Chapter 6

Empowered Committee of State Finance Ministers on GST and its recommendations.

1. CENVAT and VAT have improved the indirect taxation system at the Centre and States in avoiding cascading effect of taxation to a greater extent. However, there exists a significant scope of further improvement in this regard by integrating goods and services, under the GST, especially when the distinction between them has been fading fast. The central focus of the transition to GST is to introduce an efficient, effective and tax payer-friendly system of taxation of goods and services in the country, in line with international best practices as well as the special characteristics of the Indian economy. The first proposal for introduction of GST in India was made by the Kelkar Committee[37]. An announcement was made by the Union Finance Minister in the context of Budget 2007-08 to the effect that GST would be introduced w.e.f. 1st April, 2010. He is requested the Empowered Committee of State Finance Ministers to prepare a roadmap in this regard. The Empowered Committee of the State Finance Ministers constituted a Joint Working Group comprises of officials from the State and the Central Government. It was directed that the working group should study various models of GST existing globally and other relevant material available on the subject. It would also identify the possible alternative models for introduction of GST in India and examine various characteristics and assess their suitability in India's fiscal federal context.

2. The working Group of the Empowered Committee while selecting or devising of any model of the proposed GST in the country, was mandated to keep into consideration the following uniqueness and attributes of this country:[38]

[37] Task force Report on indirect taxes (2002)

[38] Different websites like taxindiaonline.com, finmin.gov.in,

a. Federal nature of constitution and necessity of preserving the sovereign taxation powers of the Central and the State
b. efficiency of tax collection and optimization of transaction cost
c. fiscal policy objectives
d. taxation as a means to remove disparity in social, economical, cultural, etc
e. political and Administrative capabilities and realities
f. relationship between taxation and economy growth
g. the present and future revenue potential of Centre and State
h. promotion of economic stability and economic efficiency
i. capacity of knowledge of administration in the centre and the states
j. competitiveness of the Indian industry in a common domestic market

3. Despite the success with CENVAT and VAT, there are still certain shortcomings in the structure of indirect taxation. These are discussed below:

i) Non-inclusion of several Central taxes in the overall framework of CENVAT, such as, additional customs duty, surcharges, etc; leading to cascading effect of taxes. Lately, it has been seen that Government of India have been resorting to mobilizing the revenue by imposition of surcharges, which is not shared by the State governments and which is not allowed for the credit purpose. Thus a significant amount of taxes is paid by the manufacturers or importers but benefits of comprehensive input tax and service tax set-off is out reach of them.

ii) A significant value addition on the manufactured goods is undertaken after the manufacturing process and the government is unable to levy tax on the value addition. Though, certain commodities have been brought under MRP-based assessment, yet the majority of them are still out of tax net.

iii) 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

iv) Several taxes which are in the nature of indirect tax on goods such as, luxury tax, entertainment tax, etc. and yet not subsumed in the VAT for set-off relief.

v) 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.

Thus it may be concluded that:

i) The introduction of GST at the Central level, integration of goods and service taxes for the purpose of set-off relief is achieved; this may lead to revenue gain by widening of the dealer base by capturing value addition in the distributive trade.

ii) The GST at the Central and State level will give more relief to trade, industry and agriculture through a more comprehensive and wider coverage of input tax and service tax set-off relief, further removal of cascading effects.

iii) If properly formulated with appropriate calculation of rates, then there may eventually be revenue gains for both the Central and the States.

iv) Potentiality of these revenue gains is significant, there may also be a likelihood of reduction of the overall incidence of taxes from the existing level, and yet retaining the revenue gains. This possibility of reduction of this overall incidence of taxes may mean a gain to trade, industry and consumers. In other words, there is a possibility of a collective gain for the Centre, the States, trade, industry, agriculture and also the common consumers.

4. The Empowered Committee, on the basis of reports submitted by three subgroups of the Joint Working Group, has given many recommendations in the proposed GST model for India. These subgroups were constituted by the empowered committee on the following issues:

a. Identify the central taxes and State taxes which possess properties to be appropriately subsumed under GST.
b. Identify the possible alternatives, models for introduction of GST in India and examine their various characteristics and their suitability in India's fiscal federal context.
c. Suggest base and rate structure of GST problem faced during interstate transactions, how exempted goods and services and non-VAT items such as petroleum products and alcohol might be treated under the new regime.

5. The above said subgroup were comprised of representatives from the Central and State governments. On the basis of the report given by the subgroups, the Empowered Committee has given the recommendations to the Union Government, which are under deliberation amongst various ministries and departments. Media reports and other papers in subject indicate following as salient features of the proposed model/ recommendations.

(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 and Union Territories (UTs) (hereinafter referred to as State GST). Rates for Central GST and State GST should be prescribed separately, reflecting revenue considerations and acceptability.

(ii) The Central GST and the State GST should be applicable to all transactions of goods and services. HSN classification for goods should be used both for the Central GST and the State GST. A classification for services should be evolved by examining international practices, keeping, at the same time, in view the particular characteristics of India's services sector.

(iii) The Central GST and the State GST should be credited to the accounts of the Centre and States separately.

(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.

(v) Cross utilization of ITC between the Central GST and the State GST should not be allowed.

(vi) Procedures for collection of both the Central GST and State GST should be uniform.

(vii) Under the proposed model, the productive / distribution chain for goods with regard to manufactures having gross turnover of more than Rs. 1.5 Crores would belong to both the Centre and the State. However, keeping in view the prevailing tax payer bases and the availability of the administrative machinery with the Centre and States, the remaining tax payers for goods will be assigned exclusively to the States for the purposes of registration, collection, ITC matters etc for both the Central GST and the State GST.

(viii) The present thresholds prescribed in the state VAT Acts below which VAT is not applicable (which varies from state to state), may also be adopted under the GST.

(ix) The taxpayer would need to submit one periodical return (i.e, the same document), with one copy given to the Central GST authority, the other to the State GST authority concerned.

(x) Each taxpayer should be allotted a PAN based taxpayer identification number, with two additional digits to distinguish between states, and another digit to distinguish between the Central GST and the State GST, i.e. a total of 13 digits. This would bring the GST PAN based system in line with the prevailing PAN based system for Income tax, Excise duty and Service tax, facilitating data exchange and tax payer compliance.

(xi) Functions such as assessment, enforcement, scrutiny and audit should be undertaken by the authority which is collecting tax, with information sharing between the Centre and the States.

(xii) Composition /Compounding Schemes for the purpose of GST should be designed keeping in view the present threshold limits followed by different states under V A T.

6. Some Other features of the recommendations on taxes:

(a) Central Excise Duty, Additional Excise Duties , Service tax, Additional custom duty, commonly known as countervailing duty (CVD) , Surcharges would be subsumed in GST.

(b) VAT/ Sales tax, Entertainment tax, Luxury tax , taxes on lottery, betting and gambling, State Cesses and Surcharges in so far as they relate to supply of goods and services, Entry tax not in lieu of octroi would also be subsumed in GST.

(c) Alcoholic beverages may not be brought under the GST.

(d) 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.

(e) Crude, Motor Spirit (including A TF) and HSD may be kept outside GST, as is the prevailing practice in India.

(f) Taxation of Services: With regard to taxation of services, it is proposed that the States should be given the power to levy taxes on all services. Regarding the collection of services taxes, the States may collect taxes on services of intra-state nature both for Central GST and State GST. Similarly the Centre may collect tax for services of interstate nature both for Central GST and State GST. An arrangement to transfer the Central portion of GST on interstate services to the Centre, and the State portion of the GST on the inter-state services collected by the Centre to the States, may be worked out based on the destination principle.

7. Tax rates

a. **Number of Tax Rates**

Considering the economic reality of the country and the fact that certain categories of goods and services may need to be taxed at a rate lower than the standard rate, it is recommended that there could be standard and a lower rate. A significant lower rate could be assigned for precious metals, jewellery, stones and diamonds.

b. **Rates of Central GST and State GST** : The required rate of tax can be worked out in accordance with the tax base. The calculations would have to be done separately for the Centre and the States on the basis of a transparent methodology jointly worked out by the Centre and the States.

c. **Zero Rating of Exports** : Export should be zero- rated. Similar benefits may be given to SEZs. However, such benefits should only be allowed to the processing zones of the Special Economic Zones (SEZ). No benefit to the sales made from a SEZ to Domestic Tariff Area (DT A) should be allowed.

d. **Tax Exemptions**

Exemptions should be minimized. Direct and transparent subsidies, instead of tax exemptions, are more efficient way to achieve the targeted objective. There should be a common exemption list.

8. Inter-State Transaction of Goods

It is reported that the following mechanism has been proposed to be put in place to deal with inter-state transactions of goods:

(a) The seller in the exporting State (say State A) collects GST for inter-State GST transaction from the importer i.e. the purchasing dealer in the importing State (say State B). This GST is collected at the applicable rates for both the Central and the State GST.

(b) The seller makes a monthly deposit of the GST collected for inter-state transaction in a designated bank to the credit of the respective State Government, i.e. State B in present case. The seller would provide details of all transactions, including details of purchasing dealers, to the bank.

(c) This information would be available also to the State B Government automatically though a GST portal where the bank of State A uploads the information.

(d) The purchasing dealer in State B claims ITC on the basis of a digitally signed (by the bank of State A) invoice /challan when he files his tax return. The State B grants ITC on the basis of the credit received by it from the bank.

(e) The Central and state authorities can access information regarding all inter-state dealers/ transactions and tax payment from the GST portal.

(f) If the State B purchaser is a non-dealer, then the money deposited in the State B Government account will remain with that Government since ITC will not be claimed by the purchaser.

Other major recommendations:

The authority to amend the common exempted list and the common composition scheme should rest with a joint authority *of* Central and State Governments to ensure that no single State or Central Government amends either of these unilaterally.

The success of the GST largely depends upon IT infrastructure available for collection, compilation and exchange of data at the shortest possible time. IT infrastructure with national coverage and extensive reach is critical for the successful implementation of GST. For this, an initiative at the Central Government level needs to be taken in order to put in place a strong IT infrastructure.

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