Background Material on GST

(Popularly known as VAT globally)

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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FOREWORD

A growing economy like India needs adequate resources to finance developmental activities that are inclusive and reaches all strata. Our country is continuously evolving its tax system to streamline its administration and generate more revenue for infrastructure, social welfare and a number of other activities.

Way back in the year 2004, Dr. Kelkar Task Force recommended the need of Goods and Services Tax (GST) in India. The Government came out with a First Discussion Paper on GST in November, 2009 and introduced the 115th Constitution Amendment (GST) Bill in the year 2011.

GST is a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or procuring the services. It is designed to simplify present indirect tax system by integrating the union excise duties, customs duties (CVD/SAD), service tax and state VAT into a single structure.

In order to meet upcoming changes and challenges that introduction of GST is set to bring, the Institute of Chartered Accountants of India is working in a proactive manner. The ICAI is committed to work with Central Board of Excise and Customs (CBEC) and other stakeholdersto facilitate the implementation of GST in India.

It is really heartening that the Indirect Taxes Committee of ICAI has brought out a ***"Background Material on Goods & Service Tax"*** which is duly updated with the changes brought in by 122nd Constitution Amendment Bill, 2014, GST Business Processes, Report on RNR etc. along with the Standardized PPT on GST launched by Indirect Taxes Committee. I wholeheartedly compliment the efforts of Indirect Taxes Committee for bringing out this comprehensive material directed to create awareness about GST.

I am sure this background material would be highly useful to the readers.

Date: 31.01.2016 CA. Manoj Fadnis
Place: New Delhi President, ICAI

MESSAGE FROM VICE-PRESIDENT

Introduction of GST would be second major reform in India in the area of Indirect Taxes after Value Added Tax in the State in 2005.GST is a single comprehensive tax levied on goods and services consumed in an economy. It would mainly subsume union excise duties, customs duties (CVD/SAD), service tax and state VAT into a single levy. It would require a lot of planning to ensure a smooth transition from existing structure to the new one.

Hon'ble Finance Minister Shri Arun Jaitley, in his budget speech on 10th July 2014, asserted working towards approval of legislative scheme to enable introduction of Goods and Services Tax in India. Also 122nd Constitution Amendment (GST) Bill, 2014has been passed by Lok Sabha which marks another step towards the upcoming GST regime in India. The Institute of Chartered Accountants of India also,living to its motto of being a partner in nation building, has committed itself to be pivotal in introduction of Goods and Services Tax in India.

The ICAI has been organising various educative programmes to spread awareness about GST among its members and other stakeholders. The Indirect Taxes Committee of ICAI has come up with this ***"Background Material on Goods & Services Tax"*** which briefly elucidates the existing indirect tax structure of India, the existing GST structure across various countries, the proposed model of GST in India etc. and covers changes made by 122nd Constitution Amendment Bill, 2014, draft GST Business processes on Registration, Payment, Refund & Return, extracts of 13th& 14th Finance Commission Report etc.. Standardized PPT on GST launched by Indirect Taxes Committee is also covered in this material.

I sincerely appreciate CA. Atul Gupta, Chairman, CA. Shyamlal Agarwal, Vice-Chairman and other members of the Indirect Taxes Committee for their efforts in bringing out this background material. I trust you all to benefit the most from the same.

Wish you a great learning experience.

Date: 31.01.2016 CA. M. Devaraja Reddy

Place: New Delhi Vice-President, ICAI

PREFACE

GST is a broad based and a single comprehensive tax levied on goods and services consumed in an economy. It is levied at every stage of the production -distribution chain till retail level with applicable setoffs in respect of the tax remitted at previous stages. It is a destination based tax and levied at single point at the time of final consumption of goods or services by ultimate consumer.

More than 100 countries across the world have introduced GST or Federal VAT in one form or the other. The GST rate in various countries ranges from as low as 5% in Taiwan to as high as 25% in Denmark. India is expecting to have a dual GST model. It will comprise of a Central GST and a State GST. The Centre and the States will each legislate, levy and administer the Central GST and State GST, respectively. There are indications that the Revenue Neutral Rate (RNR) could be in the range of 16% to 20%.

The Institute of Chartered Accountants of India, with a view to update the members and other stakeholder at large by way organising programme, seminar, and conferences, has brought out this Background Material GST. The material covers various topics like concept of GST, its pros and cons, its feasibility & impact in India, challenges for Indian economy, GST in other countries etc. It is an all-inclusive material, which would provide an insight to the basic concepts of GST and also covers the changes brought in by 122nd Constitution Amendment Bill, 2014 and the Standardized PPT on GST launched by Indirect Taxes Committee.

At this juncture, I would also like to express my sincere gratitude and thanks to members of the Indirect Taxes committee for their guidance and support in this initiative. I genuinely appreciate CA. Rakesh Garg for providing basic material and CA. Vijay Gupta and other members of the VAT & GST Study Group for reviewing and bringing this material to its being. I wish you all a wonderful and a knowledgeable stride with this material.

I trust this material would prove to be useful in your endeavours.

Date: 31.01.2016
Place: New Delhi

CA. Atul Gupta
Chairman
Indirect Taxes Committee

MESSAGE FROM VICE-CHAIRMAN

One of the biggest taxation reforms in India -- the Goods and Services Tax (GST) -- is all set to integrate State economies and boost overall growth. GST will create a single, unified Indian market to make the economy stronger. The implementation of GST will lead to the abolition of existing taxes such as excise duty, service tax, Central Sales Tax, State-level sales tax, octroi, turnover tax, etc. thus avoiding multiple layers of taxation that currently exist in India.

Another reason to go the GST way is to facilitate seamless credit across the entire supply chain and across all States under a common tax base. Introduction of GST would also rationalize tax content in product price, enhance the ability of companies to compete globally, and possibly trickle down to benefit the ultimate consumer.

The Institute of Chartered Accountant of India (ICAI) plays a key role in disseminating information regarding upcoming reforms in the economy. This is done with the help of various programmes, seminars, webcasts, background material, manuals etc. In order to get well versed with the Goods and Services Tax (GST), the Indirect Taxes Committee of ICAI has come up with a "Background Material on GST". The material covers various nitigrities connected with Goods and Services and addresses many questions, apprehensions of members and otherwise with its self-explanatory compilations. Topics like concept of GST, benefits arising of GST, its feasibility & impact in India, challenges for Indian economy, GST in other countries etc. are covered herein. The standardized PPT launched by Indirect Taxes Committee and the changes brought in by 122nd Constitution Amendment Bill, 2014 are also a part of this material.

A lot of efforts and hardwork is undergone in preparing this material and efforts of the contributors are commendable. I hope this material benefits you in the best possible manner. I wish you a great learning spree.

Date: 31.01.2016
Place: New Delhi

CA. Shyamlal Agarwal
Vice-Chairman
Indirect Taxes Committee

CONTENTS

Goods and Service Tax (GST)

Globally Known As VAT

Standardised PPT by

Indirect Taxes Committee

Institute of Chartered Accountants of India

Indirect Taxes Committee of ICAI

Major Initiative in 2014-15

- Organized more than 119 Program in One Council Year.
- E Learning Course on Excise, Custom, Service tax and CST Launched- to learn any where, any time.
- 15 Web Cast with recorded Lecture for free download.
- More than 15 Research based Publication launched
- 'Organized more than 25 program for CBEC officials for capacity building in Department.
- Pursuing Service Tax Audit in line with 44AB Audit in Income Tax to give bird eye view on compliance by assesses.
- Online Portal Launched for better services and various updates for Members.

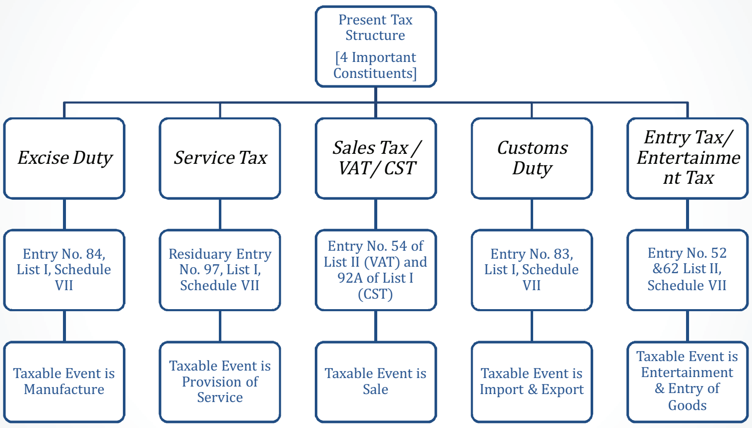
Journey Continues in 2015-16

- Organized 169 Programmes during the period.
- Revised E-learning modules on Customs, Central Excise, Service Tax & CST
- Organized 10 Sector Specific Webcasts
- Revision of 14 existing publications. 2 new publications launched on GST & State VAT
- Organized 54 programs for CBEC officials
- Representations Submitted for
  - 122nd Constitution Amendment Bill, 2014 for GST
  - Utilization of Education Cess and SHE cess for service tax
  - Representation to introduce VAT Audit in states where provision is not there
  - Suggestions on GST Business Processes
- Developed Research Paper on transitional aspects of GST
- Developed a Study Report on Impact of GST on Jammu & Kashmir Taxation System

Presentation Plan

- Present and Proposed Scheme of Indirect Taxation
- GST –Benefits and Challenges
- Challenges in GST – Lesson from Present System
- Road to GST - Milestones
- Industry' Expectations from GST
- Features of Proposed GST
- Illustration to Showcase Tax Benefit under GST
- Features of Constitution Amendment Bill
- IGST Model
- Features of Place of Supply Rules
- International Perspective in GST
- GST Planning

Present Indirect Tax Structure of India



Proposed Indirect Tax Structure

Intra State Taxable Supply	Excise and Service Tax will be known as CGST	Local VAT & Other taxes will be known as SGST
Inter State Taxable Supply	CST will be known as Integrated GST (IGST)	Approx. Sum Total of CGST and SGST
Import From Outside India	Custom Duty	In Place of CVD and SAD, IGST will be charged

Benefits to Assessee

- Reduction in multiplicity of taxes.
- Mitigation of cascading/ double taxation.
- More efficient neutralization of taxes especially for exports.
- Development of common national market.
- Simpler tax regime -
  - Fewer rates and exemptions.
  - Conceptual clarity (Goods vs. Services).

Benefits to Exchequer/Govt.

- Simpler Tax system.
- Broadening of Tax base.
- Improved compliance & revenue collections (tax booster).
- Efficient use of resources.

Challenges in GST- Lesson from Present System

- Legacy issues which will use resources
- Non Harmonization of Tax rates
- Lack of automation
- Lack of Procedural Manuals
- Lack of Skilled officials
- Double Registration- Handling old Registration
- Poor Quality of tax Returns
- No System for 100% Scrutiny of Tax Returns and Tax Audit
- Lack of Cross Verifications with other tax administrations
- Lack of mechanism to control Evasion
- Impact on Prices

Industry' Expectations from GST

- Low compliance cost
- Simple business processes
- Less requirement of automation initially
- Minimal ITC refund cases
- Exemptions instead of exclusions from GST
- Seamless flow of input credit
- Seamless flow of information between, supplier, buyer and tax administration
- Need for IT portal or agency like TINXSYS, NSDL

Industry' Expectations from GST

- Automation of process by way of e-registrations, e-returns, e-payment
- No requirement of verifications during inter state movement of Goods
- Zero rating of supplies to exporters
- Administrative efficiency in case of assessment and adjudication
- Ease of compliance
- Self-policing

FEATURES OF PROPOSED GST MODEL

Features of Proposed GST

- Destination based Taxation
- Apply to all stages of the value chain
- Apply to all taxable supplies of goods or services (as against manufacture, sale or provision of service) made for a consideration except –
  - Exempted goods or services – common list for CGST & SGST
  - Goods or services outside the purview of GST
  - Transactions below threshold limits
- Dual GST having two concurrent components –
  - Central GST levied and collected by the Centre
  - State GST levied and collected by the States

Features of Proposed GST contd.

- CGST and SGST on intra-State supplies of goods or services in India.
- IGST (Integrated GST) on inter-State supplies of goods or services in India – levied and collected by the Centre.
- IGST applicable to
  - Import of goods and services
  - Inter-state stock transfers of goods and services
- Export of goods and services – Zero rated.
- Additional Tax of 1% on Inter State Taxable supply of Goods by State of Origin and non CENVATABLE

Features of Proposed GST contd.

- All goods or services likely to be covered under GST except :
  - Alcohol for human consumption - State Excise plus VAT
  - Electricity - Electricity Duty
  - Real Estate - Stamp Duty plus Property Taxes
  - Petroleum Products (to be brought under GST from date to be notified on recommendation of GST Council)
- Tobacco Products under GST with Central Excise duty.

Features of Proposed GST contd.

Taxes to be subsumed

Central Taxes to Subsumed	State Taxes to subsumed
▪ Central Excise duty (CENVAT) ▪ Additional duties of excise ▪ Excise duty levied under Medicinal & Toiletries Preparation Act ▪ Additional duties of customs (CVD & SAD) ▪ Service Tax ▪ Surcharges & Cess	▪ State VAT / Sales Tax ▪ Central Sales Tax ▪ Purchase Tax ▪ Entertainment Tax (not levied by the local bodies) ▪ Luxury Tax ▪ Entry Tax (All forms) ▪ Taxes on lottery, betting & gambling ▪ Surcharges & Cess

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Features of Proposed GST contd.

- GST Rates – to be based on RNR – Four rates
  - Merit rate for essential goods and services
  - Standard rate for goods and services in general
  - Special rate for precious metals
  - NIL rate
- Floor rate with a small band of rates for standard rated goods or services for SGST
  - This is similar to mandatory guidelines which will be issued by GST Council in line with European Directive 12/2006
- Optional Threshold exemption in both components of GST.
- Optional Compounding scheme for taxpayers having taxable turnover up to a certain threshold above the exemption.
- HSN Code likely to be used for classification of goods.
- Present Accounting codes likely to be used for Services.

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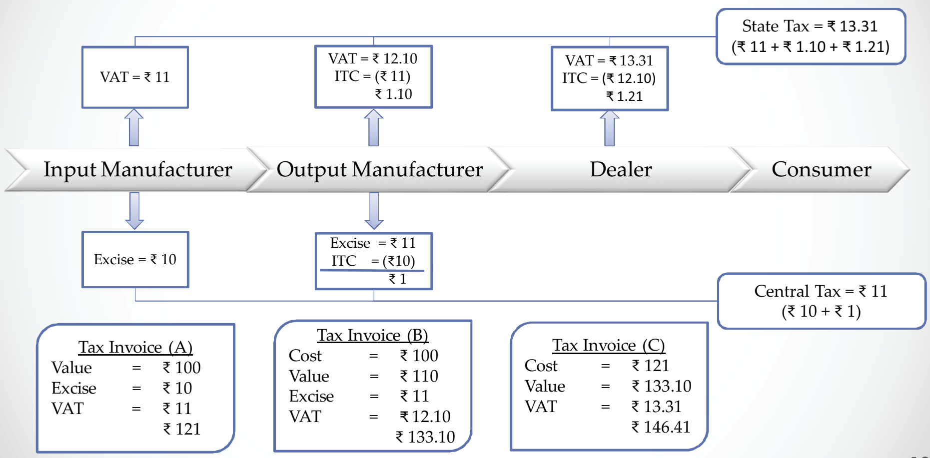
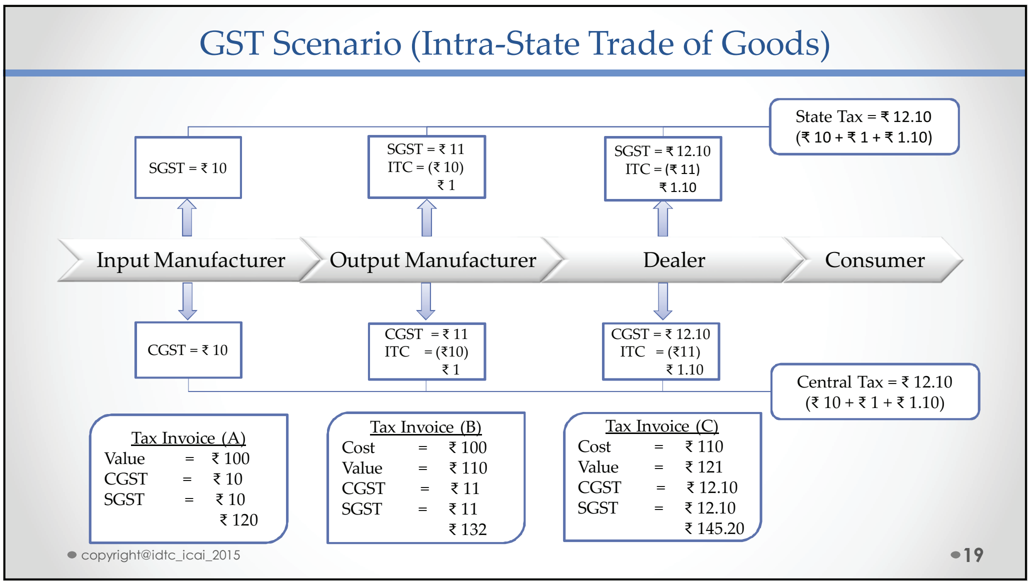
Illustration to Showcase Tax Benefit under GST

Present Scenario (Intra-State Trade of Goods)




GST Scenario (Intra-State Trade of Goods)
State Tax = ₹ 12.10
(₹ 10 + ₹ 1 + ₹ 1.10)
SGST = ₹ 10
SGST = ₹ 11
ITC = (₹ 10)
₹ 1
SGST = ₹ 12.10
ITC = (₹ 11)
₹ 1.10
Input Manufacturer
Output Manufacturer
Dealer
Consumer
CGST = ₹ 10
CGST = ₹ 11
ITC = (₹10)
₹ 1
CGST = ₹ 12.10
ITC = (₹11)
₹ 1.10
Central Tax = ₹ 12.10
(₹ 10 + ₹ 1 + ₹ 1.10)
Tax Invoice (A)
Value = ₹ 100
CGST = ₹ 10
SGST = ₹ 10
₹ 120
Tax Invoice (B)
Cost = ₹ 100
Value = ₹ 110
CGST = ₹ 11
SGST = ₹ 11
₹ 132
Tax Invoice (C)
Cost = ₹ 110
Value = ₹ 121
CGST = ₹ 12.10
SGST = ₹ 12.10
₹ 145.20
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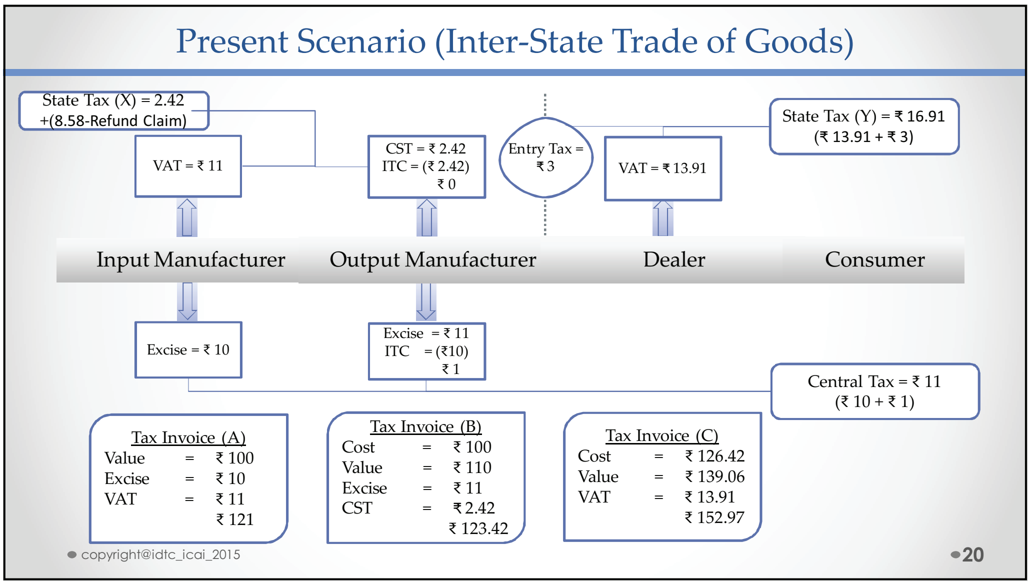
Present Scenario (Inter-State Trade of Goods)
State Tax (X) = 2.42
+(8.58-Refund Claim)
VAT = ₹ 11
CST = ₹ 2.42
ITC = (₹ 2.42)
₹ 0
Entry Tax =
₹ 3
VAT = ₹ 13.91
State Tax (Y) = ₹ 16.91
(₹ 13.91 + ₹ 3)
Input Manufacturer
Output Manufacturer
Dealer
Consumer
Excise = ₹ 10
Excise = ₹ 11
ITC = (₹10)
₹ 1
Central Tax = ₹ 11
(₹ 10 + ₹ 1)
Tax Invoice (A)
Value = ₹ 100
Excise = ₹ 10
VAT = ₹ 11
₹ 121
Tax Invoice (B)
Cost = ₹ 100
Value = ₹ 110
Excise = ₹ 11
CST = ₹ 2.42
₹ 123.42
Tax Invoice (C)
Cost = ₹ 126.42
Value = ₹ 139.06
VAT = ₹ 13.91
₹ 152.97
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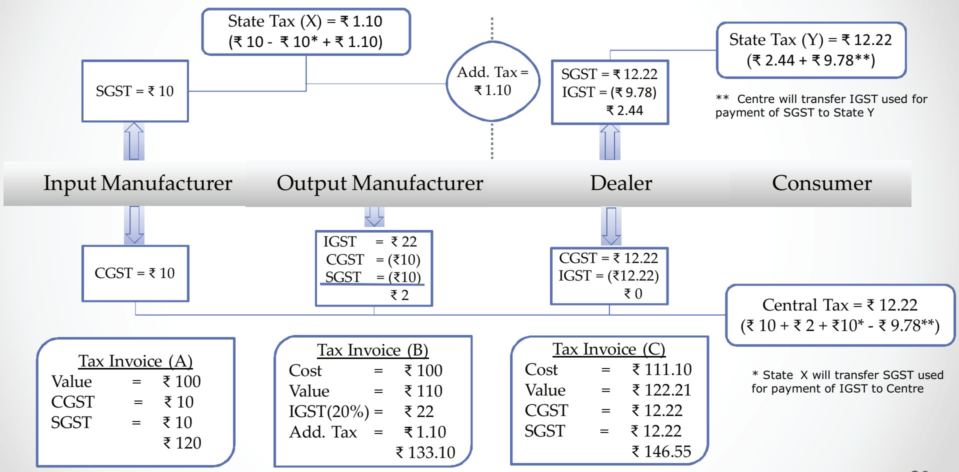
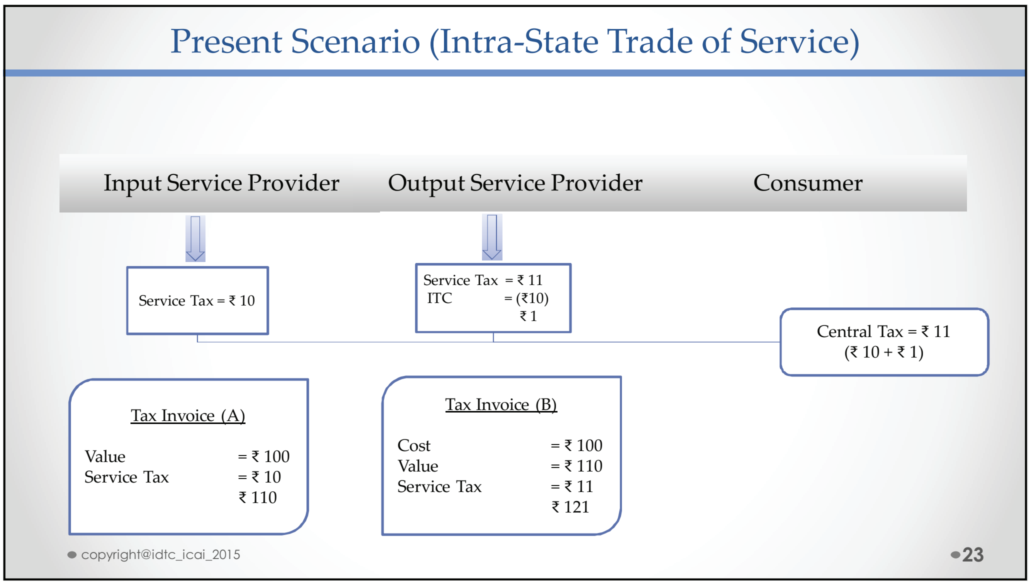
GST Scenario (Inter-State Trade of Goods)



Comparison (Trade of Goods)

Sr. No.	Particular	Intra-State		Inter-State	
		Present	GST	Present	GST
1.	Initial Value	₹ 121.00	₹ 120.00	₹121.00	₹120.00
2.	Centre's Tax	₹ 11.00	₹ 12.10	₹ 11.00	₹ 12.22
3.	State (X)'s Tax	₹ 13.31	₹ 12.10	₹ 2.42	₹ 1.10
4.	State (Y)'s Tax	-	-	₹ 16.91	₹ 12.22
5.	State's Total	₹ 13.31	₹ 12.10	₹ 19.33	₹ 13.32
6.	Total Tax paid to Govt.	₹ 24.31	₹ 24.20	₹ 38.91- 8.58 (refund claim) = 30.33	₹ 25.54
7.	Non-Vatable Tax borne by Business & paid by the Consumer indirectly	₹ 11.00 } 24.31	₹ 0.00 } 24.20	₹ 16.42 } 30.33	₹ 1.10 } 25.54
8.	Tax paid by end Consumer	₹ 13.31	₹ 24.20	₹ 13.91	₹ 24.44
9.	Final value paid by Consumer	₹ 146.41	₹ 145.20	₹ 152.97	₹ 146.65


Present Scenario (Intra-State Trade of Service)
Input Service Provider
Output Service Provider
Consumer
Service Tax = ₹ 10
Service Tax = ₹ 11
ITC = (₹10)
₹ 1
Central Tax = ₹ 11
(₹ 10 + ₹ 1)
Tax Invoice (A)
Value = ₹ 100
Service Tax = ₹ 10
₹ 110
Tax Invoice (B)
Cost = ₹ 100
Value = ₹ 110
Service Tax = ₹ 11
₹ 121
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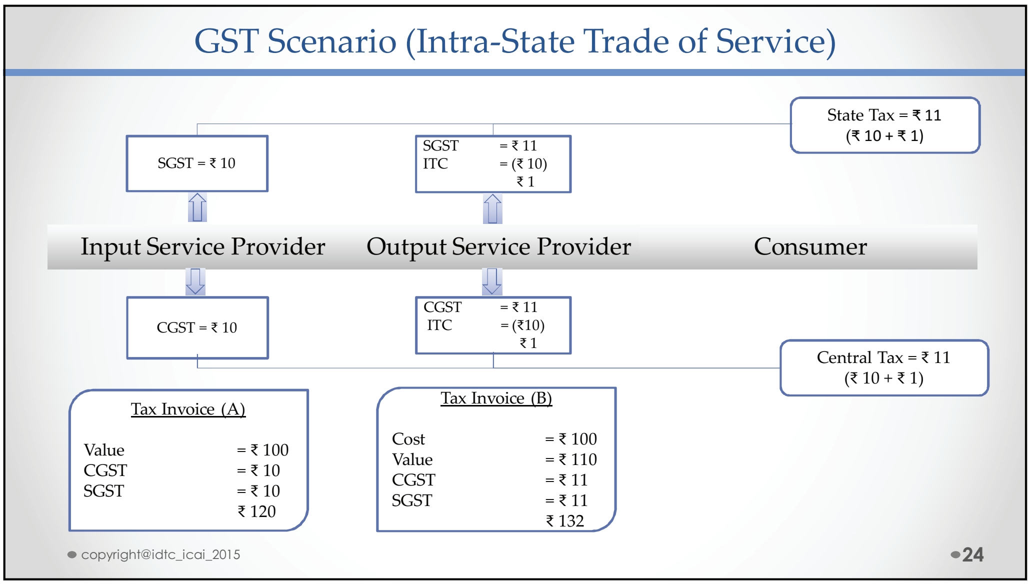
GST Scenario (Intra-State Trade of Service)
State Tax = ₹ 11
(₹ 10 + ₹ 1)
SGST = ₹ 10
SGST = ₹ 11
ITC = (₹ 10)
₹ 1
Input Service Provider
Output Service Provider
Consumer
CGST = ₹ 10
CGST = ₹ 11
ITC = (₹10)
₹ 1
Central Tax = ₹ 11
(₹ 10 + ₹ 1)
Tax Invoice (A)
Value = ₹ 100
CGST = ₹ 10
SGST = ₹ 10
₹ 120
Tax Invoice (B)
Cost = ₹ 100
Value = ₹ 110
CGST = ₹ 11
SGST = ₹ 11
₹ 132
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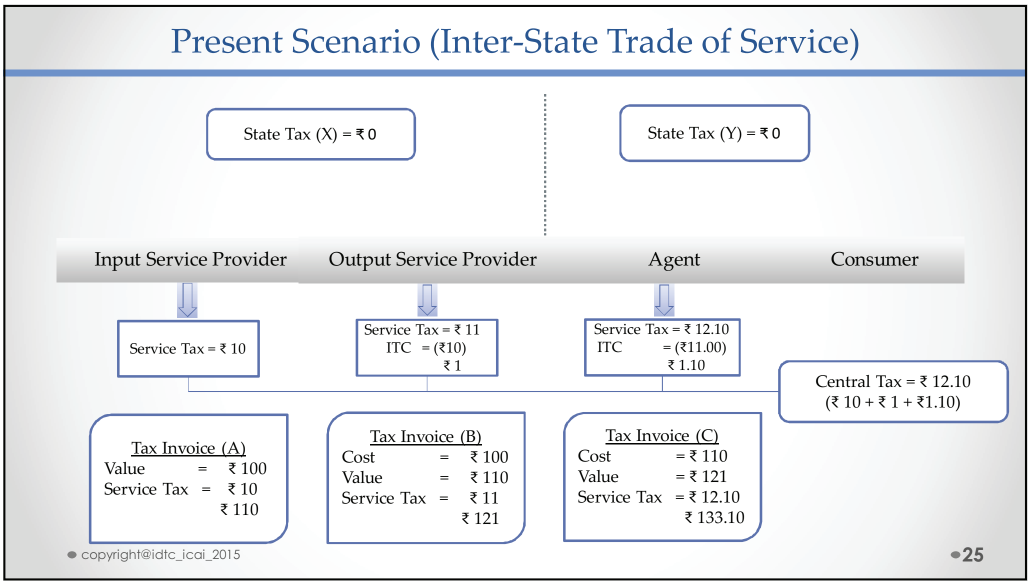
Present Scenario (Inter-State Trade of Service)
State Tax (X) = ₹ 0
State Tax (Y) = ₹ 0
Input Service Provider
Output Service Provider
Agent
Consumer
Service Tax = ₹ 10
Service Tax = ₹ 11
ITC = (₹10)
₹ 1
Service Tax = ₹ 12.10
ITC = (₹11.00)
₹ 1.10
Central Tax = ₹ 12.10
(₹ 10 + ₹ 1 + ₹1.10)
Tax Invoice (A)
Value = ₹ 100
Service Tax = ₹ 10
₹ 110
Tax Invoice (B)
Cost = ₹ 100
Value = ₹ 110
Service Tax = ₹ 11
₹ 121
Tax Invoice (C)
Cost = ₹ 110
Value = ₹ 121
Service Tax = ₹ 12.10
₹ 133.10
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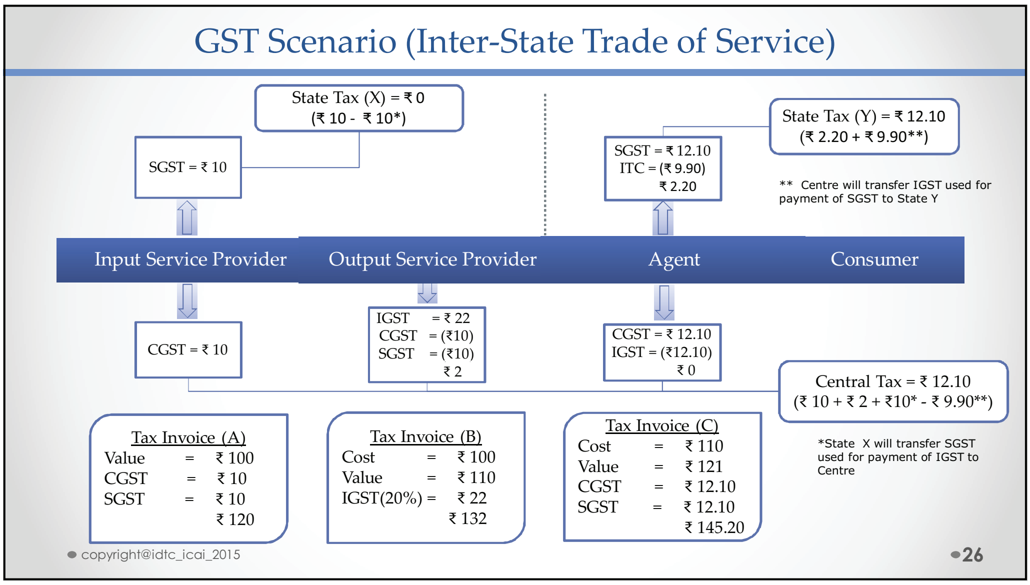
GST Scenario (Inter-State Trade of Service)
State Tax (X) = ₹ 0
(₹ 10 - ₹ 10*)
SGST = ₹ 10
State Tax (Y) = ₹ 12.10
(₹ 2.20 + ₹ 9.90**)
SGST = ₹ 12.10
ITC = (₹ 9.90)
₹ 2.20
** Centre will transfer IGST used for payment of SGST to State Y
Input Service Provider
Output Service Provider
Agent
Consumer
CGST = ₹ 10
IGST = ₹ 22
CGST = (₹10)
SGST = (₹10)
₹ 2
CGST = ₹ 12.10
IGST = (₹12.10)
₹ 0
Central Tax = ₹ 12.10
(₹ 10 + ₹ 2 + ₹10* - ₹ 9.90**)
Tax Invoice (A)
Value = ₹ 100
CGST = ₹ 10
SGST = ₹ 10
₹ 120
Tax Invoice (B)
Cost = ₹ 100
Value = ₹ 110
IGST(20%) = ₹ 22
₹ 132
Tax Invoice (C)
Cost = ₹ 110
Value = ₹ 121
CGST = ₹ 12.10
SGST = ₹ 12.10
₹ 145.20
*State X will transfer SGST used for payment of IGST to Centre
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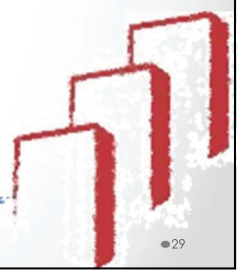
Comparison (Trade of Service)

Sr. No.	Particular	Intra-State		Inter-State	
		Present	GST	Present	GST
1.	Initial Value	₹ 110.00	₹ 120.00	₹110.00	₹120.00
2.	Centre's Tax	₹ 11.00	₹ 11.00	₹ 12.10	₹ 12.10
3.	State (X)'s Tax	₹ 0.00	₹ 11.00	₹ 0.00	₹ 0.00
4.	State (Y)'s Tax	-	-	₹ 0.00	₹ 12.10
5.	State's Total	₹ 0.00	₹ 11.00	₹ 0.00	₹ 12.10
6.	Total Tax paid to Govt.	₹ 11.00	₹ 22.00	₹ 12.10	₹ 24.20
7.	Non-Vatable Tax borne by Business	₹ 0.00	₹ 0.00	₹ 0.00	₹ 0.00
8.	Total Tax paid by Consumer	₹ 11.00	₹ 22.00	₹ 12.10	₹ 24.20
9.	Final value paid by Consumer	₹ 121.00	₹ 132.00	₹ 133.10	₹ 145.20

PART II

ROAD TO GST – MILESTONES



Roadmap to GST- Milestones

- 2006, announcement of the intent to introduce GST by 01.04.2010
- November 2009 – First Discussion Paper (FDP) released by EC on which Comments were provided by Government of India.
- June 2010- Three sub-working Groups constituted by Government of India on:
  - Business Process related issues.
  - Drafting of Central GST and model State GST legislations.
  - Basic design of IT systems required for GST in general and IGST in particular.

Roadmap To GST- Milestones contd.

- March 2011 - Constitution (115th Amendment) Bill introduced in Parliament
- November 2012 – Committee on GST Design constituted by EC
- February 2013 - Three Committees constituted by EC
  - Dual Control, Thresholds and Exemptions in GST regime
  - RNRs for SGST & CGST and Place of Supply Rules
  - IGST and GST on Imports
- March 2013- GSTN Incorporated as Section 25 Company

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Roadmap To GST- Milestones contd.

- June 2013- Committee constituted by EC to draft model GST Law
- August 2013- Standing Committee on Finance submitted Report
- April 2014- Committee constituted by EC to examine business processes under GST
- December 2014- 122nd Constitutional Amendment bill introduced in Parliament
- May 2015 - 122nd Constitutional Amendment bill passed by Lok Sabha and referred to Select Committee of Rajya Sabha.
- Oct 2015 – GST Business Processes on Registration, Payment, Refund & Return released.
- Dec 2015 - Report on the RNR and Structure of Rates for GST released

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FEATURES OF CONSTITUTION AMENDMENT BILL

Features of Constitutional Amendment Bill

- 122 nd Amendment Bill introduced in LS on 19.12.2014 and has been passed on 6th May, 2015 and referred to Rajya Sabha's Select Committee
- Key Features
  - Concurrent jurisdiction for levy of GST by the Centre and the States –proposed Article 246A
  - Authority for Centre to levy & collection of IGST on supplies in the course of inter-State trade or commerce including imports – proposed Article 269A
  - Authority for Centre to levy non-vatable Additional Tax – to be retained by originating State
  - GST defined as any tax on supply of goods or services or both other than on alcohol for human consumption – proposed Article 366(12A)

Features of Constitutional Amendment Bill contd.

- **Key Features contd.**
  - Goods includes all materials, commodities & articles – Article 366 (12)
  - Services means anything other than goods – proposed Article 366 (26A)
  - Goods and Services Tax Council (GSTC) - proposed Article 279A
    - ✓ To be constituted by the President within 60 days from the coming into force of the Constitutional Amendments
    - ✓ Consists of Union FM & Union MOS (Rev)
    - ✓ Consists of all State Ministers of Finance
    - ✓ Quorum is 50% of total members
    - ✓ Decisions by majority of 75% of weighted votes of members present & voting
    - ✓ 1/3rd weighted votes for Centre & 2/3rd for all States together

Features of Constitutional Amendment Bill contd.

- **Key Features contd.**
  - ✓ Council to make recommendations on
    - ❖ Taxes, etc. to be subsumed in GST
    - ❖ Exemptions & thresholds
    - ❖ GST rates
    - ❖ Band of GST rates
    - ❖ Model GST Law & procedures
    - ❖ Special provisions for special category States
    - ❖ Date from which GST would be levied on petroleum products
  - ✓ Council to determine the procedure in performance of its functions
  - ✓ Council to decide modalities for dispute resolution arising out of its recommendations
  - Changes in entries in List – I & II
  - Compensation for loss of revenue to States for five years

Highlights of The Report on GST Bill by Select Committee


PARLIAMENT OF INDIA
RAJYA SABHA

REPORT OF THE SELECT COMMITTEE

ON

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

PRESENTED TO THE RAJYA SABHA ON 22nd July, 2015

भारतीय संसद, राज्य सभा
PARLIAMENT OF INDIA, RAJYA SABHA

Rajya Sabha Secretariat, New Delhi
22nd July, 2015/Ashadha, 1937 (Saka)

Highlights of Report of The RAJYA SABHA Select Committee

- **Recommendation in Clause 12 of Proposed Article 279A**

  Band for GST Rate: The Committee recommended that word "Band" may be defined in GST Laws as follows :

  > *"Band": Range of GST rates over the floor rate within which Central Goods and Service Tax (CGST) or State Goods and Service 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."*

- Affix rate of SGST, within the parameters of band recommended by GST council.

Highlights of Report of The RAJYA SABHA Select Committee

- <u>Clarification in Clause 13: Definition of term 'Supply</u>
  Committee clarifies that since the term 'Supply' would be defined in the various GST laws relating to CGST and SGST, it would not be appropriate to insert the definition of 'Supply' in the GST Const. Amendment Bill

- <u>Clarification in Clause 14: Definition of term 'Services'</u>
  Committee clarifies '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.

- <u>Recommendation in Clause 18 : Explanation to be added to word "Supply"</u>
  Supply: All forms of supply made for a consideration to mean that the movement of Goods within the same company will not be subject to the provision of 1% Additional tax.

Highlights of Report of The RAJYA SABHA Select Committee

- <u>Recommendation in Clause 19 : Compensation to States</u>

  Compensation should be provided for whole period of 5 years to the States for the loss of revenue arising on account of implementation of the Goods and Services Tax

<u>Other Recommendations :</u>

- <u>Legislative Competence:</u> the Committee strongly recommends that while drafting the SGST laws due consideration to the third tier of the Government i.e local bodies as has been guaranteed by the Constitution be given and provisions of devolution of taxes to them be made.

- <u>Dispute Settlement Authority</u>: modality to resolve any differences internally lies with the Council and creation of separate Dispute Settlement Authority may hamper the functioning of the GST Council in general and Legislatures (Parliament and States) in particular.

Highlights of Report of The RAJYA SABHA Select Committee

- Government may take immediate steps to ensure Non Government financial institution shareholding in GSTN be limited to public sector banks or public sector financial institutions.
- The Committee recommends that to be internationally competitive, the GST rate for banking industry should be minimum.
- GST Rates : Committee Recommends:
  - ✓ not to go strictly by the RNR while fixing the GST rate
  - ✓ India's GST rate should not go beyond 20% for standard rate and perhaps 14% for reduced rate.
  - ✓ 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

PART III

Integrated Goods And Service Tax (IGST)

Integrated Goods and Service Tax (IGST)

- Basic Fundamental to discuss in IGST:
  - GST in India envisaged on destination/consumption principle.
  - Place of supply to determine the place where the supply of goods/services will take place and to determine whether supplies are inter state or intra state.
  - In sub-national taxation, determining the place of supply is important as tax revenue accrues to the State where the supply occur or deemed to occur.
  - IGST model envisage levy of IGST by the Centre on all transactions during inter state taxable supplies.
  - Tax revenues accrues to the destination/importing State based on **Place of Supply Rules.**

Integrated Goods and Service Tax (IGST) contd.

- IGST model permits cross-utilization of credit of IGST, CGST & SGST for paying IGST unlike intra-State supply where the CGST/SGST credit can be utilized only for paying CGST/SGST respectively.
- IGST credit can be utilized for payment of IGST, CGST and SGST in sequence by Importing dealer for supplies made by him.
- IGST Model envisages that the Centre will levy tax at a rate approximately equal to CGST+SGST rate on inter-State supply of goods & services.
- It would basically meet the objective of providing seamless credit chain to taxpayer located across States.

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Integrated Goods and Service Tax (IGST) contd.

- IGST model obviates the need for refunds to exporting dealers as well as the need for every State to settle account with every other State
- The Exporting State will transfer to the Centre the credit of SGST used for payment of IGST
- The Centre will transfer to the importing State the credit of IGST used for payment of SGST
- Thus Central Government will act as a clearing house and transfer the funds across the States

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Illustration for IGST Model

- Mr. A (based in Maharashtra) supplied Goods to Mr. B (based in Gujarat) and paid 17% IGST. Mr. A has Input credit of CGST 8% and SGST 8% from local Purchases. So he paid only 1% to Central Government Account i.e. in IGST code of that product. Maharashtra will transfer to Centre 8% SGST used for payment of IGST. Mr. B will pay 1% Additional Tax to Mr. A which will be deposited with the Maharashtra Govt. by Mr. A.
- Mr. B (based in Gujarat) who had purchased those goods supplied the same locally to Mr. C (based in Gujarat) and liable to SGST 10% and CGST 8%. He will utilize Credit of IGST of 17% first for CGST (8%) and balance for SGST (9%) and will pay 1% in cash. Gujarat Government where goods are consumed is entitled to get destination based tax i.e. SGST. Centre will transfer 9% IGST Credit used for payment of SGST to Gujarat. In this example, few important points may be noted:

Illustration for IGST Model

- Maharashtra Government in this transaction will only get additional tax @ 1%, since it is inter state supply from Maharashtra to Gujarat
- Central Government will get 9% IGST on **inter-state supply** of goods to Gujarat (8% from Maharashtra Government and 1% paid as Cash by Mr. A)
- Gujarat Government will get 10% SGST for **intra-state supply** of Goods (9% from central Government and 1 % paid as cash by Mr. B)
- Important to note is that Mr. B (based in Gujarat) has been allowed full credit of IGST paid by Mr. A (based in Maharashtra) of 17%

Key Enablers for IGST

- Uniform e-Registration
- Common e-Return for CGST, SGST & IGST
- Common periodicity of Returns for a class of dealers
- Uniform cut-off date for filing of Returns
- System based validations/consistency checks on the ITC availed, tax refunds
- Effective fund settlement mechanism between the Centre and the States

Role of Dealers in GST Framework

- Every dealer has to submit one single GST return consisting information about all his purchases/sales at Invoice level along with line item.
- Accordingly necessary records, registers are to be maintained and consolidation for return will require automation and standard procedures.

Role of Central/State Government in GST framework

- Central Government to act as clearing house for accounts settlement across States.
- Handling disputes between states over jurisdictional and enforcement issues.
- Develop and maintain GSTN with best of facilities for uninterrupted flow of credit, less litigation and facility to register, file return and in future inbuilt other features like refund, scrutiny of returns.
- Draft model Legislation for CGST, IGST and SGST which will act as a Boundary wall, binding in nature both on Centre and States to legislate their respective GST Acts.
- Affix rate of SGST, within the parameters of band recommended by GST council.
- Formulate mechanism for reconciliation of tax payments.
- Develop systems for scrutiny of returns and record of assesses for GST.
- Establish dispute resolution mechanism for issues relating to levy of GST.

PART IV

Salient features of Proposed Place of Supply Rules

- Place of Supply Rules should be framed keeping in view the following principles:
  - **Rules for B2B Supplies and B2C supplies should be different.**
  - **Place of supply for B2B supplies should normally be the location of recipient of goods or services and not where services is actually performed.**
    - This is required to maintain smooth flow of credit. To illustrate, Mr. A (located in Rajasthan) participates in exhibition organized by Mr. B (located in Delhi). Normally place of supply will be Delhi and Mr. A located in Rajasthan will not be eligible for input tax credit.

Salient features of Proposed Place of Supply Rules contd.

- Rules for B2B supplies should be such so that input tax credit should be available to recipient.
- Place of Supply Rules should be guided by the principles that tax revenue at intermediate stage does not accrue to any tax administration as they are merely wash transactions.
- Place of Supply Rules should be guided by the principles that tax revenue accrues only when the goods/services are consumed by the final consumer.
- Place of Supply Rules should take care of the situation where intangibles are ordered from locations other than the locations where they are consumed.

Way Forward

Way Forward for Introduction of GST

- AMENDMENT BILL TO BE PASSED
  - Procedure for passage of Constitutional Amendment Bill
    - ✓ To be passed by 2/3rd majority in both Houses of Parliament
    - ✓ To be ratified by at least 50% of the State Legislatures
    - ✓ Assent by President of India
- Thereafter, GSTC to be constituted
- GSTC to recommend GST Law and procedure
- GST Law to be introduced in Parliament/ State legislatures
- GSTN (GST Network) a Section 25 Company formed to design automation of GST in line with TINXYS/NSDL

Key Questions before introduction of GST

Key Design issues under Discussion –

- Extent of Dual Control
- Rate structure (based on RNR)
- Exempted Goods or Services
- Exemption threshold
- Composition threshold
- Exclusion Vs. Zero rating of certain goods in GST regime
- Role of Centre / States in inter-State Trade
- Place of Supply Rules for Goods and Services
- Mechanics of IGST model
- Account settlement between the Centre and the States under IGST model

Key Questions before introduction of GST

Key Business processes under Discussion –

- Multiple registration within one State
- Dispute settlement over taxable and enforcement jurisdiction
- Audit, enforcement, recovery etc.

Revenue Neutral Rates (RNR)

- Rate which will give at-least the same level of revenue, which the Centre and States are presently earning from Indirect taxes.
- How to achieve this rate -- require analysis of GDP, Consumer Consumptions, exclusion and desired level of collection of Centre/state.
- We may derive the same by way of an illustration.

Illustration

- Country A desires to collect Rs. 3000 Crores of revenue from Indirect Taxes. The total Consumer Expenditure on Purchases/services is Rs. 30000 Crores.
- Now in case taxes are applicable on every product then a uniform rate of 10% will suffice the collection.
- In case certain products say foods, petroleum, tobacco, electricity are excluded from tax regime and the consumer expenditure on them is Rs. 10000 Crores, then to achieve the same level of taxes, rate need to be 15%.

Exclusion Vs. Zero Rated

- Exclusion while immune a product/Services from levy of taxes on the other hand disallow the benefit of CENVAT/Input Credit of taxes paid which in turn inflate the cost of production/services. Buyer of these products/services while paying this additional cost could not claim any benefit of taxes so paid and hidden in the cost. To illustrate Electricity company while paying 5% excise duty on coal has no option but to add the same into cost of generation while claiming electricity charges from a builder who in turn may have claimed credit if such duty is charged as input taxes from him.
- Zero rated good on the other hand enable the producer/service provider to claim the refund of input taxes paid from department, hence will not form part of cost of production/services.

International Perspective in GST

- Rates and Policy issues of VAT
- Emerging Issues
  - Bit Coins/Coupons
  - B2C
  - Online Supply of Services
  - E Commerce Transactions
  - Dispute Settlement between States
  - Exclusions
  - RNR

GST PLANNING

Impact Areas for Businesses

- Pricing, Costing, Margins
- Supply-chain management
- Change in IT systems
- Treatment of tax incentives
- Treatment of excluded sectors
- Transaction issues
- Tax compliance

Role of Professionals

- Tracking GST development
- Review of draft legislation and impact analysis
- Industry preparedness/Communication issues related to Industry
- Review of final legislation and impact analysis
- Implementation assistance
- Post implementation support
- Tax Planning
- Record Keeping
- Departmental Audit

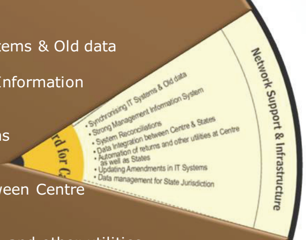
GST Way forward for CA's Knowledge Wheel

Operational Consultancy

- Legislation Impact Analysis, Place of Supply Rules
- Analysis of Costs and Price/ Margin restructuring
- Restructure Supply chain Management
- Comparative Study of Laws
- Understanding Principle of Destination
- Financial management & Competition Analysis
- Review of Existing Contracts

Network Support & Infrastructure

- Synchronising IT Systems & Old data
- Strong Management Information System
- System Reconciliations
- Data Integration between Centre & States
- Automation of returns and other utilities at Centre as well as States
- Updating Amendments in IT Systems
- Data management for State Jurisdiction



Accounting & Taxation Services

- Treatment of Incentives
- Process Documentations & Accounting Manuals
- Branch Transfers
- Budgetary Controls
- Control & Dispute Settlement
- Refunds, Appeals and Adjudications
- Point of Taxation

Compliance Requirements

- Compliance Under State Jurisdictions
- Registrations Under New Scheme
- Online Filing of Returns for each State
- Evaluation of Tax Liability with Credit Set-off
- Statutory Compliances & Record Keeping
- Filing of Declarations
- Export Management

Transitional Support

- Deregistration from Existing Laws
- Managing Pending Litigations
- Review & Certification of Stock on date of transition
- Knowledge Sharing & Capacity Building
- Credit Analysis and Utilization
- Comparative Valuation Under GST

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Centre/ State Support Services

- Conscripting Legislation & Rules/ Procedures
- Reconciliation with Clearing Houses
- Monitoring Transactions & Revenues
- Coordination between Centre/ States
- Cross – verification with Other Acts
- Training & Education
- Fixing Rate Based on RNR and Review

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Global Opportunities

- Tax Advisory Services
- International Research Issues
- Knowledge Process Outsourcing
- Information & Knowledge Sharing
- Capacity Building Services
- Technology Support Services

Audit & Assurance Services

- Internal Review of Change Management
- Internal Controls
- Internal Audit of Compliance
- Checklist for Statutory Audits
- Assistance in Departmental Audits

Thank You

For any Clarification, Please Contact
Indirect Taxes Committee of ICAI
Email: idtc@icai.in, atulservicetax@gmail.com

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INDIRECT TAX STRUCTURE IN INDIA – AN INTRODUCTION

India currently has a dual system of taxation of goods and services, which is quite different from dual GST. Taxes on goods are described as "VAT" at both Central and State level. It has adopted value added tax principle with input tax credit mechanism for taxation of goods and services, respectively, with limited cross-levy set-off.

The present tax structure can best be described by the following chart:

Present Tax Structure
[Four Important Constituents]

Excise Duty	**Service Tax**	**Sales Tax / VAT**	**Customs Duty**
Entry No. 84, List I, Schedule VII	Residuary Entry No. 97, List I, Schedule VII	Entry No. 54 of List II (State VAT) and 92A of List I (Central Sales Tax)	Entry No. 83, List I, Schedule VII
Taxable Event is Manufacture	Taxable Event is Provision of Service	Taxable Event is Sale	Taxable Event is Import & Export
Median Rate-12%%	Single Rate-12.36%	Rates - 5%, 12.5% & 20%	Median Rate-24.72%

Until the introduction of MODVAT (now CENVAT) Scheme in 1986 in respect of Central Excise Duty, duty was levied as origin based single point tax on manufacture of goods with some exceptions where set off scheme was used to reduce the cascading effect of taxes. CENVAT is only at manufacturing level and does not go up to retail level.

At State level, varieties of schemes were framed like origin based single point system (first point tax), multi point system with set off, last point (retail level) system, and so on. This was, again, not uniform even within a State. States adopted different systems for different commodities too. Cascading effect at that time was reduced to a great extent with the use of declaration forms, though, that by itself was a complex system. With the introduction of State VAT, there is combination of origin based (Central Sales Tax) and destination based multi point system of taxation.

Similarly, there was no Union level tax on services till the introduction of Service Tax in 1994 although, selective levy by the States on specified services like entertainment tax, is continuing. Service tax is currently charged on all the services except the services mentioned in the Negative List and specifically exempted from the service tax, although initially tax was charged on selected services. The VAT at Union (CENVAT) as well as State Level (VAT) is on goods only, except that at the Union level, there is input tax credit mechanism between CENVAT and Service Tax.

1.1 Excise Duty

- Central excise duty is an indirect tax levied on goods manufactured in India. The tax is administered by the Central Government under the authority of Entry 84 of the Union List (List 1) under Schedule VII read with Article 226 of the Constitution of India.
- The Central excise duty is levied in terms of the Central Excise Act, 1944 and the rates of duty, ad valorem or specific, are prescribed under the Schedule I and II of the Central Excise Tariff Act, 1985.
- The taxable event under the Central Excise Law is 'manufacture' and the liability of Central excise duty arises as soon as goods are manufactured, that is, it is not extended upto retail level. The Central Excise Officers are also entrusted to collect other types of duties levied under Additional Duties (Goods of Special Importance) Act, Additional Duties (Textiles and Textiles Articles) Act, Cess, etc.
- In 1986, the modified value added tax (MODVAT) was introduced as the first step towards reforming Union Excise Duty. This provided set-off for about a small number of commodities. In 1987, MODVAT was extended to some additional commodities. With the recommendations of the report of Tax Reforms Committee (TRC) (1991-93), MODVAT was further extended to a large number of commodities. Gradually, the procedures of MODVAT have also been overhauled, resulting in a full system of Central VAT (CENVAT).
- CENVAT is levied on all goods except petro-products and tobacco at manufacturing level. It allows instant credit for all the taxes paid on inputs as well as on countervailing duty (CVD).
- Excise duty has general rate of12%. Additional excise duty in lieu of sales tax, special excise duty, cess and surcharges on specified commodities as additional levies are also levied.
- New Central Excise Rules, 2001 replaced the Central Excise Rules, 1944 with effect from 1st July, 2001. Other Rules have also been notified namely, CENVAT Credit Rules, 2001, Central Excise Appeal Rules, 2001, etc. With the introduction of the new rules, several changes have been effected in the procedures. These rules were later repealed by The CENVAT Credit Rules, 2004, having the following broad features: -
- Elimination of cascading effect through tax credit mechanism

- Integration of excise duty and service tax and set-off of one against another
- However, there is no integration of excise duty and sales tax/VAT.

1.2 Service Tax

- Service Tax was first imposed in India in the year 1994 with three services through Chapter V of the Finance Act, 1994.Over the years, more and more services were brought into the tax-net. There is no separate legislation for imposition of service tax in India, which is governed and administered by the Finance Act, 1994, as amended from time to time.
- The tax is administered by the Central Government under the authority of Residual Entry 97 of the Union List (List 1) under Schedule VII of the Constitution of India.
- Taxable event of the service tax is provision of services. However, tax is also levied on service to be provided, i.e., the advances received for provision of services.
- The CENVAT Credit Rules, 2004 provide for availing of the credit of the service tax and central excise duties paid on the input services/inputs/capital goods used for providing output services. Such credit amount can be utilised by an assessee towards payment of service tax on their output services.
- The CENVAT credit availed by a manufacturer on the input services can also be utilised for discharging its liability towards service tax on output services and/or central excise duties. Duties of excise and the countervailing customs duty (CVD) paid on the inputs and capital goods and the service tax paid on the 'input' services can be taken as credit.
- However, cross levy set-off of service tax and sales tax/VAT is not permissible.

1.3 Central Sales Tax / State Value Added Tax (VAT)

Broadly, for taxation purposes, sales can be divided into: -

(a) Sales within a State (known as 'Intra-State Sales' or 'Local Sales').

(b) Sales from one State to another State within the domestic boundaries of India (known as 'Inter-State Sales' or 'Central Sales').

(c) Sales in the course of export from or import into India.

While sales tax on the first head, i.e. local sales, is levied by the State Governments as per the provisions of their respective State Sales Tax Laws (presently VAT Laws), the taxability of inter-State sale under the second head is within the purview of the Central Government. Sales under the third head, i.e. in the course of export or import, though defined under the Central Sales Tax Act, are exempt from the sales tax.

Entry 92A in the Union List in the Seventh Schedule to the Constitution of India confers power upon the Union to legislate in respect of "taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce”. The power to impose sales tax in the Union Territory vests with the Parliament under Article 246(4) of the Constitution of India.

Entry 54 in List II (State List) of the Seventh Schedule read with Article 246(3) of the Constitution of India empowers the States to impose “tax on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92-A of the List I”.

Restrictions imposed on States to tax sale or purchase of goods through Article 286 are as under: -

> “286(1) No law of a State shall impose a tax on the sale or purchase of goods where such sale or purchase takes place -
>
> (a) Outside the State; or
>
> (b) In the course of the import of the goods into, or export of the goods out of, the territory of India.
>
> 286(2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1).
>
> 286(3) Parliament may impose restrictions and conditions in regard to the system of levy, rates and other incidents of the tax on any law of a State in relation to the imposition of -
>
> (a) A tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, (declared goods), or
>
> (b) A tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or sub-clause (d) of sub-clause (29A) of Article 366.”

In Article 269(1), clause (g) authorises the Government of India to collect tax on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce and making it obligatory upon the Government of India to assign the tax to the collecting States.

1.3.1 Enactment of the Central Sales Tax Act, 1956

In exercise of the authority conferred by the Constitution (Sixth Amendment) Act, 1956, the Parliament enacted on December 21, 1956, the Central Sales Tax Act, 1956. All sections except section 15 (restrictions on the powers of the States to tax on declared goods) were brought into force on 5th January 1957 and section 15 was made effective w.e.f. 1st October 1958. Imposition of tax became effective from 1st July 1957.

Therefore, inter-State sale of goods is taxable under the Central Sales Tax Act, 1956. For this purpose, goods have been classified into two categories: (a) Declared goods or goods of special importance in inter-State trade or commerce, and (b) Other goods. Rates of tax have been prescribed under section 8 and differ from State to State and for a particular item, it generally depends upon the tax rate prevailing in that State.

After the amendments vide Taxation Laws (Amendment) Act, 2007 w.e.f. 01.04.2007, central sales to unregistered dealers or to registered dealers without declaration in Form 'C' or other Forms prescribed under the CST Act attract tax at the rate equal to the local rate of tax (i.e. the rate applicable within the originating State). For sales (declared or other goods) supported by declaration Form C, the CST rate is 2%, or the local rate applicable in that State, whichever is lower. The Central Government had reduced the CST rate for sales made to registered dealers on the strength of Form C from 4% to 3% with effect from 1st April 2007, which has further been reduced to 2% w.e.f. 1st June 2008.

1.3.2 Value Added Tax

Value Added Tax, one of the significant reforms in the history of indirect tax structure in India, has been implemented by a majority of the States with effect from 1st April 2005, and this could be possible due to the joint efforts of the Central Government and the State Governments. The replacement of the State Sales Taxes by the Value Added Tax marked a substantial step forward in the reform of domestic trade taxes in India. Implemented under the leadership of Dr. Asim Dasgupta, Chairman, Empowered Committee of State Finance Ministers, it addressed the distortions and complexities associated with the levy of tax under the erstwhile system and resulted in a major simplification of the rate structure and broadening of the tax base.

"Value Added Tax" (VAT), as its name suggests, is a tax on value addition. It is a multi-point tax, which is levied at every stage of sale. It is collected at the stage of manufacture/resale and contemplates rebating of tax paid on inputs and purchases. Despite its name, VAT is intended as tax on consumption, and is origin based tax.

In India, VAT replaced the general sales tax which was levied at State level, the only difference being the manner of levy. Powers of the States to levy tax on sales transactions, in the form of VAT, continue to be drawn from Entry 54 in List II of Seventh Schedule of the Constitution of India. In VAT, every transaction of sale of goods in the course of business is taxed, thus providing revenue to the Government on value addition at every stage. On account of set off being provided on preceding purchase, cascading effect on the cost of goods is avoided. It is a self policing system, reducing the scope of tax evasion. VAT reduces scope for under-valuation and tax evasion, and provides a broad tax base.

The first preliminary discussion on State-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers. Thereafter, in a significant meeting of all Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha (the then Union Finance Minister), three important decisions were taken: -

(i) Before the introduction of State-level VAT, the unhealthy sales tax rate "war" among the States would have to end and sales tax rates would need to be harmonized by implementing uniform floor rates of sales tax for different categories of commodities with effect from 1st January 2000.

(ii) In the interest again of harmonization of incidence of sales tax, the sales-tax-related industrial incentive schemes would also have to be discontinued with effect from 1st January 2000.

(iii) On the basis of achievement of the first two objectives, steps would be taken by the States for introduction of State-level VAT after adequate preparation. For implementing these decisions, an Empowered Committee of State Finance Ministers was set-up.

Thereafter, the Empowered Committee met regularly, attended by the State Finance Ministers, and also by the Finance Secretaries and the Commissioners of Commercial Taxes of the State Governments as well as senior officials of the Revenue Department of the Ministry of Finance, Government of India.

The design of State-level VAT has been worked out by the Empowered Committee through several rounds of discussion and striking a federal balance between the common points of convergence regarding VAT and flexibility for the local characteristics of the States. Since the State-level VAT centered around the basic concept of "set-off" for the tax paid earlier, the needed common points of convergence also relate to this concept of set-off/input tax credit, its coverage and related issues.

VAT has since been implemented in all the States of India.

1.4 Customs Duty

Indian Customs Department has been assigned a number of tasks; more important of which are:-

(i) Collection of customs duties on imports and exports as per basic Customs laws (Customs Act, 1962 and Customs Tariff Act, 1975).

(ii) Enforcement of various provisions of the Customs Act governing imports and exports of cargo, baggage, postal articles and arrival & departure of vessels, air crafts etc.

(iii) Discharge of various agency functions and enforcing various prohibitions and restrictions on imports and exports under Customs Act and other allied enactments.

(iv) Prevention of smuggling including interdiction of narcotics drug trafficking.

(v) International passenger processing.

The Constitutional provisions have given to the Union Government the right to legislate and collect duties on imports and exports as per Entry No. 83 of List 1 to Schedule VII of the Constitution. The Customs Act, 1962 is the basic Statute, effective from 1.2.1963 which empowers duties to be levied on goods imported into or exported from India.

The categories of items and the rates of duties which are leviable have been specified in the Schedules to the Customs Tariff Act, 1975. The First Schedule to the said Act specifies the various categories of import items in a systematic and well considered manner, in accordance with an international scheme of classification of internationally traded goods – termed 'harmonized system of commodity classification'. Different rates of duties are prescribed by the legislature on different commodities/ group of commodities mentioned in the First Schedule.

The duties are levied both on specific and ad valorem basis; while there are few cases where at times specific-cum-ad valorem duties are also collected on imported items. The Second Schedule to Customs Tariff Act, 1975 incorporates items subject to exports duties and rates thereof.

Where ad valorem duties (i.e., duties with reference to value) are collected, which are the predominant mode of levy, the value of the goods is determined for customs duty purposes as per provisions laid down under Section 14 of the Customs Act and the Customs Valuation (Determination of Prices of Imports Goods) Rules, 1988 issued thereunder.

Customs Duties on import are primarily of three types: -

(a) Basic Customs Duty (levied under section 12 of the Customs Act);

(b) Additional Customs Duty (CVD) under sections 3(1) and 3(3) of Customs Tariff Act, in lieu of excise duty;

(c) Special Additional Duty of Customs (SAD) under section 3(5) of Customs Tariff Act to counter-balance the sales tax, value added tax, local tax or any other charges for the time being leviable on a like article on its sale, purchase or transportation in India.

1.5 Other Important Indirect Taxes/Duties

- Octroi
- Entry Tax
- Luxury Tax
- Research and Development Cess
- Telecom License Fees
- Turnover Tax
- Tax on Consumption or Sale of Electricity
- Taxes on Transportation of Goods and Services
- Lottery Tax
- Betting and Gambling Tax
- Stamp Duty
- Property Tax
- Toll Tax, Passenger Tax and Road Tax.

1.6 Shortcomings in the Present Structure and need of GST

(a) Tax Cascading

Tax cascading occurs under both Centre and State taxes. The most significant contributing factor to tax cascading is the partial coverage by Central and State taxes. Oil and gas production and mining, agriculture, real estate construction, infrastructure projects, wholesale and retail trade, 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 to the exempted sectors, which include the entire service sector. Another major contributing factor to tax cascading is the Central Sales Tax (CST) on inter-State sales, collected by the Origin State for which no credit is allowed by any State Government.

(b) Levy of Excise Duty on manufacturing point

The CENVAT is levied on goods manufactured or produced in India. Limiting the tax to the point of manufacturing is a severe impediment to an efficient and neutral application of tax. Taxable event at manufacturing point itself forms a narrow base.

For example, valuation as per excise valuation rules of a product, whose consumer price is Rs. 100/-, is, say, Rs. 70/-. In such a case, excise duty as per the present provisions is payable only on Rs.70/-, and not on Rs.100/-.

Further, definitional issues as to what constitutes manufacturing, and valuation issues for determining the value on which the tax is to be levied, are other concerns. However, these concepts have evolved through judicial rulings to a great extent.

(c) Complexity in determining the nature of transaction – Sale *vs*. Service

The distinctions between goods and services found in the Indian Constitution have become more complex. 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 in the Constitution, neither the Centre nor the States can apply the tax to such bundles in a seamless manner. Each Government can tax only parts of the bundle, creating the possibility of gaps or overlaps in taxation.

Example:- In case of Installation of AC(Air Conditioner) where a bundle of services are provided like wood and other material used for installation , VAT is charged on such material and on labour part service tax is applicable, but no value is defined separately. VAT and Service Tax are charged on percentage basis as defined by State and Central Govt.

(d) Inability of States to levy tax on services

Exclusion of services from the State taxation powers is its negative impact on the buoyancy of State tax revenues. 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).

(e) Lack of Uniformity in Provisions and Rates

Present VAT structure across the States lacks uniformity, which is not restricted only to the rates of tax, but also extends to procedures and, sometimes, to the definitions, computation and exemptions.

(f) Fixation of *situs* – Local Sale *vs.* Central Sale

Whether a sale takes place in one State or another, i.e. to fix the *situs* of a sale transaction, is the major conflict, as its taxability affects the revenue of the State. Though CST is a tax levied by the Central Government, it is collected and retained by the collecting State. Whether a transaction is a direct inter-State sale from State 'X' to the customer 'ABC' located in State 'Y'; or is a stock transfer from State 'X' to branch in State 'Y' first, and then a local sale to the customer 'ABC' in the State 'Y', will have a bearing on the revenue of the State 'X' or State 'Y', as the case may be.

A significant number of litigations pertain to this issue. Ultimately, the Central Government made provisions under the Central Sales Tax Act, 1956 and created a Central Appellate Authority to resolve such matters.

(g) Interpretational Issues

Another problem arises in respect of interpretation of various provisions and determining the category of the commodities. We find a significant number of litigation surrounding this issue only. To decide whether an activity is sale or works contract; sale or service, is not free from doubt in many cases.

(h) Narrow Base

The starting base for the CENVAT is narrow, and is being further eroded by a variety of area-specific and conditional exemptions.

Earlier the service tax was applicable on selective services but after the implementation of Finance Act, 2012 the system of comprehensive taxation of services was implemented, while excluding few service by specifying them in "negative list".

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. The middle rate of 5% applies to selected basic necessities and also a range of industrial inputs and IT products. In fact, basic necessities fall into all three categories – exempted from tax, taxable at 5%, and taxable at the standard rate of 12.5%. Higher rate of 20% is also applicable mainly to petroleum products and liquor. However, 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.

(i) Complexities in Administration

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 non-existent or grossly inadequate under both Central and State administrations. Many of the administrative processes are still manual, not benefiting from the efficiencies of automation. All these not only increase the costs of compliance, but also undermine the revenue collection.

1.7 Recent Improvements in Tax Structure

[Source: Economic Survey 2008-09]

Over the past several years, significant progress has been made to improve the indirect tax structure, broaden the base and rationalize the rates.

Notable among the improvements are:

- 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 per cent, from 4 per cent, as part of a complete phase out of the tax.
- Introduction of service tax by the Centre, and a substantial expansion of its base over the years.
- 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 largely 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 design of the CENVAT and State VATs were dictated by the constraints imposed by the Constitution, with neither the Centre nor the States being able to levy taxes on a comprehensive base of all goods and services and at all points in their supply chain.

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 still remains complex. The most significant cause of complexity is, of course, policy related and is due to the existence of exemptions and multiple rates, and the extant structure of the levies. These deficiencies are the most glaring in the case of 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. The introduction of Goods and Services Tax (GST) would thus be opportune for deepening the reform process already underway. 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.

In defining options for reform, the starting point is the basic structure of the tax. The Empowered Committee of State Finance Ministers in November 2007 had recommended a "Dual" GST, to be levied concurrently by both levels of Government. The dual GST option strikes a good balance between fiscal autonomy of the Centre and States, and the need for harmonization. It empowers both levels of Government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain. It also eliminates tax cascading, which occurs because of truncated or partial application of the Centre and State taxes.

A-2
WHAT IS GST, HOW IT WORKS AND ITS ADVANTAGES

2.1 What is GST?

GST stands for "Goods and Services Tax", and is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. Its main objective is to consolidates all indirect tax levies into a single tax, except customs (excluding SAD) replacing multiple tax levies, overcoming the limitations of existing indirect tax structure, and creating efficiencies in tax administration.

One of the reasons to go the GST way is to facilitate seamless credit across the entire supply chain and across all States under a common tax base. The current framework allows limited inter-levy credits between CENVAT (tax on manufacture) and service tax. However, no cross credits are available across these taxes and the sales tax/VAT paid (on input) or payable (on output). Introduction of GST would thus rationalize the tax content in product price, enhance the ability of business entities to compete globally, and possibly trickle down to benefit the ultimate consumer.

Example:- A product whose base price is Rs.100 and after levying excise duty @ 12% value of the product is Rs. 112. On sale of such goods VAT is levied @ 12.5% and value to the ultimate consumer is Rs. 126. In the proposed GST system on base price of Rs.100 CGST and SGST both will be charged, say @ 8% each, then the value to the ultimate consumer is Rs. 116. So, in such a case the industry can better compete in global environment.

Therefore, GST is a broad based and a single comprehensive tax levied on goods and services consumed in an economy. GST is levied at every stage of the production-distribution chain with applicable set offs in respect of the tax remitted at previous stages. It is basically a tax on final consumption. To put at a single place, GST may be defined as a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or procuring the service.

Internationally, GST is a single levy for all transactions related to goods and services. In India, however, currently the power to prescribe the taxation framework, and levy and collect taxes has been segregated between the Centre and States under the Constitution.

For resolving disputes regarding GST, its implementation etc. a GST Council would be setup. Given this uniqueness, learnings of other countries cannot be directly implemented in India.

2.2 Illustration of GST [All parties are located in one State]

***<u>Assumptions</u>*: (1) Rate of Excise Duty – 8%; (2) VAT Rate – 12.5%; (3) Central GST Rate – 12%; (4) State GST Rate – 8%; (5) Profit Margin – Rs. 10,000/- fixed (before tax)**

Particulars	Under VAT	Under GST
(I) Manufacturer (D1) to Wholesaler (D2)		
Cost of Production	90,000	90,000
Input Tax Credit (Assuming nil)	-	-
Add : Profit Margin	10,000	10,000
Producers Basic Price	1,00,000	1,00,000
Add: Central Excise Duty @ 12%	12,000	-
Add : Value Added Tax @ 12.5% on Rs. 1,12,000/-	14,000	-
Add : Central GST @ 12%	-	12,000
Add : State GST @ 8%	-	8,000
Sale Price	1,26,000	1,20,000
(II) Wholesaler (D2) to Retailer (D3)		
Cost of Goods to D2	1,12,000	1,00,000
Available Input Tax Credit for set off	*14,000*	*20,000*
Add : Profit Margin	10,000	10,000
Total	1,22,000	1,10,000
Add : Value Added Tax @ 12.5%	15,250	-
Add : Central GST @ 12%	-	13,200
Add : State GST @ 8%	-	8,800
Total Price to the Retailer	1,37,250	1,32,000
(III) Retailer (D3) to Final Consumer (C)		
Cost of Goods to D3	1,22,000	1,10,000
Input Tax Credit	*15,250*	*22,000*
Add : Profit Margin	10,000	10,000
Total	1,32,000	1,20,000
Add : Value Added Tax @ 12.5%	16,500	-
Add : Central GST @ 12%	-	14,400
Add : State GST @ 8%	-	9,600
Total Price to the Consumer	**1,48,500**	**1,44,000**
Total Tax Payable in All Transactions	**28,500**	**24,000**
*Verification:- VAT @12.5% [148,500 * 12.5 / 112.5] = 16,500 + 12,000 (CENVAT) = 28,500*		
- D1 (12,000 +14,000)	*26,000*	
- D2 (15,250 - 14,000)	*1,250*	
- D3 (16,500 - 15,250)	*1,250*	
*Verification:- GST @20% [144000 *20 / 120] =24000*		
- D1 (12,000 + 8,000)		*20,000*
- D2 (22,000 - 20,000)		*2,000*
- D3 (24,000 - 22,000)		*2,000*

Note: As per the above illustration the major benefit to the consumer in the GST regime is that GST is charged always on producer basic price.

[*For illustration on GST on inter-State transactions: Refer Para No. 7.4 (6) of Chapter A-7 (Inter-State Transactions and GST)]*

It is insignificant to ascertain who the gainer is in monetary terms – Government or the Consumer but certainly, GST is a better system which is self-disciplined. Moreover, the net impact would be marginal in most of the cases since the RNR (Revenue Neutral Rate) would be determined by the Government after taking the monetary impact into consideration.

2.3 Features of an Ideal GST

GST is a comprehensive value added tax on goods and services. It is levied and collected on value addition at each stage of sale or purchase of goods or supply of services based on input tax credit method but without State boundaries. There is no distinction between taxable goods and taxable services and they are taxed at a single rate in a supply chain of goods and services till the goods / services reach the consumer. The administrative power generally vests with a single authority to levy tax on goods and services. The main features of GST are as under:-

(a) GST is based on the principle of value added tax and either "input tax method" or "subtraction" method, with emphasis on voluntary compliance and accounts based system.

(b) It is a comprehensive levy and collection on both goods and services at the same rate with benefit of input tax credit or subtraction of value of penultimate transaction value.

(c) Minimum number of floor rates of tax, generally, not exceeding two rates.

(d) No scope for levy of cess, re-sale tax, additional tax, special tax, turnover tax etc.

(e) No scope for multiple levy of tax on goods and services, such as, sales tax, entry tax, octroi, entertainment tax, luxury tax, etc.

(f) Zero rating of exports and inter State sales of goods and supply of services.

(g) Taxing of capital goods and inputs whether goods or services relatable to manufacture at lower rate, so as to reduce inventory carrying cost and cost of production.

(h) A common law and procedures throughout the country under a single administration.

(i) GST is a destination based tax and levied at single point at the time of consumption of goods or services by the ultimate consumer.

2.4 Advantages of Comprehensive GST

(a) Introduction of GST would result in abolition of multiple types of taxes on goods and services.

(b) It reduces effective rates of tax to one or two floor rates.

(c) Reduces compliance cost and increases voluntary compliance.

(d) Removes cascading effect of taxation and also distortion in the economy.

(e) Enhances manufacturing and distribution efficiency, reduces cost of production of goods and services, increases demand and production of goods and services.

(f) As it is neutral to business processes, business models, organization structure, geographic location, product substitutes, it promotes economic efficiency and sustainable long term economic growth.

(g) Gives competitive edge in international market for goods and services produced in a country, leading to increased exports.

(h) Reduces litigation, and corruption.

(i) Results in widening tax base and increased revenue to the Center and State.

(j) Reduces administrative cost for the Government.

According to Dr. Vijay Kelkar, Chairman of the 13th Finance Commission and former Union Finance Secretary and Adviser to the Finance Minister, GST has a number of advantages, including:

(a) Brings a phase change on the tax firmament by redistributing the burden of taxation equitably between manufacturing and services.

(b) Lowers the tax rates by broadening the tax base and minimizing exemptions.

(c) Reduces distortions by completely switching to the destination principle.

(d) Fosters a common market across the country and reduces compliance costs.

(e) Provides a fiscal base for local bodies to enable them to fulfill their obligations.

(f) Facilitates investment decisions being made on purely economic concerns, independent of tax considerations.

(g) Promotes exports: - A recent study on the impact of GST on foreign trade indicates that the rate of growth of exports will be significantly higher than that for imports.

(h) Promotes employment.

(i) Most importantly, it will spur growth. It has been estimated that the GST implementation increased Canadian GDP by 1.4 percent. In India, a similar kind of positive impact is expected. This means gains of about 15 billion dollars annually. Discounting these flows at a modest 3 percent per annum, the present value of the GST works out to about half a trillion dollars.

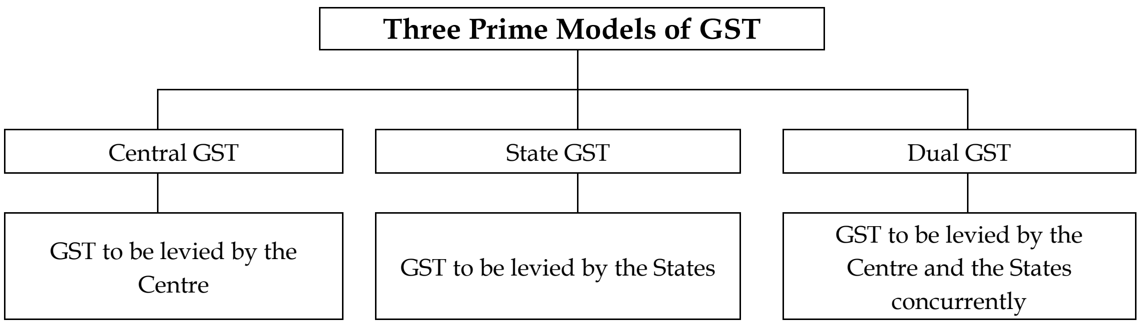
A-3
MODELS OF GST

There are three prime models of GST:

GST at Central (Union) Government Level only

GST at State Government Level only

GST at both, Union and State Government Levels



Canada has GST at Union level extending to all goods and services covering all stages of value addition. In addition, there is tax at province (State) level in different forms which include VAT, Retail Sales tax and so on. European Union (EU) Nations (each one is independent Nation but, part of a Union and have agreed to adopt common principles for taxation of goods and services) have adopted "classic" VAT.

In the Indian context, Constitution of India specifically reserves the power to impose tax on specific activities to specific level of Government, e.g., tax on import of goods can be imposed by Union Government only whereas tax on sale of goods involving movement of goods within the State can be imposed by State Governments only.

3.1 Central GST

Under this option, the two levels of government would combine their levies in the form of a single National GST, with appropriate revenue sharing arrangements among them. The tax could be controlled and administered by the Central Government. There are several models for such a tax. Australia is the most recent example of a National GST, which is levied and collected by the Centre, but the proceeds are allocated entirely to the States.

In the case of a Central GST (where all goods and services are taxed by the Central government only), the Centre will collect most of the country's total tax revenue, leaving very little for the sub-national Governments. As against this, the present proposal is to have a dual GST.

A single national VAT has great appeal from the perspective of establishment and promotion of a common market in India. However, the States may worry about the loss of control over the tax design and rates. Indeed, some control over tax rates is a critical issue in achieving accountable sub-national governance and hard budget constraints. The States may also be apprehensive that the revenue sharing arrangements would over time become subject to social and political considerations, deviating from the benchmark distribution based on the place of final consumption. The Bagchi Report also did not favour this option for the fear that it would lead to too much centralization of taxation powers.

The key concerns about this option would thus be political. Notwithstanding the economic merits of a National GST, it might have a damaging impact on the vitality of Indian federalism.

Pros:

- If levied on a comprehensive base at a single rate, it would clear the system of virtually all economic distortions and classification disputes.
- Replacing 36 taxing Statutes (of the Centre and 35 States and Union Territories) with only one would lead to a substantial reduction in compliance costs and free up resources for other more productive pursuits.
- It would make common market for India a reality. Goods and services would move freely within India with no check-posts, internal-tax frontiers or other barriers to trade.
- Ideal structure from business perspective – greater stability and facilitation of decision making.
- Businesses will have to deal with only one tax authority and comply with only one tax - A significant reduction of compliance costs.
- Excellent from consumer perspective as the consumer will know exactly how much is the indirect tax burden in the goods and service consumed by him.
- Cascading effect can be removed to a large extent as there will not be taxes at two levels leading to improved competitiveness.

Cons:

- Near impossibility of achieving the structure – It will require drastic modification to the Constitution of India.
- It might upset the present concept of fiscal federalism, which is the cornerstone of Indian polity.
- Entire infrastructure developed for taxation at both levels will have to undergo huge change.
- States may not agree to give up the power of taxation and depend on the Union for resources.

3.2 State GST

The second model is to have a State GST in which the States alone levy GST and the Centre withdraws from the field of GST or VAT completely. It can be a desirable option given the mismatch in resources and responsibilities of the States. In this case, the State GST will work as the redistributing mechanism. The loss to the Centre from vacating this tax field could be offset by a suitable compensating reduction in fiscal transfers to the States. This would significantly enhance the revenue capacity of the States and reduce their dependence on the Centre. The USA is the most notable example of such arrangements, where the general sales taxes are relegated to the States. However, there would be significant hurdles in adopting this option in India, and it may not be suitable here.

Third, a complete withdrawal of the Centre from the taxation of inter-State supplies of goods and services could undermine the States' ability to levy their own taxes on such supplies in a harmonized manner. In particular, it would be impractical to bring inter-State services within the ambit of the State GST without a significant coordinating support from the Centre.

Pros:

- Reduction of cascading effect of taxes, as there will not be tax at two levels.
- It enhances the revenue capacity of the States and reduces their dependence on the Centre.

Cons:

- It would seriously impair the Centre's revenues. The reduction in fiscal transfers to the States would offset this loss, but still the Centre would want to have access to this revenue source for future needs.
- Major amendments to the Constitution of India will be required.
- The option may not be revenue neutral for individual States. The incremental revenues from the transfer of the Centre's tax collection would benefit the higher-income States, while a reduction in fiscal transfers would impact disproportionately the lower-income States.
- Businesses will have to comply with tax laws of each State – which will definitely lack uniformity and harmony. At the same time, decision making will be impacted and may affect business stability.
- A complete withdrawal of the Centre from the taxation of inter-State supplies of goods and services could undermine the States' ability to levy their own taxes on such supplies in a harmonized manner. In particular, it would be impractical to bring inter-State services within the ambit of the State GST without a significant coordinating support from the Centre.
- Governments, both States and Union will not find it workable as it will require complete change in its finances and allocation of resources - entire distribution of taxes will need to undergo changes. But, that too will not be workable as revenue collection by each State will vary depending on the level of activities in each State and need for support to States – redistribution of taxes will become an issue.
- There may be unhealthy competition among the States using local tax structure as a tool to attract industry within the States. This could lead to retaliatory measures by other States.

3.3 Dual GST

3.3.1 Non-Concurrent Dual GST

Under the concurrent dual GSTs, the Centre and State taxes apply concurrently to supplies of all goods and services. However, it poses two challenges. First, it requires a constitutional amendment. Second, a framework is needed for defining the place of supply of inter-State services and for the application of State GST to them.

Therefore, as suggested in the Poddar-Ahmed Working Paper, to circumvent both of these hurdles, GST on goods can be levied by the States only and on services by the Centre only. The States already have the power to levy the tax on the sale and purchase of goods (and also on immovable property), and the Centre for taxation of services. No special effort would be needed for levying a unified Centre tax on inter-State services.

Under this model, while levying the VAT on services, the Centre would essentially play the coordinating role needed for the application and monitoring of tax on inter-State services. The Centre would withdraw from the taxation of goods. Even the revenues collected from the taxation of services could be transferred back to the States, partially or fully.

Within this framework, cascading could be completely eliminated by the States agreeing to allow an input credit for the tax on services levied by the Centre. Likewise, the Centre would allow an input credit for the tax on goods levied by the States.

However, the said model may not be acceptable to the Centre as well as the States. Moreover, constitutional amendment would still be required in this model since the States are not presently empowered to levy sales tax on goods where movement of such goods take place in the course of inter-State trade or commerce. Therefore, the Government has already announced its intention to follow the Concurrent Dual GST.

3.3.2 Concurrent Dual GST

Here the GST will be levied by both tiers of Governments concurrently. There will be Central GST to be administered by the Central Government and there will be State GST to be administered by State Governments. Thus, the GST would comprise a Central GST and State GST: a Central-level GST will subsume central taxes, such as, excise duty, CVD, SAD and service tax; and a State-level GST will subsume VAT, octroi, entry taxes, luxury tax, etc.

Therefore, under this model, both goods and services would be subject to concurrent taxation by the Centre and the States. This variant is closer to the model recommended by the Kelkar Committee in 2002.

Example: Under existing system Centre can levy tax on goods as well as on services, such as Excise duty on manufacture of goods and Service tax on Services but State has no power to levy Tax on manufactured goods such as VAT but in concurrent dual GST model both Centre and State will have power to levy taxes on both Goods and Services.

Pros:

- This model is achievable in the short term and no significant changes are required in the current structure of indirect taxation, however, some amendments will be required in the Constitution.
- It removes cascading effect of taxes significantly.
- It strikes a good balance between fiscal autonomy of the Centre and States, and the need for harmonization.
- It empowers both levels of Government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain.
- It requires least change in infrastructure of tax departments at the Union and State levels.
- It improves the competitive environment for company working globally, as single taxation system reduces cost to the consumer.

Cons:

- It is not an ideal model. It can be a temporary or transitional model since tax would continue to be levied at two levels and compliance costs may not reduce significantly.
- There will always be uncertainty since States might depart from the principles of uniformity.
- To frame a comprehensive model for taxation of inter-State transactions of goods and services and sharing of its revenue amongst the State will be a challenge.
- Taxation of services at State level, especially services provided nationwide (e.g. telecommunication service, transportation service), will pose challenge.

Looking to the facts, it is the most workable GST model especially taking into consideration the amendments required in the Constitution of India and achievability in the short term. This Model builds on the current structure of taxation of goods and services and does not envisage drastic changes in the broad mechanism for levy and collection of taxes.

A- 4
EXPECTED MODEL OF GST IN INDIA

In the Budget Speech for the year 2009-10, the Hon'ble Finance Minister Shri Pranab Mukherjee informed the House:

> *Para 85: "………….. The broad contour of the GST Model is that it will be a* ***dual GST*** *comprising of a Central GST and a State GST.* ***The Centre and the States will each legislate, levy and administer the Central GST and State GST, respectively****. I will reinforce the Central Government's catalytic role to facilitate the* ***introduction of GST by 1st April, 2010*** *after due consultations with all stakeholders."*

4.1 Indian Model of GST – Dual GST

4.1.1 Features

In India, the GST model will be "dual GST" having both Central and State GST component levied on the same base. All goods and services barring a few exceptions will be brought into the GST base. Importantly, there will be no distinction between goods and services for the purpose of the tax with common legislations applicable to both.

For Example, if a product have levy at a base price of Rs. 100 and rate of CGST and SGST are 8% then in such case both CGST and SGST will be charged on Rs 100 i.e. CGST will be Rs 8 and SGST will be Rs.8.

Interestingly, as per the recommendations of Joint Working Group (JWG) appointed by the Empowered Committee in May 2007, the GST in India may not have a dual VAT structure exactly but it will be a quadruple tax structure. It may have four components, namely -

(a) a Central tax on goods extending up to the retail level;

(b) a Central service tax;

(c) a State-VAT on goods; and

(d) a State-VAT on services.

Given the four-fold structure, there may be at least four-rate categories - one for each of the components given above. In this system the taxpayer may be required to calculate tax liability separately for the different rates of tax.

The significant features of Dual GST recommended in India, in conjunction with the recommendations by the JWG, are as under:

1. There will be Central GST to be administered by the Central Government and there will be State GST to be administered by State Governments.

2. Central GST will replace existing CENVAT and service tax and the State GST will replace State VAT.

3. Central GST may subsume following indirect taxes on supplies of goods and services:

   - Central Excise Duties (CENVAT)
   - Additional excise duties including those levied under Additional Duties of Excise (Goods of Special Importance) Act, 1957.
   - Additional customs duties in the nature of countervailing duties, i.e., CVD, SAD and other domestic taxes imposed on imports to achieve a level playing field between domestic and imported goods which are currently classified as customs duties.
   - Cesses levied by the Union viz., cess on rubber, tea, coffee etc.
   - Service Tax
   - Central Sales Tax – To be completely phased out
   - Surcharges levied by the Union viz., National Calamity Contingent Duty, Education Cess, Special Additional Duties of Excise on Motor-Spirit and High Speed Diesel (HSD).

4. State GST may subsume following State taxes:

   Value Added Tax

   Purchase Tax

   State Excise Duty (except on liquor)

   Entertainment Tax (unless it is levied by the local bodies)

   Luxury Tax;

   Octroi

   Entry Tax in lieu of Octroi

   Taxes on Lottery, Betting and Gambling

5. The proposed GST will have two components – Central GST and State GST – the rates of which will be prescribed separately keeping in view the revenue considerations, total tax burden and the acceptability of the tax.

6. Taxable event in case of goods would be ‘sale’ instead of ‘manufacture’.

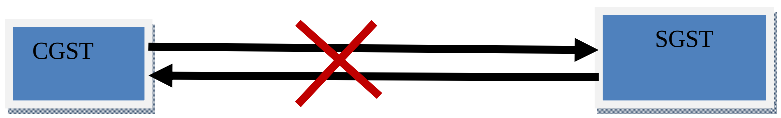
7. Exports will be zero rated and will be relieved of all embedded taxes and levies at both Central and State level.

8. The JWG has also proposed a list of exempted goods, which includes items, such as, life saving drugs, fertilizers, agricultural implements, books and several food items.

9. Certain components of petroleum, liquor and tobacco are likely to be outside the GST structure. Further, State Excise on liquor may also be kept outside the GST.

10. Taxes collected by Local Bodies would not get subsumed in the proposed GST system.

As per the proposed GST regime, the input of Central GST can be utilized only for payment of CGST & the input of State GST can be utilized only for payment of SGST. Cross- Utilization of input of CGST in payment of SGST and vice-a- versa, will not be allowed.(Source:- Hindu Business Line, dated 30-06-2009)



4.1.2 Railways and Construction Sector might be included in GST

Dr. Vijay Kelkar, Chairman of the 13th Finance Commission, , has suggested that activities like housing, construction and railways should be included in the proposed goods and services tax (GST) to increase the tax base and enhance collections, either immediately or during a subsequent phase.

He added that construction sector is a significant contributor to the national economy and housing expenditure dominates the personal consumption expenditure, so the two sectors would increase the tax base.

He said that the inclusion of the railway sector in the tax regime will provide a level playing field to road and air transportation sector.

The inclusion will also ensure that all inter-State transportation of goods can be tracked through the proposed I.T. network and, in fact, the railways itself would benefit from the inclusion.

4.1.3 Liquor, Petro Sector, Taxes of Local Bodies might be out of GST

Goods such as petroleum products are kept outside the purview of GST. But, in the case of Tobacco & Liquor some products can be covered in GST and some products will be outside the purview of GST.

(*Source: Hindu Business Line dated 30-06-2009)*

4.1.4 Stamp Duty

It has not yet been decided whether stamp duty will be part of the GST or not. As per the Poddar-Ahmad Working Paper, under a modern GST/VAT (e.g., in Australia, New Zealand, Canada, and South Africa), housing and construction services are treated like any other commodity. Thus, when a real estate developer builds and sells a home, it is subject to VAT on the full selling price, which would include the cost of land, building materials, and construction services. Commercial buildings and factory sales are also taxable in the same way, as are rental charges for leasing of industrial and commercial buildings. There are only two exceptions:

(1) resale of used homes and private dwellings, and

(2) rental of dwellings.

The Working Paper also emphasized the need to incorporate these concepts in the design of GST in India as well, because -

- Conceptually, it is appropriate to include land and real property in the GST base. To exclude them would, in fact, lead to economic distortions and invite unnecessary classification disputes as to what constitutes supply of real property.
- In the case of commercial and industrial land and buildings, their exclusion from the base would lead to tax cascading through blockage of input taxes on construction materials and services. It is for this reason that even under the European system an option is allowed to VAT registrants to elect to treat such supplies as taxable.
- Housing expenditures are distributed progressively in relation to income and their taxation would contribute to the fairness of the GST.
- The State VAT and the Service Tax already apply to construction materials and services respectively, but in a complex manner. For example, there is significant uncertainty whether a pre-construction agreement to sell a new residential dwelling is a works contract and subject to VAT. Where the VAT does apply, disputes arise about the allocation of the sale price to land, goods, and services. While land is the only major element that does not attract tax, the tax rates applicable to goods and services differ, necessitating a precise delineation of the two. Extending the GST to all real property supplies, including construction materials and services, would bring an end to such disputes, simplify the structure, and enhance the overall economic efficiency of the tax.
- Chairman of 13th Finance Commission, Dr. Vijay Kelkar, also expressed his concern on this issue, stating" The construction sector is a significant contributor to the national economy. Housing expenditure dominates personal consumption expenditure. Further, the present piece-meal taxation of this sector encourages perverse incentives. Raw material is charged CENVAT, the works contract is charged VAT and stamp duty is levied on the sale. With no provision of input tax credit in place, there is little incentive to record such transactions either at the construction stage or at the sale stage at their correct value. This leads to substantial loss of tax revenues and fuels the parallel economy."

4.1.5 Intangible Goods

The advancements in information technology and digitization have distorted the distinction between goods and services. Under the present 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 semblance of a service contract. For example, software upgrades (which are goods) can also 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.

Likewise, 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 as 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.

For example: online Subscription of Direct tax updates are considered as services and subscription of the same in the form of Magazine or books on regular interval basis are considered as purchase of goods.

Disputes have also arisen as to 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.

Therefore, the proposed Dual GST must address such issues carefully and should have clear provisions for taxation.

4.1.6 Financial Services

Financial services are exempt from VAT in all countries. The principal reason, as per Poddar-Ahmad Working Paper, is that the charge for the services provided by financial intermediaries (such as banks and insurance companies) is generally not an explicitfee but is taken as a margin, that is hidden in interest, dividends, annuity payments, or such other financial flows from the transactions. For example, banks provide the service of operating and maintaining deposit accounts for their depositors, for which they charge no explicit fee. The depositors do, however, pay an implicit fee, which is the difference between the pure interest rate (i.e., the interest rate which could otherwise be earned in the market without any banking services) and the interest actually received by them from the bank on the deposit balance. The fee is the interest foregone. Similarly, the charge for the services provided by banks to the borrowers is included in the interest charged on the loan. It is the excess of the interest rate on the loan over the pure rate of interest or cost of funds to the bank for that loan.

However, India has followed the approach of bringing virtually all financial services within the ambit of Service Tax where the consideration for them is in the form of an explicit fee. As there are no specific reasons for exempting financial services, the same approach can be continued under GST.

4.1.7 Threshold Limit, Assessment and Administration

For the purpose of assessment and administration of different assesses, following categorization has been recommended:-

Threshold limit (common for goods and services) can be allowed somewhere between Rs. 10 lacs and Rs. 20 lacs.

Gross turnover of goods upto Rs. 1.5 Crores may be assigned exclusively to the State;

Gross turnover of services upto Rs. 1.5 Crores may be assigned exclusively to the Centre.

Gross turnover of above Rs. 1.5 Crores may be assigned to both the Governments – for the administration of CGST to the Centre and for the administration of SGST to the State.

4.1.8 Probable GST Rates in India

The GST rates in India are expected to be 12% to 20% for the 1st year, 12% to 18% for the 2nd year and 16% for the 3rd Year and onwards.

Probably, the GST on goods will comprise of least two nominal rates; and a zero rate will also be present for exports and for specified goods. It will, thus, be a three-rate structure, at least. With regard to the Federal and the State GST rate on services, it should be at par with that on goods. However, a single tax rate for services is also on the cards.

The multiple rate structure is as follows:

Goods/Services	Levy	Rate in 1st Year	Rate in 2nd Year	Rate in 3rd Year
Goods-Lower Rate	Cost	6%	6%	8%
	SGST	6%	6%	8%
Goods-Standard Rate	Cost	10%	9%	8%
	SGST	10%	9%	8%
Services	Cost	8%	8%	8%
	SGST	8%	8%	8%

4.1.9 Other notable features of the Indian Dual GST

- There would a single registration or taxpayer identification number, based on the Permanent Account Number (PAN) for direct taxation. Three additional digits would be added to the current PAN to identify registration for the Centre and State GSTs. Also known as BIN (Business Identification Number).
- States would collect the State GST from all the registered dealers. To minimize the need for additional administrative resources at the Centre, States would also assume the responsibility for administering the Central GST for dealers with gross turnover below the current registration threshold of Rs 1.5 crores under the Central Excise (CENVAT). They might collect the Central GST from such dealers on behalf of the Centre and transfer the funds to the Centre.
- Procedures for collection of Central and State GSTs would be uniform. Moreover, tax payment Challan might contain some additional information, e.g., amount of CGST paid on SGST Challan, and *vice-a-versa*. Payment of tax might be only online through net-banking.
- There would be one common tax return for both taxes, with one copy given to the Central authority and the other to the relevant State authority electronically. Moreover, most likely, GST returns will be required to be filed online.
- HSN will form the basis of product classification for Central GST and State GST.

- Other indirect taxes levied by the Centre, States, or local authorities at any point in the supply chain would be subsumed under the Central or the State GST, as long as they are in the nature of taxes on consumption of goods and services.

At a broad conceptual level, this model has a lot to commend itself. It strikes a good balance between fiscal autonomy of the Centre and States, and the need for harmonization. It empowers both levels of Government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain. It also eliminates tax cascading, which occurs because of truncated or partial application of the Centre and State taxes.

4.2 Inter-GST Credit / Set-Off

The GST will facilitate seamless credit across the entire supply chain and across all States under a common tax base. The current framework allows limited inter-levy credits between excise duty (tax on manufacture) and service tax. However, no cross credits are available across these taxes and the sales tax paid (on input) or payable (on output). Introduction of GST should, thus, rationalize tax content in product price, enhance the ability of companies to compete globally, and possibly trickle down to benefit the ultimate consumer.

The Union Budget for 2009-10 spelt out that the efforts of the Empowered Committee of State Finance Ministers have translated into a proposal for a dual GST model, comprising a Central GST and a State GST. The Centre and the State would each legislate, levy and administer the Central GST or the State GST, as the case may be.

Therefore, a dual structure in India would mean that there would be a Central GST and a State GST, each levied on a comprehensive base comprising both goods and services. Thus, every transaction would attract both taxes.

It is also learned that under the proposed GST regime, the Centre will give input tax credit (set off) only for Central GST and the States will give input tax credit only for State GST. Cross-utilisation of credit between Central GST and State GST will not be allowed. However, the dealers could claim set-off within the respective heads. If that is so and cross-set-off of Central GST and State GST is not available, the very purpose of reform, i.e. to remove cascading effect, would be defeated.

Taxability of sale/service also determines the eligibility of input tax credit, as under:

S. No.	Nature of Sale	Availability of Input Tax
1	Taxable Sales	Yes
2	Zero Rated Sales	Yes
3	Exempted Sales	No

Moreover, only the registered dealers would be eligible for input tax credit.

Documents for availing tax credit

Any one of the following may be prescribed as eligible documentary proof for claiming input tax credit:

- The Invoice
- Payment of tax
- Hybrid System

Most probably, credit would be allowed either on the basis of payment of tax or hybrid system. In payment basis, the legislature may stipulate that either the seller will pay tax or, alternatively, the buyer will pay tax on reverse charge basis.

4.3 Refund

Refund of GST may arise due to the following two factors: -

- Zero rated supplies, e.g., export of goods and services; or
- Inter-State transactions.

The quantum of refund in case of inter-State transactions would depend upon the model of payment of tax being adopted by the Government, discussed in Para No. 7.4 of Chapter A-7 (Inter-State Transactions). If the seller (or the buyer under reverse charge system) is required to pay full GST, without adjusting the input tax credit, the volume of refund will certainly be higher.

4.4 How Dual GST is better than Unified GST

The Economic Survey 2008-09 recommended the Government to implement the goods and services tax (GST) throughout the country as a part of continuing fiscal reforms, while favouring a dual GST structure to be levied concurrently by both the Centre and State.

Citing the recommendation on a dual GST by the empowered committee of State Finance Ministers, the survey said a dual GST strikes a good balance between Centre and State fiscal autonomy, along with eliminating tax cascading.

"It empowers both levels of Government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain. It also eliminates tax cascading, which occurs because of truncated or partial application of the Centre and State taxes," said the survey.

Despite improvements in the country's tax design and administration over the past few years, the systems at both Central and State levels are still complex, said the survey.

The complexities, it says, are policy related and also due to the present system of multiple rates and exemptions at State and Centre level.

The survey noted that deficiencies in CENVAT (Central value added tax) and service tax are grave and need to be looked at. For instance, CENVAT's already narrowed base is being further eroded by a variety of area-specific exemptions. "The introduction of GST would thus be opportune for deepening the reform process already underway," the survey said.

A-5
REVENUE NEUTRAL RATE (RNR)

5.1 Meaning of RNR

In the proposed GST regime, the revenue of the Government would not be the same in comparison with the present tax structure due to tax credit mechanism or otherwise. Therefore, an adjustment in tax rate is required to avoid reduction in revenue of the Government. Hence, the rate of tax will have to be suitably adjusted to ensure that tax revenue does not reduce. This rate is termed as 'Revenue Neutral rate' (RNR). It is the rate at which tax revenue remains the same despite giving credit of duty paid on inputs and other factors.

5.2 Determination of RNR

"For the RNR calculations for 2005-06, the latest year for which the necessary data was available the total excise/service tax/VAT/sales tax revenues of the Centre and the States in that year were Rs. 134 thousand crore and Rs. 139 thousand crore respectively.

Assuming that approximately 40% of the central excise revenues and 20% of the State VAT/sales tax revenues are from motor fuels, the balance of the revenues from other goods and services that need to be replaced by the GST are Rs. 89 thousand crore for the Centre and Rs 111 thousand crore for the States, making up a total of Rs. 200 thousand crore.

In 2005-06, the total private consumer expenditure on all goods and services was Rs. 2,072 thousand crore at current market prices. Making adjustments for sales and excise taxes included in these values and for the private consumption expenditure on motor fuels, the total tax base (at pre-tax prices) for all other goods and services is Rs 1,763 thousand crore.

These values yield a revenue-neutral GST rate of approximately 11% (200 as per cent of 1,763 is 11.3%). The RNR for the Centre is 5% and for the States 6.3%. Allowing for some leakages, the combined RNR could be in the range of 12%. These estimates are by no means precise. Even so, they give a broad idea of the levels at which the rate or rates of GST could be set to achieve revenue neutrality for both levels of Government."

The GST rates in India are expected to be 12% to 20% for the 1st year, 12% to 18% for the 2nd year and 16% for the 3rd Year and onwards.

Goods/Services	Levy	Rate in 1st Year	Rate in 2nd Year	Rate in 3rd Year
Goods- Lower Rate	Cost	6%	6%	8%
	SGST	6%	6%	8%
Goods- Standard Rate	Cost	10%	9%	8%
	SGST	10%	9%	8%
Services	Cost	8%	8%	8%
	SGST	8%	8%	8%

The Finance Minister has asked the Revenue Department to advance a payment of Rs. 500 crores to States as a compensation of CST.

5.3 Factors for determination of RNR

- Present tax rates and collection in absolute numbers:
  - Excise duty, which is levied at various rates, median rate is 12%
  - CVD rate on import of goods
  - Service tax rate, presently 12.36%
  - State VAT rate, varies from 0% to 20% (0, 5, 12.5, 20)
  - Collection of the Government from these levies
- Broadening of tax base in GST:
  - Excise duty may be levied on a lower base by the States. Present threshold limit under CENVAT is Rs. 1.5 crores, whereas under GST, it may be between Rs. 10 lacs and 20 lacs,
  - Excise duty would be levied up to retail point instead of at manufacturing point
  - More services would come into net
  - Withdrawal of various exemptions
  - Minimizing the number of tax rates.
- Coverage of GST:
  - Share of revenue from such commodities, which would be kept outside the GST structure, e.g., petroleum products, tobacco, liquor, etc. However, Central Govt. can charge excise duty on tobacco products over and above GST.
  - Number of taxes to be subsumed in the GST, for example stamp duty, property tax, toll tax, etc. might be kept outside the GST structure.

5.4 Success of GST would depend upon the RNR

The success of GST will largely depend on the determination of ideal rate at Central level as well as State level which should be acceptable to the public and revenue neutral to Government.

The golden rule for collection of tax is given by world's oldest economist Sage Kautilya*alias* Chanakya Muni more than 2000 years ago. He said that the King should collect tax from different persons as the humble bee collects honey from different flowers without making any harm to them. Thus, all efforts should be made to keep the GST rate as low as possible.

The median rate of 12% adopted for CENVAT, Service Tax rate of 12%, along with residuary rate of VAT 12.5% brings the overall rate to 25% to 30%, which is too high a rate compared globally.

Elaborating on why the tax rates are lower in some countries, Dr. P. Shome said that voluntary compliance even by large corporations in India was not at the desirable level and that countries that had reduced VAT/GST rates have subsumed many taxes in that framework and tax structure was made linear by doing away with tax breaks.

Therefore, the GST rates would be fixed after ensuring that there would be no revenue loss from the proposed changes and a normal growth is maintained.

5.6 Most States agree to common GST rate: Revenue Secretary

In VAT each State had a separate rate of tax but unlike VAT in the case of GST all the States have reached on a consensus to charge a common rate of tax.

(*Source:* Times of India dated 16-07-2009)

5.7 GST/VAT Rate Globally

S. No.	Country	Rate (%)
1.	Australia	10
2.	Austria	20
3.	Canada	7
4.	China	17
5.	Denmark	25
6.	Finland	22
7.	France	19.6
8.	Germany	16
9.	Indonesia	10
10.	Italy	20
11.	Japan	5

S. No.	Country	Rate (%)
12.	Malaysia	5
13.	Mexico	15
14.	New Zealand	12.5
15.	Philippines	10
16.	Russia	18
17.	Singapore	7
18.	South Africa	14
19.	Sweden	25
20.	Taiwan	5
21.	U.K.	17.5

A-6
TAXES/DUTIES LIKELY TO BE SUBSUMED IN GST

6.1 Probable Taxes/Duties to be subsumed in GST

As per the dual tax regime that has been announced for GST in India, there will be a Central stream for taxes and a State stream for the same taxes. In order to allow this model of taxation both the Centre and States will have to make policy changes. It is expected that the proposed concurrent dual GST system would preserve and protect the fiscal powers and at the same time rationalize the indirect tax structure by subsuming a plethora of Central and Local Taxes into a consolidated levy.

(A) Central GST may subsume the following indirect taxes/duties on supply of goods and services:

- Central Excise Duties (CENVAT)
- Additional Excise Duties including those levied under Additional Duties of Excise (Goods of Special Importance) Act, 1957
- Additional Custom Duties in the nature of countervailing duties, i.e., CVD, SAD and other domestic taxes impose on imports to achieve a level playing field between domestic and imported goods although, under the GST regime all the imports will suffer a reverse charge.
- Cesses levied by the Union viz., Cess on rubber, tea, coffee etc.
- Service Tax
- Central Sales Tax – to be completely phased out
- Surcharges levied by the Union viz., National Calamity Contingent Duty, Education Cess, Special Additional Duties of Excise on Motor-Spirit and High Speed Diesel (HSD).

(B) State GST may subsume the following State taxes

- Value Added Tax
- Purchase Tax
- State Excise Duty (except on liquor)
- Entertainment Tax (unless it is levied by the local bodies)
- Luxury Tax
- Octroi

- Entry tax in lieu of Octroi
- Taxes on Lottery, Betting and Gambling

6.2 Taxes/Duties not to be subsumed in GST

(A) In Central GST

- Basic Customs Duty
- Excise Duty on Tobacco products
- Export Duty
- Specific Cess
- Specific Central Cess like Education and Oil Cess.

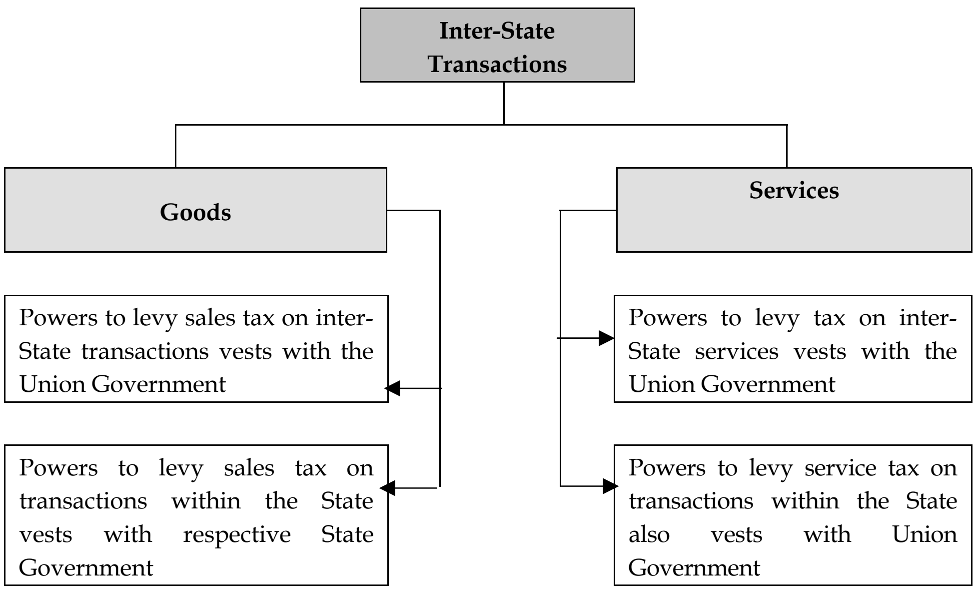
(B) In State GST

- Taxes on Liquors
- Toll Tax
- Environment Tax
- Road Tax
- Property Tax
- Tax on Consumption or Sale of Electricity – Not certain
- Stamp Duty – Not certain

(C) Certain components of petroleum, liquor are likely to be outside the GST structure. Further, State Excise on liquor may also be kept outside the GST. In other words, in such circumstances, all taxes and duties on these goods will be outside the scope of GST.

A-7
INTER-STATE TRANSACTIONS AND GST

7.1 Present Indirect Tax Structure – Inter-State Transactions



7.1.1 Tax on sale of goods

Entry 92A in the Union List in the Seventh Schedule to the Constitution of India confers power upon the Union to legislate in respect of "taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce". The power to impose sales tax in the Union Territory vests with the Parliament under Article 246(4) of the Constitution of India.

Entry 54 in List II (State List) of the Seventh Schedule read with Article 246(3) of the Constitution of India empowers the States to impose "tax on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92-A of the List I".

Restrictions are imposed on the States to impose tax on sale or purchase of goods through Article 286, as under: -

286(1) No law of a State shall impose a tax on the sale or purchase of goods where such sale or purchase takes place -

(a) outside the State; or

(b) in the course of the import of the goods into, or export of the goods out of, the territory of India.

286(2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1).

286(3) Parliament may impose restrictions and conditions in regard to the system of levy, rates and other incidents of the tax on any law of a State in relation to the imposition of -

(a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, (declared goods), or

(b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or sub-clause (d) of sub-clause (29A) of Article 366.

In Article 269(1), clause (g) authorises the Government of India to collect tax on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce and making it obligatory upon the Government of India to assign the tax to the collecting States.

Import of goods into India is taxed by the Union Government under the Customs Act. State Governments are not authorized to impose tax on import and sale in the course of import.

Inter-State sale of goods is taxable under the Central Sales Tax Act, 1956. For this purpose, goods have been classified into two categories:(a) Declared goods or goods of special importance in inter-State trade or commerce, and (b) Other goods. Rates of tax have been prescribed under section 8 and differ from State to State; and for a particular commodity, it generally depends upon the tax rate prevailing in that State.

After the amendments vide Taxation Laws (Amendment) Act, 2007 w.e.f. 01.04.2007, central sales to unregistered dealers or to registered dealers without declaration in Form 'C' or other Forms prescribed under the CST Act attract tax at the rate equal to the local rate of tax (i.e. the rate applicable within the originating State). For sales (declared or other goods) supported by declaration Form C, central sales tax rate is 2%, or the local rate applicable in that State, whichever is lower. The Central Government had reduced the CST rate for sales made to registered dealers on the strength of Form C from 4% to 3% with effect from 1st April 2007, which has further been reduced to 2% w.e.f. 1st June 2008.

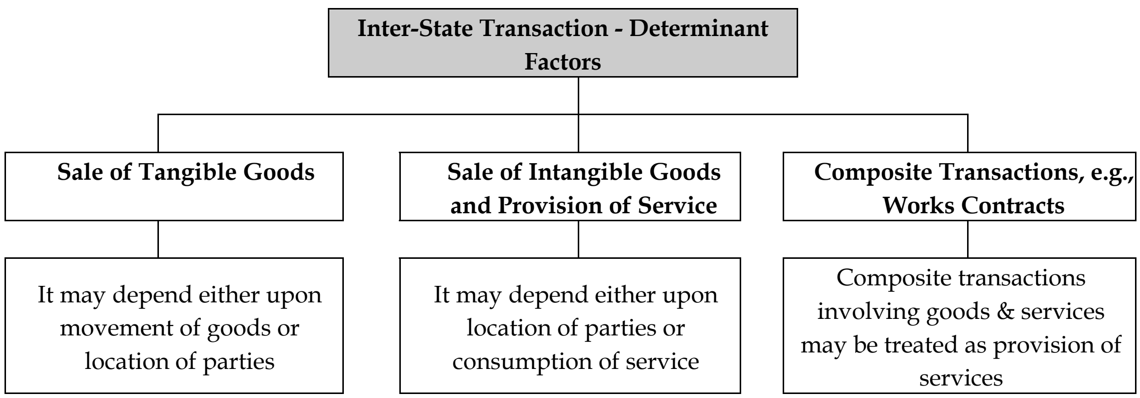
7.1.2 Tax on provision of services

Service tax is imposed by the Central Government under the authority of Residual Entry 97 of the Union List (List 1) under Schedule VII of the Constitution of India. The Central Government has absolute authority to impose tax on the services whether provided within the State or from one State to another.

Import of services in India are taxable through reverse charge method, i.e., tax is payable by the recipient of services in India at the time of import of service.

Currently, service tax is generally paid by the service provider in the jurisdiction where such person is registered, i.e., the place of rendering of service. Since the power of levy/collection vests only with Centre, it does not matter where the taxpayer is registered and where the service is actually provided, i.e., *situs* is not an issue.

7.2 GST – To Determine whether a Transaction is an Inter-State supply or Not – Determinant Factors



7.3 GST - To determine the Place of Taxation

GST is generally levied on the basis of the destination principle. For this purpose, some countries follow the practice of prescribing a set of rules for defining the place of taxation or place of supply. A supply is taxable in a given jurisdiction only if the supply is considered to take place in that jurisdiction. An alternative approach followed by other countries is to first define what supplies are potentially within the scope of the tax, and then provide the criteria for determining which of those supplies would be zero-rated as exports. The two approaches yield the same result, even though one excludes exports from the scope of the tax, while the other zero-rates them, having first included them in the scope. A supply of services or intangible property might be taxable in a jurisdiction depending upon one or more of the following factors:

- Place of performance of the service
- Place of use or enjoyment of the service or intangible property,
- Place of residence/location of the recipient, or
- Place of residence/location of the supplier.

However, following services can have their own set of Rules for fixation of *situs* :

- Services relating to immovable property, e.g., services of estate agents or architects
- Banking & other financial services
- Business auxiliary and event management services
- Transport of goods by road

- Advertisement, which are given on Pan India basis either in print or electronic media.

Further, special rules might be required for certain other supplies (also referred to as mobile services) for which there is no fixed place of performance or use/enjoyment, such as:

- Passenger travel services
- Freight transportation services
- Telecommunication Services
- Motor vehicle leases/rentals
- E-commerce supplies.
- Development of Software through electronic mode.
- Supply of Goods during transportation.

Possible Place of Taxation

B2B
(Business to Business)

- Place of destination can be the place where the recipient is established or located.

B2C
(Business to Customer)

- Supplies of a tangible/ physical nature (e.g., hair cuts, hotel accommodation, local transport, & entertainment services) - Place of destination could be the place where the supplier is established or located, which is generally also the place where the service is performed.
- For mobile supplies of an intangible nature (e.g., telecommunication and e-commerce services), or general insurance service - Place of supply could be the place of residence of the customer, or the place where services are used or enjoyed.

Special rules for specific supplies can be designed to yield best results. They serve the purpose of providing greater certainty and clarity in situations where the place or location or residence of the supplier or the recipient is not well defined or easily ascertainable at the time of supply.

7.4 Collection and Payment of Tax - Possible Mechanism in GST

A mechanism is needed for proper application of sub-national tax on inter-State supplies of goods as well as services. Instead of zero-rating of inter-State supplies, a preferred approach will be required. Various models have been adopted in other countries and have been suggested at various forums after improvisation. These are:

1. Prepaid VAT (PVAT) Model

In this system, the vendors will collect the destination State GST (SGST) on inter-State supplies (of goods and services) and remit the full tax (without claiming input tax) directly to the Destination State through Bank. The tax will then be creditable in the destination State under the normal rules, i.e., if it relates to inputs for use in making taxable supplies. Input tax credit on purchases will be claimed by the seller from his State either by way of refund or through adjustment against his local CGST and SGST output tax liability.

Features:

- Under the present CST Act, tax on inter-State sales is charged and retained by the Origin State. However, under PVAT, the tax on inter-State supplies will be charged and remitted to the Destination State. It preserves the destination principle of VAT. Vendor in the Origin State collects the tax on all of their domestic supplies, whether intra-State or inter-State. The tax collected on inter-State supplies will belong to the Destination State and remitted to that State by the vendor. On intra-State supplies, the tax collected will be that of the Origin State and paid to that State.
- Buyers who are GST registrants (in B2B transactions) will have a strong incentive to ensure that the vendor properly applies the destination tax, which will then be creditable against their output tax in the State of destination. Otherwise, the goods will be subject to the tax of the origin State, which will not be creditable in the State of destination.
- Most supplies of services and intangibles to consumers and other exempt buyers (in B2C transactions) will be taxable in the State of origin, without the benefit of zero-rating. However, inter-State shipments of goods to consumers will be zero-rated in the State of origin and attract the tax of the destination State. An inducement could be created for consumers also to ensure that the vendor charges the destination State tax on such shipments.
- However, payment of tax by the customers in the consuming State may involve many administrative problems, and the Government may decide to tax these transactions in the State of origin only since the involvement of tax might not be very significant. But, this practice may disturb the essential character of the GST, i.e., destination based GST.
- The PVAT mechanism establishes the output-tax-and-input-credit chain for inter-State transactions. Subject to documentary evidence that the seller has paid output tax, he (the seller) could claim input GST from the selling State by way of refund or through adjustment against local CGST and SGST output tax liability.

- The buyer in the other State could claim credit to the extent of tax deposited and remitted by the seller.
- Demat version can also be incorporated in this Model, where both the seller and buyer have to open their respective Demat accounts. When an inter-State seller deposits the tax in his State, he will also furnish the details of the purchaser on the basis of which, Demat Agency will allow credit to the purchaser's Demat account.
- Inter-State stock transfer and consignment sales will be carried outin the same manner. However, for valuation of these transactions, separate valuation rules have to be framed.

Drawbacks:

- It may violate the concept of destination based tax to the extent to B2C transactions.
- Buyer will pay the amount of tax (along with sale consideration) to the seller, who will deposit the tax in the designated bank. However, both these payments are not inter-dependant. Therefore, the buyer will have to unnecessarily wait for the remittance, which is subject to payment of tax by the seller in his State.
- Delay in remittance by bank will create unnecessary hassle to the buyer.
- Involves extensive refunds in the selling State.
- Involves heavy administrative cost, resources and infrastructure.

2. Postpaid VAT (TDS) Model

As a contradiction of Model No. 1 (PVAT), in TDS model, the buyer pays SGST in his (buying) State on the basis of invoice raised by the seller, claims input tax of the amount he has paid into Bank, and issues TDS certificate to the seller. The seller, on the basis of such TDS certificate, claims exemption/refund in his (selling) State.

Features:

- Separate rules are required for B2C transactions.
- The buyer will deposit tax electronically and also generate the TDS certificate through system only, so that the same amount could also appear against the TIN of the seller.
- Buyer will have an upper hand since seller can claim credit only on the basis of TDS certificate issued by the buyer.
- Bank is not required to transfer the funds to the other State since tax is collected in the Destination State itself.
- Involves considerable refunds in the selling State.

3. Demat 'C' Form Model

Under this Model, transactions are zero rated/exempt in the selling State, subject to Dematted Form C.

The procedure can be designed in the following manner:

- Seller will first enter the details of sale and purchaser through internet.
- Buyer will access through internet and fill the details of transaction, seller and other necessary columns. Subsequently, he will verify and confirm the transaction using his digital signature.
- The State Government will grant permission through internet.
- On permission being received, system will generate Demat Form C. The said Form C will be issued by the buyer to the seller, who can use the same for claiming exemption in his State.
- Inter-State stock transfer and consignment sales will be conducted in the same manner.
- The Model requires extensive automation both at the Department level and the dealer level.

4. Reverse Charge Model with Demat C Form

This Model is modification of Demat C Form Model, and can have the following elements:

- Zero rating of inter-State transactions in the selling State.
- Levy of SGST in the purchasing State using "Reverse Charge Method", similar to that applicable presently for import of services for imposition of service tax.
- Claim of credit by the purchaser in his State for the amount of tax paid by him.
- Issue of Demat Form C by the buying State Authorities to buyer.
- Submission of Form C by the buyer to the seller for claiming exemption by the later in his State.
- The system of issuing and furnishing of Demat Form C is akin to the existing system.
- Inter-State stock transfer and consignment sales will also be conducted in the same manner.

5. IGST Model

Features

- Seller in the origin State will charge IGST [(CGST+SGST) on ISS transactions, by whatever name called], which will be aggregate of CGST & SGST, i.e., IGST = CGST+SGST.
- Inter-State Seller shall use his input CGST and input SGST for payment of IGST, i.e., he shall pay net IGST.
- Inter-State Buyer shall avail input tax credit on the basis of tax invoice for payment of his own IGST, CGST or SGST.
- Both, the seller and the buyer shall report these transactions in their respective e-returns.
- To maintain the GST to be a destination based tax, amount paid by the seller in his State (alongwith input tax credit claimed by him) will be remitted by the Central Agency to the

buying State through some mechanism.

- B2B transactions could get input tax credit without break till it reaches the final consumer.
- It involves lesser refunds since the seller will pay net IGST (after claiming input tax credit) in his State.

6. Illustration – Inter-State GST

Assumptions:

(1) Central GST Rate – 12%;

(2) State GST Rate – 8%;

(3) Profit Margin – Rs. 10,000/- fixed (before tax);

(4) Both, CGST & SGST, are levied on every transaction starting from manufacturing level till it reaches the final consumer, irrespective of State boundaries; and

(5) The seller pays net GST (after claiming input tax) in his State.

Illustration

Particulars	**GST A/C**		**Total**
	CGST @ 12%	**SGST @ 8%**	
(I) Manufacturer (D1-Delhi) to Wholesaler (H2- Haryana)			
Cost of production			90,000
Input GST on Raw Material	*6,000*	*4,000*	-
Add : Profit Margin			10,000
Producers Basic Price			1,00,000
Add : GST	12,000	8,000	20,000
Less : Input GST	*6,000*	*4,000*	
GST Payable	*6,000*	*4,000*	
Sale Price			1,20,000
(II) Wholesaler (H2) to Retailer (H3) in Haryana			
Cost of Goods to H2			1,00,000
Input GST	*12,000*	*8,000*	
Add : Profit Margin			10,000
Total			1,10,000

Particulars	GST A/C		Total
	CGST @ 12%	SGST @ 8%	
Add : GST	13,200	8,800	22,000
Less : Input GST	*12,000*	*8,000*	
GST Payable	*1,200*	*800*	
Total Price to the Retailer (H3)			1,32,000
(III) Retailer (H3) to Final Consumer (C) in Haryana			
Cost of Goods to H3			1,10,000
Input GST	*13,200*	*8,800*	
Add : Profit Margin			10,000
Total			1,20,000
Add : GST	14,400	9,600	24,000
Less : Input GST	*13,200*	*8,800*	
GST Payable	*1,200*	*800*	
Total Price to the Consumer (C)			**1,44,000**
Total Tax Payable in All Transactions	**14,400**	**9,600**	**24,000**
Verification: GST @20% on 120000 = 24000			
- D1 on inputs -	*6,000*	*4,000*	*10,000*
- D1 on output -	*6,000*	*4,000*	*10,000*
- H2 -	*1,200*	*800*	*2,000*
- H3 -	*1,200*	*800*	*2,000*

7. Pre-requisites of all these models

All these Models discussed above require the following pre-requisites for successful implementation of GST:

- Extensive Computerization and strong IT infrastructure
- E-filing of periodical returns
- E-payment of tax
- Common tax period
- National portal for access of information
- National Agency
- Trained and well equipped staff.

7.5 Taxation of Import

As per Poddar-Ahmad Working Paper, in most countries, imports attract VAT/GST at the time of entry into the country. The tax is generally applied on the value of goods declared for customs purposes, including the amount of the customs duty. However, there are no well-established precedents for the application of sub-national taxes to imports. In India, the Centre levies an additional duty (called the special additional duty - SAD) on imports at the rate of 4%, which is meant to be in lieu of the State VAT. This duty is allowed as a credit against the central excise duty on manufacturing or refunded where the imports are resold and the State VAT is charged on them.

In Canada, the provincial HST is collected by the Customs Authorities on non-commercial importations of goods. The tax is collected at the time of importation on the basis of place of residence of the person importing the goods, regardless of where the goods enter the country. Commercial importations do not attract the provincial HST because of difficulties in determining their destination within the country. For example, a large consolidated commercial shipment could contain goods that are initially destined to a central warehouse, for subsequent distribution to various parts of the country.

The Canadian system is conceptually appealing and could be considered for the application of State taxes under the Dual GST in India.

7.6 Other Issues that Need consideration of the Government

(a) Specific provisions are required for determination of nature of an activity, i.e., whether it is a sale or service.

(b) Specific rules for determination of sale price/consideration, i.e., what form part of the sale price. To illustrate, in a transaction of sale of aggregates (of stone) to other State, freight element is sometimes more than the price of aggregates in total consideration - to decide whether amount of such freight is service or sale.

(c) Provisions to allow inter-GST (between Central GST and State GST) set-off/credit of input tax to avoid cascading effect. It is understood that these two taxes will run parallel to each other and there will not be cross set-off. If that is so, it may defeat the basic purpose of the reform.

(d) Whether to continue exemption for sale in the course of import and high seas sales under section 5(2) of the CST Act. Presently States are not authorized to impose tax on sale in the course of import under Article 286(1) of the Constitution of India.

(e) Whether to allow exemption to penultimate exports as defined under section 5(3) of the CST Act – Probably, will not be allowed.

(f) Whether to continue exemption on subsequent sales under section 6(2) of the CST Act – Probably, will have to go.

(g) Taxation on the sale or purchase of goods declared by Parliament to be of special importance in inter-State trade or commerce, (declared goods) under Article 286(3) of the Constitution of India read with Sections 14 and 15 of the CST Act.

(h) To prescribe extensive rules for determination of value in case of transfer of goods to branches or consignment agent or inter-related parties.

(i) Since the Government has decided to levy dual GST, measures to avoid litigation which may arise due to fixation of *situs*.

(j) Precise provisions for sharing of revenue amongst the States on inter-State transactions to avoid disputes in relation thereto.

Press Information Bureau
Government of India
Ministry of Finance

31 July2015

Sharing of GST Revenue with States

The State Governments have not objected to the proposed formula of the Union Government for sharing of revenue with States that would be earned as Goods and Service Tax (GST). Under the proposed GST regime, both Centre and States will simultaneously levy GST across the value chain. Tax will be levied on every supply of goods and services for consideration. Centre would levy and collect Central Goods and Services Tax (CGST) and States would levy and collect the State Goods and Service Tax (SGST) on all transactions within a State. The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all interstate supply of goods and services. The proceeds of IGST will be apportioned between the States and the Centre, under the proposed Article 269A, as provided by Parliament by law on the recommendations of the GST Council. Further, the CGST collected by the Central Government as well as the Union's share of IGST collected will be devolved to the States as per the provisions of Article 270.

This was stated by Shri Jayant Sinha, Minister of State in the Ministry of Finance in written reply to a question in Rajya Sabha today.

Source: www.pib.nic.in

A-8
PRESENT TAXATION *VS.* GST

S.N.	Particulars	Present Taxation	GST (Expected)
1.	Structural Difference	• Two separate VAT systems operate simultaneously at two levels, Centre and State, and tax paid (input tax credit) under one is not available as set off against the other • Tax on services is levied under separate legislation by Centre • No comprehensive taxation of services at the State level; few services are taxed under separate enactments • Imports in India are not subjected to State VAT	A dual tax with both Central GST (CGST) & State GST (SGST) levied on the same base. Thus, all goods and services, barring a few exceptions, will be brought into the GST base. There will be no distinction between goods and services for the purpose of tax with a common legislation appli-cable to both It allows seamless tax credit amongst Excise Duty, Service Tax & VAT
2.	Place of Taxation	Taxable at the place of sale of goods or rendering of service	It is consumption (destination) based tax
3.	Excise Duty	Imposed by Centre under separate Act; Taxable event: Manufacture; Taxed up to manufacturing point	To be subsumed in CGST; Taxable event : Sale; To be taxed up to retail level
4.	Basic Customs Duty	Imposed by Centre, under separate Act; Taxable event: Import	- No Change -
5.	CVD/SAD	Imposed by Centre under separate Act; Taxable event: Import	To be subsumed in CGST; Taxable event : Import
6.	Service Tax	Imposed by Centre under separate Act; Taxable event: Provision of Service	To be subsumed in CGST & SGST ; Taxable event : Provision of Service
7.	Central Sales Tax	Imposed by Centre under CST Act; Collection assigned to States; Taxable event : Movement of goods from one State to another	To be phased out

S.N.	Particulars	Present Taxation	GST (Expected)
8.	State VAT	Imposed by States; Taxable event : Sale within the State	To be subsumed in SGST; Taxable event : Sale within State
9.	Inter-State Transactions	Goods & Services : Imposed by the Centre	To be subsumed in GST & subject to SGST & CGST
10.	Powers to levy Tax on Manufacture	As Excise Duty (CENVAT) :Centre	No such powers in GST
11.	Powers to levy Tax on Sale of Goods	- Inter-State: Centre - Local: State	Concurrent powers to Centre & State
12.	Powers to levy Tax on Provision of Services	Centre	Concurrent powers to Centre & State; States to tax more than 40 services
13.	Tax on Import in India	- Goods : Under Customs Duty (comprises Basic Customs Duty, CVD & SAD); - Services : Under Service Tax	- Basic Custom Duty on goods : No Change; - CVD & SAD on import of goods and import of services : To be subsumed in GST
14.	Tax on Export of Goods & Services	Exempt/Zero-rated	- No Change -
15.	Tax on inter-State Transfer of Goods to Branch or Agent	Exempt against Form F	To be taxable
16.	Tax on Transfer of Goods to Branch or Agent within States	Generally exempt; Depending upon State procedures	Might be taxable, unless BIN of transferor and transferee is same
17.	Cross-Levy set-off	Excise duty and Service tax : Cross set off allowed	No cross set-off between CGST and SGST
18.	Cascading Effect	Allows tax credit between Excise Duty& Service Tax, but not with VAT	Allows seamless tax credit amongst Excise Duty, Service Tax & VAT
19.	Non-Creditable Goods	Exists	Might exist
20.	Credit on Inputs used for Exempted Activities	Not allowed	Will not be allowed
21.	Various Exemptions – Excise Free Zone or VAT Exemption	Exists	May go in a phased manner
22.	Exemption for transit Inter-State Sale and High Seas Sale	Exists	Might be taxable

S.N.	Particulars	Present Taxation	GST (Expected)
23.	Transactions against Declaration Forms	Exists under the CST Act	Forms will be abolished
24.	Taxation on Govt. and Non-Profit Public Bodies	Partially taxed	Might not Change
25.	Stamp Duty	Presently taxed concurrently by the Centre and State	Status not clear; If subsumed under GST, big relief to real estate industry : to claim input tax
26.	Tax Base	Comparatively, Narrow	Wider
27.	Excise Duty – Threshold Limit	Rs. 1.5 crores	- Rs.10 lacs to 20 lacs (Turnover of Rs. 1.5 crores & above to be administer by Centre and less than Rs. 1.5 crores to be administer by States)
28.	VAT - Threshold Limit	Rs. 5 lacs to 10 lacs	Rs. 10 lacs to Rs. 20 lacs
29.	Service Tax - Threshold Limit	Rs. 10 lacs	Rs. 10 lacs to Rs. 20 lacs
30.	Classification of Commodities	- Excise Duty : HSN; - VAT : None	HSN
31.	VAT/GST Regis-tration Number	Simple TIN (some States : PAN based)	PAN based BIN
32.	Procedures for Collection of Tax and Filing of Return	CENVAT& Service Tax: Uniform VAT : Vary from State to State	Will be uniform
33.	Administration	Complex due to number of Taxes	Comparatively, simple
34.	Use of Computer Network	Just started by the States; very minimum	Extensive; It is necessity for implementation of GST
35.	Nature of Present Litigations	a. Sale *vs.* Service b. Classification of goods c. *Situs* issue : between States d. Interpretation of provisions e. Sale *vs.* Works Contract f. Valuation of Composite Transactions, etc.	Will be reduced, provided GST Legislations are properly drafted

A-9
ROADMAP TO GST IN INDIA

STEPS TOWARD IMPLEMENTATION OF GST
YEARWISE DEVELOPMENTS

2004	• Dr. Kelkar Task Force recommended the need of a National GST
Jan. 2007	• First GST study released by Dr. Shome
April 2007	• CST phase out started
May 2007	• Joint Working Groups appointed by E.C.
Nov 2007	• 13th Finance Commission Constituted & • Joint Working Groups submitted Report
Feb 2008	• F.M. Announced introduction of GST from 1.4.2010 in Budget Speech 2008-09
April 2008	• Empowered Committee (EC) finalized its views on GST Structure
July 2009	• F.M. announced Dual GST from April 1, 2010 in Budget Speech 2009-10
Oct 2009	• 13th Finance Commission to submit its Report
Nov – Dec 2009	• Release of First Discussion Paper on GST • Report of Task Force on GST
2009-2010	• Consultation on Model of inter-State transactions, RNR and other issues - In progress • Nandan Nilekani given the responsibility for creating the required IT structure and NSDL has been chosen as the technology partner for operating the structure.
Dec 2014	• 122nd Constitution Amendment Bill introduced in Parliament
2015	• Feb'15 - 14th finance Commission Submits its Report • May'15 - 122nd Constitutional Amendment bill passed by Lok Sabha and referred to the Select Committee of Rajya Sabha which had submitted its report in July'15. • Oct' 15 - Draft GST Business Processes on Registration, Payment, Refund and Return released. • Dec' 15 - Report on the Revenue Neutral Rate and Structure of Rates for GST released

9.1 Roadmap to GST

"Let us Gear Up for Goods & Service Tax". This is the call given by Dr. Asim K. Dasgupta, Chairman of Empowered Committee and the then Finance Minister Shri Pranab Mukherjee. They had firmly reiterated that GST will be definitely introduced w.e.f. 1.4.2010. In the Budget Speech 2009-10, the F.M. informed the House:

> *Para 85: I have been informed that the Empowered Committee of State Finance Ministers has made considerable progress in preparing the roadmap and the design of the GST. Officials from the Central Government have also been associated in this exercise. I am glad to inform the House that, through their collaborative efforts, they have reached an agreement on the basic structure in keeping with the principles of fiscal federalism enshrined in the Constitution. I compliment the Empowered Committee of State Finance Ministers for their untiring efforts. The broad contour of the GST Model is that it will be a dual GST comprising of a Central GST and a State GST. The Centre and the States will each legislate, levy and administer the Central GST and State GST, respectively. I will reinforce the Central Government's catalytic role to facilitate the introduction of GST by 1st April, 2010 after due consultations with all stakeholders.*

Former Finance Minister Mr. P. Chidambaram had also been making this call in his four Budget Speeches, as under:

Budget Speech 2004-05:

> *Para 119: Now I turn to my indirect tax proposals ………….. It is my intention to align India's tariff structure to those of ASEAN countries. Eventually, there should be a uniform rate of tax on goods and services.*

Budget Speech 2005-06:

> *Para 94: In the medium to long term, it is my goal that the entire production – distribution chain should be covered by a National VAT, or even better a goods and service tax, encompassing both the Centre and State.*

Budget Speech 2006-07:

> *Para 155 : It is my sense that there is large consensus that the country should move towards a National level Goods and Service Tax (GST) that should be shared between the Centre and the State. I propose that we set April 1, 2010 as the date for introduction of GST. World over goods and services attract the same rate of tax. That is the foundation of the GST. People must get used to the idea of GST. Hence we must progressively converge the service tax rate and the CENVAT rate. …….*

Budget Speech 2007-08:

> *Para 116: I wish to record my deep appreciation of the spirit of cooperative federalism displayed by State Governments and especially their Finance Ministers. At my request, the Empowered Committee of State Finance Ministers has agreed to work with the Central Government to prepare a roadmap for introducing a national level Goods and Services Tax (GST) with effect from April 1, 2010.*

Budget Speech 2014-15:

The debate whether to introduce a Goods and Services Tax (GST) must now come to an end. We have discussed the issue for the past many years. Some States have been apprehensive about surrendering their taxation jurisdiction; others want to be adequately compensated. I have discussed the matter with the States both individually and collectively. I do hope we are able to find a solution in the course of this year and approve the legislative scheme which enables the introduction of GST. This will streamline the tax administration, avoid harassment of the business and result in higher revenue collection both for the Centre and the States. I assure all States that government will be more than fair in dealing with them.

Budget Speech 2015-16:

We need to revive growth and investment to ensure that more jobs are created for our youth and benefits of development reach millions of our poor. We need an enabling tax policy for this. I have already introduced the Bill to amend the Constitution of India for Goods and Services Tax (GST) in the last Session of this august House. GST is expected to play a transformative role in the way our economy functions. It will add buoyancy to our economy by developing a common Indian market and reducing the cascading effect on the cost of goods and services. We are moving in various fronts to implement GST from the next year.

9.2 Background - Kelkar II Task Force Report

GST was first brought to the fore by Kelkar II Task Force Report. This Committee made a number of recommendations that are, it is learnt, under the study of Union Finance Ministry.

The Kelkar Task Force was constituted with the mandate to recommend measures to enable the Government of India to implement the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, which sought to eliminate the revenue deficit by March 31, 2008.

As the main proposal for tax reform, Dr. Vijay Kelkar and his team recommended a single GST (Goods and Services Tax) – replacing the CENVAT/excise duty, sales tax, service tax, etc. It would use the VAT principle to tax consumption of almost all goods and services – with full tax credits across all goods and services.

The Task Force has adopted the following strategy: -

- Widen the tax base
- Few Rates; Low rates
- Enhance equity of the tax system
- Shift to non-distortionary consumption taxes
- Tariffs, excises, turnover taxes etc. have cascading effects. The aim is to eliminate these taxes by using the destination-based VAT
- Focus on buoyancy and not on immediate sources of tax revenue – The report asserts that though it is always easier to resort to imposing taxes in an ad-hoc manner on particular

sectors like telecom, banking etc., the strategy focuses on increasing tax revenues by first, increasing GDP growth and second, increasing buoyancy.

9.3 First Report on GST released by Dr. Shome

The first Report on GST was released by the Advisor to Finance Minister, Dr. P. Shome in January 2007. While releasing the report, Dr. Shome said,

> "Developing a common market is the crux of the issue here. GST should enable free trade within the country. Impediments to free trade within the country have to be removed, especially when we are signing a number of free trade agreements abroad. This is an important challenge before us."

He emphasized, "We have to think of a rate that is not too high and at the same time appropriate for meeting State expenditure". Enlisting the challenges in the implementation of GST, he said one of the biggest tasks was to conceptualize a model, which will fetch adequate revenues for the Centre and States, but that too with a lower rate.

Dr. Shome identified six major challenges that policy makers need to overcome for introduction of GST. These include issues relating to Constitutional provisions, tax assignments vis-à-vis revenue sharing, the overall level of rates, the type of rate structures, development of a common market, and successful operation of TINXSYS (Tax information exchange system).

9.4 Appointment of Joint Working Group

The real work started with the appointment of Joint Working Group (JWG) in May 2007 by the Empowered Committee of State Finance Ministers to give recommendations regarding detailed framework to be adopted for GST. JWG was given the task to suggest a model for the base and rate structure of GST.

The Working Group consisted of the following members:

a	Dr. Parthasarathi Shome	Adviser to Hon'ble Union Finance Minister. Permanent Invitee, Empowered Committee	Convener
b	Shri Satish Chandra	Member Secretary, Empowered Committee of State Finance Ministers	Convener
c	Shri L.K. Gupta	Joint Secretary (ST), Department of Revenue	Member
d	Shri Gautam Ray	Joint Secretary (TRU-I), Department of Revenue	Member
e	Shri R. Sekar	Joint Secretary (TRU-II), Department of Revenue	Member
f	Shri P.K. Mohanty	Joint Secretary (DBK), Department of Revenue	Member
g	Secretaries/Principal Secretaries of Finance/Taxation from all the States and Union Territories		Members

9.5 Role of Joint Working Group

The Joint Working Group was required to study the various models of GST existing globally and other relevant material available on the subject. It was also to identify the possible alternative models for introduction of GST in India and examine their various characteristics and assess their suitability in India's fiscal federal context. After these studies, the Working Group had to present its findings before the Empowered Committee for decision on the most appropriate model for introduction of GST in India.

The Working Group was also assigned the role to identify the Central Taxes and State Taxes which possess properties to be appropriately subsumed under GST. The Working Group was required to keep the following in mind:

(a) GST should be so designed that it should be revenue neutral to the Centre and States. Interests of the Special Category, North Eastern State and Union Territories have to be especially kept in mind.

(b) The group should examine different models and see that power of levy, collection and appropriation of revenue needs to be vested in the Centre and the States by looking at the pros and cons.

(c) Various models suggested by the working group should ensure that double taxation is avoided.

(d) Working Group should ensure that the suggested model takes into account the problems faced during inter-State transactions and any revenue loss.

(e) Working Group should consider how zero rated goods and services and Non-VAT items, such as, petroleum goods and alcohol might be treated under the new regime.

(f) The model to be developed should reflect the interest of the Centre, States, trade, industry, agriculture and services.

9.6 Recommendations of Joint Working Group

JWG submitted its report in November 2007 after making study of GST Acts of several countries and making study tours to Brazil, Australia and Singapore. The JWG of EC laid down various recommendations. Few of them are:

(1) GST, when it rolls out on 1st April 2010, shall have two components a Central tax and a single uniform State tax across the country.

(2) A tax over and above GST, which may be levied by the States on tobacco, petroleum and liquor, may help the report to find favour with the States.

(3) The GST may not have a dual VAT structure but a quadruple tax structure. It may have four components, namely: -

(a) a Central tax on goods extending up to the retail level;

(b) a Central service tax;

(c) a State-VAT on goods; and

(d) a State-VAT on services.

Given the four-fold structure, there may be at least four-rate categories - one for each of the components given above. In this system, the taxpayer may be required to calculate tax liability separately for the different rates of tax.

(4) The States must tax intra-State services while inter-State services must remain with the Centre.

(5) Petroleum products, including crude, high-speed diesel and petrol, may remain outside the ambit of GST.

(6) Elimination of the area-based and sectorial excise duty exemptions that are being given by the Centre.

(7) Central cess, like education and oil cess may be kept outside the dual GST structure to be introduced from April 2010. Besides Central Cess, the EC of State Finance Ministers has also recommended to keep purchase tax and octroi, which are collected at State and local levels, outside the GST framework.

(8) To keep Stamp duty, which is a good source of revenue for States, out of the purview of the GST. Stamp duty is levied on transfer of immovable like houses and land.

(9) To keep levies, like the toll tax, environment tax and road tax, outside the GST ambit, as these are user charges.

(10) If the levies are in the nature of user charges and royalty for use of minerals, and then they must be kept out of the purview of the proposed tax.

9.7 A clear roadmap to implement GST Needed

At a workshop on Goods and Services Tax organised by the Indian Chamber of Commerce, several speakers, while welcoming the Government’s plan to launch the tax from next April, also emphasized the need for a clear roadmap on implementation of the new system of taxation to enable people at large and the business community, in particular, to familiarize themselves with the same, according to a press release issued by the chamber.

It was felt that the implementation of GST might require amendment to the Constitution authorizing the Centre to tax sale or supplies of goods outside factory gates at any point in the supply chain and to permit States to levy tax on services. Another key issue that needed to be addressed was the determination of the manner of application of GST on inter-State or cross-border transactions.

[*Source:* The Hindu Business Line, dated 30/07/2009]

A-10
CHALLENGES BEFORE THE GOVERNMENT & TRANSITIONAL ISSUES

10.1 Challenges before the Government

Most concerns expressed about the implementation of GST can broadly be divided into three categories –

A. Design issues

B. Operational issues

C. Infrastructure issues.

A. Design issues

The broad framework of GST is now clear. This is on the lines of the model approved by the Empowered Committee of the State Finance Ministers. The GST will be a dual tax with both Central and State GST component levied on the same base. Thus, all goods and services barring a few exceptions will be brought into the GST base. Importantly, there will be no distinction between goods and services for the purpose of the tax with a common legislation applicable to both.

However, a number of issues remain to be resolved, which are under the consideration of the Empowered Committee. These issues include: -

(a) Constitutional Amendments. Amongst other, significant are:

- To shift the taxable event in case of excise duty from 'manufacture' to 'sale'.
- To allow the States to levy tax on services.
- To authorize the Union Government to impose tax on sale of goods which take place within the State.
- To authorize States to impose tax on sales of goods which take place in the course of inter-State trade or commerce.

(b) Enactment of Legislations - It has been stated by the Hon'ble Finance Minister in his Budget speech for 2009-10 that the Centre and the States will each legislate, levy and administer the Central GST and State GST, respectively.

(c) GST Rates:

- Finalizing the rate structure – Separate RNR for Central GST and State GST.
- Which tax/duty/cess will finally be subsumed in CGST and SGST respectively?
- How many rates of tax would be there in GST.
- Finalization of goods and services that will enjoy exemption, such as, food grains, education, health, etc.

(d) Activities which will be exempted and zero rated.

(e) Extensive definition of 'goods' and 'services'.

(f) Rules of supply for goods and services.

(g) Seamless input tax credit removing all cascading effects.

(h) Treatment of inter-State transaction of goods and services, determining the taxable event thereof and model of payment and collection of tax.

(i) How to broaden the tax base.

(j) To determine the threshold limit (basic exemption).

(k) Non-Vatable goods and services; and other circumstances when input tax credit would be denied.

(l) The framework for exemptions and composition.

(m) Future of various existing exemptions under CENVAT and State VAT.

(n) Taxation on the sale or purchase of goods declared by Parliament to be of special importance in inter-State trade or commerce, (declared goods) under Article 286(3) of the Constitution of India read with Sections 14 and 15 of the Central Sales Tax Act.

(o) The taxes to be charged on Long Duration Projects, say for three-four years.

(p) To make Points of Taxation and place of Provision rules, etc.

(q) Taxation of imports under GST.

B. Operational issues

(a) Common approach of the States, i.e., a common law, a common assessment procedure and even a common return.

(b) Monitoring of inter-State trade, whether to abolish check-posts.

(c) Sharing of information using comprehensive IT network.

(d) Improving relations between the Centre and the States.

C. Infrastructural Issues

(a) **IT infrastructure -** A simple system for inter-State transactions and verification of dealers is essential to ensure tax compliance and check avoidance. Given the volume of such transactions, this system necessarily has to be IT based. The present Tax Information Exchange System (TINXSYS) does not appear to be fully operational across all States. There are asymmetric benefits to States in putting in place such infrastructure and this appears to be affecting their incentives to do so.

(b) **Decision on elimination of Check Posts** to avoid enormous delays in road traffic, and reducing delivery times for goods.

(c) **Impact on Small Enterprises -** The impact of GST on small enterprises is often cited a concern. On the State GST component, the position will be exactly the same as under the present VAT regime. There may be three categories of small enterprises in the GST regime:

- Those below the threshold need not register for the GST.
- Those between the threshold and composition turnovers might have the option to pay a turnover based tax or opt to join the GST regime. Given the possibilities of input tax credit, not all small enterprise may seek the turnover tax option.
- The third category of small enterprises above the turnover threshold will need to be within the GST framework.
- Possible downward changes in the threshold in some States consequent to the introduction of GST may result in obligations being created for some dealers. In such cases suitable provisions could be made to provide direct assistance to the affected small enterprises, if considered desirable.
- In respect of Central GST, the position is slightly more complex. Small scale units manufacturing specified goods are allowed exemption of excise up to a turnover of Rs 1.5 crores presently. These units, which may be required to register for payment of State GST, may see this as an additional cost.

(d) **Harmonization** - For GST to be effective there should be identical GST laws across States as well as at the Centre. Moreover, not only the law but also the proceduresrelating to levy, assessment, collection and appropriation of the GST should be similar across States and the Centre.

(e) There should be a **thorough re-engineering of the departments of SGST and the CGST**. This is to clearly define the responsibility, accountability and authority of both departments. The day-to-day operations should be assigned to the States. That is the dealers would register and submit their return to the State department where they are located. The dealers should interact with a single tax authority only.

(f) **Cross-verification of documents must be strengthened -** In the absence of proper cross-verification; the dealers avoid tax payment and claim undue credit for taxable sales. Tax evasion can be prevented by setting up departments similar to centralized and regional anti-evasion organisation in France.

(g) **Common procedure for Levy, assessment, collection and appropriation -** For industry to reduce the transaction and compliance costs, it is necessary that apart from a common law, implementation of the law be also similar across States. All stages of the taxation chain from the levy of the tax to its assessment, collection and appropriation should be similar. This would involve similar rules across the States dealing not only with assessments, audit, refunds, but also more basic issues, like registration, filing of returns, treatment of transportation of goods etc.

(h) **A common dispute resolution mechanism** as well as a mechanism for giving advance rulings would further facilitate trade and industry.

(i) **Persuasions of the State Government -** Few State Governments have recently indicated their opposition to the implementation of GST at the present juncture. While their objections need to be carefully examined, it must also be recognized that while implementation of the GST is aimed at being revenue neutral to the States, it will be budget positive for the Government. This is because Governments are large purchasers in the market for their own consumption and their cost of procurement will come down significantly with the implementation of GST.

(j) **Role of the Finance Commission -** It is possible that some States may want assurances that existing revenues will be protected when they implement GST. The Commission is willing to consider providing for compensation in order to advance the implementation of a "flawless" GST.

(k) **Training -** Since the dual GST is considerably different from the present indirect tax regime, a massive training initiative would be required at both federal and State levels to familiarize the respective administrations with the concepts and procedures of the dual GST. However, the task is not limited to technical training but also extends to a similar effort to re-orient the attitude and approach of the tax administration in order to achieve a fundamental change in mindset.

10.2 Compensation Package to the States for Losses

Another major challenge before the Government is to finalize the compensation package for the States in case of loss due to implementation of the GST.

State Finance Ministers, at a pre-budget meeting with the then Finance Minister Sh. Pranab Mukherjee, demanded that the Center should compensate States for any loss of revenue following implementation of the GST. Although the Centre is mulling a five-year compensation programme, States are of the view that there should not be any time-frame for compensation scheme.

Under the GST structure, the tax would be collected by the States where the goods or services are consumed, and hence losses could be heavy for the producer States and the Centre would be required to compensate them for loss of revenue.

The Centre had earlier come out with a similar scheme to compensate States for loss of revenue following implementation of value added tax (VAT), which came into effect from April 1, 2005. The compensation structure was 100% in the first year, 75% in the second year and 50% in the third year. Compensation was also provided to the States for loss of revenue due reduction in CST rate from 4% to 2%.

CHALLENGES

Given the above context, let us look at some of the challenges.

GST rates

Clearly, arriving at the appropriate GST rates is the fundamental challenge. The Empowered Committee (EC) has set up a Working Group to address this issue and the group is likely to finalize its recommendations in the near future. As yet, no official confirmation of the GST rates is available. According to information available in the public domain, it appears that the aggregate rate of GST, on both goods and services, is likely to be in the range of 14 per cent to 16 per cent, with a high probability of introduction of the 16 per cent rate. The question remains as to whether the GST rate on goods at the Federal and State levels ought to be a single or a multiple one. It is most likely that the GST on goods would comprise at least of two nominal rates and a zero rate would also be present for exports and for specified goods. It would, thus, be a three-rate structure, at the least. There are many other dimensions to this debate. With regard to the Federal and the State GST rate on services, the country needs to come to terms with the fact that the GST rate on services will be at par with that on goods. Given that there is no State service tax at the moment, this would mean a significant enhancement in the aggregate incidence of taxation of services.

Constitutional changes

Another fundamental challenge is with regard to the Statute. Evidently, the GST law needs to be written from first principles and the present myriad indirect tax laws such as the Central Excise Act, 1944, the Finance Act, 1994 as well as various State VAT Acts need to be replaced by a new legislation relating to the GST. In addition, various amendments/ modifications to the Constitution would also be required, based on the particular dual GST model that will be finally adopted. This challenge is a formidable one. It is unclear whether enough preparatory work has been done and how soon it can be completed.

Inter-State transactions

A key challenge under the dual GST model concerns the taxation of inter-State supplies of goods and services. Given that the existing taxable events of manufacture and sale of goods under the present excise and VAT regimes respectively will no longer be relevant, it would be essential to draw up comprehensive rules for identifying the time and the place of 'supplies' of goods and services in order to tax them appropriately. The problem is limited to the State GST on such inter-State supplies since the

Federal GST would, in any event, be charged and collected by the Federal Government. Here again, it is understood that a specific Working Group has been formed within the EC to come up with recommendations on the taxation of such inter-State supplies. Since the Central Sales Tax, which is relevant for inter-State sales of goods, is scheduled to go down to zero with the introduction of the GST, and since there is presently no service tax at the State level, the final model of taxation of inter-State supplies of goods and services under the GST would need to evolve through a mature give-and-take approach between the Centre and the States in the EC. This consensual approach is key tothe successful implementation of the GST.

Threshold levels

It is well-recognized that GST is inherently a tax which only reasonably-sized businesses can comply with, for several reasons. Consequently, it is the universal practice notto extend the GST to taxpayers below a certain size. Hence, a key decision needs to be taken with respect to the threshold of turnover for dealers which would determine the cut-off for inclusion within the ambit of the GST. In India, this discussion is made complex because of the present varying levels of exemption threshold that exist under the federal excise and service tax as also under the State VAT regimes. The relevant threshold under excise is Rs. 1.5 crore and that under service tax is Rs. 10 lakh. As regards the State VAT, varying threshold exist ranging from Rs. 10 lakh to Rs. 20 lakh. There are serious equity considerations that need to be kept in mind and a final decision on threshold will inevitably be influenced by political compulsions.

IT readiness

It is, by now, quite clear that a successful implementation of the dual GST is based on substantive IT capability both at the tax administration level and at the taxpayer level. While efforts are going on to implement an all-India VAT data exchange and validation model called the TINSYS, significant additional investment required in either scaling up this system to cater to the GST or, alternatively, to put in place an entirely independent IT infrastructure to administer the tax.

Training

Finally, since the dual GST is considerably different from the present indirect tax regime, a massive training initiative would be required at both federal and State levels to familiarize the respective administrations with the concepts and procedures of the dual GST. However, the task is not limited to technical training but also extends to a similar effort made to re-orient the attitude and approach of the tax administration in order to achieve a fundamental change in mindset. The knowledge and awareness of the GST, at both Federal and State levels, at the staff and operational levels at present is almost non-existent and the challenge in regard to training is, thus, perhaps the most formidable of all that have been discussed in this article.

Therefore, it is now universally acknowledged and recognized that the GST, in whatever form, should be introduced at the earliest as a fundamental fiscal reform measure. If we are really serious about the early introduction policy makers, as also the tax administrations at the Federal and State levels, need to be immediately galvanised into action under a clearly laid-out timetable for introduction and implementation.

A-11
IMPACT ON KEY INDUSTRIES / SECTORS

11.1 India's GST Model

With the announcement of Finance Minister in Budget Speech 2009-10, it is now clear that India's GST will be a "Dual GST". Both, Central Government and the State Governments will levy respective GST concurrently on a common base value. Thus, all goods and services, barring a few exceptions, will be brought into the GST base. Importantly, there will be no distinction between goods and services for the purpose of imposition of tax.

11.2 Impact – Generally

(a) *Change in law, concept and procedure:* Since it is a major indirect tax reform in India, there would be new legislations and procedures. The industry, traders and professionals would be required to devote a lot of time in understanding the new concept.

Industries' gains or losses, depending upon the existing laws that are settled, need examination afresh especially when the repealed laws will have no significance at all. The entire indirect tax code will be a new one and any comparison with the old laws will be doing disfavour to the new legislations.

(b) *Change in tax-rates:* The standard rate of 12% adopted for CENVAT, Service Tax rate of 12%, along with residuary rate of VAT at 12.5% brings the overall rate to 25%-30%. But, post GST, it is likely to be in the range of 18%-20%; a net gain of almost 6%-10%.

Therefore, most of the dealers would experience the change in tax rates, either significantly or marginally. Therefore, they would be required to conduct a detailed study of the changed scenario.

(c) *Changed system of tax credit:* The GST will facilitate seamless credit across the entire supply chain and across all States under a common tax base. The current framework allows limited inter-levy credits between excise duty (tax on manufacture) and service tax However, presently, no cross credits are available across these taxes and the sales tax paid (on input) or payable (on output). Introduction of GST should thus rationalize tax content in product price, enhance the ability of companies to compete globally, and possibly trickle down to benefit the ultimate consumer.

However, it is learnt that under the proposed GST regime, the Centre will give input tax credit (set off) only for Central GST and the States will give input tax credit only for State GST. Cross-utilisation of credit between Central GST and State GST will not be allowed. Nevertheless, the dealers could claim set-off within the respective heads.

Presently, input tax credit is available under the Excise Duty and Service Tax on payment basis. However, under the State VAT, it is allowable on the basis of tax invoice, irrespective of date of payment. It is probable that tax credit under GST would be available on the payment basis. The dealers, who are presently registered under the VAT only, will have to accordingly adjust their business norms to avoid unnecessary blockage of working capital for payment of tax.

(d) *Stock transfers from one State to another:* Presently, such transfers take place free of tax against Form F. However, under the GST, stock transfers from one State to other to one's branch or consignment agent might be treated as inter-State sale.

(e) *Stock transfers to branches/consignment agents within the State:* Presently, treatment of these transactions varies from State to State. However, under GST, these transfers might also be subject to tax, unless the BIN of transferor and transferee is same.

For Example if a dealer is transferring any goods or service from one branch in a State to other branch in the same State having the same BIN (Business Identification Number) the Dealer would not be liable to pay GST on such transaction.

(f) *Sale vs. Service:* Presently, in a number of cases, particularly, transfer of intangible goods suffers the VAT as well as Service Tax. This issue could be resolved in GST by redefining the both definitions. This will reduce perennial litigation on this issue.

(g) *Situs Issue:* Since it is the Dual GST, *situs* issue, i.e., where a transaction is taxable, may continue, causing stupendous litigation. However, if the overall principles of GST are practiced seriously by all the stake holders, this may ultimately finish litigation on this issue.

(h) Industries will have to learn to *redesign their business procurement models* to optimize tax outgo.

(i) *All existing contracts may go under changes*; industry has to examine the impact without delay and go for amendments etc., or they might have to face losses.

(j) *GST will be based on HSN:* It will reduce the interpretational issues in respect of class of commodities.

(k) *Grey-market operators:* Will have a field day; with total GST levy likely to be in the range of 20%-22%; hence industry will have to take all precautions to ensure such operators are curbed by the Government very seriously. Especially on consumer goods markets, this phenomenon has been playing havoc in countries where GST was introduced. With high tax rate on purchase and sale of goods; the greed will only increase.

(l) *Upgradation of Software:* Dealers and service providers need to upgrade their accounting and tax software. In the modern world, when all large companies have sophisticated software like SAP etc., to upgrade and customize the same will be a big challenge to the software companies. Huge Cost to begin with; continuous training and development of people at each level and continuous updation of all operating system.

(m) *Training:* Comprehensive training will be required to the staff members of the business community, both at senior level and also at junior level. Further, the scope of such training should be extended to the marketing personnel, apart from accountants and legal department.

(n) *Competent Professionals:* At present, the industry, generally, has separate consultants for Excise Duty, Service Tax and VAT. With the merger of all three major taxes, they might require only a single consultant who can handle their GST matters.

11.3 Impact on specific Sector

11.3.1 Agriculture

In India, food items are generally exempt from the CENVAT. However, many food items, including food grains and cereals, attract the State VAT at the rate of 4% in many States. In Delhi, these are exempt from VAT. However, exemption under the State VAT is restricted to unprocessed food, e.g., fresh fruits and vegetables, meat and eggs, and coarse grains.

These items may be subject to tax in GST at a lower rate, which is likely to be 8% (combined GST rate), which, if so, will certainly make these items dearer by 4%.

The alternative of exempting (or zero rating) food altogether would not be any better, which would certainly have an adverse impact on the Revenue Neutral Rate. While the poor would pay less tax on food, they would pay more on other items in their consumption basket. Whether and to what extent they would be better off would depend on the composition of their consumption basket.

11.3.2 Traders

- ***Central Sales Tax Act:*** Since CST Act will be abolished, no sale or purchase could take place against Form C. Moreover, inter-State purchases (against Form C) presently costs minimum @2% of the purchase price (non-vatable), whereas, in GST, the traders would be saved from this non-vatable burden.
- ***Requirement of additional working capital:*** There are various models suggested for payment of tax on inter-State transactions. PVAT model (full tax paid by seller) and Post VAT model (tax paid by the buyer in his State) must be discouraged since gross tax will first be paid, and then, claimed as refund by the seller from the Department, which would require a lot of additional working capital.
- ***No subsequent sale under the CST Act against Form E-I/II:*** Such exemption under section 6(2) of the CST Act might be withdrawn.

11.3.3 Manufacturers

The activity of manufacture is subjected to CENVAT levied and administered by Union Government. CENVAT has a VAT mechanism and is creditable against CENVAT and Service tax. As CENVAT is imposed by the Union Government, the rates of tax are uniform across the country and no complications are created by movement of goods throughout the country. Threshold limit under the excise duty is Rs. 1.5 crores. In addition to excise duty, they are also liable to pay central sales tax/VAT, and sometimes, service tax.

Following are the main impacts on the manufacturers:

- ***Manufacturers having turnover less than Rs. 1.5 Crores:*** Under the proposed GST, States will assume the responsibility for administering the Central GST of dealers having gross turnover of less than Rs. 1.5 crores, whereas such dealers are presently exempt under the Central Excise (CENVAT). This would adversely impact the tiny sector and household industry.
- ***Purchasing capital goods against Form C from other States*:** Under the State VAT, the manufactures are facing certain restrictions in respect of eligibility of input tax credit on capital goods. To avoid the same, they can purchase such capital goods from other States at a concessional rate of tax against Form C. However, with the withdrawn of form C under the GST, they have to redesign their procurement model.
- ***Valuation for the purpose of Excise Duty*:** With the shift of taxable event from 'manufacture' to 'sale', confusion in respect of valuation of goods for the purpose of levy of CENVAT will be removed to a great extent. Under the GST, sale consideration will be subject to GST.

Other impacts: Same as to those on Traders – Refer Para . 11.3.2.

11.3.4 Works Contractors

Works contracts can straddle three taxable activities as per the current law. There is supply of goods, then, due to the very nature of the contract, there is supply of services. Further, if in the process of completing the works contract a new commodity comes into existence, there is the taxable event of manufacture.

As of now, the supply of goods is taxable in the form of Value Added Tax (VAT), while the services element is taxable as service tax. If a new commodity comes into existence, in the process of executing a works contract, then, Central Excise duty may be levied. Hence, different aspects of the same activity have a potential to be taxed by different Statutes.

In law, this is covered by the doctrine of aspects. However, there have been differing views of the Supreme Court and the High Courts on the applicability of this theory. The final word of the Apex court in *BSNL and Others vs. Union of India* (SC 2006)[Give correct citation] was that the aspects doctrine pertains to legislative competence and not the application of taxation on the same components of a transaction.

At present, State VAT laws have specific provisions for taxing works contracts. To avoid taxing the services element, these laws and associated rules provide for either separation of labour and materials or percentage deductions in transaction value. The Central Statute of service tax has also provided for similar treatment to avoid taxation of sale of goods as part of a works contract.

With the probable introduction of GST in India, it is expected that simplification and consolidation of taxes would lead to multitude of case laws and legislative history on works contracts becoming irrelevant.

The overarching concept in a GST is one of supply which subsumes the concepts of sale of goods, provision of services and manufacture. If States and the Central Government share the powers of taxing services and goods, the separation instituted between provision of services and sale of goods, for segregation of taxing powers, will become redundant. The elaborate schema of deductions and credits for taxing works contracts may slide into history.

This, of course, is based on the premise that GST will have a simple structure, and goods as well as services will be taxed on a uniform rate. Multiplicity of rates in goods or services in GST may lead to complexity of interpretation as well as implementation.

Other impacts on the contractors are as under: -

- ***Interpretational Issues:*** Complexities and confusion presently faced might be resolved in the GST to a great extent, as follows:
  - Whether a given activity is a works contract or a sale.
  - When a transaction relating to works contract does takes place in the course of inter-State trade and commerce.
  - Can tax be levied on goods, having a nominal value, which are transferred incidentally while executing a works contract.
  - Determination of taxable turnover and manner of raising invoice by the contractor and sub-contractor respectively.
  - How much consideration is taxable under the VAT/CST and how much under service tax, and so on.
- ***Goods fabricated at site:*** Presently, the contractors are generally liable to either VAT or the Service Tax; and are not liable to CENVAT, either due to certain specific exemptions or since the goods fabricated by them are not marketable commodities. Therefore, the contractors are liable only for a tax of maximum of 12.5%. However, these exemptions and interpretations might go away in GST and the contractors would be liable to a total tax of 16% to 20%, leaving an additional tax of 4% to 8%; particularly, in relation to building projects where the contractee could not get through benefit of input tax credit.
- ***No subsequent sale under the CST Act against Form E-I/II:*** The contractors are generally engaged in subsequent sales and high seas sales to the Contractee. However, in GST, in the absence of such exemptions, they have to change their execution and revenue model.

11.3.5 Leasing Companies

- ***Interpretational Issues:*** Like, the works contractors, leasing companies and the persons engaged in renting activities are facing, sometimes, the dual taxation: both under the VAT and Service Tax. If there is transfer of right to use goods involving transfer of effective control and possession, then it is subject to VAT; otherwise, it is subject to service tax. However, to decide the exact nature is to invite the litigation. Therefore, GST might bring a relief to such Companies in deciding: -

- Whether transaction is subject to VAT or service tax.
- When does a transaction relating to transfer of right to use goods takes place in the course of inter-State trade and commerce.
- Where is *situs* of a transaction of transfer of right to use movable goods.

11.3.6 Power Sector

Power to levy tax on the consumption or sale of electricity vests with the State Governments under Entry No. 53 in List II of Seventh Schedule of the Constitution of India. Though electricity is "goods", sales tax is not imposed on sale of electricity in India. Therefore, it is tax-free goods.

The noteworthy advantage available to the Power Companies is that they can purchase goods for generation and distribution of electricity from other States at a concessional rate of tax (CST) of 2%.

With the abolition of CST Act and inability of these companies to purchase at concessional rate, this sector will certainly be adversely affected, unless sale of electricity is brought within the scope of GST and set-off of input tax credit is allowed for tax paid on purchases.

11.3.7 Telecommunication

Revenue of telecommunication sector is either subject to service tax or the VAT. Therefore, GST would not have any adverse impact of this sector, except that which may arise due to variation in tax rates. However, for certain activities, e.g., sale of sim cards, rental on telecom equipments and composite transactions (such as, sale of phone instrument with talk time), confusion persists whether such activities are subject to service tax or sales tax, or both. With the integration of service tax and VAT into the GST, such controversy will be resolved to a great extent.

Similar to Power Companies, Telecom Companies can also purchase goods for telecommunication network from other States at a concessional rate of tax (CST) of 2%. With the abolition of Central Sales Tax Act and inability of these companies to purchase at concessional rate, these companies could claim input tax credit on capital goods since their activities would be subject to GST.

11.3.8 Intangible goods

Controversy in relation to transfer of intangible goods (such as software, intellectual property rights, goodwill, copyright, etc.) in respect of taxability, i.e., whether taxable under the service tax or VAT or both, will definitely be resolved. Generally, in other countries, transfer of intangible goods is taxed as service.

11.3.9 Exempt units

These exemptions can be classified into two parts:

(a) Area based exemption, such as, North East, J&K etc. – These exemptions might continue till their current eligibility period.

(b) Product based exemption, such as, exemptions available in Himachal Pradesh, Uttarakhand, etc. – These exemptions might be converted into cash refund.

Considerable litigation on this issue is expected post GST era. It is better that suchexempt units start dialogue with the respective Governments immediately and ensure their benefits are incorporated into the new Enactment. Once the old Acts are repealed without a saving clause in clear words, the Governments will be helpless to give benefits.

11.3.10 Certain petroleum, liquor and tobacco products

There are indications that certain components of petroleum, liquor and tobacco shall be kept outside the GST.

At present these products are known as demerit goods and are taxable not only at higher rate of tax but also subject to multiple taxes. However, these products contribute a major share to the total Government revenue.

By excluding these products from GST, its manufacturers would be adversely affected by cascading effect since they could not claim full input tax credit.

11.3.11 International Trade

Importers of goods and services may be affected under the GST regime due to -

- probable withdrawal of exemption high-seas sales under the CST Act (subject to amendment in the Constitution); and
- the impact which may arise due to change in tax rates.

Exporters of goods and services shall continue to be zero rated and will be eligible to claim refund of input tax credit.

11.3.12 Land & Real Estate

It is not yet clear whether land and real estate would form part of GST. However, in many countries (e.g., in Australia, New Zealand, Canada, and South Africa), for the purpose of imposing GST/VAT, housing and construction services are treated like any other commodity. Thus, when a real estate developer builds and sells a home, it is subject to VAT on the full selling price, which would include the cost of land, building materials, and construction services. Commercial buildings and factory sales are also taxable in the same way, as are rental charges for leasing of industrial and commercial buildings. However, there are only two exceptions: (1) resale of used homes and private dwellings, and (2) rental of dwellings.

As per Poddar-Ahmad working paper, conceptually, it is appropriate to include land and real property in the GST base. To exclude them would, in fact, lead to economic distortions and invite unnecessary classification disputes as to what constitutes supply of real property. In the case of commercial and industrial land and buildings, their exclusion from the base would lead to tax cascading through blockage of input taxes on construction materials and services. It is for this reason that even under the European system, an option is allowed to VAT registrants to elect to treat such supplies as taxable.

Further, the State VAT and the Service Tax already apply to construction materials and services respectively, but in a complex manner. For example, there is significant uncertainty whether or not a pre-construction agreement to sell a new building is a works contract and subject to VAT. Where the VAT does apply, disputes arise about the allocation of the sale price to land, goods, and services. While land is the only major element that does not attract tax, the tax rates applicable to goods and services differ, necessitating a precise delineation of the two. Extending the GST to all real property supplies, including construction materials and services, would bring an end to such disputes, simplify the structure, and enhance the overall economic efficiency of the tax.

One potential argument against the levy of GST to land and real property would be that they already attract stamp duty. As per the said Working Paper, this argument can be quickly discarded, as the purpose and structure of the stamp duty is quite different from that of the GST. Stamp duty is a cascading tax on each conveyance of title to real property, whereas the GST is a tax on final consumer expenditures. Thus, the two taxes cannot be viewed as substitutes. However, the application of GST to real property transactions does warrant a review of the structure and rates of stamp duties and registration fees. The rates should be lowered and the structure rationalized when the GST is introduced.

11.3.13 Service Providers

Presently, services are taxed at the place of rendering; however in GST, they would be taxed at the place of consumption. If services are rendered from one State to another, then tax would ultimately go to the consuming State. Therefore, in terms of procedure, their compliance will increase substantially.

Moreover, more than 40 services will be transferred to the States. Further, their base may further be widened by specifying more services or withdrawing the existing exemptions.

With the inclusion of VAT and Service Tax into GST, the controversy as to the nature of activity will be resolved. Moreover, disputes as to availability of certain exemption towards value of goods sold (such as photography services) will also be put to rest.

11.4 Conclusion

All stake holders need to get ready for a Dual GST – whether we like it or not. Tax is money and whether the stake holders will gain or loss depends upon the tax schedules, final GST rates and the laws that are framed for availing input tax credit on item-to-item basis or on cross basis. The stake holders need to take immediate steps and start discussions, industry specific, to frame their final view on the draft legislation, as and when released.

We would only say that the impact will be tremendous; laws will be simplified and if the stake holders rightly understand the intricacies of the law, take timely steps to upgrade their software and systems; the financial gains will be all pervasive.

The exact impact of GST on various industries could be quantified only after the release of, at least, draft legislation. A good gesture can be inverted if it is done in a wrongful manner. That is, if the provisions are susceptible to conflicting interpretations, or drafted erroneously, definitely, with the continuance of litigation the entire process and purpose of the reform will be adversely affected.

A-12
EXPECTATIONS OF INDUSTRY FROM GST

[Based on Papers by Experts in Industries and Media Reports]

12.1 Expectations from GST in general

A. Expectations from the Central & State Government – Gearing up by both Governments for GST

(a) Centre-State interaction

Considering the federal nature of our country and Centre – State relationships, Central Government should be prepared to pass more powers of taxation to the States and share more revenue with the States, if GST has to be successful.

(b) Constitutional amendments

Under the scheme of our Constitution, no tax can be levied without the authority of law. Power to levy tax on goods and services are vested with both Central Government and State Government under Article 246 and List-I and List-II of the VII Schedule of the Constitution of India. Neither the Central Government nor the State Government can usurp the powers of others without amending several provisions of the Constitution.

(c) Stability of GST Act and Rates

As recommended by Dr. Kelkar, there should be an agreement between Central Government and all State Governments that there should not be any change in the GST Act or rates without concurrence of both Central and State Governments. Only this can lead to stability of GST Act and will give global reputation to Indian continent. Such gearing up for GST by the two tiers of Government is the industries' expectation because it will facilitate smooth introduction and operations of GST.

(d) Re-engineering of Central & State employees

There should be a thorough re-engineering of the department of GST at Central level as well as State level. This is very much required to clearly define, understand and administer functions in such a way that the responsibility, accountability and authority of each tax department at the Central and State level are clearly understood.

(e) Single Authority to deal with

As it is known that the number of officials at the Centre is less as compared to State level officials, it is expected that Central officials be assigned special task to monitor the operations of large dealers (who have pan India operations) under CGST and SGST. The day to day operations related to registration, payment of tax and submission of returns for all the dealers (irrespective of their size) should be assigned to the State. The assesses with specific turnover, say, upto Rs. 500 Crore and the assesses whose operations are limited to one State only should be assessed by State Department for both CGST and SGST. In general, the idea is that assesses should interact with a single tax authority only.

Presently, under the recommendation of Joint Working Group, CGST will be monitored by the Central Government and SGST will be monitored by the State Government. It means that assesses will have to deal with two authorities which may be unacceptable by all dealers. Because from the past practical experience, everyone knows that interpretations, procedures, whims and approach widely differ at both levels. If this happens, then instead of helping, GST will create more harassment and nuisance.

(f) Verification Agency

Cross verification of documents should be strengthened under GST to avoid evasion and wrong claims. In France, the Government has created an organization called "National Directorate of Verification" which verifies transactions above 300 million Francs, involving national and international dealings. Similarly, there is Regional Directorate of Verification which verifies similar transactions within the districts / divisions. Similar arrangements should be made under Indian GST regime also.

(g) MIS amongst different Government Departments

MIS has to be an integrated activity of the CGST and SGST offices as well as other Government Departments.

The integration of activities of CGST, SGST, customs and income tax through PAN number - TINXYS should be an essential part of GST regime.

(h) Creation of IT infrastructure – GST Public Services Offices

Cross verification, MIS and interaction between different departments and dealers necessitate complete computerization of all Government departments in all States and availability of computer facility with each and every dealer covered under GST. Even today, it is observed that computers and internet facilities are not easily available in villages and towns. Lack of knowledge of computer in such areas is a hard reality. Therefore, there is a need to bring the awareness about the computer amongst the dealers across India. In the initial period of five years, opening of Government sponsored kiosk at various centers facilitating compliance of law through internet and computers should be seriously considered. In fact, we are reminded of Mr. Sam Pitroda who created the Center for Development of Telematics (C-DOT), an autonomous telecom R&D organization which made yellow signed Public Call Offices (PCO) ubiquitous throughout India. In the same fashion, it is expected that GST PSO (Public Service Offices) should be created in every town in the form of computer kiosks.

Currently, Mr. Nandan Nilekani has been given the responsibility for creating the required IT structure for GST wherein 3 major services i.e. registration, return and payments will likely be provided . The technology partner for operating the structure would be NSDL.

(i) Training of Staff

Today excise and service tax officials do not know much about VAT provisions. Similarly, State employees administering VAT Act do not know excise and service tax provisions. Thus, both Central and State staff will require learning and training in the administration of GST Act. Further, staff needs to be trained in computer operations also.

B. Expectations from the GST Acts

(a) Uniformity in the rates of tax, definitions and provisions across the States.

(b) Inter-changeable set-off/credit of Central GST and State GST.

(c) ***No SGST on CGST or vice-a-versa -*** As per legal position as on today, sales tax/VAT is charged on excise duty element also. Under the new system, excise duty, i.e., CGST will be levied on each value added transactions upto consumers. It means that, SGST will further increase on such element with each value added transaction. For example, if CGST is 10% and SGST is also 10%, with each value added transaction, there will be additional burden of 1% of SGST (10% SGST on 10% CGST). Ultimately, there will be a heavy burden on consumers. Hence, it is highly recommend that no SGST should be levied on any CGST element, or vice-a-versa; and both taxes to be levied at the common base.

(d) ***Inter-State transactions*:** It is presumed that Central Sales Tax will be phased out with the introduction of GST, but issue of GST on inter-State transactions will be there. Proper mechanism needs to be introduced so that dealers get input credits for any GST levied on inter-State transactions. Only this can avoid cascading effect in the real sense.

(e) Uniformity across the States in procedures relating to granting of registrations, preparation of bills, filing of returns, scrutiny of returns, assessments, granting of refund, audit, cross-verification, appeal, allowance of credit notes, etc.

(f) While VAT has been implemented in most of the States w.e.f. 01.04.2005 and by other States subsequently, the State machinery is still engrossed in the pending work related to assessment, appeals etc. relating to previous sales tax regime in all States. As a result, many officers are not well equipped with the VAT laws, which is not desirable. Hence, it is highly expected that when GST is planned to be implemented with effect from 01.04.2010, all steps are taken to ensure that no pending work relating to either sales tax, VAT or other indirect taxes remains outstanding so that everybody can concentrate on the new law. It is therefore, suggested that some schemes for summary disposal for all the pending cases should be pronounced before GST comes into operation. In such schemes, the approach should be to lure almost all the dealers to settle their all the disputes rather than miserly offering schemes, which do not help in achieving the objective of the scheme.

C. A clear Roadmap

Recently, at a workshop on Goods and Services Tax organised by the Indian Chamber of Commerce, the need for a clear roadmap on implementation of the new system of taxation was emphasized to enable people at large and the business community, in particular, to familiarize themselves with the same.

12.2 Expectations of Works Contractors

A transaction of works contract, which was immune from any tax till the 46th Constitutional Amendment in 1982, is now, sometimes, taxed twice; firstly as sale by the State Government and secondly as service by the Central Government. The tax payer, who along with his consultants is under confusion till date as to which tax to be levied on which portion, is left in the hands of both the imposition authorities and the Courts to litigate the matter.

A. Competing Taxes

Works contracts can straddle three taxable activities as per the current law. There is of course supply of goods. Then, due to the very nature of the contract, there is supply of services. Further, if in the process of completing the works contract, a new commodity comes into existence, there is the taxable event of manufacture.

As of now, the supply of goods is taxable in the form of Value Added Tax (VAT), while the services element is taxable as service tax. If a new commodity comes into existence, in the process of executing a works contract, then, at least in theory, Central Excise duty may be levied. Hence, different aspects of the same activity have a potential to be taxed by different Statutes.

B. Legislative, judicial background

In law, this is covered by the doctrine of aspects. However, there have been differing views of the Supreme Court and the High Courts on the applicability of this theory. The final word of the Apex court in *BSNL and Others vs. Union of India* (SC 2006) was that the aspects doctrine pertains to legislative competence and not the application of taxation on the same components of a transaction.

C. Present Status

At present, State VAT laws have specific provisions for taxing works contracts. To avoid taxing the services element, these laws and associated rules provide for either separation of labour and materials or percentage deductions in transaction value.

Another method is of prescription of a lower rate of tax in a composition/lump-sum scheme for works contracts. The service tax law has also provided for similar treatment to avoid taxation of sale of goods as part of a works contract.

As far as Central Excise is concerned, the law seeks to preclude the applicability of service tax wherever the activity amounts to manufacture. In case the works contract leads to an immoveable property coming into existence, the operation of Central Excise levy anyway is out of question, as only goods can be taxed.

The actual picture on the ground is however not as clear. Disputes on taxability and taxable value for the three competing taxes still refuse to fade away.

D. Opportunity in GST

Taxes on works contracts assume significance for the real estate/construction industry and those engaged in erection, commissioning and installation of plant and machinery. In these activities, apart from taxability, the concepts of right to use, credit of capital goods, and usage of consumables also come into play giving rise to various tax consequences.

With the probable introduction of GST in India, it is expected that simplification and consolidation of taxes would lead to multitude of case laws and legislative history on works contracts becoming irrelevant.

The overarching concept in a GST is one of supply which subsumes the concepts of sale of goods, provision of services and manufacture. If States and the Central Government share the powers of taxing services and goods, the separation instituted between provision of services and sale of goods, for segregation of taxing powers, will become redundant. The elaborate scheme of deductions and credits for taxing works contracts may slide into history.

This, of course, is based on the premise that GST will have a simple structure; and goods as well as services will be taxed on a uniform rate. Multiplicity of rates in goods or services in GST may lead to complexity of interpretation as well as implementation.

12.3 Expectations to have Kelkar’s GST

Following were the expectations of Chairman of 13th Finance Commission, Dr. Vijay Kelkar who has always pitched for the introduction of GST:

A well designed destination-based GST on all goods and services should be the most elegant method of eliminating distortions and taxing consumption.

- Under this structure, all stages of production and distribution should be interpreted as a mere tax pass-through, and the tax essentially ’sticks’ on the final consumption within the taxing jurisdiction.
- The introduction of GST should also bring about a macro-economic dividend, as it reduces the overall incidence of indirect taxation, and therefore, the overall tax burden by removing many adverse features of the present sales tax system.
- The effective revenue neutral rate at which GST can be implemented should be far lower than 30% indicating a significant reduction in the effective tax burden on our economic agents.

- The comprehensive GST should fully eliminate the export of taxes and improve international competition. This, in turn, should help in increasing the production and exports of labor-intensive manufacturers and also, boost employment in our economy.
- Considering the high level of distortions in the indirect tax system, one can argue that the real output effect of a well implemented GST in India would be at least 1.4% of the GDP in Canada. This amounts to $15 billion annually, implying that the economic value of GST reforms would, at a modest 3% discount rate, be close to half a trillion dollars or 50% of the country's present GDP.
- More importantly, this means potentially creating an additional productive employment for as many as 4 to 5 million persons. Introduction of GST would also be a reform measure whose economic impact will rival that of the elimination of licensing in 1991.
- The existing tax system introduces myriad distortions which favour some goods and services at the expense of others. Such distortions in our tax system are also adversely affecting the growth of manufacturers, particularly labor-intensive manufacturers, who are extremely important in meeting the challenge of providing productive employment. This should be achieved by the introduction of GST.

A-13
GST IN OTHER COUNTRIES

13.1 GST/HST in Canada

The goods and services tax (GST) is a tax that applies to the supply of most goods and services in Canada. Three provinces (Nova Scotia, New Brunswick, and Newfoundland and Labrador, referred to as the participating provinces) harmonized their provincial sales tax with the GST to create the harmonized sales tax (HST). The HST applies to the same base of taxable goods and services as the GST.

Effective from January 1, 2008, the GST rate was reduced from 6% to 5%, and the HST rate from 14% to 13%.

Almost everyone has to pay GST/HST on purchase of taxable supplies of goods and services (other than zero-rated supplies). Some sales and supplies are exempt from GST/HST.

Although the consumer pays the tax, businesses are generally responsible for collecting and remitting it to the government. Businesses that are required to have a GST/HST registration number are called registrants.

Registrants collect the GST/HST on most of their sales and pay the GST/HST on most purchases they make to operate their business. They can claim a credit, called an input tax credit (ITC), to recover the GST/HST they paid or owe on the purchases they use in their commercial activities.

***Taxable supplies*:** Taxable supplies refer to supplies of goods and services that are provided in the course of a commercial activity and are subject to GST/HST, or are 0% (zero-rated).

***Zero-rated supplies*:** Zero-rated supplies refer to a limited number of goods and services that are taxable at the rate of 0%. This means there is no GST/HST charged on the supply of these goods and services, but GST/HST registrants can claim an ITC for the GST/HST they pay or owe on purchases and expenses made to provide them.

Exempt supplies: Exempt supplies are goods and services that are not subject to GST/HST. Registrants cannot claim input tax credits to recover the GST/HST they pay or owe on expenses related to such supplies.

What is HST?

Three provinces - Nova Scotia, New Brunswick and Newfoundland and Labrador - harmonized their provincial sales tax with GST to create HST. These three provinces are known as participating provinces. Effective from January 1, 2008, the GST rate was reduced from 6% to 5%, and the HST rate from 14% to 13%.

The HST is composed of the GST and the 8% provincial tax and applies to the same base of goods and services that are taxable under GST. HST follows the same general rules as GST.

GST/HST registrants continue to collect GST on taxable supplies (other than zero-rated supplies) of goods and services made in Canada outside the participating provinces. On supplies made within the participating provinces, they collect HST. All GST registrants are automatically registered for HST.

[Source:http://www.cra-arc.gc.ca]

13.2 Australian GST

In Australia, the GST is a broad-based tax of 10% on most goods and services. In most cases, GST is included in the price which is paid. Only registered business entities are entitled to a tax credit. The effect of this provision is that consumers are not reimbursed for the GST paid on purchased goods and services.

Most food items, including meat, fruit and vegetables, are GST-free. However, some food and beverages have been included in GST — for example, prepared food, takeaway food, restaurant meals, confectionery, ice cream, snack foods, alcoholic beverages and soft drinks. Other GST-free items include most education and health services, eligible child care, and a range of other goods and services.

Supply

A sale in GST terms is referred to as a "supply". The definition of supply has been drafted very widely to cover most receipts so that all revenue of business is subject to GST. A supply includes: -

- Supplying goods
- Providing services
- Providing advice or information.
- Granting, assigning or surrendering real property.
- Creating, granting, transferring, assigning or surrendering any right.
- Financial services.
- Entering into an obligation to do something, refrain from doing something, or to tolerate something, or releasing someone from such an obligation.
- Any combination of these, that involves value (money, or goods/services, or in-kind) changing hands is a supply for GST purposes.

Categories of Supplies

There are three types of GST sale or supply:

- Taxable supplies
- GST-free supplies

- Input taxed supplies

It is important to mention that collection and payment of GST or entitlement to claim GST credits depends upon the category of sales/ supply, as foretasted.

Taxable Supplies

It means supplies of goods and services, connected with Australia, made by registered persons or entities, for consideration. Entities that are registered for GST must charge GST on their taxable supplies, and will be entitled to input tax credits on the GST they have paid on purchases to make those supplies. Such entities which are not registered for GST cannot charge GST on their invoices.

A taxable supply specifically excludes supplies that are GST-free and supplies that are input taxed. The main elements, which must exist in order for the supply to be a taxable supply, are:

- Supply must be for consideration
- Supply must be made in the course of or furtherance of an enterprise
- Supply must be connected with Australia
- The supplier must be registered or required to be registered for GST.

Therefore, a taxable supply is:

- a supply made for consideration
- in the course and furtherance of an enterprise,
- of a registered entity
- And the supply is connected with Australia.

unless the supply is -

- GST-free
- Input-Taxes.
- outside the scope

GST-Free Supplies

GST is not charged, or payable on GST-Free supplies. The major categories of GST-free supplies are:

- Child care
- Exports (goods and services)
- Religious services
- Non commercial activities of charitable institution
- Raffles and bingo conducted by charitable institutions

- Water, sewerage and drainage
- Overseas transport
- Sale of a continuing business
- Grants of freehold or similar interests by Governments
- Certain farmland
- Cars for use by disabled people
- International mail
- Certain transitional arrangements

Input Taxed Supplies

If a person provides input taxed suppliers, GST is not charged to the purchaser, and the seller is unable to claim any input tax credit for GST paid on purchases made for the input taxed supply. The major categories of input taxed supplies are:

- Residential rents
- Certain residential premises
- Financial Services such as interest, loans, dealings in shares Superannuation, life insurance and other financial instruments.

Collecting and claiming GST on different types of sales

Type of sale	*Whether to collect GST?*	*Whether to claim GST credits?*
Taxable	Yes	Yes
GST-free	No	Yes
Input taxed	No	No

Out of Scope Supplies

All supplies do not fall into the three categories listed above. Some supplies will be outside the scope of reporting as far as GST is concerned if they do not meet one of the tests outlined for a taxable supply.

Examples of transactions outside the scope of GST include: -

- supplies made by unregistered persons
- supplies made for no consideration
- payments of certain Government taxes and charges
- unconditional grants and donations (no supply is made in these circumstances by the recipient of the grant/donation)

- Salaries and wages.

GST will not be included in the price of supplies outside the scope of GST. However, if a person is registered for GST purposes, he will be entitled to claim input tax credits for GST included in the price of things acquired for the purpose of making these types of supply.

13.3 Indirect Tax in U.K.

In U.K., the indirect tax structure comprises excise duty as well as VAT. However, the scope of excise duty is restricted to limited commodities.

Excise duties are charged on certain goods, such as, motor fuel, alcohol, tobacco, betting and vehicles. Taxable event in case of excise duty is manufacture of goods.

Value Added Tax (VAT) is a tax that is charged on most goods and services that VAT-registered businesses provide in the UK. It is also charged on goods and some services that are imported from countries outside the European Union (EU), and brought into the UK from other EU countries.

VAT is charged when a VAT-registered business sells to either another business or to a non-business customer. When VAT-registered businesses buy goods or services, they can generally reclaim the VAT they have paid.

There are three rates of VAT, depending on the goods or services the business provides. The rates are: -

- Standard - 15 per cent
- Reduced - 5 per cent
- Zero - 0 per cent

There are also some goods and services that are: -

- exempt from VAT, or
- Outside the UK VAT system altogether.

VAT is a tax that is charged on most business transactions in the UK. Businesses add VAT to the price they charge when they provide goods and services to: -

- business customers - for example a clothing manufacturer adds VAT to the prices they charge a clothes shop;
- Non-business customers - members of the public or 'consumers' - for example a hair-dressing salon includes VAT in the prices they charge members of the public.

If a person is a VAT-registered business, in most cases, he: -

- charges VAT on the goods and services he provides
- Reclaims the VAT he pays when he buys goods and services for his business.

If he is not a VAT-registered business or organization, then he cannot reclaim the VAT he pays when he purchases goods and services.

If he is VAT-registered, the VAT he adds to the sale price of his goods or services is called his 'output tax'. The VAT he pays, when he buys goods and services for his business, is called his 'input tax'.

13.4 GST in Singapore

In Singapore, Goods and Services Tax (GST) is a tax on domestic consumption. The tax is paid when money is spent on goods or services, including imports. It is a multi-stage tax which is collected at every stage of the production and distribution chain.

"Output tax" is the GST a registered trader charges on his local supplies of goods and services. The tax is collected by him on behalf of the Comptroller of GST. "Input tax" is the GST that the trader has paid on purchases of goods and services for the purpose of his business. The input tax is deductible from output tax to arrive at the GST payable by the trader, or amount to be refunded to him.

Overview of Singapore GST

GST was first introduced in Singapore on 1st April 1994 at 3%. The GST rate was increased to 4% in 2003 and to 5% in 2004. As announced in Budget 2007, the GST rate was raised to 7% in 2007.

GST is levied on:

- goods and services supplied in Singapore by any taxable person in the course or furtherance of a business; and
- goods imported into Singapore by any person.

In general, a supply is either taxable or exempt. A taxable supply is one that is standard-rated or zero-rated. Only a standard-rated supply is liable to GST at 7%.

Zero-rating a supply means applying GST at 0% for the transaction. A GST registered trader need not charge GST on his zero-rated supplies, but he is, nevertheless, allowed a refund of the tax he has paid on his inputs. In Singapore, only "export" of goods and "international" services are zero-rated.

If a supply is exempt from GST, no tax is chargeable on it. A GST registered trader does not charge his customer any GST on his exempt supplies. At the same time, he is not entitled to claim input tax credits for any GST paid on goods and services supplied to him for the purpose of his business. The "sale and lease of residential properties" and "financial services" are exempt from GST in Singapore.

[*Source : http://www.mof.gov.sg*]

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GST - ROLE OF CHARETRED ACCOUNTANTS

A Chartered Accountant is, by virtue of his academic knowledge and practical training, well equipped to play a pivotal role as an advisor and facilitator for due compliances of law relating to goods and services tax to the general business community. The nature of services can be:

(i) Restructuring of Business System

Under the proposed GST, taxes would be levied on destination base as compared origin base in the existing excise and VAT law. The business would require restructuring their system to minimise taxation and require the services of Chartered Accountants for the same.

(ii) Tax planning

In order to establish an efficient plan for purchases and sales, a careful study of VAT is required. A Chartered Accountant is competent to analyze the impact of various alternatives and choose the most optimum way of doing business in order to minimize the tax impact.

(iii) Advisory services

A chartered accountant is a qualified, competent and knowledgeable professional who can interpret the proposed GST law and may provide required guidance and advisories to the business.

(iv) Audit of books of account

The return under the proposed GST is expected to be assessed on 'self-assessment' basis meaning thereby that the tax liability calculated and paid by the tax payers through their periodical returns will be accepted by and large and the tax payers will not be called to substantiate the tax liability shown by them in the returns by producing books of account and other relevant material. The assessments with books of account will be an exception. Thus, a check on compliance becomes necessary. Chartered Accountants can play a very vital role in ensuring tax compliance by audit of VAT accounts.

(v) Certification work

A Chartered Accountant can certify the record/documents required by the various authorities and Banks.

(vi) Procedural Compliances

Like present tax law, assessee would be required to do the following under the proposed GST law:

- Registration;
- Filing of Returns;
- Payment of taxes and;
- Assessment etc.

A Chartered Accountant is well equipped to assist the business entities in ensuring all the above the necessary legal compliances.

(vii) Record keeping

GST would require proper record keeping and accounting. Systematic records of credit of input/input service and its proper utilisation is necessary for the success of GST. Chartered Accountants are well equipped to perform such tasks.

(viii) Negotiations with suppliers

Credit of input/input service would alter cost structure of goods/services supplied as input/input services. A Chartered Accountant will ensure that the benefit of such cost reduction is passed on by the suppliers to his company. However, if the buyers of his company make the similar demand, he must be ready with full data to resist the claims.

(ix) Personal Representation

At present, a Chartered Accountant is allowed to appear before the VAT, Excise, Service Tax, Customs authorities and are fully equipped professional to represent his /her clients before the GST authorities too as and when required.

(x) Appellate work

At present, a Chartered Accountant is allowed to file and contest the appeals on the legal and factual issues before Commissioner (Appeals) and Appellate Tribunals of VAT, Service Tax, Customs and Excise for and on behalf of his clients. In GST regime, a Chartered Accountant can play this role also.

(xi) Authoring book

The experienced members of accountancy profession may also play a significant role by authoring books on GST which may help other professional members in understanding the GST law.

B-1
WORKING PAPER ON GST – DEPTT. OF ECONOMIC AFFAIRS[1]

GST REFORMS AND INTER-GOVERNMENTAL CONSIDERATIONS IN INDIA

[Source : www.finmin.nic.in]

1. Introduction

The replacement of the state sales taxes by the Value Added Tax in 2005 marked a significant step forward in the reform of domestic trade taxes in India. Implemented under the leadership of Dr. Asim Dasgupta, Chairman, Empowered Committee of State Finance Ministers, it addressed the distortions and complexities associated with the levy of tax at the first point of sale under the erstwhile system and resulted in a major simplification of the rate structure and broadening of the tax base. The State VAT design is based largely on the blueprint recommended in a 1994 Report of the National Institute of Public Finance and Policy, prepared by a team led by late Dr. Amaresh Bagchi (hereinafter, the "Bagchi Report").[2]In recommending a State VAT, the Bagchi Report clearly recognized that it would not be the perfect or first best solution to the problems of the domestic trade tax regime in a multi-government framework. However, the team felt that this was the only feasible option within the existing framework of the Constitution and would lay the foundation for an even more rational regime in the future.

Buoyed by the success of the State VAT, the Centre and the States are now embarked on the design and implementation of the perfect solution alluded to in the Bagchi Report. As announced by the Empowered Committee of State Finance Ministers in November 2007, the solution is to take the form of a 'Dual' Goods and Services Tax (GST), to be levied concurrently by both levels of government.

The essential details of the dual GST are still not known. Will it necessitate a change in the Constitutional division of taxation powers between the Centre and the States? Will the taxes imposed by the Centre and the States be harmonized, and, if so, how? What will be treatment of food, housing, and inter-state services such as transportation and telecommunication? Which of the existing Centre and State taxes would be subsumed into the new tax? What will be the administrative infrastructure for the collection and enforcement of the tax? These are issues which ultimately define the political, social, and economic character of the tax and its impact on different sectors of the economy, and households in different social and economic strata.

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[1] By Satya Poddar and Ehtisham Ahmad.
[2] Bagchi, Amaresh et al (1994).

It is some of these aspects of the proposed GST that are the subject matter of this paper. We focus on the essential questions relating to the Dual GST design, and first discuss the need for, and the objectives of GST reform. We then describes alternatives to the Dual GST already endorsed by the Empowered Committee, not because they are superior in any way to the Dual GST, but to allow a fuller discussion of the trade-offs involved in the choice among them. Subsequent sections consider the question of tax base and rate, and proper treatment of various components of the tax base (e.g., food, housing, and financial services) in light of international best practices. The last section provides a discussion of the issues that arise in the taxation of cross-border transactions, both inter-state and international. An important question in this regard is the feasibility of, and the rules for, taxation of inter-state supplies of services.

2. The Current Taxes and Their Shortcomings

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 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.[1]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.[2]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.[3]

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[4](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.

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[1] A detailed discussion of the problems can be found in the Bagchi Report.

[2] See Ahmad and Stern (1984) for the definition of effective taxes and applications to India. Bagchi (1994) provides estimates of effective excise tax rates, which are shown to vary from less than one percent to more than 22%.

[3] For example, these were precisely the reasons for the replacement of the federal manufacturers' sales tax by the Goods and Services Tax in 1991. See Canada Department of Finance (1987), and Poddar, Satya and Nancy Harley (1989).

[4] The Constitution (46th Amendment) Act 1982 amended Article 366 (29A) of the Constitution to deem a tax on six items to be a tax on the sale or purchase of goods.

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 (although see Ahmad and Stern 1984 and 1991, and Bagchi for earlier work), 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.[1]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 favor 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

[1] Kuo, C.Y., Tom McGirr, Saya Poddar (1988), "Measuring the Non-neutralities of Sales and Excise Taxes in Canada", Canadian Tax Journal, 38, 1988, provide estimates of tax cascading under the Canadian federal manufacturers' sales tax and the provincial retails sales taxes.

defined to include all services, with a limited list of exclusions (the so-called "negative list").[1]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 under both 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.

3. Objectives of Tax Reform

A. Basic Objectives

The basic objective of tax reform would be to address the problems of the current system discussed above. It should establish a tax system that is economically efficient and neutral in its application, distributionally attractive, and simple to administer.

As argued in Ahmad and Stern (1991), distributional or sectoral concerns have been at the heart of the excessive differentiation of the Indian tax system—but that the objectives are negated by the cascading effects of the taxes. While an optimal design of the consumption tax system, taking into account both production efficiency and distributional concerns, would not imply uniformity of the overall tax structure, the desired structure can be achieved by a combination of taxes and transfers.

Ahmad and Stern (1991) analyze the optimal pattern of tax rates implied by a given degree of aversion to poverty and concern for the poor. At high levels of concern for the poor, one would reduce the tax

[1] For a detailed discussion of the flaws of the current approach to taxation of services, see Rao (2001), which recommended replacement of taxation of selected services by a general tax on all services (other than excluded services).

on cereals (but not dairy products) and increase the taxes on non-food items (durables). Thus, a differentiated overall structure appears desirable for a country in which the government has consistently expressed a concern for the poor. However, individual taxes should not be highly differentiated, as that complicates administration and makes it difficult to evaluate the overall effects of the tax design. This applies particularly to value-added type of taxes. In principle, a single rate (or at the most two-rate) VAT, together with excises and spending measures could achieve the desired distributional effects, for reasonable degrees of inequality aversion of policy makers.

In particular, it is important from an administrative perspective that close substitutes should not be taxed at very different rates—to avoid leakages and distortions. Revenue considerations suggest that the tax base should be broad, and comprise all items in the consumer basket, including goods, services, as well as real property.

The neutrality principle would suggest that:

- the tax be a uniform percentage of the final retail price of a product, regardless of the supply-chain arrangements for its manufacturing and distribution;
- the tax on inputs be fully creditable to avoid tax cascading; and
- the tax be levied on the basis of the destination principle, with all of the tax on a given product/service accruing in the jurisdiction of its final consumption.

Multiple VAT rates become a source of complexity, and disputes, for example, over borderlines, adding to the costs of tax administration and compliance. It is for this reason that countries like New Zealand, Singapore, and Japan have chosen to apply the tax at a low and uniform rate, and address any concerns about vertical equity through other fiscal instruments, including spending programs targeted to lower-income households.[1]

Another important objective of tax reform is simplification of tax administration and compliance, which is dependent on three factors. The first determining factor for simplicity is the tax design itself. Generally, the more rational and neutral the tax design, the simpler it would be to administer and encourage compliance. If the tax is levied on a broad base at a single rate, there would be few classification disputes and the tax-specific record keeping requirements for vendors would be minimal. The tax return for such a system can be as short as the size of a postcard. It would simplify enforcement, and encourage voluntary compliance.

The second factor is the infrastructure for tax administration, including the design of tax forms, data requirements, system of tax rulings and interpretations, and the procedures for registration, filing and processing of tax returns, tax payments and refunds, audits, and appeals. A modern tax administration focuses on providing services to taxpayers to facilitate compliance. It harnesses information technology to enhance the quality of services, and to ensure greater transparency in administration and enforcement.

[1] Canada provides a refundable tax credit, GST Credit, lower-income households through the personal income tax system. The credit is paid in quarterly installments and income -tested for higher-income households.

The third factor in a federation such as India is the degree of harmonization among the taxes levied by the Centre and the States. The Empowered Committee has already indicated a preference for a dual GST, consisting of a Centre GST and a State GST. Under this model, harmonization of the Centre and State GSTs would be critical to keep the overall compliance burden low. Equally important is harmonization of GSTs across the states.

B. Fiscal Autonomy and Harmonization

An important consideration in the design of reform options is the degree of fiscal autonomy of the Centre and the States. It goes without saying that the power to govern and to raise revenues go together. The Constitution of India lays down a clear division of powers between the Centre and the States, including the power to levy taxes. Should the Centre and the States then have complete autonomy in levying and collecting the taxes within the parameters specified in the Constitution, or should they voluntarily or otherwise conform to certain common principles or constraints? Should they collectively agree to have their individual taxes consolidated into a single national tax, the revenues from which get shared in some agreed manner among the constituent units? Such a system would have much to commend itself from the perspectives of economic efficiency and the establishment of a common market within India. Indeed, such political-economy compromises have been adopted by China and Australia. China moved to a centralized VAT with revenue sharing with the provinces — ensuring that provinces got as much revenues as under the prior arrangements, plus a share of the increment. In Australia, the GST is a single national levy and all the GST revenues collected by the Center are returned to the states. However, such a compromise is unlikely to find much favor with the States in India, as is already revealed in their preference for the Dual GST.

To give political substance to the federal structure in India, the States (as well as the Centre) are likely to insist that they have certain autonomy in exercise of their taxation powers. Full autonomy would mean that: -

- retain the power to enact the tax,
- enjoy the risks and rewards of 'ownership' of the tax (i.e., not be insulated from fluctuations in revenue collections),
- be accountable to their constituents, and
- be able to use the tax as an instrument of social or economic policy.

Notwithstanding the above, there is a clear recognition of the need for harmonization of the Centre and State Taxes. Fiscal autonomy is important to allow the Centre and the States to set the tax rates according to their revenue needs. Harmonization of tax laws and administrative procedures is needed to simplify compliance and enforcement. It is also necessary to ensure that inter-state differences in policies and procedures do not generate additional economic distortions. An important question then is the desired degree of harmonization and the mechanism for achieving it.

The elements of harmonization can be divided into three broad sets: tax rates, tax base and tax infrastructure, i.e., the administration and compliance system. The first two elements could be viewed as important levers on which States would want to have some degree of control to achieve their social, economic, and fiscal policy objectives. However, the experience of other countries as well as their sub-national governments suggests that changes to the GST base are not a suitable instrument for social and economic policy (as discussed in greater detail in a later section in considering the treatment of food). While the tax base is a subject of intense debates at the time the tax is introduced, changes in the base after its introduction have been infrequent. This has especially been the case where the tax was initially levied on a broad and comprehensive base. Where the tax was initially levied on a narrow base, subsequent changes in the base have then been felt necessary to minimize anomalies, distortions, and revenue leakages created by the narrow base. Achieving such changes once the tax has been brought in, however logical, is invariably politically contention because of vested interests. It is thus important to get the structure right at the outset, as the base (and quite often the rate) cannot be easily changed, *ex post facto*.

The VAT in the European Union is an example reflecting these policy considerations. The base for the EU VAT is uniform, as codified in the EU Directive[1], which is binding in all Member States. There are important variations in the base, but these are essentially in the form of derogations granted for the arrangements existing at the time of introduction of the tax, and were intended to be temporary (though this has not always been the case). The tax rates are specified as floor rates (with some provision for reduced rates and maximum rates), below which Member States cannot set their rates.

Administration and compliance is an area where the need for harmonization is the greatest, and where Centre-State or inter-state variations are unlikely to serve any social or economic policy objective. This includes items such as the taxpayer registration system, taxpayer identification numbers, tax forms, tax reporting periods and procedures, invoice requirements, cross-border trade information systems and IT systems. Harmonization of these elements would result in significant savings in costs of implementing the GST (by avoiding duplication of effort in each government), as well as recurring savings in compliance costs. Harmonization would also permit sharing of information among governments, which is essential for effective monitoring of cross-border transactions. A common set of tax identifier numbers across States and the Central Government is a key element in the efficient exchange of information.

Harmonization of tax laws is also critical. Variation in the wording and structure of tax provisions can be an unnecessary source of confusion and complexity, which can be avoided by having the Centre and the States adopt a common GST law. An alternative is to agree on the key common elements if separate laws are chosen. Some of the critical elements for harmonization include common time and place of supply rules, as well as common rules for recovery of input tax, valuation of supplies and invoicing requirements. There would then be merit in harmonizing the system of tax interpretations and rulings as well (e.g., about classification of goods and services, determination of what constitutes taxable consideration, and definition of export and import).

These considerations suggest that harmonization of virtually all major areas of GST law and administration would be desirable. There is merit in keeping even the GST rate(s) uniform, at least

[1] The Commission Directive on the Common System of Value Added Tax, which replaced the Sixth Directive.

during the initial years until the infrastructure for the new system is fully developed (see Ahmad, Poddar et al, 2008 for the GCC proposals). Harmonized laws would mean lower compliance costs for taxpayers and may also improve the efficiency of fiscal controls.

The Central Sales Tax (CST) in India provides a very useful for model for such harmonization. The CST is a state-level tax, applied to inter-state sales of goods, based on the origin principle. The tax law (including the base, rates, and the procedures) is enacted by Parliament, but the States collect and keep the tax. It is a perfect example of absolute harmonization, with the States enjoying the risks and rewards of ownership of the tax.

It is worth emphasizing that harmonization should not be viewed as constraining the fiscal autonomy of the Centre or the States. Rather, this is a framework that facilitates more efficient exercise of taxation powers, and all jurisdictions would be worse off without harmonization. This was the case under the previous State sales tax system, under which inter-state tax rate wars became a race to the bottom. Even today, they all suffer because of lack of harmonization of information and technology architectures, as a result of which they are unable to share information on inter-state trade. Harmonization should allow greater exploitation of the benefits of a common market.

C. Centre and State Taxation Powers

As noted earlier, the current division of taxation of powers under the Constitution is constraining for both the Centre and the States. Neither is able to design a comprehensive and neutral tax on goods and services of the type found in modern tax systems. The Constitution divides taxation powers between the Centre and the States by sector (e.g., agriculture, manufacturing, and land and property) or type of taxes (e.g., luxury tax, tax on the sale or purchase of goods, and excise duty). A notable feature of the current division is that the two levels of government have no area of concurrent jurisdiction, with the exception of stamp duties. This approach, while it may have served the country well in the past, is no longer optimal for modern economies where the traditional dividing lines between sectors are blurred, and new social, environmental, and economic issues emerge which require new forms of taxation instruments. The need for a substantial realignment of taxation powers is also emphasized by Rao (2008):

> "Paradigm shift in tax policy is necessary to recognise that tax bases of central and state governments are interdependent. The principle of separation of tax bases followed in the Constitutional assignment does not recognise the interdependence. It is therefore desirable to provide concurrent tax powers to Centre and States in respect of both income and domestic consumption taxes. In the case of personal income tax, separation of tax powers between the centre and states based on whether the income is from agricultural or non-agricultural sector has been a major source of tax evasion. As agriculture is transformed into a business it is important to levy the tax on incomes received from all the sources both for reasons of neutrality and to minimise tax evasion. At the same time, both Centre and States could be allowed to levy the tax with the latter piggybacking the levy on the central tax subject to a ceiling rate. Similarly, it is important to unify multiple indirect taxes levied by the Central and State Governments into a single goods and services tax (GST) preferably with States piggybacking on the Central levy

> with clearly defined tax rooms for the two levels of government. The transition to such a concurrent tax system requires integrating the existing CENVAT and service taxes and extending the tax to the retail level which would, *inter alia*, entail amendment of the Constitution. The States could piggyback on the levy."

Thus, the current search for options for tax reform warrants a review of the existing Constitutional arrangements, which may well require a substantial realignment. For example, the dual GST would require giving the Centre and the States concurrent indirect taxation powers, subject to prohibition on extra-territorial taxation, i.e., that the incidence of tax be restricted to consumption within the territory of the taxing jurisdiction.[1]

While such a review is beyond the scope of this paper, our discussion of alternative options in the next section proceeds with the assumption that suitable constitutional amendments would be made to enable the implementation of the chosen option.

4. Options for the Centre and State GSTs

In defining options for reform, the starting point is the basic structure of the tax. For purposes of this discussion, we start with the assumption that any replacement of the current taxes would be in the form of a classical VAT, which is consumption type (allowing full and immediate credit for both current and capital inputs attributable to taxable supplies) and destination based (i.e., the tax levied on the basis of the place of consumption of the goods and services, not the place of production). Under this system, credits for input taxes are allowed on the basis of invoices issues by the vendors registered for the tax. This is the most common type of structure adopted around the world. Its superiority over other forms of consumption taxes is well accepted in India as well as other countries.

The choices that remain then relate essentially to the assignment of powers to levy the tax to the Centre and the States, and the tax base and rates. In the remainder of this section we deal with the question of assignment, and then turn to the question of tax base and rates in the next section.

The main options for the VAT assignments include:

- Concurrent Dual GST
- National GST and
- State GSTs.

All these options require an amendment to the Constitution. For the sake of completeness of discussion,

[1] The division of taxation powers between federal and provincial governments in Canada provides an interesting example of such concurrent powers. Under the Canadian Constitutions, the federal government can levy any tax, and the provinces have the power to levy any direct tax within the province. A tax is considered to be a direct tax if its incidence falls on the person on whom it is levied. Thus, it includes all forms of income and wealth taxes. A sales tax or VAT is also viewed to be a direct if it is levied on the buyer/consumer, but not on the vendor. The tax can be collected and remitted by the vendor, acting as an agent of the government, but it has to be levied on the buyer. As a result, the two levels of concurrent powers for all types of taxes, subject to the condition that the provincial taxes can only be levied on persons within the geographical boundary of the provinces.

we also consider an additional option, Non-concurrent Dual VAT, that does not require an amendment to the Constitution. We now discuss each of these options in turn below.

A. Concurrent Dual GST

Under this model, the tax is levied concurrently by the Centre as well as the States. Both the Central Government and the Empowered Committee appear to favor this model.

While full details of the model are still awaited, two variants have been identified in public discussions so far. The initial variant, discussed in November, 2007, entailed both the Centre and the States levying concurrently the GST on goods, but most of the services (except services of a local nature) remaining subject to the Centre GST only. The Central GST would thus apply to both goods and services, extending to the entire supply chain, including wholesale and retail trade. The State GSTs would largely be confined to goods only, with minor changes from the current State VATs.

Under the more recent variant,[1]both goods and services would be subject to concurrent taxation by the Centre and the States. This variant is closer to the model recommended by the Kelkar Committee in 2002.[2]

The main difference between the two variants is in the treatment of services, reflecting apprehensions about the feasibility of defining the place of supply (i.e., destination) of inter-state services. Even the more recent variant recognizes that there would be a set of inter-State services for which the place of destination would be difficult to determine. The State tax on these services would be collected by the Centre, and then apportioned among the States in some manner.

Other notable features of this variant are as follows:

- There would a single registration or taxpayer identification number, based on the Permanent Account Number (PAN) for direct taxation. Three additional digits would be added to the current PAN to identify registration for the Centre and State GSTs.
- States would collect the State GST from all of the registered dealers. To minimize the need for additional administrative resources at the Centre, States would also assume the responsibility for administering the Central GST for dealers with gross turnover below the current registration threshold of Rs 1.5 crores under the central Excise (CENVAT). They would collect the Central GST from such dealers on behalf of the Centre and transfer the funds to the Centre.
- Procedures for collection of Central and State GSTs would be uniform. There would be one common tax return for both taxes, with one copy given to the Central authority and the other to the relevant State authority.
- Other indirect taxes levied by the Centre, States, or local authorities at any point in the supply chain would be subsumed under the Central or the State GST, as long as they are in the nature of taxes on consumption of goods and services.

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[1] See Empowered Committee of State Finance Ministers (2008).

[2] Kelkar, Vijay, et al (2004).

At a broad conceptual level, this model has a lot to commend itself. It strikes a good balance between fiscal autonomy of the Centre and States, and the need for harmonization. It empowers both levels of government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain. It also eliminates tax cascading, which occurs because of truncated or partial application of the Centre and State taxes.

The apprehension about feasibility of application of State GST to inter-state services is understandable, given the complete absence of any framework in India for determining their place of supply. However, the task of developing such a framework is not insurmountable. In fact, such frameworks do already exist for application of national VAT to international cross-border services, which could be adapted for inter-state services. Canada has developed such a framework for application of provincial sales taxes or GST to services.

Another point to note is that inter-State services are provided predominantly by the organized sector (e.g., telecom and transportation services), which is generally tax compliant. Once the rules are framed, they would program their accounting and invoicing systems to collect and remit the tax accordingly.

Admittedly, there are inter-State services which have no unique place of supply. Take for example the supply of group health insurance to a corporation with employees throughout India, or auditing or business consulting services provided to a corporation or conglomerate with business establishments in several States. The determination of place of supply of such services is going to be somewhat arbitrary. However, such services are almost entirely B2B supplies, the tax on which is fully creditable to the recipient under a comprehensive taxation model. The arbitrariness in the rules would thus have no impact on the final tax collections of the Centre or the States.

The Empowered Committee proposal is silent on the treatment of land and real property transactions in the description of this option. Assuming this omission is deliberate, it is a major drawback of the option. As discussed further in the next section, modern VATs apply to all supplies, including supplies of land and real property. The Service Tax has already been extended to rentals of commercial property and construction services. There are no compelling social or economic policy reasons for excluding these services from the scope of the GST.

B. National GST

Under this option, the two levels of government would combine their levies in the form of a single national GST, with appropriate revenue sharing arrangements among them. The tax could be controlled and administered by the Centre, States, or a separate agency reporting to them. There are several models for such a tax. Australia is the most recent example of a national GST, which is levied and collected by the Centre, but the proceeds of which are allocated entirely to the States.[1]

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[1] The Australian Constitutional situation is that both the States and the Commonwealth (the Federal Government) have power to tax supplies of goods and services. The Constitution prevents laws interfering with interstate trade (including tax laws) and gives the power to collect Customs and excise taxes exclusively to the Federal Government. It is forbidden for the Commonwealth to tax State Property. To meet this requirement, the GST implementation laws, of which there are 6, simply state that they do not impose tax on State properties and the States accept that

In China, the VAT law and administration is centralized, but the revenues are shared with the provinces. In going to this model, the Centre had assured the provinces that they would continue to get what they did under the previous arrangement and those changes in revenue shares would be phased in over an extended period of 15 years—see Ahmad 2008.

Under the Canadian model of the Harmonized Sales Tax (HST), the tax is levied at a combined Federal and Provincial rate of 13 percent (5% federal rate, 8% provincial rate) in the three participating provinces. Tax design and collection are controlled by the Centre, but the provinces have some flexibility to vary their tax rate. The revenues from the tax are shared among the participating provinces on the basis of consumer expenditure data for the participating provinces.

In Austria, and Germany, the tax design is controlled by the Centre, but States collect the taxes. This has led to incentive problems, as some of the Länders have begun to use tax administration measures to achieve tax policy goals. In Mexico, the establishment of a VAT at the Center replaced State sales taxes, but had to be part of a political-economy compromise that assured the states an automatic share of the revenues generated from all federal taxes.

A single national VAT has great appeal from the perspective of establishment and promotion of a common market in India. However, the States may worry about the loss of control over the tax design and rates. Indeed, some control over tax rates is a critical issue in achieving accountable sub-national governance and hard budget constraints (Ambrosiano and Bordignon, 2006). The States may also be apprehensive that the revenue sharing arrangements would over time become subject to social and political considerations, deviating from the benchmark distribution based on the place of final consumption. The Bagchi Report also did not favor this option for the fear that it would lead to too much centralization of taxation powers.

These concerns can be addressed partially through suitable administrative arrangements and Centre-State agreements. The tax design could be made subject to joint control of the Centre and the States. The States would necessarily lose the flexibility of inter-state variation in tax design, but that is also the perceived strength of this option. Given that the Centre does not have the machinery for the administration of such a tax, the States would presumably play a significant role in its administration. The revenue sharing formula could also be mandated to be based on the destination principle, as under the Canadian HST.

The key concerns about this option would thus be political. Notwithstanding the economic merits of a national GST, will it have a damaging impact on the vitality of Indian federalism? With no other major own-source revenues, will individual States become too dependent on collective choices and feel dis-

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view, at least at the moment. The GST was introduced on the pretence that it was a State tax being collected by the Commonwealth in order to (a) secure the States' agreements to abolish some of their preexisting transaction taxes, in particular certain stamp duties, financial institutions duties, etc and (b) to ensure that the States wouldn't start a round of attempts to challenge the constitutional validity of the law (as was done, unsuccessfully, in the past with income tax, which both States and Commonwealth also have power to collect. The current Government has acknowledged that GST is in fact simply a Federal Tax that it uses to make grants to the States and as a result of this acknowledgement, the Auditor General has for the first time since 2000 agreed to approve the Commonwealth accounts.

empowered to act on their priorities? Will it be possible for the governments with such diverse political interests and philosophies to reach a consensus and adhere to it?

While one can have a healthy debate on each of these issues, international experience suggests that discretionary use of broad-based consumption taxes for social, political, or economic policy purposes tends to be limited. The dominant consideration in their design is their neutrality and efficiency in raising revenues. This is also reflected in the design of the State VATs in India. In spite of vast political and economic differences among them, States have been able to forge a consensus on a common VAT design. A national GST would extend this consensus to the Centre. But participation of the Centre could fundamentally alter the delicate balance of interests that currently prevails in the Empowered Committee and make the consensus harder to achieve.

C. State GSTs

Under this option, the GST would be levied by the States only. The Centre would withdraw from the field of general consumption taxation. It would continue to levy income taxes, customs duties, and excise duties on selected products such as motor fuels to address specific environmental or other policy objectives. The loss to the Centre from vacating this tax field could be offset by a suitable compensating reduction in fiscal transfers to the States. This would significantly enhance the revenue capacity of the States and reduce their dependence on the Centre. The USA is the most notable example of these arrangements, where the general sales taxes are relegated to the states.

There would be significant hurdles in adopting this option in India. First, it would seriously impair the Centre's revenues. The reduction in fiscal transfers to the States would offset this loss, but still the Centre would want to have access to this revenue source for future needs. Second, the option may not be revenue neutral for individual States. The incremental revenues from the transfer of the Centre's tax room would benefit the higher-income states, while a reduction in fiscal transfers would impact disproportionately the lower-income states. Thus the reform would be inequality enhancing—and against the traditions of successive governments in India (of all political shades). Third, a complete withdrawal of the Centre from the taxation of inter-state supplies of goods and services could undermine the States' ability to levy their own taxes on such supplies in a harmonized manner. In particular, it would be impractical to bring inter-state services within the ambit of the State GST without a significant coordinating support from the Centre.

D. Non-concurrent Dual VATs

Under the concurrent dual GSTs, the Centre and State taxes apply concurrently to supplies of all goods and services. It poses two challenges. First, it requires a Constitutional amendment. Second, a framework is needed for defining the place of supply of inter-state services and for the application of State GST to them. Both of these hurdles can be circumvented if the GST on goods were to be levied by the States only and on services by the Centre only. The States already have the power to levy the tax on the sale and purchase of goods (and also on immovable property), and the Centre for taxation of services. No special effort would be needed for levying a unified Centre tax on inter-State services.

This option would not address any of the deficiencies of the current system identified in Section 2 above, if the taxes on goods and services were to be levied in an uncoordinated manner as two separate partial taxes. It would perpetuate the difficulties in delineating supplies of goods and services, and compound tax cascading.

The main appeal of this option is as a variant of the State GST option discussed immediately above. In levying the VAT on services, the Centre would essentially play the coordinating role needed for the application and monitoring of tax on inter-state services. The Centre would withdraw from the taxation of goods. Even the revenues collected from the taxation of services could be transferred back to the States, partially or fully.

Within this framework, cascading could be completely eliminated by the States agreeing to allow an input credit for the tax on services levied by the Centre. Likewise, the Centre would allow an input credit for the tax on goods levied by the States.

The discussion above suggests that the design of a GST is going to be a challenge, regardless of the option chosen. All options require significant Centre-State coordination and harmonization, and there may be very little room for variance in rate setting by States at least in the near future. The best option would appear to be a national GST (either through the constitution or on a voluntary basis), with an appropriate Centre-State and inter-State revenue sharing arrangement. If a framework for taxation of inter-state services can be devised, then the concurrent dual VAT could be the most supportive of the objective of fiscal autonomy. To ensure harmonization of tax base, rules and procedures, it would be desirable to have a single common legislation enacted by Parliament, following the model for the CST. The law would delegate the collection of tax to the Centre and States on their respective tax bases, i.e., the Centre to collect the central GST on supplies of goods and services anywhere in India, and the States to collect the State GST on supplies within their states (as per the place-of-supply rules specified in the legislation).

5. Tax Base and Rates

We turn now to the question of the tax base and rates, within the broad structure of a consumption-type, destination-based, credit-invoice GST. Ideally, the tax should be levied comprehensively on all goods and services at a single rate to achieve the objectives of simplicity and economic neutrality. However, governments often deviate from this ideal either because of concerns about distribution of tax burden (e.g., food), or because of administrative and conceptual difficulties in applying the tax to certain sectors of the economy (e.g., health care, education, and financial services). These concerns are likely to be paramount at both Centre and State levels and there will inevitable be calls to exempt, or tax at a reduced rate, items of importance to the poor or other particular groups.

As noted earlier, reduced rates or exemptions for basic necessities may not be an efficient way of helping the poor, because of a significant spillover of their benefits to the rich. Although the rich spend a smaller *proportion* of their income on such goods than do the poor, because their income is higher they are also likely to spend a larger *absolute* amount. As a result, the rich might gain most from applying a reduced tax rate to such goods. The needs of the poor could be more effectively addressed through spending and transfer programs. Distributional concerns should be seen as part of the overall balance of all fiscal instruments and not solely for the GST. Moreover, multiple rates and exemptions increase the costs of administration and compliance. They give rise to classification disputes, necessitate additional record keeping, and create opportunities for tax avoidance and evasion through misclassification of sales.

Notwithstanding the virtues of a single-rate and comprehensive base, debates about the proper treatment of food and a variety of other items are inevitable. In what follows, we discuss some of the most critical aspects this debate, starting with a discussion of the revenue neutral tax rates in the absence of any exemptions or other preferences.

A. Tax Rates

In discussions on the GST design for India, it has been suggested that the tax would need to be levied at a combined Centre-State tax rate of 20 percent, of which 12% would go to the Centre and 8% to the states (vide, for example, the Kelkar Task Force Report). While they fall below the present combined Centre and State statutory rate of 26.5% (CENVAT of 14%, and VAT of 12.5%), GST at these rates would encounter significant consumer resistance, especially at the retail level, and would give rise to pressures for exemptions and/or lower rates for items of daily consumption. With the notable exception of Scandinavian countries, where the tax is levied at the standard rate of 25%, few countries have been successful in levying and sustaining a VAT/GST at such high rates.

Successful GST models adopted by other countries had a very broad base and a relatively modest tax rate, especially at the time of inception. For example, the New Zealand GST was introduced at the rate of 10%, with a base consisting of virtually all goods and services (with the exception of financial services). The Singapore GST was introduced at 3%, but the rate has now been raised to 7% as inefficient excises and customs duties have been progressively eliminated.

Table 1 provides a comparison of the tax base and rates in selected international jurisdictions with 'modern' VAT/GST. It provides data on C- efficiency, which is a widely-used measure of the comprehensiveness of the tax base. It is calculated as the ratio of the share of GST revenues in consumption to the standard rate. Any deviation from a 100 percent C-efficiency indicates deviation from a single tax rate on all consumption. Zero-rating of some consumption items would lead to a C-efficiency of less than 100 percent while inclusion of investment or a break in the GST chain could lead to a C-efficiency higher than 100 percent. While a C-efficiency of 100 does not imply a perfect VAT, it can serve as a useful indicator of the productivity of GST revenue per percentage point of GST rate. The last column in the table shows revenue productivity of GST in these countries, measured as GST revenues per point of the standard rate divided by the GDP (i.e., (Aggregate Revenues/Standard Rate)/GDP).

Table 1

Comparison of GST Base and Rates, Selected Jurisdictions					
Country	*Year*	*Standard Rate %*	*Consumption % of GDP*	*C-Efficiency*	*Revenue Productivity*
Canada	2005	7	74.8	0.46	0.34
Japan	2004	5	75.5	0.67	0.50
New Zealand	2005	12.5	76.0	0.94	0.73
Singapore	2004	5	54.2	0.70	0.40

[*Source: Various IMF reports and authors' own estimates*]

As shown in Table 1, the New Zealand GST, which is levied at a single rate on virtually all goods and services, has the highest C-efficiency. The Canadian GST, also levied at a single rate, has low C-efficiency because of zero-rating of food and medicines, and rebates for housing and non-profit sector. Japan and Singapore levy tax at a single rate to a comprehensive base, including food. Yet, their C-efficiency is lower than in New Zealand mainly on account of exemptions for supplies by non-profit organizations. The C-efficiency of European VATs is generally much lower, in the range of 50%, as these taxes are levied at multiple rates, and with exemption for land and housing, financial services, and supplies by public bodies. In general, VATs that have been introduced around the world in the last few years have a higher C-efficiency than the 'old' VATs.

A low C-efficiency translates into lower revenue productivity of tax, as shown in the last column of the table.

With this background, we turn to an estimation of the size of the GST base in India and the GST rates that would be required to replace the current indirect tax revenues of the Centre and the States.

Poddar and Bagchi (2007) calculations show that if the GST were to be levied on a comprehensive base, the combined Centre-State revenue neutral rate (RNR) need not be more than 12%. This rate would apply to all goods and services, with the exception of motor fuels which would continue to attract a supplementary levy to maintain the total revenue yield at their current levels.

Here are some basic ingredients of the RNR calculations for 2005-06, the latest year for which the necessary data are available. The total excise/service tax/VAT/sales tax revenues of the Centre and the States in that year was Rs.134 thousand crore and Rs. 139 thousand crore respectively. Assuming that approximately 40% of the central excise revenues and 20% of the state VAT/sales tax revenues are from motor fuels, the balance of the revenues from other goods and services that need to be replaced by the GST are Rs 89 thousand crore for the Centre and Rs 111 thousand crore for the states, making up a total of Rs 200 thousand crore.

In 2005-06, the total private consumer expenditure on all goods and services was Rs. 2,072 thousand crore at current market prices. Making adjustments for sales and excise taxes included in these values and for the private consumption expenditure on motor fuels, the total tax base (at pre-tax prices) for all other goods and services is Rs 1763 thousand crore.

These values yield a revenue neutral GST rate of approx. 11% (200 as percent of 1763 is 11.3%). The RNR for the Centre is 5% and for the states 6.3%. Allowing for some leakages, the combined RNR could be in the range of 12%. The Centre excise duty rates have been reduced substantially (the standard rate reduced from 16% to 10%) since 2005. At the current duty rates, the Centre RNR is likely to be in the range of 3%, bringing the combined RNR to below 10%.

These estimates are by no means precise. Even so, they give a broad idea of the levels at which the rate of a national GST could be set to achieve revenue neutrality for both levels of government. An important question for policy makers is the costs and benefits of deviating from this benchmark of single rate GST. While there would be pressing calls for all kinds of exemptions and lower rates, the economic benefits of a single rate are enormous. The experience of countries like New Zealand, Japan and Singapore suggests that it is feasible to resist such calls by keeping the tax rate low. There is increasing political support for such an option. It would mark a clean break from the legacy structures and herald a new era of simple and transparent tax administration.

There is virtue in keeping the GST rate in the 10% range, especially at inception. Any revenue shortfall at this rate could be made up by the use of supplementary excises on select demerit goods (e.g., tobacco, and alcohol), besides motor fuels. Excises could also be used for select luxury items which do already attract tax at higher rates. This would help minimize undesirable shifts in the distribution of tax burden (see the discussion in Ahmad and Stern, 1984 and 1991). Clearly, such excises should be limited to a very small list of items which are discrete and not amenable to tax avoidance and evasion.

B. Food

The main issue in the application of GST to food is the impact it would have on those living at or below subsistence levels. In 2005, data, food accounted for one-third of total private final consumer expenditures. For those at the bottom of the income scale, it doubtless accounts for an even higher proportion of total expenditures and incomes. Taxing food could thus have a major impact on the poor. By the same token, a complete exemption for food would significantly shrink the tax base.

There are additional considerations that are pertinent to the treatment of food.

- Food includes a variety of items, including grains and cereals, meat, fish, and poultry, milk and dairy products, fruits and vegetables, candy and confectionary, snacks, prepared meals for home consumption, restaurant meals, and beverages. In most jurisdictions where reduced rates or exemptions are provided for food, their scope is restricted to basic food items for home consumption. However, the definition of such items is always a challenge and invariably gives rise to classification disputes. In India, basic food, however defined, would likely constitute the vast bulk of total expenditures on food.
- In India, while food is generally exempt from the CENVAT, many of the food items, including food grains and cereals, attract the state VAT at the rate of 4%. Exemption under the state VAT is restricted to unprocessed food, e.g., fresh fruits and vegetables, meat and eggs, and coarse grains. Beverages are generally taxable, with the exception of milk.
- In the rural sector, the predominant distribution channel for unprocessed food would be either a

direct sale by the farmer to final consumers or through small distributors/retailers. Even where food is within the scope of the GST, such sales would largely remain exempt because of the small business registration threshold.

- Given the large size of farm community in India, which is mostly unorganized, consideration needs to be given to whether it is advisable to exempt (with no right of input tax deduction) all unprocessed farm produce sold by them at the farm gate. In the case of cash crops (produce for further manufacturing or processing, e.g., cotton, coffee beans, and oil seeds), it would not be in the interest of the farmers to be exempted from tax. They should thus be allowed the option of voluntary registration to pay the tax. It is recognized that an exemption for first sale at the farm gate would be difficult to administer and create inefficiencies in distribution and marketing of farm produce.

These considerations pose some difficult policy issues. Given that food is currently exempt from the CENVAT, the GST under a single-rate, comprehensive-base model would lead to at least a doubling of the tax burden on food (from 4% state VAT to a combined GST rate of 10-12%). It would call for some tangible measures to offset the impact on the lower-income households. One would be to limit the exemption only to cereals (see Table 1) as some of the other food items have lower distributional characteristics.

The alternative of exempting food altogether (or zero rating) would not be any better. First, the revenue neutral rate would jump from 10-12% to 18%. While the poor would pay less tax on food, they would pay more on other items in their consumption basket. Whether and to what extent they would be better off would depend on the composition of their consumption basket. The higher standard rate would, in turn, lead to pressures for exempting other items (e.g., medicines, books, LPG, and kerosene). Third, it could preclude unification of the tax rate on goods with that on services, which are currently taxable 12.36%. Imposition of tax rate at 18% on hitherto exempt services (e.g., passenger travel, health, and education) would encounter significant political resistance. Fourth, one cannot expect any improvement in taxpayer compliance at such high rates. To the contrary, greater visibility of the Centre tax at the retail level could have a negative impact on compliance. Thus, an exemption for food has the potential to totally unravel the simplicity and neutrality of GST.

One could consider a lower rate for food, instead of complete exemption. If the lower rate were to be 5%, the revenue neutral standard rate (based on 2005 rate structure) would be pushed up to 16%. This may be a reasonable compromise, provided all other goods and services are made taxable at the single standard rate of 16%. The risk is that the lower rate for food would become the thin edge of the wedge which would create irresistible demands for the opening the door wider.

An important question is the definition of food that would be eligible for the lower rate. To keep the base broad, and limit the preference to items of consumption by the lower-income households, the lower rate should be confined to 'unprocessed' food items (including vegetables, fruit, meat, fish, and poultry). Its scope can be further restricted by excluding from the preference food pre-packaged for retail sale. This definition would not be without problems, especially where the processing value added is small. For example, if wheat were taxable at 5% as unprocessed food, but flour taxable at 16% as processed food, it would encourage consumers to buy wheat and then have it processed into flour.

Overall, the preferred option would appear to be a single-rate, comprehensive-base GST. While no option is perfect, it has the advantage of simplicity and neutrality. As noted earlier, sales of unprocessed food in rural India would largely remain exempt under this option because of the small business exemption. The poor can be further insulated from its impact through direct spending programs, and/or exempt from tax any sales under the Public Distribution System (PDS).

C. Land and Real Property

Under the 'old' VATs (such as those in Europe), land and real property supplies are excluded from the scope of the tax. To minimize the detrimental impact of an exemption under a VAT, business firms are given the option to elect to pay tax on land real property supplies.

Under a modern GST/VAT (e.g., in Australia, New Zealand, Canada, and South Africa), housing and construction services are treated like any other commodity. Thus, when a real estate developer builds and sells a home, it is subject to VAT on the full selling price, which would include the cost of land[1], building materials, and construction services. Commercial buildings and factory sales are also taxable in the same way, as are rental charges for leasing of industrial and commercial buildings. There are only two exceptions: (1) resale of used homes and private dwellings, and (2) rental of dwellings:

- A sale of used homes and dwellings is exempted because the tax is already collected at the time of their first purchase, especially for homes acquired after the commencement of the tax. If the sale were to be made taxable, then credit would need to be given for the tax paid on the original purchase and on any renovations and additions after the purchase. Except where the prices have gone up, the net incremental tax on resale may not be significant. Theoretically, this system does create a windfall for the existing homes build and acquired prior to the commencement of the tax. In practice, the windfall is not significant as the home construction would have attracted other taxes on construction materials and services that prevailed at the time.
- Residential rentals are also exempted for the same reason. If rents were to be made taxable, then credit would need to be allowed on the purchase of the dwelling and on repairs and maintenance. Over the life of the dwelling, the present value of tax on the rents would be approximately the same as the tax paid on the purchase of the dwelling and on any renovation, repair, and maintenance costs. In effect (and as with other consumer durables), payment of VAT on the full purchase price at acquisition is a prepayment of all the VAT due on the consumption services that the house will yield over its full lifetime. A resale of a dwelling is exempted for the same reason: the tax was pre-paid when the dwelling was initially acquired.

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[1] Actually, in Australia and New Zealand, this is not always the case. In New Zealand, land (like any other "goods") is the subject of a deemed input tax credit under the "second hand goods" scheme, which has the effect that the tax on a development of land acquired from an unregistered person is the margin of the supplier. This provision affects mainly the land held by individuals outside a business at the commencement of the GST. Such land is permanently sheltered from tax, even where it subsequently enters a commercial supply chain. In Australia, a margin scheme for land is used to work out the taxable value in similar circumstances: the margin scheme operates as a second hand scheme and as a transitional rule to prevent the value of most (but not all) of the value of land as at 1 July 2000 entering into the tax base.

- Many private individuals and families own residential dwellings (including their homes and summer residences) which they may rent to others. They are generally not in the VAT system, so do not get a credit for the VAT paid when they initially acquire their new home. Nor do they claim any credit for any repairs or renovations they may have made to the existing homes. If the rental of such dwelling were subject to tax, owners should also be given a credit for the taxes paid on such costs—which would be complex, and difficult to monitor.

Thus, virtually all countries exempt long-term residential rents and resale of used residential dwelling. However, short-term residential accommodation (in hotels, for example) is normally subject to VAT. Any commission charged by the agents and brokers for the sale or rental of a dwelling are treated as a service separate from the sale or rental of the dwelling and attract tax regardless of whether paid by the buyer or the seller.[1]

Sale or rental of vacant land (which includes rental of car parking spaces, fees for mooring of boats and camping sites) is also taxable under the 'modern' VAT system.

It would make sense to incorporate these concepts in the design of GST in India as well.

- Conceptually, it is appropriate to include land and real property in the GST base. To exclude them would, in fact, lead to economic distortions and invite unnecessary classification disputes as to what constitutes supply of real property.
- In the case of commercial and industrial land and buildings, their exclusion from the base would lead to tax cascading through blockage of input taxes on construction materials and services. It is for this reason that even under the European system an option is allowed to VAT registrants to elect to treat such supplies as taxable.
- Housing expenditures are distributed progressively in relation to income and their taxation would contribute to the fairness of the GST.
- The State VAT and the Service Tax already apply to construction materials and services respectively, but in a complex manner. For example, there is significant uncertainty whether a pre-construction agreement to sell a new residential dwelling is a works contract and subject to VAT. Where the VAT does apply, disputes arise about the allocation of the sale price to land, goods, and services. While land is the only major element that does not attract tax, the tax rates applicable to goods and services differ, necessitating a precise delineation of the two. Extending the GST to all real property supplies, including construction materials and services, would bring an end to such disputes, simplify the structure, and enhance the overall economic efficiency of the tax.

One potential argument against the levy of GST to land and real property would be that they already attract the stamp duty. This argument can be quickly discarded as the purpose and structure of the stamp duty is quite different from that of the GST. Stamp duty is a cascading tax on each conveyance of title to real property, whereas the GST is a tax on final consumer expenditures. The GST does not

[1] Poddar (2009) provides a more detailed discussion of the options for taxation of housing under VAT/GST.

impinge on commercial property transactions, after taking into account the benefit of input tax credits. It does not result in tax cascading. Under the model described above, in the case of residential dwellings, the GST would apply to the first sale only. Thus, the two taxes cannot be viewed as substitutes. However, the application of GST to real property transactions does warrant a review of the structure and rates of stamp duties and registration fees. The rates should be lowered and the structure rationalized when the GST is introduced.

D. Non-profit Sector and Public Bodies

Historically, supplies made by governmental bodies and non-profit organizations (including religious institutions, social welfare agencies, and sports and cultural organizations) have been exempted from VAT on the grounds that such bodies are not engaged in a business and their activities are not commercial in nature. But this is often, and increasingly, not the case. Public enterprises are involved in a wide range of industrial and commercial activities. As deregulation proceeds, the dividing line between public administration and industrial/commercial activities becomes increasingly blurred. For example, postal and telecommunication services were historically viewed as public administration, but this is no longer the case. Government agencies/ enterprises provide such services in competition with private firms. The same is true for other activities such as local and inter-city transit, operation of airports, radio and television broadcasting, and provision of water, sewer, and sanitation services. Moreover, the public sector in India, as in many other countries, is large and pervasive.

Under the EU VAT Directive, activities of the public sector are divided into three categories: non-taxable, taxable, and exempt. A public body is in principle eligible to claim input tax deductions only in respect of the VAT paid on inputs acquired for use in making taxable supplies (though a number of member states pay refunds of VAT by matching grant). While this approach may have provided the EU Member States with the needed flexibility in dealing with their domestic environment, it falls short of achieving the principal criteria of an efficient VAT system identified above. The exempt or nontaxable status of a wide range of supplies by public bodies violates the criterion of economic neutrality. Biases are created in favor of the self-supply of services within the public sector to minimize the amount of non-deductible VAT on inputs. Consumers may be influenced in their purchasing decisions by the fact that the VAT does not apply to certain public sector goods and services. The non-deductible input VAT embedded in the prices of public sector goods and services is passed along to persons in the production-distribution chain who are not final consumers.

The application of a value added tax requires identification of a supply and the consumer or buyer to whom the supply is made, and valuation of consideration for the supply.

Determination of each of these elements gives rise to issues in the public sector due to the nature of the way services are delivered by governments and the manner in which the services are funded. For example, a public body may provide its services for no explicit charge (e.g., museum admissions, water, health, and education) and there may not be any identifiable buyer or consumer for certain services provided on a collective basis (e.g., sanitation, and police protection). In addition, the political sensitivity to the taxation of certain services, and the methods of inter-governmental funding may detract from a neutral application of tax to the public sector activities. As a result, the public sector is subject to special rules in almost all VAT systems currently in place throughout the world.

This is a matter that cannot be dealt with satisfactorily without a systematic review of all of the activities of the governmental bodies and non-profit organizations. However, at this stage it is useful to describe the two broad approaches that other countries have followed.

First, the highly-regarded VAT system in New Zealand (and later Australia[1]) treats all activities of public sector and non-profit bodies as fully taxable[2]. They thus collect the VAT on all of their revenues, with the sole exception of revenues from taxes, interest and dividends, and gifts and charitable donations. Under this broad and comprehensive approach, no distinction is made between public administration and commercial/ industrial activities of the state or non-profit organizations. By the same token, these bodies are eligible to claim a full credit for their input VAT in the same manner as private enterprises. This system is conceptually simple, and consequently is in some respects easy to operate. And—by putting public and private sectors on an equal footing—it minimizes potential distortions of competition. In Australia, certain basic medical and educational supplies, and supplies by non-profit organizations below market value (i.e., subsidized supplies) are zero-rated.[3]Other supplies are taxable under the standard GST rules, as in New Zealand.

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[1] The Australian system is structured quite different from the New Zealand one, even though the net outcome is similar. New Zealand's GST is designed to tax all flows of money through the Government, whereas Australia's is complicated by the Federal Structure. The Commonwealth does not in fact pay GST or claim ITCs--it just does so notionally--, whereas the States actually do pay and claim. New Zealand taxes appropriations, whereas Australian says that they are not taxed. In addition, a range of Government provided services are GST-free or exempt.

[2]See Peter Barrand (1991), for a description of the New Zealand system. Aujean, Michel, Peter Jenkins and Satya Poddar provide an analytical framework for such a system.

[3] Zero-rated (called GST-free) supplies are defined as follows:

38-7 Medical services

(1) A supply of a medical service is GST-free.

(2) However, a supply of a medical service is not GST-free under sub-section (1) if:

(a) it is a supply of a professional service rendered in prescribed circumstances within the meaning of regulation 14 of the Health Insurance Regulations made under the Health Insurance Act 1973 [other than the prescribed circumstances set out in regulations 14(2)(ea), (f) and (g)]; or

(b) it is rendered for cosmetic reasons and is not a professional service for which Medicare benefit is payable under Part II of the Health Insurance Act 1973.

[Medical services are defined by cross-reference to services covered by a health and health insurance law]

38-85 Education courses

A supply is GST-free if it is a supply of:

(a) an education course; or

(b) Administrative services directly related to the supply of such a course, but only if they are supplied by the supplier of the course.

['Education course' defined as a course leading to a diploma or degree from a primary, secondary or tertiary school with cross-references to recognition by the appropriate State education authority]

38-250 Nominal consideration etc.

(1) A supply is GST-free if:

(a) the supplier is a charitable institution, a trustee of a charitable fund, a gift-deductible entity or a government school; and

(b) the supply is for consideration that:

(i) if the supply is a supply of accommodation – is less than 75% of the GST inclusive market value of the supply; or

(ii) if the supply is not a supply of accommodation – is less than 50% of the GST inclusive market value of the supply.

The second is the traditional approach followed in most other countries. Under this approach, the activities of public and non-profit bodies are divided into two lists: taxable and exempt. There are no simple or mechanical rules for this division, which in practice is based on a variety of economic, social, and practical considerations. For example, public enterprises engaged in industrial or commercial activities are generally taxable, especially if their revenues from their clients are expected to exceed their costs. Some countries exempt all other fees and charges, while others tax them on a selective basis (including postal charges, airport landing fees, port loading and unloading charges, sale of statistical and other publications, and fees for licenses and permits). Given that not all of the activities of an organization are considered taxable under this approach, an input tax credit is allowed for only those inputs that relate to the taxable activities of the organization.

This latter approach creates difficulties in determining what is taxable and what is exempt, and also in allocating the input taxes between the two (since credit would be given only in respect of taxable activities). It also creates a distortion in the form of a bias against the use of outside contractors by public bodies in their exempt activities. For example, if a municipality used a contractor for construction of a road or a bridge, it would pay the VAT on the contractor's fees, and not be eligible to claim a credit for the tax. However, it could avoid the tax if it hired its own employees to do the construction work. As noted above, some countries provide a full or partial rebate of the tax related to minimize this 'self-supply' bias.

There is little doubt that the New Zealand approach is conceptually superior. It does, however, lead to a larger number of taxpayers, many of which will be entitled to refunds. Since the management of refunds is an especially problematic aspect of the VAT, particularly in developing countries, the control issues may be a significant drawback.

If Governments and public bodies are partially exempted, then one other issue that needs to be considered is the treatment of supplies to governments. This is especially important in a federation. Should one Government apply its non-creditable tax to supplies to another Government? Or should all Governments be immune from taxation as sovereign bodies? In India, CENVAT and State VAT currently apply to Government procurement.

Likewise, the GST could be made applicable to supplies to Governments with no special rules. However, as noted earlier, this then would create a self-supply bias for public bodies where they buy inputs for an exempt activity.

E. Financial Services

Financial services are exempted from VAT in all countries. The principal reason is that the charge for the services provided by financial intermediaries (such as banks and insurance companies) is generally not explicit-a fee-but is taken as a margin, that is hidden in interest, dividends, annuity payments, or such other financial flows from the transactions. For example, banks provide the service of operating and maintaining deposit accounts for their depositors, for which they charge no explicit fee. The depositors do, however, pay an implicit fee, which is the difference between the pure interest rate (i.e., the interest rate which could otherwise be earned in the market without any banking services) and the interest actually received by them from the bank on the deposit balance.

The fee is the interest foregone. Similarly, the charge for the services provided by banks to the borrowers is included in the interest charged on the loan. It is the excess of the interest rate on the loan over the pure rate of interest or cost of funds to the bank for that loan.

It would be straight-forward to levy the tax on this implicit fee if the reference 'pure rate' were easily observable—but it is not. The spread between borrowing and lending rates, could be measured, and taken as measuring the *total* value added by the intermediary. But in order for the crediting mechanism to work properly, it is necessary to go further and *allocate* this value-added to borrower and lender (with a credit on the tax paid due only to registered taxpayers)—which again raises the problem of identifying a reference pure interest rate.[1]

Some financial services are, of course, charged for by a direct and explicit fee, examples being an account charge or foreign exchange commission. Services provided for an explicit charge could be subjected to VAT in the normal way with the taxable recipient having a right of deduction, and a growing number of countries do this. Nevertheless, some countries exempt them all, while others limit the exemption to banking and life insurance. The exemption avoids the need to measure the tax base for financial transactions, but gives rise to other distortions in the financial markets. The denial of credit to the exempt financial institutions for the VAT charged on their inputs creates disincentives for them to outsource their business process operations. Where they render services to business clients, the blockage of input tax credits results in tax cascading, adversely affecting their competitive position in the international markets.

Taxing explicit fees for financial services, but treating margin services as exempt, is a possible answer, but it is conceptually flawed (as the same service will be treated differently for VAT purposes depending on how the remuneration for it is taken) and runs the risk that there will be some arbitrage between the two methods of charging to lessen the VAT charge (particularly in the case of supplies to final consumers with no right of deduction).

In China, financial services are taxable under their business tax, which is a tax on turnover with no tax credits allowed on inputs. Because it is a turnover tax, it can be applied to the total spread for margin services, with no need to allocate the spread between borrowers and depositors. Israel, and Korea also apply tax in such alternative forms.

Under the Service Tax, India has followed the approach of bringing virtually all financial services within the ambit of tax where the consideration for them is in the form of an explicit fee. It has gone beyond this by bringing selected margin services (where the consideration is the spread between two financial inflows and outflows) within the Service Tax net. The following are principal examples of such taxable margin services: -

- Merchant discounts on credit/debit card transactions are taxable as a consideration for credit card services, as are any explicit fees or late payment charges collected from the card member.
- In foreign currency conversion transactions without an explicit fee, tax applies to a deemed amount of consideration equal to 2% of the amount converted.

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[1] These concepts are discussed in greater detail in Poddar, S. and M. English (1997) and Poddar, Satya (2003).

The tax applies to that portion of life insurance premiums that represents a cover for risks.

As there are no compelling economic or social policy reasons for exempting financial services (other than the practical difficulties of defining the consideration for margin services), it would be appropriate to continue this approach under GST. There are, however, certain technical flaws in the measurement of consideration that need to be addressed when switching over to GST. For example, in the case of insurance, the tax applies to the gross amount of risk premium, while a proper measure would be the premiums net of any claims (whether the claim is settled in cash or in kind). This can be accomplished by allowing a credit in respect of any claims paid.

Consideration could also be given to bringing interest margin on non-commercial loans and deposits within the next net on an aggregate basis, as opposed to for each transaction separately[1].This could be done by computing the aggregate interest margin and apportioning it between the margin from B2B and B2C transactions. The B2B margin could then be zero-rated, and the tax applied to the B2C margin.

In some countries, transactions in gold, silver and other precious metals are also treated as part of the financial sector, given that these metals are often bought as investments, and not for consumption. They are exempted from tax. However, unlike the approach followed in India of applying a reduced rate of 1% to such metals and articles made of such metals, the exemption is confined to only metals of investment-grade purity levels. Jewellery and other articles made of such metals remain taxable at the standard rate.

6. Treatment of Inter-State and International Trade

Treatment of inter-State and international supplies of goods and services is one of the most crucial elements of the design of a Dual GST. A set of rules is needed to define the jurisdiction in which they would be taxable under the destination principle. Further a mechanism is needed for enforcing compliance to those rules.

The Rules can be relatively straightforward for the application of the Central GST. However, there is a concern that, under a sub-national destination-based VAT, taxation of cross-border transactions could be a significant challenge in the absence of any inter-state fiscal border controls. Even if such border controls were to exist, they would be ineffective for taxation of services, which entail no physical inter-state movement. This concern has been a topic of increased discussion over the recent years due to the growth in internet sales and transactions. Cross-border VAT leakage is also a growing concern in the EU because of the removal of border controls between Member Countries.

In what follows, we first start with the basic framework for defining the place of supply, then look at the policy options for ensuring proper compliance. This discussion draws on Ahmad, Poddar et al (2008) for the GCC Secretariat.

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[1] For a more complete discussion of the system in India and how it can be modified and extended, see Poddar, Satya (2007).

A. Place of Taxation, International Transactions

In virtually all countries, VAT is levied on the basis of the destination principle. For this purpose, some countries follow the practice of prescribing a set of rules for defining the place of taxation or place of supply. A supply is taxable in a given jurisdiction only if the supply is considered to take place in that jurisdiction. An alternative approach followed by other countries is to first define what supplies are potentially within the scope of the tax, and then provide criteria for determining which of those supplies would be zero-rated as exports. The two approaches yield the same result, even though one excludes exports from the scope of the tax, while the other zero-rates them, having first included them in the scope. The Service Tax in India follows the second approach.

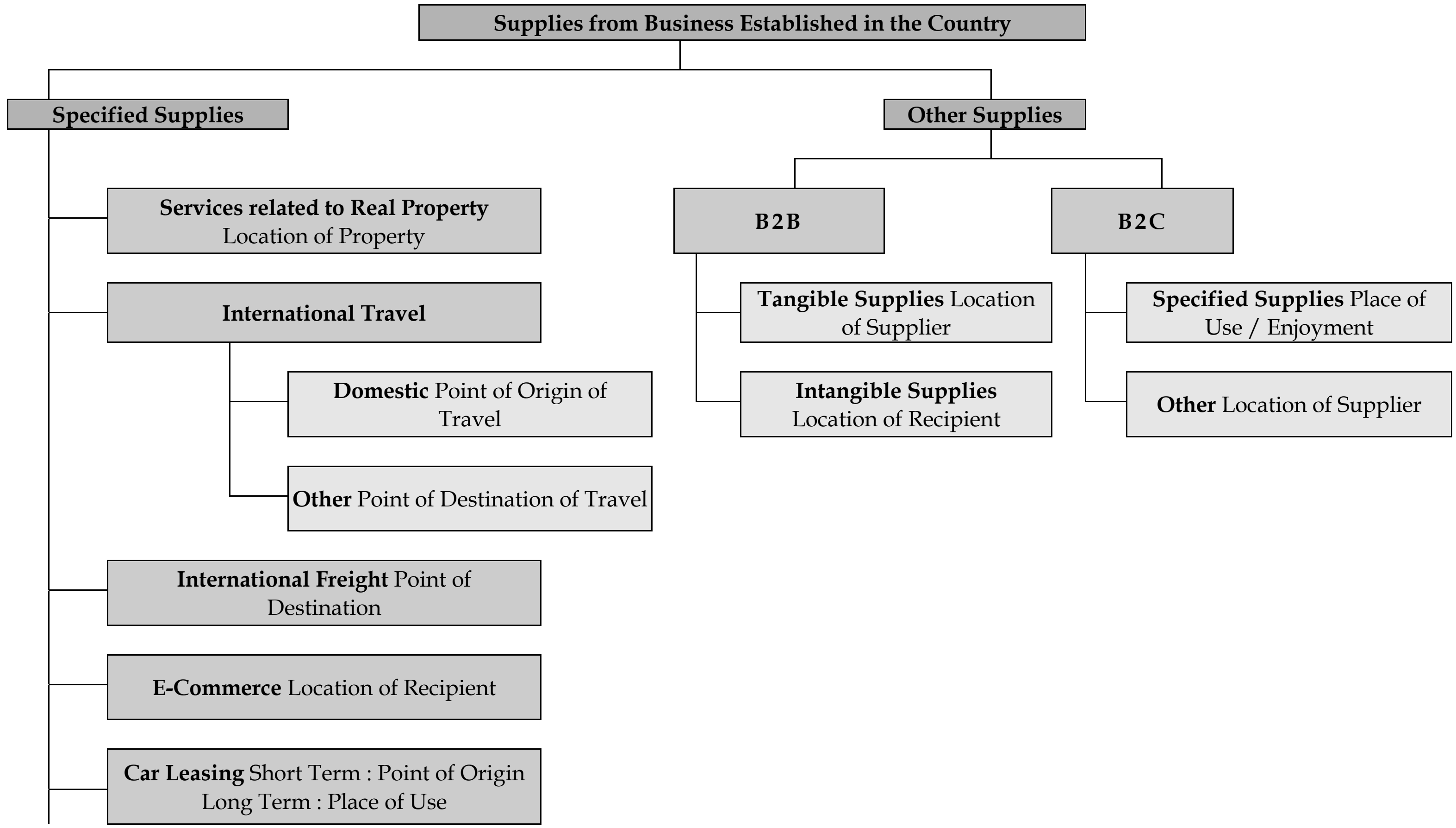
While the rules and approaches vary from country to country, the basic criteria for defining the place of taxation are as follows (approaches for taxation of services depicted in Chart 1):[1]

- A sale of goods is taxable if the goods are made available in or delivered/shipped to that jurisdiction (i.e., on the basic of place of delivery or shipment to the recipient).
- A sale of real property is taxable if the property is located in that jurisdiction (i.e., on the basis of place of location of the property). Services directly connected with real property are also taxable on this basis (e.g., services of estate agents or architects).
- A supply of other services or intangible property is taxable in that jurisdiction depending on one or more of the following factors:
    - Place of performance of the service
    - Place of use or enjoyment of the service or intangible property
    - Place of residence/location of the recipient
    - Place of residence/location of the supplier
- Special rules apply for certain supplies (also referred to as mobile services) for which there is no fixed place of performance or use/enjoyment, such as:
    - Passenger travel services
    - Freight transportation services
    - Telecommunication Services
    - Motor vehicle leases/rentals
    - E-commerce supplies

[1] What are discussed below are only the basic concepts. The actual rules can be complex, and highly varied from one jurisdiction to the next. For a more rigorous discussion of the approaches being followed in selected international jurisdictions, see Millar, Rebecca (2007).

CHART-1

PLACE OF TAXATION (Of Supplies Other Than Goods)



In defining the place of taxation of services and intangible property, a distinction is often made between supplies made to businesses (B2B) and final consumers (B2C). B2B supplies are generally defined to be made where the recipient is located or established, regardless of where the services are performed or used. This is particularly the case for the so-called intangible services (e.g., advisory or consulting services) for which the place of performance is not important. Thus, all such services rendered to nonresidents become zero-rated, and subject to a reverse charge in the country of the recipient, which charge is deductible as long as the recipient is fully taxable. This avoids tax cascading, which would otherwise occur.

By contrast, B2C services are deemed to be made in the jurisdiction where the supplier is located. Many B2C services tend to be tangible or physical in nature, e.g., haircuts, and admissions to place of amusement, which are used/consumed at the place of their performance. In some countries, B2C intangible services are treated in the same manner as B2B services, i.e., they are zero-rated when rendered to non-resident customers.

Special rules apply to the so-called mobile services. For transportation services, the place of supply is defined by reference to the point of origin or destination. In Europe, rail passenger transportation is taxed based on distance traveled in the taxing jurisdiction. For telecommunication, e-commerce and satellite broadcasting services, the origin rule (taxation in the country of the supplier) can lead to non-taxation, and various solutions have been followed to prevent this. For example, in the EU, e-commerce suppliers to EU final consumers are required to register and account for tax in the country of their customer, using a 'one stop shop' registration facility, if they wish. This rule is being extended to intra-EU supplies of telecommunications, e-commerce and satellite broadcasting from 1/1/2015 to present suppliers obtaining an arbitrage advantage by setting up their business in a low rate member state. In Canada, a "two-out-of-three" rule is followed, i.e., the supply is made in the jurisdiction if the points of origin and termination are in that jurisdiction, or if one of the points is in the jurisdiction and the supply is billed to an account in the jurisdiction. The rules for e-commerce are varied, but generally follow the rules for telecommunication services. Internet connectivity services are in fact telecommunication services. Goods and services bought and sold on-line are generally taxed on the same manner as those bought off-line.

For short-term car rentals, in Europe the place of supply is where the car is first made available to the customer, regardless of the place of its subsequent use. For long-term leases, place of supply could depend on the place of use of the vehicle or the residence of the customer; the EU is adopting such a rule from 1/1/2010 to prevent 'rate shopping'. Often, similar rules are adopted for leases and rentals of other goods also.

In addition to the above, there are a variety of other complex cross-border transactions' for which supplementary rules are required. 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 complexity of the rules for such transactions has been an issue under discussion by working groups at the OECD, with a view to developing a framework or guidance for uniformity and consistency in the treatment of international services and intangibles in different jurisdictions.[1]

It is recognized that under these rules tax could be charged to nonresident business customers on supplies of an intermediate nature (i.e., not for final consumption) which would lead to cascading and create competitive distortions. To address this concern, many countries have provisions to provide a rebate of the tax charged to business customers.[2]Such rebates can also be extended to non-business customers, e.g., rebates to foreign tourist for the tax paid on goods bought locally for subsequent export when they return back.

Generally, these rules apply in a symmetrical manner to define exports and imports. Thus, where the supply of, say, consulting services by a domestic supplier is zero-rated because it is supplied to a business located outside the country, the supply of such services by a foreign supplier to a business located in the country would be taxable as an imported service. Imports generally attract tax at the customs border. For services and intangibles, the tax is self-assessed by the recipient under the reverse-charge mechanism.

The combined result of these rules (including the system of rebates for nonresident customers) is to define the place of destination of services and intangibles as follows:

- For B2B supplies, the place of destination is the place where the recipient is established or located.
- For B2C supplies of a tangible/physical nature (e.g., hair cuts, hotel accommodation, local transportation, and entertainment services), the place of destination is the place where the supplier is established or located, which is generally also the place where the service is performed. For highly mobile B2C supplies of an intangible nature (e.g., telecommunication, e-commerce and satellite broadcasting services, for which the place of performance is not linked to the rendering of the service), the place of supply could be the place of residence of the customer (as for B2B supplies), or the place where the services are used or enjoyed. But, because it is wholly impractical to subject final consumers to the reverse charge, in Europe the non-resident supplier is required to register and account for VAT to customers resident in the European Union.
- Special rules for specific supplies are generally designed to yield a result similar to that for other supplies. They serve the purpose of providing greater certainty and clarity in situations where the place of location or residence of the supplier or the recipient may not be well defined or easily ascertainable at the time of the supply.

B. Place of Taxation, Inter-State Transactions

An important question in the context of the Dual GST is whether these rules for international cross-border supplies can be adopted for domestic inter-State supplies also. Conceptually, there are no

[1] For discussion of the issues and approaches, see OECD (2004).

[2] For example, such rebates are provided under Article XXX of the EU VAT Directive.

compelling reasons to deviate from them for defining the place of supply at the sub-national level. The only precedent available of a destination-based VAT at the sub-national level is that of Harmonized Sales Tax (HST) in Canada. (The precedent of the EU is different because it is a community of 27 Sovereign Member States rather than a single nation made up of a union of states in a federation. The EU solution of taxing intra-EU B2B supplies of goods and services by means of zero-rating and then reverse charge accounting in the member state of the taxable recipient may not be the right answer—and has led to the problem of carousel fraud). Surprisingly, Canada deviated from these rules in defining the place of supply in a province in one important respect. In defining the place of supply of services at the provincial level, the primary criterion used in Canada is the place of performance of the service. Thus, if all or substantially all of a service is performed in a province, then the place of supply of the service is considered to be that province, regardless of whether it is a B2B or B2C supply, and where it is used or enjoyed. There appear to be two reasons for it, which are also relevant for the design of the Dual GST in India.

First, it is recognized that the place where the supplier or the recipient is established cannot be defined uniquely at the sub-national level within a common market. A supplier may have establishments/ offices in several States and one or more of them could be involved in rendering the service. At the national level, the country of residence of the counter parties to a transaction needs to be determined for direct tax as well as other regulatory purposes. However, at the sub-national level, such determination is not necessary, especially where there is no direct tax at that level. The basic rules outlined above for international supplies cannot be applied in the absence of supplementary rules for defining the place where the supplier and the recipient are located or established. Take, for example, an HR consulting firm with offices in several States providing recruitment services to a corporate entity with operations through India. In this case, the basic rule of defining the place of supply of the service to be where the recipient is established cannot be applied as the recipient is established in more than one State.

Second, under the Canadian HST, any input tax paid by a business can be claimed back as an input credit under the federal GST or the HST regardless of where it is established, as long as the inputs are used in a taxable activity. Thus, there is no adverse consequence of collecting the HST on services rendered to businesses located in other provinces. The HST is integrated with the GST to such an extent that it best fits the description of as a national GST, not a Dual GST.

Given these considerations, Canada defines the place of supply of services (other than those subject to special rules) to be the place where they are performed. If they are performed in more than one province, supplementary rules are employed to determine the place of supply. The main supplementary rule defines the place of supply/taxation to be the place to which the employee/officer of the supplier, who had responsibility for negotiating the service contract with the recipient, reports. In effect, under these rules the sub-national tax on services is applied on the basis of the origin principle, i.e., where the services are performed.

The Canadian approach does not appear to be suitable for the Dual GST in India where the Centre and State GSTs would be harmonized, but not integrated. 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 could be defined simply as the place of predominant use of the service. Where there is no unique place of predominant use, the place of destination could be simply the mailing address of the recipient on the invoice, which would normally be the business address of the contracting party. The risk of misuse of this provision would be minimal if it is limited to B2B supplies where the tax is fully creditable.

For B2C services, the tax should apply in the State where the supplier is established, which, in turn, could be defined as the place where the services are performed. Where there is no unique place of performance of the service, the place of taxation could be defined to be the State where the supplier's establishment most directly in negotiations with the recipient is located. This would be similar to the Canadian rule.

C. Taxation of Imports by the States

In most countries, imports attract the VAT/GST at the time of entry into the country. The tax is generally applied on the value of goods declared for customs purposes, including the amount of the customs duty. However, there are no well-established precedents for the application of sub-national taxes to imports. In India, the Centre levies an additional duty (called the special additional duty) on imports at the rate of 4%, which is meant to be in lieu of the state VAT. This duty is allowed as a credit against the central excise duty on manufacturing or refunded where the imports are resold and the State VAT is charged on them.

In Canada, the provincial HST is collected by the Customs authorities on noncommercial importations of goods. The tax is collected at the time of importation on the basis of place of residence of the person importing the goods, regardless of where the goods enter the country. Commercial importations do not attract the provincial HST because of difficulties in determining their destination within the country. For example, a large consolidated commercial shipment could contain goods that are initially destined to a central warehouse, for subsequent distribution to various parts of the country.

The Canadian system is conceptually appealing and could be considered for the application of State taxes under the Dual GST in India.

D. Monitoring of Inter-State Supplies

We turn now to the design of a suitable mechanism for payment and collection of tax on inter-state supplies. As noted earlier, there is a concern that a sub-national destination-based VAT could be subject to substantial leakages in the absence of effective inter-state border controls. Many policy prescriptions have been made to deal with the issue, but none implemented so far at the sub-national level.[1]

In our view, these concerns are exaggerated, especially under a dual GST, harmonized between the Centre and the States and across the States. It is possible to design suitable mechanisms for proper application of tax on inter-state supplies, without resorting to border controls. The current border

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[1] See, for example, McLure, Charles (2000):, Keen, Michael and Stephen Smith (2000), and Poddar, Satya (1990).

controls for goods, in the form of inter-state check posts have not been effective in the past. Border controls would not even be feasible for services and intangibles, which involve no physical inter-State movement.

As noted by Bird and Gendron[1], under a dual GST, the application of the Centre GST to all domestic supplies would automatically serve as an audit control for reporting of inter-State supplies for purposes of the State GST. The aggregate of the turnovers reported for the State GSTs must equal the total turnover reported for the Centre GST. Dealers can misclassify the turnover to different States, but would not be able suppress the turnover for State GST below the level reported for the Centre GST. Where the GST design, rate and the base is harmonized across the States, the dealers would have little incentive to misclassify the turnover. Under such a system, the focus of the authorities should be on proper reporting of the total turnover, not inter-State turnover.

Notwithstanding the above, a mechanism is needed for proper application of sub-national tax on inter-State supplies of goods as well as services. For reasons outlined elsewhere[2], zero-rating of inter-State supplies is not advisable. Instead, the preferred approach would be to require the vendors to collect the destination state GST on inter-State supplies (of goods and services) and remit the tax directly to the destination state. The tax would then be creditable in the destination state under the normal rules, i.e., if it relates to inputs for use in making taxable supplies.

This mechanism, referred to as Prepaid VAT (PVAT), is similar to the mechanism of the CST. Under the CST, the tax on inter-state sales is charged and remitted to the origin state. Under PVAT, the tax on inter-state supplies would be charged and remitted to the destination state.[3]It preserves the destination principle of VAT. Vendor in the origin State collect tax on all of their domestic supplies, whether intra-State or inter-State. The tax collected on inter-state supplies would be that of the destination state and remitted to that state by the vendor. On intra-State supplies, the tax collected would be that of the origin State and paid to that State.

Buyers who are GST registrants (in B2B transactions) would have a strong incentive to ensure that the vendor properly applies the destination tax, which would then be creditable against their output tax in the state of destination. Otherwise, the goods would be subject to the tax of the origin state, which would not be creditable in the state of destination.

Most supplies of services and intangibles to consumers and other exempt buyers (in B2C transactions) would be taxable in the State of origin, without the benefit of zero-rating. However, inter-State shipments of goods to consumers would be zero-rated in the state of origin and attract the tax of the destination state (including, for example, mail order supplies of goods). An inducement could be created for consumers also to ensure that the vendor charges the destination State tax on such shipments. This could be done by imposing a self-assessment requirement in the destination state on any inter-state purchases on which the vendor has not charged and remitted the destination state tax.

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[1] See Bird and Gendron (1998).

[2] See Poddar, Satya, Eric Hutton, (2001).

[3] The PVAT mechanism as originally developed by the authors entailed a prepayment of the destination State VAT before the goods are shipped. However, under a harmonized Dual GST, such prepayment may not be necessary. There would be enough safeguards in the system to enforce payment of tax on inter-state supplies at the same time as on intra-state supplies.

The PVAT mechanism establishes the output-tax-and-input-credit chain for inter-state transactions and, thereby, strengthens the audit trail property of the VAT system. Unlike the system of zero-rating, it creates strong incentives for both the origin and the destination states to monitor compliance independently of each other, as revenues of both are affected by the zero-rated sales declared by the vendor. This is a unique feature of PVAT, and perhaps it is most significant. Under the traditional system of zero-rating, the quantum of zero-rated sales reported by the vendor affects the revenues of the origin state, but not of the destination state. PVAT creates a simple and effective link between the two.

7. Harmonization of Laws and Administration

The need for Centre-State and inter-State harmonization is paramount under the Dual GST. The ultimate goal would be a unified base and one set of rules for the two taxes.

What should be the mechanism for achieving this harmonization? Different options have been adopted in other federations or trading blocks. At one extreme is the example of Australia where the GST is imposed and administered as a single unified tax levied by the national government. All the revenues from the tax are then distributed to the States. Another such example is that of Harmonized Sales Tax (HST) in Canada, which is levied in three of the ten provinces. The tax is levied and administered under a unified law by the national Government, much like the Australian GST. The key difference is in the revenue allocation system. Under the Canadian system, provincial participation in the HST is elective, not mandatory. The tax is levied at the national rate of 7 percent (now reduced to 5%), which is increased by 8% percent in those provinces which have elected to participate in it. The revenues attributable to the supplementary rate of 8 percent are then distributed among the participating provinces on the basis of a statistical calculation of the tax base in those provinces (which approximates the revenues they would have collected if they had levied a separate tax of their own). In Australia, there is no State "participation". The tax is a federal tax that is distributed to the States under a political agreement. The revenues are distributed as grants to the States, taking into account factors such as fiscal capacity and need of individual States. In terms of the operation of the law, the enactment of the law, and the jurisdiction of law, it is exclusively a federal tax.

The system in the Province of Quebec in Canada offers another model of harmonization of the national and sub-national taxes. Quebec levies a goods and services tax, called Quebec Sales Tax (QST), the legislation for which follows very closely the model for the federal GST. The two taxes have the same base, definitions, and rules, but levied under two separate statutes. To ensure harmonization of administration, the two governments have entered into a tax collection agreement under which the collection, administration and enforcement of the federal GST is delegated to the provincial government. The agreement defines the role and responsibilities of the two governments and the policies and procedures to be followed in administering the tax. The federal government retains the power to make any changes in the legislation and to issue rulings, and interpretations, which are adhered to by the province in administering the federal GST. In practice, the province accepts the federal rulings and interpretations for both GST and QST, given the similarities in the two statues.

The EU model is yet another example. This model is quite distinct from the Australian and Canadian models. The focus in the EU model is on minimization of distortions in trade and competition, and not on harmonization of administration. Thus, the VAT base (subject to continuing derogations) is harmonized, as are the basic rules governing the mechanism and application of VAT (time of supply, valuation, place of supply etc). The rates are harmonized only within broad bands (e.g., the standard rate may not be less than 15%) and administration is largely a matter for the member states to decide (but must respect basic principles such as neutrality).

As noted earlier, the CST in India also offers an interesting model of the harmonization mechanism. The CST law is Central, but the tax is administered and collected by the States. Indeed, this appears to be most suitable model for India. The GST law for both the Centre and the States would be enacted by Parliament under this model. It would define the tax base, place of taxation, and the compliance and enforcement rules and procedures. The rates for the State GST could be specified in the same legislation, or delegated to the State legislatures. The legislation would empower the Centre and the States to collect their respective tax amounts, as under the CST.

If the Governments fail to reach a political compromise on the CST model, the Quebec model would appear to be the next best alternative. It respects fiscal autonomy of the two levels of government, yet facilitates harmonization through the mechanism of binding tax collection agreements between the Centre and the States. These agreements would, in turn, encourage adoption of a common GST law.

The Centre can play an important role of providing a forum to discuss and develop the common architecture for the harmonized administration of the two taxes. It would have responsibility to develop policies and procedures for GST, in consultation with the Empowered Committee, e.g., on the place of supply rules, taxpayer registration and identification numbers, model GST law, design of tax forms and filing procedures, data requirements and computer systems, treatment of specific sectors (e.g., financial services, public bodies and governments, housing, and telecommunications), and procedures for collection of tax on cross-border trade, both inter-State and international. The proposal made by the Empowered Committee (for delegation of administration of the Centre GST for smaller dealers to the States) is very similar, even though the contractual framework for it is yet to be developed.

8. Conclusion

The Empowered Committee describes the GST as "a further significant improvement – the next logical step -towards a comprehensive indirect tax reforms in the country." Indeed, it has the potential to be the single most important initiative in the fiscal history of India. It can pave the way for modernization of tax administration -make it simpler and more transparent – and significant enhancement in voluntary compliance. For example, when the GST was introduced in New Zealand in 1987, it yielded revenues that were 45% higher than anticipated, in large part due to improved compliance. Its more neutral and efficient structure could yield significant dividends to the economy in increased output and productivity. The Canadian experience is suggestive of the potential benefits to the Indian economy. The GST in Canada replaced the federal manufacturers' sales tax which was then levied at the rate of

13% and was similar in design and structure as the CENVAT in India. It is estimated that this replacement resulted in an increase in potential GDP by 1.4%, consisting of 0.9% increase in national income from higher factor productivity and 0.5% increase from a larger capital stock (due to elimination of tax cascading).

However, these benefits are critically dependent on a neutral and rational design of the GST. The discussion of selected issues in this paper suggests that there are many challenges that lie ahead in such a design. The issues are not trivial or technical. They would require much research and analysis, deft balancing of conflicting interests of various stakeholders, and full political commitment for a fundamental reform of the system.

Opportunities for a fundamental reform present themselves only infrequently, and thus need to be pursued vigorously as and when they do become available. As the choices made today would not be reversible in the near future, one needs a longer-term perspective. Achieving the correct choice is then a political economy balancing act that takes into account the technical options and the differing needs and constraints of the main partners. Fortunately, there is a very substantial consensus among all stakeholders in the country for a genuine reform. In the circumstances, an incremental or timid response would be neither politically expedient, nor would it serve the needs of India of the 21stcentury. Experience of countries with modern VATs, such as New Zealand, Singapore, and Japan suggests that a GST with single-rate and comprehensive base can be a win-win proposition for taxpayers and the fisc alike.

B-2
FIRST DISCUSSION PAPER ON GOODS AND SERVICES TAX IN INDIA

1. Introduction

1.1 Introduction of the Value Added Tax (VAT) at the Central and the State level has been considered to be a major step – an important breakthrough – in the sphere of indirect tax reforms in India. If the VAT is a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will indeed be a further significant improvement – the next logical step – towards a comprehensive indirect tax reforms in the country.

1.2 Keeping this objective in view, an announcement was made by the then Union Finance Minister in the Central Budget (2007-08) to the effect that GST would be introduced with effect from April 1, 2010 and that the Empowered Committee of State Finance Ministers, on his request, would work with the Central Government to prepare a road map for introduction of GST in India. After this announcement, the Empowered Committee of State Finance Ministers decided to set up a Joint Working Group (May 10, 2007), with the then Adviser to the Union Finance Minister and Member-Secretary of the Empowered Committee as its Co-convenors and concerned four Joint Secretaries of the Department of Revenue of Union Finance Ministry and all Finance Secretaries of the States as its members. This Joint Working Group got itself divided into three Sub-Groups and had several rounds of internal discussions as well as interaction with experts and representatives of Chambers of Commerce & Industry. On the basis of these discussions and interaction, the Sub-Groups submitted their reports which were then integrated and consolidated into the report of Joint Working Group (November 19, 2007).

1.3 This report was discussed in detail in the meeting of the Empowered Committee on November 28, 2007, and the States were also requested to communicate their observations on the report in writing. On the basis of these discussions in the Empowered Committee and the written observations, certain modifications were considered necessary and were discussed with the Co-convenors and the representatives of the Department of Revenue of Union Finance Ministry. With the modifications duly made, a final version of the views of Empowered Committee on the model and road map for the GST was prepared (April 30, 2008). These views of Empowered Committee were then sent to the Government of India, and the comments of Government of India were received on December 12, 2008. These comments were duly considered by the Empowered Committee (December 16, 2008), and it was decided that a Committee of Principal Secretaries/Secretaries of Finance/Taxation and Commissioners of Trade Taxes of the States would be set up to consider these comments, and submit their views. These views were submitted and were accepted in principle by the Empowered Committee (January 21, 2009). As a follow-up of this in-principle acceptance, a Working Group consisting of the concerned officials of the State Governments was formed who, in association with senior representatives of Government of India, submitted their recommendations in detail on the structure of GST. An important interaction has also recently taken place between Shri Pranab Mukherjee, the Union Finance Minister and the Empowered Committee (October 19, 2009) on the related issue of compensation for loss of the States on account of phasing out of CST. The Empowered Committee has now taken a detailed view on the recommendations of the Working Group of officials and other related matters. This detailed view is now presented in terms of the First Discussion Paper, along with an Annexure on Frequently Asked Questions and Answers on GST, for discussion with industry, trade, agriculture and people at large. Since the GST at the Centre and States would be a further improvement over the VAT, a brief recalling of the process of introduction of VAT in India is worthwhile.

Value Added Tax at the Central and the State level

1.4 Prior to the introduction of VAT in the Centre and in the States, there was a burden of multiple taxation in the pre-existing Central excise duty and the State sales tax systems. Before any commodity was produced, inputs were first taxed, and then after the commodity got produced with input tax load, output was taxed again. This was causing a burden of multiple taxation (i.e. "tax on tax") with a cascading effect. Moreover, in the sales tax structure, when there was also a system of multi-point sales taxation at subsequent levels of distributive trade, then along with input tax load, burden of sales tax paid on purchase at each level was also added, thus aggravating the cascading effect further.

1.5 When VAT is introduced in place of Central excise duty, a set-off is given, i.e., a deduction is made from the overall tax burden for input tax. In the case of VAT in place of sales tax system, a set-off is given from tax burden not only for input tax paid but also for tax paid on previous purchases. With VAT, the problem of "tax on tax" and related burden of cascading effect is thus removed. Furthermore, since the benefit of set-off can be obtained only if tax is duly paid on inputs (in the case of Central VAT), and on both inputs and on previous purchases (in the case of State VAT), there is a built-in check in the VAT structure on tax compliance in the Centre as well as in the States, with expected results in terms of improvement in transparency and reduction in tax evasion. For these beneficial effects, VAT has now been introduced in more than 150 countries, including several federal countries. In Asia, it has now been introduced in almost all the countries.

1.6 In India, VAT was introduced at the Central level for a selected number of commodities in terms of MODVAT with effect from March 1, 1986, and in a step-by-step manner for all commodities in terms of CENVAT in 2002-03. Subsequently, after Constitutional Amendment empowering the Centre to levy taxes on services, these service taxes were also added to CENVAT in 2004-05. Although the growth of tax revenue from the Central excise has not always been specially high, the revenue growth of combined CENVAT and service taxes has been significant.

1.7 Introduction of VAT in the States has been a more challenging exercise in a federal country like India, where each State, in terms of Constitutional provision, is sovereign in levying and collecting State taxes. Before introduction of VAT, in the sales tax regime, apart from the problem of multiple taxation and burden of adverse cascading effect of taxes as already mentioned, there was also no harmony in the rates of sales tax on different commodities among the States. Not only were the rates of sales tax numerous (often more than ten in several States), and different from one another for the same commodity in different States, but there was also an unhealthy competition among the States in terms of sales tax rates – so-called "rate war" – often resulting in, revenue-wise, a counter-productive situation.

1.8 It is in this background that attempts were made by the States to introduce a harmonious VAT in the States, keeping at the same time in mind the issue of sovereignty of the States regarding the State tax matters.

The first preliminary discussion on State-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers. Thereafter, in a significant meeting of all the Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha, the then Union Finance Minister, two important decisions, among others, were taken. First, before the introduction of State-level VAT, the unhealthy sales tax "rate war" among the States would have to end, and sales tax rates would need to be harmonised by implementing uniform floor rates of sales tax for different categories of commodities with effect from January 1, 2000. Secondly, on the basis of achievement of the first objective, steps would be taken by the States for introduction of State-level VAT after adequate preparation. For implementing these decisions, a Standing Committee of State Finance Ministers was formed which was then made an Empowered Committee of State Finance Ministers.

1.9 Thereafter, the Empowered Committee has met regularly. All the decisions were taken on the basis of consensus. On the strength of these repeated discussions and collective efforts, involving the Ministers and the concerned officials, it was possible within a period of about a year and a half to achieve nearly 98 per cent success in the first objective, namely, harmonisation of sales tax structure through implementation of uniform floor rates of sales tax.

1.10 After reaching this stage, steps were initiated for systematic preparation for introduction of State-level VAT. In order again to avoid any unhealthy competition among the States which may lead to distortions in manufacturing and trade, attempts have been made from the very beginning to harmonise the VAT design in the States, keeping also in view the distinctive features of each State and the need for federal flexibility. This has been done by the States collectively agreeing, through discussions in the Empowered Committee, to certain common points of convergence regarding VAT, and allowing at the same time certain flexibility to accommodate the local characteristics of the States. In the course of these discussions, references to the Tenth Five Year Plan Report of the Advisory Group on Tax Policies & Tax Administration (2001) and the report of Kelkar (Chairman) Task Force were helpful.

1.11 Along with these measures, steps were taken for necessary training, computerization and interaction with trade and industry. While these preparatory steps were taken, the Empowered Committee got a significant support from Shri P. Chidambaram, the then Union Finance Minister, when he responded positively in providing Central financial support to the States in the event of loss of revenue in transitional years of implementation of VAT.

1.12 As a consequence of all these steps, the States started implementing VAT beginning April 1, 2005. After overcoming the initial difficulties, all the States and Union Territories have now implemented VAT. The Empowered Committee has been monitoring closely the process of implementation of State-level VAT, and deviations from the agreed VAT rates has been contained to less than 3 per cent of the total list of commodities. Responses of industry and also of trade have been indeed encouraging. The rate of growth of tax revenue has nearly doubled from the average annual rate of growth in the pre-VAT five year period after the introduction of VAT.

Justification of GST

1.13 Despite this success with VAT, there are still certain shortcomings in the structure of VAT both at the Central and at the State level. The shortcoming in CENVAT of the Government of India lies in non-inclusion of several Central taxes in the overall framework of CENVAT, such as additional customs duty, surcharges, etc., and thus keeping the benefits of comprehensive input tax and service tax set-off out of reach for manufacturers/ dealers. Moreover, no step has yet been taken to capture the value-added chain in the distribution trade below the manufacturing level in the existing scheme of CENVAT. The introduction of GST at the Central level will not only include comprehensively more indirect Central taxes and integrate goods and service taxes for the purpose of set-off relief, but may also lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade and increased compliance.

1.14 In the existing State-level VAT structure there are also certain shortcomings as follows. There are, for instance, even now, several taxes which are in the nature of indirect tax on goods and services, such as luxury tax, entertainment tax, etc., and yet not subsumed in the VAT. Moreover, in the present State-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under State VAT, and contributing to that extent a cascading effect on account of CENVAT element. This CENVAT load needs to be removed. Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be integration of VAT on goods with tax on services at the State level as well, and at the same time there should also be removal of cascading effect of service tax. In the GST, both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level is established which reduces the burden of all cascading effects. This is the essence of GST, and this is why GST is not simply VAT plus service tax but an improvement over the previous system of VAT and disjointed service tax. However, for this GST to be introduced at the State-level, it is essential that the States should be given the power of levy of taxation of all services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment will be made for giving this power also to the States. Moreover, with the introduction of GST, burden of Central Sales Tax (CST) will also be removed. The GST at the State-level is, therefore, justified for (a) additional power of levy of taxation of services for the States, (b) system of comprehensive set-off relief, including set-off for cascading burden of CENVAT and service taxes, (c) subsuming of several taxes in the GST and (d) removal of burden of CST. Because of the removal of cascading effect, the burden of tax under GST on goods will, in general, fall.

1.15 The GST at the Central and at the State level will thus give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, subsuming of several taxes in the GST and phasing out of CST. With the GST being properly formulated by appropriate calibration of rates and adequate compensation where necessary, there may also be revenue/ resource gain for both the Centre and the States, primarily through widening of tax base and possibility of a significant improvement in tax-compliance. In other words, the GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the Central Government and the State Governments. The GST may, indeed, lead to the possibility of collectively positive-sum game.

2. Preparation for GST

2.1 Keeping this significance of GST in view, an announcement was made by the then Union Finance Minister in the Union Budget, as mentioned before, to the effect that GST would be introduced from April 1, 2010, and that the Empowered Committee of State Finance Ministers would work with the Central Government to prepare a road map for introduction of the GST. After this announcement, the Empowered Committee, as stated earlier, had set up a Joint Working Group which submitted a report on a model and road map for GST. After accommodating the views of the States appropriately on this report, the views of the Empowered Committee on the model and road map were sent to the Government of India on 30th April, 2008. The comments of the Government of India were received on 12th December, 2008. These comments were duly considered by the Empowered Committee in its meeting held on 16th December, 2008 and it was decided that a Committee of Principal Secretaries/Secretaries (Finance/Taxation) and Commissioners of Trade Taxes should consider the comments received from the Government of India and submit its views and also work out the Central GST and State GST rates. The Committee held detailed deliberations on 5th and 6th January, 2009, and submitted its recommendations to the Empowered Committee. The Empowered Committee considered these recommendations in its meeting held on 21st January, 2009 and accepted them in principle. The Empowered Committee also decided to constitute a Working Group consisting of Principal Secretaries/ Secretaries (Finance/Taxation) and Commissioners of Trade Taxes of all States/UTs to give their recommendations on (a) the commodities and services that should be kept in the exempted list, (b) the rules and principles of taxing the transactions of services including the transactions in inter-State services, and (c) finalization of the model suggested for inter-state transaction/movement of goods including stock transfers in consultation with the State Bank of India and some other nationalized banks. It was also decided that the senior representatives from the Government of India may also be associated. The Working Group deliberated on the issues on 10th February, 2009 and decided to form three Sub Working Groups to deliberate each item in depth. The Reports of the Working Group on the three issues have already been received, and the Empowered Committee has taken a view on these recommendations for concluding the details of GST structure.

While making this preparation of GST, it was also necessary, as mentioned earlier, to phase out the CST, because it did not carry any set-off relief and there was a distortion in the VAT regime due to export of tax from one State to other State. The Empowered Committee accordingly took a decision to phase out CST on the understanding with the Centre that, since phasing out of CST would result in a loss of revenue to the States on a permanent basis, an appropriate mechanism to compensate the States for such loss would be worked out. The rate of CST has already been reduced to 2% and will be phased out with effect from the date of introduction of GST on the basis of such GST structure which, with necessary financial support to the States, should adequately compensate for the loss of the States on a permanent basis. With these steps at preparation in mind, it is important now to turn to the proposed model of GST.

3. Goods & Services Tax Model For India

3.1 It is important to take note of the significant administrative issues involved in designing an effective GST model in a federal system with the objective of having an overall harmonious structure of rates. Together with this, there is a need for upholding the powers of Central and State Governments in their taxation matters. Further, there is also the need to propose a model that would be easily implementable, while being generally acceptable to stakeholders.

Salient features of the GST model

3.2 Keeping in view the report of the Joint Working Group on Goods and Services Tax, the views received from the States and Government of India, a dual GST structure with defined functions and responsibilities of the Centre and the States is recommended. An appropriate mechanism that will be binding on both the Centre and the States would be worked out whereby the harmonious rate structure along with the need for further modification could be upheld, if necessary with a collectively agreed Constitutional Amendment. Salient features of the proposed model are as follows:

(i) The GST shall 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). Rates for Central GST and State GST would be prescribed appropriately, reflecting revenue considerations and acceptability. 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.

(ii) The Central GST and the State GST would be applicable to all transactions of goods and services made for a consideration except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.

(iii) The Central GST and State GST are to be paid to the accounts of the Centre and the States separately. It would have to be ensured that account-heads for all services and goods would have indication whether it relates to Central GST or State GST (with identification of the State to whom the tax is to be credited).

(iv) Since the Central GST and State GST are to be treated separately, 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. A taxpayer or exporter would have to maintain separate details in books of account for utilization or refund of credit. Further, the rules for taking and utilization of credit for the Central GST and the State GST would be aligned.

(v) Cross utilization of ITC between the Central GST and the State GST would not be allowed except in the case of inter-State supply of goods and services under the IGST model which is explained later.

(vi) Ideally, the problem related to credit accumulation on account of refund of GST should be avoided by both the Centre and the States except in the cases such as exports, purchase of capital goods, input tax at higher rate than output tax etc. where, again refund/adjustment should be completed in a time bound manner.

(vii) 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.

(viii) The administration of the Central GST to the Centre and for State GST to the States would be given. This would imply that the Centre and the States would have concurrent jurisdiction for the entire value chain and for all taxpayers on the basis of thresholds for goods and services prescribed for the States and the Centre.

(ix) The present threshold 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 is considered 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 also considered that the threshold for Central GST for goods may be kept at Rs.1.5 crore and the threshold for Central GST for services may also be appropriately high. It may be mentioned that even now there is a separate threshold of services (Rs. 10 lakh) and goods (Rs. 1.5 crore) in the Service Tax and CENVAT.

(x) The States are also of the view that 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 would be a compounding cut-off at Rs. 50 lakh of gross annual turn over and a floor rate of 0.5% across the States. The scheme would also allow option for GST registration for dealers with turnover below the compounding cut-off.

(xi) The taxpayer would need to submit periodical returns, in common format as far as possible, to both the Central GST authority and to the concerned State GST authorities.

(xii) 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.

(xiii) Keeping in mind the need of tax payer's 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.

Central and State Taxes to be subsumed under GST

3.3 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:

(i) 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.

(ii) 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.

(iii) The subsumation should result in free flow of tax credit in intra and inter-State levels.

(iv) The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST.

(v) Revenue fairness for both the Union and the States individually would need to be attempted.

3.4 On application of the above principles, it is 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.

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 foodgrains producing States and certain other States were 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 can 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 being levied by the States may not be also 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 without 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 all 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 SGST. The working of this model is elaborated below.

3.5 Inter-State Transactions of Goods and Services: 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.

(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.

3.6 GST Rate Structure: The Empowered Committee has decided to adopt a two-rate structure –a lower rate for necessary items and goods 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, and also for facilitating the introduction of GST, 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.

The States are of the view that for CGST relating to goods, the Government of India may also have a two-rate structure, with conformity in the levels of rate under 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.

3.7 Zero Rating of Exports: Exports would be zero-rated. Similar benefits may be given to Special Economic Zones (SEZs). However, such benefits will only be allowed to the processing zones of the SEZs. No benefit to the sales from an SEZ to Domestic Tariff Area (DTA) will be allowed.

3.8 GST on Imports: The GST will be levied on imports with necessary 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 on goods and services.

3.9 Special Industrial Area Scheme: After the introduction of GST, the tax exemptions, remissions etc. related to industrial incentives should be converted, if at all needed, into cash refund schemes after collection of tax, so that the GST scheme on the basis of a continuous chain of set-offs is not disturbed. Regarding Special Industrial Area Schemes, it is clarified that such exemptions, remissions etc. would continue up to legitimate expiry time both for the Centre and the States. Any new exemption, remission etc. or continuation of earlier exemption, remission etc. would not be allowed.

In such cases, the Central and the State Governments could provide reimbursement after collecting GST.

3.10 IT Infrastructure: After acceptance of IGST Model for Inter-State transactions, the major responsibilities of IT infrastructural requirement will be shared by the Central Government through the use of its own IT infrastructure facility. The issues of tying up the State Infrastructure facilities with the Central facilities as well as further improvement of the States' own IT infrastructure, including TINXSYS, is now to be addressed expeditiously and in a time bound manner.

3.11 Constitutional Amendments, Legislations and Rules for administration of CGST and SGST: It is essential to have Constitutional Amendments for empowering the States for levy of service tax, GST on imports and consequential issues as well as corresponding Central and State legislations with associated rules and procedures. With these specific tasks in view, a Joint Working Group has recently been constituted (September 30, 2009) comprising of the officials of the Central and State Governments to prepare, in a time bound manner a draft legislation for Constitutional Amendment, draft legislation for CGST, a suitable Model Legislation for SGST and rules and procedures for CGST and SGST. Simultaneous steps have also been initiated for drafting of a legislation for IGST and rules and procedures. As a part of this exercise, the Working Group will also address the issues of dispute resolution and advance ruling.

3.12 Harmonious structure of GST and the States' autonomy in a Federal Framework: As a part of the exercise on Constitutional Amendment, a special attention would be given, as mentioned earlier in para 3.2, to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the States' autonomy in a federal structure.

3.13 Dispute Resolution and Advance Ruling: As a part of the exercise on drafting of legislation, rules and procedures for the administration of CGST and SGST, specific provisions would also be made to the issues of dispute resolution and advance ruling.

3.14 Need for compensation during implementation of GST: Despite the sincere attempts being made by the Empowered Committee on the determination of GST rate structure, revenue neutral rates, it is difficult to estimate accurately as to how much the States will gain from service taxes and how much they will lose on account of removal of cascading effect, payment of input tax credit and phasing out of CST. In view of this, it would be essential to provide adequately for compensation for loss that might emerge during the process of implementation of GST for the next five years. This issue may be comprehensively taken care of in the recommendations of the Thirteenth Finance Commission. The payment of this compensation will need to be ensured in terms of special grants to be released to the States duly in every month on the basis of neutrally monitored mechanism.

3.15 With the release of this First Discussion Paper and the Annexure on Frequently Asked Questions and Answers on GST, interaction with the representatives of industry, trade and agriculture would begin immediately at the national level, and then also simultaneously at the State levels. Similarly awareness campaign for common consumers would also be initiated at the same time. As a part of the discussion and campaign, the views of the industry, trade and agriculture as well as consumers are being sought in a structured and time bound manner.

Annexure

Frequently Asked Questions and Answers on GST

Question 1 : What is the justification of GST ?

Answer : 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 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.

Question 2. What is GST? How does it work ?

Answer : As already mentioned in answer to Question 1, 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 wholeseller 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.

Table

Stage of supply chain	**Purchase value of Input**	**Value addition**	**Value at which supply of 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	30	130	10%	13	10	13–10 = 3
Whole seller	130	20	150	10%	15	13	15–13 = 2
Retailer	150	10	160	10%	16	15	16–15 = 1

Question 3 : How can the burden of tax, in general, fall under GST ?

Answer : As already mentioned in Answer to Question 1, 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.

Question 4 : **How will GST benefit industry, trade and agriculture ?**

Answer : As mentioned in Answer to Question 3, 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.

Question 5 : How will GST benefit the exporters?

Answer : The 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.

Question 6 : How will GST benefit the small entrepreneurs and small traders?

Answer : 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. A Composition scheme for small traders and businesses has also been envisaged under GST as will be detailed in Answer to Question 14. Both these features of GST will adequately protect the interests of small traders and small scale industries.

Question 7 : **How will GST benefit the common consumers?**

Answer : As already mentioned in Answer to Question 3, 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.

Question 8 : **What are the salient features of the proposed GST model?**

Answer : The salient features of the proposed model are as follows:

(i) 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.

(ii) 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.

(iii) The Central GST and State GST are to be paid to the accounts of the Centre and the States separately.

(iv) 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.

(v) Cross utilisation of ITC between the Central GST and the State GST would, in general, not be allowed.

(vi) 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.

(vii) The administration of the Central GST would be with the Centre and for State GST with the States.

(viii) The taxpayer would need to submit periodical returns to both the Central GST authority and to the concerned State GST authorities.

(ix) 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.

(x) 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.

Question 9 : Why is Dual GST required ?

Answer : India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism.

Question 10 : How would a particular transaction of goods and services be taxed simultaneously under Central GST (CGST) and State GST (SGST)?

Answer : 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 hypothetically that 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, again hypothetically, that 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, let us 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.

Question 11 : Which Central and State taxes are proposed to be subsumed under GST ?

Answer : 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:

(i) 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.

(ii) 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.

(iii) The subsumation should result in free flow of tax credit in intra and inter-State levels.

(iv) The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST.

(v) 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. [43??]

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.

Question 12 : What is the rate structure proposed under GST ?

Answer : 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.

Question 13: What is the concept of providing threshold exemption for GST?

Answer : 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, as already mentioned in Answer to Question 6, 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.

Question 14 : What is the scope of composition and compounding scheme under GST?

Answer: As already mentioned in Answer to Question 6, a 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.

Question 15 : How will imports be taxed under GST ?

Answer : 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 on goods and services.

Question 16 : Will cross utilization of credits between goods and services be allowed under GST regime?

Answer : 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 model which is explained in answer to the next question.

Question 17 : How will be Inter-State Transactions of Goods and Services be taxed under GST in terms of IGST method ?

Answer : 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.

Question 18: Why does introduction of GST require a Constitutional Amendment?

Answer : The Constitution provides for delineation of power to tax between the Centre and States. While the Centre is empowered to tax services and goods upto the production stage, the States have the power to tax sale of goods. The States do not have the powers to levy a tax on supply of services while the Centre does not have power to levy tax on the sale of goods. Thus, the Constitution does not vest express power either in the Central or State Government to levy a tax on the 'supply of goods and services'. Moreover, the Constitution also does not empower the States to impose tax on imports. Therefore, it is essential to have Constitutional Amendments for empowering the Centre to levy tax on sale of goods and States for levy of service tax and tax on imports and other consequential issues.

As part of the exercise on Constitutional Amendment, there would be a special attention to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the powers of the Centre and the States in a federal structure.

Question 19: How are the legislative steps being taken for CGST and SGST ?

Answer : A Joint Working Group has recently been constituted (September 30, 2009) comprising of the officials of the Central and State Governments to prepare, in a time-bound manner a draft legislation for Constitutional Amendment.

Question 20: How will the rules for administration of CGST and SGST be framed?

Answer : The Joint Working Group, as mentioned above, has also been entrusted the task of preparing draft legislation for CGST, a suitable Model Legislation for SGST and rules and procedures for CGST and SGST. Simultaneous steps have also been initiated for drafting of legislation for IGST and rules and procedures. As a part of this exercise, the Working Group will also address to the issues of dispute resolution and advance ruling.

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COMMENTS OF THE DEPARTMENT OF REVENUE (DOR) ON THE FIRST DISCUSSION PAPER ON GST*

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
1	3.1	It is important to take note of the significant administrative issues involved in designing an effective GST model in a federal system with the objective of having an overall harmonious structure of rates. Together with this, there is a need for upholding the powers of Central and State Governments in their taxation matters. Further, there is also the need to propose a model that would be easily implementable, while being generally acceptable to stakeholders.	Agreed.
2	3.2	Keeping in view the report of the Joint Working Group on Goods and Services Tax, the views received from the States and Government of India, a dual GST with defined functions and responsibilities of the Centre and the States is recommended. An appropriate mechanism that will be binding on both the Centre and the States should be worked out whereby the harmonious rate structure along with the need for further modification could be upheld, if necessary with a collectively agreed Constitutional Amendment.	Dual GST model with appropriate binding mechanism to harmonise the various important aspects of the GST like rate structure, taxation base, exemption etc. between Centre and States is agreed.
3	3.2 (i)	The GST shall 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]. Rates for Central GST and State GST should be prescribed appropriately, reflecting revenue considerations	Agreed. In addition, IGST on inter-State transactions should be levied by the Centre. SGST on imports should also be levied and collected by the Centre. Centre should pass on

* *Source:* http://finmin.nic.in/gst/index.asp

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		and acceptability. This dual GST model would be implemented through multiple statutes (one for CGST and a 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. should be uniform across these statutes as far as practicable.	SGST collection on imports to concerned States on the destination principle.
4	3.2 (ii)	The Central GST and the State GST should be applicable to all transactions of goods and services made for a consideration except the exempted goods and services, goods are outside the purview of GST and the transactions which are below the prescribed threshold limits.	Agreed. There should be a common base for taxation between Centre and States.
5	3.2 (iii)	The Central GST and State GST are to be paid to the accounts of the Centre and the States separately. It would have to be ensured that account-heads for all services and goods would have indication whether it relates to Central GST or State GST (with identification of the State to whom the tax is to be credited).	Agreed. In addition, IGST should be paid to the accounts of the Centre.
6	3.2 (iv)	Since the Central GST and State GST are to be treated separately, 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. A taxpayer or exporter would have to maintain separate details in books of account for utilization or refund of credit. Further, the rules for taking and utilization of Credit for the Central GST and the State GST would be aligned.	Agreed.
7	3.2 (v)	Cross utilization of ITC between the Central GST and the State GST should not be allowed except in the case of inter-State supply of goods and services under the IGST model which is explained later.	Agreed.
8	3.2 (vi)	Ideally, the problem related to credit accumulation on account of refund of GST	Agreed.

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		should be avoided both by the Centre and the States except in the cases such as of exports, purchase of capital goods, input tax at higher rate than output tax etc. where, again refund/adjustment should be completed in a time bound manner.	
9	3.2 (vii)	To the extent feasible, uniform procedure for collection of both Central GST and State GST may be prescribed in the respective legislation for Central GST and State GST.	Agreed.
10	3.2 (viii)	The administration of the Central GST to the Centre and for State GST to the States would be given. This would imply that the Centre and the States would have concurrent jurisdiction for the entire value chain and for all taxpayers on the basis of thresholds for goods and services prescribed for the States and the Centre.	Agreed. The threshold for goods and services should be common between Centre and State on one hand and between goods and services on the other.
11	3.2 (ix)	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 is 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 also considered that the threshold for Central GST for goods may be kept Rs.1.5 Crore and the threshold for Central GST for services may also be appropriately high. It may be mentioned that even now there is a separate threshold of services (Rs. 10 lakh) and goods (Rs. 1.5 crore) in the Service Tax and CENVAT.	There should be a uniform threshold for goods and services for both SGST and CGST. This annual turnover threshold could be Rs.10 lakh or even more than that. The threshold exemption should not apply to dealers and service providers who undertake inter-State supplies. The problem of dual control is better addressed through a compounding scheme as well as administrative simplification for small dealers through measures such as: Registration by single agency for both SGST and CGST without manual interface • No physical verification of premises and no pre-deposit of security • Simplified return format • Longer frequency for return filing

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
			• Electronic Return filing through certified service centres / CAs etc. • Audit in 1-2% cases based on risk parameters • Lenient penal provisions There may not be any need to have direct link between compensation package, if decided for, and the threshold for registration for North-Eastern and special category States.
12	3.2 (x)	The States are also of the view that 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 lakh of gross annual turnover and a floor rate of 0.5% across the States. The scheme should also allow option for GST registration for dealers with turnover below the compounding cut-off.	Agreed. Centre may also have a Composition Scheme up to gross turnover limit of Rs. 50 lakh, if threshold for registration is kept as Rs.10 lakh. The floor rate of 0.5% will be for SGST alone, in case Centre also brings a Composition Scheme for small assesses. The Centre may consider leaving the administration of Compounding Scheme, both for CGST and SGST to the States.
13	3.2 (xi)	The taxpayer would need to submit periodical returns, in common format as far as possible, to both the Central GST authority and to the concerned State GST authorities.	In addition, taxpayers having inter-State transactions will require submission of returns to related Central IGST authority.
14	3.2 (xii)	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.	There should be a uniform registration system through-out the country and this registration system should enable easy linkage with Income Tax database through use of PAN number.

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
15	3.2 (xiii)	Keeping in mind the need of taxpayers 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.	Since the tax base is to be identical for the two components, viz., CGST and SGST, it is desirable that any dispute between a taxpayer and either of the tax administrations is settled in a uniform manner. The possibility of setting up a harmonised system for scrutiny, audit and dispute settlement may be developed.
16	3.4	On application of the principle, it is 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.	Agreed.
		Following State taxes and levies should 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.	Electricity duty, Octroi, purchase tax and taxes levied by local bodies should also be subsumed under GST.
		Purchase tax: Some of the States felt that they are getting substantial revenue from Purchase Tax and, therefore, it should not be subsumed under	Purchase tax is nothing but sales tax where the responsibility for collection of

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		GST while majority of the States were of the view that no such exemptions should be given. The difficulties of the food grain producing States and certain other states were 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 is with the purchaser (and not with the seller as in the case of sales tax). Keeping 'purchase tax' outside will give the loophole to the States to impose 'purchase tax' on any commodity (food-grains, agricultural / forest produce, minerals, industrial inputs etc.) over and above GST. Hence, purchase tax must be subsumed. The compensation package, if agreed, need not have any link to any particular tax being subsumed.
		Tax on items containing Alcohol: Alcoholic beverages may be kept out of the purview of GST. Sales Tax/VAT can 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 being levied by the States may not be also affected.	Alcoholic beverages should be brought under the purview of GST in order to remove the cascading effect on GST paid on inputs such as raw material and packaging material. Sales tax / VAT and State excise duty can be charged over and above GST. Similar dispensation should apply to opium, Indian hemp and other narcotic drugs and narcotics but medicines or toilet preparations containing these substances should attract only GST.
		Tax on Tobacco products: Tobacco products should be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST without ITC.	Agreed.
		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 should be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the	Keeping crude petroleum and natural gas out of the GST net would imply that the credit on capital goods and input services going into exploration and extraction would not be

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		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.	available resulting in cascading. Diesel, ATF and motor spirit are derived from a common input, viz., crude petroleum along with other refined products such as naphtha, lubricating oil base stock, etc. Leaving diesel, ATF and motor spirit out of the purview of GST would make it extremely difficult for refineries to apportion the credit on capital goods, input services and inputs. These products are principal inputs for many services such as aviation, road transport, railways, cab operators etc. As such, these may be levied to GST and in select cases credit of GST paid on these items may be disallowed in order to minimize the possibility of misuse.
		Taxation of Services: As indicated earlier, both the Centre and the States will have concurrent power to levy tax on all 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 SGST.	The sub-working group of the Empowered Committee in its report has suggested two options each for B to B and B to C transactions. A decision is required to be taken by the Empowered Committee with respect to the option to be adopted. Such a decision may be taken and communicated to DoR.
17	3.5	**Inter-State Transactions of goods & services:** The Empowered Committee has accepted the recommendations of the Working Group of concerned officials of Central and State	Agreed. It may however be noted that IGST model will work smoothly only when there is a common threshold

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		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 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 computerization is limited to inter-state dealers and Central and State Governments should be able to computerize 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.	for goods and services and for Centre and States. Having more than one rate either for CGST or SGST will complicate the working of IGST model.

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
18	3.6	**GST Rate Structure:** The Empowered Committee has decided to adopt a two-rate structure – a lower rate for necessary items and goods 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, and also for facilitating the introduction of GST, 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.	There should be a single rate of SGST both for goods and services. A two rate structure for goods would pose the following problems: (a) Likelihood of inversions in duty structure with raw materials and intermediates being at a higher rate and finished goods being at a lower rate, especially as the intention is to apply the lower rate to necessities. (b) Inversions would result in input credit accumulation and demand for refunding the same from time to time. (c) The general rate (RNR) would have to be higher than under a single rate structure. (d) Currently, services are chargeable to tax at a single rate. Adopting a dual rate for goods would generate a similar demand for services too. (e) Having different rates for goods and services would imply that the distinction between goods and services should continue. Around 99 items presently exempted under VAT may continue to remain exempted in GST regime. There should be no scope, with individual States, for expansion of this list even for goods of local

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
			importance. Efforts will be made by Centre to substantially reduce the number of items presently exempted under CENVAT regime. At the end, there must be a common list of exemptions for CGST and SGST.
		The States are of the view that for CGST relating to goods, the Government of India may also have a two-rate structure, with conformity in the levels of rate under the SGST. For taxation of services, there may be a single rate for both CGST and SGST.	There should be one CGST rate both for goods as well as services.
		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.	SGST and CGST rates are required to be put in public domain much before initiation of legislative action.
19	3.7	**Zero Rating of Exports:** Exports should be zero-rated. Similar benefits may be given to Special Economic Zones (SEZs). However, such benefits should only be allowed to the processing zones of the SEZs. No benefit to the sales from an SEZ to Domestic Tariff Area (DTA) will be allowed.	Agreed.
20	3.8	**GST on Imports:** The GST is proposed to be levied on imports with necessary 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 SGST amount 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 on goods and services.	Levy of GST on imports may be handled by Centre through a Central legislation either as a customs duty (as is being done now) or along the lines of IGST. SGST collected by Centre may be passed on to concerned State following the destination principle. Taxation of import of services may be on the basis of reverse charge model, as is being done at present.
21	3.9	**Special Industrial Area Scheme:** After the introduction of GST, the tax exemptions, remissions etc. related to industrial incentives	Agreed.

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		and special industrial area schemes should be converted, if at all needed, into cash refund or subsidy schemes after collection of tax, so that the GST scheme on the basis of a continuous chain of set-offs is not disturbed. Regarding Special Industrial Area Schemes, it is clarified that the benefits of such exemptions, remissions etc. would continue up to legitimate expiry time both for the Centre and the States. Any new exemption, remission etc. or continuation of earlier exemption, remission etc. would not be allowed. In such cases, the Central and the State Governments could provide reimbursement after collecting GST.	
22	3.10	**IT Infrastructure:** After acceptance of IGST Model for Inter-State transactions, the major responsibilities of IT infrastructural requirement will be shared by the Central Government through the use of its own IT infrastructure facility. The issues of tying up the State Infrastructure facilities with the Central facilities as well as further improvement of the States' own IT infrastructure, including TINXSYS, is now to be addressed expeditiously and in a time bound manner.	Agreed.
23	3.11	**Constitutional amendments, legislations and rules for administration of CGST and SGST:** It is essential to have Constitutional Amendments for empowering the States for levy of service tax, GST on imports and consequential issues as well as corresponding Central and State legislations with associated rules and procedures. With these specific tasks in view, a Joint Working Group has recently been constituted (September 30, 2009) comprising of the officials of the Central and State Governments to prepare, in a time bound manner a draft legislation for Constitutional Amendment, draft legislation for CGST, a suitable Model Legislation for SGST and rules and procedures for CGST and SGST. Simultaneous steps have also been initiated for	The Joint Working Group (JWG) has held several meetings by now. Department of Revenue is closely working with Ministry of Law, Government of India, for finalisation of draft Constitutional amendment. The issue of empowering States to levy GST on imports has been deliberated by the JWG and the view which has emerged out of discussion is that the Centre shall collect GST on imports and pass on the SGST component of it to

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		drafting of a legislation for IGST and rules and procedures. As a part of this exercise, the Working Group may also address the issues of dispute resolution and advance ruling.	concerned State on destination principle.
24	3.12	**Harmonious structure of GST and the States' autonomy in federal framework:** As a part of the exercise on Constitutional Amendment, there would be, as mentioned earlier, in para 3.2, a special attention to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the States' autonomy in a federal structure.	Agreed in principle.
25	3.13	**Dispute Resolution & Advance Rulings:** As a part of the exercise on drafting of legislation, rules and procedures for the administration of CGST and SGST, specific provisions will also be made to the issues of dispute resolution and advance ruling.	The provisions related to dispute resolution, advance rulings and other business processes need to be harmonised between Centre and States.
26	3.14	**Need for compensation during implementation of GST:** Despite the sincere attempts being made by the Empowered Committee on the determination of GST rate structure, revenue neutral rates, it is difficult to estimate accurately as to how much the States will gain from service taxes and how much they will lose on account of removal of cascading effect, payment of input tax credit and phasing out of CST. In view of this, it would be essential to provide adequately for compensation for loss that may emerge during the process of implementation of GST for the next five years. This issue may be comprehensively taken care of in the recommendations of the Thirteenth Finance Commission. The payment of this compensation will need to be ensured in terms of special grants to be released to the States duly in every month on the basis of neutrally monitored mechanism.	Empowered Committee has already referred the issue to the Thirteenth Finance Commission (TFC). TFC is likely to submit its report shortly. A view on the subject will be taken after more clarity on the subject is available.
27	3.15	With this First Discussion Paper and the Annexure on frequently asked Questions and Answers on GST, interaction with the	Empowered Committee may prepare a plan with clear timelines for orientation of

Sr. No.	Para No. of the Discussion Paper	Issues	Comments of the DoR
		representatives of industry, trade and agriculture would begin immediately at the national level, and then also simultaneously at the State levels. Similarly awareness campaign for common consumers would also be initiated at the same time. As a part of the discussion and campaign the views of the industry, trade and agriculture as well as consumer may be sought to be obtained in a structured and time bound manner.	stakeholders so that required steps may be taken by all the States in time.

B-4
THE IT STRATEGY FOR GST*

EMPOWERED GROUP ON IT INFRASTRUCTURE ON GST HEADED BY Shri Nandan Nilekani

1. Introduction

1.1 The merits of GST

GST will bring about a change in the tax system by redistributing the burden of taxation equitably between manufacturing and services. GST will enable broadening of the tax base, which will further result in reduction in effective rate of tax. It will reduce distortions by applying the destination principle for levy of taxes. It will foster a common market across the country, reduce compliance costs and promote exports. It can provide a fiscal base for local bodies to enable them to fulfill their obligations. It will facilitate investment decisions being made on purely economic concerns independent of tax considerations.

1.2 Urgency

The broad framework of GST is now clear, with the model being approved by the Government of India and Empowered Committee of State Finance Ministers. The GST will be a dual tax with both Central and State GST component levied on the same base. The IGST framework will be used for goods and services that are exported across state boundaries. Thus, all goods and services, barring a few exceptions, will be brought into the GST base. For reasons of simplicity for the taxpayer, ease of tax administration, and bringing about a national common market, a common PAN-based taxpayer ID, a common return, and a common challan for tax payment have been agreed to by all stakeholders.

A number of issues still remain to be resolved. These are presently under the consideration of the Empowered Committee of State Finance Ministers under the Chairmanship of Dr Asim Dasgupta. Such issues include: the rates of taxation, the revenue sharing between States and Centre, and a framework for exemption, thresholds and composition.

On the IT front, there has been consensus that there will be a common portal providing three core services (registration, returns and payments). The broad services framework of the portal has been discussed with the Sub Working group for IT. Various technology issues have been addressed including solution architecture and selection of likely service provider. However many other related issues need to be addressed which are on the critical path for GST going live by April

* *Source:* http://finmin.nic.in/gst/IT_Strategy_for_GST_ver0.85.pdf

2011. Some of these issues include incubation, ownership and governance structures, development, deployment, and integration of existing systems, and change management procedures, among others. An update on some of these issues is provided in Section 6 of this document.

Without a well-designed and well-functioning IT system, the benefits of GST will remain elusive. It is important that the design and implementation of the GST IT systems start without any further delay, and consensus is achieved on the unresolved policy issues in the earliest possible timeframe.

2. An IT infrastructure for GST

Figure 1: Desirable features of GSTN

2.1 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.

2.2 Stakeholders

The design of an IT infrastructure should serve all stakeholders and their business processes. The various stakeholders in a GST IT implementation are as follows (Figure 2):

Figure 2: 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.

2.3 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 (Figure 2), and all related workflows (Figure 3).

Figure 3: Workflows

3. The Solution Architecture

3.1 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)

Figure 4 shows the solution architecture, the role of the common GST portal, and its connections with other systems.

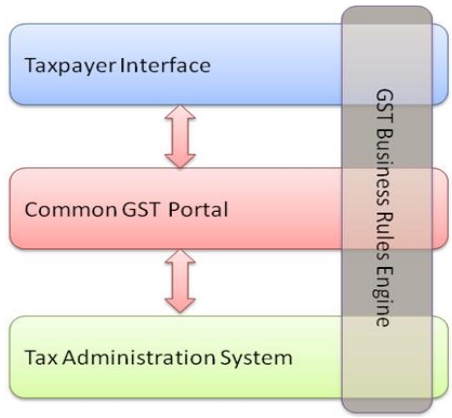

Figure 4: Solution Architecture

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.

3.2 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.

3.3 Information Flow

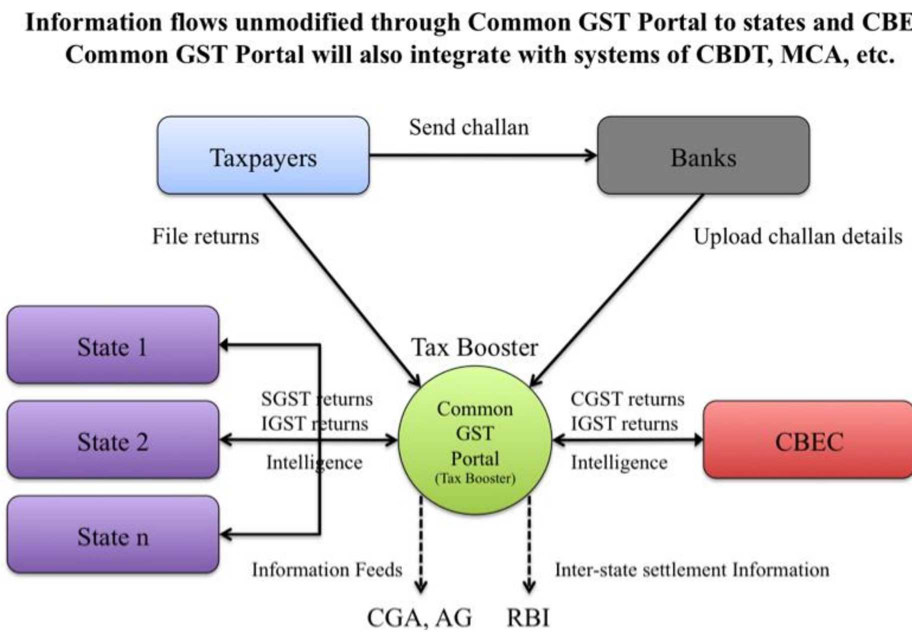

Figure 5: Information flow

The information flows are shown in Figure 5 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.

3.4 Funds flow

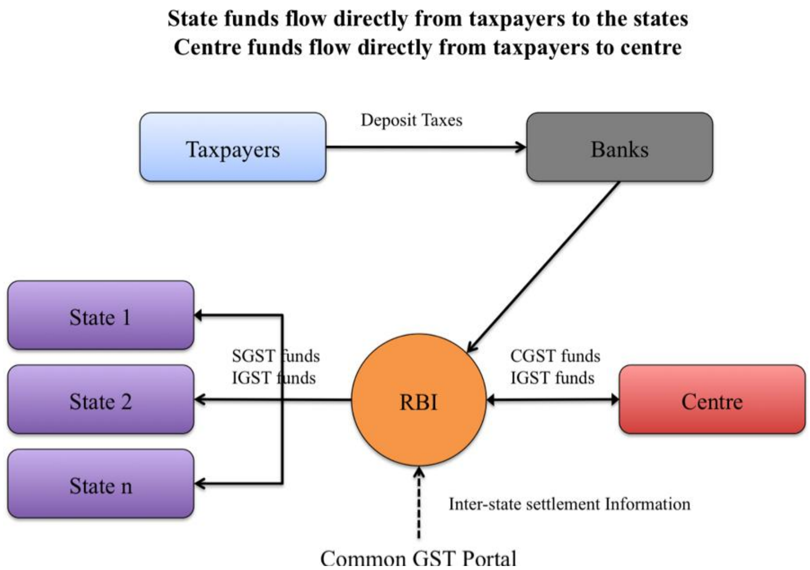

Figure 6: Funds flows

Just like the information flows, the funds flows (Figure 6) 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.

4. Tax Booster

4.1 Tax computation and accounting

Figure 7: Levels of granularity for returns

The tax returns can be filed at various levels of granularity, as shown in Figure 7.

1. **Aggregate level:** A taxpayer aggregates all his sales and purchases made across all the customers/ vendors and files one return.
2. **Dealer level:** A taxpayer aggregates all his sales and purchases made across all the customers/ vendors and files one return along with the transactions consolidated customer/ vendor wise.
3. **Invoice level:** A taxpayer aggregates all his sales and purchases made across all the customers/ vendors and files one return along with the transactions details provided invoice wise.
4. **Line item level:** A taxpayer aggregates all his sales and purchases made across all the customers/ vendors and files one return along with the invoice wise transactions capturing item wise details as well.

Invoice level detail is necessary for the reconciliation of tax deposits, and the end-to-end reconciliation of ITC. An effective IGST implementation may also require invoice-level details. A number of states are capturing invoice details even in the existing VAT systems. It is proposed to follow a two-pronged approach with Dealer level granularity of returns in the first phase followed by invoice level in the next phase. This issue is currently being discussed in the IT sub-working group for evolving consensus.

There has been some concern around reconciliation of ITC at invoice-level detail due to the sheer volume of data. However, this scale is no different than what organizations such as NSE, NSDL, RBI, and banks handle on a daily basis. Experience at states that have implemented this also shows that match quality is low initially, but improves significantly over time.

4.2 Tax booster

Type of fraud	Common GST Portal: Intelligence based deterrence
Fraudulent bills	Matching
Improper Input Tax Credit	Matching
Fraudulent use of 'exempt' rules	Electronic returns
False payment proofs	Electronic challans
Unrecorded sales	Data mining
Misuse of composition method	Data mining
Wrongful application of lower tax	Data mining
Under-invoicing	Data mining
Non-existent dealers	Data mining

Figure 8: Types of frauds

As taxpayers start filing invoice level returns, the common GST portal can start analysing the data for tax evasion and fraud. Common formats for returns and payments, combined with electronic filing and electronic payments, and a standardized PAN-based registration makes the data consistent, and amenable to mining.

Some of the common frauds, and how they may be combated are shown in Figure 8. Assuming VAT collections of ₹ 1,50,000 crores across all states, and a potential for a 20% increase in collections, the common GST portal can lead to additional revenues of up to ₹ 30,000 crores.

5. Implementation plan

Owner	Component
Taxpayer	User registration (PAN-based) File returns Tax payments
GSTN	User registration (PAN-based) Acceptance and Consolidation of returns Challan reconciliation Matching of Input Tax Credit Dashboard and MIS Helpdesk and facilitation centres
Tax Authorities	Assessment, audits, and enforcement Refunds Dispute resolution Helpdesk and facilitation centres
Banks and RBI	Tax payments and reconciliation
Accounting Authorities	Reconciliation

Figure 9: Owners of various components

The GST IT implementation requires various stakeholders to implement new IT systems, or modify existing systems. All these stakeholders are on the critical path for GST readiness in April 2011. Implementation plans for various stakeholders, and interfaces between stakeholders should be frozen, and agreed to by all before implementation can commence. Figure 9 lists the components to be implemented by various stakeholders to go live in April 2011.

6. Current Status of GSTN implementation

The Ministry of Finance, with the concurrence of the Empowered Committee of State Finance Ministers, has set up an *Empowered Group on IT Infrastructure for GST* with, inter alia, the mandate of approving the Solution architecture of the Common GST portal to be set up, Suggesting the modalities for setting up of a National Information Utility (NIU / SPV) and evaluating the suitability of the existing NIUs namely NSDL & NPCL for incubating the NIU/SPV for GST portal.

The 'Empowered Group on IT Infrastructure for GST' in its first meeting evaluated the feasibility of incubating the NIU, called GSTN, in NSDL and came to the conclusion that NSDL is well suited for this purpose. The scope of the project and implementation strategy is being worked out with the NSDL.

C-1
GST: 13TH FINANCE COMMISSION REPORT

Press Information Bureau*
Government of India
Ministry of Finance

Thirteenth Finance Commission Report Submitted

Dr. Vijay Kelkar, Chairman, 13th Finance Commission accompanied by Shri B.K. Chaturvedi, Dr. Indira Rajaraman, Prof. Atul Sarma and Dr. Sanjiv Misra, Members of the Commission called on the President Smt. Pratibha Devi Singh Patil at Rashtrapati Bhavan, here today and submitted their report. They also briefed the President on the recommendations made in the report.

The Union Government will table the report in Parliament in due course.

The Thirteenth Finance Commission was constituted by the President on 13th November, 2007 under article 280 of the Constitution to determine the sharing of tax revenues between the Centre and the States as well as to make recommendations on other related issues as required under its terms of reference. The Commission's report to cover the period 2010-15 was to be submitted by December 31, 2009.

BSC/GN421/09

Introduction

5.1. This Commission is required to consider 'the impact of the proposed implementation of Goods and Services Tax with effect from 1st April 2010 including its impact on the country's foreign trade', while formulating its recommendations. The changeover to the Goods and Service Tax (GST) will be a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues and acceleration of growth, as well as generate many positive externalities. Three other items of consideration in our Terms of Reference (ToR), viz. (i) '...estimation of the resources of the Central and State Governments'; (ii) the objective of not only balancing the receipts and expenditure on the revenue account but also to generate surpluses in the capital account'; and (iii)'. to improve the tax- gross domestic product ratio of the Center and the States' will also be influenced by the GST. This Commission therefore recognised the need to holistically examine all the issues relating to the implementation of GST.

5.2. The first phase of reform of indirect taxation occurred when the Modified Value Added Tax (MODVAT) was introduced for selected commodities at the central level in 1986, and then gradually extended to all commodities through Central Value Added Tax (CENVAT). The

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* *Source: www.pib.nic.in

introduction and integration of service tax into CENVAT deepened this effort. Reform at the state level occurred through introduction of Value Added Tax (VAT) by all the states in the country in a phased manner between April 2003 and January 2008. Buoyed by the success of VAT, and mindful of the need for further improvement, the Government of India (GoI) indicated in Feb 2007 that a roadmap for introduction of destination-based GST in the country by 1 April 2010 would be prepared in consultation with the Empowered Committee (EC) of state Finance Ministers. This commitment was reiterated in February 2008 and July 2009. The origin-based Central Sales Tax (CST) was successively reduced from 4 to 3 per cent and 2 per cent during 2007 and 2008, respectively, as part of this reform process. In November 2007, a Joint Working Group consisting of representatives of the Empowered Committee and the Government of India prepared a report on the changeover to GST. This report was discussed by the EC, which then prepared 'A Model and Road Map for Goods and Service Tax in India' in April 2008. The model and roadmap, while recommending that a dual GST be put in place, also provided preliminary views on the state and central taxes to be subsumed within the GST. The model detailed the operational issues which needed to be addressed, including the number of rates, the exemptions and exclusions from GST, as well as the treatment of inter-state transactions. The roadmap outlined the legal and administrative steps which needed to be taken in order to comply with the April 2010 time line. The Government of India's response to this document formed the basis of the second round of discussions and reviews. This culminated in the release of the 'First Discussion Paper on Goods and Service Tax in India' in November 2009. This discussion paper provides details of the taxes to be subsumed, while at the same time, outlining the modalities of implementation of the tax. It also makes recommendations on a number of building blocks of the GST, including taxation of inter-state trade, provision of compensation, treatment of area based schemes and the additional steps required to be taken. It, however, does not provide any guidance on the Revenue Neutral Rates (RNR) which need to be adopted at the central and state level. This discussion paper is expected to spark a public debate, leading to possible modification of the design and implementation modalities of the GST.

5.3 Commendable progress has been made over the past three years in generating a national consensus on GST. Agreement on the broad framework of this tax has now been reached. GST will be a dual tax, with both central and state GST components levied on the same tax base. All goods and services, excluding the agreed upon exemptions, will be brought into this base. No distinction between goods and services will be made, with a common legislation applying to both. However, a number of issues remain to be resolved. These need to be addressed carefully. Only if a model GST is put in place, can all its potential benefits be fully exploited. Given the large positive economic and fiscal externalities of the GST reform, putting in place an incentive structure to motivate all stakeholders to design and implement such a model GST was, therefore, a prime concern of the Commission. A number of State Governments and industry associations communicated to the Commission their concerns on the design and implementation of GST. To address these and other GST related issues including the mandate in our ToR, the Commission sponsored three independent studies. One, undertaken by the National Council for Applied Economic Research (NCAER) studied the impact of GST on international trade. The second was undertaken by a task force (TF) which examined the whole gamut of GST-related issues, from design to implementation and made suitable recommendations. Both these studies have been published on the website of the Finance Commission.[1] We review below their main findings and recommendations after briefly highlighting the concerns expressed by the State Governments.

Views of State Governments

5.4 The State Governments expressed their views on the structure of GST as well as its implementation modalities to the Commission during our state visits. Nine State Governments gave their views in their respective memoranda and some expressed their views through letters to the Commission. While all the states broadly supported the introduction of GST, the major concerns expressed by them are detailed hereunder.

5.5 *Determination of the tax base:* Some State Governments pointed to the importance of accurately assessing the tax base that would be available to them under GST. They noted that with regard to service tax, figures presently available were those pertaining to the point of collection, rather than to the point of incidence. Also, the rules of supply for services have not yet been finalised. States which presently have a high tax effort apprehended that the RNR finally agreed upon would not be favourable to them. Manufacturing states would suffer additionally due to the abolition of CST. They suggested that the GST rates should, therefore, be used as a floor rate.

5.6 Low income states argued that as their consumption base was low, and they had increased their tax effort significantly after implementing VAT, there was little scope for them to increase their revenues under the proposed GST regime.

5.7 *Vertical imbalance:* It was apprehended that the GST could possibly accentuate the vertical imbalance in favour of the Centre through a proportionally larger Central Goods and Services Tax (CGST) rate and access to a larger consumption base, hitherto unavailable to the Centre.

5.8 *State autonomy:* The GST requires a commitment to a stable rate structure. This will compromise the fiscal autonomy of State Governments and deprive them of the only lever of macro-economic policy available to them.

5.9 *Single rate:* A single GST tax rate would be regressive, with the tax levied on items of common the final report of the third study was awaited at the time of writing. It will also be put on the FC website after receipt. consumption increasing, while providing needless relief to the higher taxed luxury goods.

5.10 *Compensation mechanism:* Some states currently having a high tax effort noted the possibility of suffering losses upon implementation of GST. They requested that an objective compensation mechanism to support such losses be put in place. Compensation on loss of CST should also be part of this package.

5.11 *Small enterprises:* Small enterprises manufacturing specified goods with an annual turnover of less than Rs. 1.5 crore are presently exempt from excise. The GST will bring them into the tax net, rendering them uncompetitive and enhancing their compliance cost.

5.12 *Cesses and surcharges:* All cesses and surcharges levied by both the Centre and the states should be subsumed into the GST.

5.13 *Taxes to be excluded from GST:* Electricity duties; purchase tax; and taxes on crude oil, motor spirit (MS), high speed diesel (HSD), alcohol and tobacco should be excluded from the purview of GST.

5.14 *Compliance mechanism:* The GST law should be subject to rigorous compliance and deviations should not be permitted. Changes should be made only with the consent of all the states.

5.15 *Selective rollout:* States should be given the option to adopt GST at their convenience and the possibility of implementation of GST in only some states should be incorporated in the design.

5.16 *Dispute Resolution:* An independent dispute resolution mechanism should be put in place.

5.17 *Implementation modalities:* All tax returns, assessment and audit procedures should be harmonised across the country. A comprehensive information technology (IT) based infrastructure should be put in place to track inter-state transactions.

5.18 Adequate preparation for the changeover, rather than an arbitrary fixed schedule, should be the sole criterion for deciding the timing for introduction of GST.

5.19. The CST Act should be abrogated such that the provision for notifying declared goods is not available to the Centre.

5.20. The rules of supply for inter-state sales should be finalised expeditiously, in an objective manner. Further, the modalities for levying GST on imports, textiles and sugar should be agreed upon.

Views of the Central Government

5.21. During our consultations with the Central Government, they expressed concerns about the following issues:

(i) The recommendation in the Discussion Paper that GoI maintain the CGST threshold at Rs. 1.5 crore, while the State Goods and Services Tax (SGST) composition threshold would be Rs. 40 lakh.

(ii) The importance of agreeing upon a uniform and limited list of exempted items for the Centre and for all the states.

(iii) The criticality of promoting the power sector and the importance of subsuming electricity duty into GST.

(iv) The need to subsume purchase tax into GST to ensure that it remains a consumption-based tax and is not exported across tax jurisdictions.

Impact of GST on Foreign Trade

5.22. A NCAER study, commissioned by us, evaluates the possible impact of GST on India's international trade in a Computable General Equilibrium (CGE) framework. It notes that the differential multiple tax regimes across sectors of production are leading to distortions in the allocation of resources as well as production inefficiencies. Complete offsets of taxes are not being provided to exports, thus affecting their competitiveness. It estimates that implementation of a comprehensive GST across goods and services will enhance the nation's Gross Domestic Product (GDP) by between 0.9 and 1.7 per cent. This works out to between Rs. 52,600 crore and Rs. 99,450 crore on the basis of GDP figures for 2009-10. Such benefits would accrue every year. It would also lead to efficient allocation of the factors of production, with a fall in the overall price level. The report identifies a number of sectors which would directly benefit from the implementation of GST. The study estimates the gain in exports to vary between 3.2 and 6.3 per cent. Imports are expected to gain between 2.4 per cent and 4.7 per cent, thus improving the trade balance.

5.23. The study estimates the revenue-neutral GST rate across goods and services to be between 6.2 and 9.2 per cent, depending upon the assumptions made. This value was conservatively arrived at, ignoring the existence of tax thresholds and composition limits. The study assumes that the GST adopted will be a truly consumption based tax which will: (i) eliminate all origin based taxes; (ii) subsume all the other presently levied indirect taxes on goods and services (excluding customs) and (iii) will not be exported across tax jurisdictions. To exploit the benefits of GST fully, we also need to ensure that tax compliance costs are low and tax credits are available seamlessly across tax jurisdictions. Apart from uniform tax rates, this will also require harmonisation of procedures for levy, assessment, appropriation and even audit, between the states and the Centre, as well as amongst the states themselves. This is best done through a model GST, the characteristics of which are outlined in Para 5.25.

Report of the FC -XIII Task Force

5.24. The task force, appointed by this Commission, comprehensively analyzed all GST related issues and made a number of recommendations. The Task Force Report is available on the Commission's website. The key points are summarised below:

(i) Following the present VAT, the GST should be levied on consumption and computed on the basis of the invoice credit method.

(ii) All major indirect taxes (excluding customs) and all cesses and surcharges should be subsumed into the central and state GST.

(iii) Specifically, stamp duty, taxes on vehicles, taxes on goods and passengers and taxes and duties on electricity should be subsumed into the GST.

(iv) Transmission fuels, High Speed Diesel (HSD), Motor Spirit (MS) and Aviation Turbine Fuel (ATF) should be brought under a dual levy, of GST and an additional levy, with no input tax credit available on the additional levy. This would protect the existing revenues from these sources. However, all other petroleum products should be brought within the ambit of the GST, as should natural gas.

(v) The sumptuary goods of tobacco and alcohol should be taxed through GST as well as an additional levy, with no input tax credit being provided on the additional levy.

(vi) The entire transportation sector should be included in the GST base, and taxes on vehicles, goods and passengers should be subsumed into the GST. Similarly, the power sector should be included in the tax base and electricity duty subsumed.

(vii) The real estate sector (both residential and commercial) should be included in the tax base and stamp duty levied by State Governments should be subsumed into GST. A threshold of Rs. 10 lakh in this regard will permit exemption of small residential and business properties.

(viii) The entire financial services sector should be brought under the GST tax base.

(ix) Capital goods should be treated like all other goods and services, with no restrictions on availment of input tax credit at purchase, and a corresponding liability for GST on subsequent sale.

(x) No exemptions should be allowed, except for a common list applicable to all states as well as the Centre, which should only comprise : (a) unprocessed food items; (b) public services provided by all governments excluding railways, communications, public sector enterprises; (c) service transactions between an employer and employee and (d) health and education services.

(xi) 'Place of supply' rules for goods and services should be based on international best practice, and be carefully framed to ensure consistency, credibility and relevance.

(xii) An exemption threshold of Rs. 10 lakh should be adopted, with a composition limit of Rs. 40 lakh, above which GST would be mandatorily applicable. The present excise exemption upto Rs. 1.5 crore should be withdrawn. However, in the case of certain high value goods comprising: (i) gold, silver and platinum ornaments; (ii) precious stones and (iii) bullion, the dealers may, subject to the threshold limit of Rs. 10 lakh but without the ceiling of Rs. 40 lakh, also be allowed to opt for the composition scheme.

(xiii) Area-based exemptions should be withdrawn and the tax paid reimbursed wherever considered necessary.

(xiv) Inter-state transactions should be treated through a mechanism which permits sellers in one state to charge SGST from buyers in another state. The seller shall furnish the transaction related information and composite payment of tax in respect of both intra and inter state transactions, to nodal bank. This SGST should then be immediately credited to the consuming state by the bank where such payment is made.

(xv) Harmonisation should be ensured in registration, return filing, assessment, and audit across states.

(xvi) The GST tax base has been estimated at Rs. 31,25,325 crore. This is the average of five different estimations of the tax base obtained by following as many approaches. These estimates are given in Table 5.1.

Table 5.1: Estimates of the Tax Base of GST by

	Different Approaches	(Rs. *crore)*
1.	Subtraction Method	30,73,037
2.	Consumption Method	
	a. Task Force Method	37,43,077
	b. NCAER Method	30,77,952
3.	Shome Index Method	27,82,809
4.	Revenue Method	29,49,748
	Average	**31,25,325**

(xvii) The consequent Revenue-Neutral Rate works out to 11 per cent (5 per cent for CGST and 6 per cent for SGST). This excludes the additional levies which would be imposed on petroleum and sumptuary goods. The task force has recommended that all goods and services should be subject to tax at the single positive GST rate of 12 per cent (that is, 5 per cent for CGST and 7 per cent for SGST) other than exports.

The Model GST

Outline of the Model GST

5.25. Keeping in mind the recommendations of the task force, we outline the design and modalities of a model GST law. Such a model GST would not distinguish between goods and services. It should be levied at a single positive rate on all goods and services. Exports should be zero-rated. Tax compliance costs should be low and tax credits should be available seamlessly across tax jurisdictions. The other design and operational modalities of a model GST are outlined below.

Taxes to be Subsumed

5.26. For the GST to be purely consumption based, all related indirect taxes and cesses should be subsumed into it. Thus, the Central GST portion would subsume the following taxes:

(i) Central excise duty and additional excise duties

(ii) Service Tax

(iii) Additional Customs Duty (Countervailing Duty)

(iv) All surcharges and cesses

5.27. The SGST portion would subsume the following taxes:

(i) Value Added Tax

(ii) Central Sales Tax

(iii) Entry Tax, whether *in lieu* of octroi or otherwise

(iv) Luxury Tax

(v) Taxes on lottery, betting and gambling

(vi) Entertainment Tax

(vii) Purchase Tax
viii)State Excise Duties

(viii) Stamp Duty

(ix) Taxes on vehicles

(x) Tax on goods and passengers

(xi) Taxes and duties on electricity

(xii) xiii)All state cesses and surcharges

Special Provisions for Certain Goods

5.28 The taxation of petroleum products and natural gas would be rationalised by including them in the tax base. HSD, MS, and ATF could be charged GST and an additional levy by both the Central and State Governments. No input credit would be available against either CGST or SGST on the additional levy. A similar treatment would be provided to alcohol and tobacco. Such an arrangement would ensure protection of existing revenues while taking care of environmental concerns.

Exemptions

5.29 No exemptions should be allowed other than a common list applicable to all states as well as the Centre, which should only comprise: (i) unprocessed food items; (ii) public services provided by all governments excluding railways, communications and public sector enterprises and (iii) service transactions between an employer and employee (iv) health and education services.

5.30 A threshold of Rs. 10 lakh and a composition limit of Rs. 40 lakh have been agreed upon by the EC for SGST in the first discussion draft. It is desirable that these limits be applied to CGST as well. Sales of goods of local importance will fall within these threshold limits, thus keeping them out of the ambit of GST.

5.31 Dealers with turnover below Rs 1.5 crore were previously exempt from CENVAT. As thresholds need to be consistent across SGST and CGST, such exemptions should not continue. Under the GST regime, dealers with turnovers between Rs. 10 lakh and Rs. 40 lakh will have to pay both CGST and SGST. Their compliance burden will increase. This issue can be addressed if both CGST and SGST are levied and collected from such dealers by a single agency, viz. the State Government, which would then remit the CGST portion to the Central Government. State

Government will be responsible for assessment, levy, collection and audit, with Central Government retaining it right to exercise these functions in respect of CGST in specific cases. State Governments could be reimbursed the collection charges for this effort. Wherever the additional levy is likely to cause hardship, a scheme for reimbursement to economically vulnerable dealers could be considered by the government.

5.32 The present area-based exemption schemes are not consistent across the states where they are applicable. They differ in the admissibility of CENVAT credit as well as the sunset clause. Since it would be difficult to subsume these schemes into the GST structure, it is recommended that they be terminated. The existing schemes should not be grandfathered. Alternative options like refunding taxes paid by industries in these locations could be considered.

Treatment of Inter-state Sales

5.33 All transactions across tax jurisdictions should be free from tax. While exports will be zero rated, inter-state transactions should be effectively zero-rated so as to ensure that the tax is collected by the consuming state consistent with the destination principle. Therefore, any model adopted must allow accurate determination and efficient transfer of input tax credit across tax jurisdictions. Further, the model should not impose any undue restrictions on tax credit set-off or increase in compliance costs.

Formulation of Rules of Supply

5.34 The 'place of supply' rules for services need to be carefully framed to ensure consistency and credibility. It should be based on international best practice.

GST on Imports

5.35 Imports from outside the country would be subject to GST on the destination principle. This will require that proof of consumption at a pre- determined destination state should be provided. The procedure for collection and appropriation of this tax needs to be put in place. Rules for transferring this tax burden in the case of importers who sell to a consumer in a third state after the import is made, need to be clarified.

Operational Modalities

5.36 To reduce compliance costs and increase collection efficiency, all state GST laws should be harmonised. All stages of the taxation chain, from levy of the tax to its assessment, collection and appropriation, should be similar across states. This would involve similar rules across states, dealing not only with assessments, audit and refunds, but also with more basic issues like registration, filing of returns, treatment of transportation of goods, etc.

5.37 While CST will be reduced to zero, the necessity of stipulating documentation for interstate trade needs to be carefully examined. The model for taxing inter-state sales finally adopted should provide clarity on the jurisdiction of states while facilitating inter-state trade and stock transfers. Given the volume of such transactions, this system necessarily has to be IT-based. Such an IT network should enable the sharing of information between states and assist in the plugging of revenue leakages. A system to facilitate inter-state verification of dealers and transactions is also necessary. The present system, viz. Tax Information Exchange System (TINXSYS), does not appear to be fully operational across all states. There are asymmetric benefits to states in putting in place such infrastructure and this appears to be affecting their incentives to do so. A system which will uniformly incentivise all states to participate in and contribute to the verification system needs to be put in place. Alternately, one central agency could be charged with maintaining this system. The existing TINXSYS infrastructure should be updated and strengthened.

Dispute Resolution and Advance Ruling Mechanism

5.38 An effective, efficient and uniform system for redressal of anomalies in the legislation should be put in place. This could be an independent and quasi judicial authority with full powers to look into all disputes related to GST implementation, both at the Centre and state level. Such an authority could issue guidelines, administer and enforce agreement between states and the Centre, and between the states themselves. A common Advance Ruling Authority for both the Centre and the states should also be put in place.

Refunds

5.39 Prompt refunds form the core of an effective GST framework, especially as cross-utilisation of input tax credit across CGST and SGST, are not envisaged. Delayed payment of refunds enhances the cost of dealer operations and reduces the efficiency of the tax system. The experience with refunds under the VAT regime is not reassuring, even though VAT laws in a number of states mandate payment of interest for delay. State Governments must adopt a more effective refund system. They could consider an electronic system where refunds are directly credited to the eligible dealer's bank account.

Selective Rollout

5.40 VAT was introduced in a phased manner by State Governments over a period of nearly three years, between April 2003 and January 2008. VAT dealt purely with the treatment of intra-state sales and states were not explicitly disadvantaged if they did not implement VAT. Transactions between VAT and non-VAT states did not warrant special treatment. However, GST changes the rules of the game. It requires inter-state trade to be zero rated.

It empowers states by including services as well as the manufacturing stage in their tax base. It thus creates an uneven balance between states which implement GST and those which do not. Goods and services sold between complying and non-complying states would thus require to be treated differently in the wake of selective implementation of GST. If CST were to continue to apply in non-complying states, inter-state sales would become further complex. Goods passing through a non-complying state, to be finally sold in a complying state, would be burdened by a cascading tax which would adversely affect the price to the final consumer. The seamless flow of Input Tax Credit (ITC) on inter-state transactions would be interrupted. Further, rate mismatches may encourage trade diversion and cost of compliance would become extremely high for inter-state dealers. This would discourage economies of scale. We, therefore, feel that the model GST should be implemented by all states and the Centre at one time, and not be partially implemented in some states. It is for this reason that we recommend that proper preparation for the GST and generating of a consensus amongst all states is a greater priority than complying with the 2010 deadline. However, as has been suggested in some quarters, it is possible for the Centre alone to transform the CENVAT into a GST at the manufacturing stage at any time. It could unify the CENVAT rates and impose a general tax on all services, while adopting a common threshold. As mentioned earlier, a dual tax on petroleum products, tobacco and alcohol could be levied-a GST component and an additional levy component with no input credit being provided on the latter.

Transition Provisions

5.41 A number of transitional issues will arise. Provisions to address such issues must be consistent with the model GST.

Benefits from Supporting the Model GST

5.42 This Commission supports the implementation of a model GST for the following reasons:

(i) The NCAER study computed the present value of GST-reform induced gains in GDP as the present value of additional income stream based on the discount rate of 3 per cent representing the long-term real rate of interest. The present value of total gain in GDP is estimated as between Rs. 14.69 lakh crore and Rs. 28.81 lakh crore. The corresponding dollar values are US $325 billion and $637 billion. This represents between 25 and 50 per cent of the 2009-10 GDP gained through this major tax reform. The all-government tax revenue will also increase by about 0.20 per cent of GDP, a significant increment to revenues through implementation of the model GST.

(ii) The Task Force report estimated that such a GST would have a tax base of around Rs. 31,00,000 crore. It further estimated that this would require a revenue-neutral rate of only 12 per cent (5 per cent for the Central GST and 7 per cent for the State GST). This is a substantial decrease from the present 20.5 per cent (8 per cent for CENVAT and 12.5 per cent for VAT). This should be the target.

(iii) Adoption of such a model GST would make India a dynamic common market and also result in generation of positive externalities. Despite lower levels of taxes, the revenue of the Union and the states will be buoyant. Subsumation of all major indirect taxes will result in removal of inefficient taxes. Our manufactures will become more competitive and consequently exports will grow. Provision of seamless input tax credit across all transactions will avoid tax cascading, eliminate double taxation and improve resource allocation. It will foster a common market across the country, reorient supply chains and remove the present bias towards backward integration. Further, it will also inhibit tax induced migration of investment. It will, thus, support the growth of lagging but resource-rich regions. A single rate across all goods and services will eliminate classification disputes and make tax assessment more predictable. The harmonisation of tax assessment, levy and collection procedures across states proposed under the GST will reduce compliance costs, limit evasion, enhance transparency and improve collection efficiency.

(iv) Successful implementation of GST also offers the possibility of strengthening the revenue base of local bodies that form the third tier of government.

(v) The inclusion of real estate in the GST tax base will constrain the parallel economy with consequent positive spillovers into governance and the development of land markets.

(vi) The NCAER model suggests that GST could lead to better environmental outcomes.

Concerns of State Governments

5.43 We address below the principal concerns of states relating to revenue from certain products, loss of autonomy in a GST framework, possibilities of states entering GST in a phased manner and treatment of small enterprises.

Revenue from Certain Products

5.44 The model GST will accommodate the concerns of governments with regard to maintenance of their revenues from transmission fuels and sumptuary goods by allowing the imposition of an additional levy over and above the GST.

Dilution of Fiscal Autonomy of States

5.45 Concerns have been expressed by some state governments that the GST regime will constrict their fiscal autonomy and further tilt the vertical imbalance. However, this argument should be viewed in the following perspective:

(i) While the states will normally not be able to deviate from the nationally agreed model for the GST, such constraints will apply to the Centre as well. Further, the states still have fiscal headroom available. They can impose an additional levy on transmission fuels as well as sumptuary goods and the authority to levy temporary cesses and surcharges in case of emergencies, remains. They can also continue to levy user charges for services provided to citizens. Expenditure policy will continue to remain as a powerful fiscal instrument. Further, the strengthening of their fiscal base will improve their access to capital markets, enhancing their borrowing capacity.

(ii) The tax base of State Governments will significantly increase with the inclusion of the tax on services as well as the tax on manufacture. The tax base of the Centre, on the other hand, will increase only to the extent of tax on sales. Thus, it cannot be said that the vertical imbalance will increase in favour of the Centre.

(iii) States will benefit from the abolition of the cesses and surcharges presently being levied by the Centre, as the size of the divisible pool will rise. Presently this amounts to about 15 per cent of the divisible pool.

(iv) Tax policy is tax administration, and significant scope exists for improving tax collection efficiency through implementation of GST.

(v) The GST grant recommended by this Commission compensates for the seeming limitation in fiscal autonomy by enhancing expenditure autonomy through compensation payments and additional formulaic transfers.

(vi) The GST will be a landmark effort by the states and the Union to further co-opertive federalism with all stakeholders contributing to national welfare by accepting its framework.

Compensation Mechanism

5.46 An objective compensation mechanism incorporated in the 'Grand Bargain' will provide reassurance to both the Central and State Governments. This has been proposed in Para 5.60.

Checkposts

5.47 Most states have put in place a system of checkposts on their border roads. There are a number of reasons for putting in place such physical barriers to trade. These include (i) enforcement of state excise, market cess, forest and vehicle fitness regulations (ii) applicability of lower taxes on inter-state trade than on intra-state trade (iii) there being no tax on stock transfers (iv) levy of entry tax on specified goods (v) levy of octroi by some municipalities and (vi) internal security. The onset of GST will not obviate all these reasons, and therefore, check posts on state borders may remain. However, it must be recognised that such checkposts, by the very nature of their operations, generate enormous delays in road traffic. The arrangement also encourages rent-seeking behaviour. It may be difficult to eliminate checkposts, given the valid concerns of State Governments. But what appears to be egregious is that the same vehicle has to pass through two checkposts-the exporting state's checkpost and the importing state's checkpost—while crossing one border. Both these checkposts are often located within a couple of kilometres of each other and a transport vehicle has to spend considerable time at both. Perhaps, it may be possible for both states to put up a combined checkpost. Officials of both states could sit together and conduct their verifications in a single check post. Alternately, one state could handle traffic in one direction and the other state in the other direction, essentially ensuring that there would be only one check per border for a goods vehicle. Such an arrangement would significantly reduce travel time and we recommend it for consideration. There is an overwhelming retionale for minimising delays and thus reducing transaction costs. States could be encouraged to consider user-friendly options like electronically issued passes for transit traffic in order to reduce truck transit time through their states.

The Grand Bargain

5.48 We propose that both the Centre and the states conclude a 'Grand Bargain' to implement the model GST. Keeping the experience of the implementation of VAT in mind, we suggest that the six elements of the Grand Bargain comprise: (i) the design of the GST; (ii) its operational modalities;(iii) binding agreement between Centre and states with contingencies for change in rates and procedures; (iv) disincentives for non compliance; (v) the implementation schedule and (vi) the procedure for states to claim compensation. The design of the model GST is suggested in paras 5.25 to 5.35. The operational modalities are outlined in paras 5.36 to 5.41. The proposed agreement between the Centre and states, with contingencies for changes in the agreement, is described in paras 5.49 to 5.51. The disincentives for non-compliance are described in paras 5.52. The implementation schedule is described in paras 5.57 to 5.59. The procedure for claiming compensation is at Para 5.60.

Binding Agreement between Centre and States

5.49 Compliance of states with the previously agreed upon guidelines for VAT has not been very uniform. A number of states have deviated from the three-tier VAT rates, thus indicating the need to put in place an enforcement mechanism. States are equally apprehensive that the Centre may unilaterally raise tax rates without consulting them. The Constitution does not envisage sharing of tax bases. Taxation powers are listed either in the State List or in the Central List, but not in the Concurrent List. For the first time since the Constitution was enacted, a tax base is proposed to be shared between the Centre and the states. It is, thus, necessary that a firm arrangement be put in place for implementing the GST to prevent deviations from the agreed upon model by either the Centre or the states.

5.50 One option is the possibility of a Constitutional provision to facilitate a tax agreement between the Centre and the states on the lines of the erstwhile Article 278. One suggestion is that the new Article 278 could read: 'Notwithstanding anything in this Constitution, the Government of a state may enter into an agreement with the government of any other state or the union government with respect to the levy and collection of any tax or duty leviable by them, and during the period such agreement is in force, the power of such states and union as the case may be, to make laws to impose any tax shall be subject to the terms of such agreement.' It has been argued that such a provision will eliminate the need to amend the taxing powers entrusted to the Union and the states through Schedule VII of the Constitution.

5.51 Such an agreement (between the 28 states and the Centre as parties) could specify the tax rates adopted as well as the conditions under which the agreed tax rates can be changed. The agreement can be made part of Goods and Service Tax laws which the Center and all the states will separately enact. The agreement will, amongst other things, specify the rates to be adopted in these enactments and the implementation schedule. For amending the rates subsequently, it is proposed that all states would need to agree to a proposal to decrease rates. Only three quarters of the number of states would need to agree if the rates have to be increased. The Centre would have a veto power. All amendments to the agreement should be consistent with (i) maintaining the integrity of the GST base; (ii) providing for administrative simplicity and (c) minimizing compliance costs for taxpayers. The agreement will need to be monitored by the Empowered Committee which could be transformed after the implementation of GST into a Council of Finance Ministers with statutory backing.

Disincentives for Non Compliance

5.52 Keeping in mind the experience under VAT it may become necessary to deter violations of agreement by visiting a penalty on non-complying states. We recommend that Finance Commission's state specific grants and the state's share of the GST incentive grant be withheld for the period during which a state is in violation of the agreement. If a state is in violation for only part of a year, its grant should be reduced to a proportionate extent.

Compensation/Incentive Grants

5.53 This Commission is aware that the tenor of the ongoing discussions on the GST model and implementation modalities does not include some of the major elements of the model GST outlined above. In our view, any major deviation from the concept of the model GST would dilute its positive externalities, significantly reduce its benefits and reduce the incentive to switch over. For the reasons outlined in Para 5.42, this Commission strongly urges that any GST model adopted be consistent with the Grand Bargain described in Para 5.48. To incentivise implementation of such a Grand Bargain between the states and the Centre, this Commission recommends the sanction of a grant of Rs. 50,000 crore to be provided to all states in the aggregate, subject to the GST framework adopted being consistent with the Grand Bargain. We recognise that while GST on the whole will be revenue neutral, there may be some winners and losers during the initial years of implementation. This grant will accommodate claims for compensation from the adversely affected states and balance will be distributed amongst states as per the devolution formula.

5.54 The grant of Rs. 50,000 crore would be used for meeting the compensation claims of State Governments between 2010-11 and 2014-15. Unspent balances in this pool would be distributed amongst all the states as per the devolution formula, on 1 January 2015. To allow for the possibility of implementation of GST during 201011, we propose that the grant be initially allocated as given in Table 5.2:

Table 5.2- Scheduling of GST Grant

2010-11	Rs. 5000 crore
2011-12	Rs. 11250 crore
2012-13	Rs. 11250 crore
2013-14	Rs. 11250 crore
2014-15	Rs. 11250 crore

5.55 We see this allocation as substantial for two reasons. First, the Task Force estimation of RNR provides assurance that such a level of compensation may not be required. Second, the amount of compensation required will depend upon the year in which GST is implemented. The total amount of Rs. 50,000 crore may be earmarked for GST compensation and incentive provided the model GST is implemented before 31.3.2013. Unspent grants at the end of a year will be carried forward to the next year if GST is implemented before 31.3.2013. If GST is implemented during 2013-14, the grant will be restricted to Rs 40, 000 crore. If GST is implemented during 2014-15, the grant will be restricted to Rs 30,000 crore.

5.56 To be eligible to draw down this grant, all the elements of the Grand Bargain outlined in Para 5.48 will need to be adopted. If the GST framework adopted is not consistent with this, then this Commission recommends that this grant of Rs. 50,000 crore not be disbursed. Thus, if the Grand Bargain is not concluded, this grant will not mean any net fiscal outgo. If a model GST is implemented and the grant is disbursed, then the resultant increase in GDP and tax revenue will fully finance it. If the Grand Bargain is not put in place, then the grant lapses. There are, thus, no fiscal risks with this grant- only advantages.

Implementation schedule of the Model GST

5.57 We recognise that building consensus on implementing the model GST may be an involved process but equally appreciate that the requirement of a good design is paramount and should not be subordinated to a deadline. International experience tells us that flaws in design are extremely difficult to correct subsequently. We therefore recommend that marginal rescheduling of the timetable for implementation should be acceptable if the design adopted is consistent with the model GST.

5.58 The objective of the model GST is to optimise tax collection with minimal economic distortions. The Model GST should, inter alia, comprise of (i) a uniform rate for goods and services (ii) a uniform rate across states (iii) a zero rate for exports and (iv) for all other goods and services a single rate, excluding the rate for precious metals. There could be two possible approaches to the implementation of the Model GST: the 'big-bang' approach and the 'incremental' approach. The introduction of the GST is the last mile in the reform of the indirect tax system of this country initiated in 1986 with the introduction of the MODVAT. All stakeholders stand to gain from a swift comprehensive changeover to the GST. To the extent the switchover is staggered, the potential gains from the comprehensive GST outlined in Para 5.42 would remain unrealised. Therefore, we recommend that all the elements of the model GST should be implemented comprehensively at one instance.

5.59 However, we are aware that two essential elements of the model have not yet been formally discussed by the states and consensus needs to be built before they are adopted. These are the inclusion of stamp duty in the GST tax base to enable the taxation of real estate and the use of a single rate in the GST framework. More time may be required for these elements to be included in the GST framework. Given that the terminal year of the period covered by our recommendations is 2014-15, we propose as follows. If found necessary, the GST may be initially implemented without these two elements provided that

(i) At the time of its implementation, the road map for their inclusion in the framework before 31 December 2014 is announced.

(ii) The GST is introduced with not more than two rates.

(iii) Properties other than individually owned residential properties are brought into the ambit of GST within two years of its implementation.

This contingency does not preclude the possibility of the Centre implementing GST at an accelerated pace.

Modalities for Disbursing Compensation

5.60 As mentioned in Para 5.10, states had requested that an objective compensation mechanism to support possible revenue losses after implementing GST be put in place. We recommend the following:

(i) The present Empowered Committee be transformed into a statutory Council of Finance Ministers with representation from the Centre and states. A GST Compensation Fund should be created under the administrative control of this Council.

(ii) The Central Government shall transfer to the GST Compensation Fund amounts as indicated in Table 5.2 and subject to the conditionalities indicated in paras 5.55 and 5.56.

(iii) The amounts in the Fund should be used for compensating states for any revenue loss on account of adoption of the model GST and the Grand Bargain as indicated above. The balance, if any, remaining on 1 January 2015, will be distributed amongst the states on the basis of the devolution formula indicated in Chapter 8 of our report, used for distributing resources in the divisible pool amongst states.

(iv) The amount will be disbursed in quarterly instalments on the basis of the recommendations made by a three-member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India; Secretary to the EC and chaired by an eminent person with experience in public finance. This person would be appointed by the Union Government.

The Way Forward

5.61 A number of legal and administrative steps need to be taken prior to the implementation of GST. These include stakeholder consultations, amendments to the Constitution and state laws, administrative reorganisation, preparation of GST registration, assessment and audit manuals, staff training and conduct of awareness campaigns amongst stakeholders. We have not touched upon these milestones in our discussion, but are aware that these processes may take substantial time. This is also a reason why we have earlier recommended that the putting in place an excellent design and operational framework for the GST should be given priority, even if this implies rescheduling the previously announced implementation timetable.

5.62 We recognise that the process of generating a consensus to implement the Grand Bargain as outlined by us may be difficult and involved. However, we believe that such a consensus can, and should be, generated to fully exploit the potential of GST and reap the benefits of its positive externalities. While we would like to support this model GST, which is fully consumption based, has provision for seamless credit and imposes low compliance cost, we must allow for the possibility that political economy considerations may will otherwise. In the unlikely event that such a consensus cannot be achieved and the GST framework finally adopted is different from the Grand Bargain suggested by us, this Commission recommends that the grant amount of Rs. 50,000 crore shall not be disbursed.

Impact of GST on Projections made by the Finance Commission

5.63 Though GST requires that all cesses and surcharges be abolished, and this Commission recommends that GST be implemented as early as possible, we have, in our projections, assumed continuing revenue for the Central Government from cesses for the period 2010-15. This has been done for the following reasons.

(i) Ignoring the positive externalities of GST, the Commission has conservatively assumed that GST will be revenue-neutral. Thus, income from cesses and surcharges will be included in the computation of RNR. In the scenario when GST is implemented, the aggregate revenue figures in our projections will remain unchanged, though the accounting heads under which they are reported may change. Since the catalysing effect of GST on the economy has not been factored in our projections, they can be seen as conservative.

(ii) A number of critical sectors, including roads, education, and calamity relief, are being funded from the proceeds of cesses levied by the Government of India. The transition plan to the GST must ensure that budget provisions are made to support such initiatives.

5.64 The model, the modalities as well as the timing of implementation of the GST have not yet been finalised. Making projections over a five-year period, assuming the implementation of the GST during this period, would, be a hazardous exercise. This Commission has, thus, for the purpose of our financial projections, assumed that the impact of GST will be revenue-neutral and that the gross revenues of the Centre and states will not be lower than those projected even after GST is implemented.

Summary of Recommendations

5.65 Both the Centre and the states should conclude a Grand Bargain to implement the model GST. The Grand Bargain comprises five elements: (i) the design of the model GST is suggested in paras 5.25 to 5.35; (ii) the operational modalities are outlined in paras 5.36 to 5.41; (iii) the proposed agreement between the Centre and states, with contingencies for changes is at paras 5.49 to 5.51; (iv) the disincentives for non-compliance are described in paras 5.52 (v) the implementation schedule is described in paras 5.57 to 5.59. (vi) the procedure for claiming compensation is at Para 5.60 (Para 5.48).

5.66 Any GST model adopted must be consistent with all the elements of the Grand Bargain. To incentivise implementation of the Grand Bargain this Commission recommends the sanction of a grant of Rs. 50,000 crore which will taper down to Rs. 40,000 crore and Rs. 30,000 crore if GST is implemented after 1.4.2013 and 1.4.2014 respectively. The grant would be used for meeting the compensation claims of State Governments for revenue losses on account of GST implemented, consistent with the Grand Bargain, between 2010-11 and 2014-15. Unspent balances in this pool would be distributed on 1 January 2015 amongst all the states as per the devolution formula (paras 5.54 and 5.55).

5.67 The EC should be given formal authority. The compensation should be disbursed in quarterly instalments on the basis of the recommendations by a three-member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India; Secretary to the EC and chaired by an eminent person with experience in public finance to be appointed by the Central Government (Para 5.60).

5.68 In the unlikely event that a consensus to implement all the elements of the Grand Bargain cannot be achieved and the GST mechanism finally adopted is different from the model GST suggested by us, this grant of Rs. 50, 000 crore shall not be disbursed. (Para 5.62).

5.69 States should take steps to reduce the transit time of cargo vehicles crossing its borders by combining checkposts with adjoining states and adopting user friendly options like electronically issued passes for transit traffic (Para 5.47).

C-2

EXTRACTS OF WORKING PAPER OF NACER (PREPARED FOR 13TH FINANCE COMMISSION REPORT)

Executive Summary

The broad objectives of this study refer to analysing the impact of introducing comprehensive goods and services tax (GST) on economic growth and international trade; changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectoral level. The results and conclusions of this study are comparative static in nature and may not be interpreted as forecasts of the variables under analysis.

The differential multiple tax regime across sectors of production leads to distortions in allocation of resources thus introducing inefficiencies in the sectors of domestic production. With regard to India's exports, this leads to lack of international competitiveness of the sectors which would have been relatively efficient under distortion-free indirect tax regime. Add to this, the lack of full offsets of taxes loaded on to the fob export prices. The export competitiveness gets negatively impacted even further. Efficient allocation of productive resources and providing full tax offsets is expected to result in gains for GDP, returns to the factors of production and exports of the economy.

While indirect taxes paid by the producing firms get offsets under state VAT and CENVAT, the producers do not receive full offsets particularly at the state level. The multiplicity of taxes further adds the difficulty in getting full offsets.

The Joint Working Group of the Empowered Committee of the State Finance Ministers submitted its report on the proposed Goods and Services Tax (GST) to the Finance Minister in November 2007. A dual GST, one for the Centre and other for the states, would be implemented by 1 April 2010. The new system would replace the state VAT and the CENVAT.

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 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. 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 crore and 2,881 thousand crore. The corresponding Dollar values are $325 billion and $637 billion.

In alternate scenario we assume a discount rate as the long-term real rate of interest at 5 per cent. The present value of total gain in GDP turns out to be somewhere between Rs 856 thousand crore and 1,678 thousand crore. The corresponding Dollar values are $189 billion and $371 billion.

The sectors of manufacturing 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 non-ferrous metal industries. There are minor gains and losses in output of other sectors Intersectoral movements of labour and capital would be in line with changes in output with these factors of production moving into sectors with increased output and away from others

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. 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 sectors with relatively high proportional increase in exports include textiles and readymade garments; beverages; industrial machinery for food and textiles; transport equipment other than railway equipment; electrical and electronic machinery; and chemical products: organic and inorganic. The moderate gainers are agricultural machinery; metal products; other machinery; and railway transport equipment. Exports are expected to decline in agricultural sectors; iron and steel; wood and wood products except furniture; and cement. There are minor gains and losses in exports of other sectors

The major import gaining sectors include leather and leather products; furniture and fixtures; agricultural sectors; coal and lignite; agricultural machinery; industrial machinery; other machinery; iron and steel; railway transport equipment; printing and publishing; and tobacco products. The moderate gainers include metal products; non-ferrous metals; and transport equipment other than railways. Imports are expected to decline in textiles and readymade garments; minerals other than coal, crude petroleum, gas and iron ore; and beverages.

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. Consequently, the terms-of-trade move in favour of agriculture vis-avis manufactured goods within a range of 1.8 to 3.8 per cent.

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.

The efficiency of energy resource use improves in the new equilibrium. The introduction of GST would thus be environment friendly.

Based on our 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.

As with any other modelling exercise, the results of our exercise are subject to certain limitations. The general equilibrium model that we have used is comparative static in nature. Aggregate supplies of labour, capital, and agricultural land are assumed to remain fixed so as to abstract from macroeconomic considerations. Given these limitations the results must not be read as *forecasts* of variables but only as indicative directional changes.

Moving to Goods and Services Tax in India: Impact on India's International Trade

I. Backdrop

India has posted high rates of growth since the early 1990s. It has become increasingly integrated with the global economy. Exports have become an important engine of India's economic growth (Krueger, 2008). The share of exports (goods and services) in GDP has increased from 8 per cent in 1990-91 to 14.7 per cent in 2000-01 and further up to 25.6 per cent in 2008-09. The competitiveness of India's exports has increased over time but gets partially impeded due to certain domestic constraints, one of them being an inefficient indirect tax regime.

Even though the country has moved on the path of tax reforms since the mid-1980s yet there are various issues which need to be restructured so as to boost productivity and international competitiveness of the Indian exporters Sales of services to the consumers are not appropriately taxed with many types of services escaping the tax net. Intermediate purchases of inputs by the business firms do not get full offset and part of non-offset taxes may get added up in prices quoted for exports thus making exporters less competitive in world markets (Poddar and Ahmad, 2009). Even though we do not have precise numbers on the non-offset indirect tax components for various sectors of production it may still be somewhere close to 20 to 30 per cent of the total tax revenue.

The ongoing tax reforms on moving to a goods and services tax would impact the national economy, international trade, firms and the consumers A rich set of reports, papers and books is available on issues relating to strengths and weaknesses of the India's existing tax regime. However, there has not been much work on the impact of tax reforms on India's international trade in a general equilibrium framework. The present study makes an attempt to fill this gap albeit in a modest way. Analysis in this study is conducted using a computable general equilibrium (CGE) model of the Indian economy (Chadha *et al,* 1998).

The broad objectives of our study refer to analysing the impact of introducing comprehensive goods and services tax (GST) on economic growth and international trade; changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectoral level. The results and conclusions of this study are comparative static in nature and may not be interpreted as forecasts of the variables under analysis.

II. India's Tax Regime

Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavour to generate tax revenues to support government expenditure on public services and infrastructure development. Cascading tax revenues have differential impacts on firms in the economy with relatively high burden on those not getting full offsets. This analysis can be extended to international competitiveness of the adversely affected sectors of production in the economy. Such domestic and international factors lead to inefficient allocation of productive resources in the economy. This results in loss of income and welfare of the affected economy.

For a developing economy like India it is desirable to become more competitive and efficient in its resource usage. Apart from various other policy instruments, India must pursue taxation policies that would maximise its economic efficiency and minimise distortions and impediments to efficient allocation of resources, specialisation, capital formation and international trade. With regard to the issue of equity it is desirable to rely on horizontal equity rather than ve rtical equity. While vertical equity is based on high marginal rates of taxation, both in direct and indirect taxes, horizontal equity relies on simple and transparent broad-based taxes with low variance across the tax rates.

Traditionally India's tax regime relied heavily on indirect taxes including customs and excise. Revenue from indirect taxes was the major source of tax revenue till tax reforms were undertaken during nineties. The major argument put forth for heavy reliance on indirect taxes was that the India's majority of population was poor and thus widening base of direct taxes had inherent limitations. Another argument for reliance on indirect taxes was that agricultural income was not subjected to central income tax and there were administrative difficulties involved in collecting taxes.

The ratio of indirect taxes to GDP in India increased from 3.99 per cent in 1950-51 to 13.32 per cent in 1985-86. It then decline to 10.95 per cent in 1999-2000 and increased thereafter to 12.7 per cent in 2008-09 (Figure-1).

A comparison of indirect tax to GDP ratio for some select countries for the year 2007 is depicted in Figure-2. It may be observed that the ratio for India is relatively high with only Russian Federation posting a higher rate within this select group of countries.

The share of indirect tax in total tax for the year 2007 is portrayed for the same select group of countries in Figure-3. India has the highest share among this select group of countries.

In order to simplify and rationalise indirect tax structures, Government of India attempted various tax policy reforms at different points of time. Through 1950s to 1970s, base of the indirect taxes particularly excise duties was widened. In case of excise duty, attempts were made to curb the consumption of luxury and semi luxury items, mopping excess profits in the case of commodities in short supply and for encouraging exports. In 1975-76, a general levy of one per cent *ad valorem* covering all goods produced for sale or other commercial purposes not specified in the central excise tariff was imposed with exemptions for a few items.

Around the same time, it became evident that indirect taxes lead to undesirable effects on prices and allocation of resources. The Government of India constituted the Indirect Taxation Enquiry Committee in 1976 headed by Shri L. K. Jha to study the structure of indirect taxes, central, state and local level taxes and suggest policy reforms. It submitted its report in 1978. The committee found a major problem with indirect tax regime as it had caused unintended distortion in the allocation of resources and cascading effects. The committee recommended that indirect taxation should move towards taxation of final products and introduc e modified form of value added tax.

However, a major obstacle in rationalisation of indirect tax system was the levy of tax on commodities by government at different levels viz., centre, state and local authorities. This multiple taxation provides incentives for tax evasion and undermines efficiency. Further, there is lack of uniformity in the pattern of commodity taxation resulting in harassment to the public by multiple tax authorities. Heavy reliance on indirect taxes for raising revenue was also found to increase cost and fuel inflation.

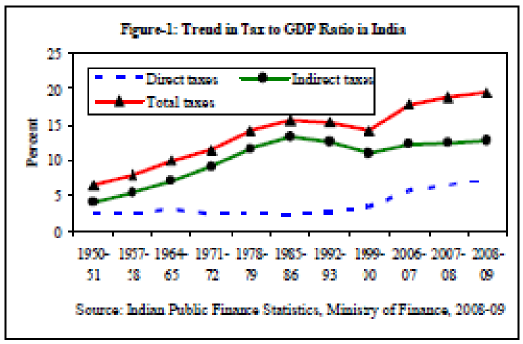

Figure-1: Trend in Tax to GDP Ratio in India

Source: Indian Public Finance Statistics, Ministry of Finance, 2008-09

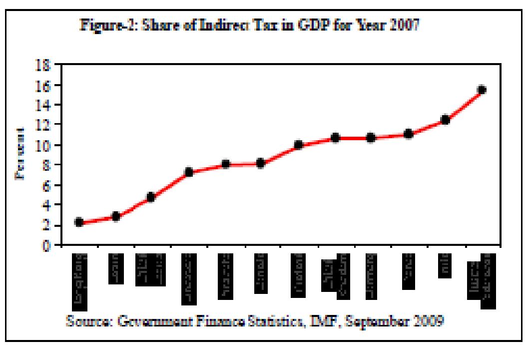

Figure-2: Share of Indirect Tax in GDP for Year 2007

Source: Government Finance Statistics, IMF, September 2009

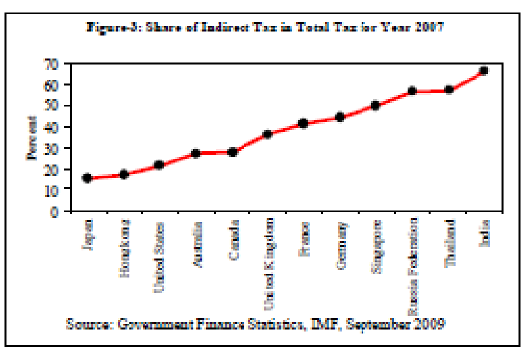

Figure-3: Share of Indirect Tax in Total Tax for Year 2007

Source: Government Finance Statistics, IMF, September 2009

The government introduced the Long Term Fiscal Policy (LTFP) on 19 December 1985 for prudent fiscal management. LTFP was expected to provide a definite direction and coherence to annual budgets and to bring about a greater predictability and stability in the economic system. It would provide rule based fiscal and financial policies rather than discretionary approach. Further, it would also facilitate effective coordination of different dimensions of economic policies. Major reforms in excise and customs taxation were proposed under LTFP. These reforms were considered for progressively moving from discretionary, quantitative restrictions and physical controls to non-discretionary fiscal methods. The major reforms announced under Union excise taxation aimed at reducing the number of effective rates after harmonisation of the tariff classification with the custom nomenclature and implementing a modified system of value added taxation, i.e., MODVAT. Excise duty is collected as CENVAT introduced in 2000 through re-naming of MODVAT of 1986.

However, fillip to tax policy reforms came in with the introduction of economic reforms in 1990s. It was realised that a complex tax structure involving both the centre and the states taxing production and sales of commodities was not fostering efficiency in the economic activities. The presence of central sales tax acted as constraint to inter-state trade movement and contradicted the idea of India being a common market.

The Government of India constituted Tax Reforms Committee under the Chairmanship of Dr. Raja J. Chelliah in August 1991 so as to bring comprehensive reforms in the Indian tax system. The Committee suggested policy reform measures to restructure both direct and indirect tax systems. For indirect tax, the Committee recommended reduction in the general level of import tariffs comparable with similar developing countries, reduction in dispersion of tariff rates and abolition of end use exemptions. The excise duty was to be progressively converted from MODVAT to VAT. Some specific recommendations of the Tax Reforms Committee included higher import tariffs on finished goods than basic raw materials and moderate rates for components and machinery. Central excise duties were to be restructured into three-rate MODVAT regime at the manufacturing level at 10, 15 and 20 per cent and selective excise on nonessential commodities at 30, 40 and 50 per cent.

The 1990s tax reforms brought structural changes in the tax system. These reforms aimed at correcting imbalances in the sources of revenues through increasing the share of direct taxes. In July 2002, Government of India constituted a Task Force under the Chairmanship of Dr. Vijay Kelkar to suggest measures for simplification and rationalisation of indirect taxes. The Task Force recommended various measures including trust based customs clearance, automation and modification of CENVAT rules to remove the distinction between capital goods and inputs. On central excise, all duties should be replaced by only one levy, the CENVAT. Scope of service tax should be expanded.

A system of VAT on services at the central government level was introduced in 2002. The states collect taxes through state sales tax VAT, introduced in 2005, levied on intrastate trade and the CST on interstate trade.

The Government of India constituted a Task Force on implementation of Fiscal Responsibility and Budget Management Act, 2003 to chalk out a framework for fiscal policies to achieve FRBM targets. Task Force headed by Dr. Vijay L. Kelkar made a number of recommendations. Among others, it suggested an All India goods and services tax (GST) which would help achieve a common market and widen the tax base. It recommended that the multiplicity of tariffs should be reduced to three components viz., basic customs duty, additional duty and anti-dumping duties. All exemptions should be removed barring life saving drugs, security items, goods for relief and charitable purposes and international obligations.

Despite all the various changes the overall taxation system continues to be complex and has various exemptions. The Report of the Task Force on implementation of the FRBMA, chaired by Dr. Vijay Kelkar, submitted its Report in July 2004. It has recommended introduction of a national VAT on goods and services (GST) which would help improve the revenue productivity of domestic indirect taxes and enhance welfare through efficient resource allocation.

The Joint Working Group of the Empowered Committee of the State Finance Ministers submitted its report on the proposed Goods and Services Tax (GST) to the Finance Minister in November 2007. A dual GST, one for the Centre and other for the states, would be implemented by 1 April 2010. The new system would replace the state VAT and the CENVAT.

Most of the indirect taxes would be subsumed under GST except for stamp duty, toll tax, passenger tax and road tax. All goods and services would be taxed with some exceptions. There is a debate on the specific rate of the GST within a band varying from 12 to 20 per cent. Nevertheless the move to GST would be one of the most important indirect tax reforms in India.

An "Empowered Committee of the State Finance Ministers" (EC), constituted by the Government of India in July 2000, submitted a White Paper on State-Level Value Added Tax in January 2005. It suggested state VAT to have two basic rates of 4 per cent and 12.5 per cent. There is an exempt category and a special rate of 1 per cent for a few selected items.

The items of basic necessities and goods of local importance are put under the exempted category. Special rate of 1 per cent is applicable for Gold, silver and precious stones. The 4 per cent rate applies to other essential items and industrial inputs. The 12.5 per cent rate is residual rate of VAT applicable to commodities not covered by other schedules. There is also a category with 20 per cent floor rate of tax, but the commodities listed in this schedule will not be subjected to VAT. This category covers items like motor spirit (petrol, diesel and aviatio turbine fuel), liquor, etc.

VAT system makes provision for eliminating the multiplicity of taxes. Several State taxes on purchase or sale of goods have been subsumed in VAT. It also permits input tax credit. Since VAT is implemented intra-state and does not cover inter-State sale transactions. Input credit is not available for inter-state purchases. Further, exports will be zero-rated, and at the same time, credit will be given for all taxes on inputs purchases related to such exports.

"A well designed destination-based GST 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 mere tax pass-through, and the tax essentially 'sticks' on final consumption within the taxing jurisdiction." (Kelkar, 2009a).

"What would be the design of the GST? The broad framework of GST is now clear. This is on the lines of the model approved by the Empowered Committee of the State Finance Ministers The GST would be a dual tax with both central and the State GST component levied on the same base. Thus all goods and services barring a few exceptions will be brought into the GST base. Importantly, there would be no distinction between goods and services for the purpose tax with a common legislation applicable to both." (Kelkar, 2009b).

III. Literature Survey

Value added tax was first introduced by Maurice Laure, a French economist, in 1954. The tax was designed such that the burden is borne by the final consumer. Since VAT can be applied on goods as well as services it has also been termed as goods and services tax (GST). During the last four decades VAT has become an important instrument of indirect taxation with 130 countries having adopted this resulting in one-fifth of the world's tax revenue. Tax reform in many of the developing countries has focused on moving to VAT. Most of these countries havegained thus indicating that other countries would gain from its adoption (Keen and Lockwood, 2007).[1]

McLure (2003) outlines characteristics of a well designed indirect tax regime in the context of Canada. While consumers should be taxed at single rate sales of inputs to business should not carry any tax liability. With regard to exports the tax should be levied under the destination principle, i.e. exports should be tax-free and imports should be taxed at the same rate as domestic products.

McLure points out some adverse outcomes emanating from inefficient indirect taxation:

- Differential tax regime on taxation of consumers on goods and services has adverse implications for economic neutrality as well as equity. Consumers with relatively strong preference for taxed goods are at disadvantage vis-a-vis consumers with the same income level but preferring consumption of non-taxed / less taxed services. The equity aspect refers to the fact that the higher income household allocate relatively proportion of their incomes on purchase of services.
- Failure to provide full tax offsets to the business firms leads to distortions of choice of methods of production based on the types of differentially taxed inputs and also impacts household consumption patterns.
- Taxation of capital goods without apt offsets to business is perhaps the most serious consequence of inefficient taxation system. This discourages savings and investment and decelerates growth of productivity. [2]
- Domestic producers face competitive disadvantage in the absence of destination based taxation principle both between India and rest-of-world as well as across states.
- Some states may have more complex tax regime as compared with some other states. Lack of proper coordination between the central and the state-level tax administration creates complexities and cost inefficiency.

GST is VAT applied to goods and services. We would refer to GST though VAT may also be used as an alterative for the same.

[2] "Perhaps the most celebrated example of tax-induced migration of industry is that of Intel, which built a new factory in New Mexico, rather than pay California sales tax on its construction costs. Although Intel is one of the quintessential corporations of the digital age, this episode could have occurred in any industry that was footloose.", McLure (1998).

Imports which are currently implicitly subsidised (since much of these do not have to pay intermediate taxes but only taxes at the final sale to the consumer) would be taxed under the GST regime. While tariffs have protective effect, GST, through eliminating implicit subsidy on imports, creates a level playing field. Thus GST does not distort domestic production. Further, GST is superior to import tariffs since consumption provides a wider tax base than imports so that tax on consumption has a smaller deadweight loss per rupee of revenue collected (Bird and Gendron, 2007). Apart from improving export competitiveness, GST also creates level playing field between imports and domestic production since it does away with flawed structure of domestic indirect taxes.

One of the areas of interest has been to analyse the impact of moving to GST on resource allocation and efficiency of sectors of production and on economy as a whole. Apart from other analysis, Computable general equilibrium (CGE) models have also been used to assess the impact of GST on an economy though there has not been much work on assessing the impact of GST specific to international trade of an economy for all the sectors of an economy.

Devarajan *et al* (1991) analyse the impact of introducing 10 per cent VAT in Thailand using a general equilibrium model to identify gainers and losers and the effect on output, prices and incomes. Though the paper provides an overall view of the changes in aggregate exports and imports it does not bring out sectoral changes therein. It does not provide reference to the type of the model used.

Wittwer and Kym (2002) use a computable general equilibrium model (CGE) to analyse the impact of the GST and wine tax reform on Australia's wine industry introduced in 2000. It is concluded that export-oriented premium segment would gain at the expense of non-premium segment of wine industry. The implicit message is that such gains would originate from increased prospects of exports of the premium wine segment.

Meagher and Parmenter (1993) analyse short-run implications of Australia's tax reforms of 1992 proposed as *Fightback (Liberal and national Parties, 1992). Fightback* was a radical economic reform package and incorporated move to 15 per cent GST. They use a general equilibrium model for their analysis. The conclusion states that: "The GST does not discriminate between imports and domestic commodities and affects exports only in a minor indirect way. Hence, its impact on cost-sensitive industries exposed to international competition is smaller than the impacts of other taxes. Hence the implications of the GST foroutput and employment are relatively small". However, the paper does not lay out changes in the composition of Australia's foreign trade.

Dixon and Rimmer (1999) use a general equilibrium model to analyse the impact of Australia's tax reforms contained in Treasury Paper *(ANTS)* of 1998. *ANTS* programme proposed tax reforms including move to 10 per cent GST. The paper concludes that the long-run resource allocation gains flowing from the proposed tax changes will be negligible. Terms-of-trade effect would be negative. Composition of exports would change away from services and in favour of goods. For example, the package would harm tourism and benefit traditional exporters like iron ore.

A desirable tax system should be able to enhance economy's competitiveness through enabling efficient allocation of productive resources thus resulting in increase in growth and increase in real income of consumers in a country. Most of the static models focus on productive services of primary factors of production. Such analysis does not incorporate the additional impact of capital coefficients which, in turn, would enhance efficiency and result in higher returns to the factors of production. Hamilton *et al* (1991) use a general equilibrium model to analyse the impact of GST on economic growth in Canada. The federal sales tax (FST) in Canada, as in 1989, created several distortions. One of the important distortions refers to tax applied on capital goods used in production process. It was about 4 per cent on capital goods. The removal of taxes from capital goods would, over time, lower the cost of capital to domestic producers This would lead to increases in investments, productivity and domestic real output. The GST reforms would have substantial impacts on real output, particularly for sectors which rely heavily on taxed inputs and those which compete in the international markets - either exports or import-competing domestic products. The GST reform would increase the real output of the Canadian economy by approximately 1.4 per cent, i.e. about $9 billion over 1989.

GST is destination based. It implies export prices do not include any taxes while imports are taxed at the same rates as domestically produced goods. It is generally believed that GST encourages exports may be at the cost of imports or / and domestic consumption. But this may not hold true according to the theory of international trade. [3] The economic theory suggests that the destination-based feature of GST does not affect exports and imports. Exchange rates adjust to nullify the effects on imports and exports of moving to GST. However, the evidence from 136 countries in 2000 brings out contradiction between commonly believed view that GST encourages exports versus GST has no effect on trade pattern of a country. While the evidence based on data for 1950-2000 showed negative relationship between GST and international trade of a country a well-designed and properly-administered GST is expected to international trade of countries adopting such reformed tax structure in future.

The evidence that the GST implementation by a country impedes international trade is based on two undesirable reasons: a) GSTs were generally imposed heavily on traded sectors; and b) governments often failed to provide adequate GST rebates for exports. However, there has not been much work on empirical relationship between VAT usage and export and import performance (Desai and Hines, 2002).

It is thus clear that it was lack of implementation of GST in letter and spirit that resulted in distorted consequences. The GST must be applied on all sectors both tradable and non-tradable. Thus all services must fall under the preview GST and that the export should be fully tax rebated. The countries now introducing GST without weaknesses of the past would get benefits of expansion of their international trade with special affect on exports.

While economic theory needs a careful review, there is case for implementing the GST in full earnest. It should be applied across the board on all goods and services. Further the basic purpose of analysing the effect of GST on international trade gets defeated if exporters do not receive full tax offsets.

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[3] "In theory, the destination-based nature of a VAT should have no effect whatsoever on exports and imports. The reason is that exchange rates adjust to undo the effects of VATs on

IV. Scheme of Analysis

4.1 Sources of Data

India's international trade has increased rapidly during the last two decades. Differential indirect tax rates in the economy without apt setoffs have lead to tax cascading which distort production efficiency as well consumption pattern basket. Such taxes are likely to impact comparative advantage of exports in sectors in which taxes paid on various inputs have not been fully set off. This results in implicit taxation of such exports. Further, in the absence of efficient input tax setoffs, productive resources would move towards less taxed sectors and away from high taxed sectors

We assume that the non-offset component of exports acts as export tax equivalent (ETE). Once GST gets introduced, exporters would be able to take full credit of non-offset components of the net indirect taxes (NIT) paid by them. This would make exports 'zero-rated', i.e. subject to zero tax rates. GST would thus provide competitive advantage to India.

While much of the taxes paid on intermediate purchases by the business firms get rebates there still exist components which do not get this benefit. While the Central indirect taxes including customs and excise duties get nearly fully reimbursed, the state-level taxes do not get full offsets. Some such state-level taxes include central sales tax (CST), electricity duty, sales tax on petroleum products, mandi tax, entry taxes, octroi and municipal taxes. The cumulative impact of such un-rebated taxes has been estimated as between 3 per cent to 12 per cent of the fob export value depending on the product and its state of origin (Ministry of Commerce and Industry, Government of India, 2009). These figures include 1 per cent to 9 per cent as electricity duty, CST and sales tax on petroleum products and the remainder on account of mandi tax, entry tax, octroi, municipal taxes and cesses (NCAER 2005). Since all taxes, central as well as state, would be subsumed in GST exports are expected to become tax-free thus enhancing competitiveness of Indian exporters In fact, all local duties and cesses should also get full offset through the instrument of GST.

The objective of this study is to estimate the impact of moving to a national GST, i.e. VAT on both goods and services, on India's foreign trade vis-a-vis the rest-of-world. It is expected that non-rebated indirect tax-induced resource allocation distortions would be done away with through state-level and centre-level GST and hence productivity of the economy would increase thus leading to enhanced welfare. The changes in comparative advantage in different sectors of production would alter composition of imports and exports - both of goods and services.

The Input-Output Transactions Tables (IOTT) for 2003-04 along with data obtained from the Annual Survey of Industries (2004-05) and the National Accounts Statistics (2008) provide background information for our analysis.[4] The base year thus predates the introduction of state-

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[4] **Input-Output Transactions Table - 2003-04**, (2008): Central Statistical Organisation (CSO), Ministry of Statistics and Programme Implementation (MOSPI), Government of India.

National Accounts Statistics (2008): Central Statistical Organisation (CSO), Ministry of Statistics and Programme Implementation (MOSPI), Government of India.

level sales tax VAT though CENVAT was already in vogue. There are 130 sectors of production - 37 primary, 68 manufacturing and 25 tertiary (discussion in the following paragraphs of this section has been extracted from the background note on IOTT).

We have mapped 130 IOTT sectors (Appendix 5 of IOTT 2003-04) into 60 IOTT sectors

(Appendix 4 of IOTT 2003-04). In present study we work with these 60 sectors of production. In our analysis, the Commodity x Commodity (C x C) matrix has been prepared by following the standard methodology of the CSO. The 60 sectors include 7 agriculture and allied sectors; 4 mining sectors; 33 manufacturing sectors; and 16 services sectors (Refer to Table-1 for sectoral classification).

All the entries in the IOTT are at factor cost. These exclude trade and transport margins and net indirect taxes (NITs). In fact, the IOTT is first prepared at original purchasers' prices, i.e. prices at which actual transactions take place. The entries at factor cost are derived thereafter by removing the components of trade and transport margins and NITs. The NITs are shown in a separate row in IOTT and depict indirect taxes paid by the industries on intermediate inputs used in the process of production of industries' outputs.

Much of the information on industries and capital coefficients has been sourced from the Annual Survey of Industries and the National Accounts Statistics provides background information for primary service sectors

NIT is the difference between indirect tax paid and subsidy received by a sector of production. Indirect taxes are distinguished as commodity taxes and other indirect taxes. Commodity taxes include union & state excise duties, sales tax, custom duties (on imports & exports) and various other duties and cesses. Other indirect taxes include levies like electricity duty, motor vehicle tax, entertainment tax, and stamp duty, etc. The types of indirect taxes by commodities and services on which they are levied have, therefore, been ascertained and each particular tax has been apportioned in proportion to the value of flow of commodities going to different industry sectors and final uses. The source material used for different components of net indirect taxes on various commodity groups is described as follows (IOTT, 2003-04, CSO):

1. Commodity-wise union excise duties for the year 2003-04 have been taken from the Receipts budget 2005-06 of Central Government whereas data on state excise duties from respective State budget documents for the year 2005-06.

2. The budget documents of State Governments give only the state-wise break-up of the total sales tax levied and do not furnish their commodity-wise data. There is very little uniformity in the rates and exemptions of sales tax levied in different States & Union Territories. For allocating the total sales tax amongst different commodity sectors, the commodities on which sales tax are levied are identified, to the extent possible, and are allocated to the respective sectors The remaining amount of sales tax is allocated to the different commodity sectors in proportion to the norms arrived on the basis of the industry-wise data on sales tax from the ASI- 2003-04.

Annual survey of Industries (2004-05): Central Statistical Organisation (CSO), Industrial Statistics Wing, Ministry of Statistics and Programme Implementation (MOSPI), Government of India.

3. Imports are reported at c.i.f. values and are exclusive of import duties and domestic taxes. The commodity-wise custom duties (both on imports and exports) are available from the Ministry of Finance. Data on import duties have been used to build up commodity sector-wise import duties (130 sectors). Adjustments have been made for refunds & withdrawals to arrive at net import duties. Similarly, using the same source, commodity-wise export duties/cesses have been prepared.

4. Source material used for "other indirect taxes" is the budget documents of state governments and Finance Accounts of the Union and State Governments. These taxes have been identified and allocated to the respective sectors of the IOTT.

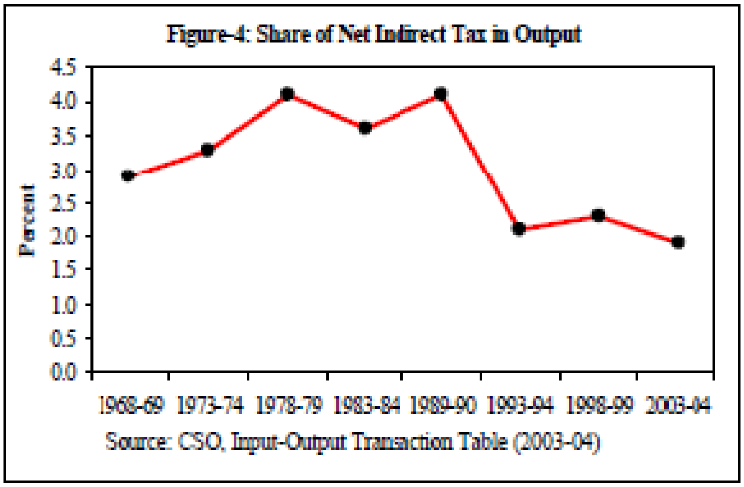
5. The commodity-wise subsidies have been compiled from the budgets of Central and State governments. These are identified to the relevant commodity sectors and allocated to different consuming industry sectors and final uses in proportion to the domestic flow. Some of the subsidies meant for specific purpose like subsidy provided for electricity and subsidy on the construction of wells for agriculture purposes have been allocated to the respective cells of the domestic flow matrix. Requisite details are, however, not available for many items like subsidies to agriculture, industry, irrigation, Food Corporation of India (FCI), National Small Industries Corporation, Small and Marginal Farmers Development Agencies, industrial corporations and subsidies for product promotion etc. Subsidies paid to FCI have been allocated to items such as wheat, rice and other crops on the basis of detailed data available from the Annual Report and Accounts of FCI, 2003-04. Similar subsidies given to Khadi and Village Industries Commission (KVIC) have been allocated on the basis of details available in the report of KVIC. Irrigation subsidy has been allocated to various crops in proportion to irrigated crop area.

This may, however, be noted that requisite details of indirect taxes and subsidies by products are generally not available, particularly in respect of VAT type taxes collected by different states, as well as in respect of the indirect taxes collected by local bodies.

4.2 Indirect Tax - Matrix Structure

A matrix of net indirect taxes is available from CSO. It provides the aggregate value of indirect taxes (130 x 130) paid during the IO transactions. Let NIT denote net indirect tax paid by sector-j for purchases of inputs from sector-i.

Summation NIT i varying from 1-130, indicates the total of net indirect taxes paid by sector-j for purchases of various inputs i (1-130) in its production process. This is the vertical summation of all the net indirect taxes paid by the jth sector on purchases of various inputs from 130 sectors



Summation NIT j varying from 1-130 is the sum of net indirect taxes paid by 130 sectors of production while buying inputs from sector-i. This thus indicates total net indirect taxes paid on sales of sector-i to various sectors which purchase the output of sector-i as their inputs. This is the horizontal summation of all the net indirect taxes paid by 130 sectors on purchase of output of a particular sector as input in their respective production processes.

The ratios of total NIT to total output have large variations across sectors of production (Table 1). The manufacturing sectors as a whole are subjected to 5.7 per cent NIT. The corresponding ratio is 6.3 per cent in the case of capital goods and 5.3 per cent in buildings and construction. [5] Thus net indirect tax rates are relatively high in capital goods as well as construction vis-a-vis overall rate of 1.9 per cent for the economy as a whole. The overall NIT of the seven capital goods sectors is higher than NIT of all the 33 manufacturing sectors taken together. Relatively high taxes on capital goods affect investment through higher cost of capital (Bird *et at)*.

The share of net indirect tax to output for India had increased from 2.9 per cent in 1968-69 to 4.1 per cent in 1978-79 and remained nearly the same till 1989-90 (Figure-4). It has declined thereafter to 1.9 per cent in 2003-04.

4.3 Analytical Framework

The objective of this study is to analyse the impact of GST introduction on India's foreign trade. Net indirect taxes lead to distortions in domestic resource allocation. Sectors of production which pay relatively high net indirect taxes without getting setoffs thereof might lose out on allocation of new resources in favour of sectors which pay relatively low net indirect taxes or receive full setoffs. Net indirect taxes may be viewed as implicit export tax equivalents (ETE). In fact, exports of all the products which do not get tax offsets suffer comparative disadvantage with high taxed sectors suffering relatively more vis-a-vis others.

[5] Capital goods sectors include Sectoral Classification Codes 37-43. Construction refers to Sector Code 45 (Table-1)

The values of exports and imports during 2003-04 may be considered to be the base values. The NCAER / Michigan stand-alone CGE model has been used for our analysis in this study.

The structural input coefficients, a_{ij} in the C x C matrix (Matrix-A) do not reflect capital requirements of the economy. These represent flows from sector "i" to sector "j" of inputs required to produce one rupee's worth of output in the current year and are not representative of the capital coefficients in each of the 60 sectors of the economy.

In the standard input-output flow matrix (IO), sector-wise inputs required for capital formation are included in the final demand vector. In order to make the original input coefficients representative of the capital requirements we formulate an additional matrix called the "Capital Matrix - B". The detailed methodology for computing of the B-matrix is presented in the following discussion.

4.4 Leontief Dynamic Theory

Net indirect taxes on capital goods can have long-lasting effects on the economy if the same do not get full offsets. This limits the growth of capital stock and reduce productivity and employment over time (Smart and Bird, 2006).

The static input-output scheme used in earlier versions of our CGE model explains mutual interdependence of some distinct sectors of the national economy in terms of a given set of structural coefficients, aj (i = n; j = n). Each such coefficient represents the amount of the i^{th} sector's output which is absorbed by per unit output of the j sector. A complete set of such coefficients for the j^{th} sector determines the flows of raw materials, fuel, labour and replacement parts from "n" supplying sectors in order to produce one unit of output. Given the vector of final demand for output of "n" sectors the Leontief Input-Output Model determines the total output of various sectors of the economy: $X = (I - A)^{-1} F$.

The input coefficients aij do not reflect the stock requirements of the economy (Leontief, 1953). These do not explain the magnitude of those input flows which serve directly to satisfy the capital needs of sectors of the economy, either as additions to fixed investment in buildings or in plant & equipment. In the open static system, such as described above, the capital inputs are not assigned to the sectors which absorb these but are shown as components of their final demand. This implies that whereas the effects of investment demand on outputs of all the sectors of production are explained the observed magnitude of the demand for capital goods is not explained.

Such explanation becomes possible as soon as the stock requirements of all the individual sectors of the economy are included in the structural map of the system along with the intermediate Aij flows.

We have assumed that fixed assets created in a specific sector of production impact the output of this sector during the following year, i.e. assumption of one year lag. The reasons to assume one-year lag between capital formation and consequent increase in output have been discussed in Douette (1973).

Matrices A and B

- Structural input coefficients a_ij do not reflect capital requirements of an economy
- These represent flows from sector "i" to sector "j" of inputs required to produce one rupee's worth of output in the current year
- In standard input-output flow matrix inputs required for capital formation are included in the final demand vector
- B matrix (b_ij) represents capital requirements of 60 sectors of the economy

Structural Balance

X = AX + F

X = AX + B AX + F

i = 1, 60; j = 1, 60

Xi = S aij Xj + S bij AXj + Fj

Need for Additional Investment

XI = anX1 + a12X2 + bn AX1 + b12 AX2 + F1

X2 = a21X1 + a21X2 + b21 AX1 + b22 AX2 + F2

X1 = (an+bn) X1+ (a12+b12) X2 - ($bnX1^0$+ $b12X2^0$) + F1

X2 = (a21+b21) X1 + (a22+b22) X2 - ($b21X1^0$+ $b22X2^0$) + F2

Where

AXi = Xi - Xi^0

bij AXj = AKj is the additional capital requirement of the j^{th} sector for capital good coming from the i^{th} sector

Details of computing Capital Matrix (B) are provided in Annex-1.

V. Modelling GST

5.1 General Equilibrium Model

We use a general equilibrium model to analyse the impact of India moving towards a comprehensive GST on goods and services along withy ensuring full tax rebates on exports.

The CGE model that we have developed is distinctly different from existing models of the Indian economy (Brown *et at* 1996 and Chadha *et at,* 1998). Our India Model is a single-country, multi-sectoral CGE model. The present model incorporates some of the features of the new trade theory, viz. increasing returns to scale, monopolistic competition and product heterogeneity. India is modelled to produce, consume and 60 goods.

The market structure in 33 manufacturing sectors is modelled as monopolistically competitive. Perfect competition is assumed in agriculture, mining and service sectors

The final demand equations for various sectors are obtained assuming a single representative consumer who maximises utility subject to a budget constraint. It is assumed that the revenue from tariffs and indirect taxes gets re-distributed to consumers and then spent. Intermediate demands are derived from the profit- maximising decisions of the representative firms in each sector. Products in all the tradable sectors are characterised by some degree of product differentiation. In the nine sectors where markets are taken to be perfectly competitive, products are differentiated by country of origin, i.e., whether from India or rest-of-world (ROW). In the monopolistically competitive industries, products are differentiated by firm. India is assumed to be a small country such that world prices of various tradable goods are exogenous.

Consumers and producers are assumed to use a two-stage procedure to allocate expenditure across differentiated products. At the first stage, expenditure is allocated across goods without regard to the country of origin (whether India or ROW) or the producing firm. At this stage, the utility function is taken to be Cobb-Douglas and the production function requires intermediate inputs in fixed proportion. In the second stage, expenditure on monopolistically competitive goods is allocated across competing firms in India and ROW. However, in the case of perfectly competitive goods, since individual firm supply is indeterminate, expenditure on each good is allocated over the industry as a whole. The aggregation function in the second stage is a Constant Elasticity of Substitution (CES) function. We assume that aggregate expenditure varies endogenously to hold aggregate employment constant. Such a closure may be thought of as analogous to the Johansen closure rule.

With respect to factor markets, the variable input requirements are taken to be the same for the three market structures. Primary and intermediate input aggregates are required in fixed proportion to output.[6] Expenditures on primary inputs are allocated between capital and labour, assuming that a CES function is used to form the aggregate of these primary inputs. In the case of the four agricultural sectors, land (along with capital and labour) is also assumed to be one of the primary factors of production. The primary inputs aggregate in these cases is a CES function of labour and a CES composite of land and capital. In the monopolistically competitive sectors as well as in the state monopoly sectors, additional fixed inputs of capital and labour are required. It is assumed that fixed capital and fixed labour are used in the same proportion as variable capital and variable labour so that production functions are homothetic. Capital and labour are assumed to be perfectly mobile across sectors However, we keep the option of specifying sector-specific capital for some purposes, especially for short-term analysis. Land usage in agriculture is assumed to be substitutable across the four agricultural sectors Returns to land, capital and labour are determined to equate factor demand to an exogenous supply of each factor. The aggregate supplies of labour, capital, and agricultural land are assumed to remain fixed so as to abstract from macroeconomic considerations involving, for example, determination of investment, since our focus is on the intersectoral allocation of resources. We introduce an element of capital coefficients during the base period though its effect on additional output gets reflected only in the post-simulation new equilibrium values. However, this does not imply that we increase the base year capital stock in any direct way. In fact, we estimate the impact of capital coefficients in addition to the input-output structural coefficients.

[6] Intermediate inputs include both domestic and imported varieties.

Perfectly competitive firms are assumed to set price equal to marginal cost, while monopolistically competitive firms maximise profits by setting price as an optimal mark-up over marginal cost. The numbers of firms in sectors under monopolistic competition are determined by the condition that there are zero profits. The price changes are relative to the domestic *numeraire* price of the sector "iron and steel". This price is held constant while solving the model.

It is assumed that trade remains balanced, i.e. the initial trade imbalance remains constant as trade barriers are changed. This assumption reflects flexible exchange rate. Moreover, this is an appropriate way of abstracting from the macroeconomic forces and polices that are the main determinants of trade imbalance.

This model is solved using GEMPACK (Harrison and Pearson, 1996). The solution of simulation yields percentage changes in sectoral employment and certain other variables of interest for India. Multiplying the percentage changes by actual levels given in the data base yields the absolute changes, positive or negative, that might result from India's unilateral trade and domestic policy reforms.

In addition to the sectoral effects that are the primary focus of our analysis, the model also yields results for changes in exports, imports, the overall level of welfare (measured through GDP) in the economy, and the economy-wide changes in real wages and returns to land and capital. Because both labour and capital are assumed to be homogeneous and mobile across sectors in these scenarios, we cannot distinguish effects on factor prices by sector. Nor can we distinguish effects on different skill groups or other categories of labour. Though we would like to know more about the distributional issues associated with the reforms, the model in its present form is not set up to accomplish this. Our model also does not account for changes in foreign direct investment, and it does not make any allowance for dynamic efficiency changes and economic growth.

5.2 Simulations Design

The Net Indirect Taxes (NIT) paid by exporters on intermediate purchases (if they are producer exporters) or NIT passed on to them by producers from whom they purchase the exportable commodities are supposed to be fully offset. However, the same is not true in practice. We consider non-offset net indirect taxes as being exported and hence act like "export tax equivalent" (ETE).

While most of the Central taxes are offset the same is not true at the state-level. In order to facilitate our analysis we assume non-rebated tax proportions to vary between 25 per cent and 50 per cent (Box-1).

For the present study, we design two sets of simulations, Set-1 and Set-2. While Set-1 refers to experiments in which export tax equivalents (ETE) are brought down to zero by the full knocking off the ETE in all the sectors except primary sectors (codes 1-11). The methodology used is based on standard IOTT "A" matrix. We do not incorporate the additional impact of capital coefficients in our experiments.

Set-2 refers to the same experiments as in Set-1 but assuming the additional impact of capital coefficients in our experiments. We use both the "A" and the "B" matrices in S2.1 and S2.2.

The experiments under Set-1 refer to the simulations on providing full tax offsets for the non-offset component which gets exported through higher export fob price. We assume two different scenarios as mentioned in Box-1.

The Set-2 of simulations corresponds to those of Set-1 except that these are conducted under the additional impact of capital coefficients on output of the economy. These parallel simulations are labelled as S2.1 and S2.2.

As discussed above, our simulations have been designed to study the effect of offsets experimenting with various scenarios. Under the hypothetical offset of 75 per cent, the remaining 25 per cent of the ETE is completely eliminated in S1.1 and S2.1. In simulation S1.2 and S2.2 we assume that there are 50 per cent offsets and that the entire amount of remaining NIT needs to be eliminated. Our results are presented in Table 2-10.

Box-1: Simulations Design

SET 1	
S1.1	Export tax equivalents are estimated at 25 per cent of NIT without the effect of capital-coefficients
S1.2	Export tax equivalents are estimated at 50 per cent of NIT without the effect of capital-coefficients
SET 2	
S2.1	Export tax equivalents are estimated at 25 per cent of NIT with the additional impact of capital- coefficients
S2.2	Export tax equivalents are estimated at 50 per cent of NIT with the additional impact of capital- coefficients

VI. Results

6.1 Macro Variables: Simulations

In the absence of the additional impact of capital coefficients in the model, the reduction in ETE of the NIT leads to an improvement in productivity of the economy. The improvement increases for Simulations under Set 2 as compared with Simulations under Set 1.

Gain in GDP under S1.1 is 0.04 per cent which increases to 0.09 per cent in S1.2 (Table 2). However, a substantial improvement may be observed when we consider the additional impact of capital coefficients (Set-2). Here, the gain in GDP increases from 0.87 per cent to 1.7 per cent between S2.1 and S2.2. The gain in growth of GDP is one-time though the additional absolute return would be perpetual.

The efficiency of energy resource use improves in the new equilibrium. The domestic consumption of coal, petroleum products and electricity as ratio to GDP goes down from 14.3 per cent to 13.9 per cent. While the GDP grows by 1.7 per cent under scenario S2.2 the usage of coal & lignite and electricity grows only by 1 per cent each. The usage of petroleum products declines by 4.5 per cent. The introduction of GST would thus be environment friendly.

Under Set-1, gain in exports increases from 1.55 per cent to 3.07 per cent between S1.1 and S1.2. The comparable gains under the additional impact of capital coefficients (Set-2) are 3.22 per cent and 6.34 per cent, respectively.

Gains in imports increase from 1.09 per cent in S1.1 to 2.16 per cent in S1.2. Under Set-2 the corresponding increase is 2.39 per cent to 4.71 per cent, respectively.

Gain in net exports of the economy expands from 0.46 per cent to 0.91 per cent in S1.1 and S1.2, respectively. Their comparable values in Set-2 are 0.83 per cent to 1.63 per cent.

The economy-wide gain in output expands by 0.21 per cent in S1.1 and by 0.42 per cent in S1.2. Comparable expansions for Set-2 simulations are 0.32 per cent and 0.64 per cent, respectively.

Real returns to labour and capital show improvements between the Simulation-1 and Simulation-2 under both the sets, Set-1 and Set-2. The returns to these factors of production show substantial improvements with the inclusion of capital coefficients in the model.

Real returns to land deteriorate for both the simulations conducted under Set-1. However, we get indications of positive real returns to land under simulations of Set-2. This clearly highlights that land becomes more efficiently allocated in the latter set of experiments.

Using the results, changes in GDP and trade (imports and exports) in absolute values, over the corresponding values of 2008-09, are provided in Table 3.

6.2 Macro Variable: Comparisons across S1.1, S1.2, S2.1 and S2.2

Gain in absolute value of GDP is Rs 2,169 crore under S1.1 which increases to Rs 4,427 crore under S1.2. The corresponding changes in Dollar values are $480 million and $979 million, respectively. The results exhibit significant increases under S2.1 and S2.2. Gain in GDP is Rs 42,789 crore under S2.1 which increases to Rs 83,899 crore under S2.2. The corresponding changes in Dollar values are $9,461 million and $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. 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 crore and 2,881 thousand crore. The corresponding Dollar values are $325 billion and $637 billion.

In alternate scenario we assume a discount rate as the long-term real rate of interest at 5 per cent. The present value of total gain in GDP turns out to be somewhere between Rs 856 thousand crore and 1,678 thousand crore. The corresponding Dollar values are $189 billion and $371 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.

6.3 Sectoral Results

We discuss our observations on sectoral output and scale effects for simulation S2.1 and 2.2 (Tables 4 and 5). Results for other simulations have also been presented in these Tables. It may be observed that output of agricultural sectors shows gains under simulation S2.1as compared with S1.1 in which output of agricultural sectors shows expected decline. Further the gains under S2.2 are higher than those observed under S2.1. The largest increases in output occur in 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 (Table 4). The sectors in which output is expected to decline include natural gas and crude petroleum; iron ore; coal tar products; and non-ferrous metal industries. There are minor gains and losses in output of other sectors

The scale effect (Table 5), which indicates the per cent change in output per firm, is positive and relatively high for sectors including beverages; textiles and readymade garments; coal tar products; chemical products; fertilisers; sugar; paints; pesticides; and cement. Scale effects are positive for all other sectors of manufacturing. Increased output per firm (scale effect) in the imperfectly competitive manufacturing sectors is an indicator of efficiency gains. The sectors, in which output grows, the proportional change in output is greater than proportional increase in number of firms. On the other hand, the sectors, in which output declines, the proportional decline in output is less than proportional decline in number of firms.

The intersectoral movements of labour and capital are recorded in Tables 6 and 7. Generally, labour and capital move into the sectors in which output is expected to increase.

The results of our study are based on using capital coefficients computed in B-matrix (Annex-1). These refer to the registered / organised sectors of the economy. Our analysis in this study is thus based on the assumption that the capital coefficients computed for the registered sectors are also applicable to the unregistered sectors However, it is worthwhile to compute capital coefficients for unregistered manufacturing sectors also and incorporate the same in the overall capital matrix. We have not been able to do so due to data limitations. Using information from the "Unorganised Manufacturing Sector in India: Employment, Assets and Borrowings", NSSO (2005-06) we have computed some crude estimates of sectoral as well as overall capital coefficients in the unregistered sector. The aggregate incremental capital-output ratio turns out to be 1.46 for the unregistered manufacturing compared with 1.36 for the registered manufacturing sector. Capital coefficients are significantly high in certain unregistered sectors, viz. food products, textiles, garments, chemicals and some other manufacturing sectors It may thus be observed that capital-output ratios are higher in some of the unregistered sectors than in the registered sectors The GST reform would benefit the small-scale and other manufacturing units in unregistered sectors, relatively more than the corresponding registered sectors, through making capital cheaper than before through providing the benefits of full tax offsets. The unorganised sector would thus benefit more than the organised sector as a whole. The same may be true of some of the sectors within the unorganised sector thus making these more competitive in international markets than the scenario before the GST reform. The sectors mentioned in this paragraph are export intensive and hence would add to the exports from India.

6.4 Returns to the Factors of Production

GST would lead to efficient allocation of factors of production. It is expected that the real returns to the factors of production would go up under the scenarios of Set-2 as compared with Set-1. Our results for Set-2 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.

6.5 Exports and Imports

The details of gains in merchandise exports and imports under different scenarios are given in Tables 8 and 9. Under simulation S2.2 the sectors with the largest proportional change in exports increases include textiles and readymade garments; beverages; industrial machinery for food and textiles; transport equipment other than railway equipment; electrical and electronic machinery; and chemical products: organic and inorganic. The moderate gainers are agricultural machinery; metal products; other machinery; and railway transport equipment. Exports are expected to decline in agricultural sectors; iron and steel; wood and wood products except furniture; and cement. There are minor gains and losses in exports of other sectors (Table 8).

The major import gaining sectors include leather and leather products; furniture and fixtures; agricultural sectors; coal and lignite; agricultural machinery; industrial machinery; other machinery; iron and steel; railway transport equipment; printing and publishing; and tobacco products. The moderate gainers include metal products; non-ferrous metals; and transport equipment other than railways. Imports are expected to decline in textiles and readymade garments; minerals other than coal, crude petroleum, gas and iron ore; and beverages (Table 9).

6.6 Changes in Prices

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

Terms of trade would improve in favour of agriculture vis-a-vis manufactured goods. The overall prices of agricultural goods (Sectors 1 - 7) go up by 0.57 per cent under S-2.1 and by 1.12 per cent under S-2.2. The overall prices of all the manufacturing sectors (sectors 12 - 44) decline by 1.22 per cent under S-2.1 and by 2.53 per cent under S-2.2. Consequently, the terms-of-trade move in favour of agriculture vis-a-vis manufactured goods within a range of 1.8 to 3.8 per cent.

The increase in agricultural prices would benefit millions of farmers in India. With regard to the food crops the poor would continue to remain secured through the public distributionsystem. 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.

N.C.: Not Computed; Sectors 45, 46, 47, 50, 56, 57, 58 and 60 are not internationally traded (IO 2003-04) and hence the changes in their prices could not be computed.

6.7 Net Indirect Tax and Gains in Exports

We have computed regression equation with percentage change in exports as dependent variable and "net indirect tax to output ratio (NIT-to-Q ratio)" as independent variable. Results show positive and significant relationship between percentage changes in exports to NIT-to-Q ratio. This is indicative of the fact that full tax offsets in relatively high taxed sectors would lead to higher gains in exports compared to less taxed sectors

VII. Revenue Neutral GST Rate

Based on the results of our simulations, we have attempted to determine a uniform revenue-neutral GST rate. This implies computation of GST rate which results in the same net indirect revenue as collected in 2003-04, i.e. the IOTT used in this study. The total NIT was 2,16,073 crore. The revenue neutrality exercise has been undertaken for the simulations S2.1 and S2.2. The model does not have details on government budget. It abstracts from macroeconomic variables

The output tax rates (row-wise) are given in Table 11.[7] However, given the sensitivity of the subsided sectors, i.e. sectors with negative NIT values, our computations have excluded such sectors from the ambit of computing the revenue neutral GST rate. We have conducted two alternative exercises:

1. Applying GST to all the sectors of goods and services excluding sectors: food crops (01); cash crops (02); plantation crops (03); other crops (04); and fertilizers (30).
2. Applying GST to all the goods and services sectors excluding sectors: fishing (07); electricity (46); railway transport services (48); and communication (51) over and above those mentioned in Scenario-1.
3. Applying GST to all goods and services sectors excluding food crops (01), education and research (57) and medical and health (58). Under the assumption that the petroleum tax would not be subsumed in GST, the base tax value has been adjusted through subtracting the NIT on output of petroleum products from total NIT. The total NIT is Rs.2,16,073 crore. The NIT on output of petroleum products (IO sector 26) is Rs.39,184 crore. Thus, the revised base tax after excluding NIT for the petroleum products is Rs.1,76,889 crore.
4. Applying GST on all goods and services (no exemptions) with initial tax base being sam as in Scenario-3.

[7] We do not assume any exemptions on indirect taxes paid on final consumption in our computations. The GST rate would be higher than what we have computed if there are some exemptions for taxing consumption of certain goods and services.

The computation of revenue neutrality is based on taxing all the goods and services going to final consumption, i.e. "final demand net of change in stocks *minus* exports *plus* imports (excluding imports going for intermediate usage)". We have attempted two different variants.

The results of these four cases are tabulated in Box-2. Based on our 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. GST rates of some other countries are shown in Figure-5.

Box 2: Revenue Neutral GST Rates

Group	**uded IO sectors**	**Revenue Neutral GST Rate (%)**	
		S2.1	**S2.2**
1	Food crops (01), Cash crops (02), Plantation crops (03), Other crops (04), Fertilizers (30)	9.04	9.01
2	Food crops (01), Cash crops (02), Plantation crops (03), Other crops (04), Fishing (07), Fertilizers (30), Electricity (46), Railway transport services (48), Communication (51)	9.42	9.40
3*	Food crops (01), Education and research (57), Medical and health (58)	7.25	7.22
4*	None	6.22	6.20

* In scenario 3 and 4, the revised base tax has been computed after excluding NIT on output of petroleum products (IO 26) from total NIT.

S2.1: Export tax equivalents are reduced by 25 per cent with additional impact of capital-coefficients.

S2.2 Export tax equivalents are reduced by 50 per cent with additional impact of capital-coefficients.

Source: NCAER computations

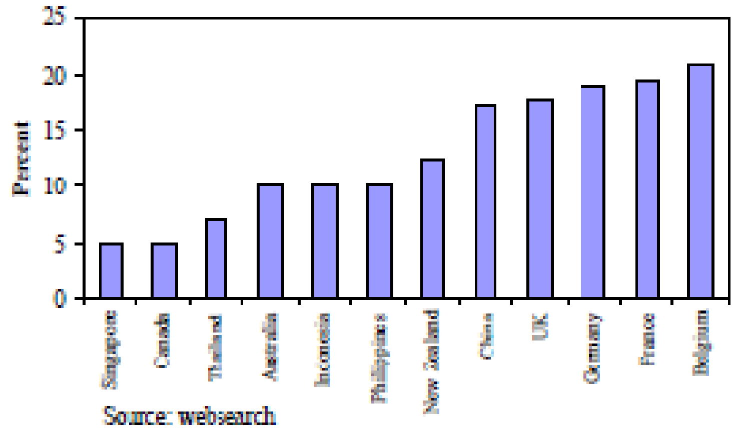


Figure-5: Country-wise GST Rates

Source: websearch

VI. Concluding Remarks

Implementation of a comprehensive GST across goods and services is expected, ceteris paribus, to increase India's GDP somewhere within a range of 0.9 per cent to 1.7 per cent. The corresponding changes 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 $9,461 million and $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. 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 crore and 2,881 thousand crore. 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.

The efficiency of energy resource use improves in the new equilibrium. The introduction of GST would thus be environment friendly.

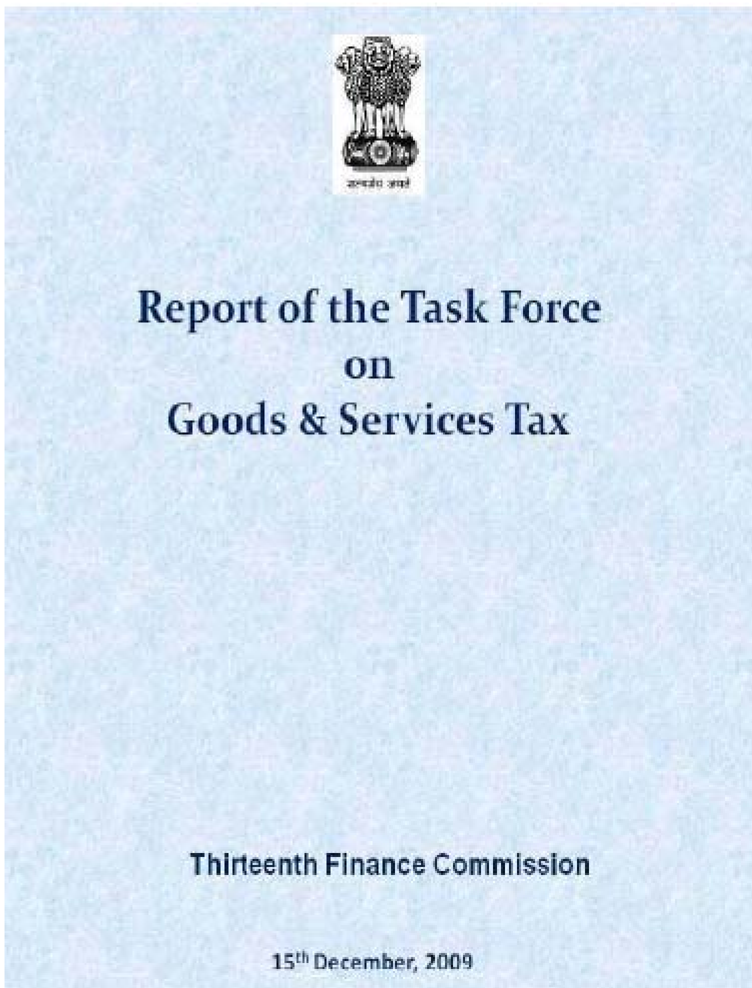
Based on our computations, the revenue neutral GST rate across goods and services is expected to be positioned somewhere in the range of 6.2 per cent and 9.4 per cent, depending on various scenarios of sectoral exemptions.

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.

As with any other modelling exercise, the results of our exercise are subject to certain limitations. The general equilibrium model that we have used is comparative static in nature. Aggregate supplies of labour, capital, and agricultural land are assumed to remain fixed so as to abstract from macroeconomic considerations. Given these limitations the results must not be read as *forecasts* of variables but only as indicative directional changes.

C-3

REPORT OF TASK FORCE ON GST (PREPARED FOR 13TH FINANCE COMMISSION REPORT)


Report of the Task Force
on
Goods & Services Tax

Thirteenth Finance Commission

15th December, 2009

Executive Summary

1. 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. **(Para 2.1)**

2. A well designed 'value added tax on all goods and services (GST) 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. **(Para 2.2)**

3. The 'flawless' GST recommended by us comprises of the following elements:

i. It should be a dual levy imposed concurrently by the Centre and the States, but independently to promote cooperative federalism. **(Para 2.4)**

ii. Both the Central Goods and Services Tax (CGST) and the State Goods and Services Tax (SGST) should be levied on a common and identical base. **(Para 2.4)**

iii. The Centre and the States should adopt a consumption-type GST[1], that is, there should be no distinction between raw materials and capital goods in allowing input tax credit. **(Para 2.7)**

iv. The tax base should comprehensively extend over all goods and services upto the final consumer point. **(Para 2.7)**

v. There should be no classification between goods and services in law so as to ensure that there is no classification dispute. **(Para 2.7)**

vi. 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 both CGST and SGST and exports should be relieved of the burden of goods and service tax by zero rating. Consequently, revenues will accrue to the State in which the consumption takes place or is deemed to take place; **(Para 2.13)**

vii. The computation of the CGST and SGST liability should 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

[1] Reference to GST in this Report includes both CGST and SGST

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. **(Para 2.16)**

viii. The CGST and SGST should be credited to the accounts of the Centre and the States separately. 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. Cross utilization of ITC between the CGST and the SGST should not be allowed. **(Para 2.16)**

ix. 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. Similarly, any kind of transfer of the capital goods at a later stage should also attract GST liability like all other goods and services. **(Para 2.18)**

x. Ordinarily, there should not be any exemption from CGST or SGST. However, if for some reason, it is considered necessary to provide exemption, the Centre and the States should draw up a common exemption which should be restricted to the following:-

   a. 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;

   b. Any service transactions between an employer and employee either as a service provider, recipient or vice versa;

   c. 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

   d. **education services** provided by non-Governmental schools and colleges; and

   e. **health services** provided by non-Governmental agencies. **(Para 2.26)**

xi. The SIN -goods comprising of emission fuels, tobacco products and alcohol should be subject to a dual levy of GST and excise. No input credit should be allowed for excise. However, industrial fuels should be subjected only to GST (both Central and State) with the benefit of input credit like any other intermediate good. **(Paras 2.27 to 2.32)**

xii. all inter-state transactions in goods and services should be effectively zero rated by adopting the Modified Bank Model. **(Paras 3.1 to 3.19)**

xiii. 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. **(Para 3.20)**

xiv. 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. The cost of the scanners should be entirely borne by the Central Government. 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. **(Para 3.20)**

xv. 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. Further, the threshold exemption limit should be uniform for both CGST and SGST and across States. **(Paras 2.61 and 2.62)**

xvi. Further, with a view to reduce administrative and compliance burden, small dealers with annual aggregate turnover of goods and services between Rs.10 lakh to Rs.40 lakh[2] 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. **(Para 2.63)**

xvii. 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, we recommend 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. **(Para 2.64)**

xviii. The existing **exemption upto Rs.1.5 crores of turnover for small-scale industries should not be continued under the GST framework.** However, in order to inspire confidence of the small scale industry in the new GST framework, the scrutiny/audit of the small scale industry should be conducted only by the state tax administration. The enforcement by the State tax administration would be adequate to even deal with CGST evasion. **(Paras 2.66 and 2.67)**

xix. 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. **(Para 2.74)**

xx. Since the GST is designed to ensure that all producers and distributors are treated as complete pass- through and exports are zero-rated, there **should be no exemption for the developers of, or units in, the Special Economic Zones.** **(Para 2.75)**

xxi. The tax regime for power sector, vehicles, goods and passengers, financial services and the real

[2] 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.

estate and housing services sector should be reformed and integrated into the GST framework along the lines summarized in the paragraphs 4 to 7 and explained in detail in Chapter-II.

xxii. The rate of CGST and SGST on all non-SIN goods and services should be fixed at a single positive rate of 5 per cent and 7 per cent, respectively. In addition, there should be a zero rate applicable to all goods and services exported out of the country. **(Paras 5.9 and 5.79)**

xxiii. The following central taxes should be subsumed in the CGST[3]:

a. Central Excise Duty (including Additional Excise Duties);

b. Service Tax;

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

d. Surcharges and all cesses

(Para 2.11)

xxiv. 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:-

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

b. Entertainment tax (other than levied by local bodies);

c. Entry taxes not in lieu of Octroi;

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

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. **(Para 2.11)**

xxv. Any amount collected through these taxes on the SIN goods 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. **(Para 2.11)**

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[3] This is consistent with the proposal of the EC in their Discussion paper dated 30th April,2008.

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

(Para 2.11)

4. 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. The tax regime for the power sector should be the same as in the case of any other normal good. The electricity duty levied by the States should be subsumed in the SGST. 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. **(Para 2.35)**

5. The **tax on vehicles and the tax on goods and passengers** levied by the State Governments should be subsumed in the GST. 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. The tax regime for the transport equipments and transport services should be the same as in the case of any other normal goods. **(Para 2.38)**

6. The **consumption of financial services** should be comprehensively taxed under the GST framework on the basis of the full taxation method. **(Paras 2.39 to 2.41)**

7. The **real estate sector** should be integrated into the GST framework by subsuming the stamp duty on immovable properties levied by the States to facilitate input credit and eliminate cascading effect. 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. 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.

c. 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.

d. 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.

e. 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.

f. 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.

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. **(Paras 2.42 to 2.48)**

8. 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. After analysing the various Models, we recommend a Modified Bank Model, which comprises, inter alia, of the following functional components:-

(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 authorized 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. The 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 explained in para 3.12.

9. It is now well-recognised that **tax administration** is tax policy. An inefficient tax administration will not be able to provide the requisite level of deterrence thereby leading to non-compliance and under performance of the tax regime. Therefore, the full potential of the pure tax regime will remain unrealised. Hence, the structure, design and the business process of the tax administration is an important factor in the determination of the revenue performance. 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. However, from a taxpayer's perspective all compliance and enforcement procedures under CGST and SGST should be uniform. The Central Government shall establish a common IT infrastructure which will serve the needs of both CGST and SGST. **(Para 4.8)**

10. The jurisdiction between the CBEC and the State Administration may be divided between the two in such manner that the interface of the taxpayer is confined to one tax administration only. The basis for division could be turnover or any other criteria which is considered reasonable so that the compliance and administrative burden is minimized. **(Para 4.8)**

11. All persons with annual aggregate turnover of goods and services exceeding Rs.10 lakh (excluding CGST and SGST) should be required to register and obtain a GST registration number. Persons with lower turnover may be allowed an option to register. The GST registration number

should be a twelve digit alpha numeric number. The first ten digits should be the alpha-numeric Permanent Account Number (PAN) followed by a space and two more digits indicating the state code. This number scheme should be publicised widely and should be self-generated after obtaining a PAN. **(Para 4.4)**

12. 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.

13. 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. The VAT period should be a calendar month. **(Para 4.8)**

14. The administration of this **levy should be based on audited accounts** and not on the basis of any form of physical controls. Since the tax base will be common, there should be a **common appellate authority.** Similarly, the Authority for Advance Ruling should also be common. Best international practices should be embedded in the Central-GST, particularly in respect of laws relating to levy of penalties, and circumstances and method of prosecution. No authority should have any power to make preventive detention for the purposes of CGST and SGST. Procedures for collection of both the CGST and SGST should be uniform. **(Para 4.8)**

15. Another important element of the taxpayer information base is the **VAT invoice,** which forms the primary source of information and therefore a crucial control document of VAT. In an invoice based VAT system, the issue of invoices in the proper form is an essential part of the procedure for imposing and enforcing the VAT. Therefore, it should be mandatory for a supplier making a taxable supply to another taxable person to provide a VAT invoice with that supply or the payment for it. The requirement should be enforceable by some penalty. The VAT invoice should be standardised across all states so as to contain a minimum of information about the supply being invoiced. **(Para 4.6)**

16. The choice of a single or a multiple VAT rates is extremely critical to the efficiency and performance of the GST. In terms of best international practice, recent experience shows that the preference of the policymakers is for adoption of a single rate as it is more efficient. Therefore, we recommend one **positive rate,** each for CGST and SGST on all goods and services. In addition, there should be a **zero rate** applicable to all goods and services exported out of the country. **(Para 5.9)**

17. One of the crucial issues relates to the determination of the rate of CGST and SGST. Since the GST is primarily intended as an exercise in reforming the consumption tax in India and not an exercise for additional resource mobilisation through discretionary changes, the CGST and SGST rates should be such rates which would yield the same revenue as collected from the various taxes which will be subsumed in the CGST and SGST , that is, it should be a **'revenue neutral rates'** or **'RNR').** **(Para 5.17)**

18. Using **the fiscal year 2007-08 as the base year for calculation of the RNR, we first estimate**

the GST base under five different methods. These methods are (i) Subtraction-Indirect Method; (ii) Consumption Method-Task Force Estimate; (iii) Consumption Method-NCAER Estimate; (iv) Shome Index Method; and (iv) Revenue Method. The various estimates of the GST Base for 2007-08 are summarized in Table-10. The Task Force estimate of the GST Base using the Consumption method is the highest (Rs.37,43,077 crores) whereas the Shome Index method provides the lowest estimate. All other estimates fall within this range. Since the five estimates are different, we use their average (Rs 31,25,325 crores) as the size of the comprehensive GST base for 2007-08 for the purposes of estimating the RNR. Since the tax base for both the CGST and the SGST are proposed to be identical, we use the same tax base for calculating the RNR for both levies. **(Paras 5.22 to 5.75)**

19. Given the estimate of the GST Base and the level of central taxes which are intended to be subsumed in the GST, we estimate the RNR for the CGST at 5.0 percent. Similarly, the RNR in respect of the state level TF-taxes which are proposed to be subsumed in the SGST is estimated to be 6.0 percent. **Therefore, the combined RNR is estimated to be 11 percent.** Incidentally, this estimate is the same as estimated by Poddar and Bagchi in their pioneering study published in November, 2007. These estimates do not factor in the revenue gains from increased compliance and GDP. To the extent, the flawless GST will reduce cascading effect, there will be significant increase in the corporate profits and hence corporate tax collections. Hence, in actual practice, the RNR of 11 percent will be revenue positive. However, all entry and Octroi taxes by state governments and other sub-national Governments are also proposed to be abolished. Accordingly, it is imperative to provide for an alternate buoyant source of revenue to the third-tier of Government. Hence, we recommend the following:-

i. The rate of CGST and SGST on all non-SIN goods should be fixed at the **single rate of 5 percent and 7 percent, respectively;**

ii. A formula-based devolution of an amount equivalent to collection of SGST at **2 percentage points** should be made to the third-tier of Government after an appropriate Constitutional Amendment;

iii. The formula should be based on the recommendations of the State Finance Commission.

iv. Pending Constitutional Amendment, the collection from 7 percent SGST shall accrue to the State Government and devolution to the third-tier Government should continue to be made on the basis of the recommendations of the State Finance Commission.

v. Both the Central and the State Governments may continue to levy taxes, in addition to the CGST and SGST, on the various non-SIN goods as at present. **(Paras 5.76 to 5.79)**

20. 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. The existing tax system introduces myriad distortions which favour some goods and services at the expense of others. These distortions yield inefficient resource allocation and consequently, inferior GDP growth. The introduction of the GST will bring about a macroeconomic dividend by reducing what have been called the "negative grey area dynamic effects" of cascading taxation. As a result it reduces the overall incidence of indirect taxation by removing the many distortionary features of the present indirect tax system. The switchover to a flawless GST will have significant macroeconomic effects. The overall

macroeconomic effect of reduction in economic distortions due to GST would be to It would 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. **(Paras 7.1 to 7.5)**

21. 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. Assuming the long-term real rate of interest of about 3 per cent as the discount rate, the present value of total gain in GDP is 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. **(Para 7.6)**

22. 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. 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. **(Para 7.11)**

23. The benefit to the poor from the implementation of GST will flow from two sources: first through increase in the income levels and second through reduction in prices of goods consumed by them. The proposed switchover to the 'flawless' GST should, therefore, be viewed as pro-poor and not regressive. Hence, the switchover will improve the vertical equity of the indirect tax system. Similarly, to the extent it will impose a higher burden on the informal economy by reducing the cascading effect, the switchover will also improve horizontal equity. **(Para 7.22 and Para 7.29)**

24. 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. The prices of agricultural goods would increase between 0.61 and 1.18 percent whereas the overall prices of all manufacturing sector would decline between 1.22 and 2.53 percent. Consequently, the terms of trade will move in favour of agriculture between 1.9 to 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. **(Paras 7.24, 7.27 and 7.28)**

25. 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. Therefore, 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. **(Para 7.31 and 7.32)**

26. As regards the State Governments, in the first year of implementation of GST and phasing out of the Stamp duty, the States should expect additional revenues to the extent of Rs 70,000 crores (excluding the incentive amount). However, in the subsequent years this gain would diminish on account of the phasing out of stamp duty but will be more than adequately compensated as compliance starts improving. **(Para 7.33)**

27. Under the proposed GST, the expansion in the power of the States is significantly larger than the Centre. Therefore, the proposed GST will alter the balance of power in favour of the states thereby reducing the vertical imbalance. **(Para 7.36)**

28. The GST envisages a mechanism whereby both the Centre and the States will cease to have any independent power to make changes in the design and structure once agreed upon. The existing mechanism for arriving at a collective decision on the structure of the GST should be permanently institutionalised so that changes in the initial design of the GST are collectively agreed and implemented by both the Centre and the States. The Empowered Committee of State Finance Ministers may, upon the introduction of the GST, be transformed into a permanent constitutional body known as the Council of Finance Ministers. This Council shall comprise of the Union Finance Minister and all State Finance Ministers. The Union Finance Minister would be the Chairman of this Council. **(Paras 8.11 and 8.12)**

29. The Council should be responsible for any modification in the initial design of the dual GST and regulating the indirect tax system in the country. The initial design of the dual GST should be approved by the Chairman and three-fourth of the State Finance Ministers. Thereafter, any change in the structure of the GST (both base and the rates) should be allowed to be carried out only if the Chairman **and** two-thirds of the State Finance Ministers agree to do so. Consequently, neither the Centre nor any State will have the authority to unilaterally make any change in the agreed design of the GST. However, in the event of a crisis, the Member State or the Centre may take immediate steps to impose a surcharge subject to ex-post facto approval by the Council within one month. Further, such surcharge should not be allowed to remain in force beyond a period of one year. **(Para 8.13)**

30. We do not expect any revenue loss to the States on account of the switch-over to GST. However, with a view to incentivising the States and establishing a credible mechanism for deciding on compensation claims, if any, we recommend the following:-

i) A GST Compensation Fund should be created under the administrative control of the **Council of Finance Ministers.**

ii) The Central Government shall transfer to the GST Compensation Fund a minimum sum of Rs 6000 crores per annum over the next five years (i.e. a total amount of Rs 30,000 crores) if, and only if, the States-

a. introduce the 'flawless' GST as recommended by us; and

b. follow the road map, as suggested by us, for its introduction;

iii) The amounts in the Fund should be used only for the following purposes:-

a. To compensate the states for any revenue loss on account of the adoption of the 'flawless' GST;

b. The balance, if any in the Fund, to be carried forward to the subsequent year;

c. The balance, if any remaining at the end of the fifth year, to be distributed amongst the states on the basis of the same formula used for distributing resources in the divisible pool.

iv) The amount will be transferred in quarterly instalments.

v) The amounts shall be disbursed by the Council on the basis of the recommendations by a three member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India, Secretary to the Council and any fiscal expert appointed by the Central Government for this purpose.

vi) No contribution to the Fund shall be made by the Central Government in any year in which the States fail to adhere to the roadmap for implementation of the GST.

vii) The methodology to be used for estimating the revenue loss and the compensation shall be decided by the Council. **(Paras 9.3 to 9.6)**

31. The States should also be liable to a penalty in case they deviate from the agreed design and structure of the GST. **(Para 9.8)**

32. Since the design of the GST will also impact the indirect tax system of the Central Government, it is necessary for the Central Government to play a more proactive role in this effort. Towards this, the leadership of the Union Finance Minister would be vital. This will provide the necessary impetus to the process of 'grand bargaining' for the GST. **(Para 10.4)**

33. On account of lack of adequate preparedness, the implementation of the GST scheduled for 1st April, 2010 should be postponed by six months to 1st October, 2010. However, the Council should release a timeline of various activities for introduction of GST simultaneously with the announcement for postponement. **(Para 10.6)**

34. All taxes on goods and services including cesses and surcharges levied at the State and sub-national level should be subsumed in the SGST. However, if for some political economy reasons it is considered expedient to introduce the GST in a phased way, we recommend the phasing in the following manner:-

a) In the year 2010-11, all elements of the Flawless GST recommended by us whereby

   i. the single CGST rate should be 5 percent and the corresponding SGST rate should be 7 percent; and

   ii. Transactions in immoveable property (i.e real estate and housing services) should be brought within the fold of GST; and

   iii. Stamp duty **may** not be subsumed but the rate of stamp duty in all states should be calibrated so as not to exceed 4 percent. As a result, transactions in real estate will be subject to a dual levy like in the case of SIN-goods;

b) In the year 2011-12, same as (a) above, with the modification that the rate of stamp duty should be reduced to 2 percent; and

c) In the year 2012-13, same as (a) above, with the modification that-

   i. Stamp duty should be eliminated and replaced by a Registration Fee at a specific rate;

   ii. the revenues attributable to 2 percentage point out of the 7 percentage point of SGST should be set apart for devolution to the third-tier of Government and the revenues from the balance 5 percentage points will remain with the State Government so that the third-tier of Government have a interest in the efficient functioning of the GST and do not have to impose any cascading taxes like cess, entry tax or Octroi.

(Paras 10.3 to 10.10)

CHAPTER - I

Introduction

1.1 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[4]. Therefore, the Task Force recommended the introduction of a destination based VAT type dual Goods and Services Tax (hereafter referred to as 'GST').

1.2 In general, the recommendation was viewed as the ultimate goal but there was certain degree of scepticism about whether India should immediately move to a 'flawless' GST[5]. Experts, in particular, were of the view that the dual GST was an idea whose time had not come.

1.3 By mid-2004, the State Governments were already at an advance stage of preparation for a switch over from the cascading type sales tax to a partial VAT regime which was eventually introduced with effect from the 1st April, 2005[6]. The VAT has two basic rates of 4 percent and 12.5 percent. There is an exempted category and a special rate of 1 percent for a few selected items. The items of basic necessities and goods of local importance are put under the exempted category. Special rate of 1 percent is applicable for Gold, silver and precious stones. The 4 per cent rate applies to other essential items and industrial inputs. The 12.5 percent is residual rate of VAT applicable to commodities not covered by other schedules. There is also a category with 20 percent floor rate of tax, but the commodities listed in this schedule will not be subjected to VAT. This category covers items like motor spirit (petrol, diesel, and aviation turbine fuel), liquor, etc. While input-credit is available for intra-state transactions, no such credit is available for inter-state transactions. Therefore, the VAT, like its predecessor the Sales tax, continues to be characterised by narrow base, plethora of exemptions, multiple rate structure and cascading effect on account of break in the input-credit chain. The introduction of VAT is, at best, a toddler's tentative step towards indirect tax reform.

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4 Report of the Task Force on Implementation of Fiscal Responsibility and Budget Management Act, 2003, Government of India (July, 2004)

5 "Flawless" GST means a GST which has all the elements described in para 3 of the Executive Summary.

6 Haryana was the first State to introduce the partial VAT regime in 2003.

1.4 As a step towards the eventual introduction of the GST, the Centre also took immediate steps to integrate the CENVAT and the services tax and expand the scope of the service tax in a phased manner. Recognising the need for a giant leap to cleanse the indirect tax system of its distortionary impact on the economy, the Finance Minister, while presenting the Union Budget 2006-07, set April 1, 2010 as the date for introducing GST and requested the Empowered Committee of State Finance Ministers to work with the Central Government to prepare a road map for introduction of GST in India.

1.5 The Thirteenth Finance Commission has been mandated to make recommendations after considering the impact of the proposed implementation of the GST with effect from the 1st April, 2010 including its impact on foreign trade. For this purpose, it is necessary to know the structure of the Goods and Services Tax which will be in place. The authority to design the structure of the GST Model jointly vests in the Empowered Committee of States' Finance Ministers and the Central Government. The Empowered Committee brought out its preliminary views on the design of the GST in a paper[7] of April, 2008 and the Union Government gave its response to these proposals. After further consultations, the Empowered Committee presented the first discussion paper in November, 2009. The contours outlined in this paper do not adequately advance the cause of indirect of tax reforms due to a number of infirmities. This initiative seems to be an amalgam of compromises and continued fear of possible revenue losses and adverse impact on the low income groups. Clearly, there are a number of important unresolved issues relating to the design of the GST and resolving these will need further discussions between Central and State Governments. Hopefully, by providing comprehensive discussion of the issues, this Report of the Task Force will make useful contribution towards the Union and the State Governments reaching such a 'grand bargain' so that we have a world class GST regime in India.

7 "A Model and Road Map for Goods and Services Tax in India-Views of the Empowered Committee of State Finance Ministers", New Delhi, April 30, 2008.

CHAPTER-II

Goods and Services Tax: The Model

2.1 In the absence of a firm Model of the GST, it is necessary for us to construct a comprehensive Model in the light of the roadmap prepared by EC, the views expressed by the Central Government, the ongoing discussion on unresolved issues and best international practice. Therefore, the Group seeks to design the Model in such manner as 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.

2.2 With a view to attaining the objectives set out above, we recommend 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

2.3 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[8] 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.

2.4 In view of the above, we recommend the following:-

(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

2.5 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

8 This refers to a single National level GST to be levied and collected by the Central Government.

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.

2.6 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.

2.7 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, we recommend 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.

2.8 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.

2.9 In this context, we would like to point 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 services 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, we recommend that all goods and services should be subject to tax other than those specified in the negative list.

2.10 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, we recommend that the following principles[9] 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.

2.11 Based on the aforesaid principles, we recommend the following:-

a. The following central taxes should be subsumed in the CGST[10]:

1. Central Excise Duty (including Additional Excise Duties);
2. Service Tax;
3. Additional Customs Duty (commonly referred to as 'CVD');
4. 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[11]);

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[9] In general, these principles are consistent with the principles laid down by the EC in their Discussion Paper dated 30th April, 2008.

[10] This is consistent with the proposal of the EC in their Discussion paper dated 30th April,2008.

[11] The Discussion Paper dated 30th April, 2008 released by the Empowered Committee indicates that Purchase Tax will be subsumed by the SGST. However, the Discussion Paper released on 10th November, 2009 indicates that

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)[12];

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 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.[13]

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

2.13 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

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Purchase Tax will not be subsumed by the SGST. This does not advance the cause of a 'flawless' GST and is a retrograde step in the reform of indirect taxes. We recommend that the purchase tax should be subsumed in the SGST.

[12] This does not include (i) Stamp Duty,(ii) Taxes on Vehicles, (iii) Taxes on Goods and Passengers, and (iv) Taxes and Duties on electricity.

[13] This has already been done by all States other than Maharashtra.

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, we recommend 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

2.14 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.

2.15 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.

2.16 In view of the above, we recommend 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

2.17 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,[14] 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[15].

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.

2.18 Therefore, in recent years, most countries have introduced a full and immediate credit for the

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[14] Other reasons for rationalizing the depreciation rates were significant control over rate of inflation in the price of capital goods and reduction in corporate tax rates.

[15] However, forward shifting is unlikely if competing imports can be sold without the element of tax on capital goods.

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, we recommend 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

2.19 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.

2.20 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.

2.21 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.

2.22 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.

2.23 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, we recommend 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.

2.24 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, we recommend that the choice may be made keeping in view the considerations discussed above.

2.25 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, we recommend 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.

2.26 Keeping in view the above-mentioned economic and administrative implications of exemptions and zero rating, we summarize our 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

2.27 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.

2.28 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.

2.29 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 dealer[16] 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.

2.30 We also recommend 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.

2.31 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

2.32 Like emission fuels, all tobacco goods and alcohol are also **SIN-goods[17].** Therefore, on the same analogy, we recommend 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

2.33 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. We recommend accordingly.

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[16] For example, a dealer operating a petrol station will be allowed input credit in respect of GST on petrol purchased by him from an oil marketing company.

[17] SIN-goods are goods whose consumption create negative externalities and for the purposes of this Report, collectively or severally, refers to emission fuels, tobacco goods and alcohol.

j. Treatment of the power sector

2.34 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 effect[18] 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.

2.35 In view of the above, we recommend 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.

2.36 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

2.37 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.

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[18] The Task Force has not made any independent assessment of the impact of the embedded taxes in power generation and distribution. However, discussions with experts in the field suggest that the embedded taxes could account for as high as 30 per cent of the cost of power production and distribution.

2.38 Accordingly, we recommend 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

2.39 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, we recommend that the consumption of financial services should be comprehensively taxed under the GST framework.

2.40 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, we recommend that the consumption of financial services should be taxed on the basis of the full taxation method.

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

m. Treatment of immovable properties

2.42 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.

2.43 **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.

2.44 **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.

2.45 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.

2.46 **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.

2.47 Keeping in view the implications of the different methods for taxing real estate and housing services discussed in Annexe-I, we recommend 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[19] 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

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[19] The increase in the value of land is attributable to the direct or indirect improvements in the form of development of townships, landscaping, and construction of infrastructure that make it usable for agricultural, industrial, or residential purposes. Raw land is similar to the minerals underneath, which are of little or no value unless they can be extracted for commercial/industrial use or consumption. VAT is applied to the full selling price of minerals. In the same manner, VAT should apply to the full value of land.

transaction in immovable property, which is merely a user charge for the IT systems used in property registration.

2.48 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

2.49 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.

2.50 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).

2.51 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.

2.52 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.

2.53 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.

2.54 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.

2.55 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.

2.56 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.

2.57 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.

2.58 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.

2.59 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.

2.60 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, we recommend 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

2.61 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.

2.62 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 disproportionately 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, we recommend that the threshold exemption limit should be uniform for both CGST and SGST and across States.

2.63 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[20] 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.

2.64 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, we recommend 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

2.65 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.

2.66 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, we recommend that this exemption should not be continued under the GST framework.

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[20] 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.

2.67 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

2.68 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.

2.69 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."**

2.70 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.

2.71 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."**

2.72 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.

2.73 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.

2.74 In view of the above, we recommend 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

2.75 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. We recommend accordingly.

CHAPTER - III

Treatment of Inter-State transactions

3.1 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.

3.2 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.

3.3 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 obtain ing 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.

3.4 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.

3.5 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:-

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.

3.6 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.

3.7 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.*[7].

3.8 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.

3.9 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.

3.10 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.

3.11 We 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 interstate 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, we do not support the adoption of the IGST Model. We would recommend a modified version of the Bank Model (hereafter referred to as 'Modified Bank Model') for inter-state trade in goods and services.

3.12 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 authorized 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. The 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.

3.13 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.

3.14 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.

3.15 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.[21] The problem lies in the fact that the seller is allowed a float

[21] 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.

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.

3.16 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.

3.17 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.

3.18 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.

3.19 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.

3.20 In view of the above, we recommend 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.

CHAPTER - IV

Administrative Structure

4.1 It is now well-recognised that tax administration is tax policy. An inefficient tax administration will not be able to provide the requisite level of deterrence thereby leading to non-compliance and under performance of the tax regime. Therefore, the full potential of the pure tax regime will remain unrealised. Hence, the structure, design and the business process of the tax administration is an important factor in the determination of the revenue performance.

4.2 In the context of the GST we are not embarking on an exercise of comprehensively designing all the elements of the tax administration. We intend to restrict our recommendations only to a few important issues.

a. Registration of taxpayers

4.3 The creation of an efficient taxpayer information system for the purposes of administering a VAT necessarily entails the creation of a taxpayer's master file through a mechanism of registration of all dealers liable to GST. Registration brings a person within the control of the tax authorities. Steps towards its compilation must be taken well in advance of the start of the GST.

4.4 Fortunately, there exists a unique taxpayers identification number at the central level in the Income Tax Department in the form of the Permanent Account Number (PAN). All persons who are liable to income tax or whose sales exceed Rs.5,00,000 are required to obtain a PAN. The Customs and the Central Excise Department has already adopted the PAN for registration of importers and exporters and manufacturers. Since the operation of a successful VAT entails coordination between the tax administrations at both the national and the state level through computerised information sharing we recommend the following:

i. All persons with annual aggregate turnover of goods and services exceeding Rs.10 lakh (excluding CGST and SGST) should be required to register and obtain a GST registration number. Persons with lower turnover may be allowed an option to register.

ii. The GST registration number should be a twelve digit alpha numeric number. The first ten digits should be the alpha-numeric Permanent Account Number (PAN) followed by a space and two more digits indicating the state code. This number scheme should be publicised widely and should be self-generated after obtaining a PAN[22].

iii. There will be a single GST registration number for all branches in a State. Therefore, a dealer having branches across States will have as many GST registration numbers as the number of States in which he operates.

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[22] At present, PAN has been allotted to more than 80 million people, including companies, firms and other business entities. Therefore, it is highly unlikely that there would be any existing business entity which would not have obtained a PAN.

iv. The registrant dealer should be required to furnish a form, only by way of information, indicating the registration number for every State in which he operates. He should not be allowed to use the registration number, though self-generated, unless he has furnished the form.

v. Since the number is PAN based, it is not necessary to have any pre-registration verification. However, the states may, if necessary, undertake post-registration verification to eliminate any potential abuse.

vi. To begin with, on the eve of the introduction of GST, the dealer must furnish a consolidated form for all States in which he operates. If, at a later stage, the dealer extends his operation to a new State, he should berequired to furnish a form for extension of activities and register the self-generated number for the new State.

vii. Overtime, the string corresponding to PAN will be replaced by the Unique Identification Number (UIN) proposed to be issued to all residents.

viii. It should be mandatory for all registrant dealers to obtain an e-mail ID and also open an internet banking account with any bank. The form must capture the e-mail ID and the internet bank account number. ix. All persons with annual aggregate turnover of goods and services exceeding Rs.10 lakh (excluding CGST and SGST) would be required to compulsorily acquire the 18 digit identification number. Persons with lower turnover will have the option of obtaining the identification number.

4.5 These recommendations will enable the GST administration to save on considerable time for registration and also enable computerisation of transactions by distinguishing one record from another. Given the simplicity of the proposed registration system, the GST administration can begin registration of dealers from 1st January, 2010.

b. GST invoice

4.6 Another important element of the taxpayer information base is the VAT invoice, which forms the primary source of information and therefore a crucial control document of VAT. In an invoice based VAT system, the issue of invoices in the proper form is an essential part of the procedure for imposing and enforcing the VAT. Typically, under the VAT laws the allowance of a credit for input tax is conditional on the existence of a VAT invoice issued during the period for which the credit is claimed. An invoice is also required by the tax authorities to audit the collection of VAT. Further as indicated above, the VAT invoices form the primary source from which the return of VAT invoices will have to be prepared and furnished to tax authorities for third party information matching. Accordingly, we make the following recommendations relating to VAT invoices:

i. The law should require a supplier making a taxable supply to another taxable person to provide a VAT invoice with that supply or the payment for it. The requirement should be enforceable by some penalty.

ii. The VAT invoice should be standardised across all states so as to contain a minimum of information about the supply being invoiced.

c. Periodicity of GST Payment

4.7 Since the amount of VAT collected by a dealer is related to his turnover, the dealer is likely to accumulate a huge VAT liability within a very short period. Hence, it is necessary to minimise the risk of payment defaults by dealers, in particular fly-by-night operators. Given that the collection under VAT will serve as the dominant source of revenue for state governments it is imperative to provide for a collection mechanism which would ensure a periodic flow of revenue to the exchequer subject to a minimum compliance burden on taxpayers and risk of revenue loss. Therefore, we recommend that the VAT period should be a calendar month.

d. Administrative structure

4.8 The proposed GST will be a dual levy. Therefore, concern has been expressed at different for a on the administrative structure for implementing the CGST and the SGST consistent with the autonomy of the different levels of Government. Therefore, we recommend that the tax administration and procedures for the dual GST should be designed 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[23]. 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

[23] The jurisdiction between the CBEC and the State Administration may be divided between the two in such manner that the interface of the taxpayer is confined to one tax administration only. The basis for division could be turnover or any other criteria which is considered reasonable so that the compliance and administrative burden is minimized.

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.

(j) The information furnished shall be stored in a common database to which both the CBEC and the State tax administration will have access.

(k) For the purposes of audit, both CBEC and the State tax administration can design an independent risk management strategy. However, both must coordinate to ensure that the same taxpayer is not subject to simultaneous audit under CGST and SGST.

(l) The administration of this levy should be based on audited accounts and not on the basis of any form of physical controls.

(m) Since the tax base will be common, there should be a common appellate authority. Similarly, the Authority for Advance Ruling will also be common.

(n) Best international practices should be embedded in the Central-GST, particularly in respect of laws relating to levy of penalties, and circumstances and method of prosecution.

(o) No authority should have any power to make preventive detention for the purposes of CGST and SGST.

(p) Procedures for collection of both the CGST and SGST should be uniform.

4.9 The uniformity in the procedures recommended by us will considerably reduce compliance and administrative cost. This should undoubtedly result in improved voluntary compliance.

CHAPTER V

Rates of Tax

I. Single or Multiple Rates

5.1 The choice of a single or a multiple VAT rates is highly controversial. There is a belief that the public will accept a VAT type GST more easily if products consumed by low-income households are taxed at lower rates than products consumed by those that are better off. Administrators who actually implement the tax know that every additional rate will significantly increase cost and complexity. The cost of auditing the classification of exempt and taxable items and the applicable rates thereon at every stage of production, distribution and sale is also extremely high. Therefore, they support the elegance of a single rate (other than the zero rates). Economists espouse the optimality of tax rates based on elasticity. In general, business and industry also espouse a single rate since it is simple to comply and eliminates the problem of classification which arises under the multiple rates regime leading to protracted legal disputes and taxpayers' grievances. Further, multiple rates also implies that the standard rate is relatively high. Since taxes result in economic distortion which increases exponentially with the increase in the applied tax rate, a relatively high standard rate creates much larger economic distortion. It also provides an incentive for evasion and frequent lobbying by trade and industry for favourable modifications in the tax schedule.

5.2 Early VAT systems were characterised by a progressive tax structure whereby basic necessities were taxed at lower rates, luxuries at higher rates and all other goods and services at a standard rate. The problem was further compounded by numerous exemptions. However, since the 1990s there is a growing trend towards a single positive rate, a zero rate and some, or no, exemptions.

5.3 The Task Force on Implementation of the Fiscal Responsibilities and Budget Management Act, 2003 sketched the elements of a reform strategy which would achieve the core economic policy goals of promoting efficiency, equity and high quality growth.

These elements, inter-alia, included low and few rates. The Task Force expressed the view that "*High tax rates distort economic decisions and fuel and deployment of resources into tax avoidance and tax evasion. A large number of rates of taxes exacerbates the problem of bracket creep and classification disputes. These arguments suggest that a rational tax system is one with very few rates and low rates. For example, debates on customs duties have universally argued that if customs tariffs have to exist, there should be a single uniform rate on all goods. Similarly, it is well accepted that there should be a single VAT rate covering all kind of production*". In view of the fact that both the Centre and the States had multiple rates, the service tax base was extremely narrow, and the States had not moved to VAT, the Task Force, even while recognising the efficacy of a single VAT rate, recommended multiple rates as a transitory step towards a single VAT rate[24] . The recommendation does not, in any way, undermine the efficacy of a single VAT rate[25].

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[24] This has been ascertained from Dr. Vijay L. Kelkar, who headed the Task Force.

[25] The recommendation for multiple VAT rates was adversely commented upon by experts.

5.4 Bogetic and Hassan (1993)[26] analysed a diverse group of 34 countries on a wide spectrum of VAT structures bases and revenues. In terms of VAT structure, two groups of countries were identified: single rate and multiple rate countries. Given the revenue performance data and the consensus preference of tax experts for single rates, they examined whether existing data on VAT support the contention that countries with single rate mobilise more revenue than those that have multiple rates. The empirical results confirm that the dispersion of rates if found to negatively affect VAT revenues. The results also confirm in other conventional view that VAT generates, other things being constant, higher revenue in single VAT rate countries than in multiple rates countries. The difference in the estimated models for the two country groups statistically significant indicating a structural change[27]. Accordingly, they recommend that to generate superior revenues, a VAT should be levied in a single rate on as broad base as possible; it also must be accompanied by a strong tax administration to ensure enforcement and compliance.

5.5 Mello (2008)[28] empirically analyses 38 OECD and non-OECD countries and concludes that VAT efficiency is inversely related to the statutory rate and the share of tax administration costs in tax revenue (proxying for tax administration efficiency)[29]. The VAT efficiency is affected adversely by the level of the statutory rate. The co-efficient in the tax is small in magnitude, although it is highly significant, so that the loss in efficiency due to an increase in the VAT rate is relatively modest. The elasticity of VAT revenues to VAT rate is (-) 0.3 approximately. Silvani and Wakefield (2002) analyse a sample of 22 countries in the 1990s and show that, if the VAT tax rate is raised by one percentage point, productivity falls by 3.6 per cent.

5.6 The Group took note of the fact that, in 2007-08, the combined statutory incidence of CENVAT, CST and State level VAT on goods was in the range of 27 per cent and 30 per cent[30]. This combined rate is one of the highest in the world and is not conducive to voluntary compliance. Further, it also underscores the need for multiple rates.

5.7 The Group also took note of the need to minimize the tax burden on consumption by low income households. However it does not recommend a low rate of tax, or exemption, for products

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[26] Bogetic, Zeljko and Fareed Hassan (1993). Determinants of Value-Added Tax Revenue: A Cross-Section Analysis, The World Bank Working Paper No.1203.

[27] They also point out that the change in the pattern of VAT revenues cannot be exclusively explained in terms of difference in rate structures.

Mello, Luiz de (2008). Avoiding the Value Added Tax: Theory and Cross-Country Evidence, OECD, Economics Department Working Paper No. 604.

[29] VAT efficiency also tends to be higher in countries where the regulatory framework in product markets is pro-business and governance (regulatory quality, rule of law and government effectiveness) is strong. Moreover, VAT productivity does not seem to differ in a statistically significant manner between OECD members and non-members. Finally, the ratio of administrative costs to tax revenue is the best-performing indicator of tax administration quality used in the empirical analysis, with other metrics, such as the ratio of audit and other non-audit verification assessments to net revenue having a much lower predictive power.

[30] This does not include the incidence of embedded taxes which are not vatable. This combined statutory incidence has since reduced to a lower range of 18 per cent to 20 per cent in 2008-09 as a consequence of the sharp temporary cut in the CENVAT rate.

consumed by low income households since the same products also form part of the consumption basket of the middle and high income households. As stated earlier, the introduction of a low rate or exemption for products commonly consumed by low income households also results in increase in the standard rate. Since low income households also consume goods liable to tax at the standard rate, the cumulative burden on the aggregate consumption by the low income households remains unaffected in spite of the exemption orlow rate for the common goods consumed by them. The Group also recognized that, in general, the low income households purchase their requirement of daily necessities from the small neighbourhood retail outlets whose turnover is generally low/moderate. Therefore, the burden of GST on consumption by low income households should be minimized, more appropriately, by providing a moderate threshold exemption for registration of dealers. Accordingly, the Group has, in para 2.61 above, recommended a threshold exemption limit of Rs.10 lakh.

5.8 Further, in terms of best international practice, recent experience shows that the preference of the policymakers is for adoption of a single rate as it is more efficient.[31].

5.9 In the light of the above, the Group recommends **one positive rate,** each for CGST and SGST on all goods and services. In addition, there should be a **zero rate** applicable to all goods and services exported out of the country.

5.10 A view has been expressed that a single rate of State GST for all goods and services will, in our country with its large low income population, be highly regressive. It is mainly the articles of common consumption which are in the lower rate bands of VAT. The single revenue-neutral rate will definitely be much higher than the rate now prevailing at the lower bands. In short, the incidence of taxation on the articles consumed by the common man will rise, while the rate of tax on luxuries will fall. The implementation of a regressive tax during an economic slowdown is even worse than doing so in a boom. In other countries where such a shift to a single rate has occurred, an increased propensity to evade has also been noticed. Those who argue for a single rate GST on grounds of economic efficiency and growth are ignoring the adverse distributional consequences. The implementation of a single rate will thus be highly unpopular with the common man.

5.11 Under the present Indirect Tax regime at the State level, the lower rate is generally 4 per cent. However, in the absence of a seamless flow of the input credit mechanism resulting in cascading of taxes **and** the CENVAT-inclusive tax base, the incidence on products liable to the lower rate of 4 per cent is substantially higher. Since we recommend in para 5.79 a single rate, which is extremely low in comparison to the existing standard rate of 12.5 per cent, there is little scope for providing a further lower rate. In addition, the proposed GST design structure envisages a comprehensive base with a seamless flow of the input credit mechanism. Consequently, the cascading effect would be negligible. Further, the tax base will be exclusive of CENVAT. The cumulative effect would be that the real tax incidence under the proposed GST model would approximate the statutory rate and would not be significantly different from the present levels of incidence on such products. The proposed single rate GST regime will be transparent in comparison to the present opaque system. A move to a single rate of GST is regressive if the initial point is a destination based VAT type regime across a comprehensive

[31] Michael Keen (2009): "What makes a successful VAT?", Presentation at the Workshop on September 30, 2009 at the National Institute of Public Finance and Policy (NIPFP), New Delhi.

base and allowing for seamless flow of input credit where the cascading effect is either non-existent or negligible. Since the existing indirect tax structure is characterised by significant cascading effect, the move to a single rate of GST which approximates the real incidence, does not result in any adverse distributional consequences.

5.12 A tax on consumption can be regressive. The structure should be designed to alleviate the tax incidence on consumption by the relatively poorer section of the society. One of the methods could be to identify such items of consumption by the poor and either exempt them from GST or subject them to a lower rate. Under this method, consumption by the rich would also suffer the same level of tax since no distinction can be made between the rich and the poorer consumers at the point of sale. Therefore, this method is highly regressive. The second method is to provide for a moderate threshold exemption level for registration of dealers. Consequently, all small dealers would remain outside the purview of the GST and, therefore, the tax incidence on products sold through such dealers would be relatively lower. Since the poorer section of the society tend to make their purchases from such small and unregistered dealers, the consumption of any commodity by the poor would bear a relatively lower incidence of tax than the consumption of the same commodity by the relatively richer section of the society. In the aforesaid paragraphs, we haverecommended a modest threshold exemption level of Rs.10 lakh. This recommendation is aimed to address the issue.

5.13 The distributional consequences of the proposed GST should be analysed keeping in view its impact on economic growth and employment. To the extent it enhances economic efficiency, it will also create new opportunities for employment which would obviously benefit the relatively poorer section of the society and improve equity[32]. There is yet another instrument to improve the distributional outcome of this by direct cash transfer to the target groups. With the proposed UIN system such a policy is feasible and a more efficient option.

5.14 In view of the above, the apprehension that the move to a single rate would be regressive is misplaced.

5.15 It has been argued that the proposal to have a uniform rate of State GST reduces the autonomy of the States and, therefore, undermines the federal structure of our Constitution. Further, the States would lose the flexibility to swiftly respond to any crisis[33]. In the present context, the design of the structure of the GST will be determined through the collective process of a 'grand bargain' between the Centre and all the States for the collective welfare of its people. The decision to have a uniform rate should, therefore, be viewed as a collective decision of all States and Centre to harmonize the tax rates, arrived on the basis of consensus in the Empowered Committee of State Finance Ministers. Further, the proposed GST structure would confer upon the States the power to tax services which accounts for about 54 per cent of the GDP. This would significantly improve the vertical imbalance in the federal fiscal relations in favour of the States[34]. The States would also have the flexibility to impose surcharges to meet any financial need in an emergency-like situation.

Unemployment results in an implicit taxation of the poor at the rate of 100 per cent.

[33] Some States have argued that but for the flexibility, the Central Government would not have been able to reduce the CENVAT rate as a response to the economic slowdown witnessed in the second half of the fiscal year 2008-09.

[34] This would be so even after making appropriate adjustment for allowing the Centre to levy tax upto the retail stage.

5.16 It is now well recognised that the performance of GST is dependant, amongst others, on the ratio [$\frac{\text{Weighted average of statutory rates}}{\text{Standard rate}}$][35]. Therefore, the ratio is less than one if there are multiple rates. Hence, it is necessary to adopt a single rate so as to optimize the performance of the GST.

II. Determination of the rate of GST

5.17 One of the crucial issues relates to the determination of the rate of CGST and SGST. Since the GST is primarily intended as an exercise in reforming the consumption tax in India and not an exercise for additional resource mobilisation through discretionary changes, the CGST and SGST rates should be such rates which would yield the same revenue as collected from the various taxes which will be subsumed in the CGST and SGST (hereafter such rates shall be referred to as **'revenue neutral rates'** or **'RNR').**

5.18 The Thirteenth Finance Commission has been mandated to make its recommendations having regard to the basis of levels of taxation likely to be reached at the end of 2008-09. However, the fiscal year 2008-09 has been characterised by unprecedented economic meltdown necessitating immediate and temporary midyear corrections in the rates of CENVAT and Service Tax. Further, due to intra-year extreme volatility in the prices of various commodities, the levels of taxation achieved in 2008-09 are substantially lower than what would have been achieved if the trend of the preceeding five years had continued. Further, detail firm level data is required for the purposes of calculation of RNR. This is available only upto the fiscal year 2007-08. **Therefore, the Group has used the fiscal year 2007-08 as the base year for calculation of the RNR.**

5.19 The RNR for the CGST and the SGST is determined in accordance with the formula-

$$\textbf{RNR} = \frac{\textbf{R}}{\textbf{100}} \times \textbf{100}$$

Where,

RNR : Revenue Neutral Rate for the Centre or the States as the case may be;

R : Collection from the Central or State taxes, as the case may be, which are proposed to be subsumed in the CGST and SGST;

B : Estimated Tax base of the GST

a. Taxes to be subsumed in the GST

5.20 The **Central taxes** which are proposed to be subsumed by the Empowered Committee in the CGST are indicated in Para 2.11 of Chapter-II of this Report. We concur in this proposal of the EC. Further, the SIN goods will be subject to a dual levy comprising of the CGST and Excises. The total

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[35] A **standard rate** is defined to mean the rate on supply of all general goods and services for which no other specific rate is provided. In effect, this is the rate applicable to the residuary category of goods and services. Further, detail analysis of this is presented in Chapter - VI.

collection from these central taxes in 2007-08 was **Rs 233435 crores** (including collection from petroleum and tobacco products) of which collection from non-SIN goods and services was **Rs 157733 crores only.** The breakup of the collections is presented in Table-1. Since the SIN-goods will continue to be subject to excises as at present, the RNR for the CGST is sought to be calculated only in respect of **Rs 157733 crores,** being the collections from non-SIN goods and services.

Table-1: Revenues from Central taxes to be subsumed in CGST

Sl No	Nature of Tax	Non-SIN Goods	POL	Tobacco	Total
1	CVD	53510	5199	0	53709
2	Union Excise Duties	52922	60231	10272	123425
3	Service Tax	51301	0	0	51301
4	Total	157733	65430	10272	233435

Note: Union Excise Duties includes Additional Excise Duties and the various cesses listed out for subsunnation in the CGST

5.21 Similarly, the total collection from **"EC-taxes"** in 2007-08 was **Rs.118356 crores** (excluding collection from petroleum, alcohol and tobacco products). However, the total collection from **"TF-taxes"** (excluding collection from petroleum, alcohol and tobacco products) was **Rs 188285 crores** in 2007-08 as per details presented in Table-2. Since we are of the view that all the **"TF-taxes"** should be subsumed in the SGST, our RNR for the SGST is sought to be calculated in respect of an amount of **Rs 188285 crores.**

Table-2: Revenues from State taxes to be subsumed in SGST

SI. No	Nature of Taxes	Non-SIN Goods	POL	Tobacco	Alcohol	Total
1	Stamp Duty	38473				38473
2	Taxes on Vehicles	15549				15549
3	Taxes on Goods & passengers	6719				6719
4	Taxes and Duties on Electricity	9188				9188
5	Sales Tax/VAT (incl. CST and Purchase Tax)	110826	56442	3000	11450	181718
6	Entertainment tax	1062				1062
7	Entry taxes not in lieu of Octroi	3914				3914
8	Other taxes and Duties*	2254				2554

9	Total (sum of 1 to 8)	188285	56442	3000	11450	259177
10	TF- Taxes (sum of 1 to 8)	188285				
11	EC- Taxes (sum of 1 to 8)	118356				

This includes (i) taxes on lottery, betting and gambling; (ii)luxury tax; and (ill) cesses and surcharges by States

b. Estimation of the GST base

5.22 For the purposes of estimating the RNR, we need to first **estimate the GST base** in the light of the GST Model designed by us. There are essentially two methods of estimating the GST base. **One method** is to estimate the final consumption in the country and make appropriate allowance for leakage. However, the pre-GST indirect tax system is generally characterised by high leakage while the shift to a consumption-type GST is compliance enhancing. Therefore, estimating the degree of leakage under the proposed GST is vexatious. The **second method** is to estimate the gross value addition by the producers of goods and services and make appropriate adjustments relating to imports and exports. The gross value addition by the producers can be estimated by either using the input-output table or the profit and loss account of the producers.

5.23 For the purposes of estimation of the GST base, we use the following methods/ approaches:-

1. Subtractive - indirect method (SI method);
2. Consumption method
   i. Task Force Estimate; and
   ii. NCAER Estimate.
3. Shome Index method
4. Revenue method

5.24 We use the average of the estimates under these methods as the estimate of the GST Base for the purposes of calculating RNR.

1. Subtractive - indirect method (SI method)

5.25 At the producer level, the GST base is equivalent to the value added which is the value that a producer adds to his raw materials or purchases before selling the new or improved product or service. That is, the inputs (the raw materials, transport, rent, advertising, and so on) are bought, people are paid wages to work on these inputs and, when the final good or service is sold, some profit is left. So value added can be looked at from the additive side (wages plus profits) or from the subtractive side (output minus inputs).

5.26 Value added = wages + profits = output - input. If the tax rate on this value added is 't', there are four basic forms that can produce an identical result:

(1) *t* (wages + profits) : the additive - direct (accounts) method;

(2) *t* (wages) + *t* (profits): the additive - indirect method[36],

(3) *t* (output - input) : the subtractive - direct (accounts) method; and

(4) *t* (output) - *t* (input) : the subtractive - indirect (the invoice or credit) method.

5.27 While there are four possible ways of levying a VAT, in practice, the method used (number 4) never actually calculates the value added; instead, the tax rate is applied to a component of value added (output and inputs) and the resultant tax liabilities are subtracted to get the final net tax payable. This is sometimes called the "indirect" way to assess the tax on value added.

5.28 The Subtractive - indirect method (SI method) is based on the profit and loss account of producers. Since extensive producer level data was available with the Income Tax Department, the Group analysed the profit and loss accounts of 2**8, 51, 248 business entities** for the financial year ending on the 31st March, 2008 (financial year 2007-08) which have electronically filed their profit and loss account along with their return of income with the Income Tax Department for assessment year 2008-09. The activities of these entities are classified into 9 sectors and further sub classified into 74 sub-sectors (refer Annex - II). Further, the sample includes **3,50,894** companies and **3,84,425** partnership firms. Since it is mandatory for firms with an annual turnover of more than Rs.40 lakhs and all companies to electronically file their return of income, the dataset includes all companies and such firms, who have filed their return upto 15th August, 2009 for the financial year 2007-08 (assessment year 2008-09). In addition, it also includes other business entities which have voluntarily opted to electronically file their return. For the purposes of this exercise, we assume that these **28, 51,248** entities constitute the universe of the GST taxpayers. This sample does not include the multitude of taxpayers who have filed their tax returns in paper form. Charitable organizations are required to file their return only in paper form. Therefore, the sample does not include the tax returns of any charitable organization. Since most entities engaged in providing education and health services operate as charities, the sample does not include education and health services providers. Further, since agricultural income is exempt from income tax, the sample does not capture the data relating to the agricultural sector.

Table 3: Turnover based Distribution of sample entities

Turnover* range	**Number of cases**	**Amount of Output base (Rs in crores)**	**Share in the total turnover (in percent.)**
Less than zero	2014	-719	-0.01
Between 0 to Rs 10 lakh	1616362	25761	0.28

[36] This method is so called because value added itself is not calculated but only the tax liability on the components of value added is calculated.

Between 10 lakh to Rs 25 lakh	237333	33933	0.42
Between 25 lakh to Rs40 lakh	146934	43061	0.51
Between 40 lakh to Rs 100 lakh	333047	219065	2.34
Between 1 crore to Rs 2 crore	199099	230773	3.00
Between 2 crore to Rs 5 crore	1653S5	519055	5.55
Between 5 crore to Rs 10 crore	71341	493332	5.33
Between 10 crore to Rs 100 crore	71332	1840605	19.63
Above 100 crore	8160	5884524	62.91
Gross Total	2851557	9354445	100
Less: Indirect Taxes		281168	
Turnover net of indirect taxes		9073277	
* Turnover is defined as total credits in	the Profit and Loss Account as reduced by the value		
of closing stock. This is the same definition used for computing the GDP			

5.29 The distribution of taxpayers across turnover is shown in Table-3. For this purpose, "turnover" is defined to mean the aggregate of all income receipts credited to the Profit and Loss account so as to align it with the definition of "gross value of output" for the purposes of National Accounts by the CSO. The aggregate gross value of output of the sample entitiesis Rs.90,73,277 crores[37] in 2007-08 as against the gross value of output of Rs.75,78,410 crores estimated by CSO for the non-agricultural sector[38]. Therefore, it is obvious that the CSO estimation of gross value of output seems to be an under estimation.[39] Consequently, the estimation of GDP, private final consumption etc., by the CSO also appears to be under stated. Therefore, the sample size is extremely large and any estimation of the GST base on the basis of this sample will be fairly representative of the actual GST base.

5.30 The computation of the GST base under the SI method involves the following steps:

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[37] Since agricultural income is exempt from income tax and persons whose income is predominantly from agriculture are not required to file their tax returns, this does not include the gross value of output produced in the agricultural sector.

[38] This is derived by reducing the aggregate of the value of output of Rs.9,18,846 crores in agriculture, Rs 3,33,098 crores in Public Administration and Defense and Rs 2, 84, 953 crores being 50 percent of the value of the output under 'Other services' from the value of total output of Rs 91,89,784 crores in 2007-08 as reported by CSO.

[39] The turnover of the sample entities relate to the organised sector. The under reporting of the value of output by the CSO is further accentuated if we adjust for the unorganised sector.

a. The receipt items on the credit side of the Profit and Loss Account, which would be liable to output tax, are identified and appropriately adjusted for indirect taxes to arrive at the **'value of supply of domestically produced goods and services (net of indirect taxes)'** (hereinafter referred to as **'net value of supply of domestically produced goods and services');**

b. Since imports are liable to GST at the point of importation, the **'value of imports'** is aggregated with the **'net value of supply of domestically produced goods and services'** to arrive at the **'net value of domestically available goods and services'.**

c. Since exports are zero rated in a GST regime, the value of exports is reduced from the **'net value of domestically available goods and services'** to arrive at the **'net value of goods and services available for domestic consumption'** or the **'aggregate output tax base'.**

d. Similarly, the expense items on the debit side of the Profit and Loss Account, in respect of which input tax credit would be potentially available, are identified and appropriately adjusted for indirect taxes to arrive at the **'value of purchase of intermediate goods and services'.**

e. Under the GST Model, full and immediate input credit is proposed to be allowed for GST paid on purchase of capital goods in the year of purchase. Therefore, the **'value of purchase of capital goods'** is aggregated with the **'value of purchase of intermediate goods and services'** to arrive at **'gross value of purchase of intermediate goods and services'.**

f. Since no input tax credit would be available in respect of purchases made from unregistered dealers, the **'value of purchases from the unregistered dealers'** is reduced from the **'gross value of purchase of intermediate goods and services'** to arrive at the **'aggregate input tax base'.**

g. The **'aggregate output tax base'** is reduced by the **'aggregate input tax base'** to arrive at the **'GST Base'.**

5.31 On the basis of the profit and loss accounts of the 28,51,248 business entities, the **"net value of supply of domestically produced goods and services"** is the aggregate of the value (net of indirect taxes) of (i) Sales/gross receipts from business; (ii) Commission; (iii) Profit on sale of fixed assets; and (iv) 'Any other income' since output tax would be charged only in respect of these four items credited to the profit and loss account.[40] This is estimated to be **Rs. 87,21,874 crores in the financial year 2007-08 for all sectors.** This constitutes 105.02 percent of the gross value of the output in the non-agriculture sector in 2007-08, as reported by CSO. However, the corresponding figure for the **taxable sectors (excluding financial, rail and real estate sectors) is Rs. 77,62,224 crores.**

5.32 The item 'any other income' as reported in the accounts does not include rent, dividend, interest, profit on sale of investments liable to STT, profit on other investment, profit on currency

[40] In the case of rent, the expenditure on rent is reduced by the rental income reported. Therefore, we do not separately include this item in the 'net value of supply of domestically produced goods and services'.

fluctuation and agricultural income. In practice, a large number of professional entities report their gross receipts under this item since they do not view themselves as carrying on business or engaged in sales. Since the Group has recommended a comprehensive GST base to include all goods and services, the value of supply of goods and services must therefore, include the item 'any other income'. As regards, rent, dividend, interest, profit on sale of investment liable to STT, profit on other investment, profit on currency fluctuation and agricultural income, these have been excluded from the value of the supply of goods and services since the source of these items of income is, in general, a business-to-business transaction and therefore, a wash transaction in the context of GST.

5.33 The various receipts which have been excluded from the item 'any other income' basically arise from transaction in financial services and immovable property. While the base for GST is proposed to include financial services and immovable property (real estate), the size of the base relating to these services is determined separately and not on the basis of the subtractive-indirect (invoice or credit) method.

5.34 Input tax base comprises of all goods and services used as intermediate inputs in the production of goods and services and on which output tax has been paid. The **'value of purchases of intermediate goods and services'** is the aggregate of the expenditure on items listed in Table-4. The aggregate of such expenditure by all the sample entities during the financial year 2007-08 is Rs.73,29,483 crores of which Rs 4,32,910 crores relates to purchase of agricultural commodities and the balance Rs 68,96,573 crores relates to purchases from the non-agricultural sector. However, the **'value of purchases of intermediate goods and services'** by the **taxable sectors (excluding financial, rail and real estate sectors) is Rs. 67,12,418 crores.**

Table 4. Intermediate goods and services forming part of Input Tax Base

A	**Purchases** of trading **goods and** raw **material**	
B	**Special services**	
	1	Freight
	2	Consumable Stores
3		Power & Fuel
	4	Building repair
	5	Machinery repair
	6	Total expenditure on insurance
	7	Workmen and staff welfare expenses
	8	Entertainment
	9	Hospitality
	10	Conference
	11	Sales promotion including publicity (other than advertisement)
	12	Advertisement

	13	Commission
	14	Hotel boarding and lodging
	15	Travelling expenses including foreign travelling
	16	Conveyance expenses
	17	Telephone expenses
	18	Guest house expenses
	19	Club expenses
	20	Festival celebration expenses
	21	Gift
	22	Audit fee
C	**Miscellaneous Services**	
		Other expenses

5.35 The aggregate of the purchases of trading goods and raw material by all the sample entities during the financial year 2007-08 is Rs.56,70,610 crores. However, the corresponding figure for the **taxable sectors (excluding financial, rail and real estate sectors) is Rs. 51,80,108 crores. These purchases include purchase of trading goods and raw materials from registered and unregistered dealers in both the primary and secondary sector. To the extent these include** purchases of trading goods and raw materials from the unregistered dealers, no input tax credit would be available since no output tax would have been paid by the unregistered dealers. In the case of primary articles like cereals and plantation crops, these would generally be purchased from agriculturists who would be outside the scope of GST either by virtue of exemption or by virtue of their turnover being below the threshold limit. If for some reason, the agriculturist falls within the scope of the GST, he would be liable to collect GST for which the purchaser in our sample would be eligible to claim input credit. Since agriculturists do not ordinarily file an income tax return, his sales do not form part of the output base estimated above. Therefore, purchases of primary articles would not be entitled to any input credit. Such purchases are estimated to be Rs.4,32,910 crores. Further, we also estimate 10 percent of the purchases of trading goods and raw materials from the secondary sector to have been purchased from the unregistered dealers on which no input credit would be available. Such purchases amount to Rs.5,23,770 crores. Therefore, the aggregate purchases of trading goods and raw material from unregistered dealers is Rs 9,56,680 crores in 2007-08 for all sectors.

5.36 The value of **Special services** availed by all sample entities is Rs.7,25,657 crores. Given the nature of the services, we estimate 25 percent of the services to have been acquired from **unregistered dealers** and therefore, no input credit would be available. The **value of such services is estimated to be Rs.1,92,756 crores.**

5.37 Similarly, the value of **Miscellaneous Services** availed is Rs.8,67,077 crores which is charged to the profit and loss account under the head 'other expenses'. These are generally petty expenses in nature most of which are acquired from unregistered dealers. It is estimated that 60 percent of this amount would be from unregistered dealers. Accordingly, a sum of Rs. 5,32,709 crores will not be eligible for input credit.

5.38 Accordingly, the **'value of purchases from the unregistered dealers'** in 2007-08 for all sectors is computed at Rs.16,82,145 crores of which Rs 4,32,910 crores relate to purchases of agricultural commodities and the balance Rs .12,49,235 crores to non -agricultural goods and services. In the course of discussion in different fora on the estimated purchase from unregistered dealers, a view was expressed that this estimate may be upwardly biased. Therefore, it is important to undertake a validation check of the estimate.

5.39 In general, the unorganized sector in terms of the National Accounts Statistics is a good proxy for the unregistered dealers under the GST. The share of the unorganised sector in the non-agriculture Net Domestic Product in 2007-08 is 48.69 percent and 90.27 percent in the agricultural sector.[41] Applying theses ratios to the firm level profit and loss account, the purchases from the unorganised sector/unregistered dealers is estimated at Rs37,48,729.crores of which Rs 3,90,788 crores relates to agricultural commodities and the balance Rs 33, 57, 941 crores relate to purchase of non-agricultural goods and services from the unorganised sector. Our own estimate of Rs 16,82,145 crores is only 45 percent of the purchases from the unorganised sector estimated on the basis of the National Accounts Statistics. Therefore, there is no reason to doubt the veracity of our estimates.[42]

5.40 On the basis of the above, the GST bases for the **'Taxable sectors'** and **'Exempt sectors'** (which comprises of the Food sector and health and education services) are computed separately.

- **Exempt sectors**

5.41 We have earlier recommended exemption from GST of unprocessed food articles. Producers of food grains do not file income tax returns. Similarly, most of the trading in food grains is undertaken by small traders with low turnover. Such traders, in general, file their income tax returns in paper form. However, the sample represents electronically filed returns only. The impact of the exemption for unprocessed food articles (rice and wheat) on our estimation of the GST base is not significant.

5.42 Similarly, we have also recommended exemption from GST in respect of health and education services. The health and the education sector is mostly organised as charitable trusts. The charitable trusts are required to file their returns in paper form and therefore do not form part of the sample. However, 3928 trusts with a total turnover of Rs 8133 crores have electronically filed their returns. Assuming that these trusts operate in the health and education sector, the volume of the total turnover is insignificant to make any material difference to the estimation of the GST base. Therefore, no separate adjustment is made to provide for the exemption for the health and education sector under the proposed GST.

5.43 Separate data relating to life-saving drugs is not available. Therefore, we estimate the GST base relating to this sector at Rs 5000 crores on the basis of anecdotal information.

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[41] See Statement 76.1 of National Accounts Statistics 2009

[42] In reality, it is likely that the purchases from unregistered dealers would be substantially larger than our estimate. To the extent it is so, the GST base is likely to increase, and the RNR would be lower, than our estimate.

5.44 Therefore, the GST base relating to the 'Exempt sectors' is estimated at **Rs 86, 575** crores.

- **Taxable sectors**

5.45 The **'Taxable sectors'** is sub-divided into two, namely, the **'General sectors'** and the **'Special sectors'.** The latter comprises of the Financial Sector, Rail Transport Sector and Real Estate Sector. The GST base relating to the **'General sectors'** is computed by using the **SI method.**

5.46 In terms of the proposed GST Model, the tax base will include real estate (land and buildings) and housing services. In the case of real estate transactions, the incremental value between two transactions will be subject to GST thereby, subsuming the stamp duty within the GST base. Further, rent, whether from residential or commercial property, will also form part of the GST base. However, rent in a business-to-business transaction will be a wash transaction. Since expenditure on rent is greater than the rental income in the case of sample entities, the net expenditure on rent is included in the **'value of purchase of intermediate goods and services'.** To the extent GST on rent will also be collected on business-to-consumer transactions, it is not feasible to make any estimate of the volume of such rental transactions. Therefore, the estimate of the tax base relating to real estate and housing services is limited to the estimated base in respect of real estate (land and buildings) transactions. In 2007-08, the Gross Fixed Capital Formation by way of construction in the household sector is Rs 429260 crores. This does not include the value of land. Assuming that the land value accounts for 50 percent of the total value of the real estate, the GST base relating to land is estimated at Rs 429260 crores.

5.47 The comprehensive GST is intended to bring within its fold rail transport services also. However, this is intended to be confined to rail services provided for transportation of goods only. The rail transportation sector is entirely under the Ministry of Railways which is not required to file a tax return. Therefore, the sample does not include rail services. Accordingly, based on the information contained in the National Accounts (2009), the GST Base in respect of rail services is estimated at Rs 44,746 crores.

5.48 The GST Base in respect of the **'General sectors'** is computed on the basis of the Profit and Loss Account of the entities who filed their income tax returns electronically by following the steps indicated in Para 5.30. The GST Base for 2007-08 is estimated at Rs 24,29,924 crores.

5.49 The **'GST Base' for all the sectors is summarized in Table-5. As would be noted, the 'GST Base' for the 'Taxable sectors' is estimated at Rs 30,50,228 crores.**

Table-5 : Estimation of the GST Base under the SI Method

Sl.No	Description	Unit	All Sectors	Exempt Sector	Taxable Sector				
					Special Sectors			General Sectors	Total
					Financial Services	Rail Services	Land Sector		
					1	2	3	4	5
	Sample Size	Nos.	2851248	77851	100055			2673342	2773397
A.	Output Tax Base								
	1 Net value of supply of domestically produced goods and services	Rs. In crs	8721874	112713				7762224	
	2 Value of Imports	Rs. In crs	1200678					1200678	
	3 Net value of domestically available goods and services (1+2)	Rs. In crs	9922552	112713				8962902	
	4 Value of Exports	Rs. In crs	989505					989505	
	5 Aggregate Output Tax Base (3-4)	Rs. In crs	8933047	112713				7973397	
B.	Input Tax Base								
	1 Value of purchase of Capital Goods	Rs. In crs	457504	9743				431504	
	2 Value of purchase of Intermediate Goods and Services	Rs. In crs	7329483	98091				6712418	
	3 Gross value of purchase of intermediate goods and services (1+2)	Rs. In crs	7786987	107835				7143921	
	4 Value of purchases from Unregistered dealers	Rs. In crs	1682145	81696				1600449	
	5 Aggregate Input Tax Base (3-4)	Rs. In crs	6104842	26138				5543473	
C.	GST Base (A5-B5)	Rs. In crs	2828205	86575	193103	20750	429260	2429924	3073037

2. Consumption Method

i. Task Force Estimate

5.50 In addition to the SI method, we also estimate the GST Base by estimating the total final consumption.

5.51 For this purpose, we use the Input Flow Matrix 2006-07 at factor cost[43] published by the National Accounts Division of the CSO. The Input Flow Matrix or contains details of 130 commodities consumed as input in 130 industries, covering the entire range of economic activities. Commodities are recorded in columns and industries are recorded in rows in a square matrix form. The value of each commodity consumed by each industry is at factor cost. It also provides commodity-wise detail of Total final use, that is, private final consumption expenditure (PFCE), government final consumption expenditure (GFCE), gross fixed capital formation (GFCF), change in stock (CIS), export and import.

5.52 To estimate the GST base, we need to estimate the contribution of all commodities in the primary, secondary and tertiary sectors of economy to the value addition chain. Since GST will be applicable only on the output of registered dealers with a turnover of more than Rs 10 lakh, consumption of goods and services from unregistered dealers will not be subject to GST. Therefore, it is necessary to estimate the value of such purchases forming part of the Private Final Consumption Expenditure (PFCE). For this purposes, we assume that the share of purchases from the unregistered dealers is in the same ratio as the share of the unorganised sector in the total National Domestic Product (NDP). The contribution of the organized and unorganized sectors in the NDP for 2006-07 is calculated on the basis of information available in statement 76.1 of National Accounts Statistics, 2009. The PFCE on goods and services from registered dealers (organized sector) for inclusion in the GST base is estimated at **Rs 10,12, 609 crores** (Table-6).

5.53 Government Final Consumption Expenditure (GFCE) comprises of two elements, namely, compensation to employees and Net purchase of Goods and Services. Since compensation to employees will be outside the scope of the GST base, we exclude public administration in the Input Flow Matrix from the GFCE to arrive at the Net purchases of goods and services by Government.

5.54 Gross Fixed Capital Formation (GFCF) comprises of two broad components i.e., construction and machinery equipments. The machinery equipments component is in the nature of capital goods which, under the GST, are proposed to be treated as intermediate inputs. Therefore, this element is not included as part of the GST base. Similarly, expenditure on construction by the Public Sector and the Private Corporate Sector is also proposed as intermediate input by allowing full and immediate input credit on capital goods. Therefore, for the purposes of this exercise what is relevant is the estimate of the Gross fixed Capital Formation in the household sector.

5.55 The expenditure on construction as reported in Statement 19 of National Accounts Statistics, 2009 is Rs. 5,00,036 crores comprising of Rs. 3,66,855 crores towards construction and Rs. 1,33,181 crores towards plant and machinery. The household sector in general would be in the un-organised sector (unregistered dealers or final consumers) and therefore, the expenditure on plant and machinery and

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[43] This matrix is also referred to as 'The Absorption Matrix'

construction by the household sector would be in the nature of final consumption. The expenditure on construction in the household sector would comprise of two components, namely, material and labour. In general, tax would be payable on the material component only since the labour component being from the un-organized or own labour will not be captured under the GST. Accordingly, we estimate the labour component as one-third of Rs. 3,66,855 crores i.e. Rs. 1,22,285 crores. Hence, the final consumption component in the Gross Fixed Capital Formation in the household sector in 2006-07 is estimated at Rs. 3,77,751 crores.

5.56 Some element of the food sector, and education and health services are proposed to be exempt from the GST. Similarly, services categorised under the labels 'Other Commercial, Social, Personal Services', 'Others Services' and 'Public Administration' are also proposed to be excluded since these would essentially be rendered by entities with turnover below the threshold limit or by government or by the non-profit sector.

5.57 The estimate of the non-land GST Base for 2006-07 is obtained by aggregating the PFCE on goods and services from registered dealers (organized sector), the net purchases of goods and services by the Government and the component relating to final consumption in the Gross Fixed Capital Formation in the household sector.

In Table-6, the size of the non-land **GST Base for 2006-07** is estimated at **Rs 28,98,520 crores,** which accounts for 76.69 percent of the GDP at factor cost at current prices (Rs. 3779385 crores). Applying the same ratio, the size of the non-land **GST Base in 2007-08** is estimated to be **Rs 33,13,817 crores.** The GST Base relating to land for 2007-08 is estimated to be **Rs. 4,29,260 crores** as computed under the SI method. **Therefore, the aggregate GST Base in 2007-08 is estimated at Rs. 37,43,077 crores.** This estimate is significantly higher than the size of the GST base estimated under the SI method.

Table 6 :Task Force Estimate of the GST Base using the Consumption Method

Sl. No.	Description	Units	Amount
1	Aggregate Private Final Consumption Expenditure	Rs. in crs	2260042
2	Private Final Consumption Expenditure relating to purchases from unregistered dealers (unorganised sector)	Rs. in crs	1247433
3	Private Final Consumption Expenditure (Organized sector) (Row 1 - Row 2)	Rs. in crs	1012609
4	Government Final Consumption Expenditure on goods and services	Rs. in crs	421059
5	Gross Fixed Capital Formation in household sector (excluding labour)	Rs. in crs	377751
6	Intermediate inputs from unregistered dealers	Rs. in crs	1713887
7	Gross Total (Row 3 + Row 4 + Row 5 + Row 6)	Rs. in crs	3525306
8	Exemption for food, health , education and some services	Rs. in crs	626786
9	Estimated non-land GST Base in 2006-07 (Row 7 - Row 8)	Rs. in crs	2898520
10	GDP at factor cost in 2006-07	Rs. in crs	3779385
11	Non-land GST base as a proportion of GDP (Row 9 divided by Row 10)	in percent	76.69
12	GDP at factor cost in 2007-08	Rs. in crs	4320892
13	Estimated non-land GST Base in 2007-08 (Row 11 * Row 12)	Rs. in crs	3313817
14	GST base relating to land for 2007-08 /1	Rs. in crs	429260
15	Estimated GST Base in 2007-08 (Row 13 + Row 14)	Rs. in crs	3743077

/1 The GST base relating to land in 2006-07 is estimated at Rs.366855 crores.

ii. NCAER Estimate

5.59 The Thirteenth Finance Commission had assigned a study to Dr. Rajesh Chadha of the NCAER to carry out a study on the implication of GST for international study. Using CGE Model, NCAER has, inter alia, also estimated the RNR for a comprehensive GST factoring the impact ofexemption for the food sector, education and health services. However, it **does not** factor the impact of-

a. exemption for small businesses (i.e. the threshold exemption of Rs 10 lakh for GST registration by dealers); and

b. inclusion of land transactions within the scope of the GST.

5.60 The RNR for non-petroleum taxes of Rs 1,76,893 crores for the base year 2003-04 has been estimated to be 7.22 percent[44]. Implicit in this estimate is the estimate of the GST Base at Rs 2450042 crores for 2003-04.

5.61 We use the purchases from the unorganized sector as a proxy for the purchases from the unregistered dealers. The private final consumption expenditure (PFCE) at market prices in 2003-04 was Rs 1699485 crores. We first adjust for the embedded net indirect taxes by applying the ratio of GDP at factor cost at current prices to the GDP at market prices at current prices for the financial year 2003-04 to the PFCE to arrive at the PFCE at factor cost at current prices. Thereafter, we estimate the purchases from the unorganised sector at Rs 894152 crores by applying the share of the unorganised sector in the net domestic product in the year 2007-08.

5.62 In 2007-08, the Gross Fixed Capital Formation by way of construction in the household sector is Rs 429260 crores. This does not include the value of land. Assuming that the land value accounts for 50 percent of the total value of the real estate, the GST base relating to land is estimated at Rs 429260 crores.

Table 7: NCAER Estimate of the GST Base

Sl. No.	Description	Units	Amount
1	Estimated GST Base (excluding land and the threshold exemption) in 2003 04	Rs. in crs	2450042
2	Impact of the threshold exemption (purchases from the unorganised sector)	Rs. in crs	894152

[44] NCAER has estimated the RNR for non-petroleum taxes at 6.20 percent under the **first scenario** that there will be no threshold exemption for registration and no specific goods and services based exemption. This scenario is not relevant for us since we intend to provide a threshold exemption and exemption for some specific goods and services. Under the **second scenario** of no threshold exemption but exemption of the same goods and services which we have recommended, the RNR is estimated to be 7.22 percent for non-petroleum taxes. Similarly, **the third and fourth scenarios** envisage that the GST will subsume all taxes including petroleum taxes and the scope of commodity specific exemptions will expand to larger baskets. The estimates of RNR under the third and fourth scenarios are 9.01 and 9.4 percent, respectively. However, the two latter scenarios are irrelevant for our purposes since we do not intend to subsume petroleum taxes within the scope of GST.

3	Non-land GST Base in 2003-04 adjusted for thresh old exemption (Row 1 - Row	Rs. in crs	1555890
4	GDP at factor cost in 2003-04	Rs. in crs	2538170
5	Estimated non-land GST Base in 2003-04 (Row 3 divided by Row 4)	in percent	61.30
6	GDP at factor cost in 2007-08	Rs. in crs	4320892
7	Estimated non-land GST Base in 2007-08 (Row 5* Row 6)	Rs. in crs	2648592
&	GST base relating to land for 2007-08/1	Rs.in crs	429260
1	Estimated GST Base in 2007-08 (Row 7 + Row 8)	Rs. in crs	3077952

/1The GST base relating to land in 2003-04 is estimated at Rs. 197305 crores

5.63 After adjusting the NCAER estimates to reflect the design and structure of the GST recommended by us, the GST Base in 2007-08 is estimated at Rs 30,77,952 crores as per calculations indicated in Table-7. This estimate of the GST Base also approximates the estimate under the SI method.

3. Shome Index Method

5.64 Parthasarathi Shome, one of our leading fiscal economists, has written extensively on tax policy and revenue trends. Among his observations is one that pertains to the revenue productivity of the VAT. The relationship between VAT rate and its revenue implication in terms of GDP could be referred to as the Shome Index as has sometimes been reflected in the context of Latin America. Thus, if the general rate of the VAT is, say 10 percent, the revenue collection from the VAT can be expected to be 5 percent of GDP[45]. This revenue achievement is possible

If

i. the VAT base is broad with few exemptions;

ii. the general VAT rate is not impeded by other lower rates;

iii. tax administration is transparent; and

iv. social norms do not erode tax compliance.

5.65 This has been observed in Chile whose VAT bases were proverbially wide. With an 18% VAT rate, Chile's VAT revenue was almost 9% of GDP. Chile taxed even unprocessed food and fresh vegetables.

5.66 If the VAT base is narrow as is the case in the U.K., then the Shome Index would reveal a small percent collection in terms of GDP. Thus, in the U.K., with a VAT rate of 17.5%, the revenue intake has hovered around 6%. In terms of the Shome Index, at a VAT rate of 'X' percent, the VAT revenue in terms of GDP is nearly as low as (1/3rd * 'X') percent. In other countries, say with some other characteristic such as low compliance, a similar outcome would be experienced.

This is calculated by the formula (1/2)*10 percent = 5percent of GDP

5.67 In most countries, as a thumb rule, VAT revenue hovers between (1/3rd * 'X') percent and (1/2 * 'X') percent of GDP. The strategy for countries that have an x% VAT rate should invariably be to design the VAT structure and enhance its administration in a way that the achievement of (1/2 * 'X') percent of GDP in revenue is feasible.

5.68 However, this Index is valid generally for countries which do not include real estate and housing services and financial services within the scope of VAT.

5.69 Based on the Shome Index, the GST Base is estimated in Table-8 at **Rs 27,82,809 crores.**

Table-8: Estimating the GST Base on the basis of the Shome Index

Sl. No.	Description	Amount [Rs in crs]
1	GDP at factor Cost at current prices	43,20,892
2	Estimated base on the basis of Shome Index [50 percent of row 1]	21,60,446
3	Estimated base relating to Financial Services	1,93,103
4	Estimated base relating to Real Estate	4,29,260
5	**GST Base** [Row 2+Row 3+ Row 4]	**27,82,809**

5.70 This estimation of the base is lower than the base estimated under the SI method primarily due to the fact that the estimates of GDP per se appears to be under reported since the value of output reported in the sample is substantially higher than the value of output as estimated from the National Accounts Statistics prepared by CSO for comparable sectors.

4. Revenue Method

5.71 A common method used by the revenue authorities both at the centre and state levels is to estimate the implicit GST base in the revenues actually collected and make such adjustments as are necessary to reflect the increase or decrease in the base on the basis of the recommended design and structure of the GST.

5.72 As would be seen, the output tax base is computed by estimating the implicit base underlying the aggregate of (i) the amount of collection by way of countervailing duty and Union excise duties for non-POL goods; and (ii) the estimated revenue foregone as reported in the Receipts Budget of the Union Government). This implicit base is calculated at the aggregate Union Excise Duty rate of 16.48 percent (inclusive of 3 percent of education cess). Similarly, the input tax base is computed by estimating the implicit base underlying the CENVAT credit allowed to producers at the same duty rate. The difference between the output tax base and the input tax base so calculated is the GST base relating to goods which is estimated at **Rs 11,77,706 crores** in 2007-08 (Table-9). Similarly the service tax base is estimated at **Rs 4,13,697 crores** for 2007-08 as shown in the said Table.

5.73 Since the proposed GST is comprehensive in its base, it will extend to a much larger base particularly in the financial services, rail transport, land, petroleum, tobacco and alcohol, trade and construction sectors. The estimated increase in the tax base in respect of each of these sectors is indicated separately in Table. The aggregate of the increase is estimated at Rs. 13, 58,344 crores for 2007-08 as shown in the said Table.

A	Non-POL (Existing Base)		Units	Amount	
		Countervailing Duty	(Rs. In crs)	53510	
		Public Ledger Account (paid to Govt)	(Rs. In crs)	53108	
		Revenue foregone	(Rs. In crs)	87468	
		Cenvat	(Rs. In crs)	147447	
		Output Tax	(Rs. In crs)	341533	
		Output tax Base	(Rs. In crs)	2072409	
		Input Tax Base	(Rs. In crs)	894703	
		Existing GST Base (Goods)	(Rs. In crs)		1177706
B	Services (Existing Base)		(Rs. In crs)		413697
C	Additional Base				
		Financial Services	(Rs. In crs)	66835	
		Rail	(Rs. In crs)	20750	
		Land	(Rs. In crs)	429260	
		Trade	(Rs. In crs)	518102	
		Petroleum, Power and Tobacco	(Rs. In crs)	191513	
		Construction	(Rs. In crs)	131884	
		Sub-total	(Rs. In crs)		1358344
D	GST Base		(Rs. In crs)		2949748

5.74 Based on the above, the aggregate GST Base for 2007-08 is estimated at **Rs 29,49,748 crores** as shown in Table-9. As would be noted this estimate is larger than the estimate under the Shome Index Method but lower than the estimate under the SI method.

5.75 The various estimates of the GST Base for 2007-08 are summarized in Table-10. As may be noted, the Task Force estimate of the GST Base using the Consumption method is the highest (Rs.37,43,077 crores) whereas the Shome Index method provides the lowest estimate. All other estimates fall within this range. Since the five estimates are different, we adopt their average of Rs 31,25,325 crores[46](row E of Table-10), as the size of the comprehensive GST base for 2007-08 for the purposes of estimating the RNR. Since the tax base for both the CGST and the SGST are proposed to be identical, we use the same tax base for calculating the RNR for both levies.

[48] The standard deviation of these estimates is calculated to be Rs 640977 crores.

Table-10: Estimation of GST Base and the RNR

SI No	Description	Units	Amount
A	**Subtraction-Indirect Method**	(Rs in crs)	**3073037**
H	**Consumption Method**		
	i. Ta sk F **orce Esti m ate**	(Rs in crs)	**3743077**
	ii Chadha Estimate	(Rs in crs)	**3077952**
C	**Shome Index Method**	(Rs in crs)	**27&2S09**
D	**Revenue Method**	(Rs in crs)	**2949748**
E	**Average of all estimated GST Base**	(Rs in crs)	**3125325**
F	**Centre's RNR**	(in percent)	**5.05**
G	**State's RNR**	(in percent)	**6.02**

c. The Revenue Neutral Rate(RNR)

5.76 Given the estimate of the GST Base and the level of central taxes which are intended to be subsumed in the GST, we estimate the RNR for the CGST at 5.0 percent. Similarly, the RNR in respect of the state level TF-taxes which are proposed to be subsumed in the SGST is estimated to be 6.0 percent. **Therefore, the combined RNR is estimated to be 11 percent.** Incidentally, this estimate is the same as estimated by Bagchi and Poddar in their pioneering study published in November, 2007[47].

5.77 These estimates do not factor in the revenue gains from increased compliance and GDP. To the extent, the flawless GST will reduce cascading effect, there will be significant increase in the corporate profits and hence corporate tax collections. Therefore, in actual practice, the RNR of 11 percent will be revenue positive.

5.78 As would be noted, we have, in para 2.11, recommended the abolition of all entry and Octroi taxes by state governments and other sub-national Governments. Therefore, it is imperative to provide for an alternate buoyant source of revenue to the third-tier of Government.

5.79 In view of the aforesaid, we recommend the following:-

i. The rate of CGST and SGST on all non-SIN goods should be fixed at the **single rate of 5 percent and 7 percent, respectively;**

ii. A formula-based devolution of an amount equivalent to collection of SGST at 2 percentage points should be made to the third-tier of Government after an appropriate Constitutional Amendment;

iii. The formula should be based on the recommendations of the State Finance Commission.

iv. Pending Constitutional Amendment, the collection from 7 percent SGST shall accrue to the State Government and devolution to the third-tier Government should continue to be made on the basis of the recommendations of the State Finance Commission.

v. Both the Central and the State Governments may continue to levy taxes, in addition to the CGST and SGST, on the various non-SIN goods as at present.

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[47] Poddar, Satya and Amaresh Bagchi (Nov 2007), "Revenue-neutral rate for GST", The Economic Times, 15th

Chapter VI

Revenue Performance of GST

6.1 As is well-known, VAT is, potentially, a broad-based tax levied on all commodity sales with a view to, ultimately, taxing the whole of final consumption. VAT is not a progressive but a proportional tax. It was never designed to meet social or redistributive objectives. In theory, the tax is, therefore, most "efficient" when imposed on all goods and services at a single standard rate. The efficiency of the VAT system can be optimized depending on the ability of tax administration to collect the tax due effectively. In this respect, a single rate and a simpler tax system is easier for tax administrations to administer and for businesses to comply. In this perspective, a VAT system is, in absolute terms, "efficient" when it covers the whole of the potential tax base (consumption by end users) at a single rate and where all the tax due is collected by the tax administration. Therefore, the ratio of the revenues actually collected and the revenues that would arise from a theoretically "pure" VAT system with a single rate applied to all final consumption and 100 per cent compliance would be a good measure to evaluate the performance of VAT. In literature, this ratio is referred to as the VAT Revenue Ratio (VRR). This ratio gives an indication of the efficiency of the VAT regime in a country compared to a standard norm.

6.2 In theory, the closer the VAT system of a country is to the "pure" VAT regime, the more its VRR is close to 1. Any other value - higher or lower - indicates deviation from a single tax rate applied on all final consumption or a failure to collect all tax due. A VRR close to 1 is taken as an indicator of a VAT bearing uniformly on a broad base with effective tax collection. On the other hand, a low VRR may indicate an erosion of the tax base at the standard rate. This can result from exemptions, reduced rates, registration thresholds for small traders, poor compliance or poor tax administration or a combination of these.

6.3 The VRR is characterised by a number of deficiencies. The estimation of the potential VAT tax base (i.e. consumption by end users or national consumption) is difficult to assess with precision. In general, the figures of national consumption used to calculate the VRR are taken from the national accounts[48], but "consumption" within the meaning of national accounts does not exactly match the potential VAT tax base. For example, several investment goods (such as new buildings) are not considered as consumption in national accounts (where they are treated as "investments" or "gross fixed capital formation") but they are subject to VAT in many countries. A combination of this factor together with the cascading effects of exemption in the value chain may lead to a VRR above one. Therefore, for the purposes of calculation of VRR in respect of the proposed 'flawless' GST, we compute the potential tax base by expanding the scope of final consumption within the meaning of National Accounts to include also the Gross fixed capital formation (including transaction ("consumption") in land) in the household sector. Accordingly, the **'potential tax base'** of a GST is estimated at Rs 39,49,907 crores as indicated in Table-11. However, the **'actual tax base'** under the 'flawless' GST is estimated at a reduced amount of Rs 31, 25,325 crores. **Accordingly, VRR of the 'flawless' GST is calculated to be 0.79.**

6.4 The VRR is affected by both policy decisions - over the base and the number of rates -and compliance levels. The VRR is actually the product of a **"Policy efficiency ratio"** (comparing the

There is currently no internationally agreed method to assess a VAT theoretical base.

theoretical revenue from actual VAT law and revenue from a pure VAT system) and a **"Compliance efficiency ratio"** (comparing actual VAT revenues with theoretical revenue from actual tax law). Therefore, mathematically expressed,-

$$\text{VRR}=\frac{\text{Weighted average of statutory rates}}{\text{Standard rate}} * (1 - \text{Exemptions})*(\text{Compliance level})$$

The product of the two terms [$\frac{\text{Weighted average of statutory rates}}{\text{Standard rate}}$ * (1 – Exemptions] denotes the **"Policy efficiency ratio"** and the term *(Compliance level)* denotes the **"Compliance efficiency ratio".**

6.5 Our recommendation is for a single rate for both CGST and SGST and zero rate is applicable only for international exports. Therefore, the weighted average of statutory rates is equal to the single rate (standard rate) and accordingly, the ratio $\frac{\text{Weighted average of statutory rates}}{\text{Standard rate}}$ is equal to 1 (one).

Table-11: Computation of VAT Revenue Ratio (VRR) under the 'Flawless' GST*

Sl. No	Description	Unit	Amount
A	Private Final Consumption Expenditure	Rs in crs	2605859
B	Government Final Consumption Expenditure	Rs in crs	479099
C	Gross Fixed Capital Formation(Household Sector)	Rs in crs	435689
D	Gross Fixed Capital Formation(Land)	Rs in crs	429260
E	Potential GST Base (A+B+C+D)	Rs in crs	3949907
F	Actual Tax Base	Rs in crs	3125325
G	VAT Revenue Ratio (F divided by E)	Nos	0.79
H	Standard Rate	in percent	12.00
I	Weighted Average of Statutory rates	in percent	12.00
J	Weighted average of Statutory rates as a ratio of Standard rate	Nos	1.00
K	Amount of Exemption**	Rs in crs	206830
L	Impact of exemption [K divided by (F+K)]	Nos	0.062
M	**Policy Efficiency Ratio**	Nos	0.938
N	**Compliance Efficiency Ratio**	Nos	0.84

* The estimates should be taken as approximates.

**The exemptions relate only to exemptions for unprocessed food articles, health services and education services. This does not include the impact of threshold exemption

6.6 Similarly, the 'flawless' GST recommended by us envisages very limited number of exemptions. These are essentially restricted to food, education and health services, the threshold exemption for registration of small dealers and public administration. As regards the threshold exemption for registration of small dealers, it has both a positive and a negative impact on revenues. To the extent sales by unregistered dealers is exempt, there is a revenue loss. However, part of the revenue loss is recouped since purchases from unregistered dealers are not eligible for input tax credit. Similarly, a large part of the food items is distributed by small dealers and therefore there is significant overlap in the revenue effect of the threshold exemption and the food sector. The same also holds well in the health and education sector. The net impact of the exemptions under the 'flawless' GST on the tax base is estimated to be Rs 206830 crores only. This accounts for **6.2 percent** erosion in the potential tax base. Hence, the ratio $(1 - \mathit{Exemptions})$ is calculated to be 0.938. Consequently, the **'Policy Efficiency Ratio'** is estimated to be **0.938.**

6.7 We do not have any method of making a direct estimate of compliance. However, compliance level is the ratio of the VRR to the 'Policy Efficiency Ratio'. Therefore, the implicit **compliance level is estimated to be 0.84.**

6.8 It has been pointed out by some that given the cross-country estimates of the VRR, our estimate of VRR is extremely high. It is argued that if the VRR is aligned to the international norm, the revenue neutral rate (RNR) would be substantially higher than the 11 percent estimated by us. In this context it would be useful to point out that given the deficiencies in the VRR as a measure of the revenue performance of VAT, it is difficult to draw typical profiles for "efficient" and "inefficient" countries in the collection of VAT revenues on the basis of this VRR. Since the VRR depends upon a number of factors, there is considerable variation in the VAT Revenue Ratio across countries. Therefore, it is best to use VRR as a tool to measure a single country's performance over a number of years rather than as a tool for comparison across countries. Nevertheless, 5 countries (i.e. Korea, Japan, Switzerland, Luxemburg and New Zealand) from amongst 29 OECD countries indeed have a VRR exceeding 0.7; another 17 countries have a VRR ranging between 0.5 and 0.7 and the balance 7 countries have a VRR of less than 0.5. Therefore, our estimate of VRR (and also the RNR) cannot be considered as anoutlier. The reason underlying such high VRR is the minimization of the exemptions and the elimination of the multiple rates.

6.9 The existing VRR in the case of Central Government levy on goods and services is extremely low. The current base is estimated to be as low as 0.36 [49]. Further, the factor $\frac{\text{Weighted average of statutory rates}}{\text{Standard rate}}$ is also estimated to be 0.75[50]. Therefore, the Policy efficiency ratio' is estimated to be a low of 0.27[51]. We have no estimate of the compliance level but we have anecdotal

[49] The value of exemptions (excluding threshold exemption) from Table-9 is estimated to be Rs 18,89,096 crores (Rs 1358344 crores plus Rs 530752 crores) and the estimated potential base is Rs 29,49,748 crores. Therefore, the share of exemptions in the potential base is estimated to be 0.64. Hence, the share of the actual base is 0.36.

[50]**.** The standard rate is 16.48 percent and the weighted average of statutory rates is estimated to be 12.28 percent. Therefore, the ratio of weighted average of statutory rates to standard rate is 0.75.

[51] This is the product of 0.36 and 0.75.

information that there is substantial evasion. If we assume that the compliance is 0.84, the VRR for central taxes on goods and services is estimated to be 0.23[52].

6.10 Given this estimate of an extremely low VRR, it is not surprising that the estimate of the GST Base by both Central Government and State Governments on the basis of the existing revenues is extremely low. As is well known, the existing tax structure is riddled with a plethora of incentives and multiple rates. Therefore, the 'Policy efficiency ratio' is extremely low. Once these policy deficiencies are removed the VRR would automatically increase to a substantially higher level of 0.76. The purpose of introducing the flawless GST is precisely to achieve this policy objective. Our calculation of the VRR of the 'flawless' GST is based on the existing level of compliance and not on the basis of any increase in the compliance level. Hence, any apprehension that given the existing compliance level, the high level of VRR cannot be achieved is totally misplaced. The VRR under the 'flawless' GST can be achieved by eliminating the policy deficiencies under the existing regime for taxation of goods and services. **What is required is a strong political consensus to do so.**

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[52] This is the product of the 'Policy Efficiency Ratio' (0.27) and the 'Compliance Efficiency Ratio'(0.84).

CHAPTER - VII

Implications of the Goods and Services Tax

7.1 The economic case for a 'flawless' GST is straightforward: Income is taxed irrespective of source and use; therefore, consumption should also be taxed on the same principle. This is the feasible second-best solution, compared to the unattainable first best distortion-free world of lump sum taxation. The 'flawless' GST is rooted in this breathtakingly simple analytical proposition. In the Indian economic policy context, poverty reduction and inclusive growth are key policy objectives and will, undoubtedly, continue for some time. What, then, are the implications of the **switchover** from the cascading and distortionary taxation of goods and services to the the 'flawless' GST for, amongst others, economic growth, equity and poverty?

a. GST and economic growth

7.2 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. The existing tax system introduces myriad distortions which favour some goods and services at the expense of others. These distortions yield inefficient resource allocation and consequently, inferior GDP growth. In India, the motivation underlying the hugely differentiated scheme of indirect taxation of production and sales that has evolved over the country's history was progressive and noble; the actual impact of such a structure is now widely acknowledged to be regressive, capricious, and sub optimal in terms of the efficiency of tax effort, leaving the door open for lobbyists and special pleading. The problem of the present distortionary indirect tax system can be effectively addressed by shifting the tax burden from production and trade to final consumption. The 'flawless' GST, which subsumes all indirect taxes on goods and services, is the most elegant method of 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.

7.3 The introduction of the GST will also bring about a macroeconomic dividend by reducing what have been called the "negative grey area dynamic effects" of cascading taxation. As a result it reduces the overall incidence of indirect taxation by removing the many distortionary features of the present indirect tax system. 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[53]. 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[54]. 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[55] 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.

7.4 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.'.

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[53] This is a league table in which we have long languished at the bottom.

[54] Prior to the tax cut in December 2008 as part of the economic stimulus, the combined rate was 28 per cent approximately.

[55] However, there will be a special rate of 1 percent on high value items like gold and platinum and zero rate on exports.

7.5 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.

7.6 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.

7.7 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.

7.8 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.

b. GST and International Trade

7.9 There are also benefits to foreign trade that can be reasonably expected. At present export of taxes to other countries is sought to be eliminated through the mechanism of duty draw back on the basis of estimated incidence of embedded taxes. This scheme is far from satisfactory.

7.10 Destination based taxation is a fundamental principle of a sound GST. It requires that exports from the taxing jurisdiction would be tax free by zero rating and imports into the jurisdiction would be taxed at the same rate as products produced and consumed within the jurisdiction. The 'flawless' GST embodies this principle. Consequently, both export-oriented industries and import-substituting industries would become internationally more competitive. As a result, while exports can be expected to register an increase, imports are likely to decrease. These outcomes are supported by the NCAER study.

7.11 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. 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.

7.12 The sectors with relatively high proportional increase in exports include textiles and readymade garments; beverages; industrial machinery for food and textiles; transport equipment other than railway equipment; electrical and electronic machinery; and chemical products: organic and inorganic. The moderate gainers are agricultural machinery; metal products; other machinery; and railway transport equipment. Exports are expected to decline in agricultural sectors; iron and steel; wood and wood products except furniture; and cement. There are minor gains and losses in exports of other sectors.

7.13 The major import gaining sectors include leather and leather products; furniture and fixtures; agricultural sectors; coal and lignite; agricultural machinery; industrial machinery; other machinery; iron and steel; railway transport equipment; printing and publishing; and tobacco products. The moderate gainers include metal products; non-ferrous metals; and transport equipment other than railways. Imports are expected to decline in textiles and readymade garments; minerals other than coal, crude petroleum, gas and iron ore; and beverages.

7.14 In general, our imports are sourced from countries which effectively zero rate their exports. Further, India has also entered into a large number of free trade agreements under which it will, in general, not be possible for India to use customs duty as a means to providing protection/level playing field. Therefore, it is necessary to ensure that the imports into the country are subject to the same level of taxation as domestically produced goods. The 'flawless' GST will ensure this by subjecting the imports to both CGST and SGST. This will provide a level playing field to the domestic industry and, in particular, the manufacturing sector vis-a-vis imports.

c. GST: Equity and Poverty reduction

7.15 Poverty reduction will continue to remain the central objective of economic policy making in India. Any policy for poverty reduction must enable the provision of, at least, food, clothing, shelter, education and health.

7.16 At present, primary food articles like rice and wheat are liable to tax by many states either by way of purchase tax or sales tax at a lower rate. As a result, the incidence of tax on primary food articles comprises of two elements: tax on inputs and tax on the output (primary food articles). However, under the 'flawless' GST, all food items covered under the public distribution system are proposed to be exempt from GST. As a result primary food articles like rice and wheat would be exempt from GST (i.e. there will be no output tax). Hence, the tax incidence on such items of mass consumption will be limited to tax on inputs. Since expenditureon food constitutes a large proportion of the total consumption expenditure of the poor, the GST is designed as a pro-poor policy initiative. In any case, the poor will continue to have accessibility to these items at subsidised prices through the public distribution system. Therefore, the poor will not suffer any additional burden on their consumption of food items due to the implementation of GST.

7.17 Like food, basic health and education services are also intended to be fully exempt. As a result consumption of these services will bear a relatively lower burden. Since these services are necessary to meet the basic human needs, the tax exemption for these services will enable the poor to have cheaper accessibility. In any case, as at present, these services will continue to be exempt from tax and therefore no additional burden will arise on account of the switchover to GST.

7.18 Housing is yet another important item of basic needs of the poor. The GST provides for including within its scope the transactions in real estate. Therefore, for a registered real estate builder, all taxes on inputs (including on land) will be off-set against the tax payable on the constructed property.[56] This will effectively reduce cost of housing to the extent of embedded taxes and hence, benefit the poor.

7.19 Another necessary item of consumption by the poor is clothing. The NCAER study shows that the implementation of the GST will result in a sharp decline in the prices of cotton textiles (by 6.44 percent), wool, silk & synthetic fibre textiles (by 11.4 percent), and textile products including wearing apparel (by 17.45 percent). To the extent, the share of expenditure on clothing in the total expenditure on consumption is relatively higher than in the case of the rich, the poor will gain relatively more from large drop in prices.

7.20 The rural poor comprise essentially of small and marginal farmers and landless labourers. Similarly, the urban poor comprises of the unemployed. The implementation of GST will witness an increase in the real returns to land, labour and capital (as shown in the NCAER study). Therefore, the rural poor will also enjoy an increase in their income. Similarly, on account of increase in economic activity resulting in higher growth, there will be new opportunities for employment which will directly benefit the urban poor.

7.21 Further, in terms of the theory of optimal taxation, tax rates should ***not*** be uniform. They should, rather vary inversely with the elasticity of demand for particular goods and services, and tax rates should be higher on products that are complementary with leisure that cannot be taxed directly. (as opposed to work which generates income that can be taxed). This holds well in a world where it is possible to implement optimal tax reforms without any residual distortions caused by successful attempts at incidence shifting. However, in practice, shifting of tax incidence is well documented. Further, the representative consumer assumption that operates an optimal tax model is not just invalid, but actively dangerous in a policy context where poverty reduction and inclusive growth are key policy objectives. For instance, if, as intuition would lead us to expect, the demand for the basket of goods consumed by the poor is less elastic than that consumed by the rich, then the regressive policy implications of implementing optimal tax reform would be horrific i.e impose a higher tax on goods of consumption by the poor. Hence, the principle remains valid that all consumption should be taxed uniformly without regard to source and use. Even in this context, the GST reform is potentially far pro poor than theoretically elegant competing alternatives.

7.22 The benefit to the poor from the implementation of GST will therefore, flow from two sources: first through increase in the income levels and second through reduction in prices of goods consumed by them. The proposed switchover to the 'flawless' GST should, therefore, be viewed as pro-poor and not regressive. Hence, the switchover will improve the vertical equity of the indirect tax system.

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[56] At present, the value of a constructed property includes stamp duty on land and other indirect taxes on inputs. Hence, these taxes form part of the cost of the property. On registration of the constructed property, stamp duty is payable on the entire cost including the embedded taxes. There is no mechanism for complete off-set of these taxes. This results in an increase in the overall cost of the property

7.23 The switchover to GST also entails the taxation of all goods and services in the formal sector. To the extent purchases are made from the informal sector by producers in the formal sector, no input tax credit would be available. Consequently, the value addition in the informal sector on such inputs would be recaptured when used in the formal sector. Similarly, to the extent purchases are made from the formal sector by the informal sector, they will be GST borne and since no output tax will be payable in the informal sector, the tax will stick on the producer. Therefore, comprehensive consumption type destination based GST will also result in a higher tax burden on the informal economy than the present level. Hence, the switch over to the 'flawless' GST will also improve horizontal equity.

d. GST and Prices

7.24 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.

7.25 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.

7.26 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.

7.27 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 and 1.18 percent whereas the overall prices of all manufacturing sector would decline between 1.22 and 2.53 percent. Consequently, the terms of trade will move in favour of agriculture between 1.9 to 3.8 percent.

7.28 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.

e. GST and informal sector

7.29 Another challenge to the consensus on GST based indirect tax reform in developing countries like India has been the argument that given the existence of an informal sector, a comprehensive GST can be welfare reducing, when revenue neutral. The argument rests on the premise that when the choice of a commodity set for VAT increase is restricted by the existence of a large informal sector, then there are negative welfare effects in transition to a revenue neutral VAT. If this holds true then there are serious policy implications if such negative welfare incidence impacts the consumption basket of the poor. However this argument rests on the foundation that the relative size of the formal and informal economies is exogenous to the tax structure in place. In India, the implementation of VAT is in fact expected to reduce the size of the informal economy relative to the formal economy by moving producers who choose to remain in the informal sector for *tax avoidance* reasons, incentivized by the size biased nature of indirect tax exemptions in the historic regime of taxation of domestic goods and services. When this is taken into account the welfare effects of GST can, in fact, be expected to be positive.

7.30 This highlights the fact that a GST based reform of the present indirect tax system can be expected to have significant positive welfare effects even while maintaining revenue neutrality.

f. GST and Fiscal Management

7.31 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.

7.32 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.

7.33 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 from the 'TF- taxes'). If the States decide to phase out the stamp duty over a period of three years, the revenues from stamp duty will be additionality for the States. Therefore, in the first year of implementation of GST and phasing out of the Stamp duty, the States should expect additional revenues to the extent of Rs 70,000 crores (excluding the incentive amount). However, in the subsequent years this gain would diminish on account of the phasing out of stamp duty but will be more than adequately compensated as compliance starts improving.

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

g. GST and vertical balance of power

7.35 The GST envisages a mechanism whereby both the Centre and the States will cease to have any independent power to make changes in the design and structure once agreed upon. Since both levels of Government would be similarly placed, this has no impact on the balance of power.

7.36 Under the proposed GST, both the Centre and the States will have concurrent power to tax all goods and services. Therefore, the taxing powers of the states would now also extend to services which comprises 54 percent of the GDP and also constitutes the fastest growing sector in the economy. Similarly, the taxing powers of the Centre will also extend to the retail stage and to this extent there will be an expansion in its taxing powers. This increase will be limited to about 12 percent of the GDP (assuming a retail margin of 25 percent on manufacturing value). In addition, the Centre will also acquire the power to tax land /real estate transaction which would account for an estimated 10 percent of GDP. Since the expansion in the power of the States is significantly larger than the Centre, the proposed GS T will alter the balance of power in favour of the states thereby reducing the vertical imbalance.

7.37 **To conclude,** the implications of a switch over to the 'flawless' GST recommended by us are indeed far-reaching. Every stakeholder stands to gain. This has the potential to transform not only the tax system in the country but also the way we organise and do business.

CHAPTER - VIII

"Flawless" Goods and Services Tax and the autonomy of States

8.1 The design of the GST based on a common base and a uniform rate across states without the power to make any unilateral changes, is viewed by some states as undermining the fiscal autonomy of the States. Therefore, it is argued that the states should agree to a floor rate of tax and should have the flexibility to increase their rates to meet any revenue crisis.

8.2 Full autonomy in the exercise of taxation powers would mean that the Centre or the States, as the case may be,-

a. Retain the power to enact the tax;

b. Enjoy the risks and rewards of 'ownership' of the tax (i.e. not be insulated from fluctuations in revenue collections),

c. Be accountable to their constituents; and

d. Be able to use the tax as an instrument of social or economic policy.[57]

8.3 Tax autonomy to any level of Government is necessary to enable it to design the base and set the tax rates according to its revenue needs. However, it is equally important to ensure that the exercise of these powers do not result in inter-jurisdictional differences in policies and procedures so as to generate additional economic distortions, create negative externalities, or impose higher compliance and enforcement burden.

8.4 In general, the States would like to have some degree of control to design the base and set the rates as an instrument to promote various social and economic policy objectives. However, cross-country experience shows that there is complete disillusionment with the use of the tax system as a tool to promote various social and economic objectives by allowing exemptions and incentives. Therefore, tax reforms undertaken across countries since the mid-1980 have focussed on re-designing the tax system so as to restrict its role to revenue collection. There is almost unanimity amongst fiscal experts on assigning a limited role of revenue collection to the tax system and using the direct transfer mechanism for achieving the various social and economic objectives. Given this new strand of economic thinking, the ability to use the tax system as a tool for achieving various social and economic objectives should cease to be a measure of tax autonomy.

8.5 In the past under the sales tax regime in the states, the flexibility to use the tax system as a tool for achieving various social and economic objectives has generated economic distortions and also triggered a race to the bottom. Further, if the States are allowed the autonomy to increase the rates by setting the SGST rates as the floor rates, they would have a tendency to opt for this lazy option rather than improve their enforcement mechanism. Such increase in rates would mean a greater incentive to evade which, in turn, would make industries in competing states uncompetitive. It would also trigger tax-induced migration. Consequently, the decision to increase the rate would generate negative externalities which must necessarily be curbed.

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[57] See Poddar, Satya and Ehtisham Ahmad (2009)

8.6 Hence, it is only appropriate that in a federal structure with overlapping powers to tax goods and services, Governments across levels cease to enjoy the autonomy to design the base, set the rates and the flexibility to use the tax system as a tool for achieving various social and economic objectives. In the context of the federal structure of India, what is relevant is overall fiscal autonomy rather than tax autonomy per se. Since States would continue to have the full freedom to promote various social and economic objectives through direct transfers, effectively, there would be no loss of fiscal autonomy of the States.

8.7 The design of the 'flawless' GST, as recommended by us in the preceding Chapters, is essentially an attempt at **absolute harmonization** of the tax base, tax rates and tax infrastructure(i.e. the administration and compliance system) across Centre and all States. As discussed above, harmonization of the tax base and the tax rates will eliminate the distortionary impact on economic efficiency and equity arising from inter-jurisdictional differences. Further, such harmonization will enable consequent harmonization of the tax laws and the administration and compliance systems.

8.8 Harmonization of tax laws is critical. Variation in the wording and structure of tax provisions can be an unnecessary source of confusion and complexity, which can be avoided if the Centre and all the States adopt a common GST law as in the case of the Central Sales Tax **or** agree to separately legislate an identical GST law. In either situation, there would be harmonization in respect of critical elements like common time and place of supply rules, common rules for recovery of input tax, valuation of supplies, invoicing requirements, tax interpretations and rulings regarding classification of goods and services, determination of what constitutes taxable consideration and definition of export and import.

8.9 Administration and compliance is an area where the need for harmonization is the greatest, and where Centre-State or inter-state variations are unlikely to serve any social or economic policy objective. This includes items such as the taxpayer registration system, taxpayer identification numbers, tax forms, tax reporting periods and procedures, invoice requirements, cross-border trade information systems and IT systems. Harmonization of these elements would result in significant savings in costs of implementing the GST (by avoiding duplication of effort in each government), as well as recurring savings in compliance costs. Harmonization would also permit exchange of information between different levels of Government so as to enable effective monitoring of cross-border transactions. A common tax identifier number across states and the Central government is a key element in the efficient exchange of information.

8.10 Harmonization of the GST tax base, tax rate and administrative and compliance systems should be viewed as an imperative for optimizing the efficiency and productivity of GST across jurisdictions in a federal structure. All jurisdictions will be worse off without harmonization. Therefore, it should not be perceived as eroding the fiscal autonomy of the Centre or the States.

8.11 If harmonization across Centre and all states is envisaged, what should be the institutional mechanism to usher and maintain such harmonization? At present, the responsibility for designing the initial structure of the GST has essentially been left to the Empowered Committee of State Finance Ministers and official level representatives of the Central Government. This body is now internationally recognised as an important institutional arrangement which has rendered yeoman service in substantially furthering the cause of indirect tax reform in the country. However, there is also a need to maintain stability and integrity in the structure of the GST to ensure that no distortions creep into the indirect tax system. Therefore, the existing mechanism for arriving at a collective decision on the structure of the GST should be permanently institutionalised so that changes in the initial design of the GST are collectively agreed and implemented by both the Centre and the States.

8.12 In view of the above, we recommend that the Empowered Committee of State Finance Ministers may, upon the introduction of the GST, be transformed into a permanent constitutional body known as the **Council of Finance Ministers.** This Council shall comprise of the Union Finance Minister and all State Finance Ministers. The Union Finance Minister would be the Chairman of this Council.

8.13 The Council should be responsible for any modification in the initial design of the dual GST and regulating the indirect tax system in the country. The initial design of the dual GST should be approved by the Chairman and three-fourth of the State Finance Ministers. Thereafter, any change in the structure of the GST (both base and the rates) should be allowed to be carried out only if the Chairman **and** two-thirds of the State Finance Ministers agree to do so. Consequently, neither the Centre nor any State will have the authority to unilaterally make any change in the agreed design of the GST. However, in the event of a crisis, the Member State or the Centre may take immediate steps to impose a surcharge subject to ex-post facto approval by the Council within one month. Further, such surcharge should not be allowed to remain in force beyond a period of one year.

8.14 This Council should, in due course, have a permanent secretariat of its own in NewDelhi.

8.15 The proposed mechanism will also ensure that all changes are thoroughly analysed and debated before being implemented. More importantly, since both the Centre and the States would surrender their individual autonomy to change the structure of the GST to the proposed constitutional body, the existing balance of federal fiscal powers will continue to be maintained. **8.16** Further, with a view to compensating for the **perceived** erosion in the tax autonomy of the States, we also recommend that there should be an increase in the formula-based devolution to the states.

CHAPTER - IX

Incentivising States to adopt GST

9.1 The movement from sales tax to VAT at the state level entailed the adoption of uniform RNR rate by all states. The RNR rate is the weighted average of rates across states. Since there was no significant expansion in the base, it implied that states with average weighted rate higher than the RNR would lose revenue while those below it would gain revenue. Hence, the States demanded compensation for adopting VAT. The States have now also demanded compensation for any loss which might be incurred as a result of the shift from the existing indirect tax system at the state level to the GST level.

9.2 States have expressed concern that the RNR for State GST may be revenue neutral at the aggregate level but not necessarily for all individual States. It has, therefore, been suggested that if the States were to be denied the flexibility of upward adjustment to the tax rates, they should be compensated for the revenue loss estimated on a transparent basis.

9.3 The RNR calculated by us in the preceding paragraph is estimated to be 6 percent if all the taxes listed in paragraph are subsumed. Our calculations of revenue estimates, based on estimated C-efficiencies of the existing state level indirect tax structure and of the proposed State GST, for each state indicates that there would be no revenue loss for any state on account of the switch over to GST at the estimated RNR rate of 6 percent and existing level of compliance. This is primarily due to the fact that the change entails significant increase in the tax base for the States. In fact, we estimate that there would be significant revenue gain at 7 percent RNR as recommended by us.[58]

9.4 The Group recognises that the adoption of the GST would create significant positive externalities to impact GDP and various other macroeconomic variables. This would result in reduced cost of economic management to the Central Government. Hence it is logical that the Central Government shares with the States such positive externalities.

9.5 Some States have expressed their lack of confidence in the existing compensation arrangement for revenue loss to the States. It has been suggested that the compensation mechanism, to be credible, must be administered by a body independent of the Finance Ministry in which the State Governments have a say in governance. The suggestion merits consideration.

9.6 Therefore, we recommend the following:-

i) A GST Compensation Fund should be created under the administrative control of the **Council of Finance Ministers.**

ii) The Central Government shall transfer to the GST Compensation Fund a minimum sum of Rs 6000 crores per annum over the next five years (i.e. a total amount of Rs 30,000 crores) if, and only if, the States-

a. introduce the 'flawless' GST as recommended by us; and

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[58] Our detail calculations can be made available on request.

b. follow the road map, as suggested by us, for its introduction;

iii) The amounts in the Fund should be used only for the following purposes:-

a. To compensate the states for any revenue loss on account of the adoption of the 'flawless' GST;

b. The balance, if any in the Fund, to be carried forward to the subsequent year;

c. The balance, if any remaining at the end of the fifth year, to be distributed amongst the states on the basis of the same formula used for distributing resources in the divisible pool.

iv) The amount will be transferred in quarterly instalments.

v) The amounts shall be disbursed by the Council on the basis of the recommendations by a three member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India, Secretary to the Council and any fiscal expert appointed by the Central Government for this purpose.

vi) No contribution to the Fund shall be made by the Central Government in any year in which the States fail to adhere to the roadmap for implementation of the GST.

vii) The methodology to be used for estimating the revenue loss and the compensation shall be decided by the Council.

9.7 These recommendations will serve as an incentive for the states to adopt the flawless GST and also ensure that the payment for compensation, if any, is legitimate and transparent.

9.8 One of the lessons drawn from the implementation of VAT at the State-level is the frequent tendency by the States to deviate from the collectively agreed position relating to the base and the rates. This creates significant tax induced distortions in economic behaviour across states. Further, as stated earlier, it also creates negative externalities. Therefore, it is imperative to establish a mechanism whereby the defaulting state is made liable to pay for the negative externalities. Accordingly, we recommend the following:

i. Any state which deviates from the GST base or rates, collectively agreed upon, without the authority of the Council, should be liable to such penalty for the year, as may be recommended by the Thirteenth Finance Commission.

ii. If the deviation is for a period less than a year, the state will be liable for a proportionate amount of penalty attributable to the period of deviation. Similarly, if the deviation is for a period more than a year, the state will be liable for the completed years and the proportionate amount relating to the remainder period.

iii. The amounts collected in penalty shall be deposited in the GST Compensation Fund for formula based devolution to the States.

9.9 This mechanism will provide symmetric treatment of positive and negative externalities whereby creation of positive externalities will be rewarded and negative externalities will be penalised.

CHAPTER X

Goods and Services Tax - The way forward

10.1 The introduction of the Value Added Tax at the state level was discussed over a prolonged period of more than a decade before implementation. Given the fact that the reform of the indirect tax system is critical to any effort to increase efficiency and economic growth, such prolonged period of discussion on issues in respect of which there is adequate well documented international experience is costly and should, therefore, be avoided. Inspite of such prolonged period of discussion, the state VAT regime in the last four years has witnessed many States deviating from the classification and the rates agreed upon in the White Paper of the Empowered Committee, released in January, 2005.

10.2 Similarly, the discussions on the introduction of a comprehensive dual GST, both at the Centre and State level, have been in progress since early 2006. It is unfortunate that no agreement on the GST has yet been reached even though the target date for its introduction i.e., 1st April, 2010, is less than six months.

10.3 The Central Government has entered into a number of free trade agreements. As these agreements are operationalized, it is necessary to optimise the efficiency and competitiveness of Indian industry. There is no headroom for pursuing distortionary policies. To the extent, the distortions are induced by the indirect tax system, there is an urgent need to reform the same by adopting a flawless Goods and Services Tax along the lines recommended in this Report. The adoption of a flawless Goods and Services Tax is critical to the survival of the Indian industry in the face of increasing international competition consequent to a number of free trade agreements entered into by India.

10.4 Hitherto, the approach of the Central Government has been to act as a catalyst in the process of the design of the GST. This responsibility has essentially been left to the Empowered Committee of State Finance Ministers and official level representatives of the Central Government. Since the design of the GST will also impact the indirect tax system of the Central Government, it is necessary for the Central Government to play a more proactive role in this effort. Towards this, the leadership of the Union Finance Minister would be vital. This will provide the necessary impetus to the process of 'grand bargaining' for the GST.

10.5 While the Council is engaged in the process of designing the GST, the Council should approve the draft of the amendment to the Constitution to the effect that the Centre and the States shall exercise concurrent jurisdiction to subject all goods and services (other than SIN-goods) to a consumption type value added tax based on destination principle where exports will be zero rated and all imports will be subject to the levy like any other goods and services domestically produced and consumed. Further, it should also provide that the base for the levy should be common for both the Centre and the States and there would be a legislated agreement amongst the States and the Centre to (a) adopt uniform classification, (b) adopt uniform rates, (c) not modify the classification or the rates except with the agreement of all the States and the Centre and (d) provide for other essential common features like zero-rating of (or credit by importing State for) inter-State sale of goods. This could be on the lines of the GST legislation in Australia, under which all the States and the Commonwealth (the Centre) have to agree before any change in the rate or the base of GST can be implemented.

10.6 The implementation of the GST is scheduled for 1st April, 2010. However, given the fact that the discussion paper on GST has not yet been released for public debate, it is unlikely that the Centre and the States would be able to complete all legislative and administrative processes before the 1st April, 2010. Therefore, it would be appropriate for the Council to postpone the implementation by six months to 1st October, 2010. However, the Council should release a timeline of various activities for introduction of GST simultaneously with the announcement for postponement. This will enable all stakeholders to monitor the progress and ensure that the new implementation date is not missed out. The new timeline starting 1st January, 2010 is contained in Annexures.

10.7 The SGST is being designed by the Empowered Committee to subsume the **'EC-taxes'**[59] only. One of the main elements of the 'flawless' GST recommended by us is that all taxes on goods and services, levied by the Centre or the States, should be subsumed in the GST. Therefore, we have recommended that the following other taxes levied by the States on goods and services should also be subsumed:

a. Stamp duty;

b. Taxes on Vehicles;

c. Taxes on Goods and Passengers; and

d. Taxes and duties on electricity.

10.8 There is also a view amongst States that while they agree that these taxes should eventually be subsumed, they would like to gradually move in that direction rather than adopt a 'big bang' approach.

10.9 The introduction of the GST should be viewed as the last mile in the reform of the indirect tax system of this country initiated in 1986 with the introduction of the MODVAT. The present system of taxes on goods and services is an outcome of a gradual approach to tax reform over the last 23 years. Consequent to this approach, the country has undoubtedly lost out on potentially higher economic growth, higher real wage rates, fiscal consolidation and consumer welfare. All stakeholders other than the oligarchs, both within and outside the system, stand to gain from a swift comprehensive changeover to the GST. The multitude of the poor will gain from this reform measure more than any other stakeholder. To the extent the switchover is staggered, the potential gains from the comprehensive GST would remain unrealised thereby adversely impacting the poor. We therefore, recommend that all taxes on goods and services, whether levied by the Centre or the States, should be subsumed in the GST in the very first year of its introduction.

10.10 However, if for some political economy reasons it is considered expedient to introduce the GST in a phased way, we recommend the phasing in the following manner:-

a) In the year 2010-11, all elements of the Flawless GST recommended by us whereby

    i. the single CGST rate should be 5 percent and the corresponding SGST rate should be 7 percent; and

    ii. Transactions in immoveable property (i.e real estate and housing services) should be brought within the fold of GST; and

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[59] See para 2.11

iii. Stamp duty **may** not be subsumed but the rate of stamp duty in all states should be calibrated so as not to exceed 4 percent. As a result, transactions in real estate will be subject to a dual levy like in the case of SIN-goods;

b) In the year 2011-12, same as (a) above, with the modification that the rate of stamp duty should be reduced to 2 percent; and

c) In the year 2012-13, same as (a) above, with the modification that-

i. Stamp duty should be eliminated and replaced by a Registration Fee at a specific rate;

ii. the revenues attributable to 2 percentage point out of the 7 percentage point of SGST should be set apart for devolution to the third-tier of Government and the revenues from the balance 5 percentage points will remain with the State Government so that the third-tier of Government have a interest in the efficient functioning of the GST and do not have to impose any cascading taxes like cess, entry tax or Octroi.[60]

10.11 Further, we also recommend that the phased program for introduction of the GST as outlined above should be incorporated in the GST legislation so that there is no uncertainty on the evolution of the GST which will enable trade and industry to appropriately structure their business.

10.12 We do not envisage any loss of revenue at the rates of CGST and SGST recommended by us. However, the rates being sufficiently low, we expect more than normal growth in revenues through better compliance and ease of administration. These low rates will also provide sufficient fiscal space to the Government to meet any contingency which may arise in the future by raising the rates as was done in Japan, Singapore and New Zealand[61].

10.13 The Central Government and State Governments must come together in national interest to build a consensus on the GST and adhere to the new deadline of 1st October, 2010 for rolling out GST. Given the strategic importance of this game changing reforms, the country can little afford any delay.

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[60] We are aware that this aspect will also require to be included in the proposed amendment to the Constitution for introduction of GST.

[61] Japan increased the VAT rate from 3percent to 5 percent, Singapore from 3 percent to 7 percent and New Zealand from 10 percent to 12.5 percent.

Chapter-XI

Conclusion

11.1 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. It is well recognised that this problem can be effectively addressed by shifting the tax burden from production and trade to final consumption. 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.

11.2 The efficiency of the VAT enhances with increase in the purity of the GST Model. The most important **ten** elements of a pure GST are the following:-

a. The base should extend to **all goods and services** including immovable property;

b. There should be a **single low rate;**

c. The tax should be **destination based;**

d. The tax should be designed on **invoice-credit method;**

e. **Full and immediate input tax credit** in respect of **capital goods;**

f. The GST must **replace all transaction based taxes** on goods and services and factors of production.

g. There should be **seamless flow of the tax** through all stages of production and distribution so as to stick on "final" consumption;

h. The **exports** should be **zero rated** and **imports** should be **fully taxed;**

i. There should be a **threshold exemption** for small dealers;

j. **Full computerisation** of the compliance and administrative systems.

11.3 In the light of the above, we have recommended a 'flawless' GST in the context of the federal structure which would optimise efficiency, equity and effectiveness. The 'flawless' GST is designed as a consumption type destination VAT based on invoice-credit method. It provides for a comprehensive base including financial services and immovable property. To the extent there are exemptions, albeit limited to items covered for distribution through the public distribution system, and health and education services, the purity of the GST is diluted. A threshold exemption of Rs. 10 lakh has also been provided for small businesses. Imports into the country are proposed to be taxed in the same manner as domestically produced goods. Like intermediate inputs, full and immediate credit for tax paid on capital goods will also be provided. Further, it also provides for a single rate of tax of 12 percent for all general goods and services across all states, comprising of 5 percent by the Centre and 7 percent by the

States[62]. However, products of high value like gold and platinum will be subject to tax at the rate of 1 percent each by the Centre and the States and exports will be zero rated.

11.4 There is empirical evidence to suggest that the switchover from the present distortionary taxation of goods and services to a 'flawless' GST will, amongst others, increase productivity of all factors of production and hence enhance GDP. The switchover has also been analysed to be pro-poor and therefore, further the cause of poverty reduction. Further in the Indian context, a dual VAT type tax concurrently levied by both the Centre and the States would enable the creation of a common market.

11.5 Given the benefits of the changeover to the flawless GST, it would be economically rational for all levels of Government to introduce and successfully implement the flawless GST and for the Central Government to invest in incentivising the State Government to adopt the flawless GST. We have, therefore, recommended that the Central Government should provide a sum of Rs 30,000 crores over the next five years which will be used to compensate the Statesfor revenue loss, if any, and the balance for distribution between the States on the basis of the same formula applicable for tax devolution to the States.

11.6 The implications for fiscal management are far-reaching. It will significantly improve fiscal management through higher tax buoyancy. While the RNR for State level **TF- taxes'** (including Stamp duty) is only 6 percent, we have allowed them a higher rate of 7 percent along with the flexibility to phase out the stamp duty over a period of next three years. This has the potential to increase the combined tax revenues of States by an estimated amount of Rs 70,000 crores. In addition, we have also recommended that the States should be provided with an additional Rs 30,000 crores as incentive to adopt a 'flawless' GST. Therefore, the switch over to the flawless GST will augment the combined resource base of the States by an aggregate sum of Rs 100,000 crores[63].

11.7 We recognise that the levy will be imposed and enforced by a large number of Governments. Therefore, there would be constant pressure on States to deviate from the pure VAT model and trigger harmful tax competition. This would jeopardise the sustainability of the benefits from the implementation of the 'flawless' GST. Therefore, it is also necessary to establish an institutional mechanism which would be responsible for making any change in the design and structure of the VAT. Our recommendation to establish a Council of Finance Ministers is intended to subsume the independent powers of the both the Central and State Governments to levy tax on goods and services in favour of collective exercise of the powers. Therefore, there is no exacerbation in the vertical imbalance in the fiscal powers.

11.8 The First Discussion Paper released by the Empowered Committee of Finance Ministers on 10th November, 2009 envisages an extremely diluted form of GST under which, inter alia, (i) a number of cascading taxes including purchase tax will continue to be levied by the States; and (ii) the base is considerably eroded on account of the proposed continuation of the exemptions. We are also given to understand that the Empowered Committee is considering a two rate structure for general goods and

[62] However, products of high value like gold and platinum will be subject to tax at the rate of 1 percent each by the Centre and the States and exports will be zero rated.

This is equivalent to 2 percent of GDP.

services (other than high value goods).The design of the GST as envisaged by the Empowered Committee is, therefore, a significant dilution of the 'flawless' GST. Consequently, the potential economic benefits from a switch over to the flawless GST, which we have discussed in the foregoing chapter, would not be realised.

11.9 We have recommended that the implementation of the GST should be postponed to 1st October, 2010. We believe that it should be possible to adhere to this timeline. The benefits from the switch over to the GST are contingent upon the purity of the GST design. In the context of VAT, international experience shows that any design-related 'VAT mistakes are very hard to rectify'. Therefore, it must be ensured that there are no design related mistakes at birth. However, if there is a trade-off between the timeline and the design of the GST, the dilemma must be resolved in favour of design.

11.10 Further, in order to implement the 'flawless' GST it would be necessary to undertake constitutional amendments to enable both the Centre and the States to exercise concurrent jurisdiction over the taxation of all goods and services, creation of the proposed Council of Finance Ministers and assignment of part of the GST proceeds to the third-tier of government. These amendments must, inter alia, provide that the taxation of goods and services by both the Centre and the States should be a consumption-type, destination based GST.

11.11 The introduction of the 'flawless' GST is one of the most important reform agenda which can provide a new impetus to Indian industry and inclusive growth. It is an economic game changer. All stakeholders must unite and develop the necessary will to cooperate in introducing the flawless GST. It would be worthwhile to make greater political investment in this endeavour.

Annexures

Treatment of immovable properties under Goods and Services Tax

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 underreporting 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.

At a conceptual level, under a VAT, sales, rentals, and rental values of immovable property would be taxable and credit would be available for the VAT embedded in purchases. Immovable property that generates housing services should be treated in the same manner. The theoretically most attractive solution would be to register all legal persons, who own or buy residential real estate, for VAT purposes. By purchasing a dwelling, these persons would become producers of housing services. In their role as producers, they would subsequently sell the housing services to consumers. These consumers could be lessees who buy the services for consideration, i.e., a rental charge. It is also possible that producers would put the dwelling at their own disposal. In other words, as owner-producer they would "sell" the housing services to themselves in their role as occupier consumers. Therefore, the purchaser of an immovable property could use the housing services produced from ownership either for self-consumption or for 'sale' by renting out the property.

The VAT consequences of these events are as follows. On purchase of a bundle of housing services in the form of dwelling, the registered taxpayer pays tax on the purchase price, but at the same time, he is entitled to a tax credit (and refund, if due) for the same amount. If he sells the housing services to lessee, he would have to charge VAT on the amount of the rental. The lessee, being an unregistered consumer, would not be able to pass the tax on; he would be stuck with it just like consumers of other services. Similarly, in his role as owner-occupier, the producer of housing services would "charge" VAT on these services, whose value equals the rental value of the dwelling rendered to himself as consumer. And like the lessor, he would have to remit that tax (net of any tax on inputs, such as repair and maintenance services) to the government.

In practice, the registration of all owner occupiers and the computation of all imputed rental values present formidable administrative problems and are, therefore, not feasible. If imputed rental values cannot be taxed, the taxation of rental charges would appear to favour owner-occupiers over lessees. Further, the practical difficulties of taxing small landlords might be severe. Therefore, as a second-best approach, it would be appropriate to provide a threshold exemption for GST which would ensure that the large majority of small landlords are outside the scope of GST. Since the imputed rental values in the case of self owners would predominantly be below the threshold exemption limit, it would be desirable from an administrative aspect to exclude imputed rental values in the case of self owners from the scope of GST.

The treatment of housing under a VAT like GST regime can be designed following either the comprehensive taxation method or one of the two variants of the exemption method. The treatment of transactions in immovable property and real estate/housing services under the three methods is summarised in the Table below.

Table

VAT treatment of immovable property under two approaches

Nature of transaction	Comprehen-sive taxation	Exemption method	
		(Variant-A)	(Variant-B)
A. Existing residential property stock			
i. Sale	T	T	E
ii. Rental charges	T	E	E
iii. Imputed rental values	E	E	E
iv. Alteration and maintenance	T	T	T
B. New residential property			
i. Construction/ First Sale	T	T	T
ii. Resale	T	T	E
iii. Rental charges	T	E	E
iv. Imputed rental values	E	E	E
v. Alteration and maintenance	T	T	T
C. Existing commercial property stock			
i. Sale	T	T	T
ii. Rental charges	T	E	T
iii. Imputed rental values	E	E	E
iv. Alteration and maintenance	T	T	T
D. New commercial property			
i. Construction/First Sale	T	T	T
ii Resale	T	T	T
iii. Rental charges	T	E	T
iv. Imputed rental values	E	E	E
v. Alteration and maintenance	T	T	T
E. Inputs (both goods and services) used for construction	T	T	T

Under the **comprehensive taxation method,** all new properties (both residential and commercial) constructed after the introduction of the VAT are liable to tax on construction/first sale of the building on the reasoning that the cost of construction or the price of first sale represent the present discounted value of the flow of imputed rental services over the life of the property. Thereafter, the rental charges for leasing of such properties is also liable to VAT with the landlord being entitled to input credit on the tax paid on construction/purchase of the building. However, if the property is owner occupied, no VAT is applicable on imputed rental value of the house. Correspondingly, the owner is also not entitled to input tax credit. Upon resale of the property, VAT is realised on the full resale value and input credit to the extent not utilised against rental income is allowed as a deduction. If the input credit is greater than the VAT on resale value, the excess is ignored and no refund for such excess is allowed. As a result, VAT is payable on the margin earned on sale of the property i.e., the difference between the sale price and the cost of procurement and improvements thereto. It applies only to enhancement in the value of the property. The treatment in respect of resale of properties built prior to the introduction of VAT would be the same with the modification that no input tax credit is allowed in respect of VAT which is paid at the time of its purchase. Further, VAT is also levied on the value of the supply of all goods and services for construction, alteration and maintenance of an immovable property.

The comprehensive method, as its name suggests, is extremely wide in its scope. **Firstly,** it extends to the consumption of existing stock of properties, as well as to any unanticipated future increases in the rental value of the new properties. **Secondly,** this method also effectively entails full taxation of imputed rental value of owner-occupied properties. New properties attract tax on their full capital value (i.e., the purchase price) at the time of purchase, for which no deduction is allowed to the owner during the period of self-occupation of the property. **Thirdly,** the existing properties also attract tax on their full capital value at the time of resale. Further, this method simplifies legislation in as much as no distinction is required to be made between residential or commercial properties.

The case against the comprehensive method is essentially built on the following considerations. **Firstly,** under the method landlords would tend to register themselves to avail of credit in respect of input tax paid on construction/purchase of the property thereby increasing the administrative burden of dealing with a large number of small registrants. However, this problem is highly exaggerated in the context of a reasonably moderate threshold exemption for small businesses whereby most small landlords would remain exempt. **Secondly,** application of tax on resale of dwellings would require the owners to keep track of input taxes paid on the acquisition of the dwellings, on improvements undertaken over the period of their ownership and input credit availed against VAT payable on rental value. Further, in many cases, there are frequent changes in the use of the dwelling as owner-occupied residence or rental dwelling. Since input tax credits are allowed only for houses used for rental purposes, these changes in the usage of the dwelling would require special rules for appointment of the input tax credits resulting in increased administration burden for the tax office. However, these problems are surmountable by not allowing any credit for input tax paid on construction/purchase of the property or improvement thereto against VAT payable on rental value. The credit for such input tax can be allowed only at the time of resale, after adjusting the same for inflation. **Thirdly,** in the case of existing stock of properties, the tax applies on the full resale value. This may be appropriate only where the existing properties did not previously bear the taxes that were being replaced by the VAT. If indeed substitute taxes (though of the cascading variety) are applied to some or all components of the existing properties, subjecting them to full taxation again under VAT would amount to double taxation. This can be resolved by allowing credit for the taxes already paid or levying the VAT only to enhancement in the value of the property.

Under the Variant - A of the exemption method, like in the comprehensive taxation method, all new properties (both residential and commercial) constructed after the introduction of the VAT are liable to tax on construction/first sale of the building. However, both the rental charges for leasing of such properties and the imputed rental value are exempt with no benefit for input tax credit whatsoever. Upon resale of the property VAT is realised on the full resale value and input credit for tax paid on construction/purchase of the property is allowed as a set off. If the input credit is greater than the VAT on resale value, the excess is ignored and no refund for such excess is allowed. As a result, like in the comprehensive taxation method, the VAT on resale is payable only on the margin earned on sale of the property. The treatment in respect of resale of properties built prior to introduction of VAT is the same with the modification that no input tax credit is allowed in respect of VAT which is paid at the time of its purchase. Further, VAT is also levied on the value of the supply of all goods and services for construction, alteration and maintenance of an immovable property.

The Variant-A is economical neutral between rented properties and owner occupied properties in as much as both the actual rent and imputed rent is exempt. Similarly, this method is also neutral across properties constructed before and properties constructed after the introduction of VAT since resale of the property is liable to VAT. The administrative and compliance difficulties are similar to those faced under the comprehensive taxation method with the modification that the number of landlords seeking registration would be relatively small since actual rent is exempt. However, administrative complexity would increase in case of mixed use of properties i.e. where the building is partly used for residential and partly for commercial rentals or where the use of the unit changes between commercial and residential use since this would required special rules of apportionment of the input tax credits. Further, in many cases, along with the renting of the unit, various related services such as utilities, furnishings, meals and maid services are also provided. Special rules would need to be framed to segregate residential rentals from the related supplies.

Under Variant-B of the exemption method, a distinction is made between residential and commercial properties. The commercial properties are treated in the same manner as under the comprehensive taxation method. In the case of residential properties, VAT is levied at the time of construction/first sale of such properties which are constructed after the introduction of VAT. All resale of properties, whether constructed before or after the introduction of the VAT is exempt. As a result, the scope of VAT does not extend to existing properties. Further, VAT is also levied on the value of the supply of all goods and services for construction, alteration and maintenance of an immovable property.

Variant-B is extremely narrow in its scope since sale and resale of both existing and new residential properties, rental value and imputed rent are exempt. This can be highly distortionary since the benefit from such exemption would depend on the mix of taxable and non-taxable inputs used in construction. Further, a distinction would also need to be made between residential and non-residential properties to allow for the exemption and input tax credit. This would add to the complexity in the tax administration.

The real estate sector should be integrated into the GST framework keeping in view the implications of the different methods.

Table-13: States' Own Tax Revenues on goods and services -2007-08

(All figures in Rs in crores)

S. No.	States	State Excise	Sales Tax, VAT and Purchase Tax	Central Sales Tax	Other Receipts	Total Sales Tax	Sales tax and CST on POL	Sales Tax on alchohol	Total Non-POL Non-Alch'l Sales Tax	Entt Tax	Entry tax in lieu of Octroi	Taxes on Vehicles	Taxes on Goods and Passengers	Taxes and Duties on Electricity	Stamps and Regn Fees	Other Taxes and Duties	Total EC-taxes*	Total TF-taxes*
		Col. 1	Col. 2	Col. 3	Col. 4	Col.5 (2+3+4)	Col.6	Col.7	Col.8 (5-6-7)	Col.9	Col.10	Col.11	Col.12	Col.13	Col.14	Col.15	Col.16	Col. 17
	General Category State																	
1	Andhra Pradesh	4041	17538	1433	56	19026	5301	3248	10478	0	78	1604	80	195	3086	171	10727	15692
2	Bihar	525	2491	44	-1	2535	1133	147	1255	14	979	273	938	64	654	0	2249	4178
3	Chhattisgarh	843	2448	521	54	3024	939	0	2085	5	0	277	511	395	463	2	2092	3737
4	Goa	76	3	60	817	879	370	0	509	11	127	82	113	0		191	838	1032
5	Gujarat	47	189	1905	13010	15105	5332	12	9760	0	240	1310	152	2047	2018	263	10253	15790
6	Haryana	1379	6364	1357	0	7721	2040	11	5670	17	0	234	379	107	1763	7	5696	8179
7	Jharkhand	157	2215	636	-6	2846	730	45	2070	5	151	136	71	78	156	0	2227	2666
8	Karnataka	4767	3507	1262	9125	13894	3896	0	9998	353	0	1650	837	449	3409	37	10388	16734
9	Kerala	1169	3335	1016	5021	9372	2336	1998	5038	1	0	853	0	39	2028	78	6117	8037
10	Madhya Pradesh	1854	5488	557	0	6045	2512	0	3533	12	0	703	916	626	1532	16	3562	7338
11	Maharastra	3963	24362	2385	6	26753	10076	1080	15596	410	0	2143	388	2688	8550	634	18840	30409
12	Orissa	525	3567	551	0	4118	1077	132	2910	2	0	459	627	327	405	29	2941	4760
13	Punjab	1862	4920	328	94	5342	1482	29	3832	5	587	499	0	604	1568	2	4427	7098
14	Rajasthan	1805	7126	405	219	7751	2819	1	4931	16	0	1164	161	584	1544	43	4990	8443
15	Tamil Nadu	4764	16434	1722	0	18156	5081	3889	9186	9	1097	1483	1097	37	3805	173	10468	16888
16	Uttar Pradesh	3948	12464	1385	1174	15023	4653	28	10342	94	553	1146	110	207	3977	63	11062	16491
17	West Bengal	935	7249	798	14	8060	2465	342	5253	30	0	532	1	507	1417	311	6596	8052
	Total	**32660**	**119701**	**16365**	**29585**	**165651**	**52242**	**10961**	**102448**	**986**	**3812**	**14549**	**6581**	**8959**	**36374**	**2020**	**109266**	**175524**
	Special Category States																	
1	Arunachal Pradesh	12	0	0	77	77	16	0	61	0	0	6	0	0	1	0	61	68
2	Assam	189	1310	0	1382	2691	1154	0	1537	3	0	139	12	5	110	4	1544	1809
3	Himachal Pradesh	390	979	113	0	1092	239	32	821	0	0	114	55	82	87	137	968	1295
4	Jammu & Kashmir	244	1802	0	3	1805	341	80	1384	0	97	73	265	93	66	3	1484	1981
5	Manipur	4	0	0	115	115	27	1	87	0	0	4	1	0	3	0	88	96
6	Meghalaya	42	52	21	8	81	68	26	0	1	0	5	2	0	5	1	2	12
7	Mizoram	2	51	0	11	62	21	0	41	0	0	5	1	0	0	0	41	48
8	Nagaland	3	10	9	75	95	28	0	66	0	0	12	2	0	1	0	66	82
9	Sikkim	29	25	4	27	56	21	0	35	1	0	4	0	0	2	4	40	46
10	Tripura	38	263	2	0	265	59	14	192	0	0	23	0	0	15	2	194	232
11	Uttaranchal	442	1627	0	0	1627	404	38	1185	6	5	155	0	55	424	5	1201	1836
	Total	**1398**	**6119**	**150**	**1698**	**7967**	**2378**	**192**	**5397**	**11**	**102**	**541**	**338**	**235**	**718**	**156**	**5666**	**7492**
	Union Territories																	
1	Chandigarh	128	429	124	0	553	114	0	439	5	0					0	444	444
2	Delhi	1295	5285	1723	0	7009	1695	293	5021	60	0	425	0	0	1350	378	5459	7234
3	Daman and Diu	0	120	50	0	170	8	0	162	0	0					0	162	162
4	Pondicherry	224	185	181	0	369	5	4	360	0	0	35	0	0	37	0	360	432
5	Port Blair	0	0	0	0	0	0	0	0	0	0					0	0	0
	Total	**1647**	**6028**	**2078**	**0**	**8100**	**1822**	**297**	**5981**	**65**	**0**	**460**	**0**	**0**	**1387**	**378**	**6424**	**8271**
	Grand Total	**35701**	**131848**	**18593**	**31282**	**181718**	**56442**	**11450**	**113826**	**1062**	**3914**	**15549**	**6719**	**9188**	**38471**	**2554**	**121356**	**191287**

* This includes an estimated amount of Rs 3000 crores as Sales Tax on Tobacco products for which we do not have State-wise breakup.Therefore, the amount of EC-taxes and TF-taxes for the purposes will be lower by Rs 3000 crores each.

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(All figures in Rs in crores)

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		Col. 1	Col. 2	Col. 3	Col. 4	Col.5 (2+3+4)	Col.6	Col.7	Col.8 (5-6-7)	Col.9	Col.10	Col.11	Col.12	Col.13	Col.14	Col.15	Col.16	Col. 17
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5	Gujarat	47	189	1905	13010	15105	5332	12	9760	0	240	1310	152	2047	2018	263	10263	15790
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13	Punjab	1862	4920	328	94	5342	1482	29	3832	5	587	499	0	604	1568	2	4427	7098
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6	Meghalaya	42	52	21	8	81	68	26	0	1	0	5	2	0	3	1	2	12
7	Mizoram	2	51	0	11	62	21	0	41	0	0	5	1	0	0	0	41	48
8	Nagaland	3	10	9	75	95	28	0	66	0	0	12	2	0	1	0	66	82
9	Sikkim	29	25	4	27	56	21	0	35	1	0	4	0	0	2	4	40	46
10	Tripura	38	263	2	0	265	59	14	192	0	0	23	0	0	15	2	194	232
11	Uttaranchal	442	1627	0	0	1627	404	38	1185	6	5	155	0	55	424	5	1201	1836
	Total	**1393**	**6119**	**150**	**1698**	**7967**	**2378**	**192**	**5397**	**11**	**102**	**541**	**338**	**235**	**713**	**156**	**5666**	**7492**
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2	Delhi	1295	5285	1723	0	7009	1695	293	5021	60	0	425	0	0	1350	378	5459	7234
3	Daman and Diu	0	120	50	0	170	8	0	162	0	0					0	162	162
4	Pondicherry	224	189	181	0	369	5	4	360	0	0	35	0	0	37	0	360	432
5	Port Blair	0	0	0	0	0	0	0	0	0	0					0	0	0
	Total	**1647**	**6023**	**2078**	**0**	**8100**	**1822**	**297**	**5981**	**65**	**0**	**460**	**0**	**0**	**1387**	**378**	**6424**	**8271**
	Grand Total	**35701**	**131843**	**18593**	**31282**	**181718**	**56442**	**11450**	**113826**	**1062**	**3914**	**15549**	**6719**	**9188**	**38473**	**2554**	**121356**	**191287**

* This includes an estimated amount of Rs 3000 crores as Sales Tax on Tobacco products for which we do not have State-wise breakup.Therefore, the amount of EC-taxes and TF-taxes for the purposes will be lower by Rs 3000 crores each.

Terms of Reference of the Task Force

The Task Force shall examine the impact of the proposed implementation of the Goods and Services Tax (GST) with effect from 01.04.2010. For this purpose, it shall examine, inter alia, -

(a) the GST model best suited for the country;

(b) the modalities of the implementation of GST including threshold limits, composition limits, treatment of inter-state transactions, place of supply rules;

(c) the potential tax base of the GST as exhaustively as possible and determine an appropriate revenue neutral rate for the Centre and the states;

(d) suggest ways to incentivize states to adopt a model GST; and

(e) recommend a framework for administering the GST including payment of compensation, monitoring of compliance and institutional mechanism for making any change in the initial design of the GST.

C-4
LIST OF COUNTRIES IMPLEMENTING VAT/GST

Currently, there are **152** countries from UN Member States that have implemented VAT/GST. Region wise list of Countries are as follows:

No.	Region	No. of Countries
1	ASEAN (Indonesia, Thailand, Singapore, Philippines, Cambodia, Vietnam, Laos)	7
2	Asia (Bangladesh, China, India, Iran, Japan, Jordan, Kazakhstan, Kyrgyzstan, Lebanon, Mongolia, Nepal, Pakistan, Papua New, Guinea, South Korea, Sri Lanka, Tajikistan, Turkmenistan, Uzbekistan)	18
3	Europe (Albania, Austria, Armenia, Azerbaijan, Belarus, Belgium, Bosnia Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, , Ireland, Israel, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Macedonia, Malta, Moldova, Monaco, Montenegro, Netherlands, Norway, Poland, Portugal, Romania, Russia, Turkey, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Ukraine, United Kingdom)	47
4	Oceania (Australia, Fiji, New Zealand, Samoa, Tonga, Vanuatu)	6
5	Africa (Algeria, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Democratic Republic of the, Congo, Ethiopia, Egypt, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Republic of Congo, Rwanda, Senegal, Seychelles, Sierra Leone, South Africa, Sudan, Tanzania, Togo, Tunisia, Uganda, Zambia, Zimbabwe)	44
6	South America (Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Guyana, Paraguay, Peru, Uruguay, , Venezuela)	11
7	Caribbean, Central & North America (Antigua and Barbuda, Barbados, Belize, Canada, Commonwealth of Dominica, Costa Rica, Dominican Republic, El Salvador, Grenada, Guatemala, , Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Trinidad and Tobago)	19

Following **Eight** countries which are **not** United Nation (UN) Member States have implemented GST:

- Azores;
- Taiwan;
- Faroe Islands;
- Isle of Man;
- Jersey;
- Kosovo;
- Madeira; and
- Niue.

41 out of 193 countries from UN Member States have**not** implemented VAT/GST, details of which are as follows:

S. No.	Region	No. of Countries
1.	ASEAN (Malaysia, Brunei, Myanmar)	3
2.	Asia (Afghanistan, Bahrain, Bhutan, Iraq, Kuwait, Maldives, North Korea, Oman, Qatar, Saudi Arabia, Syria, Timor Leste, United Arab Emirates, Yemen)	14
3.	Europe (Andorra, San Marino)	2
4.	Oceania (Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Solomon Islands, Tuvalu)	7
5.	Africa (Angola, Comoros, Djibouti, Eritrea, Liberia, Libya, Sao Tome and Principe, Somalia, South Sudan, Swaziland)	10
6.	Caribbean, South, Central & North America (Bahamas, Cuba, Saint Lucia, Suriname, United States of America)	5

D-1

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

(AS INTRODUCED IN LOK SABHABILL NO. 192 OF 2014)*

Press Information Bureau*

Government of India

Ministry of Finance

19-December-2014 19:46 IST

Union Finance Minister Shri Arun Jaitley Introduces the Constitution Amendment Bill on Goods and Services Tax (GST) in Lok Sabha; New Article 246A Proposed to Confer Simultaneous Power to Union and State Legislatures to Legislate on GST; Centre To Compensate States for Loss of Revenue Arising on Account of Implementation of the GST for a period up to Five Years

The Union Cabinet approved on 17th December,2014 the proposal for introduction of a Bill in the Parliament for amending the Constitution of India to facilitate the introduction of Goods and Services Tax (GST) in the country. The Union Finance Minister Shri Arun Jaitley introduced the said Bill in the Lok Sabha today.

The proposed amendments in the Constitution will confer powers both to the Parliament and State legislatures to make laws for levying GST on the supply of goods and services in the same transaction.

GST will simplify and harmonize the indirect tax regime in the country. 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 state 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. It is thus, expected that introduction of GST will foster a common and seamless Indian market and contribute significantly to the growth of the economy.

Following are the salient features of this Bill:

- A new Article 246A is proposed which will confer simultaneous power to Union and State legislatures to legislate on GST.
- A new Article 279A is proposed for the creation of a Goods & Services Tax Council which will be a joint forum of the Centre and the States. This Council would function under the Chairmanship of the Union Finance Minister and will have Ministers in charge of Finance/Taxation or Minister

*__Source__ :http://www.egazette.nic.in/

**Source*: www.pib.nic.in

nominated by each of the States & UTs with Legislatures, as members. The Council will make recommendations to the Union and the States on important issues like tax rates, exemptions, threshold limits, dispute resolution modalities etc.

- It is proposed to do away with the concept of 'declared goods of special importance' under the Constitution.
- Centre will compensate States for loss of revenue arising on account of implementation of the GST for a period up to five years. A provision in this regard has been made in the Amendment Bill (The compensation will be on a tapering basis, i.e., 100% for first three years, 75% in the fourth year and 50% in the fifth year).

The proposed GST has been designed keeping in mind the federal structure enshrined in the Constitution and will have the following important features:

- Central taxes like Central Excise Duty, Additional Excise Duties, Service Tax, Additional Customs Duty (CVD) and Special Additional Duty of Customs (SAD), etc. will be subsumed in GST.
- At the State level, taxes like VAT/Sales Tax, Central Sales Tax, Entertainment Tax, Octroi and Entry Tax, Purchase Tax and Luxury Tax, etc. would be subsumed in GST.
- All goods and services, except alcoholic liquor for human consumption, will be brought under the purview of GST. Petroleum and petroleum products have also been Constitutionally brought under GST. However, it has also been provided that petroleum and petroleum products shall not be subject to the levy of GST till notified at a future date on the recommendation of the GST Council. The present taxes levied by the States and the Centre on petroleum and petroleum products, i.e., Sales Tax/VAT, CST and Excise duty only, will continue to be levied in the interim period.
- Both Centre and States will simultaneously levy GST across the value chain. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State.
- The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. There will be seamless flow of input tax credit from one State to another. Proceeds of IGST will be apportioned among the States.
- GST is a destination-based tax. All SGST on the final product will ordinarily accrue to the consuming State.
- GST rates will be uniform across the country. However, to give some fiscal autonomy to the States and Centre, there will a provision of a narrow tax band over and above the floor rates of CGST and SGST.
- It is proposed to levy a non-vatable additional tax of not more than 1% on supply of goods in the course of inter-State trade or commerce. This tax will be for a period not exceeding 2 years, or further such period as recommended by the GST Council. This additional tax on supply of goods shall be assigned to the States from where such supplies originate.

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:—

Short title and commencement.

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.

Insertion of new article 246A.

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

Special provision with respect to goods and services tax.

"246A.(1)Notwithstandinganythingcontainedinarticles246and254,Parliament, and, subject to clause (2), the Legislature of every State, have power tomake 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.''.

Amendment of article 248.

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.

Amendment of article 249.

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.

Amendment of article 250.

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.

Amendment of article 268.

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.

Omission of article 268A.

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

Amendment of article 269.

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.

Insertion ofnewarticle269A.

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

Levy and collection of goods and services tax in course of inter-State trade or commerce.

''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.''.

Amendment of article 270.

10. In article 270 of the Constitution,—

(i) in clause (1), for the words, figures and letter "articles 268, 268A and article269", 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 article269A, shall also be distributed between the Union and the States in the manner provided in clause (2).''.

Amendment of article 271.

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.

Insertion of new article 279A.

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

Goods and Services Tax Council.

''279A. (1) The President shall, within sixty days from the date of commencement of the Constitution (One Hundred and Twenty-second Amendment) Act, 2014, byorder, 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."

Amendment of article 286.

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.

Amendment of article 366.

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;'.

Amendment of article 368.

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, article241 or article 279A" shall be substituted.

Amendment of Sixth Schedule

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.".

Amendment of Seventh Schedule.

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.Dutiesofexciseonthefollowinggoodsmanufacturedorproduced 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 thecourseofinter-Statetradeorcommerceorsaleinthecourseofinternational 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.".

Arrangement for assignment of additional tax on supply of goods to States for two years or such other period recommended by the 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.

Compensation to States for loss of revenue on account of introduction of goods and services tax.

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.

Transitional provisions.

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. Power of President to remove difficulties.

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.

STATEMENT OF OBJECTS AND REASONS

The Constitution is proposed to be amended to introduce the goods and services tax for conferring concurrent taxing powers on the Union as well as the States including Union territory with Legislature to make laws for levying goods and services tax on every transaction of supply of goods or services or both. The goods and services tax shall replace a number of indirect taxes being levied by the Union and the State Governments and is intended to remove cascading effect of taxes and provide for a common national market for goods and services. The proposed Central and State goods and services tax will be levied on all transactions involving supply of goods and services, except those which are kept out of the purview of the goods and services tax.

2. The proposed Bill, which seeks further to amend the Constitution, *inter alia*, provides for—

(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.

Illustration:

In terms of clause (9) of the proposed article 279A, the "weighted votes of the members present and voting" in favour of a proposal in the Goods and Services Tax Council shall be determined as under:—

WT = WC+WS

Where,

$$WT = WC+WS\left(\frac{WST}{SP}\right) \times SF$$

Wherein—

WT = Total weighted votes of all members in favour of a proposal.

WC = Weighted vote of the Union $= \frac{1}{3}$ *i.e.*, 33.33% if the Union is in favour of the proposal and be taken as "0" if, Union is not in favour of a proposal.

WS = Weighted votes of the States in favour of a proposal.

SP = Number of States present and voting.

WST = Weighted votes of all States present and voting *i.e.* $\frac{1}{3}$ *i.e.*, 66.67%

SF = Number of States voting in favour of a proposal.

(j) Clause 20 of the proposed Bill makes transitional provisions to take care of any inconsistency which may arise with respect to any law relating to tax on goods or services or on both in force in any State on the commencement of the provisions of the Constitution as amended by this Act within a period of one year.

3. the Bill seeks to achieve the above objects.

NEW DELHI; ARUN JAITLEY

The 18th December, 2014

PRESIDENT'S RECOMMENDATION UNDER ARTICLE 117 OF THE CONSTITUTION OF INDIA

[Copy of letter No. S-31011/07/2014-SO(ST), dated the 18th December, 2014 from Shri Arun Jaitley, Minister of Finance to the Secretary-General, Lok Sabha.]

The President, having been informed of the subject matter of the proposed Bill, recommends under clauses (1) and (3) of article 117, read with clause (1) of article 274, of the Constitution of India, the introduction of the Constitution (One Hundred and Twenty-second Amendment) Bill, 2014 in Lok Sabha and also the consideration of the Bill.

FINANCIAL MEMORANDUM

Clause 12 of the Bill seeks to insert a new article 279A in the Constitution relating to

Constitution of Goods and Services Tax Council. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State incharge 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.

2. The creation of Goods and Services Tax Council will involve expenditure on office expenses, salaries and allowances of the officers and staff. The objective that the introduction of goods and services tax will make the Indian trade and industry more competitive, domestically as well as internationally and contribute significantly to the growth of the economy, such additional expenditure on the Council will not be significant.

3. At this stage, it will be difficult to make an estimate of the expenditure, both recurring and non-recurring on account of the Constitution of the Council.

4. Further, it is provided 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. The exact compensation can be worked out only when the provisions of the Bill are implemented.

MEMORANDUM REGARDING DELEGATED LEGISLATION

Clause 12 of the Bill seeks to insert a new article 279A relating to the constitution of a Council to be called the Goods and Services Tax Council. Clause (1) of the proposed new article 279A provides that the President, shall within sixty days from the date of the 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. Clause (8) of the said article provides that the Council shall determine the procedure in the performance of its functions.

2. The procedures, as may be laid down by the Goods and Services Tax Council in the performance of its functions, are matters of procedure and details. The delegation of legislative power is, therefore, of a normal character.

D-2
RELEVANT ARTICLES OF THE CONSTITUTION OF INDIA

245. Extent of laws made by Parliament and by the Legislatures of States

(1) Subject to the provisions of this Constitution, Parliament may make laws for the whole or any part of the territory of India, and the Legislature of a State may make laws for the whole or any part of the State.

(2) No law made by Parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation.

246. Subject-matter of laws made by Parliament and by the Legislatures of States

(1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List").

(2) Notwithstanding anything in clause (3), Parliament, and, subject to clause (1), the Legislature of any State also, have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution referred to as the "Concurrent List").

(3) Subject to clauses (1) and (2), the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution referred to as the "State List"').

(4) Parliament has power to make laws with respect to any matter for any part of the territory of India not included in a State notwithstanding that such matter is a matter enumerated in the State List.

Residuary powers of legislation.

248*. (1) *Parliament has exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or State List.*

(2) *Such power shall include the power of making any law imposing a tax not mentioned in either of those Lists.*

* * * * *

Power of Parliament to legislate with respect to a matter in the State List in the national interest.

249*. *(1) Notwithstanding anything in the foregoing provisions of this Chapter, if the Council of States has declared by resolution supported by not less than two-thirds of the members present and voting that it is* *necessary or expedient in the national interest that Parliament should make laws with respect to any matter enumerated in the State List specified in the resolution, it shall be lawful for Parliament to make laws for the whole or any part of the territory of India with respect to that matter while the resolution remains in force.*

(2) A resolution passed under clause (1) shall remain in force for such period not exceeding one year as may be specified therein:

Provided that, if and so often as a resolution approving the continuance in force of any such resolution is passed in the manner provided in clause (1), such resolution shall continue in force for a further period of one year from the date on which under this clause it would otherwise have ceased to be in force.

(3) A law made by Parliament which Parliament would not but for the passing of a resolution under clause (1) have been competent to make shall, to the extent of the incompetency, cease to have effect on the expiration of a period of six months after the resolution has ceased to be in force, except as respects things done or omitted to be done before the expiration of the said period.

* * * * *

Power of Parliament to legislate with respect to any matter in the State List if a Proclamation of Emergency is in operation.

250. (1) Notwithstanding anything in this Chapter, Parliament shall, while a Proclamation of Emergency is in operation, have power to make laws for the whole or any part of the territory of India with respect to any of the matters enumerated in the State List.

* * * * *

265. Taxes not to be imposed save by authority of law

No tax shall be levied or collected except by authority of law.

Distribution of Revenues between the Union and the States

Duties levied by the Union but collected and appropriated by the States.

268*. *(1) Such stamp duties and such duties of excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied by the Government of India but shall be collected—*

(a) in the case where such duties are leviable within any Union territory, by the Government of India, and

(b) in other cases, by the States within which such duties are respectively leviable.

(2) The proceeds in any financial year of any such duty leviable within any State shall not form part of the Consolidated Fund of India, but shall be assigned to that State.

* * * * *

Service tax levied by Union and collected and appropriated by the Union and the States

268A*. *(1) Taxes on services shall be levied by the Government of India and such tax shall be collected and appropriated by the Government of India and the States, in the manner provided in clause (2).*

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

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

(b) appropriated by the Government of India and the States, in accordance with such principles of collection and appropriation as may be formulated by Parliament by law.

Taxes levied and collected by the Union but assigned to the States

269*. *(1) Taxes on the sale or purchase of goods and taxes on the consignment of goods shall be levied and collected by the Government of India but shall be assigned and shall be deemed to have been assigned to the States on or after the 1st day of April, 1996 in the manner provided in clause (2).*

Explanation.– For the purposes of this clause, –

(a) the expression "taxes on the sale or purchase of goods" shall mean taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce;

(b) the expression "taxes on the consignment of goods" shall mean taxes on the consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce.

(2) The net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Union territories, shall not form part of the Consolidated Fund of India, but shall be assigned to the States within which that tax is leviable in that year, and shall be distributed among those States in accordance with such principles of distribution as may be formulated by Parliament by law.

(3) Parliament may by law formulate principles for determining when a sale or purchase of, or consignment of, goods takes place in the course of inter-State trade or commerce.

* * * * *

Taxes levied and distributed between the Union and the States

270*. *(1) All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268, 268A and 269, respectively, surcharge on taxes and duties referred to in article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States in the manner provided in clause (2).*

(2) Such percentage, as may be prescribed, of the net proceeds of any such tax or duty in any financial year shall not form part of the Consolidated Fund of India, but shall be assigned to the States within which that tax or duty is leviable in that year, and shall be distributed among those States in such manner and from such time as may be prescribed in the manner provided in clause (3).

(3) In this Article, "prescribed" means, –

(i) until a Finance Commission has been constituted, prescribed by the President by order, and

(ii) *after a Finance Commission has been constituted, prescribed by the President by order after considering he recommendations of the Finance Commission.*

* * * * *

Surcharge on certain duties and taxes for purposes of the Union

271*. *Notwithstanding anything in articles 269 and 270, Parliament may at any time increase any of the duties or taxes referred to in those articles by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part of the Consolidated Fund of India.*

* * * * *

Prior recommendation of President required to Bills affecting taxation in which States are interested

274 (1) No Bill or amendment which imposes or varies any tax or duty in which States are interested, or which varies the meaning of the expression "agricultural income" as defined for the purposes of the enactments relating to Indian income-tax, or which affects the principles on which under any of the foregoing provisions of this Chapter moneys are or may be distributable to States, or which imposes any such surcharge for the purposes of the Union as is mentioned in the foregoing provisions of this Chapter, shall be introduced or moved in either House of Parliament except on the recommendation of the President.

(2) In this Article, the expression "tax or duty in which States are interested" means—

(a) a tax or duty the whole or part of the net proceeds whereof are assigned to any State; or

(b) a tax or duty by reference to the net proceeds whereof sums are for the time being payable out of the Consolidated Fund of India to any State.

Taxes on professions, trades, callings and employments

276 (1) Notwithstanding anything in Article 246, no law of the Legislature of a State relating to taxes for the benefit of the State or of a Municipality, District Board, Local Board or other local authority therein in respect of professions, trades, callings or employments shall be invalid on the ground that it relates to a tax on income.

(2) The total amount payable in respect of any one person to the State or to any one municipality, district board, local board or other local authority in the State by way of taxes on professions, trades, callings and employments shall not exceed two thousand and five hundred rupees per annum.

(3) The power of the Legislature of a State to make laws as aforesaid with respect to taxes on professions, trades, callings and employments shall not be construed as limiting in any way the power of Parliament to make laws with respect to taxes on income accruing from or arising out of professions, trades, callings and employments.

Restrictions as to imposition of tax on the sale or purchase of goods.

286. (1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place—

(a) outside the State; or

(b) in the course of the import of the goods into, or export of the goods out of the territory of India.

(2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1).

(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of,—

(a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce; or

(b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or sub-clause (d) of clause (29A) of article 366,

be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify.

Exemption from taxes on electricity

287. Save in so far as Parliament may by law otherwise provide, no law of a State shall impose, or authorise the imposition of, a tax on the consumption or sale of electricity (whether produced by a Government or other persons) which is—

(a) consumed by the Government of India, or sold to the Government of India for consumption by that Government; or

(b) consumed in the construction, maintenance or operation of any railway by the Government of India or a railway company operating that railway, or sold to that Government or any such railway company for consumption in the construction, maintenance or operation of any railway,

and any such law imposing, or authorising the imposition of, a tax on the sale of electricity shall secure that the price of electricity sold to the Government of India for consumption by that Government, or to any such railway company as aforesaid for consumption in the construction, maintenance or operation of any railway, shall be less by the amount of the tax than the price charged to other consumers of a substantial quantity of electricity.

Exemption from taxation by States in respect of water or electricity in certain cases

288. (1) Save in so far as the President may by order otherwise provide, no law of a State in force immediately before the commencement of this Constitution shall impose, or authorise the imposition of, a tax in respect of any water or electricity stored, generated, consumed, distributed or sold by any authority established by any existing law or any law made by Parliament for regulating or developing any inter-State river or river-valley.

Explanation.—The expression "law of a State in force" in this clause shall include a law of a State passed or made before the commencement of this Constitution and not previously repealed, notwithstanding that it or parts of it may not be then in operation either at all or in particular areas.

(2) The Legislature of a State may by law impose, or authorise the imposition of, any such tax as is mentioned in clause (1), but no such law shall have any effect unless it has, after having been reserved for the consideration of the President, received his assent; and if any such law provides for the fixation of the rates and other incidents of such tax by means of rules or orders to be made under the law by any authority, the law shall provide for the previous consent of the President being obtained to the making of any such rule or order.

Freedom of trade, commerce and intercourse

301. Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free.

Power of Parliament to impose restrictions on trade, commerce and intercourse

302. Parliament may by law impose such restrictions on the freedom of trade, commerce or intercourse between one State and another or within any part of the territory of India as may be required in the public interest.

Restrictions on the legislative powers of the Union and of the States with regard to trade and commerce

303. (1) Notwithstanding anything in article 302, neither Parliament nor the Legislature of a State shall have power to make any law giving, or authorising the giving of, any preference to one State over another, or making, or authorising the making of, any discrimination between one State and another, by virtue of any entry relating to trade and commerce in any of the Lists in the Seventh Schedule.

(2) Nothing in clause (1) shall prevent Parliament from making any law giving, or authorising the giving of, any preference or making, or authorising the making of, any discrimination if it is declared by such law that it is necessary to do so for the purpose of dealing with a situation arising from scarcity of goods in any part of the territory of India.

Restrictions on trade, commerce and intercourse among States

304. Notwithstanding anything in Article 301 or Article 303, the Legislature of a State may by law—

(a) impose on goods imported from other States or the Union territories any tax to which similar goods manufactured or produced in that State are subject, so, however, as not to discriminate between goods so imported and goods so manufactured or produced; and

(b) impose such reasonable restrictions on the freedom of trade, commerce or intercourse with or within that State as may be required in the public interest: Provided that no Bill or amendment for the purposes of clause (b) shall be introduced or moved in the Legislature of a State without the previous sanction of the President.

366* Definition

In this Constitution, unless the context otherwise requires, the following expressions have meaning hereby respectively assigned to them, that is to say:

(12) 'goods' includes all materials, commodities and articles;

(28) "taxation" includes the imposition of any tax or impost, whether general or local or special, and "tax" shall be construed accordingly;

(29-A) "tax on the sale or purchase of goods" includes -

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) a tax on the delivery of goods on hire-purchase or any system of payment by installments;

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of person to a member thereof for cash, deferred or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration; and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

* * * * *

Power of Parliament to amend the Constitution and procedure therefore.

368*. *(1) Notwithstanding anything in this Constitution, Parliament may in exercise of its constituent power amend by way of addition, variation or repeal any provision of this Constitution in accordance with the procedure laid down in this article*

(2) An amendment of this Constitution may be initiated only by the introduction of a

Bill for the purpose in either House of Parliament, and when the Bill is passed in each House by a majority of the total membership of that House and by a majority of not less than two-thirds of the members of that House present and voting, it shall be presented to the President who shall give his assent to the Bill and thereupon the Constitution shall stand amended in accordance with the terms of the Bill:

Provided that if such amendment seeks to make any change in—

(a) article 54, article 55, article 73, article 162 or article 241, or

(b) Chapter IV of Part V, Chapter V of Part VI, or Chapter I of Part XI, or

(c) any of the Lists in the Seventh Schedule, or

(d) the representation of States in Parliament, or

(e) the provisions of this article,

the amendment shall also require to be ratified by the Legislatures of not less than one-half of the States by resolutions to that effect passed by those Legislatures before the Bill making provision for such amendment is presented to the President for assent.

(3) Nothing in Article 13 shall apply to any amendment made under this article

(4) No amendment of this Constitution (including the provisions of Part III) made or purporting to have been made under this article whether before or after the commencement of Section 55 of the Constitution (Forty second Amendment) Act, 1976 shall be called in question in any court on any ground

(5) For the removal of doubts, it is hereby declared that there shall be no limitation whatever on the constituent power of Parliament to amend by way of addition, variation or repeal the provisions of this Constitution under this article PART XXI TEMPORARY, TRANSITIONAL AND SPECIAL PROVISIONS

**** Proposed to be amended by 122nd Constitution (GST Amendment) Bill, 2014***

SIXTH SCHEDULE

[Articles 244(2) and 275(1)]

Provisions as to the Administration of Tribal Areas in the States of Assam, Meghalaya, Tripura and Mizoram

Powers to assess and collect land revenue and to impose taxes.

8. (1) The Regional Council for an autonomous region in respect of all lands within such region and the District Council for an autonomous district in respect of all lands within the district except those which are in the areas under the authority of Regional Councils, if any, within the district, shall have the power to assess and collect revenue in respect of such lands in accordance with the principles for the time being followed by the Government of the State in assessing lands for the purpose of land revenue in the State generally.

(2) The Regional Council for an autonomous region in respect of areas within such region and the District Council for an autonomous district in respect of all areas in the district except those which are under the authority of Regional Councils, if any, within the district, shall have power to levy and collect taxes on lands and buildings, and tolls on persons resident within such areas.

(3) ***The District Council for an autonomous district shall have the power to levy and collect all or any of the following taxes within such district, that is to say—***

(a) taxes on professions, trades, callings and employments;

(b) taxes on animals, vehicles and boats;

(c) ***taxes on the entry of goods into a market for sale therein, and tolls on passengers and goods carried in ferries *; and***

(d) taxes for the maintenance of schools, dispensaries or roads *.

(4) A Regional Council or District Council, as the case may be, may make regulations to provide for the levy and collection of any of the taxes specified in sub-paragraphs (2) and (3) of this paragraph and every such regulation shall be submitted forthwith to the Governor and, until assented to by him, shall have no effect.

* ***Proposed to be amended by 122nd Constitution (GST Amendment) Bill, 2014***

Press Information Bureau Government of India Ministry of Finance

04-December-2015 17:35 1ST

Goods and Service Tax on Alcohol and Products, Tobacco Etc.

The Government proposes to impose Goods and Service Tax (GST) on alcohol products except alcoholic liquor for human consumption. It is proposed in Constitution (122nd Amendment) Bill, 2014 that tobacco will be subjected to GST along with the Central Excise Duty. However, the rate of duty to be charged on this product will be decided by the GST Council as proposed in the Article 279A of the Constitution (122nd Amendment) Bill, 2014.

After introduction of GST, the VAT imposed by the states, Central Sales Tax, Excise Duty, Service Tax along with other indirect taxes would be subsumed into Goods and Service Tax. GST will simplify and harmonize the indirect tax regime in the country. It is also expected that introduction of GST will foster a common 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.

This was stated by Shri Jayant Sinha, Minister of State in the Ministry of Finance in written reply to a question in Lok Sabha today.

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ENTRIES IN SCHEDULE VII TO THE CONSTITUTION OF INDIA (RELATING TO INDIRECT TAXES)

SEVENTH SCHEDULE

(Article 246)

List I- Union List

1. Defence of India and every part thereof including preparation for defence and all such acts as may be conducive in times of war to its prosecution and after its termination to effective demobilization.
2. Naval, military and air forces; any other armed forces of the Union.

2A. Deployment of any armed force of the Union or any other force subject to the control of the Union or any contingent or unit thereof in any State in aid of the civil power; powers, jurisdiction, privileges and liabilities of the members of such forces while on such deployment.

3. Delimitation of cantonment areas, local self-government in such areas, the constitution and powers within such areas of cantonment authorities and the regulation of house accommodation (including the control of rents) in such areas.
4. Naval, military and air force works.
5. Arms, firearms, ammunition and explosives.
6. Atomic energy and mineral resources necessary for its production.
7. Industries declared by Parliament by law to be necessary for the purpose of defence or for the prosecution of war.
8. Central Bureau of Intelligence and Investigation.
9. Preventive detention for reasons connected with Defence, Foreign Affairs, or the security of India; persons subjected to such detention.
10. Foreign affairs; all matters which bring the Union into relation with any foreign country.
11. Diplomatic, consular and trade representation.
12. United Nations Organisation.

13. Participation in international conferences, associations and other bodies and implementing of decisions made thereat.
14. Entering into treaties and agreements with foreign countries and implementing of treaties, agreements and conventions with foreign countries.
15. War and peace.
16. Foreign jurisdiction.
17. Citizenship, naturalization and aliens.
18. Extradition.
19. Admission into, and emigration and expulsion from, India; passports and visas.
20. Pilgrimages to places outside India.
21. Piracies and crimes committed on the high seas or in the air; offences against the law of nations committed on land or the high seas or in the air.
22. Railways.
23. Highways declared by or under law made by Parliament to be national highways.
24. Shipping and navigation on inland waterways, declared by Parliament by law to be national waterways, as regards mechanically propelled vessels; the rule of the road on such waterways.
25. Maritime shipping and navigation, including shipping and navigation on tidal waters; provision of education and training for the mercantile marine and regulation of such education and training provided by States and other agencies.
26. Lighthouses, including lightships, beacons and other provision for the safety of shipping and aircraft.
27. Ports declared by or under law made by Parliament or existing law to be major ports, including their delimitation, and the constitution and powers of port authorities therein.
28. Port quarantine, including hospitals connected therewith; seamen's and marine hospitals.
29. Airways; aircraft and air navigation; provision of aerodromes; regulation and organisation of air traffic and of aerodromes; provision for aeronautical education and training and regulation of such education and training provided by States and other agencies.
30. Carriage of passengers and goods by railway, sea or air, or by national waterways in mechanically propelled vessels.
31. Posts and telegraphs; telephones, wireless, broadcasting and other like forms of communication.
32. Property of the Union and the revenue there from, but as regards property situated in a State subject to legislation by the State, save in so far as Parliament by law otherwise provides.

34. Courts of wards for the estates of Rulers of Indian States.
35. Public debt of the Union.
36. Currency, coinage and legal tender; foreign exchange.
37. Foreign loans.
38. Reserve Bank of India.
39. Post Office Savings Bank.
40. Lotteries organised by the Government of India or the Government of a State.
41. Trade and commerce with foreign countries; import and export across customs frontiers; definition of customs frontiers.
42. Inter-State trade and commerce.
43. Incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations, but not including cooperative societies.
44. Incorporation, regulation and winding up of corporations, whether trading or not, with objects not confined to one State, but not including universities.
45. Banking.
46. Bills of exchange, cheques, promissory notes and other like instruments.
47. Insurance.
48. Stock exchanges and futures markets.
49. Patents, inventions and designs; copyright; trade-marks and merchandise marks.
50. Establishment of standards of weight and measure.
51. Establishment of standards of quality for goods to be exported out of India or transported from one State to another.
52. Industries, the control of which by the Union is declared by Parliament by law to be expedient in the public interest.
53. Regulation and development of oilfields and mineral oil resources; petroleum and petroleum products; other liquids and substances declared by Parliament by law to be dangerously inflammable.
54. Regulation of mines and mineral development to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.
55. Regulation of labour and safety in mines and oilfields.
56. Regulation and development of inter-State rivers and river valleys to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.

57. Fishing and fisheries beyond territorial waters.

58. Manufacture, supply and distribution of salt by Union agencies; regulation and control of manufacture, supply and distribution of salt by other agencies.

59. Cultivation, manufacture, and sale for export, of opium.

60. Sanctioning of cinematograph films for exhibition.

61. Industrial disputes concerning Union employees.

62. The institutions known at the commencement of this Constitution as the National Library, the Indian Museum, the Imperial War Museum, the Victoria Memorial and the Indian War Memorial, and any other like institution financed by the Government of India wholly or in part and declared by Parliament by law to be an institution of national importance.

63. The institutions known at the commencement of this Constitution as the Benares Hindu University, the Aligarh Muslim University and the Delhi University; the University established in pursuance of article 371E; any other institution declared by Parliament by law to be an institution of national importance.

64. Institutions for scientific or technical education financed by the Government of India wholly or in part and declared by Parliament by law to be institutions of national importance.

65. Union agencies and institutions for—

    (a) professional, vocational or technical training, including the training of police officers; or

    (b) the promotion of special studies or research; or

    (c) scientific or technical assistance in the investigation or detection of crime.

66. Co-ordination and determination of standards in institutions for higher education or research and scientific and technical institutions.

67. Ancient and historical monuments and records, and archaeological sites and remains, declared by or under law made by Parliament to be of national importance.

68. The Survey of India, the Geological, Botanical, Zoological and Anthropological Surveys of India; Meteorological organisations.

69. Census.

70. Union Public Service; All-India Services; Union Public Service Commission.

71. Union pensions, that is to say, pensions payable by the Government of India or out of the Consolidated Fund of India.

72. Elections to Parliament, to the Legislatures of States and to the offices of President and Vice-President; the Election Commission.

73. Salaries and allowances of members of Parliament, the Chairman and Deputy Chairman of the Council of States and the Speaker and Deputy Speaker of the House of the People.

74. Powers, privileges and immunities of each House of Parliament and of the members and the Committees of each House; enforcement of attendance of persons for giving evidence or producing documents before committees of Parliament or commissions appointed by Parliament.

75. Emoluments, allowances, privileges, and rights in respect of leave of absence, of the President and Governors; salaries and allowances of the Ministers for the Union; the salaries, allowances, and rights in respect of leave of absence and other conditions of service of the Comptroller and Auditor General.

76. Audit of the accounts of the Union and of the States.

77. Constitution, organization, jurisdiction and powers of the Supreme Court (including contempt of such Court), and the fees taken therein; persons entitled to practice before the Supreme Court.

78. Constitution and Organisation (including vacations) of the High Courts except provisions as to officers and servants of High Courts; persons entitled to practice before the High Courts.

79. Extension of the jurisdiction of a High Court to, and exclusion of the jurisdiction of a High Court from, any Union territory.

80. Extension of the powers and jurisdiction of members of a police force belonging to any State to any area outside that State, but not so as to enable the police of one State to exercise powers and jurisdiction in any area outside that State without the consent of the Government of the State in which such area is situated; extension of the powers and jurisdiction of members of a police force belonging to any State to railway areas outside that State.

81. Inter-State migration; inter-State quarantine.

82. Taxes on income other than agricultural income.

83. Duties of customs including export duties.

84*. Duties of excise on tobacco and other goods manufactured or produced in India except—

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

85. Corporation tax.

86. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.

87. Estate duty in respect of property other than agricultural land.

88. Duties in respect of succession to property other than agricultural land.

89. Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.

90. Taxes other than stamp duties on transactions in stock exchanges and futures markets.

91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

92*. Taxes on the sale or purchase of newspapers and on advertisements published therein.

92A. Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.

92B. Taxes on the consignments of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce.

92C*. Taxes on services.

93. Offences against laws with respect to any of the matters in this List.

94. Inquiries, surveys and statistics for the purpose of any of the matters in this List.

95. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List; admiralty jurisdiction.

96. Fees in respect of any of the matters in this List, but not including fees taken in any court.

97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.

List II—State List

1. Public order (but not including the use of any naval, military or air force or any other armed force of the Union or of any other force subject to the control of the Union or of any contingent or unit thereof in aid of the civil power).

2. Police (including railway and village police) subject to the provisions of entry 2A of List I.

3. Officers and servants of the High Court; procedure in rent and revenue courts; fees taken in all courts except the Supreme Court.

4. Prisons, reformatories, Borstal institutions and other institutions of a like nature, and persons detained therein; arrangements with other States for the use of prisons and other institutions.

5. Local government, that is to say, the constitution and powers of municipal corporations, improvement trusts, districts boards, mining settlement authorities and other local authorities for the purpose of local self-government or village administration.

6. Public health and sanitation; hospitals and dispensaries.
7. Pilgrimages, other than pilgrimages to places outside India.
8. Intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors.
9. Relief of the disabled and unemployable.
10. Burials and burial grounds; cremations and cremation grounds.

* * * * *

12. Libraries, museums and other similar institutions controlled or Financed by the State; ancient and historical monuments and records other than those declared by or under law made by Parliament to be of national importance.
13. Communications, that is to say, roads, bridges, ferries, and other means of communication not specified in List I; municipal tramways; ropeways; inland waterways and traffic thereon subject to the provisions of List I and List III with regard to such waterways; vehicles other than mechanically propelled vehicles.
14. Agriculture, including agricultural education and research, protection against pests and prevention of plant diseases.
15. Preservation, protection and improvement of stock and prevention of animal diseases; veterinary training and practice.
16. Pounds and the prevention of cattle trespass.
17. Water, that is to say, water supplies, irrigation and canals, drainage and embankments, water storage and water power subject to the provisions of entry 56 of List I.
18. Land, that is to say, rights in or over land, land tenures including the relation of landlord and tenant, and the collection of rents; transfer and alienation of agricultural land; land improvement and agricultural loans; colonization.

* * * *

21. Fisheries.
22. Courts of wards subject to the provisions of entry 34 of List I; encumbered and attached estates.
23. Regulation of mines and mineral development subject to the provisions of List I with respect to regulation and development under the control of the Union.
24. Industries subject to the provisions of entries 7 and 52 of List I.
25. Gas and gas-works.
26. Trade and commerce within the State subject to the provisions of entry 33 of List III.
27. Production, supply and distribution of goods subject to the provisions of entry 33 of List III.
28. Markets and fairs.

* * * * *

30. Money-lending and money-lenders; relief of agricultural indebtedness.

31. Inns and inn-keepers.

32. Incorporation, regulation and winding up of corporations, other than those specified in List I, and universities; unincorporated trading, literary, scientific, religious and other societies and associations; co-operative societies.

33. Theatres and dramatic performances; cinemas subject to the provisions of entry 60 of List I; sports, entertainments and amusements.

34. Betting and gambling.

35. Works, lands and buildings vested in or in the possession of the State.

* * * * *

37. Elections to the Legislature of the State subject to the provisions of any law made by Parliament.

38. Salaries and allowances of members of the Legislature of the State, of the Speaker and Deputy Speaker of the Legislative Assembly and, if there is a Legislative Council, of the Chairman and Deputy Chairman thereof.

39. Powers, privileges and immunities of the Legislative Assembly and of the members and the committees thereof, and, if there is a Legislative Council, of that Council and of the members and the committees thereof; enforcement of attendance of persons for giving evidence or producing documents before committees of the Legislature of the State.

40. Salaries and allowances of Ministers for the State.

41. State public services; State Public Service Commission.

42. State pensions, that is to say, pensions payable by the State or out of the Consolidated Fund of the State.

43. Public debt of the State.

44. Treasure trove.

45. Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues.

46. Taxes on agricultural income.

47. Duties in respect of succession to agricultural land.

48. Estate duty in respect of agricultural land.

49. Taxes on lands and buildings.

50. Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:—

    (a) alcoholic liquors for human consumption;

    (b) opium, Indian hemp and other narcotic drugs and narcotics,

    but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

52*. Taxes on the entry of goods into a local area for consumption, use or sale therein.

53. Taxes on the consumption or sale of electricity.

54*. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

55*. Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

56. Taxes on goods and passengers carried by road or on inland waterways.

57. Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provisions of entry 35 of List III.

58. Taxes on animals and boats.

59. Tolls.

60. Taxes on professions, trades, callings and employments.

61. Capitation taxes.

62*. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.

64. Offences against laws with respect to any of the matters in this List.

65. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List.

66. Fees in respect of any of the matters in this List, but not including fees taken in any court.

List III—Concurrent List

1. Criminal law, including all matters included in the Indian Penal Code at the commencement of this Constitution but excluding offences against laws with respect to any of the matters specified in List I or List II and excluding the use of naval, military or air forces or any other armed forces of the Union in aid of the civil power.

2. Criminal procedure, including all matters included in the Code of Criminal Procedure at the commencement of this Constitution.

3. Preventive detention for reasons connected with the security of a State, the maintenance of public order, or the maintenance of supplies and services essential to the community; persons subjected to such detention.

4. Removal from one State to another State of prisoners, accused persons and persons subjected to preventive detention for reasons specified in entry 3 of this List.

5. Marriage and divorce; infants and minors; adoption; wills, intestacy and succession; joint family and partition; all matters in respect of which parties in judicial proceedings were immediately before the commencement of this Constitution subject to their personal law.

6. Transfer of property other than agricultural land; registration of deeds and documents.

7. Contracts, including partnership, agency, contracts of carriage, and other special forms of contracts, but not including contracts relating to agricultural land.

8. Actionable wrongs.

9. Bankruptcy and insolvency.

10. Trust and Trustees.

11. Administrators-general and official trustees.

11A. Administration of Justice; constitution and organisation of all courts, except the Supreme Court and the High Courts.

12. Evidence and oaths; recognition of laws, public acts and records, and judicial proceedings.

13. Civil procedure, including all matters included in the Code of Civil

Procedure at the commencement of this Constitution, limitation and arbitration.

14. Contempt of court, but not including contempt of the Supreme Court.

15. Vagrancy; nomadic and migratory tribes.

16. Lunacy and mental deficiency, including places for the reception or treatment of lunatics and mental deficients.

17. Prevention of cruelty to animals.

17A. Forests.

17B. Protection of wild animals and birds.

18. Adulteration of foodstuffs and other goods.

19. Drugs and poisons, subject to the provisions of entry 59 of List I with respect to opium.

20. Economic and social planning.

20A. Population control and family planning.

21. Commercial and industrial monopolies, combines and trusts.

22. Trade unions; industrial and labour disputes.

23. Social security and social insurance; employment and unemployment.

24. Welfare of labour including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits.

25. Education, including technical education, medical education and universities, subject to the provisions of entries 63, 64, 65 and 66 of List I; vocational and technical training of labour.

26. Legal, medical and other professions.

27. Relief and rehabilitation of persons displaced from their original place of residence by reason of the setting up of the Dominions of India and Pakistan.

28. Charities and charitable institutions, charitable and religious endowments and religious institutions.

29. Prevention of the extension from one State to another of infectious or contagious diseases or pests affecting men, animals or plants.

30. Vital statistics including registration of births and deaths.

31. Ports other than those declared by or under law made by Parliament or existing law to be major ports.

32. Shipping and navigation on inland waterways as regards mechanically propelled vessels, and the rule of the road on such waterways, and the carriage of passengers and goods on inland waterways subject to the provisions of List I with respect to national waterways.

33. Trade and commerce in, and the production, supply and distribution of,—

    (a) the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products;

    (b) foodstuffs, including edible oilseeds and oils;

    (c) cattle fodder, including oilcakes and other concentrates;

    (d) raw cotton, whether ginned or unginned, and cotton seed; and

    (e) raw jute.

33A. Weights and measures except establishment of standards.

34. Price control.

35. Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied.

36. Factories

37. Boilers.

38. Electricity.

39. Newspapers, books and printing presses.

40. Archaeological sites and remains other than those declared by or under law made by Parliament to be of national importance.

41. Custody, management and disposal of property (including agricultural land) declared by law to be evacuee property.

42. Acquisition and requisitioning of property.

43. Recovery in a State of claims in respect of taxes and other public demands, including arrears of land-revenue and sums recoverable as such arrears, arising outside that State.

44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.

45. Inquiries and statistics for the purposes of any of the matters specified in List II or List III.

46. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List.

47. Fees in respect of any of the matters in this List, but not including fees taken in any court.

"* Proposed to be amended by 122nd Constitution (GST Amendment) Bill, 2014"

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GST: 14TH FINANCE COMMISSION REPORT

Press Information Bureau Government of India Ministry of Finance*

24-February-2015 20:02 1ST

14th Finance Commission (FFC) Report Tabled in Parliament; FFC Recommends by Majority Decision that the States' Share in the Net Proceeds of the Union Tax Revenues be Raised to 42% Which is a Huge Jump from the 32%

Recommended by the 13th Finance Commission

Article 280 of the Constitution of India requires the Constitution of a Finance Commission every five years, or earlier. For the period from 1st April, 2015 to 31st March, 2020, the 14th Finance Commission (FFC) was constituted **by** the orders of President on 2nd January, 2013 and submitted its report on 15th December, 2014.

The Finance Commission is required to recommend the distribution of the net proceeds of taxes of the Union between the Union and the States (commonly referred to as vertical devolution); and the allocation between the States of the respective shares of such proceeds (commonly known as horizontal devolution).

With regard to vertical distribution, FFC has recommended **by** majority decision that the States' share in the net proceeds of the Union tax revenues be 42%. The recommendation of tax devolution at 42% is a huge jump from the 32% recommended **by** the 13th Finance Commission. The transfers to the States will see a quantum jump. This is the largest ever change in the percentage of devolution. In the past, when Finance Commissions have recommended an increase, it has been in the range of 1-2% increase. As compared to the total devolutions in 2014-15 the total devolution of the States in 2015-16 will increase **by** over 45%.

The consequence of this much greater devolution to the States is that the fiscal space for the Centre will reduce in the same proportion. As recorded in Chapter-8 of FFC s Report, amongst other demands of the States, the States had demanded both an increase in share of tax devolution, and a reduced role of CSS. In Paras 8.6 & 8.7 of its Report, the FFC has noted that

"8.6: ***Another dominant view has been that a majority of the resources should flow in the form of tax devolution— "***

"8.7: ***An overwhelming majority of States have suggested reducing the number of CSS as well as outlays on them—."***

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* *Source*: www.pib.nic.in

FFC has taken the view that tax devolution should be primary route of transfer of resources to States. It may be noted that in reckoning the requirements of the States, the FFC has ignored the Plan and Non-Plan distinction; it sees the enhanced devolution of the divisible pool of taxes as a "compositional shift in transfers from grants to tax devolution" (Para 8.13 of FFC Report). Thus, basically the FFC Report expects the CSS, in fact Central assistance to State Plans as a whole, to reduce and be replaced **by** greater devolution of taxes.

Keeping in mind the spirit of cooperative federalism that has underpinned the creation of National Institution for Transforming India (NITI), the Government has accepted the recommendation of the FFC to keep the States' share of Union Tax proceeds (net) at 42%.

In recommending horizontal distribution, the FFC has used broad parameters of population (1971) and changes of population since, income distance, forest cover and area. The details of this criteria and the weight assigned to them are given in **Annexure-1.** The State-wise share of the divisible pool of Central taxes, in percentage terms, is given in **Annexure-2.** As service tax is not levied in J&K, the share of the States, in percentage terms has been calculated separately by FFC. These are given in **Annexure-3.**

The Finance Commission is also required to recommend on 'the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State'.

FFC has recommended distribution of grants to States for local bodies using 2011 population data with weight of 90% and area with weight of 10%. The grants to States will be divided into two, a grant to duly constituted Gram Panchayats and a grant to duly constituted Municipal bodies, on the basis of rural and urban population.

FFC has recommended grants in two parts; a basic grant, and a performance grant, for duly constituted Gram Panchayats and municipalities. The ratio of basic to performance grant is 90:10 with respect to Panchayats and 80:20 with respect to Municipalities.

FFC has recommended out a total grant of Rs 2,87,436 crore for five year period from 1.4.2015 to 31.3.2020. Of this the grant recommended to Panchayatas is Rs 2,00,292.20 crores and that to municipalities is Rs 87,143.80 crores. The transfers in the year 2015-16 will be Rs 29,988 crores. Inter-se share of each state in respect of local bodies grant is at **Annexures-4 and 5.**

The Government has accepted the recommendations of the Finance Commission with regard to grants to local bodies. The Finance Commission is also required to 'review the present arrangements as regards financing of Disaster Management with reference to the National Calamity Contingency Fund and the Calamity Relief Fund and the funds envisaged in the Disaster Management Act, 2005 (Act 53 of 2005), and make appropriate recommendations thereon'.

FFC has recommended that up to 10 percent of the funds available under the SDRF can be used by a State for occurrences which State considers to be 'disasters' within its local context and which are not in the notified list of disasters of the Ministry of Home Affairs. The FFC has noted in Para 10.26 as follows:

"The financing ofNDRF has so far been almost wholly through the levy of cess on select items, but if the cess are discontinued or when they are subsumed under the Goods and Services Tax (GST) in future, we recommend that the Union Government consider ensuring an assured source offunding for NDRF

In view of the above, with regard to disaster relief, the Government has decided that the percentage share of the States will continue to be as before, and that the flows will also be of the same order, as in the existing system; and that, once GST is in place, the recommendation of FFC on disaster relief would be implemented in the manner recommended by the Finance Commission.

The Finance Commission is also required to make recommendation regarding the principles governing grants-in-aid of the States' revenues, by the Centre. As noted by the FFC in Para 11.28, while calculating grants to the States they "have departed significantly from previous Finance Commissions, by taking into consideration a States' entire revenue expenditure needs without making a distinction between Plan and Non-Plan". Taking thus into account the expenditure requirements of the States, the tax devolution to them, and the revenue mobilization capacity of the States, the FFC have recommended "Post-Devolution Revenue Deficit Grants" of a total of Rs. 1,94,821 crores, for the five year period. The States of Andhra Pradesh, Assam, J&K, Himachal Pradesh, Kerala, Manipur, Meghalaya, Mizoram, Nagaland, Tripura and West Bengal (a total of 11 States) have been identified for receiving these revenue deficit grants. The details are given in **Annexure-6.** The Government has accepted the recommendation in principle.

To summarize, the Grants-in-Aid to the States total to Rs. 5.37 lac crores is given in the Table given below:

Grants-in-Aid to States

		(Rs. crore)
1.	Local Government (all States)	287436
2.	Disaster Management (all States)	55097
3.	Post-devolution Revenue Deficit (11 States)	194821
4.	**Total**	**537354**

As stated above, the compositional shift recommended by the FFC would substantially impact Central Assistance. In this regard, para 7.43 of the FFC Report states as follows :

"Plan revenue expenditure of States is financed by States' own resources, borrowing and Plan grants from the Union. The Plan grants include normal Central assistance, which is untied, additional Central assistance for specific-purpose schemes and transfers,special Plan assistance.special Central assistance.Central Plan schemes and CSS.For the purpose of our assessment of Plan revenue expenditure of States, we have included expenditure incurred on State Plans and States' contribution to CSS. This excludes Union expenditure on CSS, central Plan schemes and North Eastern Council Plan schemes and externally aided projects financed through grants from the Union. We have estimated the 2014-15 base year Plan revenue expenditure (as defined above) for each State, applying an annual growth rate of 13.5 per cent over 2012-13 and 2013-14. For the purpose of our projection period, we have assumed an annual growth rate of 13.5 per cent over base year estimates for all the States, implying that the Plan revenue expenditure will increase at the same rate as the GDP growth rate."

Based on the above, over 30 Centrally Sponsored Schemes have been identified which ought to have been transferred to the States because expenditure on them has already been taken into account as State expenditure, in arriving at the greater devolution of 42% to the States. However, keeping in mind that many of these schemes are national priorities, and some are legal obligations (such as MGNREGA) and in order to underline the Central Government's continued support to national priorities, especially with regard to schemes meant for the poor, most of these are proposed to be continued. The Government has decided that only 8 Centrally Sponsored Schemes be delinked from support from the Centre.

Certain programmes of the Government will have to continue unaltered as they are either legal/Constitutional obligations, or are privileges available to the elected representatives for welfare of their constituents. Further, and more importantly it is proposed that the Union Government may continue to support certain programmes which are for the benefit of the socially disadvantaged in an unaltered manner from its own resources.

In respect of various Centrally sponsored schemes, the sharing pattern will have to undergo a change with States sharing a higher fiscal responsibility for scheme implementation. Details of changes in sharing pattern will have to be worked out by the administrative Ministry/Department on the basis of available resources from Union Finances.

Other recommendations of the FFC

In addition to the recommendations regarding Vertical, and Horizontal devolution and grants, the FFC has made certain other recommendations. These relate to cooperative federalism, Goods & Services Tax, Fiscal Consolidation Roadmap, Pricing of Public Utilities and Public Sector Enterprises. The recommendations of the Finance Commission will be examined by the Government in due course in consultation with the concerned stakeholders. Click here to see **Annexure.**

13.1 Our TOR 6(xi) requires us to consider "the impact of the proposed Goods and Service Tax on the finances of Centre and States and the mechanism for compensation, in case of any revenue loss". After the introduction of value added tax (VAT) in the fiscal year 2005-06, further reform of indirect taxes for evolving a comprehensive and broad based goods and services tax (GST) has been under consideration since 2007.[1] Although the implementation of GST has been delayed,there has been a steady expansion of the base of service taxation over the years. A series of changes have taken place in the taxation of services since its introduction, both by bringing in more services under the tax net and by periodic revision of the rates of taxation.

13.2 In the fiscal year 2010-11, the Union Government was levying service tax on 104 selected services. The Union Budget 2012-13 introduced the concept of a negative list in service taxation, which implied that except for certain identified services, all other services would be subject to taxation. Seventeen services were placed in the negative list that year. The introduction of the negative list concept has, to a large extent, rendered the tax base comprehensive and eliminated selectivity and discretion in service taxation and has contributed to an increase inrevenue growth. Revenue growth in 2012-13 over 2011-12 was 36.0 per cent and is projected to be 24.4 per cent and 31.0 per cent in 2013-14(RE) and 2014-15 (BE) respectively. The share of service tax in total tax revenue is expected to

[1]The Union Finance Minister made an announcement that GST would be introduced from 1 April 2010 in his Budget speech of 2007-08

increase from 10.9 per cent in 2011-12 to 15.8 per cent in 2014-15 (BE). The Union Finance Minister, in his 2014-15 Budget speech, emphasised the need for early implementation of GST and assured that the Union Government would be fair when it comes to the question of the fiscal autonomy of States and compensation to them for any revenue loss.[2]

Views of Previous Finance Commissions

13.3 The FC-XIII appointed a task force on GST and recommended a single rate of 5 per cent for Central GST and 7 per cent for State GST, based on the report of this task force. It also recommended a uniform threshold of Rs 10 lakh for goods and services under both the levies and uniform treatment for both goods and services to avoid classification disputes. The GST design proposed by the FC-XIII limited the exemption from the tax to public services of the government, unprocessed food under the public distribution scheme, health and education services. The design also included motor spirit, alcohol and tobacco under GST as a creditable levy. It also recommended a compensation amount of Rs. 50,000 crore, in case of revenue loss to the States, for five years from 2010-11 to 2014-15.

Views of the Union Government

13.4 In its memorandum to the Commission, the Union Government mentioned that it had envisaged progress in the implementation of GST during the award period of the FC-XIII. It explained that this did not happen owing to the long process of building consensus between the Union and the States, along with the time required in undertaking the necessary Constitutional amendments.

13.5 The Union Government, in its subsequent submission on GST to the Commission, stated that key aspects like tax base and rate, exemption limit and place of supply rule for services, are still evolving. It said that in the absence of clarity on these issues, it is not possible to assess the likely impact of GST. The Union Government also emphasised that GST rates should be as close to the revenue neutral rate (RNR) as possible, so that revenue loss is minimised.

13.6 The Union Government has explained that the RNR of the States should take into account the revenue loss to the States due to abolition of Central sales tax (CST). It urged that since the CST rates has already been brought down from 4 per cent to 2 per cent, the revenue loss be estimated not on the basis of 4 per cent CST, as was done by the Empowered Committee of State Finance Ministers, but at the current rate of 2 per cent CST. According to the Union Government's estimates, with this adjustment alone, the revenue loss for the year 2012-13 would be only Rs. 46,500 crore as against Rs. 93,000 crore estimated by the Empowered Committee. It has also been highlighted by the Union Government that Empowered Committee of State Finance Ministers' estimate does not take into

[2] "The debate whether to introduce a Goods and Services Tax (GST) must now come to an end. We have discussed the issue for the past many years. Some States have been apprehensive about surrendering their taxation jurisdiction; others want to be adequately compensated. I have discussed the matter with the States both individually and collectively. I do hope we are able to find a solution in the course of this year and approve the legislative scheme which enables the introduction of GST. This will streamline the tax administration, avoid harassment of the business and result in higher revenue collection both for the Centre and the States. I assure all States that government will be more than fair in dealing with them." (Budget Speech 2014-15, 10 July 2014, pp. 3-4).

consideration the gains accruing due to GST, in terms of better tax compliance and higher economic growth.

13.7 On the question of an independent Constitutional mechanism for compensation of revenue loss, as demanded by the States, the Union Government argued that this was not necessary as compensation is a temporary feature. It has proposed the creation of a GST compensation fund through a Union legislation, in order to allay the fears of the States. It also proposed that an autonomous body may be constituted to study the impact of GST on Union and State finances and also to recommend the quantum of compensation to each State. This would be based on a common formula to be applied on each State for arriving at the actual revenue loss it would face. It also mooted the idea of working out an independent mechanism for directly transferring funds from the Union's resources to this proposed GST compensation fund in order to bridge the trust deficit between the Union and the States.

Views of the State Governments

13.8 States, in their submissions have generally favoured the implementation of GST and focussed their stand on five critical issues: (i) revenue compensation, including the issue of pending CST compensation; (ii) goods and services that should come under the purview of GST; (iii) state-specific issues with regard to inclusion/exclusion of specific taxes having implication on the GST design; (iv) issues related to RNR; and (v) capacity building.

Revenue Compensation

13.9 The main concern about compensation highlighted by the States are (a) proper estimation of revenue loss and corresponding compensation package, (b) a credible compensation mechanism and (c) the period of compensation. A few States have suggested that a GST compensation fund may be created under the GST Council. States have also urged that all pending CST claims for the year 2010-11, 2011-12 and 2012-13 should be released by the Union Government.

State Taxes to be Subsumed Under GST

13.10 There are differing views across States regarding the list of goods to be subsumed under GST. States have argued that motor spirits and alcohol should remain outside GST and they should be allowed to levy higher rates of tax on these products. One State has raised an apprehension on the powers to be given to the GST Council, as it may come directly in conflict with the legislative powers of States.

Exemption of Specific Goods and Services

13.11 States have suggested that they should be allowed to exempt certain goods of local importance from the purview of GST. The States levying purchase tax are strongly in favour of retaining it outside GST. A few States are also of the view that that the GST design should provide flexibility for the levy of any separate entry tax/cess entertainment tax for the purpose of transferring it to local bodies. Further, some flexibility in the design of GST to enable levying a "Green Tax" on certain polluting goods has been suggested by some States.

Revenue Neutral Rate

13.12 Some States have suggested that the RNR should be determined on the basis of a robust study by the Union Government or the FC-XIV. A few States have argued that although a uniform GST rate is desirable, States should be given some flexibility in deciding the rates of GST within a band. One State has argued that GST with a uniform rate would erode the autonomy of States. A few States have suggested that the rate of CST may be increased to 4 per cent till GST is introduced.

Capacity Building

13.13 Many States have suggested that a one-time grant awarded by the FC-XIV for capacity building and strengthening the administration would be desirable. According to the States, capacity building for improving the accounting system, forms and procedures, assessment, auditing and computerisation of the administration would be a prerequisite for a successful outcome of GST. They accordingly suggested a special grant for upgradation of information systems and training of personnel for GST.

Meeting with the Empowered Committee

13.14 We had a meeting with the Empowered Committee of State Finance Ministers in September 2014. The meeting facilitated our interaction with individual States and the Ministry of Finance, Government of India on the progress of the implementation of GST.

13.15 In the meeting, Secretary of the Empowered Committee summarised the consensus on the following matters. It would be a dual GST model implemented through multiple statutes (one for the Central GST and the other for State GST) on a destination-based principle. The Central GST and the State GST would be applicable to all transactions of goods and services except those which were exempted and those goods outside the purview of the GST and transaction below the threshold limits. The State taxes and levies to be subsumed under GST are VAT/sales tax, entertainment tax, luxury tax, taxes on lottery, betting and gambling, States' cesses and surcharges relating to the supply of goods and services and entry tax not in lieu of octroi. The State taxes proposed to be kept outside the purview of GST are those on petroleum products, alcohol for human consumption, tobacco and entry tax in lieu of octroi. However, States levying purchase tax wanted to retain this tax outside the purview of GST.

13.16 The Secretary, Empowered Committee, explained that the revenue gains from GST will come from the levy of State GST on services and on imports into States. However, according to him, the adverse revenue impact of the proposed GST on the finances of the States would arise mainly on account of the abolition of CST as well as the removal of cascading effect and the corresponding increase in input tax credit. The Secretary indicated that while some States may gain from this, many would suffer a revenue loss and would need to be compensated by the Union Government. He added that some States wanted a separate compensation to be given for any loss arising from subsuming the purchase tax on agricultural products if it is subsumed under the GST. He mentioned that the total GST loss, as estimated by the Empowered Committee taking into consideration these factors for the year 2012-13, worked out to be Rs, 96,500 crore.

13.17 The Secretary mentioned that the impact of the proposed GST would be different across States. He explained that as the GST is a destination-based tax, the respective RNR for individual State and Union Territories would vary substantially depending on whether it is a consuming State or a manufacturing State. It was also mentioned that it would be difficult to assess the gain from the inclusion of services in the base. He made it clear that RNR needs to be worked out for the entire country, after due consideration by the proposed GST Council and needs to be adopted by all States with consensus. He recognised that the introduction of GST may result in better tax compliance and may provide an impetus to higher growth in gross domestic product (GDP), but added that it would be difficult to make an assessment of such gains and take them into account while the RNR was being worked out by the Empowered Committee.

13.18 The Secretary, Empowered Committee, also highlighted the important issue of the need for adequate compensation and a compensation mechanism in case of revenue loss after the implementation of the GST. He said many States had pointed out the unsatisfactory experience in getting CST compensation from the Union Government, resulting in a trust deficit between the two levels of governments. Hence, the States wanted an independent mechanism through which the GST compensation should be paid to them. It was argued that since the loss on account of implementation of GST would be of permanent nature and that it would take nearly five years to reap the benefits of GST, full compensation for five years needs to be given to the States. **He added that the Parliamentary Standing Committee on Finance has also emphasised the need for an automatic compensation mechanism. He emphasised that States endorsed the recommendations of the Standing Committee to institute a well-defined automatic compensation mechanism. The suggestion was to create the GST compensation fund under the administrative control of GST Council to address the legitimate revenue concern of the States.**

13.19 The Secretary, Empowered Committee, pointed out that the FC-XIII gave its recommendations on GST and GST compensation at a time when the Union and the States were in the initial stages of implementing GST. He added that a final decision about the structure of GST would soon emerge since sufficient ground has since been covered and States are more or less in agreement with the basic design, exemptions and commodities to be kept in the lower rate etc. He clarified that a final decision would include GST rates, threshold, composition scheme and exemptions.

13.20 We were requested by the Secretary, Empowered Committee, to take all the above issues into consideration while formulating our recommendations about the impact of the proposed GST on State revenues and GST compensation, based on the design of GST broadly agreed upon and also keeping in view the recommendations made by the Parliamentary Standing Committee on Finance.

13.21 In the meeting, a majority of the States stated that they were in broad agreement with the suggestions, views, opinions and recommendations of the Empowered Committee as placed before the Finance Commission. All of them reiterated their apprehensions on the revenue loss and raised the issue of some of the taxes to be subsumed under the proposed GST. They also raised the issue of keeping some of the goods like petroleum products, alcohol for human consumption, tobacco out of the purview of GST. State-specific concerns were raised on the issue of entry tax in lieu of octroi, compensation package, a separate and independent compensation fund under the administrative control of the GST Council, automatic compensation mechanism and the quantum of compensation.

13.22 The North-eastern States were in agreement with the issues raised by different States and mentioned that adequate compensation should be paid for the revenue loss. The representatives of Union Territories requested the Commission to consider the issue of amending Article 270 and 280 of the Constitution so as to enable the Union Territories to be treated equally with the States. The Union Territories welcomed the introduction of GST and agreed with the issues raised by various States on the impact of the proposed implementation of GST.

13.23 The representative from the Ministry of Finance conveyed the Union Government's view on the concerns of the States regarding the impact of the proposed implementation of GST and the revenue losses that were likely to result. It was clarified that the Union Government would compensate the States if the introduction of GST results in a revenue loss to them. The representative also highlighted the quantum of compensation already paid to the States on account of abolition of CST.

13.24 We gathered from the meeting that there is a significant trust deficit on the part of the States vis-a-vis the Union (whether warranted or not) on the issue of CST compensation. The States, therefore, insisted on an independent compensation mechanism outside the Ministry of Finance. The representative of the Ministry of Finance assured that an independent compensation mechanism will be put in place in the GST regime.

Revenue Implications of GST& Compensation

13.25 We recognise that while tax reform involving both Union and State Governments is not an easy task in a complex federal system like India, it is a process which would help in building a more harmonised tax structure and minimise distortions. We are of the view that a broad based tax like GST would help develop a common market and, in turn, would help increase economic growth and revenue outcome. We also hope that the application of technology in tax administration would result in higher revenue gain. **We expect that the final GST design would have all the characteristics of a good tax system such as broad base, low rate, minimum rate differentiation, low compliance cost and reduced distortions to the economy.**

13.26 Our mandate is to examine the impact of the proposed GST on the finances of the Union and States and suggest a mechanism of compensation in case of any revenue loss. **There are several challenges and many unresolved issues. In the absence of clarity on the design of GST and the final rate structure,we are unable to estimate revenue implications and quantify the amount of compensation in case of revenue loss to the States due to the introduction of GST.**

13.27 In our assessment of Union finances, we were unable to explicitly factor in the quantum of compensation required in the event of introduction of GST during our award period for the reasons cited above. However, we recognise that States should be provided with the assurance of compensation by the Union. **The Union Government may have to initially bear an additional fiscal burden arising due to the GST compensation.This fiscal burden should be treated as an investment which is certain to yield substantial gains to the nation in the medium and long run. We also believe that GST compensation can be accommodated in the overall fiscal space available with the Union Government.** At the same time, States should keep broader public interest of the nation as a whole, and long-term interest of each of the States, and contribute to a consensus on this issue. In order to facilitate a speedy resolution of major issues in this subject of great national interest, we make the following suggestions for consideration of the Union and States relating to (a) period of GST compensation, (b) legal status of the compensation fund and (c) universal application of the GST regime.

Period of GST Compensation

13.28 **Introduction of GST in the country may lead to revenue losses for a few years to some States, as GST marks a shift from an origin-based system of indirect taxes to a destination-based system.** However, as GST will broaden the tax base, result in better tax compliance, and lead to higher growth in the economy, it is expected that the revenue earnings of the States will stabilise in a few years. Therefore, to ensure that the States do not face undue financial hardship in the initial years, the Union Government may compensate the States on a tapering basis for a period of five years for the revenue losses calculated as the difference between projected and actual revenues. We have, in this regard, the precedent of VAT. **In the case of VAT, compensation was provided to the States for three years, at 100 per cent in the first year, 75 per cent in the second year, and 50 per cent in the third year. In our view, it will be appropriate to keep this precedent as the basis for compensation for GST also. However, given the scale of reform and the apprehensions of revenue uncertainty raised by the States, the revenue compensation, in our view, should be for five years. It is suggested that 100 per cent compensation be paid to the States in the first, second and third years, 75 per cent compensation in the fourth year and 50 per cent compensation in the fifth and final year.**

Legal Status of GST Compensation Fund

13.29 The Commission recommends that a GST Compensation Fund be set up by the Union to compensate the States for their revenue losses. States have been demanding that the GST Compensation Fund must be created Constitutionally. As already mentioned, this insistence on an appropriate institutional arrangement arises from considerable doubts that States have about the Union discharging its obligations. However, the Union Government noted that since the compensation would be a temporary feature, there appears to be no requirement of creating the Fund through a Constitutional provision. We believe that in the interest of a resolution of the issue, acceptable and appropriate institutional arrangements should be put in place to allay the fears of States**.We, therefore, recommend the creation of an autonomous and independent GST Compensation Fund through legislative actions in a manner that it gives reasonable comfort to States, while limiting the period of operation appropriately.**

Universal Application of GST Regime

13.30 There is merit in the universal application of GST in order to have a comprehensive base and, in the long run, all goods and services should be brought under the ambit of GST. In particular, exclusion of any goods from the ambit of GST through Constitutional guarantee is not desirable. This could lead to leakages of revenues due to disruption of tax credit chain and audit trails and would continue to have the problem of cascading. Further, the origin-based distortionary CST presently levied on inter-State sales of goods would have to be dispensed with once universalisation is achieved. **We, therefore, recommend that the Constitutional legislative and design aspects of the GST enable**

transition towards universal application of GST over the medium to long term, while making necessary provisions for smooth transition through temporary arrangements.

Recommendations

i. There are several challenges and many unresolved issues. In the absence of clarity on the design of GST and the final rate structure, we are unable to estimate revenue implications and quantify the amount of compensation in case of revenue loss to the States due to the introduction of GST. (para 13.26)

ii. The Union may have to initially bear an additional fiscal burden arising due to the GST compensation. This fiscal burden should be treated as an investment which is certain to yield substantial gains to the nation in the medium and long run. We also believe that GST compensation can be accommodated in the overall fiscal space available with the Union Government. (para 13.27)

iii. In the case of VAT, compensation was provided to the States for three years, at 100 per cent in the first year, 75 per cent in the second year and 50 per cent in the third year. In our view, it will be appropriate to keep this precedent as the basis for compensation for GST also. However, given the scale of reform and the apprehensions of revenue uncertainty raised by the States, the revenue compensation, in our view, should be for five years. It is suggested that 100 per cent compensation be paid to the States in the first, second and third years, 75 per cent compensation in the fourth year and 50 per cent compensation in the fifth and final year. (para 13.28)

iv. We recommend creation of an autonomous and independent GST Compensation Fund through legislative actions in a manner that it gives reasonable comfort to States, while limiting the period of operation appropriately. (para 13.29)

v. We, therefore, recommend that the Constitutional legislative and design aspects of the GST enable transition towards universal application of GST over the medium to long term, while making necessary provisions for smooth transition through temporary arrangements. (para 13.30)

D-5

REPORT OF THE SELECT COMMITTEE OF RAJYA SABHA

PARLIAMENT OF INDIA RAJYA SABHA

REPORT OF THE SELECT COMMITTEE

ON

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

PRESENTED TO THE RAJYA SABHA ON 22nd July, 2015

Rajya Sabha Secretariat, New Delhi
22nd July, 2015/Ashadha, 1937 (Saka)

REPORT

CHAPTER- I

INTRODUCTION

1.1 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 **(Annexure-I)** moved by the Minister of Finance, Corporate Affairs and Information and Broadcasting, was referred to the Select Committee for examination and the Committee was asked to submit its Report by the last day of the first week of the next Session(Monsoon Session).

1.2 The Bill contains 21 clauses on which the Committee has been asked to submit a report and these clauses proposes to, inter alia, amend Constitution of India by inserting new Articles-246 A, 269A and 279 A 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.

1.3 By bringing this bill into effect, the Govt. 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.

1.4 This bill is a next step forward towards a comprehensive indirect tax reform in the country after the introduction of Value Added Tax (VAT). Though the indirect tax system in the country has been going through a series of reforms over the last two decades and one of them is the introduction of Value Added Tax called, CENVAT at the Central level providing credit of tax paid on inputs and capital goods upto the manufacturing stage and Subsequently, in 1994, a tax on services (commonly known as Service Tax) was introduced by the Centre. The Service Tax with the passage of time expanded its domain to cover more services and now applies to about 115 service categories which contributed 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.

1.5 In spite of the fact that many of the aforesaid measures have been taken, goods and services continue to be bogged down with multiple indirect taxes at different stages of the value chain with significant tax cascading under the present indirect tax regime and therefore a need to introduce GST was strongly felt.

1.6 In international arena GST is known for its end user consumption tax. The broad objectives of introducing the Goods and Services Tax (GST) would widen the tax base through the coverage of multifarious economic activities into its ambit and by cutting down exemptions; mitigate cascading and double taxation and enabling better compliance through the lowering of overall tax burden on goods and services. By doing away with latent or embedded taxes, it would provide leeway for the competitiveness of domestic industry vis-a-vis imports and in international markets. Unifying the tax structure across States, the new scheme of tax regime would pave way for a common national market for goods and services.

1.7 The proposal for the introduction of GST was first mooted in the Budget Speech for the financial year 2006-07. Since then, detailed deliberations and negotiations were held with the Empowered Committee of State Finance Ministers (EC) on the topic. The 115th Constitutional (Amendment) Bill, 2011, for the introduction of GST was first introduced in the Lok Sabha in March 2011. The Bill was referred to a Parliamentary Standing Committee (PSC) which submitted its report in August 2013. The Bill however lapsed with the dissolution of the 15th Lok Sabha.

Rationale behind moving towards GST:

1.8 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.

1.9 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'.

1.10 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.

1.11 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.

1.12 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.

Roadmap for the implementation of GST:

1.13 Amendment of the Constitution: Government introduced on 19.12.2014 the Constitution (122nd) Amendment Bill, 2014 in the Lok Sabha for amending the Constitution of India to facilitate introduction of Goods and Services Tax (GST) in the country. The Bill has been passed by the Lok Sabha on 06.05.2015 and is pending in Rajya Sabha. After the Bill is passed in both the Houses of the Parliament by two-thirds majority, the Constitutional Amendment Bill will be sent to State Legislatures for ratification. The ratification by at least 50% of the State Legislature will be required before the proposed amendments are brought in effect.

1.14 Enactment of enabling legislation in the Centre and States: For the levy of CGST, SGST and IGST, a set of three laws would need to be enacted. CGST and IGST laws would need to be enacted by the Parliament, and the SGST law would have to be enacted by each of the State Legislatures.

Status on design and mechanics of GST:

1.15 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, GOI, 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.

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

1.16 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.

<u>Deliberations</u>

1.17 The Committee held its first meeting on 22nd May, 2015. At its introductory meeting the Committee decided to chalk out its future course of action. As the State Governments were the main stakeholders, it was unanimously decided by the Committee to seek their written views on the Bill by 5th June, 2015. The Members were also requested to suggest the names of the Experts/stakeholders to be heard by the Committee.

1.18 In response thereto, the Committee received written memorandum from the State Governments of Madhya Pradesh, Bihar, Odisha, Himachal Pradesh, Uttar Pradesh, Punjab, Sikkim, UT of Puducherry, Maharashtra, Chhattisgarh, Goa, Gujarat, Kerala, West Bengal, Tamil Nadu, Karnataka and Assam.

The Committee heard the views of the Secretaries of Ministries of Finance (Department of Revenue) and Law & Justice (Legislative Department) on the Bill.

1.19 Secretary, Department of Revenue made a presentation before the Committee informing the Committee about a brief history and background of the Bill and the reason and purpose to bring about the constitutional Amendments proposed in the Bill.

1.20 The Committee held its second meeting on 29th May, 2015. As the Bill was going to have a wider implication on the Municipal Bodies and Gram Panchayat, the Committee invited Ministries of Urban Development and Panchayati Raj in the meeting. In addition to this, the Secretaries, Ministries of Finance (Department of Revenue) and Law and Justice (Legislative Department) had also been invited to be present in the meeting to clarify points/issues, if any, being raised by the Members on the Bill.

1.21 In his deposition before the Committee, Secretary, Ministry of Urban Development highlighted the importance of the Municipalities in the wake of urbanization and also thereby deteriorating the quality of life in the cities. He also emphasized that due to urbanization and their meager financial resources to cope with the demands of their present needs, these municipalities were facing unprecedented cash flow problems so the basic infrastructure in the cities has deteriorated to a great extent though on a comparable scale the life in cities has been more rewarding and comfortable than that of countryside. So, by way of the proposed constitutional amendment, the Ministry expected some positive changes in the present scenario whereby financial independence of the local bodies including gram panchayat could be realized in the new scheme of things and these bodies could match up and cope up with the demands and pressure being exerted on their resources and may not remain financially dependent on the sweet will of their respective states. In his deposition, before the Committee, Secretary, Panchayati Raj endorsed the views expressed by Secretary, Urban Development.

1.22 As the Bill was of very vast nature and has been described as a reform measure of unparalleled importance in the sphere of Indian Taxation regime in independent India, the Committee felt that State Governments being major stakeholders, their views would be crucial in preparation of Report on the Bill. Therefore, the Committee decided to undertake a study visit to Chennai, Kolkata and Mumbai from 21st to 25th June, 2015 to interact with the representatives of the various State Governments, Public and Private authorities/ organisations/ financial institutions, etc on the Bill.

1.23 During its visit to Chennai, Kolkata and Mumbai, the Committee heard the views of the State Governments/ UTs of Tamil Nadu, Puducherry, Kerala, West Bengal, Maharashtra, Gujarat and Goa. Apart from this the Committee also heard the views of the experts namely Dr. V. Bhaskar, Former Special Chief Secretary, Finance Department, Govt. of Andhra Pradesh, Dr. Partho Shome, Former Chairman, Tax Administration Reforms Commission, Dr. Asim Das Gupta, Former Finance Minister, Govt. of West Bengal including the Industrial Houses i.e. CII, ASSOCHAM and FICCI on the Bill.

1.24 In addition to this, the Committee also heard the views of financial institutions/ Associations/Organisations during the visit of the Committee. A list of the same is enclosed at **Annexure-II**

1.25 The Committee received 58 Memoranda from State Governments/ Experts/other Stakeholders. These Memoranda were transmitted to the Ministry of Finance (Department of Revenue) for their comments and suggestions. While framing the specific and general recommendations on the Bill, the Committee has duly taken into consideration the suggestion made by the State Government/experts/other Stakeholders and the Department of Revenue on these memoranda.

CHAPTER-II

CLAUSE BY CLAUSE CONSIDERATION

Clause 1

2.1 This clause provides for short title and commencement of the Constitution (Amendment) Bill.

Recommendation

2.2 **This clause has been adopted with no change.**

Clause 2

2.3 This clause makes enabling provisions for the Union and States with respect to GST.

2.4 Sub-clause (1) of this clause seeks to provide that 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.

2.5 Sub-clause (2) of the said clause seeks to provide that 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 with an explanation that that provision of this article in respect of goods and services tax referred to in clause (5) of article 279A, that is, on petroleum crude, high speed diesel, petrol, natural gas and aviation turbine fuel shall take effect from the date recommended by the Goods and Services Tax Council.

2.6 In respect of this clause, apprehensions were expressed by some Members that the clause may affect the powers of the State Governments mentioned under the concurrent list. In this regard, the Committee felt that their apprehensions were unwarranted as the clause will not affect any powers of the State Government under concurrent list.

2.7 As regards the amendments proposed in article 246A (1) to insert the words, "not exceeding 18 per cent" between "goods and services tax" and imposed by the Union or by such State" is concerned, "the Members moving the amendment stressed the need to keep GST rates moderate and reasonable so that consumers are not excessively burdened, and to this end proposed that the GST Council be bound by the Constitution to not exceed 18% as the rate for an adequately revenue-generating GST."

Views of the Government

2.8 In response thereto, the Ministry of Finance, Department of Revenue has stated that rates of GST cannot be fixed in the Constitution as this is a dynamic variable. The rates of GST would have to be recommended by the GST Council depending on various factors such as economic conditions, revenue buoyancy, etc. At the same time, every effort would be made by the GST Council to ensure that the rate of GST is reasonable. Further, there may be certain demerit goods such as tobacco, or luxury goods, that may, if the GST Council so decides, attract a higher rate of

GST. RNR was calculated by NIPFP before introduction of GST Constitution amendment Bill. NIPFP and the Committee headed by CEA are working out rates under GST as per provisions of Bill.

2.9 The Department of Revenue stated that Petroleum products have been included under definition of "goods and services tax" provided in proposed clause (12A) of article 366. An Explanation has been added in proposed article 246A to clarify that GST will not be levied on petroleum and petroleum products till a future date to be recommended by the GST Council. This has been done after FM's meeting with State Finance Ministers on 15.12.2014 and is also as per the recommendations of the Empowered Committee to protect the revenue streams of the States.

2.10 With regard to providing for a maximum rate of GST in the Bill, the Department of Revenue mentioned that rates of GST cannot be fixed in the Constitution, as this is a dynamic variable. The rates of GST would have to be recommended by the GST Council depending on various factors such as economic conditions, revenue buoyancy, etc. To allay fears of revenue loss a provision of compensation to States has been provided in the Bill. At the same time, every effort would be taken to ensure that the rate of GST is reasonable. Further, there may be certain demerit goods such as tobacco, or luxury goods, that may attract a higher rate of GST.

Views of the Stakeholders

2.11 Most of the State Governments in their written replies have objected to bringing petroleum products under the ambit of GST. Another suggestion was to include Aviation Gasoline in that list.

2.12 However, the Experts/stakeholders were of the considered opinion that it needs to be emphasised that since a large part of the petroleum and petroleum products are important intermediate inputs, it is absolutely necessary to bring them under the GST ambit sooner than later to eliminate cascading effect and its associated inefficient economic cost. Even in a GST regime, these could be taxed at higher rate if revenues have to be protected. It is well known that petroleum and petroleum products and alcohol together contribute around 40 to 45 per cent of VAT/Sales tax revenues of States. The share of excise duty collection from petroleum and petroleum products is substantial for Central Government as well. It appears that revenue consideration alone is holding back inclusion of these items in GST. It is necessary for the Bill to specify a specific date for inclusion of these items under GST especially when the economic efficiency benefit from inclusion is much more than the direct short run revenue impact to the Central and the State Governments.

Recommendation

2.13 T**he clause has been adopted with no change.**

Clause 3

2.14 This clause seeks to make consequential amendments in article 248 of the Constitution in view of the proposed amendment in clause 2 of the Bill. Since Union has residuary power to make laws on subjects not mentioned in any of the Lists, it is proposed to make it clear that if anything is not covered specifically then, as per Constitutional Scheme, it would fall under article 248.

Recommendation

2.15 **This clause has been adopted with no change.**

Clause 4

2.16 This clause seeks to make consequential amendments in article 249 of the Constitution in view of the proposed amendment in clause 2 of the Bill. This amendment enables Parliament to make laws in national interest, if so required as per the procedure laid therein.

2.17 **This clause has been adopted with no change.**

Clause 5

2.18 This clause seeks to make consequential amendments in article 250 of the Constitution in view of the proposed amendment in clause 2 of the Bill. The amendment makes it clear that Union may legislate as in other cases if a proclamation of emergency is in operation.

Recommendation

2.19 **This clause has been adopted with no change.**

Clause 6

2.20 This clause seeks to amend article 268 of the Constitution to omit the duties of excise on medicinal and toilet preparations from the purview of the power of the Government of India in view of the proposed imposition of goods and services tax on goods and services.

Recommendation

2.21 **This clause has been adopted with no change.**

Clause 7

2.22 This clause seeks to omit article 268A of the Constitution as inserted by section 2 of the Constitution (Eighty-eighth Amendment) Act, 2003. The said article empowers the Government of India to levy taxes on services. As it is proposed to bring tax on services under GST, such a provision would no longer be required for the reason that the provision though enacted, it is yet to be notified so far.

2.23 **This clause has been adopted with no change.**

Clause 8

2.24 This clause seeks to amend clause (1) of article 269 of the Constitution to insert after the words "consignment of goods" the words, figures and letter "except as provided in article 269A" in view of the new article 269A which provides for levy of goods and services tax on supplies in the course of inter-State trade or commerce and apportionment of such tax between the Union and the States in the manner provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Recommendation

2.25 **This clause has been adopted with no change.**

Clause 9

2.26 This clause 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.

2.27 As regards this clause, Members sought clarifications about the distinction between "supplies, sales and purchase; and consignment".

2.28 Some Members suggested that that after 269A (1), the following proviso may be added:-

2.29 "Provided that the expression "supplies" shall not apply to goods and services supplied by one unit of a firm to another unit of the same firm under the same ownership in another location or State.

Provided further that if two or more firms are together engaged in the supply of the same end product, the expression "supplies" shall not apply to such transactions."

Views of the Government

2.30 In this regard, 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.

2.31 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.

Views of the Stakeholders

2.32 The stakeholders were of the view that proceeds of IGST shall be used for settlement of accounts among the States for flow of input tax credit in inter-State transactions, and in theory, there should be zero balance in the proceeds of IGST in a fiscal year. But, in practice, there may be a distinct possibility of a positive balance in the proceeds of IGST at the end of a fiscal year. In that event, there should be a constitutionally appropriate mechanism for distribution of these remaining proceeds in a year, to be provided in terms of suitable provision in article 269A in clause 9.

Recommendation

2.33 **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, hence the Clause has been adopted with no change.**

Clause 10

2.34 This clause seeks to amend clause (1) of article 270 of the Constitution to substitute the words, figures and letter "article 268, 268A and 269", the words, figures and letter "article 268, 269 and article 269A" in view of the proposed amendments referred to above; to insert a new clause (1A) after the existing clause (1) of article 270 to provide that 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).

Views of the Stakeholders

2.35 It was proposed by one of the State Government that the words "not apportioned" should be replaced with "not appropriated" in order to be in sync with the term used in the proposed Article 269A(1). Likewise, the word "distributed" should be replaced with the expression appropriated".

Recommendation

2.36 **This clause has been adopted with no change.**

Clause 11

2.37 Clause 11 of the Bill seeks to amend article 271 of the Constitution to insert after the words "in those articles", the words "except the goods and services tax under article 246A", with a view to put restrictions on the powers of Parliament to levy surcharge for the purposes of the Union on the GST. In other words, it provides that goods and services on which GST is levied shall not be subject to any surcharge under article 271.

Recommendation

2.38 **This clause has been adopted with no change.**

Clause 12

2.39 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 Services Tax Council consisting of the Members referred to in subclause (2) of this clause.

2.40 Sub-clause (2) of the said clause seeks to provide that the Goods and Services Tax Council shall consist of the Union Finance Minister as Chairperson; the Union Minister of State in charge of Revenue or Finance as Member; the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government as Members.

2.41 Sub-clause (3) of the said clause seeks to provide that 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.

2.42 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 may be subjected to, or exempted from the goods and services tax; 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; the threshold limit of turnover below which goods and services may be exempted from goods and services tax; the rates including floor rates with bands of goods and services tax; any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster; 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 any other matter relating to the goods and services tax, as the Council may decide.

2.43 Some Members proposed that under clause 4 (c), among the "principles" to be considered by the GST Council while preparing GST laws the principle of "share of local bodies in revenue buoyancy and compensation for losses sustained through taxes subsumed" should be included as articles 243H and 243X provide for State Legislatures to, by law, ensure the "sound finances" of the local bodes. This would also enable State Finance Commissions set up under articles 243 I and 243 Y to provide for augmenting the share of local bodies in revenue buoyancy generated by the adoption of GST.

2.44 With reference to sub-clause (4) (g) which provides for "special consideration" to certain States, some Members proposed, in keeping with article 243 B (2), that "special consideration" may also be extended to States like Goa and Union territories like Puducherry by adding at the end of 4(g) " and any State or Union territory having a population not exceeding twenty lakhs".

2.45 Sub-clause (5) of the said clause seeks to provide that 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. These items have been kept out of GST to protect the revenue interest of the States.

2.46 Some members sought the inclusion in clause 12(5) of highly revenue-generating products like tobacco and tobacco products, alcohol for human consumption and electricity supply and consumption within a period not later than five years so that India, within a few years, fulfills the fundamental GST objective of making the entire nation a single common market for all products.

2.47 Sub-clause (6) of the said clause seeks to provide 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.

2.48 Sub-clause (7) of the said clause seeks to provide that one half of the total number of Members of the Goods and Services Tax Council shall constitute the quorum at its meetings so that the States have say in the matters of their interest.

2.49 Sub-clause (8) of the said clause seeks to provide that the Goods and Services Tax Council shall determine the procedure in the performance of its functions.

2.50 Sub-clause (9) of the said clause seeks to provide that 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 vote of the Central Government shall have a weightage of one-third of the total votes cast, and the votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast, in that meeting. Sub-clause (10) of the said clause provides that No act or proceedings of the Goods and Services Tax Council shall be invalid merely by reason of— any vacancy in, or any defect in, the constitution of the Council; or any defect in the appointment of a person as a member of the Council; or any procedural irregularity of the Council not affecting the merits of the case. Sub-Clause (11) of the said Clause provides that the Goods and Services Tax Council may decide about the modalities to resolve disputes arising out of its recommendation.

2.51 In respect of this clause some Members proposed amendment that while discharging the functions conferred by this article, the Goods and Services Tax Council shall be guided by the destination based taxation principle and need for a harmonised structure of goods and services tax and for the development of a harmonised national market for goods and services.

2.52 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-fourth of the total votes cast, and

(b) The votes of all the State Governments taken together shall have a weightage of three-fourth of the total votes cast, in that meeting. And the vote of each state shall have a weightage proportionate to the population of that State.

After 279A, add the following new article 279B:

2.53 (1) Parliament may, by law, provide for the establishment of a Goods and Services Tax Dispute Settlement Authority to adjudicate any dispute or complaint referred to it by a State Government or Governments of the Government of India arising out of a deviation from any of the recommendations of the Goods and Services Tax Council constituted under article 279A that results in a loss of revenue to a State Government or Governments or the Government of India or affects the harmonized structure of the Goods and Services Tax.

2.54 (2) The Goods and Services Tax Dispute Settlement Authority shall consist of a Chairperson and two other Members.

2.55 (3) The Chairperson of the Goods and Services Tax Dispute Settlement Authority shall be a person who has been Judge of the Supreme Court or Chief Justice of a High Court to be appointed by the President on the recommendation of the Chief Justice of India.

2.56 (4) The two other members of the Goods and Services Tax Dispute settlement Authority shall be persons of proven capacity and expertise in the field of law, economics or public affairs to be appointed by the President on the recommendation of the Goods and Services Tax Council.

2.57 (5) The Goods and Services Tax Dispute Settlement Authority shall pass suitable orders including interim orders.

2.58 (6) A law made under clause (1) may specify the powers which may be exercised by the Goods and Services Tax Dispute Settlement Authority and provide for the procedure to be followed by it.

2.59 (7) Notwithstanding anything in this Constitution, Parliament may, by law, provide that no Court other than the Supreme Court shall exercise jurisdiction in respect of any such adjudication or dispute or complaint as is referred to in clause (1).

2.60 Explanation- For the purposes of this article, "State" includes a Union territory with Legislature.

Views of the Government

<u>Proposed article 279A (4)(c):</u>

2.61 The GST Council would now make recommendations on the model GST laws, principles of IGST apportionment, and place of supply rules. This has been done as per the recommendations of the Empowered Committee after their meeting in Shillong in November 2013. It may not be appropriate for the GST Council or any other body to stipulate the share of local bodies in the revenues collected by the respective States. 73rd Amendment of the Constitution provides for setting up of State Finance Commissions which have been given the responsibility to make recommendations on principles which govern distribution of finances between the States and local bodies i.e., Panchayats and Municipalities. Deficiencies, if any, in functioning of State Finance Commissions in individual States may have to be dealt with separately.

2.62 The Department further clarified that taxing powers of local bodies --Panchayats and Municipalities -- are derived from Acts and laws passed by the State Legislatures. The State Legislatures, under Article 243H and 243X of the Constitution, are authorized to make laws, which are the taxes that the local bodies will levy. This power has not been interfered with and the current structure in the Constitution remains intact.

2.63 So far as other arrangements which are currently provided under the Constitution with regard to formation of the State Finance Commissions and with regard to devolution which the State Governments should make are concerned, they also remain intact in the Constitution. These have not been interfered with.

Proposed article 279A (4)(e)

2.64 To give flexibility to the States, the provision of 'bands' over the GST floor rates, to be recommended by the GST Council, has been introduced. Depending on the local situations and requirements, the States have the option to levy slightly higher tax within this band. This shall also enable the States to cushion the impact of any potential loss of revenue arising out of implementation of GST. The word "band" does not need to be defined in the Constitution but would need to be defined in the model State tax law or the SGST law and the CGST law which shall be recommended by the GST Council. This provision has been made as per the recommendations of the Empowered Committee after their meeting in Bhubaneswar in January 2013, and also the recommendations of the Parliamentary Standing Committee.

Proposed article 279A (4) (f), (g)

2.65 Special category status has been granted to 11 States by the National Development Council comprising the Prime Minister, Union Ministers, Chief Ministers and members of the erstwhile Planning Commission (Now NITI Aayog). Provision of special category States is not based on population but on specific issues such as hilly and difficult terrain, strategic location along borders with neighbouring countries, economic and infrastructural backwardness, and non-viable nature of state finances. The proposed amendment shall mean inclusion of the State of Goa and UT of Puducherry in the list of States with special provisions. Goa has the highest per capita income in the country while Puducherry has fifth highest per capita income in the country. Neither of them have any of the specific problems listed in the criteria above.

Proposed article 279A (5)

2.66 Initially, as recommended by the Parliamentary Standing Committee on Finance and the Empowered Committee in its Bhubaneshwar meeting in January 2013, 'petroleum products' had been proposed to be subsumed in GST. However, since taxes on petroleum products constitute a major portion of State revenues, many States expressed apprehension over possible revenue loss in case petroleum products are subsumed under GST. Hence, these products have been constitutionally brought under GST and it has been provided that they would not be subject to GST till notified at a future date on the recommendation of the GST Council. It may be mentioned that petroleum products constitute a major input in most manufacturing industries and their non inclusion would mean these industries would not be able to claim input tax credit for such inputs resulting in cascading of taxes and increased cost of production. It is expected that once GST regime is stabilised, the States may want to include petroleum under GST after two or three years itself. As per the proposed amendment, the GST Council shall not be able to make any recommendation before five years to include petroleum products under GST. Hence, it is better to keep the option open for Council to decide rather than binding the GST Council for five years.

2.67 Further, the Bill leaves it to the GST Council to recommend the date on which GST shall be applicable on petroleum products. Since the States would have 2/3rd vote share in the Council, if the States do not want GST to be imposed on petroleum products, in any case it would not be possible for GST to be imposed on petroleum products as long as the States do not agree. Further, losses, if any suffered by the States, will be compensated by the Centre.

Proposed article 279A (9)

2.68 The structure of GST Council represents the federal nature of governance in this country. This has been done as per the recommendations of the Empowered Committee after their meeting in Bhubaneswar in January 2013, and also the recommendations of the Parliamentary Standing Committee. This provision has been consciously adopted to ensure the federal balance in the functioning of the GST Council, and also to enhance co-operative federalism. The existing pattern of vote-share in the GST Council ensures that no decision can be taken by the Council either by the Centre or the States acting on their own. Hence, neither the States nor the Centre alone can take a decision in the Council. Providing 3/4th weightage to the States would upset the federal balance between the Centre and the States. Presently, in the concurrent list, in case of any difference between Central and State legislation, the Central legislation prevails. The present weightage of votes in the GST Council would ensure that neither the Centre nor the States are able to take a decision without the support of the other. In other words both would enjoy a veto.

2.69 Further, with Centre holding only 1/3rd of the votes, the Centre would require support of 20 States/Union Territories to get a resolution passed. This shows that Centre would need co-operation of States to get any decision taken at the GST Council.

Proposed article 279A (11)

2.70 The hitherto proposed article 279B for the creation of a GST Dispute Settlement Authority *has been omitted*, and a provision has been made in Article 279A itself empowering the GST Council to decide about the modalities to resolve the disputes arising out of its recommendations .The States were apprehensive that the proposed GST Dispute Settlement Authority under proposed article 279B would affect the fiscal powers of the States and the Union. Hence, this provision has been done away with. This has been done as per the recommendations of the Empowered Committee after their meeting in Bhubaneswar in January 2013, and also the recommendation of the Parliamentary Standing Committee.

2.71 It may further be mentioned that Article 279A (11) only provides that GST Council may decide the 'modalities' to resolve disputes arising out of its recommendations. The 'modalities' could include any dispute resolution mechanism which could be *inter-alia* negotiation, mediation, arbitration or even a judicial authority as deemed appropriate by the GST Council depending on the nature of dispute before it. Thus, as per the proposed Bill, the GST Council shall, by itself, not be resolving the disputes but decide on the modalities for resolving the disputes.

Views of the Stakeholders

2.72 The Stakeholders were of the view that vote of the Central Government and State Government shall have the weightage of 1/4th and 3/4th respectively otherwise it would be difficult to get the proposals approved, in the constitution of GST Council instead of the words 'Union Minister of State in charge of Revenue or Finance" it should be 'Ministers' in charge for these functions, as these positions are not explicitly mandated in the Constitution, No dispute resolution mechanism can be meaningful and effective without an explicit linkage between the empowerment clause for the levy of GST (Articles 246A and 366(12A)) and the GST Council recommendations, Goods and Services Tax Council shall be guided by the destination based taxation principle and need for a harmonized structure of goods and services tax and for the development of a harmonized national market for goods and services, Requisite provisions may be incorporated to make the decisions of the GST Council binding on the States and the Union, Include the State/UT of Goa and Puducherry in Article 279A (4) (G), The Threshold limit for applicability of GST may be fixed at Rs. 50 Lacs, GST Rate may be kept in the range of 16-18%, Tax rate on Goods and Services is to be same to avoid disputes, Tax on interstate supply of goods from one state to other of the same company may be exempted from the purview of GST, The Input taxes paid by the exporters are to be refunded automatically, etc.

Recommendation

2.73 **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.**

2.74 **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.*

2.75 **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.**

2.76 **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.**

2.77 **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.**

2.78 **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 has been adopted with no change.**

2.79 **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

2.80 This clause seeks to amend clauses (1) and (2) of article 286 of the Constitution which is a consequential amendment in view of the proposed amendments in clause 2 of the Bill.

> 2.81 One Member proposed insertion of a new clause (1A) in article 286 of the Constitution to provide as under-
>
> "No law of a State shall impose, or authorize the imposition of, any restriction on reimbursement of a tax levied under the law of a State in respect of any supply of goods or of services of both inside the State, when such goods or services or both are supplied in the course of inter-State trade or commerce or export outside the territory of India.
>
> Explanation.- For the purpose of this clause, consumption or use of goods or services or both whether partly or wholly, in supply of any other goods or services or both in the course of inter-State trade or commerce or export outside the territory of India, shall be deemed to be supply of goods or services or both in the course of inter-State trade or commerce or export outside the territory of India to the extent of such consumption or use. "

Views of the Government

2.82 Article 286 put restriction on the imposition of tax on the sale or purchase of goods if such sale or purchase takes place outside the States or in the course of import of goods into or export of goods outside the territory of India. By making amendments so as to substitute the words "sale or purchase of goods" the words "supply of goods or services or both", the restrictions would continue to apply any IGST or CGST and therefore it may not be necessary to go for the above amendment.

2.83 Some Members sought the definition in the Constitution amendment Bill itself of the term "supply" in proposed clause I (A) of article 286.

Recommendation

2.84 **The term 'supply' would be defined in the various GST laws relating to CGST and SGST. Hence, the Committee feels that it would not be appropriate to insert the definition of supply in this clause. This clause has been adopted with no change.**

<u>Clause 14</u>

2.85 Clause 14 of the Bill 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.

2.86 Some Members proposed amendments in clause (12A) to delete the word "any" and the words "except taxes on the supply of alcoholic liquor for human consumption so as to progressively ensure a true common market for all goods".

2.87 In (26A) delete "anything other than goods" and substitute with "commercial transactions in intangibles so as to avoid the circular definition of 'services' meaning 'anything other than goods."

Views of the Government

2.88 In this regard the Ministry of Finance, Department of Revenue has stated that term '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.

2.89 On the issue of inclusion of Petroleum and petroleum products under GST constitutionally, Department of Revenue in their written submission stated that:

2.90 Petroleum and petroleum products have been included under GST constitutionally by keeping only "alcoholic liquor for human consumption" outside of definition of "goods and services tax" given in newly introduced clause (12A) of article 366. However, GST would be leviable on these products only w.e.f. the date recommended by the GST Council. This has been done taking into consideration the concern expressed by Empowered Committee in their various meetings about the likely loss of Revenue, if the Petroleum products are included in GST. Parliamentary Standing Committee had recommended that there should be no exclusions from GST provided under the Constitution Amendment Bill.

2.91 The Department of Revenue mentioned that petroleum products constitute a major input in most manufacturing industries and their non inclusion would mean these industries would not be able to claim input tax credit for such inputs resulting in cascading of taxes and increased cost of production. It is possible that once GST regime is stabilised, the States may want to include petroleum under GST after two or three years itself. In such a situation, since petroleum products have been included Constitutionally, including petroleum products under GST would not require a Constitution amendment.

Views of the Stakeholders

2.92 The Experts/Stakeholders were of the considered views that:

Definition of Services

2.93 "Supply of Services' means any business activity which is not supply of goods."

2.94 In view of Article 246A empowering both Centre and States to levy tax on supply of goods and services, it is the view that the Clause (29A) of Article 366 may be considered for deletion as this would become redundant.

Petroleum

2.95 The international practice is to include petroleum in the GST base, and then apply a supplementary excise on selected petroleum products (e.g., petrol and diesel). A credit is allowed for the GST portion of the tax to commercial or industrial use of the fuels, but not for the supplementary excise. It would be advisable for India also to adopt this structure.

2.96 Thus, it is recommended that the provisions limiting the scope of GST (to exclude petroleum products) be deleted. Specifically, Explanation to Article 246A is redundant. The GST Council has the powers in any case to exclude any products from the GST base, if it so decides.

Goods and Services Tax

2.97 It is advisable to change the definition of 'goods and services tax' in Article 366 (12A) as follows. Further, goods in Article 366(12) need to be redefined to include real property.

2.98 "goods and services tax" means a multi-stage destination-based value added tax on supply of goods, or services, or both, and levied as per the framework recommended by the GST Council.

2.99 "goods" includes, for purposes of the goods and services tax, all materials, commodities, articles, and immovable property

Recommendation

2.100 **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 has been adopted with no change.**

Clause 15

2.101 This clause seeks to amend article 368 of the Constitution in view of the proposed amendments referred to in clause 12 of the said Bill so as to apply the special procedure provided in the proviso to clause (2) thereof which requires the ratification of the Bill by the Legislatures of not less than one half of the States in addition to the method of voting provided for amendment of the Constitution.

Recommendation

2.102 **This clause has been adopted with no change.**

Clause 16

2.103 This clause seeks to amend the sub-paragraph (3) of paragraph 8 of the Sixth Schedule to the Constitution with a view to empower the District Council for an autonomous district to have the power to levy and collect taxes on entertainment and amusements within such district.

Recommendation

2.104 **This clause has been adopted with no change.**

Clause 17

2.105 This clause seeks to amend the Seventh Schedule of the Constitution to substitute the items under entry 84 of the List I and to omit entries and 92 and 92C; to omit entries 52 and 55 of List II and substitute the entries 54 and 62 of List II of the Seventh Schedule to the Constitution. These amendments are consequential to the insertion of new article 246A.

2.106 With a view to progressively promoting a common market in all goods and services, some Members proposed amendment to Entry 84 of Union List as follows:

(g) sale and consumption of electricity'

(h) alcohol for human consumption.

2.107 Some Members also sought clarifications as it does not figure in the Constitution (a) (ii): What is entry 92C?

Recommendation

2.108 **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.**

2.109 **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.**

(iii) After Clause 17(b)(i), **add:**

Entry 53 shall be omitted

(iv) Further amend entry 54 to add between "alcoholic liquor for human consumption," and "but not including sale" the words: and tobacco and tobacco products and sale and consumption of electricity,

(v) Further amend Clause 17(b)(iv) to read as follow:

2.110 "Entry 62. Taxes on entertainment and amusements and any other taxes, duties, tolls, levies, or royalties devolved by State legislatures to institutions of local self-government under articles 243 H and 243 X to the extent levied, collected and appropriated by a Panchayat or a Municipality or a Regional Council or a District Council".

Views of the Government

2.111 Inclusion of electricity under GST has not been envisaged ever since the First Discussion Paper was published in 2009 on GST. Neither the Empowered Committee, nor the Parliamentary Standing Committee ever recommended inclusion of electricity under GST. Taxes on electricity and water have been treated separately from taxes on other goods and services in the Constitution. Entry 53 of 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.

2.112 Further, in the case of alcohol, the States have been consistently opposing the inclusion of alcohol under GST. Even in the First Discussion Paper, it had been recommended that alcohol be excluded from GST. This is also as per the recommendations of the Empowered Committee.

2.113 Under the proposed Constitution scheme, the Centre has the power to tax one demerit good (tobacco), while the States have the power to tax the other demerit good (alcohol). Tobacco, unlike alcohol has been subsumed in GST, and the States will have the right to levy SGST on it. This arrangement was specifically recommended in this light where alcohol, being the other demerit good, has not been subsumed into GST, and States retain the powers to levy excise duty as well as sales tax on alcohol. Centre has no powers *vis-a-vis* alcohol.

Views of the Government

2.114 As regards petroleum and petroleum products, the views of the Department have been recorded while dealing with the proposed Article 279A (5).

2.115 In their written replies, the Department of Revenue stated that all forms of Entry Tax have been subsumed under GST by omitting Entry 52 of List II (State list) of Seventh Schedule. The Parliamentary Standing Committee had recommended Entry tax to be subsumed under GST. At the same time, a Constitutional commitment has also been given to the States that their losses caused due to introduction of GST would be compensated for five years. The Department has also mentioned that provision of Entry tax is an impediment to creation of common market, which is a goal of GST, as it acts like a tariff barrier on movement of goods into a local area and discriminates between goods produced within and outside the area. It impedes free movement of goods and also increases compliance cost for business.

Views of the Stakeholders

Clause 17 (b) (ii) in List II-State List

2.116 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, tobacco and tobacco products 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.";

2.117 State Governments may be allowed to levy higher taxes on tobacco and tobacco products; betting and Gambling activity may be kept out of the purview of GST; retain Entry 52 and Omit Entry 55; Insert a new Entry 54A "other polluting goods and services to be notified by GST Council.

2.118 Clause 17 (b) (iii) in List II-State List

2.119 "55. Taxes on advertisement other than advertisements published in the newspapers and advertisements broadcast by radio or television,"

Electricity

2.120 Electricity must form an integral part of the GST base, as is any other normal good. It is therefore suggested that electricity duty also be subsumed within the GST framework. This approach can reduce the cost of electricity by 20%, significantly enhancing the competitiveness of our domestic manufacturing sector.

2.121 The GST need not be a full replacement of the electricity duty. Only a part of the duty can be replaced by GST, which should be fully creditable to industrial/commercial users of electricity.

2.122 Given that Article 246A empowers the Union and States impose GST, notwithstanding anything contained in articles 246 and 254, GST can be extended to electricity even if Entry 53 in List II - State List (Taxes on the consumption or sale of electricity) is not omitted. Continuing this entry would allow States the flexibility to levy a supplementary tax to electricity in addition to GST, if they consider it necessary or desirable.

Real Estate

2.123 Real Estate merits inclusion in GST from another significant perspective, i.e., to bring transparency to the sector. Real estate is known to be the breeding ground of corruption. Bringing this sector into GST will significantly reduce tax evasion through more efficient transactions tracking and improved enforcement and compliance.

2.124 For inclusion of real Estate in the GST base, the definition of 'goods and services tax' under Clause 14 of the Bill should be broadened to include property, movable or immovable as suggested below.

2.125 Given the practice in other jurisdictions to levy supplementary taxes in the form of land transfer taxes, levy stamp duties, and registration fees on real property transactions, the existing entries in the Union and State Lists relating to these taxes on land and buildings can be left unchanged. The tax rates and base for these levies can be adjusted (including reducing them to zero) as per the recommendations of the GST.

Alcohol

2.126 Any explicit restrictions on the application of GST to alcohol in the Constitution itself are thus not appropriate. Accordingly, a change in the definition of GST in Article 366(12A) is recommended.

2.127 Alcohol should be given the same treatment as is being given to Petroleum and its products. In that case, the clause 'except taxes on the supply of the alcoholic liquor for human consumption' would have to be deleted from the definition of GST at Clause 12A of the Bill. Further, as has been done in the case of Petroleum and its products, the levy of GST on Alcohol may be postponed to a later date to be decided by the GST council. Till that time, the States will continue to levy State Excise duty and State VAT on Alcohol. The advantage would be that no further amendment of the Constitution would be needed, when the States agree to bring in Alcohol within GST at a later date.

Entertainment Tax

2.128 The Bill proposes that local levies such as octroi and entry taxes should be fully subsumed under the GST. This is necessary to ensure free flow of goods and services within the common market of India. This is equally true of the entertainment tax. The funding needs of the local bodies can be better addressed through vertical devolution of State GST revenues to local bodies, as opposed to such nuisance taxes which are difficult to administer and comply with, and do not yield much revenue. The quantum of revenues earned by local bodies from entertainment tax levied and collected by them is insignificant and constitutes a miniscule fraction of their budgets. For smaller towns and cities, the revenues from the tax might not cover even the cost of administration and enforcement.

2.129 It is recommended that Entry 62 in List II - State List be omitted. **Entry 84**

2.130 List I Union List, the powers of the Union to levy supplementary taxes on petroleum and tobacco are limited to excise on the manufacture or production of these goods. By contrast, the powers of States for levy of supplementary taxes extend to purchase or sale of the specified products. It is desirable that the Union powers also be likewise extended to sale or purchase of the specified goods.

2.131 Purchase Tax/Entry Tax/Octroi are to be allowed as input Tax credit.

Recommendation

2.132 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 has been adopted with no change.

Clause 18

2.133 Sub-clause (1) of this clause seeks to provide that 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).

2.134 Sub-clause (2) of this clause seeks to provide that 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.

2.135 Sub-clause (3) of this clause seeks to provide that the Government of India may, where it considers necessary in the public interest, exempt such goods from the levy of tax under clause (1).

2.136 Sub-clause (4) of this clause seeks to provide that 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.

2.137 Some Members of the Committee proposed to delete this clause because under clause 19, 100 percent compensation be provided for a period not less than five years. In view of guaranteed compensation for any loss incurred by any State or Union Territory, there is no need to levy a market-distorting 1% additional levy.

Views of the Government

2.138 In this regard the Ministry of Finance, Department of Revenue has explained that since GST is a destination based tax, the manufacturing States were apprehensive of their loss in revenues. To allay their fears, and to bring them on board, a provision has been made for the levy of 1% additional tax on the supply of goods. This tax shall be credited to the exporting State. Since it is expected that in the medium and long run, the revenues of all the States would increase due to better compliance and enforcement under GST, this provision of 1% additional tax has been made only for the first two years. The GST Council would have the power to recommend continuation of this tax at the end of 2 years, if it so deems fit. This was decided in view of the consultations with State Finance Ministers by FM on 15.12.2014. It is also in line with the recommendations made by the Empowered Committee in their various meetings for the protection of the revenues of the manufacturing States. Clause 18 in itself does not make any distinction of a "manufacturing state" and this tax shall be levied by all States who send their produce outside the State.

Views of the Stakeholders

- In place of "An Additional Tax" in Clause 18 (1) and "additional tax" in Clause 18(2), it may be "Central Sales Tax." Instead of introducing a new additional tax, the same purpose may be served by "Central Sales Tax," which is already known to the Centre, the States, in industry, trade and others.
- 1% levy against the spirit of GST.
- Any specific reference to a period of two years would be arbitrary and unnecessary. The portion, "a period of two years", may therefore be considered for deletion.
- It is important to recognize that GST is a destination based tax levied at the point of consumption. Introduction of an additional tax on supply of goods, not exceeding one per cent for two years would make the tax partly origin based and partly destination based. Allowing continuation of origin based tax system would be a major distortion and continuation of significant tax exportation from the richer producing states to the poorer consuming states.
- In fact, this method of compensating the manufacturing states through one percent origin based tax is not at all necessary, since in any case the Bill itself envisages compensation by Centre for the states in case of revenue loss. Therefore, the view is that this provision would need to be deleted.

- o Since, the Bill already contains a provision for compensating the States for any losses under GST for five years, it would result in no net revenue gain to the States where they indeed suffer a revenue loss under the GST and are recipient of compensation from the Centre. It would effectively mean an extra profit to the States who gain revenues from the GST. If so, it does not serve its intended purpose. These concerns warrant a removal of the 1% origin based tax.
- o Restricting the levy only to 2 years, with no powers to extend the same for any further period. Restricting levy only to interstate sale and purchase of goods. This means that no such additional tax should be levied on interstate supply of goods otherwise than by way of sale and purchase.

Recommendation

2.139 **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

2.140 This clause seeks to provide that 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.

In this clause some Members proposed amendments by adding the words "100 per cent" in the second line between "provide for" and "compensation to the States" and by **deleting** "such period which may extend to five years" and **substituting** with "a period not less than five years" **and to insert a new clause in clause 19 that-**

2.141 19(1) To this end, there shall be established a Goods and Services Compensation Fund under the administrative control of the Goods and Services Tax Council into which the Central Government shall deposit the Goods and Services Tax Compensation.

2.142 **By inserting** the words, "as well as the panchayats and Municipalities through States" between the words "to the States" between the words "to the States" and "for the loss of the revenue"

2.143 Further, some of the Members proposed amendments that for the words "Parliament may", the words "Parliament shall" should be substituted.

2.144 Some Members proposed the addition of the words "as well as the Panchayats and the Municipalities through State Legislatures" so as to ensure the "sound finances" of the local bodies while respecting the Constitutional order that as local bodies are in the State List it is for State Legislatures, by law, to "authorise a Panchayat/Municipality to levy, collect and appropriate" such taxes.

Views of the Government

2.145 Regarding the said amendments the Ministry of Finance, Department of Revenue has stated that it may not be appropriate to stipulate that States would compensate the local bodies for any losses caused to them. 73rd Amendment of the Constitution provides for setting up of State Finance Commissions which have been given responsibility to make recommendations on principles which would govern distribution of finances between the States and local bodies i.e., Panchayats and Municipalities. Deficiencies, if any, in the functioning of State Finance Commissions in individual States may have to be dealt with separately.

2.146 Further, one of the Members proposed amendments that for the words "Parliament may", the words "Parliament shall" should be substituted.

2.147 Regarding the proposed amendment to substitute the words "for a period of not less than five years", in place of the words "which may extend to five years", the Ministry of Finance, Department of Revenue has stated that to bridge the trust deficit with the States, and to ensure no revenue loss to them, it has been Constitutionally provided that the States shall be compensated for five years for their losses caused due to introduction of GST. This has also been recommended by the 14th Finance Commission.

Views of the Government

2.148 Regarding substitution of word 'may' by 'shall', the Legislative Department has clarified that under the Constitution, wherever law making power is conferred on Parliament, the language used is "may" in view of the fact that within the constitutional parameters Parliament is supreme. However, in contrast, wherever, the power to make law is subject to certain contingency, then in such situation like Proclamation of Emergency, the provisions of the Constitution, uses the word "shall". (as used in article 250 below). In view of this, it may not be necessary to substitute the word "may" with the word "shall"

2.149 In this connection, it would be appropriate to reproduce the provisions of the following articles, namely:-

2.150 "2. Admission or establishment of new States.—Parliament may by law admit into the Union, or establish, new States on such terms and conditions as it thinks fit.

2.151 Formation of new States and alteration of areas, boundaries or names of existing States.—Parliament may by law—

(a) form a new State by separation of territory from any State or by uniting two or more States or parts of States or by uniting any territory to a part of any State

2.152 Art 245. Extent of laws made by Parliament and by the Legislatures of States.—(1) Subject to the provisions of this Constitution, Parliament may make laws for the whole or any part of the territory of India, and the Legislature of a State may make laws for the whole or any part of the State.

2.153 Art 247. Power of Parliament to provide for the establishment of certain additional courts.—Notwithstanding anything in this Chapter, Parliament may by law provide for the establishment of any additional courts for the better administration of laws made by Parliament or of any existing laws with respect to a matter enumerated in the Union List.

2.154 Art 250. Power of Parliament to legislate with respect to any matter in the State List if a Proclamation of Emergency is in operation.—(1) Notwithstanding anything in this Chapter, Parliament shall, while a Proclamation of Emergency is in operation, have power to make laws for the whole or any part of the territory of India with respect to any of the matters enumerated in the State List.

2.155 Art 368. Power of Parliament to amend the Constitution and procedure therefor.— (1) Notwithstanding anything in this Constitution, Parliament may in exercise of its constituent power amend by way of addition, variation or repeal any provision of this Constitution in accordance with the procedure laid down in this article.".

2.156 On the issue of period of GST Compensation, Department has stated that:-

"It is expected that the revenues of the Central and State Governments will not be impacted in the long run. However, due to a shift from origin-based to destination-based indirect tax structure, some States might face drop in revenue in the initial years. To help the States in this transition phase, a number of provisions have been incorporated in the Bill as enumerated in Para I, points (a) to (e), above. In the medium and long run, the revenues of all States and Centre are expected to grow due to widening of tax base, better tax compliance and enforcement, and growth in the economy".

2.157 Further, the smaller and weaker States will benefit from GST from the start. Since these are primarily consuming States, all SGST collected on goods and services will flow to the consuming States under the GST regime. Hence, the revenue of these States will increase and they are not likely to suffer any loss even during initial years.

Views of the Stakeholders

- Parliament shall, 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 a period not less than five years.
- In place of "protection to," it may be 'protection of 100 percent to". This will provide required comfort fully to the States and shield against anxiety during the initial phase of introduction of GST.
- On the basis of past experience, the need for timely payment of compensation, without delay, in every financial year.
- As the Bill made a provision for compensation in the event of revenue loss to the States after the introduction of GST, on the recommendations of the GST council, for such period which may extend to five years, this should provide comfort to the States. Since Union government eventually by law would be committed to compensation for revenue loss, it may be proper to eliminate tax on interstate supply of goods as proposed in the new Bill during the first two years of GST regime to introduce a destination based tax system.

- Having agreed to give compensation, there is no harm in Centre agreeing to give 100% compensation for all five years, in case of loss of revenue; - that would raise the comfort level of the States, and bridge the evident trust-deficit between Centre and the States.

2.158 **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'.**

2.159 **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 offive years."***

Clause 20

2.160 This clause seeks to provide for transitional provisions which provides that 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 in force until amended or repealed by a competent Legislature or other competent authority or until expiration of one year from such commencement, whichever is earlier.

2.161 This clause prescribe a timeframe within which the subsuming of different indirect taxes into GST would take place and enable the competent Legislature to amend or repeal their existing laws to pave the way for imposition of SGST in the States.

Recommendation

2.163 **This clause has been adopted with no change.**

Clause 21

2.164 This clause seeks to provide that 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.

2.165 However, no such order shall be made after the expiry of three years from the date of such assent. It also seeks to provide that every order made under sub-clause *(1)* shall, as soon as may be after it is made, be laid before each House of Parliament.

Recommendation

2.166 **This clause has been adopted with no change.**

CHAPTER -III

OTHER RELATED ISSUES IN CONTEXT OF THE BILL

3.1 The Committee, thereafter, discussed plethora of inter-connected issues like source of revenue of Panchayats and Municipalities, Losses to Municipalities on account of deletion of Entry 52, creation of National Compensation Fund, non- functioning of State Finance Commissions, provision of Dispute Settlement Authority, inclusion of enabling clause to bring alcohol at a later stage to avoid constitutional amendment, GST Rate and Revenue Neutral Rate (RNR), etc. which have been dealt separately in the succeeding paras.

Issue of Legislative Competence

3.2 Concerns were raised before the Committee on the adverse impact which the Constitution (122nd Amendment) Bill, 2014, may have on the finances of local bodies.

3.3 ***Competence of States to authorize local bodies to levy, collect and appropriate taxes, duties, tolls and fees***

3.4 The Constitution makes elaborate provisions to deal with powers, authority and responsibilities of Panchayats, their power to impose taxes and Constitution of Finance Commission to review their financial position (articles 243G, 243H and 243-I). Similar provisions exist in case of Municipalities (articles 243W, 243X and 243Y). These provisions speak of powers, functions, responsibilities, power to levy and collect tax by Panchayats and Municipalities. The powers to levy and collect taxes is delegated by State Legislatures by enacting law for the purpose and thus enabling them to perform the Constitutional functions and duties entrusted to them.

3.5 Articles 243H and 243X speak of power that the State Legislatures may give to Panchayats and Municipalities to levy collect and appropriate taxes, duties, tolls and fees and also of assigning such of them as are levied and collected by the State Government and to provide grants-in-aid from the Consolidated fund of the States.

3.6 From the provisions, it may be seen that the State's power to levy taxes is derived from the Constitution and the Panchayats and Municipalities power to tax is derived from the State Legislature which it would delegate in the manner Constitution permits. Those articles make it clear that the concerned State Legislature has to pass a law to confer taxing power on Panchayats and Municipalities. Further, it may be seen that the source of power rests with State Legislatures and the Constitution has not empowered the Panchayats and the Municipalities to impose taxes on their own. In the present set up there are State laws which enable the Panchayats and Municipalities to levy and collect the taxes.

3.7 In conclusion, it can be submitted that the provisions of articles 243H and 243X bestow a Constitutional obligation and responsibility on the State to enable revenue generation of Panchayats and Municipalities by enacting laws; which shall continue to apply when the States get the simultaneous power to levy GST under the proposed article 246A once the indirect taxes are subsumed into GST. The present Constitutional Amendment also requires enactment of State 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.

Subsuming of Entry 52 under GST

3.8 Thereafter, the Committee discussed the rationale for deletion of Entry 52, State List and its possible impact on the revenue sources of the local bodies. Entry 52, State List provides for "Taxes on the entry of goods into a local area for consumption, use or sale therein."

3.9 The Committee felt that municipal-level taxes are an important source of revenue for many local bodies. If, we take the example of city of Mumbai, municipalities' main source of revenue is octroi. The revenue collection in 201415 on octroi in the city of Mumbai was somewhere around Rs. 6733 crores which is individually around 42% of the entire finance generated there. If that is taken away how development would be ensured. Although the Government of India is assuring that compensation would be given to State Governments for the losses incurred by them but that too would be through State Government.

3.10 In his submission, Secretary, Department of Revenue stated that 'Entry tax is an impediment to the free flow of goods and services in India. It creates inefficiencies in the supply chain. Further, in many States, Entry tax is not VATable, and hence, results in compounding and cascading of taxes. Therefore, 13th Finance Commission headed by Dr Vijay Kelkar, had recommended that Entry tax should be fully subsumed under GST. The same view was endorsed by the Standing Committee on Finance, while examining the Constitutional 115th Amendment Bill, 2011. Keeping that in mind, in the proposed Bill, a provision of "floor rate with bands" has been made, under which the States may levy additional SGST within the band to raise additional resources for passing on to the local bodies.

Impact of subsuming of Entry Tax on the financial independence of local bodies

311 He further stated that 'It has been seen that Entry tax in lieu of octroi or Octroi is only collected by local bodies in Maharashtra. Most States like Gujarat, Karnataka, and Punjab already levy and collect Entry tax for distribution to local bodies. As stated above, under the GST regime, provision of "floor rate with bands" has been provided in the Bill which shall enable the States to raise additional resources through levy of additional SGST within the band, for passing it on to the local bodies.

3.12 Since Mumbai is the largest beneficiary of revenue collected from octroi, the case of Mumbai has been presented in detail. All other local bodies in the country are not so dependent on Entry tax or octroi for their revenue. In their 2015-16 budget, the Municipal Corporation of Greater Mumbai (MCGM) has estimated that they would earn about Rs. 7900 crores from octroi, out of a total revenue income of Rs. 19,255 crores, or about 41%. The other sources of revenue for MCGM are property tax, receipts from development plan, various user fees and charges, etc, which are not being affected by the Constitutional Amendment, and will continue to accrue to MCGM.

3.13 Further, in their 2015-16 budget, the MGCM has identified that they would need to introduce new taxes such as property tax on slums, transport cess, conservancy cess and fire cess. Incidentally, Mumbai is expected to yield very high revenues from service tax to the State of Maharashtra. It is open to the State to devolve suitable amount there from to the MCGM. Further, under Articles 243 H and 243 X of the Constitution, the State Government can also empower the local bodies to collect certain other levies such as profession tax or other taxes in the State List in the concerned Jurisdiction.

Devolution of funds to the local bodies by the State Government

3.14 The issue of devolution of funds to the local bodies and Municipalities by the respective State Government engaged the attention of the Committee from the day the Bill was referred to the Select Committee. Apprehensions and concerns were expressed from all quarters, even after the clarifications given by the Department of Revenue and Legislative Department, that the bodies which were actually doing the work at the ground level may find it difficult to cope up with their requirements in the post GST era. Concerned over the availability of funds to them, several points were raised i.e how much funds would be allocated to them, how it would be done, whether the funds would ultimately be passed on to them, whether the amount so received would be enough to run their day today activities, there has to be a mechanism in the Bill to protect their interests, how constitutional provisions related to them would be protected and taken care of, etc. otherwise these bodies where actual activity is done would be at the sheer mercy of the Governments in their States. Here, the role of the State Finance Commissions becomes all the more important because while submitting their report they have to give due impetus to this fact that these bodies may not be deprived of their legitimate right guaranteed by the Constitution of India

3.14 The Committee felt that there is no question at all that the concerned State Governments have to devolve funds to the local bodies for their smooth functioning, and in order to do that they have to accept the recommendations of the State Finance Commissions, but what concerned most of the Members was that, either the State Finance Commissions are non-existent or even when they exist their recommendations were not followed in right spirit/ accepted. So, ultimately the local bodies suffer and this in turn hampers the various development works to be undertaken by them.

3.15 In his clarifications, Secretary Revenue stated that Constitution 73rd Amendment provides for setting up of State Finance Commissions which have been given responsibility to make recommendations on principles which would govern distribution of finances between the States and local bodies i.e. Panchayats and Municipalities. Deficiencies, if any, in the functioning of State Finance Commissions in individual States may have to be dealt with separately.

Recommendation

3.16 **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.**

3.17 **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.**

3.18 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.**

3.19 **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).**

3.20 **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.**

3.21 **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 243 G 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.**

3.22 **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.

Creation of National Compensation Fund

3.23 The issue of creation of National Compensation Fund on the lines of National Calamity Fund also engaged the attention of the Committee. One of the Members opined that once the Government of India has decided to compensate the State Governments for any losses incurred by them after the introduction of GST, it would be judicious enough to make National Compensation Fund be part of the Bill. This would act as a confidence building measures and allay their fears as well to a great extent. The Standing Committee on Finance had in their report recommended for creation of such fund.

3.24 In their response, Secretary, Department of Revenue stated that to bridge the trust deficit of the States vis-a-vis the Centre, and to ensure that there is no revenue loss to them, a provision has been made in the Bill to provide compensation to States through a Central Legislation for loss of revenue arising on account of implementation of GST for a period which may extend up to five years on the recommendation of GST Council.

3.25 He further stated that as noted by the Fourteenth Finance Commission, GST Compensation would be a temporary feature, and hence, there is no need to create a GST Compensation Fund through Constitutional Amendment. It is therefore proposed to consider creation of a GST Compensation Fund through Central Legislation.

Recommendation

3.26 **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.**

Dispute Settlement Authority

3.27 Some of the Members were of the opinion that disputes arising out of the recommendations of the GST Council will be decided by a system to be evolved by GST Council. They were of the view that as the principles of natural justice hold that a party to a dispute cannot be a judge in its own cause, leaving disputes to be settled in accordance with the directives of the GST Council would be tent amount to allowing all disputes, which would necessarily involve one or more members of the GST Council as judges in disputes to which they are party.

3.28 With regard to the Dispute Settlement Authority, the Ministry of Finance (Department of Revenue) clarified that the States were apprehensive that the earlier proposed GST Dispute Settlement Authority under proposed new Article 279B will have powers of overriding the supremacy of the Parliament and the State Legislatures and will, thus, affect the fiscal autonomy of the States. The Parliamentary Standing Committee had, therefore, recommended that proposed

Article 279B be omitted. On the recommendations of the Parliamentary Standing Committee on Finance and the Empowered Committee, it was decided to delete this provision, and instead, clause (11) in the proposed Article 279A was inserted to enable the GST Council to decide the modalities to resolve disputes arising out of its recommendations.

3.29 In the proposed Bill, every State would enjoy one vote in the GST Council. Thus there would be no possibility of 'crowding out' of small States in the GST Council.

Recommendation

3.30 **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.**

3.31 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.

Benefit to Consumers

3.32 GST will largely eliminate cascading of taxes and this will benefit the consumers because manufacturers, traders and service providers are expected to be forced to pass on the benefit to ultimate consumers due to operation of market forces and competition. Simplification and automation under GST regime will reduce transaction cost, improve compliance and transparency and will curb undue rent seeking and profiteering in the long run. Such efficiency gains are expected to have beneficial effects on prices which will also ultimately benefit the consumers.

Results of studies conducted in other countries like Australia, Canada and New Zealand on the impact of GST on consumer prices

3.33 Ministry of Finance (Department of Revenue) in their written submission before the Committee stated that 'Results of studies conducted in other countries cannot be directly applied to the Indian economy as India is at a different stage of development and has its own unique features. A study by National Council of Applied Economic Research (NCAER) commissioned by the Thirteenth Finance Commission has projected that after introduction of GST, the overall price levels will go down due to more efficient allocation of factors of production. It also projects that introduction of GST would lead to GDP growth in the range of 0.9 to 1.7 percent and export growth of between 3.2 and 6.3 percent'.

Recommendation

3.34 **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.**

Role of Financial Institutions in post GST era

3.35 The Committee was of the considered opinion that concerns of the Financial Institutions must be given due weightage as their views would be equally important as those expressed by other stakeholders in forming an opinion on the Bill.

3.36 In that backdrop, the Committee interacted with the representatives of various Financial Institutions during its study visit to Chennai, Kolkata and Mumbai. When the question was raised by the Committee as to whether the financial institutions were willing to play the role of nodal bank, receive the CGST and SGST and act as a 'clearing house' for the tax, all the financial institutions expressed their willingness to do so. The public Sector Banks informed the Committee that they should given a greater role under GST. The Committee asked the financial institutions to submit their written views on it.

3.37 In response thereto, the views received from United Bank of India and State Bank of India are as under:-

United Bank of India

3.38 GSTN which is a special purpose vehicle set up under u/s 125of the Companies Act to provide IT infrastructure and service support to the Central and State Governments for implementation of GST has shareholders other than Government of India and State Government, three Banks, viz. ICICI Bank HDFC Ltd., HDFC Bank constitute 30% of the total shareholding of the company. No public sector bank is a stakeholder in the company. As the bulk of tax collection is undertaken by public sector banks, including State Bank of India, we hereby submit to kindly consider inducting at least one of the public sector banks as stakeholder in the GSTN. However, if the same is not possible due to any administrative reason, at least a representation of public sector bank should be given in the Board of GSTN.

Since the fee earned on services being provided by the banks to customer may also be covered under the proposed GST, we submit before the Committee that filing of return and deposit of GST so collected be made applicable in the centralized manner as is being currently done by the Bank while levying service tax on the fees earned on services rendered to the customer.

State Bank of India

3.39 (i) Financial services are exempt from GST/VAT in almost all countries. However, In India, service tax is leviable on fee based services provided by the banks and financial institutions. Presently, the tax is applicable on all fee based activities including the services provided to weaker section of society, whose accounts were opened for financial inclusion to achieve the social goal of the Government. Retail transactions, in terms of volume, constitute more than 90% in banks. The value of service for most of these transactions does not exceed Rs. 100/- considering the larger goal of the Government, it is requested that GST should not be applicable on services rendered to retail depositors. In case the Government wishes to levy GST on such services, some abatement may be considered so that the cost of services to retail customers does not go up, as GST rate is likely to be substantially higher than the present service tax rate. This will go a long way in continuing with affordable banking services to all.

3.40 (v) Considering the huge network of branches/ATM and also considering the complexities involved, we request that banks should be permitted to have a single registration and discharge GST liability centrally and credits of SGST should be available across States.

3.41 (xi) Newspaper reports that the GST rate is likely to be 20-22% as against service tax rate of 14%. Considering that in most of the countries, banking services are outside GST, 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. To be internationally competitive, the GST rate for banking industry should be minimum and in no case should it be more than what is being levied today.

3.42 We request that the best practices followed internationally may be followed and banking services are kept outside GST. 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.

Recommendation

3.43 **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.**

3.44 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.

3.45 **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.**

3.46 On a point raised during the meetings about the differential treatment to alcoholic liquor for human consumption, efforts made to encourage manufacturing activity and Floor Rates with Bands, the Department of Revenue in their written submission stated that:

Treatment of alcoholic liquor for human consumption

3.47 Only alcoholic liquor for human consumption has been excluded from the ambit of GST Constitutionally. All other forms of alcohol like alcohol for industrial use and medicinal and toilet preparation containing alcohol which falls in the taxing domain of the Central Government have been included in GST. This exclusion has been done to address the strong concern of the states regarding loss of revenue if potable alcohol was to be subsumed under GST.

Incentives to State Government to encourage manufacturing activities

3.48 The very nature of GST has features to incentivize manufacturing activity. As GST is a destination based consumption tax, higher the consumption of goods and services in a state, higher would be tax collection. It is well known that higher level of manufacturing activity results in a host of ancillary benefits such as creation of more jobs, higher earnings and higher standard of living, all of which encourage higher consumption of goods and services within the state leading to higher tax collection.

Floor Rates with Bands

3.49 To give flexibility to the States, the provision of 'bands' over the GST floor rates, to be recommended by the GST Council, has been introduced. Depending on the local situations and requirements, the States have the option to levy slightly higher tax within this band.

GST Rate

3.50 I. On the aforesaid issue, experts in their written comments stated the following:

3.51 Once the enabling framework is created for the levy of GST, the next most crucial step in its implementation is the determination of the tax base and tax rate. This issue has been discussed in detail in the "Report of the Task Force on GST" that was submitted to the 13th Finance

Commission. The Report recommends a broad base for the GST, and a combined Centre and State revenue neutral rate of 12%.

3.52 A broad base and moderate rate is an essential feature of a good tax system. Multiplicity of tax rates is also to be avoided. A majority of the VAT/GST system introduced in the last three decades embrace these features. For example, VAT/GST in New Zealand is levied on a comprehensive base at a single rate of 12.5% (at inception), in Singapore at 3%, Japan at 3%, Australia at 10%, South Africa at 16%, and Malaysia at 6% (most recent, implemented in 2015). Levy of GST on a comprehensive base makes it an economically efficient and productive source of revenue. In each of the examples cited, the revenue yield as a percent of GDP is estimated to be 0.5% or more for each percentage point of the GST rate. In New Zealand, the GST yield was the highest, at 0.74% of GDP (i.e., 12.5% GST was yielding revenues in excess of 9% of GDP).

3.53 The Centre and State revenues in India to be replaced by GST are a little less than 6% of GDP. The international benchmark revenue productivity of 0.5% of GDP yields a target revenue neutral rate for India of less than 12%. In their view, this remains a realistic option for India, which would be politically appealing, catalyse voluntary compliance, and provide a significant boost to investment and economic growth. While the tax base and rates are to be decided by the GST Council, the Bill should not create any barriers to levy of such a tax, i.e., it should allow the levy of tax to the broadest possible base.

GST Rate - it must not be inflationary

3.54 II. In terms of the proposed Article 279A (4)(e), the GST Council shall make recommendations to the Union and the States on 'the rates including floor rates with bands of goods and services tax'. The GST rate is a very important factor in earning the trust of the tax payers. Howsoever efficient the GST machinery may be, the tax-payers won't welcome GST happily if the GST rate is kept high because that will lead to high inflation. Even in developed countries like Australia and Canada, GST was opposed by the poorer sections of the taxpayers because of high GST rate.

GST and Revenue Neutral Rate (RNR)

3.55 The GST rate would normally be based on the Revenue Neutral Rate (RNR). In the present circumstances, the RNR is expected to be high because Petroleum and its products and Alcohol have been kept out of GST and consequently, the tax base would shrink. But, a high GST rate in line with high RNR would definitely lead to high inflation. India cannot afford to have high inflation at this stage of the economy. Therefore, it is submitted that **not to go strictly by the RNR while fixing the GST rate.** The newspaper reports suggested first a RNR of around 27%, and later it was reported to be somewhere between 20 and 23%. Internationally, GST rate normally varies between 16 to 20%, with exceptions like Australia at 10%, New Zealand at 15%, Japan at 8%, Germany at 23% and Malaysia at 6%. France has four rates, the highest 20% and lowest 2.1%, while UK has two rates 20% and 5%. To start with, **India's GST rate should not go beyond 20% for standard rate and perhaps 14% for reduced rate.**

<u>**Recommendation**</u>

3.56 **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

3.57 The issue as to whether the proposed Article 246A intends to interfere in the State Governments powers mentioned under in the Concurrent List was also raised during the meeting of the Committee held on 3rd July, 2015. Replying to the Query, the Secretary, Department of Revenue informed the Committee that "*GST is a composite tax. Both the Centre and the States will have the power to levy it. Therefore, a separate specific provision is being made in Article 246A to enable both the Parliament and the State Legislatures to enact a proposal to levy and collect this tax. In no way this is diluting the powers of the States. "This will in no way interfere with the powers of the States under the Concurrent list.*

IT Preparedness

3.58 Building IT infrastructure and developing IT services through GSTN: Central and State Governments have jointly registered Goods and Services Tax Network (GSTN) as a not-for-profit, non-Government Company to provide shared IT infrastructure and services to Central and State Governments, tax payers and other stakeholders for implementation of GST. GSTN was incorporated in March 2013. GSTN is working on creating a GST portal and related ICT infrastructure together with an interface with State IT systems. To support the States, GSTN will prepare the necessary software for front-end modules which would include Registration and Returns. GSTN would also prepare back end processing modules like assessment, audit, etc. which would be required by the various States. In case the States want to develop their own software for backend modules, they shall be free to do so and in case they want to use the backend modules prepared by GSTN, they shall be provided the same.

3.59 The Committee was given to understand that an 'As-Is' Study was conducted by the NSDL to assess the capacities of the existing State IT systems and operational procedures, and to identify gaps with respect to the envisaged GST system. It is also expected that development of IT infrastructure and services is to complete by March, 2016.

3.60 The Committee is aware that Goods and Services Tax Network (GSTN) a not-for-profit, non-Government Company has been jointly set up by the Central and State Governments and it will provide shared IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders. Further, it is expected that GSTN would complete the development of IT infrastructure and services by March, 2016 i.e. exactly one month before the date from which the Government of India intends to implement it throughout the country.

3.61 Apprehensions related to level of IT preparedness have been expressed at various fora together with concerns related to its implementation. There are many questions to be answered and many more will arise at the time of its implementation and how it is to be linked with the system available with states, but at the very same time what has to be seen is its long lasting benefits that would accrue to the nation in the years to come.

3.62 The Committee feels that together with IT preparedness, training would be a crucial element to look for. Our is a society where most of the population is not techno savvy and there would be hitch in using it by those who are at the helms of affairs. Hence, to overcome all these apprehensions it would be imperative to impart training to the personnel's at all levels and at the very onset so that their fear about its usage, implementation, affects, etc may be removed and results in building their confidence in doing or performing various tasks.

Recommendation

3.63 **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 ofunparallel 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.**

Apprehension among State Governments

3.64 Many State Governments/UTs either submitted their written views or appeared before the Committee on the Bill. Doubts clubbed with apprehensions of numerous types were raised and brought to the notice of the Committee. Apprehensions were cast over the losses in revenue and their sources after the implementation of Goods and Services Taxes in India. Similarly, there were apprehensions relating to/ demands from all corners that whether States may be empowered to levy higher taxes on tobacco and tobacco products, 100% compensation for a period of 5 years should be given, Abrupt deletion of entry 52 from the state list may financially cripple the local bodies, Flexibility may be given to the states to fix SGST rates as per their needs from time to time, to protect the revenue of the local bodies special category states may be allowed to levy entry tax, Inclusion of petroleum products in the present bill with the safeguard that it shall be operationalised on the recommendation of GST Council on a date later than five years, In clause 19 of the Bill, instead of the words "for such period which may extend to five year" words "for a period not less than five years" may be replaced. Similarly, for the words "Parliament may" the words "Parliament shall" be substituted, Amend the entry 62 to read it as under 62 taxes on entertainment, betting and gambling". Similar demands in respect of Entertainment, Amusement, Betting & Gambling that proposed Amendment by way of insertion of clause 16 (e) be omitted, Taking into consideration of adverse impact on environment, proposes for levy of an additional non-rebatable cess subject to suitable framing of guidelines, "Taxes on food grains contributed by the States to National Food Grains Pool subject to any limitations imposed by Parliament by law", etc.

Recommendation

3.65 **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.**

3.66 **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 the introduction of it, 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.**

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

AS REPORTED BY THE SELECT COMMITTEE No.- of 2015

	THE CONSTITUTION (ONE HUNDRED AND FIRST AMENDMENT) BILL, 2015 [Words underlined indicate the amendments suggested by the Select Committee and asterisks indicate omissions]	
	A **BILL**	
	further to amend the Constitution of India.	
	BE it enacted by Parliament in the Sixty-sixth Year of the Republic of India as follows:—	
	1. (1) This Act may be called the Constitution (One Hundred --------Amendment) Act, 2015.	Short title and commencement.
	(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:—	Insertion of new article 246A.
	"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.	Special provision with respect to goods and services tax.
	(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.	Amendment of article 248.

	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.	Amendment of article 249.
	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.	Amendment of article 250.
	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.	Amendment of article 268.
	7. Article 268A of the Constitution, as inserted by section 2 of the Constitution (Eighty-eighth Amendment) Act, 2003 shall be omitted.	Amendment of article 268A.
	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.	Amendment of article 269.
	9. After article 269 of the Constitution, the following article shall be inserted, namely:—	Insertion of new article 269A.
	"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.	Levy and collection of goods and services tax in course of interState 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,—	Amendment of article 270.
	(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.	Amendment of article 271.
	12. After article 279 of the Constitution the following article shall be inserted, namely:—	Insertion of new article 279A.
	'279A. (1) **The President shall, within sixty days from the date of commencement of the Constitution (One Hundred ---------- Amendment) Act, 2015, by order, constitute a Council to be called the Goods and Services Tax Council.**	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; the rates including floor rates with bands of goods and services tax; 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. Meetings**	
	(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	
	(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 toresolve disputes arising out of its recommendations.".	

	13. In article 286 of the Constitution,—	**Amendment of article 286.**
	(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,—	Amendment of article 366.
	(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, article241 or article 279A" shall be substituted.	Amendment of article 368.
	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.".	Amendment of Sixth Schedule.
	17. In the Seventh Schedule to the Constitution,—	Amendment of Seventh Schedule.

	(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 sub-section (2).	Arrangement for assignment of additional tax on supply of goods to States for two years or such other period recommended by Council.
	(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 sub-section (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. (5) For the purposes of this section, "State" shall have the meaning assigned to it in clause (26B) of article 366 of the Constitution.	
	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 a* period **** of five years.	Compensation to States for loss of revenue on account of introduction of goods and services tax.
	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 in force until amended or repealed by a competent Legislature or other competent authority or until expiration of one year from such commencement, whichever is earlier.	Transitional provisions.
	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.	Power of President to remove difficulties.

Annexe

to

Note of Dissent submitted by

Madhusudan Mistry, Mani Shankar Aiyar and Bhalchandra Mungekar

Text of amendments to the draft Report submitted by Madhusudan Mistry, Mani Shankar Aiyar, Bhalchandra, Mungekar

Clause 2

Paragraph 5.4

In the third line, after "concerned" and before "the Ministry of Finance" **add:** "the members moving the amendment stressed the need to keep GST rates moderate and reasonable so that consumers, particularly poor consumers, are not excessively burdened, and to this end proposed that the GST Council be bound by the Constitution ~o not exceed 18% as the rate for an adequately revenue-generating GST. They clarified that there is the precedent of a specific rate of taxation provided for in article 276(2) as also in clause 18 of the Bill before the committee."

Clause 9

Paragraph 32.3A

Add new paragraph to read as follows: "These members rejected the argument made by Government representatives that as the definition of the term was being decided by three government committees working on GST, SGST and IGST there was no need to define the term in the Constitution, stating that a Select Committee of Parliament cannot be subordinated to ongoing work of governmental committees and, therefore, it would be improper to commend a Bill to Parliament that did not adequately define so crucial a term as "supply /supplies".

Clause 12

Paragraph 35.3A

Add new paragraph to read as follows:

Some members proposed that under clause 4(c), among the "principles" to be considered by the GST Council while preparing GST laws the principle of "share of local bodies in revenue buoyancy and compensation for losses sustained through taxes subsumed" should be included as articles 243H and 243X provide for State Legislatures to, by law, ensure the "sound finances" of the local bodies. This would also enable State Finance Commissions set up under articles 243 I and 243 Y to provide for augmenting the share of local bodies in revenue buoyancy generated by the adoption of GST.

Paragraph 35.38

Add a new paragraph to read as follows:

With reference to sub-clause (4) (g) which provides for "special consideration" to certain States, some members proposed, in keeping with article 2438 (2), that "special consideration" may also be extended to States like Goa and Union territories like Puducherry by adding at the end of 4(g) "and any State or Union territory having a population not exceeding twenty lakhs". This proposal was made in response to the specific request of Goa and Puducherry to be given special consideration in view of their small size and limited sources of revenue. **Paragraph 35.4**

Amend the last sentence to read: "These items have been kept out of GST **for the present** to protect the revenue interest of the States"

Paragraph 35.4A

Add the following paragraph to read as follows:

Some members sought the inclusion in clause 12(5) of highly revenue-generating products like tobacco and tobacco products, alcohol for human consumption and electricity supply and consumption within a period not later than five years so that India, within a few years, fulfills the fundamental GST objective of making the entire nation a single common market for all products.

Clause 13

Paragraph 39.3A

Add the following new paragraph to read as follows:

Some members sought the definition in the Constitution amendment Bill itself of the term "supply" in proposed clause I(A) of article 286

Clause 14

Paragraph 40.1

Add at the end of the draft sentence the words: "so as to progressively ensure a true common market for all goods"

Paragraph 40.2

Add at the end of the draft sentence the words: "so as to avoid the circular definition of ,services' meaning 'anything other than goods'."

Clause 16

Paragraph 46.1

Amend the opening line to read as follows: "With a view to progressively promoting a common market in all goods and services," before "Some members"

Paragraph 46.2

Add at the end of the present draft sentence the following words: "as it does not figure in the Constitution?"

Paragraph *46.8A*

Add the following new paragraph:

Some members did not accept Government's views as set out under paragraphs 46.6, 46.7 and 46.8 as the overarching objective of GST is to progressively render India a common market for all goods and services, including so-called 'demerit' goods. If a higher rate of tax has to be imposed on such goods, the GST Council may be authorised to do so.

Clause 18

Paragraph 52.5

Add at the end of the draft sentence the following words: "because these members have proposed that, under clause 19, 100 percent compensation be provided for a period not less than five years. In view of guaranteed compensation for any loss incurred by any State or Union territory, there is no need to levy a market-distorting 1% additional levy"

Clause 19

Paragraph *53.4A*

Add the following new paragraph:

Some members proposed the addition of the words: ", as well as The Panchayats and The Municipalities through State Legislatures" so as to ensure the "sound finances" of the local bodies while respecting the Constitutional order that as local bodies are in the State List it is for State Legislatures, by law, to "authorise a Panchayat/Municipality to levy, collect and appropriate" such taxes. They held that a mere recommendation to this effect by the Select Committee would not be binding in the sense that an appropriate provision in the Constitution would be.

Chapter IV

Dispute Settlement Authority Paragraph 62.1

Amend the second sentence to read as follows:

They were of the view that as the principles of natural justice hold that a party to a dispute cannot be a judge in its own cause, leaving disputes to be settled in accordance with the directives of the GST Council would be tantamount to allowing all disputes, which would necessarily involve one or more members of the GST Council as judges in disputes to which they are party.

DISSENT NOTE BY AIADMK PARTY ON THE REPORT OF THE SELECT COMMITTEE ON THE CONSTITUTION (ONE HUNDRED AND TWENTY-SECOND AMENDMENT) BILL, 2014

The views of the AIADMK Party on the Constitution (One Hundred and Twenty-Second Amendment) Bill, 2014 on Goods and Services Tax (GST) passed by the Lok Sabha on 6th May, 2015, and which is presently under consideration of the Select

Committee by the Rajya Sabha, are in consonance with the letters dated 17.8.2014 and 19.12.2014 addressed by our Leader and the Hon'ble Chief Minister of Tamil Nadu to the Hon'ble Prime Minister and the letter dated 10.9.2014 addressed to the Union Finance Minister, in so far as they impinge upon the fiscal autonomy of States, and are as follows: -

I. PROVISIONS RELATING TO GOODS AND SERVICES TAX COUNCIL:

GST Council as a constitutional body impinges on the legislative sovereignty of both Parliament and the State Legislatures. It also completely jeopardizes the autonomy of the States in fiscal matters. In spite of our repeated objections, the present Bill also envisages the formation of the GST Council. We strongly object to the provision for the GST Council.

Ideally it should not exist. The existing mechanism of the Empowered Committee of State Ministers which dealt with VAT issues is adequate. No statutory GST Council is required.

Furthermore, the decision making rule and voting weightage in the proposed Council are completely unacceptable. They give the Government of India an effective veto in the GST Council and no distinction is sought to be made amongst the States in weightage. Hence, if at all a Council is formed, the weightage of the vote of the Central Government should be reduced to **one-fourth** of the total votes cast and that of the States should be increased to three-fourths of the total votes cast. Further, the weightage of each State's vote should be in proportion to the representation of each State in the Council of the States. This is important as the changeover to GST has different implications for different States based on their size and reliance on own tax revenues.

However, the Select Committee has not considered these views on the GST Council and has not recommended appropriate amendments. Hence the AIADMK Party dissents from the report of the Select Committee.

II. PROVISIONS RELATING TO PETROLEUM AND PETROLEUM PRODUCTS:

Petroleum and Petroleum products, which are currently outside the purview of State VAT in most States, are proposed to be covered under GST in the Constitution Amendment Bill though the date on which such tax will be levied on these products has been left to the recommendation of the GST Council. Bringing these products under the ambit of GST will entail huge revenue loss to the States as Input Tax Credit will have to be provided eventually. Further, there is no guarantee that GST will not be prematurely imposed on these products. Hence, considering the limited revenue resources of the State, as has been repeatedly insisted upon by our Leader, the Hon'ble Chief Minister of Tamil Nadu Puratchi Thalaivi Amma, Petroleum and Petroleum products should be totally kept outside GST. However, the Select Committee has not considered these views on the provisions relating the petroleum and petroleum products and has not recommended appropriate amendments. Hence the AIADMK Party dissents from the report of the Select Committee.

III. PROVISIONS RELATING TO TOBACCO AND TOBACCO PRODUCTS:

States should also be empowered to levy higher taxes on Tobacco and Tobacco products over and above SGST similar to what has been allowed to the Centre.

However, the Select Committee has not considered these views on the provisions relating to tobacco and tobacco products and has not recommended appropriate amendments. Hence the AIADMK Party dissents from the report of the Select Committee.

IV. PROVISIONS RELATING TO ADDITIONAL LEVY OF 10% IN THE COURSE OF INTER-STATE TRADE OR COMMERCE:

Manufacturing States like Tamil Nadu stand to permanently lose substantial revenue if GST is implemented, as GST will be based on the destination principle. Though the Bill envisages that an additional tax on supply of goods to the extent of 1% in the course of inter-State trade or commerce for a period of 2 years or such other period as the GST Council may recommend, it also empowers the Government of India to exempt goods from this additional levy of 1%. The Select Committee has recommended that this additional levy of 1 per cent shall be restricted to "all forms of supply made for a consideration".

None of these formulations relating to the levy of 1 per cent additional tax really meet the requirements of a manufacturing State like Tamil Nadu. **Instead, the States should be permitted to retain 4% of CGST part of the IGST on all inter-State sales/transfer of both goods and services.** This will enable a substantial reduction in the compensation payable to the States. At the same time, since it would come out of the CGST part of the IGST, hence it would not place the destination States at any disadvantage with regard to revenue flow.

However, the Select Committee has not considered these very valid views on the issue of taxation of interstate rate and has not recommended appropriate amendments. Hence the AIADMK Party dissents from the report of the Select Committee.

V. PROVISIONS RELATING TO COMPENSATION OF REVENUE LOSS TO THE STATES:

The Bill provides for Parliament to enact a law to provide for compensation to the States for such period which may extend to 5 years on the recommendation of the GST Council.

The Select Committee has suggested a modification indicating provision of compensation for a period of five years. While this removes the uncertainty regarding the period for which the compensation would be provided, it still falls short of the demands of the States regarding the extent of compensation.

In the 14th Finance Commission's Report it has been recommended that 100% compensation may be provided for the first 3 years, 75% for the 4th year and 50% for the 5th year. In discussions it appears that the Government of India is in line with this view.

However, taking into account the permanent loss that would accrue to the States, the AIADMK party suggests that **1000/0 compensation should be provided for a period of not less than 5 years** and a consensus should be arrived at on the methodology of computation of compensation and the mechanism to administer the compensation. As the Select Committee's report falls short of the expectations of the AIADMK Party we dissent from the report of the Select Committee.

VI. CONSENSUS ON IMPORTANT ISSUES RELATING TO GOODSAND SERVICES TAX:

As our Leader, the Hon'ble Chief Minister of Tamil Nadu has pointed out, it would be appropriate to arrive at a **broad consensus** on a number of other important issues relating to GST like revenue neutral rates, floor rates with bands, commodities to be excluded from GST, IGST model and clarity on dual administrative control before proceeding further with the enactment, so as to allay the genuine fears of the States over loss of fiscal autonomy and permanent revenue loss.

The Select Committee has also gone beyond its brief on the issue of Revenue Neutral Rate (RNR) and recommended that to start with, India's GST rate should not go beyond 20% for standard rate and perhaps 14% for reduced rate. This is a matter for the Empowered Committee of State Finance Ministers/ GST Council on which to take an appropriate view. Hence the AIADMK Party is unable to accept this recommendation in the Select Committee's report.

On behalf of the AIADMK of the Rajya Sabha was requested above serious concerns relating to the and Twenty-second Party, the Select Committee to duly take into account the Constitution (One Hundred Amendment) Bill, 2014 while finalizing the report of the Committee.

As these views have not been duly considered by the Select Committee, this note may be appended to the Report as a dissent note containing the views of the AIADMK Party.

<u>Recommendations/Observations at a Glance</u>

1. CLAUSE 1 TO CLAUSE 8 : THESE CLAUSES HAVE BEEN ADOPTED WITH NO CHANGE.

2. 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.

3. CLAUSE 10 & CLAUSE 11 : THESE CLAUSES HAVE BEEN ADOPTED WITH NO change.

4. Clause 12 - 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.

5. Clause 13 - The term 'supply' would be defined in the various GST laws relating to CGST and SGST. Hence, the Committee feels that it would not be appropriate to insert the definition of supply in this clause. This clause has been adopted with no change.

6. Clause 14 - 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.

7. Clause 15 & Clause 16 -These clauses have been adopted with no change.

8. Clause 17- 2.108 **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.

9. Clause 18- 2.139 **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 ".

10. Clause 19 - 2.158 **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."

11. Clause 20 & Clause 21 : This clause has been adopted with no change.

12. 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 243 G 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.

13. 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.

14. 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.

15. 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.

16. 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.

17. 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

18. 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.

19. 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 the introduction of it, 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.

Acronyms

1.	ASSOCHAM	The Associated Chambers of Commerce and Industry of India
2.	CII	The Confederation of Indian Industry (CII)
3.	CST	Central Sales Tax
4.	CGST	Central Goods and Services Tax
5.	CVD	Countervailing Duty
6.	EC	Empowered Committee
7.	FICCI	Federation of Indian Chambers of Commerce and Industry
8.	GST	Goods and Services Tax
9.	GSTN	Goods and Services Tax Network
10.	VAT	Value Added Tax
11.	IGST	Integrated Goods and Services Tax
12.	MCGM	Municipal Corporation of Greater Mumbai (MCGM)
13.	NIPFP	National Institute of Public Finance and Policy
14.	NCAER	National Council of Applied Economic Research
15.	NSDL	National Securities Depository Limited
16.	RNR	Revenue Neutral Rates
17.	SGST	State Goods and Services Tax
18.	SFC	State Finance Commission

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PRESENT STATE OF GOODS AND SERVICES TAX (GST) REFORM IN INDIA

Sacchidananda Mukherjee

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Present State of Goods and Services Tax (GST) Reform in India

Sacchidananda Mukherjee*

Abstract

To remove cascading effect of taxes and provide a common nation-wide market for goods and services, India is moving towards introduction of Goods and Services Tax (GST). Under the proposed indirect tax reform both Central and State Governments will have concurrent taxation power to levy tax on supply of goods and services. It is expected that the proposed regime will improve tax collection and minimize leakage, as both Central and State Tax Administrations will monitor and assess same set of taxpayers. There are several challenges before introduction of GST and these can be classified into two broad heads - a) GST Design and Structure related, and b) GST Administration and Institutional. On design related issues, broad consensus on choice of revenue neutral rates (RNRs), harmonization of GST rate(s) across States, harmonization of list of exempted and excluded goods and services and thresholds for mandatory GST registration across States are yet to be reached. Similarly, there are several issues involved in tax administration (between Central and State Tax Administrations and also across State Tax Administrations) which are not yet solved. Taking cognizance of discussion available in the public domain this paper attempts to provide a broad contour of the proposed GST regime and highlights major challenges which require immediate attention of the Governments.

KEYWORDS: Goods and Services Tax, Value Added Tax, Design and Administration of Taxation, Fiscal Federalism, Indirect Taxation, India.

JEL Classification Codes: H250, H710, H770

1. Introduction

India is moving towards introduction of Goods and Services Tax (GST). GST would be multistage comprehensive Value Added Tax (VAT) encompassing both goods and services. Given federal structure of India and the constitutionally assigned taxation powers to different governments, GST would be major indirect tax reform in India where both Centre and State Governments will have rights to tax goods as well services at every stage of production and distribution. Introduction of

* Associate Professor, National Institute of Public Finance and Policy (NIPFP), 18/2, Satsang Vihar Marg, Special Institutional Area (Near JNU East Gate), New Delhi - 110067. INDIA. Tel: +91-11-26852398/26569780, Mobile: +91 9868421239/ 9953978287, Fax: +91-11-26852548. E-mail: sachs.mse@gmail.com/ sacchidananda.mukherjee@nipfp.org.in

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Value Added Tax (VAT) at State level since April 2005 resulted in first round of cleaning up of hidden indirect taxes which facilitated expansion of tax base,[1] better tax compliance and higher tax buoyancy for majority of Indian States. It is envisaged that the proposed GST system will further clean up the indirect tax system by reducing cascading of taxes and facilitating nation-wide market for goods and services. Under GST, it is expected that harmonization of indirect tax structure (tax rates and tax base across States), concurrent taxation power of Centre and States on consumption of goods and services and joint monitoring of same taxpayers would result in better tax compliance, minimum leakage of revenue and better tax coordination between Central and State tax administrations. Among other factors, reduction of cascading of taxes and transaction costs associated with inter-State sales of goods could facilitate achieving higher economic growth by attracting investment.[2] It is expectation of the Central Government that introduction of GST will improve India's ranking in World Bank's ease of doing business as it will remove cascading of taxes as well as transaction costs involved in distribution of goods and provide services across States.[3] Major fiscal motives behind introduction of GST could be - a) expansion of fiscal space of the governments -the rising demands for public expenditure and given the revenue constraints, it is likely that GST could provide additional fiscal space to finance public expenditures, b) overcoming the Constitutional barriers relating to taxation by removing definitional differences between goods and services and that of manufacturing and distribution of goods, and c) achieve better fiscal prudence by aligning taxation powers to expenditure commitments/ responsibilities under fiscal federalism.

Adoption of rule-based fiscal management system in India (under the Fiscal Responsibility and Budget Management (FRBM) Act, 2003) since 2003 resulted in better fiscal management in majority of Indian States. Under the Act, individual States are required to maintain zero revenue deficits and limit fiscal deficit of maximum 3 per cent of Gross State Domestic product (GSDP). While majority of Indian States met their FRBM targets at least in revenue deficits, Central Government is not able to contain its revenue as well as fiscal deficit to meet FRBM targets. The major reasons for low fiscal performance of the Central Government are falling share of indirect tax in GDP since 1987-88 and average indirect tax buoyancy with reference to GDP is well below 1 per cent since the introduction of economic liberalization in 1991, whereas indirect tax buoyancy of States is well above the Centre since 2008-09. It is expected that under the proposed GST system, Central Government will share tax buoyancy of indirect taxes with

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For majority of Indian States, sales tax was first point tax on sales which was not able to capture value addition in subsequent sales.

There are three alternative ways that GST could attract investments - a) removal of cascading of taxes could release working capital which is currently blocked as unpaid ITC, b) removal of stranded costs (including transaction costs) involved in inter-state sales of goods will induce investment, c) if benefits of cascading of taxes are passed on to consumers, it will induce consumers' behavioural changes through price and income effects, and generate additional demand for goods and services. It is also expected that seamless access to market across Indian States will facilitate achieving better efficiency in production and distribution and could minimise costs which will attract larger investment.

India's rank in World Bank's ease of doing business is 142 out of 189 countries, as on June 2014.

States and vice versa. The resulting effect of this sharing could be a win-win situation for both stakeholders.[4]

Stated objectives of proposed GST reform are - a) widening the tax base by expanding the coverage of economic activities under GST and cutting down exemptions, b) achieving better tax compliance through mitigation of tax cascading, double (multiple) taxation and by lowering tax burden under GST, c) improving the competitiveness of domestic industries in international market by removing hidden and embedded taxes and d) achieving common national market for goods and services by unifying the tax structure across States (Government of India, 2015). The present paper attempts to review these objectives by considering the design and structure of GST as available in the public domain as a point of reference.

We briefly discuss the present system of indirect taxation of India in the next section and highlight the major drivers for introduction of GST in India. In section three, we present the proposed structure and design features of GST. In section four, we discuss the challenges in design and administration of GST and possible scope for tax coordination. We provide a brief discussion of GST institutions in section five and draw our conclusions in the last section.

2. Present System of Taxation of Goods and Services in India

Indirect tax system in India has gone through several reforms in the last two decades (Rao and Rao, 2005).[5] At the Central level, introduction of Central Value Added Tax (CENVAT) in 2000-01 and Service Tax in 1994 are the major ones. Following the recommendations of Tax Reform Committee (TRC),[6] CENVAT was introduced in India which gradually unified tax rates on manufacturing and gave greater importance on account-based administration in addition to allowing for input tax credit against inputs and capital goods up to the manufacturing stage. However, before introduction of CENVAT, manufacturing level VAT system (Modified Value Added Tax, MODVAT) was introduced in 1986 with limited coverage and provision for input tax credit / set off (based on physical verification of goods) (Aggarwal, 1995).[7] In 1994, the scheme was expanded and credit of duty paid on capital goods was also brought under the scheme. In design MODVAT system was inspection intensive (physical verification of goods) and allowance of input tax "credit-based on a one-to-one correspondence between inputs and outputs" resulted in substantial administrative and compliance costs (Rao and Rao, 2005). Introduction of CENVAT widened the tax base and allowed input tax credit without physical verification. At the Central

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[4] Currently taxation power of services lies with Centre and under the GST States will also have power to tax services and therefore will share tax buoyancy of services with Centre.

[5] Liberalization of Indian economy in 1991 associated with major changes in the tax system and the recommendations of Tax Reforms Committee (TRC) played an important role in modernizing the tax system. A comprehensive review of the present indirect taxation system is presented in Rao and Rao (2005).

[6] Tax Reform Committee was set up in 1991 under the Chairmanship of Dr Raja J. Chelliah and the Committee submitted three reports during 1991-93 (Bird, 1993). Recommendations of the Committee helped to modernise Indian taxation system.

[7] MODVAT excluded textiles, petroleum and its products, tobacco and its products (Aggarwal, 1995).

Government level, service tax is introduced in 1994 with tax initial on three services.[8] Gradually number of services under service tax expanded with rationalization of tax rates (Rao and Chakraborty, 2013). In the Union Budget 2012-13, the concept of negative list based taxation of services is introduced with a list of 17 services (as on 2013-14).[9] However, a number of services which are in the negative list are either taxed by the State Governments (e.g., service of transportation of passengers, services by way of transportation of goods, betting, gambling or lottery, access to a road or a bridge on payment of toll charges, Trading of Goods) or by the Central government by other taxes (e.g., processes amounting to manufacture or production of goods).[10] In 2004, the input tax credit scheme for CENVAT and Service Tax was merged to permit cross flow of credit across these taxes.

Prior to introduction of Value Added Tax (VAT) at State level, there was tax competition between States (Rao and Vaillancourt, 1994), disharmony in tax rates, number of tax schedules and exempted items.[11] VAT introduced since 2005-06 replaces the sales tax system which encompasses sale of goods up to the retail stage. VAT is levied on intra-State sale of goods where input tax credit on inputs and capital goods is available only for intra-State purchases of these goods. VAT credits are adjusted against VAT and/or Central Sales Tax (CST) liabilities.[12]

Introduction of VAT could be termed as the first coordinated tax reform initiative ever carried out in India since independence and it achieved many milestones. The first, Empowered Committee of State Finance Ministers is formed to build a bridge across States as well as Central Government. The Committee played a crucial role to build consensus among States and Central Government to roll out VAT. Second, relatively harmonized tax structure, rates, tax schedules and tax base under VAT which resulted in relatively cleaner tax system for State tax administration and harmonization of rules and regulation created a favorable environment for economic activities. Third, introduction of pre-announced (informed) audit instead of surprise inspection of premises resulted in greater reliance on voluntary compliance by taxpayers. Fourth, by allowing input tax credit against inputs as well capital goods, the system facilitated the State tax administration to get familiar with processes of refunds which prepared the base for further tax reforms like GST. Fifth, adoption of IT intensive infrastructure empowered State tax administration to sharpen their skills in more crucial parts of tax administration (e.g., scrutiny assessment, risk analysis, fraud detection). Sixth, by allowing ITC the system unlocked substantial working capital previously

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[8] Tax on telephone billing, tax on general insurance premium and tax on stock brokerage commission

[9] Introduction of negative list based taxation of services resulted in transition from selective list based taxation of services to comprehensive approach where all services, except those are in the negative list, are brought under the service tax.

[10] Public good nature of some services (e.g., services provided by government or local authority, services provided by Central Bank (Reserve Bank of India), services provided by a foreign diplomatic mission located in India) make difficult to tax.

[11] As for example, there were minimum 7 (in Odisha and West Bengal) to maximum 25 (in Gujarat) tax rates and sales tax general rate used to vary from 4 to 12 percent. In addition, a wide variation in sales tax rate around the general rate was also reported across the States (Aggarwal, 1995).

[12] Central Sales Tax (CST) is central levy on inter-State sales of goods. However, it is collected and retained by the State Governments.

locked in as unpaid ITC and provided incentives to taxpayers for voluntary compliance.

2.1 Taxation of Goods

There are four major taxes on domestically produced goods in India. First, the Central Excise (or CENVAT) duty is a Value Added Tax (VAT) at the central level levied and collected by the Central Government on the manufacture of goods. CENVAT duty is uniform across States and due input tax credits (CENVAT Credit) are allowed against Central Excise Duty, service tax (since 2004), and Countervailing Duty (CVD) and cesses thereof (for imported goods/ inputs) (since the era of MODVAT).

Among other three taxes, State sales tax or VAT and Entry Tax (in lieu of Octroi) are levied by the States and also collected and retained by the State Governments.[13] The Central Sales Tax (CST) is levied by the Central Government on inter-State sales of goods but it is collected and retained by the exporting States. The rates of State taxes vary across States and also the rules and regulations to allow input tax credits. For example standard VAT rate varies across States - from 12.5 percent for majority of States to 14.5 percent (e.g., in West Bengal, Rajasthan). For goods which are under State VAT, due input tax credits (against State purchases) are allowed. For majority of States, Entry Tax (in lieu of Octroi) is commodity specific (e.g., Bihar, Himachal Pradesh, Gujarat) and some States do not allow ITC against entry tax (e.g., Assam, Karnataka, Odisha). Entry tax rates vary across States and commodity. CST is levied on inter-State sales.[14] It is expected that under GST regime, the tax structure across States will be harmonized and multiple taxes will be subsumed under GST. The present system results in substantial transaction costs for businesses, as they have to comply with different State tax rules and regulations with different tax rates for same commodity, and it discourages voluntary compliance which leads to revenue leakage.[15]

Present system of taxation of goods can be better described as origin-based tax system where manufacturing (originating) State collects Central Sales Tax (CST) on goods being sold inter-State. Since it is a tax collected by the origin (exporting) State, the destination (importing) State does not allow input tax credit against CST. Therefore, CST remains a stranded cost for inter-State dealers and manufacturers using goods procured from other States. Though, input tax credit against CST sales is allowed, withholding of ITC for various reasons is common for many States (e.g., in case of consignment / branch transfers). Present rate of CST (with effect from 1 June 2008) is 2 percent (maximum limit) at which States could levy entry tax. Many States, mostly special category States, do not levy CST. However, if the goods are sold from the origin State to final consumer (B2C transactions), the origin State levies CST at the rate equivalent to State VAT whereas the destination State does not get any tax on the transaction. However, if the incoming good is imported for trading (B2B transactions), the import attracts full State VAT in addition to Entry Tax depending on the type of the good and State of operation. States where entry tax is collected on behalf of local governments and the revenue is passed on to them, entry tax remains a stranded

[13] Also oblige to share with local bodies (Urban and Rural) as per the recommendation of State Finance Commission.

[14] A tax on inter-State sales of goods levied by the Central Government (the Central Sales Tax (CST) Act, 1956) but collected and retained by exporting States.

[15] It is expected that under GST, rules and regulations related to indirect taxes will be harmonized across States which will allow ease of doing business.

cost for these States (e.g., Karnataka, Odisha) as no ITC against Entry Tax is allowed.[16] A few States provide input tax credits against entry tax provided the goods are meant for further value addition or trade in the concerned State (e.g., Bihar, Gujarat). The present system of tax on inter-state movements of goods provides incentive to manufacturers to either locate their branch offices and/ or set up their own distribution networks across all the States of their operations so that they could send the goods as branch/ consignment transfers and avoid paying CST and entry tax.[17] The present system does not allow the generation of a seamless common market for goods and services. In addition to the structure, business faces different tax rates across States and also rules and regulations for allowance of ITC also differ from State to State. Since legal trade attracts multiple taxes, the system also encourages illegal trades of at least high value goods (e.g. tobacco products). Therefore removal of CST and Entry Tax from inter-State movements of goods will help to shift indirect taxation system from origin-based to destination-based which is desired outcome of the proposed GST regime. At present, consumers in importing States pay taxes to exporting States where manufacturing is taking place. Since, manufacturing base in India is not evenly distributed across States, a few States gain from this distortionary tax system.

Depending on definitional difference between goods and services, and stage of value addition (production or distribution), the Constitution of India assigns taxation power to Centre as well as State Governments. Central Excise duty (also known as Central Value Added Tax, CENVAT) is levied on manufactured goods at the factory gate whereas manufacturers also attract State sales tax or Value Added Tax (VAT) on sale of the goods.[18] Since, manufacturers are assesses of State sales tax/ VAT, due input tax credits are allowed on purchases of inputs (including capital goods) within the State and it is adjusted against VAT or CST payable to State Government. Similarly, manufacturers adjust input taxes paid on input goods (CENVAT and/or CVD), plants and machinery, and services (service tax) against tax payable to Central Government. Since traders (distributors) are not liable to tax under CENVAT, taxes paid by manufacturers (Central Excise Duty) remain a stranded cost for traders. The service taxes paid on input services by traders are not adjusted against their tax liability to State Government. Similarly service providers are not liable to State VAT. So, any VAT paid on input goods remains a stranded cost for them. Non-allowance of ITC breaks the chain of input tax credit which is not conducive for businesses as it causes cascading of taxes and substantial locking up of working capital as unpaid ITC. The system also does not provide enough incentives to businesses to take registration. Non-inclusion of a large section of businesses under the tax net is not conducive for the economy as well as taxation system. These features of the present indirect taxation system encourage a large part of economic activities to evade taxes and generate unaccounted income (NIPFP, 2014). For the tax department, non-participation by a segment of the economy can induce lower confidence in the

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[16] In addition to Central Excise and VAT, Central sales tax (CST) is collected on inter-State sales of goods.

[17] Provided input tax credit is not allowed against Entry Tax.

[18] The Constitution assigns taxation of alcoholic beverages for human consumption to State Governments and taxation of certain tobacco (including manufactured tobacco products) to Central Government. However, in the present system State Governments can impose an additional excise duty on tobacco products. Under GST, taxes on tobacco and tobacco products will be subsumed under Central GST and States cannot levy and collect any tax on tobacco and tobacco products.

tax regime resulting in higher non-compliance even among segments which would normally pay taxes. In addition, input taxes are adjusted only against tax payable to output whereas duties, surcharges and cesses paid on input goods and services remain stranded costs for assessee.

2.2 Taxation of Services

Service tax is a Central Tax levied by the Central Government on all services except a few services which are exempted (e.g., education, medical and health services) by keeping them under negative list in the Union Budget 2012-13. Since these are not zero rated, the exempted services cannot claim refund of CENVAT paid on purchase of goods and services tax paid on services and those remain stranded costs for them. Central government allows selective cross credits across CENVAT and service tax provided the assessee falls either under Central Excise and/or Service Tax assessment.[19] State governments also levy standalone taxes on a few services (e.g., passenger and goods tax, luxury tax on hotels and lodging houses, entertainment and advertisement tax) but do not allow ITC against their VAT purchases. In addition, being assessee of Central Government, service providers cannot claim ITC against VAT purchases of goods.

3. Proposed System of Goods and Services Tax (GST) in India

The key features of the proposed new regime are briefly summarized as follows:

1. The tax is to cover all goods and services; it is however, proposed that there would be a small negative list of goods and services which will not be taxed under GST. All other supplies of goods and services would be subject to tax.

2. Dual GST: there will be two taxes levied on each such supply - one as a part of the Central GST and the other as a part of the State GST.

3. It is proposed that the GST regime would have two rates of tax, a lower rate for supply of specially identified goods and services and the rest of the supplies would be taxable at a standard rate.

    (a) Some supplies that are to remain outside the base for GST are petrol, diesel, ATF, crude petroleum, natural gas, alcoholic beverages for human consumption, real estate and electricity.

    (b) The constitutional amendment allows for the incorporation of petrol, diesel, ATF and crude petroleum in the base at a subsequent date.

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[19] "At the stage of determining eligibility for CENVAT credit, provisions of CENVAT Credit Rules, 2004 since its inception have contained requirement to establish nexus between the activity of manufacture/provision of service and goods/service in respect of which credit is being claimed. The nexus theory has been interwoven in the definitions of capital goods, inputs and input services providing that in order to be eligible for CENVAT credit, goods/ services should have been used 'in the factory of manufacture of final goods' or 'for providing output service' or 'used in or in relation to manufacture of final products and clearance of final products up to the place of removal', etc." (Source: http://www.taxindiaonline.com/RC2/print story.php?newsid=16827, last accessed on 20 September 2015).

4. On inter-state supplies, it is proposed that the Centre will levy and collect Integrated GST (IGST) – the importing dealer can claim input tax credit for IGST paid on these goods against taxes payable on subsequent transactions.

(a) While in principle, all governments are in agreement that Central Sales Tax regime would be removed when GST is introduced, this tax would remain on goods and services which are explicitly excluded from the GST regime.

5. It is proposed that for the standard rate there would be a band which allows the states some flexibility in fixing rates.

6. In order to protect the states from any loss of revenue in the process of reform, Central government has proposed to compensate for any loss of revenue.

(a) Another measure which has been introduced in the same spirit is a temporary levy of 1 percent on inter-state supply of goods to be collected and transferred to the exporting state. This levy is initially proposed for a period of two years, to be subsequently reviewed by the GST Council.

7. So as to put in place a mechanism which ensures the creation and sustenance of GST which is comprehensive and comparable across States, all policy decisions regarding GST are to be taken on the advice of the GST Council where the Central government is to have a 33.33 percent vote with the rest being assigned to the states.

8. GST is to be administered separately by the Central and State Tax Administrations. It is proposed that there would be common registration and common portal for filing of returns. There are no clear decisions available in the public domain on whether there would be further coordination between the two sets of tax administrations.

In the proposed system of GST both Central and State Government will have concurrent taxation power of goods and services at all stages of value addition (production and distribution or trade). The proposed system is an improvement over the present system as it will reduce the cascading of taxes arising due to- a) non-allowance of ITC against input goods (or services) for production/ distribution of services (or goods)[20] due to inter-jurisdiction (cross tax authority) nature of taxes as well as differences (non-overlapping nature) in taxation power of goods and services, and b) non-allowance of ITC against inter-State sales. However, inconvenience arising due to non-allowance of inter-jurisdiction (cross Tax Authority) ITC may not arise though under the proposed GST regime inter-jurisdiction, ITC flow is not allowed. Under the proposed system there will be two parallel tax payment and credit system - one for Central GST (CGST) and another one for State GST (SGST), where ITC of each tax will be adjusted before paying taxes to respective tax authorities. Since GST is the multistage value added tax, tax liability will depend on level of value addition. Under the proposed system continuation of input tax credit chain is ensured even for inter-State sales. For inter-State sales, the exporting dealers will pay Integrated GST (IGST) to

[20] As under the present system power of taxation of services goes with Central Government whereas the taxation of goods attracts both Central Excise Duty (up to manufacturing stage), and State VAT/ Sales Tax (beyond manufacturing). Input tax credits against Central taxes (CENVAT and Service Tax) are not available to traders (distributors) similarly service providers are denied input tax credit against VAT/ Sales Tax.

Central Tax Authority by adjusting ITC arising against SGST, CGST and IGST (if any). The IGST liability will comprise of CGST, SGST (rate prevailing in destination State) and any other taxes imposed on inter-State sales of goods. Dealers in destination State will pay CGST and SGST liabilities on subsequent sales by adjusting IGST credit pool. First, IGST will be utilized to pay CGST and then SGST. The proposed system is an improvement from the present system. However, under the proposed system, there will be substantial compliance cost if SGST rates vary across States. In addition, the present discussion on levying 1 percent additional CST type tax on inter-State sales (excluding Branch/ Consignment Transfer) of goods for initial two years and subsequent to decision of the GST council will break the input tax credit chain and it would be very much against the spirit of the tax reform.[21] It is prescribed that Government of India (Central Tax Authority in practice) will levy and collect the additional tax and pass on the net proceeds to the exporting (origin) State (Government of India, 2013).[22] Though the interests of the manufacturing States will be protected through imposition of the additional tax, it will generate cascading of taxes. In addition, non-inclusion of goods and services under GST will also generate cascading of taxes. Therefore the very purpose of having GST will be diluted. Non-inclusion of certain fossil fuels (e.g., petrol, diesel, ATF, natural gas and crude petroleum) and electricity which are directly and indirectly used as inputs for all goods and services, will result in cascading of taxes across all sectors and will hamper competitiveness of domestic industries in international market (Mukherjee and Rao, 2015a). Therefore, it is expected that the resulting tax system will not be free from cascading of taxes but it would be relatively cleaner than the present system. Therefore, it is worthwhile to raise the question- whether it is desirable to introduce GST with so many structural defects or not.[23] Definitely it would provide relief to business community as they do not have to block substantial working capital as unpaid ITC.[24] There are several challenges before the introduction of GST, and these could be classified under two broad heads: a) GST design and structural issues, and b) GST administration and institutional issues.

4. Challenges in Designing and Administration of GST

The benefits of the proposed GST system could only be reaped if certain challenges related to design and structure of GST, are addressed by the governments.

4.1 Challenges in Designing GST

Learning from international experience, it is not expected that a faultless GST could be designed

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[21] It is not clear what the purpose this additional levy would serve when full compensation of revenue to States for switching over to GST is assured by the Centre for first five years.

[22] This goes against the destination principle of GST.

[23] Several scholars criticized the proposed structure of GST for many reasons, for example see Shome (2015) and Vaitheeswaran and Datar (2015).

[24] It is argued that proposed GST will favour big manufacturing firms having pan India operations whereas small and medium businesses will be marginalized. Compliance burden is cited as one of the obstacles for small and medium businesses to take part in the GST.

and rolled out in India as a single event, but some structural faults could easily be addressed and rectified without hampering basic spirit of the reform.

4.1.1 Limitations in Estimation of GST Base and Revenue Neutral Rates

Estimation of correct tax base for GST is important to understand the tax potential and estimation of tax rate(s) to achieve revenue neutrality. Estimation of GST base depends on several structural features of GST design and the most important are - a) whether proposed GST would be origin (production) or destination (consumption) based, b) whether income or consumption type, c) whether implemented with credit (input tax) invoice based subtraction method or formula based (ad hoc) subtraction method for allowance of credit against input taxes and d) having many or a few exemptions (Rao and Chakraborty, 2013). So far as Indian GST is concerned it would be destination based, consumption type system and it would be implemented with credit invoice based method with a few exemptions. In addition to these, there are also issues related to turnover based threshold for mandatory GST registration, special scheme for small and medium enterprises (e.g., composition / compounding scheme) and exclusions of goods and services from GST system which all make the design complex.

Estimation of revenue neutral rate for GST is a complex issue and given the complexity in the design of GST, it would be difficult to estimate RNRs without any revenue implications. Setting perfect RNR for GST cannot be a onetime event but options should be kept open to adjust the rate in future based on trial and error process depending on revenue targets of the governments. Given the dual nature of GST, there will be two RNRs - one for Central Government on which CGST will be levied and another one for State Government. However, there is no consensus whether single SGST rate will prevail across all States or it will vary. It is also not clear whether within SGST it would be single rate or will there be two (or multiple) rates - one lower rate and one higher rate. Rajya Sabha Select Committee suggested that GST rates will be levied with floor rates and with bands, where band is defined as "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" (Government of India, 2015). There are also discussions that maximum 1 to 2 percent deviation from the floor rate should be allowed. However, if the suggested deviation is accepted it may hamper the fiscal autonomy of the States, as their freedom to set tax rate depending on revenue needs will be hampered. In the long run it will affect the fiscal relationship between the Centre and the States. Revenue importance of the tax base on which GST would be levied is different for different States, and given the federal structure of India, protecting revenue is the foremost priority of the States. Therefore, any rule based restriction on fiscal decisions of the State will go against the spirit of cooperative federalism. There is always a tradeoff between harmonization oftax system and fiscal autonomy of States. Given the federal structure of India, it is desirable that tax rates will be harmonized across States to minimize the compliance burden. Moreover, harmonization of tax rules and regulations is more important than harmonization of tax rate from business perspective.

There are also discussions on legal restriction for the GST rate at maximum 18 percent (Government of India, 2015). However, any attempt to put a cap on GST rate will restrict the fiscal freedom of governments as they cannot set their fiscal priorities depending on their revenue needs. In addition, estimation of GST revenue neutral rate cannot be a static exercise and ideally it should reflect behavioral responses of tax rates also. GST rate depends on dynamics of the economy and if introduction of GST improves economic efficiency, it will attract investment which would have multiplier impacts on the economy and may require lower rate to achieve revenue neutrality.

4.1.2 Revenue Consideration under GST

The proposed tax system will subsume both Central and State indirect taxes and levies. On the combined tax base dual GST (CGST, SGST and IGST) will be levied. The details of State and Central taxes those will be subsumed under GST are presented below.

State Taxes	**Central Taxes**
• 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), • Entry tax (in lieu of Octroi), • Purchase Tax, • Luxury tax, • Taxes on lottery, betting and gambling; and • State cesses and surcharges (related to supply of goods and services)	• Central Excise Duty • Additional Excise Duty • 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 (related to supply of goods and services)

Source: Government of India (2015)

Non-inclusions of a few petroleum products and alcohol for human consumption make estimation of revenue baskets for Central and State Government difficult, given the level of disaggregated data available in the public domain. State-wise data presented by Rao and Chakraborty (2013) for 2009-10 on taxes that will be subsumed under GST are considered here for our analysis.[25] To clean out the Central Government tax collection from non GST goods, we have used detailed tax collection data as available in the Receipt Budget of Union Government for the year 2009-10 (available in the Union Budget 2011-12) and commodity-wise Central Excise and Custom Duty collection from the Central Excise and Customsdatabase for 2009-10 as available in the Annual Publication of Directorate of Data Management, Central Board of Customs and Central Excise

25. Rao and Chakraborty (2013) received the detailed information on State-wise, tax-wise data of revenue collection (excluding non-GST goods) from Empowered Committee of State Finance Ministers. The set of data for recent years is not available in the public domain. However, 2009-10 is a "non-representative" year for Central government since tax rates were below "normal", due to stimulus package announced by the State Governments in the aftermath of global recession.

(CBEC).

Table 1 shows that total revenue consideration under GST is only Rs. 3,31,671 crore of which States' share is 53.2 percent (Rs. 1,76,419 Crore) and Central Government share is 46.8 percent (or Rs. 1,55,252 Crore). The removal of cascading of taxes under GST will further shrink the revenue due to input tax credits to be adjusted against final tax payment. For State Governments, the revenue under consideration contributes only 22.3 percent of revenue receipts, 32.5 percent of total tax revenue, 46.7 percent of own tax revenue and could finance only 16.9 percent of total expenditure (revenue and capital together). For Central Government, the revenue under consideration contributes only 27.1 percent of revenue receipts, 24.9 percent of gross tax revenue (or 34.01 percent of net tax revenue - after deduction of States' and UTs' share in Central Taxes). However, entire revenue consideration under GST for the Central Government will not be available to finance Central Government expenditures alone, as a part of net tax collection from CGST (after deduction of cost of collection) is required to be shared with State Governments according to the recommendation of the Finance Commission.[26] Non-inclusion of major revenue earning goods under GST (like alcohol and petroleum products), reduces the revenue importance of GST and also keeps the GST design as complex as the present system. However, gradual inclusions of out of GST goods under the GST system, governments could clean up the indirect tax system. However, inclusions of these goods under GST will raise the GST rate and the proposed system may face resistance from consumers as their tax burden will go up for inclusions of commodities which they may not consume (e.g., alcohol, petrol). Therefore, the argument of Board Base Low Rate (BBLR) may not hold for the proposed GST. It is expected that the proposed GST system would be relatively cleaner and enhance the ease of doing business. Clean GST system could not only reduce unwarranted workload of tax administrators but also improve tax compliance.[27] Inclusion of out of VAT items under GST could expand the combined (Centre and all States together) revenue under consideration by 1.4 times for 2009-10 or Rs. 4,67,124 crore. The revised States' revenue under consideration under GST would be Rs. 2,55,111crore, which will be 32.2 percent of revenue receipts, 47 percent of total tax revenue, 67.6 percent of own tax revenue and 24.4 percent of aggregate expenditure. For Central Government, revised revenue would have been Rs. 2,12,013 crore, which will be 37 percent of revenue receipts, 33.9 percent of gross tax revenue and 20.7 percent of aggregate expenditure. By excluding goods of major revenue importance (like petroleum products and alcohol) from GST system, both Central as well as State Governments protect their respective fiscal autonomy though it would imply continuation of tax cascading and hamper export competitiveness of domestic industries. Cascading of taxes generates revenue for government though it goes against the interest of business. Removal of tax cascading has revenue implications for government and it will affect different governments

26. According to the recommendation of the Fourteenth Finance Commission 42 percent of Net Tax collection needs to be shared with State Governments.

27. A cleaner taxation system with clear rules and regulations (with little scope for alternative interpretations) is easy to administer and could reduce litigations/ disputes. In cleaner tax system, tax administrator could devote more time to more sophisticated parts of tax administrations - scrutiny assessment, audit, risk analysis and fraud detection etc. A cleaner tax system is likely to reduce both transaction and compliance cost and induces voluntary tax compliance.

differently depending on their revenue importance of taxes subsumed under GST. In addition, more harmonized taxation system (like GST) leads to little fiscal freedom for individual governments to deviate from common harmonized tax structure. In the long run, it could erode fiscal autonomy of governments to protect revenue by changing tax rates or any other policy measures to generate revenue.[28]

Table 1:
Revenue Consideration under GST for All States and Union Government: 2009-10 (Rs. Crore)[29]

State Taxes	State Governments*	Central taxes	Union Government**
VAT/ Sales Tax[a]	138,655	Central Excise Duties[d]	46,730
Entertainment tax[b]	904	Service Tax[e]	58,422
Central Sales Tax[c]	23,255	Customs[f]	50,100
Luxury Tax	1,204		
Taxes on lottery, betting and gambling	531		
States cesses and surcharges in so far as they relate to supply of goods and services	1,971		
Entry tax not in lieu of octroi	8,381		
Purchase tax	1,518		
Total State Taxes	**176,419**	**Total Central Taxes**	**155,252**
Revenue Receipts	791,429		572,811
Total Tax Revenue	542,390		
Own Tax Revenue	377,377		624,528[A]
Aggregate Expenditure	1,043,860		1,024,487

Notes:

* -Including NCT of Delhi and Puducherry
** -Excluding United Territories
^ -Gross Tax Revenue (includes States' share in Central taxes and taxes collected from United Territories)
a Excluding tax on petroleum products and liquor

28. It would be difficult for States to deviate from common harmonized structure of GST. Therefore tax effort (e.g., strengthening tax administration) and non-tax revenue mobilization would be playing important roles in mobilising additional revenue to keep the pace of rising demand for public expenditure.

29 crore = 10 million

b Unless it is levied by the local bodies

c Includes ITC adjustment and excludes taxes collected from crude petroleum and petroleum products (petrol, diesel and ATF)

d Excludes basic excise duty, additional duties, cesses and surcharges on petrol, diesel, ATF and crude petroleum.

e Includes education cesses

f Includes Additional Duty of Customs (CVD), Special CV Duty, NCCD, and Education Cesses and excludes all duties and cesses on petroleum products.

Data Sources: Rao and Chakraborty (2013), Receipt Budget (Union Government): 2011-12, Customs and Central Excise 2009-10: Annual Publications of Directorate of Data Management, CBEC, New Delhi.

4.1.2.1 Alternative Estimates of GST Rate

An attempt is made to estimate the tax rate for the proposed GST in India. This estimate is based on average 'C-efficiency' of lower middle income countries and that of Asia/ Pacific region. 'C-efficiency' is a measure to assess the performance of VAT (Keen, 2013).[30] Keen (2013) defines 'C-efficiency' as "an indicator of the departure of the VAT from a perfectly enforced tax levied at a uniform rate on all consumption". Apart from 'C-efficiency', depending on differentiation in tax rates across goods and services and exemptions, tax collection under VAT varies. 'C-efficiency' is defined as:

*C-efficiency = (VAT Revenue) /(Tax Rate * Consumption Expenditure)* (1)

Therefore, *Tax Rate = (VATRevenue)/(C-efficiency* Consumption Expenditure)* (2)

For a given C-efficiency and Consumption Expenditure, we have estimated Tax Rate in Table 2. The estimated tax rates for the proposed GST system would vary from 23.2 to 19 percent depending on average 'C-efficiency' targets that we would like to achieve. Table 2 also shows that with more inclusive GST, tax rate will rise, given the target for 'C-efficiency'. The estimated tax rates are not very different from the rates estimated for 2009-10 by Rao and Chakraborty (2013) for the proposed GST regime, if one combines RNRs for both Centre and States together.

Table 2:
Estimation of GST Tax Rate

Description	2009-10	
Private Final Consumption Expenditure (A) (Rs. Crore)	37,07,566	
Adjusted Pvt. Final Consumption Expenditure (B) (Rs. Crore)	2,969,040	
Adjusted Pvt. Final Consumption Expenditure[2] (C) (Rs.	31,39,618	

[30] For other measures of VAT efficiency, see Martinez-Vazquez and Bird (2010).

Crore)		
Government Final Consumption Expenditure - Net Purchase of Commodities & Services[3] (D) (Rs. Crore)	168,717	
Total Adjusted Consumption Expenditure (E=B+D) (Rs. Crore)	31,37,757	
Total Consumption Expenditure (F=C+D) (Rs. Crore)	33,08,335	
Revenue Consideration under Proposed GST[4] (F) (Rs. Crore)	3,31,671	
Revenue Consideration under All Inclusive GST (G) (Rs. Crore)	4,67,124	
GST Rate Estimation (%)	Proposed GST	All Inclusive GST
C- Efficiency	Tax Rate	Tax Rate[5]
Average of Lower Middle Income Economies (2009): 45%	23.5	31.4
Average of Asia / Pacific (2009): 55%	19.2	25.7

Note: excludes consumption expenditures on electricity, other fuel (other than LPG & kerosene), beverages
(alcohol), education, medical care & health services, and gross rent & water charges
2 excludes consumption expenditures on education, medical care & health services, and gross rent & water charges.
3 excludes expenditures on compensation of employees and consumption of fixed capital from Government Final
Consumption Expenditure
4 excludes taxes on tobacco & tobacco products, alcoholic beverages, petroleum products
5 under this scenario all excluded goods (alcoholic beverages and petroleum products) are taken under GST

Data Source: CSO (2014), Rao and Chakraborty (2013), and Keen (2013)

4.1.3 Non inclusions of Goods under GST

The proposed design of GST does not include a) alcoholic liquor for human consumptions, b) electricity, and c) real estate. In addition to these, inclusions of petroleum products (petrol, diesel and ATF) and natural gas have been postponed to an unspecified future date that would be decided by the GST Council. Non availability or partial availability of input tax credit will result in stranded costs for some sectors (where direct use of out of GST items are high) but the costs will be spread across all sectors of the economy, through sectoral interlinkages. By non-including electricity and some other sources of fossil fuels (like petrol, diesel, ATF, natural gas and crude petroleum), the proposed GST system will retainsubstantial cascading of taxes which will be detrimental for achieving export competitiveness of Indian industries in the international markets (Mukherjee and Rao, 2015a). Mukherjee and Rao (2015a) suggests alternative design of GST where tax cascading goes down and prices fall and the Government revenue remains unchanged. Dismantling the administered pricing mechanism for diesel along with introduction of comprehensive GST for petroleum products could benefit both upstream and downstream sectors. Being final consumption goods, keeping out alcohol from GST does not result in cascading of taxes but some researchers argue that present system of multiple taxes and without provision for input tax credit encourages illegal (tax avoided) sales and sales of counterfeit (spurious) alcohol which is an important issue specially after deaths of many people due to consumption of spurious alcohol (hooch). Under the present system, real estate transactions attract stamp duty and registration fees. In addition, some States have also brought real estate promoters under the preview of VAT registration where VAT is levied on jobs contract. Non-inclusion of real estate under GST will not allow ITC and the sector cannot pass on the benefits to customers where property is purchased for commercial/ business purposes, which constitutes 80 percent of real estate transactions.

However, there is a common misconception that inclusion of the excluded goods and services under GST could expand the GST base and therefore lower GST rate is required for achieving revenue neutrality. Goods which are presently kept out of GST (e.g., petroleum products and alcohol) hold substantial share in total tax base of the Central and State Governments and attract tax rates which are substantially higher than standard CENVAT and/ or VAT rates. For example, effective tax rate on petroleum products (other than natural gas and crude petroleum) is 40 percent (Mukherjee and Rao, 2015a). Therefore, if these goods are included under GST, GST revenue neutral rate will go up. Table 2 supports this claim. For example, an additional 3 percent tax, over and above standard GST rate, is required to include all petroleum products and electricity under GST (Mukherjee and Rao, 2015a).

There are some misconceptions regarding GST which required clarifications. First of all, many people think that introduction of GST will widen the tax base by expansion of coverage of economic activities under the tax net and by reducing the list of exemptions. However, most economic activities are presently taxed either by Central and/ or State Governments and there is not much scope for further expanding the tax base by bringing more goods and services under the purview of GST unless we reduce the list of goods and services that kept under the exemption list. [31] However, no consensus on thresholds and exemption has been reached among the concerned governments yet; at least the information is not available in the public domain. Therefore only possibility of expanding GST base remains if services kept under the negative list are brought under the GST. However, there are only a few services under the negative list that do not attract some other tax. Secondly, it is common perception that mitigation of cascading and double (multiple) taxation and lower tax burden under GST would induce better tax compliance. Even under the proposed design of GST with exclusion of goods like electricity and petroleum products, cascading of taxes would be retained (Mukherjee and Rao, 2015a). Tax payers who hitherto faced with single tax administration (e.g. retailers, service providers) would face two tax administrations and complying with different tax authorities for single transaction could enhance

31. Being consumption based tax, if proposed GST could induce behavioural changes in the consumption patterns of households and for that overall consumption expenditure increase, there might be a possibility of more revenue collection under GST. However, consumption pattern depends on income and prices, and if the proposed GST regime influences these factors in favour of consumers, possibility of expansion of tax revenue under GST might arise.

the compliance costs and this could work against voluntary compliance. Therefore, the argument on possibility of "lowering of overall tax burden on goods and services" (Government of India, 2015) does not have any basis. Thirdly, it is envisaged that competitiveness of domestic industries in international market will improve as the system will remove latent and embedded taxes. However, by keeping major revenueearning as well as major energy sources like electricity, petroleum products (petrol, diesel and ATF), natural gas, crude petroleum out of the GST, the removal of cascading will be limited and therefore the impact on export competitiveness of Indian industries would be limited (Mukherjee and Rao, 2015a). Fourthly, it assumes that GST will provide common national market for goods and services by unifying the tax structure across States. However, with the present discussion on additional 1 percent tax on inter State supplies of goods, and since there is no consensus on common GST rates, threshold and exemptions across States, providing common national market for goods and services is very much under question.

4.1.4 Consequences of GST on Inequality

Impact of GST on different strata of the society will be different depending on composition of their consumption basket. Under the present system different goods attract different tax rates (both CENVAT and VAT rates vary) and the purpose of having multiple tax schedules is to minimize tax incidence on poor section of the society. If single rate is proposed under GST (both for CGST and SGST) with a few exemptions, the resultant tax system could be regressive.[32] Therefore, it is expected that introduction of GST would have an immediate impact on prices of goods and services and it will induce behavioural changes among consumers, provided the benefits of removal of cascading of taxes and/or costs of additional tax burden are passed on to consumers. Different group of consumers will have different response to changes in prices and in the long run it is expected that inflationary pressure will subside due to removal of cascading of taxes under GST. Given the criticism that VAT (or GST) is regressive (Emran and Stiglitz, 2007), it is expected that a detailed tax incidence analysis should be carried out to understand the consequences of GST adoption on different strata of the society.

4.1.5 Consequences of GST on Informalization

Introduction of comprehensive GST may induce informalization of the economy for developing countries like India (Emran and Stiglitz, 2005; Piggott and Whalley, 2001). Given the large informal sector that escapes tax net and substantial cash-based (without invoice) transactions, opportunity cost of being under the tax system cannot always outweigh the benefits. The presence of informal credit and labour markets and large domestic demand for locally produced goods and services often lead to unaccounted incomes and avoid taxes. A recent paper by Mukherjee and Rao (2015b) shows that facilitating access to formal credits and government assistance in financial loan, subsidy, machinery/ equipment, training, marketing and raw material could encourage enterprises to register under VAT.

32 Unless commodity-wise impact analysis is carried out it would be difficult to decide on tax rates for each commodity.

4.2 Challenges in GST Administration

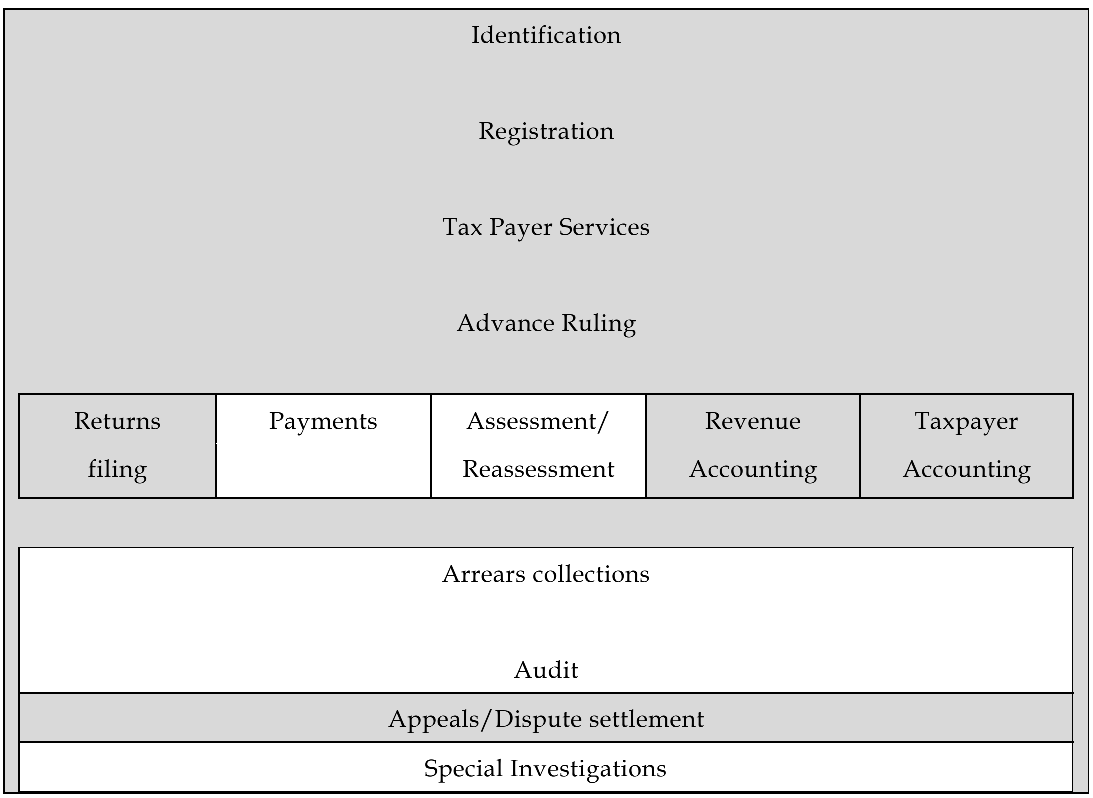
The proposed GST design suggests for dual GST where CGST and IGST will be administered by the Central Board of Excise and Customs (CBEC) and the SGST will be administered by the State Commercial Tax Department of the respective State Governments. From available policy documents in the public domain it is not clear whether in the proposed system certain common administrative functions (e.g., taxpayer registration, return filing) will be undertaken jointly or independently by each of theadministrations. Since both the tax administrations will deal with same set of taxpayers (ideally), separating common administrative functions will add compliance costs to taxpayers and additional burden on tax administration. It is also not clear whether there will be a common threshold for mandatory registration for all taxes under GST (CGST, IGST and SGST) or separate thresholds for Central and State taxes.[33] Harmonization of thresholds across States for registration under SGST is another area of concern which requires broad consensus among States. The issue of single registration for all States or separate registration for each State of functions/ operations for multi-State nature of businesses/ services requires clarity. For example, whether Commercial Banks require to register in each State of their operation and pay due taxes separately or a Single nation-wide registration and payment of due taxes under GST through Head Office will suffice is not clear yet. The issue of apportionment of revenue for multi-State nature of services (e.g., telecom) is an area which requires clarifications. The issue of point of taxation and place of supply rules for taxation of services are not available in the public domain yet.

With some progress in the design of Goods and Services Tax (GST), there is an emerging need to explore the options for administering the new tax regime. From the discussions and decisions taken so far, one of the important parameters of the new regime is the applicability of two taxes (Central GST, CGST and State GST, SGST) on each and every transaction of supply of good and/or service in the country. The central tax would accrue to the Central government and the state tax would accrue to the State governments. Compared to the existing regime, the proposed tax represents a significant change in the tax administration. The central tax administration would need to deal with wholesale and retail traders in addition to its existing taxpayers (e.g., manufacturers, service providers). Similarly, the state tax departments would need to deal with service providers. The workload per employee as well as the skill set associated with tax administration would have to undergo a sharp change if the taxes are to be administered by maintaining a status quo on the forms of administration. In other words, grafting the new tax on to existing tax administrations would impose a significant cost of transition in addition to higher costs of collection. On the other hand, there would be quite a sharp change in the tax environment faced by a segment of the tax payers - all tax payers other than the manufacturers who had faced one tax and one tax department (e.g., wholesale and retail traders), under new regime potentially they will face two tax departments, and potentially an increase in the compliance cost associated with the new regime, thereby raising the opportunity cost of being in the tax system. The result

[33] One option to overcome the differences in setting thresholds for CGST and SGST may be to allow uniform threshold where States will get additional power to administer CGST for those tax payers whose turnover falls below the desired turnover of the Central Tax Authority. Tax collected by the States on CGST part may be transferred to Centre after deducting the cost of collection. Alternatively, the same proceed could be utilized for making payment to States for GST compensation.

could either be higher evasion or higher resistance to the new tax regime. Some segments of the tax payers are already articulating a demand for addressing the sharp increase in the compliance requirements of the new regime. Rao and Mukherjee (2010) explore various options for GST administration and one of their suggestions is joint administration for common functions (highlighted in the Figure below).[34] In addition adoption of functional specialization based scrutiny assessment of tax payers could reduce compliance as well as administration costs. For example, Central tax authority is dealing with service providers for long time and they have better understanding to deal with service tax assessee as compared to any State tax administration. Similarly, all State tax administrations are well conversant in dealing with traders/ distributors. Therefore, coordination across tax authorities by assigning superiority of decisions taken by one tax authority over other could be mutually beneficial.

Figure:
GST Administration - Possible Scope for Joint Administration



Source: Rao and Mukherjee (2010)

34. One of the suggestions of the paper was to set up Semi-Autonomous Revenue Agency (SARA) by comprising both Central and State tax administrators and delegating the task of GST collection to the agency.

4.2.1 Bringing Unorganized Sector under GST

The proposed transition to GST regime in the near future is expected to bring in a significant change in the economic environment of the country. With a reduction in the extent of cascading in the tax regime, it is argued by some, that move to GST would result in expansion of economic activity. Since this new tax regime works through more integrated and redefined supply chains, for units to benefit from this new tax regime and for the success of the new regime, it is important that more and more firms find it useful to be a part of the GST regime. While firms and enterprises in the organized sector do participate in the GST regime, those in the unorganized sector may not be as well integrated. This poses a problem both for the units and the tax administration. For the former, apart from being unable to benefit from the growth enhancing processes in the economy, these units may also be subject to irregular visits by various authorities often associated with the payment of bribes (Rao et al., 2014). For the tax department, non-participation by a segment of the economy can induce lower confidence in the tax regime resulting in higher non-compliance even among segments which would normally pay taxes.

Depending on respective turnover based threshold set for VAT registration by State Governments, different State tax administration face different level of challenges of bringing unincorporated enterprises under the tax system. Since, the exemption from registration under CENVAT is up to annual turnover of Rs. 1.5 crore is allowed, till now the challenge of bringing unincorporated enterprises under tax system is not severe for Central tax administration (Central Excise and Customs). If the threshold for registration for Central GST remains same under the forthcoming Goods and Services Tax (GST) regime, the challenge for Central tax administration will not be much different from the present. However, to integrate the unincorporated enterprises with the rest of the economy, it is imperative to bring the enterprises under the tax system. Though there are costs associated with remaining outside the tax system, a number of enterprises and firms chose to remain outside the tax system, it appears that the self-policing dimension of the VAT regime does not provide adequate benefits. Even the presently existing tax compounding schemes do not seem to be attractive enough to bring the small dealers into the system. Mukherjee and Rao (2015b) based on NSS 67th round Enterprises Survey explore factors which influence decision of unincorporated enterprises to register under VAT. From the results in the study, it appears that facilitating access to formal sector credit might be one such instrument. The other can be a focus on expanding the consumer's incentives to ask for an invoice. If larger segments of the economy ask for invoices for the purchases made, the incentive and the option to remain out of the tax regime would be correspondingly reduced. Designing appropriate incentives structure for consumers to ask for invoice and setting up an information exchange between tax authorities and consumers could reduce the possibility of under reporting of sales / income.

5. GST Institutions

For successful adoption of GST framework in India, establishment of GST institutions is very important. Given federal structure of India, the character of the institutions should be neutral and both Centre and State government should have equal space (opportunities) in these institutions to propagate the spirit of cooperative federalism.

5.1 GST Council

The GST Bill proposed establishment of GST Council which will be the highest body to examine and make recommendations on issues related to GST to Central as well as State Governments.

Though a broad contour on the structure and roles and responsibilities of the Council is available from the Bill (Government of India, 2015), the details on roles and responsibilities and Constitutional power of the Council is yet to be decided. The Council will comprise of Union Finance Minister as Chairperson and a Vice Chairperson who will be selected among the members. Union Minister of State in Charge of Revenue or Finance will be another representative from the Central Government to the council as member. From each of the States, Minister in charge of Finance or Taxation or any other minister as nominated by the State Government will be member of the Council. Every decision of the Council shall be backed by a majority of the members and it cannot be less than three-fourths (75%) of the weighted votes of the members present and voting. The weightage of vote of the Central Government will be one-third (33.33%) of the total votes cast and that of State Governments taken together will be two-thirds (66.67%). From the broad design of the Council, it can be concluded that the Central Government will have veto power on each and every decisions of the Council and it could throw its weight for any decision which will be in line with revenue interest of the Centre. However, the proposed design will make impossible for any individual State or group of States to change the decision in favor of its/ their own interest. This disproportionate power relationship is not conducive for fiscal federalism for federal country like India. For example, if any State wants to deviate from harmonized GST rate for revenue consideration, it cannot do that unless it is backed by other States and/or Centre, which is unlikely. Therefore, the proposed design will hamper the fiscal autonomy of the States and it is not conducive for cooperative federalism. It is not clear whether the GST Council could act as a recommending body or as a decision making body. It is unclear what will be dispute settlement/ redressal mechanism for any dispute arising due to decision taken by the Council. For example, if any State deviates from harmonized structure of GST what will be the mechanism to handle the deviation? It is also not clear what will be the degree of fiscal freedom (or limit of tolerance) at which individual States could take their decision to secure their respective revenue interests. Given the federal structure of India and constitutionally assigned fiscal powers, it would be detrimental for cooperative federalism if any entity tries to encroach upon other's freedom. In one hand the need for fiscal flexibility of each of the stakeholders and on the other hand not establishing dispute redressal authority above the GST Council - a constitutional body - could lead to complete failure of the Council which may go against the spirit of the taxation reform.

5.2 GST Network (GSTN)

Modern tax administration is very much dependent on Information Technology (IT) infrastructure where achievements of coveted objectives of the proposed GST system are very much dependent on establishing an IT system and to integrate the IT systems already prevailing across State and Central Governments. Integration of IT system will provide smooth transfers of input tax credits across States and act as tax clearing house for inter-State transactions. The same platform could also provide seamless automatic transmission of information across governments. To achieve the objectives, the Goods and Services Tax Network (GSTN) is formed as a Section 25 (not for profit), non-Government private limited company.[35] It was incorporated on 28 March 2013 and the

[35] http://www.gstn.org/Organization-Profile.html (last accessed on 10 September 2015)

Authorized Capital of the company is Rs. 10 crore. The Government of India holds 24.5 percent 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 percent. Balance 51 percent 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 GST. Not having in equity share by Public Sector Banks in GSTN an area which has been highlighted by the Rajya Sabha Select Committee. Being major interface between governments and taxpayers in collection of taxes, it is desirable that PSBs could be given opportunities to bring forward their views in designing the IT platform. Given the information available in the public domain, present status of development of the IT platform is not clear. Simplification of the procedures and common harmonized structure for return submission could induce voluntary compliance and therefore it is expected that minimum burden on tax payers in terms of information sharing could induce them for better tax compliance.

5.3 Other GST Institutions

5.3.1 Whether GST Dispute Settlement Authority?

The GST Amendment Bill, as passed by the Lok Sabha, proposed that "The Goods and Services Tax Council may decide about the modalities to resolve disputes arising out of its recommendations". It is not clear how a recommending or decision making body could act as dispute settlement body also for disputes arising due its own decision. However, the earlier Amendment Bill [The Constitution (One Hundred Fifteenth Amendment) Bill, 2011] "proposed to set up Goods & Services Tax Dispute Settlement Authority (Article 279B), which may be approached by the affected Government (whether the Centre or the States) seeking redressal for any loss caused by any action due to a deviation from the recommendations made by the Goods & Services Tax Council or for adversely affecting the harmonious structure and implementation of the GST." However, main objection behind the setting the Authority was that "...this authority shall have powers of overriding the supremacy of the Parliament and the State Legislatures. It shall affect the fiscal autonomy of the States."[36] (Government of India, 2013). By not having the dispute settlement authority, it is expected that both Centre and State Governments would agree to follow all the recommendation or decisions taken at the GST Council and there will be no deviation from common harmonized structure of GST, even in the event of revenue shortfall, which quite unlikely for federal country like India.

5.3.2 Whether GST Compensation Fund?

The GST Bill [The Constitution (122nd Amendment) Bill 2014] envisages that States will be fully compensated from the Central Government for any loss of revenue due to implementation of the

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36. The Attorney General of India's comments on the objection was "The Dispute Settlement Authority is primarily with regard to the aspect of disputes in relation to deviation from any recommendation of the GSTC, and it is not just any deviation but a deviation which results in loss of revenue to a State Government or the Government of India, or affects the harmonized structure of the Goods and Service Tax. Notwithstanding the decision on the DSA, the ultimate control over finance will always be that of the legislatures." (Government of India, 2013)

Goods and Services Tax for a period of five years. The Rajya Sabha Select Committee on GST Bill recommends for establishment of Goods and Services Compensation Fund under the administrative control of the Goods and Services Tax Council into which the Central Government shall deposit the GST Compensation. It is expected that the establishment of such a fund will only build the credibility of the Central Government and regain the trust of the States where their past experience of getting compensation for loss of revenue in VAT implementation or phase out of CST resulted in trust deficit. On the basis of past experience of the States, timely payment of compensation in every financial year is a vital issue which is highlighted before and by the Rajya Sabha Select Committee.

5.4 Present Status of the GST Bill [The Constitution (122nd Amendment) Bill 2014]

The Lok Sabha (Lower House of the Parliament) passed the Bill on 6 May 2015 and passed on the same to Rajya Sabha (Upper House of the Parliament) for consideration. The Rajya Sabha referred the Bill to its Select Committee on 14 May 2015 and the Select Committee of Rajya Sabha submitted their report on the Bill on 22 July 2015. The Committee accepted majority of provisions of the Bill and recommended that a few changes. However, the Bill cannot be taken up for voting in the monsoon session of the Parliament (21 July - 13 August 2015). After passing the Bill in the Rajya Sabha, it will again come back to Lok Sabha for final approval and then it will be sent to the President of India for his final approval. After passing the Bill, it needs to be ratified at least half of the States to become a law. There are also three Bills that need to be passed - one by the Parliament and two by State Legislative Assembly - before GST is implemented.

6. Conclusions

Till now all decisions on GST have been taken without consultation of major stakeholders like businesses and citizens (consumers). All the decisions taken by the Empower Committee of State Finance Ministers and the Central Government are not available in the public domain and therefore it is difficult to get clarity on various aspects of GST. Since businesses are not consulted, their views on the present design and structure of GST are not clear. This may lead to resistance to the tax reform and/or negotiated tax environment which are not conducive for a modern rule based tax system. Keeping major stakeholders out of the discussions on GST is not a good sign for any tax reform as decisions taken by the governments will influence their day-to-day decisions. It is desirable that more transparent approach would be followed to disseminate the decisions among stakeholders and taking into account their views in policy designs.

Reform in tax administration is as important as tax policy for mobilization of revenue, given the present state of diversities in tax administration across governments, it is expected that tax administration reforms will be taken up sooner than later to enable tax officials to administer the GST efficiently. By moving towards GST, it would be difficult for individual States to deviate from harmonized structure of GST and it will further enhance the importance of tax administration to achieve revenue objectives of the State Governments. The present state of investment in tax administration is miniscule. Large scale vacancies in tax departments, limited availability of infrastructure are major constraints which influence tax efficiency. A large section of tax officials are engaged in carrying out routine works, there is hardly any scope for skill development and specialization in tax administration. Modernization of tax administrations by investing in manpower and infrastructure along with continuous research and training could inculcate the desires for specialization in various aspects of tax administration.

At last, the success of the proposed GST system in terms of compliance and revenue mobilization will largely depend on - a) provision of incentives for tax invoice based transactions and b) simplification of tax administration. A large part of transactions (both in goods and services) remain outside the tax net. Even there is no mechanism to verify the originality of the tax invoice issued by the vendors or service providers. Prevailing system of without- invoice transactions results in generation of unaccounted income as it escapes tax nets of both direct and indirect taxes. The present system of separate tax administrations by Centre and States is not conducive for GST like tax system and it will increase both compliance and administrative costs. Therefore, options for joint tax administration may be explored.

E-1

REPORT OF THE JOINT COMMITTEE ON GST REGISTRATION PROCESSES

1.0 Introduction

During the Empowered Committee meeting held on 10^{th} March, 2014, it was decided that a Joint Committee under the co-convenership of the Additional Secretary (Revenue), Government of India and the Member Secretary, Empowered Committee should be constituted to look into the Report of the Sub-Group-I on Business Processes for GST and make suitable recommendations for Registration and Return to the Empowered Committee. It was also decided that the Joint Committee should also keep in view the Registration and Return requirements necessary for IGST Model. Accordingly, a Joint Committee, in consultation with the Government of India, was constituted on 7^{th} April, 2014 (Annexure-I).

1.1. The Committee held its deliberations on 28^{th} October, 2014, 12^{th} November, 2014, 25^{th} November, 2014, 22^{nd} December, 2014, 2^{nd} and 3^{rd} February, 2015, 19^{th} and 20^{th} February, 2015, 16^{th} and 17^{th} April, 2015 and 7^{th} and 8^{th} July, 2015. The Report of the Joint Committee on Business Processes on Registration was accordingly circulated to all the States. However, this Report was further discussed in the meeting of the Joint Committee on Business Processes held on 22^{nd} and 23^{rd} July, 2015. Some changes were made as per the discussions in the meeting of the Joint Committee on Business Processes held on 22^{nd} and 23^{rd} July, 2015. The report of the Joint Committee on Business Processes on Registration was accordingly finalized. The list of the participants of the meeting of the Joint Committee on Business Processes held on 22^{nd} and 23^{rd} July, 2015 is appended at Annexure-II.

1.2. Registration of a business with the tax authorities implies obtaining a unique identification code from the concerned tax authorities so that all the operations of and data relating to the business can be agglomerated and correlated. In any tax system this is the most fundamental requirement for identification of the business for tax purposes or for having any compliance verification program. Registration under Goods and Service Tax (GST) regime will confer following advantages to the business:

- Legally recognized as supplier of goods or services.
- Proper accounting of taxes paid on the input goods or services which can be utilized for payment of GST due on supply of goods or services or both by the business.
- Pass on the credit of the taxes paid on the goods or services supplied to purchasers or recipients.

2.0 Assumptions

2.1 The business process proposed in this document is based on the following assumptions:

(1) A legal person without GST registration can neither collect GST from his customers nor claim any input tax credit of GST paid by him.

(2) There will be a threshold of Gross Annual Turnover including exports and exempted supplies (to be calculated on all-India basis[1]) below which any person engaged in supply of Goods or Services or both will not be required to take registration. Once a dealer crosses the required threshold or he starts a new business, registration application must be filed within 30 days from the date of the dealer's liability for obtaining such registration. Effective date of registration would be the date of application in all cases i.e. whether the application has been filed within prescribed time limit of 30 days or otherwise. The taxpayer would be eligible for ITC in respect of all his purchases from the date of application in case application for registration has been filed within 30 days. The taxpayer would, however, not be eligible for ITC in respect of his purchases prior to the date of registration in case the registration application is not filed within the prescribed time limit of 30 days, although Centre is of the view that such a provision may not stand the test of judicial scrutiny. On the other hand States, based on their experience under VAT, were of the view that having relevant provision in the GST law has helped them contest cases in courts. **GST Law Drafting Committee to make provision relating to eligibility for ITC accordingly as well as for levying penalty in case of a dealer failing to register within the stipulated time period.**

(3) However, such person with all-India gross annual turnover below the threshold turnover would be allowed to take registration, if he wants to. By taking such voluntary registration he can enter the credit chain even prior to crossing the threshold limit, provided he does not opt for the Compounding scheme (as defined below).

(4) There will be another relatively higher threshold of Gross Annual Turnover (to be calculated on all-India basis) to be called Compounding turnover up to which the registered person can opt to pay tax at a specified percentage of the turnover, without entering the credit chain. Such registered person will neither be allowed to collect tax from his customers nor claim any input tax credit. Compounding dealers shall remain under compounding scheme till their turnover crosses threshold or they opt for out of the scheme. Such dealers don't have to apply every year to remain under the compounding scheme. However, if the compounding dealer opts out of compounding in a financial year, for any reason, but eligible and wish to avail compounding in the next financial year, such dealer will have to apply afresh for compounding in the beginning of the financial year in which he wishes to claim compounding scheme.

(5) All other taxable persons will be required to take GST registration. Such persons will be able to take the credit of taxes paid on inputs / input services / capital goods and pass on the credit of GST to his customers / recipients of goods or services or both.

Please refer Para 7 of the **Report of the Committee on the Problem of Dual Control, Threshold and Exemptions in GST Regime (Annexure-VIII)**

(6) The registered person eligible for the Compounding scheme but opting against the Compounding can pay regular taxes and file tax returns on monthly basis, and thereby make his supplies eligible for input tax credit in the hands of the purchasers/recipients.

(7) Irrespective of turnover, if a taxable person carries out any inter-state supply and / or is liable to pay GST under reverse charge, he will be compulsorily required to take registration. Such person shall neither be eligible for exemption threshold nor for Compounding scheme. **However, an individual importing services for personal consumption will not be liable to pay GST under reverse charge or register under GST if the GST law so provides.**

(8) All UN bodies seeking to claim refund of taxes paid by them would be required to obtain a unique identification number (ID) from the GST portal. The structure of the said ID would be uniform across the States in uniformity with GSTIN structure and the same will be common for the Centre and the States. The supplier supplying to these organizations is expected to mention the UID on the invoices and treat such supplies as B2B supplies and the invoices of the same will be uploaded by the supplier.

(9) A unique identification number (ID) would be given by the respective state tax authorities through GST portal to Government authorities / PSUs **not making outwards supplies of GST goods (and thus not liable to obtain GST registration)** but are making inter-state purchases. The structure of the said ID would be uniform across the States in uniformity with GSTIN structure. The supplier supplying to these organizations is expected to mention the UID on the invoices and treat such supplies as B2B supplies and the invoices of the same will be uploaded by the supplier.

(10) **The concept of Input Service Distributor (ISD) presently being followed in Centre's Law may continue if the GST Law so provides.** They would be required to obtain GSTIN for distributing the credit of GST paid on services proposed to be used at multiple locations which are separately registered. This would be an exception/ deviation in case of services only. **GST Law Drafting Committee to make appropriate provisions for the same**.[While, at this stage it has been decided to make exception only for services, it is worth mentioning here that the Cenvat Credit Rules provide for a mechanism to allow distribution of inputs, which is basically a mechanism to distribute credit on inputs. Such mechanism is necessary for service provider as the location of payment of GST may be distinct from the location where goods are received. Therefore, drafting Committee may look into this issue.]

(11) All existing registered persons, whether with the Centre or State under any of the tax statues being subsumed in GST, would be allotted a GST registration number called Goods and Services Tax Identification Number (GSTIN) on voluntary basis. Dealers who are below the GST threshold will have option to remain in GST chain. **GST Law Drafting Committee to make appropriate provision.**

(12) Tax authorities, in case of enforcement cases, may grant suo-moto registration. If 6 such person does not have PAN, the registration would be initially temporary and later converted into a PAN based registration. [GSTN to develop temporary registration numbering system]

2.2 For each State the taxable person will have to take a separate registration, even though the taxable person may be supplying goods or services or both from more than one State as a single legal entity.

2.3 Multiple registrations within one State to business verticals [as defined in Accounting Standard (AS) 17 issued by ICAI] of a taxable person may also be permitted, subject to all the verticals being on the same scheme of tax treatment **if the GST Law so provides.**

2.4 A supplier who is not registered on regular basis, whether on mandatory or voluntary basis, in other State (s) and desires to conduct business in a particular State for a limited period, will have to obtain registration in that State for that limited period. Such suppliers are known as casual dealers and shall not be allowed to opt for composition scheme. However, the supplier would be eligible to claim ITC on purchases / inward supplies. The period of registration would be mentioned in the registration certificate also. The format of Registration Certificate for such taxpayers is different from the regular taxpayers. Even the application form for registration will have field for ascertaining estimated supplies. Return for such taxpayers would also be different. Such taxpayers would be required to self-assess their likely liability and deposit the same as an Advance Tax. Such amount would be deposited by way of two Demand Drafts (one for Centre and other for State) which would be returned to the taxpayer after he has discharged his final liability. **The GST Law Drafting Committee may provide for conditions for registration and tax payment.**

2.5 A Non-resident Supplier is a person who, in the course of business, makes an intra-state supply of goods or services or both, but is not a resident in the state in which he has applied for registration, but is already registered in any other state. Since the Non-Resident Supplier is already registered in another State, there would be an easy way of registering such entities in the State in which registration is applied as Non-Resident Supplier. The provisions applicable on casual dealers (as detailed in para 2.4 above) may apply to them except that no security deposit or advance tax collection may be made in their case.

3.0 Structure of registration number

3.1 Each taxpayer will be allotted a State wise PAN-based 15-digit Goods and Services Taxpayer Identification Number (GSTIN).

3.2 Various digits in GSTIN will denote the following:

State Code		**PAN**										**Entity Code**	**BLANK**	**Check Digit**
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15

3.3 In the GSTIN, the State Code as defined under the Indian Census 2011 would be adopted. In terms of the Indian Census 2011, each State has been allotted a unique two digit code e.g. '09' for the State of Uttar Pradesh and '27' for the State of Maharashtra.

3.4 13th digit would be alpha-numeric (1-9 and then A-Z) and would be assigned depending on the number of registrations a legal entity (having the same PAN) has within one State. For example, a legal entity with single registration within a State would have '1' as 13th digit of the

GSTIN. If the same legal entity goes for a second registration for a second business vertical in the same State, the 13th digit of GSTIN assigned to this second entity would be '2'.This way 35 business verticals of the same legal entity can be registered within a State.

3.5 14th digit of GSTIN would be kept BLANK for future use.

3.6 In GST regime, multiple registrations within a State for business verticals of a taxable person would be allowed. This provision should be subject to following specific stipulations -

(1) Input Tax Credit across the business verticals of such taxable persons shall not be allowed unless the goods or services are actually supplied across the verticals.

(2) For the purpose of recovery of dues, all business verticals, though separately registered, will be considered as a single legal entity. **(Final view needs to be taken by the GST Law drafting committee)**

3.7 Switching over from Compounding scheme to Normal scheme and *vice-versa* would be dealt in the manner described below -

(1) Any existing taxpayer not under Compounding scheme may opt for Compounding scheme, if eligible, only from the beginning of the next Financial Year. The application will have to be filed on or before 31st March of the previous year so that Returns can be filed accordingly.

(2) Compounding dealer may be allowed to switch over to Normal scheme even during the year if they so want, with a condition that they cannot switch over to Compounding scheme again during the same financial year.

(3) Any existing taxpayer under the Compounding scheme upon crossing the Compounding threshold will be switched over to the Normal scheme automatically from the day following the day of crossing the Compounding threshold. **GST Law drafting committee should provide for a suitable time-period of inputs and capital goods purchases on which ITC would be permitted at the time of switching over to Normal scheme.**

(4) For the changes covered by (1) to (3) above, the validation in the return module should change automatically under intimation to the concerned taxpayer and both the tax authorities. A suitable validation / dependency of the return module should be established.

The above changes should also be published on the common portal in addition to beingintimated to other taxpayers who have identified such taxpayer as their counter-party taxpayer.

4.0 Procedure for obtaining Registration

4.1 For obtaining registration, all the taxable persons shall interact with tax authorities through a common portal called GST Common Portal[2] that would be set up by Goods and Services Tax Network (GSTN). The portal will have backend integration with the respective IT systems of the Centre and States.

4.2 The procedure prescribed in para 6.0 below is meant for new applicants. The procedure for migration of existing registrants either with the Centre or State or both is dealt in para 7.0 below.

4.3 A new applicant would be allowed to apply for registration without prior enrollment. Once a complete application is submitted online, a message asking for confirmation will be sent through email and SMS to the authorized signatory of the applicant. On receipt of such confirmation from the authorized signatory, Acknowledgement Number would be generated and intimated to the applicant. Once the application is approved and GSTIN is generated, the same along with Log-in ID and temporary Password will be sent to the authorized signatory. This credential will be permanently used to access the GST Common Portal subsequently. Provision for capturing e-mail and Mobile Number of authorized representative of the taxpayer has also been incorporated in the proposed GST Registration Form. It would be the responsibility of the taxpayer to keep this information updated.

4.4 Online verification of PAN of the Business / Sole Proprietor/ Partner/Karta**/Managing Director and whole time directors**/Member of Managing Committee of Association, Managing trustee/authorized signatory etc. of the business would be mandatory and without such verification, registration application will **not be allowed to be submitted.**

5.0 Facilitation Center and Tax Return Preparer Scheme

5.1 In order to cater to the needs of taxpayers who are not IT savvy, following facilities shall be made available:-

5.2 Tax Return Preparer (TRP): A taxable person may prepare his registration application / returns himself or can approach the TRP for assistance. TRP will prepare the said registration document / return in prescribed format on the basis of the information furnished to him by the taxable person. The legal responsibility of the correctness of information contained in the forms prepared by the TRP will rest with the taxable person only and the TRP shall not be liable for any errors or incorrect information. **If so provided in the GST law, TRPs would be approved by the tax administration of the Centre and the States and will also be provided appropriate training by them, as per common curriculum to be devised by EC/ GST Council.**

5.3 Facilitation Centre (FC) shall be responsible for the digitization and / or uploading of the forms and documents including summary sheet duly signed by the Authorized Signatory and given to it by the taxable person. After uploading the data on common portal using the ID and Password of FC, a print-out of acknowledgement will be taken and signed by the FC and handed over to the taxable person for his records. The FC will scan and upload the summary sheet duly signed by the Authorized Signatory. This is the system in vogue for submitting TDS returns by more than 2 million tax deductors to the Income Tax Department.

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[2] Refinement to the process for States opting for two-way API based integration and flexibility (decision dated 18.4.2012 of EC) will be formulated separately **(Annexure-IX).**

5.4 Registration of TRP/FC is recommended. Final view may be taken by the GST Law drafting committee on the same.

6.0 New Applicants

6.1 The process highlighted in the paragraphs below is applicable for new applicants for registration, both mandatory and voluntary.

6.2 New applicant can apply for registration:

(1) at the GST Common Portal directly[3] ; or

(2) at the GST Common Portal through the Facilitation Center (FC)

Multiple applications can be filed at one go where a taxable person seeks registration in more than one State or for more than one business vertical located in a single / multiple State(s).

6.3 Following scanned documents are required to be filed along with the application for Registration -

Relevant Box No. in the Registration Form	**Document required to be uploaded**	**Reason for requirement**
2. Constitution of Business	• Partnership Deed in case of Partnership Firm ; • Registration Certificate in case of other businesses like Society, Trust etc. which are not captured in PAN.	In case of Companies, GSTN would strive for online verification of Company Identification Number (CIN) from MCA21. Constitution of business / applicant as per PAN would be taken except for businesses such as Society, Trust etc. which are not captured in PAN. Partnership Deed would be required to be submitted in case of Partnership Firms.
11. Details of the Principal Place of business	• In case of Own premises - any document in support of the ownership of the premises like Latest Tax Paid Receipt or Municipal Khata	This is required as an evidence to show possession of business premises. If the documentary evidence in Rent Agreement or Consent

[3] Refinement to the process for states opting for two-way API based integration and flexibility (decision dated 18.4.2012 of EC) will be formulated separately **(Annexure-IX).**

	copy or Electricity Bill copy • In case of Rented or Leased premises - a copy of the valid Rent / Lease Agreement with any	letter shows that the Lessor is different from that shown in the document produced in support of the ownership of the property, then the case must be flagged as a "Risk
	document in support of the ownership of the premises of the Lessor like Latest Tax Paid Receipt or Municipal Khata copy or Electricity Bill copy • In case of premises obtained from others, other than by way of Lease or Rent - a copy of the Consent Letter with any document in support of the ownership of the premises of the Consenter like Municipal Khata copy or Electricity Bill copy • Customer ID or account ID of the owner of the property in the record of electricity providing company, wherever available should be sought for address verification.	Case", warranting a post registration visit for verification. GST Law Drafting Committee may add penalty provision for providing wrong lease details.
12. Details of Bank Account (s)	Opening page of the Bank Passbook held in the name of the Proprietor / Business Concern - containing the Account No., Name of the Account Holder, MICR and IFS Codes and Branch details.	This is required for all the bank accounts through which the taxpayer would be conducting business.
17. Details of Authorised Signatory	For each Authorised Signatory • Letter of Authorisation or copy of Resolution of the Managing Committee or Board of Directors to that effect	:This is required to verify whether the person signing as Authorised Signatory is duly empowered to do so.
Photograph	• Proprietary Concern - Proprietor	

	• Partnership Firm / LLP - Managing/ Authorized Partners (personal details of all partners is to be submitted but photos of only ten partners including that of Managing Partner is to be submitted) • HUF - Karta • Company - Managing Director or the Authorised Person • Trust - Managing Trustee • Association of Person or Body of Individual -Members of Managing Committee (personal details of all members is to be submitted but photos of only ten members including that of Chairman is to be submitted) • Local Body - CEO or his equivalent • Statutory Body - CEO or his equivalent • Others - Person in Charge

6.3.1 For Field No 16 (i.e. Details of Proprietor / all partners / Karta / Managing Director and whole-time Director / Members of the Managing Committee of Association of Persons / Board of Trustees etc.) and Field No 17 (i.e. Details of the Authorized Signatory), verification of PAN with CBDT database and GSTN database will be carried out online before the submitted application is sent to the State/ Centre. In case of mismatch the applicant will be given an opportunity to correct the same.

6.4 A registration form has been designed and is annexed as Annexure-III. This form should be developed by GSTN as per the standard practices / protocols on IT notified by the Govt. of India e.g. for digitally capturing a postal address, name etc. *In case there is no standard practice for any of the field, the same should be developed by the GSTN and form designed accordingly.* Fields marked by asterisk in the form are mandatory fields and must be filled by the applicant.

Separate application forms are to be designed for:

(1) Multiple registration for business verticals of same legal entity (it must be registered already) within a State;

(2) Application for registration in more than one State (that can be filed at one go);

(3) Amendments to existing Registration(s);

(4) Cancellation of Registration(s);

(5) Option to avail / withdraw from the Compounding scheme;

(6) Enrolment of Tax Practitioner or Facilitation Centre if provided for in the GST Law;

(7) Assignment of Role (by a dealer) to TP/FC, as agent of the dealer if so provided for in the GST Law;

(8) Application for new registration on account of Succession / Amalgamation / De-merger etc. of existing GST registrants;

(9) Application by UN bodies for getting a Unique Identification Number (ID).

6.5 In some North-eastern States, individuals (Proprietorship firms) are exempt from Income Tax. However, to obtain GSTIN they will have to obtain a PAN before they can apply for registration under GST. Further Government departments will also be required to obtain PAN if they are required to obtain registration under GST. Under *GST regime, registration will not be allowed without a valid PAN.*

6.6 If applicant files application through the Facilitation Center, then the above procedure shall be followed by him through the FC by making available the requisite documents to the FC. The User ID and Password of taxable person will however be forwarded by portal to the e-mail furnished by the taxable person (that of primary authorized signatory) and by SMS to the mobile number furnished by taxable person or by post, if the taxable person so desires. It will not be sent to FC.

6.7 The GST common portal shall carry out preliminary verification / validation, including real-time PAN validation with CBDT portal, Adhaar No validation with UIDAI, CIN (Company Identification) with MCA and other numbers issued by other Departments through inter-portal connectivity before submission of the application form. Taxpayers would have the option to sign the submitted application using valid digital signatures (if the applicant is required to obtain DSC under any other prevalent law then he will have to submit his registration application using the same). In the absence of digital signature, taxpayers would have to send a signed copy of the summary extract of the submitted application form printed from the portal to a central processing center to be operated by GSTN. The location details of this central processing center would be intimated to the applicant along with the application acknowledgement number. The application will be processed even without waiting for receipt of the signed copy of the summary extract. If the signed copy is not received within 30 days, a reminder will be sent through e-mail and SMS to the authorized signatory through the portal. If the copy is not received within 30 days after such reminder being sent, the system will prompt the concerned tax authority to initiate the action for cancellation of the registration. Such cancellation will have prospective effect i.e. from the date of cancellation. GST portal would acknowledge the receipt of application for registration and issue an Acknowledgement Number which could be used by the applicant for tracking his application. Such Acknowledgement Number would not contain the details of jurisdictional officers.

6.8 The application form will be passed on by GST portal to the IT system of the concerned State/ Central tax authorities for onward submission to appropriate jurisdictional officer (based on the location of the principal place of business) along with the following information -

(1) Uploaded scanned documents;

(2) State specific data and documents;

(3) Details if the business entity is already having registration in other States. This should also include GST compliance rating[4];

(4) Details of the PAN(s) of individuals mentioned in the application which are part of the other GST registrations;

[4] Please refer para 23 IX. of the report of the Committee on IGST and GST on imports **(Annexure-X).**

(5) Acknowledgment number stated in para 6.7 above;

(6) Details of any record of black-listing or earlier rejection of application for common PAN(s).

(7) Last day for response as per the 3 common working day limit for both tax authorities asset out through Holiday Master.

On receipt of application in their respective system, the Centre / State authorities would forward the application to jurisdictional officers who shall examine whether the uploaded documents (as detailed in para 6.3 above) are in order and respond back to the common portal within 3 common working days, excluding the day of submission of the application on the portal, using the Digital Signature Certificates.

An indicative process for processing of the application by the concerned tax authorities will be drafted and shared separately. Submission of latitude and longitude data in respect of principal place of business will be of help in automatic identification of jurisdictional officer in case of geographically distributed officials mapped on a digital map. However, submission of latitude and longitude would be optional.

6.9 After verification, the following situations are possible:

(1) If the information and the uploaded documents are found in order, the State and the Central authorities shall approve the application and communicate the approval to the common portal within 3 common working days. The portal will then automatically generate the Registration Certificate.

(2) If during the process of verification, one of the authorities raises some query or notices some error, the same shall be communicated to the applicant either by the Tax Authority directly or through the GST Common Portal and also simultaneously to the other authority and to the GST Common Portal within 3 common working days. The applicant will reply to the query / rectify the error / answer the query within a period informed by the concerned tax authorities (Normally this period would be seven days). A separate sub-process and interactive form for this purpose will have to be designed. On receipt of additional document or clarification, the relevant tax authority will respond within 7 common working days. **(time-period that would be allowed to the applicant for rectification of any error will be decided by the GST Law drafting committee)**

(3) Thereafter the processing of registration application will commence resulting in either grant of registration or refusal to grant registration. If either of the two authorities (Centre or State) refuses to grant registration, the registration will not be granted.

(4) In case registration is refused, the applicant will be informed about the reasons for such refusal through a speaking order. The applicant shall have the right to appeal against the decision of the Authority. **A deeming provision to the effect that rejection of the registration application by one authority amounts to rejection by both Centre and State will need to be incorporated in the GST law.**

(5) The tax authorities in the Centre and State would have a period of 3 common working days to respond to the application, either conveying approval or raising a query. In case any of the authority neither reject the application nor raise a query within 3 common working days, then the registration would be deemed to have been approved by both the authorities and the GST Common Portal will automatically generate the registration certificate. In case either authority raises a query within 3 common working days, applicant will have to respond to the same within next 7 common working days failing which the application will be rejected. After the applicant has responded to the query raised by any authority, a period of another 7 common working days will be given to the authorities to respond to the application. In case any of the authority neither rejects the application nor raises a query during this period, then the registration would be deemed to have been approved by both the authorities and the GST Common Portal will automatically generate the registration certificate. (**GST law to have provision for the same)**

6.10 The applicant shall be informed of the fact of grant or rejection of his registration application through an e-mail and SMS by the GST common portal. Jurisdictional details would be intimated to the applicant at this stage.

6.11 In case registration is granted, applicant can download the Registration Certificate from the GST common portal. **GST law may provide that GST Registration certificate shall be displayed at the principal place of business of the taxpayer.**

6.12 The GST common portal will provide a risk profile to the tax authorities based on the risk parameters made available by the tax authorities. The Central/State tax authorities will also have their own risk profile based on their own risk parameters. It was noted that submission of Adhaar No. cannot be made compulsory. Non -submission of Adhaar No. could be one of the risk parameters for deciding about the post registration physical verification. **On the basis of both risk profiles, the jurisdictional officer of tax authorities will take a decision about post registration verification of the application if so provided in the GST Law.**

6.13 **GST Law Drafting Committee may provide for appropriate provision for imposition of substantial penalty in cases of fraudulent registrations.**

7.0 Migration of existing registrants

7.1 Existing registrants are those who are either registered with States or with the Centre or with both.

7.2 In case of such registrants, the system shall be designed to migrate cleaned and verified data from the existing database to the GST Common Portal and a GSTIN shall be generated. With regard to the migration of data of the existing registrants, following steps are necessary:

(1) The process of migration of data must be started sufficiently in advance so that the business of existing registrants does not suffer and transition from the present system to GST is smooth.

(2) At present, tax payers are separately registered with State and/ or with Central tax administrations or with both based on their business activity. In the GST regime, a taxpayer will have to obtain State wise registration. Even within a State, the taxpayer may either opt for a single registration or multiple registrations for different business verticals.

(3) Analysis of registration data available with States and Centre conducted by NSDL and GSTN reveals the following:

(a) The number of fields in the registration database of various State VAT and CBEC system are different than that finalized for GST. The number of fields varies from 50 to 107 in case of States/Centre whereas GST Registration Form has 120 fields. Thus there is a gap of 13 to 70 fields, meaning that data will have to be collected from the taxpayers.

(b) As per report of NSDL, which conducted as is study of State Systems as well as that of CBEC, in majority of cases, the available data does not comply with Metadata and Data Standards (MDDS) of Government of India. This is also confirmed by the feedback received from States in May 2015. Importing such data, which is not MDDS compliant, will lead to wrong or incomplete results on query.

(c) The data from States also shows that they do not have scanned copies of supporting documents for mandatory fields like principle place of business, photos of MD or Karta etc. in their database. This again will have to be collected from them.

Since, lots of reports will be using registration database, purity of registration data will be of paramount importance. Migrating half-complete and incorrect data from existing registration databases to GST database will adversely impact the reports and intelligence derived out of it. Thus data will have to be collected afresh from the existing taxpayers. GSTIN can be issued based on State and validated PAN. In case of taxpayers under Excise and VAT, source of data for issuing GSTIN should be VAT data as in most cases Excise assesse will also be registered under VAT. For taxpayers under Service Tax the source of data for issuing GSTIN should be Service Tax.

Out of six mandatory data fields in the GST Registration field, three can be filled up from validated PAN data, namely PAN, name of business, constitution of business. The name of State is known in case of VAT data. The remaining two mandatory data fields namely 'Principal Place of Business' and 'details of promoters' will have to be collected from taxpayers along with non-mandatory items. In case of Service Tax, State will have to be collected before generating GSTIN. With this the following process has been suggested:

(4) For Taxpayers Registered under State VAT/Excise

(i) GSTIN will be generated by NSDL in case of all VAT TINs where PAN has been validated. Along with a password the GSTIN will be sent to respective State Tax Authorities.

(ii) State tax authorities will communicate the GSTIN/password to taxpayers, with instruction to log on the GST portal and fill up the remaining data. State specific data over and above what is contained in the GST Registration Form can be collected after GST registration becomes operational.

(iii) The data so collected by GSTN/NSDL will be provided to States so that they can undertake the verification exercise as per their convenience after 1/4/2016 in a staggered manner spread over a period of one to two quarters so that it does affect the working of the tax authorities. This is being suggested as the dealer is already registered with VAT department.

(iv) In case, PAN has been validated but the email or mobile numbers of dealers are not available, such dealers may be advised through newspaper advertisement to visit the GST portal and use the following data for user authentication:

1. VAT-TIN
2. PAN
3. Date of Birth/Date of Incorporation in DDMMYYYY format. (This data is available with PAN Database)
    i. Date of birth of proprietor in case of Proprietorship firm.
    ii. Date of incorporation in case of all other types of dealers.

(v) In those cases where PAN has not been validated, State VAT department will have to collect the taxpayers.

(5) In case of Service Tax, the taxpayers are not registered under a State, a different approach will have to be adopted.

I. Since all Service Taxpayers have user ID and password and Service Tax has their email IDs, they may advice the taxpayers to intimate State(s) where they would like to get themselves registered in.

II. Service Tax portal will check from GST portal whether GSTIN has been generated for combination of State and PAN of the taxpayer. If not generated, request GST portal to generate the same.

III. GST portal will generate the GSTIN and communicate to Service Tax, which will be communicated to the taxpayer asking him/her to provide remaining data at GST Portal.

(6) Any verification / updation of the information as outlined above would have to be done by the taxable person within a specified period.

(7) If the verification/updation is not done within the stipulated period, the GSTIN will be suspended till the taxable person does the needful.

(8) Any verification by State / Central authorities can be done after GSTIN is issued.

8.0 Registration of Compounding Dealers

8.1 Dealers below the Compounding ceiling will be provided with an option of availing the Compounding scheme i.e. they can pay the tax at Compounding rate (to be specified) without entering the credit chain.

8.2 Although the Compounding scheme is only a temporary phase before the taxable person starts functioning as a normal taxable person, separate format annexed as Annexure-V has been prescribed for enabling such taxable persons to opt for Compounding scheme. When the taxable person opts for Compounding scheme he should indicate so in the registration form and GST Common Portal would internally flag him as a Compounding dealer. Later on when he goes out of the Compounding scheme due to his turnover crossing the Compounding ceiling (change will be triggered by the tax return values) or he opts out of the scheme (through an amendment application annexed as Annexure-VI), the said flag will be removed and he would continue operating with the same registration number, without undertaking any fresh registration.

9.0 Amendments in the Registration Form

9.1 Capturing registration information is not a one-time activity and any change in critical information should be entered at the common portal within a stipulated time period. Except the fields mentioned in Para 7.2 (7) above, changes to other registration data can be done on self-service basis. The changes to fields mentioned in Para 7.2 (7) above and a change to Compounding scheme will require submission of reasons and prescribed relevant documents, and will be subject to approval by the concerned tax authorities. All amendments in the details in registration application form will be retained in the database of the GSTN and will be made visible to the tax authorities.

10.0 Cancellation/Surrender of registration

10.1 In the following cases, the registration can be either surrendered by the registrant or cancelled by the tax authorities:

(1) Closure of business of tax payer;

(2) Gross Annual Turnover including exports and exempted supplies (to be calculated on all-India basis) falling below threshold for registration;

(3) Transfer of business for any reason including due to death of the proprietor of a proprietorship firm;

(4) Amalgamation of taxable person with other legal entities or de-merger;

(5) Non commencement of business by the tax payer within the stipulated time period prescribed under the GST laws **(Suitable provision to be made in the GST law).**

10.2 In case of surrender, the system will send an acknowledgment by SMS and e-Mail to the applicant regarding his surrender of registration and he will be deemed to be unregistered from the date of such acknowledgement. There will be a provision in the system to prompt such surrendered registrants to update their address and mobile number at a prescribed periodicity till all dues are cleared/refunds made. Application form for Surrender / Cancellation of registration is annexed as Annexure-IV.

10.3 GST Law drafting committee would make appropriate provision for recovery of arrears, other dues and compliance verification pertaining to past periods.

10.4 The cancellation of registration may be done by tax authorities in the following situations:

(1) In case signed copy of the summary extract of submitted application form is not received even after a reminder;

(2) In case a tax payer contravenes specified provision of the GST law;

(3) In case a taxpayer has not filed any return at all during a predetermined period (say six months). In case a taxpayer has filed a nil return continuously for this period, then the provisions of cancellation will not be applicable**. (GST Law drafting committee should provide for the time period for which if there is a continuous failure by a taxpayer to file returns, the registration shall be cancelled)**

(4) The cancellation of registration may be preceded by system generated notice giving 7 days' time for furnishing reply by the taxpayer. Principle of natural justice to be followed before cancellation, i.e., giving an opportunity to taxpayer to be heard and passing of order.

10.5 If the taxpayer approaches the tax authority for revocation of surrendered or cancelled registration, the surrendered / cancelled registration can be revoked. The action for revocation would be initiated by that Authority which has cancelled the registration or had earlier accepted the surrender of registration.

10.6 The GST Law would contain appropriate provisions relating to revocation / surrender / cancellation of registration.

10.7 The action for revocation / cancellation of registration would have to be initiated by both Centre and State tax authorities. Once the registration is cancelled by one authority it would be deemed to be cancelled by other authority also.

10.8 The cancellation or surrender of registration would always have prospective effect.

11. Explanation of the Entries in the Form (should be attached to the Form)

11.1 The critical information / documents required from the applicant while making the application has been outlined in para 6.3 above. Here the manner of organization of the said information in the registration form (Annexure-III) has been explained.

11.2 The form has fields from 1- 21 requiring various details from the applicant. These fields have been organized so that applicant can introduce himself and the nature of his business to the tax authorities in simple interactive manner. To maintain uniformity in the manner of submission of the form, the fields are provided in the standard conventional manner. These can be adopted from the forms notified by the Information Technology department of the Central and State Governments. For example, the legal name can be either a single field or it could be split into first name, middle name and last name. *In case there is no standard practice for any of the fields, the same should be developed by the GST common portal.* The form is self-explanatory and has online validation facility before the submission of the form. Wherever possible, drop down menu will be provided so that the form is user friendly and there is no dispute about the information submitted.

11.3 The fields marked with asterisk are the critical fields and need to be filled before the form can be submitted to the portal. In case of non-availability of the information such as PAN Number with the applicant, the common portal will direct the applicant to the website of the income tax department where he can submit the application for obtaining the PAN and after obtaining PAN, can apply for registration under GST.

11.4 Fields 1 -5 are the basic introductory fields and need no explanation.

11.5 Field 6 is relevant for taxable persons opting for Compounding scheme.

11.6 Field 7 asks for date of commencement of business in the State in which the taxable person is applying for registration. As has been discussed earlier, the taxable person in the GST regime will be required to take State specific single registration for CGST, IGST and SGST purposes (multiple registrations in a state for business verticals are permitted) .

11.7 Field 8 asks for the date on which liability to pay tax has arisen. Field 9 asks for the details of time period for which registration is required by the casual dealers. Field 'From' - 'To' - will be mandatory for casual /non-resident dealers in the registration application. For others field 'From' only would be mandatory. Field 10 captures the reason for such liability. This field would not be enabled in case of registration application by casual/non-resident dealer.

11.8 Field 11 is for the existing registrants. They have to indicate the details of their existing registrations, so that information already available in the respective data bases can be culled out and made use by the tax authorities for granting new registration to the applicant under GST.

11.9 Field 12 asks for the details of the principal place of business of the applicant. Principal place of Business in the State is the place declared by the taxable person, where-

(1) He will make available all the records to the tax authorities when called for.

(2) The tax authorities will serve all the communications, notices, orders etc. and service of the communications, notices and orders at this place will be treated as legal service of such communications, etc.

11.10 Field 13 seeks the details of the Bank Accounts of the applicant. The taxable person is required to disclose the details of all the bank accounts maintained by him for conducting his business.

11.11 Field 14 and 15 ask for the details of top 5 goods or services **(in terms of turnover or any other parameter to be specified by the GST Law drafting Committee)** which taxable person is supplying or likely to supply.

11.12 Field 16 captures details of the additional places of business. In this field the applicant has to give the details of all the places from where he conducts the business.

11.13 Field 17 asks for the details of Proprietor, partners, Karta, Directors, Member of Managing Committee of Association, Managing trustee etc. of the business depending on the constitution of the business.

11.14 Field 18 asks for the details of the authorized signatory.

11.15 Field 19 asks for the details of authorized representative (TRP / CA/ Advocate, etc.) of the taxpayer.

11.16 Field 20 is kept to capture any State specific information, **if so provided in the GST law.**

11.17 Field 21 is required to capture the scanned documents (as mentioned in para 6.3. above) required to be uploaded along with the application

11.18 Field 22 is the field for verification and declaration made by the applicant about correctness of the information submitted by him in the registration application.

(Satish Chandra)
Member Secretary
Empowered Committee
of State Finance Ministers

(Rashmi Verma)
Additional Secretary
Department of Revenue
Government of India

Annexure (s)	Particulars
I	Constitution Order of Joint Committee on Business Processes for GST
II	List of Participants of the Meeting Held on 22nd and 23rd July, 2015
III	Application for Registration under Goods and Services Tax Act
IV	Application for Surrender of Registration under Goods and Services Tax Act, Year
V	Application to Opt for Composition Scheme
VI	Application for withdrawal from Composition Scheme
VII	Application for Amendment(s) in Particulars subsequent to Registration under Goods & Services Tax Act
VIII	Extract of the Report of The Committee on The Problem of Dual Control, Threshold and Exemptions In GST Regime
IX	Extract of the Minutes on Refinement to the Process for States Option for two-way API based Integration and Flexibility (Decision dated 18.04.2012 of EC) will be formulated separately
X	Extract of the Report of the Committee on IGST and GST on Imports

For detailed annexures please visit: http://idtc.icai.org/download/Report_on_GST_Registration.pdf

ANNEXURE-VIII

EXTRACT OF THE REPORT OF THE COMMITTEE ON THE PROBLEM OF DUAL CONTROL, THRESHOLD AND EXEMPTIONS IN GST REGIME

Para 7. The matter was deliberated upon by the Committee. It was felt that the threshold, both for SGST and CGST should be common except for North-eastern States where the threshold could be prescribed at lower level. It was also felt by the Committee that the threshold both for services and goods should be same. However, for inter-state dealers, the threshold should be zero. The threshold should be worked out taking into account both the supply of goods and services on gross turnover basis. Such turnover would include the turnover of exempted goods and services (including non-taxable) and exports. It was also agreed that the turnover so calculated would be applicable for the purposes of Threshold, Compounding Scheme and Dual Control. While the State representatives felt that turnover should be State-wise of a legal entity, the representatives of Government of India strongly felt that it should be All India turnover of a legal entity, otherwise it may lead to tax evasion. It was pointed out by the Centre's representatives that if the turnover of an entity is considered State-wise, the threshold for CGST would increase steeply when calculating the turnover of the entity on an All India basis. This would adversely affect the revenue of theCentre.What would happen is that an entity will open office in States and Union Territories (which are 37 in number) for availing of State-wise threshold for SGST purposes. In such a scenario, the threshold for CGST purposes would work out to Rs. 9.25 Crores (Rs. 25 Lacs * 37). Similar impact would be there for the compounding scheme as well as for the issue relating to dual control. The suggestion of the Central Board of Excise and Customs (CBEC) that legal entity on all India basis should be taken was considered by the Committee and after due deliberations the suggestion was agreed to avoid tax evasion by the manufacturers/ traders/dealers.

ANNEXURE-X

EXTRACT OF THE REPORT OF THE COMMITTEE ON IGST AND GST ON IMPORTS

I. ***Norms for blacklisting of dealers for blocking tax credits***

A system of "GST Compliance Rating" can be introduced. Any fall in the rating below a prescribed level will have impact of blacklisting a dealer. The rating is only a measure to facilitate informed choices by the purchasers and not a punishment measure. There should be clear declaration in the law that blacklisting does not mean that ITC claim on other non-blacklisted dealers is assured by the Government as any eligibility for ITC primarily depends on the selling dealer owning up the tax invoice and paying the due tax. However, if the rating falls below the prescribed level resulting in that dealer becoming blacklisted, purchases from him will no longer be eligible for ITC, on self-assessment basis, (they however will be eligible for availing the ITC only after the tax has been paid by such selling dealers) by the buyers, till improvement of the rating to normal level.

IX.A. Trigger for Blacklisting

(i) Continuous default for 3 months in paying ITC that has been reversed.

(ii) Continuous default of 3 months or any 3 month-period over duration of 12 months in uploading sales details leading to reversal of ITC for others. Defaulters of even a single event should also be flagged and put in public domain as being a potential black listed dealer so as to alert the buyers.

(iii) Continuous short reporting of sales beyond a prescribed limit of 5% (of total sales) for a period of 6 months.

IX.B. Default

Not doing the activity within the prescribed cut off dates. A system of rating the dealers based on their compliance should also be done and put in public domain to inform prospective buyers.

IX.C. Rating and Compliance Profile

There should also be a continuous rating system, provided under model law, for dealers based on parameters such as promptness in e-return filing, discrepancies detected where the dealer has had to make corrections, making prompt payment in lieu of reversed ITC, etc. The profiles for all dealers would be posted in public domain so that the dealer community is kept aware of the compliance profile of all registered dealers with whom they may have to deal with during the course of their business. While the system of blacklisting may only highlight deviant behaviour after it crosses a certain threshold, a system-updated dealer profile will serve as a continuing rating mechanism for the entire community and leaders within a certain industry can set a benchmark for others to emulate.

IX. D. Blacklisting

i. Only for regulating ITC by others.

ii. Will be based on dealer rating. A dealer will be blacklisted if dealer rating falls below the prescribed limit.

iii. To be put in public domain.

iv. To be notified (auto-SMS) to all dealers who have pre-registered this dealer (black listed now) as their supplier.

v. To be prospective only (from month next to blacklisting)

vi. Blacklisted GSTINs cannot be uploaded in purchase details. Corresponding denial of ITC to be supported by suitable provision in the law.

vii. ITC reversal in hands of the buyer should take place for disowning of any tax invoice with date prior to effect of blacklisting of the seller.

viii. Once blacklisting is lifted, buyers can avail unclaimed ITC subject to this dealer uploading sales details along with tax and interest.

E-2

REPORT OF THE JOINT COMMITTEE ON GST PAYMENT PROCESS

Introduction

1. During the Empowered Committee meeting held on 10th March, 2014, it was decided that a Joint Committee under the co-convenership of the Additional Secretary (Revenue), Government of India and the Member Secretary, Empowered Committee should be constituted to look into the Report of the Sub-Group-I on Business Processes for GST and make suitable recommendations for Payment and Return to the Empowered Committee. Accordingly, a Joint Committee, in consultation with the Government of India, was constituted on 7th April, 2014 (Annexure-I). The Committee held its deliberations on 28th October, 2014, 12th November, 2014, 25th November, 2014, 22nd December, 2014, 2nd and 3rd February, 2015, 19th and 20th February, 2015 and 16th and 17th April, 2015.

2. The Joint Committee on Business Processes for GST held on 2nd February, 2015, it was decided to constitute a sub-committee on GST Payment Process. Pursuant to that decision, the Member Secretary, Empowered Committee constituted the Sub-Committee vide his memorandum letter dated 3rd February, 2015 (Annexure-II). Shri V Rajendaran, DG (Government Accounts), CAG, Mrs. Krishna Tyagi, CCA, CBEC, Government of India, Shri Madan Mohan, Jt. CGA, Government of India and Shri G Sreekumar, CGM, RBI were co-opted as members of the Sub-Committee. Shri Ravneet S. Khurana, Deputy Commissioner GST Cell, CBEC also participated in the deliberations of the Sub-Committee. The Sub-Committee met in Bengaluru on 14th and 15th February, 2015 and on 06th and 7th April, 2015. The Sub-Committee also exchanged drafts on emails during the interregnum period. The Sub-Committee submitted its final report on 10th April, 2015.

3. The report of the Sub-Committee was discussed in the meeting of the Joint Committee of Business Processes held in Delhi on 16th and 17th April 2015 and was accepted with certain modifications. The meeting of the Joint Committee was attended by the officers as listed in Annexure III.

4. In modern day taxation regime, every transaction of the tax payer with the tax administration should be transparent, responsive and simple. It has been experience of tax administrations that more the system and procedures are made electronic more is the efficiency of tax administration and greater is the satisfaction of taxpayer. In this context, payment system of GST should also be based on Information Technology which can handle both the receipt and payment processes.

5. The objectives of this report are as under:

   (a) Highlight key issues in tax collection, collation, remittance and reporting of tax collection into Government account;

   (b) Need for a uniform system of banking arrangements for collection, remittance and reporting of GST to both Central and State Governments;

   (c) Proper accounting and bank reconciliation of taxes derived from basic data of payments made by taxpayers to banks, with the required classification of heads of accounts indicated on the Challan;

   (d) Designing the format of a new Challan for use by the taxpayers paying GST;

   (e) Developing a detailed accounting procedure common to both Central and State Governments for GST, covering all relevant aspects of payments, accounting and related banking arrangements.

6. It is noted that under GST regime, some taxes and duties may remain outside the purview of GST and will continue to be collected in the manner prescribed under existing accounting procedures/rules/manuals, etc. This means that two types of challans (one for GST and other for non-GST) will be used and accounted for by the respective Pay and Accounts Offices (PAOs)/State AGs.

7. The payment processes under proposed GST regime should have the following features:

   (a) Electronically generated challan from GSTN Common Portal in all modes of payment and no use of manually prepared challan;

   (b) Facilitation for the taxpayer by providing hassle free, anytime, anywhere mode of payment of tax;

   (c) Convenience of making payment online;

   (d) Logical tax collection data in electronic format;

   (e) Faster remittance of tax revenue to the Government Account;

   (f) Paperless transactions;

   (g) Speedy Accounting and reporting;

   (h) Electronic reconciliation of all receipts;

   (i) Simplified procedure for banks;

   (j) Warehousing of Digital Challan.

8. With the above features in mind the following three modes of payment are proposed:

   (a) Payment by taxpayers through Internet Banking through authorized banks and through credit card/debit card;

(b) (Section 45 of RBI Act, 1934 permit banks other than RBI to be appointed as agency banks for carrying out government business. Agency banks are permitted to both receive and make payments on behalf of the Government and therefore act as Banker to respective governments. However, authorized banks are only permitted to receive payment of GST on behalf of the Government, and keeping this distinction in view, the expression 'authorized bank' is used throughout this Document.)

(c) Over the Counter payment (OTC) through authorized banks;

(d) Payment through NEFT/RTGS from any bank (including other than authorized banks).

9. Mode of payment described at b) above will be available for payments up to Rs. 10,000/- per challan only. Model GST law may have suitable provisions in relation to this. However, there should not be any IT system constraints for this i.e. the systems should be able to receive payments through all three modes irrespective of the amount. Other means of payment, such as payment by book adjustment as is presently being allowed by Government of India to some departments / State governments or payment by debit to export scrips, while paying tax would not be allowed. It is also noted that all taxpayers under Centre are paying taxes electronically and possibly the same situation exists in some State Tax administrations. It is desirable that under the GST regime, all taxpayers should gradually move to internet payment over an indicative time frame.

10. The Committee recommends that RBI should play the role of an aggregator through its e-Kuber system. Such role will facilitate participation of larger number of banks in GST receipts enhancing convenience for the tax payers and provide single source of information for credit of the receipts to Government accounts and thereby simplifying accounting and reconciliation tasks. In case of any discrepancy found during the reconciliation by the Accounting Authorities, they would directly interact with RBI. Joint CGA suggested that as per the provisions of Section 20 of the RBI Act, 1934 in the proposed scenario, RBI would be the sole banker to the Governments. RBI, on the other hand, has indicated that Section 20 and Section 45 of the RBI Act, 1934 are not mutually exclusive and therefore there would not be any conflict in the role envisaged for the RBI in the proposed model.

11. Each of the above modes is discussed separately along with the role of stakeholders involved, process of reporting, accounting and reconciliation of data. As already mentioned above, it is envisaged that for each mode of payment, the challan will be generated electronically at the GSTN and no manual challan will be used under any mode of payment.

I. PAYMENT BY TAXPAYERS THROUGH INTERNET BANKING THROUGH AUTHORIZED BANKS AND THROUGH CREDIT CARD/ DEBIT CARD:

12. With increasing spread of internet and electronic communication, this mode has emerged as one of the preferred modes of tax payment for both the taxpayers and administrators. As the name suggests, this mode of payment involves payments by the taxpayers that utilize the electronic

network, right from the generation of the challan by the taxpayer to the ultimate reconciliation of the data by the Accounting authorities.

Before understanding the process involved in e-payments, it is important to list the stakeholders involved in this mode of payment. The following stakeholders will pay a key role in establishing an effective e-payment network in the proposed GST scenario:

(a) GSTN (Goods and Service Tax Network);

(b) e- FPBs (Electronic Focal Point Branches) of authorized banks;

(c) e-Kuber of RBI;

(d) Central Accounts Section (CAS) of RBI, Nagpur;

(e) e-PAOs (Electronic Pay and account Offices) / e-Treasuries of State Governments;

(f) Pr. CCA, CBEC (Principal Chief Controller of Accounts) / Accountant General of the States;

(g) Tax authorities of Centre and States.

Process involved in e-payment of GST:

13. Every tax payer who wants to avail the facility of e-payment will access GSTN for generation of the Challan through which payment is to be made. The following methods for creation of draft challan for GST payments are recommended:

(a) By Registered tax payer or his authorized person by logging on to GSTN Common Portal where basic details (such as name, address, email, mobile no. and GSTIN) of the tax payer will be auto populated in the challan;

(b) By authorized representatives of tax payers by logging on to the GSTN Common Portal whereafter the list of registered taxpayers represented by him will be displayed. He can select any tax payer on whose behalf he proposes to pay GST and challan details for such tax payer will be auto populated;

(c) By grant of temporary Registration number by any one Tax authority on GSTN Common Portal which can be used by both the tax authorities for facilitating tax payments on behalf of an unregistered person. Such a situation can arise during enforcement action by a tax authority and this temporary registration can be later converted into a regular registration number (GSTIN) if the tax payer has a regular GST liability to discharge after the enforcement action (detailed procedure described in Para 78 below);

(d) By creation of a challan without requirement of USER ID and Password, for enabling payment of GST by a registered or an unregistered person on behalf of a taxpayer as per the directions of the tax authority using the GSTIN (like the present provision under Service tax). In this method, GSTN would provide for a validation check (like CAPTCHA) so that challan can be created by a person and not by machine.

14. The issue whether challans should have provision for entering jurisdictional location (e.g. Commissionerate, division and range) was discussed in detail and it was decided that the same will not be mentioned in the challan. Instead, the Tax authorities would send the Taxpayers updated master data to GSTN as well as to Accounting Authorities. The incremental changes in the said master would also be sent on real time basis by the Tax authorities to GSTN and Accounting authorities. As challan would not have a jurisdictional location code, the Accounting Authorities would use the TAXPAYER Master received from Tax authorities for mapping the challans with the Jurisdictional PAOs / tax authorities' offices by having a suitable mapping mechanism.

15. Upon creation of the draft challan, the taxpayer will fill in the details of the taxes that are to be paid. The challan page will have sets of mandatory fields, which the user has to provide. The tax payer will have the option to pay CGST, IGST, Additional Tax and SGST concurrently. The tax payers can partially fill in the challan form and temporarily "save" the challan for completion at a later stage. A saved challan can be "edited" before finalization. After the tax payer has finalized the challan, he will generate the challan, for use of payment of taxes. The remitter will have option of printing the challan for his record. The challan so generated will have a 14-digit (yymm followed by 10-digit) Unique Common Portal Identification Number (CPIN), assigned only when the challan is finally generated, this will help the portal and other authorities in identifying the challan. The CPIN would be a running serial number to be initialized every calendar month. After the challan is generated, it will be frozen and will not be allowed to be modified. The CPIN/challan so generated would be valid for a period of seven days. In case of payment through Mode III, CPINs would remain live with RBI for a period of 30 days. GSTN would purge all unused CPINs on the day immediately after the date on which the validity period is over (i.e. 7 days if Mode I or II is selected and 30 days if Mode III is selected for payment). At the end of each day (EOD), GSTN would send all the CPINs generated on that day to the Accounting authority of the Centre and to those accounting authorities of the states that so desire.

The suggested format of the challan is appended at Annexure - IV which is a common format for all three modes of payment. Since the challan would be prepared electronically, chances of errors will be minimal. However to deal with challan correction in exceptional circumstances, a challan correction mechanism, prepared in consultation with the office of Pr. CCA, CBEC is detailed in paras 123 and 124 below.

16. Since there are three modes of payment, the tax payer has to choose the e-payment mode. This mode will also cover payment by Credit/Debit Card which can be used only after log in on the GSTN.

17. Once e-payment mode is selected, options will be shown to taxpayer to choose between Internet Banking and Credit / Debit Cards for making payment. In case Internet Banking mode is selected, a field with drop down box detailing names of various authorized banks, registered with GSTN for Internet Banking, would be displayed. The taxpayer will have option of choosing his preferred bank for Internet Banking. Credit and Debit Cards of all banks shall be accepted. However, the payment gateway services should be obtained by GSTN from the authorised banks or their payment gateway SPVs only. To encourage competition, preferably more than one such

gateway should be provided on the GSTN portal, with display of their respective charge rate and service performance level. The taxpayer can choose any of the gateways available on the portal for making the payment. The exact charge should be calculated separately by the gateway service provider. The gateway provider should collect this amount separately over and above the challan amount. The challan amount should be fully credited to respective Government accounts maintained with the authorised bank (acquiring bank for CC/DC payments), while the gateway charges should be retained back by the gateway provider. The Government/GSTN should procure the payment gateway services from the authorised banks (or their SPVs) through an appropriate competitive process to keep the charge rates low. The Committee also deliberated the issue of charge back claims in case of credit card based payment, and felt that the possibility of such claims on payments to the government is minimal and manageable, especially in view of implementation of two-step authentication norm by the banks. In addition, the taxpayer would be required to pre-register his credit card, from which the tax payment is intended, with the GSTN system. GSTN may also attempt to put in a system with banks in getting the credit card verified by taking a confirmation from the credit card service provider. The payments using credit cards can therefore be allowed without any monetary limit to facilitate ease of doing business. In the event of such claims, recommended standard operating procedure, prepared in consultation with RBI, is enclosed as Annexure-V.

18. In case of Payment Gateway, the first choice for a taxpayer would be to select the card type to be used for making the payment. Upon choosing the card type, the taxpayer would be displayed available gateway service providers servicing the card type. Once a taxpayer chooses a gateway, the interface of the gateway would be invoked. Alongside, GSTN will forward the same electronic string as was passed for Internet Banking (details in para 19 below). The service provider will capture and verify the card details and debit the challan amount and additional gateway charges from the card holder. The Payment Gateway service providers are expected to build their interface with GSTN common portal to capture challan amount breakup in terms of CGST, IGST, Additional Tax and SGST. Along with the interface, associated accounts for CGST, IGST, Additional Tax and state-wise accounts for SGST should be created by the Authorized banks associated with the gateway service providers. The breakup received from GSTN common portal will be used to credit the amounts received under respective accounts created for the purpose. The Committee noted that in respect of credit card payments, presently the acquiring bank is permitted to transfer the amount to the merchant on T+3 basis. Thus there may arise some situations where the taxpayers account has been debited on T+0 basis whereas Government's account in authorised bank would be credited on T+3 basis. It was informed by RBI that this time could be reduced to T+1 basis by suitable negotiations with the payment gateways. It is recommended that suitable negotiations may be carried out by the Accounting authorities and RBI with payment gateways to credit the amount on T+1 basis.

19. In case of payment through Internet Banking, once the taxpayer chooses a particular bank for payment of taxes, GSTN will direct him to the website of the selected bank. Alongside, GSTN will forward an electronic string to the selected bank carrying the following details for each challan on real time basis:

(a) GSTIN;

(b) CPIN;

(c) Challan Amount;

(d) Break Up of the Amount into CGST, IGST, Additional Tax and SGST ;

(e) State/UT Government to which SGST remittance pertains. GSTN in consultation with banks would decide about the requirement of merchant code as a GSTN identifier.

20. Taxpayer will make the payment using the USER ID and Password provided by the bank to enter into the secured e- banking area of his bank. He will select an account for debiting the total tax amount and authorize the payment. While making the payment, the bank will display the breakup of total amount payable into CGST, IGST, Additional Tax and SGST and seek confirmation from the user. No change in the break up as well as the total amount would be allowed on the Bank's portal. In case the user wants to change the break up or the total amount, he should abort the transaction and go back to GSTN portal from the bank's portal and reinitiate the process.

21. After the successful completion of a transaction, e-FPB of the concerned bank will create a unique Challan Identification Number (CIN) against the CPIN. This will be a unique 17-digit number containing 14-digit CPIN generated by GSTN for a particular challan and unique 3-digit Bank code (MICR based which will be communicated by RBI to GSTN). The incorporation of the date of payment in the CIN may be examined from the IT's perspective. This CIN, as a combination of CPIN and Bank Code, will be reported by the banks along with its own Unique Bank reference number (BRN). Such CIN is an indicator of successful transaction and will be used as a key field for accounting, reconciliation etc. by taxpayers, accounting authorities and tax authorities. After every successful e-payment transaction, there will be an instantaneous reverse flow of information through an electronic data string from the collecting bank to the GSTN containing the following details:

(a) CIN;

(b) GSTIN;

(c) Bank Reference number (BRN);

[Since there could be maximum of four credits against one debit, banking practice may be ascertained by GSTN. If such transactions (i.e. four credits against one debit require multiple BRNs i.e. one for each credit entry), all BRNs should be reported.]

(d) Challan amount;

(e) Date of Payment;

(f) Time of Payment

22. If the transaction cycle is not completed because of failure of credential verification, there would be no response from the bank to portal informing about the same. If a response (positive or negative) is not received by GSTN within the stipulated period (few minutes), there would be a feature in GSTN to re-ping the bank system and seek a response against CPIN. There may be a scenario in which the internet banking transaction is successful, but the connection drops before

the control comes back to GSTN portal, and the re-ping facility will help in finding the status of such transactions.

23. Upon receipt of confirmation from the bank regarding successful completion of the transaction, GSTN will inform the relevant tax authorities about payment of taxes. A copy of the paid challan (downloadable/printable) with auto-populated CIN, date and time of payment and a statement confirming receipt of the amount by the bank will be provided to the taxpayer by GSTN.

24. Thereafter the tax paid challan (CIN) will be credited to the tax ledger account of the taxpayer. It was discussed and agreed by the Committee that there would be 20 ledger accounts (one for each Major heads i.e. CGST, IGST, Additional Tax & SGST and 4 Minor heads for each Major Head i.e. Interest, Penalty, Fees & Others).

Role to be played by each Stakeholder:

GSTN:

25. In the framework of GST administration, GSTN is envisaged to be a "pass through portal" that works as a common interface between taxpayers, tax authorities, authorized banks, RBI and accounting authorities. So GSTN will play the following role in this mode of payment:

(a) Generation of challan along with CPIN;

(b) Facilitating e-payments by providing a linkage to Internet Banking interfaces of authorized banks and payment gateways of authorised banks for CC/DC based payments;

(c) Receipt of real time data from IT system (e-FPBs) of each authorized bank regarding successful completion of payment transaction by the taxpayer (CIN);

(d) Generating receipt containing BRN No. of collecting bank for taxpayer acknowledging receipt of payment by the bank. A further facility of generating receipt containing RBI's scroll number for taxpayer would also be provided;

(e) Information to the respective Tax Authorities on real time basis for each successful transaction reported by banks. The communication at this stage may contain a minimal set consisting of GSTIN, CIN (i.e. CPIN + Bank Code), BRN(s), Challan amount, break-up of the amount into CGST, IGST, Additional Tax and SGST and date of payment;

(f) At EOD, GSTN will also send the details of CPIN generated for the particular day to the Accounting Authority of the Centre (to facilitate estimation of revenue and fund management) and to such State accounting authorities that may so desire;

(g) On T+1 morning, GSTN will generate a consolidated file containing a summary as well as entire details of the challans for which successful transactions were reported by the banks on real time basis for the date value of T=0 (for this purpose, daily transactions would include transactions from 20:01 hrs on previous day to 20:00 hrs in the current day). The file will be sent to the respective accounting authorities. At this stage, the challan data will also include CIN (i.e. CPIN + Bank Code) and BRN reported by the banks. GSTN would generate this file on all working days including the days on which no transaction took place;

(h) GSTN will receive 39 consolidated e-scrolls from RBI (one each for CGST, IGST and Additional Tax and one each for SGST for each State/UT Govt, see para 26(a) below) on T+1 basis. The contents of the scrolls are mentioned in para 28 below;

(i) On receipt of consolidated transaction level e-scrolls from RBI during latter part of the day, GSTN will carry out preliminary system based reconciliation with reference to the successful transactions already reported real time by the banks and consolidated by GSTN as per step (g) above. GSTN will append the RBI scroll Number on each challan and thereafter forward its reconciliation results to the respective accounting authorities;

(j) Once the amount reflected in the CIN, received by GSTN from Bank on real time basis, is credited in the cash ledger of the taxpayer, GSTN will lock that CIN to prevent its further usage;

(k) Purge all unused CPINs after the expiry of seven days in case of Mode I & II / 30 days in case of Mode III;

(l) Receive TAXPAYER master as well as updates thereto from the respective Tax Authorities on real time basis.

e-FPBs (ELECTRONIC FOCAL POINT BRANCHES) OF AUTHORIZED BANKS:

26. There would be a single e-FPB for each Authorized bank for the entire country. It will perform the following role:

(a) Each e-FPB will open a major head wise (CGST, IGST, Additional Tax and SGST) account of each government (total 39 accounts) to which the remittances received by it would be credited. Currently, the Constitutional Amendment Bill states that the Additional Tax will be collected by Centre and assigned to States. If this arrangement is continued, the e-FPB will maintain one account for Additional Tax for Centre. A Committee has been constituted by the EC to examine the operational issue of Additional Tax and if it is decided that this tax will be collected by the respective State Government and retained by them, separate accounts for every State will have to maintained for Additional Tax also, on the lines of SGST;

(b) Sending real time data regarding successful completion of payment transaction by the taxpayer (CIN);

(c) At the end of each day (T+1), each e-FPB will be responsible for preparing daily luggage files Major Head wise (CGST, IGST, Additional Tax and SGST) for each government detailing receipts from all modes of payments on a particular day (including nil payment days) and forwarding it to RBI in the morning. Each luggage file will have a Unique Serial Number which will be a running serial number extending through a financial year which will facilitate identification of missing files. This luggage file number will become part of the electronic file. For operational purposes such as size of the file, it may be broken up into different parts with each part being numbered uniquely and also mentioning the total number of parts of that file;

(d) In the morning of each day (T+1), each e-FPB will also forward the daily luggage file mentioned above to accounting authorities of the Centre and the respective State, in case their accounting authorities so desire, so that they can independently monitor delayed remittances, if any, from the banks to the Government account in RBI; e) On the first day of every month, e-FPB will provide Datewise Monthly Statements (DMS) for each tax and government separately to RBI for the preceding month with following details:

  (i) Name of Tax;

  (ii) Government Name;

  (iii) Datewise number of successful transactions and total credit reported to RBI; and

  (iv) List of discrepancies remaining unresolved at the end of the report month (MOE UIN, CIN, BRN, Amount, Nature of discrepancy).

These statements will be simultaneously communicated to the respective Accounting Authorities, if they desire so.

27. Each authorised bank should have one or more service branch in each State to serve as GST help desk and to receive queries / e mails to resolve the issues from Taxpayers, Tax Authorities and Accounting Authorities.

e-Kuber (Core Banking System) of RBI:

28. The following functions will be performed by RBI (e-Kuber):

(a) RBI will consolidate luggage files received from all authorized banks, debit their accounts and correspondingly credit the CGST, IGST and Additional Tax accounts of Government of India and SGST accounts of each State/UT Government maintained in RBI(39 accounts);

(b) RBI would send consolidated, digitally signed e-scrolls, along with all the challan details, for each type of Tax (one each for CGST, IGST and Additional Tax for Government of India, and separate e-scrolls of SGST for each State/UT Governments) per day (including NIL payment day) after including the amount collected by it in Mode - III to Accounting Authority of Centre (e-PAO)/each State (e-Treasury) and GSTN simultaneously. Daily Major head account-wise scroll from RBI will consist of following information:-

(i) Merchant Code given to GSTN;

(ii) Scroll Number and Date;

(iii) Name of Government to which the scroll pertains;

(iv) CIN;

(v) GSTIN;

(vi) BRN;

(vii) RBI Transaction Number;

(viii) Mode of payment;

(ix) Tax amount;

(x) Control parameters like total transaction, Total Amount in the scroll, etc.

(c) If any discrepancy is reported by Accounting Authority or GSTN, it would carry out the correction mechanism with the authorized bank and thereafter report the corrected data to respective Accounting Authority and GSTN.

(d) RBI will consolidate Datewise Monthly Statements (DMS) received from the banks for each tax and government, validate the consolidated statements (39) with reference to its own data of e-scrolls reported during the report month, have a systemic review of unresolved discrepancies and communicate the statements to the respective accounting authorities within 3 days from end of the report month.

Central Accounts Section (CAS) of Reserve Bank of India, Nagpur:

29. CAS, Nagpur reports daily consolidated credits and debits to each Government and Accounting Authorities. Such daily statements cover all receipts and payments for the respective governments including inter-government transactions. GST credits will be one of the items reported by CAS, Nagpur in its daily statements. The scroll number mentioned in para 28 (b) (ii) above should be the credit identifier in the daily statements.

e-PAOs (Electronic Pay and Account Offices) of Centre and e-Treasuries of State Governments:

30. In the case of Central government, the existing e-PAO (Central Excise) and e-PAO (Service Tax) can work as e-PAO (IGST), e-PAO (CGST) in the GST regime. Another e-PAO (Additional Tax) can be operated till the time that the Additional Tax remains in force. All these e-PAOs can be located at Delhi itself. The State governments will need to establish their e-PAOs / e-Treasuries (proposed Central Accounting Unit in the RBI Report of 2014). The following functions will be performed by e-PAOs/e-Treasuries:

(a) At EOD, the Central Accounting Authority and those State accounting authorities that so desire will receive details of CPIN generated by GSTN for the particular day. (Centre's accounting authorities require this to facilitate estimation of revenue and fund management);

(b) Each morning (T+1), e-PAOs / e-Treasuries will receive from GSTN a consolidated file of entire details of the challans (including CIN) for which successful transactions were reported by the banks to GSTN on real time basis for the previous day;

(c) Each morning (T+1), e-PAOs for CGST, IGST & Additional Tax and e-Treasuries of the State Government will get consolidated transaction level digitally signed daily e-scrolls from RBI (along with all the challan details) pertaining to the successful transactions of the previous day (date value T=0);

(d) E-FPB of authorized banks would also send such scrolls on T+1 basis to central accounting authorities and to those e-Treasuries that may so desire;

(e) They will also receive from GSTN, later in the day, results of reconciliation by GSTN with the bank's and its own data;

(f) The e-PAO and e-Treasuries of the States would reconcile the challan details [received in step b) above] with the e-Scroll information [received from RBI in step c) and from GSTN in step e) above], and do the detailed revenue accounting based on the information provided in the e-scroll provided by RBI to the accounting authorities;

(g) They will receive TAXPAYER master from the respective Tax Authorities (backend module) and the same would be required to be kept updated on real time basis by the respective Tax Authorities. The said TAXPAYER master would be used by the Accounting Authorities for mapping the challan details with the Jurisdictional PAOs by having a suitable mapping mechanism. This is a requirement of the Government of India for determining revenue from each formation. States may also follow a similar procedure, if they so desire;

(h) They will also provide CIN wise payment / challan details to the respective Tax Authorities daily or periodically as per requirements / norms of their governments for departmental reconciliation and for updating Tax Authorities database that the tax amount has been accounted in the government's books. Accounting Authorities should provide their accounting reference number (in Government of India, CIN is used for this purpose; some State Governments seem to be generating their own accounting reference number) for each challan accounted by them along with the tax amount as per the credit accounted by them to the jurisdictional Tax Authorities for reconciling their records.

(i) They will provide verified Datewise Monthly Statement (DMS) to Pr. CCA, CBEC (Principal Chief Controller of Accounts) and Accountant General of the states:

Pr. CCA, CBEC (PRINCIPAL CHIEF CONTROLLER OF ACCOUNTS) AND ACCOUNTANT GENERAL OF THE STATES:

31. The following functions will be performed by them:

(a) They will receive daily and monthly Put Through Statements from CAS, RBI;

(b) They will also receive verified Datewise Monthly Statement (DMS) from e-PAOs and e-Treasuries of the States respectively;

(c) The reconciliation of both the data will be carried out by them;

(d) Office of Pr. CCA CBEC will also consolidate the total collection and forward the same to the Office of CGA for further consolidation.

II. OVER THE COUNTER PAYMENT THROUGH AUTHORIZED BANKS:

32. Another mode of payment that will be employed in the proposed GST regime will be Over the Counter (OTC) payments which will enable the taxpayers to make payment of the taxes at the Authorized Bank's counter. This will be beneficial for smaller taxpayers that do not have access to internet banking facilities. CCA raised an issue that the authorized banks might be asked as to whether they would be able to scroll these OTC payments through e-FPBs. This was discussed and RBI's representative assured that the scrolling by e-FPBs of OTC payments in one scroll would be ensured. The authorized banks will be required to establish / upgrade their IT software for accepting GST receipts.

33. The following stakeholders will play a key role in establishing an effective OTC payment system in the proposed GST scenario:

(a) GSTN;

(b) Branches of Authorized Banks;

(c) e-FPBs of Authorized banks;

(d) e-Kuber of RBI;

(e) e- PAOs of Centre / e-Treasuries of State Governments;

(f) Pr. CCA, CBEC / Accountant General of the States;

(g) Tax authorities of Centre and States.

Process involved in Over the Counter payment of GST through authorized banks:

34. Every tax payer who wants to avail the facility of OTC payment (only for paying tax upto Rs. 10,000/- per challan), will access GSTN for generation of a challan through which payment is to be made.

35. Upon creation of the draft challan, the taxpayer will fill in the details of the taxes that are to be paid. From the available payment options, the taxpayer would select option of cheque, DD or cash based payment. The name of the authorized bank and its location (city/town/village) where the instrument/cash is to be presented is required to be filled in necessarily. No outstation cheques are to be accepted except those which are payable at par at all branches of bank having presence at that location. In case cheque or DD is selected as the mode of payment, entry of

Instrument details is recommended, but not mandatory, as the taxpayer may not have the instrument ready at the time of challan generation. The tax payers can partially fill in the challan form and temporarily "save" the challan for completion at a later stage. A saved challan can be "edited" before finalization. After the tax payer has finalized the challan, he will generate the challan, for use of payment of taxes. The challan so generated will have a Unique Common Portal Identification Number (CPIN), assigned only when the challan is finally generated, that will help the portal and other authorities in identifying the challan. After the challan is generated, it will be frozen and will not be allowed to be modified. The CPIN / challan so generated would be valid for a period of seven days within which payment is to be tendered. GSTN will inform the challan details including validity period to the CBS (Core Banking System) of the selected bank on a real time basis.

36. Upon successful saving of the challan details, the challan will be available on the dashboard of the taxpayer in downloadable/printable form. So the taxpayer can either download the challan form and print it offline or can print the challan directly from GSTN. If the payment is made by cheque or DD, the challan itself would have a disclaimer that the payment is subject to realization of cheque or DD.

37. Thereafter taxpayer will approach the branch of the authorized bank for payment of taxes along with the instrument or cash. Since the tax payer is required to pay four types of taxes and the amount is required to be credited in the accounts maintained by bank for each type of tax, one option for the tax payer is to submit four instruments for crediting to the respective accounts. Four instruments may not be required if pooled account for realization of instrument is maintained. The matter was discussed in detail and it was recommended, that in the interest of facilitating the payment, each e-FPB should maintain a GST pool account so that the tax payer can issue only one instrument which will be written in the name of the GST pool account of the concerned bank. The bank's IT system upon realization of the instrument, will immediately first credit that amount to the GST pool account and then immediately transfer that amount to the respective tax accounts [CGST, IGST, Additional Tax or SGST(39 accounts) as per details in challan (CPIN Data)]. However RBI representatives observed that since there would be real-time sharing of data between GSTN and Agency Banks, the details would be available to the bank official before submission of the challan by the customer. In such a situation, GSTN would have already shared the break-up of the total amount to the bank and the bank needs to credit the same in the appropriate head. The internal Accounting mechanism of bank may be left to the bank to design, as the requirement here is the proper booking and reporting of the transaction which banks would have to ensure. It was decided that those banks need not operate a GST pool account which can credit the amount in the respective tax accounts 'on the fly'.

38. There should be a linkage between the GSTN and the Core Banking System (CBS) of the authorized banks whereby the details of challan are shared with the Authorized bank selected by the tax payer on real time basis so that they can be stored in the database of banks and also to facilitate the cashier / Teller to verify the details of the challan submitted by the remitter. This will eliminate the need for manual feeding of the challan details by the cashier / Teller in the banking system and thereby reduce the errors in data processing.

39. The taxpayer should preferably carry two copies of the challan, one for the bank's record and another for himself to get acknowledgement. In the alternative, he can use a normal pay-in-slip and mention CPIN and challan amount in it. On approaching the bank, he should provide the challan itself or at least CPIN number on normal pay-in-slip to enable the cashier / teller to fetch the challan details in his system. There should be a customized IT application (software) in the bank's system to accept GST receipts on OTC basis. While each branch can accept GST receipts, the credits should always be to the GST accounts maintained and operated by e-FPB . The banks not having such system should not be allowed to accept OTC payments. The minimum requirements to be met by the banks for being authorized to accept GST receipts for all modes including OTC mode are detailed in para 85 below.

40. The cashier / teller will verify the details of challan, payment instrument and amount provided by the taxpayer with those displayed in his system and should accept the receipt only when no discrepancy is found. If the challan has crossed its validity period of seven days, the bank's system itself should bar acceptance of the payment. In any case, the challan would also not be available in the GSTN and consequently in the bank's system because it would have been purged from the System by GSTN upon the expiry of the 7 day validity period.

41. The tax payer may make payment by cash or instruments drawn on the same bank or on some other bank in the same city. In case of cash payments or same bank instruments, the payment would be realized immediately and a transaction number (BTR/BRN) and CIN will be generated immediately at the authorized bank's system which will be unique for each and every transaction. Such successful transactions shall be intimated to GSTN on real-time basis with details similar to those mentioned in para 21 above. This message will convey to the common portal that the payment has been successfully received at the bank's counter.

42. After generation of BRN, the bank cashier may give a printed receipt from his system including the Bank's transaction number (BTR/BRN) and CIN. However, if it not found feasible to print a separate receipt, the cashier should record the BRN and CIN generated from the system, on the tax payer's copy of the challan or pay-in-slip as acknowledgment.

43. In case an instrument drawn on another bank in the same city is presented, the payment would not be realized immediately. In such case, CIN will not be generated immediately, and cashier should write only the system generated acknowledgment number on the challan / pay-in-slip and a stamp to the effect that the acknowledgment by the bank is subject to realization of the cheque / DD. The tax-payer need not visit the bank again to get CIN as the same will be communicated to him from GSTN as per the process detailed in para 47 & 48 below. However, if he does not receive any communication from GSTN within 3 days, he should visit the bank to ascertain the status of his payment.

44. Where the instrument is drawn on another bank, there should be a validation in the bank's system to prevent out station cheques (except those payable at par across cities), and to also prevent deduction of commission charges for instruments drawn on another bank in the same city.

45. The Authorized Bank would send the instrument for collection and the transaction would be treated as complete and successful only after the actual receipt of the amount by the said bank.

46. The bank will inform GSTN on real time basis in two stages. First when an instrument is given OTC. At this stage the Authorized bank will forward an electronic string to GSTN which will contain the following details:

(a) CPIN;

(b) GSTIN;

(c) Challan Amount;

(d) Bank's acknowledgement number.

On receipt of the above first message, GSTN should send a SMS to the tax payer, in addition to showing the status of the payment on its portal as subject to realization.

47. The bank's system would send a second message to GSTN once the cheque is realized, the total amount is credited first to GST pool account and thereafter the funds are credited to the respective tax accounts as per CPIN data (as stated in para 34 above, GST pool accounts are not required to be maintained by those banks who can credit the amount in the respective tax accounts 'on the fly'). On the day of realization, it will become a successful transaction to be reported to RBI on T+l (T = 0 being day of realization). After the successful completion of transaction, the second acknowledgement will have the same details as mentioned in para 46 above with three additional details:

(a) CIN;

(b) Date of Realization of Cheque;

(c) Time of realization of cheque;

(d) Bank Transaction Number (BRN/BTN).

On receipt of the second message, GSTN would send a SMS to the tax payer, in addition to updating the status of the payment on its portal.

48. This 2 stage intimation by authorized banks is recommended for the following reasons:

(a) Keep a watch on delays on the part of authorized banks in realization;

(b) Maintaining a system based control as all branches of authorized banks will be allowed for OTC.

49. On receipt of the real time information for a successful transaction as per para 4l above (cash, cheque on same bank or DD) or receipt of the second message from Bank as per para 47 above (cheque drawn on another bank), the tax paid challan will be credited to the tax ledger account of the taxpayer. If the OTC payment was subject to realization (para 46), the initial status on the dashboard will state so. If the cheque is dishonoured, the presenting bank should inform GSTN about the fact of dishonour and same will be informed by GSTN to taxpayer and reflected on his dashboard.

Role to be played by each stakeholder:

50. The role played by each stakeholder in this mode of payment will be the same as mentioned in Mode I. There is an additional stakeholder in this mode, namely Branch of Authorized bank that receives the remittances and its role is discussed below.

Branch of Authorized bank:

51. Being the first point of contact for the remittance by the taxpayer, the branch of the Authorized bank receiving the payment will play a key role in the accounting and reconciliation of data with GSTN. It will perform the following functions:

(a) Accept the payment only through the customized GST software/screen in its system.

(b) Provide an acknowledgement to the tax payer;

(c) Send the instrument (if pertaining to another bank) to the clearing house for realization and record the result in the IT system as and when the response is received. Such recording should be system based rather than manual and include realization or dishonouring of the cheque, as the case may be, so that the IT software can take up further action including intimation to GSTN on real time basis;

(d) Credit the realized amount into either GST pool account, if so, maintained by the authorized bank (in its e-FPB) and thereafter transfer the said amount into the individual tax head accounts as indicated in the challan (all Authorized banks must develop a suitable GST software for this purpose) or to credit the amount directly to the respective government's account (39 accounts).

(e) In case the instrument is dishonoured, the presenting bank should inform GSTN.

52. It is to be noted that banks will have to develop a mechanism/IT application where all these amounts tendered at individual branches of an authorized bank are only handled through the e-FPB of that authorized bank. This is because the tax accounts will be maintained only by the e-FPB. Individual branches have not been authorized by RBI to operate Government account. It is also important to provide for a mechanism in GST Law to debar those tax payers whose cheques have once bounced from using this mode of payment. The most effective mechanism will be through GSTN which should debar such defaulters from using this mode.

III. PAYMENT THROUGH NEFT/RTGS FROM ANY BANK (INCLUDING OTHER THAN AUTHORIZED BANKS):

53. The third mode of payment envisaged under the GST regime is OTC payment through all banks including other than authorized banks, i.e., a bank where a tax payer may have account but that bank may not be authorized by the Government to accept GST receipts. The payment through this mode will strictly be a matter of normal banking service of NEFT / RTGS provided by that bank to its customer. The chances of error in this mode are similar to that of any remittance done through NEFT / RTGS. However, care needs to be taken to ensure that CPIN number is correctly

mentioned in NEFT / RTGS message. The Committee recommends that this mode being a new mode of remittance should be scaled up gradually starting with a pilot run by RBI. It was informed by RBI that a detailed process flow could be worked out with specific provisions for validations. RBI further informed that this concept was being tested in Karnataka and this experience would be further used for developing this mode of payment. NEFT / RTGS mandate would have the same validity period of seven days as the CPIN and the date upto which it would remain valid would be printed on it. The Committee observed that in this mode of payment, it would not be possible to automatically ensure that a CPIN was not used beyond its validity period of 7 days. It was decided that CPIN once generated and intimated by GSTN to RBI in this mode though will have a validity period of 7 days but would remain live with RBI for a period of 30 days. In case the payment is received after the expiry of the said 30 days, RBI would return the amount to the remitter bank. Beside this, it was also decided that there should be a provision in the GST law whereby any taxpayer using this mode beyond the validity period (seven days) of the CPIN more than two times would be barred by GSTN from availing this mode of payment.

54. Although the process under this mode will be more or less similar to the OTC payment discussed earlier in paras 32-52 above, but due to involvement of a new stakeholder i.e. a non-authorized bank, certain modifications are required for this process. This process will be beneficial for those taxpayers who do not have a bank account in any of the authorized banks or find such bank to be far away for OTC payment or want to make the payment directly from their account in their own bank only. In this mode, only payment through National Electronic Funds Transfer (NEFT) / Real Time Gross Settlement (RTGS) is to be allowed as other payment instruments would require the Central and the State Governments to create accounts with non-authorized banks also which will not be desirable.

Process involved in payment through NEFT / RTGS from any Bank (including other than authorised banks):

55. Every tax payer who wants to avail the facility of payment through NEFT/RTGS mode will access GSTN for generation of a challan through which payment is to be made.

56. Upon creation of the draft challan, the taxpayer will fill in the details of the taxes that are to be paid. As agreed by the RBI representative, RBI would itself be the recipient of the amount transferred through NEFT / RTGS, thus eliminating the need for a link-up first with an authorized branch to receive the payment and thereafter its transfer to the RBI. RBI would thus perform the role of Authorized bank and that of e-FPB in this mode of payment. In this view, the name of the authorized bank will be auto populated as RBI. As a part of the challan preparation, a tax payer will have to choose the mode of payment as NEFT / RTGS from any bank. The challan so generated will have a Unique Common Portal Identification Number (CPIN), assigned only when the challan is finally generated. The generated Challan will have a NEFT / RTGS mandate associated with it. This mandate will contain NEFT / RTGS pooling bank account details (i.e. of RBI) along with IFSC for receiving money. After the challan is generated, it will be frozen and will not be allowed to be modified. The CPIN so generated would be valid for a period of seven days within which payment is to be tendered but would remain live with RBI for a period of 30 days. NEFT/RTGS mandate would have the validity period of CPIN printed on it. As mentioned above,

there shall be a provision in the GST Law whereby any taxpayer using challan under this mode beyond the validity period of seven days of the CPIN more than two times would be barred from availing this facility by GSTN.

57. Upon successful saving of the challan details, the challan will be available on the dashboard of the taxpayer in downloadable / printable form. So the taxpayer can either download the challan form or print it offline or can print the challan directly from GSTN.

58. Besides the generation of challan, GSTN will also generate NEFT / RTGS mandate form in prescribed format. The CPIN generated at the portal shall be incorporated in NEFT/RTGS mandate form in "Account Name" field. RBI would provide for suitable validations for this field. The "Sender to Receiver" field shall carry the entry "GST Payment". In case of NEFT / RTGS payments, there shall also be a disclaimer on the challan copy and the mandate form that the payment through NEFT / RTGS is a transaction between the tax payer and his bank and the payment will be deemed to be received by the government only when the amount is credited to the designated account in RBI. The payments in this mode would be permitted only against cheques and no cash payments would be permitted to initiate NEFT / RTGS transaction for the reasons mentioned in Para 67 below.

59. The following details will be available in the NEFT / RTGS mandate form:

(a) Beneficiary IFSC : IFSC of RBI hosting the NEFT / RTGS account for GST;

(b) Beneficiary Account Number : Account Number of RBI's pooled account for GST;

(c) Account Name : CPIN of relevant challan (suitable validation to be provided by RBI);

(d) Total Amount;

(e) Sender to Receiver Remarks: GST Payment.

The form will have a provision to write the NEFT/RTGS charges manually and then record the total amount to be collected by the bank (sum of challan amount and charges). The entire NEFT/RTGS form will be auto-populated except the part relating to the charges.

60. Thereafter taxpayer can print a copy of NEFT / RTGS mandate form and approach his bank branch (any bank) for payment of taxes (within a period of seven days of the generation of CPIN, so that when the amount is received by RBI, the CPIN is still valid.) The payments in this mode would be permitted only against cheques and no cash payments would be permitted to initiate NEFT / RTGS transaction. NEFT/RTGS mandate would have validity period of CPIN printed on it. As already mentioned above, there should be a provision in GST law whereby any taxpayer using this mode beyond the validity period (seven days) of the CPIN more than twice would be barred from availing this facility by GSTN.

61. GSTN will inform RBI on real time basis the following details:

(a) CPIN;

(b) GSTIN;

(c) Challan Amount;

(d) Break Up of the Amount into CGST, IGST, Additional Tax and SGST;

(e) State/UT Government to which SGST remittance pertains.

62. The accepting bank should add its charges for doing NEFT / RTGS remittance and collect gross amount from the customer. The amount indicated as GST amount for remittance should be transferred by the remitter bank to the designated account of the government in RBI. For the proper identification of the transaction, there should be a Unique Transaction Reference (UTR) that should be conveyed along with file details to RBI. The remitter bank must also mention the CPIN in the NEFT/RTGS mandate as part of the Account Name. The Remarks field shall mention 'GST Payment'.

63. Upon successful completion of the transfer at the end of the remitter bank, the remitter will get a receipt detailing Unique Transaction Reference (UTR). Taxpayer should thereafter login back to GSTN portal and update the challan details with Unique Transaction Reference (UTR) provided by the remitter bank for NEFT / RTGS transaction. An alternate SMS based facility for such updating by the tax payer (instead of internet based) may be established by GSTN to facilitate those taxpayers who do not have an internet access. On receipt of the transaction number, GSTN will communicate this Unique Transaction Reference (UTR) (for the corresponding CPIN) also to RBI on real time basis.

64. Once the RBI receives the payment in its account with NEFT/RTGS message, it will link up the payment with the CPIN earlier received from GSTN and report the transaction to GSTN on real time basis through an electronic string which will contain the following details:

(a) CIN (CPIN and Bank Code of RBI);

(b) GSTIN;

(c) Challan Amount;

(d) BRN of RBI;

(e) Unique Transaction Reference (UTR);

(f) Time of Payment;

(g) Date of Payment.

65. Upon receipt of the electronic string regarding successful completion of the transaction by GSTN, the tax paid challan will be credited to the cash ledger of the taxpayer. The GSTN will thereafter lock the CIN so that it cannot be used again.

66. As recommended in para 58 above, the Mode III may be implemented with arrangement of CPIN being mentioned as the "Account Name" in NEFT/RTGS message. RBI will provide for a suitable validation for this field. In such arrangement, the chances of error will be only marginal as the remitter banks take care to mention the account name correctly in any NEFT/RTGS message. In case of error, NEFT/RTGS unique transaction number (UTR) intimated by the tax payer can be used as a secondary identifier. The primary matching by RBI should be with reference to CPIN only, i.e., CPIN as contained in NEFT/RTGS message and CPIN data provided

by GSTN. On successful matching, the GST pooled account should be debited and the respective 39 tax accounts (CGST, IGST, Additional Tax and SGST) should be credited simultaneously as per the challan details with generation of CIN and BRNs. At this stage, the transaction should be treated as successful and CIN and BRNs should be communicated to GSTN by RBI.

67. As stated in para 15 above, though the CPIN is valid for a period of 7 days, the same would remain live with RBI for a period of 30 days. Thus RBI can accept the payment during the said period of 30 days. In case payment is received after the expiry of 30 days, RBI would refund the said amount to the remitter bank. Keeping in view this requirement, it has been recommended, as mentioned above, that payments in cash would not be accepted for initiating NEFT / RTGS transaction.

68. The Committee deliberated the need for a pooled GST account. Based on inputs provided by RBI, a receiving account is necessary for NEFT/RTGS process. Therefore, a pooled GST account as an operational necessity will have to be opened in RBI. This account may be opened in the name of the Accounting Authority of the Government of India solely for the operational reasons as a transit account. There should be a validation in RBI system that no funds pertaining to the transactions with date value T=0 are left in this account when the scroll is prepared on T+1.

69. If the matching based on CPIN does not succeed, the role of UTR as secondary matching identifier becomes important. However, it is possible that RBI may receive NEFT/RTGS message even before the tax payer updates his challan with UTR number and GSTN informs RBI on real time basis. In case of failure of CPIN based matching and UTR not being available, the funds will remain in the pooled account till the UTR is received or scroll is prepared, whichever is earlier. Such credit in the pooled account should be with a "CPIN mis-match" flag that a secondary level matching needs to be carried out before scroll is generated on T+1 basis. Once UTR is provided by GSTN, the secondary matching of all such transactions remaining in the pooled account should be carried out. If a transaction can now be linked to the correct challan, the respective Tax accounts should be credited with generation of CIN and BRNs. There should be a validation in RBI system that all the transactions with "CPIN mis-match" and date value T=0 in the pooled account are subjected to secondary level matching before generation of scroll for all taxes.

70. If the matching based on CPIN and UTR NEFT / RTGS transaction number UTR both fails, the entire receipt should be credited to CGST account with a "CPIN mismatch" flag so that the Accounting Authorities of Government of India can account such amount under a separate suspense sub-head (possibly receipts awaiting transfer i.e. RAT).

71. In all such cases of CGST credits with "CPIN mis-match", the tax payer will not get a confirmation SMS from GSTN and his ledger will not reflect the payment. He can be expected to provide UTR at this stage. Once the UTR becomes available, GSTN should carry out the matching with CPIN, and communicate following details to the Accounting Authorities of Government of India and concerned State Government.

(a) RBI scroll number and date which carried the credit (CGST scroll);

(b) BRN;

(c) CIN (of credit to CGST account with "CPIN mis-match" flag);

(d) Challan amount;

(e) Breakup of total amount in CGST, IGST, Additional Tax and SGST;

(f) Name of State Government to whom SGST pertains.

72. Based on the communication from GSTN, CGST Accounting Authorities shall take steps for clearing the suspense sub-head by transferring the credit to CGST, IGST and Additional Tax accounting heads, and for carrying out inter-government transfer to the concerned State Government.

73. The reconciliation between e-Scroll sent by RBI on T+1 and the transaction details available with GSTN (provided earlier by RBI) will be performed using CIN and Unique Transaction Reference (UTR).

Role to be played by each stakeholder:

74. As for the role played by each stakeholder in this mode of payment, it will be same as for their role in OTC payments through authorized banks. The role of Branch of remitter bank that transfers the funds to RBI and the additional role of RBI performing the functions akin to authorized banks is discussed below.

Branch of remitter bank:

75. The branch of the remitter bank would perform the following functions:

(a) Remitter bank is required to ensure that the correct CPIN is entered in the NEFT / RTGS message and also inform UTR to the taxpayer;

(b) Transfer the amount indicated in the NEFT / RTGS message [which includes Unique Transaction Reference (UTR)] to RBI.

RBI performing functions akin to authorized banks:

76. RBI's role for the Mode III will be akin to that of authorised banks for other modes, i.e, RBI will be the bank which will receive the funds directly from a taxpayer's account in a pooled account. It should be possible to have a suitable IT system which will carry out CPIN or UTR based matching (as detailed in para 66 above) for each NEFT/RTGS receipt and credit the remittance to a specially created pooled GST account and thereafter transfer it to the respective tax accounts of each government.

77. Once the remittances are received by RBI, it will perform the following functions:

(a) RBI will receive and validate the NEFT/RTGS transaction against the Challan details received by it;

(b) RBI would communicate the receipt of payment (CIN) to GSTN on real time basis;

(c) On first day of every month, RBI as e-FPB will provide Datewise Monthly Statements

(DMS) for each tax and government separately to the concerned wing of RBI for the preceding month with following details:

(i) Name of Tax;

(ii) Government Name;

(iii) Date wise number of successful transactions and total credit reported to RBI; and

(iv) List of discrepancies remaining unresolved at the end of the report month (MOE UIN, CIN, BRN, Amount, Nature of discrepancy).

These statements will be simultaneously communicated to accounting authorities of the Centre and the respective States in case their accounting authorities so desire.

(d) RBI will also be responsible for incorporating these payment details in their daily master scroll generated by them as an aggregator for amounts received through Mode I and II.

PAYMENT ACROSS DEPARTMENTAL COUNTER:

78. The issue was discussed in the Joint Committee on Business Process and it was decided that since the emphasis in GST regime is towards automation and least human interface between the tax administration and the taxpayer, therefore there is no need to provide for this mode i.e. payment across departmental counters. It was also stated that taxpayers have been provided various other modes to facilitate anytime, anywhere payment and this mode would be retrograde especially when e-payment is being declared as the preferred mode of payment. However, the departmental officers will accept the deposit of taxes during the course of enforcement and anti-evasion investigations including by flying squads, etc. While doing so, if the concerned person is not already registered, the departmental officer will create a temporary GSTIN on the GSTN common portal. For this purpose, GSTN will provide a separate module and a GSTIN series for giving temporary GSTIN. The officer will collect the amount in respect of all types of taxes payable by him in cash/cheque/DD from the said person, issue a temporary receipt to him, generate the challan from GSTN, fill up the challan (at a later stage, if not possible at that time) and remit the amount using Mode2. GSTN will provide a facility for linking of the temporary GSTIN to the permanent GSTIN, if taken at a later stage.

PENALTY MECHANISM FOR ERRING BANKS:

79. At present, banks are subjected to penalty for delayed fund remittances only. Current system of remuneration to banks for collection of Central Excise, Service Tax and Customs duties is determined on the basis of challans. New parameters of bank performance could be developed, based on timely remittance and reporting of error-free data to all stakeholders. A system of incentives / penalties to be administered by the respective Accounting Authority (i.e. if defaults arise in remission of CGST/IGST/Additional Tax, by Accounting Authority of Centre and if defaults arise in remission of SGST, by Accounting Authority of the concerned state) can be built-

in, based on a transparent evaluation mechanism of the quality of data of collection reported by banks for accounting and reconciliation purposes. The CGA has suggested that penalties for inaccurate reporting and delayed settlement of taxes is already in place in the case of Direct Taxes and the same may be put in place in GST regime. It is further recommended that a framework of desired features and validations at Banks for collection of taxes under GST regime should be devised by RBI in consultation with the Accounting Authorities. Any bank found not having built capabilities to adhere to the framework, should not be allowed to collect GST receipts. Due care should be taken so that discontinuities arising from manual interventions in the banks' internal processes are removed. The Committee also recommends that, over a long term, Accounting Authority should develop a service quality rating for the participating banks based on identified transparent and quantifiable parameters.

BANKING ARRANGEMENTS UNDER GST:

80. At present Central Government and each State Finance Department prescribes banking arrangements for collection of government taxes. At present, Central and State governments utilize the services of Public Sector Banks/ Other Public Sector Banks (IDBI)/ Private Sector Banks (ICICI Bank, Axis Bank, HDFC Bank) for tax collection. The committee was informed that Non-Scheduled and Cooperative banks operating in State(s) are not permitted to collect taxes.

81. The list of all authorized banks participating in the GSTN should be common across all states. This can be a super set consisting of existing authorized banks of the Central Government and all State Governments and Union Territories. A list of banks that have been presently authorized either by the Centre or State Tax Authorities has been provided by RBI and the same is enclosed as Annexure-VI. It is recommended that all these banks may be considered for authorization in the GST regime in consultation with the Department of Financial Services.

82. Only those banks should be accredited who refine their IT systems to handle GST remittances in a seamless manner obviating need for manual intervention for data entry, funds flow and exchange of data.

83. It is also noted that a participating bank in the current context has limited mandate for tax receipts as compared to that of an authorized bank. The mandate of participating banks, though essentially agents of RBI, is limited to acceptance of tax receipts through internet banking mode only. Whereas, authorized banks have a broader mandate of accepting government receipts through both internet banking mode and physical mode (OTC) of Cash, DD and Cheques, in addition to mandate of making government payments. In order to give a broader choice to the tax payers, and hence to enhance ease of doing business, it is recommended that the participating banks can also be allowed to accept GST receipts through OTC mode envisaged in this report.

84. Out of the superset of existing authorized banks and participating banks only those banks should be authorized to accept GST receipts who meet the minimum requirements suggested below. The objective of these minimum requirements is to ensure that a bank has the capability to handle GST receipts in a seamless manner in a consistent and error free manner underpinned by a robust IT system with no process flow discontinuities.

85. Minimum requirements to be met by a bank for being authorized for GST remittances are recommended to be as follows:

(a) A centralized application for handling GST receipts for both modes (internet banking and OTC) in an end-to-end manner should be established.

(b) There should not be any process flow discontinuities for any mode of the receipt.

(c) The system should not require any post-event data entry at any stage.

(d) The data entry at any stage of the process should be limited to the operations performed at the bank's end.

(e) The data received from GSTN portal should not require any fresh data entry and should not be open for modification.

(f) There should be functional integration with GSTN portal and banks for both modes.

(g) The IT system should have the ability to receive challan data and to communicate successful remittances on real time basis to GSTN portal for both modes.

(h) The collation of data and reporting to GSTN portal and to RBI should be system based and not require manual operations.

(i) The standards of communication prescribed by RBI (ISO 20022) should be followed.

(j) There should be an upfront (before being authorized) as well as periodic audit of the IT system and the centralized application for handling GST receipts. The system audit should cover operational, technical and security aspects as per terms of reference and periodicity set by GSTN in consultation with Accounting Authorities.

(k) One branch of the concerned authorized bank in the entire country should be established / designated as the e-FPB (Electronic Focal Point Branches) to handle all backend operations of GST receipts including operation of 39 tax accounts, data collation, reporting and reconciliation with RBI / GSTN / Accounting Authorities.

(l) In addition, one or more branch of the concerned authorized bank in each State Capital should serve as GST helpdesk (Refer Para 27 above).

(m) Three separate tax accounts for Government of India (one each for CGST, IGST and Additional Tax) and one tax account for each State/UT Government (36 in total) (for SGST) should be set up and operated by e-FPB alone.

(n) The credit to respective tax accounts should be simultaneous with debit to the tax-payer's account in case of internet banking mode, realization of a cheque or submission of DD/cash in case of OTC mode and receipt of NEFT / RTGS remittances from remitter banks into RBI's pool account and then its transfer to tax accounts.

(o) The above mentioned credit to the respective tax accounts should be by the IT system itself as per the mandate contained in the Challan data received from GSTN and not require manual intervention.

(p) In addition to tax specific 39 accounts (for CGST, IGST, Additional Tax and SGST account for each State / UT Government), a common pooled account for cheque/Draft and CC/DC payments should be set up and operated by e-FPB (but not required by those banks who can credit the amount 'on the fly').

(q) As a part of the daily consolidated but transaction level report of successful receipts in each government account to RBI, there should be an assurance that all transactions credited to respective CGST, IGST, Additional Tax and SGST Accounts are being reported to RBI and no balances are left in these accounts meant for cheque realization. RBI will need to build a similar assurance for NEFT/RTGS remittances.

(r) Suitable validations prescribed by GST Law should be inbuilt in the IT system / GST application. Some of such validations will pertain to non-acceptance of outstation cheques and non-deduction of cheque collection charges for OTC receipts, and mark up and collection of CC/DC charges (to be agreed) from tax payers.

86. It was agreed that the minimum standards to be met by the participating banks, as encapsulated above, should be communicated to the banks well in advance in consultation with RBI.

ACCOUNTING SYSTEMS UNDER GST

87. State governments/UTs accounting system also follows, to a large extent, the general principles and procedures of Central government accounting, with minor variations in respect of classification of tax heads of accounts. While the List of Major and Minor Heads of accounts are common to both Central and State/UT Governments accounts, classification below Minor Heads may vary at the State level.

88. Under the proposed GST regime, it is recommended that a uniform system of banking arrangement for both the Central and State/UTs governments to facilitate fund flow, reporting and accounting may be framed.

PROPOSED ACCOUNTING SYSTEM UNDER GST

89. Four different Major Heads of accounts would be required to be opened for classifying CGST, IGST, Additional Tax and SGST along with underlying minor heads and sub-heads, wherever required, to account for various taxes.

90. There is a need to standardize these accounting codes for all items covered under GST regime among all the States and UTs, since settlement of IGST would be based on centralized reporting. SGST will be accounted for by the States and credited to individual State Treasuries, through the existing system followed in each State. SGST will not be reflected in accounts of the Central Government.

91. There may be cases of mis-classification and erroneous scrolling under Major Heads of accounts which may lead to less or excess revenue settlements between the Centre and State(s). To deal with such transactions, detailed accounting procedures should be designed. It is recognized that it is IT system issue, and not an accounting issue. The debit from tax-payers account should result in auto-credit to respective accounts of Government of India and the concerned State Government. Except in case of remittance through any authorized bank including a non-agency

bank (where the funds have to necessarily come to a designated account in RBI), there should not be any mix-up of the funds belonging to two governments.

92. The CGA has suggested the following in this regard:

(a) Codal provisions of the DDO & PAO should be complied with for discharge of PAO's role. The automation as proposed should conform to this basic requirement.

(b) PAO is the sole authority for receipt, payment and reconciliation of accounts book with Bank Reconciliation statement (BRS).

(c) Any compromise on this fundamental work flow may lead to legal complications in preparation of Finance Accounts / Appropriation Accounts which is constitutional mandate.

(d) Each challan detail must be linked with one DDO and PAO and bank account.

(e) As part of standard operating process, accounts classification should be done by the PAO in his books and no one else. Bank is not involved in classification of accounts.

93. The challan will reflect only the net tax paid amount along with related bifurcations of nature of tax liability, such as, Interest, Penalty, Fees, other charges, etc. Presently, the Tax Payment Challan information forms the basis of accounting and reconciliation between the banks, RBI, Tax authorities and Accounting authorities of the Centre/States/UTs. A list of sample tax accounting codes under GST is proposed in the table below:-

S. No.	Type of Tax Liability	Sample Accounting Code
1	CGST - Tax	00010001
2	CGST - Interest	00010002
3	CGST - Penalty	00010003
4	CGST - Fees	00010004
5	CGST - Other	00010005
6	IGST - Tax	00020001
7	IGST - Interest	00020002
8	IGST - Penalty	00020003
9	IGST - Fees	00020004
10	IGST - Other	00020005
11	SGST- Tax	00030001
12	SGST - Interest	00030002
13	SGST - Penalty	00030003
14	SGST - Fees	00030004
15	SGST - Other	00030005
16	Additional Tax - Tax	00040001

17	Additional Tax - Interest	00040002
18	Additional Tax - Penalty	00040003
19	Additional Tax - Fees	00040004
20	Additional Tax - Others	00040005

The actual accounting codes have to be finalized by CGA in consultation with CAG on the basis of proposals from Tax Authorities.

94. CGST, IGST and Additional Tax components will be accounted for under Consolidated Fund of India (CFI). Transfers of due IGST amount and Additional Tax to the States can thereafter be made there from as per the existing procedure.

95. The interest, penalty, fees or other charges, if any, under GST will need to be accounted for separately. Hence, they would be reflected under separate heads in the Tax Payment Challan.

96. The IT audit of the process flows and settlement of funds by the FPBs / Link cells with RBI will be conducted periodically by a CERT-IN empanelled agency selected by the office of Pr. CCA, CBEC, or by a designated authority of States/UTs so as to ensure correctness of revenue collections.

RECONCILIATION OF RECEIPTS:

97. Well-developed and stabilized IT systems without manual process discontinuities in banks, RBI and common portal should eliminate/reduce possibilities of errors. However, there may still be reconciliation challenges arising due to errors encountered during the stabilization phase of the IT systems of the stakeholders and their mutual functional integration. Even in the post stabilization phase, some errors may be seen due to problems external to the IT systems, e.g., in the public network used for sharing the data. A process and standard operating procedure for handling the errors, if they arise, will have to be established, as multiple agencies would be handling funds and related information pertaining to different governments.

98. The proposed GST payment process envisages a paradigm shift from the processes and validations currently being used for payment of taxes to the Government. This shift is aimed at establishing a convenient, consistent and efficient payment process for the tax payers as well as for the 37 governments simultaneously. This shift is possible in view of current IT capabilities in the eco-system and the experience gained in various systems for payments to the governments.

99. Following are the fundamental changes from the existing systems:

(a) Tax payer will generate the electronic challan, and therefore that challan data can be trusted for its correctness for its contents, as filled in by the taxpayer.

(b) The challan thus generated on GSTN portal will provide a unique Id (CPIN) which would be used uptill the time payment has been received by the bank and CIN (CPIN plus Bank Code) has been generated. The said CIN would be used thereafter for accounting, reconciliation, etc.

(c) All modes of payment will use the system generated electronic challan and there would not be re-digitization of the challan data, as recorded by the taxpayer, by any agency in their part of the workflow.

(d) Any agency handling the payment process will merely add its unique Id and parameter to the basic data received by it from another agency earlier in the work-flow chain, and thereafter pass on the data to the agency next in the chain.

(e) RBI will play the role of the aggregator for flow of funds as well as information from the banks.

(f) GSTN will have the primary anchor position in the payment process with responsibility for information flow to various agencies whereas RBI will have the primary anchor's role in relation to funds flow, information flow about receipts and correction of discrepancies noticed during reconciliation process.

(g) e-Scroll from RBI will be the basis for accounting, reconciliation and other incidental activities to be carried out by the accounting authorities of both Centre and States.

100. In view of these fundamental changes, the key Id for information exchange with banks and RBI should use the unique Id generated by GSTN, i.e., CPIN. Once the payment has been made by the taxpayer and CIN is generated and reported by the recipient bank along with its transaction number (BRN), CIN which has CPIN embedded there in, would be used as key Id in subsequent stages. CIN is recommended to be used as a key Id as it is the sole indicator of the receipt of actual payment. Similarly, the transaction reported by RBI for the funds flow (credit) to government accounts through the e-scrolls should form the basis for accounting as it reflects the actual credit in the Government Accounts.

RECONCILIATION BY GSTN

101. GSTN through its IT system should carry out reconciliation in following two stages:

(a) When the banks report each successful transaction on real time basis, the IT system should validate the bank's message with reference to CPIN and total amount of the challan, and communicate the discrepancy, if any, immediately. This validation and real time response by GSTN is particularly relevant for Mode II and III for which the entire payment is not in a single workflow.

(b) When consolidated e-scrolls are received from RBI on T+1 basis, GSTN should carry out the reconciliation between those scrolls and the consolidated challan files communicated to the Accounting Authorities earlier in the day. The discrepancies should be communicated by GSTN to the Accounting Authorities and RBI simultaneously on the same day. The purpose of this reconciliation is to assist those Accounting Authorities who may not have IT systems to carry out transaction level reconciliation in an automated manner, and to identify systemic and service level issues for taking up with the authorized banks and RBI.

102. The role of GSTN in the reconciliation process should be limited to the above set of activities. GSTN should not be expected to take up MOE process for any error type as that is fairly

resource intensive, requires manual appreciation of facts and is time consuming. The transaction level resolution of discrepancies through the Memorandum of Error (MOE) process with RBI and banks should be the responsibility of the respective Accounting Authorities.

Reconciliation by Accounting Authorities:

103. The Accounting Authorities through their IT systems are expected to carry out the reconciliation at their level *de novo*based on communication by GSTN of challan data for successful transaction received on T+1 basis (State AG authorities to be assisted for setting up accounting interface with GSTN) or through Tax Authorities system (based on the integration capabilities at Central / State level) and e-scrolls received from RBI for each day on T+1 basis. The reconciliation results communicated by GSTN would act as additional validation in the reconciliation process. The reconciliation would be performed on the basis of CIN, which will be the unique identifier across all databases.

Resolution of Reconciliation Outcomes (discrepancies noted during the reconciliation process):

104. There would be to and fro data transmission between GSTN, e-FPB of Authorized Banks, banks other than authorized Banks, RBI, Accounting Authorities and Tax Authorities. There is a scope of error occurring at each leg of communication. The process for reconciliation of such errors in each leg of communication is discussed in succeeding paras.

First leg of communication of data (CPIN linked to a GSTIN) starts from GSTN to Authorized banks:

105. If the data forwarded by GSTN (CPIN linked to a GSTIN) itself has an error then this error will be reflected in all the later transactions. So significance of accuracy of this data cannot be overemphasized. It would be important for GSTN to maintain a robust system for maintaining data integrity and keeping the data error free by having suitable validations at the time of creation of CPIN. Key elements here are CPIN and GSTIN.

Second leg of communication of data (CIN with embedded CPIN) starts from Authorized banks / RBI to GSTN (T=0):

106. This communication is not meant to be the basis for accounting, but act as an enabler to reduce errors in the overall process and to facilitate fleet-footed monitoring by the Tax Authorities. The IT system of the authorized banks should have the following validations to reduce possibility of discrepancies in this leg:-

(a) In any reporting of successful transactions by the banks to GSTN, CPIN field is never a blank;

(b) The response sent back to GSTN is always against a CPIN received from GSTN;

(c) Sum total of all credits to Tax accounts for a particular CPIN adds up to the challan amount.

(d) CIN reported by the authorized banks/RBI should always have a CPIN embedded in it.

107. In spite of the above mentioned validations, if a discrepancy is found in a bank's response, the discrepancy will get noticed in the real time validation of the response by the GSTN. The response sent by e-FPB of authorized bank (in Mode I & II) / RBI (in Mode III) should be validated with the data sent earlier by GSTN to Authorized bank / RBI. Key elements are CPIN, GSTIN, CIN & Challan amount in case of authorized banks and CPIN, GSTIN, CIN, NEFT/RTGS UTR and Challan amount in case of RBI. This validation between CPIN available with GSTN and CIN received from e-FPB of authorized banks / RBI should be done on real time basis and the discrepancies, if found should be communicated to the concerned banks immediately by GSTN's IT system so as to enable time to the banks for correction, if possible, before communicating the receipts to RBI on T+1 basis.

108. The validation by GSTN may throw up following discrepancies in the transaction being reported (with CIN added by the bank) by e-FPB of authorized bank / RBI:

(a) without CPIN;

(b) with incorrect CPIN;

(c) with challan amount mismatch.

109. In all these cases, the resolution at e-FPB may require manual intervention. The bank may resend the data to GSTN after correction. If the bank is unable to resolve by T+1 reporting time to RBI, the bank should include the transaction in the luggage file with whatever CPIN data it may have for that transaction. It will be type (c) error in the third leg.

Third leg of communication of data (luggage file) starts from Authorized banks to RBI

110. In this leg, the data is being collated and transferred by authorized banks to RBI in daily luggage files for each type of tax of Government of India (CGST, IGST & Additional Tax) and SGST (state wise; for 29 states and 7 UTs) separately [there will be total thirty nine luggage files (3+29+7)]. The key element here is CIN. So the accurate reporting of the same by the authorized bank to RBI has to be underlined. As RBI would prepare e-scrolls based on this data, correctness and cleanliness of this data is crucial. RBI collates daily luggage files (thirty nine) received from all the authorized banks, includes payments received directly by it in Mode III, adds RBI Transaction Id for all modes, prepares and sends daily e-scroll (one for each major head for Centre and each State) to GSTN and Accounting Authorities. Reconciliation by GSTN and Accounting Authorities (of the Centre and the States) will be initiated after they receive their respective files (Government of India authorities will receive three files while State Authorities will receive a file each). Errors in this leg of communication would be detected at this stage. Various situations that can be envisaged in this leg are as follows:

(a) Transaction reported to GSTN by authorized banks but not to RBI (CIN reported to GSTN but not included in luggage file):

111. To prevent/minimize this type of error, the bank's IT system should have a validation that all credits to the Tax accounts for the date value being the previous day should get reported to RBI in

the luggage file. This discrepancy will be detected at the stage when GSTN and Accounting Authorities compare the challan data (CIN) of the day received from authorized banks with the e-scroll of the corresponding date received from RBI on T+1 basis. If GSTN detects such a discrepancy, it will communicate the same to the relevant Accounting Authority and RBI. On the basis of this information or on the result of their own reconciliation with reference to CINs reported earlier by GSTN, the Accounting Authority will generate a Memorandum of Error (MOE) with a Unique Identification Number (UIN) and communicate the same to the RBI and copy the same to the concerned authorized bank and GSTN. GSTN being only a pass through portal, should not be entrusted the work of MOE and its resolution. Moreover, MOE process requires manual appreciation of facts, accounting expertise and decision making on behalf of each Government, which will be beyond GSTN's mandate/capacity. The steps involved in the correction mechanism in the aforesaid situation are as follows:

(i) GSTN to report the error to the relevant Accounting Authority (and Tax Authority, if GOI or concerned State so wants) and RBI, if the discrepancy is detected by GSTN;

(ii) The relevant Accounting Authority to generate a MOE with a UIN and communicate the same to RBI with a copy to concerned authorized bank for resolution (Accounting Authorities of the Centre and States will have to initiate MOE in respect of their respective taxes) (This may be on the basis of discrepancy detected and communicated by GSTN or by the Accounting Authorities themselves);

(iii) RBI to ascertain from e-FPB of the concerned authorized bank / RBI and get the discrepancy corrected. E-FPB of the concerned Authorized bank / RBI must rectify this discrepancy within a period of two days from the date of receipt of MOE from the Accounting Authority;

(iv) Rectification by the concerned e- FPB / RBI will be by way of identifying the missing transaction, putting it in a separate luggage file containing the UIN of the relevant MOE and then transmitting the same to RBI;

(v) RBI will send a separate e-scroll relating to MOE to the concerned Accounting Authority containing the missing transaction;

Points at (iv) and (v) are design issues, which can be decided by GSTN in consultation with RBI. The reporting by e-FPB and thereafter by RBI can be through separate files as mentioned above, or the normal luggage file from banks and scroll from RBI can contain the now resolved transaction with a MOE resolution flag and UIN as additional field for the relevant record.

(vi) Accounting Authority to note the correction of MOE and report the same to GSTN and the concerned Tax authority thereby completing the transaction cycle

(vii) RBI to take steps to penalize the e-FPB of the concerned Authorized bank.

(b) Transaction reported by Bank to RBI but not to GSTN (CIN included in luggage file but CIN not reported to GSTN):

112. In case of payment through internet banking (Mode I), this seems to be an unlikely scenario, as all payments will be processed at the Core Banking Solution (CBS) of the concerned e-FPB of authorized bank and therefore the compiled data that it reports to RBI on T+1 basis will be nothing but the compilation of data (CIN) already reported by e-FPB of authorized bank on real time basis to GSTN. This discrepancy may however arise due to communication failure even after the prescribed rounds of pinging.

113. This discrepancy can arise in other modes of payment (Mode II and III), because the payment cycle is not a single workflow, is spread over a longer period of minimum two days and requires participation of various banking officials even though the entire cycle is supposed to be done on the IT system customized for GST payments.

Such a discrepancy will be detected by GSTN when it undertakes a reconciliation of the challan details (CIN) of a day available with it with the e-scroll of the same day received from RBI on T+1 basis. In such cases, the correction mechanism will involve the following steps:

(i) If CPIN and associated data reported in the scrolls received from RBI matches with GSTN's CPIN data, GSTN can forward the entire challan details of that CPIN to the concerned Accounting Authorities with a copy to Tax Authorities. There will not be any need for MOE in such case. The Accounting Authorities will carry out the accounting based on scroll data received from RBI and tally it with the challan data (CIN) now received from GSTN. GSTN would also update the taxpayer's cash ledger after confirming the payment from the authorized bank / RBI;

(ii) If e-FPB of an authorized bank has reported a transaction to RBI in GST luggage file, without it being a GST transaction or without realization of the amount, it should take up such cases for refund outside the MOE process as a more comprehensive verification will be needed before allowing the refund. For minimizing this kind of error, the bank's IT system should have validations/controls mentioned in para 85 above;

(iii) Only if the CPIN and associated data in the scroll does not match with GSTN's data there will be a need for MOE. That will be type c) error, discussed in the paragraph below. In those cases, the Accounting Authority should create MOE with a UIN and communicate it to RBI with a copy to e-FPB of the concerned authorized bank. (The Accounting Authorities will identify the concerned bank on the basis of bank code contained in the CIN reported against the successful CPIN in the e-scroll received from RBI).

(c) Transaction reported to RBI but with incorrect details of CIN (CIN level mismatch):

114. This kind of error can be minimized through suitable validations in the bank's IT system. If the error still occurs, it will be noted when the scroll data is processed by GSTN / Accounting Authorities. Even if the error gets noticed earlier as mentioned in para 109 above but remains unresolved till the time of reporting to RBI on T+1 basis, the bank should report the transaction to RBI with whatever CIN data it has received from the e-FPB of authorized bank. The bank should not hold back any balance in the tax accounts beyond the reporting time to RBI in respect of

transactions of the previous day. When such unresolved transaction is reported to RBI, it should carry a flag indicating type of discrepancy. RBI should credit the amount to the account of the respective government as mentioned in the luggage file. As the scroll from RBI will have an unresolved CPIN discrepancy, the Accounting Authorities may credit the amount to a separate sub-head under the relevant major head and simultaneously take up MOE process. If the discrepancy pertains to the total challan amount, its impact on individual taxes will get known during reconciliation of the scroll data with the challan data, and the Accounting Authorities of the affected government should take up MOE process.

(d) Money transferred to wrong government accounts though CIN matches with data in e-scroll received from RBI (major head level):

115. It may so happen that while sending the luggage file to RBI, the e-FPB of the authorized bank / RBI reflects the amount received in a tax head different from the one specified in the challan (major head level) (CPIN).

116. In such a situation, Accounting Authorities will play a crucial role as they are statutorily responsible not only for proper accounting of money but also for its credit into the correct government account. This discrepancy will be ascertained by the Accounting Authorities while carrying out reconciliation between the challan data obtained from GSTN on T+1 basis (detailing major heads) and e-scroll (for each major head separately) received from RBI. Steps involved in the correction mechanism are as follows:

(i) The relevant Accounting authority would generate MOE with UIN and communicate the same to RBI. Accounting Authorities of the Centre and States will have to initiate MOE in respect of their respective taxes;

(ii) RBI to ascertain from e-FPB of the concerned Authorized bank / RBI (in case of Mode III) and get the discrepancy corrected within a time period of 2 days from the receipt of MOE from the Accounting Authorities;

(iii) E- FPB of the concerned Authorized bank / RBI would verify the details in the CIN transmitted to GSTN with the details transmitted to RBI in the daily luggage file. Thereafter correction entry would be transmitted to RBI in a separate luggage file with UIN of MOE;

(iv) On the basis of information transmitted by e-FPB of the concerned Authorized bank, RBI would carry out the corrective Debit/Credit entries in the accounts of the concerned governments;

(v) Thereafter RBI would send a separate e-scroll relating to MOE to the relevant Accounting authority about the corrective entry carried out resulting in reconciliation and correction;

(vi) Relevant Accounting Authority to account for the corrective entry in its records and report correction of MOE to GSTN and relevant Tax authority thereby completing the transaction cycle;

(vii) RBI to take steps to penalize e-FPB.

(e) CIN neither transmitted to GSTN nor conveyed in luggage file from authorized bank to RBI and therefore not included in e-scroll received from RBI:

117. This scenario will reflect the failure of the system at two ends. In this scenario the taxpayer has properly paid taxes into the government account through authorized / non-authorized banks but the same has neither been reported to GSTN nor to RBI thereby in effect eliminating the transaction from the system itself. So it is crucial that suitable protocol should be developed for dealing with this kind of errors. It has to be kept in mind here that CPIN generated at GSTN has a validity period of only 7 days within which the payment is to be tendered. This error cannot be ascertained on the basis of any reconciliation as there will not be any flow of information from authorized banks / RBI. The error will be noticed only when the taxpayer on not receiving a credit confirmation SMS from GSTN or not finding the credit in his ledger inform GSTN. Steps involved in correction are:

(i) In case of OTC payment through authorized banks in cash or by instruments drawn on the same bank, taxpayer will be provided with an instantaneous acknowledgement by the bank containing CIN. As CIN is available with the taxpayer, he should inform GSTN about the transaction (CIN, bank branch where OTC payment was made and date of payment). On the basis of this information, GSTN should ascertain from e-FPB of the concerned authorized bank regarding receipt of payment. Once the confirmation is received through an electronic string, GSTN will validate the same against CPIN and thereafter the tax paid challan (CIN) will be credited to the taxpayer's ledger. e-FPB of the Authorized bank is now expected to include this receipt in the luggage file for the day for transmission to RBI.

(ii) In case of OTC payment through authorized banks by instruments drawn on another bank in the same city, the process of giving acknowledgement would be in two steps. In case CIN is not reported to GSTN by the e-FPB of the authorized bank, the taxpayer may follow the procedure detailed in sub-para i) above. E-FPB of the authorized bank is now expected to include this receipt in the luggage file for the day for transmission to RBI.

(iii) In case of OTC payment through banks via NEFT/RTGS, upon successful completion of the transfer at the end of the bank, the taxpayer will get a receipt detailing Unique Transaction Reference (UTR). Taxpayer can thereafter login into GSTN and update the details of UTR provided by the bank for NEFT/RTGS transaction in the challan. GSTN is expected to communicate the UTR to RBI. In case the CIN is not communicated by RBI, GSTN will now take up the matter with RBI (instead of with authorized bank) in the manner detailed in sub para i) above. RBI is now expected to include this receipt in the e-scroll for the day, if NEFT/RTGS remittance was received. If the remittance was not received, RBI will inform GSTN accordingly. In turn, the tax payer will be intimated by GSTN for taking up the matter with his bank (through which NEFT / RTGS was effected by him) for deficiency of service.

(f) Sum total of amount for a CIN reported in e-scroll by RBI is lesser / greater than that reported by e-FPB of authorized bank / RBI to GSTN:

118. This error relating to the shortfall can occur if a bank has deducted collection charges in Mode II and a bank has collected remittance charges for NEFT / RTGS transaction from the challan amount Mode III . Such errors in Mode II can be minimized through suitable validations in the bank's IT system. In such case, one of the tax amounts will be less than the amount indicated in the challan. The relevant Accounting Authority (for whom the amount received is less than the amount mentioned in challan) will have to take up MOE process with RBI with a copy to the concerned bank as detailed in para 116 above for getting the shortfall amount.

119. In case the amount in the scroll is more than the challan amount for any tax, the bank will have to raise the MOE with the concerned Accounting Authority for the refund. Without approval of the Accounting Authority, the banks should not be allowed to adjust the excess amount against future receipts.

Fourth leg of communication of data is between RBI and GSTN & Accounting Authorities:

120. RBI is collating luggage files from e-FPBs of various authorized banks, including amount received by it in Mode III and thereafter generating and transmitting e-scrolls Major head wise to Government of India and SGST (state wise). During collation of the data, an error can creep into e-scroll resulting in missing / additional transaction. Since there is simultaneous flow of information to two different agencies i.e. GSTN and Accounting Authorities, following situations may arise:

(a) Transaction reported to GSTN by e-FPB of authorized banks but not by RBI in its e-scroll (CIN level);

(b) Transaction reported by RBI in its e-scroll but not by e-FPB of authorized bank / RBI to GSTN (CIN level);

(c) Transaction reported by RBI but with incorrect details of CIN (CIN level);

(d) Sum total of the amount for CIN reported to RBI is lesser/greater than that received by GSTN/Accounting Authority.

(e) There is mismatch between tax wise amounts while the total challan amount matches.

121. In all the situations mentioned above, the reconciliation and error correction mechanism would be similar to that in the third leg of communication (para 110 to 119 above) as the source of discrepancy cannot be identified. It can be at the bank level or at RBI level. Therefore, the concerned Accounting Authorities should take up MOE with RBI with a copy to concerned authorized bank. RBI should first verify the data at its own end for corrective measure, if the error had arisen from its actions, if the source of error is found by RBI to be the one of the authorized bank, it should facilitate/ensure corrective measure by the identified bank in a time bound manner.

Recording by Tax Authorities:

122. After reconciliation and successful accounting of each payment, the transaction level data with unique accounting number, if required by a State Government (some governments have that practice) should be communicated by the Accounting Authorities to the Tax Department's system for updating the records, which would finally contain following unique Ids for each receipt:

(a) CIN;

(b) GSTIN;

(c) Bank Transaction Number (BRN);

(d) RBI Transaction Number;

(e) Accounting Entry ID Number/confirmation flag.

The presence of all the above mentioned five fields would constitute the assurance for credit to the government account with RBI, and the reconciliation and accounting in the government books.

Challan Correction Mechanism:

123. In view of the presumptions listed above, the requirement of providing for a challan correction mechanism would be minimal though not completely ruled out. The Committee recommends for providing the correction mechanism in following situations:-

(a) ERROR IN GSTIN: This may happen in situations where the payment of tax is being made by either authorized representative such as CA or any other person on behalf of the taxpayer. Such kind of error will have no impact on the transfer of the funds to the account of the concerned governments as the money will be correctly transferred on the basis of the CIN. Further once the payment confirmation is received by GSTN from the concerned bank then the amount will be credited to the ledger of the taxpayer whose GSTIN is mentioned in the electronic string that is relayed by the bank to GSTN (earlier the same GSTIN was communicated by GSTN to bank). Therefore taking into account both the above factors as well as the fact that Challan has been generated either by the taxpayer himself or through his authorized representative and the mistake being committed has no impact on the funds with tax administration, there is no need for providing an error correction mechanism for the same. The authorized representative, acting as an agent for the taxpayer should be responsible to the principal for any error committed while performing authorized acts and tax administration should have no role to play in this matter.

(b) ERROR IN MAJOR HEAD: In such a scenario, the bank though has collected the correct amount but has credited the wrong head of tax account. This would impact the transfer of funds to the account of the respective governments as bank has transferred the funds on the basis of the data not detailed in CPIN. Thus bank would be required to withdraw funds from one account and credit the other account(s). It is proposed to permit banks to rectify such error before the end of the day during which the amount has been received by the bank as at the end of the day, the amount would have been credited in respective government accounts and thereafter the same would also have been accounted by Accounting Authorities of the Centre and State. No correction in the challan data is required even in this case. If the error is noted after reporting of the credit on T+1 basis, the normal MOE process should be used.

(c) ERROR IN TOTAL AMOUNT: If the amount paid is in excess then there is provision for either claim of refund by the taxpayer or the amount can be carried forward to the next period and therefore there is no need to provide for correction mechanism.

124. In view of recommended maintenance of cash ledger, the fields relating to 'Tax period' and 'purpose' will not be captured in the challan as being done presently and therefore correction mechanism for correcting these two fields has not been provided for.

CHALLAN FORMAT:

125. e-Challan will remain the source document for the purpose of accounting and reconciliation

by the accounting authorities of the Centre/States/UTs. The Office of C & AG has stressed upon the need for ensuring the availability of e-Challan for accounting and reconciliation purposes. A proper Challan format (Annexure -IV) that covers all the details required for accounting and reconciliation is essential to be prescribed, that will be treated as proof of payment to the government.

126. In the GST regime, the existing practice of entry of challan data at the bank branch level will be dispensed with as the challan would be shared on real time basis from the GSTN portal to the CBS of the authorized bank / RBI indicated in the challan.

127. Central Government Accounts (Receipt and Payment) Rules, 1983 provides for submission of Challan in form GAR 7 along with the payments to facilitate the Pay and Accounts Officer to classify the receipts accurately in his accounts. The form will need to be suitably modified for use in the electronic systems envisaged for GST payments. Almost all the information currently required in GAR 7 has been provided in proposed GST challan form. However, as discussed in para 14 above, the jurisdictional location code will not be available in the challan and the same would need to be mapped with the help of the backend system of each tax administration.

(Satish Chandra)
Member Secretary
Empowered Committee
of State Finance Ministers

(Rashmi Verma)
Additional Secretary
Department of Revenue
Government of India

Annexure (s)	**Particulars**
I	Joint Committee on Business Processes for GST
II	Sub-committee on Payment Processes under GST
III	List of Participants of the Meeting
IV	GST Challan form
V	Issue of charge back in CC/DC Payment
VI	List of Banks presently authorised in Centre and States

For detailed annexures please visit: *http://idtc.icai.org/download/Report_on_GST_PaymentProcess.pdf*

E-3
REPORT OF THE JOINT COMMITTEE ON GST REFUND PROCESSES

Introduction

1.0 During the Empowered Committee meeting held on 10th March, 2014, it was decided that a Joint Committee under the co-convenership of the Additional Secretary (Revenue), Government of India and the Member Secretary, Empowered Committee should be constituted to look into the Report of the Sub-Group-I on Business Processes for GST and make suitable recommendations for Registration and Return to the Empowered Committee. It was also decided that the Joint Committee should also give its recommendations on Refund Processes in GST regime. Accordingly, a Joint Committee, in consultation with the Government of India, was constituted on 7th April, 2014 (Annexure-I).

1.1 In the second meeting of the Joint Committee on Business Processes for GST held on 12th November, 2014, it was decided to constitute a Sub-Committee on GST Refund Processes. Pursuant to that decision, a Sub-Committee under the Co-convenership of Shri Manoj Ahuja, Commissioner, Commercial Tax, Odisha and Shri Upender Gupta, Additional Commissioner, GST, CBEC, Government of India was constituted on 14th November, 2014 (Annexure-II). Shri Sanjeev Khirwar, Commissioner, Trade Taxes, Delhi was co-opted as a member of the Sub Committee.

1.2 The Sub-Committee examined the present practices prevalent in the Central and the State VAT laws and also noted the proposed structure for verifications, etc. envisaged under the IGST Model. The Sub-Committee submitted its Report on 28th January, 2015. The Report of the Sub-Committee was considered by the Joint Committee on Business Processes for GST in its meeting held on 2nd February, 2015 and 3rd February, 2015. The list of the participants of the last meeting of the Joint Committee on Business Processes is appended at Annexure-III. The Joint Committee broadly agreed with the recommendations of the Sub-Committee and the two Conveners of the Sub-Committee were requested to finalise the Report of the Sub-Committee keeping in view the observations made during the meeting of the Joint Committee on Business Processes on 2nd February, 2015 and 3rd February, 2015. Accordingly, a final Report was received on 11th February, 2015 from the Co-convener of the Sub-Committee. The Report of the Joint Committee on Business Processes for GST was prepared accordingly. The Report was further discussed in the Joint Committee on Business Processes for GST meeting held on 22nd and 23rd July, 2015. Changes have been incorporated as per discussions.

Situations where refunds would arise

2.0 In the taxation administration, refund refers to any amount that is due to the tax payer from the tax administration. In the present taxation system it is considered as a strained area, both for the taxpayer and the tax administration. So in order to establish an effective and efficient tax administration system it is essential that issues on which refund arises ought to be kept at minimum and be clearly defined in the law. Since GST is going to subsume many of the existing taxation laws such as Central Excise, Service Tax, VAT, CST, etc., the situations under which refund arise under these laws are as follows:

(A) Excess payment of tax due to mistake or inadvertence.

(B) Export (including deemed export) of goods / services under claim of rebate or Refund of accumulated input credit of duty / tax when goods / services are exported.

(C) Finalization of provisional assessment.

(D) Refund of Pre - deposit for filing appeal including refund arising in pursuance of an appellate authority's order (when the appeal is decided in favor of the appellant).

(E) Payment of duty / tax during investigation but no/ less liability arises at the time of finalization of investigation / adjudication.

(F) Refund of tax payment on purchases made by Embassies or UN bodies.

(G) Credit accumulation due to output being tax exempt or nil-rated.

(H) Credit accumulation due to inverted duty structure i.e. due to tax rate differential between output and inputs.

(I) Year-end or volume based incentives provided by the supplier through credit notes.

(J) Tax Refund for International Tourists.

Each of the situations mentioned above are being discussed hereunder individually for better appreciation of the issue and the proposed process to handle them under the proposed GST regime:

(A) EXCESS PAYMENT OF TAX DUE TO MISTAKE OR INADVERTENTCE:

(i) As the heading suggests, it refers to the situations where the tax payer has made excess payment of tax either by mistake or by inadvertence resulting in more payment of tax than due to the Government. Since the tax that has been paid is in excess, which was actually not required to be paid, the same should be refunded to the taxpayer.

(ii) Such excess payment may be on account of:-

(a) wrong mention of nature of tax (CGST / SGST / IGST),

(b) wrong mention of GSTIN, or

(c) wrong mention of tax amount.

(iii) In first two situations i.e. in case of wrong mention of nature of tax (CGST / SGST / IGST) or in case of wrong mention of GSTIN, the tax administration is required to verify the correctness of the taxpayer's claim and therefore the taxpayer may file a refund application which should be decided within a period to be prescribed by the GST Law.

(iv) A dealer is required to make tax payment on two accounts i.e. payment linked to a return or payment in response to a specific demand arising out of audit, etc. The IT system should be in a position to make a distinction between these two type of payment. Perhaps the payment challan may have a field to select the purpose of payment.

(v) The GST Law Drafting Committee / Payment Committee may decide as to whether the payment is to be made tax period wise or a system of Personal Ledger Account (PLA) is to be used. Maharashtra has suggested that Kerala model of return cum challan may also be examined by the GST Law Drafting Committee / Payment Committee.

(vi) In the third situation i.e. where the amount has been mentioned wrongly, the refund of excess amount of tax, at the option of the taxpayer, would either be automatically carried forward for adjustment against future tax liabilities or be refunded on submission of application (return itself can be treated as a refund application) by the taxpayer. The automatic carry forward would be allowed if the excess payment was made against a return and not against any other liability. The GST Law may provide for automatic set off if the excess payment of tax is not on account of interpretation of notifications, application of exemptions etc., i.e. the excess payment is not on account of difference of opinion between the tax administration and the taxpayer. The GST Law may also lay down the time limit within which the excess amount of tax, as reflected in the return filed by a taxpayer for that relevant period, can be re- credited *suomoto* and can be utilized by the taxpayer for payment of future tax liability.

(vii) The refund may be on account of CGST, SGST or IGST as the case may be.

(B) EXPORT (INCLUDING DEEMED EXPORT) OF GOODS / SERVICES UNDER CLAIM OF REBATE OR REFUND OF ACCUMULATED CREDIT OF TAX WHEN GOODS / SERVICES ARE EXPORTED:

The treatment for export of goods and services and that of deemed export would be different under GST regime because of their inherent nature Therefore these are being discussed separately as follows:

EXPORT OF GOODS:

(i) Presently under the Central Law, every exporter has three options available for neutralization of taxes paid on inputs used for export goods or taxes paid on finished goods exported by him which are delineated hereunder:

   (a) Obtaining non duty paid inputs and exporting final product without payment of duty.

(b) Obtaining duty paid inputs and claiming refund of the same at the time of export of the finished goods without payment of duty.

(c) Obtaining duty paid inputs, availing the input tax credit thereon and exporting finished goods after payment of duty (after utilizing such input tax credit) and thereafter claiming the rebate of the duty paid on exported goods.

(ii) It was noted that in the proposed GST regime, exports are proposed to be Zero rated which means that the export goods would not suffer any actual tax liability although the inputs for them would be tax paid which would be subsequently neutralized. So there should be a mechanism whereby the GST paid on the inputs or on exported finished goods, either through cash or by utilization of input tax credit, is refunded to the exporter. This would serve two objectives simultaneously. On the one hand, the ITC chain through the various dealers will not be broken and on the other hand, the exporter of the finished goods will get the refund of the GST paid on the inputs or on finished goods thereby making the exports actually free from the burden of taxes. The system should be simple and efficient so that exporters do not experience any hassles while claiming refund of taxes. For this it is essential to devise a system based verification mechanism so that human intervention is reduced to the minimum.

(iii) It is recommended that the first option mentioned above i.e. option to procure duty free inputs for exported goods should not be available in the GST regime. This would obviate the requirement of submission of statutory form and the supplier of goods to the actual exporter would be required to pay the GST and will not be required to comply with various formalities presently required for making tax free supplies.

(iv) It is further recommended that other two options may be made available to the exporter in the proposed GST regime. It is recommended that GST Law drafting Committee may provide for the provision of rebate and the legality of the same will be examined at the time of vetting of the GST law by the Law Ministry.

(v) Since the process for payment of refund of GST paid on inputs (including input services) or payment of rebate of GST paid on finished goods is similar to a large extent, the same is being discussed here together. The following process is proposed for making this system as simple as possible:

(a) The IEC details of taxpayer will be captured at the time of issuance of GSTIN and the same can be verified online with DGFT for verifying the correctness of the exporter's particulars.

(b) The refund of ITC / rebate of GST paid on exported goods may be granted on submission of application to this effect by the taxpayer.

(c) Since the trigger point for refund is export of goods, therefore the event of export needs to be verified (mostly online) so as to minimize cases of erroneous / fraudulent claims of refund / rebate.

(d) It is recommended that linkage between ICEGATE of Customs administration and the proposed GSTN of GST administration may be established so that online verification of the exports can be carried out In any case such linkage has to be established to verify IGST paid at the time of import of goods / services.

(e) It is also noted that, as per IGST Model, there is a requirement for online filing of invoice wise sale / purchase details by the taxpayers' along with the monthly returns. These details can be linked with the Customs data (for export cases) available with ICEGATE.

(f) Normally for export verification the following documents are sought from the applicant :

(i) Shipping Bill (Export Promotion copy);

(ii) Mate's Receipt / Transporter's Challan (in case of export by road);

(iii) Export invoice;

(iv) Packing list;

(v) Bill of Lading / Airway Bill;

(vi) Bank Realization Certificate (BRC).

(g) Since it is proposed to establish linkage between ICEGATE and GSTN, therefore shipping bill, which includes relevant details from the export invoice and packing list, can be verified online and there would not be any need for the exporter to submit the same. Further, Mate's Receipt and Bill of Lading are the crucial documents that determine the occurrence of event of export, the exporter would be required to upload the scanned copies of the same with online refund application. As regards the BRC, it was noted that as per the RBI guidelines, the exporter has a time period of one year from the date of export, within which the export proceeds are required to be remitted into India. Thus BRC will not be available till the time export proceeds are realized. Therefore it is recommended that submission of BRC may not be insisted upon at the time of filing of refund application and post facto verification can be carried out by the tax authorities. The refund in such cases should be subject to submission of BRC details within a period of maximum one year or such period as extended by RBI from the date of the export If such details are not submitted at the portal at which the refund application was made, the portal should generate an alert/report for the concerned tax authorities to take up appropriate action In case of any short receipt of export receipts, necessary action for recovery of proportionate refunded amount may be taken accordingly.

(h) BRC, however, may be verified at the time of exports itself if the payment has already been received in advance. It is also recommended that e-BRC module may be integrated in the Refund process under GST.

(i) The time limit for filing of refund application is normally linked with the date of export and it is proposed that this time limit should be fixed at one year from the date of export. This date is the date on which the proper officer under the Customs Act gives an order for export of goods commonly known as "Let *Export Order* (LEO). This date can also be verified online in view of the proposed linkage between ICEGATE and GSTN.

(j) Once the export is established, verification of the duty paid on the final products at the time of export is required to be carried out. For this, normally, copy of challans/ invoices evidencing duty payment are sought from the exporter and the same are verified manually by the jurisdictional authority In the proposed GSTN, the payment of GST on exported goods can be verified online (as the sales invoices are required to be filed along with the monthly return) and there is no need for separate submission of these documents. Once the GST paid character of exported goods is established, refund can be sanctioned.

(k) In respect of refund claimed for GST paid on inputs (including input services) used for exported goods, once the export is established, verification of the GST paid on the inputs (including input services) as well as their utilization for the exports is required to be carried out. For this normally copy of invoices evidencing GST payment are sought from the exporter and the same are verified manually by the jurisdictional authority. Besides a declaration is filed by the applicant with the proper officer declaring *inter alia* input-output ratio for inputs on which refund is sought. In the proposed GST regime, the GST paid character of inputs (including input services) can be established online (as the purchase invoices are required to be filed along with the monthly return) and the refund of input tax credit on inputs (including input services) can be sanctioned once the input tax credit has been matched from the purchase and sale statements filed by the exporter and supplier respectively and there is no need for separate submission of these documents. As regards utilization of the inputs for exports, a simple formula can be adopted that will provide for proportionate credit based on export turnover divided by total turnover Moreover, a declaration can be obtained from the exporter regarding utilization of inputs in the exported goods.

EXPORT OF SERVICES:

(i) It is noted that in case of export of services there are no custom documents that can substantiate the occurrence of event of export as no shipping bill is required to be filed. Thus invoice and Bank Realization Certificate (BRC) are the only documents that can substantiate the occurrence of event of exports. It is, therefore, recommended that in the case of export of services, BRC would be required before sanction of the refund of GST paid on inputs (input services) / rebate of GST paid on exported services.

(ii) It is further noted that the invoice and BRC are the crucial documents for filing of the refund application. Therefore the relevant date, in case of export of services, will be the date of invoice or the date of BRC, whichever is later. This will take care of the situation if the payment has already been received in advance. It is also recommended that e-BRC module may be integrated in the refund process under GST.

(iii) It is suggested that since exports of services cannot be verified online through ICEGATE, there should be a separate application for refund of service exported.

DEEMED EXPORT OF GOODS OR SERVICES:

(i) It was noted that there is a concept of deemed export for situations listed in Chapter 8 of the Foreign Trade Policy. Supplier of domestically produced duty paid goods when supplied to EOUs / SEZs / Projects under International Competitive Bidding (ICB) / Mega Power Plants / World Bank. Funded Projects can seek refund of terminal excise duty as also drawback of the duty paid on the inputs used in manufacture of such goods. However such refund is not permissible for VAT paid on such domestically supplied goods.

(ii) It is recommended that the deemed export need to be treated on equal footing as export and the similar provision as detailed above for actual exports of goods or services would be applicable except the following:

   (a) The supplier of final goods, in the course of deemed export, will pay the IGST on his supplies and can claim refund, only if, the IGST amount has not collected from the recipient. It is also required to be verified that the recipient has not availed the input tax credit in respect of such supplies.

   (b) The supplier may file a simple refund application along with a Chartered Accountant's Certificate certifying the fact of non-passing of the GST burden by him, being claimed as refund GST Law. Drafting Committee may prescribe a threshold amount below which self-certification (instead of CA Certificate) would be sufficient.

   (c) The recipient unit would be eligible for refund of IGST, if it has actually paid IGST at the time of obtaining goods / services from the domestic supplier. In no case, both the supplier and the recipient unit can obtain refund at the same time in respect of the same transaction. A suitable validation to block such double claim should be built in the GSTN /refund processing backend system.

   (d) Such recipients may not be registered under GST regime and therefore they would have to submit copies of all the invoices, etc. in case claim of refund is filed by them.

(iii) It is also recommended that this recommendation may be specifically brought to the notice of EC as this is deviation from the present practice being followed by the States.

GENERAL:

(i) It was suggested that as a thumb rule, up to 90% of the refund claimed by the taxpayer may be sanctioned automatically by the system. The balance amount of refund may be granted after completion of verification of documents / accounts to be done at the end of the financial year and to be completed within a period of three months. The issue was discussed and it is recommended that partial refund may not be allowed and entire refund claim may be sanctioned within the time limit laid down in the GST Law.

(ii) It was noted that there may be certain goods on which Customs Export Duty may be leviable. It is recommended that in such cases refund of ITC of GST paid on inputs (including input services) used for such exported goods may not be admissible.

(iii) Requirement of BRC for sanction of refund in respect of export of services and as a post facto verification in case of export of goods may be provided in the GST Law.

(iv) It was noted that the exports would be treated as inter-state supplies and therefore IGST would be required to be paid by the taxpayer in cases GST is paid at the time of export. Refund of such IGST would have to be paid by the Centre In case of refund of GST paid on inputs (including input services) used for exported goods, the refund of CGST, SGST or IGST may arise and the same needs to be paid by the respective tax administration. A suitable validation to block use of same tax invoices for more than one refund claim should be built in the GSTN /refund processing backend system.

(v) It was further noted that the principle of unjust enrichment is not applicable in case of actual export of goods or services as the recipient is located outside the taxable territory. In case of deemed exports, however, the concept is applicable.

(vi) It is further recommended that the amount of input tax credit claimed as refund may be blocked at the time of time of submission of application for refund itself. And if the refund claim is rejected wholly or partially the rejected portion of the ITC claim amount will be restored in the ITC ledger of the applicant.

(C) FINALIZATION OF PROVISIONAL ASSESSMENT:

As discussed in Para No (I) below, the issues relating to provisional assessment being presently followed by Central Tax Authorities would be handled by the system of issuance of debit and credit notes, therefore refund may not arise in such cases. The process has been delineated here under, if the GST Law provides for continuance of the system of provisional assessment:

(i) In the proposed GST regime the returns of the taxpayer will be electronically filed. In the return itself there should be a field for indicating whether the tax being paid is provisional or final. In case the tax has been paid on provisional basis, there should be a drop box that would indicate the reasons for which the tax has been paid on provisional basis.

(ii) Once such a return comes up before the assessing officer and if he agrees with the reason mentioned by the taxpayer, the return / assessment may be kept provisional.

(iii) Thereafter the return may be taken up for finalization once the issue involved in provisional assessment is settled GST law may prescribe time period for finalization i.e. 90 days and this time line should not be breached, as far as possible.

(iv) At the time of finalization of the return / assessment by the assessing officer, a speaking order may be issued which will also mention the amount that the taxpayer is required to pay or is eligible for refund.

(v) The refund would be granted only if the incidence of GST paid by him has not been passed on to the consumer (the concept of unjust enrichment). This issue would be examined by the assessing officer at the time of finalization of assessment.

(vi) The model GST Law may provide for appropriate provisions relating to the principle of unjust enrichment.

(vii) For satisfying the requirement of unjust enrichment, the taxpayer would be required to submit a Chartered Accountant's Certificate certifying the fact of non-passing of the GST burden by the taxpayer, being claimed as refund GST Law Drafting Committee may prescribe a threshold amount below which self certification (instead of CA Certificate) would be sufficient. This would also settle the issue of ITC that would have been claimed by the purchaser on the basis of the provisional tax paid by the taxpayer as ITC would have to be reversed by the recipient before sanction of refund to the supplier.

(viii) The differential amount claimed as refund will be reflected in the return for the month in which the finalization takes place.

(ix) The refund may be on account of CGST, SGST or IGST as the case may be.

(D) REFUND OF PRE-DEPOSIT FOR FILING APPEAL INCLUDING REFUND ARISING IN PURSUANCE OF AN APPELLATE AUTHORITY'S ORDER:

Refund arising in pursuance of appellate authority's order is another area that has been subject of judicial scrutiny and strictures. The following process is recommended in order to make this process streamlined, efficient and in line with the judicial decisions on the matter:

(i) Looking at the policy objective of making the refund process hassle free, it is recommended that the taxpayer may file a simple refund application along with a Chartered Accountant's Certificate certifying the fact of non-passing of the GST burden by the taxpayer, being claimed as refund. As mentioned earlier, the GST Law. Drafting Committee may prescribe a threshold amount below which self certification (instead of CA Certificate) would be sufficient.

(ii) The refund may not be kept in abeyance if the appellate authority's order (in pursuance of which refund arises) is appealed against at the next higher appellate forum unless the jurisdictional authority has obtained a stay from the higher appellate authority against the operation of the appellate authority's order in pursuance of which refund has arisen. This position may be appropriately reflected in the GST Law itself so that any ambiguity on this issue can be avoided and the tax administrations are made more accountable for early action in case of such refunds.

(iii) GST Law may provide for certain predefined period during which refund may not be granted which can be regarded as the mandatory waiting period for the outcome of the appeal / application for stay.

(iv) GST Law Drafting Committee may also consider for providing powers to jurisdictional authority at sufficiently senior level for withholding the refund in exceptional cases on the condition that interest at appropriate rate has to be paid.

(v) The refund may be on account of CGST, SGST or IGST as the case may be.

(E) PAYMENT OF DUTY/TAX DURING INVESTIGATION BUT NO / LESS LIABILITY

ARISES AT THE TIME OF FINALIZATION OF INVESTIGATION / ADJUDIACTION:

Presently the Central Law (State Laws do not have similar provision) does not debar suo-motto payments during investigation / audit without issuance of a formal show cause notice / demand If the GST Law does not debar such payments during investigation / audit process and ultimately no / less demand arises vis-a-vis amount already paid, then refund of such amount may be handled as per the procedure given below:

(i) A separate mechanism for the accounting of such payments has to be designed.

(ii) Refund in such cases requires utmost attention as such amount of tax paid during investigation, etc become non leviable once the investigation is finalized and / or an adjudication order in favor of the taxpayer is issued. Therefore this process should be simple and hassle free.

(iii) As soon as the investigation, etc is over which does not lead to issuance of a show cause notice or where after investigation, show cause notice is issued but the adjudication order is in favor of the taxpayer i.e. where the demand of duty is dropped in full or in part, the taxpayer should be immediately eligible to claim refund of the amount that is found to have been paid in excess during investigation, etc.

(iv) Looking at the policy objective of making the refund process hassle free, it is recommended that the taxpayer may file a simple refund application along with a Chartered Accountant's Certificate certifying the fact of non-passing of the GST burden by him, being claimed as refund. GST Law Drafting Committee may prescribe a threshold amount below which self certification (instead of CA Certificate) would be sufficient.

(v) However, as every adjudication order can potentially be appealed against, the model. GST Law may provide for a time limit after which only the refund can be sanctioned either by cash or by adjustment order at the option of the tax payer by the jurisdictional officers. This time limit should be concurrent with the time limit available for filing of an appeal so that department has time to file an appeal along with stay application, if any against adjudication order.

(vi) Refund may be withheld only if the department has obtained a stay order on the operation of the adjudication order, failing which, refund has to be allowed.

(vii) The GST Law Drafting Committee may also consider for providing powers to jurisdictional authority at sufficiently senior level for withholding the refund in exceptional cases on the condition that interest at appropriate rate has to be paid.

(viii) The refund may be on account of CGST, SGST or IGST as the case may be.

(F) REFUND FOR TAX PAYMENT ON PURCHASE BY UN BODIES, SUPPLIES TO CSD CANTEENS, PARA MILITARY FORCES CANTEENS, ETC:

(i) Presently the UN bodies are eligible for refund of taxes paid by them at the time of purchases made by them from the market. GST Law may provide for similar provision and in such a case, the following process for grant of refund is recommended:

(a) Refund on purchases by UN Bodies may be granted from only one office each of both the tax administrations within one State.

(b) UN Bodies may be assigned a unique identification number (ID) the structure of which would be uniform across the States in conformity with the GSTIN Structure (Some other structure may have to be considered as such bodies do not have PAN).

(c) The registration document, return document and invoice would contain a column for capturing this Unique ID.

(d) There has to be a separate field for allotting ID to such bodies.

(e) While making supplies to such bodies, the suppliers must indicate the Unique ID on the invoices.

(f) The UN Bodies may file their purchase statements (without purchase invoices) along with their claim for refund.

(g) The GST Law may provide that some purchases are ineligible for refund (e.g. invoice value less than the prescribed threshold, goods / services specified as ineligible for refund, etc.) Such cases should be specifically marked in the purchase statement or may not be included in the purchase statement.

(h) The net claim will be related to GST paid on total purchases minus GST paid on ineligible purchases.

(i) The IT system will carry out the matching with the sales statements of the counter party suppliers.

(j) The matched and claimed to be eligible invoices will be seen by the jurisdictional authority to verify that none of the ineligible purchases have been included in the refund claim.

(k) The refund may be granted based on the matching and the limited manual verification.

(l) There might be situations when the supplier does not declare the supply in his monthly return. In such a case, unmatched invoices will get marked by the IT system and the supplier will be notified accordingly.

(m) The UN body may be granted refund along with its next claim if any of the unmatched supplies have been accepted and related. GST has been paid by the supplier and return has been filed subsequently.

(n) The personal purchases by the staff may also be done seeking ID of the UN body on the invoice.

(o) Such invoices in the statement can be marked as "for personal consumption" for any additional verification in case of any restriction under the GST Law.

(p) GST Law Drafting Committee may provide for appropriate provisions whether refund has to be given for the personal purchases by the staff of UN bodies and Embassies. Such provisions may also relate to limits or restrictions, if any on such refunds.

(ii) It is recommended that the suppliers to CSD Canteens, Para Military Canteens would not be eligible for exemption. The procedure as detailed above would apply in respect of supplies to CSD Canteens, Para Military Forces canteens etc and these bodies would claim refund.

(iii) Form of application for refund which may be used by such bodies is enclosed as Annexure-VII to this document.

(iv) The refund may be on account of CGST, SGST or IGST as the case may be.

(G) TAX CREDIT ON INPUTS USED FOR MANUFACTURING / GENERATION / PRODUCTION / CREATION OF TAX FREE SUPPLIES OR NON-GST SUPPLIES:

(i) There would be certain goods or services which may be either exempted or NIL rated in GST regime. Further there may be certain goods or services which may not be brought under GST regime. Persons supplying such exempted / nil rated / non-GST goods or services would be receiving goods or services as their input supplies after payment of GST.

(ii) The issue, whether such taxpayers are entitled to cash refund of the GST paid by them in respect of such input supplies (including input services or capital goods) which will be used for making supplies without payment of GST, was discussed at length.

(iii) It is felt that the ITC is allowed to remove cascading and under modern VAT laws, tax is charged on value addition only and not on tax paid at the earlier level of supply chain. It is for this reason that the ultimate consumer is liable to bear the tax. Most State VAT administrations as well as Centre do not allow refund of ITC on inputs used for tax exempt / nil rated goods.

(iv) Further the inputs (including input services or capital goods) received by such suppliers would become exempt if the refund is allowed to them, which is not intended by tax design.

(v) It is recommended that the model GST Law may provide that the suppliers of exempted / NIL rated / non GST goods or services would not be entitled to the ITC of GST paid on inputs (including input services or capital goods) received by them and consequently for refund of GST paid by them In case of mixed supplies, ITC may be allowed proportionately.

(vi) The tax credit on the inputs used for supply of exempted / NIL rated / non GST goods or services should be treated as "ineligible input tax credit" and there should be an appropriate provision in the return to provide the related invoice details.

(vii) In addition to ineligible input tax credit arising from inputs used for supply of exempted / Nil rated / non-GST goods or services, there may be other types of ineligible input tax credits such as those related to specified capital goods / assets. It is recommended that the model GST law may provide for the full scope of such ineligible input tax credits.

(viii) It is also recommended that such ineligible tax credit should accrue to the importing States in accordance with the Place of Supply Rules. This imperative will also apply to the inter-state supplies procured by the economic entities / government departments / public bodies supplying tax exempt / nil-rated / non-GST goods and services only. The mechanism for flow of such funds to the importing state by way of a system based apportionment in a consistent manner may be decided as a part of the return process.

(H) REFUND OF CARRY FORWARD INPUT TAX CREDIT:

(i) As stated earlier, ITC is allowed to remove cascading and under modern VAT laws, tax is charged on value addition only and tax is not charged on tax. It is for this reason that the ultimate consumer is liable to bear the tax burden.

(ii) It is noted that the ITC may accumulate on account of the following reasons :

(a) Inverted Duty Structure i.e. GST on output supplies is less than the GST on the input supplies;

(b) Stock accumulation;

(c) Capital goods; and

(d) Partial Reverse charge mechanism for certain services.

(iii) As regards the accumulated ITC attributed to accumulation of stock or capital goods, it is recommended that GST Law may provide that refund of carried forward. ITC may not be allowed and such amount would be carried forward to the next tax period(s). The GST Law may provide for appropriate provisions in this regard.

(iv) Under the proposed GST law, it is proposed to have fewer tax rates and fewer exemptions and therefore it is felt that chances of inverted duty structure would not be there or would be very minimal. But still there might be a possibility that ITC may accumulate on account of inverted duty structure.

(v) It is recommended that in such case, cash refund may be granted after due audit and should be sanctioned only after the input tax credit has been matched from the purchase and sales statements filed along with monthly returns. The refund would be granted on submission of application. It may be mentioned, however, that presently the Centre does not grant refund in such cases.

(vi) Two options i.e. blocking the utilization of input tax credit claimed as refund at the time of submission of application for refund itself or debiting the input tax credit account / cash ledger subject to the amount available in either account at the time of issuance of sanction order of refund were discussed. It is recommended that the first option should be adopted. Suitable linkage between the refund application and blocking of the "carry forward input tax credit" in the return/cash ledger should be built in GSTN and refund backend processing system.

(vii) ITC may also accumulate on account of circumstances wherein liability to pay service tax is under Partial reverse Charge Mechanism. Presently the liability to pay service tax is either on the service provider or on service recipient or on both. The third category is popularly known as joint / partial reverse charge where both the service provider and the service recipient are liable to pay the service tax.

(viii) In case of partial reverse charge, service provider may be left with unutilized balance in the input credit account as he is not liable to discharge the tax liability in full In such cases, refund may be granted if the GST law provides for a joint reverse charge mechanism.

(ix) The refund may be on account of CGST, SGST or IGST as the case may be.

(I) REFUND ON ACCOUNT OF YEAR END OR VOLUME BASED INCENTIVES PROVIDED BY THE SUPPLIER THROUGH C REDIT NOTES:

It is noted that suppliers are allowing year end or volume based discounts through credit notes. Such practice is being misused by the trade where the downstream dealers show negative value-additions. Some States have placed restrictions on such ITC. It is felt that the GST Law may provide for suitable provisions in this regard as provisions for such discounts is a trade practice and will have to be permitted in the GST regime. The following procedure is recommended:

(i) The refund would be granted on submission of a simple application along with a Chartered Accountant's Certificate certifying the fact of non-passing of the GST burden by the taxpayer, being claimed as refund. The GST Law Drafting Committee may prescribe a threshold amount below which self-certification (instead of CA Certificate) would be sufficient.

(ii) In such cases, the eligibility for ITC at the buyer's end and the output liability at the supplier's end will get simultaneously reduced / adjusted on the basis of credit notes issued by the supplier and the corresponding debit notes issued by the buyers.

(iii) This would also obviate the need for resorting to provisional assessment presently provided in Central Law and discussed in para (C) above.

(iv) The GST Law may contain suitable provision to this effect and the GSTN should have suitable validations to this effect. The validation should include matching of credit and debit notes and reversal of the reduction of the output tax liability in case of the mismatch.

(v) The refund may be on account of CGST, SGST or IGST as the case may be.

(J) TAX REFUND FOR INTERNATIONAL TOURISTS:

Tax Refund for International Tourist (TRT) scheme provides an opportunity to the foreign tourists to purchase goods during their stay in any country on payment of GST and obtain refund of the GST so paid, at the time of exit from the country. Nearly 52 countries have adopted such kind of refund mechanism. It was noted that such a scheme helps in attracting tourist and is in line with avowed objective of GST regime of zero rating of goods and Make in India initiative of Government of India. State governments are offering VAT refunds to foreign diplomats and officials of multilateral agencies. This scheme will be implemented through particular retailers who are registered for this scheme. Refund of GST will be available at designated airports and ports only and the refund of the GST paid on retail purchase by the foreign tourists during their stay in India is allowed. A part of the eligible amount of refund will be deducted as handling fee for services rendered GST law drafting Committee may provide for this provision as well delineate the details of the scheme.

REFUND FORMS:

3.0 The form should be simple to fill, easy to understand and more importantly, in the context of the technological world, it should be in electronic format. The forms for Refund Claim, Refund order and Reduction / Adjustment summary are enclosed as Annexure -IV to VII to this document.

TIME PERIOD FOR FILING OF REFUND AND RELEVANT DATE:

4.0 It is recommended that a period of one year from the relevant date may be allowed for filing of refund application. Relevant date for filing of each kind of refund needs to be defined separately. The following dates are recommended as relevant dates for different type of refund cases:

(i) Date of payment of GST when the refund arises on account of excess payment of GST due to mistake or inadvertence.

(ii) Date on which proper officer under the Custom Act gives an order for export known as "LET *EXPORT ORDER*" for the purpose of refund filed on account of export of goods under claim of rebate of GST paid on exported goods or refund of accumulated input credit of GST when goods are exported.

(iii) Date of BRC in case of refund on account of export of services under claim of rebate of GST paid on exported services or refund of accumulated input credit of GST when services are exported.

(iv) Date of the finalization order where refund arises on account of finalization of provisional assessment (May not be required if the GST law does not provide for provisional assessment).

(v) Date of communication of the appellate authority's order where the refund arises in pursuance of an appellate authority's order in favor of the taxpayer.

(vi) Date of communication of adjudication order or order relating to completion of investigation when refund arises on account of payment of GST during investigation, etc when no/less liability arose at the time of finalization of investigation proceedings or issuance of adjudication order.

(vii) Date of providing of service (normally the date of invoice) where refund arises on account of accumulated credit of GST in case of a liability to pay service tax in partial reverse charge cases.

(viii) Date of payment of GST for refund arising out of payment of GST on petroleum products, etc. to Embassies or UN bodies or to CSD canteens, etc on the basis of applications filed by such persons.

(ix) Last day of the financial year in case of refund of accumulated ITC on account of inverted duty structure.

SUPPORTING DCOUMENTS:

5.0 Documents evidencing tax payments required to be enclosed with the refund application should be minimal but adequate so that both the taxpayer and tax authority find it easy to deal with the application. Normally following documents are required to establish the rightful claim of refund:

(i) Copy of TR-6 / GAR-7/ PLA / copy of return evidencing payment of duty. It is recommended that these forms may not be called for as in the proposed GST scenario payment of duty will be in electronic mode and the same will be easily visible to the refund sanctioning authority on screen.

(ii) Copy of invoices (in original) (for the purpose of evidencing the supply of goods and the fact that duty is not reflected in the same). It is noted that the IGST Committee has recommended that the taxpayers would upload their invoice details on monthly basis. Once the same is done and the refund sanctioning authority is able to examine and view them on screen then submission of invoices can be dispensed with. It was noted that the field relating to "Quantity" is not captured in the invoice details proposed to be uploaded either before or alongwith the Return. It was further noted that this information would be required in case of refund in relation to exports. The applicant for refund in such cases would submit the copies of the invoices or a statement containing details of quantity along with the refund application. Documents evidencing export In the proposed GST scenario it is recommended that the ICEGATE and GSTN would be inter linked, and therefore these documents can be verified on line and therefore can be dispensed with.

(iii) Documents evidencing that the tax burden has not been passed on to the buyer. Since GST is an Indirect tax, there will be a rebuttable presumption that the tax has been passed on to the ultimate consumer. Therefore there is a need for establishing that principle of "unjust enrichment" does not apply to the refund claim It is recommended that a Chartered

Accountant's Certificate certifying the fact of non-passing of the GST burden by the taxpayer, being claimed as refund should be called for The GST Law Drafting Committee may prescribe a threshold amount below which self-certification (instead of CA Certificate) would be sufficient.

(iv) Any other document as prescribed by the refund sanctioning authority. It is recommended that the state and central tax authorities together prescribe the documents that are required for demonstrating the legitimacy and correctness of refund claimed and checklists can be generated for refund sanctioning process.

RECEIPT OF REFUND APPLICATION AND PROCEDURE FOR GENERATING PROOF OF RECEIPT OF APPLICATION FOR REFUND:

6.0 It is recommended that the State Tax authorities shall deal with the SGST refund and Central Tax authorities shall deal with refund of CGST and IGST The following procedure is proposed in this regard:

(i) Applicant may be given the option of filing refund application either through the GSTN portal or through the respective State / Central Tax portal. Filing through GSTN portal may be beneficial for those applicants whose refund relates to CGST / IGST as well as SGST or the refund arises in different State Tax jurisdictions Instead of filing applications with different tax authorities, the same may be filed with the GSTN portal which will forward it to the respective tax authority.

(ii) On filing of the electronic application, a receipt/ acknowledgement number may be generated and communicated to the applicant via SMS and email for future reference. A provision may be made to display the application for refund in dealer's online dashboard when he logs into the system.

(iii) The "carry forward input tax credit" in the return and the cash ledger should get reduced automatically, if the application is filed at GSTN portal itself. In case the application is filed at the tax department portal, suitable integration of that portal with GSTN portal should be established to reduce/block the amount before taking up the refund processing.

(iv) It should be clearly mentioned / highlighted that generation of this number does not in any way affirm the legality, correctness or completeness of the refund application.

NUMBER OF COPIES OF APPLICATIONS TO BE FILED:

7.0 As the filing of the electronic refund application is a preferred mode, filing of multiple copies of applications is not required.

REQUIREMENT FOR TAXPAYER TO KEEP A COPY OF REFUND APPLICATION FOR THE PRESCRIBED PERIOD:

8.0 Since the application for refund is expected to be filed electronically, the application form should have a print option along with the option for the applicant to download the same so that he can store the same for future reference and record. This would serve the purpose of record keeping for the applicant.

PROCEDURE AND TIME WITHIN WHICH PRELIMINARY SCRUTINY OF SUBMISSION OF THE RELEVANT DOCUMENTS IS CARRIED OUT:

9.0 After the receipt of the application in the jurisdictional officer's menu, the same should be examined for deficiency, if any. Since the recommendation is to reduce the number of documents that are to be filed along with the application and most of the documents related to refund application will be available online, it is recommended that the preliminary scrutiny may be carried out within 30 common working days and deficiency, if any, should be communicated to the applicant directly from the respective tax portal (In case refund relates to different jurisdictions or involves both central and state GST levy, then the said deficiency needs to be forwarded to GSTN also which will communicate the same to the corresponding tax authority relating to that refund).

9.1 It is recommended that tax authorities should make efforts to ensure that piece meal queries are avoided. Applicant may file his reply through the respective tax authority portal / GSTN. Any further queries should be raised only with the approval of higher authorities so that unnecessary queries are avoided. Once the refund application is found to be complete in all respect, the same may be communicated to applicant via SMS and e-mail and the date of communication shall be considered as the relevant date for the purpose of time limit prescribed for sanctioning of refund and initiation of interest clause.

PROCEDURE FOR DEALING WITH REFUND THEREAFTER INCLUDING EXAMINATION OF PRINCIPLE OF "UNJUST ENRICHMENT " :

10.0 Once the refund application is found to be complete and the fact of completeness has been intimated to the applicant, the jurisdictional tax authority should examine the same in the light of the provisions of the GST Law relating to refund. Important parameters include the timeliness of refund application, tax payment, date of export (if relating to export), reasons for refund etc.

10.1 It is recommended that for the sake of uniformity, the state and central laws should have similar provisions.

10.2 As GST is an indirect levy, there is always a rebuttable presumption that the tax has been passed on to the ultimate consumer by the applicant. So it is essential that every refund application should be examined in light of the principle of "unjust enrichment" and the appropriate provisions may be incorporated in the GST law. The burden of discharging the obligation under "unjust enrichment" should be on the applicant and documents manifesting the same should be submitted along with the application. As discussed above, a Chartered Accountant's Certificate certifying the fact of non-passing of the GST burden by the taxpayer, being claimed as refund should be submitted. The GST Law Drafting Committee may prescribe a threshold amount below which self-certification (instead of CA Certificate) would be sufficient.

10.3 If the refund is not found to be legal or correct for any reason, then the jurisdictional authority should issue Show Cause Notice (SCN) to the applicant and thereafter the refund will be kept in abeyance in the system till the SCN is adjudicated. In case, the refund application is found to be in order but does not satisfy the test of unjust enrichment, the refund amount, after sanction, would be credited to the Consumer Welfare Fund. The GST Law Drafting Committee may examine whether such amount should be credited to Consumer Welfare Fund or to the consolidated fund of State / Union.

MINIMUM AMOUNT BELOW WHICH REFUND SHALL NOT BE GRANTED:

11 Filing of refund application and processing of the same involves investment of resources, in terms of time, money and manpower, by both the applicant and tax administration. Therefore the amount should not be meager enough to create uneconomical burden on the applicant as well as tax administration. Looking at the rising inflation, it is recommended that an amount in the range of Rs 500-1000/- may be fixed below which refund shall not be granted. This limit should be uniform for both CGST/IGST and SGST.

SANCTIONING OF REFUND:

12 To make the process of refund hassle free, it is important that even this last stage of refund processing should be simple and free from human intervention so that the applicant may have a pleasant experience while dealing with tax authorities. Therefore it becomes significant that once the tax authority decides about sanctioning of the refund, the same shall be granted to the applicant promptly. For this it would be essential that the details of the bank account are sought from the applicant at the time of filing of the refund application itself so that the amount of refund can be transferred to the applicant electronically through NEFT /RTGS/ECS.

VERIFICATION AND CONTROL

13 Every refund that is sanctioned would need to go through a process of review by higher authorities in order to ensure the correctness of the decision of refund sanctioning authority. So once the refund is sanctioned, the same shall be transferred through the IT system to the menu of the higher authority along with the documents on the basis of which decision was taken by the refund sanctioning authority. Any documents that were sought besides those in the application

should also be forwarded manually to the higher authority for taking a decision about review of the order. It is essential that there is simultaneous flow of the refund documents in paper along with the electronic application to the audit section so that the process of post audit can be carried out concurrently.

13.1 It is recommended that looking at the higher level of compliance and self regulating mechanism in the form of system based ITC verification, uploading of sales and purchase invoices, reconciliation, compliance rating etc post audit of refund application (and not of the accounts of the taxpayer) can be dispensed with if so decided by the respective Tax Jurisdiction for refunds upto Rs One lakh for normal taxpayers and for refund upto Rs 2 lakhs for certain prescribed categories of applicants (like public sector undertakings, applicants having the AEO Status, etc.) but the process of review of refund may be provided in the GST Law.

13.2 Besides this, for refund amounts exceeding a pre-determined amount a provision for pre-audit of refund application (and not of the accounts of the taxpayer) before the sanction of the refund may be provided for. Keeping in view the points mentioned above regarding increased compliance, self-regulation and system based verification, etc., it is recommended that the monetary limit for pre- audit of the refunds sanctioned may be kept at Rs one crore or as may be decided by the respective Tax Jurisdiction. The procedure for pre-audit will be same as that for the post audit except that the application will have to move to and fro between the refund sanctioning authority and the audit authority before grant of refund. The GST Law may provide that the process of audit should be time bound with clearly defined timeline so that quality of audit does not suffer from insufficiency of time.

13.3 It is recommended that either the review procedure or system of pre-audit & post-audit may be kept in the GST Law. GST Law Drafting Committee may provide for the appropriate provision.

INTEREST:

14 It is recommended that the GST Law may provide for a prescribed time limit of 90 days from the date of the system generated acknowledgment of refund application within which refund has to be paid. It may also be provided in the GST law that, interest clause will start automatically once the prescribed time limit for sanctioning of refund has been breached.

14.1 The issue relating to dealing with the refund cases in which refund application has been filed but the same is found to be incomplete or deficient was discussed. It is recommended that the GST Law may clearly specify that the time limit for payment of interest will start from the date of the electronically generated acknowledgement of the refund application signifying that the application is complete in all respects. The GST Law may also provide for a time limit of 30 days from the date of receipt of refund application for raising queries/ deficiency memos by tax authorities regarding incompleteness of the refund documents. Piece meal queries must be avoided. Once the applicant files a reply to the deficiency memo and the refund application is found complete as per the prescribed documents, the same should be acknowledged electronically by the refund sanctioning authority and the time limit for interest will start from the date of such electronic acknowledgement.

14.2 It is recommended that the rate of interest for delayed payment of refund and that in case of default in payment of GST should be different. The Committee recommends that the rate of interest in case of refund may be around 6% and that in case of default in payment of interest may be around 18%. The GST Law may provide accordingly. The GST Law may also provide that the interest will accrue from the last date when refund should have been sanctioned even when the refund is ordered to be paid by the order of the appellate authority in the appeal filed by the applicant against order of rejection passed by the refund sanctioning authority. This would discourage refund sanctioning authority from rejecting refund claims on frivolous grounds.

ADJUSTMENT:

15 In some cases, the taxpayer may have outstanding demand under GST Act. The GST Law may provide for adjusting the refund claim against any amount of un-stayed confirmed demand lying beyond the appeal period. The refund order may clearly state the amount so adjusted and particulars of the adjusted demand may also be stated in the annexure to be attached with the order. Format of Application for refund and Refund order can be designed accordingly. Suggested format is enclosed as Annexure-IV to VI to this document.

RECOVERY OF ERRONEUS REFUND:

16 It is recommended that the GST law may provide for the provisions for recovery of erroneously granted refunds along with interest.

(Satish Chandra) Member Secretary Empowered Committee of State Finance Ministers	**(Rashmi Verma)** Additional Secretary Department of Revenue Government of India

Annexure (s)	**Particulars**
I	JOINT COMMITTEE ON BUSINESS PROCESSES FOR GST
II	CONSTITUTION OF SUB-COMMITTEE ON GST REFUND PROCESSES
III	LIST OF PARTICIPANTS OF THE MEETING HELD ON 22nd AND 23rd JULY, 2015
IV	Refund Claim Form for taxpayers
V	Refund Order under GST Act
VI	Reduction/ Adjustment Summary
VII	Refund Claim Form for Embassies, International and Public organisations and their officials

For detailed annexures please visit: <u>*http://idtc.icai.org/download/Report_on_GST_RefundProcess.pdf*</u>

E-4
REPORT OF THE JOINT COMMITTEE ON GST RETURN

1. Introduction

1.1 During the Empowered Committee meeting held on 10th March, 2014, it was decided that a Joint Committee under the co-convenership of the Additional Secretary (Revenue), Government of India and the Member Secretary, Empowered Committee should be constituted to look into the Report of the Sub-Group-I on Business Processes for GST and make suitable recommendations for Registration and Return to the Empowered Committee. It was also decided that the Joint Committee should also keep in view the Registration and Return requirements necessary for IGST Model. Accordingly, a Joint Committee, in consultation with the Government of India, was constituted on 7th April, 2014.

1.2 The Committee held its deliberations on 28th October, 2014, 12th November, 2014, 25th November, 2014, 22nd December, 2014, 2nd and 3rd February, 2015, 19th and 20th February, 2015, 16th and 17th April 2015,7th and 8th July,2015, 22ndand 23rd July, 2015 and 9th October, 2015. The list of the participants of the last meeting of the Committee held on 9th October, 2015 is appended. (Annexure-I)

1.3 A return is a statement of specified particulars relating to business activity undertaken by the taxable person during a prescribed period. A taxable person has a legal obligation:

(i) To declare his tax liability for a given period in the return;

(ii) Furnish details about the taxes paid in accordance with that return; and

(iii) File correct and complete return within stipulated time frame.

1.4 GST is a self-assessed destination based taxation system. The submission and processing of return is an important link between the taxpayer and tax administration as it is an important tool for:

(i) Compliance verification program of tax administration;

(ii) Providing necessary inputs for taking policy decision;

(iii) Management of audit and anti-evasion programs of tax administration;

(iv) Finalization of the tax liabilities of the taxpayer within stipulated period of limitation.

1.5 This document lists out the salient aspects of the process related to filing of GST returns.

1.6 There will be common e-return for CGST, SGST, IGST and Additional Tax.

Who needs to file Return in GST regime?

1.7 Every registered person is required to file a return for the prescribed tax period. A return needs to be filed even if there is no business activity (i.e. Nil Return) during the said tax period of return.

1.8 UN agencies etc. will have unique GST ID and will file return for the month (in simpler form) during which they make purchases. They would not be required to file regular return. They would submit their purchase statements (without purchase invoices) as per the periodicity prescribed for claim of refund.

1.9 Government entities / PSUs , etc. not dealing in GST supplies or persons exclusively dealing in exempted / Nil rated / non - GST goods or services would neither be required to obtain registration nor required to file returns under the GST law. However, State tax authorities may assign Departmental ID to such government departments/ PSUs / other persons. They will ask the suppliers to quote the Department ID in the supply invoices for all inter-State purchases being made to them. Such supplies will be at par with B2C supplies and will be governed by relevant provisions relating to B 2C supplies.

2. Periodicity of Return Filing

2.1 Common periodicity of returns for a class of taxpayers would be enforced. There will be different frequency for filing of returns for different class of taxpayers, after payment of due tax, either prior to or at the time of filing return. The return can be filed without payment of self-assessed tax as per the return but such return would be treated as an invalid return and would not be taken into consideration for matching of invoices and for inter-governmental fund settlement among States and the Centre. The periodicity of return for different categories of taxpayers is as follows:

S. No.	Return / Ledger	For	To be filed by
1	GSTR 1	Outward supplies made by taxpayer (other than compounding taxpayer and ISD)	10^{th} of the next month
2	GSTR 2	Inward supplies received by a taxpayer (other than a compounding taxpayer and ISD)	$15^{th}$of the next month
3	GSTR 3	Monthly return (other than compounding taxpayer and ISD)	$20^{th}$of the next month
4	GSTR 4	Quarterly return for compounding Taxpayer	$18^{th}$of the month next to quarter
5	GSTR 5	Periodic return by Non-Resident Foreign Taxpayer	Last day of registration

6	GSTR 6	Return for Input Service Distributor (ISD)	15th of the next month
7	GSTR 7	Return for Tax Deducted at Source	10th of the next month
8	GSTR 8	Annual Return	By 31st December of next FY
9	ITC Ledger of taxpayer		Continuous
10	Cash Ledger of taxpayer		Continuous
11	Tax ledger of taxpayer		Continuous

2.2 Other important points relating to periodicity of return filing are as under:-

(i) Normal / Regular taxpayers (including casual taxpayers) would have to file GSTR-1 (details of outward supplies) (Annexure-II), GSTR-2 (details of inward supplies) (Annexure-III) and GSTR-3 (monthly Return) (Annexure-IV) for each registration.

(ii) Normal / Regular taxpayers with multiple registrations (for business verticals) within a State would have to file GSTR-1, GSTR-2 and GSTR-3 for each of the registrations separately.

(iii) Compounding taxpayers would have to file a quarterly return called GSTR-4 (Annexure-V).

(iv) Taxpayers otherwise eligible for the compounding scheme can opt against the compounding and file monthly returns and thereby make their supplies eligible for ITC in hands of the purchasers.

(v) Casual/ Non-Resident Taxpayers (other than foreigners) would have to file GSTR-1, GSTR-2 and GSTR-3 returns for the period for which they have obtained registration. The registration of Casual/Non -Resident taxpayers will be done in the same manner as that of Normal / Regular taxpayers.

(vi) Non-Resident Taxpayers (foreigners) would be required to file GSTR-5 return for the period for which they have obtained registration within a period of seven days after the date of expiry of registration. In case registration period is for more than one month, monthly return(s) would be filed and thereafter return for remaining period would be filed within a period of seven days as stated earlier. For these taxpayers the registration format to be used will be the same as that for UN Bodies/Embassies (Annexure-VI].

(vii) Annual return (GSTR-8) (Annexure-IX) will be filed by all normal / regular taxpayers. It will be based on financial records.

(viii) Compounding taxpayer will also file a simple annual return.

(ix) Cut-off date for filing of details of outward supplies (GSTR-1), inward supplies (GSTR-2) and Monthly return (GSTR-3) would be10th, 15th and 20th day respectively of the succeeding month for all Monthly filers.

(x) Cut-off date for filing of Quarterly return (GSTR-4) by compounding taxpayer would be 18thday of the first month of the succeeding quarter.

(xi) Cut-off date for filing of Input Service Distributor return (GSTR-6) (Annexure-VII) would be 15th day of the succeeding month.

(xii) Cut-off date for filing of TDS (Tax Deducted at Source) return (GSTR-7) (Annexure-VIII) by Tax Deductor would be 10th day of the succeeding month.

(xiii) For Annual return, the cut-off date would be 31st December following the end of the financial year for which it is filed.

(xiv) The filing of return would be only through online mode although the facility of offline generation and preparation of returns would be provided. The returns prepared in offline mode would have to be uploaded.

3. Monthly Return

There would be separate returns for the outward supplies, inward supplies and a consolidated return based on these two returns. Besides that, there would be separate returns for the Input Service Distributors, non-resident taxpayers (foreigners) and Tax Deductors. The components of each of these return is being discussed hereunder:

3.1. Components of valid GST Return for Outward Supplies made by the Taxpayer (GSTR-1):

3.1.1 This return form would capture the following information:

1. Basic details of the Taxpayer i.e. Name along with GSTIN
2. Period to which the Return pertains
3. Gross Turnover of the Taxpayer in the previous Financial Year. This information would be submitted by the taxpayers only in the first year and will be auto-populated in subsequent years.
4. Final invoice-level supply information pertaining to the tax period separately for goods and services:

   (i) For all B2B supplies (whether inter-state or intra-state), invoice level specified details will be uploaded.

   (ii) For all inter-state B2C supplies (including to non-registered Government entities, Consumer / person dealing in exempted / NIL rated / non GST goods or services), the suppliers will upload invoice level details in respect of every invoice whose value is more than Rs. 2,50,000/-. For invoices below this value, State-wise summary of supply statement will be filed covering those invoices where there is address on record. The address of the buyer has to be mandatorily reflected in every invoice having a value of Rs. 50,000/- or more. (Model GST Law may provide for such a provision). Invoices for a value less than Rs. 50,000/- that do not have address on record will be treated as intra-state supply. In other words, State-wise summary of inter-State supply would be filed covering (a) those invoices value of which is less than Rs. 50000/- and where address is on record and (b) those invoices whose value is between Rs. 50000/- to Rs. 250000/-.

(iii) The recommendation of the Committee on IGST and GST on Imports with respect to the details about HSN code for goods and Accounting code for services to be captured in an invoice have been accepted with certain modifications. The details proposed by this Committee are as follows:-

(a) HSN code (4-digit) for Goods and Accounting Codes for Services will be mandatory initially for all taxpayers with turnover in the preceding financial year above Rs. 5 Crore (For the first year of operations of GST, self-declaration of turnover of previous financial year will be taken as the basis as all India turnover data will not be available in the first year. From the 2nd year onwards, turnover of previous financial year under GST will be used for satisfying this condition).

(b) For taxpayers with turnover between Rs 1.5 Crores and Rs 5 Crores in the preceding financial year, HSN codes may be specified only at 2-digit chapter level as an optional exercise to start with. From second year of GST operations, mentioning 2-digit chapter level HSN Code will be mandatory for all taxpayers with turnover in previous financial year between Rs. 1.5 Crores and Rs. 5.0 Crores.

(c) Any taxpayer, irrespective of his turnover, may use HSN code at 6-digit or 8-digit level if he so desires.

(d) To start with, compounding dealers may not be required to specify HSN at 2-digit level also.

(e) Prescribed Accounting code will be mandatory for those services for which Place of Supply Rules are dependent on nature of services to apply the destination principle, irrespective of turnover.

(f) HSN Codes at 8-digit level and Accounting Codes for services will be mandatory in case of exports and imports.

(iv) The above parameters with respect to HSN code for goods and Accounting Code for services will apply for submitting the information in return relating to relevant invoice level information for B2B supplies (both intra-state and inter-state) and inter-state B2C supplies (where taxable value per invoice is more than Rs. 2.5 lakhs). It is proposed that in the return form the description of goods and services may not be required to be submitted by the taxpayer as the same will be identified through the submission of HSN code for goods and Accounting Code for services. In order to differentiate between the HSN code and the Service Accounting Code (SAC), the latter will be prefixed with "s". The taxpayers who have turnover below the limit of Rs. 1.5 Crore will have to mention the description of goods/service, as the case may be, wherever applicable.

(v) For all Intra-State B2C supplies (including to non-registered Government entities, consumer / person dealing in exempted / NIL rated / non GST goods or services), consolidated sales (supply) details will be uploaded. However a dealer may at his option furnish invoice wise information in respect of exempted and nil rated supplies also.

(vi) The supply information will also have details relating to the Place of Supply in order to identify the destination state as per the Place of Supply Rules where it is different from the location of the recipient.

(vii) Details relating to supplies attracting Reverse charge will also be submitted

5. Details relating to advance received against a supply to be made in future will be submitted in accordance with the Point of Taxation Rules as framed in the GST law.

6. Details relating to taxes already paid on advance receipts for which invoices are issued in the current tax period will be submitted.

7. Details relating to supplies exported (including deemed exports) both on payment of IGST as well as without payment of IGST would be submitted.

8. There will be a separate table for submitting the details of revisions in relation to the outward supply invoices pertaining to previous tax periods. This will include the details of Credit/Debit Note issued by the suppliers and the differential value impact and the concomitant tax payable or refund/tax credit sought.

9. There will be a separate table for effecting modifications/correcting errors in the returns submitted earlier. The time period for correcting these errors will be provided in the GST Law.

10. There will be a separate table for submitting details in relation to NIL rated, Exempted and Non GST outward supplies to (both inter-state and intra-state) to registered taxpayers and consumers.

3.1.2 The return (GSTR-1) would be filed by the 10th of the succeeding month. Late filing would be permitted on payment of late fees only.

3.2. Components of valid GST Return for Inward Supplies received by the Taxpayer (GSTR-2)

3.2.1 This return form would capture the following information:

1. Basic details of the Taxpayer i.e. Name along with GSTIN

2. Period to which the Return pertains

3. Final invoice-level inward supply information pertaining to the tax period for goods and services separately

4. The information submitted in GSTR-1 by the Counterparty Supplier of the taxpayer will be auto populated in the concerned tables of GSTR -2. The same may be modified i.e. added or deleted by the Taxpayer while filing the GSTR-2. The recipient would be permitted to add invoices (not uploaded by the counterparty supplier) if he is in possession of invoices and have received the goods or services.

5. There will be separate tables for submitting details relating to import of Goods/Capital Goods from outside India and for the services received from outside India.

6. The details of inward supplies would be auto-populated in the ITC ledger of the taxpayer on submission of his return. The taxpayer will select the invoice details regarding the in-eligibility and eligibility of ITC in relation to these inward supplies and the quantum available in a particular tax period.

7. There will be a separate table for submitting details in relation to ITC received on an invoice on which partial credit has been availed earlier.

8. In respect of capital goods, there will be a field to capture appropriate information regarding availment of ITC over a period (to be prescribed in GST Law in terms of duration and number of installments) from the date of accountal of capital goods in the taxpayer's books of account s. [GST Law may provide that Input credit pertaining to Capital Goods will be allowed to be availed over a period of 2 years in two equal installments]

9. In respect of inputs, there can be two situations. If inputs are received in one lot, the ITC will be given in the return period in which the purchase is recorded in the books of accounts. In case inputs covered under one invoice are received in more than one instance/lot, the ITC will be given in the return period in which the last purchase is recorded in the books of accounts. (GST Law to contain appropriate provision in this regard). A note in this regard has been incorporated in the Return form for the guidance of the taxpayer.

10. There will be a separate table for submitting the details of revisions in relation to inward supply invoices pertaining to previous tax periods (including post purchase discounts received). This will include the details of Credit/Debit Note issued by the suppliers and the differential value impact and concomitant tax payable or refund/tax credit sought.

11. There will be a separate table for effecting modifications/correcting errors in the returns submitted earlier. The time period for correcting these errors will be provided in the GST Law.

12. There will be a separate table for submitting details in relation to NIL rated, Exempted and Non GST inward Supplies (Both Inter-State and Intra-State) including those received from compounding taxpayers and unregistered dealers.

13. There will be a separate table for the ISD credit received by the taxpayer.

14. There would be a separate table for TDS Credit received by the taxpayer.

3.2.2 Auto Population in this return from GSTR-1 will be done on or after 11th of the succeeding month. Addition or Deletion of the invoice by the taxpayer will be permitted between 12th and 15th

of the succeeding month. Adjustments would be permitted on 16th and 1 7th of the succeeding month.

3.2.3 The return (GSTR-2) would be filed by 17th of the succeeding month. Late filing would be permitted on payment of late fees only.

3.3. Components of valid GST Return (GSTR-3):

3.3.1 The GST Monthly Return form would capture the following information:

1. Basic details of the Taxpayer i.e. Name and Address along with GSTIN
2. Period to which the Return pertains
3. Turnover Details including Gross Turnover, Export Turnover, Exempted Domestic Turnover, Nil Rated Domestic Turnover, Non GST Turnover and Net Taxable Turnover
4. Final aggregate level outward and inward supply information. These details will be auto populated from GSTR-1 and GSTR-2.
5. There will be separate tables for calculating tax amounts on outward and inward supplies based on the information contained in various tables in the GSTR-3 return.
6. There will be a separate table for capturing the TDS credit received and which has been credited to his cash ledger (the deductee).
7. Tax liability under CGST, SGST, IGST and Additional Tax.
8. Details regarding revision of invoices relating to outward and inward supplies (as per details in para 3.1.1 and 3.2.2 above)
9. Details of other liabilities (i.e. Interest, Penalty, Fee, others etc.).
10. Information about ITC ledger, Cash ledger and Liability ledger (these are running electronic ledgers maintained on the dashboard of taxpayer by GSTN). These would be updated in real time on an activity in connection with these ledgers by the taxpayer. Both the ITC ledger and the cash ledger will be utilized by the taxpayer for discharging the tax liabilities of the returns and others. Details in these ledgers will get auto populated from previous tax period return (irrespective of mode of filing return i.e. online / offline utility)
11. Details of ITC utilized against tax liability of CGST, SGST and IGST on supplies of goods and services.
12. Net tax payable under CGST, SGST, IGST and Additional Tax.
13. Details of the payment of tax under various tax heads of CGST, SGST, IGST and Additional Tax separately would be populated from the debit entry in Credit/Cash ledger. GST Law may have provision for maintaining four head wise account for CGST, SGST, IGST and Additional tax and at associated minor heads for interest, penalty, fee and others. Excess payment, if any, will be carried forward to the next return period. The taxpayer will have the option of claiming refund of excess payment through the return for which appropriate

field will be provided in the return form. The return form would display all bank account numbers mentioned in the registration, out of which one will be selected by the taxpayer to which the refund will be credited.

14. Details of other payments - Interest/Penalties/Fee/Others, etc. This will be auto populated from the Debit entry in Cash ledger irrespective of mode of filing i.e. online / offline utility.

15. Details of ITC balance (CGST, SGST and IGST) at the end of the tax period will be auto-populated in the ITC ledger irrespective of mode of filing return. In case of net exporter or taxpayers dealing with inverted duty structure or similar other cases, where input tax credit is greater than output tax due on supply, the taxpayer would be eligible for refund. The return would have a field to enable the tax payer to claim the refund or to carry forward the ITC balance (CGST, SGST and IGST). The return form should display all bank account numbers mentioned in the registration, out of which one will be s elected by the taxpayer to which the refund will be credited. To begin with GST law may provide that the refund will be processed quarterly.

16. Details of cash balance (CGST, SGST, IGST and Additional tax) in personal ledger at the end of the tax period (this will be auto populated irrespective of mode of filing return).

17. Information regarding quantity of goods (as per Unique Quantity Code) supplied will not be contained in the monthly return. However, the same would be submitted by the taxpayer in the annual return. (GST Law may contain appropriate provision in this regard). The format of the annual return would have a suitable field for this purpose.

3.3.2 The return (GSTR-3) would be entirely auto- populated through GSTR-1 (of counterparty suppliers), own GSTR-2, ISD return (GSTR-6) (of Input Service Distributor), TDS return (GSTR-7) (of counterparty deductor), own ITC Ledger, own cash ledger, own Tax Liability ledger. However, the taxpayer may fill the missing details to begin with.

3.3.3 The return would be permitted to be filed both on online and offline mode. In case of offline mode, payment by debit to cash / ITC ledger can be done at an earlier date also and such debit entry number would be verified at the time of uploading of the return. In online mode, both debiting and filing can be done simultaneously.

3.3.4 The return would be filed by 20th of the succeeding month. Late filing would be permitted on payment of late fees only.

3.4 Quarterly Return for compounding Taxpayers (GSTR-4):

3.4.1 After crossing the threshold exemption limit, the taxpayers may opt for compounding scheme wherein they would be required to pay taxes at fixed rate without any ITC facilities. Such taxpayers would be required to file a simplified quarterly return (GSTR-4) as per the format prescribed. In this return the taxpayer is only required to indicate the total value of supply made during the period of return and the tax paid at the compounding rate along with the details of payment of tax in the return. The compounding taxpayer will also need to declare invoice-level purchase information (auto-drafted from supply invoice information uploaded by counter-party taxpayers) for the purchases from normal taxpayers. The Compounding taxpayer will also be required to submit details of the goods and services imported from outside India. The Compounding taxpayers would be allowed to export supplies outside India. GST Law may provide for suitable provisions with respect to the eligibility of such taxpayers to purchase only tax paid supplies and that they can make purchases from unregistered suppliers on payment of GST on reverse charge basis.

3.5 Non-Resident Foreign Taxpayers (GSTR-5):

3.5.1 Non-Resident foreign taxpayers would be required to file GSTR-5 for the period for which they have obtained registration within a period of seven days after the date of expiry of registration. In case registration period is for more than one month, monthly return(s) would be filed and thereafter return for remaining period would be filed within a period of seven days as stated earlier.

3.6 Components of a valid ISD Return (GSTR-6):

3.6.1 This return form would capture the following information.

1. Basic details of the Taxpayer i.e. Name along with GSTIN
2. Period to which the Return pertains
3. Final invoice-level inward supply information pertaining to the tax period separately for goods and services on which the ITC is being claimed. This will be auto populated on the basis of GSTR-1 filed by the Counterparty Supplier of the taxpayer. The same may be modified i.e. added or deleted by the Taxpayer while filing the ISD return. The recipient would be permitted to add invoices (not uploaded by the counterparty supplier) if he is in possession of invoices and have received the services.
4. Details of the Invoices along with the GSTIN of the receiver of the credit i.e. to whom the ISD is distributing credit.
5. There will be separate ISD Ledger in the return that will detail the Opening Balance of ITC (to be auto- populated on the basis of previous return), credit for ITC services received, debit for ITC reversal and ITC distributed and Closing Balance.

3.6.2 This return would be filed by 15th of the succeeding month. Late filing would be permitted on payment of late fees only.

3.7 Components of a valid TDS Return (GSTR-7):

3.7.1 This return would capture the following information:

1. Basic details of the Taxpayer i.e. Name along with GSTIN
2. Period to which the Return pertains

3. Details of GSTIN of the Supplier along with the invoices against which the Tax has been deducted. This will also contain the details of tax deducted against each major head i.e. CGST, SGST and IGST.

4. Details of other payments - Interest/Penalties/Fee/Others, etc. (This will be auto populated from the Debit entry in Cash ledger)

3.7.2 This return would be filed by 10th of the succeeding month. Late filing would be permitted on payment of late fees only.

3.8 Steps for Return Filing:

Step 1: The taxpayer will upload the final GSTR-1 return form either directly through data entry at the GST Common Portal or by uploading the file containing the said GSTR-1 return form through Apps by10thday of month succeeding the month during which supplies has been made. The increase / decrease (in supply invoices) would be allowed, only on the basis of the details uploaded by the counter-party purchaser in GSTR-2, upto 17th day of the month. (i.e. within a period of 7 days). In other words, the supplier would not be allowed to include any missing invoices on his own after 10th day of the month.

GSTN will facilitate periodic (may be daily, weekly etc.) upload of such information to minimize last minute load on the system. GSTN will facilitate offline preparation of GSTR-1.

Step 2: GST Common Portal (GSTN) will auto-draft the provisional GSTR-2 of taxpayer based on the supply invoice details reported by the counter-party taxpayer (supplier) on a near real-time basis.

Step 3: Purchasing taxpayer will accept / reject/ modify such auto-drafted provisional GSTR-2. (A taxpayer will have the option to download his provisional purchase statement from the Portal or through Apps using Application Programming Interface (APIs) and update / modify it off-line).

Step 4: Purchasing taxpayer will also be able to add additional purchase invoice details in his GSTR-2 which have not been uploaded by counter-party taxpayer (supplier) as described in ***Step 1 and 2***above, provided he is in possession of valid invoice issued by counter-party taxpayer and he has actually received such supplies.

Step 5: Taxpayers will have the option to do reconciliation of inward supplies with counterparty taxpayers (suppliers) during the next 7 days by following up with their counterparty taxpayers for any missing supply invoices in the GSTR-1 of the counter-party taxpayers, and prompt them to accept the same as uploaded by the purchasing taxpayer. All the invoices would be auto-populated in the ITC ledger of taxpayer. The taxpayer would, however, indicate the eligibility / partial eligibility for ITC in those cases where either he is not entitled or he is entitled for partial ITC.

Step 6: Taxpayers will finalize their GSTR-1and GSTR-2 by using online facility at Common Portal or using GSTN compliant off-line facility in their accounting applications, determine the liability on their supplies, determine the amount of eligible ITC on their purchases and then generate the net tax liability from the system for each type of tax. Cash details as per personal ledger/ carried forward from previous tax period, ITC carried forward from previous tax period, ITC reversal and associated Interest/Penalty, taxes paid during the current tax period etc. would get auto-populated in the GSTR-3.

Step 7: Taxpayers will pay the amount as shown in the draft GSTR-3 return generated automatically at the Portal post finalization of activities mentioned in Step 6 above.

Step 8: Taxpayer will debit the ITC ledger and cash ledger and mention the debit entry No. in the GSTR-3 return and would submit the same.

3.9 Acknowledgement

3.9.1 On submission of return, an Acknowledgement Number will be generated. In case of submission of a return which has been prepared by using offline tools, acknowledgement of submission will take some time as GSTN System will need to first verify details like the carry forward cash as per personal ledger, ITC, tax payment details etc. In such cases, initially a Transaction ID confirming receipt of data will be conveyed to the taxpayer, (as also envisaged in case of filing of short paid / non - paid return). Final acknowledgement of receipt of return will be generated after validation of data is completed, which will also lock-in the Transaction ID.

3.9.2 The acknowledgement of e-return would contain the following details:

(i) Return acknowledgement number (unique number generated by the GSTN), Date and Time

(ii) Transaction ID No., Date and Time

(iii) GSTIN of taxpayer

(iv) Relevant tax period details

(v) Gross Supplies, Taxable Supplies and Tax paid / refund claimed (CGST, SGST, IGST and Additional tax separately) during the Return period

3.10 Contents of Invoice level information:

3.10.1. The following invoice level information would be captured in the return:

1. Invoices pertaining to B2B transactions (Intra-State, Inter-State and supplies to UN organizations/embassies) [both for supply and purchase transactions]:

(i) Goods and Services Tax Identification Number (GSTIN)/Unique ID issued to UN organizations/Embassies

(ii) Invoice Number, Date and value

(iii) HSN code for each item line (for Goods)/ Accounting code for each item line (for services)

(iv) Taxable Value

(v) Tax Rate (CGST & SGST or IGST and/ or Additional Tax)

(vi) Tax Amounts (CGST & SGST or IGST and / or Additional Tax)

(vii) Place of Supply (State)

(viii) For Capital Goods, there will be separate column in the Table of the return for ease of tracking of credit due and availed over the period as prescribed by GST law

(ix) An Invoice may have two items having different tax rates or different HSN codes in case of B2B supplies. If the invoice contains more than one tax rate/one HSN Code, the taxpayer would have to submit line-wise information separately for each HSN Code / each tax rate.

2. ***Invoices pertaining to B2C transactions*** (Inter-State B2C supplies for consumer on record)[only supply transactions]:

A. In respect of invoices whose taxable value is more than Rs. 2.5 lakhs (to enable transfer of funds to respective states):

(i) Invoice Number, Date and value

(ii) HSN Code for goods / Accounting code for services

(iii) Taxable Value

(iv) Tax Rate (IGST and Additional Tax)

(v) Tax Amount (IGST and Additional Tax)

(vi) Buyer's address (State Code)

(vii) Departmental ID allotted by State Government to Government entities / PSUs , etc. not dealing in GST supplies or to persons dealing in exempted / Nil rated / non -GST goods or services

(viii) Place of Supply (State) if different than S. No. (vi) above

B. For invoices whose taxable value is upto Rs 2.5 lakhs, only aggregated taxable value of all such invoices will be submitted, state-wise and tax rate-wise.

(GST Law may provide for mandatory mention of address of the buyer in every invoice whose taxable value is more than Rs. 50000/-)

3. ***Invoices pertaining to B2C transactions (Intra-State B2C supplies)*** [only supply transactions] :

For intra-state B2C supplies, aggregated taxable value of all such invoices will be submitted tax rate-wise.

4. ***Invoice pertaining to Export and deemed export supply [only supply transactions]:***

(i) Invoice Number, Date and value

(ii) 8-digit HSN Code for goods/ Accounting Code of Services for each line item (as HSN Code / Accounting code is mandatory in case of exports)

(iii) Taxable Value

(iv) Tax Rate

(v) Tax Amounts (IGST, CGST & SGST) (in case exports on payment of GST).

(vi) Shipping Bill/ Bill of Export Number

5. Invoices pertaining to exempted including Nil ratedsupply ***[both for supply and purchase transaction]***

Aggregate value of all exempted (including Nil rated) supplies made by the taxpayer during the return period would be submitted. The aggregate value of exempted (including Nil rated) purchases would also be declared by the taxpayer in the return.

6. Bills of Entry relating to Import ***[only purchase transactions]:***

(i) Bill of Entry Number, Date and value

(ii) Assessable Value for IGST

(iii) 8-digit HSN Code for goods

(iv) IGST rate

(v) IGST Amount

(vi) Importer's address (for transfer of IGST) [Will get auto populated in case of registered taxpayer. In case of others, it will have to be provided by them]

These details would be verified from Bill of Entry data available at ICES/ ICEGATE.

7. Credit Note / Debit Note ***[for Sales-Purchase return, Post-sale discount]:***

For sale-purchase return, on account of differential value/quantity/tax rates:

(i) Debit/Credit Note Number

(ii) Original Invoice Number and Date

(iii) Taxable Value, Tax Rate and Tax Amount (CGST & SGST or IGST and Additional Tax) (that is being modified)

The credit/debit note will be reflected in the monthly return in which such notes have been issued.

GST Law may provide the time period within which sales return can be made and the date (invoice date or date of receipt by the buyer) from which such time period is to be calculated.

8. ***Post sales discount***

GST Law may provide what constitutes a sale price especially with respect to post sales discount. The Law may also contain suitable provisions about admissibility or otherwise of post supply discounts. The adjustments for post sales discount will be completed before filing of annual return. The credit/debit note will be reflected in the monthly return in which the said adjustment is made.

9. ***Advances received against a supply to be made in future-.***

GST law may provide for Point of Taxation Rules which will determine the point at which the taxes would be paid by the taxable person. So, accordingly, if the tax is to be paid on the basis of advance payment received against a future supply of goods and/or services, then the following details would be required to be provided:

(i) GSTIN/UID/GDI/Name of customer

(ii) State Code

(iii) HSN Code for goods / Accounting code for services

(iv) Amount of advance received

(v) Tax Rate (CGST and SGST or IGST and Additional Tax)

(vi) Tax Amount (CGST and SGST or IGST and Additional Tax)

10. TDS:

GST law may provide for provision of TDS (Tax Deducted at source) for certain supplies of goods and/or services made to specified categories of purchasers who will be obligated to deduct tax at a certain percentage from the payment due to the suppliers. They will be required to file a TDS return and submit the following details:

(i) GSTIN/GDI of deductor

(ii) GSTIN of deductee/supplier

(iii) Invoice no. with date (iv) TDS Certificate no. with date and value

(v) Taxable value

(v) Rate of TDS for IGST, CGST and SGST as applicable

(vi) Amount of IGST, CGST and SGST as applicable, deducted as TDS

11. ***ISD:***

GST law may retain the concept of Input Service Distributor (ISD). Accordingly, ISDs would be required to file a monthly return and submit the following details:

(i) Details of ISD i.e. GSTIN, name and address

(ii) Details of recipient i.e. GSTIN, name and address

(iii) Details of the inward supply invoices on the basis of which Input Tax Credit is claimed.

(iv) Invoice / Document no. with date

(v) Amount of IGST, CGST, SGST Credit, as applicable, being distributed.

3.10.2 GST Law may provide the suitable provisions for the mandatory fields and data structure which must be contained in a GST invoice.

3.11 Where will the taxpayer file Return?

3.11.1 A registered Tax Payer shall file GST Return at GST Common Portal either:

(i) by himself logging on to the GST Common Portal using his own user ID and password;

(ii) Through his authorized representative using the user Id and password (allotted to the authorized representative by the tax authorities), as chosen at the time of registration, logging on to the GST Common Portal.

The filing may be done either directly or by using Applications developed by accounting companies / IT companies which will interact with GST System using APIs or through Facilitation Center (FC).

3.11.2 At the time of registration, every taxpayer has to enroll with GST Common Portal (GSTN). A unique User-ID and Password will be generated and intimated to the taxpayer. This User-ID and Password shall be used by him for filing the tax return on the Common Portal as well. However, a taxable person may prepare and submit his returns himself or can use services of a TRP. The process for filing return through TRP is given below:

(i) A TRP will have to be chosen by the taxpayer out of TRPs registered with respective State tax authorities/CBEC. (taxpayer will have the option to change TRP any time);

(ii) The TRPs registered with tax authorities will be provided separate user ID and password;

(iii) Using his own user Id and password, the TRP will prepare the return in prescribed format on the basis of the information furnished to him by the taxable person. (The legal responsibility of the correctness of information contained in the return prepared by the TRP will rest with the taxable person only and the TRP shall not be liable for any errors or incorrect information.);

(iv) The TRP will be able to upload all types of return, based on the information provided by the taxpayer who has authorized him to do so at the portal;

(v) The system will generate an email and SMS having basic data of return and send the same to the taxpayer;

(vi) The taxpayer can accept the correctness of the return and submit the same by just clicking on the link provided in the e-mail. In case he does not respond to the e-mail, return will be considered as not submitted;

(vii) In case taxpayer wants to respond to the SMS, he may do so by replying YES and mention the OTP sent alongwith the SMS. In case he does not respond to the SMS, return will be considered as not submitted;

(viii) This mechanism may be provided in the GST law and the TRPs would have to be approved by the tax administration and allotted a Unique ID and will also be provided appropriate training by them.

3.11.3 The return can also be submitted by the taxpayer through any Facilitation Center (FC) approved by the Tax authorities and selected by the taxpayer at GST System. The taxpayer shall make available the requisite documents to the facilitation center. Facilitation Centre (FC) shall be responsible for the uploading of all types of return given to it by the taxable person. After uploading the data on the common portal using the ID and Password of FC, the GSTN system will generate an email/SMS for the taxpayer. The process explained in Para 3.11.2 above will be followed. With e-sign being worked out by Department of Electronics and Information Technology (DEITY), individual signing of return by one-time Digital Signature Certificate (DSC) can also be completed. This will do away with the requirement of print-out of acknowledgement of return proposed earlier based on the current system of ITR filing.

3.11.4 Registration of TRP/FC will be done by CBEC / respective State tax authorities and the registration data will be shared with GSTN to enable applicants/taxpayers to choose one from the available list of registered TRPs/FCs. The GST Law may also contain suitable provisions about it.

3.11.5 The common portal will display the electronic form to be used for filing the return. The form can be downloaded, filled and then uploaded using approved e-tools.

3.11.6 The portal will provide a form generation utility which can be downloaded by the taxpayer for preparation of the return offline and for conducting the preliminary arithmetic checks before return is uploaded on the portal using APIs.

3.11.7 Along with the return, taxpayer is not required to submit any other document. The documents as required for scrutiny or audit shall be made available by the taxpayer to the audit party deputed by the CBEC /State tax authorities/CAG.

3.11.8 The Common Portal will maintain and display the ledger of the Tax Payer providing information about the tax deposited, input tax credit availed/taken, input tax credit utilized, tax liability created, balance ITC carried forward, tax payments made by debiting the ledgers under respective major tax heads, refund granted and balance in respective cash ledger and credit ledger carried forward [Separate ledger will be maintained for ITC and Cash for each Taxpayer]. The information of Interest on delayed payments, Penalty for legal defaults, Tax Demand as per adjudication/appellate orders, etc. would also be provided. The ledger will also give the status of the tax dues or excess payment on any given date. Thus such ledger would have eight pages and cash ledger would have 20 pages.

3.11.9 A return related liability should mean the tax liability for the transactions (including credit/debit notes) of the return period and the additional liability arising out of any ITC reversal or late inclusion of the supply in the return period. Arrears pertaining to audit/reassessment/ enforcement outcomes would be handled separately, and not mixed with the return related liabilities and payments. The payments made on this account, however, would be reflected in the return.

3.12 Revision of Return

3.12.1 There would be no revision of returns.

3.12.2 All unreported invoices of previous tax period would be reflected in the return for the month in which they are proposed to be included. The interest, if applicable will be auto populated.

3.12.3 All under-reported invoice and ITC revision will have to be corrected using credit/debit note and such credit / debit note would be reflected in the return for the month in which such adjustment is carried out. The credit/debit note will have provision to record original invoice, date etc. to enable the system to link the same with the original invoice as also to calculate the interest, if applicable. Its format will be like the invoice.

3.12.4 There would be separate tables in the returns for reflecting those adjustments for which credit / debit notes are not required to be issued / issued. The interest, if applicable will be auto populated.

3.13 Non-filing, late-filing and short-filing of return

A. Non-Filers & Late-Filers

In case of failure by the taxpayer to submit periodic returns, a defaulter list will be generated by the IT system by comparing the return filers with the registrant database. Such defaulter list will be provided to the respective GST Authorities for necessary enforcement and follow up action.

GST Common Portal can auto generate and send the notice to all non-filers (being done by many State VAT authorities) in the form of email and SMS. Jurisdictional tax authorities can get the same printed and dispatch such notices. The details of non-filers shall be made available on the dash board of jurisdictional officers. GST Law may also provide for imposition of automatic late fees for non-filers and late filers which can also be in-built in the notices.

B. Short-Filers

As per the requirement of the IGST model, Return should be allowed to be filed only on payment of due tax as self-assessed and declared in the return. It has, however, been decided that e-Return should be allowed to be uploaded even in case of short payment for the limited purpose of having the information about self-assessed tax liability even though not paid. The invoice matching and inter-governmental fund settlement would, however, take place only after the full tax has been paid. Return without full payment of tax will be allowed to be uploaded but it will be treated as an invalid return and this return will not be used for matching of invoices and settlement of funds.

Any invalid return (including the one not supported by full payment) will merely be recorded with unique transaction ID, but not accepted in the system, and that aspect will be made known to the taxpayer at the time of communicating the ID itself.

[GST Law may provide adequate penal provisions for short-filing and non-filing of return]

4. Return for Casual/Non-Resident Taxpayers:

Casual/Non-Resident Taxpayers should file GSTR-1, GSTR-2 and GSTR-3 for the period for which they have obtained registration within a period of seven days after the date of expiry of registration. In case registration period is for more than one month, monthly return(s) would be filed and thereafter return for remaining period would be filed within a period of seven days as stated earlier.

5 Annual Return (GSTR-8):

5.1 All the Normal taxpayers would be required to submit Annual Return. This return to be filed annually is intended to provide 360 degree view about the activities of the taxpayer. This statement would provide a reconciliation of the returns with the audited financial statements of the taxpayer.

5.2 This return is a detailed return and captures the details of all the income and expenditure of the taxpayer and regroups them in accordance with the monthly returns filed by the taxpayer. This return also provides for the reconciliation of the monthly tax payments and will provide the opportunity to make good for any short reporting of activities undertaken supply wise. The said return would also capture the details of pending arrears against the taxpayer and the current status of the orders leading to such arrears. The details of all the refund claims pending with the tax authorities would also be captured. Since this return captures the minutest details of income and expenditure of the taxpayer, the gross profit/loss arrived on the basis of the details submitted in this statement should tally with the gross profit/loss indicated in the Profit and Loss Account of the dealer. Accordingly, this return is to be submitted along with the audited copies of the Annual Accounts of the dealer and would be filed by 31^{st} December following the end of the financial year for which it is filed.

5.3 A separate reconciliation statement, duly certified by a Chartered Accountant, will have to be filed by those taxpayers who are required to get their accounts audited under section 44AB of Income Tax Act 1961. Currently this limit is Rs 1 Crore.

5.4 Consolidated statement of purchases and supplies based on monthly returns filed by the taxpayer can be made available to taxpayers by GSTN common portal as a facilitation measure for enabling him to prepare annual return.

5.5 The format of Reconciliation statement would be finalized after finalization of GST Model law.

6 Processing of Return:

After the GST Return has been uploaded onto the GST Common Portal, the Portal will undertake the following activities:

(i) Acknowledge the receipt of the return filed by the taxpayer after conducting required validations.

(ii) Acknowledgement number would be issued as per procedure detailed in Para 3. 9 above.

(iii) Once a return is acknowledged, forward that GST Return to tax authorities of Central and appropriate State Govt. through the established IT interface.

(iv) The ITC claim will be confirmed to purchasing taxpayer in case of matched invoices after 20th of the month succeeding the month of the tax period month provided counterparty supplying taxpayer has submitted the valid return (and paid self-assessed tax as per return).

(v) Communicate to the taxpayers through SMS/e-Mail, about the macro-results of the matching. The details will be in the taxpayer s' dashboard/ledger which can be viewed after log-in at the Portal.

(vi) Auto-populate the ITC reversals due to mismatching of invoices in the taxpayer's account in the return for the 2nd month after filing of return for a particular month.

(vii) Aggregation of cross-credit utilization of IGST and SGST for each State and generation of settlement instructions based on IGST model and as finalized by the Payments Committee. This has to be with dealer-wise details as the concerned tax administration's follow on activities will be dependent on that detailing.

(Satish Chandra)
Member Secretary
Empowered Committee
of State Finance Ministers

(Rashmi Verma)
Additional Secretary
Department of Revenue
Government of India

Annexure (s)	**Particulars**
I	LIST OF PARTICIPANTS OF THE MEETING HELD ON 9th OCTOBER, 2015
II	GSTR-1: Outward Supplies made by the taxpayer
III	GSTR-2: Inward Supplies/ Purchases Received
IV	GSTR-3: GST Return
V	GSTR4: Quarterly Return for Compunding Dealer
VI	GSTR 5: Return for Non-Resident Taxpayers (Foreigners)
VII	GSTR 6: Return for Input Service Distributors
VIII	GSTR 7: TDS Return
IX	GSTR 8: Annual Return

For detailed annexures please visit: *http://idtc.icai.org/download/Report_on_GST_Return_Process.pdf*

F-1

REPORT ON THE REVENUE NEUTRAL RATE AND STRUCTURE OF RATES FOR THE GOODS AND SERVICES TAX (GST)

Press Information Bureau Government of India Ministry of Finance*

04-December-2015 18:32 IST

Committee headed by the Chief Economic Adviser Dr. Arvind Subramanian on Possible Tax rates under GST submits its Report to the Finance Minister; On the Revenue Neutral Rate (RNR), the Committee recommends the same in the range between 15 percent and 15.5 percent (Centre and states combined) with a preference for the lower end of that range based on the analysis made in the Report

Committee headed by the Chief Economic Adviser Dr. Arvind Subramanian on Possible Tax rates under GST submitted its Report to the Finance Minister here today. The Committee in its concluding observations has stated that this is a historic opportunity for India to implement a game-changing tax reform. Domestically, it will help improve governance, strengthen tax institutions, facilitate "Make in India by Making One India," and impart buoyancy to the tax base. It will also set the global standard for a value-added tax (VAT) in large federal systems in the years to come.

Following are the highlights of the Executive Summary of the Report submitted today:

The GST has been an initiative that has commanded broad consensus across the political spectrum. It has also been a model of cooperative federalism in practice with the Centre and states coming together as partners in embracing growth and employment-enhancing reforms. It is a reform that is long awaited and its implementation will validate expectations of important government actions and effective political will that have, to some extent, already been "priced in."

Getting the design of the GST right is, therefore, critical. Specifically, the GST should aim at tax rates that protect revenue, simplify administration, encourage compliance, avoid adding to inflationary pressures, and keep India in the range of countries with reasonable levels of indirect taxes.

There is first a need to clarify terminology. The term revenue neutral rate (RNR) will refer to that single rate, which preserves revenue at desired (current) levels. In practice, there will be a structure of rates, but for the sake of analytical clarity and precision it is appropriate to think of the RNR as a single rate. It is a given single rate that gets converted into a whole rate structure, depending on policy choices about exemptions, what commodities to charge at a lower rate (if at all), and what to charge at a very high rate. The RNR should be distinguished from the "standard" rate defined as that rate in a GST regime which is applied to all goods and services whose taxation is not explicitly specified. Typically, the majority of the

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* *Source*: www.pib.nic.in

base (i.e., majority of goods and services) will be taxed at the standard rate, although this is not always true, and indeed it is not true for the states under the current regime.

Against this background, the Committee drew a few important conclusions.

• Because identifying the exact RNR depends on a number of assumptions and imponderables; because, therefore, this task is as much soft judgement as hard science; and finally also because the prerogative of deciding the precise numbers will be that of the future GST Council, this Committee has chosen to recommend a range for the RNR rather than a specific rate. For the same reason, the Committee has decided to recommend not one but a few conditional rate structures that depend on policy choices made on exemptions, and the taxation of certain commodities such as precious metals.

The summary of recommended options is provided in the table below.

Summary of Recommended Rate Options (in percent)

RNR	Rate on precious metals	"Low" rate (goods)	"Standard" rate (goods and services)	"High/Demerit" rate or (goods	Non-GST excise
Preferred	15	6	12	16.9	40
		4		17.3	
		2		17.7	
Alternative	15.5	6	12	18.0	40
		4		18.4	
		2		18.9	

All rates are the sum of rates at center and states

- On the RNR, the Committee's view is that the range should between 15 percent and 15.5 percent (Centre and states combined) but with a preference for the lower end of that range based on the analysis in this report.
- On structure, in line with growing international practice and with a view to facilitating compliance and administration, India should strive toward a one-rate structure as the medium-term goal.
- Meanwhile, the Committee recommends a two-rate structure. In order to ensure that the standard rate is kept close to the RNR, the maximum possible tax base should be taxed at the standard rate. The Committee would recommend that lower rates be kept around 12 per cent (Centre plus states) with standard rates varying between 17 and 18 per cent.
- It is now growing international practice to levy sin/demerit rates—in the form of excises outside the scope of the GST--on goods and services that create negative externalities for the economy. As currently envisaged, such demerit rates—other than for alcohol and petroleum (for the states) and tobacco and petroleum (for the Centre)—will have to be provided for within the structure of the GST. The foregone flexibility for the center and the states is balanced by the greater scrutiny that will be required because such taxes have to be done within the GST context and hence subject to discussions in the GST Council. Accordingly, the Committee recommends that this

sin/demerit rate be fixed at about 40 percent (Centre plus states) and apply to luxury cars, aerated beverages, paan masala, and tobacco and tobacco products (for the states).

- This historic opportunity of cleaning up the tax system is necessary in itself but also to support GST rates that facilitate rather than burden compliance. Choices that the GST Council makes regarding exemptions/low taxation (for example, on gold and precious metals, and area-based exemptions) will be critical. The more the exemptions that are retained the higher will be the standard rate. There is no getting away from a simple and powerful reality: the broader the scope of exemptions, the less effective the GST will be. For example, if precious metals continues to enjoy highly concessional rates, the rest of the economy will have to pay in the form of higher rates on other goods, including essential ones. As the table shows, very low rates on precious metals would lead to a high standard rate closer to 20 percent, distorting the economy and adding to inflationary pressures. On the other hand, moderately higher taxes on precious metals, which would be consistent with the government's efforts to wean consumers away from gold, could lead to a standard rate closer to 17 percent. This example illustrates that the design of the GST cannot afford to cherry pick—for example, keeping a low RNR while not limiting exemptions--because that will risk undermining the objectives of the GST.

- The GST also represents a historic opportunity to rationalize the tax system that is complicated in terms of rates and structures and has become an "Exemptions Raj," rife with opportunities for selectivity and discretion. Tax policy cannot be overly burdened with achieving industrial, regional, and social policy goals; more targeted instruments should be found to meet such goals, for example, easing the costs of doing business, public investment, and direct benefit transfers, respectively; cesses should be reduced and sparingly used. Another problem with exemptions is that, by breaking up the value-added chain, they lead in practice to a multiplicity of rates that is unpredictable, obscured, and distortionary. A rationalization of exemptions under the GST will complement a similar effort already announced for corporate taxes, making for a much cleaner overall tax system.

- The rationalization of exemptions is especially salient for the center, where exemptions have proliferated. Indeed, revenue neutrality for the center can only be achieved if the base for the center is similar to that of the states (which have fewer exemptions—90 products versus 300 for the center). If policy objectives have to be met, instruments other than tax exemptions such as direct transfers could be deployed.

- The Committee's recommendations on rates summarized in the table above are all national rates, comprising the sum of central and state GST rates. How these combined rates are allocated between the center and states will be determined by the GST Council. This allocation must reflect the revenue requirements of the Centre and states so that revenues are protected. For example, a standard rate of 17% would lead to rates at the Centre and states of say 8 percent and 9 percent, respectively. The Committee considers that there are sound reasons not to provide for an administration-complicating "band" of rates, especially given the considerable flexibility and autonomy that states will preserve under the GST (including the ability to tax petroleum, alcohol, and other goods and services).

- Implementing the GST will lead to some uncharted waters, especially in relation to services taxation by the states. Preliminary analysis in this report indicates that there should not be large shifts in the tax base in moving to the GST, implying that overall compensation may not be large. Nevertheless, fair, transparent, and credible compensation will create the conditions for effective implementation by the states and for engendering trust between the Centre and states;

REPORT ON THE REVENUE NEUTRAL RATE AND STRUCTURE OF RATES FOR THE GOODS AND SERVICES TAX (GST)

I. INTRODUCTION

1.1 As the world economy slows, and increasing financial volatility and turbulence become the "newest normal," only a few economies have the resilience to be a refuge of stability and the potential to be an outpost of opportunity. India is one of those few. As oil and commodity prices continue to be soft, and in the wake of actions taken by the government and the Reserve Bank of India, macro-economic stability seems reasonably assured for India. This bedrock of stability coupled with reforms to unleash the entrepreneurial energies of India can create the policy credibility and business environment that India is indeed seizing the historic opportunity afforded by domestic and international developments to propel the economy to a high growth trajectory. Key amongst these reforms is the goods and services tax (GST), which has, in some ways, been "priced" into expectations of the government's reform program.

1.2 For nearly ten years, India has been on the verge of implementing a GST. But now, with political consensus close to being secured, the nation is on the cusp of executing one of the most ambitious and remarkable tax reforms in its independent history. Implementing a new tax, encompassing both goods and services, to be implemented by the Centre, 29 States and 2 Union Territories, in a large and complex federal system, via a constitutional amendment requiring broad political consensus, affecting potentially 2-2.5 million tax entities, and marshalling the latest technology to use and improve tax implementation capability, is perhaps unprecedented in modern global tax history.

1.3 It is easy to overlook how ambitious the Indian GST will be, and a cross-country comparison highlights the magnitude of ambition. According to the World Bank (2015), over 160 countries have some form of value added tax (VAT), which is what the GST is. But the ambition of the Indian GST experiment is revealed by a comparison with the other large federal systems—European Union, Canada, Brazil, Indonesia, China and Australia—that have a VAT (the United States does not have a VAT).

1.4 As Table 1 highlights, most of them face serious challenges. They are either overly centralized, depriving the sub-federal levels of fiscal autonomy (Australia, Germany, and Austria); or where there is a dual structure, they are either administered independently creating too many differences in tax bases and rates that weaken compliance and make inter-state transactions difficult to tax (Brazil, Russia and Argentina); or administered with a modicum of coordination which minimizes these disadvantages (Canada and India today) but does not do away with them.

Table 1: Comparison of Federal VAT Systems

Nature of VAT	Country Examples	Disadvantages
Independent VATs at Centre and States	Brazil, Russia, Argentina	Differences in base and rates weaken administration and compliance. Inter-state transactions difficult to manage.
VAT levied and administered at Centre	Australia, Germany, Austria, Switzerland, etc.	State government relieved of responsibility of raising taxes which also takes away fiscal discretion of States

Dual VAT	Canada and India today	A combination of the above two and hence limits both their disadvantages
"Clean" dual VAT	India's GST	Common base and common or similar rates facilitate administration and compliance, including for inter-state transactions, while continuing to provide some fiscal autonomy to States

Source: World Bank (2015)

1.5 The Indian GST is expected to represent a leap forward in creating a much cleaner dual VAT which would minimize the disadvantages of completely independent and completely centralized systems. A common base and common rates (across goods and services) and very similar rates (across States and between Centre and States) will facilitate administration and improve compliance while also rendering manageable the collection of taxes on inter-state sales. At the same time, the exceptions—in the form of permissible additional excise taxes on sin goods (petroleum and tobacco for the Centre, petroleum and alcohol for the States)—will provide the requisite fiscal autonomy to the States. Indeed, even if they are brought within the scope of the GST, the states will retain autonomy in being able to levy top-up taxes on these "sin/demerit" goods.

1.6 Provided it can be reasonably well-designed, the Indian GST will be the 21st century standard for VAT in federal systems.

1.7 It is, therefore, imperative to ensure that the design and implementation of this policy is done right. And, one important, perhaps critical, dimension of this is the level and structure of tax rates on which this Committee has been asked to make recommendations.

II.BENEFITS OF PROPOSED GST

2.1 Many benefits are claimed for the GST: that it will increase growth[1]; that it will increase investment by making it easier to take advantage of input tax credits for capital goods; and that it will reduce cascading.[2] While these are important, in our view three benefits stand out in today's context: governance/institutional reform and "Make in India by Making one India," which are two key pillars of the government's reform efforts. The investment, and hence growth, benefits could also be substantial.

Governance

2.2 The government has placed a great deal of emphasis on curbing black money reflected in the Black Money Bill. These measures can be very significantly complemented by a GST, which, especially if it is extended to as many goods and services as possible (especially alcohol, real estate and precious

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An oft-cited study by the NCAER (2010) suggested that growth would increase by 0.9-1.7 per cent of GDP, purely based on the elimination of the cascading of taxes on exports. What is unclear is the quantitative importance of the elimination of the embedded taxes on exports under the GST relative to the current regime of zero-rating of exports. In other words, how incomplete is the current zero-rating of exports and how much will the GST improve upon it are questions that need further investigation.

Whether cascading is a serious problem and why is discussed by Keen (2013).

metals), can be a less intrusive, more self-policing, and hence more effective way of reducing corruption and rent-seeking.

2.3 Under the GST, this can happen in two ways. The first relates to the self-policing incentive inherent to a valued added tax. To claim input tax credit, each dealer has an incentive to request documentation from the dealer behind him in the value-added/tax chain. Provided, the chain is not broken through wide ranging exemptions, especially on intermediate goods, this self-policing feature can work very powerfully in the GST.

2.4 According to Pomeranz (2013), "The Value Added Tax (VAT) is a stark example of a tax believed to facilitate enforcement through a built-in incentive structure that generates a third-party reported paper trail on transactions between firms, which makes it harder to hide the transaction from the government (e.g. Tait, 1972; Burgess and Stern, 1993; Agha and Haughton, 1996; Kopczuk and Slemrod, 2006). This belief has contributed to one of the most significant developments in tax policy of recent decades (Keen and Lockwood, 2010): a striking increase in VAT adoption from 47 countries in 1990 to over 140 today (Bird and Gendron, 2007)."

2.5 The best evidence of the impact of the paper trail on evasion comes from an experiment in Chile which shows that firms that are part of the VAT chain are less responsive (in terms of evasion) to announcements of an increase in audit, suggesting that being part of the VAT itself performs the self-auditing function (Pomeranz, 2013). Moreover, the study finds that increasing the audit probability of firms suspected of evasion generates spillovers up the VAT paper trail that lead to an increase of their suppliers' tax payments. In a sense, the supplier, because of the paper trail left by the VAT, knows that his evasion will be more likely to be detected once his client is audited.

2.6 Second, the GST will in effect have a dual monitoring structure—one by the States and one by the Centre. Hence, there will be a greater probability that evasion will be detected. Even if one set of tax authorities overlooks and/or fails to detect evasion, there is the possibility that the other overseeing authority may not.

Make in India by Making one India

2.7 The current tax structure unmakes India, by fragmenting Indian markets along state lines. This has the collateral consequence of also undermining Make in India, by favouring imports and disfavouring domestic production. The GST would rectify it not by increasing protection but by eliminating the negative protection favouring imports and disfavouring domestic manufacturing.

2.8 These distortions are caused by three features of the current system: the central sales tax (CST) on inter-state sales of goods; other numerous inter-state taxes that will be replaced by the (one) GST; and the extensive nature of countervailing duty (CVD) exemptions.

CST[3]

2.9 The 2 per cent CST on inter-state sales of goods leads to inefficiencies in supply chain of goods. Goods produced locally within the jurisdiction of consumption attract lower tax than those produced

[3] The proposed Constitutional Amendment bill provides for a 1 percent duty on inter-state sales for a limited period. We strongly recommend that this provision be deleted for the very reason that the CST militates against Make in India.

outside. This tax encourages geographic fragmentation of production. The tax can be avoided partially through branch/stock transfers by manufacturers. However, the tax savings from branch transfers get substantially offset by the incremental costs of logistics and warehousing of goods in multiple locations.

2.10 Consider a simple example, where intermediate goods produced in Maharashtra go to Andhra Pradesh for production of a final good which in turn is sold in Tamil Nadu. Effectively, the goods will face an additional tax of 4 per cent, which will reduce the competitiveness of the goods produced in Andhra Pradesh compared with goods that can be imported directly to say Chennai from South and East Asian sources.

2.11 How quantitatively significant is the impact of the CST? We have some suggestive evidence based on data provided by six States: Maharashtra, Andhra Pradesh, Karnataka, Gujarat, Tamil Nadu and Kerala. In these States, stock transfers, on average, account for as much of inter-state trade as the trade subject to the CST (in the case of Gujarat and Andhra Pradesh, stock transfers are more than twice as much) (Table 2). In other words, the distortion affects fifty per cent of the total trade that flows between States.

Table 2: Impact of the Central Sales Tax (In Rs. Crore)

	Maharashtra	Tamil Nadu	Kerala	Karnataka	Andhra Pradesh	Gujarat	Total
Taxable turnover	316598	214771	293151	186045	60669	304479	1375713
Non-taxable turnover	241319	142321	44683	98300	160910	651620	1339154
(stock transfer +							
consignment sales)							
Ratio of non-taxable to taxable turnover	76%	66%	15%	53%	265%	214%	97%

Source- Respective States Government's Revenue Division.

Eliminating other inter-state taxes

2.12 Currently, there are a number of inter-state taxes that are levied by the States in addition to the CST. These include: entry tax not in lieu of octroi and entry tax in lieu of octroi.

2.13 Under the GST, all these taxes would be folded into the GST with enormous benefits. What are the benefits?

2.14 There is ample evidence to suggest that logistical costs within India are high. One study suggests that, for example, in one day, trucks in India drive just one-third of the distance of trucks in the US (280 kms vs 800 kms). This raises direct costs (wages to drivers, passed on to firms), indirect costs (firms keeping larger inventory), and location choices (locating closer to suppliers/customers instead of lowest-cost location in terms of wages, rent, etc.). Further, only about 40 per cent of the total travel time is spent driving, check points and other official stoppages take up almost one-quarter of total travel time. Eliminating check point delays could keep trucks moving almost 6 hours more per day, equivalent to additional 164 kms per day -pulling India above global average and to the level of Brazil. So, logistics costs (broadly defined, and including firms' estimates of lost sales) are higher than the wage bill or the cost of power, and 3-4 times the international benchmarks.[4]

2.15 Another study shows that inter-state trade costs exceed intra-state trade costs by a factor of 7-16, thus pointing to clear existence of border barriers to inter-state movement of goods. Further, inter-state trade costs in India exceed inter-state costs in the US by a factor of 6, suggesting that India's border effects are large by international comparison. Bringing India's inter-state trade costs down to the US level (reducing by a factor of 6) increases welfare by 15 per cent; conversely, completely eliminating intra-state trade frictions raises welfare by 5 per cent.[5]

2.16 All of these barriers to inter-state trade become even more important in India because the share of roads in freight traffic is high (about 72 per cent) and much higher than in comparable countries and rising over time because of under-investment in the Railways (Economic Survey, 2015, pp.92-94). The implication is that it is especially important for India to reduce costs to inter-state trade because of the excessive reliance on roads for movement of goods.

2.17 Now, all of these costs are not due to taxes. But, the World Bank estimates that about 20-30 per cent are (World Bank).[6] It is these costs that can be expected to decline with the introduction of the GST, providing a boost to inter-state trade and hence productivity growth within India.[7]

CVD and SAD Exemptions

2.18 It is insufficiently appreciated that India's border tax arrangements undermine Indian manufacturing and the "Make in India" initiative. Eliminating exemptions in the countervailing duties (CVD) and special additional duties (SAD) levied on imports will address this problem. How so?

2.19 It is a well-accepted proposition in tax theory that achieving neutrality of incentives between domestic production and imports requires that all domestic indirect taxes also be levied on imports. So, if a country levies a sales tax, VAT, or excise or GST on domestic sales/production, it should also be levied on imports. In India, this is achieved through the CVD/SAD which is levied on imports to offset the impact of the excise duty levied on domestically manufactured goods.

2.20 However, CVD/SAD exemptions act perversely to favour foreign production over domestically produced goods; that is, they provide *negative protection* for Indian manufacturing. Table-3 illustrates the impact of CVD/SAD and excise exemptions. When there are no CVD/SAD and excise exemptions (Scenario 1), neutrality of incentives between domestic goods and imports is achieved which is desirable. In scenario 2, there is no excise exemption but there is a CVD/SAD exemption which results in a large penalty on domestic producers (of 12.36 per cent under certain assumptions about costs). But the important and subtle point relates to scenario 3 when the excise and CVD/SAD are both exempted.

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[4] JPS Associates (2011), "Economic Cost of Inter-State Barriers in Goods Traffic,"

[5] Leemput (2014), "A Passage to India: Quantifying Internal and External Barriers to Trade."

[6] World Bank (2014), "Supply Chain Delays and Uncertainty in India: The hidden constraint on manufacturing growth." Report No: ACS14223, Republic of India Manufacturing Plan Implementation.

[7] There will also be gains stemming from simplification of the documentation requirements under the GST.

This may seem apparently neutral between domestic production and imports but it is not. The imported good enters the marketwithout the CVD/SAD imposed on it; and, because it is zero-rated in the source country, is not burdened by any embedded input taxes on it. The corresponding domestic good does not face the excise duty, but since it has been exempted, the input tax credit cannot be claimed. The domestic good is thus less competitive vis-a-vis the foreign good because it bears input taxes which the foreign good does not. In the example, the penalty on domestic producers is over 6 per cent. In effect, a policy designed to promote domestic manufacturing through excise exemption creates a perverse incentive for the exempt industry and its eventual decline.

2.21 The CVD/SAD, which is levied to offset the excise duty imposed on domestic producers, is not applied on a whole range of imports. These exemptions can be quantified. The effective rate of excise on domestically-produced non-oil goods is about 9 per cent. The effective collection rate of CVDs should theoretically be the same but is in actual fact only about 6 per cent. The difference not only represents the fiscal cost to the government of Rs 40,000 crore, it also represents the negative protection in favour of foreign produced goods over domestically produced goods.

2.22 Two defenses of CVD exemptions are typically made. First, that CVD exemptions on inputs help manufacturers by reducing their input costs. But under the current system and in future when the GST is implemented, the CVD on inputs can always be reclaimed as an input tax credit. So, CVD exemptions do not provide additional relief. In fact, they help collection efficiency because they are levied at customs. 8

2.23 The second rationale advanced for exempting many imported goods from CVD is that there is no competing domestic production. This argument is faulty because the absence of competing domestic production may itself be the result of not having the neutrality of incentives that the CVD creates. Domestic producers may have chosen not to enter because the playing field is not level.

The CVD exemption strips the tax from its effective way of taxing the informal sector - where imported inputs are used directly or indirectly by the sector.

Table 3: Effect of Countervailing Duty (CVD) Exemptions: An Illustration

	Scenario 1 No excise exemption for: domestically produced good, no CVD exemption for imported good		*Scenario 2 No excise exemption for: domestically produced good, CVD exemption for imported good*		*Scenario 3 No excise exemption for: domestically produced good, CVD exemption for imported good*	
	Domestic good	***Imported good***	***Domestic good***	***Imported good***	***Domestic good***	***Imported good***
Cost of raw materials	100	100	100	100	100	100
Input tax 1/	12.36	NA	12.36	NA	12.36	NA
Total cost of raw materials 2/	100	100	100	100	112.36	100
Value added	100	100	100	100	100	100
CVD (@12.36 per cent) 3/	NA	24.72	NA	0	NA	0
Excise duty (@12.36 per cent)	24.72	NA	24.72	NA	0	NA
Total cost	224.72	224.72	224.72	200	212.36	200
Protection for domestic good	**0.0%**		**-12.36%**		**-6.16%**	

1. Excise tax rate = 12.36 per cent. Input tax does not apply for imported good because it is zero rated in the exporting country

2. In scenarios 1 and 2, total cost of raw materials for domestic good is unaffected by input tax because there is no excise exemption and hence credit is available for the tax. Customs duty is assumed to be 0 per cent

3. CVD applied on total base of 200; 12.36 % of200 = 24.72

Source: Committee's calculations

2.24 Indian tax policy is therefore effectively penalising domestic manufacturing. How can this anomaly be remedied? Simply by enacting an exemptions-free GST. In one stroke the penalties on domestic manufacturing would be eliminated because the GST (central and state) would automatically be levied on imports to ensure neutrality of incentives. In effect, India would be promoting domestic manufacturing without becoming protectionist and without violating any of its international trade obligations under the World Trade Organization (WTO) or under India's free trade agreements (FTAs).

2.25 In the meantime, the effect of the GST can be partially simulated even now by eliminating the exemptions applied to CVD/SAD. The default situation should be an exemptions-free regime. If particular sectors seek relief from the CVD/SAD, they should be required to make their case at the appropriate forums.

2.26 In a sense, India finds itself in a de facto state of negative protection on the one hand, and calls for higher tariffs on the other. It is win-win to resist these calls that would burnish India's openness credentials and instead eliminate the unnecessary and costly penalty on domestic producers.

2.27 All these three sets of costs—the CST, the CVD exemptions, and other inter-state taxes— should be viewed as undermining Make in India because in all cases, they favour foreign production to domestic production. GST can then be thought of as a trade and productivity shock and one that can be harnessed without recourse to protectionism: in effect, the GST will be eliminating negative protectionism.

2.28 This increase in inter-state trade will then have another powerful consequence. A common market will help attain convergence within India because production can be based on comparative advantage. In other words, implementing the GST will help the lagging regions catch up with the more advanced regions by making the former more profitable production destinations.

The growth effect via the boost to investment

2.29 Under the current tax system, while the Union excise duties and State VAT applies to all capital goods, input tax credits are generally limited to manufacturing plant and equipment. For example, no input tax credits are allowed for the Union excise duties on capital equipment acquired for use in transportation, infrastructure, distribution, or construction sectors because these sectors are all outside the scope of excise duties which are applicable to manufacturing only. Similarly, no credit is allowed for the State VAT on capital goods acquired by the service sector (e.g., telecommunications, transportation, finance, insurance, and IT services).

2.30 Estimates vary on how much of current investment in a given year suffers from non-creditable excise duties and/or VAT. For example, indirect tax collection data for 2014-15 indicate that the total amount of capital goods purchases for which CENVAT credit was claimed was Rs. 1.6 lakh crore, divided between goods (Rs. 1 lakh crore) and services (Rs. 0.6 lakh crore). National income accounts data suggests that investment in plant and equipment for the same year by the non-government, non-household sector was about Rs. 7.4 lakh crore. Apparently, the blocked input taxes could amount to as much as 75 per cent of total investment. What could account for the difference and could the GST fill this gap?

2.31 If the GST could provide for a more seamless and efficient crediting of taxes paid on capital goods, then capital goods prices would become effectively 12-14 per cent cheaper (because they are taxed at the standard rate of 12.5 per cent currently by the Centre), increasing the demand for capital goods, raising investment and hence growth.

2.32 Assuming an elasticity of investment demand with respect to price to be -0.5, GST, by allowing full input tax credit for capital goods, could higher investment in capital goods by 6 per cent, resulting in 2 per cent higher investment (as machinery and equipment account for around one-third of total investment), which in turn could lead to incremental GDP of 0.5 per cent, assuming an incremental capital output ratio of 4.

2.33 Prior to the introduction of GST in 1991, Canada also had an excise duty regime similar to that in India. Studies for Canada estimated this beneficial impact of GST to be 0.5 per cent as a result of the GST at the federal level only. The extent of tax cascading in India is much greater because of more stringent rules in India for claiming tax credits.

2.34 In sum, investment is discouraged under the current system through the application of excise duties and VAT to capital goods, for which no set off or input tax credit is provided. This increases the cost of capital goods and reduces investment, which in turn leads to lower employment and output.

III. CURRENT STRUCTURE OF INDIRECT TAXES: HIGHLIGHTS

3.1 This section describes briefly the structure of current rates of domestic indirect taxes at the Centre and the States. The key takeaways are that the current tax structure is highly complex, highly leaky (riddled with exemptions in goods that we estimate to be about 2.7 per cent of GDP for the Centre and States together) characterized by significant differences between the Centre and the States, and by a rate structure that does not confirm to what the evidence suggests might be good policy. The GST, therefore, affords a unique opportunity to simplify and rationalize the structure and also eliminate serious anomalies to make it consistent with policy objectives (see paragraphs 5.56 to 5.60 and Box 3).

3.2 The details, also summarized in the Table 4, are the following

Centre

3.3 In relation to goods, the Centre has a very complicated tax structure (Table-4), more complex than that of most of the States, characterized by:

- a multiplicity of rates, including central excise (the most important), cesses, countervailing and special additional duties;
- a multiplicity of central excise rates-8 ad valorem and several specific rates;
- extensive exemptions, amounting to about 300 items compared to say 90 for most of the States. These exemptions amount to about 1.8 lakh crore, amounting to about 1.5 per cent of GDP;
- an incomplete base that stops at the manufacturing stage; and
- ➢ an exemptions threshold of 1.5 crore with exports and exempted goods not counting towards the threshold

3.4 In relation to services too, the Centre has a complicated rate structure. Although there is one statutory rate, in practice, there are 10 other rates because of so-called "abatement" which amounts to fixing a rate different from the standard rate and not allowing further input tax credits. Abatement is necessitated in some part because of uncertainty in the base, and specifically being unable to distinguish "goods" from "services." The exemptions threshold is Rs. 10 lakh.

3.5 At the Centre, there is incomplete provision of input tax crediting for goods, and incomplete cross-crediting between goods and services.

States

3.6 In relation to goods, the States have structures characterized by:

- a base that is complete in extending all the way to the retail stage
- an exemptions threshold that varies across States between 5 and 10 lakh with a provision for "compounding" that also varies across States in design[9]

Compounding refers to the exemption of firms from the VAT chain; instead they are charged a small turnover tax without allowing for any input tax credits

- a multiplicity of rates, including the VAT but additional taxes on inter-state trade (octroi, entry tax)
- fewer VAT rates (4 plus) and fewer exemptions (than at the Centre), with both rates and exemptions varying across States. On exemptions, there is both a set that is broadly common to all States and some state-specific ones like agriculture equipment, aquatic feed, cereals and pulses are mostly common across the States whereas Agate (Akik) stones and articles are state specific.
- a standard VAT rate for goods that in most of the States is typically about 12.5-15 per cent (compared with the standard rate of 12 per cent at the Centre)

Table 4: Summary of India's Indirect Tax System

Type	*Base*	*Number of Rates 1/*	*Rates (%) 2/*		*Base (%)*		*Collections (%)*		*Average rate (%)*		*Description of Commodities xx/*			*Threshold 3/*	*Exemptions*	
			Standard	*Lower*	*Standard*	*Lower*	*Standard*	*Lower*	*Base-weighted*	*Collections-weighted*	*Exempted*	*Lower rate*	*Higher rate*		*Number 4/*	*value*
Goods 5/																
Centre (Excise)	manufacturing	8	12.0	6.0	59.2	39.6	84.9	11.1	8.4	11.7	Food	Textiles, mobile phones; fertilizers; some intermediates	Tobacco, petroleum products, automobiles, aerated water	1.5 crores	300	1.8 lakh crore (a)
States (VAT)	up to retail	3+	12.5-14.5	4-5.5	28.5	67	32.8	54.8	7.5	9.6	Food, goods of local importance	Intermediates; capital goods; gold & precious metals	Alcohol, petroleum, tobacco	5-10 lakhs	90	1.5 lakh crore(b)
Services																
Centre	negative list	11	12.4	4.1	65.2	34.8	86.2	13.8	9.4	11.2	Education, health, public services	construction, work contract, restaurant, transport, life insurance		10 lakhs		
States 7/		None	None													

1/ Number of ad valorem rates. There are also numerous specific rates on goods charged by the centre. For services, there is one standard rate and 10 abatements.
2/ At the centre, there are 2 lower rates which are akin to a turnover tax; the states levy a lower rate of 1 percent on gold; the center levies higher rates on luxury xars and aerated drinks
3/ Does not apply to exports and exempted goods for goods at the centre
4/ Approximate; precise amounts vary by state. Exemption lists are not identical across states.
5/ Other excises on goods include cesses, countervailing duties and special additional duties (at the Centre) and octroi (in the States).
6/ Incomplete provision of input tax crediting for goods, incomplete cross-crediting between goods and services.
7/ Authority to tax services rests with the Centre but states tax services de facto, e.g. restaurants.
xx/ negative list of services includes health care services, veterinary clinic, charitable activities (under section 12AA of the Income tax Act, 1961) and others.
(a) From tax expenditure statement.
(b) Estimated by the committee
(*)=based only on Gujarat data

Source: Compiled by Committee.

Centre and States

3.7 Another key difference between the Centre and the States, with implications for any future standard rate is that the States have a much larger portion of the base (more than 65 per cent) [10] taxed at the lower rate while the comparable number for the Centre is about 40 per cent. One reason is that States typically place intermediate goods in the lower rate category. The higher standard rate is therefore almost compelled by the fact of placing so much of the base at the lower rate.

3.8 One corollary is that the weighted average statutory rate for goods is 8.4 per cent and 7.5 per cent for the Centre and States, respectively.

IV.ESTIMATING INDIA'S REVENUE NEUTRAL RATE (RNR) UNDER THE GST

4.1 The Committee had the benefit of 3 technical approaches to estimating the RNR which are described in detail in Annexes 1-3. These will constitute the basis for the Committee's recommendations on the RNR.[11] These are briefly summarised in this section.

4.2 Before describing the recommendations, it is important to make a point relating to terminology. Throughout this report, the term RNR will refer to that single rate, which preserves revenue at desired (current) levels. In practice, there will be a structure of rates, but for the sake of analytical clarity and precision but also to facilitate comparisons across methodologies, it is more useful and appropriate to think of the RNR as a single rate. It is a given single rate that gets converted into a whole rate structure, depending on policy choices about exemptions, what commodities to charge at a lower rate (if at all), and what to charge at a very high rate. That single rate will be the focal point for the RNR. The RNR should be distinguished from the "standard" rate defined as that rate in a GST regime (which has more than one rate), which is applied to all goods and services whose taxation is not explicitly specified. Typically, the majority of the base will be taxed at the standard rate, although this is not true for the States under the current regime.

4.3 The essence of calculating the RNR is highlighted in the simple equation:

$$t=R/B$$

where t is the RNR, R is equal to revenues (both Centre and state) generated from existing sales and excise taxes, which will be replaced by the GST. The revenues to be replaced are estimated to be Rs. 3.28 lakh crore for the Centre, and Rs. 3.69 lakh crore for the States, including the revenues that will have to be compensated for the elimination of the Central Sales Tax (CST). The total amounts to Rs. 6.97 lakh crore (excluding revenues from petroleum and tobacco for the Centre, and from petroleum and alcohol for the States) or 6.1 per cent of GDP, with all numbers pertaining to 2013-14 (the date chosen for all the technical studies) and for 29 States and 2 UTs.

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[1] Based on data for Karnataka, Maharashtra, Andhra Pradesh, Gujarat, Tamil Nadu, Bihar, Odisha, Chhattisgarh, Delhi, Uttar Pradesh, Jharkhand, Rajasthan, Madhya Pradesh, West Bengal, Harayana and Puducherry accounting for 78.5 per cent of the VAT base.

There have been other attempts at estimating the RNR, including by the Thirteenth Finance Commission and NIPFP, We restrict the scope of our technical inputs to the three studies described in this section as they are the most recent by way of data and methodology; they are also the three that were discussed within the Committee.

What all the RNR exercises attempt to do is to calculate B, the total tax base for generating the required GST revenues. The three approaches presented to the Committee can be called, respectively, the macro, the indirect tax turnover (ITT), and the direct tax turnover (DTT) based approaches.

Macro approach

4.4 The macro approach—presented by the staff of the International Monetary Fund—makes use of national income accounts data and supply-use tables to arrive at the base B. It uses the following formula:

$$B = \Sigma + (Y + M - X) - | \quad (1 - e) \ \Sigma \ (N + 1 \ | \ ]$$

Where B is the potential GST base; Y is domestic output, (M-X) is net imports (imports minus exports); (N+I) is consumption of intermediate and capital inputs; e is the exempt output ratio (i.e. the tax base associated with inputs used in the production of exempt final consumption); and the summation is over 140 goods and services and 66 sectors, based on the 2011-12 national accounts. The following assumptions were made: (1) full compliance; (2) full pass-through of the GST into prices; (3) no behavioral response; (4) the GST has a single positive rate, and a zero rate on exports.

4.5 Under a standard scenario exempting health, education, financial intermediation and public administration, the GST's potential base is 59 per cent of GDP. Exempting basic food items in addition (essentially unprocessed foods) reduced the potential base to 55 per cent of GDP. However, exempting petroleum or electricity increases the potential base to 67 per cent of GDP—given that such items are largely consumed as inputs rather than final consumption, their exemption increases the base due to cascading. Assuming that the maximum revenue to be replaced is 6.1 per cent of GDP, these estimates for the GST tax base, ranging from 55 per cent to 67 per cent of GDP, suggest that the GST RNR rate, itself ranges between 9.1 (0.061/0.67) and 11.1 per cent (0.061/.55).

4.6 Losses in the order of 10 to 20 per cent of potential revenues are common in OECD countries; assuming 20 per cent increases the range of the RNR from 9-11 per cent to 11-14 per cent.

4.7 In summary, this analysis suggests that the GST RNR rate ranges between 11 to 14 per cent, depending on key policy choices regarding exemptions. The scenario that corresponds closest to the proposed Constitutional Amendment bill yields an RNR of 11.6 percent after factoring in a compliance rate of about 80 per cent of potential GST revenues.

Indirect Tax Turnover Approach

4.8 This approach, presented by the National Institute of Public Finance and Policy, estimates the base in a three step process. First, it estimates the goods base at the level of the States. This base is estimated by converting data on actual collections and statutory rates into a goods base. In other words, the effective rate becomes the basis for the estimation of the goods base. In the absence of data for all the States, the key assumption is that States collect revenues at the three rates (1 per cent, 6 per cent, and 14 per cent) in such a proportion so as to yield a total taxable base of Rs. 30.8 lakh crore.

4.9 In the second stage, the services base is estimated based on turnover data of 3.25 lakh firms from the newly available MCA database (this base is estimated at Rs. 40.8 lakh crore).

4.10 In a third stage, adjustments are made to this base to remove IT-related services, because a large part of them are exported, and to remove most of real estate and financial services from the base because of the manner in which these items will be treated under the GST. This adjusted base is then subject to an input-output analysis to deduct from the base taxable inputs used for service provision and also deduct services used as inputs into taxable manufacturing. All these adjustments result in an incremental services base (incremental to whatever has already been incorporated in goods) of Rs. 8.5 lakh crore and a combined base (goods and services) of Rs. 39.4 lakh crore.

4.11 This base, in turn yields a single RNR of 17.69 per cent under the scenario of having to compensate the States for the 2 per cent CST. The corresponding standard rate under current structures of taxation is estimated at 22.76 per cent. It is worth recalling that an earlier analysis based on the same methodology by NIPFP was presented to the Empowered Committee of the GST in February 2014. That analysis yielded an estimate of the RNR of 18.86 percent and a standard rate of 25 per cent.[12]

Direct tax turnover Approach

4.12 A third approach—which was described in the Thirteenth Finance Commission--is based on using income tax data which are available for about 94.3 lakh registered entities (including companies, partnerships, and proprietorships but not charitable organizations). The data are classified into 10 sectors and 75 sub-sectors. These data allow the potential base for the GST to be calculated. Unlike the indirect tax turnover approach but like the macro approach, this approach yields a combined base for goods and services, rather than separate bases for goods and services.

4.13 The profit and loss accounts provide data on value of supply of goods and services (which is equivalent to turnover) to which can be added imports of goods and services. Thisyields the tax base of at about Rs. 222 lakh crore in turnover terms. Deducting the exempt sectors from this base (petroleum, land component of real estate, the interest component of the financial sector, electricity, gem and jewellery, education, health, and agricultural produce) narrows the output tax base down to about Rs. 194 lakh crore.

4.14 Next, purchases are divided into 2 categories, those that reduce the base because of the availability of input tax credits and those that add to the base either because they are purchases by or from exempt sectors.[13] The former include intermediate goods and services (Rs. 183 lakh crore) and capital goods (Rs. 6 lakh crore). The latter include purchases by exempt sectors (Rs. 25 lakh crore), purchases of primary goods (Rs. 11 lakh crore) and purchases from unregistered dealers Rs. 24 lakh crore). This yields an input tax base of Rs. 130 lakh crore.

4.15 Further adjustments are made to take account of the value added of firms that will fall below the exemptions threshold (removed from the taxable base); of the alcohol sector (removed from the taxable base); and the rail sector (added to the base because this sector is not part of the data set in the first place).

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[12] "Revenue implications of GST and estimation of revenue neutral rate: Estimates for 2011-12" submitted to the Empowered Committee of State Finance Ministers in February 2014.

The export sector is exempt with full refund (i.e. zero-rated).

4.16 Putting all these together gives a potential tax base of Rs. 58.2 lakh crore, yielding a combined RNR of 11.98 per cent.

4.17 Table 5 highlights the estimated GST base and corresponding RNR of the three approaches to estimating RNR.

Table 5: Summary of approaches to estimating RNR

Approach	GST Base (in lakh crore)	RNR (per cent)
Macro	59.9	11.6
ITT	39.4	17.7
DTT	58.2	12.0
ITT= Indirect Tax Turnover DTT=Direct Tax Turnover		

Source: Based on three approaches to estimating RNR

V. RECOMMENDATIONS

5.1 Consistent with the Committee's terms of reference, we make recommendations on a number of issues: the RNR; the distribution of RNR between the Centre and States; the structure of rates; and the potential price impact of the GST. In addition, we make recommendations on other relevant issues: the bands for the GST; compensation, the treatment of precious metals, and the tax treatment of certain commodities such as alcohol, electricity, education, and health.

The Magnitude of the RNR

5.2 Three different approaches have been presented to determine the RNR. Each has it merits and drawbacks because of the underlying assumptions made and the data used. Coming up with an RNR is as much soft judgement as hard science. We cannot be confident that any one number is the right one. Moreover, there is a certain endogeneity effect—like a Heisenberg Uncertainty Principle—that the very choice of rates could affect the outcome relating to revenues, compliance, convenience, etc.

5.3 We will make our recommendations in two steps. First, we will critically evaluate each of the three approaches both in terms of the methodology and in terms of the results they generate for the RNR. We then present the Committee's recommendations for the RNR and validate these results against independent benchmarks. These recommendations will be supported by a complementary discussion on the risks associated with our estimates for the RNR.

5.4 Our recommendation for the RNR will not be unduly guided by short-term considerations, for example, relating to compensation. The RNR should be one that achieves the objectives of the government over a horizon that is not short term. If compensation is necessary, it should be found/funded from government resources elsewhere and the GST should not have to bear the long-term burden of having to meet short-term exigencies.

5.5 The estimates presented for the national RNR, range from about 11.6 per cent under the Macro approach to 17.7 per cent under the ITT approach. Where does the truth lie?

Critical assessment of the methodology of the three approaches

5.6 Each approach has advantages and shortcomings that are described below. The Empowered Committee of the GST has had the benefit of familiarity only with the ITT approach of the NIPFP and we will dwell to some extent on this analysis. The Committee would underscore that the focus on the ITT approach does not signify that it is superior to the other two; indeed, focusing on one approach can be limiting and misleading.

5.7 Five key features drive the results of the ITT approach:

(i) The assumptions of collections at the different rates determine the goods base for the States. We have obtained the actual data on such collections for16 States (Karnataka, Maharashtra, Andhra Pradesh, Gujarat, Tamil Nadu, Bihar, Odisha, Chhattisgarh, Delhi, Uttar Pradesh, Jharkhand, Rajasthan, Madhya Pradesh, West Bengal, Haryana and Puducherry) that together account for about 78.5 per cent of all States' VAT base. These data vary significantly from the assumptions underlying the ITT approach. Specifically, our data suggest that the aggregate base is distributed between the three different rates—1 per cent, 2-6 per cent, 12-15 per cent and higher rate--in the ratio of 11.6 per cent, 55.4 per cent, 28.5 per cent and 4.7 per cent. In contrast, the ITT assumed—without analyzing actual data—tax base proportions of 2 per cent, 56.15 per cent, and 41.85 per cent at the 1 per cent, 5 per cent, and 14-15 per cent, respectively.

(ii) The estimation of the services base by the ITT approach does not make any allowance for purchases from the unorganized sector. Such purchases will lead to an increase in the base—via cascading--because the final value will reflect the embedded taxes which cannot be set off as input tax credit.

(iii) The estimation of the services base also ignores one potentially important issue. Currently, States tax most intermediate goods at the lower rate. If these goods were shifted to the normal rate—as States have indicated they might be willing to do—there would be an effective expansion of the tax base. It may be noted that taxes on intermediates in a GST system are like withholding—collecting early on in the value added chain but refunding them later on. So, in principle, this shift of intermediate goods should not yield any additional taxes. But to the extent that the unorganized sector buys intermediates from the organized sector, this shifting will result in greater taxes because the withheld taxes on intermediates will not be refunded later in the chain because the buyer is outside the tax chain. The lost base from these two effects—cascading and withholding—is difficult to estimate. But we cannot assume, as the ITT approach does, that this estimate should be zero. Corporate income tax data allows a guesstimate of the cascading effect.

(iv) A similar withholding type effect would come into play with the elimination of all CVD exemptions which the ITT approach does not fully take into account.[14]

The ITT approach also does not include in the base that component of imports of goods and services that is sold directly to consumers outside the dealer network. The Committee has not been able to quantify this omission.

(v) The ITT approach also does not fully incorporate into the base, sugar products and textiles[15] that are sold directly to the consumer.[16]

5.8 The DTT approach on the other hand is subject to two uncertainties: whether the output tax base has sufficiently taken account of exempted sectors, and whether the estimates of purchases from the unorganized sector—a key input that drives the final result—are reasonable.

5.9 The macroeconomic approach of the IMF suffers from being too aggregate in nature and the implied tax base of Rs. 59.9 lakh crore seems to be on the high side. One particular source of worry is that the tax base seems to increase substantially account of the exclusion of electricity and petroleum. This seems unlikely given that in both cases, there is some considerable sales to the final consumer.

5.10 But these two approaches have two important merits. They help provide a cross-check for the ITT approach; perhaps more significantly, they highlight the need to validate the estimates generated by all three approaches. We turn to this validation in the next section.

5.11 All three approaches implicitly assume that there will be no benefits to the base and/or revenues from improving compliance and or improved growth consequent upon implementing the GST. But the macro approach does not assume current levels of compliance—as the other two approaches do—but a theoretical one which may or may not correspond to current reality.

Recommendations and validation

5.12 Our recommendation is based first on making adjustments to the ITT approach:[17] Rs. 3.12 lakh crore for the data-based revision to the States' VAT base; Rs. 30,000 crore for the omission of sugar; Rs. 45,000 crore for the cascading effect; and Rs. 95,000 crore for the choice of the statutory rather than effective excise rate in quantifying the base. Then, we add an adjustment for compliance efficiency gains (Rs. 2 lakh crore).

5.13 What is the basis for these adjustments?

5.14 Note that the ITT approach was based on a pure assumption about the States' VAT base which we have improved upon by collecting the relevant data for 16 States, accounting 78.5 per cent of the entire VAT base of the states.

There has been some uncertainty whether the states tax textiles products, especially man-made fibres. But it appears that most—even a preponderance of—states do not. In that case, the tax base could be substantially under-estimated. Textiles going as inputs into clothing would not add to the base as clothing products are subject to tax. But textiles going into other textiles production or sold directly to the consumer would add to the potential future tax base. The uncertainty on textiles taxation stems from the fact that the Centre gave up most of its power to tax textiles (in the form of Additional Excise Duties) to the States. For example, in 2002-03, the Centre collected Rs. 4369 crore in AEDs (the nominal value of this was estimated at about Rs. 8800 crore in 2014-15), which has since shrunk to about Rs. 600-800 crores. It appears that the States did not take up the power ceded by the Centre, resulting in virtually no State-level taxation of textiles.

Another issue-- a technical one—is that the calculation of the base uses the statutory rate of excise of 12.36% rather than the effective rate of 9%.

[17] It is worth emphasizing that the ITT approach has itself undergone revision from a previous version. Some of the important revisions in the latest version were adding real estate in to GST base and removing additional base on account of unorganized sector, sugar and textile.

5.15 The adjustment for sugar is based on the national income estimate for value-added in the sugar sector of Rs. 40,000 crore. We conservatively adjust this down to Rs. 30,000 crore.

5.16 Note that the authors of the ITT approach acknowledge that the withholding, cascading and compliance effects are important. But they chose to ascribe a value of zero to these effects because of uncertainty about arriving at a quantitative estimate. But that is clearly biased downwards as the authors of the approach would themselves acknowledge. We have chosen to address this bias by making some conservative estimates about the magnitude of these effects.

5.17 For the cascading effect, the ITT approach had earlier estimated an addition to the base of 10% of the incremental services base. The DTT approach estimates an addition to the base of about 16%. We, conservatively, estimate that the under-statement of the base would be half that assumed by the ITT approach which amounts to 45,000 crore.

5.18 For the compliance effect we draw upon cross-country experience. In Box 1, econometric analysis of that experience yields an estimate that a 1 percentage point reduction in the standard rate would increase the collection efficiency by 1 percent. The GST would lead to about a 4.1 percentage point reduction in the standard rate (in weighted terms) which would translate into a 4.1 percentage point increase in the C-efficiency or 9.3% increase in collection efficiency (based on the current C-efficiency of 0.44). This is equivalent to an expansion in the tax base of Rs. 4.3 lakh crore. Again, we assumed, conservatively, and after consulting with the CBEC, that just under half of this compliance improvement (Rs. 2 lakh crore) would be realized.

5.19 To summarize, our adjustments to the ITT approach are conservative in the following ways:

- We do not make any adjustments for the ITT approach understating the contribution of textiles to the tax base which could be substantial. The magnitude of this omission is suggested by the fact that the gross value of output and gross value added of textiles and cotton ginning are 5.9 lakh crore and 1.7 lakh crore, respectively.
- We do not increase the tax base to take account of the withholding effect;
- We include only half of the NIPFP's previous estimates of the magnitude of the cascading effect; and
- We incorporate under half the change of the compliance-enhancing effect suggested by our econometric analysis;
- We incorporate nothing for the impact of the possible growth-enhancing effect of the GST

5.20 Under GST, the compliance gains would be the following:

- At the Centre, the rate structure will be significantly simplified from more than 10 rates (for both goods and services) and numerous exemptions to 2-3 rates and fewer exemptions;
- At the Centre and the States, significant improvements in compliance will result because of the IT systems under which matching of supplier and purchase invoices will be electronic and instantaneous, reducing the scope for fraud and evasion; this will also improve compliance for direct taxes;

- General compliance will improve because of dual monitoring by the Centre and the States; and
- The comprehensive definition of taxation of goods and services should result in a smaller amount of the base falling through the cracks between "goods" and "services" as happens currently. The elimination of abatements on services will reduce overstatement of input tax credits.

5.21 The experience of all countries suggests improvements over time in GST implementation, and in India's case, a number of design features should contribute to such improvements in efficiency. These are not improvements that will take years to materialize.

5.22 Adding up these adjustments yields a single RNR of 15 per cent. However, we recognize that there may be uncertainty about the adjustments we have made. An alternative scenario is that not all of the adjustments are valid. In this case, the single RNR would be 15.5 percent (Table 6).

Table 6: Committee's recommendations compared with other approaches to estimating RNR

Approach	GST Base (in lakh crore)	RNR (per cent)	C-Efficiency
Macro	59.9[18]	11.6	0.70
ITT	39.4	17.7	0.42
DTT	58.2	12.0	0.68
Committee's (Preferred)	46.2	15.0	0.56
Committee's (Alternative)	44.2	15.5	0.53
ITT= Indirect Tax Turnover	DTT=Direct Tax Turnover		

Source: Different approaches and committee's calculation

5.23 Our recommendation for the RNR is, therefore, a range for the RNR of 15-15.5%, with a strong preference for the lower end of that range.

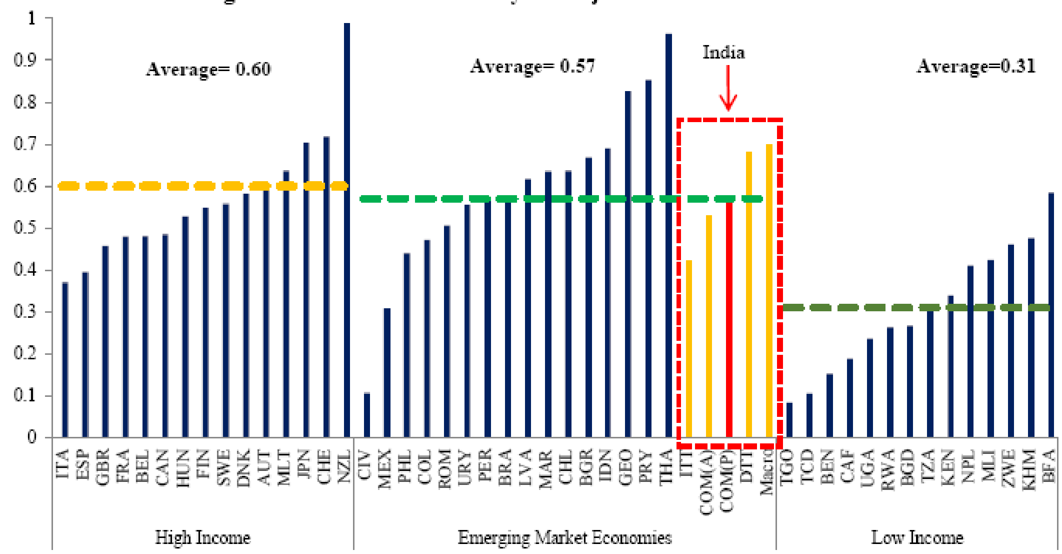
5.24 Next we validate this recommendation. Since there is the possibility of error in all the approaches, including our recommendation, we must independently validate them against other benchmarks. One important benchmark for validation relates to the efficiency of the tax system. A commonly-used measure of performance of a VAT system is to compute a C-efficiency ratio. This is measured as:

$$\text{C-eff}=R/(S*C)$$

where R stands for revenues collected, S is the standard rate and C is total final consumption (net of value-added taxes). The denominator is a measure of the potential revenues that can be potentially collected and the numerator actual collections. C-efficiency is simply a measure of comparing actual against potential. The C-efficiency implied by the three approaches and the Committee's recommendations are then compared against C-efficiency in a number of other countries and this comparison is shown in Figure 1.

This base calculation corresponds closest to the policy envisaged under the Constitutional Amendment Bill.

Figure 1: Collection-efficiency in Major VAT/GST Economies



Source-IMF and Committee's calculations

5.25 The average C-efficiency is about 0.6 for high income countries and 0.57 for emerging market countries, and 0.31 for low income countries. The C-efficiency implied by the macro and DDT estimates for the RNR (of 0.70 and 0.68 respectively) would place India above other emerging market countries. In contrast, the c-efficiency implied by the ITT approach of 0.40 would put India well below the average of emerging market countries and only somewhat above that for low-income countries.

5.26 Put differently, if the RNR, and the associated standard rate, of the ITT approach were reasonably estimated, it would imply that India has either come up with an effective policy base under the GST that is unusually narrow and/or Indian indirect tax administration is unusually poor relative to comparator countries. This inference would be puzzling, if not problematic, not least for implying that India's tax efficiency is closer to that of Mali than of Brazil, Chile, Indonesia or Thailand. This cross-country comparison is important evidence that the RNR estimated by the ITT approach is too high.

5.27 In contrast, the RNR estimates for the other two approaches would place India at levels comparable to other countries.[19] Our recommendations yield estimates for the RNR that are at or below the average of other EMEs. In that sense, they are conservative estimates for the RNR because they too imply similar levels of efficiency of the Indian tax system. [20]

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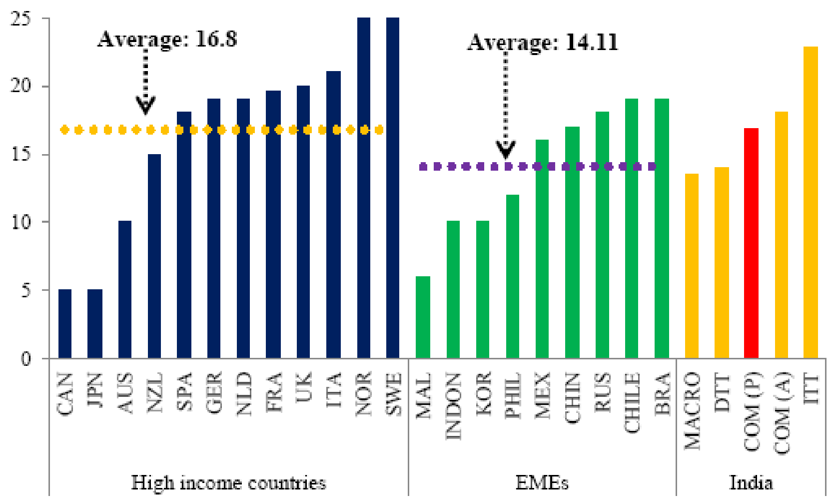
[19] It is worth noting that the exclusion of intermediates such as petroleum and power from the GST base tend to make India's C-efficiency better than it actually is. Excluding these inputs essentially lower the standard rate by more than it lowers the foregone revenues from taxing these inputs: the measured C-efficiency improves as a result.

[20] At the center, there are likely to be large revenue and base-enhancing effects which will increase C-efficiency. These include: a decrease in the magnitude of exemptions from 300 items to 90 items in line with the

5.28 Another consideration can be invoked to support the RNR of 15-15.5 per cent. Suppose this RNR requires to be operationalized in a two rate GST structure with a lower rate of say 12 per cent and a standard rate of 17-19 per cent, depending on how goods are allocated between the lower and standard rate.

5.29 Figure-2 shows data on the standard rate of VAT in selected high income and large emerging market economies. It shows that the average standard rate for comparable EMEs is per cent and the highest standard rate is 19 per cent; and even for the high-spending and therefore high-taxing advanced economies it is 16.8 per cent. An RNR of anything beyond 15 per cent will likely result in a standard rate of about 19-21 per cent which would make India an outlier amongst comparable emerging economies. For example, the ITT approach's RNR of 17.7 per cent would translate into a standard rate of 22.8 per cent, identifying India as having the highest GST tax rate amongst emerging market economies. Our recommendations would still place India at the upper end of the standard rates found across comparable countries. It is worth emphasizing that the GST is intrinsically a regressive tax and the higher the rate the greater the regressivity. Countries that have well developed social safety nets can better offset this regressivity but India at a lower level of development is less able to do so and hence needs to be especially mindful of rates that are out of line with international ones.

Figure 2: Standard rate of VAT in High and Emerging Market Economies



Source-IMF, Credit Suisse and Committee's own calculation

recommendations of the Empowered Committee. Currently about Rs. 1.8 lakh crore are lost in central excise exemptions of which a substantial proportion can be recovered; expansion of tax base from manufacturing to retail level; bringing precious metals, gold, etc. into the tax base and taxed at the lower rate; reduction in the exemptions threshold from Rs. 1.5 crore in the case of goods to Rs. 25 lakh; this will offset the raising of the exemptions threshold for services from the current level of Rs. 10 lakh. Offsetting some of these effects will be the fact that cascading could decline because of better administrative efficiency.

A risk analysis

5.30 Since we cannot be certain of the RNR—it is after all our best assessment or best guess— a risk assessment framework poses the question: should we err on the side of an RNR that is a little low or a little high?

5.31 One risk of setting an RNR that is low is the re-emergence of a trust deficit between the Centre and the States as happened in relation to compensation for lost CST revenues after the global financial crisis. If revenues fall short, and the fiscal position of the Centre and States is affected, the Centre will face a double whammy, with weak revenues for itself and an additional burden of having to compensate the States. And, if as a result, compensation is delayed or diluted, a trust deficit could re-emerge.

5.32 The second risk of setting a low RNR is that it could interact with slower growth and/or weaker buoyancy going forward to magnify the revenue shortfall.

5.33 On the other hand, some of these risks can be overcome. In the event of a revenue shortfall, the Centre and the States can both raise non-GST taxes (petroleum, tobacco and tobacco products, and alcohol); they can together raise GST rates; and, as a last resort, the Centre could even afford to relax its deficit target, based on the fact that was actually an investment for implementing unprecedentedly ambitious tax reform with enormous long-run gains; moreover, a moderately higher deficit due to a low GST will benefit consumers, especially poorer ones.

5.34 Second, given the unavoidable teething troubles that will afflict GST implementation, it seems inadvisable to further burden the initial stages of implementation with higher rates that will increase taxpayer displeasure, reduce compliance and increase disaffection. On balance, lower rates will facilitate compliance as our evidence in Box 1 shows. The econometric analysis suggests that a 1 percentage point reduction in the standard rate will lead to an improvement in administrative efficiency (and compliance) of 1 percentage point which in the GST setting would translate into an efficiency gain of about 15 percent.

5.35 Further, the improvement in compliance will not be restricted to indirect tax collections. The paper trail of the GST will also help direct tax administration and improve compliance in collections of corporate income taxes.

5.36 Third, the price consequences of a GST will be small, especially under a dual rate structure with essential food items exempted. As the analysis in Section V reveals, an RNR in the 15-15.5 per cent range with a lower rate of 12 per cent and a standard rate of 18 per cent would have no aggregate inflation impact. But a higher RNR with a lower rate of 12 per cent and a standard rate of 22 per cent would increase inflation by between 0.3-0.7 percent. Care will have to be taken to ensure that the GST does not become the target of popular disaffection on the grounds that it fed higher inflation. In that respect a lower RNR is safer than a higher one, especially considering that the GST is inherently regressive relative to direct income taxes.

5.37 Fourth, there is also a perception issue. Today's GST rate is 14.36 per cent for services (now nearly 15 per cent with the Swacch Bharat cess). If the RNR is greater than 15-15.5 per cent, the rate for services will be in the 20-22 percent range which will make the GST seem like a substantial tax increase when it strictly speaking is not and should not (after all, the new rate should be revenue neutral). Optically, the GST as a rate hike should be avoided to the greatest extent possible. A lower rate will be seen as more politically acceptable and will help taxpayer compliance.

5.38 Fifth, even if the proposed RNR is on the side of being a little low, all the evidence suggests that over time, compliance will improve, so that the GST will become a buoyant source of revenue. This could happen even in the short run as discussed earlier. A marginally lower rate, if it turns out to be that way, will signal the government's confidence in the GST as a medium term tax reform. This would re-inforce the signal that the government has already sent—in a sense under-writing the GST—by committing to compensation for five years (despite the fact that when the state VATs were implemented, compensation was not required beyond the second year.)

Allocation of RNR between Centre and States

5.39 The Committee's recommendations on rates are all national rates, comprising the sum of central and state GST rates. How these combined rates are allocated between the center and states will be determined by the GST Council. This allocation must reflect the revenue requirements of the Centre and states so that revenues are protected. For example, a standard rate of 17% would lead to rates at the Centre and states of say 8 percent and 9 percent, respectively because that is roughly the ratio of GST revenues that would have to be generated by the centre and states assuming that the 2013-14 data on which these estimates are calculated remain valid.

It would be preferable to keep all other rates identical between the center and states to minimize distortions and facilitate compliance.

The structure of rates

Exemptions

5.40 Given the historic opportunity afforded by the GST, the aim should be to clean up an Indian tax system that has effectively become an "exemptions raj" with serious consequences for revenues but also governance. According to the government's own figures, excise tax exemptions (and taxing goods at low rates) result in foregone revenues of Rs. 1.8 lakh crore or nearly 80 per cent of actual collections. Tentative estimates by the Committee suggest that the comparable figure for the States is about Rs. 1.5 lakh crore. Together, India loses about 2.7 per cent of GDP because of exemptions.

5.41 The Committee cannot state this in any stronger terms: if the GST is to be a success— with an uninterrupted value chain that facilitates compliance and a buoyant source of revenue— these exemptions must be plugged. Using exemptions as selective industrial policy has led to generous un-selective policy, and proliferating exemptions. The road to exemptions hell is paved with the good initial intention of restricting exemptions to a few industries.

5.42 It is also worth emphasizing that exemptions need not, and often do not, result in low or zero tax burdens. If a product is exempted, the effective tax burden will depend on all the embedded taxes on inputs going into that product. If the move to the GST results in lower rates of taxation, it is possible that eliminating exemptions might actually reduce the effective tax burden. This is especially likely in relation to small scale industries (SSIs) which are likely to come within the scope of the GST because of reductions in the exemptions thresholds. The combination of input tax credits that they can reap combined with lower standard rates might result in SSIs facing lower tax burdens. Another hidden cost of exemptions is that it leads to effective tax burdens that can vary widely across goods, leading to a multiplicity of effective tax rates.

5.43 We would recommend that:

- The exemptions list be narrow, restricted to a few goods, that are merit goods which feature prominently in the consumption basket of the poor such as food items (see Box 3 for a detailed analysis of which items deserve exemption status);
- Exemptions should also be confined to final goods because taxes on intermediates are in any case reclaimable as input credits;[21]
- Exemptions must be common across the Centre and States;
- Precious metals not be exempted to the extent they are for reasons described below;
- Area-based and CVD exemptions be phased out.

5.44 For the dual GST system to be a success, the tax base must be common across the Centre and States, otherwise tax administration becomes fiendishly complicated. Hence the importance of the recommendation that the exemptions list be common across the Centre and the States.

Lower, standard and "demerit" rates

5.45 Ideally, the GST should aspire to a single rate, which would then also be the standard rate. Since 2000, about 90 per cent of countries that have adopted a VAT have chosen to have a single rate. The tax administration benefits of having a single rate are substantial. However, in the years ahead, it may not be feasible to adopt a single rate GST system for social reasons. A 2-rate structure (or a modified 2-rate structure) may therefore be adopted. What should be the lower rate and the standard rate, and the demerit rate which would apply to a small group of luxury items?

5.46 Consider the following simple formula for determining the structure of rates:

$$R = aL^G + PS^G + yS^S + uD^G$$

Where R is the RNR, L^G is the lower rate on goods, S^G is the standard rate on goods, S^S the standard rate on services; and D^G the demerit rate on goods; a, P, y, and u are the respective shares of these four rates in the underlying tax base, and together add up to 1.

5.47 The first point to note is that the standard rate for goods and services must be the same because that is the raison d'etre of the GST—to provide a common base for goods and services, obviating the need for defining goods and services separately.

Thus: $S^G = S^S = (R - aL^G - uD^G) / (P + y)$

5.48 The next point to note is that for any given RNR (that has been estimated), and a given higher rate (discussed below), the lower is the lower rate, the higher will be the standard rate.

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[21] Taxing intermediates will, however, have the advantage of increasing the tax base via the "withholding effect" discussed earlier.

5.49 Ideally, the lower rate should not be far lower than the RNR for two reasons. The lower the rate and the more the commodities that are taxed at this lower rate, the higher will be the standard rate just as a matter of arithmetic. In fact, this is the pattern in the States. Lower rates of 4-5 per cent with a large part of the base taxed at these rates (about 60-70 per cent) results in the necessity of high standard rates of 14-15 per cent. High standard rates make compliance considerably more difficult.

5.50 The second reason for having lower rates that are close to the RNR relates to political economy. The temptation to push commodities to the lower rate increases the lower is the low rate. The benefit for any industry group of seeking to reduce the tax on its output is directly proportional to the tax advantage: moving a product from 14 per cent to 6 per cent is worth more than moving a product from 14 to 12 per cent. And in fact the pattern in the States reflects this political economy at work.

5.51 So, if the RNR is close to 15 per cent, the effort should be to keep the low rate at about 12 (6 +6 each for the Centre and States) per cent.

5.52 As discussed earlier, a lot will depend on the magnitude of exemptions and decisions about what goods are taxed at the lower rate and at the demerit rate. One of the major items either exempted or taxed at a very low rate currently is gold, silver, and precious metals. If the Centre moves to the smaller list as recommended and the States shift more of their tax base, especially intermediate goods, toward the standard rate also as recommended, the pattern of standard rates will look roughly as follows in table 7.

5.53 To illustrate the impact of policy choices on the standard rate, we present in Table 7, the consequences for the standard rate (for the given RNR of 15 per cent) of the treatment of gold and precious metals (for details on the tax treatment of these commodities, see Box 3). As the table shows, the lower the rate that these commodities are taxed, the higher will be the standard rate that is applied to all commodities. For example, if gold is taxed at 4 percent the standard rate will be 17.3 percent. In contrast, if gold is taxed at 6 per cent, the standard rate can come down to as much as 16.9 per cent (table-8).

Table 7: RNR and Standard Rate structure for center and states (per cent)

	RNR	Lower Rate	Standard Rate (a)	Higher Rate
Goods				
Center	7	6.0	8.0	20
States	8	6.0	9.0	20
Services				
Center	7	-	8.0	-
States	8	-	9.0	-

Source: Committee's calculation.

a: This corresponds to committee's preferred scenario with rate on precious metal at 6per cent.

Table 8: Gold rate and it impact on Standard Rate

	RNR	Rate on precious metals	"Low" rate (goods)	"Standard" rate (goods and services)	"High/Demerit" rate or Non-GST excise (goods)
Preferred	15	6	12	16.9	40
		4		17.3	
		2		17.7	
Alternative	15.5	6	12	18.0	40
		4		18.4	
		2		18.9	

Source: Committee's calculation.

5.54 It is now growing international practice to levy sin/demerit rates—in the form of excises outside the scope of the GST--on goods and services that create negative externalities for the economy (for example, carbon taxes, taxes on cars that create environmental pollution, taxes to address health concerns etc.). As currently envisaged, such demerit rates—other than for alcohol and petroleum (for the states) and tobacco and petroleum (for the Centre)—will have to be provided for within the structure of the GST. The foregone flexibility for the center and the states is balanced by the greater scrutiny that will be required because such taxes have to be done within the GST context and hence subject to discussions in the GST Council.

5.55 We recommend one demerit rate and that rate should be such that the current revenues from that high rate are preserved. Accordingly, we recommend that this sin/demerit rate be fixed at about 40 percent (Centre plus States) and apply to luxury cars, aerated beverages, paan masala, and tobacco and tobacco products (for the states). The Centre can, of course, levy an additional excise on tobacco and tobacco products over and above this high rate. These goods are final consumer goods and should be of high value (so that small retail outlets are not burdened with the complication of having to deal with multiple rates) and clearly identifiable so that there are no issues related to classification that could complicate tax compliance.

Assigning products to rates

5.56 Typically, the assignment of goods to different tax categories will be motivated by considerations of equity. Goods that account for a large share of expenditures of poorer households—for example, food-- will typically be merit goods and will either be exempt or placed in a lower rate category. A related feature will be that this share will decline for richer households.

5.57 But even if a good is a merit good, warranting an exemption or lower rate, policy makers will want to ask how effective that decision will be based on how well targeted the implicit subsidy will be, where the implicit subsidy is the difference between taxing a good at the standard tax rate and the lower or zero rate: if the poor also account for a large fraction of total expenditure on the merit good, then the subsidy will be well targeted; if, on the other hand, they account for a small share of the total expenditure, then the subsidy decision will come with the cost that most of the benefits of the subsidy will accrue to the relatively better off. [22]

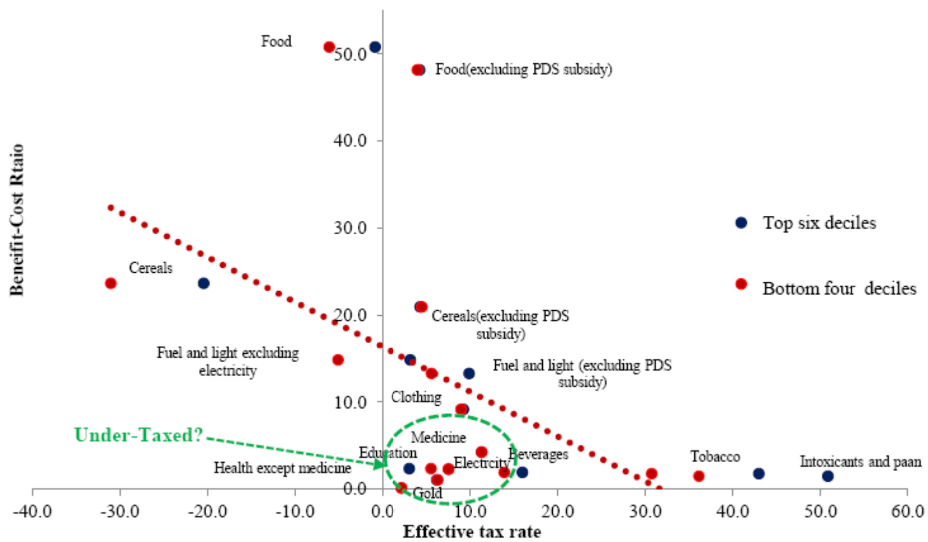
5.58 So, one can think of a commodity-wise benefit-cost analysis for determining the rate structure. The benefit could be thought of as the subsidy rate for the target group, say the bottom four deciles of the population.23 The subsidy essentially measures how much the expenditure of the target group would be increased by exempting a good rather than taxing it at the standard rate.

5.59 The cost could be measured in relation to the principle of effective targeting. The cost is simply that proportion of the total subsidy for any particular good that does not reach the target group and instead "leaks" to the non-target group, in this case, the top 6 deciles.

5.60 When we do a benefit-cost analysis of different commodities and compare it against the actual structure of rates, a few broad policy conclusions emerge captured in Figure 3 (Box 3 has a detailed analysis).

- A number of commodities are treated fairly under the current system. Thus, merit goods such as food items, especially cereals, pulses, edible oils, vegetables, and fuel are appropriately taxed at zero or low rates (in Figure 3, these commodities have high benefit-cost ratios and attract low taxes).

Figure 3: Comparing "Desirable" Taxation with Actual Taxation of Selected Commodities



Source: NSS,CBEC, World Bank and Committee's calculation

Ideally, of course, if governments had well-designed transfer programs, they would achieve the desired objective of helping poorer households by providing cash transfers and sparing the tax system from having to attain equity objectives. In practice, this is not always possible and in India DBTs are still a work-in-progress. See Keen (2015).

The analysis can be re-worked for other target groups, say the bottom 3 or 5 deciles.

- But there are a number of anomalies. The most glaring is gold, silver and precious metals. They are a strong demerit good: the very rich consume most of it (see Table 2 in Box 3 which shows that the top 2 deciles account for roughly 80 percent of total consumption) and the poor spend a small fraction of their total expenditure on it; moreover, they have become a source of macro-economic instability and less important as a savings vehicle. Indeed, it is inconsistent for the government to actively promote schemes (gold bonds and gold monetization) to wean consumers away from gold, on the one hand, and also give highly concessional tax rates to buy gold, on the other. For all these reasons, these commodities should in principle be taxed at the standard rate: instead they are taxed at about 1-1.6 percent (center plus States). This anomalous treatment must be rectified at least by raising current tax levels to 4 or 6 percent (see Box 3).

- Education, health (excluding medicines), and electricity are also not appropriately treated. They are all commodities that prima facie seem to be merit goods, warranting zero or low tax burdens. However, in India, they are mostly consumed by the rich, and many are largely privately provided. In the case of education, the current tax structure turns out also to be regressive, with the bottom 4 deciles effectively paying greater taxes than the top 6 deciles They deserve to be taxed more like standard goods. Yet, most education and health services will be exempted under the GST. Electricity is planned to be excluded from the GST. These exemptions and exclusions—which are bad from a tax policy and administration perspective because they will break down the value added chain--merit reconsideration. • Conversely, a number of demerit goods such as alcohol and tobacco are appropriately taxed at high rates. But the case for alcohol's inclusion in the GST relates to governance and reducing corruption. A similar argument applies to including real estate in its entirety in the GST.

Exemptions threshold

5.61 The current situation and proposed thresholds are described in Table 8. (Compounding refers to the exemption of firms from the VAT chain; instead they are charged a small turnover tax without allowing for any input tax credits). Setting an exemptions threshold has to balance three considerations.

5.62 First, minimizing the burden on small taxpayers would call for higher thresholds. Second, a high threshold also achieves social objectives because poorer households are more likely to buy from smaller outlets (such as *kirana* shops). Third, on the other hand, a high threshold not only risks foregoing revenues but also undermines the value-added chain that is so critical for the governance benefits of having a GST. The current proposal is to have a common threshold of Rs. 25 lakh for goods and services combined but raising this threshold say upto Rs. 40 lakh may be considered.

Table 9: Exemption Thresholds: Current and Proposed

	Current			***Proposed** under GST*	
	Goods	***Services***	***Compounding***	***Goods plus Services***	***Compounding***
Center	1.5 crore; exports and exempted goods	10 lakh	not permissible	25 lakh combined with no exemptions and aggregated at the	to be decided; but possibility of compounding from exemptions

	excluded from threshold			level of legal entity	threshold (25 lakh) up to 1 crore
States	5-10 lakh	not applicable	permissible in some States for some items and at varying rates	same as above	same as above

Source: Department of Revenue

5.63 Corporate income tax data suggests that between for turnover in the Rs. 25-40 lakh crore range, there are 3.26 lakh registered entities (0.22 corporate and 3.04 non-corporates), accounting for just over Rs. 1.04 lakh crore in total turnover. The benefit cost ratio of minimizing the compliance burden relative to the revenue foregone may need to be considered. Also, the option should be given to firms to be part of the GST chain even if they are below the exemption threshold.

5.64 That said, the concern that reducing the threshold will raise the tax burden faced by small scale industries (SSIs) may need to be reviewed. Under plausible scenarios, the effective burden on SSI plants can actually decline, if the standard rate (currently around 25-26% in goods for the center and States combined) comes down, as envisaged by the Committee (see the illustrative example in the Annex Table).

Rates or Rate Bands and the issue of fiscal autonomy of States under the GST

5.65 The proposed GST bill provides for States to have a band of 2 per cent above the standard GST rate so that they have some fiscal flexibility to adapt to state-level conditions. There are two reasons why this flexibility may need to be reassessed. First, the argument for fiscal flexibility/autonomy becomes less compelling: under the proposed GST, the States still retain considerable flexibility because alcohol and petroleum—the biggest sources of revenues for the States about 29 per cent of overall States' indirect tax revenue and about 41.8 per cent ofthe total revenue of States to be subsumed under GST—as well as power, real estate, health and education remain outside the scope of the GST. Even if petroleum, alcohol and tobacco are subsumed in the GST, States will retain the right to levy top-up excises on them.

5.66 In other words, the design of the GST is such that states will continue to have considerable autonomy under the proposed GST either in its current form (which has a number of exemptions and exclusions) or in a future GST regime that reduces these exemptions and exclusions because there will be scope for states to levy top-up excises. That is the sense in which, the Committee argued earlier that the Indian GST has the potential to marry the best of centralized and decentralized features of VATs in large federal systems.

5.67 Second, if States exercise this flexibility, there would be varying rates for a given product, which would create distortions across States and reduce efficiency and increase compliance costs, especially for companies planning multi-state activities. These distortions and costs must be seen against the fact that they will not lead any meaningful additional fiscal autonomy to the states.

5.68 Rate bands would also create another complication for administering the CVD: under World Trade Organization (WTO) rules, the CVD has to be the lowest of the state rates. Supposing one state charged 8 per cent and another 12 per cent. The CVD would have to be based on 8 per cent, which would immediately disadvantage production in the state charging the higher rate, undermining Make in India programme.

Potential price impact of GST[24]

5.69 In principle, the GST should have no aggregate impact on inflation and the price level because the new rate will be a revenue neutral one. Revenue neutrality may, however, not be enough to guarantee that there will be no price impact across all categories of goods and services. This is because the weights of commodities in the consumption basket (on which the CPI is based) are different from their contribution to indirect tax collections. The impact on particular goods and services will depend on the current structure of taxation (including exemptions) and the future structure of the GST both at the Center and the states. To estimate the impact on future inflation, we need to begin with understanding the current structure of taxes.

Current taxes on the consumption basket

5.70 The average effective tax rate on consumption as measured by the Consumer Price Index (CPI) is 10.4%. Excluding items outside GST coverage, the rate drops to 7%, as the excluded items (e.g. alcohol, petrol and diesel) have very high tax rates. This relatively low rate reflects a number of key features.

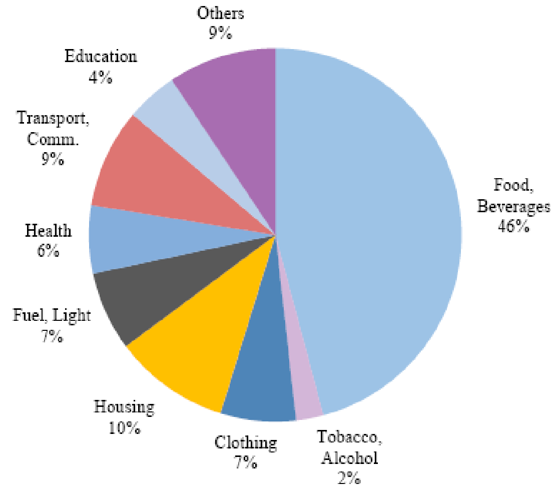
5.71 First, categories like food and beverages, rent and clothing have large weights in CPI basket (Figure 4). These are categories that are either exempted or taxed at low rates. For example, 75% of CPI is exempt from excise, and 47% of CPI is exempt from sales tax (Figure 5)25. Excluding taxed items that are outside GST (e.g. alcohol, petrol and diesel), 54% of the CPI would be GST exempt.

5.72 Second, most items, where not exempted are taxed at a lower rate. Thus, in addition to exempted commodities, a further 32% is taxed at a low rate, and only 15% at a normal rate (Figure 6). The 4% taxed at a high rate are mostly the items excluded from GST, like petrol, diesel and alcohol.

The analysis in this section should not be considered definitive because it is based on a number of assumptions. The caveats are noted in greater detail in footnote 27 in Box 3.

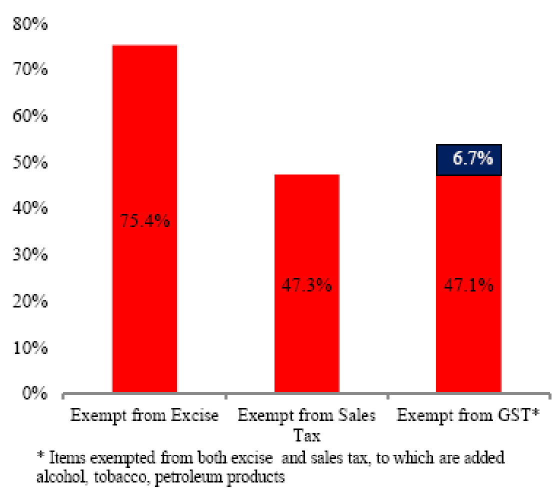
We use the Excise schedule from CBEC. Sales tax rates were provided by four states: Tamil Nadu, Karnataka, Kerala and Gujarat. Items exempt from VAT in three of the four states are assumed to be exempt for this analysis.

Figure 4: Food, rent and clothing have high weight in CPI



Source: CMIE

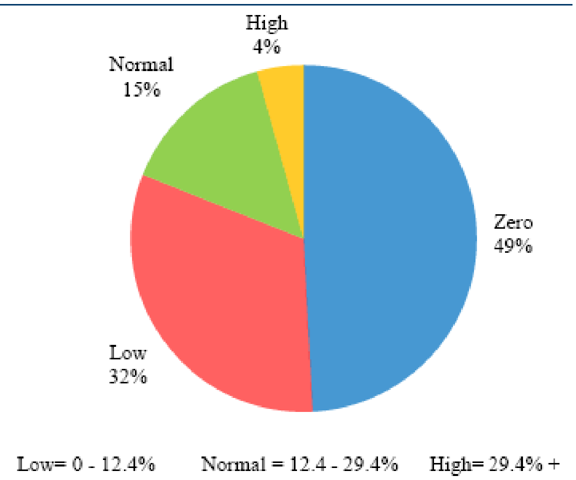
Figure 5: A large part of CPI is exempt from Excise/VAT



Source: CBEC, State Governments, Estimates

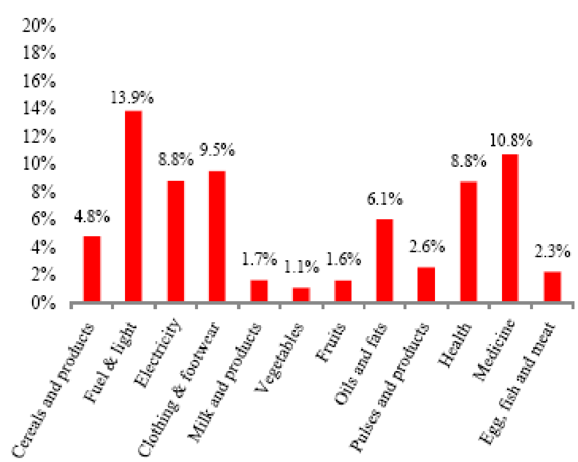
5.73 The taxation of some essential commodities in the CPI is shown in Figure 7. Most of the categories with a large CPI weight have traditionally been taxed at low rates to reflect distributional concerns; that is, these are goods and services which are important for poorer sections of society and hence are taxed at zero or low rates. In some cases, while the headline tax rate is zero, the effective tax rate is higher given the taxes on inputs. For example, the headline average tax rate on cereals is 2.3%, and vegetables and fruits is 0.5%, but adjusted for the taxes paid on inputs, the effective tax rate on cereals and vegetables rises to 4.8% and 1.1% respectively. The same holds true for electricity: this is not taxed explicitly, but the effective tax rate is 8.8%. Even after these adjustments however, these effective rates are low. Further, to some extent, even these numbers do not truly reflect the net tax burden because of the subsidies provided by the public distribution system (PDS) as described below.

Figure 6: Only 15% of CPI is taxed at a "normal" rate



Source: CBEC, State Governments, Estimates

Figure 7: Low average tax rate on most large categories



Source: CBEC, State Governments, Estimates

Distribution of taxes by income groups

5.74 These commodity-specific taxes can in turn be disaggregated by broad income groups using consumption data from the 2011-12 NSS. Figures 8 and 9 present these for the top 60 (T60) per cent of the population and bottom 40 per cent (B40) of the population, respectively.

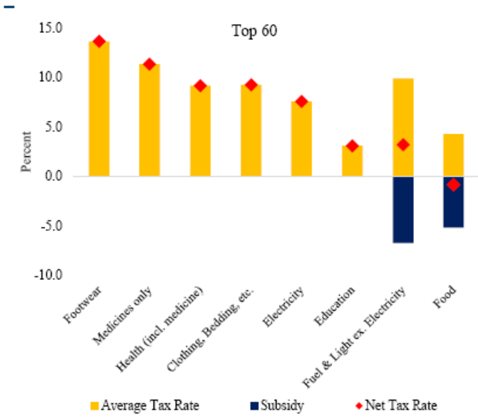
5.75 Taxes on food are about 4 per cent for both groups. This is because even though many food items are exempt in most states, there are embedded taxes in food items such as fuel. This is an important point to emphasize: exemptions do not lead to zero taxation because embedded taxes via inputs cascade into the final product.

5.76 Because of the PDS, however, these taxes are offset by food subsidies so that the net tax rate is negative for the B40 and close to zero for the T60. The magnitude of the impact of the PDS, however, varies by states—high in Tamil Nadu and low in Gujarat. A similar pattern of negative net taxes on the B40 can be observed in fuel and light because the PDS covers kerosene.

5.77 Taxes on health turn out to be among the highest (Figure 8): and the burden is higher for the bottom 40 per cent, as bulk of healthcare expenditure is on medicines (which are taxed at a higher rate than medical services), and particularly so for the bottom 40 per cent (Figure 9). Education taxes also turn out to be regressive, as the consumption of books and school supplies is a higher part of education spend for the bottom 40%, and tuition (mostly tax exempt) is a higher spend for the top 60%.

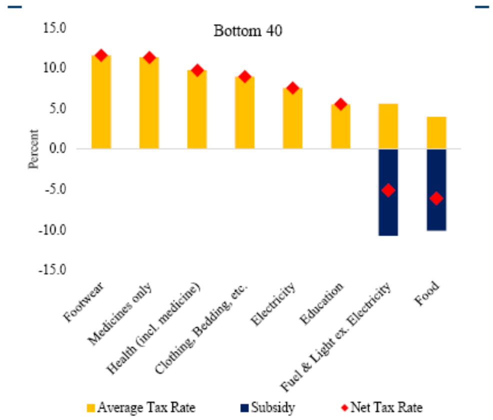
5.78 For clothing the average tax rates are relatively similar—about 9 %--between the two groups, and across states. In fuel and light, overall taxes are progressive but because electricity comprises a higher share of consumption of the top 60%, the exemption given to electricity benefits the top 60% more than the bottom 40%.

Figure 8: Average tax rates by category for top 60%



Source: NSSO, CBEC, State Governments, World Bank Estimates

Figure 9: Average tax rates by category for bottom 40%



Source: NSSO, CBEC, State Governments, World Bank Estimates

These are an aggregate of five states: Tamil Nadu, Kerala, Karnataka, Gujarat and Andhra Pradesh. Estimates do not take in CST, and do not also factor in inter-state movements (the numbers were calculated for each state and then added up to get a national proxy).

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The price impact of the GST Regime

5.79 We analyse scenarios for both a single rate (of 14%) and two scenarios involving a dual rate GST (12% and 18%; and 12% and 22%, respectively). In the dual rate scenarios, we apply a high tax rate of 35% to about 1% of CPI (that relate to luxury goods).

5.80 In the single rate scenario, we assume that whatever attracts any duty right now would be taxed. In the dual rate scenarios, we assume that most food items are exempt except where processing is involved (e.g. cooked meals, biscuits, sugar, tea, papad, bhujia). We assume that processed food is taxed at the low rate of 12% (this is 9.6% of the 45.9% of CPI that is food & beverages). We also assume that textiles and clothing are taxed at a low rate. We find that the normal tax rate would then apply to about 11.2% of CPI.

5.81 The category-wise effective tax rates for major categories in these scenarios are shown in Annex-5 (Figures 1-2), and the inflation impacts in Figures 10-14.

5.82 While assessing inflation, for each scenario we look at two outcomes: one if there is no input-tax credit26, and the second with input-tax credit. In each of the three scenarios, we assume that a change in the tax rate would drive the supplier to change pricing. In some cases, even if the headline tax rate does not change (particularly for the exempt categories) if the taxes on inputs go up, the producer may be motivated to raise prices. For example, if taxes on fertilizers go up, the rice or cotton producer may take price increases. The reality may fall between the two alternatives: even if GST credits start flowing in relatively fast, some producers may still price on the headline rate.

5.83 We have also not factored in producers' pricing power in assessing the impact on inflation: some may not have the pricing power to take price increases (e.g. prices that are determined globally, say a cotton farmer that sees an increase in input prices), while others, like producers of personal products, may not cut prices even if they see a reduction in their tax rates.

5.84 Single-rate GST: The higher the single rate, the greater the price impact. For example, a 14% rate would drive CPI higher by 1.0% if the producers don't factor in the input-tax credit and 0.7% if they do. An 18% single rate would increase prices by 2.5% with or without input tax credits. (Figure 10 shows the sensitivity to various rates). The items that may see the largest increase in prices are clothing and medicines (Figure 11). The (small) increase in food and beverages is largely because a number of even primary food items are currently taxed in some states (though not in all). As we have assumed the current tax rate to be an average of state tax rates, the average tax rate jumps from low single digits to the RNR, a substantial increase.

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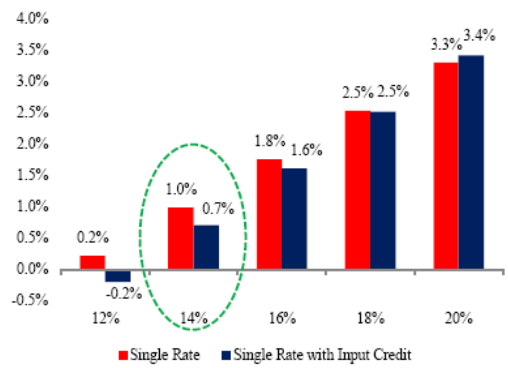
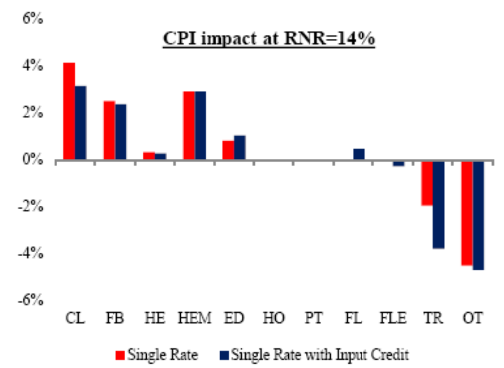
[26] We use the CSO's Input-Output Table (IOT) for 2007-08 (this is the latest available); the 299 CPI items were then manually mapped to the 130 IOT categories.

Figure 10: CPI would have high sensitivity to single RNR



Source: CBEC, State Governments, Estimates

Figure 11: Scenario 1: some categories to see inflation

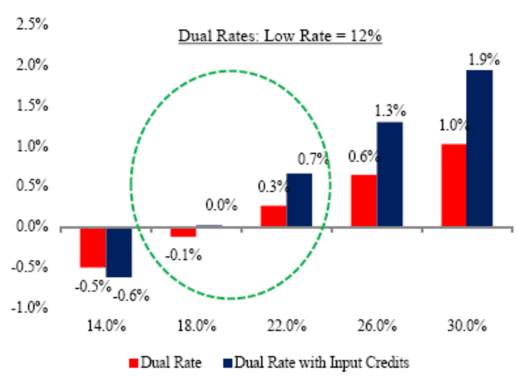


Source: CBEC, State Governments, some Estimates

Category codes: HE = Healthcare (excluding Medicines); HEM: Healthcare (Medicines); FL = Fuel & Light; CL = Clothing; FB = Food & Beverages; TR = Transport & Communication; ED = Education; HO = Housing; OT = Others (personal products, etc); PT = Paan & Tobacco

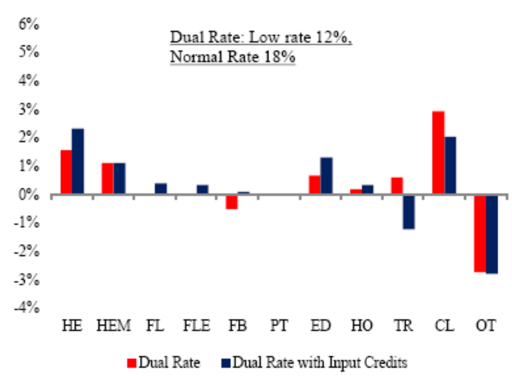
5.85 Dual-rate GST with a lower rate of 12 per cent and a standard rate of 18 per cent: This rate structure would correspond broadly to an RNR of about 15-15.5 per cent. As one can expect, this has low inflation impact given the small part of CPI that gets taxed at the normal tax rate (Figure 12 shows the sensitivity). An 18% standard rate would impact CPI by -0.1% if all producers reacted to headline tax changes and 0% if they reacted after adjusting for input tax credits as well. Under this dual rate structure, food and beverages would see virtually no price increase and neither would fuel and light, which would be especially important for protecting poorer consumers (Figure 13).

Figure 12: Dual rate sensitivity (Normal on 11% of CPI)



Source: CBEC, State Governments, some Estimates

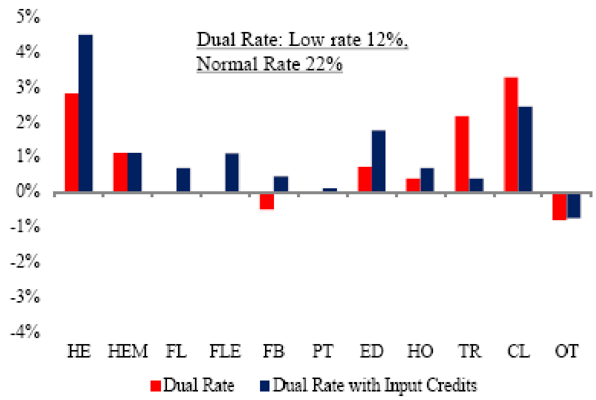
Figure 13: Scenario 2: Less than 3% inflation for items seeing price rise



Source: CBEC, State Governments, some Estimates

5.86 Dual-rate GST with a lower rate of 12% and standard rate of 22%: This rate structure would correspond broadly to an RNR of about 17-18%. The inflation impact in this scenario lies in between the first and second scenarios: a 22% standard rate would drive a CPI increase of 0.3% if all producers reacted to headline tax changes and by 0.7% if they adjusted for input taxes: the increase is a reflection of hidden taxation, i.e. the headline taxes may be low, but an increase in input taxes would raise inflation. Health (excluding medicines) would see the highest increases (Figure 14).

Figure 14: Scenario 3: Only health to see high inflation



Source: CBEC, State Governments, some Estimates

Concluding observations

5.89 The experience in a number of economies like Australia, New Zealand and Canada, was that GST implementation drove a step increase in prices: this boosted inflation for a year, and once these prices came into the base, inflation declined, indicating low persistence of this inflation.

5.90 For India, one broad conclusion is that under a dual rate GST, the aggregate impact on inflation will depend on the RNR and the standard rate. An RNR in the 15-15.5 % range with a lower rate of 12% and a standard rate of 18 percent would have negligible inflation impact. A higher RNR with a lower rate of 12% and a standard rate of 22 percent would have 0.3-0.7% impact on aggregate inflation. However, under both these scenarios, if food and fuel and light were exempted, and with the PDS in operation, the price impact on these items of consumption for the poor can be minimal.

5.91 These aggregate calculations would depend on a number of details in the design of the eventual GST, including:

(a) Final synchronized exemption lists;

(b) The choice of categories to which low-rates are applied;

(c) Exemption threshold for enterprises: a low threshold would mean that more producers/sellers pay GST, and thus re-price their goods/services, whereas a high threshold would bring that down (some categories like food could be particularly sensitive to this choice). In many categories the bulk of the goods/service are accessed through suppliers/outlets that don't pay tax (e.g. if all barbers/beauticians paid service tax, collections would be Rs 5000-plus crore, but the collections are about Rs. 100 crore);

(d) How many suppliers react just to the headline rate and have the pricing power to either take price increases or hold on to prices even when they are net beneficiaries of GST implementation;

(e) Given the large impact of PDS on food and fuel and light, the impact on the bottom 40% can be offset by state governments making changes to the PDS.

(f) f) New GST features: currently excise and VAT cannot be offset, and cascade; in addition, VAT credits cannot be carried across states. Both these characteristics would change in the GST regime, and affect the eventual inflation.

5.92 However, to ensure that producers do not take advantage of the GST, the government might consider setting up mechanisms to monitor the price impact, especially of sensitive items, as was done by Australia. The Competition Commission of India should be especially vigilant in identifying anti-competitive producer behavior that hurts consumers via excessive price increases.

Compensation

5.93 Under the proposed agreement on the GST, the Centre has agreed to compensate the States for any shortfall in their indirect tax collections in the transition from the current state VAT and other taxes to the unified GST. This compensation will be provided for 5 years. In the earlier experience of implementing the state VATs the Centre provided compensation for three years but at a declining rate: 100 per cent of the shortfall in 2005-06, 75 per cent and 50 per cent in the following two years respectively.

5.94 In the aggregate, of course, the States should not suffer any loss in revenues because that is intrinsic to the calculation of a revenue neutral rate. That is, if the RNR for the States is set appropriately, States as a whole should have the same revenue as before. But there are two situations why shortfalls may arise. First, the aggregate RNR might be set too low. In this case, of course, the GST Council may have to decide to raise rates going forward but interim shortfalls will have to be compensated.

5.95 A more likely scenario is for shortfalls to be experienced by individual States even if States as a whole experience revenue neutrality. Now, by definition, the move from the status quo to the GST will involve a shift in revenues from producing States to consuming States, from manufacturing to services, and within manufacturing from intermediate and capital goods toward final goods. This distributional shift is unavoidable because it is in some ways intrinsic to the move to the GST. Most States will stand to gain and it is likely that poorer States will be beneficiaries because they consume more, on average, than they produce; and their economies are more services-than manufacturing-based.

5.96 But pinning down exactly which particular States will gain is not easy because disaggregated state-wise data that would allow reliable computation of the current and future tax base for the States is simply not possible. Moreover, the taxable base of States will also depend on rules on supply of goods and services and changing behavior of firms in response to these rules (for example, headquarters and where supplied). For these reasons, this report has chosen not to provide state-wise RNR calculations.

5.97 But we undertake an illustrative exercise in Box 2 to show that anxieties of some of the major States may be unwarranted and that the compensation requirements may well turn out to be minimal. We project the likely future tax base of goods consumption using NSS data and likely future tax base of services by estimating urban incomes. We find that the share of the future tax base for States is very similar to their share in current GST revenues. For those States that receive a large share of current revenue because they have a large manufacturing base, their anxieties can be reassured on the grounds that such States are also likely to have a large base in services going forward.

5.98 Notwithstanding the above, there need to be clear rules on compensation to avoid glitches and controversy in the implementation of GST and to reassure the States so that they too can embark on GST implementation with enthusiasm and confidence.

5.99 Compensation will have to be provided for the shortfall between the actual level of collection (RA) in any particular year and the collection level to be protected (RP) in that year. The challenge will be in identifying the latter.

5.100 Under the system used to provide compensation for the transition to the state VAT, the formula used for compensation was the following: the three best annual growth rates of *revenue* collected in the previous six years was taken, was averaged, and then used for the calculation of RP, namely the future revenue to be protected. This method had the virtue of simplicity because state governments knew in advance the actual revenue they could expect to receive in the coming year and could hence plan accordingly.

5.101 Going forward, there might be one issue in applying the same methodology to GST compensation. In some of the last five years, revenues witnessed unusually high levels of growth because of the combination of high real GDP growth and high inflation. The average of the highest three revenue growth figures for the last three years (for the States as a whole) was over 16.8 per cent; and the corresponding average of highest three nominal GDP growth figures was 13.4 per cent.

5.102 Looking ahead, this picture could change dramatically both because real GDP growth has slowed but more important because inflation has declined dramatically and is expected to remain low. For example, in FY2016, nominal GDP growth is expected to be about 9.5 per cent and the forecast for the period ahead is in the range of 11 per cent and rising slowly on expectations of a pick-up in real GDP growth. Now, if historical buoyancy prevails, this will lead to substantially lower collections which would be normal and which should not be attributed to the GST and hence would not necessarily need to be compensated.

5.103 Hence, the formula for GST compensation going forward would have to take account of two factors: on the one hand, erring on the side of generous compensation would provide reassurance and certainty to the States on revenue availability and help them better plan their expenditures; on the other hand, the formula should take account of the dramatically changed outlook for nominal GDP and hence revenue growth for both the Centre and the States.

Other issues

5.104 The Committee has not been asked explicitly to analyze all issues relating to GST, some of which have been reflected in the Constitutional Amendment Bill. But the Committee would be remiss if it did not state its views on some important issues, for example, the exclusion of alcohol from the scope of taxable items in the Constitutional Bill. Political compulsions may require the exclusion of alcohol in the current conjuncture. But this is at odds with the aim of improving governance and reducing rent-seeking which is pervasive in relation to alcohol.

5.105 Leaving that aside, there is still little reason to exclude alcohol constitutionally. Far better to leave it in, and to allow the Centre and States at some future date to decide collectively to bring alcohol within the GST net—like foreseen for petroleum products. To leave it out is to rule out even the possibility of choice for all time which cannot be good policy.

5.106 Another misconception pervades discussions of bringing alcohol in the GST. Bringing alcohol into the scope of the GST need not take away the right of States to tax alcohol. As is envisaged for tobacco, it is perfectly possible—and indeed desirable—for some basic tax to be levied on alcohol within the GST, and allow States to levy top-up sin taxes on alcohol for other revenue or social reasons. In other words, bringing alcohol within the scope of GST would not curtail States' fiscal autonomy in this area.

5.107 The same applies to real estate which is also a major arena of rent-seeking. Bringing electricity into the GST could also improve the competitiveness of Indian manufacturing. And, as argued in detail in Box 3, reducing the exemptions on health and education services in the GST would be more consistent with social policy objectives than the status quo.

VI. CONCLUSIONS

6.1 This is a historic opportunity for India to implement a game-changing tax reform. Domestically, it will help improve governance, strengthen tax institutions, facilitate "Make in India by Making One India," and impart buoyancy to the tax base. It will also set the global standard for a value-added tax (VAT) in large federal systems in the years to come.

6.2 The GST has been an initiative that has commanded broad consensus across the political spectrum. It has also been a model of cooperative federalism in practice with the Centre and states coming together as partners in embracing growth and employment-enhancing reforms. It is a reform that is long awaited and its implementation will validate expectations of important government actions and effective political will that have, to some extent, already been "priced in."

6.3 Getting the design of the GST right is therefore critical. Specifically, the GST should aim at tax rates that protect revenue, simplify administration, encourage compliance, avoid adding to inflationary pressures, and keep India in the range of countries with reasonable levels of indirect taxes.

6.4 There is first a need to clarify terminology. The term revenue neutral rate (RNR) will refer to that single rate, which preserves revenue at desired (current) levels. In practice, there will be a structure of rates, but for the sake of analytical clarity and precision it is appropriate to think of the RNR as a single rate. It is a given single rate that gets converted into a whole rate structure, depending on policy choices about exemptions, what commodities to charge at a lower rate (if at all), and what to charge at a very high rate. The RNR should be distinguished from the "standard" rate defined as that rate in a GST regime which is applied to all goods and services whose taxation is not explicitly specified. Typically, the majority of the base (i.e., majority of goods and services) will be taxed at the standard rate, although this is not always true, and indeed it is not true for the states under the current regime.

6.5 Against this background, we would draw a few important conclusions.

- Because identifying the exact RNR depends on a number of assumptions and imponderables; because, therefore, this task is as much soft judgement as hard science; and finally also because the prerogative of deciding the precise numbers will be that of the future GST Council, this Committee has chosen to recommend a range for the RNR rather than a specific rate. For the same reason, the Committee has decided to recommend not one but a few conditional rate structures that depend on policy choices made on exemptions, and the taxation of certain commodities such as precious metals. The summary of recommended options is provided in Table 10 below.

- On the RNR, the Committee's view is that the range should between 15 percent and 15.5 percent (Centre and states combined) but with a preference for the lower end of that range based on the analysis in this report. The Committee has noted the risks both of setting rates that are marginally high and low. On balance, however, it is easier to address the consequences of erring on the side of marginally low rates.

Table 10: Summary of Recommended Rate Options (in per cent)

	RNR	**Rate on precious metals**	**"Low" rate (goods)**	**"Standard" rate (goods and services)**	**"High/Demerit" rate or Non-GST excise (goods)**
Preferred	15	6	12	16.9	40
		4		17.3	
		2		17.7	
Alternative	15.5	6	12	18.0	40
		4		18.4	
		2		18.9	

Source: Committee's calculations.
Note : All rates are the sum of rates at center and states

- On structure, in line with growing international practice and with a view to facilitating compliance and administration, India should strive toward a one-rate structure as the medium-term goal.

- Meanwhile, we recommend a three-rate structure. In order to ensure that the standard rate is kept close to the RNR, the maximum possible tax base should be taxed at the standard rate. The Committee would recommend that lower rates be kept around 12 per cent (Centre plus states) with standard rates varying between 17 and 18 per cent.

- It is now growing international practice to levy sin/demerit rates—in the form of excises outside the scope of the GST--on goods and services that create negative externalities for the economy. As currently envisaged, such demerit rates—other than for alcohol and petroleum (for the states) and tobacco and petroleum (for the Centre)—will have to be provided for within the structure of the GST. The foregone flexibility for the center and the states is balanced by the greater scrutiny that will be required because such taxes have to be done within the GST context and hence subject to discussions in the GST Council. Accordingly, the Committee recommends that this sin/demerit rate be fixed at about 40 percent (Centre plus states) and apply to luxury cars, aerated beverages, paan masala, and tobacco and tobacco products (for the states).

- This historic opportunity of cleaning up the tax system is necessary in itself but also to support GST rates that facilitate rather than burden compliance. Choices that the GST Council makes regarding exemptions/low taxation (for example, on gold and precious metals, and area-based exemptions) will be critical. The more the exemptions that are retained the higher will be the standard rate. There is no getting away from a simple and powerful reality: the broader the scope of exemptions, the less effective the GST will be. For example, if precious metals continues to enjoy highly concessional rates, the rest of the economy will have to pay in the form of higher rates on other goods, including essential ones. As the table shows, very low rates on precious metals would lead to a high standard rate closer to 20 percent, distorting the economy and adding to inflationary pressures. On the other hand, moderately higher taxes on precious metals, which would be consistent with the government's efforts to wean consumers away from gold, could lead to a standard rate closer to 17 percent. This example illustrates that the design of the GST cannot afford to cherry pick—for example, keeping a low RNR while not limiting exemptions--because that will risk undermining the objectives of the GST.
- The GST also represents a historic opportunity to rationalize the tax system that is complicated in terms of rates and structures and has become an "Exemptions Raj," rife with opportunities for selectivity and discretion. Tax policy cannot be overly burdened with achieving industrial, regional, and social policy goals; more targeted instruments should be found to meet such goals, for example, easing the costs of doing business, public investment, and direct benefit transfers, respectively; cesses should be reduced and sparingly used. Another problem with exemptions is that, by breaking up the value-added chain, they lead in practice to a multiplicity of rates that is unpredictable, obscured, and distortionary. A rationalization of exemptions under the GST will complement a similar effort already announced for corporate taxes, making for a much cleaner overall tax system.
- The rationalization of exemptions is especially salient for the center, where exemptions have proliferated. Indeed, revenue neutrality for the center can only be achieved if the base for the center is similar to that of the states (which have fewer exemptions—90 products versus 300 for the center). If policy objectives have to be met, instruments other than tax exemptions such as direct transfers could be deployed.
- The Committee's recommendations on rates summarized in the table above are all national rates, comprising the sum of central and state GST rates. How these combined rates are allocated between the center and states will be determined by the GST Council. This allocation must reflect the revenue requirements of the Centre and states so that revenues are protected. For example, a standard rate of 17% would lead to rates at the Centre and

states of say 8 percent and 9 percent, respectively. The Committee considers that there are sound reasons not to provide for an administration-complicating "band" of rates, especially given the considerable flexibility and autonomy that states will preserve under the GST, including the ability to tax petroleum, alcohol, and other goods and services. Even in the future, when these products are brought into the GST, states should and will retain fiscal autonomy by being able to levy top-up taxes on demerit goods.

- Implementing the GST will lead to some uncharted waters, especially in relation to services taxation by the states. Preliminary analysis in this report indicates that there should not be large shifts in the tax base in moving to the GST, implying that overall compensation may not be large. Nevertheless, fair, transparent, and credible compensation will create the conditions for effective implementation by the states and for engendering trust between the Centre and states;
- The GST also represents a historic opportunity to Make in India by Making One India. Eliminating all taxes on inter-state trade (including the 1 percent additional duty) and replacing them by one GST will be critical to achieving this objective;
- Analysis in the report suggests that the proposed structure of tax rates will have minimal inflationary consequences. But careful monitoring and review will be necessary to ensure that implementing the GST does not create the conditions for anti-competitive behavior;
- Complexity and lags in GST implementation require that any evaluation of the GST— and any consequential decisions—should not be undertaken over short horizons (say months) but over longer periods say 1-2 years. For example, if six months into implementation, revenues are seen to be falling a little short, there should not be a hasty decision to raise rates until such time as it becomes clear that the shortfall is not due to implementation issues. Facilitating easy implementation and taxpayer compliance at an early stage—via low rates and without adding to inflationary pressures--will be critical. In the early stages, if that requires countenancing a slightly higher deficit, that would be worth considering as an investment which would deliver substantial long-run benefits. Moreover, the counterpart of revenues falling short will be gains to consumers, especially poorer ones.
- Finally, the report has presented detailed evidence on effective tax burdens on different commodities which highlights that in some cases they are inconsistent with policy objectives. It would be advisable at an early stage in the future, and taking account of the experience of the GST, to consider bringing fully into the scope of the GST commodities that are proposed to be kept outside, either constitutionally or otherwise. Bringing alcohol and real estate within the scope of the GST would further the government's objectives of improving governance and reducing black money generation without compromising on states' fiscal autonomy. Bringing electricity and petroleum within the scope of the GST could make Indian manufacturing more competitive; and eliminating the exemptions on health and education would make tax policy more consistent with social policy objectives.

6.6 There is a legitimate concern that policy should not be changed easily to suit short term ends. But there are enough checks and balances in the parliamentary system and enough pressures of democratic accountability to ensure that. Moreover, since tax design is profoundly political and contingent, it would be unwise to encumber the Constitution with the minutiae of policy that limits the freedom of the political process in the future: the process must retain the choice on what to include in/exclude from the GST (for example, alcohol) and what rates to levy. The credibility of the macroeconomic system as a whole is undermined by constitutionalising a tax rate or a tax exemption. Setting a tax rate or an exemptions policy in stone for all time, regardless of the circumstances that will arise in future, of the macroeconomic conditions, and of national priorities may not be credible or effective in the medium term. This is the reason India—and most credible polities around the world--do not constitutionalise the specifics of tax policy. The GST should be no different.

6.7 The nation is on the cusp of executing one of the most ambitious and remarkable tax reforms in its independent history. Implementing a new tax, encompassing both goods and services, to be implemented by the Centre, 29 states and 2 union territories, in a large and complex federal system, via a constitutional amendment requiring broad political consensus, affecting potentially 2-2.5 million tax entities, and marshalling the latest technology to use and improve tax implementation capability, is perhaps unprecedented in modern global tax history. The time is ripe to collectively seize this historic opportunity.

Box 1. Estimating the association between rates and compliance

Many considerations will go into the determination of the revenue neutral rate, but one of them will also be the impact of rates on compliance. Theory suggests that increases in rates will lead to reduced tax compliance. But is there any evidence from the experience of VAT itself?

Based on data provided by the IMF, the Committee undertook a simple econometric analysis to test whether tax rates and compliance were correlated. Data was provided for 86 countries, developed and developing. Compliance was measured in two ways: collection efficiency (CE) and revenue productivity (RP). CE is measured as:

$$\text{C-eff} = R/(S^*C)$$

where R stands for revenue collected, S is the standard rate and C is total final consumption net of VAT collections. The denominator is a measure of the potential revenues that ought to be collected and the numerator actual collections. C-efficiency is simply a measure of comparing actual against potential. Revenue productivity (RP) simply replaces final consumption with GDP in the denominator.

Simple regressions of the following form were run:

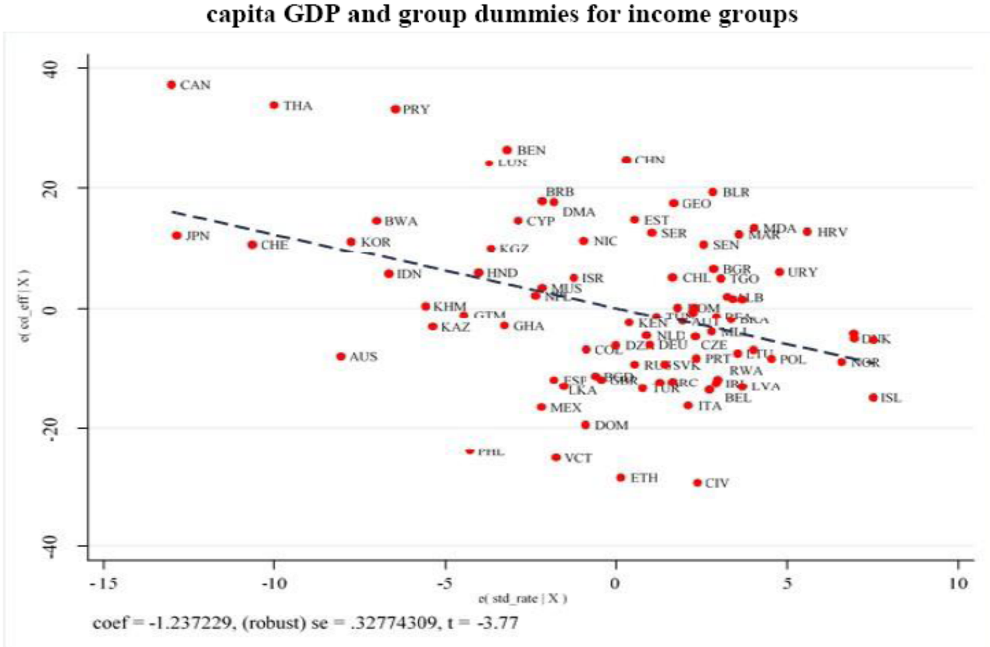
$$CE\ (RP) = a + A^*S + B^*\ln(Y) + DUM+u$$

Where the left hand side is either collection efficiency or revenue productivity; a is the intercept term; S is the standard rate; Y is the per capita GDP of a country which controls for other factors—such as quality of tax administration—that can affect collection efficiency; and DUM is a dummy for country groups arranged according to income to again control for certain group characteristics that might affect compliance; and | is the standard error term.

The regressions are shown in Tables 1 and 2. There is a very strong association between the standard tax rate and all measures of compliance even after controlling for per capita GDP and group dummies

(Figure 1). For example, for collection efficiency the coefficient (A) is about (-) 1.22. This suggests that a 1 percentage point increase in the standard rate worsens compliance by 1.22 percentage points.[27]

Figure 1: Regression of collection efficiency on standard rate, after controlling for per capita GDP and group dummies for income groups



Source: Committee's calculation

This has an important implication for the RNR in India. It suggests that a lower RNR will not lead to as much of a loss in revenue as a simple calculation suggests. For example, if the standard rate were reduced by say 4.1 percentage points in weighted terms that should increase C-efficiency by 4.1 percentage points (using the conservative regression estimate of 1 rather than 1.22) which amounts to about 9.3 per cent given the current C-efficiency ratio of 0.44. Better compliance could therefore fetch potential additional revenues of nearly Rs 4.3 lakh crore.

Table 1: Regression Results of Collection Efficiency

	(1) Estimation 1	**(2) Estimation 2**
Log per capita GDP	7.16***	7.20**
	(1.40)	(2.89)
Standard Rate	-1.24***	-1.22***

[27] The same regressions were carried out for more recent data (for the year 2012) for a set of 36 countries. The results are similar with a strong and significant negative association between collection efficiency and standard rates, although the coefficient is slightly smaller (close to 1).

	(0.33)	(0.35)
Constant	2.15	-0.64
	(13.04)	(24.85)
Income Group FE	No	Yes
Observations	84	84
Adjusted R^2	0.293	0.276

Standard errors in parentheses
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$
Collection efficiency (Revenue/(Standard Rate* Consumption)

Table 2: Regression Results of Productivity

	(1) Estimation 3	(2) Estimation 4
Log per capita GDP	2.66*	1.02
	(1.34)	(2.46)
Standard Rate	-0.81***	-0.85***
	(0.29)	(0.31)
Constant	27.87**	38.29*
	(12.53)	(21.51)
Income Group FE	No	Yes
Observations	84	84
Adjusted R^2	0.088	0.076

Standard errors in parentheses
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$
Productivity (Revenue/(Standard Rate* GDP))

Box 2: Will There be Large Compensation Requirements? An Illustrative Exercise

The GST will necessarily entail some shift in revenues from production to consumption and from manufacturing toward services. This shift is desirable but has raised concern especially from the major manufacturing producing States that they might suffer some loss in revenues. As noted earlier, it is nearly impossible to construct reliable tax bases—both new and old—at the level of the States, especially for consumption of services. Hence, this report has refrained from estimating state-specific RNRs.

But we can shed some light on this question by looking at proxies for the likely future tax base of States. This future tax base will be based on consumption rather than production. So, we need to find proxies for the States' share in consumption of taxable goods and taxable services. We turn to the NSS—which measures consumption--to calculate taxable goods consumption. We define each state's share in taxable consumption of goods as $S^G i$ where G the superscript refers to goods and i the subscript refers to the State.

Since it is difficult to distinguish taxable from non-taxable services in the NSS, we turn to urban incomes as a proxy for taxable services. After all, urban incomes will be a key determinant of spending on business-to-consumer (B2C) services such as financial services, restaurants, advertising, real estate, professions services etc all of which are taxable.

We compiled data on urban populations of the major States and on urban income, the latter by multiplying urban population by state per capita domestic product[28]. This will under-estimate urban incomes to the extent that urban per capita incomes are disproportionately greater than rural per capita incomes especially in more urbanized States. We define, analogously to goods, each state's share in total consumption of services as $S^{S}i$.

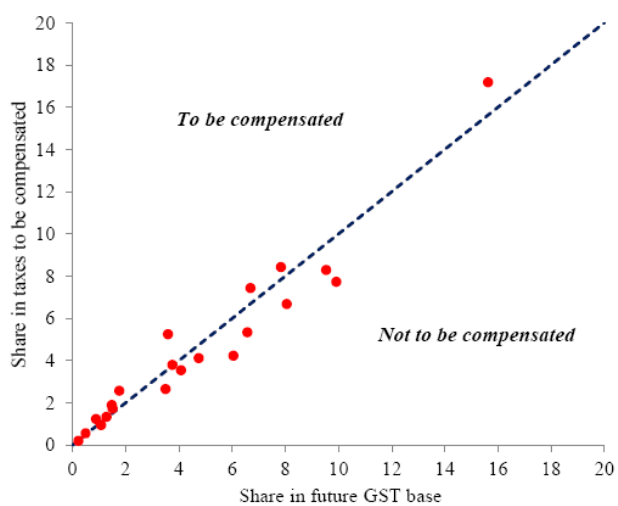
Then each state's share of the total potential GST tax base (goods and services) can be defined as:

$S^{T}i = a\, S^{G}i + (1\text{-}a)\, S^{S}i$

Where a refers to the share of goods and (1-a) the share of services, respectively in the overall GST base.

We plot in Figure 1 below, each state's share in the total GST revenues to be compensated (on the y-axis) (current tax base) against the state's share of total potential GST tax base (future tax base) as defined above (on the x-axis). In this figure the weights assigned to goods and services are 45 per cent and 55 per cent, respectively. A 45 degree line is also fitted to the chart which shows points on the line where the current and future tax base are likely to be the same. All points above the line denote States that will potentially need to be compensated. The chart has two interesting and potentially significant implications for compensations:

Figure 1: Share of revenues to be compensated and share of potential GST base



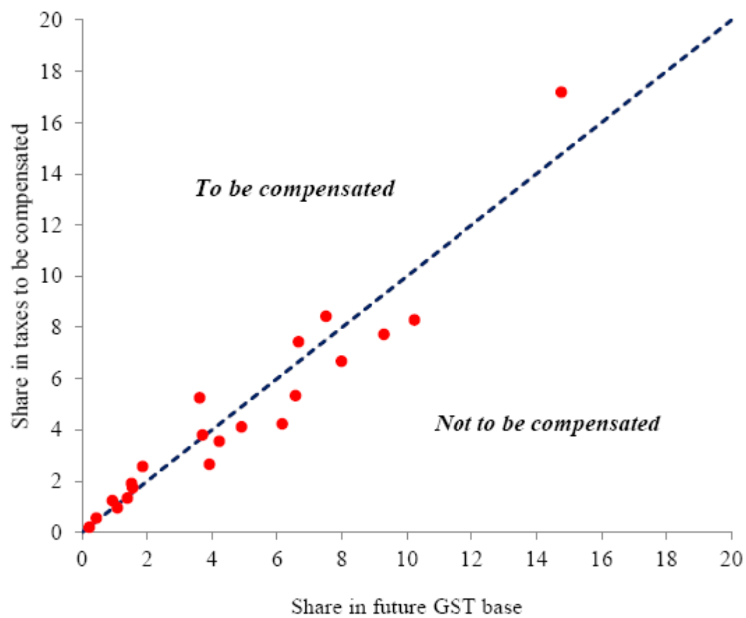
Source: NSS, CSO and Committee own calculations

At current market prices for 2011-12.

- First, most of the points are below or close to the 45 degree line, and where they are above the line, they are not very far above it. This suggests that on aggregate there will not be a huge re-shuffling of taxable revenues
- Second, the largest manufacturing States and the ones that currently get a lion's share of revenues either lie below the line, suggesting that far from needing compensation they will actually be benefitting from the move to the GST; or in the one case, where it is above, it is actually very close to the line, implying a small compensation requirement

We do a sensitivity analysis by changing the goods and services base to 50-50 and the results are shown in Figure 2. In this case, too, the main conclusions described above continue to hold.

Figure 2: Share of revenues to be compensated and share of potential GST base (robustness)



Source: NSS, CSO and Committee own calculations

In sum, we cannot be sure that the GST will lead to large shifts in the tax base away from the advanced manufacturing States but the evidence presented above should provide some reassurance that these shifts will not be seriously adverse for the country as a whole and also for the large manufacturing States because they will also be substantial consumers of services.

Box 3. Evidence-based tax policy? Incorporating social policy objectives in the GST

Once the RNR is known, it has to be operationalized by making decisions relating to: exemptions, the structure of rates, including how many rates to have, and whether to have a separate lower rate for merit/essential goods and a higher rate for de-merit or sin goods; and the threshold below which firms will not have to be part of the GST tax administration.

Typically, the assignment of goods to different tax categories will be motivated by considerations of quity. Goods that account for a large share of expenditures of poorer households—for example, food—will either be exempt or placed in a lower rate category. But these decisions have to be underpinned by analysis and evidence. This section undertakes such an analysis and then compares the outcome of this analysis with current policy. In other words, the question is whether current tax policy is consistent with social objectives in relation to a number of key commodity groups:

- Food and beverages (and sub-groups)
- Clothing
- Fuel and light (excluding power)
- Medicines
- Gold and precious metals
- Power
- Education
- Non-medical health
- Alcohol
- Tobacco

These groups have been chosen because they are of special interest in the context of the GST: either they are exempted (food, gold (Centre), power, non-medicine health, and education); or they are taxed at a lower rate (clothing, gold (States), medicines); or they are charged at very high, demerit rates (petroleum, tobacco, and alcohol).

Two concepts provide the starting point for making policy decisions based on evidence: equity and effectiveness.

Equity allows for categorization of goods as merit/essential/sensitive (hereafter "merit"), etc.

Goods that account for a high share of expenditure of the poorer households will typically be merit goods; and a related feature will be that this share will decline for richer households.

But even if a good is a merit good, warranting a lower or zero rate, policy makers will want to ask how effective that decision will be based on how well targeted the implicit subsidy will be, where the implicit subsidy is the difference between taxing a good at the standard tax rate and the lower or zero rate: if the poor also account for a large fraction of total expenditure on the merit good, then the subsidy will be well targeted; if, on the other hand, they account for a small share of the total expenditure, then the subsidy decision will come with the cost that most of the benefits of the subsidy will accrue to the relatively better off. [29]

So, one can think of a commodity-wise benefit-cost analysis for determining the rate structure. The benefit could be thought of as the subsidy rate for the target group, say the bottom four deciles of the population.[30] The subsidy essentially measures how much the expenditure of the target group would be increased by exempting a good rather than taxing it at the standard rate.

The cost could be measured in relation to the principle of effective targeting. The cost is simply that proportion of the total subsidy for any particular good that does not reach the target group and instead "leaks" to the non-target group, in this case, the top 6 deciles.

We depict this benefit cost analysis graphically in Figure-1 for different group of commodities. We want to focus on the groups (and related sub-groups) that are going to be the focus of important policy choices in the GST mentioned earlier. The data are from the 2011-12 thick NSS household expenditure survey.

The vertical axis measures the benefit—the effective subsidy rate, which is the subsidy as a share of the total expenditure of the target group. The horizontal axis depicts the costs measured as the share of total subsidy on any given product that leaks to the non-target group.

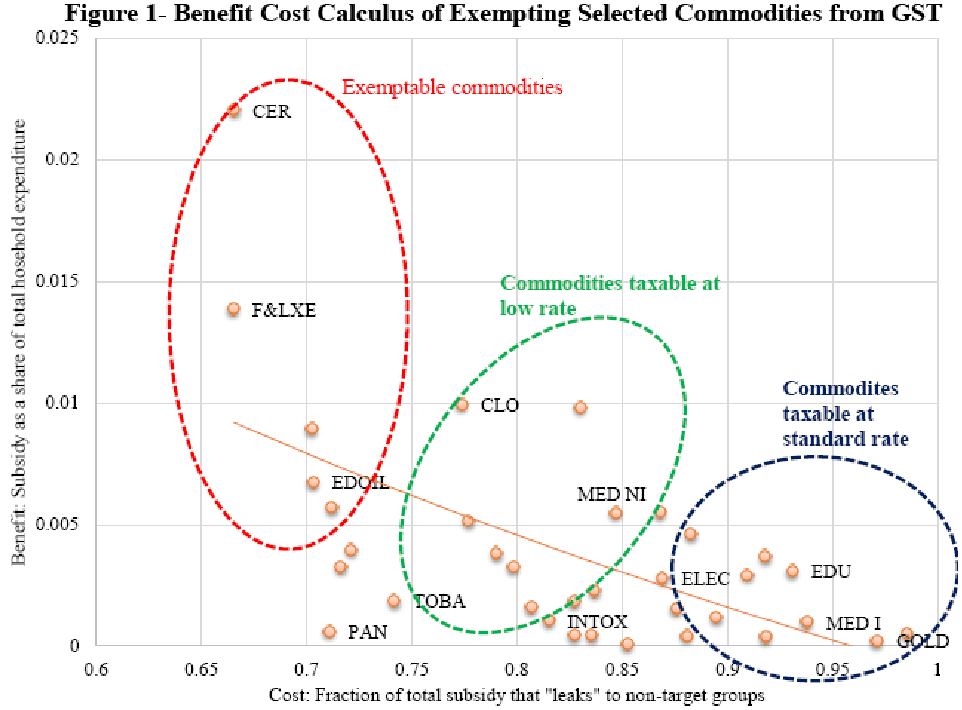
Three circles are drawn to highlight desirable evidence-based choices: commodities in the northwest corner of the graph circled in red are socially worthy of exemption because the benefits are high and the costs are low. These include cereals, vegetables, pulses, edible oils, and fuel and light (excluding electricity). Conversely, commodities in the south-east corner of the graph, circled in blue are less worthy of being treated favorably in tax terms because the benefits are low and the costs high. These include gold, non-medicine health services, education, and power. In the middle are commodities, circled in green, that lie somewhere in between that are perhaps worthy of being included at the lower tax rate. These include milk, poultry products and perhaps clothing.[31]

Ideally, of course, if governments had well-designed transfer programs, they would achieve the desired objective of helping poorer households by providing cash transfers and sparing the tax system from having to attain equity objectives. In practice, this is not always possible and in India DBTs are still a work-in-progress. See Keen (2015).

The analysis can be re-worked for other target groups, say the bottom 3 or 5 deciles.

Strictly speaking, the benefit calculation should deduct the extra burden on the target group because the RNR will go up as a result of the implicit subsidy. The RNR will go up to a greater extent the more the leakage that occurs to non-target households.

Figure 1- Benefit Cost Calculus of Exempting Selected Commodities from GST



CER: Cereals
F&LXE: Fuel & Light ex. Electricity
MED I: Health except Medicine
OHCs: Other household consumables
S&S: Salt and sugar

EDU: Education
ELEC: Electricity
TOBA: Tobacco
INTOX: Intoxicants
PAN: Pan

CLO: Clothing
MED NI: Medicine
TOI: Toilet articles
GOLD: Gold
CONV: Conveyance

Source: NSS 68th round data

The data that underlie this graph are presented in Table 1 for the commodities of policy interest. In each table, the share of each commodity in total expenditure of the target group (bottom 40 percent, B40) and the non-target group (the top 60 percent, T60) is presented. This is a measure of equity.

Table 1: Categorizing Commodities according to Equity and Effectiveness Criteria

Commodity	*EQUITY: Expenditure on commodity as share of total expenditure on all commodities*		*EFFECTIVENESS: Share of total expenditure on commodity accounted for by target group*	
	Bottom 4 deciles	*Top 6 deciles*	*Bottom 4 deciles*	*Top 6 deciles*
Food	38.3%	25.9%	24.7%	75.3%
excluding PDS subsidy	36.5%	25.5%	24.2%	75.8%
Cereals	15.7%	7.0%	33.4%	66.6%
excluding PDS subsidy	14.2%	6.6%	30.1%	62.8%

Fuel & Light ex. Electricity	9.9%	4.4%	33.5%	66.5%
excluding PDS subsidy	9.0%	4.1%	32.5%	67.5%
Clothing	7.1%	5.4%	22.6%	77.4%
Medicines	4.5%	5.0%	16.8%	83.2%
Education	2.2%	6.6%	6.9%	93.1%
Electricity	2.0%	3.0%	13.1%	86.9%
Beverages(non-alcoholic)	1.6%	1.9%	16.3%	83.7%
Tobacco	1.3%	0.9%	25.8%	74.2%
Intoxicants including pan	1.2%	1.0%	21.3%	78.7%
Health (except medicine)	1.0%	2.5%	7.9%	92.1%
Gold	0.2%	1.2%	2.9%	97.1%

Note:

1. The consumption categories are arranged in the decreasing order of benefit-cost ratio.
2. The category "food" includes cereals, cereal substitutes, pulses and products, egg, fish and meat; vegetables, fruits, processed food, packaged food, salt and sugar
3. The category "Fuel and light excluding PDS subsidy excludes the consumption of Kerosene (PDS)
4. The category Cereals excluding PDS subsidy excludes consumption of Rice-PDS and Wheat/Atta-PDS

Source: NSS

The table 1 also presents the share of the total expenditure on a commodity group that is accounted for by the target and non-target groups. This provides a measure of effectiveness because the greater the expenditure accounted for by the non-target group the more the subsidy will not reach the target group.

We can then compare how these commodities should be treated in terms of equity and effectiveness and how they are in terms of the current effective tax rate on these same commodities (Figure 2).

When measuring the tax on an exempted good, it is important to remember that the effective tax need not be zero. If a good is exempted, it will not be able to claim tax credits on the taxes embedded in it by way of the inputs that have gone into it. If rice flour is exempted, for example, the tax paid on milling will be reflected in the price paid by the final consumer. This, of course, would not be the case, if that good were charged a lower tax rate because in this case input tax credits would be availed of. In other words, the difference between a good being taxed at a lower rate say, 5 per cent and exempted could be less than 5 per cent (5-0) because of embedded taxes.[32]

How do we measure embedded taxes? As part of inputs for this Committee, the World Bank, as an illustrative exercise, computed the embedded taxes for 11 categories of goods for the bottom 4 and top 6

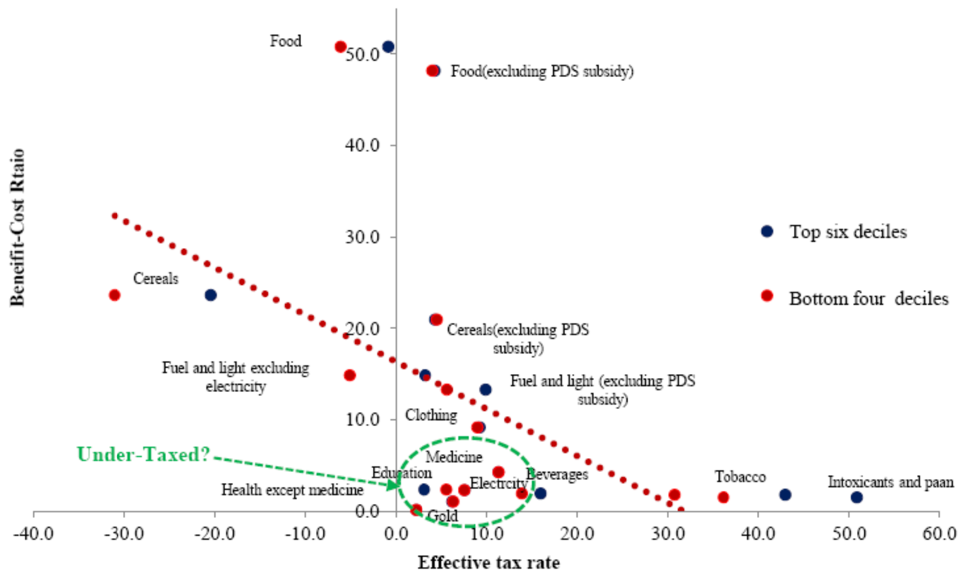
[32] So, for example, if the embedded taxes on a commodity is e (expressed in per cent), and t is the standard rate, then the effective subsidy rate of exempting a good is (t-e)/E, where E is the total expenditure of the target group. In contrast, if that good is taxed at the lower rate l, then the subsidy rate is (this ratio should be (t-(l-e))/E instead) because input tax credits will be available on the embedded taxes.

deciles based on input-output tables and detailed data for five large States: Andhra Pradesh, Gujarat, Kerala, Karnataka, and Tamil Nadu.[33] In Figure 2, the benefit cost ratio of exempting a good is shown on the Y axis and the effective tax rate on the X axis. In principle, the higher the benefit cost ratio, the lower should be the tax. The line of best fit is downward sloping, indicating that tax policy is broadly sensible.

Food, fuel, and clothing

A number of commodities are treated fairly under the current system. Thus, merit goods such as food items, especially cereals, pulses, edible oils, vegetables, and fuel are appropriately taxed at zero or low rates. Conversely, a number of demerit goods such as alcohol and tobacco are appropriately taxed at high rates.

Figure 2: Comparing "Desirable" Taxation with Actual Taxation of Selected Commodities



Source: NSS,CBEC, World Bank and Committee's calculation

The calculations in Figure 2 are somewhat tentative and subject to a number of caveats. There remains some uncertainty about the assignment of tax rates to commodities in the data in the National Sample Survey, CPI and the Input-Output table. This would have to be reviewed and refined in future work. Second, a key benefit of the GST will be the ability for producers to claim input tax credits regardless of where their inputs are produced. The calculations have not fully reflected the input taxes (except for petroleum products), and given that not all input taxes can currently be claimed this means that current tax rates are effectively higher than what is reflected. Third, another factor that would increase the effective tax rates is central sales tax on the movement of goods between States. In future work, this will need to be captured. Fourth, the calculations use 2011-12 consumption aggregates but 2015 tax rates. Finally, the calculations assume not only perfect compliance, but also ignored threshold effects. Businesses below the VAT/Excise thresholds are not liable to collect tax, and this leads taxes to be overestimated, especially for the B40 who would be more likely to shop in businesses below the threshold.

In the case of food and fuels, the PDS system helps make the system fair. For example, taking account of the PDS, the effective tax rate on the bottom 4 deciles is -7.4% for food as a whole, -32% for cereals, and -5.7% for fuel and light excluding power. The PDS has therefore served as reasonably effective social policy.

Clothing is also an anomaly but not as striking as the other commodities mentioned above. It is taxed currently at about 3-3.5 percent even though it does not constitute as large an expenditure item for the poor. On balance, it warrants being taxed at the lower rate by both the center and the States.

Gold, silver and precious metals

Currently, gold, silver and precious metals face no central excise and most States tax these commodities at the non-standard rate of 1 per cent. There could be two reasons to under-tax these metals: for reasons of equity and to promote savings. Consider each in turn.

It turns out that there is very little achieved by way of equity and a high cost is paid for exempting these commodities from taxation. Figures 3 and Table 2 illustrate these points. Gold as a consumption good constitutes a small portion of the total expenditure of the poor and a much higher share of the expenditure of the rich (Figure 3). It has the characteristics of a luxury good than an essential good. For example, the richest decile spends 3.5 per cent of its expenditures on gold, silver, and precious metals. In contrast the poorest decile spends about 0.03 per cent.

Table 2 highlights how ineffective or unfair is the implicit gold subsidy. It shows the expenditure of these commodities of each decile as a share of total gold expenditures. The top decile accounts for over 63 per cent of total gold expenditure. And this is a serious under-estimate because we know that NSS is very ineffective at capturing the expenditure of the very rich. Cumulatively, the top 2-3 deciles account for an overwhelming share of total gold consumption and therefore appropriate nearly all the subsidy given to gold.

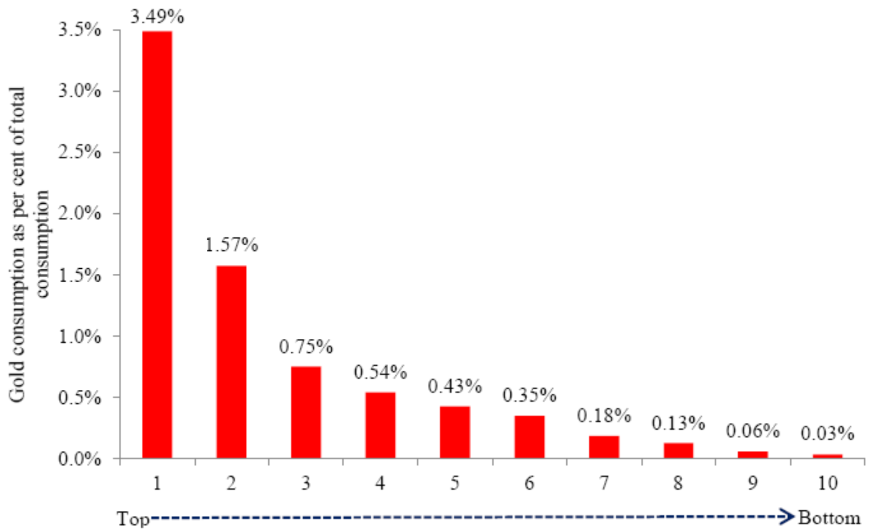
Table-2 Share of Different Deciles in Gold Consumption

	Decile	% share in gold consumption	Cumulative share
Top	1	63.4	63.4
	2	16.4	79.7
	3	6.9	86.6
	4	4.5	91.1
	5	3.4	94.5
	6	2.6	97.1
	7	1.3	98.4
	8	0.9	99.4
	9	0.4	99.8
Bottom	10	0.2	100.0

Source: NSS, committee's calculation

A second reason for favouring gold and precious metals could be to promote savings. At a time when there were few savings instruments, it may have made sense to incentivize the purchase of gold via a lower rate in order to promote savings. But today, this objective has been overtaken by two developments: on the one hand, the emphasis is on proper financial inclusion via the Jan Dhan Yojana which would also serve as the more effective means of promoting savings; on the other hand, gold far from being a desired savings instrument has become a problem, with large gold purchases and imports becoming a cause of macro-economic instability.

Figure 3- Share of Gold in the Total Consumption Expenditure of Different Deciles



Source: NSS, committee's calculation

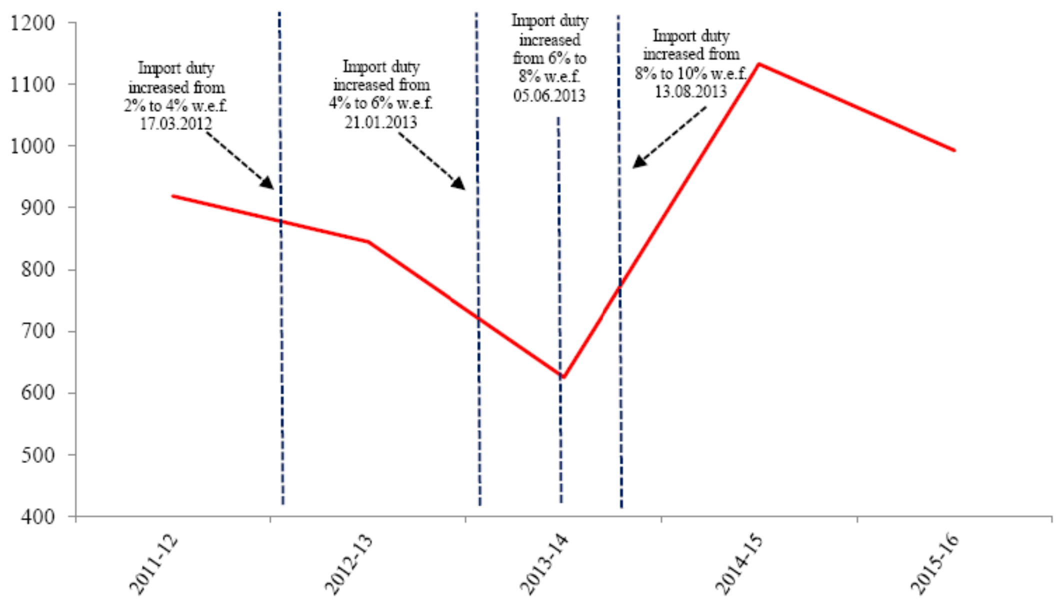
Recognizing this, the government has recently tried to wean consumers away from gold via the gold monetization and gold bond schemes. It would be perverse and contradictory to use taxes to incentivize the holding of gold, and undo what the government is trying to do via these gold schemes. At the very least, tax policy should be neutral on consuming precious metals.

Thus, on grounds of equity and effectiveness of targeting, on grounds of consistency of policy, gold should be taxed at the standard rate (bullion can be exempted from the GST). Instead, it is taxed at 1 percent, dramatically highlighting the incongruity of policy.

The final point to make, of course, is that the more rational gold taxation can be, the lower will be the standard rate which will be critical in creating a buoyant and compliance friendly GST. As shown in Table 8, the standard rate could come down to as much as 16.8 per cent if gold is taxed at 12 (6+6) per cent.

There might be concerns that increasing taxes on gold will lead to increased smuggling and evasion. This is a legitimate concern. But there is some evidence on how serious the impact of increased taxes might be. Import duties have been increased several times in the recent past on gold. These too are tax increases. In Figure 4 below, we plot the imports of official gold since 2011-12 and highlight the timing of import duty increases. The chart clearly shows that there is no seriously deleterious impact on gold imports in response to tariff increases. To some extent, there will be declines in consumption and imports if taxes increase but these are modest and manageable. The notion that there will be rampant evasion and smuggling if the taxation of gold is increased is not borne out by the data.

Figure 4: Gold imports in India (in MT)



Number for 2015-16 is annualized

Source: CBEC

Power, health, and education

Some key sectors have been excluded or exempt from the scope of GST. These include power, health and education probably on the grounds that these are public goods, publicly provided, and of importance to relatively poorer sections of the population. But what evidence do we have on the underlying assumptions justifying such a policy?

Figure 2 suggests that these sectors are perhaps under-taxed currently (They lie well below and to the left of the line of the best fit). The design of tax policy, thus, needs to more carefully take account of evidence. For all three sectors, the benefits of exemptions (even without taking account of any embedded taxes) for the poorer sections is small because these items constitute a small share of their total expenditure. For the top 6 deciles, these sectors are three times as important as they are for the bottom 4 deciles. Moreover, the top 6 deciles also consume such an overwhelming large share of these services (probably privately provided) that nearly all the benefits of the implicit subsidy go to the relatively well off. In the case of education, the current tax structure turns out also to be regressive, with the bottom 4 deciles effectively paying greater taxes than the top 6 deciles. These commodities deserve to be taxed more like standard goods. Yet, today, they face low taxes and they are planned to be excluded from the GST.

Thus, tax policy in the name of the poor turns out to be poor or ineffective social policy. And the cost is a tax base that is narrow, exemptions-ridden, and in the case of power, the cost also includes breaking up the value added chain because it is an important intermediate input. In the medium run, of course, direct benefit transfers or better public provision of essential services would relieve tax policy of the burden of having to meet social objectives. But even in the short run, greater attention needs to be devoted to finding better instruments of social policy, and leaving tax policy to meet broad macro-economic objectives.

Annex 1: Macro-Approach to Estimating RNR

The contemplated GST is a consumption tax of the VAT type. It would tax value added at each stage of the production-distribution chains of goods and services, with a credit/refund for taxes on inputs. The provision of a credit/refund to intermediate and capital inputs is the single most important design element of the GST; and, given the assumption of revenue neutrality, it is what mostly distinguishes it from the current system of federal/States sales and excise taxes, and what makes it a fundamental reform of the indirect tax system in India.

The revenue implication of such reform can be analyzed using a simple macroeconomic framework, written as $t=R/(C+G)$, where: t is the tax rate to be estimated, R is the revenue target, and C and G are, respectively, private and government final consumption of goods and services. In India's case, given the revenue neutrality assumption, R is equal to revenues (both federal and state) generated from existing sales and excise taxes, which India wants to replace with the GST. Assuming that R is known, policy decisions on the GST base become the Centre of policy discussions and design, and are intimately linked to the estimation of the RNR.

National accounts data on final consumption, or supply and use tables can be used to estimate the equation above. They should yield similar results, but the latter provides more insight into how the GST is likely to affect various sectors of the economy, and is particularly relevant, if not necessary, when exemptions or lower rates are part of the options considered during the design phase.

The macroeconomic approach to estimating the RNR has a number of advantages relative to a methodology based on firm-level data, from tax returns or other sources. First, the existing system of sales and excise taxes, which combines federal and state level taxes, produce insufficient information for estimating value added at the firm level for the whole economy, mainly because it is riddled with exemptions and exceptions, and administrative data are of poor quality. National accounts data provide a more accurate picture of sectoral value-added and final consumption.

Second, firm-level data do not always separate intermediate and capital inputs, which may receive different tax treatment under the GST - the methodology by A. Modi, which relies on tax returns of the corporate income tax, is interesting in that it uses depreciation schedules for income tax purposes as proxies for long-term capital consumption. Third, firm-level data rarely, if ever, contain a clear separation between supplies to export markets (which would be taxed at zero per cent under the GST), and supplies to domestic markets, which would be fully or partially taxed. Again, this is easily addressed with national accounts data.

One of the main disadvantages of the macroeconomic approach is that national accounts data do not reflect misreporting of the tax base and the tax liability, while tax returns do (implicitly). Another disadvantage is that sectoral analysis using national accounts data is usually limited, relative to firm-level data—where, for example, mixed supplies such as taxed/exempt by the same firm can be analyzed more effectively.

As noted above, estimating the RNR requires clarity on policies regarding the revenues to be subsumed by the GST and the GST base; but these are still the subject of some debate, and are likely to remain until late in the policy process. A useful analysis then consists in examining the potential revenue impact of the GST for India as a whole under various base scenarios, starting first with a very broad base. The macro approach outlined above was applied using the following formula:

$$PB=£(Y+M-X)-(1 -e)X(N+I)$$

PB is the potential GST base; Y is domestic output, (M-X) is net imports (imports minus exports); (N+I) is consumption of intermediate and capital inputs; e is the exempt output ratio (i.e. the tax base associated with inputs used in the production of exempt final consumption); and the summation is over 140 goods and services and 66 sectors, based on 2011-12 national accounts. The following assumptions were made: (1) full compliance; (2) full pass-through of the GST into prices; (3) no behavioral response; (4) the GST has a single positive rate, and a zero rate on exports.

Under a standard scenario exempting health, education, financial intermediation and public administration, the GST potential base is 59 of GDP. Exempting basic food items in addition (essentially unprocessed foods) reduced the potential base to 55 of GDP. However, exempting petroleum or electricity increases the potential base to 67 of GDP—given that such items are largely consumed as inputs rather than final consumption, their exemption increases the base due to cascading. These estimates suggest that the GST RNR rate, assuming maximum revenue to be replaced of 6 of GDP, ranges between 9 and 11.

Among the assumptions listed above, compliance is perhaps the most important factor to consider. Although the design of the GST is likely to improve compliance—even assuming no changes in administration, the federal/state coordination of the GST will improve information for cross-verification, especially regarding inter-state transactions—experience suggests that some losses to poor compliance and enforcement should be expected. Losses in the order of 10 to 20 of potential revenues are common in OECD countries; assuming 20 increases the range of the RNR from 9-11 to 11-14.

In summary, this analysis suggests that the GST RNR rate ranges between 10 to 15, depending on key policy choices regarding exemptions, and a compliance rate of about 80 of potential GST revenues.

Annex 2: Indirect Tax Turnover-based approach to estimating RNR

The taxes to subsumed into GST and the corresponding revenues earned are summarised in Tables 1 and 2 below. The reported revenue for the Centre includes the entire revenue from Tobacco products. However, since a part of the revenue on tobacco products is to be realized through non-rebatable excises, for the purposes of the present exercise, it is assumed that one fourth of the revenue from tobacco products would be realized from GST.

Table 1: Summary of Revenue to be compensated for all States combined

Tax Heads	Revenue to be Compensated
CST (including ITC adjustment)	38338
VAT & Sales Tax (excluding Non-VAT)	27832
Non VAT (collected on services/works contract)	1047
Entertainment Tax	2138
Lottery, Betting & Gambling	608
Luxury Tax	1946
Entry Tax not in lieu of octroi	15896
Entry Tax in lieu of octroi	20772
Toll tax not in lieu of service charges	552
Cesses & Surcharges	4742
Advertisement Tax	1
Purchase Tax	4559
ITC Reversal	11677
TOTAL	535722
Revenue to be Compensated (4 per cent)	**407167**
Revenue to be Compensated (2 per cent)	**368829**

To derive the tax base for GST, we have broken down the exercise into two parts - one, to derive the base corresponding to goods, we have used the revenue collections from individual States, the tax rates applicable in these States and some assumptions based on discussions with States regarding the composition of turnover taxable by the 1 per cent rate, the lower rate and the standard rate. The assumptions adopted are 2 per cent of total base taxable at 1 per cent, 56.15 per cent taxable at the lower rate and the rest taxable at the standard rate. For each state, taxes have been classified into two groups - taxes, the base of which can be added to the taxable base in GST and taxes, whose base might not add to the taxable base under GST. The first category we have VAT, entry tax not in lieu of octroi, entertainment tax. Rest of the levies are classified in the second category. This is because, taxes such as entry tax in lieu of octroi would be leviedover and above VAT or GST and hence would not provide additional base to the tax. Similar would be the case of purchase tax for instance. VAT revenue is further bifurcated into revenue from commodities which will be brought into tax under GST and those that would remain outside the base, i.e, liquor, diesel, petrol and ATF. We have used weighted average tax rates for the estimation of taxable turnover from the data on tax collected under entry tax not in lieu of octroi and VAT excluding those which would not form part of the GST, viz., liquor, diesel, petrol and ATF. Further, since state VAT is applied on a base inclusive of excise duty, the base is deflated by 1.1236 to derive the base net of taxes.[34] To this is added an estimate of the likely base from entertainment tax

[34] The headline rate of tax for central excise was 12.36 per cent in 13-14.

assuming the tax rate is 30 per cent. This gives us the base corresponding to the taxation of goods under GST. Adding across all States, we get a base for the goods part of GST.

Table 2: Revenues of the Central Government: 2013-14 (Rs crore)

S. No.	Type of duty	Shared with States	Not shared with States			Total	Tobacco Correction
		Basic	NCCD	Education cess*	Others		
1	**CE duty**						
a)	Non Pol (excluding Tobacco products)	53672	1913	2441	2675	60701	
b)	Tobacco products	14855	1319	528	1153	17855	44637.5
	Total CE duty {Non Pol} [a)+b)]	68527	3232	2969	3828	78556	
2	**CVD (Non-Pol)**	77965	479	3663	883	82990	
3	**SAD (Non-Pol)**	24837	0	0	0	24837	
4	**Service Tax**	150417	0	4319	0	154736	
5	**TOTAL**	**321746**	**3711**	**10951**	**4711**	**341119**	
6	**Total revenue to be compensated**					**327728**	
6i	**Non Tobacco revenues to be compensated**					**323264**	
6ii	**Tobacco products revenue at 10 per cent**					**4463.75**	

Note: * includes secondary and higher education cess. Source: Provided by CBEC.

Turning to the services component, to derive the total turnover of services that would be subject to GST, we have used to data sources: the activity code wise information on sales from the MCA database and the turnover derived from the service tax collection. The MCA data needed some cleaning and updation which is summarised below.

In this database, the activity codes assigned to companies was as per 2004 NIC code. On examining the data it was found that some companies did not have a valid activity code as per the NIC classification. Further, since the data for 2013-14 appeared incomplete since fewer companies where reflected for 2013-14 when compared to 2012-13, the data available for 201314 has been augmented by using information from 2011-12 and 2012-13. Before attempting these corrections, it would be useful to examine the data that is available for each of these years.(Table 3) The total number of firms reporting data in 2011-12 and 2012-13 appear to be much larger than those reporting for 2013-14. However, if one compares the number of firms with valid activity code and working in the supply of services, the differences are not that large -3.56 lakh in 2012-13 as against 3.25 lakh in 2013-14. A comparison of turnovers suggests that while the overall turnovers in 2011-12 and 2012-13 are higher than those in 2013-14, the turnover of firms reporting to be service providers with a valid code is comparable to the turnover available for 2013-14.

Table 3: A comparison of MCA data

Number of Firms	2011-12	2012-13	2013-14
1. Firms with no valid code	34720	34059	21996
2. Firms not engaged in services	169042	175154	0
3. Firms in services	331124	356752	325013
4. Firms in service but not included due to coverage[35]	71813	76128	0
Total	606699	642093	347009
Turnover (Rs crore)			
1. Firms with no valid code	1058035	22941162	730001
2. Firms not engaged in services	50129647	14171531	0
3. Firms in services	3062734	3778774[36]	3412732
4. Firms in service but not included due to coverage	1043559	1161634	0
Total	55293975	42053102	4142732

Source: computed from data provided by Ministry of Corporate Affairs

Using the concordance tables, companies first are classified as per the NIC code for 2008. Further, since it was noted that a number of companies which filed returns in 2012-13 did not file returns in 2013-14, an attempt is made to undertake some corrections to get a more comprehensive base for 2013-14. These are discussed below.

Step 1: For all companies reporting information in 2012-13 but not for 2013-14 and had a valid activity code, the data from 2012-13 has been extrapolated using the average growth rate for 2013-14 when compared to 2012-13.

Step 2: For all companies for which there was no description and/or no valid activity code, all companies with turnover above Rs 100 crore have been individually explored and classified into an appropriate activity code. These companies account for 89.88 per cent of the total turnover of uncoded companies.

Table 4 below summarises the numbers after each of these steps and Table 7 provides estimates of the size of the additional base subsequent to all corrections using MCA database.

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[35] Companies associated with electricity, gas and steam and construction for instance are excluded from the analysis

[36] Data for one company appeared spurious it increased from Rs 89 crore in 2012-13 to Rs 115 lakh crore in 2013-14 and then dropped to Rs 180 crore in 2013-14. For purposes of comparison this value was corrected.

Table 4: Computing Total Turnover for the year 2013-14

(Rupees in crore)

Steps	Turnover
1.Data provided for 2013-14	3412732
2.Including companies for which data from 2012-13 was extrapolated for companies with valid activity code	3974753
3.Turnover without activity code in 2012-13	1511747
4.Turnover classified through assigning activity codes in 2012-13	1358755
5.Taxable turnover from step 4 (in 12-13 prices)	377204
6.Taxable turnover in 13-14 prices	405707
7.Total turnover from MCA after all corrections (2013-14)	4083607

This information relates to companies alone. Since the tax would be payable by non-corporate service providers as well, we have used information from service tax collection to correct any shortfall from the MCA related estimates. Further, for all the services, two kinds of adjustments have been made, viz., deduction for taxable inputs used for service provision and deduction of services provided when used as inputs into taxable activities. For these corrections, the input-output table for 2006-07 has been used to derive service specific input-output ratios (see table 5).

In addition to the above, there are three sector specific corrections made in the data

1. For computer related services, it has been argued that a sizeable part of the turnover is associated with exports- this component will not add to the taxable base for GST. Based on an IBEF study, the domestic supply of computer services is 30 per cent of total sales value of computer related activities and hence this 30 per cent is included in this study for arriving at the net additional base available for taxation.

2. From decisions taken so far, it appears that taxation in the real estate sector would be limited to the extent to which it is taxed today through taxation of works contracts and pre-completion sales of properties. To incorporate this view, the turnover from service tax collections is given primacy.

3. For financial services, there are two difficulties. First, the coverage of financial services tends to be incomplete being largely limited to fee based services. The present regime of taxation of financial services within Service Tax too is of this form. There is no clear indication to suggest that a radically new approach would be adopted in the proposed GST regime. Therefore, the base corresponding to the present service tax regime is considered a more appropriate base to incorporate into GST RNR estimation in both cases- PROWESS and MCA based estimates. Second, as per the input output table, more than 80 per cent of total financial services are used as inputs. But since a significant part of financial services are in the form of embedded services, the

possibility of taking input tax credit can be limited. So using the ratio of FISIM to total financial services, the extent of financial services used as inputs is reduced from 80 per cent to 50 per cent.

In addition to the above, since services provided by railways are not captured within either of these methods, the base is augmented to the extent of passenger services and transport of exempt services.[37]

Table 5: Input Coefficients and the Adjusted Base: MCA Database

NIC 2008	Range	Taxable i-o ratio	Share of Sales used as inputs	Net additional Base available for taxation
19	Bottling of LPG/CNG		1	0
35	Power transmission line infrastructure		1	0
46	Trade		1	0
47	Commission agent services & Retail outlets		1	0
491	Rail Transport	0.1582	0.8175	1553
492	Road Transport	0.1130	0.5328	24979
493	Transport via Pipeline	0.1130	0.5328	16376
50	Water Transport	0.1803	0.4931	5778
51	Air Transport	0.2265	0.4523	24462
521	Storage and Warehousing	0.0739	0.9894	1397
522	Other transport service activities	0.0624	0.6605	4910
55	Hotel and Restaurant	0.1833	0.1887	36394
61	Post & Telecommunication	0.1020	0.7716	49069
62 & 63	Computer related activities	0.0425	0.1256	116242
64, 65 & 66	Banking and other financial services	0.0361	0.6151	110927
42, 68, 77	Real Estate	0.5523	0.4202	126995
72 & 85	Research & Development and Education	0.0075	0.0112	50295
70, 73, 74, 78, 79, 80 & 82	Business services	0.0788	0.9947	7550
84	Public administration	0.0000	0.0000	3781
86	Health	0.2256	0.0231	2177
93, 94	O.com, social & personal services	0.1123	0.4170	43668
	Others / Undifferentiated services	0.0765	0.3567	118838
Total				**745390**
Total after all corrections[38]				**853235**

[37] Transport of taxable services is not included since this would be a wash transaction - while railways would collect revenue, the taxpayer who pays this tax would claim credit against subsequent transactions.

[38] Two corrections are incorporated here - correction for revenue from railways and for base corresponding to restaurants which is already included in the base for goods computed from the state side.

The RNR corresponding to the proposed design, with CST compensated at 2 per cent is summarised in the table below. The results presented contain four scenarios. The GST bill proposes that in the short term, the States would be enabled to levy a 1 per cent tax on inter-statesale of goods. Scenario 1 presents a case where there is no such levy while scenario 2 presents the case where such a levy does exist. Further, in each of these cases, the results report an RNR for whether there is a single rate GST or a two rate GST. In single rate case, the entire base is taxed at the same rate. In the two rate case, the base currently taxed at the lower rate and 1 per cent in the States is retained in the same categories and the rest of the base is taxable at the standard rate. The lower rate is assumed to be 6 per cent for Centre and 6 per cent for the States.

Table 6: Additional base for GST: Alternative estimates

	Value (Rs crore)	**As of relevant GVA**
Incremental Services Base (MCA)	853235	15.87
Services GVA (2011-12 series)	5376045	
Total GST Base (MCA)	3936610	37.57
GVA Total	10477140	

Table 7: Revenue Neutral Rates: Alternative Scenarios

	2 per cent	
	Single rate	**Standard rate**
Scenario 1		
Centre	**8.33**	**10.42**
State (Average)	**9.37**	**12.34**
Total	17.69	22.76
Scenario 2		
Centre	**8.33**	**10.42**
State (Average)	**8.88**	**11.44**
Total	17.21	21.86

To consider an alternative case within scenario 1, if one proposes a 30 per cent tax on all transport vehicles (15 per cent for the Centre and 15 per cent for the States), and retain only the 1 per cent tax on gold and bullion, what will the RNR look like. From the National Accounts Statistics, output of manufacturing in organised sector in transport equipment is Rs 652251 crore. Assuming that value added subsequent to manufacturing, including trader margins and transport costs is 10 per cent of this value, the value of sales of transport vehicles is Rs 717476 crore.[38] Assuming that this part of the base is taxed at 15 per cent each by both Centre and States, the RNR got the rest of the base would be 6.81 per

[38] The figures for exports and imports for transport vehicles suggest that there is a net export in this segment. If this be the case then the downward correction in the RNR would be smaller.

cent for the Centre, 8.09 per cent for the States adding up to 14.91 per cent overall as compared to 17.69 per cent reported above.

To understand what these numbers indicate, it would be useful to look at the composition of the revenues from the States. The composition indicates that 19 per cent of the revenue to be compensated is not adding to the taxable base for the States. Now if the RNR exercise were to be undertaken only with the first set of taxes, then the RNR for the States would turn out to be considerably lower than if we sought to find the resources to compensate for all the other taxes in category II as well. (Table 9)

Table 8: Decomposition of state revenues

I. Revenue adding to base, of which	**297312**
a. VAT	279278
b. Entry tax not in lieu of octroi	15896
c. Entertainment tax	2138
II. Revenue not adding to the base, of which	**71517**
a. CST	38338
b. Lottery, betting and gambling	608
c. Luxury tax	1946
d. Entry tax in lieu of octroi	20772
e. toll taxes	552
f. cesses and surcharges	4742
g. Advertisement tax	1
h. purchase tax	4559

Considering the single rate case in scenario 1 above, the RNR excluding revenues from II above would be 7.55 per cent with the overall RNR being 15.88 per cent. Assuming that the rate structure for taxation in the state is 1 per cent, 5 per cent and 12.5 per cent, on bullion, lower rate and standard rate, the corresponding average statutory tax rate would be 9.05 per cent incorporating the fact that VAT is levied on a base inclusive of excise. In other words, the RNR gets placed below the average tax rate. On the other hand, if one sought to find resources for all the taxes incorporated in category II, then the RNR increases to 9.37 for the States and 17.69 overall.

Table 9: Impact on RNR of design of GST

	State rate	Overall rate
RNR excluding II	7.55	15.88
Effective tax rate for States	9.05	
RNR for finding revenue for II as well	9.37	17. 69

Annex 3: Direct Tax Turnover Approach to Estimating RNR

At the producer level, the GST base is equivalent to the value added which is the value that a producer adds to his raw materials or purchases before selling the new or improved product or service. That is, the inputs (the raw materials, transport, rent, advertising, and so on) are bought, people are paid wages to work on these inputs and, when the final good or service is sold, some profit is left. So value added can be looked at from the additive side (wages plus profits) or from the subtractive side (output minus inputs).

2. Value added = wages + profits = output - input. If the tax rate on this value added is't', there are four basic forms that can produce an identical result:

1) *t* (wages + profits) : the additive - direct (accounts) method;

2) *t* (wages) + *t* (profits): the additive - indirect method[39],

3) *t* (output - input) : the subtractive - direct (accounts) method; and

4) *t* (output) - *t* (input) : the subtractive - indirect (the invoice or credit) method.

3. While there are four possible ways of levying a VAT, in practice, the method used (number 4) never actually calculates the value added; instead, the tax rate is applied to a component of value added (output and inputs) and the resultant tax liabilities are subtracted to get the final net tax payable. This is sometimes called the "indirect" way to assess the tax on value added. Since in actual practice, input tax credit will be allowed only on the basis of invoice, we use the subtractive - indirect method for calculating the GST base and the consequential, revenue neutral rate (RNR). The present exercise is an attempt to calculate the single RNR using this method. Mathematically,-

Total Revenues (R) = t* (output) - t*(inputs) = t* (output - inputs)

= t* (Base)

or, Single RNR, **'t'** = R / Base

4. For the purpose of estimating the RNR, we use the extensive producer level data in the form of profit and loss accounts available with the Income Tax Department. These accounts relate to 94, **31, 508 business entities** for the financial year ending on 31st March, 2013 (financial year 2013-14)[40]. These entities comprise of all companies, partnership firms and proprietorships but do not include charitable organizations. The activities of these entities are classified into 10 sectors and further sub classified into 75 sub-sectors. We assume that these 94, **31, 508 entities** constitute the universe of the GST taxpayers. This sample does not include taxpayers who have filed their tax returns in paper form[41] or engaged in charitable activities or wholly engaged in agriculture. The summary of the data is presented in Table 1.

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[39]This method is so called because value added itself is not calculated but only the tax liability on the components of value added is calculated.

[40] These accounts have been electronically filed with the Income Tax Department along with their return of income for assessment year 2014-15. They relate to returns filed up to 30th June , 2015.

[41] This does not affect the estimation results since these are very small taxpayers with low turnover; therefore, they are likely to be below the threshold limit of Rs 40 lakh envisaged under the GST.

5. The computation of the GST base under the SI method involves the following steps:

a. The receipt items on the credit side of the Profit and Loss Account, which would be liable to output tax, are identified and appropriately adjusted for indirect taxes to arrive at the **'value of supply of domestically produced goods and services (net of indirect taxes)'** (hereinafter referred to as **'net value of supply of domestically produced goods and services');**

b. Since imports are liable to GST at the point of importation, the **'value of imports'** is aggregated with the **'net value of supply of domestically produced goods and services'** to arrive at the **'net value of domestically available goods and services'.**

c. Since exports are zero rated in a GST regime, the value of exports is reduced from the **'net value of domestically available goods and services'** to arrive at the **'net value of goods and services available for domestic consumption'** or the **'aggregate output tax base'.**

d. Similarly, the expense items on the debit side of the Profit and Loss Account, in respect of which input tax credit would be potentially available, are identified and appropriately adjusted for indirect taxes to arrive at the **'value of purchase of intermediate goods and services'.**

e. Under the GST Model, full and immediate input credit is proposed to be allowed for GST paid on purchase of capital goods in the year of purchase. Therefore, the **'value of purchase of capital goods'** is aggregated with the **'value of purchase of intermediate goods and services'** to arrive at **'gross value of purchase of intermediate goods and services'.**

f. Since no input tax credit would be available in respect of purchases made from unregistered dealers, the **'value of purchases from the unregistered dealers'** is reduced from the **'gross value of purchase of intermediate goods and services'** to arrive at the **'aggregate input tax base'.**

g. Under the proposed GST Model, several sectors will be exempt from the scope of GST; these are petroleum, land component of real estate, the interest component in the financial sector, electricity, gem and jewellery, education and health services, and agricultural produce. Reflecting this, appropriate downward adjustments have been made to both the output and input tax base.

h. The threshold limit is proposed to be increased to Rs 40 lakh for both goods and services. Therefore, appropriate downward adjustment to the GST base is made to also reflect this.

i. The **'aggregate output tax base'** is reduced by the **'aggregate input tax base'** to arrive at the **'GST Base'.**

Table 1: Summary of Data

Sl. No.		Description	Unit	All Sectors	Taxable Sectors
A		**Sample Size**	in nos	9431508	9087529
B		**Net value of supply of domestically produced goods and services**			
	1	**Sale of Goods**	Rs. In crs	18055276	15180098
	2	**Sale of Services**	Rs. In crs	2818183	2764294
	3	**Other operating revenues**	Rs. In crs	896139	889567
	4	**Financial services (in case of finance company) excluding interest**	Rs. In crs	49998	49991
	5	**Commission**	Rs. In crs	63526	63480
	6	**Other income** (excluding rent, interest, dividend, profit on sale of fixed assets, profit on sale of securities liable to STT, profit on sale of other investments, agricultural income and profit on account of currency fluctuation)	Rs. In crs	336661	332841
	7	**Total**	Rs. In crs	**22219783**	**19280272**
C		**Purchases from Primary and Secondary Sector**			
	1	**Purchases** (net of refunds and duty or tax, if any) including primary goods	Rs. In crs	**14879025**	**12969557**
D		**Specified services**			
	1	Freight	Rs. In crs	300557	282113
	2	Consumption of stores and spare parts	Rs. In crs	241393	214741
	3	Repairs to building	Rs. In crs	23320	21642
	4	Repairs to machinery	Rs. In crs	99921	81977
	5	Insurance	Rs. In crs	31067	28232
	6	Workmen and staff welfare expenses	Rs. In crs	46761	43121
	7	Entertainment	Rs. In crs	1469	1401
	8	Hospitality	Rs. In crs	1385	1336
	9	Conference	Rs. In crs	2421	2306
	10	Sales promotion including publicity (other than advertisement)	Rs. In crs	55018	53507
	11	Advertisement	Rs. In crs	67801	66471
	12	Commission	Rs. In crs	65424	63818
	13	Royalty	Rs. In crs	36562	34021
	14	Professional / Consultancy fees / Fee for technical services	Rs. In crs	102244	93883
	15	Hotel , boarding and Lodging	Rs. In crs	12055	11943
	16	Traveling expenses other than on foreign traveling	Rs. In crs	69477	66842
	17	Foreign traveling expenses	Rs. In crs	12656	12387
	18	Conveyance expenses	Rs. In crs	24968	23963
	19	Telephone expenses	Rs. In crs	27831	27003
	20	Guest House expenses	Rs. In crs	499	449
	21	Club expenses	Rs. In crs	137	128
	22	Festival celebration expenses	Rs. In crs	1200	1166
	23	Gift	Rs. In crs	414	374
	24	Audit fee	Rs. In crs	7290	7042
	25	**Total** (D1 to D24)	Rs. In crs	**1231869**	**1139866**
E		**Miscellaneous Services**			
	1	Other expenses	Rs. In crs	**2211903**	**1723601**
F		**Total value of inputs on which input tax credit could be available**	Rs. In crs	**18322797**	**15833024**

6. The **"net value of supply of domestically produced goods and services"** is the

aggregate of the value of (i) sale of goods; (ii) sale of services; (iii) other operating expenses; (iv) financial services (excluding interest) provided by financial companies; (v) Commission; and (vi) other income. The item 'other income' as reported in the accounts excludes rent, interest, dividend, profit on sale of fixed assets, profit on sale of securities liable to STT, profit on sale of other investments, agricultural income and profit on account of currency fluctuation. In practice, a large number of professional entities report their gross receipts under this item since they do not view themselves as carrying on business or engaged in sales. Since all goods and services (except a small negative list) are proposed to be included in the GST base, the value of supply of goods and services must therefore, include the item 'other income'. However, receipts by way of rent, dividend, interest, profit on sale of fixed assets, profit on sale of investment liable to STT, profit on other investment, profit on currency fluctuation and agricultural income have been excluded from the value of the supply of goods and services because either they represent accretion to savings or have been effectively netted out in the calculation of the input base eligible for input tax credit.

7. The **"net value of supply of domestically produced goods and services"** by all sectors is estimated to be Rs. **222,19,873 crore** in the financial year 2013-14. However, diamond cutting, petroleum, rice and flour mill and power and energy sectors (hereafter collectively referred to as "exempt sectors") are proposed to be exempt from GST. After adjusting for the "exempt sectors", the **"net value of supply of domestically produced goods and services"** for the taxable sectors is estimated to be **Rs 192, 80,272 crore.**

8. Input tax base comprises of all goods and services used as intermediate inputs in the production of goods and services and on which output tax has been paid. The **'value of purchases of intermediate goods and services' by all sectors** is the aggregate of the expenditure on items listed in Table-1. These purchases can be classified as purchases from the primary sector, secondary sector and tertiary sector. The aggregate of purchases by all entities from these three sectors is estimated to be Rs 183, 22,797 crore during the financial year 201314. After adjusting for the exempt sectors, the aggregate of purchases by taxable sectors is estimated to be Rs 158, 33,024 crore.

9. In the case of **purchases from the primary sector** (i.e. primary goods) like cereals and plantation crops, no input tax credit would be allowed since these goods would be exempt from GST. If for some reason, the agriculturist falls within the scope of the GST, he would be liable to collect GST for which the purchaser in our sample would be eligible to claim input credit. However, agriculturists do not ordinarily file an income tax return, and therefore, their sales do not form part of the output base estimated above. In either case, purchases of primary goods in this exercise would not be entitled to any input tax credit. The value of such purchases by the taxable sectors is estimated to be Rs.11, 04,545 crore during the financial year 2013-14.

10. As regards **purchases from secondary sector** is concerned, they are generally made from both registered and unregistered dealers. To the extent these are acquired from registered dealers, full input tax credit would be available. However, where purchases of trading goods and raw materials are made from unregistered dealers, no input tax credit would be available since no output tax would have been paid by the registered dealer purchaser. Since there is no bifurcation of purchases from registered and unregistered dealers in the Profit and Loss Accounts, the amount of purchases from unregistered dealer needs to be estimated. Based on anecdotal information, it is estimated that 10 per cent of the purchases of trading goods and raw materials from the secondary sector is acquired from unregistered dealers on which no input credit would be available. The value of such purchases from unregistered dealers, by taxable sectors, is estimated to be Rs 11, 86,501 cores during the financial year 2013-14.

11. Similarly, value of **specific services and miscellaneous services purchased** by taxable sectors, from unregistered dealers, are estimated to be 25 per cent and 40 per cent, respectively. This translates to Rs 4, 36,619 crore and Rs 6, 89,440 crore, for specific services and miscellaneous services, respectively. The aggregate purchase of services from unregistered dealers is determined at Rs 11, 26,059 crore.

12. Accordingly, the **'value of purchases from unregistered dealers'** in 2013-14 for taxable sectors is determined at Rs.23, 12,560 crore. Since no input tax credit would be allowed on these purchases, the same is deducted from the value of purchases of intermediate goods and services for determining the GST base.

13 In the design of the GST, several **exemptions** are envisaged. In particular, these relate to primary goods including unprocessed food, health, education, petroleum, land component of real estate, alcohol and power and energy. The impact of these exemptions has been factored in the calculation of GST. In the case of some of these exemptions, the producers are not required to file their income tax returns and, therefore, do not form part of the sample. Accordingly, while no adjustment is required to be made to the output tax base, a downward adjustment has been made to the input tax base. In all other cases, downward adjustment has been made to both the output tax and input tax base.

14. In terms of the proposed GST Model, the tax base will include **real estate** to the extent that the present scheme of taxation will continue. In the light of this, the value of rental services has been excluded from both the output tax and the input tax base. However, in the case of land, no information is separately available for the amount embedded in real estate services. Since the value of land is included in both the output tax and input tax base, this amounts to a wash transaction having no impact on the GST base.

15. Under the GST, a **threshold exemption** is proposed to be provided for registration of dealers. Since no decision has yet been taken on the level of the threshold exemption, we assume that the same will be fixed at Rs 40 lakh. Table -2 shows the distribution of taxpayers across turnover. As would be noted, there are 7442736 dealers with turnover below Rs 40 lakh accounting for a total turnover of Rs 3,00,377 crore only. Effectively, 79 per cent of the total dealers accounting for approximately 1.35 per cent of the total turnover base will remain outside the GST net. Calculated on a pro-rata basis, the value addition by these dealers is estimated at Rs 63,109 crore and the GST base is reduced accordingly.

Table 2: Distribution across Turnover

Turnover	Corporate		Non-Corporate		Total	
	Number of cases	Total Turnover (in Rs. crs)	Number of cases	Total Turnover (in Rs. crs)	Number of cases	Total Turnover (in Rs. crs)
Less than 0	0	0	0	0	0	0
Between 0 and Rs 10 lakh	356036	3186	6077867	81777	6433903	84964
Between Rs 10 lakh and Rs 25 lakh	35152	5898	647707	105854	682859	111751
Between Rs 25 lakh and Rs 40 lakh	21875	7010	304099	96652	325974	103662
Between Rs 40 lakh and Rs 1 crore	51385	34476	616905	412195	668290	446671
Between Rs 1 crore and Rs 2 crore	41455	59682	461638	653155	503093	712837
Between Rs 2 crore and Rs 5 crore	48910	158340	378129	1182874	427039	1341213
Between Rs 5 crore and Rs 10 crore	31696	226691	155235	1081062	186931	1307752
Between Rs 10 crore and Rs 100 crore	60571	1891079	124932	2800947	185503	4692026
Above Rs 100 crore	14130	12579433	4186	1146675	18316	13726108
Total	661210	14965794	8770698	7561190	9431908	22526984

16. The comprehensive GST is intended to bring within its fold **rail transport services** also. The rail transportation sector is entirely under the Ministry of Railways which is not required to file a tax return. Therefore, the sample does not include rail services. Accordingly, based on the information contained in the National Accounts (2014), the GST Base in respect of rail services is estimated at Rs 79,759 crore.

17. In the light of the aforesaid discussions, the step-wise calculation of the GST Base for base year 2013-14 is presented in Table -3. As would be noted, **the GST base is determined at Rs 58, 15,262 crore.** The implicit value addition is estimated to be 31 per cent of the total output tax base. **Consequently, the RNR for the Centre and the State is estimated to be 5.64 per cent and 6.34 per cent, respectively. The combined RNR is determined at 11.98 per cent.**

Table 3 Estimate of RNR for GST: SI Method

		Unit	Amount
A	Sample Size	Nos	9431508
B	Output Tax Base		
	1 Net value of supply of domestically produced goods and services	Rs. In crs	22219783

	2	Value of imports	Rs. In crs	1744465
	3	Total value of goods and services (1+2)	Rs. In crs	23964248
	4	Value of supply by exempt sectors	Rs. In crs	2939511
	5	Value of exports	Rs. In crs	2177633
	6	Aggregate Output Tax Base (3-4-5)	Rs. In crs	18847105
C	Input Tax Base			
	1	Value of purchase of Capital goods	Rs. In crs	606609
	2	Value of purchase of intermediate goods and services	Rs. In crs	18322797
	3	Gross value of intermediate goods and services (1+2)	Rs. In crs	18929406
	4	Value of purchases by exempt sectors	Rs. In crs	2489773
	5	Value of purchases of primary goods	Rs. In crs	1104545
	6	Value of purchases from unregistered dealers	Rs. In crs	2312560
	7	Aggregate Input Tax Base (3-4-5-6)	Rs. In crs	13022528
D	Estimated value addition by dealers below threshold exemption of Rs 40 lakhs		Rs. In crs	63109
E	Estimated value addition attributable to alcohol sector		Rs in crs	25965
F	Estimated value addition by Rail Sector		Rs in crs	79759
G	GST Base (B6-C7-D-E+F)		Rs. In crs	5815262
H	Revenues to be compensated			
	1	Centre	Rs. In crs	327728
	2	States	Rs. In crs	368829
	3	Combined (1+2)	Rs. In crs	696557
I	Revenue Neutral Rate (RNR)			
	4	Centre	in percent	5.64
	5	State	in percent	6.34
	6	Combined	in percent	**11.98**
J	GST Productivity Ratio		11345056	0.51
K	GST C-Efficiency Ratio		9698671	0:60.

Annex 4: The Possible Impact of the GST on Small Scale Industries (SSIs)

Sl. No.	Description	Existing Position	Under GST	Remarks
1	**Central tax rate**	12	8	We assume that the GST rate would be 8 percent each for Centre and States
	a. Output			
	b. Input	12	8	
2	**State tax rate**			
	a. Output	13.5	8	
	b. Input	5	8	
3	Base value of Inputs	60	60	
4	UED on Inputs	7. 2	4 . 8	
5	Value of inputs for State VAT	67.2	60	
6	I PnuprupostVeAs T	3 . 3 6	4 . 8	
7	Value Addition	32.8	32.8	We assume that the value addition is 32.8
8	Base value of Output (Row 3 + Row 7)	100	92.8	In the existing regime, the output is exempt and no input credit is allowed. UED on inputs become a cost for the taxpayer and therefore included as part of value addition.
9	UED on Output	0	7.42	The output is exempt and therefore there is no UED on output
10	Output VAT (Row 8 * Row 2a)	13.5	7.42	
11	Aggregate Value addition (excluding embedded taxes, if any) (Row 3 + Row 7)	92.8	92.8	
12	Price to the consumer (Row 8 + Row 9 + Row 10)	1 1 3 . 5	1 0 7 . 6 5	
13	Combined Tax Incidence (Row 9 + Row 10 plus Row 4 if Row 9 is zero)	20.7	1 4 . 8 5	
14	Rate of tax incidence (Row 13 divided by Row 11)	**2 2 . 3 1 %**	**1 6.00 %**	

Note: Under GST, the tax incidence on small-scale industries would be lower in spite of withdrawal of exemption. Similarly the price of the products manufactured by SSIs would be lower under the GST regime if the SSIs pass on the benefit of lower tax incidence to consumers. Alternatively, their profitability would increase. Therefore, the new GST regime without SSI exemption will be more beneficial to SSIs.

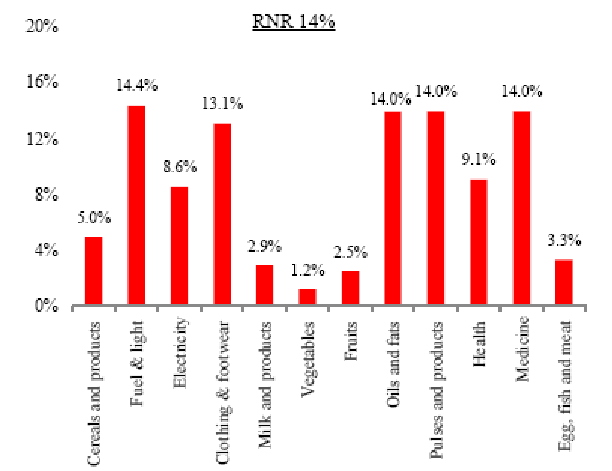
Annex 5: Effective tax rates by commodities under 3 GST scenarios

Figure 1 (Scenario 1: a single rate GST of 14%)

Figure 2 (Scenario 2: a dual-rate GST, with a low rate of 12%, a standard rate of 18%, and a high rate of 35%)

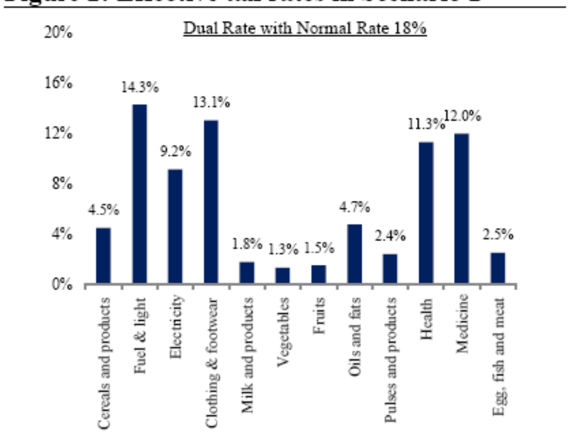
Figure 3 (Scenario 3: Scenario 2 with just the standard rate changed to 22%).

Figure 1: Effective tax rates in Scenario 1



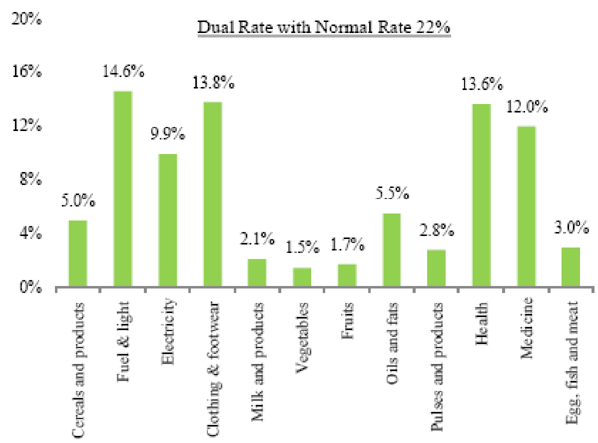
Source: CBEC, State Governments, Estimates

Figure 2: Effective tax rates in Scenario 2



Source: CBEC, State Governments, Estimates

Figure 3: Effective tax rates in Scenario 3



Source: CBEC, State Governments, Estimates

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Notes

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