cushion the impact of demonetization on different sectors, central and State schemes and the public.

The Committee should also suggest the quantum of Central compensation for revenue loss suffered by each State Government. It should also work out revised date for GST roll-out. The Centre must realize that introduction of GST in economy disrupted by severe cash crunch is fraught with grave risks.

The Centre should realize that it has already pushed weaker States to the brink of financial crisis by unilaterally implementing award of Pay Commission, whose formation has been repeatedly opposed by Finance Commission.

Ideally, the Centre should provide grants or soft loans to the States to enable them to implement wage hike for their respective staff keeping in view Pay Commission award as they have done in the past.

It is here pertinent to recollect that NDA-I/Vajpayee Government constituted in 2002 a committee under the Chairmanship of Union Finance Minister to assess the impact of pay revision on States' finances and make suitable recommendations. It took this step **"in the spirit of cooperative federalism,"** as it stated in Parliament at that time.

The sooner the Centre constitutes a Committee to study the impact of demonetization and Pay Commission award on States, the better it is for tax certainty including minimizing delay in launch of GST. Reduction of tax uncertainty in particular and economic uncertainty in general would also improve investment climate.

It is high time the union ministers confine political rhetoric over benefits of demonetization to electoral arena and concentrate on minimizing its negative effects on the economy.

As put by National Institute of Public Finance and Policy (NIPFP),

"The demonetisation undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished."

In a Working Paper captioned 'Demonetisation: Impact on the Economy' issued on 14th November, NIPFP concludes:

"While it has been argued that the cash that would be extinguished would be 'black money' and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy, this argument is based on impressions rather than on facts. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility."