

Appendix A

Estimation of tax buoyancies

A.1 QUESTIONS AND METHODS

In this appendix, we address the question of estimation of the empirical experience with tax buoyancies. This effort in measurement fed into the judgments and assumptions that went into the baseline projections which are shown in Section 3.5. At the same time, the numerical values used in that section are not narrowly driven by these empirical results.

If T is a time-series of tax collections and B is a tax base, then regressions of the form $\log T = \alpha_0 + \alpha_1 \log B + \epsilon$ are used in order to estimate α_1 , which can be interpreted as the tax buoyancy, i.e. the average percentage change in T for a one percent change in B .

The T and B time-series are typically both $I(1)$, which introduces difficulties in estimation and inference which are not squarely addressed here. However, in order to obtain feedback on the economic significance of this problem, we also estimate the $I(0)$ regression consisting of percentage changes in T on percentage changes in B .

A key concern is the extent to which the very tax buoyancies have themselves been evolving over time, reflecting the considerable policy efforts which have been taking place in India, particularly in recent

Table A.1 Personal income tax and GDP

| | Estimate | t statistic |
|-----------|----------|---------------|
| Intercept | -7.189 | -28.02 |
| log(GDP) | 1.198 | 62.87 |

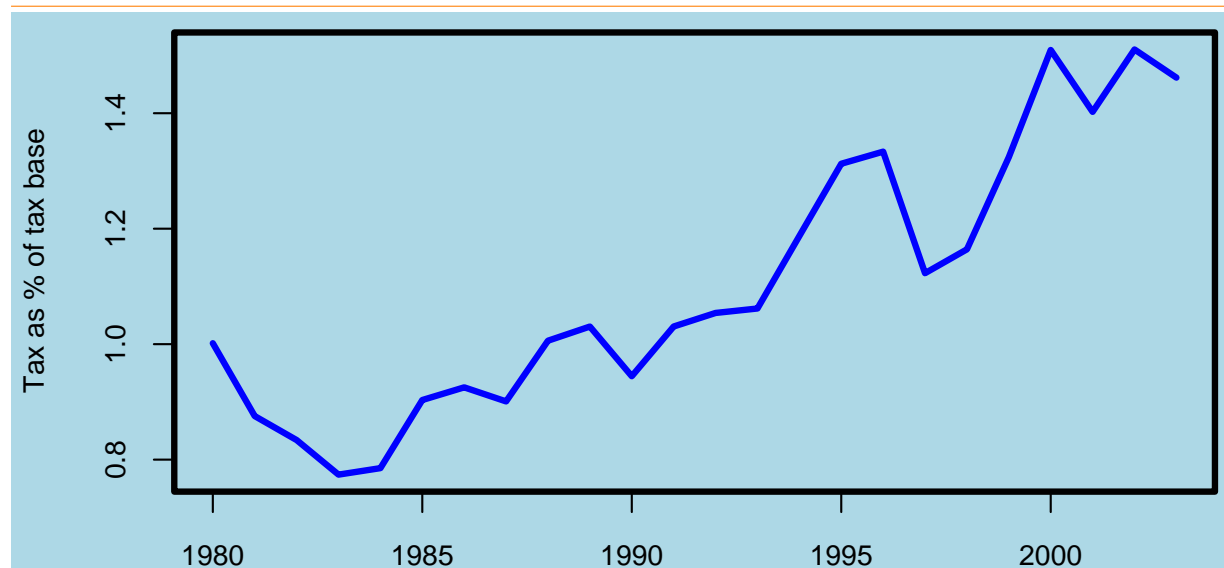
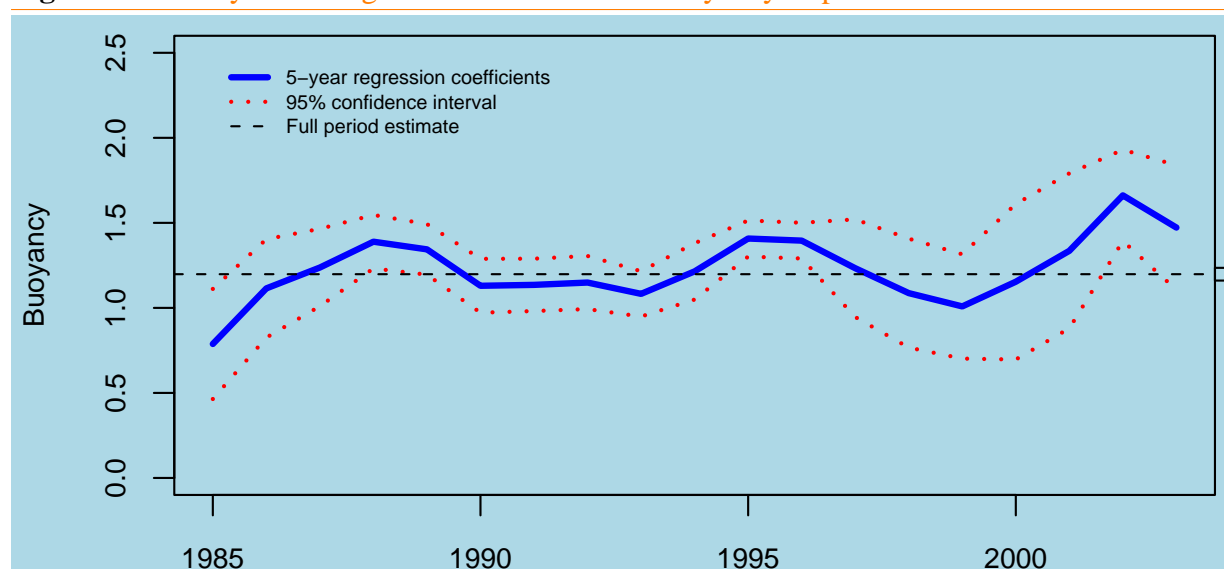
years. In addition to the overall estimates (from 1980 to 2003), we also compute rolling window regressions, with a window width of 5 years. Each of these regressions has limited statistical precision. The 95% confidence intervals of these buoyancy estimates are superposed on the graphs below, in order to ensure that we take cognisance of the innate limitations upon our knowledge.

These computations are applied on three questions of tax buoyancy: personal income tax, corporate income tax and non-POL excise. In the first two cases, overall GDP is treated as the tax base. In the latter case, manufacturing GDP is treated as the tax base.

A.2 PERSONAL INCOME TAX

Figure A.1 shows trends in personal income tax collections, expressed as percent of GDP.

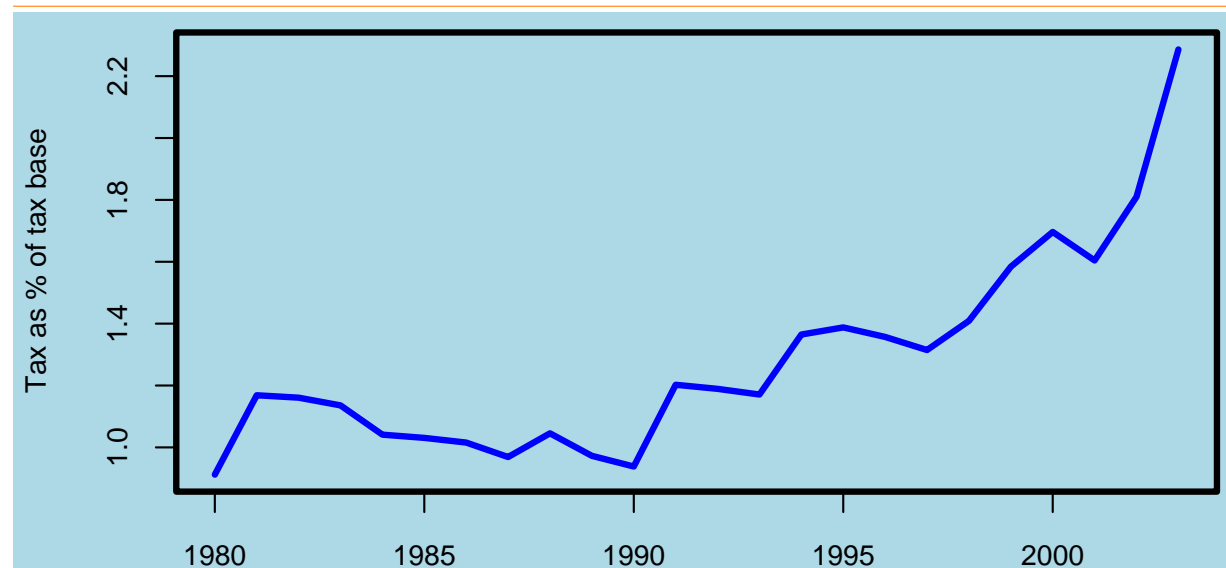
Table A.1 shows the overall OLS estimates for a log/log model explaining log personal income tax as a function of log GDP. A regression of percentage changes on percentage

Figure A.1 Growth of personal income tax as percent of GDP**Figure A.2** Five-year rolling window estimates of buoyancy of personal income tax

changes yields a similar coefficient, of 1.12.

In order to focus on the evolution of the tax buoyancy over time, Figure A.2 shows five-year rolling window estimates of the log/log regression. In the latest two years, the five-year OLS estimates have been 1.66 and 1.47

respectively.

Figure A.3 Growth of corporate income tax as percent of GDP**Table A.2** Corporate income tax and GDP

| | Estimate | <i>t</i> statistic |
|-----------|----------|--------------------|
| Intercept | -7.129 | -18.25 |
| log(GDP) | 1.204 | 41.52 |

A.3 CORPORATION TAX

Figure A.3 shows trends in corporate income tax collections, expressed as percent of GDP.

Table A.2 shows the overall OLS estimates for a log/log model explaining log corporate income tax as a function of log GDP. A regression of percentage changes on percentage changes yields a similar coefficient, of 1.44.

In order to focus on the evolution of the tax buoyancy over time, Figure A.4 shows five-year rolling window estimates of the log/log regression. In the latest two years, the five-year OLS estimates have been 1.63 and 1.91 respectively.

Table A.4 Non-POL Excise and manufacturing GDP

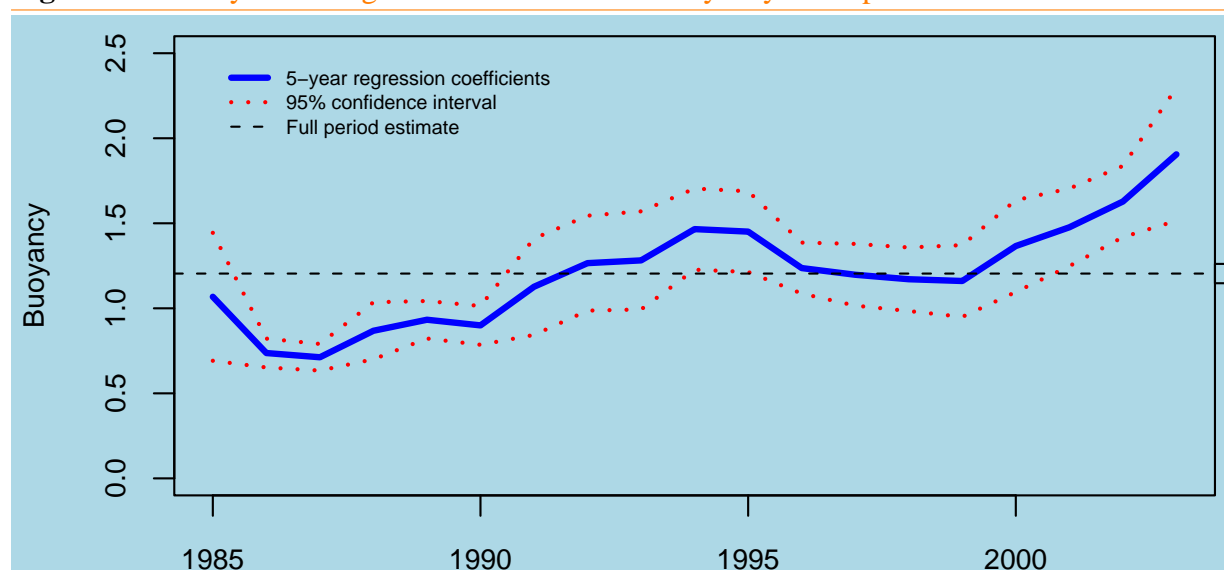
| | Estimate | <i>t</i> statistic |
|-----------|----------|--------------------|
| Intercept | 0.815 | 3.20 |
| log(GDP) | 0.756 | 35.73 |

A.4 NON-POL EXCISE

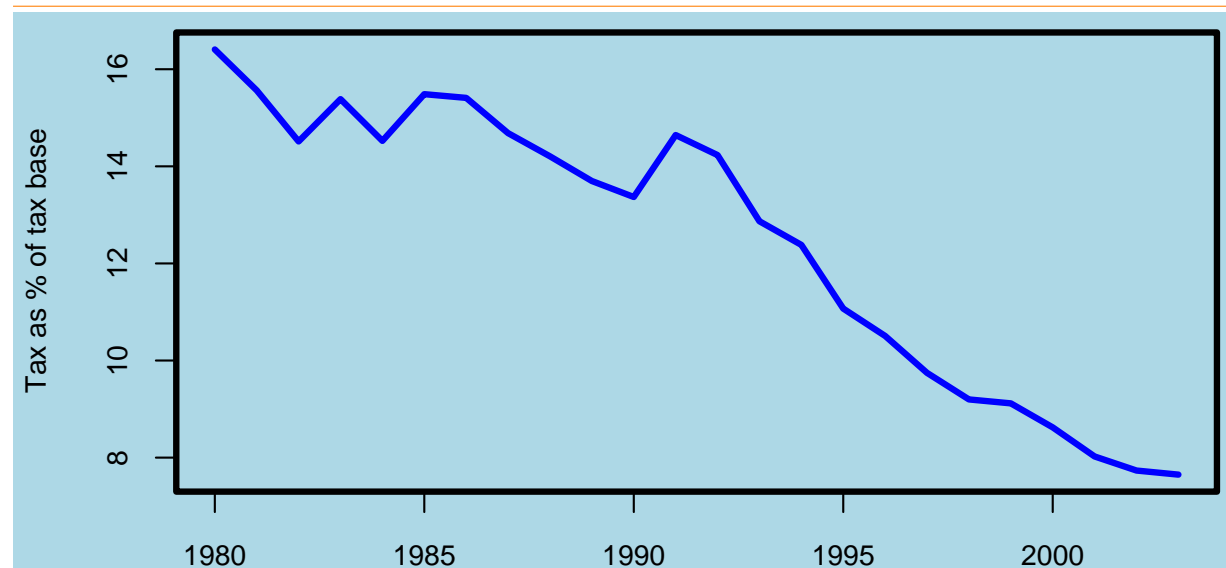
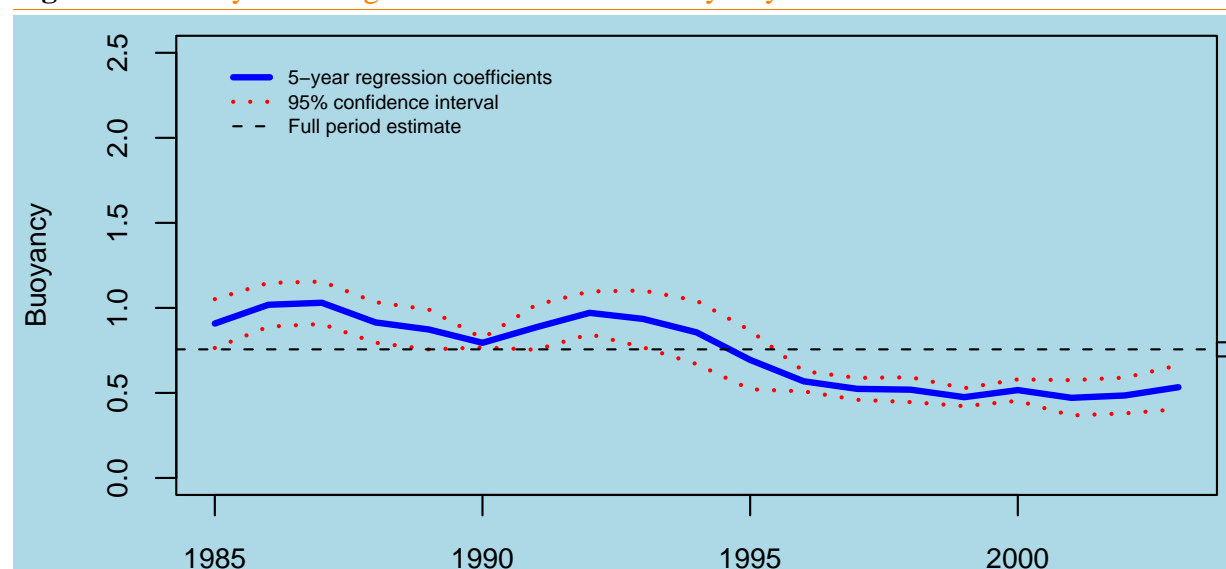
Figure A.5 shows trends in non-POL excise collections, expressed as percent of manufacturing GDP. The data underlying this has not been previously released, hence it is shown in Table A.3.

Table A.4 shows the overall OLS estimates for a log/log model explaining log non-POL excise as a function of log manufacturing GDP. A regression of percentage changes on percentage changes yields a similar coefficient, of 0.7541.

In order to focus on the evolution of the tax buoyancy over time, Figure A.6 shows five-year rolling window estimates of the log/log

Figure A.4 Five-year rolling window estimates of buoyancy of corporate income tax**Table A.3** Breakup of excise collections: POL versus Non-POL

| | Total Excise | POL Excise (Rs. crore) | Non-POL Excise | Non-POL Excise per Industry GDP (Per cent) |
|---------|-----------------|------------------------------|-------------------|--|
| 1980-81 | 6500 | 1216 | 5232 | 16.41 |
| 1981-82 | 7421 | 1405 | 5998 | 15.56 |
| 1982-83 | 8059 | 1605 | 6346 | 14.51 |
| 1983-84 | 10222 | 2267 | 7869 | 15.38 |
| 1984-85 | 11151 | 2450 | 8466 | 14.52 |
| 1985-86 | 12956 | 2728 | 10200 | 15.49 |
| 1986-87 | 14470 | 3014 | 11393 | 15.41 |
| 1987-88 | 16426 | 3968 | 12378 | 14.68 |
| 1988-89 | 18841 | 4435 | 14303 | 14.21 |
| 1989-90 | 22406 | 5662 | 16535 | 13.70 |
| 1990-91 | 24514 | 5478 | 18878 | 13.37 |
| 1991-92 | 28110 | 5262 | 22759 | 14.64 |
| 1992-93 | 30832 | 5042 | 25609 | 14.23 |
| 1993-94 | 31697 | 5310 | 26402 | 12.87 |
| 1994-95 | 37347 | 6695 | 30772 | 12.38 |
| 1995-96 | 40187 | 7160 | 33405 | 11.07 |
| 1996-97 | 45008 | 9076 | 35842 | 10.51 |
| 1997-98 | 47962 | 10947 | 36890 | 9.75 |
| 1998-99 | 53246 | 13493 | 38961 | 9.20 |
| 1999-00 | 61902 | 20202 | 41545 | 9.12 |
| 2000-01 | 68526 | 24663 | 43973 | 8.62 |
| 2001-02 | 72555 | 29338 | 43081 | 8.02 |
| 2002-03 | 82310 | 35961 | 46293 | 7.73 |
| 2003-04 | 92379 | 40044 | 50966 | 7.65 |

Figure A.5 Growth of non-POL excise as percent of manufacturing GDP**Figure A.6** Five-year rolling window estimates of buoyancy of non-POL excise

regression. In the latest two years, the five-year OLS estimates have been 0.48 and 0.53 respectively.

Table A.5 Summarising buoyancy estimates

| | '80-'03 | '98-'02 | '99-'03 |
|---------------------|---------|---------|---------|
| Personal income tax | 1.198 | 1.66 | 1.47 |
| Corporation tax | 1.204 | 1.63 | 1.91 |
| Non-POL excise | 0.756 | 0.48 | 0.53 |

A.5 SUMMARISING

Table A.5 summarises the results of this analysis. It forms a backdrop for the numerical values used in Section 3.5.

Appendix B

Estimation of revenue potential for a goods and services tax (GST) using firm-level data

This paper was prepared by the Centre for Monitoring Indian Economy (CMIE) at the request of the Ministry of Finance. It constitutes an element of the empirical backdrop for the policy proposals of this report, and is hence presented here as an appendix.

B.1 QUESTIONS ABOUT REVENUE POTENTIAL FROM THE GST

The¹ goal of indirect tax reform is to have a single goods and services tax (GST) that is applied on all firms. This would involve VAT credits running across all kinds of firms in the economy. The use of a single rate would eliminate political lobbying about rates, and eliminate problems of classification. The use of a single rate is neutral to the nature of activity of the firm, thus removing one

¹CMIE expresses its gratitude to the several officials from the Central Board of Direct Taxes and the Central Board of Excise and Customs for the gainful insights provided by them during discussions and their comments on the computations used in this paper. Limitations, if any, remain ours.

source of tax-induced distortions in resource allocation.

One major change about the GST concerns the taxation of services production. While the services sector is a substantial fraction of GDP, relatively little is known about the full potential tax revenues from this sector, given the small set of services which have been thus far been brought under the ‘service tax’.

Planning the transition into the GST, from the existing mix of excise, CENVAT and the service tax, requires estimation of the revenue potential from GST. This involves two kinds of difficulties. First, there is the problem of estimating the extent to which firms will obtain credits, and the true revenue potential of the GST after all credits are recognised. Second, there is the question of enforcement. While CENVAT chains will undoubtedly lead to improved compliance, there are always questions about the extent to which enforcement will take place.

This paper seeks to bring fresh evidence to bear on this question, and thus assist the process of policy formulation and decision making. It is organised in two

parts. Section B.2 describes the database, the difficulties in measurement, and the estimation methodology used in this paper. Section B.3 shows estimates for the revenue potential for an economy-wide GST applied to a certain subset of the firms of India.

B.2 METHODOLOGY

B.2.1 The CMIE firm-level database

Limited liability firms in India are registered with the Registrar of Companies. All such registered firms are required to file their audited Annual Accounts with the Registrar of Companies every year.

Through an extensive process of developing methodology, systems, and primary information gathering that started in the early 1970s, CMIE has built India's largest firm-level database. This database contains data extracted from the audited Annual Reports of companies (along with several other kinds of data). Manufacturing companies in this database account for more than 90 per cent of the total excise revenues of the Government of India, 70 per cent of the gross value added and 75 per cent of the value of output in the manufacturing (registered) sector of the economy.

Industrial (including manufacturing) and services companies in the CMIE firm-level database together accounted for 75 per cent of the total corporate taxes collected by the Government of India in 2002-03.²

The measures of coverage in Table B.1

²The CMIE firm-level database reflects the corporate taxes reported by companies in their profit and loss accounts. The data is not adjusted for provisions for previous years and write-back of excess provisions.

have been derived from only the top 5,000-odd firms in the CMIE firm-level database. The larger CMIE firm-level database has information for 2,74,446 companies.

The larger database represents a fairly robust sample of the overall corporate sector in India. It reflects the size and the spread of the organised economic entities in the country. Besides the large companies, the database includes hundreds of thousands of small and tiny enterprises. This sample is particularly relevant from the point of estimating the potential for tax collection. The probability of tax compliance from this set of companies collectively is arguably higher than from the unorganised sector. We thus use this set of companies to estimate the potential goods and service tax that can be generated if such a tax is applied uniformly.

B.2.2 Database methodology

The CMIE firm-level database contains financial information extracted from the audited annual accounts in respect of 2,74,446 companies. Information for all these 2,74,446 companies is not available for all the years. CMIE has information for 1,69,965 companies for the year ended March 2000.³

In the following years, the number of companies in the database has steadily declined. This decline is the result of a conscious decision to reduce the expenditure for building this database, after having attempted initially to build a comprehensive

³The scope of the CMIE firm-level database expanded substantially in 2000 following an arrangement with the Department of Company Affairs that provided access to records available with the Registrar of Companies.

Table B.1 The CMIE firm-level database : Coverage: 2002-03

| Measure | CMIE Sample | Total Value | Official Source | (Rs.crore) |
|-------------------------------|----------------|----------------|--------------------|-----------------|
| | | | | Coverage (%) |
| Gross value added in regd mfg | 1,63,719 | 2,31,833 | CSO | 70.6 |
| Value of output in regd mfg | 7,97,087 | 10,77,262 | CSO | 74.0 |
| Gross savings in corporates | 1,04,435 | 1,76,078 | CSO | 59.3 |
| Corporate taxes | 35,044 | 46,172 | Budget | 75.9 |
| Excise duties | 92,544 | 1,06,617 | Budget | 86.8 |

Source: *Corporate sector report*, Economic Intelligence Service, CMIE, April 2004

database. Initial efforts had showed that a large number of companies were miniscule in size. Their exclusion was expected to make only an insignificant difference to the larger inferences that could be drawn at the aggregate level.

In 1999-00, 28 per cent of the companies had a sales of less than Rs.1,000. Nearly 37 per cent of the companies had sales of less than Rs.5 lakh. Companies with sales less than Rs.10 lakh in 1999-00 accounted for 51.7 per cent in numbers, but only 0.07 per cent of the total sales. In the light of this distribution, CMIE decided to concentrate its resources on companies that had a sales of at least Rs.10 lakh.

The number of companies for which data is available varies from year to year. One reason for this is that CMIE shifted its attention to the larger companies. We have seen already, that this decision does not significantly adversely affect the aggregate results. Now we look at the other factors that cause the year-to-year variations and consider solutions to overcome these to help us prepare the dataset for our estimation.

Often, companies change their accounting periods. Usually, accounts are prepared for a 12-month period. Conventionally, most of these end with the fiscal year in March.

However, sometimes companies do change their accounting period from 12 months in one year to 15 or 18 months in the next. As a result, it is quite possible that in three years a company publishes only two accounts. In such a case, the estimation of aggregates from individual company accounts would miss the company's results for one year and have a correspondingly higher value in the following year because the company reports results for more-than 12 months. We overcome this by annualising all information to 12 months uniformly and by repeating the earlier year's information in the year in which the company's results were missed in the preparation of the panel data.

Companies may merge and cease operations as independent entities. Or they may cease to operate for other reasons and thus may not prepare their annual accounts. Variations are also caused by new entrants into business. These are genuine variations and do not merit any adjustments.

Finally, although CMIE makes its best efforts to procure information, there is no guarantee that it is able to access all possible Annual Reports prepared by companies. Companies are not required by any law to provide information to CMIE. Often, they do not file Annual Reports with the Registrar of Companies. If companies do not provide

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Table B.2 The CMIE firm-level database : Size Distribution: 1999-00

| Size by Sales (Rupees) | Count (Numbers) | Sales (Rs.crore) | Cumulative Count (%) | Cumulative Sales (%) |
|---------------------------|--------------------|---------------------|----------------------------|----------------------------|
| Less than 1,000 | 48,257 | 0.03 | 28.4 | neg. |
| 1,000 - 10,000 | 3,392 | 2 | 30.4 | neg. |
| 10,000 - 50,000 | 6,527 | 17 | 34.2 | neg. |
| 50,000 - 100,000 | 4,445 | 32 | 36.8 | neg. |
| 100,000 - 500,000 | 16,070 | 421 | 46.3 | neg. |
| 5 lakh - 10 lakh | 9,180 | 667 | 51.7 | 0.1 |
| 10 lakh - 50 lakh | 27,863 | 7,231 | 68.1 | 0.5 |
| 50 lakh - 1 crore | 12,817 | 9,265 | 75.6 | 1.1 |
| 1 crore - 50 crore | 38,342 | 2,70,390 | 98.2 | 18.2 |
| 50 crore - 100 crore | 1,375 | 95,080 | 99.0 | 24.2 |
| Above 100 crore | 1,697 | 11,95,537 | 100.0 | 100.0 |

information to the Registrar of Companies and refuse to provide the same to CMIE, we will have gaps in the database. In this paper, imputation is done for these gaps by using the prior year's information, if the prior year's information is available.

After making these adjustments, we arrive at a dataset of 89,445 firms that had their accounts ending sometime during the period April 2002 to June 2003 (mostly ending in March 2003). If a company did not report (or if we did not have) accounts for a period ending in this range, we use the older information available with us, but subject to the condition that such information is not older than for an accounting period ending September 2001. Stated differently, for these 89,445 firms, the CMIE firm-level database had some audited accounts data available for a period ending between September 2001 and June 2003 and, we have used the latest available data in this period.

It is this set of 89,445 companies⁴ that we use

⁴Strictly, these are not only companies as they include several entities that are not registered as companies. For example, Indian Farmers Fertiliser Co-op is a cooperative and is not registered as a

to estimate the potential goods and service tax that can be generated. These are the larger and well-organised entities that can be expected to pay a tax levied upon them.

B.2.3 Services sector coverage in the database

The services sector presents qualitatively different problems in obtaining compliance. About two-thirds of the manufacturing activity is in the organised sector. It is easier to deal with this organised industrial activity than with the myriad small and tiny enterprises in the unorganised sector. "Organised" can be construed more tangibly in the case of manufacturing firms – these are registered under the Factories Act.

There is no similar legislation by which all

company. But, the CMIE firm-level database includes it as it does several other cooperatives. Similarly, State Bank of India is not registered as a company, like say, UTI Bank Ltd is. Nevertheless, the CMIE firm-level database would include a State Bank of India. The objective of the CMIE firm-level database is to create a database of all possible business entities, independent of the legal structure of the entity.

services sector firms can be enumerated or classified. Regulation is limited to banks and a few other services.

A larger proportion of the enterprises in the services sector are unorganised. Wholesale and retail trade is characterised by a very large number of business entities that are proprietary and household enterprises. Similarly, there are a number of small restaurants, second-tier or third-tier intermediaries in the financial sector, professional services, etc. that could be classified as unorganised. The diverse nature of services activities and the larger proportion of firms being in the unorganised sector makes the task of estimating the potential revenue from the levy of a service task daunting.

It can be assumed that the organised institutional entities in the services sector can be persuaded to comply with the levy of a service tax. It would thus be useful to estimate the size of the large and medium firms in the services sector to derive a realistic estimate of the potential revenue that can be generated from the services sector.

Firm-level information in the services sector has become stronger in the past one decade or so, compared to the situation earlier. There are three reasons for this. First, several departmental undertakings of the government have been corporatised. For example, the Department of Telecommunications is now Bharat Sanchar Nigam Ltd. Secondly, several activities that were largely outside the purview of the corporate world, such as hospitals, entertainment, courier services, etc have joined the organised business domain and therefore do publish publicly accessible information. Thirdly, the exceptional growth of the services sector has attracted substantial investments in the organised sector. The

best example of this is the private sector investment in the telecommunications sector.

The CMIE firm-level database contains financial information extracted from the audited annual accounts in respect of 1,46,976 companies that are engaged essentially in services activities. Information on all these 1,46,976 companies is not available for all the years. CMIE has information for 1,04,625 companies for the year ended March 2000. In the following years, the number of companies in the database declines steadily since CMIE decided to concentrate its effort only the larger companies. It was anticipated that the exclusion of companies of sales less than Rs.10 lakh would make an insignificant impact upon the inferences drawn at the aggregate level.

31 per cent of the 1,04,625 companies in 1999–00 reported sales of less than a thousand rupees. A third of the companies had sales of less than ten thousand rupees. Most of the very small companies were investment and trading companies.

For the year 2001–02, CMIE compiled statistics essentially on companies whose sales size was greater than Rs.10 lakh per annum. The number of companies covered by the CMIE firm-level database dropped by half as a result of the reduced outlays for this activity. The coverage, in terms of the proportion of the total gross value added in the services sector dropped insignificantly – from 22.6 per cent in 1999–00 to 22.2 per cent in 2001–02.

The 52,456 companies for which we have compiled the statistics for 2001–02 are thus likely to reflect the size of the activities of the organised services sector almost as well as the entire set of 1.4 lakh companies. The set of 14,921 companies for which we have data

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Table B.3 CMIE firm-level database : Coverage of Services Sector

| Year | Count (Numbers) | Sales (Rs.crore) | Gross Value Added | |
|---------|--------------------|---------------------|-------------------|------------------------------|
| | | | (Rs.crore) | % of total (services GVA) |
| 1999–00 | 1,04,625 | 5,23,208 | 1,91,032 | 22.6 |
| 2000–01 | 95,559 | 6,21,486 | 2,09,294 | 22.5 |
| 2001–02 | 52,456 | 6,06,317 | 2,28,784 | 22.2 |
| 2002–03 | 14,921 | 4,99,015 | 2,21,685 | 19.4 |

Note: Only companies with sales greater than Rs.10 lakh covered in 2001-02 and 2002-03.
Coverage in 2002–03 is incomplete, as work was in progress.

for 2002–03 reflects the incomplete database for the year. Annual Accounts for companies for this year are still flowing in and many of those that have been received by us are still being processed. Nevertheless, a good proportion of the larger companies have been captured in the database.

A dataset of 52,304 companies was prepared for the purpose of our computations. These had their accounts ending sometime during the period April 2002 to June 2003 (mostly ending March 2003). Or if there were companies for which data was not available for this period, then we have used the older information available for these, subject to the condition that the information is not older than for an accounting period ended in September 2001. This set of 52,304 companies is used to estimate the potential service tax that can be generated. These are the larger and well organised enterprises that can be expected to pay a tax levied upon them.

This set of 52,304 companies covers 22.1 per cent of the gross value added in the services sector in India. Firm-level databases do not cover public administration and defence sectors. These account for 12.7 per cent of the gross value added in the services sector as a whole. If we exclude this sector, then the CMIE firm-level database has a coverage

of 25.3 per cent.

Intriguingly, the CMIE firm-level database provides a higher estimate of the gross value added in the banking and insurance sector than the National Accounts Statistics. This is likely because the CMIE firm-level database does not cover the State Finance Corporations, State Industrial Development Corporations and the Regional Rural Banks – all which are likely to be grossly loss-making and possibly contributing negatively to the gross value addition.

Nevertheless, the coverage of over-100 per cent is intriguing. This is because we have had to drop a number of small investment companies and smaller non-banking financial companies from our sample because of the need for more detailed information in respect of finance companies than was readily available for such small finance companies in the CMIE firm-level database. The problem arises because the payment of interest by banks is lower than the interest received by banks and, if we net the two (like we do for all other enterprises), to derive the value addition, banks would reflect net negative interest payments. This would be misleading. The National Accounts Statistics imputes income equivalent to interest and dividend receipts of banking and financial enterprises net of interest paid to depositors. We have

Table B.4 Sub-sectors of the services sector: CMIE firm-level database compared with NAS, 2002–03

| | (Rs.crore) | | | |
|--|------------|---------------------------------|---------------------|--------------|
| | NAS data | Estimates using firm-level data | Coverage (per cent) | Firms (Nos.) |
| Trade | 2,99,059 | 16,965 | 5.7 | 15,375 |
| Hotels & Restaurants | 22,935 | 2,484 | 10.8 | 1,579 |
| Railways | 21,551 | | | |
| Transport by other means | 1,14,889 | 12,869 | 11.2 | 2,247 |
| Storage | 1,331 | 988 | 74.2 | 574 |
| Communication | 35,620 | 28,682 | 80.5 | 483 |
| Banking & insurance | 1,58,279 | 1,61,450 | 102.0 | 13,369 |
| Real estate, ownership of dwellings, bus. services | 1,52,079 | 23,870 | 15.7 | 10,904 |
| Public admin & defence | 1,45,406 | | | |
| Other services | 1,89,898 | 4,791 | 2.5 | 7,773 |
| Total | 11,41,047 | 2,52,099 | 22.1 | 52,304 |

followed a similar approach in computing interest income of banks. We deduct interest payments made to depositors from the income earned by finance companies by lending and by investments in securities. It is quite likely that the inclusion of these smaller finance companies would have raised the gross value added in this sector a little more.

The dataset has a fairly good coverage of the communications sector. The gross value added covered is more than 80 per cent of the estimates in the National Accounts. Storage is similarly well covered with over 70 per cent. In other cases, the coverage in the firm-level database is much lower – ranging between 2.5 and 15.5 per cent.

In comparing the coverage of the CMIE firm-level database with the National Accounts, firms engaged in software development and in IT-enabled services are mapped to the broad heading “Real estate, ownership of dwellings & business consultancy”.

Half of the revenue base in the CMIE firm-

level database lies in commercial banks. Financial institutions, NBFCs, housing finance companies, investment service companies and other financial service companies account for another 17 per cent. Thus, the financial sector would account for nearly two-thirds of the potential revenue.

Telecom companies and trading companies follow in importance, after the financial sector. The firm-level database does not include the Indian Railways. However, the other transport service companies could yield more than a thousand crore. Of this air transport companies would provide nearly half the amount.

The classification of services presented in official publications on NAS are at broad aggregate levels. These offer little insight into the nature of production of the services sector. Table B.5 shows greater detail, using a classification system developed at CMIE, showing the number of firms and the size of economic activity taking place in various kinds of services. This evidence could be

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Table B.5 Industry classification of services firms in the CMIE firm-level database (2002-03)

| | | | (Rs.crore) | |
|--|-----------------|--------|-------------------------|----------------|
| | Firms (Nos.) | Sales | Gross Value Added | Net Exports |
| Financial Services | 13369 | 307125 | 161450 | 665 |
| Banking services | 87 | 164954 | 119176 | 0 |
| Financial institutions | 28 | 24668 | 11824 | -310 |
| Non-banking financial cos. (NBFCs) | 561 | 7089 | 5090 | 431 |
| Housing finance services | 22 | 4764 | 2772 | -261 |
| Investment services | 10355 | 15206 | 5925 | 136 |
| Other financial services | 2316 | 90444 | 16663 | 668 |
| Hotels & tourism | 1579 | 5172 | 2484 | 1201 |
| Hotels & restaurants | 1533 | 4909 | 2353 | 1098 |
| Tourism | 46 | 263 | 131 | 103 |
| Recreational services | 660 | 3458 | 963 | 150 |
| Production of TV serials/films | 240 | 2105 | 690 | 181 |
| Broadcasting/distribution of TV serials/films | 22 | 95 | 4 | -2 |
| Processing of films/colour labs, etc. | 11 | 145 | 80 | -3 |
| Pre-recorded and recorded cassettes | 52 | 229 | -22 | -7 |
| Amusement parks/entertainment centres/theatres | 117 | 477 | 74 | -5 |
| Other recreational services | 218 | 407 | 137 | -14 |
| Health services | 914 | 2186 | 873 | -32 |
| Trading | 15375 | 187075 | 16965 | -9772 |
| Transport services | 2247 | 37558 | 12869 | -114 |
| Road transport | 305 | 4454 | 959 | -3 |
| Railway transport | 4 | 254 | 213 | -628 |
| Air transport | 41 | 15971 | 5587 | -552 |
| Shipping | 260 | 6755 | 3419 | 770 |
| Transport support services | 1637 | 10125 | 2691 | 300 |
| Communication services | 483 | 48752 | 28682 | -947 |
| Telecommunication services | 407 | 47760 | 28432 | -937 |
| Telephone services | 11 | 39900 | 26670 | 987 |
| Other telecommunication services | 396 | 7860 | 1762 | -1924 |
| Courier services | 76 | 992 | 249 | -9 |
| Misc. services | 17677 | 62487 | 27813 | 24817 |
| Commercial complexes | 3164 | 2802 | 738 | 41 |
| Storage & distribution | 574 | 2588 | 988 | -274 |
| Business consultancy | 6362 | 11466 | 4805 | 3042 |
| Misc. other services | 6199 | 13512 | 2955 | 1266 |
| ITES | 59 | 849 | 534 | 509 |
| Computer software | 1319 | 31270 | 17793 | 20233 |
| Total | 52304 | 653813 | 252099 | 15968 |

useful in planning administrative procedures.

B.2.4 Issues in using this database for GST estimation

In this paper, we harness this economy-wide database about the firms of India in order to estimate the revenue potential from the GST. A 10 per cent GST is estimated by us to yield GST revenues which are one-tenth of the value added of the firms as seen in this database. We believe that these estimates are conservative. There are two key characteristics of the imputation process adopted by us that lead to conservative estimates. These are:

Problem of credits When firms are charged a GST on their revenue, there is the question about how much credit they will obtain, reflecting the tax payments embedded in the inputs they have purchased. We address this question by focusing on value added, as observed in the accounting data. We treat the tax base as the value added of the firm. This is a conservative assumption, in the sense that not all inputs purchased by the firm may involve tax credits. In practice, collections are likely to be somewhat higher than those portrayed in this paper.

Questions of enforcement The GST would be applied to all production in the economy, including production by limited liability companies, cooperatives, proprietorships, non-profit firms, etc. We focus on a subset of this universe: limited liability companies, and some other firms for which data is available. This is a conservative estimate, in the sense that the GST will yield revenues from many organisations which are not covered in this subset.

B.3 ESTIMATING POTENTIAL GST REVENUES USING FIRM-LEVEL DATA

We use two indicators to estimate the potential revenue that can be expected by the levy of a goods and service tax. These are,

sales and gross value added. Sales is a robust number compared to the gross value added, as it is directly observed in the accounts of the company. However, sales obviously overestimates the potential tax revenues from a value added tax.

Estimation of the gross value added from the Annual Accounts of companies is somewhat difficult. We estimate gross value added by adding the payments made to the factors of production. We thus take the sum of wages, interest payments, rent, profits and depreciation for the year. However, companies do not account for rent if they own the premises. And, depreciation charges are not uniformly applied.

We make no adjustments for these. It is assumed that rent that does not get reported shows up as profits and nevertheless gets captured in the GVA estimate. The argument holds for any under-reporting of depreciation in the accounts of companies. We also need to make adjustment for interest income of financial intermediaries. This is explained by us in Section B.2.3.

It is likely that the gross value added from firm level data would underestimate the potential tax revenues. Using the GVA as the base from which the GST is imputed implies that firms would claim credit for tax payments embedded in all inputs purchased. This is a conservative assumption.

Assuming that non-finance companies would claim setoffs against taxes included in interest payments made by them, we compute the tax potential by deducting interest payments from the GVA. Further, assuming that companies would get set-offs against net exports, we also deduct net exports from sales and gross value added in estimating the potential service tax revenue that can be

17 Estimation of revenue potential for a goods and services tax (GST) using firm-level data

Table B.6 Summary statistics about CMIE firm-level database : 2002-03

| (Rs.crore) | | | | | |
|---------------------------|--------------|-----------|-------------------|-------------|----------------------------|
| Industry | Firms (Nos.) | Sales | Gross Value Added | Net Exports | GVA less Interest Payments |
| Manufacturing | 32,236 | 11,35,588 | 1,87,417 | -54,929 | 1,44,428 |
| Of which: POL | 43 | 2,65,721 | 23,424 | -66,445 | 21,180 |
| : Non-POL | 32,193 | 8,69,867 | 1,63,993 | 11,516 | 1,23,248 |
| Mining | 931 | 73,435 | 37,990 | -6,519 | 36,346 |
| Electricity | 183 | 68,755 | 27,723 | -4,566 | 22,179 |
| Construction | 3,791 | 24,531 | 5,717 | 224 | 4,230 |
| Services | 52,304 | 6,53,814 | 2,52,098 | 15,969 | 2,32,929 |
| Of which: Financial Serv. | 13,369 | 3,07,125 | 1,61,450 | 665 | 1,60,785 |
| Total | 89,445 | 19,56,123 | 5,10,045 | -49,821 | 4,40,112 |

generated from firms in the services sectors. The net exports figures are also derived from the Annual Audited Accounts of the companies used in this study.

Table B.6 presents a summary of the aggregates generated by using the audited annual accounts of 89,445 firms for the year 2002-03. Although this is the largest compilation of aggregates based on firm-level data, there are some limitations in coverage. These again point to the conservativeness of the ultimate estimates that we derive.

Nearly half the value addition in these firms is generated from the services sector. However, this excludes the Indian Railways. This administratively easy potential source of tax revenue is completely missing in the computations because the Indian Railways does not publish accounts in the traditional sense of the term. Transport by other means is also under-represented in our computations. The estimates reflect essentially, the airlines. However, the road transport industry is grossly undercovered because of paucity of data.

Firms engaged in construction activities are large and reasonably organised although,

most of these are not registered as companies. These are also under-represented in our computations.

Table B.7 presents estimates of the GST that can be collected if the tax is imposed on sales or on sales net of net exports. These are the upper bounds of the potential GST that can be generated from these firms.

In making estimates of the potential GST with the GVA as the base, we introduce an additional element of the setoff that non-finance companies may claim against interest payments made by them. Besides, we deal with the petroleum sector differently. Instead of using the GVA, we use the sales as the base. We have assumed that the petroleum sector would continue to attract excise on its sales and not a tax based on the GVA. Table B.8 presents estimates based on the GVA and Table B.9 presents estimates based on GVA net of net interest payments. In both tables, we show separately, the estimates net of net exports and again, in both tables, POL estimates are based on sales and not on GVA.

All the estimates presented above relate to the year 2002-03. The full dataset for 2003-04 was under preparation at the time of

Table B.7 Estimates of potential revenue from a uniform GST based on Sales in 2002-03

| (Rs.crore) | | | | | | |
|---------------|----------------|----------|----------|-----------------------------------|----------|----------|
| | Tax on Sales @ | | | Tax on Sales net of net exports @ | | |
| | 8% | 12% | 16% | 8% | 12% | 16% |
| Manufacturing | 90,847 | 1,36,271 | 1,81,694 | 95,241 | 1,42,862 | 1,90,483 |
| Of which: POL | 21,258 | 31,887 | 42,515 | 26,573 | 39,860 | 53,147 |
| : Non-POL | 69,589 | 1,04,384 | 1,39,179 | 68,668 | 1,03,002 | 1,37,336 |
| Mining | 5,875 | 8,812 | 11,750 | 6,396 | 9,594 | 12,793 |
| Electricity | 5,500 | 8,251 | 11,001 | 5,866 | 8,799 | 11,731 |
| Construction | 1,962 | 2,944 | 3,925 | 1,945 | 2,917 | 3,889 |
| Services | 52,305 | 78,458 | 1,04,610 | 51,028 | 76,541 | 1,02,055 |
| Total | 1,56,490 | 2,34,735 | 3,12,980 | 1,60,476 | 2,40,713 | 3,20,951 |

Table B.8 Estimates of potential revenue from a uniform GST based on GVA in 2002-03

| (Rs.crore) | | | | | | |
|---------------|--------------|--------|----------|---------------------------------|--------|----------|
| | Tax on GVA @ | | | Tax on GVA net of net exports @ | | |
| | 8% | 12% | 16% | 8% | 12% | 16% |
| Manufacturing | 34,377 | 51,566 | 68,754 | 38,771 | 58,157 | 77,543 |
| Of which: POL | 21,258 | 31,887 | 42,515 | 26,573 | 39,860 | 53,147 |
| : Non-POL | 13,119 | 19,679 | 26,239 | 12,198 | 18,297 | 24,396 |
| Mining | 3,039 | 4,559 | 6,078 | 3,561 | 5,341 | 7,121 |
| Electricity | 2,218 | 3,327 | 4,436 | 2,583 | 3,875 | 5,166 |
| Construction | 457 | 686 | 915 | 439 | 659 | 879 |
| Services | 20,168 | 30,252 | 40,336 | 18,890 | 28,335 | 37,781 |
| Total | 60,259 | 90,390 | 1,20,519 | 64,244 | 96,367 | 1,28,490 |

Note: POL estimations are based on sales and not GVA

Table B.9 Estimates of potential revenue from a uniform GST based on GVA net of interest payments in 2002-03

| (Rs.crore) | | | | | | |
|---------------|------------------------------|--------|----------|--|--------|----------|
| | Tax on GVA net of interest @ | | | Tax on GVA net of net exports & interest @ | | |
| | 8% | 12% | 16% | 8% | 12% | 16% |
| Manufacturing | 31,118 | 46,676 | 62,235 | 35,512 | 53,268 | 71,024 |
| Of which: POL | 21,258 | 31,887 | 42,515 | 26,573 | 39,860 | 53,147 |
| : Non-POL | 9,860 | 14,790 | 19,720 | 8,939 | 13,408 | 17,877 |
| Mining | 2,908 | 4,362 | 5,815 | 3,429 | 5,144 | 6,858 |
| Electricity | 1,774 | 2,661 | 3,549 | 2,140 | 3,209 | 4,279 |
| Construction | 338 | 508 | 677 | 320 | 481 | 641 |
| Services | 18,634 | 27,951 | 37,269 | 17,357 | 26,035 | 34,714 |
| Total | 54,772 | 82,158 | 1,09,544 | 58,758 | 88,137 | 1,17,516 |

Note: POL estimations are based on sales and not GVA

these computations. However, it is possible to make estimates for 2003-04 based on the sales growth observed in the sales of

listed companies. As per SEBI regulations, listed companies are required to release their quarterly results within one month of the end

of the quarter. We see from these results that sales grew by about 12 per cent during the year. Using the estimates made above and assuming that the overall sales growth of all companies grew by ten per cent, the potential GST that can be generated from firms that publish their audited annual accounts can be easily computed.

If a uniform GST of eight per cent is levied on the GVA net of net exports and net of interest payments on all firms, then the potential GST that could be generated in 2003-04 would be Rs.64,634 crore. If GST is 12 per cent this rises to Rs.96,951 crore and at 16 per cent it rises to Rs.129,267 crore. These are the lower bounds of the potential revenue, given the extent to which value added in the country takes place in firms outside the CMIE firm-level database.

B.4 DETERMINING A MINIMUM SIZE FOR LEVYING A GST

The distribution of the gross value added amongst firms in the CMIE firm-level database is skewed. A few firms account for most of the gross value added while a large number contribute negligibly to the overall GVA⁵. We find that a little over half the firms account for 99.7 per cent of the total GVA. More precisely, firms that reported a gross value added of Rs.20 lakh or more account for 51.7 per cent of all GVA-positive firms and these account for 99.7 per cent of the total GVA reported by GVA-positive firms.

Administratively, it would be far more

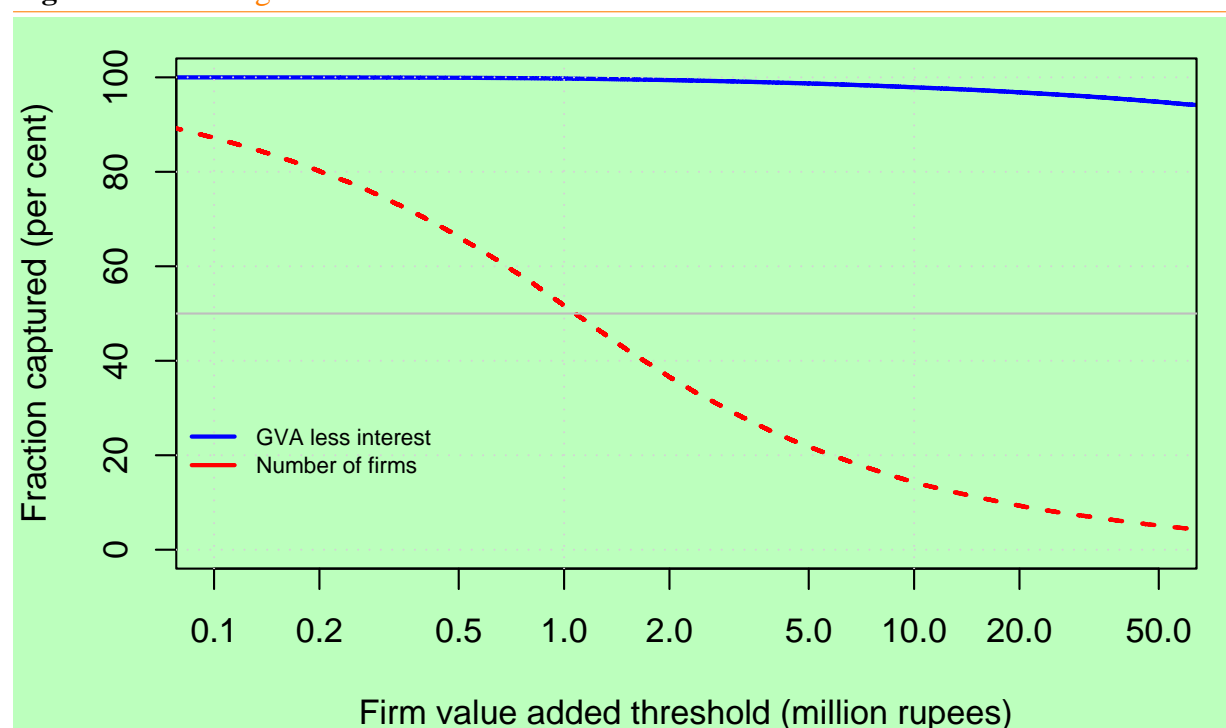
⁵Unlike measures such as sales or assets, the GVA can take a negative value. Loss making firms can report a negative GVA. Thus, some firms also contribute negatively to the overall GVA. We find that 22 per cent of the firms reported a non-positive GVA.

efficient to concentrate on these relatively larger firms. Every VAT implementation in the world uses a lower size threshold below which firms are exempted from VAT payment. Figure B.1 shows empirical evidence for firms with positive value added. Alternative size thresholds are placed on the *x* axis (in log scale). For each candidate value of the minimum size threshold, two values are shown on the *y* axis: (a) The fraction of total value added that is captured in the tax net under this threshold, and (b) the fraction of firms that fall above this threshold.

The results show that roughly half of the firms have a value added of below Rs.10 lakh. This suggests that the cost of tax administration would come down by roughly half, by using such a threshold. At the same time, roughly 100% of the value added lies above this threshold. Hence, it appears useful to use Rs.10 lakh of value added as the minimum size threshold; this seems to be associated with a negligible revenue loss, and a halving of the cost to the government.

In practice, it would be far more convenient to use a measure such as sales instead of GVA. As a broad average, in the CMIE firm-level database it is found that sales is usually six times the GVA. This approximation can be used to convert GVA cutoffs into turnover cutoffs.

These estimates should be viewed with caution owing to the extent to which firms self-select themselves into organisational structures. Larger firms are more likely to incorporate. Hence, estimates about size cutoffs based on the CMIE firm-level database are likely to be biased upwards.

Figure B.1 Coverage of firms obtained under alternative size thresholds

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Appendix C

The FRBM Act and associated Rules

C.1 FRBM ACT, 2003



The Gazette of India **Extraordinary**

Ministry of Law and Justice **(Legislative Department)**

New Delhi, the 26th August, 2003,/Bhadra 4, 1925 (Sakes)

The following Act of Parliament received the assent of the President on the 26 August 2003, and is hereby published for general information:-

The Fiscal Responsibility and Budget Management ACT, 2003

No. 39 of 2003

[26th August, 2003]

An Act to provide for the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macro-economic stability by achieving sufficient revenue surplus and removing fiscal impediments in the effective conduct of monetary policy and prudent debt management consistent with fiscal sustainability through limits on the Central Government borrowings, debt and deficits, greater transparency in fiscal operations of the Central Government and conducting fiscal policy in a medium-term framework and for matters connected there with or incidental thereto.

Be it enacted by Parliament in the Fifty-fourth Year of the Republic of India as follows:-

1. (1) This Act may be called the Fiscal Responsibility and Budget Management Act, 2003.
 - (2) It extends to the whole of India.
 - (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf.
2. In this Act, unless the context otherwise requires:-
 - (a) **fiscal deficit** means the excess of total disbursements, from the Consolidated Fund of India, excluding repayment of debt, over total receipts into the Fund (excluding the debt receipts), during a financial year;
 - (b) **fiscal indicators** means the measures such as numerical ceilings and proportions to gross domestic product, as may be prescribed, for evaluation of the fiscal position of the Central Government;
 - (c) **prescribed** means prescribed by rules made under this Act;
 - (d) **Reserve Bank** means the Reserve Bank of India constituted under sub-section (1) of section 3 of the Reserve Bank of India Act, 1934;
 - (e) **revenue deficit** means the difference between revenue expenditure and revenue receipts which indicates increase in liabilities of the Central Government without corresponding increase in assets of that Government;
 - (f) **total liabilities** means the liabilities under the Consolidated Fund of India and the public account of India.
3. (1) The Central Government shall lay in each financial year before both Houses of Parliament the following statements of fiscal policy along with the annual financial statement and demands for grants, namely:-
 - (a) the Medium-term Fiscal Policy Statement;
 - (b) the Fiscal Policy Strategy Statement;
 - (c) the Macro,-economic Framework Statement.
 - (2) The Medium-term Fiscal Policy Statement shall set forth a three-year rolling target for prescribed fiscal indicators with specification of underlying assumptions.
 - (3) In particular, and without prejudice to the provisions contained in sub-section (2), the Medium-term Fiscal Policy Statement shall include an assessment of sustainability relating to
 - (i) the balance between revenue receipts and revenue expenditures;

- (ii) the use of capital receipts including market borrowings for generating productive assets.
- (4) The Fiscal Policy Strategy Statement shall, *inter alia*, contain
 - (a) the policies of the Central Government for the ensuing financial year relating to taxation, expenditure, market borrowings and other liabilities, lending and investments, pricing of administered goods and services, securities and description of other activities such as underwriting and guarantees which have potential budgetary implications;
 - (b) the strategic priorities of the Central Government for the ensuing financial year in the fiscal area;
 - (c) the key fiscal measures and rationale for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administered pricing and borrowings;
 - (d) an evaluation as to how the current policies of the Central Government are in conformity with the fiscal management principles set out in section 4 and the objectives set out in the Medium-term Fiscal Policy Statement.
- (5) The Macro-economic Framework Statement shall contain an assessment of the growth prospects of the economy with specification of underlying assumptions
- (6) In particular, and without prejudice to the generality of the foregoing provisions, the Macro-economic Framework Statement shall contain an assessment relating to-
 - (a) the growth in the gross domestic product;
 - (b) the fiscal balance of the Union Government as reflected in the revenue balance and gross fiscal balance;
 - (c) the external sector balance of the economy as reflected in the current account balance of the balance of payments.
- (7) The Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-economic Framework Statement referred to in sub-section (1) shall be in such form as may be prescribed.
- 4. (1) The Central Government shall take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by the 31 March, 2008 and thereafter build up adequate revenue surplus.
- (2) The Central Government shall, by rules made by it, specify-
 - (a) the annual targets for reduction of fiscal deficit and revenue deficit during the period beginning with the commencement of this Act and ending on the 31 March, 2008;
 - (b) the annual targets of assuming contingent liabilities in the form of guarantees and the total liabilities as a percentage of gross domestic product:

Provided that the revenue deficit and fiscal deficit may exceed such targets due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify:

Provided further that the ground or grounds specified in the first proviso shall be placed before both Houses of Parliament, as soon as may be, after such deficit amount exceed the aforesaid targets.
- 5. (1) The Central Government shall not borrow from the Reserve Bank.
- (2) Notwithstanding anything contained in sub-section (1), the Central Government may borrow from the Reserve Bank by way of advances to meet temporary excess of cash disbursement over cash receipts during

any financial year in accordance with the agreements which may be entered into by that Government with the Reserve Bank:

Provided that any advances made by the Reserve Bank to meet temporary excess cash disbursement over cash receipts in any financial year shall be repayable in accordance with the provisions contained in sub-section (5) of section 17 of the Reserve Bank of India Act, 1934.

- (3) Notwithstanding anything contained in sub-section (1), the Reserve Bank may subscribe to the primary issues of the Central Government securities during the financial year beginning on the 1st day of April, 2003 and subsequent two financial years:

Provided that the Reserve Bank may subscribe, on or after the period specified in this sub-section, to the primary issues of the Central Government securities due to ground or grounds specified in the first provision to sub-section (2) of section 4.

- (4) Notwithstanding anything contained in sub-section (1), the Reserve Bank may buy and sell the Central Government securities in the secondary market.

6. (1) The Central Government shall take suitable measures to ensure greater transparency in its fiscal operations in the public interest and minimise as far as practicable, secrecy in the preparation of the annual financial statement and demands for grants.

- (2) In particular, and without prejudice to the generality of the foregoing provision; the Central Government shall, at the time of presentation of annual financial statement and demands for grants, make such disclosures and in such form as may be prescribed.

7. (1) The Minister-in-charge of the Ministry of Finance shall review, every quarter; the trends in receipts and expenditure in relation to the budget and place before both Houses of Parliament the outcome of such reviews.

- (2) Whenever there is either shortfall in revenue or excess of expenditure over the pre-specified levels mentioned in the Fiscal Policy Strategy Statement and the rules made under this Act during any period in a financial year, the Central Government shall take appropriate measures for increasing revenue or for reducing the expenditure (including curtailing of the sums authorised to be paid and applied from and out of the Consolidated Fund of India under any Act so as to provide for the appropriation of such sums):

Provided that nothing in this sub-section shall apply to the expenditure charged on the Consolidated Fund of India under clause (3) of article 112 of the Constitution or to any other expenditure which is required to be incurred under any agreement or contract or such other expenditure which cannot be postponed or curtailed.

- (3) (a) Except as provided under this Act, no deviation in meeting the obligations cast on the Central Government under this Act, shall be permissible without approval of Parliament.

- (b) Where owing to unforeseen circumstances, any deviation is made in meeting the obligations cast on the Central Government under this Act, the Minister-in-charge of the Ministry of Finance shall make a statement in both Houses of Parliament explaining

(i) any deviation in meeting the obligations cast on the Central Government under this Act;

(ii) whether such deviation is substantial and relates to the actual or the potential budgetary outcomes; and

(iii) the remedial measures the Central Government proposes to take.

8. (1) The Central Government may, by notification in the Official Gazette, make rules for carrying out the provisions of this Act.

- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-
- (a) the annual targets to be specified under sub-section (2) of section 4;
 - (b) the fiscal indicators to be prescribed for the purpose of sub-section (2) of section 3;
 - (c) the forms of the Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-economic Frame Work Statement referred to in sub-section (7) of section 3;
 - (d) the disclosures and form in which such disclosures shall be made under sub-section (2) of section 6;
 - (e) any other matter which is required to be, or may be, prescribed.
9. Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.
10. No suit, prosecution or other legal proceedings shall lie against the Central Government or any officer of the Central Government for anything which is in good faith done or intended to be done under this Act or the rules made thereunder.
11. No civil court shall have jurisdiction to question the legality of any action taken by, or any decision of, the Central Government, under this Act.
12. The provisions of this Act shall be in addition to, and not in derogation of the provisions of any other law for the time being in force.
13. (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:
- Provided that no order shall be made under this section after the expiry of two years from the commencement of this Act.
- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

C.2 FRBM RULES, 2004

Notification

New Delhi, the 2nd July, 2004

G.S.R. 396(E). - In exercise of the powers conferred by section 8 of the Fiscal Responsibility and Budget Management Act, 2003 (39 of 2003), the Central Government hereby makes the following rules, namely:-

1. Short title and commencement

- (1) These rules may be called the Fiscal Responsibility and Budget Management Rules, 2004.
- (2) They shall come into force on the 5th day of July, 2004.

2. Definitions - In these rules, unless the context otherwise requires,

- (a) **Act** means the Fiscal Responsibility and Budget Management Act, 2003 (39 of 2003);
- (b) **Form** means a form appended to these rules;
- (c) **GDP** means gross domestic product at current prices;
- (d) **section** means a section of the Act;
- (e) words and expressions used herein but not defined and defined in the Act shall have the meanings respectively assigned to them in the Act.

3. Annual targets

- (1) In order to achieve the target of revenue deficit as set out in 'sub-section (1) of section 4, by the 31th day of March, 2008, the Central Government shall reduce such deficit by an amount equivalent to 0.5 per cent or more of the GDP at the end of each financial year, beginning with the financial year 2004–2005.
- (2) The Central Government shall reduce the fiscal deficit by an amount equivalent to 0.3 per cent or more of the GDP at the end of each financial year beginning with the financial year 2004–2005, so that fiscal deficit is brought down to not more than 3 per cent of GDP at the end of 31st day of March, 2008.
- (3) The Central Government shall not give guarantees aggregating to an amount exceeding 0.5 per cent of the GDP in any financial year beginning with the financial year 2004–2005.
- (4) The Central Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of 9 per cent of GDP for the financial year 2004–2005 and in each subsequent financial year, the limit of 9 per cent of GDP shall be progressively reduced by at least one percentage point of GDP.

4. Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro Economic Framework Statement -

The Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-Economic Framework Statement required to be laid before both Houses of Parliament by the Central Government along with the annual financial statement and demands for grants shall be in Forms F-1, F-2 and F-3 respectively.

5. Fiscal Indicators -

- (1) In the Medium Term Fiscal Policy Statement, three year rolling targets in respect of the following, fiscal indicators shall be
as given in Form F-1, namely:-
 - (i) revenue deficit as a percentage of GDP;
 - (ii) fiscal deficit as a percentage of GDP;
 - (iii) tax revenue as a percentage of GDP; and
 - (iv) total outstanding liabilities of the Central Government as a percentage of GDP.

- (2) The Fiscal Policy Strategy Statement in Form F-2 shall also contain the intra-year benchmarks for assessing the trends in receipts and expenditure relating to annual targets and Budget Estimates.

6. Disclosures -

- (1) In order to ensure greater transparency in its fiscal operation in the public interest, the Central Government shall, at the time of presenting the annual financial statement and demands for grants, make disclosures of the following:-

- (a) any significant change in accounting standards, policies and practices affecting or likely to affect the computation of prescribed fiscal indicators.
- (b) statements of receivables and guarantees in Forms D-1 to D-3.
- (c) a statement of assets in Form D-4.

- (2) The provisions of sub-rule (1) shall be complied with not later than with the presentation of the annual financial statement and demands for grants for the financial year 2006-2007.

7. Measures to enforce compliance

In case the outcome of the quarterly review of trends in receipts and expenditure, made under sub-section (1) of section 7, at the end of second quarter of any financial year beginning with the financial year 2004-2005 shows that -

- (i) the total non-debt receipts are less than 40 per cent of Budget Estimates for that year; or
- (ii) the fiscal deficit is higher than 45 per cent of the Budget Estimates for that year; or
- (iii) the revenue deficit is higher than 45 per cent of the Budget Estimates for that year,

then, -

- (a) as required under sub-section (2) of that section, the Central Government shall take appropriate corrective measures; and
- (b) as required under sub-section (3) of that section, the Minister-in-charge of the Ministry of Finance shall make a statement in both Houses of Parliament during the session immediately following the end of the second quarter detailing the corrective measures taken, the manner in which any supplementary demands for grants are proposed to be financed and the prospects for the fiscal deficit of that financial year.

Form F-1 [See rule 4]

MEDIUM TERM FISCAL POLICY STATEMENT

A. Fiscal Indicators – Rolling Targets

| | Current Year Revised Estimates | Ensuing year Target: Budget Estimates Y | Targets for next Two years | |
|---|---|---|-------------------------------|-----|
| | | | Y+1 | Y+2 |
| 1. Revenue Deficit as percentage of GDP | | | | |
| 2. Fiscal Deficit as percentage of GDP | | | | |
| 3. Tax Revenue as percentage of GDP | | | | |
| 4. Total Outstanding Liabilities as percentage of GDP | | | | |

B. Assumptions underlying the Fiscal Indicators -**1. Revenue receipts**

- (a) Tax-revenue - Sectoral and GDP growth rates
- (b) Non-tax-revenue - Policy stance
- (c) Devolution to States - Finance Commission

2. Capital receipts - Debt stock, repayment, fresh loans and policy stance

- (a) Recovery of loans
- (b) Other receipts
- (c) Borrowings - Public Debt and Other Liabilities

3. Total expenditure - Policy Stance -

- (a) Revenue account
 - (i) Interest payments
 - (ii) Major subsidies
 - (iii) Others
- (b) Capital account
 - (i) Loans and advances
 - (ii) Capital outlay

4. GDP Growth**C. Assessment of sustainability relating to-**

(i) The balance between revenue receipts and revenue expenditure. The Medium Term Fiscal Policy Statement may specify the tax-GDP ratio for the current year and subsequent two years with an assessment of the changes . required for achieving it. It may discuss the non-tax revenues and the. policies concerning the same. An assessment of the capital receipts may be made,

including the borrowings and other liabilities, as per policies spelt out. The statement may also give projections for GDP and discuss it on the basis of assumptions underlying the indicators. Expenditure on revenue account, both plan and non-plan, may also be made with particular emphasis on the measures proposed to meet the overall objectives.

(ii) The use of capital receipts including market borrowings for generating productive assets. The Medium Term Policy Statement may specify the proposed use of capital receipts for generating productive assets in different categories. It may also spell out proposed changes among these categories and discuss it in terms of the overall policy of the Government in achieving the national objective.

Form F - 2 [See rule 4]

FISCAL POLICY STRATEGY STATEMENT

A: Fiscal Policy Overview: [This paragraph will present an overview of the fiscal policy currently in vogue.]

B: Fiscal policy for the ensuing financial year: [This paragraph shall have five sub-paragraphs dealing with -

(1) Tax Policy

In the sub-paragraph on tax policy, major changes proposed to be introduced in direct and indirect taxes in the ensuing financial year will be presented. It shall contain an assessment of income tax exemption limits and how far it relates to per capita income, principles regarding tax exemptions and target group for exemptions.

(2) Expenditure Policy

Under expenditure policy, major changes proposed in the allocation of expenditure shall be indicated. It shall also contain an assessment of principles regarding the benefits and target group of beneficiaries.

(3) Government Borrowings Lending and Investments.

In this sub-paragraph on Government borrowings, the policy relating to internal debt, external debt, Government lending, investments and other activities; including principles regarding average maturity structure, bunching of repayments, etc., shall be indicated.

(4) Contingent and other Liabilities.

Any change in the policy on contingent and other liabilities and in particular guarantees which have potential budgetary implications shall be indicated.

(5) Pricing of Administered Goods.

Any change proposed in the pricing of administered products, including the progress towards market-based principles shall be spelt out.]

C: Strategic priorities for the ensuing year:

- (1) [Resource mobilisation for the ensuing financial year through tax, non-tax and other receipts shall be spelt out.
- (2) The broad principles underlying the expenditure management during the ensuing year shall be spelt out.
- (3) Priorities relating to management of public debt proposed during the ensuing year shall be indicated.]

D: Rationale for Policy changes

- (1) [The rationale for policy changes consistent with the Medium Term Fiscal Policy Statement, in respect of direct and indirect taxes proposed in the ensuing Budget shall be spelt out.
- (2) The rationale for major policy changes in respect of budgeted expenditure including expenditure on subsidies shall be indicated.
- (3) Rationale for changes, if any, proposed in the management of the public debt shall be indicated.
- (4) The need for changes, if any, proposed in respect of pricing of administered goods shall be spelt out.]

E: Targets for the ensuing year

[At the end of the second quarter, a mid-year assessment shall be made of the trends in receipts and expenditures and achievement of targets of deficit reduction in relation to Budget Estimates. In case the total non debt receipts are less than 40 per cent of Budget Estimates for that year; or the fiscal deficit is higher than 45 per cent of the Budget Estimates for that year; or the revenue deficit is higher than 45 per cent of the Budget Estimates for that year, the Central Government shall take action as required, under sub-sections. (2) and (3) of section 7.]

F: Policy Evaluation:

[This paragraph shall contain an evaluation of the changes proposed in the fiscal policy for the ensuing year with reference to fiscal deficit reduction and objectives set out in the medium term fiscal policy statement.]

Form F - 3 [See rule 4]

MACRO ECONOMIC FRAMEWORK STATEMENT

1. **Overview of the Economy:** [This paragraph shall contain a synoptic analysis of trends in growth rates, prices, output, external sector, money and capital markets. Information on key macro-economic indicators will be presented in the format appended.]

2. **GDP Growth:** [This paragraph shall contain an analysis of trends in overall GDP growth and its sectoral composition.]

3. **External Sector:** [Under this paragraph, trends in exports, imports, foreign exchange reserves, current account balance and balance of payments shall be presented.]

4. **Money, Banking and Capital Markets:** [This paragraph shall present an account of the trends in money supply, bank deposits and credit and developments in the capital market.]

5. **Central Government Finances:** [Under this paragraph an analysis of trends in revenue collections and expenditure shall be presented. Trends in important fiscal deficit and debt indicators shall also be presented. Trends in Central Government finances shall be presented in the format appended.]

6. **Prospects:** [Based on the trends in major sectors presented in the previous sections, an assessment shall be made regarding the growth prospects, along with the underlying assumptions.]

F-3(Contd)
Macro Economic Framework Statement
Economic Performance at a Glance

| | | Absolute Value | | Percentage Changes | |
|-----|--|-------------------------|--------------|-------------------------|--------------|
| | | April-Reporting period* | | April-Reporting period* | |
| | | Previous Year | Current Year | Previous Year | Current Year |
| | Real Sector | | | | |
| 1 | GDP at factor cost | | | | |
| (a) | at current price | | | | |
| (b) | at 1993-94 price | | | | |
| 2 | Index of Industrial Production | | | | |
| 3 | Wholesale Price Index (point to point) | | | | |
| 4 | Consumer Price Index | | | | |
| 5 | Money Supply (M3) | | | | |
| 6 | Imports at current prices | | | | |
| (a) | In Rs. Crore | | | | |
| (b) | In US \$ million | | | | |
| 7 | Exports at current prices | | | | |
| (a) | In Rs. Crore | | | | |
| (b) | In US \$ million | | | | |
| 8 | Trade Balance | | | | |
| 9 | Foreign Exchange Assets | | | | |
| (a) | In Rs. Crore | | | | |
| (b) | In US \$ million | | | | |
| 10 | Current Account Balance | | | | |
| | Government Finances | | | | |
| 1 | Revenue Receipts | | | | |
| 2 | Tax Revenue(Net) | | | | |
| 3 | Non-Tax Revenue | | | | |
| 4 | Capital Receipts(5+6+7) | | | | |
| 5 | Recovery of loans | | | | |
| 6 | Other Receipts | | | | |
| 7 | Borrowings and other liabilities | | | | |
| 8 | Total Receipts(1+4) | | | | |
| 9 | Non-Plan Expenditure | | | | |
| 10 | Revenue Account | | | | |
| | Of which: | | | | |
| 11 | Interest payments | | | | |
| 12 | Capital Account | | | | |
| 13 | Plan Expenditure | | | | |
| 14 | Revenue Account | | | | |
| 15 | Capital Account | | | | |
| 16 | Total Expenditure(9+13) | | | | |
| 17 | Revenue Expenditure (10+14) | | | | |
| 18 | Capital Expenditure (12+15) | | | | |
| 19 | Revenue Deficit (17-1) | | | | |
| 20 | Fiscal Deficit 16-(1+5+6) | | | | |
| 21 | Primary Deficit (20-11) | | | | |

*Data will relate to the period up to which information for the current year is available. To facilitate comparison, data of previous year corresponds to the same period of current year. Accordingly, reporting period may vary for different items.

Form D - 1

[See rule 6]

TAX REVENUES RAISED BUT NOT REALISED

(principal taxes)

(As. at the end of the reporting year)

| Major Head | Description | Amounts under dispute Rs. crore | | | | | Amounts not under dispute Rs. crore | | | | | Grand Total |
|------------|--|-------------------------------------|------------------------------------|-------------------------------------|---------------|-------|--|------------------------------------|-------------------------------------|---------------|-------|-------------|
| | | Over 1 year but less than two years | Over 2 years but less than 5 years | Over 5 years but less than 10 years | Over 10 years | Total | Over 1 year but less than two years | Over 2 years but less than 5 years | Over 5 years but less than 10 years | Over 10 years | Total | |
| | Taxes on Income & Expenditure | | | | | | | | | | | |
| 0020 | Corporation Tax | | | | | | | | | | | |
| 0021 | Taxes on Income other than Corporation tax | | | | | | | | | | | |
| | Taxes on Commodities & Services | | | | | | | | | | | |
| 0037 | Customs | | | | | | | | | | | |
| 0038 | Union Excise | | | | | | | | | | | |
| 0044 | Service Tax | | | | | | | | | | | |
| | TOTAL | | | | | | | | | | | |

Note: Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.

Form D - 2**[See rule 6]****ARREARS OF NON-TAX REVENUE**

(As at the end of the reporting year)

| Description | Amounts pending (Rs. crore) | | | | Total |
|--|-----------------------------|-----------|-----------|---------------|-------|
| | 0-1 years | 1-2 years | 2-3 years | above 5 years | |
| Fiscal Services | | | | | |
| Interest receipts | | | | | |
| Of which | | | | | |
| From State Governments and Union Territory Governments | | | | | |
| From Railways | | | | | |
| From Departmental Commercial Undertakings | | | | | |
| From Public Sector & other Undertakings | | | | | |
| Dividends and Profit | | | | | |
| General Services | | | | | |
| Police receipts | | | | | |
| Economic Services | | | | | |
| Petroleum Cess/Royalty Communications (License Fee) Receipts | | | | | |
| Other Receipts | | | | | |
| Total | | | | | |

Note : Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.

Form D-3
[See rule 6]

Guarantees given by the Government

| Class (No. of Guarantees Within bracket) | Maximum Amount Guaranteed during the year (Rs. crore) | Outstanding at the beginning of the year (Rs.crore) | Additions during the year during (Rs. crore) | Deletions (other than invoked) the year (Rs. crore) |
|--|--|---|---|--|
| 1 | 2 | 3 | 4 | 5 |
| | | | | |

| Invoked during the year Rs. crore | | Outstanding at the end of the year (Rs. crore) | Guarantee Commission or Fee (Rs. crore) | | Other Material Details |
|---|-------------------|---|---|----------|------------------------------|
| Discharged | Not discharged | | Receivable | Received | |
| 6 | 7 | 8 | 9 | 10 | 11 |
| | | | | | |

Note: The year in the above table refers to the second year preceding the year for which the annual financial statement and demands for grants, are presented.

From D-4
[See rule 6]

ASSET REGISTER

| | Assets at the beginning of the reporting year | Assets acquired during the reporting year | Cumulative total of assets at the end of the reporting year |
|-----------------------------|---|---|--|
| | Cost (Rs.cr) | Cost (Rs. cr) | Cost (Rs.cr) |
| Physical assets: | | | |
| Land | | | |
| Building | | | |
| Office | | | |
| Residential | | | |
| Roads | | | |
| Bridges | | | |
| Irrigation Projects | | | |
| Power projects | | | |
| Other capital projects | | | |
| Machinery & Equipment | | | |
| Office Equipment | | | |
| Vehicles | | | |
| Total | | | |
| Financial assets | | | |
| Equity Investment | | | |
| Shares | | | |
| Bonus shares | | | |
| Loans and advances | | | |
| Loans to State & UT Govts | | | |
| Loans to Foreign Govts | | | |
| Loans to companies | | | |
| Loans to others | | | |
| Other financial investments | | | |
| Total | | | |

Notes:

1. Assets above the threshold value of Rupees two lakh only to be recorded.
2. This disclosure statement does not include assets of Cabinet Secretariat, Central Police Organisations, Ministry of Defence, Departments of Space and Atomic Energy.
3. Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.

F No. 7(3)-B(D)/2003
M. PRASAD, Jt. Secy.

Appendix D

The Constitution (88th amendment) Act, 2003

As passed by the Lok Sabha on 6 May, 2003:¹



THE CONSTITUTION(EIGHTY-EIGHTH AMENDMENT) ACT, 2003
(15th January, 2004.)

An Act further to amend the Constitution of India.

BE it enacted by Parliament in the Fifty-fourth Year of the Republic of India as follows:—

1. (1) This Act may be called the Constitution (Eighty-eighth Amendment) Act, 2003.
(2) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.
2. After article 268 of the Constitution, the following article shall be inserted, namely:—
“268A. (1) Taxes on services shall be levied by the Government of India and such tax shall be collected and appropriated by the Government of India and the States in the manner provided in clause (2).

¹See <http://indiacode.nic.in/coiweb/amend/amend88.htm>

(2) The proceeds in any financial year of any such tax levied in accordance with the provisions of clause (1) shall be –

(a) collected by the Government of India and the States;

(b) appropriated by the Government of India and the States,

in accordance with such principles of collection and appropriation as may be formulated by Parliament by law.”.

3. In article 270 of the Constitution, in clause (1), for the words and figures “articles 268 and 269”, the words, figures and letter “articles 268, 268A and 269” shall be substituted.

4. In the Seventh Schedule to the Constitution, in **List I – Union List**, after entry 92B, the following entry shall be inserted, namely:–

“92C. Taxes on services.”.

T. K. VISWANATHAN,

Secy. to the Govt. of India.

Appendix E

Terms of reference of the task force

Ministry of Finance

Creation of a Task Force for implementation of the Fiscal Responsibility and Budget Management Act, 2003

Parliament passed the Fiscal Responsibility and Budget Management Act (FRBM), to establish a broad framework for the conduct of fiscal policy by setting a medium term target to guide fiscal policy formulation. The framework places an increased emphasis on transparency in budget formulation, implementation and assessment. The FRBM requires the Central Government to eliminate the revenue deficit of around 3.6 per cent of GDP by March, 2008. Towards this, the Central government needs to fix annual targets indicating the path of adjustments and required policy measures.

In view of the above, I hereby constitute a Task Force under the chairmanship of Dr. Vijay Kelkar. Other members of this Task Force will include:

1. Shri D. C. Gupta, Finance Secretary
2. Smt. Vineeta Rai, Revenue Secretary
3. Shri N. S. Sisodia, Secretary (FS)
4. Shri D. Swarup, OSD (Expenditure)
5. Dr. Ashok Lahiri, CEA

Shri M. Prasad, Joint Secretary would be the Convenor.

The Task Force will draw up the medium term framework for fiscal policies to achieve the FRBM objective. It will also formulate the annual targets indicating the path of adjustment and required

policy measures.

The Task Force will submit its report by 30th April, 2004.

(Jaswant Singh)
Minister of Finance
18.2.2004

Appendix F

Glossary

Expansions of acronyms are in italics, and terms in boldface are present in the glossary.

Buoyancy The percentage change in tax collections associated with a one percent change in the tax base. For example, if excise collections go up by 0.5 per cent for a 1 per cent increase in manufacturing GDP, the ‘buoyancy of excise collections’ is said to be 0.5.

Central GST *Central goods and services tax*. This is the term used in this report for the proposed central levy on goods and services along the **VAT** principle. It is proposed that the Central GST would replace the existing **CENVAT** and the existing Service tax. See Section 5.3.

CENVAT *Central VAT*. This is a modified **VAT** levied by the central government upto the manufacturing level. The bulk of what is commonly termed ‘excise collections’ in India now takes place under the framework of the CENVAT.

CMIE *Centre for Monitoring Indian Economy* (<http://www.cmie.com>).

EEE *Exempt-Exempt-Exempt*. A framework for tax treatment of savings and investment where contributions, accumulations and benefits (withdrawals) are all tax-exempt. See Section 5.5.4.

EET *Exempt-Exempt-Taxed*. A framework for tax treatment of savings and investment where contributions are exempt, accumulations are exempt, but benefits are taxed as ordinary income. See Section 5.5.4.

FRBM Act *Fiscal Responsibility and Budgetary Management Act*, 2003. See Section 2.6 and Appendix C.

IGST Act *Indian Goods and Services Act*. This is the proposed name for the new legislation which will give legal foundations to the Central-GST.

NHAI *National Highway Authority of India* (<http://www.nhai.org>).

NHDP *National Highway Development Program*, being executed by **NHAI**.

NSDL *National Securities Depository Limited* (<http://www.nsdl.co.in>).

OLTAS The *Online Tax Accounting System*, which became functional from 1 June 2004. See Section 5.7.1.

RIN The proposed *Risk Intelligence Network* for integrated risk-based assessment of firms, which combines monitoring of **GST** and income tax. See Section 5.7.4.

TIN *Tax Information Network*, the new system for handling tax deducted at source (TDS), and other third party information, that has been built by **NSDL** for the Income Tax Department. See Section 5.7.1.

VAT *Value added tax*. In India, this has become a generic term for a consumption tax collected at all points of exchange of goods and services. This principle is used in the present **CENVAT**, the State VAT and the proposed **GST**.