

Chapter 7:

Implication of implementation of three major recommendations of the Empowered Committee

1. This chapter proposes to take for analysis following three major recommendations of the report:
 - a. Dual GST- whether whole exercise is just window dressing?
 - b. Interstate transactions : Harmonization between states and likely evasion of taxes, and;
 - c. Collection of GST by State on behalf of Centre- vulnerability of Centre and the country as a whole!

2. This dissertation has taken the above said three recommendations for analysis because they may have a major implication upon the taxation powers of Centre and State in future. If the recommendations of the Empowered Committee are implemented, it will require amendment of the Constitution of India which will have the effect of strengthening the States ability to tax and hence enabling them with major chunk of revenue available with them. Till now, major chunk of the revenue is collected by the central government and devolved upon states under the formula made by the Finance Commission.

3. While finalizing the reports for the appropriate model, the group has taken into consideration the following important issues:
 - i. The need for preserving their sovereign powers of the central and the State governments in the matter of taxation which include among others, power to levy tax and also legislate on matters relating to taxation
 - ii. the present and the future revenue potential of the state and the centre
 - iii. efficiency of tax collection and optimizations of transaction cost

- iv. relations between taxation and economic growth
- v. objective of fiscal policy
- vi. promotion of economics stability and economic efficiency
- vii. political and administrative realities
- viii. domain knowledge of the tax Administration of Centre and the States
- ix. current macro economics in India both national and international
- x. competitiveness of Indian industry
- xi. need to have a common domestic market

It may be inferred from the above that Empowered Committee was mandated to take into consideration all possible realities existing in the country in political, constitutional, economical, social, administrative realm and suggest model which can meet all the expectations.

4. India comprises of 35 States and Union territories with diverse economic conditions. There exists a huge economical disparities between many states. The job opportunities in BIMARU and NE states are limited, which is evident from unemployment rate and low per capita income. The Centre has been playing a pivotal role in striving to reduce disparity by way of introducing Centrally Sponsored Schemes, whereby employment is provided to the people or their living standards is sought to be improved in the field of education, health, etc. Under the Direct transfer of Central Plan Assistance to State/ District level Autonomous Bodies/ implementing agencies, a sum of Rs 54776 Crs has been spent in 2007-08 and RE for 2008-09 is Rs 87053 Crs (**Table 1³⁹**). A perusal of the list indicate that assistance is many important sectors like agriculture, environment and forests, health and family welfare,

³⁹ Union Budget 2009-10

human resource development, women and child development, rural development, drinking water supply, social justice and empowerment, etc. Under the same category, a huge sum of Rs 30000 crs had been given under NREGA, which is providing employment of hundred days to the people in the country and has been found to be very successful in mitigating problems arising out of poverty. The assistance provided by the central government to various states has been instrumental in achieving vertical integration in the society and helping the real poor people in joining the mainstream of the country. Further, most of the states depend upon the Centre for financial support by way of grant or devolution, as the states do not have sufficient mechanism to mobilise revenue on their own. Rs 258757 Crs was transferred to States by the Centre in Xth Plan to support their budget. Similarly, XIth Plan propose to transfer an amount of Rs 324851 Crs to enable the States to meet their plan and non-plan expenditure. The details of budgetary support provided to these states from 1985-86 till now, are indicated in **Table 2⁴⁰** which indicate state's dependence upon the Central government. These states have a significant higher % of revenue to Gross State Domestic Product ratio compared to other states (**Table 3**). It may be seen that almost all NE states and poorer states have this percentage in the range of 80% above, whereas the developed state has this ratio in the range of 20-30%. The allocation of Central Plan assistance to special Category states and weaker states, as per the Gadgil formula is very significant, as compared to other developed states. (**Table 4**) one can imagine plight of the people living in the States, once a special assistance provided to them is withdrawn or curtailed because of paucity of funds with the central government. All these funds have been instrumental in generating employment opportunities in some of these states and also uplifting the living standards of the people by providing education, said drinking water, sanitation facilities, electricity, transportation, etc.

⁴⁰ Planning Commission, XI th plan

4.1 Language, culture, religion, beliefs, etc. in the past several important issues relating to regions have acquired bigger dimensions which have contributed to growth of many regional political parties coming to power in the States. The polarization of politics, especially last in 10 years periods, saw major impact of regional parties in the overall functioning of the Union government. In the era of coalition government at the Centre, some regional political parties is significantly affecting the overall functioning of the government to the detriment of the nation as a whole. It is very likely that such situation may continue to exist in future, whereby the more and more regional parties would clamor for regional benefits and power. It is feared that the Federal structure of India will come under serious strain with the emergence of more regional parties, which may not be in the overall interest of the country. In these circumstances, it would be imperative that Union of India remain a strong force to keep India United for which financial strength is the utmost required. Any attempt of dilution of power in this regard may have a wide-ranging impact on the Federal nature of India.

Dual GST:

5. The choice between single GST and dual GST depend upon the constitution of the country, political expediency, will of administration, expected role of federal and the provincial governments, etc. The choice will also be dependent upon desirability of a strong federal government or provincial governments or striking a balance between them. For India, making the choice is more ticklish because of huge disparities between States, inability of many states to raise their own resources to meet their expenditure and dependency upon the central government. Further, the political situation in and around India, wherein disruptive antinational elements are operating, duly supported by hostile countries in the immediate neighborhood from all sides. It is very imperative that the

centre should not only be the political powerful but also have financial soundness.

6. If an independent and isolated decision has to be taken, then Single GST would have been the best method of taxation as it would have been very simple to implement with less compliance cost and ease of administration as well as levy. Further, single GST with just one rate would have been the most ideal situation from the ease of administration point of view. A large number of countries implementing VAT has prescribed just single rate. Bird⁴¹ observes desirability of just one agency to administer and collect the tax. The manufacturers and the traders would also have been very delighted to work under single GST as this would reduce the compliance cost significantly and they would be required to interact with just one agency. However, in a country where there are different class of people having different economic background, prescribing a single rate will not be politically possible. There may be preferential rate, exemptions besides standard rate.

7. However, if there are more than two or three rates in the GST and that too is implemented by two agencies, the compliance cost will go up significantly. Some critics feel that there seems to be no any real need to levy the VAT at two levels of government just because there is a federal and the provincial government. Canada experience demonstrates that multiple consumption tax arrangement in a federal system are possible but such arrangement create additional Administrative cost of government and businesses. The tax system complexity and compliance burden in Canada vary among provinces depending on the level of co-ordination between the provinces and the Federal VAT. Businesses in provinces where provincial and federal VAT exist on goods and services, and administered by the federal government, then the compliance burden is less since they

have to comply with one set of requirements.⁴² It is desirable to vest commodity taxation only on one level of government and that can be done either at federal or state levels. It would reduce the compliance cost to a very significant level and at the same time the problem of coordination between the national and sub-national level would not be faced. Under this situation, the likelihood of evasion or avoidance of taxes would be significantly reduced.

7.1 If the federal government is entrusted with the task of collection of VAT, it would require provinces or states to give up their power of taxation. This would be a political sensitive issue, the states or provinces would not be merely satisfied with the loss of revenue on account of surrendering their powers of taxation, but will have to be adequately compensated by a generous revenue-sharing mechanism by the central or the federal government. They may also like to have power to tax personal income tax and corporate tax, as done in some of the advanced countries.

(a) One suggestion could be to empower the states to collect taxes from the personal income tax or the corporate tax as compensation to loss of sales tax to the centre. Though, most of the country in the world assigns the personal income tax to the central government, yet there are exceptions to this practice including Scandinavian countries, Switzerland, Baltic countries, Russia and other countries of the Soviet Union. In the United States, the income tax is levied both by the federal and state governments and in some cases by the city governments; while in Canada, the central and the provincial government levy income-tax concurrently. Since, the mobility of individuals and households tends to be less than that of business, the personal income tax as pointed out by Ter- Minassian⁴³ is more suitable for partial assignment- through tax overlapping-to the sub

⁴¹ Bird R M (1998)

⁴² US Government Accountability Office Report (2008)

national particularly, the province level. Since the international experiences is in favour of allowing both federal and the provincial governments to exploit the personal income tax, this is best achieved by permitting the states to "piggyback" its income tax on the federal tax base. In this regard it may be suggested that power to impose surcharge on income tax may be delegated to the state governments.

(b) The loss of revenue of the state governments on accounts of commodity taxation by the federal government can be further compensated by permitting the state governments to collect corporate income tax base on the line of the system existing in countries like Canada and United States. The argument put forward by some of these countries to collect provincial corporate tax is that the economy could benefit from the state and local governments competing for industrial development in the local government and are entitled to recoup the cost of public services used by business and that in any case many companies do most of their production and sales within a single jurisdiction. According to Norregaard⁴⁴, there is almost universal agreement that the taxation of the large businesses and in particular corporate profit taxes should be left to the national government and to the provinces state only where these are very large as in Canada. In the USA, 46 states levy corporate income tax and use a factor formula to apportion income to its jurisdiction. Non-business income such as capital gains, royalties, dividends, interest and rent will be taxed separately by the state if the income is earned on its jurisdiction. However, some states apportion all sources of business and non-business income. The factors generally include sales, property and payroll factors but they vary from state to state. The maximum rates of corporate income tax at the state level vary from 3.4% in Indiana to 12.25% in Pennsylvania; the average is being about 7%. State taxes are deductible from the federal corporate

⁴³ Ter- Minassian Teresa (1995)

⁴⁴ Norregaard John (1997)

income tax. Under the Canadian system, the federal government collects provincial corporate income taxes at no charge and the provinces agreed to use the federal corporate base for determining incomes. Three provinces, Ontario, Quebec and Alberta, collect their own corporate income tax. In fact these three provinces account for about 75% of the provincial corporate income tax base in Canada. In Switzerland, the cantons levy corporate income tax on a progressive basis subject to minimum and maximum rates. The Swiss cantons may use their own factor formula and there is no consolidation of returns in Switzerland. In Brazil, the state can levy of 5% surcharge on the corporate income tax.

© In India, approximately, 65% of the combined tax revenue of the Centre and the State is collected by the Centre, the balance 35% being raised by the states. There has been a significant change in the percentage of corporate income tax and personal income tax in last couple of years at the expense of union excise duties and customs duties. The 65% share of the centre is made up of union excise duties (18%), customs duty (18%), service tax (10%), corporate income tax (35%) and personal income tax (19%)⁴⁵. The 35% share of the state is composed of sales tax (20%), state excise (5.25%) and vehicle tax (3%). However, the states continue to collect about 35% share, as done in the past. To compensate for the expected loss, in case the commodity taxation is given to the federal government, suitable revenue-sharing mechanism may also have to be put in place besides permitting states to collect personal income tax and the corporate taxes as discussed in earlier paras. The sharing mechanism/formula may be suggested by the Finance Commission.

(d) However, the existing political scenario in the country may not allow the above said option to become operational. In the recent

⁴⁵ Union Budget 2009-10

past, powerful regional parties have come on political scenes, which are espousing the cause of regionalism. Many of these regional parties are in power in the States and they also exercise significant control at the centre. In the backdrop of the above, it is very unlikely that the above said suggestion of exclusive levy and collection of GST by the federal government would be accepted.

7.2 The next best solutions will be to entrust the powers of commodity taxation in full to the states. If this were to be done it would be possible to have VAT in India on the lines of countries of the European Union.

(a) While this could be an ideal solution, it should be recognized that the Cenvat and Service Tax accounts for as much as 28% of the Center's tax revenue receipts and therefore such a system would require fundamental changes in the structure of the centre state financial relations. Currently about 26% of the Center's net tax revenue is being passed on to the states as devolution. If the powers to levy central GST were to be delegated to the states, it would be difficult to have devolution of Central taxes. There is already a school of thought that the central plan assistance of the states should be confined to the loan components and the plan revenue components should become the responsibility of the state themselves. In such a scenario, it would be necessary to take care of states of North-East region, Orissa, Rajasthan, Bihar, Kerala etc which account for relatively low collection of Cenvat. Under these circumstances, perhaps the federal government will not be able to discharge its function of regional equality and parity leading to further worsening of special category states and other states mentioned here in above. It is very likely that more industrialized states like Gujarat, Maharashtra, Tamil Nadu, Delhi etc would grow at a much faster pace and the other states like Bihar, Orissa, Rajasthan and other northeastern states would lag much behind in the development

process due to the restricted revenue available with them.

(b) This option is fraught with danger, inasmuch as the Center's capability of resource mobilization may be curtailed. Despite, 60 years of independence, the regional disparity in the country has not diminished and the centre is continue to play important role in providing financial support to many of the states.

7.3 Perhaps, keeping the above said factors in the mind, the Empowered Committee has recommended for dual GST. The Committee, while recommending dual GST, had the benefit of studying the taxation system of other federal countries like Brazil and Canada, where the system of taxation has been in force for some time now.

8. Under the proposed dual GST model, the GST shall have two components: one to be levied by the Centre and other to be levied by the state governments. The levy by the central and the state GST will be separate and the rates can be prescribed by the concerned governments independently. Under the proposed system, the central GST and the state GST will be accounted separately. Since the central GST and state GST are being treated independently and separately, the taxes paid against the central GST said are allowed to be taken as input credit for payment of central GST and the same cannot be utilized for payment of the state GST. Similar, provisions would be made applicable for state GST, whereby the credit of state GST would be utilized for payment of state GST on the finished goods or services. For Administration of GST, the model proposes that up to the current threshold limit of Rs 150 lakhs for CENVAT, States be empowered to collect CGST. States will collect both SGST and also CGST from dealers while Centre will collect its levy from manufacturers only, subject to the threshold limit of Rs 150 lakhs. Intra-state GST on services will be collected by States only (for both

States and the Centre). Inter-state GST on services, where destination is ascertainable, will be collected by destination states. Centre will collect only those inter-states GST on services where destination is not ascertainable. States may be assigned the responsibility of collecting CV Duty on imported goods. The concept of instant credit is done away with in inter-state transactions, as credit will be available only when receipt of remittance of duty is confirmed by the bank in the Destination State. Banks should be entrusted to Programme, develop and implement an on-line accounting system through a clearing house for inter-state credit management.

9. Some of the critics have opined that the proposed model is just a window dressing and it may not entail complete abolition of cascading effect of taxes. Subscribers to this school of thought are of the view that dual GST as recommended by the EC will bring about a mere cosmetic change to the existing tax scenario, by re-naming State VAT as State GST and CENVAT as Central GST.

10. It is reported in some portals that Union Finance Ministry has proposed a model, which subscribing to the concept of dual GST, but is opposed to the idea of assigning the responsibility of collection of CGST to ⁴⁶States, whether on goods or on services, on the ground that in such event credit management would be exceedingly difficult. Further, Finance Ministry is not in agreement that States should collect CV Duty, on the ground that it is essentially a duty of Customs and is collected online through a stabilized EDI system. Any interference with the current automated system will be counter-productive.

11. Dual GST is indispensable for the country for the reasons mentioned here in above. To start with, the GST should be levied at a single rate (not necessarily the same at both levels or across states)

on all goods and services. The single rate can be supplemented by an additional tax on certain products such as motor fuels, tobacco, and alcohol. Multiple rates, often justified for basic necessities to lessen the burden on the poor, lead to classification disputes and increase the costs of compliance and administration. Also, they are an inefficient means of helping the poor as the benefit of lower rates accrues to all regardless of their income status⁴⁷. The current model of 4% and 12.5% state VAT rates violates this dictum and vividly illustrates how rate multiplicity generates complexity and inefficiency. The 4% rate has been extended to a large basket of goods consisting of food, utensils, fabrics and garments, paper, sporting goods, as well as industrial inputs, and IT products. Classification of goods between the two rates is often arbitrary and cannot be seen in any way to be helping the poor. The two rates can be replaced by a single revenue-neutral rate, which could be as low as 5- 6%. A tax at this rate would not only be simpler, but should also lead to a significant improvement in compliance. It would also facilitate calibrating the CGST to achieve an acceptable aggregate level of trade taxation in the country. If, however, the tax has to be levied at more than one rate, there should be only two rates: a standard rate and a lower rate applicable to a narrow list of basic necessities. The Centre and the states should adhere to a common classification of commodities eligible for the lower rate. While inter-state uniformity in rates is highly desirable to minimize tax-induced shifts in trade, flexibility could be provided to the states to levy the SGST at different rates (not more than two in any case) as long as they adhere to the fixed categories of goods, i.e., all commodities in a given category are taxed at the same rate.⁴⁸

12. Dual GST would undoubtedly increase the compliance cost as

⁴⁶ Raha (2008)

⁴⁷ Bagchi Amaresh and Satya Poddar (2004)

⁴⁸ ibid

the trader/manufacturer may have to deal with two agencies. This may not only involve delay in assessment, availment of credit but also hassles because of poor IT infrastructure in many states. The Empowered Committee has also stressed the need for reliable IT infrastructure for collection, compilers and an exchange of data in the shortest possible time. The success of the GST will depend upon the national coverage and extensive reach in all states. The committee has expected Central Government to take initiative to put in place a strong IT infrastructure. Though all states in the country have switched to the VAT system of taxation, yet, not many state had been able to put in place a strong IT infrastructure which could capture vital data contained in invoices of the goods manufactured/traded. The assessment, compilation, etc work is undertaken manually and there appeared to be no risk management system in any of the states to check evasion of taxes. Further, staff dealing in VAT has not been adequately trained in the use of computers and interpretation of data. For setting up of any national IT network for GST, it would be very essential to work out the number of traders/manufacturers likely to be registered in next 20 years period in the country. It would be also important to prescribe some standard formats for invoice or other document which could be fed into the national IT network.

Inter-state transactions and likely evasion of taxes

13. Under the proposed model relating to interstate transaction of goods, the role of IT based banking networks has been heavily envisaged. As per the proposal,

- a. The seller in exporting state (say state A) collects GST for interstate 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

interstate transaction in a designated bank to the credit of the respective State government, i.e. State B. The seller would provide details of all transactions including details of purchasing dealer's to the bank.

- c. This information would be available also to the State B government automatically through GST portal where the bank of state A uploads the information
- d. The purchasing dealer in a state B claims credit on the basis of a digitally signed (by the bank of State A) invoice. The State B grants credit on the basis of credit received by it from the bank.

14. The purchasing dealer would be required to have in his possession a digitally signed invoice from the bank and it will take away the facility of instant credit available to them now. It is gathered that Ministry of Finance is opposed to the proposition of doing away with instant credit in inter-state sales on the ground that the above facility is time-tested and has passed the scrutiny of tax administration all over the world, and also that the trade will be opposed to sudden withdrawal of the above facility. Further, it appears that the methodology proposed by the Empowered Committee, the credit mechanism is heavily dependent upon banks' efficacy to serve as the Clearing House. It has been presumed by the committee that the communication network of the banks has been using information technology to allow online transfer of data and information. However, the experience of Central Board of Excise and Customs (CBEC) while implementing Electronic Accounting System in Excise and Service Taxes (EASIEST) and of Central Board of Direct Taxes (CBDT) while implementing On-line Tax Accounting System (OLTAS) through de-materializing of challans by collecting banks is quite unsatisfactory⁴⁹. Even after several years of commissioning,

⁴⁹ Raha (2008)

several banks are in default in entering challan data, off-line, in the above-said electronic Systems. In the above backdrop, it is not conceivable that banks in India will be able to do onerous task of commissioning and administering a complex electronic accounting system like the Clearing House for credit management. Thus the implementation of GST by the appointed date of April 1, 2010, is most likely to flounder on account of failure to set up an electronic accounting system for inter-state credit management, in the absence of which GST is hardly feasible.

15. Another major weakness of the EC model is that it provides for collection of CGST by States, without addressing the issue how credit of CGST and SGST will be regulated/ adjusted when systems of accounting are at variance. India comprises of many states and union territories and all of them have varying level of computer related infrastructure as well as trained manpower. The awareness of the information technology and its acceptability varies between states. Any apathy or casualness on the part of any one of these states would be very likely to be misused by the evaders. Many instances of misuse of area base exemption given to NE states, Jammu, Uttranchal, Himachal and Kutch has been reported⁵⁰. It is very likely that the same may be reported in GST because of isolation of these areas and difficulty in appropriate checking mechanism. All VAT designs have compliance risk that generates considerable Administrative costs and compliance burden. Adding to the complexity to the tax design increases the risk, cost and burden, which is very likely to be complex. During the study conducted by US GAO⁵¹ it was found that the selected countries (Canada, Australia, France, New Zealand and United Kingdom) have devoted significant enforcement sources to addressing compliance that would be found

⁵⁰ Jha (2008)

⁵¹ US Government Accountability Office (2008)

even in simple VAT- one with broad base with few exemptions for goods and services. The risk includes refund fraud and missing trader fraud. Under the refund fraud, businessman or fraudsters submit fraudulent refund claim based on false paperwork. Missing traders setup businesses for the sole purpose of collecting VAT and then disappear from their premises. Because of such compliance risk, even simple VAT required enforcement activities such as audit and record keeping by businesses that create Administrative cost for both government and compliance burden for business.

15.1. The experience of GST compliant countries in evasion is very revealing. On a modest estimate, the UK loses annually over 10 billion sterling pounds of VAT through Missing Trader and carousel frauds while other EU countries collectively lose about 100 billion Euros annually on same account. In Canada, since the inception of GST in 1991 till March 2003, about 600 individuals and businesses have been convicted of GST fraud⁵². In Brazil, GST experiment has failed for same reasons. The only effective safeguard to prevent GST frauds, as has been envisaged by the EU Commission, is real time settlement of all VATable transactions. It is a well-known fact that the judiciary in these countries is very effective in disposing of disputes in the shortest possible time. Compliance with the VAT, as pointed out by Jantscher and Silvani⁵³, will depend largely upon how all taxpayers are informed of their obligations and how vigorously penalties for non compliance is enforced. It is not enough to enact penalties on VAT law- the penalties must actually be applied. Tait classifies penalties broadly into four categories: automatic financial, automatic non-financial, criminal financial and criminal non-financial. The automatic financial penalties are easily the best known and the most famous for VAT crimes. In France, penalties for late

⁵² Raha, (2008)

⁵³ Milka C Jantscher and Carlos Silvani(1991)

payment-3% for the first month and 1% for each succeeding month. Automatic financial penalty is in vogue in a number of countries like France, Belgium, Ireland and Argentina. In Argentina, a VAT taxpayer who fails to issue an invoice for taxable under action is subject to a penalty ranging from 50% to hundred percent of the tax evaded. In Bolivia, Philippines and Taiwan province of China, VAT taxpayer who commit certain offences may be punished with a temporary shutdown of the premises of the suspension of their trading license which has the same effect and a penalty successfully applied to several states of the United States to enforce sales tax violations. Non-financial penalty has been successful in improving compliance and could be applied for repeated nuisances of invoices and it could also be considered for taxpayers to persistently fail to file return after being officially reminded to do so⁵⁴.

15.2 In India there is no evidence as yet of any such effective, all encompassing system being considered. There is a propensity among the small and medium level manufacturers/ dealers in India to avoid computerization of their records. This compounded with the fact that the dispute resolving mechanism in India is a long drawn process stretching for decades. All these factors allure manufacturers or trader to indulge in evasion of taxes, which is not the case in other developed countries where the cases are disposed off in most expeditious manner. In fact, in our country, the tax related matters are not taken with due seriousness and culprits remain out of punishments for many years, and even if they are convicted after a decade, the punishment does not act as a deterrent.

15.3 There is an urgent need to set up separate courts at the High Court and the Supreme Court level to exclusively deal with the

⁵⁴ Milka C Jantscher and Carlos Silvani(1991)

matters relating to all taxes. There appeared to be no fear in the mind of the tax evaders as they appear to indulge in evasion of taxes with impunity as judgement takes years to come by, sometime decades to be pronounced. The deterrent effect of the tax evasion is completely missing and that could be one of the factor of huge black money being reported in the media and accepted by the people in the Government. Further, the tax laws should be amended so as to ensure timely disposal of cases in the original jurisdiction and appellate forums by prescribing certain time limits. The practice of de-nova adjudication should be prohibited by making suitable amendment to the constitution. The number of adornment sought by individual parties, both state as well as taxpayers, should be limited to 2 or 3, and in any case, the tax cases should not be allowed to linger more than six months in any forum. Exemplary punishment for tax evasions, including barring him from future business activities besides appropriate jail terms, should be prescribed. In other words, tax related frauds and evasion should be treated at par with the criminal law if any country has to survive in this era of cutthroat competition and globalization.

Collection of GST by State on behalf of Centre- vulnerability of Centre and the country as a whole!

16. The Empowered Committee in its recommendation had suggested collection of major portion of CGST by the State Governments. Under the proposed model, products/distribution chain for goods with regard to manufacturers having gross turnover of more than Rs 1.5 CRS would belong to both the Centre and the State. The same limit would apply to the service providers. It has also suggested that the remaining taxpayers will be assigned exclusively to the States for the purpose of registration, collection, ITC matter. The EC has also recommended that assessment, enforcement,

scrutiny and audit to be undertaken by the authority collecting the tax, with information sharing between the Centre and the States. Since, the major portion of the GST would be collected by the State, all these functions would be undertaken by the states.

17. If the recommendations of the EC are implemented in toto, the major functions of revenue collection, assessment, enforcement and audit would dwell upon the States concerned and the tax administration at the Centre will not have significant role to play. Though, under the proposed system, the Central GST and State GST to be credited to the accounts of the Centre and the States separately, yet the efficiency and efficacy of tax administration and compliance vis-à-vis Central GST would be a matter of great concern. If by implementation of the recommendations to be effective from 1 April 2010 result into curtailment of fund unavailability with the Centre, it may have disastrous impact. It may affect the preparedness of the country in meeting challenges from the opponent and hostile countries. Defense expenditure in any annual budget constitutes a significant percentage of total budget of the country (about 10-12%) which has risen from Rs 49622 crs in 2001-02 to Rs 114600 crs(RE) in 2008-09.(**Table 5**) It would be in the interest of the country that the financial soundness of the union government is not up to risk. The Government of India provides subsidy on many commodity of public usage to make it available at affordable price. The subsidy extended has increased from Rs 49622 crs in 2000-01 to Rs 129243 crs (RE) in 2008-09.(**Table 5**). All these are possible because of dominating role given to Centre under the Constitution. Implementation of recommendation would have effect of dilution of Center's domination. While, the dual GST may be the call of the day, but it should be done in manner, which does not result in situation making Center vulnerable. Certain apprehensions crop up in this regard, which have foundations discussed here in below:

- a. A unified GST with separate taxing power of Centre and the State would require continuous coordination between the governments. In recent years, emergence of powerful regional parties has made coordination with the Centre a very difficult task. On almost every issue concerning both governments, the consensus are difficult to come by as seen in the case of law and order, terrorism, sharing of water, etc. Adding another subject of revenue would add problem further. The experience in other countries also indicates that the coordination between the Federal government and the provincial government is one of deterrent in the effective implementation of GST. This problem may become more acute in India because of diversity and politics on the regional lines. The GST would not succeed if the harmonization amongst the States is not achieved, which would require some sort of legally binding agreement between them or the uniformity of the GST. Similarly, Centre-State financial relationship may have to be properly examined by the committee of representatives from the Central as well as the State governments for the separation of taxing powers, levy and collection of taxes, enforceability of the law, sharing of revenue without affecting the revenue buoyancy, etc . A legally enforceable agreement between Centre and States may have to be prepared and signed. Reaching a consensus on this issue would be a Herculean task.
- b. The success of GST would dependent upon the availability of a reliable IT network for the country, in which all data relating to transactions are fed into the system religiously without any failure. At the same time, it is required that the manpower employed in this area has in-depth knowledge of use of computers and interpretation of data to monitor and check evasion of taxes. The experience of the computerization in the country has so far has not been very encouraging. The central

excise department has made an attempt to compile and computerize invoice data in 1989, after the introduction of MODVAT scheme. However, the project failed completely and finally it was wound up. Though VAT scheme is in the Centre for more than 20 years, yet, no processing centers have been set up in the country, which could capture relevant data. The VAT in the state is in operation for only three years and not attempt whatsoever appeared to have been made by a majority of the states to capture these data which could help in assessment, audit, enforcement, etc. Absence of any credible and effective IT network would defeat the very purpose of GST, and the same would be more liable to be exploited by the evaders seriously affecting the revenue of both Centre and State.

- c. The volume of traders and manufacturers which will be required to be registered in the country would be very significant in the GST regime. Such a large volume of traders/manufacturers would be difficult to be monitored unless risk management system is properly developed and implemented. The risk management system will have to take into consideration multiplicity of factors like sector, area, value, quality, commodity/service, etc. The risk management system has to be invariably integrated with the IT network to catch the tax evaders.

18. Today, the Centre plays a very pivotal role in the overall development of the country by providing financial assistance to the States lacking in funds. A large number of states do not have adequate means of raising the resources to provide basic amenities to its people, and the central government comes to the aid of such states by providing financial assistance by way of grants, loans. The

devolution of taxes to the States is also dependent upon the population of the States by which some poorer and undeveloped states like Uttar Pradesh and Bihar are immensely benefited. In the recent years, to avoid the delay and plug the loopholes in diversion of funds, the Union Government is directly reaching to the affected people through a large number of Centrally Sponsored Schemes (CSS). The schemes are covered in almost all walks of life and a substantial amount of fund is allocated by the union government. The impact of these CSS is being felt now as we have seen significant reduction in the people below the poverty line, reduction in unemployment rate, increase in literacy, raising of life expectancy, reduction in child immortality, development of infrastructure like power generation, road and transport, ports, etc.

19. Several States like Uttar Pradesh, Bihar, Rajasthan, Orissa and special category states (NE states) have not been able to grow industrially and as such their revenue collection capability is greatly curtailed. Unfortunately some of these states have a very large population of the country which compounds their problem. The employment opportunities in these states are very minimal and the people are forced to go to other states like Gujarat, Maharashtra, Delhi, Tamil Nadu, etc. If the states are not financed adequately, the problem in these States would aggravate further which may become problem of law and order. Some of these states are already facing these problems under Naxal movements or others. The isolation of northeastern States and the lack of development appeared to have given rise to formation of various militant groups in the area, which are supported by the country hostile to India. Under the situation, it is essential that Central government continues to play an important role, which would be possible only if it is financially strong and become instrumental in further growth of the States. Development of these states would provide employment to the people in the States

and would further reduce the poverty, illiteracy. This will be enough to isolate all those who are propagating militancy and the threat to the country's integrity and sovereignty would be minimized.

20. It may be said that implementation of recommendation of Empowered Committee on introduction of GST from 1st April 2010 is fraught with danger. Some of the recommendations relating to credit mechanism need to be revisited. Recommendation regarding dominant role of states in assessment, collection, enforcement of the taxation in the country also need to be seriously looked into in the backdrop of rising regionalism, likely impact upon one's availability with the weaker States and perceived threat upon the integrity and the sovereignty.
