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Referencer on Goods & Services Tax

THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

REFERENCER
ON
GOODS AND SERVICES TAX

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PREFACE

Goods and Services Tax (GST) – a comprehensive tax regime to be levied on manufacture, sale and consumption of goods and services, is one of the most ambitious indirect tax reforms in the country since independence. It seeks to address challenges with the current indirect tax regime by broadening the tax base, eliminating cascading of taxes, increasing compliance, and reducing economic distortions caused by inter-state variations in taxes. It is expected to bring incremental GDP growth of the country.

GST will subsume central indirect taxes like excise duty, countervailing duty and service tax, as also state levies like value added tax, octroi and entry tax, luxury tax. The final consumer will bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

According to the 122nd Constitutional Amendment, Parliament and State Legislatures will have concurrent powers to make laws on GST. The GST Council consisting of the Union Finance Minister, Union Minister of State for Revenue, and state Finance Ministers will recommend rates of tax, period of levy of additional tax, principles of supply, special provisions to certain States etc.

The Institute as a part of its capacity building initiatives under emerging areas for practice, decided to develop this Referencer on 'Goods and Services Tax' to guide its members and other professionals on the challenges and opportunities which will be thrown open upon them when the law finally sees the light of the day.

I place on record my sincere thanks to CS Rajiv Bajaj, Council Member, ICSI for his valuable inputs in finalizing the referencer. I commend the dedicated efforts put in by team lead by Dr. S K Dixit, Joint Secretary and comprising CS Saurabh Jain, Deputy Director, ICSI and CS Sharad Kumar Jhunjhunwala, Assistant Director, ICSI for preparing the manuscript of this Referencer under the dynamic leadership of CS Sutanu Sinha, Chief Executive & Officiating Secretary, ICSI.

I have great pleasure in introducing this Referencer to the professional fraternity. I am sure this effort will be of immense value to the practitioners and learners in the subject.

I look forward to your valuable suggestions and constructive criticism for further refinement of the Referencer.

September 17, 2015 — **CS Atul H. Mehta**
New Delhi — *President*

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Referencer on Goods and Services Tax

Prelude

The task force on the implementation of Fiscal Responsibility and Budget Management Act, 2003 under the chairmanship of Shri Vijay Kelkar, which submitted its report on February 28, 2004 had strongly recommended the adoption of GST for the indirect taxation in India. The concept of GST was introduced in the Parliament for the first time on February 28, 2006 by Shri P Chidambaram, the then Finance Minister in the Union Budget Speech of 2006-07. The Empowered Committee of state FM's was set up after that to prepare a roadmap for introducing a national level GST. First discussion paper (FDP) was released by the Empowered Committee on November 10, 2009. The FDP gave details of the structure of the GST model to be introduced in India and an Annexure on FAQ on GST. A task force on GST formed by the 13th Finance Commission gave its report on December 15, 2009.

After much deliberation, finally the first formal step towards the long awaited tax reform was taken with the passage of 122nd Constitutional Amendment Bill by the Lok Sabha on May 06, 2015. However still a long process needs to be completed. The Amendment Bill is presently pending with the Rajya Sabha. The select committee of Rajya sabha has already submitted its report to Rajya Sabha on 22nd July, 2015. Since the list in Seventh schedule is to be changed by the constitutional amendment, the constitutional bill would need the ratification of not less than one-half of the State Legislatures.

After the constitutional amendment, three bills- on the Centre's GST (CGST), State's GST (SGST) and Integrated GST (IGST) would come up. Once this background legal framework is ready along with setting up of GST Council as envisaged in the Constitution amendment bill, the GST can be realised. The three draft legislations will lay down the fine print of the uniform indirect tax regime.

This referencer, is an attempt to compile the most relevant material available on the subject, and present it in a user friendly manner. The reference is divided under 13 headings. The most authoritative sources on the subject are the various reports and discussion papers of committees entrusted with the task of facilitating the legislative process on the subject. Inputs from First Discussion Paper, Report of Task force (Thirteenth Finance Commission), literature present on the website of Empowered Committee, Standing committee report on Finance, Select committee report of Rajya Sabha etc. The GST model is still not final and there are several issues relating to the same. However in this referemcer, we have incorporated the model envisaged in the Report of task force on Goods and Service Tax- 13th Finance Commission. The industry perspective has been taken from the various presentations made by industry bodies like FICCI and CII.

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India Inc. calling for Goods and Services Tax[1]

Goods and Services Tax (GST) is one of the biggest indirect tax reforms in the country since independence slated to be made applicable in the country from April 2016. It is expected to bring about a 2% incremental GDP growth of the country. So GST is the need of the hour.

Why we need GST?

Presently in terms of Article 246 – Schedule VII of the Constitution of India we have got three lists, the Union List, the State List and the Concurrent List. Under the Union list only the Central Government can levy taxes. In respect of the items contained in the State List only the State Government can levy taxes. And under the Concurrent List both the Centre as well as the State Government can levy taxes.

A look at the Central Taxes reveals a list that includes Customs duty, Central Excise, Service Tax and to top it all we have education cess and secondary higher education cess. We have got product specific cess like automobile cess, research and development cess, etc., all central levy driven by Union List.

Coming to the State List we have value added tax (VAT) along with Central Sales Tax (CST). We have entry levy tax, octroi, entertainment tax, luxury tax and at the same time local body tax in some states such as Maharashtra. So we have multiple taxes both at the Central and State Level.

India Inc. is looking at some simplification, clarification and uniformity in indirect taxes. Hence GST is the need of the hour.

Issues in Central Excise, Service Tax and VAT

Under Central levy we start with the customs duty when we import goods, we pay basic customs duty (BCD), we pay countervailing duty which is the equivalent of excise duty and applicable

1. CS Saurabh Jain, Deputy Director, ICSI. Views expressed by the Author are his personnel views and not necessarily the views of the Institute.

on like goods manufactured in India. We pay customs cess, we pay special additional duty (SAT) in lieu of sales tax. The existing problem in customs duty is that the manufacturer can claim the credit of CVD and SAT but he can't avail the credit of BCD and customs duty which become cost of production for the manufacturer.

At the same time service provider can avail the credit of countervailing duty only. He can't avail the credit of SAT. So for the service provider BCD, Customs Duty and SAT become cost. This is just one of the problems from the credit perspective and the additional problems arise from inverted duty structure and accumulation of standard credit in the hands of the manufacturer in view of low value addition because they avail the credit of CVD and SAT but as there is not enough value addition, they are not able to utilize the credit and thereby there is accumulation. They can't go for the refund which is applicable to the importer of goods for the trading of imported goods. To find out a solution all manufacturers are looking for all these aspects in GST.

Moving from Customs duty to excise duty, we see that the taxable event is manufacturing of goods in India. So the term "manufacture" is very important. Manufacture means any activity which is incidental or ancillary to the completion of manufactured products or any activity which is defined in section note or chapter note of 1st Schedule to CETA. At the same time we have got deemed manufacture, which is any activity which may be packing, re-packing, labeling, re-labelling, alteration of retail sale price pertaining to the product specified in Schedule 3.

Then we have variable rates under Excise Duty such as 2% without CENVAT, multiple rates such as 6%, 10%, 18%, 24%, 27% and even 30%. We have multiple valuation system majorly which is followed on the basis of production capacity or on the basis of Maximum Retail Price (MRP). Under Section 4A of the Excise Act, we have transaction value which got a different dimension in view of the judgment of the Hon'ble Supreme Court in the case of Fiat India. Transaction Value is applicable on the price, i.e., sole consideration and the time and place of removal and the buyer and assessee are not related but in the Fiat judgment the concept of transaction value got changed and now transaction value should not be driven by any direct or indirect consideration flowing from the buyer to the assessee. Some exemptions under excise are absolute while some are conditional exemptions. At the same time we have excise free zones such as Uttaranchal and Himchal Pradesh, where there is absolute exemption. We have excise free zones by way of refund mechanism like in the State of Jammu and Kashmir and then we also have classification of Central Excise by way of Central Excise Tariff Act, 1985.

Service Tax

Service tax came into effect from 1st July 1994 on three services at the rate of 5%. Until 1st July 2012, service tax was applicable under the positive list regime of service tax. There has been paradigm shift from 1st July 2012 with the coming into being of the negative list regime of service tax. The taxable event for applicability of service tax is rendering of service. After 18 years of applicability of service tax we got the definition of service.

What would be service under GST scenario?

Under the 122nd Constitutional Amendment Bill the term, "Services" means anything other than goods. This broad definition of the term 'service' will altogether remove the disputes on the aspect whether something is goods or services (unless Government proposes different rates for GST on goods or services or both).

The law provides for reverse charge and partial reverse charge under service tax. Under the partial reverse service charge both the service provider and the service receiver have to pay service tax. There are four partial reverse service charge, viz., renting of vehicle for carrying passengers, supply of manpower, security services and works contract. It is applicable when the service provider is an individual, firm, HUF providing services to a body corporate registered as an entity in taxable territory.

Service Tax is a happening issue for Government of India and now service tax forms a major portion of the indirect taxes collected by the government as compared to excise duty and customs duty.

Moving on to State Taxes we have Value Added Tax (VAT), which is applicable on the value of the transfer of property in goods and then we have deemed sale concept. In terms of Article 366 (29A) deemed sale concept includes works contracts, air conditioned restaurants, etc. At the same time when VAT was implemented in the country, the respective Finance Ministers of all the states agreed to keep a uniform VAT rate - floor rates like 1%, 4%, 5% and 20%. But what is happening today is that the same states are charging VAT at different rates, we have some states charging 5% or 6% wherein the floor rate is 4%. Some of the states as against the floor rate of 12.% are charging 13.5% and even 18.5%, which is creating imbalance of trade between the states. At the same time under VAT we have multiple diversities. There is no uniformity in terms of registration, due date of payment, return filing, etc. The forms to be filed in various states are altogether different, thus, complicating the whole mechanism.

A business establishment having offices in three different states in the country has to follow the laws of the respective states. At the same time the assessment process is different, there is difference in the appellate process, difference in refund mechanism and different Input Tax Criteria (ITC) as given by the respective state provision.

There is diversity in the VAT procedures across the country, difference in rates of VAT, difference in forms and procedures from state to state, differences in determining the taxable event for charging VAT all complicate the system.

Central Sales Tax

Central Sales Tax (CST) is applicable for inter-state sale of goods. No credit is available for CST. And it has been having a cascading effect on the cost of goods parallel to our indirect tax system.

Having seen the major indirect taxes from the Central Government's perspective and from the perspective of the states, we conclude that we have double taxation as the main problem in our indirect taxes system.

Comparing Excise and Service Tax – double taxation is applicable on software, designing, erection and commissioning equipment along with supply of goods. "Double Taxation" disputes are persisting for excise and service tax.

Comparing Service Tax and VAT – there are multiple line items wherein double taxation is applicable. Starting with construction, before completion both VAT as well as Service Tax are chargeable.

Take the case of Intellectual Property Rights (IPRs), e.g., software both VAT as well as Service Tax are chargeable.

In the case of dining at air conditioned restaurants, a buyer buying a coffee for Rs. 30/- has to pay VAT on Rs. 30/- and at the same time has to pay service tax on 40% of Rs. 30/-. Which is nothing but double taxation.

Looking back at the cascading effect of indirect taxes – customs duty, customs cess are cascading in the hands of the manufacturer as he cannot avail any credit for the same, and at the same time he has to pay excise duty on manufacture for which no credit is available at the hands of the VAT dealer. And to top it all there are entry tax and octroi. States allow credit of entry tax with a VAT liability. If there is not octroi, there is no credit available.

GST is clearly the need of the hour and solution to the cascading effect of so many indirect taxes. With GST coming into being, it is expected to give an incremental 2% in the GDP of the country.

Some important events in the evolution of Goods and Services Tax (GST):

- In 1974 the L K Jha Committee suggested implementation of GST in the country.
- In 1991 the Chelliah Tax Reforms Committee suggested either GST or VAT for the country.
- On 1st July 1994 – Service Tax was implemented on three services at the rate of 5%.
- During 1999-2000 the Empowered Committee of all States' Finance Ministers was formed and they prescribed a uniform floor rate for the VAT chargeable at the rate of 1%, 4% and 12.5%.
- In 2003, Haryana became the first State in the country to implement VAT.
- In 2004, MODVAT was abolished and the credit account was merged with service tax and excise to provide for cross utilization.
- During 2005-2006 more than 25 states implemented VAT in the country.

- In 2007, the Finance Minister of the country spoke about GST for the first time and on that premise the Central Sales Tax rate was reduced from 4% to 3%.
- On 10th November, 2009 the first discussion paper on GST was released.
- On 15th December, 2009 the Commission gave its report on GST.
- In January 2010, the Department of Revenue commented on the first discussion paper on GST.
- April 2010, the then Finance Minister suggested the probable GST rate.
- In February 2011, a team was set up for laying down the road map for GST.
- In March 2011, the 115th Constitutional Amendment Bill for GST was placed before the Parliament.
- On 1st July 2012 the negative list regime of service tax was implemented.
- In July 2013, the Parliamentary Standing Committee submitted its report on the 115th Constitutional Amendment Bill.
- During April 2014, the 115th Constitutional Amendment Bill lapsed and was reintroduced as the 122nd Constitutional Amendment Bill on 19th December, 2014.

GST Models

A look at the various models of GST functioning across the world reveals that Australia and China levy a National GST with a provision for sharing the same amongst the states. Some countries follow the State GST model wherein the States levy GST. In countries like Brazil and Canada, the concurrent dual GST model is followed, wherein both the centre and the states levy taxes on Goods and Services. Another model known as the Cubic model involves States levying taxes on goods and the centre levying taxes on services. Only a few countries follow the cubic model and separate legislations are made by the centre and state governments for their tax collection, procedures, administration and amount of tax to be collected, etc.

India too can follow the concurrent dual GST model, wherein both the State as well as the Centre will levy taxes on both goods and services, provided there is political will for the same.

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What is GST

The economic case for GST is straightforward: Income is taxed irrespective of source and use; therefore, consumption should also be taxed on the same principle.

GST is one of the widely accepted indirect taxation system prevalent in more than 150 countries across the globe. Globally, GST has been structured as a destination based comprehensive tax levied at a specified rate on sale and consumption of goods and services within a country.

GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point upto the retailer's level. It is essentially a tax only on value addition at each stage, and a supplier at each stage is permitted to set-off, through a tax credit mechanism, the GST paid on the purchase of goods and services as available for set-off on the GST to be paid on the supply of goods and services. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

The illustration shown below indicates, in terms of a hypothetical example with a manufacturer, one wholesaler and one retailer, how GST will work. Let us suppose that GST rate is 10%, with the manufacturer making value addition of Rs.30 on his purchases worth Rs.100 of input of goods and services used in the manufacturing process. The manufacturer will then pay net GST of Rs. 3 after setting-off Rs. 10 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 13. The manufacturer sells the goods to the wholeseller. When the wholeseller sells the same goods after making value addition of (say), Rs. 20, he pays net GST of only Rs. 2, after setting-off of Input Tax Credit of Rs. 13 from the gross GST of Rs. 15 to the manufacturer. Similarly, when a retailer sells the same goods after a value addition of (say) Rs. 10, he pays net GST of only Re.1, after setting-off Rs.15 from his gross GST of Rs. 16 paid to wholeseller. Thus, the manufacturer, wholeseller and retailer have to pay only Rs. 6 (= Rs. 3+Rs. 2+Re. 1) as GST on the value addition along the entire value chain from the producer to the retailer, after setting-off GST paid at the earlier stages. The overall burden of GST on the goods is thus much less. This is shown in the table below. The same illustration will hold in the case of final service provider as well.

Stage of Supply Chain	Purchase Value of Input	Value Addition	Value at Which Supply Goods and Services Made to Next Stage	Rate of GST	GST on Output	Input Tax Credit	Net GST=GST on output-Input Tax Credit
Manufacturer	100	50	150	10%	15	10	15-10=5
Whole Seller	150	30	180	10%	18	15	18-15=3
Retailer	180	20	200	10%	20	18	20-18=2

Deficiency in present system

The present forms of CENVAT and State VAT have remained incomplete in removing fully the cascading burden of taxes already paid at earlier stages. Besides, there are several other taxes, which both the Central Government and the State Government levy on production, manufacture and distributive trade, where no set-off is available in the form of input tax credit. These taxes add to the cost of goods and services through "tax on tax" which the final consumer has to bear. Since, with the introduction of GST, all the cascading effects of CENVAT and service tax would be removed with a continuous chain of set- off from the producer's point to the retailer's point, other major Central and State taxes would be subsumed in GST and CST will also be phased out, the final net burden of tax on goods, under GST would, in general, fall. Since there would be a transparent and complete chain of set-offs, this will help widening the coverage of tax base and improve tax compliance. This may lead to higher generation of revenues which may in turn lead to the possibility of lowering of average tax burden.

The GST will give more relief to industry, trade and agriculture through a more comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of several Central and State taxes in the GST and phasing out of CST. The transparent and complete chain of set-offs which will result in widening of tax base and better tax compliance may also lead to lowering of tax burden on an average dealer in industry, trade and agriculture.

By subsuming of major Central and State taxes in GST, complete and comprehensive setoff of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports. The uniformity in tax rates and procedures across the country will also go a long way in reducing the compliance cost.

The present threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. The existing threshold of goods under State VAT is Rs. 5 lakhs for a majority of bigger States and a lower threshold for North Eastern States and Special Category States. A uniform State GST threshold across States is desirable and, therefore, the Empowered Committee has recommended that a threshold of gross annual turnover of Rs. 10 lakh both for goods and services for all the States and Union Territories may be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime. Keeping in view the interest of small traders and small scale industries and to avoid dual control, the States considered that the threshold for Central GST for goods may be kept at Rs.1.5 crore and the threshold for services should also be appropriately high. This raising of threshold will protect the interest of small traders.

With the introduction of GST, all the cascading effects of CENVAT and service tax will be more comprehensively removed with a continuous chain of set-off from the producer's point to the retailer's point than what was possible under the prevailing CENVAT and VAT regime. Certain major Central and State taxes will also be subsumed in GST and CST will be phased out. Other things remaining the same, the burden of tax on goods would, in general, fall under GST and that would benefit the consumers.

The salient features of the proposed model

Consistent with the federal structure of the country, the GST will have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States (hereinafter referred to as State GST). This dual GST model would be implemented through multiple statutes (one for CGST and SGST statute for every State). However, the basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. would be uniform across these statutes as far as practicable.

The Central GST and the State GST would be applicable to all transactions of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits. The Central GST and State GST are to be paid to the accounts of the Centre and the States separately. Since the Central GST and State GST are to be treated separately, in general, taxes paid against the Central GST shall be allowed to be taken as input tax credit (ITC) for the Central GST and could be utilized only against the payment of Central GST. The same principle will be applicable for the State GST. Cross utilisation of ITC between the Central GST and the State GST would, in general, not be allowed. To the extent feasible, uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislation for Central GST and State GST. The administration of the Central GST would be with the Centre and for State GST with the States. The taxpayer would need to submit periodical returns to both the Central GST authority and to the concerned State GST authorities. Each taxpayer would be allotted a PAN linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN- based system for Income tax facilitating data exchange and taxpayer compliance. The exact design would be worked out in consultation with the Income-Tax Department. Keeping in mind the need of tax payers convenience, functions such as assessment, enforcement, scrutiny and audit would be undertaken by the authority which is collecting the tax, with information sharing between the Centre and the States.

The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits. Further, both would be levied on the same price or value unlike State VAT which is levied on the value of the goods inclusive of CENVAT. While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, SGST would be chargeable only when the supplier and the recipient are both located within the State. Illustration I: Suppose the rate of CGST is 10% and that of SGST is 10%. When a wholesale dealer of steel in Uttar Pradesh supplies steel bars and rods to a construction company which is also located within the same State for , say Rs. 100, the dealer would charge CGST of Rs. 10 and SGST of Rs. 10 in addition to the basic price of the goods. He would be required to deposit the CGST component into a Central Government account while the SGST portion into the account of the concerned State Government. Of course, he need not actually pay Rs. 20 (Rs. 10 + Rs. 10) in cash as he would be entitled to set-off this liability against the CGST or SGST paid on his purchases (say, inputs). But for paying CGST he would be allowed to use only the credit of CGST paid on his purchases while for SGST he can utilize the credit of SGST alone. In other words, CGST credit cannot, in general, be used for payment of SGST. Nor can SGST credit be used for payment of CGST.

Illustration II: Suppose, the rate of CGST is 10% and that of SGST is 10%. When an advertising company located in Mumbai supplies advertising services to a company manufacturing soap also located within the State of Maharashtra for, say Rs. 100, the ad company would charge CGST of Rs. 10 as well as SGST of Rs. 10 to the basic value of the service. He would be required to deposit the CGST component into a Central Government account while the SGST portion into the account of the concerned State Government. Of course, he need not again actually pay Rs. 20 (Rs. 10+Rs. 10) in cash as it would be entitled to set-off this liability against the CGST or SGST paid on his purchase (say, of inputs such as stationery, office equipment, services of an artist etc). But for paying CGST he would be allowed to use only the credit of CGST paid on its purchase while for SGST he can utilise the credit of SGST alone. In other words, CGST credit cannot, in general, be used for payment of SGST. Nor can SGST credit be used for payment of CGST.

The various Central, State and Local levies were examined to identify their possibility of being subsumed under GST. While identifying, the following principles were kept in mind:

Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services. Taxes or levies to be subsumed should be part of the transaction chain which commences with import/ manufacture/ production of goods or provision of services at one end and the consumption of goods and services at the other. The subsumation should result in free flow of tax credit in intra and inter-State levels. The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST. Revenue fairness for both the Union and the States individually would need to be attempted. On application of the above principles, the Empowered Committee has recommended that the following Central Taxes should be, to begin with, subsumed under the Goods and Services Tax:

(i) Central Excise Duty

(ii) Additional Excise Duties

(iii) The Excise Duty levied under the Medicinal and Toiletries Preparation Act

(iv) Service Tax

(v) Additional Customs Duty, commonly known as Countervailing Duty (CVD)

(vi) Special Additional Duty of Customs - 4% (SAD)

(vii) Surcharges, and

(viii) Cesses.

The following State taxes and levies would be, to begin with, subsumed under GST:

(i) VAT / Sales tax

(ii) Entertainment tax (unless it is levied by the local bodies).

(iii) Luxury tax

(iv) Taxes on lottery, betting and gambling

(v) State Cesses and Surcharges in so far as they relate to supply of goods and services

(vi) Entry tax not in lieu of Octroi.

Purchase tax: Some of the States felt that they are getting substantial revenue from Purchase Tax and, therefore, it should not be subsumed under GST while majority of the States were of the view that no such exemptions should be given. The difficulties of the foodgrain producing States was appreciated as substantial revenue is being earned by them from Purchase Tax and it was, therefore, felt that in case Purchase Tax has to be subsumed then adequate and continuing compensation has to be provided to such States. This issue is being discussed in consultation with the Government of India. Tax on items containing Alcohol: Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT could be continued to be levied on alcoholic beverages as per the existing practice. In case it has been made Vatable by some States, there is no objection to that. Excise Duty, which is presently levied by the States may not also be affected. Tax on Tobacco products: Tobacco products would be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST with ITC. Tax on Petroleum Products: As far as petroleum products are concerned, it was decided that the basket of petroleum products, *i.e.* crude, motor spirit (including ATF) and HSD would be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. A final view whether Natural Gas should be kept outside the GST will be taken after further deliberations. Taxation of Services: As indicated earlier, both the Centre and the States will have concurrent power to levy tax on goods and services. In the case of States, the principle for taxation of intra-State and inter State has already been formulated by the Working Group of Principal Secretaries /Secretaries of Finance / Taxation and Commissioners of Trade Taxes with senior representatives of Department of Revenue, Government of India. For inter-State transactions an innovative model of Integrated GST will be adopted by appropriately aligning and integrating CGST and IGST.

The Empowered Committee has decided to adopt a two-rate structure –a lower rate for necessary items and items of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items. For upholding of special needs of each State as well as a balanced approach to federal flexibility, it is being discussed whether the exempted list under VAT regime including Goods of Local Importance may be retained in the exempted list under State GST in the initial years. It is also being discussed whether the Government of India may adopt, to begin with, a similar approach towards exempted list under the CGST.

For CGST relating to goods, the States considered that the Government of India might also have a two-rate structure, with conformity in the levels of rate with the SGST. For taxation of services, there may be a single rate for both CGST and SGST. The exact value of the SGST and CGST rates, including the rate for services, will be made known duly in course of appropriate legislative actions.

Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

(a) It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them.

(b) The compliance cost and compliance effort would be saved for such small traders.

(c) Small traders get relative advantage over large enterprises on account of lower tax incidence.

The present thresholds prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. A uniform State GST threshold across States is desirable and, therefore it has been considered that a threshold of gross annual turnover of Rs. 10 lakh both for goods and services for all the States and Union Territories might be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime. Keeping in view the interest of small traders and small scale industries and to avoid dual control, the States also considered that the threshold for Central GST for goods may be kept Rs.1.5 Crore and the threshold for services should also be appropriately high.

Composition/Compounding Scheme will be an important feature of GST to protect the interests of small traders and small scale industries. The Composition/Compounding scheme for the purpose of GST should have an upper ceiling on gross annual turnover and a floor tax rate with respect to gross annual turnover. In particular there will be a compounding cut-off at Rs. 50 lakhs of the gross annual turnover and the floor rate of 0.5% across the States. The scheme would allow option for GST registration for dealers with turnover below the compounding cut-off.

With Constitutional Amendments, both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import of goods and services.

Cross utilization of credit of CGST between goods and services would be allowed. Similarly, the facility of cross utilization of credit will be available in case of SGST. However, the cross utilization of CGST and SGST would generally not be allowed except in the case of inter-State supply of goods and services under the IGST.

The Empowered Committee has accepted the recommendation for adoption of IGST model for taxation of inter-State transaction of Goods and Services. The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information is also submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

The major advantages of IGST Model are:

(a) Maintenance of uninterrupted ITC chain on inter-State transactions.

(b) No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.

(c) No refund claim in exporting State, as ITC is used up while paying the tax.

(d) Self monitoring model.

(e) Level of computerisation is limited to inter-State dealers and Central and State Governments should be able to computerise their processes expeditiously.

(f) As all inter-State dealers will be e-registered and correspondence with them will be by e-mail, the compliance level will improve substantially.

(g) Model can take 'Business to Business' as well as 'Business to Consumer' transactions into account.

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3

Need for GST

"In 2004, analysing the structure of the prevailing indirect tax system both at the Central and State level, the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003 observed that "high import tariffs, excises and turnover tax on domestic goods and services have enormous cascading effects, leading to a distorted structure of production, consumption and exports. This problem can be effectively addressed by shifting the tax burden from production and trade to final consumption, and from savings to consumption. The existing tax system introduces innumerable distortions resulting in inefficient resource allocation and adversely impacting GDP growth. It also provides an incentive to firms to engage in political lobbying for exemptions and favourable modifications in the tax schedule. The Indian consumer is known to be remarkably sensitive to apparently small changes in relative prices. The goal of a rational tax system is to *empower households* to engage in undistorted decision making, driven by their own needs and preferences." Accordingly, the Task Force recommended that "a well designed destination-based value added tax on all goods and services is the most elegant method of eliminating distortions and taxing consumption. Under this structure, all different stages of production and distribution can be interpreted as a mere tax pass-through, and the tax essentially 'sticks' on final consumption within the taxing jurisdiction. Therefore, the Task Force recommended the introduction of a destination based VAT type dual Goods and Services Tax (hereafter referred to as 'GST')."[2]

There was a burden of "tax on tax" in the pre-existing Central excise duty of the Government of India and sales tax system of the State Governments. The introduction of Central VAT (CENVAT) has removed the cascading burden of "tax on tax" to a good extent by providing a mechanism of "set off" for tax paid on inputs and services upto the stage of production, and has been an improvement over the pre-existing Central excise duty. Similarly, the introduction of VAT in the States has removed the cascading effect by giving set-off for tax paid on inputs as well as tax paid on previous purchases and has again been an improvement over the previous sales tax regime.

But both the CENVAT and the State VAT have certain incompleteness. The incompleteness in

2. Report of the task force on Goods and Service Tax- Thirteenth Finance Commission

CENVAT is that it has yet not been extended to include chain of value addition in the distributive trade below the stage of production. It has also not included several Central taxes, such as Additional Excise Duties, Additional Customs Duty, Surcharges etc. in the overall framework of CENVAT, and thus kept the benefits of comprehensive input tax and service tax set-off out of the reach of manufacturers/ dealers. The introduction of GST will not only include comprehensively more indirect Central taxes and integrate goods and services taxes for set-off relief, but also capture certain value addition in the distributive trade.

Similarly, in the present State-level VAT scheme, CENVAT load on the goods has not yet been removed and the cascading effect of that part of tax burden has remained unrelieved. Moreover, there are several taxes in the States, such as, Luxury Tax, Entertainment Tax, etc. which have still not been subsumed in the VAT. Further, there has also not been any integration of VAT on goods with tax on services at the State level with removal of cascading effect of service tax. In addition, although the burden of Central Sales Tax (CST) on inter-State movement of goods has been lessened with reduction of CST rate from 4% to 2%, this burden has also not been fully phased out. With the introduction of GST at the State level, the additional burden of CENVAT and services tax would be comprehensively removed, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level would be established which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax. This is the essence of GST. Also, major Central and State taxes will get subsumed into GST which will reduce the multiplicity of taxes, and thus bring down the compliance cost. With GST, the burden of CST will also be phased out. Thus GST is not simply VAT plus service tax, but a major improvement over the previous system of VAT and disjointed services tax – a justified step forward.

GST is recognized internationally as a destination based consumption tax which is least distortionary. The broad objectives of introducing the Goods and Services Tax (GST) in India are to expand the tax base through wider coverage of economic activities and reduction in exemptions; mitigate cascading and double taxation and enable better compliance through the lowering of overall tax burden on goods and services. By removing hidden or embedded taxes, it would improve the competitiveness of domestic industry vis-à-vis imports and in international markets. By harmonizing the tax structure across States, this reform would also lead to the development of a common national market for goods and services.

The indirect tax system in the country has been going through a series of reforms over the last two decades. At the Central level, a Value Added Tax called, CENVAT, providing credit of tax paid on inputs and capital goods was introduced upto the manufacturing stage. Subsequently, in 1994, a tax on services (commonly known as Service Tax) was introduced by the Centre. The Service Tax has grown consistently in scope to cover more services and now applies to about 115 service categories with commensurate growth in revenue from this tax. In 2004, the input tax credit scheme for CENVAT and Service Tax was merged to permit cross flow of credit across these taxes. As for the States, they have switched over from a multiple point Sales tax to a Value

Added Tax (VAT) covering all transactions of sale of goods within the State up to the retail stage in a phased manner starting from 2005-06. Despite these measures, goods and services continue to be burdened with multiple indirect taxes at different stages of the value chain with significant tax cascading under the present indirect tax regime. The important reasons for this are as under:

(a) In respect of taxation of goods, CENVAT is confined to the ¯manufacturing stage and does not extend to the distribution chain beyond the factory gate. As such, CENVAT paid on goods cannot be neutralized against State VAT payable on subsequent sale of goods. This is true both for CENVAT collected on domestically produced goods as well as that collected as additional duty of customs on imported goods.

(b) CENVAT is itself made up of several components in the nature of cesses and surcharges such as the National Calamity Contingency Duty (NCCD), education and secondary and higher education cess, additional duty of excise on tobacco and tobacco products etc. This multiplicity of duties complicates the tax structure and often obstructs the smooth flow of tax credit.

(c) While input tax credit of CENVAT or additional duty of customs paid on goods is available to service providers paying Service Tax, they are unable to neutralize the State VAT or other State taxes paid on their purchase of goods.

(d) State VAT is payable on the value of goods inclusive of CENVAT paid at the manufacturing stage so that the VAT liability of a dealer gets inflated by this component without compensatory set-off.

(e) Inter-State sale of goods attracts the Central Sales Tax (CST) levied by the Centre and collected by the States. This is an origin-based tax and cannot be set-off against VAT in many situations.

(f) State VAT and CST do not directly apply to the import of goods on which special additional duties of customs are levied at a uniform rate of 4% by the Centre. Input tax credit of these duties is available only to those manufacturing excisable goods. Other importers have to claim refund of this duty as and when they pay VAT on subsequent sales.

(g) VAT dealers are unable to set-off any Service Tax that they may have paid on their procurement of taxable input services.

(h) State Governments also levy and collect a variety of other indirect taxes such as luxury tax, entertainment tax, entry tax etc. for which no set-off is available.

Introduction of GST is a logical culmination of the tax reform process involving the switch over to CENVAT; levy of service tax and the transition from sales tax to state VAT. By replacing a large number of taxes levied both by the Centre and the States, GST would integrate the tax base and allow seamless flow of input tax credit across the value chain of goods and services.

This would eliminate multiplicity of taxes, cascading of taxes and overall simplification of indirect taxation regime. Seamless input tax credit chain will lead to reduced cost of goods and services. As the credit chain will function only if all the transactions are recorded, GST environment would lead to improved disclosure of economic transactions which may have a positive impact on direct tax collections also.

It is in the context of India's federal structure that a dual GST, wherein both the Centre and the States concurrently levy and collect the tax, has been envisaged. It would be mutually beneficial to both by allowing an expansion of their respective fiscal space; and better tax compliance. Internationally, comprehensive Goods & Services tax has already been introduced in more than 100 countries across the world. The Empowered Committee of State Finance Ministers (EC) has visited and studied the best practices of many countries like Australia, Brazil, etc. which has similar political structure as that of India. At the same time, the Indian model would have to be unique owing to the quasi-federal nature of its polity. Under the GST regime, both the Centre and the State would have the powers to tax the ¯supply of goods and services right from their primary stage to final consumption. Such a regime with IGST on inter-state supplies would result in establishing a seamless Input Tax Credit (ITC) chain from the primary to the tertiary stage. Such seamless credit chain and the removal of differential in tax rates on inter-state and intra-state transactions are likely to lower costs for the consumers and will result in better tax compliance. In addition since all the dealers will be given PAN based registration number under GST regime and will be required to file returns on a common portal, more robust information sharing and analysis between the Centre and the States as also amongst States would be feasible. This will definitely help in checking evasion and boost revenues of the Centre as well as States since currently, there is no systematic sharing of information between Central and State tax administrations allowing sufficient scope for wrong reporting by dealers and thus the tax evasion. Under the existing system, Centre and States have been granting relief from payment of tax to promote investments. This leads to a lot of inefficiency in the taxation system. It is expected that in Centre as well as States will not grant such tax relief in the GST regime to make taxation system more efficient.

The benefits of GST can be summarised as under:-

For business and industry

- Easy compliance
- Removal of cascading
- Improved competitiveness

For Central and State Governments

- Simple and easy to administer

- Better controls on leakage
- Consolidation of tax base
- Higher revenue efficiency

For the consumer

- Single and Transparent tax proportionate to the value of goods and services
- Reduction of prices

GST, by its design, encourages the system to be transparent. There is an inbuilt system of Input Tax Credit *i.e*, the tax paid at earlier stage of the production distribution chain will be set off at the final stage of sale of goods and services. Also the rate arbitrage between the inter-state and intra-state supplies will get eliminated. This is because it is proposed to equalize the total rate of tax applicable to intra and inter-state supplies unlike the present regime where the CST rate is 2% while the normal VAT rate is either 5% or 12.5%. Thus it is expected that tax evasion would be largely reduced. The Centre and States today fix rate of tax and grant exemptions many times not in sync with each other. States also try to compete with each other to attract investment *etc*. and offer reduced rate of tax on select goods, which leads to tax rate war between States and ultimately hurts them. The affected State today has no forum to go to get its grievance redressed. The Bill proposes to set up GST council which after discussion will recommend rate of tax *etc.* to Centre as well as States. Centre and States will be expected to follow the recommendations of the GST Council and State and Centre will have a forum in the form of GST Dispute Settlement Authority for seeking redressal of grievances related to loss of revenue because of such deviating action of the other State which may have affected their revenue. This will bring transparency, accountability and efficiency in the tax administration and reduce the arbitrage opportunities available to tax avoidance and evasion.

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4

Overview of Current Taxes & Issues Connected

Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on intra-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas.

This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry. Firstly, there is no uniformity of tax rates and structure across States. Secondly, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice-versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this 'tax on tax'.

The principal broad-based consumption taxes that the GST would replace are the CENVAT and the Service Tax levied by the Centre and the VAT levied by the states. All these are multi-stage value-added taxes. The structure of these taxes today is much better than the system that prevailed a few years ago, which was described in the Bagchi Report as "archaic, irrational, and complex – according to knowledgeable experts, the most complex in the world". Over the past several years, significant progress has been made to improve their structure, broaden the base and rationalize the rates. Notable among the improvements made are:

- the replacement of the single-point state sales taxes by the VAT in all of the states and union territories,
- reduction in the Central Sales Tax rate to 2%, from 4%, as part of a complete phase out of the tax,

- the introduction of the Service Tax by the Centre, and a substantial expansion of its base over the years, and
- rationalization of the CENVAT rates by reducing their multiplicity and replacing many of the specific rates by *ad valorem* rates based on the maximum retail price (MRP) of the products.

These changes have yielded significant dividends in economic efficiency of the tax system, ease of compliance, and growth in revenues. The State VAT eliminated all of the complexities associated with the application of sales taxes at the first point of sale. The consensus reached among the States for uniformity in the VAT rates has brought an end to the harmful tax competition among them. It has also lessened the cascading of tax.

The application of CENVAT at fewer rates and the new system of CENVAT credits has likewise resulted in fewer classification disputes, reduced tax cascading, and greater neutrality of the tax. The introduction of the Service Tax has been a mixed blessing.

While it has broadened the tax base, its structure is complex. The tax is levied on specified services, classified into one hundred different categories. This approach has spawned many disputes about the scope of each category. Unlike goods, services are malleable, and can and are often packaged into composite bundles that include taxable as well as non-taxable elements. Also, there is no standardized nomenclature for services, such as the Harmonised system of Nomenclature (HSN) for goods.

The design of the CENVAT and state VATs was dictated by the constraints imposed by the Constitution, which allows neither the Centre nor the States to levy taxes on a comprehensive base of all goods and services and at all points in their supply chain. The Centre is constrained from levying the tax on goods beyond the point of manufacturing, and the States in extending the tax to services. This division of tax powers makes both the CENVAT and the state VATs partial in nature and contributes to their inefficiency and complexity. The principal deficiencies of the current system, which need to be the primary focus of the next level of reforms, are discussed below.

A. Taxation at Manufacturing Level

The CENVAT is levied on goods manufactured or produced in India. This gives rise to definitional issues as to what constitutes manufacturing, and valuation issues for determining the value on which the tax is to be levied. While these concepts have evolved through judicial rulings, it is recognized that limiting the tax to the point of manufacturing is a severe impediment to an efficient and neutral application of tax. Manufacturing itself forms a narrow base. Moreover, the effective burden of tax becomes dependent on the supply chain, *i.e.*, the taxable value at the point of manufacturing relative to the value added beyond this point.

It is for this reason that virtually all countries have abandoned this form of taxation and replaced it by multi-point taxation system extending to the retail level. Australia is the most recent example of an industrialized country replacing a tax at the manufacturing or wholesale level by the GST extending to the retail level. The previous tax was found to be unworkable, in spite of the high degree of sophistication in administration in Australia. It simply could not deal with the variety of supply chain arrangements in a satisfactory manner.

B. Exclusion of Services

The States are precluded from taxing services. This arrangement has posed difficulties in taxation of goods supplied as part of a composite works contract involving a supply of both goods and services, and under leasing contracts, which entail a transfer of the right to use goods without any transfer of their ownership. While these problems have been addressed by amending the Constitution to bring such transactions within the ambit of the State taxation (by deeming a tax on them to be a tax on the sale or purchase of goods), services *per se* remain outside the scope of state taxation powers. This limitation is unsatisfactory from two perspectives.

First, the advancements in information technology and digitization have blurred the distinction between goods and services. Under Indian jurisprudence, goods are defined to include intangibles, *e.g.,* copyright, and software, bringing them within the purview of state taxation. However, intangibles are often supplied under arrangements which have the appearance of a service contract. For example, software upgrades (which are goods) can be supplied as part of a contract for software repair and maintenance services. Software development contracts could take the character of contracts for manufacturing and sale of software goods or for rendering software development services, depending on the roles and responsibilities of the parties. The so-called 'value-added services (VAS) provided as part of telecommunication services include supplies (*e.g.,* wallpaper for mobile phones, ring tones, jokes, cricket scores and weather reports), some of which could be considered goods. An on- line subscription to newspapers could be viewed as a service, but online purchase and download of a magazine or a book could constitute a purchase of goods. This blurring also clouds the application of tax to transactions relating to tangible property. For example, disputes have arisen whether leasing of equipment without transfer of possession and control to the lessee would be taxable as a service or as a deemed sale of goods. The traditional distinctions between goods and services (and for other items such as land and property, entertainment, and luxuries) found in the Indian Constitution have become archaic. In markets today, goods, services, and other types of supplies are being packaged as composite bundles and offered for sale to consumers under a variety of supply-chain arrangements. Under the current division of taxation powers, neither the Centre nor the States can apply the tax to such bundles in a seamless manner. Each can tax only parts of the bundle, creating the possibility of gaps or overlaps in taxation.

The second major concern with the exclusion of services from the state taxation powers is its negative impact on the buoyancy of State tax revenues. With the growth in *per capita* incomes, services account for a growing fraction of the total consumer basket, which the states cannot tax. With no powers to levy tax on incomes or the fastest growing components of consumer expenditures, the States have to rely almost exclusively on compliance improvements or rate increases for any buoyancy in their own-source revenues. Alternatives to assigning the taxation of services to the states include assigning to the states a share of the central VAT (including the tax from services), as under the Australian model.

C. Tax Cascading

Tax cascading occurs under both Centre and State taxes. The most significant contributing factor to tax cascading is the partial coverage Central and State taxes. Oil and gas production and mining, agriculture, wholesale and retail trade, real estate construction, and range of services remain outside the ambit of the CENVAT and the service tax levied by the Centre. The exempt sectors are not allowed to claim any credit for the CENVAT or the service tax paid on their inputs.

Similarly, under the State VAT, no credits are allowed for the inputs of the exempt sectors, which include the entire service sector, real property sector, agriculture, oil and gas production and mining. Another major contributing factor to tax cascading is the Central Sales Tax (CST) on inter-state sales, collected by the origin state and for which no credit is allowed by any level of government.

While no recent estimates are available for the extent of tax cascading under the Indian tax system, it is likely to be significant, judging by the experience of other countries which had a similar tax structure. For example, under the Canadian manufacturers' sales tax, which was similar to the CENVAT, the non-creditable tax on business inputs and machinery and equipment accounted for approximately one-third of total revenues from the tax. The extent of cascading under the provincial retail sales taxes in Canada, which are similar to the State VAT, is estimated to be 35-40% of total revenue collections. *A priori*, one would expect the magnitude of cascading under the CENVAT, service tax, and the State VAT to be even higher, given the more restricted input credits and wider exemptions under these taxes. The Service Tax falls predominantly on business to business (B2B) services and is thus highly cascading in nature.

Tax cascading remains the most serious flaw of the current system. It increases the cost of production and puts Indian suppliers at a competitive disadvantage in the international markets. It creates a bias in favour of imports, which do not bear the hidden burden of taxes on production inputs. It also detracts from a neutral application of tax to competing products. Even if the statutory rate is uniform, the effective tax rate (which consists of the statutory rate on finished products and the implicit or hidden tax on production inputs) can vary from product to product depending on the magnitude of the hidden tax on inputs used in their production and distribution. The intended impact of government policy towards sectors or households may be negated by the indirect or hidden taxation in a cascading system of taxes.

D. Complexity

In spite of the improvements made in the tax design and administration over the past few years, the systems at both central and state levels remain complex. Their administration leaves a lot to be desired. They are subject to disputes and court challenges, and the process for resolution of disputes is slow and expensive. At the same time, the systems suffer from substantial compliance gaps, except in the highly organized sectors of the economy. There are several factors contributing to this unsatisfactory state of affairs.

The most significant cause of complexity is, of course, policy related and is due to the existence of exemptions and multiple rates, and the irrational structure of the levies. These deficiencies are the most glaring in the case of the CENVAT and the Service Tax.

The starting base for the CENVAT is narrow, and is being further eroded by a variety of area-specific, and conditional and unconditional exemptions. A few years ago the Government attempted to rationalize the CENVAT rates by reducing their multiplicity but has not adhered to this policy and has reintroduced concessions for several sectors/products.

The key problem with the service tax is the basic approach of levying it on specified services, each of which generates an extensive debate as to what is included in the base. Ideally, the tax base should be defined to include all services, with a limited list of exclusions (the so-called "negative list"). The Government has been reluctant to adopt this approach for the fear that it could bring into the tax net many services that are politically sensitive.

The complexities under the State VAT relate primarily to classification of goods to different tax rate schedules. Theoretically, one might expect that the lower tax rates would be applied to basic necessities that are consumed largely by the poor. This is not the case under the State VAT. The lowest rate of 1% applies to precious metals and jewellery, and related products—hardly likely to be ranked highly from the distributional perspective. The middle rate of 4% applies to selected basic necessities and also a range of industrial inputs and IT products. In fact, basic necessities fall into three categories –exempted from tax, taxable at 4%, and taxable at the standard rate of 12.5%. The classification would appear to be arbitrary, with no well accepted theoretical underpinning. Whatever the political merits of this approach, it is not conducive to lower compliance costs. Most retailers find it difficult to determine the tax rate applicable to a given item without referring to the legislative schedules. Consumers are even less aware of the tax applicable to various items. This gives rise to leakages and rent seeking. Another source of complexity under the State VAT is determining whether a particular transaction constitutes a sale of goods. This problem is most acute in the case of software products and intangibles such as the right to distribute/exhibit movies or time slots for broadcasting advertisements.

Compounding the structural or design deficiencies of each of the taxes is the poor or archaic infrastructure for their administration. Taxpayer services, which are a lynchpin of a successful self-assessment system, are virtually nonexistent or grossly inadequate underboth central and state administrations. Many of the administrative processes are still manual, not benefiting from the efficiencies of automation. All this not only increase the costs of compliance, but also undermines revenue collection.

The introduction of GST would mark a clear departure from the scheme of distribution of fiscal powers envisaged in the Constitution. The proposed dual GST envisages taxation of the same taxable event, *i.e.,* supply of goods and services, simultaneously by both the Centre and the States.

GST will simplify and harmonise the indirect tax regime in the country. It is expected to reduce cost of production and inflation in the economy, thereby making the Indian trade and industry more competitive, domestically as well as internationally. It is also expected that introduction of GST will foster a common or seamless Indian market and contribute significantly to the growth of the economy.

Further, GST will broaden the tax base, and result in better tax compliance due to a robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an in-built mechanism in the design of GST that would incentivize tax compliance by traders.

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The recommendations of the Rajya Sabha Select Committee on the GST Bill

The contours of GST are still evolving. Key aspects of GST like the tax rate, tax base, exemption limits, place of supply rules for services, appropriate IGST model etc. will be finalized on passage of the Bill. In this regard, the Empowered Committee of State Finance Ministers (EC) and the Department of Revenue, Government of India, have constituted several working groups and committees for drafting the GST Rules and processes as follows:-

(i) Committee on Dual Control, Threshold and Exemptions in GST Regime;

(ii) Committee on IGST and GST on imports;

(iii) Committee on Revenue Neutral rates for State GST & Central GST and Place of Supply Rules;

(iv) Committee to draft model GST Law;

(v) Committee to examine the Report of the sub-Group-I on Business Processes.

The salient features of the GST Bill as introduced in the Lok Sabha are as follows:-

(a) subsuming of various Central indirect taxes and levies such as Central Excise Duty, Additional Excise Duties, Excise Duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955, Service Tax, Additional Customs Duty commonly known as Countervailing Duty, Special Additional Duty of Customs, and Central Surcharges and Cesses so far as they relate to the supply of goods and services;

(b) subsuming of State Value Added Tax/Sales Tax, Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States), Octroi and Entry tax, Purchase Tax, Luxury tax, Taxes on lottery, betting and gambling; and State cesses and surcharges in so far as they relate to supply of goods and services;

(c) dispensing with the concept of 'declared goods of special importance' under the Constitution;

(d) levy of Integrated Goods and Services Tax on inter-State transactions of goods and services;

(e) levy of an additional tax on supply of goods, not exceeding one per cent. in the course of inter-State trade or commerce to be collected by the Government of India for a period of two years, and assigned to the States from where the supply originates;

(f) conferring concurrent power upon Parliament and the State Legislatures to make laws governing goods and services tax;

(g) coverage of all goods and services, except alcoholic liquor for human consumption, for the levy of goods and services tax. In case of petroleum and petroleum products, it has been provided that these goods shall not be subject to the levy of Goods and Services Tax till a date notified on the recommendation of the Goods and Services Tax Council.

(h) compensation to the States for loss of revenue arising on account of implementation of the Goods and Services Tax for a period which may extend to five years;

(i) creation of Goods and Services Tax Council to examine issues relating to goods and services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government. It is further provided that every decision of the Council shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting in accordance with the following principles :–

  (A) the vote of the Central Government shall have a weightage of one-third of the total votes cast, and

  (B) the votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast in that meeting.

Recommendations/Observations of the Select Committee of the Rajya Sabha at a Glance:-

Out of the 21 clauses in the GST Bill , 14 clauses, *i.e,* clauses 1 to 8, 10, 11, 15, 16, 20 and 21 have been adopted with no change. The recommendations/observations on other 7 clauses are as follows:-

Clause 9 – The Committee feels that since imposition of GST on the supplies of goods and services in the course of inter-State trade would not lead to cascading of taxes, the Clause may be adopted with no change.

Clause 12 – Sub-clause (1) of this clause seeks to provide for insertion of a new article 279A which empowers the President to constitute, by order, a Council to be called the Goods and

Service Tax Council consisting of the Members referred to in sub-clause (2). Sub clause (4) of the said clause seeks to provide that the Goods and Services tax Council shall make recommendations to the union and the States on the taxes, cesses and surcharges levied by the union, the States and the local bodies which may be subsumed in the goods and services tax; the goods and services that my be subjected to, or exempted from the goods and service tax; model goods and service tax laws, principles of levy, apportionment of integrated goods and service tax and the principles that govern the place of supply, the threshold limit of turnover *etc.*

After having deliberated on the issue of finances of local bodies, the Committee strongly feels that the revenues of local bodies need to be sustained and protected for ensuring that standards of local governance are maintained. The Committee, thus, strongly recommends that the State Governments take adequate measures to ensure that adequate revenues flow to the local bodies, and their resources are not adversely affected. The Committee noted that Article 243H and 243X contain provisions for State Legislatures to authorize Panchayats and Municipalities to collect and appropriate taxes in the State list. The Committee further noted that Article 243I and 243Y provide for setting up of State Finance Commissions to make recommendations regarding devolution of funds to local bodies. The Committee noted that the above provisions notwithstanding, local bodies find managing their resource requirements quite challenging. In light of above, with respect to Article 279A (4(e)), the Committee strongly recommends that the word 'band' used in the proposed Article may be defined in GST laws. The Committee recommends the following definition of 'band':

"Band": Range of GST rates over the floor rate within which Central Goods and Service Tax (CGST) or State Goods and Services Tax (SGST) may be levied on any specified goods or services or any specified class of goods or services by the Central or a particular State Government as the case may be.

With respect to Article 279A(5), taking note of the provision that inclusion of petroleum products into GST can take place only on recommendation of GST Council which could happen only with the consent of both the Centre and the States, the Committee recommended that the clause be adopted with no change.

The Committee is aware that while discharging the functions conferred by this article, the Goods and Services Tax Council shall be guided by the need for a harmonised structure of goods and services tax and for the development of a harmonised national market for goods and services.

In view of the clarifications submitted by the Department of Revenue and Legislative Department, the Committee finds no merit in disturbing the voting pattern proposed in the Bill, as the same has been worked out on a formula where no one is at an disadvantageous or dominating position be it Centre or States. Moreover, under clause 2, Parliament and the Legislature of every State shall have power to make laws with respect to GST simultaneously.

In the GST Council, all the decisions have to be taken collectively by the Centre and States and in order to take decision on any issue 75% votes are necessary. So, in order to strike a fine balance Centre vote share has been kept at 1/3rd and that of the States at 2/3rd. In that backdrop, the Committee recommends that these amendments may not be necessary since our Constitution is a federal Constitution and so, it is necessary to make the provisions providing for a manner that disallow the dominance of one over the other. Keeping this in view, the voting formula has been worked out. Hence, the clause may be adopted with no change. The Committee, having noted the point mentioned by the Department of Revenue that the GST Council shall decide only the 'modalities' to resolve disputes, did not agree to recommend inclusion of Article 279B as was proposed in Constitution(115th Amendment) Bill, 2011.

Clause 13 – This clause seeks to amend clauses (1) and (2) of article 286 of the Constitution. The recommendation made was that the term 'supply' would be defined in the various GST laws relating to CGST and SGST. Hence, it would not be appropriate to insert the definition of supply in this clause. This clause has been adopted with no change.

Clause 14 – The clause seeks to insert a new definition clause (12A) in article 366 of the Constitution to define the words "goods and services tax". It also seeks to insert two clauses (26A) and (26B) to define the words "Services" and "State", respectively.

Endorsing the view of the Department, the Committee feels that 'services' has been so defined in order to give it wide amplitude so that all supplies that are not goods can potentially be covered within the ambit of services and no activity remains outside the taxable net. This would also minimize disputes. Further, having noted the points mentioned by the Department of Revenue regarding inclusion of petroleum products under GST, the clause may be adopted with no change.

Clause 17 – This clause seeks to amend the Seventh Schedule of the Constitution. Regarding the aforesaid Entry, the Committee is of the view that Entry 92C was inserted by the Constitution (Eighty-Eighth Amendment) Act, 2003 to empower the Union to impose service tax on certain services read with article 268A of the Constitution. Notwithstanding, the service tax levied under the Finance Act, 1994 were continuing as such. The amendment was carried out in the Constitution but the provision was never brought into force. Since Parliament has enacted the said constitutional provision and as such the provision stands as the part of Constitution; and therefore, unless it is omitted by a Constitution Amendment Act by Parliament, it will continue to sit in the Constitution. On the need for formal repeal, the Law Commission, in its One Hundred and Forty-eighth Report on "Repeal of Certain Pre-1947 Central Acts", has observed that "the statues, unlike human beings, do not die a natural death, with the possible exception of statute whose life is pre-determined by the Legislature at the time of their enactment. A statute, unless it is expressly enacted for a temporary period, survives until it is killed by repeal. To this extent, statutes enjoy immortality." Therefore, it is necessary to omit the said provision to ward of any future doubts about GST. The Committee is of the view that the entry in the list II- State List empowers the State Government to make laws in respect of the subjects mentioned therein.

The Committee is also of the considered view that taxes on electricity and water have been treated separately from taxes on other goods and services in the Constitution. Entry 53 of the List II (State List) deals with taxes on sale or consumption of electricity, and this entry is not being touched by the Constitution (122nd Amendment) Bill, 2014. The Committee also noted the rationale for the provisions relating to alcohol for human consumption and tobacco as provided by the Department of Revenue. Hence, the clause may be adopted with no change.

Clause 18 – The clause deals with taxation in course of inter-state trade or commerce. The Committee feels that the provision of 1% additional tax in its present form is likely to lead to cascading of taxes. Therefore, the Committee strongly recommends that in the concerned GST law, an explanation should be given that for the purpose of Clause 18, the word 'supply' would mean: Supply: "All forms of supply made for a consideration".

Clause 19 –This clause provides for compensation to the States for loss of revenue arising on account of implementation of the goods and service tax for such period which may extend to five years. In view of the clarifications given by the Legislative Department, the Committee feels that there is no justification for substitution of the word 'may' with 'shall'. Having regard to the concerns expressed by the various States and some of the Members of the Committee in their submissions made before the Select Committee, the Committee recommends amendment in clause 19. The amended clause 19 should read as follows:

> "19. Parliament may, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for the loss of revenue arising on account of implementation of the Goods and Services Tax for a period of five years."

The Committee feels that the concerns expressed by all the Members of the Committee related to local bodies and Municipalities are not unwarranted. Based on the years of experience and being witnessed to their work in their respective constituencies they were of the view that their interest needs to be protected. The same view was also endorsed by nearly all the stakeholders who have either submitted their memorandum or appeared before the Committee on the Bill. But, at the same time we may not forget that the Constitution of India clearly defines the ambit under which the Centre and each of the State has to function. Any encroachment into the State List would disturb the whole system and could strain the Centre-State relations.

The Committee feels that although the issues raised by the Members to protect and preserve the interest of local bodies are valid, it would not be appropriate for the Committee to advise, recommend and guide the State Governments what they have to do with regard to the interests of the local bodies. As per the provisions of the Bill, while the Parliament would pass law relating to CGST, every State Government has to pass a similar law relating to SGST. Hence, while drafting the SGST, the role of the drafters and the concerned State Governments becomes all the more important as they have a duty to protect the revenue sources of the Panchayats, Municipalities, *etc.*, enshrined under Constitution of India. The Committee also feels that here the role of the GST Council is also very important, because while recommending to the Centre and State Governments for subsuming of the taxes, cesses and surcharges levied by the Union, the States and the local bodies in the goods and services tax under Article 279(4)(a), it may also ensure protection of revenue sources of local bodies under provisions of Article 279(4)(c) and (h). In the light of the above, the Committee feels that in a cooperative federalism, each unit of it interacts cooperatively and collectively resolves their problems by taking appropriate action at their end. On the same analogy, Government at the helm of the affairs is duty bound both morally and constitutionally to protect the interest of local bodies by giving them suitable space of functioning and power to levy and generate taxes for their day today functioning. Having full faith in our Constitution from where each tier of the Government draws its powers, the Committee believes that all the State Governments would enact laws on the basis of Model GST Laws recommended by the GST Council and while making such laws States would abide by the constitutional provisions relating to Panchayats and Municipalities. Concerned about the very existence and survival of local bodies, the Committee feels that Local government is a State subject figuring as item 5 in List II of the Seventh Schedule to the Constitution. Article 243G of the Indian Constitution enshrines the basic principle for devolution of power to the local bodies. In the nation's journey towards becoming an economic power, local bodies play an important part in enabling infrastructure availability to the citizens. Local bodies are institutions of the local self governance, which look after the administration of an area or small community such as villages, towns, or cities. The local bodies in India are broadly classified into two categories. The local bodies constituted for local planning, development and administration in the rural areas are referred as Rural Local Bodies (Panchayats) and the local bodies, which are constituted for local planning, development and administration in the urban areas are referred as Urban Local Bodies (Municipalities) and the Constitution of India gives protection to them through various articles, so while drafting the SGST laws due consideration should also be given to this fact. In that backdrop, the Committee strongly recommends that while drafting the SGST laws due consideration to the third tier of the Government as has been guaranteed by the Constitution be given and provisions of devolution of taxes to the local bodies be made.

The Committee is perturbed to know that State Finance Commissions (SFC) in some of the States are either non-existent or even when exist their recommendations were not accepted by the respective State Governments. The Committee understands that each tier of the Government draws it powers through the Constitution and there is a clear demarcation of fields through List I, II and III within which each tier has to function. Any encroachment by any of them would paralyze the whole system and defeat the very foundation of our Constitution. Hence, the Committee while not venturing into the domain of the State List desires that for the betterment of our States in general and country in particular it would be prudent to abide by the recommendations of the SFCs.

Endorsing the view envisaged by Fourteen Finance Commission, the Committee feels it would be wise to keep the GST Compensation Fund out of the purview of the Bill as has been done in the present case, because it is a temporary component and that too only for five years.

The Committee feels that each and every State is being represented in the GST Council by their Revenue/Finance/Taxation Minister. Be it a small State or a big State, in the GST Council, all of them enjoy equal status and power to cast one vote. In the event of difference, it can very well be presumed that the GST Council will try to evolve consensus on contentious issues before going for casting of votes, as all the States are members of the Council. Thus, modality to resolve any differences internally lies with the Council. If any Dispute Settlement Authority is created separately it will certainly hamper the functioning of the GST Council in general and Legislatures (Parliament and States) in particular. Thus, it would be judicious not to have a separate and distinct authority having far reaching powers and which could preempt and supersede the powers of Parliament and State Legislatures in the long run. The Committee also feels that when concept of Empowered Committee (EC) was coined for the first time, it may not have been presumed how it would function, whether it would serve the purpose for which it would be created, how States would be represented/heard, how issues would be taken up and resolved, *etc.* But experience has shown that the faith with which the concept of EC was coined has actually delivered. Empowered Committee headed by one among the State Finance/ Revenue Ministers of all States deliberate meticulously on each of the issues raised by its Members and with the passage of time it had taken the shape of arbitration centre where disputes related to them or between two or many States are raised, deliberated and settled amicably without any arbitration charges or fees borne by the disputant States. It would not be over exaggeration of facts if the Committee would say that on the one hand EC had worked as a forum where any issue of State importance could be raised and on the other hand it had gained the confidence of States in solving their problems and allaying their fears. Such confidence building measure had been initiated by the EC that it could well be termed as a forum where disputes are settled broadly with consensus.

The Committee feels that it would be too early to presume as to whether the price levels will go down or up in the post GST era. What has to be seen and watched by the Government with eyes open is whether the benefit, if any, arises would certainly be passed on to the consumers or not. Hence, the Committee feels that at the most if price stability is achieved it would serve the very purpose of GST in the entire country as inflation, nowadays has not left even a single field untouched.

The Committee feels GSTN shall play a crucial role in implementation of GST as it shall provide the IT infrastructure for implementation of GST. It noted that Non Government shareholding of GSTN is dominated by private banks. This is not desirable because of two reasons . Firstly, public sector banks have more than 70% share in total credit lending in the country. Secondly, GSTN's work is of strategic importance to the country and the firm would be a repository of a lot of sensitive data on business entities across the country. In light of above, the Committee strongly recommends that Government may take immediate steps to ensure Non Government financial institution shareholding be limited to public sector banks or public sector financial institutions. Endorsing the views of the SBI, the Committee having same feeling as the bank recommends that the best practices followed internationally may be followed and if possible banking services may be kept outside GST. Furthermore, if this is not possible then, interest, trading in securities and foreign currency and services to retail customers should not be liable to GST and suitable provision should be there to avail of CenVAT credit of input services taken to provide activities involved in such services. Further, single registration coupled with IGST provision should be made available to enable CenVAT credit for consumers of banking services. The Committee is of the considered opinion that if the GST rate is more than the service tax rate of 14%, the increase in the tax rate will further increase the cost of banking services. This results into cost of doing business to be much higher in India as compared to other competing countries. Therefore, the Committee recommends that to be internationally competitive, the GST rate for banking industry should be minimum.

The Committee feels that although the GST Council has been entrusted with the task of fixing the rate including floor rates with bands in mutual consent with other State Governments who are part and parcel of the Council. But implementation of GST in other countries has shown GST rate is a very important factor in earning the trust of the consumers. If the GST rate is kept high, it will surely erode the confidence of the consumers badly and may lead to high inflation. Therefore, the Committee is of the considered view that while fixing the rate, the GST Council may opt for a broad base and moderate rate as it is an essential feature of a good tax system and as far as possible multiplicity of tax rates may be avoided. Non-Interference in the State Governments powers stated in Concurrent List.

In that backdrop, the Committee recommends that all out effort should be made to improve upon the IT preparedness of the States, so that the apprehensions related to its level of preparedness may gets addressed. For its smooth implementation, the Committee immediately recommends implementation of comprehensive training programmes at all levels to allay the fears of consumers, stakeholders, organisations, etc. A message should go loud and clear to all that we as a country are ready to adopt tax reform of unparallel nature. The Committee also recommends that for having no discernible blemishes in the implementation of GST, it is imperative that not only IT preparedness is at very high level but also prerequisites like IT infrastructure, unified tax credit clearing mechanism, etc may be put in place for its implementation.

Having heard the views of the main stakeholders *i.e.,* State Governments/UTs, the Committee feels that States are like the arteries of the India and if the arteries find themselves choked the whole body will fall. Hence, for the sake of our survival, what needs to be done is to protect and preserve our arteries. Based on that analogy, the Committee feels that although the apprehensions brought to the notice of the Committee are not unwarranted but due care have been taken constitutionally to overcome any constraints come in their way. All these initiatives ushered by the Government of India having been evolved and brought in the form of current Bill are based on the views expressed in the Empowered Committee meetings. To allay the fear of all State

Governments in general and manufacturing states in particular, safeguards like 1% additional tax on supply of goods, compensation to States/UTs for losses in the revenue, States have been given the voting weightage of 2/3rd, decision in GST Council to be arrived at by the majority of not less than 3/4th, etc. on the recommendation of the GST Council have been provided. More so, all this has been done constitutionally so that there may not be any doubt in the minds of the States/UTs.

Therefore, the Committee feels due consideration has been given by the Government of India to the aforesaid apprehensions raised by the States/UTs while coming forward with this comprehensive Constitutional Amendment Bill. The Committee feels that apprehensions cast over the introduction of goods and services taxes are early hiccups and with its introduction, the States/UTs would realise that they have many more options available to them to generate and augment their revenue source. Survival of the Union is on the States, the Committee close by saying that would the body (Centre) survive if arteries get choked, so vibrancy of the States comes first for the survival of the Centre.

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Importance of GST to the economy

A National Council of Applied Economic Research (NCAER) study, commissioned by the Thirteenth Finance Commission has stated that Implementation of a comprehensive GST across goods and services is expected, *ceteris paribus*, to provide gains to India's GDP somewhere within a range of 0.9 to 1.7 per cent. The corresponding change in absolute values of GDP over 2008-09 is expected to be between Rs. 42,789 crore and Rs. 83,899 crore, respectively. The comparable dollar value increment is estimated to be between $ 18, 550 million, respectively. The additional gain in GDP, originating from the GST reform, would be earned during all years in future over and above the growth in GDP which would have been achieved otherwise. The present value of the GST-reform induced gains in GDP may be computed as the present value of additional income stream based on some discount rate. Assuming a discount rate as the long-term real rate of interest at about 3 per cent, the present value of total gain in GDP has been computed as between Rs 1,469 thousand crores and 2,881 thousand crores. The corresponding dollar values are $325 billion and $637 billion.

Gains in exports are expected to vary between 3.2 and 6.3 per cent with corresponding absolute value range as Rs. 24,669 crore and Rs. 48,661 crore. The comparable dollar value increment is estimated to be between $5,427 million and $10,704 million, respectively. Imports are expected to gain somewhere between 2.4 and 4.7 per cent with corresponding absolute values ranging between Rs. 31,173 crore and Rs. 61,501 crore. The comparable dollar value increment is estimated to be between $6,871 million and $13,556 million, respectively. GST would lead to efficient allocation of factors of production. The overall price level would go down. It is expected that the real returns to the factors of production would go up. Our results show gains in real returns to land ranging between 0.42 and 0.82 per cent. Wage rate gains vary between 0.68 and 1.33 per cent. The real returns to capital would gain somewhere between 0.37 and 0.74 per cent. Based on certain computations, the revenue neutral GST rate across goods and services is expected to be positioned somewhere in the range of 6.2 per cent and 9.4 per cent, depending on various scenarios of sectoral exemptions.

In sum, implementation of a comprehensive GST in India is expected to lead to efficient allocation of factors of production thus leading to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, *viz.* land, labour and capital.

When asked as to how GST would help fiscal consolidation, Dr. Vijay L. Kelkar, Ex-Chairman, Thirteenth Finance Commission in his post-evidence replies stated as under :

"The changeover to GST is designed to be revenue neutral at existing levels of compliance. Given the design of the flawless' GST, the producers and distributors will only be pass through for the GST. Further, given the single and low rate of tax the benefit from evasion will significantly reduce. Therefore, there will be little incentive for the producers and distributors to evade their turnover. Accordingly, this policy initiative should witness a higher compliance and an upsurge in revenue collections. This will also have an indirect positive impact on direct tax collections. Further, given the fact that GST will trigger an increase in the GDP, this in turn would yield higher revenues even at existing levels of compliance. Another important source of gain for the Government would be the savings on account of reduction in the price levels of a large number of goods and services consumed by the Government.

However, to the extent, the Central Government will be required to incentivise the States to adopt the GST, there will be an increase in the budgetary outgo. Given the smallness of the size of the compensation, it is expected that there would be a net gain in the tax revenues. This should enable the Central Government to better manage its finances.

As regards the State Governments, the design and the road map of the GST recommended by us would lead to substantial gain in revenues. While the revenue neutral rate for the States is estimated to be 6 percent, we have recommended that the states should be allowed to impose GST at the rate of 7 percent. An increase in the RNR of the States by 1 percent implies a revenue gain of Rs. 31381 crores per annum in the base year 2007-08 (i.e., 16.67 percent increase in the revenues). This gain will be further augmented by better compliance.

Therefore, overall the implementation of GST should enable the Government at both levels to better meet the challenges of fiscal correction.

GST will positively impact the common man in many ways. **Firstly,** it will add to the overall economic growth by removing economic distortions. It will create new employment opportunities (about 20 million high end jobs over a period of time) thereby increasing the levels of income across a large section of the society. **Secondly**, it will reduce inflation if GST is levied at the combined rate of 12 percent as recommended by the Thirteenth Finance Commission. **Thirdly**, it will decentralize production to areas enjoying comparative advantage so more jobs can be expected to be created in rural areas. This will in turn slow down the pace of migration to urban areas. **Fourthly**, it will improve governance since the introduction of a comprehensive GST will bring about more transparency and an end to crony capitalism. **Finally**, GST can create further opportunities for relief under direct taxes over time since it is viewed as a revenue generating machine. Alternately, it will facilitate fiscal consolidation thereby reducing the debt burden of citizens in general".

However, the representatives of Gujarat and Madhya Pradesh Government disagreed with the assessment of Dr. Vijay L. Kelkar and submitted as under :

(*i*) ***Views of Government of Gujarat* :** The most critical aspect of the proposed Amendment and introduction of GST in the country related to the expected revenue losses to the states. While the loss of revenue is expected due to removal of cascading effect, unacceptable revenue losses would arise mainly on account of the inability to achieve Revenue neutral rates, the loss of CST revenues and the sub-optimal collections from services sector. The Task Force on GST of Thirteenth Finance Commission (TFC has worked out a Revenue-Neutral Rate (RNR) of 12% (5% CGST and 7% SGST) assuming there is a single GST rate and stamp duty and electricity duty are also subsumed in the GST. It is not clear whether services and goods will have the same rate or be subjected to tax at different rates. The proposed RNR by the NIPFP does not match the rates suggested by Thirteenth Finance Commission. Our calculations show that RNR will be as high as 19.68%. Such high rates cannot be levied on all goods and services and therefore revenue losses will certainly occur. The anticipated revenue losses to the State of Gujarat would be around Rs. 9,000 crore.

(*ii*) ***Views of Government of Madhya Pradesh*** **:** Fiscal health of States is likely to be deteriorate because of the substantial tax revenue loss, they will not be able to mobilize additional resources for development as they cannot change the rates structure of the most important tax instrument available to them and they cannot raise additional resources through borrowing as their borrowing limit is determined by the Centre and has been fixed at 3% of GSDP. Backward States generally have poor fiscal health and are more dependent on Central Devolution and Grants. The share of taxable services in the consumption basket of the poor is always smaller as compared to the better off sections off the society. Therefore, the additional revenue accruing to backward States from ¯final consumption of services in GST will be meager to compensate the loss of tax revenue from taxation of primary commodities only on the Destination Principle. When asked as to how GST will affect the fiscal health of the states Shri Sushil Kumar Modi, Chairman, Empowered Committee of State Finance Ministers in his post-evidence reply has stated as under :

(*a*) With the introduction of GST, the cascading effects of CENVAT and service tax would be removed with a continuous chain of set-off from the producer's point to the retailer's point, major Central and State taxes would be subsumed in GST and CST will also be phased out, the final net burden of tax on goods, under GST would in general fall. Since there would be a transparent and complete chain of set-offs, this will help widening the coverage of tax base and improve tax compliance. This may lead to higher generation of revenues which may in turn lead to the possibility of lowering of average tax burden on the stakeholders. Hence, implementation of GST will provide a better environment for growth and possibly may result in the increase of the GDP. Therefore, in long run implementation of GST is not likely to affect the fiscal health of the States. On the contrary, it may improve the generation of the revenue of the States. However, in the initial few years of the implementation of GST, because of subsumation of several State Taxes, removal of the cascading affect, provision of additional set-offs may result in some State specific losses and, therefore, there may be a need for provision of GST compensation to such States in the initial few years.

(*b*) *Prices* : When asked as to how GST will impact prices, Dr. Vijay L. Kelkar, Ex-Chairman, Thirteenth Finance Commission in his post-evidence reply stated as under : ¯Prices of agricultural commodities and services are expected to rise. Most of the manufactured goods would be available at relatively low prices especially textiles and readymade garments. There are two opposing forces which determine the changes in price levels. First, increased payments to the primary factors of production, *viz.* land, labour and capital, increase the cost of production and hence tend to have upward pull on prices. Second, sectors under imperfect competition (manufacturing sectors) get benefits of cost reduction through increasing returns to scale which are not reaped by sectors assumed to be in perfect competition. The relative impact of the force determines the overall price change. It may also be noted that the share of primary inputs (land, labour and capital) in total output is relatively high in agricultural and services sectors. Another factor that impacts the price levels refers to the quantum of intermediate input purchases from sectors under perfect competition versus imperfect competition. Relatively low proportions of intermediate inputs purchased by agriculture and service sectors *(i.e.,* sectors under perfect competition) are sourced from manufacturing sectors and hence these sectors do not reap the benefit of relatively low cost inputs from manufacturing sectors. Therefore, fall in prices of manufactured goods should benefit agriculture and services sectors. Further, the terms of trade can also be expected to improve in favour of agriculture *vis-a-vis* manufactured goods. The prices of agricultural goods would increase between 0.61 percent and 1.18 percent whereas the overall prices of all manufacturing sector would decline between 1.22 percent and 2.53 percent. Consequently, the terms of trade will move in favour of agriculture between 1.9 percent and 3.8 percent. The increase in agricultural prices would benefit millions of farmers in India. Similarly, the urban poor will also benefit from new employment opportunities. With regard to the food crops the poor would continue to remain secured through the public distribution system. The prices of many other consumer goods are expected to decline. These include sugar; beverages; cotton textiles; wool, silk and synthetic fibre textiles; and textile products and wearing apparel.

Further, moving forward, the combined lower rate of Union Excise Duty (UED) and State level VAT on inputs and goods consumed by vulnerable section of the society is already 11 percent which will be marginally increased to 12 percent when GST is introduced. Similarly, the present rate of Service Tax of 12 percent is already aligned to the 12 percent combined GST rate recommended by the

Thirteenth Finance Commission. However, the combined standard rate of 25.5 percent under the UED and State-VAT is substantially higher than the 12 percent. With the introduction of GST the 25.5 percent will have to be reduced to 12 percent which will have a strong downward effect on inflation. In addition, the service tax coverage has also been extended to all services except a negative list. Therefore, overall inflationary impact of GST will be negative through lower prices, lower fiscal deficit and higher output .

(*c*) *Consumer prices – international experiences* : In a note submitted to the Committee, the Government of Madhya Pradesh has cited some studies illustrating adverse impact of GST upon consumer prices which has been reproduced as below : (a) The empirical data relating to the consumer price changes in Australia, Canada and New Zealand is given by (Bolton & Dollery, 2004). On the issue of the effect of GST on consumer price inflation Tom Bolton and Brian Dollery have drawn the following conclusion from the empirical data : ¯It seems useful to frame the comparison of the macroeconomic inflationary effect in terms of Alston's (1996) case study methodology. At the time of New Zealand's GST introduction all three countries had roughly 4% to 6% annual consumer price inflation rates. In the year following the introduction of the GST in Canada, the average of the three countries had dropped to between 1% and 2%. The average was still low in the year before the introduction of the GST in Australia. Accordingly, the observed spike in price levels that occurred in all three countries should not be compared directly inter temporally with regards to economic performance since almost all the other factors impinging on the rate of inflation were different. However, while all three countries did exhibit a spike in price level, there was nonetheless no indication of subsequent wage-price spirals. (b) Ruggeri and Wart have examined the effects of GST in Canada. They have come to the following conclusion : ¯The GST has contributed substantially to higher inflation and has seriously weakened the Canadian economy in 1991. Statistics Canada has estimated that the GST is responsible for most of the first-quarter 1991 increase in the consumer price index (CPI) of 1.5 percent and has contributed to a decline of 1.2 percent in real GDP (which is equivalent to an annual compound decline of 4.6 percent). The CPI jumped by 2.6 percent from December 1990 to January 1991, with 1.6 percentage points of that rise attributed by Statistics Canada to the GST. The introduction of the GST has added to the inflation rate, first because it entails a tax rise of about $1.5 billion over what the MST would have yielded in 1991, 7 and, second, because not all the savings from the elimination of the MST were passed forward immediately. In the medium term, the effect of the initial price shock depends upon the degree of competition on affected industries, the price sensitivity of demands for affected good, the state of labour relations, and aggregate demand.

The inflationary pressure generated by this rise in consumption taxation has restricted the ability of the Bank of Canada to soften the impact of the current recession through lower interest rates, and as a result it has taken a prolonged and deep economic slide to bring interest rates down to the levels experienced before 1989. (c) Tom Bolton and Brian Dollery have drawn the following conclusions regarding the effect on GDP of New Zealand, Canada and Australia. It is immediately apparent that the economic impacts of the GST package were quite varied across countries, suggesting no common denominator. For example, the dramatic jump in GDP in 1987 in New Zealand can hardly be attributed to GDP growth since both Australia and Canada experienced a simultaneous boom period. For the same reason, the Canadian recession could not have been induced by the introduction of the GST because it formed part of the (then) global recession. The Ministry of Finance in their post-evidence reply *inter-alia* stated that however, in most of the countries it has been a success though each one of them has been carrying out changes post rollout. In Europe, New Zealand, South Africa, Canada, Australia etc. the effects of GST/VAT have been encouraging and have led to buoyancy in collections and moderation of rates.

(d) *Producing States and Consuming States :* Some States like Gujarat and Madhya Pradesh in their memoranda have stated that public investments in infrastructure are a critical factor in inducing and sustaining economic growth. Infrastructure such as roads, power and water supply do not only promote industrial growth, but also agricultural development, services sector, and enhanced quality of life. GST is proposed as a destination based tax, with tax revenues moving to the consuming states. The states which consume the most shall be the importing states and the states like Gujarat which are having a large manufacturing base, will be one of the net exporting states. This will lead to a situation where the net exporting states which have made heavy investments in infrastructure and industrial promotion measures will lose their tax revenues to the net consuming states as the tax will be destination based and the CST would be done away with. There will not be incentive to the net exporting states to invest further in industrial infrastructure. It may be appreciated that this is likely to lead to de-acceleration in public investments in infrastructure, across the states. On the other hand, net exporting states that have already invested heavily in such infrastructure, would be hard pressed to recover the investment from tax revenues. It is required to be examined, whether this is a healthy condition to create. The Ministry of Finance in their post-evidence reply stated that there is no scientific data yet available to gauge the impact of the proposed GST on the producing States *viz-a-viz* consuming States. However, under GST the states which are net importers of goods and services will gain while the states which

are net exporters (manufacturing states) may lose on account of destination based IGST. However, this is in consonance with the basic philosophy of the GST that the burden of taxes should not be imposed on non-residents of a State.

(*e*) *MSMEs and Employment Generation* : The Government of Gujarat in their memorandum submitted to the Committee has stated that at present threshold under Central Excise is Rs. 1.5 crore. The proposed threshold limit of Rs. 10 lakhs under CGST would bring many of the Micro Small and Medium Enterprises (MSMEs) under the central tax net. This is likely to adversely affect the employment generating units under MSME sector. Some of the units may become financially unviable and lose competitiveness due to additional burden of tax, cost of compliance and dual control. Around 30,000 MSME s will be affected in Gujarat alone and this contributes to employment of 2.18 lakh families. The importance of the MSME sector in the economic arena cannot be under-estimated. Not only is the direct employment generated per unit of capital deployed generally much higher, but the MSME also provide ancillary and support services to large industries, in a cost-efficient manner. The spirit of innovation and enterprise thrives in the MSME sector. The contribution of MSMEs in export competitiveness of the country is considerable. These aspects are likely to be adversely affected, by bringing in the MSME into the central tax net. When asked to comment upon the impact of GST on MSMEs, Dr. Vijay L. Kelkar in his post-evidence reply stated as under : ¯At present small scale industries are entitled to exemption from payment of CENVAT in respect of their turnover upto Rs 1.5 crores. However, there is no such threshold exemption in respect of state level VAT. The main reason for exemption from payment of CENVAT is to liberate them from the onerous compliance burden under the CENVAT regime particularly in the context that, in general, the small scale industries are managed by one or two entrepreneurs with the support of a handful of semi-skilled office staff. In the context of the GST, it has been recommended that the reporting of payment and transaction information of both CGST and SGST should be allowed through a combined Form. Therefore, in any case the small scale industry has to comply with the reporting of payment and transaction information of SGST. No additional burden is cast upon the small scale industry for compliance with the CGST. Hence, the case for continuing with the existing exemption upto Rs 1.5 crores of turnover is extremely weak. Accordingly, it is recommended that this exemption should not be continued under the GST framework. Further, the small scale industries are generally wary of dealing with multiple tax administrations. Therefore, in order to inspire confidence of the small scale industry in the new GST framework, it is also recommend that the scrutiny/audit of the small scale industry should be conducted only by the state tax administration. However, the State tax administration may seek the assistance of the central tax

> administration or any other state tax administration if the operations of the small scale industry transcend the state boundaries. Since the CGST and the SGST are proposed to be levied on an identical GST tax base, the outcome of any investigation impacting SGST will also have a corresponding impact on CGST. Therefore, enforcement by the State tax administration would be adequate to even deal with CGST evasion. Further, it must be noted that the combined GST rate of 12 percent recommended by the Thirteenth Finance Commission will be less than the 13.5 percent liability under State VAT and the burden of embedded input tax under Union Excise duty and Service Tax. Therefore, withdrawal of exemption will not be onerous for the MSME sector. In fact the liability will substantially reduce .

There are seven important macroeconomic channels through which the 'flawless' GST minimises the distortions. **First**, the failure to tax all goods and services distorts consumption decisions; it weakens the signalling power of relative prices. GST will reduce these distortions and enable all economic agents to respond more effectively to price signals. This will improve the allocative efficiency of the tax system. **Second**, the failure to exempt all sales to business distorts decisions regarding choice of production methods, particularly decisions on vertical and horizontal integration and what inputs to produce or sell. Since the GST will be a tax on consumption, all stages of production and distribution will be mere pass-through. Therefore, there will be no tax incentive for vertical and horizontal integration. **Third**, the taxation of capital goods discourages savings and investment and retards productivity growth. The 'flawless' GST envisages full and immediate credit for GST on capital goods (both buildings and plant and machinery), thereby fully eliminating the incidence of any indirect tax on the capital goods. This enhances the productivity of capital and hence reduces the incremental capital-output ratio (ICOR). This is perhaps the most important gain through the introduction of the GST in India. **Fourth**, for a given constellation of exchange rates and price levels, violation of the destination principle places local producers at a competitive disadvantage, relative to producers in other jurisdictions. The GST envisages comprehensive taxation of imports on consideration of consumption in India and irrespective of whether the imported goods and services are produced in India or not, thereby, providing a level playing field to domestic producers particularly in the import-substitution industry. **Fifth**, differences in the tax structure of different States and the Central Government greatly increase the cost of doing business. The proposed GST, though dual in nature, envisages a uniform structure, design and compliance system at all levels of Government and across States. Therefore, the cost of doing business in India will significantly reduce. The GST based tax reform provides a real policy opportunity to deal with this problem without waiting for prior and sweeping political economy changes. **Sixth**, GST, once introduced, will create a common market across the length and breadth of the country- something which has eluded us since long. The size of the market will cease to be limited by tax considerations. Further, it will restore the comparative advantage of resource rich states and enable them to emerge as production hubs. **Seventh**, at present, the combined statutory rate of VAT is close to 22 per cent. Further, this marginal rate is applied to a very narrow base on account of a plethora of exemptions. Since economic decisions and compliance behaviour are based on the marginal rate, the higher the rate the greater the distortion and evasion. This is further compounded by distortion in resource allocation on account of a plethora of exemptions. Since we have recommended a substantially lower, uniform, and combined single rate of 12 percent on all goods and services, the economic distortion and the incentive to evade will be considerably reduced. We can also expect an upsurge in compliance and hence, revenue collections. This in turn will improve fiscal management and reduce the 'crowding-out' effect.

The overall macroeconomic effect of reduction in economic distortions due to GST would be to provide an impetus to economic growth. Using CGE Model, the NCAER study commissioned by the Thirteenth Finance Commission estimates the impact of the introduction of a GST which would eliminate all taxes on production and distribution and rest on final consumption only. The study is based on two important assumptions of full employment and that 50 percent of indirect taxes remain embedded and 'stick' on production and distribution. The study concludes that 'implementation of a comprehensive GST in India will lead to efficient allocation of factors of production thus leading to gain in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, i.e. land, labour and capital. The gains in real returns to land range between 0.42 and 0.82 per cent. Wage rate gains vary between 0.68 and 1.33 per cent. The real returns to capital would gain in the range of 0.37 and 0.74 percent.'.

Further, the study also shows that 'implementation of GST across goods and services is expected, *ceteris paribus*, to provide gains to India's GDP somewhere within a range of 0.9 to 1.7 per cent. The corresponding change in absolute values of GDP over 2008-09 is expected to be between Rs. 42,789 crore and Rs. 83,899 crore, respectively.

These additional gains in GDP, originating from the GST reform, would be earned during all years in future over and above the growth in GDP which would have been achieved otherwise. The present value of the GST-reform induced gains in GDP may be computed as the present value of additional income stream based on some discount rate. We assume a discount rate as the long-term real rate of interest at about 3 per cent. The present value of total gain in GDP has been computed as between Rs. 1,469 thousand crores and 2,881 thousand crores. The corresponding dollar values are $325 billion and $637 billion or as much as one-third to one-half of the country's GDP for the year 2009-10.

The manufacturing sectors would benefit from economies of scale. Output of sectors including textiles and readymade garments; minerals other than coal, petroleum, gas and iron ore; organic heavy chemicals; industrial machinery for food and textiles; beverages; and miscellaneous manufacturing is expected to increase. The sectors in which output is expected to decline include natural gas and crude petroleum; iron ore; coal tar products; and nonferrous metal industries.".

The results of the NCAER Study are also suggested of the GSTs positive environmental impact on the economy.

Further, the changeover to GST will be neutral to vertical and horizontal integration. This will therefore, encourage industries to be located in states which enjoy a comparative advantage. This has far reaching implication for resource rich backward states; it will serve as an attraction to natural resources based industries to locate in these states regardless of the fact that the consumer is located elsewhere. Another dynamic implication of the GST would be to generate greater employment as GST helps to increase labour intensive sectors.

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GST in other countries

Internationally, countries are moving towards simplification of tax structures

- South Korea replaced eight indirect taxes representing 40% of revenue by GST
- Other countries such as Japan Australia, New Zealand, Singapore and South Africa have strived to achieve a world class GST.

"GST is one of the widely accepted indirect taxation system prevalent in more than 150 countries across the globe. Globally, GST has been structured as a destination based comprehensive tax levied at a specified rate on sale and consumption of goods and services within a country. It facilitates creation of national tax standards with consumers paying uniform rates of GST, thereby enabling flow of seamless credit across the supply chain. In Countries where GST has been adopted, producers (Manufacturers, wholesalers, retailers and service providers) charge GST at the specified rate on price of the goods and services and claims input credits for GST included in the price paid by them on procurement of goods and services (raw material). Technically, sellers or service providers collect GST from their customer (who may or may not be their final consumer) and prior to depositing this with the exchequer, deduct the tax (GST) paid by them.

The ultimate cost is borne by the final consumer who cannot claim GST credit. In the sense, it is and indirect tax – not borne by manufacturers and service providers. The net effect is that the seller or service provider charges GST but does not retain it and pays GST but receives a credit for it, making him a pseudo collecting agent for the government. On most of the goods and services, the tax rate is uniform, but depending upon the circumstances in a country, certain goods and services can be declared 'exempted' or charged at lower rate.

MODELS

There are several models of GST, each with its own merit and demerit. A look at some of the models in circulation:

(1) ***Australian Model*:** In Australia GST is a federal tax, collected by the Centre and distributed to the states. But India is a heterogeneous country and there is no chance that states may

allow the Centre to collect all the taxes while they become just spending institutions;

(2) ***Canadian Model*:** The GST in Canada is dual between the Centre and the states and has three varieties:

(i) Federal GST and provincial retail sales taxes (PST) administered separately - followed by the largest majority;

(ii) Joint federal and provincial VATs administered federally (Harmonious Sales Tax - HST); and

(iii) Separate federal and provincial VAT administered provincially (QST) – only for Quebec as it is like a breakaway province. The first variety is fundamentally the Canadian model, which is similar (though not the same) to the existing situation in India.

(3) ***Kelkar-Shah Model*:** This model of a unified GST, is based on a grand bargain to merge central excise, service tax and state VAT into one common base. Two different rates of tax are to be levied by the Centre and the states. The collection may be by the Centre. This is like the HST model in Canada;

(4) ***Bagchi-Poddar Model*:** This model, just like Kelker- Shahs, envisages a combination of central excise, service tax and VAT to make it a common base of GST to be levied both by the Centre and the states separately. This means that the Central Excise Act, 1944 may be abolished and the goods tax may be only on the sale of goods. It may merge in it the service tax. To put this in legal lingo, the taxable event for the GST may be the act of sale of goods and services. The concept of manufacture may simply vanish. The difference between the Bagchi-Poddar and Kelker-Shah models is that in the former, the collection is at two levels, by the Centre and the states, while in the latter the collection is only by the Centre. So while the Kelkar-Shah model is like the Canadian HST, the Bagchi-Poddar one is like the Quebec model. Although the model says that it is based on the Quebec model, it is actually not fully so as this model envisages collection both by the Centre as well as the states, whereas the Quebec model envisages collection only by the state of Quebec.

The Bagchi-Poddar model also clearly envisages that a Constitutional amendment is necessary to bring the taxing powers on goods and services under the concurrent list and to abolish the present division of taxing powers between the Centre and the states."[3]

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3. The next big reform- GST by Anuj Arora. ACS and Saurabh Gupta, February 2010 Chartered Secretary

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GST Model in India[4]

The taxation of goods and services in India has, hitherto, been characterised as a cascading and distortionary tax on production resulting in mis-allocation of resources and lower productivity and economic growth. It also inhibits voluntary compliance. Therefore, it is necessary to replace the existing indirect tax system by a new regime which would foster the achievement of the following objectives:

(a) The incidence of tax falls only on domestic consumption;

(b) The efficiency and equity of the system is optimized;

(c) There should be no export of taxes across taxing jurisdictions;

(d) The Indian market should be integrated into a single common market;

(e) It enhances the cause of cooperative federalism.

With a view to attaining the objectives set out above, the task force on GST recommended a VAT type Goods and Services Tax (GST). In the context of the design of the GST, some of the important issues are discussed in the following paragraphs.

(*a*) *Single GST versus Dual GST*

In a federal country like India where the power to tax domestic trade is divided between the Central Government and the State Government, the designing of a destination based GST becomes extremely complicated. A conventional national GST cannot be implemented without the States losing their fiscal autonomy. However, this is not feasible since revenues from State VAT account for substantial proportion of State's revenues. Therefore, the solution has to be found within the existing federal framework where both levels of Governments have the concurrent powers to tax domestic trade in goods and services.

In view of the above, following recommendations were made:-

4. Report of task force on Goods and Service Tax- 13th Finance Commission

(a) The GST will be a dual levy imposed concurrently by the Centre and the States, but independently. It will have two components: one levied by the Centre (hereinafter referred to as CGST), and the other levied by the States and Union Territories (UTs) [hereinafter referred to as SGST].

(b) Both the CGST and SGST will operate over a common base. That is, the base will be identical.

(*b*) *Type of GST – Consumption, income or production*

There are three possible variants of VAT, depending upon what macro-aggregate the government wants to tax: gross income, net income or consumption. A **gross product type VAT** treats both consumption and capital formation as final uses of the good; hence capital goods purchased by the dealer would not be treated as inputs. Input tax credit will not be available on taxes paid on capital goods. A **income type VAT** would give credit for tax paid on current inputs and tax paid on capital goods to the extent attributable to depreciation of capital goods, in any given year. Credit for tax on capital goods will therefore be spread over the life of the capital good. A **consumption type VAT** goes a step further in that only final consumption is treated as the final use of a good; full credit, therefore, is given for taxes paid on capital goods as well, in the year of purchase.

The consumption base has been a much favoured tax base from both the perspective of economic neutrality and ease of administration. It is also the only VAT that is equivalent to a retail sales tax, in that it restricts the burden of the tax to final consumption goods. In effect, the tax is only on the pure value added within the production stage in question. Consumption VATs are also the easiest to compute—all taxes previously paid on purchases from other firms to be simply subtracted from taxes due on sale. No distinction needs to be drawn between capital goods and other inputs, and no depreciation need be computed. Consumption, it is argued, is also a broad measure of the ability to pay taxes, much like income. Furthermore, it excludes savings from the base, hence does not discourage investment.

From an economic growth perspective, both the income and gross product VAT have an anti-investment bias. This is all the more significant in countries that impose substantial income taxes. An income tax taxes saved income and hence investment twice—one as the income is being earned and again as the rewards for saving appear as interest and profit, which are again taxed. Since income tax is fairly well established in India, the task force recommended that-

(a) The Centre and the States should adopt a consumption type GST, *i.e.*, there should be no distinction between raw materials and capital goods in allowing GST credit. Only this GST variant is equivalent to a retail sales tax.

(b) The tax base of both CGST and SGST should comprehensively extend over **all goods and services** going up to the final consumer (retail level), reflecting the tax base of a typical consumption VAT.

(c) Since the tax base will extend to all goods and services, no distinction will be maintained between goods and services. A registered dealer will be required to collect taxes on every invoice irrespective of whether the supply is for goods or services. Therefore, no classification of goods and services should be provided for in law. This will eliminate all classification disputes.

In the course of discussion with officials in the Department of Revenue a view was expressed that in the context of service tax, it should be levied on all services but there should be a positive list of such services. This view was based on the consideration that the assessing officer feels comfortable in levy and collection of tax if he knows exactly on which service the levy is being imposed.

In this context, it was pointed out that **firstly**, it is not possible to draw up a positive list which is all comprehensive. Invariably there would be gaps in the base. **Secondly**, it would lead to classification disputes thereby imposing higher compliance and administrative burden. **Thirdly**, with the introduction of the GST no distinction is required to be made between goods and services. Therefore, the issue relating to separate taxation of does not arise. **Fourthly**, under the GST regime, it is not necessary for the assessing officer to know what he should be taxing. The design should be so structured that he would need to know that all supply transactions will attract GST except those prescribed. Since the negative list is intended to be a very small list, it would not be difficult for him to administer. In the case of a positive list, the assessing officer must familiarize himself with a much longer list and any gap in his knowledge base could lead to erroneous judgement. Therefore, we are not inclined to agree with the view of the Department of Revenue officials that the taxation of services should be based on a positive list. Accordingly, the task force recommended that all goods and services should be subject to tax other than those specified in the negative list.

In view of the fact that the CGST and SGST are intended to be levied on consumption of all goods and services, these two taxes must subsume all taxes presently levied on various goods and services by the Centre and the States, respectively. For the purposes of identifying the taxes which needs to be subsumed in the CGST and SGST, the task force recommended that the following principles should be adopted:-

(a) Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.

(b) Taxes or levies to be subsumed should be part of the transaction chain which commences with import/manufacture/production of goods or provision of services at one end and the consumption of goods and services at the other.

(c) The sub-summation should result in free flow of tax credit at the intra and inter State levels.

(d) Any tax/fee/charge which is in the nature of a user charge for supply of goods & services should not be subsumed under the GST.

Based on the aforesaid principles, the task force recommended the following:-

(a) The following central taxes should be subsumed in the CGST:

(i) Central Excise Duty (including Additional Excise Duties);

(ii) Service Tax;

(iii) Additional Customs Duty (commonly referred to as 'CVD');

(iv) Surcharges and all cesses

(b) The following State level taxes, as also recommended by the Empowered Committee (EC) in its discussion paper dated 30th April, 2008, should be subsumed in the SGST:-

(i) VAT/Sales Tax (including Central Sales Tax and Purchase tax);

(ii) Entertainment tax (other than levied by local bodies);

(iii) Entry taxes not in lieu of Octroi;

(iv) Other Taxes and Duties (includes Luxury Tax, Taxes on lottery, betting and gambling, and all cesses and surcharges by States);

(c) Since all taxes on goods and services, levied by the Centre or the States, should be subsumed in the GST, the following other taxes levied by the States on goods and services should also be subsumed:

(i) Stamp duty;

(ii) Taxes on Vehicles;

(iii) Taxes on Goods and Passengers; and

(iv) Taxes and duties on electricity.

(d) Any amount collected through these taxes on the *SIN goods*[5] should not be subsumed either in the CGST or the SGST. Similarly any amount which is collected as tax/fee/charge/cess which is essentially in the nature of a user charge for supply of goods and services (including environmental goods and services) also should not be subsumed under the CGST or SGST. Further, both Centre and the States should take steps to consolidate all taxes (other than proposed GST) on the SIN goods as a single levy termed as Central Excises and State Excises, respectively.

(e) All entry and Octroi duties levied by the third-tier of Government must be abolished.

For the purposes of this Report, the set of taxes which the EC has recommended for being

5. SIN Goods- Goods deemed to be harmful to society, such as alcohol and tobacco.

subsumed in the SGST will be referred to as **"EC-taxes".** Similarly, the larger set of taxes which we have recommended for being subsumed in the SGST will be referred to as **"TF-taxes".**

(*c*) *Origin versus Destination Principle*

A GST can be implemented under either the origin or the destination principle. Under the former, the GST is imposed on the value added of all taxable products that are produced domestically; under the latter, the GST is imposed on the value added of all taxable products that are consumed domestically. Obviously, the two principles are identical in a closed economy. In an open economy, the difference between them lies solely in their treatment of imports and exports: exports are taxed but imports are not under the origin principle, while just the converse holds under the destination principle. It is important to note that the distinction between the two principles is based on the location of production and consumption. In view of our recommendation for a consumption type GST and the need for increased international competitiveness, the task force recommended that -

(a) the GST should be structured on the destination principle. As a result, the tax base will shift from production to consumption whereby imports will be liable to tax and exports will be relieved of the burden of goods and service tax. Consequently, revenues will accrue to the State in which the consumption takes place or is deemed to take place;

(b) international exports should be zero rated;

(c) international imports should be subject to both CGST and SGST at the time of importation irrespective of whether or not the imported goods are produced domestically;

(d) SGST on B2B imports should be collected by the same agency which collects the CGST and should be remitted to the state in which the place of destination of the imports is located regardless of where the goods enter the country. However, the place of destination may be defined to mean the address of the importer on the import invoice; and

(e) SGST on B2C imports should be collected by the same agency which collects the CGST and should be remitted to the state in which the place of residence of the person importing the goods is located regardless of where the goods enter the country.

(*d*) *Method of Computation*

There are essentially three methods of computing VAT liability: addition method, subtraction method and the credit method (also known as the invoice method). The principal debate concerning choice of methods in computing VAT liability is normally restricted to the credit and subtraction methods. The credit method requires that the amount of VAT charged be explicitly stated on the invoice associated with any taxable transaction. The amount of tax a dealer submits to tax authorities is simply the difference between the tax he collected on his sales and the tax he paid on his purchases. Under the subtraction method, each dealer's tax liability is computed by applying the applicable VAT rate to the difference between his total sales (inclusive of the VAT element in his sales price) and his total purchases (inclusive of the VAT element in his purchase price). Hence, unlike the credit method, the amount of VAT connected with a taxable transaction is not required to be explicitly stated on the associated invoice.

The credit method therefore, is more transparent, whereby the effective tax rate on any commodity is easily identifiable as the rate applicable to the last transaction in that commodity. In the case of the subtraction method, the rate of VAT is not separately indicated and to this extent there is a loss of transparency. Further, since the effective rate under the subtraction method is a weighted average of the rates at the various stages, there could exist an incentive to shift value added to the stages with the lower tax rate. This kind of tax distortion needs to be avoided.

In view of the above, the task force recommended that –

(i) the credit method should be adopted for computation of the VAT liability.

(ii) The computation of the CGST and SGST liability will be based on the invoice credit method i.e., allow credit for tax paid on all intermediate goods or services on the basis of invoices issued by the supplier. As a result, all different stages of production and distribution can be interpreted as a mere tax pass-through, and the tax will effectively 'stick' on final consumption within the taxing jurisdiction. This will facilitate elimination of the cascading effect at various stages of production and distribution.

(iii) The CGST and SGST are to be credited to the accounts of the Centre and the States separately.

(iv) Since the CGST and SGST are to be treated separately, taxes paid against the CGST should be allowed to be taken as input tax credit (ITC) for the CGST and could be utilized only against the payment of CGST. The same principle will be applicable for the SGST.

(v) Cross utilization of ITC between the CGST and the SGST should not be allowed.

(*e*) *Treatment of capital goods*

In the past, a number of countries, introduced accelerated depreciation or investment allowance to compensate for domestic trade taxes paid on capital goods. With the gradual introduction of VAT and the feasibility of extending credit for VAT on fixed assets, depreciation rates were rationalised. Later in some countries, VAT was used to slow down the development of capital intensive production processes. To this end, they disallowed the credit for the VAT on fixed assets (defined as all assets which are subject to depreciation) and non-material assets, like technical know-how. The case for allowing full and immediate credit for the VAT on capital goods rests on several arguments:

1. Depending on the capital intensity of the production process, the VAT on fixed assets enters into the price, causing uneven effects on consumer prices.
2. Any kind of restriction on full and immediate credit for VAT on fixed assets deters investment and hampers technological change, unless it can be fully shifted forward to consumers.
3. Limiting the credit for VAT on fixed assets in any manner results in increased cost of exports thereby undermining international competitiveness. Hence, it serves as a disincentive to exports.
4. Capital goods need to be defined thereby creating scope for considerable disputes.
5. Denial of immediate credit for VAT on capital goods leads to implicit taxation. This is further aggravated if excess credits are not refunded but must be applied against VAT on future sales. Further, in the face of inflation, the real value of the tax credits carried forward declines rapidly becoming equivalent in effect to a tax on fixed assets. Any denial of full and immediate credit for the VAT on capital goods violates the neutrality of VAT.

Therefore, in recent years, most countries have introduced a full and immediate credit for the VAT on capital goods applied for the purpose of registered businesses. Under the Central Excise Act, credit for CENVAT paid on capital goods or CVD on imported capital goods is spread over two years resulting in the kind of distortions discussed above. The rationale for this spread over is essentially loss in revenues. The estimated total credit for CENVAT paid on capital goods and CVD on imported capital goods in 2002-03 was Rs. 8,500 crore and could be expected to increase to about Rs. 9,000 crore in 2004-05. Since the credit is allowed over a period of two years, the loss in revenues is, therefore, estimated to be Rs.4,500 crore and restricted to the transitional year only. However, in the context of revenue gain from reduction in depreciation rates proposed in the section on corporate tax, the impact on revenue could be fully absorbed. In the light of the arguments in support of full and immediate credit for VAT on capital goods and the revenue implications thereof, the task force recommended that-

(i) Full and immediate input credit should be allowed for tax paid (both CGST and SGST) on all purchases of capital goods (including GST on capital goods) in the year in which the capital goods are acquired; and

(ii) any kind of transfer of the capital goods at a later stage should also attract GST liability like all other goods and services.

(*f*) *Exemption from GST*

Suppliers of goods and services are either taxable or tax exempt. By definition, exemption relieves the exempt trader's value added from the tax, but all his purchases including capital goods are taxed. Exemption will therefore increase the amount of tax finally paid on intermediate goods— the opposite effect that the exemption was supposed to provide. In the case of final goods, exemption eliminates the tax on value added in the final stage only. In other words, if a commodity is exempt only at the retail level, then only the retail level is freed of VAT. Although the retailer would not charge VAT on its sale, the retailer would not be entitled to a credit for tax paid on the purchase of an exempt item. If a commodity or service is zero rated, the zero rated trader's value added is not taxed and the trader receives a credit for the tax paid on the purchase of materials and other inputs used. Zero rating, in theory, is the only way to ensure that a product is truly free of VAT, since any tax paid would be credited on the last sale. The considerations influencing the choice between zero rating and exemption are:

(1) The desirability of freeing users of specific goods or services completely from VAT (as with zero rating), or only partially (as with exemption);

(2) The merits of excluding certain firms from the registration and filing of returns. Even from the perspective of firms themselves, there are conflicting considerations. If a firm's goods are completely exempt, it is not required to register or file a return, but the prices of the goods sold by the exempt firm will include the tax incurred by the exempt firm on its purchases.

This may be particularly objectionable to the exempt firm's customers who cannot receive credit for the embedded tax. In this case, exemption would place the exempt firm at a competitive disadvantage.

If the objective is to have a broader tax base, however, exempting certain goods may become preferable to zero rating them. In addition, the administrative burden of the zero rating procedure can be onerous. Zero-rating implies build up or payout of refunds, which may entail huge administrative costs, requiring verification and disbursement of refund cheques. Furthermore, there is the issue of controlling evasion or fraud. Zero rating creates an incentive for sellers to exaggerate the values of their final sales and to correspondingly inflate the value of taxable inputs purchases, in order to avail themselves of the refund of a larger input tax element. The resources needed to cross-check such claims can impose additional and perhaps unsustainable demands on prevailing systems.

Further, tax exemptions are economically inefficient, inequitable, lead to revenue loss, breed rent-seeking behaviour, increase compliance cost and enhance administrative burden. The case for tax incentives is further weakened in the existing tax regime of moderate tax rates.

In general, a case is often made for exempting **food** on the consideration that the levy of GST would have a significant impact on those living at or below the subsistence levels. Food constitutes a large variety of items and attempt at any definition will lead to complexity in legislation. If the exemption is extended to all categories of food items, the revenue base will shrink significantly and the standard rate would need to be substantially higher. This would trigger demands for other goods which form the consumption basket of the poor. To the extent the poor consume other goods also, any increase in the standard rate will also adversely affect them. Contrary to popular perception, food items are indeed subject to tax at the state level though at lower rates. As stated in earlier paragraphs, the distribution channel for unprocessed food in the rural sector is either a direct sale by the farmer to the final consumer in village hats or through small retail stores who would even otherwise remain exempt because of the threshold exemption for dealer registration. A lower rate for food in contrast to the relatively high standard rate would mean a two rate structure and gradual expansion of the lower rate category as is the international experience. As a compromise, the task force recommended that any food item which is covered under the public distribution system should be exempt regardless of the outlet through which it is sold. This principle may be applied to other non-food items also.

In the case of **health services**, there are two approaches. The first approach is the full taxation model whereby the health services form part of the comprehensive GST base. As a result, there is effectively zero tax liability in the case of publicly funded subsidised health care facilities since input tax credit will be more than the output tax. As regards, health care availed in other health care facilities covered by insurance, there would be no additional burden on the consumer since the expenditure would be borne by the insurance company and can be claimed as input credit. Essentially, there would be zero incidence of GST on health care. Consequently, there would be opportunities for reduction in the price of health care. The second approach is the exemption approach which does not allow for full rebating of input taxes and therefore, effectively there is a significant element of GST embedded in the price of the final health care. Therefore, while public may prefer exemption, in reality it imposes a higher tax burden particularly on the publicly funded health care and for care provided in facilities covered by insurance. Since health services do not form part of our sample used for calculation of our RNR in the later part of this Report, the choice of the method of treatment of health services will not impact the estimation of the GST base and hence the RNR rate. Accordingly, the task force recommended that the choice may be made keeping in view the considerations discussed above.

The considerations discussed in the context of health services similarly apply to education services except that these services are not covered by insurance. In fact, the problem is more complex since the sector is more diverse covering child care facilities, formal education (both school and college levels), professional education, occupational programs, diploma programs and recreational programs. Therefore, defining educational services is more complex. However, given the multitude of schools and colleges in the country and the disproportionately large administrative burden, the task force recommended that the educational services may be exempted from the levy of GST and such exemption should be limited to formal education services provided by schools and colleges.

Keeping in view the above-mentioned economic and administrative implications of exemptions and zero rating, the task force summarized there recommendations on exemption from GST as under:-

(a) Ordinarily, there should not be any exemption from CGST or SGST. If for some reason, it is considered necessary to provide exemption, the Centre and the States should draw up a common exemption;

(b) The common list of exemption should be restricted to the following:-

(i) All public services of Government (Central, State and municipal/panchayati raj) including Civil administration, health services and formal education services provided by Government schools and colleges, Defence, Para-military, Police, Intelligence and Government Departments. However, public services will not include Railways, Post and Telegraph, other commercial Departments, Public Sector enterprises, banks and Insurance, health and education services;

(ii) Any service transactions between an employer and employee either as a service provider, recipient or vice versa;

(iii) any **unprocessed food article** which is covered under the public distribution system should be exempt regardless of the outlet through which it is sold; and

(iv) **education services** provided by non-Governmental schools and colleges; and

(v) **health services** provided by non-Governmental agencies.

(*g*) *Treatment of petroleum products*

One of the classes of products whose consumption needs to be checked to restrict negative externalities is petroleum products. The entire range of petroleum products is subject to multiple taxation at both the Central and State level. As a result, the incidence of tax on products essentially used as intermediate inputs cannot be estimated and leads to a cascading effect on downstream products. Consequently, it is necessary to rationalise the tax treatment of petroleum products.

The petroleum products can essentially be classified into two categories: (i) industrial inputs or fuels such as crude oil; (ii) transportation fuels comprising of HSD, MS and ATF; and (iii) household fuels comprising of kerosene and Liquefied Petroleum Gas (LPG). While industrial fuels are intermediate inputs, transportation fuels and kerosene (collectively referred to as "emission fuels") are used both as intermediate inputs and in final consumption. The emission fuels generate negative externalities, whose consumption needs to be checked. Therefore, generally, such emission fuels are subject to an excise against which no input tax credit is allowed in respect of inputs (including capital goods) used in the manufacture of such fuels. However, in large number of cases, such emission fuels are also used as intermediates. As a result, the cascading effect of embedded input taxes is significant.

In view of the above, the Task Force recommends a dual levy of GST and excise on the entire range of emission fuels. As a general rule, no input credit will be allowed to any person in respect of GST on the emission fuels since emission fuels are predominantly used in final consumption and has the potential for creating a flourishing market in trading of invoice and input tax credit. However, this general rule should be relaxed in the case of consumption of transportation fuels by the Ministry of Railways, the State Road Transport Corporations, the Airlines, truckers, taxi operators and a dealer16 trading in these goods on the consideration that the consumption is essentially intermediate in nature and the unlikelihood of these entities indulging in purchase of bogus invoices. However, in the case of truckers and taxi operators, the benefit of input tax credit has the potential of misuse and therefore credit may be allowed through the abatement mechanism only. Further, no input tax credit in respect of excise would be allowed to any other person.

The task force also recommended that the industrial fuels should be subjected only to GST (both Central and State) with the benefit of input credit like any other intermediate good.

Both the Central and the State Governments may determine the appropriate revenue neutral rate of excise in the case of emission fuels.

(*h*) *Treatment of tobacco goods and alcohol*

Like emission fuels, all tobacco goods and alcohol are also **SIN-goods**. Therefore, on the same analogy, the task force recommended a dual levy of GST and excise on the entire range of these goods. As a general rule, no input credit will be allowed to any person in respect of GST on these goods since they are predominantly used in final consumption. However, this general rule should be relaxed in the case of a dealer trading in these goods on the consideration that the consumption is essentially intermediate in nature. Further, no input tax credit in respect of excise would be allowed to any person. Both the Central and the State Governments may determine the appropriate revenue neutral rate of excise in the case of these products. However, we would like to point out that excessively high rates of tax on tobacco and alcohol may encourage evasion and become a source for financing of undesirable activities.

(*i*) *Treatment of natural gas*

Natural gas, like petroleum products, is derived from the same source. However, unlike petroleum products, natural gas does not generate negative externalities. Therefore, the tax regime for natural gas should be distinctively different from the regime applicable to petroleum products. Accordingly, natural gas should be subjected only to GST (both Central and State) with all the benefits of input credit as in the case of other normal goods. The task force recommended accordingly.

(*j*) *Treatment of the power sector*

Power is one of the most important inputs in the process of production of goods and services. Hence, it is necessary to rationalise the tax treatment of the power sector so as to ensure that there is seamless flow of input tax credit across all the processes/activities in the power sector. At present, the power sector is subject to multiple taxation. At the Central Government level, power equipments are either exempt from CENVAT or subject to concessional rates. As a result, either no or partial input tax credit is available and the input taxes remain embedded in the cost of the power equipments. This problem is further compounded by the absence of a levy on power generation, distribution or consumption thereby denying input tax credit even for equipments and stores which are subject to CENVAT. Similarly, at the State level, there is no benefit of input tax credit in respect of the State VAT on inputs used in the process of power generation and distribution. The cumulative impact of the taxation regime at both the Central and State level is significant cascading effect18 of taxes when power is used as an intermediate input. This phenomenon partly explains the cause for high cost of power generation and distribution. As a result, the international competitiveness of Indian industry is significantly undermined.

In view of the above, the task force recommended the following:

(i) The electricity duty levied by the States should be subsumed in the SGST.

(ii) The power sector must form an integral part of the comprehensive GST base recommended by us over which both the Central and State Governments would have concurrent jurisdiction.

(iii) The tax regime for the power sector should be the same as in the case of any other normal good.

(iv) Article 278 and Article 288 of the Constitution should be amended to enable levy of GST on supply of electricity to Government at all levels like any other normal goods.

The inclusion of the power sector in the GST model would significantly reduce the cost of power projects and consequently the cost of generation and distribution of electricity. As a result, it will improve profitability of power projects thereby attracting new investments into the sector. To the extent the cost of power will witness reduction, downstream industries will also benefit from cost savings and thus become internationally more competitive.

(*k*) *Treatment of transport services*

Transport services, like most other services, is used both as intermediate input and in final consumption. Further, the transport equipments are also subject to multiple taxation at both Central and State level. The present regime leads to cascading effect of embedded taxes on the downstream industry which do not get rebated thereby leading to enhanced cost for such industries. Hence, it is imperative to rationalise the taxation regime for transport services.

Accordingly, the task force recommended the following:

(i) The tax on vehicles and the tax on goods and passengers levied by the State Governments should be subsumed in the GST.

(ii) All transport equipments and all forms of services for transportation of goods and services by railways, air, road and sea must form an integral part of the comprehensive GST base recommended by us over which both the Central and State Governments would have concurrent jurisdiction.

(iii) The tax regime for the transport equipments and transport services should be the same as in the case of any other normal good.

(iv) It is not necessary to levy higher rates of taxes on vehicles as is the existing practice since it is proposed to subject the use of these vehicles to tax at higher rates through excise on emission fuels. Accordingly, the present practice of levying higher rates of taxes on vehicles should be done away.

(*l*) *Treatment of financial services*

The financial sector constitutes a significant component of the gross domestic product and also private final consumption. Further, in developing countries, taxation of consumption of financial services is viewed as progressive because such services as banking, brokerage, property and casualty insurance and foreign exchange transactions are connected closely with those having higher income and wealth. The progressive revenue objective thus dictates as wide an application of VAT to financial services as possible. It also encourage countries to consider compensatory taxes where an exemption must be provided and even additional *ad hoc* taxes for revenue purposes. Therefore, given the progressive nature of taxation of financial services and the distortionary impact of compensatory and ad hoc taxes, the task force recommended that the consumption of financial services should be comprehensively taxed under the GST framework.

We recognise that there are predominantly three alternative methods for levying GST on financial services: the exemption method, the zero rating method and the full taxation method. While the exemption method and the zero rating method reduces the potential GST base and also distorts consumption across financial services and other business services, the full taxation method significantly enhances the tax base and also results in equal treatment of all services. Therefore, the task force recommended that the consumption of financial services should be taxed on the basis of the full taxation method.

There are alternative approaches to full taxation of financial services. These are the addition method, the subtraction method and the cash flow method. The task force recommended that the choice of the method may be based on administrative and compliance consideration.

(*m*) *Treatment of immovable properties*

The **case for** including the real estate sector in the tax base for the GST rests on a number of competing reasons. **Firstly**, the construction and exploitation of real estate comprises one of the larger sources of gross domestic product. Therefore, any exclusion of the real estate sector would lead to significant reduction in the tax base. This would lead to an increase in the GST rate for other sectors thereby distorting economic efficiency and incentive for compliance.

Secondly, expenditure on housing also constitutes a significantly large proportion of total personal consumption expenditure. Therefore, the exemption of the housing sector from the GST base would distort the consumption pattern. Further, it would also undermine vertical equity in as much as consumption of housing services is relatively high in the case of the rich.

Thirdly, real estate is subject to multiple taxation at both levels of Government. At the Central Government level, there has been an attempt to introduce service tax on housing services and allow credit for inputs used for the supply of such services. However, at the State level input tax credit is not available for all taxes, thereby leading to significant cascading effect. Further, there is no incentive to the purchaser to obtain an invoice. Consequently, the audit trail of such transactions is lost and producers of inputs are also encouraged to suppress such transactions. The cumulative effect is to incentivise transactions in black money.

At the State level, the taxes on the real estate sector include 'sales tax' on works contract, state level VAT on various inputs used in the construction of real estate, stamp duty and registration fee. Registration and stamp duties exhibit the same distortionary cumulative and cascading effects as excises. The problem is further compounded by the fact that in most states, the statutory rates of stamp duty on immovable property transaction are high. Therefore, the effective rate on value addition is exorbitant, thereby encouraging under-reporting of transactional value and evasion of stamp duty. Since stamp duties are directly or indirectly related to other taxes, any stamp duty evasion triggers a similar adverse response to compliance with other taxes. As with other transaction taxes, it generates a bias in favour of not selling, and inhibits the development of a liquid secondary market. In the context of a distortionary tax regime governing the real estate industry in India, there is a strong tendency for this industry to remain outside the organised sector and consequently the regulatory framework. Therefore, it serves as a breeding ground for tax evasion and criminal activities.

Fourthly, rationalisation of the tax regime governing the real estate industry could yield numerous benefits: improve tax compliance in the property tax which is critical for the revenue base of local government, a reduced role for black money, and a reduced role for the criminal element in the real estate sector and significantly lowering of costs by mass housing.

Keeping in view the implications of the different methods for taxing real estate and housing services, the task force recommended the following strategy for integrating the real estate sector into the GST framework:

(i) The stamp duty on immovable properties levied by the States should be subsumed in the GST to facilitate input credit and eliminate cascading effect.

(ii) The new GST regime for immovable property transactions and real estate services should be designed on the lines of the comprehensive taxation method. Therefore, the new regime would comprise of the following elements: -

  (a) The GST should apply for all newly constructed property (both residential and commercial). If it is self-used by the person who constructed it, the GST should be applied on the cost of construction. If it is sold or transferred, the GST should be applied on the consideration received at first transfer or sale. In both cases, credit should be allowed in respect of input tax paid on raw materials used in construction.

(b) Rental charges received (excluding imputed rental values) in respect of leasing of immovable property used for both residential and commercial purposes should be charged to GST. Input tax credit would be allowed only in respect of input tax paid on goods and services used for maintenance. No input tax credit should be allowed in respect of tax paid on construction or acquisition of the property or tax paid on improvements thereto.

(c) All secondary market transactions in immovable properties (whether constructed before or after the introduction of GST) should be liable to GST. However, if the property has been constructed after the introduction of GST, the GST should be levied on the resale value and input tax credit should be allowed in respect of the GST paid upon construction or purchase of the property after making adjustment for inflation. If the property has been acquired by the seller before the introduction of GST, the GST should be levied on the difference between the sale price and the cost of acquisition and improvements thereto. In such cases, no input tax credit would be allowed.

(d) The adjustment for inflation may be made on the basis of the same inflation index as provided for the purposes of determination of capital gains under the Income-Tax Act, 1961.

(e) The new regime will also be subject to the threshold exemption of Rs.10,00,000/- for small businesses thereby eliminating the problem of excessively large number of landlords seeking GST registration.

(f) Immovable property will also include land and, therefore, the new regime will also be applicable to land transactions. However, where land is used for construction of a property, it will be treated as an input. In such cases, the GST paid in respect of land will be allowed as input tax credit in the same manner as other inputs used in construction.

(iii) The State Governments would continue to perform essential asset registry functions, and enforces property rights associated with them. These functions are comparable to those of a depository on the markets. The registration fees can be interpreted as user charges for these records keeping functions – which justify small charges. The imposition of large scale indirect taxes through registration and stamp duties constitutes a case of erroneous tax policy. Therefore, States may continue to levy a registration fee at a specific rate not exceeding Rs. 1000 per transaction in immovable property, which is merely a user charge for the IT systems used in property registration.

The proposed new regime will lead to more efficient allocation of resources in as much as it will be comprehensive in its scope for taxation of immovable property transactions and real estate services. It will be neutral between old and new properties, and between rented and self occupied properties. It will be administratively less burdensome since no distinction would be required to be made between residential and commercial properties. Similarly, the treatment of input tax credit will be relatively simple with the tax paid on construction/acquisition of the property being allowed as a set off, after inflation indexing, against the GST on resale of the property **and** any tax paid on minor repairs and maintenance being allowed as set off against the rental charges, if any, in the same year. Further, under the model, the real estate developer will also be entitled to set off input tax on all inputs (including land) used for the purposes of construction and development of the real estate. As a result, the distortionary cascading effect of the existing tax regime for immovable property transaction and real estate services will be fully eliminated. This would have significant downward effect on pricing of real estate. The new regime has the potential for creating an efficient secondary market in immovable property and real estate services which will facilitate better price discovery. The role of the underworld elements associated with this sector will be eliminated. Since the new regime will impart greater transparency through market mechanism, it will also strike a major blow to the underground economy. Therefore, it is imperative that the reform of the present system of taxation of immovable property transaction and real estate services forms an integral part of the proposed GST design.

(*n*) *Place of supply rules*

The value added tax system is based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to the margin realised on transactions, or the difference between the VAT paid out to suppliers and the VAT charged to customers.

In practice, most countries with value added taxes impose the tax at all stages and normally allow immediate deduction of taxes on purchases by all but the final consumer. These features give value added taxes their main economic advantage, that of neutrality. The full right to deduction of input tax through the supply chain, with the exception of the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain and the technical means used for its delivery (stores, physical delivery, Internet).

Internationally, VAT is designed on the destination principle which allows the tax to keep its neutrality in cross-border trade. According to this principle, exports are exempt with refund of input taxes ("zero-rated") and imports are taxed on the same basis and with the same rates as local production. This VAT on imports is generally collected at the same time as customs duties, although in some countries collection is postponed until declared on the importer's next VAT return. Deduction of the VAT incurred at importation, in the same way as input tax deduction on domestic supply, ensures neutrality and no distortion of international trade. This implies that the total tax paid in relation to a commodity is determined by the rules applicable in the jurisdiction of its consumption and therefore all revenue accrues to the jurisdiction where the sale to the final customer occurs.

In the international trade in tangible goods, the place of taxation (or the place of supply) is the place of delivery, or shipment, of the goods to the recipient (buyer). In other words, a sale of goods is taxable in a jurisdiction if the goods are made available in, or delivered/shipped, that jurisdiction.

However, the nature of service and intangible products does not allow for the application of the same rules. In principle, the provider should account for the tax in the jurisdiction where the service or the intangible property is consumed or used, irrespective of the contract, payment, beneficial interest or the location of the supplier and customer at the time of the supply. Whether intangible property is used or a service is actually performed in a jurisdiction is essentially a matter of fact. However, it is not always easy to determine where services and intangibles are likely to be consumed. The increasing global nature of businesses and communication technologies makes it more difficult to apply a pure consumption test. The solution developed in most countries consists of identifying the place of consumption by reference to proxies rather than directly trying to identify the actual or intended place of consumption. The nature of those proxies and the way they are used vary widely across jurisdictions since they result from local history and legal frameworks.

While the rules and approaches vary across countries, the basic criteria for determining the place of taxation (or place of supply) in the case of services is as follows:-

(a) In the case of a sale of real property, the place of supply is the jurisdiction in which the property is located. Similarly, services directly connected with real property (i.e., services provided by real estate agents or architects) are also taxed in the place in which the property is located.

(b) In the case of mobile services (that is, passenger travel services, freight transportation services, telecommunication services, motor vehicles lease/rentals and E-commerce supplies), there is no fixed place of performance or use/enjoyment of the service. Therefore special rules need to be framed keeping in mind the basic destination principle.

(c) In the case of other services and intangible property, the place of supply is determined on the basis of one or more of the following proxies:

    (i) Place of performance of service;

(ii) Place of use or enjoyment of the service or intangible property;

(iii) Place of location/residence of the recipient; and

(iv) Place of location/residence of the supplier.

In defining the place of supply of services and intangible property, a distinction is often made between supplies made to businesses (B2B) and final consumers (B2C). In general, the place of supply in the case of B2B transaction is the place where the recipient is located or established regardless of where the services are performed or used. This is particularly in the case of intangible services like advisory or consulting services for which the place of performance is not important. Therefore, all such services rendered to a non-resident are zero-rated. By contrast, many B2C services tend to be tangible or physical in nature, *e.g.* haircuts, hotel accommodation, local transportation and entertainment services which are consumed in the place of their performance. Therefore, the place of supply in the case of B2C transaction is the place where the supplier is located. In some countries even such services to non-residents is zero-rated.

In addition to the above, there are a variety of other complex cross-border transactions for which supplementary rules are required to ensure uniformity and consistency across jurisdictions. They relate to global transactions(or master service agreements) for individual supplies to legal entities of a corporate group around the world, triangular transactions, supplies among branches and between branches and head office, and cost reimbursement/ allocation arrangements.

The place of supply rules indicated above relate to international transactions of goods and services. Ordinarily, these rules should also apply to inter-state supplies. However, in practice there are substantial deviations in these rules. The recipient of the services may be located in more than one state and there is no practice to determine the residency of the recipient unlike in the case of international transactions. Therefore, it is extremely difficult to identify the place in which the recipient is established/ located. In general, it would be desirable to tax B2B supplies of services and intangibles in the State of destination, and not of origin.

Given that any tax on B2B supplies would generally be fully creditable, excessive sophistication would not be warranted for defining the place of destination of such supplies. For multi-establishment business entities, the place of destination should be defined as the place of predominant use of the service. However, if there is no unique place of predominant use, the place of destination could be the mailing address of the recipient as stated on the invoice, which would normally be the business address of the contracting party. The risk of misuse of this rule would be minimal if it is limited to B2B supplies where the tax is fully creditable.

For B2C services, the place of supply should be the State in which the supplier is located, which, in turn, could be defined as the place where the services are performed. If there is no unique place of performance of the service, the place of supply could be defined as the State where the supplier's establishment most directly in negotiation with the recipient is located.

The rules relating to the place of supply of goods and services, discussed above, are in conformity with best international practice and expert advice. Therefore, the task force recommended that the Centre and the States may consider framing the rules on the basis of the guidelines indicated above.

(*o*) *Threshold Limit for registration of GST dealers*

Typically a small number of firms account for a large proportion of revenues from taxes on goods and services. Simultaneously, resources used in the collection of taxes are scarce and must therefore be deployed effectively; these need to be concentrated on the largest taxpayers as part of the risk management strategy. Further, the compliance burden under the invoice credit method is relatively high and it is uneconomical to collect revenues from a large number of small taxpayers. Hence, keeping in view the compliance cost and administrative feasibility, small dealers (including service providers) and manufacturers should be exempted from the purview of both CGST and SGST if their annual aggregate turnover (excluding both CGST and SGST) of all goods and services does not exceed Rs.10 lakh. However, like in most other countries, those below the threshold limit may be allowed to register voluntarily to facilitate sales to other registered manufacturers/dealers, limit competitive distortions and avoid inequities.

A case is made out that the states should be allowed to adopt different threshold limits keeping in view the size of the revenue base. Consequently, states with low revenue potential like the North-eastern states in particular must be allowed to adopt a lower threshold limit to protect their revenues. The objective of providing a threshold exemption is two-fold; firstly to mitigate the incidence of tax on the poor who generally make purchases of their goods and services from small dealers and secondly to reduce administrative burden of dealing with a multitude of small dealers who account for a dis- proportionately low share in the revenues. Hence, allowing some states to adopt a lower threshold implies that the poor in these states will bear the incidence of tax on their consumption unlike those similarly placed in other states and therefore, would be inequitable. This will also have the potential to trigger tax-induced migration from these states. Accordingly, the task force recommended that the threshold exemption limit should be uniform for both CGST and SGST and across States.

Further, with a view to reduce administrative and compliance burden, we also recommend small dealers with annual aggregate turnover of goods and services between Rs 10 lakh to Rs 40 lakh may be allowed to opt for a compounded levy of **one percent**, each towards CGST and SGST. However, no input credit should be allowed against the compounded levy or purchases made from exempt dealers. The limit of Rs 40 lakh is based on the consideration that dealers with turnover of Rs 40 lakh or more are subject to tax audit under the Income Tax Act, 1961 and therefore they would suffer fromany additional burden in terms of documentation under the GST.

The Group recognizes that certain high value goods comprising of (i) gold, silver and platinum ornaments; (ii) precious stones; and (iii) bullions (hereafter referred to as "high value goods") are prone to smuggling due to high tax incidence thereby generating negative externalities in terms of social and economic disorder. Therefore, the task force recommended that dealers in such high value items may, subject to the threshold exemption but without the ceiling of Rs. 40 lakh, also be allowed to opt for the compounded levy of **one percent**, each towards CGST and SGST.

(*p*) *Treatment of Small Scale Industries*

At present small scale industries are entitled to exemption from payment of CENVAT in respect of their turnover upto Rs 1.5 crores. However, there is no such threshold exemption in respect of state level VAT. The main reason for exemption from payment of CENVAT is to liberate them from the onerous compliance burden under the CENVAT regime particularly in the context that, in general, the small scale industries are managed by one or two entrepreneurs with the support of a handful of semi-skilled office staff. In the context of the GST, we have recommended the reporting of payment and transaction information of both CGST and SGST through the combined Form No. GST-I. Therefore, in any case the small scale industry has to comply with the reporting of payment and transaction information of SGST. No additional burden is cast upon the small scale industry for compliance with the CGST. Hence, the case for continuing with the existing exemption upto Rs 1.5 crores of turnover is extremely weak. Accordingly, the task force recommended that this exemption should not be continued under the GST framework.

Further, the small scale industries are generally wary of dealing with multiple tax administrations. Therefore, in order to inspire confidence of the small scale industry in the new GST framework, we also recommend that the scrutiny/audit of the small scale industry should be conducted only by the state tax administration. However, the State tax administration may seek the assistance of the central tax administration or any other state tax administration if the operations of the small scale industry transcend the state boundaries. Since the CGST and the SGST are proposed to be levied on an identical GST tax base, the outcome of any investigation impacting SGST will also have a corresponding impact on CGST. Therefore, enforcement by the State tax administration would be adequate to even deal with CGST evasion.

(*q*) *Area based exemptions*

Under the CENVAT, industries set up in the North East, Jammu & Kashmir, Sikkim, Uttaranchal and Himachal Pradesh (hereinafter referred to as 'specified areas') enjoy exemption from payment of CENVAT. This area based exemption creates economic distortions and affect economic viability of units located in non-exempt areas. They are difficult to administer and prone to misuse. Moreover, durability of investment attracted by such measures beyond the exemption period is also doubtful. The Prime Minister's Economic Advisory Council, which had recently examined the issue of area based exemption in the context of its impact on pharmaceutical industry, has observed that:-

> **"The policy of granting area based exemptions was ill advised. It created a host of distortions. We have to design and introduce subterfuges to neutralize those distortions. But such subterfuges make the tax administration needlessly clumsy and complex and run counter to our declared policy of simplifying the tax system. There is clearly a case for revisiting the whole issue of area based tax exemptions. If their premature withdrawal is not possible for political and business reasons, at the minimum such incentives should not be extended to fresh areas and the ones already in force should be extinguished when their applicability ends."**

Further, the existing exemption for Uttranchal and Himachal has been objected to by many States. In particular, Chief Ministers of Haryana, Uttar Pradesh and Punjab have often expressed their opposition to such exemptions as these had the effect of diverting industries to Himachal Pradesh and Uttranchal.

Para 3.3.2.(viii) of the draft of "An Approach to the 11th Five Year Plan" has also commented on the undesirability of the area based exemptions. To quote :-

> **"The existing incentive programmes such as those available for the North East, J&K, Himachal Pradesh and Uttranchal need to be reviewed with a view to assessing their impact on industrialization in these regions. The extension of excise duty exemption to Himachal and Uttranchal has had an adverse impact on industrial investments in both the North Eastern region and the adjacent States. Consideration would need to be given to restricting these incentives to only hilly areas or to replacing these incentives by a special programme for roadways and railway development in these States."**

The area based exemptions erode the tax base. The revenue foregone on account of area-based exemptions is estimated to be Rs. 8,073 crores in 2007-08. Further, the case for providing area based exemption is extremely weakened in the face of our recommendation for a sharp reduction in the combined rates of CGST and SGST and the ease of compliance through a combined transaction reporting and payment Form No. GST-I.

In view of the above, the task force recommended that the area based exemption in respect of CENVAT should not be continued under the GST framework. In case it is considered necessary to provide support to industry for balanced regional development, it would be appropriate to provide direct investment linked cash subsidy.

(*r*) *Treatment of Special Economic Zones*

Since the GST is designed to ensure that all producers and distributors are treated as complete pass- through and exports are zero-rated, there is no case for allowing any form of incentive to the developers of, or units in, the Special Economic Zones. The task force recommended accordingly.

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Constitutional provisions with respect to GST law in India

The Constitution (One Hundred and Twenty Second Amendment) Bill, 2014 was passed by Lok Sabha on 6th May, 2015. The said Bill on a motion moved by the Hon'ble Minister of Finance, Corporate Affairs and Information and Broadcasting, was referred to the Select Committee for examination.

The proposed amendments in the Constitution are targeted to achieve the objective of conferring simultaneous power on Parliament and State legislatures to make laws for levying GST simultaneously on every transaction of supply of goods & services. In addition, the proposed amendments would allow subsuming of a number of indirect taxes presently being levied by Central & State Governments into GST and thus will remove cascading of taxes and provide a common national market for goods and services.

The Bill contains 21 clauses and these clauses propose to, *inter alia*, amend Constitution of India by inserting new Articles-246A, 269A and 279A with respect to special provision to Goods and Services Tax, levy and collection of Goods and Services Tax in course of inter-state trade or commerce and Goods and Services Tax council, respectively. Apart from that, the bill also purports to amend Articles 248, 249, 250, 268, 269, 270, 271, 286, 366 and 368 of Constitution of India and amendment of the Sixth and the Seventh schedule of the Constitution as well. The Bill also seeks to repeal Article 268A of the Constitution.

By bringing this bill into effect, the Government of India intends to usher in fundamental systemic reforms in the indirect taxes dispensation currently being implemented in the country by integrating and harmonizing the tax structure across the country in the form of Goods and Services Tax (GST). The proposed amendments would subsume a number of indirect taxes presently being levied by Central and State Governments into GST thereby doing away the cascading of taxes and providing a common national market for Goods and Services. The aim to bring about these amendments in the Constitution is to confer simultaneous power on Parliament and State legislatures to make laws for levying GST simultaneously on every transaction of supply and Goods and Services.

Salient features of the Constitution (122nd) Amendment Bill, 2014

The salient features of the GST Bill as introduced in the Lok Sabha are as follows:-

(a) subsuming of various Central indirect taxes and levies such as Central Excise Duty, Additional Excise Duties, Excise Duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955, Service Tax, Additional Customs Duty commonly known as Countervailing Duty, Special Additional Duty of Customs, and Central Surcharges and Cesses so far as they relate to the supply of goods and services;

(b) subsuming of State Value Added Tax/Sales Tax, Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States), Octroi and Entry tax, Purchase Tax, Luxury tax, Taxes on lottery, betting and gambling; and State cesses and surcharges in so far as they relate to supply of goods and services;

(c) dispensing with the concept of 'declared goods of special importance' under the Constitution;

(d) levy of Integrated Goods and Services Tax on inter-State transactions of goods and services;

(e) levy of an additional tax on supply of goods, not exceeding one per cent. in the course of inter-State trade or commerce to be collected by the 14 Government of India for a period of two years, and assigned to the States from where the supply originates;

(f) conferring concurrent power upon Parliament and the State Legislatures to make laws governing goods and services tax;

(g) coverage of all goods and services, except alcoholic liquor for human consumption, for the levy of goods and services tax. In case of petroleum and petroleum products, it has been provided that these goods shall not be subject to the levy of Goods and Services Tax till a date notified on the recommendation of the Goods and Services Tax Council.

(h) compensation to the States for loss of revenue arising on account of implementation of the Goods and Services Tax for a period which may extend to five years;

(i) creation of Goods and Services Tax Council to examine issues relating to goods and services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government. It is further provided that every decision of the Council shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting in accordance with the following principles:—

(A) the vote of the Central Government shall have a weightage of one-third of the total votes cast, and

(B) the votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast in that meeting.

(*Source*: Report of select committee on the constitution 122nd Ammendment bill, 2014)

The text of the Bill as introduced in Lok Sabha is appended.

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10

Industry Expectation vis-a-vis Industry Impact

FICCI's views on some key aspects of the GST.[6]:

1. Option for the States to stay out or opt out of the GST

It is understood that the Centre and the States may proceed with implementing the GST irrespective of the fact that some States may opt not to come on board at the time of its introduction. Further, it is understood that States may also be given the option to opt out of the GST at a point of time subsequent to their introducing the GST.

It will be appreciated that simultaneous operation of the existing VAT regime and the new GST regime negates the objective of a common market in goods and services. It will also impose considerable hardship on the industry. Further it would lead to some peculiar issues such as taxability of inter-state transactions where, under the existing tax regime, the originating State is empowered to collect tax whereas, under the GST regime, it will be the consuming State which would demand taxes based on the destination principle. Further, the dual compliance requirements under the two regimes would lead to complexities and increased costs of compliance.

It is therefore recommended that if any of the States wish to remain outside the ambit of the GST for some period of time, the CST should, in any case, be replaced by the IGST. In other words, the recommendation is that in any case, no origin based tax such as the CST should continue to be in the statute post the introduction of a destination based consumption tax such as the GST. Moreover, once these States join in later, they cannot continue to retain the option of withdrawing from the GST at a subsequent date.

2. Rates of tax

***Goods versus Services*:** There should be a uniform rate of GST applicable on both goods and

6. Towards the GST an approach paper- FICCI

services. This will put an end to interpretative disputes on what are "goods" and what are "services". For example, in the existing tax regime, there are divergent views between the tax-authorities and the tax-payers on whether software, customised or otherwise, should be taxed under VAT or Service Tax. Moreover, a common rate will also do away with the cumbersome and dispute prone method of segregation of works-contracts between the goods portion and the services element in order to determine the tax liability.

Number of Rates: The tax structure should be simple and should have minimal rates. FICCI is of the view that (a) there should be one Standard Rate (RNR) applicable on all goods and services; (b) a common list of goods and services under a Concessional Rate (*e.g.*, for basic necessities like grains, pulses, cereals, edible oils and public utilities); and, (c) a common list of exempted goods and services.

Band of Rates: Some States seem to be in favour of a band of rates in the GST regime - in line with the practice adopted by the European Union and perhaps elsewhere - in order to have flexibility in the rate structure. Adoption of a band of rates is undesirable since the resultant differential tax rates between neighbouring tax jurisdictions create tax arbitrage opportunities and encourage clandestine trade. In the European Union, smuggling of goods like mineral oils, cigarettes, alcohol, perfumes and the like have reached alarmingly high levels with huge revenue losses for the member countries. FICCI therefore recommends that a uniform rate of GST be adopted for a category of goods or service as against a band. If the band is completely unavoidable, the recommendation would then be that the band be a very narrow one in range, not extending beyond two percentage points.

3. Classification of Goods and Services

(i) Classification of goods should be uniform across the Centre and the States. Differences in classification and consequently, applicability of different rates of tax – as is the case under VAT, leads to avoidable litigation and lock-up of tax revenues. FICCI is of the view that the internationally accepted Harmonised System of Nomenclature (HSN) be adopted for classification of goods under the GST. It would be pertinent to note that the HSN has been adopted for the Central Excise Tariff and the Customs Tariff (as also the import policy and maintenance of foreign trade statistics) and logically, the same should be adopted for the GST as well. Further, on imports, the Basic Customs duty will be determined by Customs Authorities on the basis of the HSN code. The GST on import of the same goods should obviously be with reference to the same HSN, especially as it is expected to be collected by the same Customs Authorities.

(ii) Insofar as services are concerned, the Negative list of Services – implemented with effect from 1st July 2012 has obviated the need for classification since almost all services are now under the Service Tax net.

4. Threshold Limits

(i) As far as threshold limits are concerned, it is understood (as per the First Discussion Paper on GST issued by the EC) that different threshold levels are proposed for the CGST - Goods (Rs. 1.50 crore *p.a.),* CGST-Services (appropriately high) and SGST (Rs. 10 lakhs *p.a*.). In addition, a Composition Scheme has been suggested with a gross turnover limit of Rs. 50 lakhs *p.a*.

(ii) FICCI believes that different threshold levels may cause confusion amongst the trade and also encourage unethical practices. Ideally, the threshold level should be uniform across goods and services and be the same for both CGST and SGST. A sufficiently high threshold level will enable ease of tax administration since the tax will be collected from only those tax-payers who have a sizeable turnover (and thus, tax liability). A high threshold level will also ensure that small and marginal traders do not face any hardship on account of the rigorous record-keeping and compliance requirements anticipated under the GST.

(iii) A large segment of trade and industry comprising of micro, small and medium scale enter-prises will require time to transition to the GST. Suitable threshold limits and composition schemes should be incorporated in the statutes to provide relief to the MSME sector.

(iv) Accordingly, FICCI recommends that a uniform threshold limit be set and further that this limit for registration under both the CGST and the SGST be set at a gross turnover of approximately Rs. 50 lakhs *p.a.* Thereafter, a composition Scheme could be introduced for annual gross turnover between Rs. 50 lakhs and Rs. 1 crore.

5. Exemptions

• ***Area Based Exemption Schemes***

(i) Exemptions from indirect taxes like Central Excise and VAT have been extended to industry under various schemes of the Central and the State Governments. These schemes serve the twin objectives of development of industrially backward areas as well as encouragement to industries that are considered to be critical for the economic development of the country.

(ii) Based on the nature of exemptions and the time period for which such exemptions have been granted, industry has made significant investments across the country. Accordingly, it is for consideration whether these exemption schemes should be grandfathered to continue up to their legislated lives. This could be done by granting exemption from the GST, where the current exemption is for both Central Excise and VAT, or by granting exemption from the CGST, in cases where the existing exemption is from Central Excise, and exemption from the SGST, if the existing exemption is from VAT. More importantly, in order to ensure that there is no break in the GST chain, conversion of the exemption schemes to cash refund schemes must be carried out so as to ensure that the grandfathering of these benefits do not impact the GST value added chain. FICCI, therefore, recommends that all existing exemption schemes be converted into cash refund schemes for the remaining duration of their validity or for the remaining portion of the underlying investment value.

• ***Uniform Exemptions under Central and State GST***

(i) It is necessary to bring uniformity in the list of goods which are exempted and in the list of merit goods under both Central Excise and State VAT in order to ensure smooth transition. These lists need to be aligned across all States before the introduction of the GST, so that the rate changes are uniform at the time of transition. FICCI strongly recommends therefore that these lists be standardised across the CGST and the SGST prior to their coming into force.

6. Neutralisation of Taxes / Prevention of Tax Cascading

(i) In a GST regime, full neutralization of input taxes must be guaranteed in order to remove tax cascading. The efficiency of neutralization would, to a large extent, ensure the success of this fiscal policy imperative. Accordingly, the common list of exempt goods and services should be kept to a minimum and wherever required or desirable, goods and services should be "zero" rated. This will ensure that the tax chain is not broken and that all input taxes are recouped. Consequently, input tax credit of GST on goods and services must be allowed to all tax-payers without any restrictions like nexus of inputs to output or disallowances on account of stock-transfers. Obtaining refunds in the existing VAT regime is a long drawn process and assessees have to follow cumbersome procedures and frequently engage in litigation with the Commercial Tax Department/Central Government Tax administration. In order to avoid such cash lock up under GST, an automatic refund system should be put in place for input taxes related to all "zero" rated goods and services. Further, it is recommended that all unutilised input tax credits at the end of the fiscal year should be either refunded in cash or be allowed to be carried forward to the next financial year, at the option of the assessee. This is in line with global best practices.

7. Uniform Laws and Simple Tax Administration

(i) To ensure seamless implementation of GST and full compliance with the provisions of the GST, including on documentation, all Invoices, Returns, Forms, Challans, Accounting Codes and so on must be uniform across the country. In addition, the procedures and documentation for collection and payment of tax, movement of goods, returns, assessments, *etc.,* under GST must be simple, transparent and assessee friendly with reliance on private records rather than on maintenance of voluminous statutory records.

(ii) FICCI also recommends an expeditious release of the draft GST Tax code by both the Centre and the States so as to allow industry to assimilate and suggest changes / modifications.

(iii) Multiple jurisdictions and multiple filing of returns are undesirable under GST. Assessees should be required to submit one composite return covering CGST, SGST and IGST and be subjected to one common jurisdiction with uniform assessment proceedings. It is recommended that the jurisdiction and consequently, assessment, scrutiny, audit, etc. be the responsibility of a single authority, representing both the Centre and the States.

(iv) Under the prevailing tax regime assessees are subjected to audits by the central tax authorities, *i.e.,* Central Excise and Service Tax Audit. At the State level, VAT was supposed to usher in an era of self-assessment and audit of a few assessees on a sample basis. The reality is that whilst the Department has continued with "scrutiny-assessment" and audit of almost all assessees, over and above this, most VAT laws require audit of assessees' records by an independent Chartered Accountant. Under the GST, the concept of a risk based audit should be introduced based on international practices and audit by the Department should only be conducted in cases of any attempted tax evasion. The assessees with proven track record should be given the facility of self-assessment.

8. Unified adjudication and appellate Authority

(i) It is expected that there will be uniform provisions for both SGST and CGST with respect to classification, valuation, input credits etc. Any dispute that may arise would typically encompass both CGST and SGST. Hence, there cannot be separate adjudication of the same dispute by the Central Government and State Governments. It is hence imperative that the existing adjudication mechanisms be unified to handle the litigation and the decisions of such authorities be made binding on both the administrations.

(ii) A professional administration of taxes and uniformity in approach is mandatory – this will minimise the scope for diverse interpretations and proceedings and simultaneously, aid the evolution of a uniform fiscal law across the country. This is critical if the GST is to succeed.

9. GST network & removal of check posts / elimination of entry permits

(i) The current system of entry permits/way bills not only increases transaction costs but also delays the business cycle. The GST Network is expected to facilitate the introduction of online information input at each check post and thereby eliminating the cumbersome procedure of entry permits/way bills.

(ii) The GST Network (GSTN) will need to be a robust automated system for registrations, movement of goods, returns and payments. However, before the advent of the GST, current systems should be revamped in order to create databases for procedures such as registrations that can be replicated in the GSTN. It is therefore desirable that States adopt common GSTN based procedures for registration, payment *etc.*

10. Transitional Issues

There is currently no understanding on how transitional issues will be dealt with upon the introduction of the GST. For a seamless changeover to the GST, it is vital that information on transitional provisions be placed in the public domain well in advance to enable industry and policy-makers to engage in determining the best way forward. Further, the IT solution service providers can also make modifications in the ERP and MIS systems in order to ensure easy adaptability of the GST. Particularly, the following issues need to be addressed as on the date of changeover to the GST:

(i) treatment of accumulated Cenvat and VAT credits in the hands of the tax-payers.

(ii) treatment of tax-paid inventory – both with manufacturers as well as with trade.

(iii) taxability of un-invoiced services.

(iv) taxability of continuing contracts

(v) taxation of transactions that straddle the date of implementation of GST – both in respect of domestic transactions as well as imports.

FICCI recommends the following measures to resolve the aforesaid issues:-

(i) As far as accumulated credits of taxes are concerned, it is recommended that these be converted to deemed GST credits. Credits of all central taxes can be deemed to be CGST credits while credit of State / Local level taxes can be deemed to be SGST credits.

(ii) Embedded taxes in inventories could also be dealt with in a similar manner – all central taxes em-bedded in inventory could be deemed to be CGST credits and State/Local taxes as SGST credits.

(iii) As far as inventories of finished goods in the hands of trade are concerned, the GST laws may provide for a one-off window of, say, three months from the date of implementation of GST wherein goods can be sold at the pre-GST MRP. This will ensure equitable treatment of goods – on which excise duty and VAT have been paid – remaining unsold at the time of implementation of GST.

In the event this is not possible, credit of embedded excise duty may be allowed on the basis of certified stock in hand and a declaration from the manufacturer – endorsed by the manufacturer's jurisdictional excise office – with respect to the excise duty per unit paid by the manufacturer at the time of clearance of goods.

(iv) In case of un-invoiced services, the same to be taxed at the rate of Service Tax prevailing prior to GST in case the service was completed before implementation of GST. In case of continuous services, the portion completed before GST implementation to be taxed at the Service Tax rate and the services provided thereafter to be taxed at the Standard Rate of GST.

In respect of transactions that straddle the date of implementation of GST, embedded taxes (Central Excise and/or VAT) should be allowed as CGST/SGST credits, as the case may be, and all forward transactions thereafter should be under GST. Similarly, in respect of imports, all goods reaching Indian ports before implementation of GST should be subjected to CVD and SAD (as applicable), with credit of such CVD and SAD extended to the importer under CGST and SGST respectively.

Conclusion

The above points that have been discussed in the Approach paper are illustrative and not exhaustive. However, these points are of critical importance as they are fundamental to the effective introduction and implementation of the dual GST. It is now well-recognized and understood that the GST is a necessary condition if the country has to go back to double digit GDP growth. It is hence of utmost importance that the GST that is to be introduced is well thought-out and is introduced only upon the Central Government and the State Governments being fully and completely ready and prepared. Industry is a key stakeholder and FICCI, as a leading representative of industry, is ready and keen to engage with the authorities at all levels in order to ensure that the GST is business friendly and is introduced in a manner that it becomes a “win-win” for everyone. It is, therefore, FICCI’s hope and request that all aspects of GST are fully and adequately discussed and debated before they are incorporated in the statutes. We hope further that FICCI will be provided ample opportunities to engage with the Empowered Committee as well as the Central Government as soon as the final recommendations of the 3 panels are debated and discussed. In order for a fundamental fiscal reform such as the GST to succeed, it is imperative that all stakeholders are fully on board and are in agreement with the underlying proposals. FICCI is ready to partner with the Empowered Committee and the Central Government as well as any other stakeholders in order to bring about a modern GST, in line with the international best practices, within shortest possible time.

Concerns of Petroleum industry

(1) Input (goods and services) consumed in exploration and production of crude oil and natural gas will be under the GST regime while crude oil and natural gas will be outside GST.

(2) Crude oil ,which is input for re finery will be out side the purview of GST where as other inputs for refineries will be under GST.

(3) Crude Oil ,Natural gas ,MS, HSD, and ATF will be outside GST and will remain under

existing taxation system. Other Petroleum products, such as Naphtha, Light Diesel Oil, Kerosene, furnace oil, etc. will be under the GST regime.

The above will lead to:

- avoidable multiple tax regimes for petroleum sector
- Extra burden on the consumer and add to the tax burden on the Petroleum sector/ Economy.
- will result in more compliance work for Governments and the Petroleum Industry

Alcohol Industry –Requests for Consideration

- To include alcoholic beverages under the GST regime based on –recommendations of the JWG, the FC and the DoR;–International precedents–Adverse Impact of exclusion
- State excise may continue on the products at current rates less GST
- CGST collections on supplies of Alcohol may be apportioned to States
- State excise rates to be adjusted based on estimates of SGST collections and the CGST allocations to States to maintain revenue neutrality for States

ŸSolicit consensus of States based on revenue neutrality, equity and growth considerations

ŸExclusion of alcoholic beverages from GST, if necessary, should not be through exclusion from the draft bill but through an appropriate exclusion in the GST legislation –just as in the case of sevices [Clause (12A) of Article 366 to be amended]

Transportation and Logistics Industry[7]

Change in business strategies for logistics and warehousing service providers:-

Currently, the decision to base inventory and distribution models are based on levy of Central Sales Tax and varied state-Value Added Tax (VAT) rates and provisions. Tax optimization and administration is often considered over the operational and logistics effi ciency. However, under the GST regime the tax will be levied on stock transfers and full credit will be available on inter-state transactions. This will free the decisions on warehousing and distribution from tax considerations and decisions will be based purely upon operational and logistics efficiency.

This will lead to change in dimensions for logistics requirements of the clients forcing logistics service providers to rethink their business operations including creating new warehousing and logistics locations and expanding / closing existing warehouses at certain locations. In

7. KPMG and CII- Transportation & Logistics, Goods and Service Tax Ready. Steady. Go?

fact, networks and infrastructure associated with warehousing and logistics hubs are expected to be most impacted in the entire supply chain. Network and infrastructure related businesses would get drastically realigned, ensuring proximity to manufacturing locations or consumption markets and ultimately resulting into several hub-and-spoke models. From the infrastructure perspective, the scenario would consist of lesser number of warehouses but with larger sizes, amounting to consolidation of currently widely spread warehouses almost one in each state. This would translate into expansion of some of the existing warehouses, development of new ones and indeed shutting down of several existing setups. In addition, locations of strategic significance for warehousing and logistics networks would eventually also turn out to be critical transportation hubs. Such impacts would command fulfilment of certain pre-requisites pivoted around infrastructure including land availability, road/rail/multimodal connectivity, power, etc. This would in turn require all stakeholders – Logistics Service Providers (LSPs), end users, industry associations and the government – to plan in advance so that foreseeable issues could be addressed in time and would help evolve a more agile, efficient, flexible and futuristic supply chain. LSPs and their end users both would need to re-engineer their supply chains, focusing on optimal locations for warehouses and logistics centres. Some of the target regions would include Chennai-Bangalore belt in the South, Nagpur region in the Central part and Mumbai-Gujarat-Rajasthan- National Capital Region (NCR) corridor in the North-West, driven by the high potential for upcoming manufacturing activities and the planned Delhi-Mumbai Industrial Corridor (DMIC).

Recommendation: In order to assist industry players to optimally develop and successfully implement revamped supply chains, government may commission an exhaustive study to identify tactical locations for logistics-cum transportation hubs, multimodal opportunities, crucial haulage corridors and related infrastructure requirements. Findings of such a study would help the Government to be ready with the infrastructure requirement once GST is introduced and would also alleviate the concerns and nervousness that industry players currently witness regarding the expected benefits and unforeseen challenges GST may bring up.

Cash Impact Planning

Currently, abatements are available to transport service providers under the Service Tax law. These are not likely to continue in the GST regime. Also, the liability to pay tax may shift from the recipient of service to provider of transport service requiring it to pay full taxes on accrual basis. On account of this, a major impact will be seen on the cash flow for transport service providers who generally operate on marginal profit basis. Businesses need to quantify the cash impact and realign their working capital strategies to reduce / mitigate the cash flow impact.

Recommendation: An alternative model for taxing transport service providers will have to be evolved to mitigate the cash flow implications on the transport service providers.

Petroleum Products – Impact of exclusion from GST

The most important benefit under the GST regime would be availability of credits across goods and services on all purchases and inputs used in the course of business with denial of input tax credits in very exceptional circumstances only. This will help achieve the goal of introduction of a truly consumption tax, reduction in the operating costs for businesses and rationalization of the cost of goods and services It is proposed that petroleum products will be out of the GST net. This will have severe implications on the Transportation sector, where motor spirits constitutes the largest cost component for the business (almost 55-60 percent). On the other hand, GST at the full rate will be payable on the transport charges. Exclusion of petroleum products from the GST net will break the chain of credits thus adding to the costs.

Recommendation: Petroleum products should form part of the GST regime albeit with a higher of rate of tax. Input tax credit should be fully allowed to transportation service providers.

Place of Supply, Tax Administration and Input Tax Credits

The most important change will be the transition from the present central tax regime (service tax) to the dual GST regime requiring payment of taxes simultaneously to the Centre and States and compliances across the country. The Place of Supply rules will govern the State where the tax will be payable on any transaction of Transportation & Logistics. In the case of warehousing, the Place of Supply can be defined as the place where the warehouse is situated. On the other hand, for transportation contracts, taxes may be levied by each State through which the goods move, perhaps based on the distance traversed in each State or alternatively in the State from where the journey of transport commences. The latter that is, the State from where the journey of transport commences, would be an ideal basis for taxation. Though being a simplistic model, the same would pose challenges to the transportation service providers such as registration and compliances requirements across all the locations from where the goods are loaded and dispatched. Also, another challenge envisaged is the ability of the transportation service providers to capture credits in respect of the expenses incurred enroute. Transportation service providers may incur expenses in different States during the journey from one location to another and it will be essential to avail input tax credits on such costs. In the event, appropriate rules are not framed under the GST law for claim of these credits, the transportation sector will have to be ready to absorb the impact on account of these tax costs.

Recommendation: It will be essential to evolve a mechanism for centralized registration and compliances, the absence of which will add to the administrative costs of the service providers. Scrutiny of records, etc. by multiple States will complicate tax compliance. On the other hand, States may fi nd it diffi cult to track and tax the transactions taking place in their respective territory. Similarly, only centralized registration will enable transportation service providers to claim and utilize credits on expenses incurred enroute. In the absence of such mechanism, there could arise situations requiring claim of refunds from different States.

Critical business implications in light of expected increase in organized business

Supply chain re-engineering:

Many service providers and end users would revamp their supply chains, realigning the locations of warehouses, corridors used and transportation options exercised, thus generating tremendous business opportunities for Fourth-party Logistics (4PL) firms specializing in supply chain reengineering as well as for providers of network optimization tools such as Transportation Management Systems (TMS).

***Transportation*:**

Re-organized countrywide networks would decrease cost of primary freight since warehousing locations are likely to be placed closer to manufacturing/import/export locations. In contrast, this would increase secondary freight due to fewer warehouses.

Outsourcing:

The expected improvement in service levels and more competitive pricing due to increased penetration of organized players may pull end users/ manufacturers to re-think their conventional inhibitions towards outsourcing.

***Consolidation*:**

Increased availability of efficient and organized players may spur a wave of consolidation activities, including inbound and domestic transactions. Increasing business collaborations among new entrants and fresh unorganized-turned-organized players may be visible. This may catalyze collaborative usage of supply chain assets, thus driving efficiency for all stakeholders.

Service levels:

- The general service levels may witness an upswing. Especially, hi-end Value Added Services (VAS) such as world class track and trace, kitting, picking and packing may witness increased application.
- Increased demand/supply of day/time-defi nite services is also likely due to increased customer expectations and better organized supply chains.

***Automation*:**

Efficient handling of larger volumes per warehouse (owing to new/ consolidated warehousing) would command increased reliance on automation/ technology applications such as Put-to-Light, Pick-to-Light, Enterprise Resource Planning (ERP) and Warehouse Management System (WMS).

Skill set up gradation:

With increasing share of organized logistics setups, the need for technically qualified and optimally skilled workforce across the supply chain is likely to become more glaring. Hence, to cater to this increasingly indispensable need, supply of skilled workforce may improve.

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11

GST treatment of Inter State movement of Goods & Services

Extract from report of select committee relating to IGST

Clause 9 of the Constitutional Amendment Bill, seeks to insert a new Article 269A which provides for goods and services tax on supplies in the course of inter-State trade or commerce which shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council. It also provides that Parliament may, by law, formulate the principles for determining the place of supply, and when a supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

The Ministry of Finance, Department of Revenue stated that while "sale" is for consideration, "consignments" are in the nature of branch transfers. "Supplies" would constitute both "sale" as well as "consignment" transactions. Further, since GST charged on supply of goods and services would be VATable, this would not have any cascading impact. Since input tax credit would be available for GST paid on both sales as well as consignments in the course of inter-State trade, there would be no cascading impact of levying GST on supplies of goods and services in the course of inter-State trade. The words 'on the recommendations of the GST Council' have been added to proposed Article 269A (1) vide this clause. This would ensure that the law made by Parliament for apportioning the proceeds of IGST between the Union and the States will be made on the recommendation of the GST Council. This has been done as per the recommendations of the Empowered Committee after their meeting in Shillong in November 2013.

The Committee recommended that since imposition of GST on the supplies of goods and services in the course of inter-State trade would not lead to cascading of taxes, hence the Clause may be adopted with no change.

Extracts from First Discussion Paper on Goods and Service Tax in India

The Empowered Committee has accepted the recommendations of the Working Group of concerned officials of Central and State Governments for adoption of IGST model for taxation of inter-State transaction of Goods and Services. The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

The major advantages of IGST Model are:

(a) Maintenance of uninterrupted ITC chain on inter- State transactions.

(b) No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.

(c) No refund claim in exporting State, as ITC is used up while paying the tax.

(d) Self monitoring model.

(e) Level of computerization is limited to inter-State dealers and Central and State Governments should be able to computerize their processes expeditiously.

Observations/ recommendation of Standing Committee on Finance- 15th Lok Sabha

The IGST model envisages that the Centre will levy tax at a rate approximately equal to (CGST + SGST) rate on inter-State supply of goods and services. It will be collected by the Centre and transferred to States depending upon whether the State is net exporter or net importer for the given period of settlement. The Committee note that the settlement of accounts will be done by the Centre that would function as a clearing house for this purpose. The proceeds of the IGST arising out of inter-state trade or commerce shall thus be used for the settlement of accounts among the States for the flow of input tax credit in the course of Inter-State transactions based on, "destination principle" thereby providing a continuous credit chain across States. The Committee further note that to the extent, goods or services are supplied from one State to another for further distribution, IGST transactions would be revenue neutral. However, in practice, there may be a possibility of a positive balance in the proceeds of IGST at the end of a fiscal year. The Committee, therefore, desire that a suitable proviso in the Article 269A in both Clause 9 and Clause 10 of Amendment Bill may be made for distribution of remaining proceeds of IGST when the accounts of the fiscal year have been settled.

It has also been submitted to the Committee by some experts that the IGST model could be onerous in terms of compliance and administrative burden and that since it is meant for effectively tax inter-state trade on destination principle, the Central Government need not get involved in this process. A simpler model (Modified Bank Model) as recommended by the Task Force on GST set up by Thirteenth Finance Commission has been suggested for settlement of proceeds arising out of inter-state trade. The Committee note that the Central Government will only act as a clearing agent with regard to IGST, which remains in effect a clearing mechanism between States for inter-State transactions. The Committee would thus suggest that the alternate model, suggested by the Task Force on GST constituted by the 13th Finance Commission could be considered with a view to simplifying and easing compliance and administrative burden and ensuring a smooth clearing house mechanism between States for facilitating the process of IGST after consideration by the GST Council. Further, as the destination-based IGST model favours predominantly consumer States more than producer States, the revenue concerns of these States also needs to be factored in and duly addressed. The proposed model should not thus act as a dampener or dis-incentive for States with a strong manufacturing base.

Extracts from Report of the task force on Goods and Service tax, Chapter III

The Indian Constitution as it originally stood envisaged taxation of interstate sales only in the state where it was consumed. Unfortunately, this led some states to issue notices to dealers not resident within their jurisdictions to file returns. To bring some order in the matter, a law was enacted by the Parliament in 1956 authorising the central government to levy a tax on interstate sales called the central sales tax (CST). But the power to administer the tax was delegated by the Centre to the states of origin of the sales who were also allowed to retain the revenue. Initially, the tax was levied at the rate of only 1 per cent but it was raised successively to 4 per cent. In 2006-07, the Central Government and the State Governments came to an understanding to reduce CST in a phased manner and completely eliminate it by 1st April, 2010. Accordingly, the CST was reduced to 3 per cent. in 2007-08 and subsequently to 2 per cent. in 2008-09. However, on account of revenue implications, it has now been decided to continue with the CST at the present level of 2 per cent until GST is introduced.

The rate of CST is 2 per cent if the sale is between two registered dealers across states and the transaction is documented through the use of "C Forms". The latter is issued by the importing state to the importing registered dealers within the state, and is submitted to the exporting dealer in order that the latter can avail himself of the concessional rate of tax. If the good is sold to unregistered dealers outside the state and is not a declared good, the transaction, by law attracts the rate applicable in the exporting state. If the rate applicable in the exporting state is less than the CST rate, the transaction is not required to be documented through the "C Form". Since sales tax applies only when there is a sale, no tax is attracted when goods move from one state to another as transfer between branches of the same enterprise or on a 'consignment' basis.

The CST constitutes a distorting factor in the location of industries and the flow of internal trade, impeding the growth of a truly common market in the country. It also causes inter-jurisdictional inequity and reduces the international competitiveness of exports. Further, the administration of and compliance with the CST is also beset with problems. The Department is constantly under pressure to monitor the exports to registered dealers. Similarly, the importers have to incur considerable transaction cost to procure "C Forms" from the department. The exporters are also burdened with the responsibility of obtaining the "C Forms" from the importers on time. Further, the treatment of branch transfers and consignment sale under the CST provides an easy avenue for evasion. In spite of the adverse economic implications of the CST, the States have come to acquire a vested interest in maintaining the status-quo since it account for about 15 per cent of their tax revenues.

In the context of the GST, it is necessary to resolve the problem relating to the treatment of inter-state sales/transfers in a manner that the incidence of the tax falls on the consumption of commodities without any distortionary cascading effect and the revenue accrues to the State where the final consumer is located.

The Empowered Committee of State Finance Ministers had set up a Working Group for designing the model. The following models for treatment of inter-state trade have been analysed by the Group:-

(i) Bank model

(ii) TDS model

(iii) SGST authority model

(iv) CGST authority model

(v) TINXSYS (De-matted C-form) model

(vi) TINXSYS with reverse charge model

(vii) Full De-mat model

(viii) Inter-State De-mat model

(ix) IGST model.

After a detailed analysis of the merits and demerits of all the models, the Group recognised that the success of every model depended on the following pre-requisites:-

(a) E-filing of return every month with dealer wise transaction details

(b) E-payment of taxes

(c) National Portal for access to information by member States and dealers

(d) National agency for overseeing the flow of information and taxes

(e) Strong IT infrastructure for the above issues

(f) The intra and inter state rates of tax should be equal to avoid evasion and camouflaging the intra state transactions as inter state transactions.

Based on its analysis, the Group has recommended the adoption of the IGST Model for implementation with the caveat that a *'strong IT infrastructure and complete information of the interstate transactions is a precondition and essential prerequisite for considering the IGST model. Without addressing these fundamental concerns of IT infrastructure and information support systems, the adoption of IGST model which is still at a conceptual stage is far from realistic at this stage in adoption of GST in the course of interstate transaction in goods and GST for the nation.'*.

The 'Road Map to GST' released by the Empowered Group of Ministers proposed the Bank Model as a mechanism to deal with inter-state transaction of goods and services. The functional components of the Model are :-

(a) Collection of SGST by the seller of the selling State.

(b) Remittance of SGST collected by the seller to the respective buying State's Account in the designated bank, along with the details of buyers and invoices.

(c) Transfer of remitted tax amount by the designated bank to the respective buying State.

(d) Refund of input SGST by the selling state to the seller in the event of inter-state transactions

(e) Allowance of Input tax credit to the buyer in the buying State to the extent of the SGST received by remittance and transfer of tax amount. The Bank Model was found to be more suitable Model, to monitor the interstate transactions of goods including stock transfer, on the following assumptions:

   (i) This model would ensure evasion free tax environment and easy administration of credit flow to the buyers in the buying States.

   (ii) This model envisages a level of automation that would ensure capturing all the information relating to interstate transactions in the exporting state and transferring the same to the importing state.

   (iii) This model requires the bank to evolve an IT infrastructure to communicate electronically with all concerned in respect of interstate transaction of goods through a national level portal and to provide the related information to all concerned.

The Working Group recognised that the Bank Model is a 'better system ensuring evasion free inter-state business environment'. However, the Group was of the view that it would entail higher cost of both compliance and administration. Further, it was also alarmed by the fact that 'few members' created an uproar by stating "*Why should the importing States permit their buyers* *to pay tax to the sellers of the exporting States and wait for the tax money so paid till remittance by the sellers and transfer by the bank to their exchequer?; and why can't the Importing States levy SGST on the interstate purchases treating them as import from outside for commencement and flow of SGST credit in the importing States?."* Therefore, the Group abandoned the Bank Model.

The task force have also analysed the various Models presented in the Report of the Working Group. The IGST Model recommended by the Group, while requiring a IT and complex accounting infrastructure, would also require a separate legislation for levy of IGST on inter-state transactions. This will have to be similar to the present CST legislation. Further, the IGST Model envisages that the IGST may be paid either by using the CGST or the SGST. Similarly, credit for the IGST by the buyer can be claimed to make payment of either CGST or SGST. Rules would also be required to be framed for prioritising the set off against CGST, IGST and SGST. This implies a complex accounting of input tax credit and apportionment between CGST and SGST which would considerably enhance both compliance and administrative burden. Further, the Centre and the States may also have to compensate each other at different points in time. It also envisages the establishment of a centralized agency for settlement of accounts between the Centre and the States. Therefore, the task force did not support the adoption of the IGST Model. The task force recommended a modified version of the Bank Model (hereafter referred to as 'Modified Bank Model') for inter-state trade in goods and services.

The functional components of the **Modified Bank Model** would be as under :-

(i) In the course of inter-state B2B supply, the seller in the origin State shall collect the SGST leviable on the transaction from the buyer in the destination State as if the sale was within the origin State.

(ii) The seller would issue an invoice to the buyer indicating the details of the transaction (including the date of the transaction) and his business identification number (BIN).

(iii) The seller shall use the input SGST for payment of the output SGST on both intra-state and inter-state transactions. To the extent total output SGST is in excess of the input SGST, the same shall be paid into any of the authorised bank in the prescribed manner. This will ensure a self-adjustment mechanism for input credit thereby minimizing the need for issue of refunds.

(iv) The buyer in the destination State shall make use of the SGST so paid in the State of origin for making payment of output SGST in the destination State.

(v) All registered dealers across the country shall pay the sum due as CGST and SGST to the credit of the Central Government and all other States within one week from the end of the month to which the sale transactions relate.

(vi) The Central Government and State Governments shall jointly identify a nodal bank to receive the collection of CGST and SGST by collecting banks nodal bank will also receive all information relating to purchase and sale by registered dealers.

(vii) The nodal bank shall host the IT infrastructure, provide payment gateway to all banks in India and provide screen-based upload or file upload facility for receiving payment and transaction information.

(viii) It would be mandatory for all registered dealers to make the payment by electronically furnishing Form No. GST-I, which would be a combined monthly payment and return form for all intra-state and inter-state transactions.

(ix) As far as the registered dealer is concerned, he would be required to make a **single payment** of the aggregate of all sums due to the Centre and all other States. Even though he would have collected tax in the Origin State for inter-state transactions with buyers in a number of destination States, he can fulfil his obligation of directly remitting the tax so collected to all the destination states through a single payment made along with the electronic furnishing of Form No. GST-I. This mechanism will have the benefit of extremely low compliance cost.

(x) It would be mandatory for all registered dealers to make electronic payment of CGST and the SGST by electronically remitting it in to the RBI, SBI or any authorized bank.

(xi) The procedure for making payment of CGST and SGST and furnishing information relating to transactions of both purchases from and sales to registered dealers in Form No. GST-I shall be as under:-

(a) Seller will open Nodal Bank website or approach GST facilitation centre (which will provide Bank website access and also guide Seller) to submit Form No.GST-I. The Nodal Bank would only serve as the payment gateway to facilitate payment in any bank in which the dealer has an internet banking account.

(b) Seller will enter his basic details such as his BIN, Name, Phone and email (Financial year will be current year by default and can be changed, date of deposit will be the current date) on Form No.GST-I.

(c) In case the number of Invoices for sale to registered dealers and purchases from registered dealers is less than 10, the Seller shall enter the details of such individual invoices online (Invoice number, date of the invoice, BIN of the registered purchaser or seller and amount of GST collected or paid for the Invoice). If the number of invoices for sale or purchase to registered dealers is more than 10 , the seller can enter these details offline and upload the file.

(d) The total of GST will be computed automatically and Seller can enter additional details for Interest, penalty or other amounts as applicable. The complete total will be calculated automatically and mentioned in figures and words.

(e) Seller will have to submit this information for payment by direct debit to his bank account (as per his selection on the Nodal Bank website) as is the procedure for any e-payment.

(f) Nodal Bank will transmit ONLY the total GST amount information, along with details of the Seller as per the challan information, to the bank for debit to the Seller's bank account. Nodal Bank will NOT transmit any information about the Invoices to the bank.

(g) The Internet banking website of the bank will be opened automatically and the Seller will have to enter his login and password relevant for internet banking to access his bank account. Then the total GST amount as per the challan will be debited to his account and credited to Government account by the bank.

(h) The bank will confirm to Nodal Bank details of successful deposit of GST amount to Government account.

(i) Nodal Bank, upon receipt of confirmation from bank of the GST payment by Seller, would generate the Form No. GST-I, which can be printed out by the Seller for his own record purposes.

(j) The Seller would issue an Invoice to the Buyer with details of the Invoice Number and the GST amount for that Invoice. The Buyer can verify if the GST amount has been credited to the Government by using the Seller BIN, Invoice number, date of invoice and Invoice Amount to verify the corresponding entry from the nodal bank website.

(xii) Input credit for GST would be available to the Buyer against that Invoice by using the combination of Seller BIN, Invoice Number, date of invoice and Amount of GST for that Invoice

(xiii) All banks receiving payments from the registered dealers would be required to transfer the funds to the Nodal Bank on T+1 basis. The Nodal Bank in turn would credit the funds to the respective States.

(xiv) The software can be designed in a manner which would have the capacity to allocate the amount paid by any registered dealer between the States on the basis of the business identification number of the buyer. The amounts so allocated can be automatically credited to the account of the destination States without any manual intervention. As a result, it would not be necessary to set up any clearing house mechanism whereby at any given point in time sums would be due to, or from, any other States. Therefore, the destination State would not be dependent on any other State for collection of revenue.

(xv) There will be no requirement for the buyer to make pre-payment of taxes separately for each transaction in the destination State. It will also eliminate the problem of extensive documentation like the 'C' Form in the case of CST.

(xvi) Since every registered dealer would be required to furnish information relating to both the purchases and sales to registered dealers, this would enable automatic matching of input credit claims and identify all mismatches for follow up action. This will eliminate any possibility of fraudulent claim of input credit and evasion.

(xvii) The Nodal Bank should be paid on per transaction record basis and the entire cost should be borne by the Central Government.

(xviii) Further, in case of any default, the administrative responsibility and control over the collection and recovery of SGST should vest in the origin State.

As described above, the Modified Bank Model will continue to be evasion proof as the Bank Model. Since the Model envisages a single payment mechanism through a combined monthly payment-cum-return Form No. GST-I, the registered dealer can develop the data relating to the transactions on a real time basis over the entire month and eventually upload the file anytime in the first week of the following month. As a result the compliance cost would be minimal.

The IT infrastructure would be hosted by the Nodal Bank and the State tax administration would be required to establish a central computer server to download the data from the Nodal Bank. The data so downloaded can be allowed to be used by its officers through IT Network or through any other communication system. This will also reduce immediate pressure to set up the IT infrastructure in all States on or before 1st April, 2010. Further, the Model does not envisage the establishment of a clearing house mechanism. Therefore, the Model is also administratively efficient.

As stated above, the Bank Model was abandoned by the Working Group in view of an alarm set off by few States. In this context, it must be recognised that trade flow is, in general, a two way process between States. Buyers in the destination State have to pay tax to the sellers in the origin State in all cases. Therefore, if buyers in State 'A' have made payment to sellers in State 'B' and, therefore, certain amounts have become due to State 'A', there would be similar situations where sellers in State 'A' would be required to make good certain amounts to either State 'B' or any other State. Hence, it would result in almost no gain or loss to any State as they would mostly cancel each other over a period of time and over a number of transactions. The problem lies in the fact that the seller is allowed a float for a certain period before remitting the amounts to the destination States. The alternate remedy of collecting taxes like on imports at the State border check posts is fraught with severe economic inefficiency. It has been well documented that border check posts are extremely inefficient mechanisms for tax collection since they slow down the movement of goods across borders which in turn translates into high cost of inventory management. The deadweight loss on account of such economic inefficiencies far outweighs the loss on account of float allowed to the sellers in the origin State. Therefore, we are of the view that the apprehensions expressed by few States on the Bank Model are exaggerated in the absence of sufficient information and analysis.

This may not apply to States which are net exporters. However, in the Modified Bank Model proposed by us, the input tax which would be required to be refunded by these States to the registered dealers within their jurisdiction on account of inter-state transactions would be required to be paid directly to the importing State and not to the dealer.

The Modified Bank Model would not require large resources to be committed since the nodal bank would be paid on per transaction record basis. Further, since the cost would be entirely borne by the Central Government, it would not impose any additional burden on the States. In fact, the states will be able to save resources since input credit mismatches will be automatically detected thereby significantly improving its effectivity. This Model does not require any separate clearing house mechanism as under the Bank Model. Under this Model, there is no possibility of default or failure on the part of the Sellers of the selling State to remit the SGST collected to the destination State since a single consolidated payment is required to be made in respect of all CGST and SGST liability.

In some quarters, doubts have been expressed about the efficacy of the Bank process in transfer and reconciliation of SGST remittances and its ability to handle and transfer the vast information of inter-state transactions of goods between millions of business entities across the State borders In this context, it may be pointed out that, even today, all taxes of the Central and State Governments are collected by the banks, reconciled and transferred to the Government at different levels. Further, the large volume of data can be smoothly handled by creating appropriate IT structure. Such capacity has been developed by TCS for NSDL to handle the Income tax Department's database. We believe other large IT firms like Infosys and WIPRO also have similar software design and IT project executing capacity. The Nodal Bank can hire any such firm for developing the IT structure for GST payment and transaction information management. Therefore, such doubts are entirely misplaced.

Another apprehension expressed relates to the refund of accumulated Input tax credit on the basis of interstate transaction of goods which would continue to be a challenge and require high level of audit trails. The accumulated input tax credit on the basis of interstate transaction can be utilised to make payment of output SGST in respect of local transactions. In most cases the accumulated credit would be fully exhausted. In cases where accumulated credit remains unutilised, the same would have to be refunded. The number of such cases may not be very large. Nevertheless, the Government can establish a centralised processing centre (CPC) for processing of returns (Form No GST-I), along the same lines as the CPC established by the Income tax Department at Bangalore. This will fully meet the challenge of issuing refunds. Another argument advanced against the Bank Model is that there is no international precedence (even in EU) in favour of adopting this model to the complexities of Indian situation. **Unlike in the EU, we have a common thread in the form of CGST which binds inter-state transactions**.

This, coupled with the system of consolidated payment of CGST and SGST **and** transaction related information, ensures a fool proof compliance mechanism.

In view of the above, the task force recommended that-

(i) all inter-state transactions in goods and services should be effectively zero rated by adopting the Modified Bank Model along the lines discussed in the aforesaid paragraphs.

(ii) the consignment sales and branch transfers across states should be subject to treatment in the same manner as if it was a inter-state transaction in the nature of sale between two independent dealers.

(iii) the function of all state border check posts should be reduced to checking contrabands by setting up large scanners for trucks to pass through without any need for physical verification.

(iv) The cost of the scanners should be entirely borne by the Central Government.

(v) All check-posts should be jointly manned by both States so as to reduce the number of check-posts and enhance efficiency in the road movement of goods.

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12

Preparing for transition to GST Implementation: Government as well as Trade & Industry

The Union Finance Minister in his budget speech for 2010 stated that all endeavours will be initiated to implement the GST by April 2011 along with DTC (Direct Taxes Code). Considering the complexity involved in the implementation and designing the proper administrative mechanism as well as consensus to be arrived at between the states and the union regarding compensation for possible revenue losses the states may suffer or the factors of revenue neutrality of such states, the probability of meeting the above date in respect of GST is remote. Though late, the steps taken by the union and states at the initiative of the empowered committee to introduce a revolutionary change in the indirect tax history of our nation are highly appreciable. The supports from all corners are to be duly extended to bring it into reality. On our way towards a developing nation we require a more civilized taxation structure.

Problems to be addressed in the GST regime[8]

There are a lot of unfriendly practices/procedures prevalent in the country's taxation regime directly affecting the Commerce and Industry. The trade and industry is looking at the introduction of GST as a free trade regime within the territory of India on the principle that 'one India one tax'. Some of the points the new taxation structure should address is listed below:

(i) Uniformity in forms and procedures

It is a known factor that Indian States are having different regional languages. When we are looking at India becoming a single tax destination, there should be a uniform language in official communications and forms or records used in taxation matters. Under the GST system the forms used across the nation shall have same numbers and the content should also be same. It

8. Extracts from article:- Transition to the GST regime- Rajesh Kumar K. Pillai, ACS. Senior Company Secretary and Compliance officer Malabar Gold Pt. Ltd., October 2010 Chartered Secretary

should be acceptable in all states within India. The Forms generated from one State must be freely acceptable in all other states falling across the movement of goods until it reaches the final destination. For example, in the case of delivery notes. It is a form widely used for sending goods from one state to another and for movement of goods within the state. Even in the VAT regime state have different numbers or other identification marks. In Kerala, delivery notes are given as Form No. 15, in the neighboring state, Tamil Nadu, it is given the identification as Form JJ. To do business in two states the trader shall follow how many forms. It is more a punishment for doing business in the country what ever may be the justifications the states can offer. Therefore in the GST regime if delivery note is devised, it should have a common content and identification name or number across all the states.

(ii) Practices in Check posts

Check posts are an inevitable part of the revenue administration for several reasons not only for checking tax evasion but in consideration of the security aspects also. The procedures in the check post in respect of all bonafide assesees to be simplified. The movement of goods shall be un-fettered. Mere mistake in the accompanying statements or records should be given consideration which will advance the interest of trade. Proper computerization is required at all levels with inter connectivity among the states. The officer in the check post must be able to access the originating states records in case of a doubt in the accompanying documents to see its authenticity. On satisfaction, he shall release the goods to its destination. There are several situations where goods are detained at the check post for small reasons. Several times goods are detained for production of a certificate from the assessing officers about the Registration number of the asessee, the reason being that the number shown in the records is having some mistakes. These kinds of approaches of the officers results in substantial loss not only to the trade and industry but to the revenue of the state also. Simple procedure in taxation legislation will ensure more compliance and the base of taxation will expand automatically. In many border check posts time taken by the checkpost authorities are unduly long. The efforts of new legislation should be directed to resolve this situation also. Simple and user friendly systems should be the theme of the new legislation.

(iii) Behavioral changes in authorities

It is a fundamental issue in our country that the true legislative intent or that of the policy framers for that matter is not transmitted to the authorities in the implementation/ monitoring levels. There is always a tug of war between the trading community and of tax officials. A vast majority of the officers are approaching an issue of the assessee in the angle of an attempt to evade tax. This approach has resulted in several avoidable litigations with the departments and the assessee. This is so even in case of assessments of Government companies/undertakings. The officers shall be given more freedom to deal with the cases in hand without the fear of un-necessary audit objections or victimization of the officers in the guess that an officer has taken a judicious view in a case. The present system and style of administration often put the officers on defence so that they are trying to put the interest of revenue only to avoid any personal harm to his career even in situations he is convinced that there is no attempt on the part of the trader to evade tax but the lapse is clerical or accidental. There should be a change to this approach and they shall be allowed to put their judgment fearlessly. This will help avoiding repetitive appeals and the valuable time and money being wasted by both the side more importantly this prolonged legal battle further troubles our judiciary already pregnant with bundles and bundles of cases. Each trader should be given the consideration that he is a pillar of our national economy. It is the duty of the system to strengthen him more and let him grow.

(iv) More efficient and friendly appellate mechanism

Another important aspect in tax reform is the strengthening of the appeal mechanism whereby the appellate authorities comes forward to look the cases in a judicious manner rather than adopting a protective measure of the interest or revenue forcing the assessee to prefer appeal to the next higher stages and finally ending with the High courts or Appex court speedy disposal of cases are very important to the interest of all concerned. Heavy penalties and never ending litigations are the products in the present system. It is not the intention of the author that evaders should not be punished. But to highlight that the authorities should not look at every one in the same way.

(v) Setting up of trader's forum

Along with the introduction of the GST, there will be arising a series of confusions among the trade and the lack of proper information among the field formations of the Government. Setting up of a traders forum in each Commissionerate will be of a great help in such a situation to assist the trading community in a better way. This kind of forums will also help to maintain the better relations between the authorities and the traders. Such forums shall have the representatives of traders and officers of the department alike. This forum shall act as the conduit between the trading community and the tax administrators. The matters that can be dealt with such forums should be listed after necessary dialogue with various forums of the traders.

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13

Evolving IT Systems & Business Structures

To reap the full benefits of the Goods and Services Tax, it is essential that a well designed and well functioning IT system is available to both the Centre and the States. With this objective and to facilitate the establishment of the IT infrastructure for rolling out the proposed Goods and Services Tax across the country, an Empowered Group on IT Infrastructure on Goods and Services Tax was constituted by the Government of India on 26th July, 2010. The Group prepared an IT strategy for Goods and Services Tax which was submitted to the Empowered Committee of State Finance Ministers for its approval. This strategy was considered by the Empowered Committee in its meeting held on 20th September, 2010. The Empowered Committee endorsed the IT strategy document for Goods and Services Tax prepared by the Empowered Group on IT Infrastructure and also agreed for the engagement of NSDL with all the States for Goods and Services Tax implementation specifically to study the issues related to incorporation of the State systems with the common portal and to study the requirements of the States. After which several meetings were held by the Empowered Group on IT Infrastructure on Goods and Services Tax. In the meeting held on 12th May, 2011, the Group had suggested setting up of a "Not for Profit" non-Government Company under Section 25 of the Companies Act with strategic control to remain with the Government. The Company is to run a common portal providing three core services, namely, registration, returns and payments. The recommendation of the Group about setting up of such a company was approved by the Empowered Committee and also the Government of India.

A Company, namely Goods and Services Tax Network (GSTN), was accordingly incorporated on 28th March, 2013. The Company will have shareholding of 51% of the private entities, 24.5% of the Government of India and 24.5% of all the States and Empowered Committee. The Chairman and the Directors from the Government of India, State Governments, Empowered Committee and the private entities have already been appointed. An Advisory Committee has also been constituted to advice the Goods and Service Tax Network (GSTN) Board on strategic matters, on the matters pertaining to levels of service delivery to be provided and matters relating to procedures and processes involving stakeholders. All the Commissioners of the Commercial Tax of the States and Union Territories have been nominated by designation to represent each State and UT on the Advisory Committee. (Extracts from annual report of EMPOWERED COMMITTEE OF STATE FINANCE MINISTERS, 2013-14)

Goods and Services Tax Network (GSTN) is a Section 25 (not for profit), non-Government, private limited company. It was incorporated on March 28, 2013. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions. The Company has been set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of the Goods and Services Tax (GST).

The Authorised Capital of the company is Rs. 10,00,00,000 (Rupees ten crore only).

Shareholders

Central Government	24.5%
State Governments & 2 UTs & EC Collectively	24.5%
LIC Housing Finance Ltd	11%
ICICI Bank Ltd	10%
HDFC Ltd	10%
HDFC Bank Ltd	10%
NSE Strategic Investment Corporation Ltd	10%

Goods and Service Tax

GST is a broad-based, comprehensive, single indirect tax which will be levied concurrently on goods and services across India. It will replace most of the Central and State indirect taxes such as Value added Tax (VAT), Excise Duty. Service Tax, Central Sales Tax, Additional Customs Duty and Special Additional Duty of Customs. GST will be levied at every stage of the production and distribution chains by giving the benefit of Input Tax Credit (ITC) of the tax remitted at previous stages; thereby, treating the entire country as one market.

Introduction of Goods and Services Tax (GST) in India is perceived to be the most ambitious initiative in the arena of indirect tax reform. It would change the Indian tax structure and pave the way for modernization of tax administration.

Desirable features of Goods & Service Tax Network (GSTN)

Simplicity for taxpayers: The process of filing of tax returns and payment of tax should be simple and uniform and should be independent of taxpayer's location and size of business. In addition, the compliance process should not place any undue burden on the taxpayer and should be an integral part of his business process.

Respect autonomy of states: The design of the IT system should respect the constitutional autonomy of the states. Several business processes will be re-engineered as a new IT system for GST is put into place. There should be no dilution of the autonomy of states as a result of the IT system, or the re-engineering. On the contrary, it should strengthen the autonomy of states. This is a key factor in the design of the IT system presented in the rest of this document.

Uniformity of policy administration: The business processes surrounding GST need to be standardized. Uniformity of policy administration across states and centre will lead to a better taxpayer experience, and cut down costs of compliance as well as tax administration.

Enable digitization and automation of the whole chain: All the business processes surrounding GST should be automated to the extent possible, and all documents processed electronically. This will lead to faster processing and reconciliation of tax information and enable risk based scrutiny by tax authorities. For small taxpayers, facilitation centres can be set up to ease the migration.

Reduce leakages: A fully electronic GST can dramatically increase tax collections by reducing leakages. Tools such as matching the input tax credit, data mining and pattern detection will deter tax evasion and thus increase collections.

Leverage existing investments: Existing IT investments of states should be leveraged. The Mission Mode Project on Commercial Tax should be aligned with the GST implementation going forward.

Stakeholders

Small taxpayers: Much of the economic activity in India is concentrated among small taxpayers. They may not have the skill or the resources to effectively migrate to GST. Thus, adequate preparations must be done to ensure smooth migration for small taxpayers to GST. This includes extensive consultations, setting up of facilitation centres, education and training.

***Corporate taxpayers*:** Corporate taxpayers may operate across various states and typically have sophisticated IT systems for accounting, e-filing returns, payments *etc.* Common file formats and message specifications should be released early to allow IT vendors that provide software to corporate taxpayers to modify and release updated versions with GST support.

State tax authorities: The state tax authorities would be responsible for collecting SGST. Common file formats, interfaces, and policy administration will enable accurate and timely assessment, and risk-based investigations resulting in enhanced productivity and revenues.

***CBEC*:** CBEC would be responsible for collecting CGST and IGST. Common file formats, interfaces, and policy administration will increase the productivity of CBEC. It will allow for accurate and timely assessment, risk-based investigations and facilitate IGST settlement by Centre at agreed time intervals.

***RBI*:** The Reserve Bank of India will facilitate the interface with various banks to facilitate movement of states' and center's funds. The processes of funds settlements and documentary compliance are independent.

***Banks*:** Banks will accept duty from the taxpayers and process challans. All tax collections (whether physical or electronic) will happen at bank branches, or through the banks' IT systems. Banks will route the tax collected to the concerned authorities through the RBI channel.

Other Stakeholders include CAG, GSTN, TRPs and facilitation agencies.

Workflows

The following three processes constitute the most important workflows of the GST administration and would be covered in the first phase:

***Registration*:** A unique ID is necessary to identify each taxpayer. The PAN based ID should be common to both the states and the centre. A common PAN-based taxpayer registration has several benefits including a unified view of taxpayers for all tax authorities. A PAN based registration system has already been implemented in CBEC and several states are also capturing PAN data.

***Returns*:** Both, the states and centre require taxpayers to file periodic returns to assess whether the taxpayers have computed, collected, and deposited their taxes correctly. ITC credit can also be verified on the basis of the returns filed and revenues reconciled against challan data from banks.

***Challans*:** Challans are the payment instruments used by taxpayers to actually pay their taxes. Challans are deposited at collecting banks and are forwarded by them to the tax administrations.

***IGST*:** Under GST, inter-state trade will be leviable to IGST. Under IGST, the tax paid by the selling dealer in the exporting state will be available as ITC to the purchasing dealer in the importing state. This requires verification of ITC claims and transfer of funds from one state to another. Further, in an interstate business to consumer transaction, tax collected in one state has to be transferred to another state as finalized by the business processes. Thus, periodic inter-state settlement is required.

In addition, there are several other workflows such as processing refunds, taxpayer audits, and appeals. It is reiterated that the **core services** envisaged through common portal are limited to registration, payments and returns in the first phase. Other value added services will be added subsequently based on the needs of the Stakeholders. The IT infrastructure should be designed taking into account all stakeholders, and all related workflows.

A common GST portal

The solution architecture should be designed to meet the design goals for GSTN, described in the previous section. For the purpose of simplicity for taxpayers, uniformity of tax administration, digitization of all documents, and automation of related processes, it is necessary to have:

1. Common PAN-based registration
2. Common standardized return for all taxes (with different account heads for CGST, SGST, IGST)
3. Common standardized challan for all taxes (with different account heads for CGST, SGST, IGST)

A common GST portal, operated by GSTN, is the fastest and most cost-effective way to provide common PAN-based registration, common returns, and common challans for all stakeholders. It can marry the taxpayers standard interface with the varied systems of the tax administrations. Each tax authority will have full flexibility in using this data for in-house automation, integration, and enforcement.

Basic solution architecture

Given the need for a common GST portal, the basic solution architecture is as follows:

1. Taxpayer files through a standardized taxpayer interface.
2. States and CBEC implement tax administration systems for assessments, audits, and enforcement within their domain. This is desirable but not a pre-condition since the GSTN can provide support for states that do not have the necessary IT systems in place.
3. The taxpayer and tax authority systems are connected with a Common GST Portal, operated by GSTN.
4. Policy decisions are captured in GST Business Rules Engine that defines the tax rates, revenue sharing rules, and exceptions for all parties.

The Business Rules Engine is a component of the solution architecture that spans all entities. It codifies policies and business rules such as the rates of taxation, the revenue sharing between states and centre, a framework for exemption, and thresholds, among other things. All systems in the rest of the solution architecture will be designed so that they load business rules from the Business Rules Engine. This decoupling of the business rules from the rest of the solution architecture allows for a great deal of flexibility. At a later date, if rates are changed or new items are added to the list of taxable items, or if existing items are exempted; these changes can be reflected in the Business Rules Engine, without affecting the rest of the system. This also makes it possible to start the design and implementation of all IT systems, even while policies and rates are debated. Once the policies and rates are fixed, they can simply be reflected in the Business Rules Engine.

In addition to common registration, returns, and challans, the Common GST portal will provision for selected information needs of states.

Information Flow

The information flows are designed keeping the constitutional autonomy of states in mind, while simultaneously building intelligence in the system to plug leakages. The common GST portal is simply a pass-through device. The taxpayer files the return with GSTN, which keeps a copy of the return for analysis, and forwards it in near real-time to the respective state and CBEC. The taxpayer pays the actual duty in the bank, which uploads only the challan details into the GSTN. Actual funds never pass through the GSTN.

The common GST portal reconciles the returns and the challans. In addition to its pass-through role, the common GST portal also plays two other critical roles:

1. It acts as a tax booster, matching the input tax credits in the returns to detect tax evasion. It can also integrate with various other systems at MCA, CBDT for verification of PAN or other corporate information and perform data mining and pattern detection to detect tax fraud. It sends this information as alerts/ reports to the respective tax authorities.

2. It also computes inter-state settlement, netting IGST across states.

Funds flow

Just like the information flows, the funds flows are also designed keeping the constitutional autonomy of states in mind. The design ensures smooth and timely availability of funds as soon as they are deposited. The SGST funds that are intended for the states directly go from the taxpayer to the state treasuries. Similarly, the CGST funds go directly to the centre. With the help of information from GSTN, IGST will be settled between states and centre by RBI.

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14

Role of PCS under the GST law envisaged for India

A company secretary is well versed in laws subject without any doubt by virtue of his academic knowledge and practical training and particularly master to understand the laws subjects. Indirect taxes/GST would be more laws compared to computation to tax, it is easiest for the Company Secretary to understand and be an expert in the subject of Indirect Taxes/ GST. Company secretary can play an important role being an advisor and facilitator for due compliances of laws relating to Indirect Taxes/goods and Service Tax(GST) to the general business community and corporate world as well. The company secretary can perform the following types of services to clients:-

(i) Advisory services or strategic advisor

A company secretary can better interpret the law of Indirect taxes or proposed GST law and provide comprehensive guidance and advisory to the business. Company secretary are more suited for the services because for their knowledge of laws and good communication skills

(ii) Tax Planning

Company secretary is competent to understand the impact of laws and its various alternatives based on the proper tax planning of indirect taxes/GST.

(iii) Procedural Compliances

Procedure Compliance includes registration, filing of returns, payments of taxes, assessment etc. the procedure compliance is the easiest task because Company Secretary is already playing a role of Compliance Officer under various other laws.

(iv) Book/Record Keeping

Like other tax laws indirect taxes/ GST would require proper record keeping and accounting systematic records of credit of input/input service and its proper utilisation is necessary for this success of GST. Company secretary must learn and equipped to perform this tasks and it is easy because CS course have all the subjects.

(v) Representation

Company Secretary can provide this service with confidence because of practical exposure with various competent authorities. Company secretary can better justify this service.

(vi) Appellate work

Because of legal drafting skill, the Company Secretary can provide better service in the appellate work.

At present, our members are already recognised under various state VAT legislations to perform various functions. An illustrative list is as under:-

1	West Bengal Value Added Tax Rules, 2005	Authorized to appear before Appellate and Revisional Board, the Commissioner, the Special Commissioner, the Additional Commissioner or any person appointed to assist the Commissioner on behalf of a dealer [Rule 2 (1)(a)(iv)].
2	Bihar Value Added Tax Act, 2005	Authorised to appear before VAT authorities appointed under Section 10 or the Tribunal or an Officer of the Bureau of Investigation constituted under Section 86 of the Act [Section 87(d)].
3	Daman and Diu Value Added Tax Regulation, 2005	Authorised to appear before any VAT authority in connection with any proceedings under this Regulation. [Regulation 82(1)(b)].
4	Goa Value Added Tax Act, 2005	Authorised to appear before any VAT authority including the Tribunal in connection with any proceedings under this Act [Section 82(1)(b)].
5	Jharkhand Value Added Tax Act, 2005	To conduct VAT Audit under section 63(1) To appear before VAT authorities under Rule 51(1)(c)

Similarly under the excise laws and service tax laws, the Company secretary have been performing functions which can be classified under following heads:-

- Acting as authorised representative before Central Excise Authorities.
- Valuation and classification of goods.
- Assessment of duty and obtaining refunds.
- Complying with formalities for removal of excisable goods for home consumption and exports.

- CENVAT procedures.
- Advising on search, seizure *etc*.
- Documentation.

As per the proposed administrative structure, as recommended by the task force on GST, case for uniformity in the procedures has been made so as to reduce compliance and administrative cost, which would in turn result in improved voluntary compliance.

In the report, the task force has envisioned the design of dual GST in the following manner:-

(a) The Central Board of Excise & Customs (CBEC) shall be responsible for implementing the CGST and the State Tax administrations will be separately responsible for implementing the SGST. The various tax administrative functions such as assessment, enforcement, scrutiny and audit should be undertaken by the CBEC in respect of the CGST and by the State tax administration in respect of the SGST subject to our recommendation on small-scale industries.

(b) All procedures under CGST and SGST should be uniform.

(c) Each taxpayer should be allotted a PAN based taxpayer identification number, as recommended above.

(d) The unit of taxation for the purposes of GST should be persons as defined under the Income Tax Act. Consequently, for the purposes of CGST, all production units/branches of a person located anywhere in the country will be treated as a single taxable entity eligible for CGST input credit across units/branches. Similarly, for the purposes of SGST, all production units/branches of a person located anywhere within the State will be treated as a single taxable entity eligible for SGST input credit across units/branches in that State.

(e) The Central Government shall establish a common IT infrastructure which will serve the needs of both CGST and SGST.

(f) The Central Government will be responsible for establishing a taxpayers information network (TIN) keeping in view the information requirement of CBEC and the State tax administration. The TIN will be shared between the Centre and the States.

(g) The payment of tax and the transaction reporting should be made through a combined payment and transaction reporting statement in Form No. GST-I. This statement should detail all business to business transactions relating to sales. This statement should be common for both CGST and SGST compliance and it should be mandatory to file this statement electronically on a monthly basis while making payment of taxes.

(h) Taxpayers opting for the compounded levy may be required to pay their taxes and file their returns on a quarterly basis.

(i) Electronic filing of all other returns, if any, should also be mandatory. Therefore, the return forms should be common for CGST and SGST compliance.

It can be seen that as per the recommendation of task force, although in theory the GST model would be a dual-tax structure, however for all practical and administrative purposes, the implementation of tax would be a single process. Hence Company Secretary being a trained professional, having a long track record and who is already recognised for performing various important functions under Central tax statutes and State taxes, should be recognised under the proposed GST legislation also.

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Annexure

Bill No. 192 of 2014

THE CONSTITUTION (ONE HUNDRED AND TWENTY-SECOND AMENDMENT) BILL, 2014

A

BILL

further to amend the Constitution of India.

BE it enacted by Parliament in the Sixty-fifth Year of the Republic of India as follows: –

1. (*1*) This Act may be called the Constitution (One Hundred and Twenty-second Amendment) Act, 2014.

(*2*) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the commencement of that provision.

2. After article 246 of the Constitution, the following article shall be inserted, namely: –

"246A. (1) Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of every State, have power to make laws with respect to goods and services tax imposed by the Union or by such State.

(2) Parliament has exclusive power to make laws with respect to goods and services tax where the supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

Explanation.—The provisions of this article, shall, in respect of goods and services tax referred to in clause (5), of article 279A, take effect from the date recommended by the Goods and Services Tax Council.".

3. In article 248 of the Constitution, in clause (1), for the word "Parliament", the words, figures and letter "Subject to article 246A, Parliament" shall be substituted.

4. In article 249 of the Constitution, in clause (1), after the words "with respect to", the words, figures and letter"goods and services tax provided under article 246A or" shall be inserted.

5. In article 250 of the Constitution, in clause (1), after the words "with respect to", the words, figures and letter "goods and services tax provided under article 246A or" shall be inserted.

6. In article 268 of the Constitution, in clause (1), the words "and such duties of excise on medicinal and toilet preparations" shall be omitted.

7. Article 268A of the Constitution, as inserted by section 2 of the Constitution (Eighty-eighth Amendment) Act, 2003 shall be omitted.

8. In article 269 of the Constitution, in clause (1), after the words "consignment of goods", the words, figures and letter "except as provided in article 269A" shall be inserted.

9. After article 269 of the Constitution, the following article shall be inserted, namely:—

"269A. (1) Goods and services tax on supplies in the course of inter-State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services

Tax Council.

Explanation. – For the purposes of this clause, supply of goods, or of services, or both in the course of import into the territory of India shall be deemed to be supply of goods, or of services, or both in the course of inter-State trade or commerce.

(2) Parliament may, by law, formulate the principles for determining the place of supply, and when a supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.".

10. In article 270 of the Constitution, –

(*i*) in clause (1), for the words, figures and letter "articles 268, 268A and article 269", the words, figures and letter "articles 268, 269 and article 269A" shall be substituted;

(*ii*) after clause (*1*), the following clause shall be inserted, namely:–

"(1A) The goods and services tax levied and collected by the Government of India, except the tax apportioned with the States under clause (1) of article 269A, shall also be distributed between the Union and the States in the manner provided in clause (2).".

11. In article 271 of the Constitution, after the words "in those articles", the words, figures and letter "except the goods and services tax under article 246A," shall be inserted.

12. After article 279 of the Constitution, the following article shall be inserted, namely:—

"279A. (1) **The President shall, within sixty days from the date of commencement of the Constitution (One Hundred and Twenty-second Amendment) Act, 2014, by order, constitute a Council to be called the Goods and Services Tax Council.**

(2) **The Goods and Services Tax Council shall consist of the following members, namely:–**

(*a*) **the Union Finance Minister........................ Chairperson;**

(*b*) **the Union Minister of State in charge of Revenue or Finance................. Member;**

(*c*) **the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government....................Members.**

(3) **The Members of the Goods and Services Tax Council referred to in sub-clause (*c*) of clause (2) shall, as soon as may be, choose one amongst themselves to be the Vice-Chairperson of the Council for such period as they may decide.**

(4) **The Goods and Services Tax Council shall make recommendations to the Union and the States on –**

(*a*) **the taxes, cesses and surcharges levied by the Union, the States and the local bodies which may be subsumed in the goods and services tax;**

(*b*) **the goods and services that may be subjected to, or exempted from the goods and services tax;**

(*c*) **model Goods and Services Tax Laws, principles of levy, apportionment of Integrated Goods and Services Tax and the principles that govern the place of supply;**

(*d*) **the threshold limit of turnover below which goods and services may be exempted from goods and services tax;**

(*e*) **the rates including floor rates with bands of goods and services tax;**

(*f*) **any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster;**

(*g*) **special provision with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and**

(*h*) **any other matter relating to the goods and services tax, as the Council may decide.**

(5) **The Goods and Services Tax Council shall recommend the date on which the goods and services tax be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.**

(6) **While discharging the functions conferred by this article, the Goods and Services Tax Council shall be guided by the need for a harmonised structure of goods and services tax and for the development of a harmonised national market for goods and services.**

(7) **One half of the total number of Members of the Goods and Services Tax Council shall constitute the quorum at its meetings.**

(8) **The Goods and Services Tax Council shall determine the procedure in the performance of its functions.**

(9) **Every decision of the Goods and Services Tax Council shall be taken at a meeting, by a majority of not less than three-fourths of the weighted votes of the members present and voting, in accordance with the following principles, namely:–**

(*a*) **the vote of the Central Government shall have a weightage of one third of the total votes cast, and**

(*b*) **the votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast, in that meeting.**

(10) **No act or proceedings of the Goods and Services Tax Council shall be invalid merely by reason of –**

(*a*) **any vacancy in, or any defect in, the constitution of the Council; or**

(*b*) **any defect in the appointment of a person as a member of the Council; or**

(c) **any procedural irregularity of the Council not affecting the merits of the case.**

(11) **The Goods and Services Tax Council may decide about the modalities to resolve disputes arising out of its recommendation.".**

13. In article 286 of the Constitution, –

(i) in clause (1), –

(A) for the words "the sale or purchase of goods where such sale or purchase takes place", the words "the supply of goods or of services or both, where such supply takes place" shall be substituted;

(B) in sub-clause *(b),* for the word "goods", at both the places where it occurs the words "goods or services or both" shall be substituted;

(ii) in clause (2), for the words "sale or purchase of goods takes place", the words "supply of goods or of services or both" shall be substituted;

(iii) clause (3) shall be omitted.

14. In article 366 of the Constitution,–

(i) after clause (12), the following clause shall be inserted, namely: –

'(12A) "goods and services tax" means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption;';

(ii) after clause (26), the following clauses shall be inserted, namely: –

'(26A) "Services" means anything other than goods;

(26B) "State" with reference to articles 246A, 268, 269, 269A and article 279A includes a Union territory with Legislature;'.

15. In article 368 of the Constitution, in clause (2), in the proviso, in clause (*a*), for the words and figures "article 162 or article 241", the words, figures and letter "article 162, article 241 or article 279A" shall be substituted.

16. In the Sixth Schedule to the Constitution, in paragraph 8, in sub-paragraph (3), –

(i) in clause *(c),* the word "and" occurring at the end shall be omitted;

(ii) in clause *(d)*, the word "and" shall be inserted at the end;

(iii) after clause *(d),* the following clause shall be inserted, namely: –

"*(e)* taxes on entertainment and amusements.".

17. In the Seventh Schedule to the Constitution, –

(*a*) in List I – Union List,–

(i) for entry 84, the following entry shall be substituted, namely:–

"84. Duties of excise on the following goods manufactured or produced in India, namely:–

(a) petroleum crude;

(b) high speed diesel;

(c) motor spirit (commonly known as petrol);

(d) natural gas;

(e) aviation turbine fuel; and

(f) tobacco and tobacco products.";

(ii) entries 92 and 92C shall be omitted;

(b) in List II – State List,–

(i) entry 52 shall be omitted;

(ii) for entry 54, the following entry shall be substituted, namely:–

"54. Taxes on the sale of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption, but not including sale in the course of inter-State trade or commerce or sale in the course of international trade or commerce of such goods.";

(iii) entry 55 shall be omitted;

(iv) for entry 62, the following entry shall be substituted, namely:–

"62. Taxes on entertainments and amusements to the extent levied and collected by a Panchayat or a Municipality or a Regional Council or a District Council.".

18. (*1*) An additional tax on supply of goods, not exceeding one per cent. in the course of inter-State trade or commerce shall, notwithstanding anything contained in clause (1) of article 269A, be levied and collected by the Government of India for a period of two years or such other period as the Goods and Services Tax Council may recommend, and such tax shall be assigned to the States in the manner provided in clause (2).

(*2*) The net proceeds of additional tax on supply of goods in any financial year, except the proceeds attributable to the Union territories, shall not form part of the Consolidated Fund of India and be deemed to have been assigned to the States from where the supply originates.

(*3*) The Government of India may, where it considers necessary in the public interest, exempt such goods from the levy of tax under clause (1).

(*4*) Parliament may, by law, formulate the principles for determining the place of origin from where supply of goods take place in the course of inter-State trade or commerce.

19. Parliament may, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for such period which may extend to five years.

20. Notwithstanding anything in this Act, any provision of any law relating to tax on goods or services or on both in force in any State immediately before the commencement of this Act, which is inconsistent with the provisions of the Constitution as amended by this Act shall continue to be inforce until amended or repealed by a competent Legislature or other competent authority or until expiration of one year from such commencement, whichever is earlier.

21. (*1*) If any difficulty arises in giving effect to the provisions of the Constitution as amended by this Act (including any difficulty in relation to the transition from the provisions of the Constitution as they stood immediately before the date of assent of the President to this Act to the provisions of the Constitution as amended by this Act), the President may, by order, make such provisions, including any adaptation or modification of any provision of the Constitution as amended by this Act or law, as appear to the President to be necessary or expedient for the purpose of removing the difficulty:

Provided that no such order shall be made after the expiry of three years from the date of such assent.

(*2*) Every order made under sub-section (*1*) shall, as soon as may be after it is made, be laid before each House of Parliament.

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