



GOVERNMENT OF GUJARAT

Speech of
Shri Saurabh Patel
Hon'ble Minister of State for Finance

during the meeting of

Empowered Committee of
State Finance Ministers

August 4, 2010

New Delhi



**Hon'ble Chairman of Empowered Committee,
my colleague Finance Ministers from different
States and senior officers.**

We are meeting at this very critical juncture to discuss the proposed Constitutional amendment and other issues related to the implementation of GST in the country. At this stage, it is necessary to clarify that while Gujarat welcomes every positive move for progressive indirect tax reforms, it is necessary to safeguard States' interests as enshrined under the Constitution and to protect the federal nature of Indian polity.

2. Need for Second Discussion Paper :

After deliberations amongst State Finance Ministers, the first discussion paper was released on November 10, 2009. It was product of series of meetings and immediately a large number of comments came in, which were discussed in subsequent meetings of Empowered Committee of State Finance Ministers. The views of the Government of India were also considered in the third

meeting of 2010 and response, accordingly, was sent to the Government of India. Now, we have received response from the Government of India as well as other stakeholders on issues related to rate structure, threshold levels, matters of inter-State trade and VAT on imports, list of exempted goods etc. It is now time to give finality to the views of the Empowered Committee by producing a second discussion paper, which could include, inter-alia; structure of GST, rate structure, threshold limits and list of exempted goods; power of Centre and States to alter, reduce, levy additional tax, disallow ITC etc.; means of administration of GST and structure of IT backbone. A consensus within Empowered Committee on all these matters needs to be developed and the second discussion paper should be brought out as was contemplated earlier. Only after receiving public comments on second discussion paper, we should move forward with drafting of Constitutional changes.

However, movement on the Constitutional amendment has been unduly fast without paying adequate and appropriate attention to the details that I have just outlined.

3. Short time-frame for the Constitutional Amendment :

As I have mentioned before, the proposed constitutional amendment has come at a time when consensus is lacking even within the Empowered Committee on many features of GST. This proposed amendment is not a result of discussions between States and Centre, as mentioned in the covering letter of the Government of India, but is merely a draft prepared by Ministry of Finance, Government of India. **This amendment fundamentally alters powers of the States to levy and collect indirect taxes.** Such an important amendment should not be considered unless it is widely discussed by key stakeholders, such as, Legislators, trade, industry, consumer fora and, of course citizens at large. It is only after input is received from stakeholders that State Government can give its views on this amendment. Time given to States is very short and it is not possible to do justice to such a momentous piece of legislation in such a short time frame.

4. Preliminary comments on the proposed Constitutional amendment :

I had earlier written a letter that in order to have a full discussion on constitutional amendment, perhaps more time would be required on account of aforementioned reasons. However, since we are meeting today, I will briefly outline our preliminary comments on the proposed amendment.

Constitution of India is embodied with features of federal system in normal times. The very first Article of Constitution says, "**India, that is Bharat, shall be Union of States**". The main feature of federal system and autonomy of States is reflected in scheme of distribution of Legislative Powers (Article 246), Executive Powers (Article 162) and Finance Autonomy (Articles 264-282 and entries 45-63 in State list of Schedule-VII). This enables State Governments to perform their functions and exercise their powers and execute programmes related to their spheres of development work.

New proposed Article 246(A) inflicts severe blow on provision of distribution of legislative powers by

introducing a separate category. This provision also nullifies the impact of Articles 246 and 254. While exclusivity has been given to Centre to legislate on inter-State trade & commerce and imports, no such exclusivity has been given to State Governments to legislate on goods and services. **We feel that concurrent powers for Centre and State to legislate on goods and services would confuse matters further and nowhere has it been made explicit that whose writ would prevail in case of conflict.**

Inter-State Trade : A new Article 269(A) proposes that Goods and Services Tax shall be levied and collected by the Government of India and such tax shall be "**apportioned**" between Union and States. I think this is not a balanced provision. In all the provisions of Constitution, the terms used are either "**distribute**", or "**assign**". This new term is ambiguous and would give arbitrary powers to Union Government. Government of Gujarat also opposes inclusion of GST on import of goods within the purview of Union Government.

GST Council : The proposed new Article 279 (A) makes a provision for Goods and Services Tax Council. While

a collegial decision-making body that evolves consensus is welcome, but proposed provisions are aimed at throttling the financial autonomy of State Governments. The principles on which this Council should work, as enumerated in Clause 4 of Article 279 (A) does not refer to developmental needs of State and fiscal autonomy of State legislature. These principles should be bedrock of any such Council. I am also of the view that to ensure an equal and fair exchange of views there should be rotating Chairpersonship of the Council, so that even smallest State of the country gets to head such a vital body. All the decisions of this body should be by consensus and not as suggested in Clause (5). With due respect to Union Finance Minister, I find it difficult to support the measure of veto given to Union Finance Minister in Clause (5) of this proposed Article.

Clause 3 of proposed Article 279(A) gives very wide powers to the Council, which includes determination of rates of taxes, exemption list and threshold limit and also taxes, cesses and surcharges associated with Centre and States that shall be subsumed. The power to determine rate of taxes is a basic function of legislative body like Parliament or, as the case may

be, State Legislature. Article 265 very clearly states that no tax shall be levied or collected except by authority of law. Thus, provisions of proposed Article 279 (A) run counter to the existing provision of Constitution. I find it difficult to agree to wide ranging powers given to GST Council. **These powers shall remain within legislative and administrative purview of States and cannot be ceded to the Council as it will take away entire financial autonomy of the States.** GST Council can deliberate on issues related to common IT platform, inter-State trade and commerce and issues that crop up on account of application of such a law.

Also, sub-clauses (a), (b), (c) and (d) of Clause-3 of Article-279(A) should remain within the purview of Parliament or State Legislature, as the case may be. We also do not support omnibus special clause, namely, any other matter, being placed within the powers of GST Council.

Taxes to be subsumed : Proposed Article 279(A) gives GST Council powers to decide taxes, cesses, and surcharge to be subsumed. The taxes, cesses, surcharge

that are to be subsumed have already been discussed in the Empowered Committee and consensus arrived. Any further subsumation of taxes by GST Council, at a later stage, may affect autonomy of the States and therefore, this Article needs greater discussion in the Empowered Committee. I find it difficult to agree with the provisions of deletion of Entries 52, 53 from VIIIth Schedule of Constitution as read with entry tax and tax on sale of electricity. These are powers of State and shall remain as such. In fact, I would suggest that new amendment should be brought in Constitution to include VAT on imports in the State list.

Powers of amendment to Constitution is vested by Article 368 in Parliament and additional requirement of ratification by State legislature. This principle has been very well established in the case of Keshavanand Bharti Vs. State of Kerala. However, in para 19 of the Clause on removal of difficulties, power to modify Constitution has been vested in President. This provision is contrary to established wisdom and Constitutional provisions. The entire clause on power to remove difficulties needs re-drafting.

As I have mentioned above, these are but preliminary observations and detailed analysis could not be carried out on account of paucity of time. However, a Constitutional amendment has to follow a model, which is evolved after a consensus. I have mentioned earlier that "**upfront compensation**" to the States should be an accepted principle in GST model. However, not only upfront compensation but even compensation to the State does not find mention anywhere in the proposed amendment. This leaves States completely at the mercy of Central Government. Our experience so far with CST compensation is hardly encouraging.

5. Inflationary Impact of GST on consumers :

GST may affect common man badly, that too in an environment of high inflation. A rate of 10 per cent of CGST and a higher rate of SGST will cause the common man to pay tax at more than 20 per cent against a present rate of 5 per cent even on essential items like food, medicines, agriculture produce, footwear, readymade clothes, etc., and 12.5% on other goods.

There are some services like Facsimile services, Mandap Keeper Services, Cleaning activity services, Tour

operator, Outdoor caterers, etc. in which there is no ITC involved. So, there will be an additional burden of 4 per cent in case of services. One of the key assumptions suggested by the EC for calculating RNR for SGST is half the items in Lower Rate will be moved to higher or Standard Rate. Thus almost 25 per cent of value of all taxable goods will be charged at a much higher rate of 20 per cent or more from existing 5 per cent. This will worsen the already severe inflationary situation prevailing in the country.

So, the EC should commission a study to gauge the impact of the proposed GST rates across the country on prices of essential goods, particularly on excisable items taxed at a lower rate, like medicines and impact of moving half the items of Lower Rate to Standard Rate; and on services, etc.

6. Protection of State Revenue :

While, the powers to decide GST rates are shown to be vested with the GST council in the draft Amendment for the Constitution; the Government of India, has, unilaterally declared rates of 6 per cent and 10 per cent for CGST and 8 per cent for Service Tax. Further, the

Finance Minister has requested the States to replicate it for SGST as well. This has sent a wrong message to the stake holders that the GST Council will have no power when it comes to the issues relating to the Government of India. Further, when services are to be taxed by the States, then the Government of India should have at least discussed the modalities of service tax rates in the EC meetings. Details of the methodology and calculations of these rates with the tax base for each and its underlying assumptions, etc. should be shared with the States so that the impact on State revenues can be analyzed and a suitable RNR for SGST can be arrived at. Such a unilateral announcement by Government of India has put pressure on the State Governments to match the rates of CGST. This would raise issues of compensation in the long run.

It was suggested that the States would benefit from the revenues from Services. However, the service tax base is not wide and B2B transaction will in effect be washed out transactions as all the business related services will be eligible for Input Tax Credit. Further, there is no accurate State-wise revenue data available for service tax. On the other hand, the CST compensation will be

phased out completely, causing a loss of about Rs. 5000 crore to Gujarat State, based on 2007-08 revenues. Even if CST is continued at 2 per cent, it may not be enough to cover the losses.

Since Union Government has arrived on certain rates on taxes, I feel that this must have been done after appropriate calculation regarding revenue flows. As data of tax flows presently and future flows are in public domain, it would be useful that **Central Government shares with Empowered Committee the data** on which tax revenue accruing to Central Government from present taxes to be subsumed and projections of tax revenue from CGST. If there is an additionality coming to Central Government, then there is a strong case for an upfront sharing of such additional revenue.

Notwithstanding our expectation of positive impact of GST on trade & commerce and evolution of common national market, it is important that **the proposed GST model should not have any adverse impact on States' revenue as it would immediately impact the developmental programmes.** Therefore, I suggest that **Empowered Committee appoint an Expert Group** that would also include representatives of various

States as well as Central Government. This Group should look into the revenues that would accrue to various States under the proposed regime and also carry out a detailed sensitivity and scenario analysis. Only then we would be in a position to understand and appreciate the impact of the proposed model on the finances of individual States.

7. Compensation under GST Regime :

As I have mentioned earlier in the Empowered Committee meeting that GST regime system can only work if there is an "upfront compensation model". In the previous meeting of Empowered Committee of States all States had raised issue of CST compensation. Unless an upfront compensation model is built into the Scheme of GST, it would be very difficult to retain financial autonomy of the States and some of the States may even face huge revenue deficits as the compensation does not come in time.

CST compensation for the year 2010-11 :
Compensation package for the year 2010-11 should be firmed up at the earliest. It is suggested that the formula for CST compensation should be continued as per the

guidelines dated 22.08.2008 issued by Government of India. The compensation package should be free from any pre-conditions of additional resource generation. CST compensation should be continued till the time GST is introduced.

Double deduction on account of abolition of D-Form:

Also, the issue of double deduction on account of D-Form needs quick resolution. This has been raised before this august gathering earlier, but no decision has come so far.

8. Empowered Group on IT Infrastructure :

The decision to form an Empowered Group on IT Infrastructure is welcome. A detailed study about the IT preparedness in all the States needs to be carried out first in order to find out the present status of where all the States do stand as regards IT preparedness; work out the minimum IT requirement; set up the benchmarks and identify the gaps with respect to the present status in all the states. The EC has to come up with detailed analysis of benchmarks for minimum IT requirements for successful implementation of the GST. The present status of IT infrastructure in terms of availability of

hardware, connectivity, e-services, etc., in various States may be put in the public domain, State-wise.

Under GST, ITC on inter state purchases will have to be cross checked, so invoice-wise details have to be captured and cross checked through e>Returns and e-payments. If an efficient IT infrastructure is not in place ahead of GST, not only taxpayers will be put to difficulties, but at the same time the States will lose revenues due to the lack of proper IT mechanisms to check tax compliance. The CAG has also sounded alarm about the evasion under VAT due to the absence of sound IT infrastructure. Hence, I feel that a time bound IT implementation schedule for all States and the Centre needs to be done first before the roll over to the GST.

Conclusion :

It will take at least few months to finalize the views of the States on the proposed Constitutional Amendments. In the mean-time, the EC may work closely with the Government of India to:

- A. Put a suitable IT platform in place;
- B. Issue the 2nd discussion paper;

- C. Resolve CST compensation issues;
- D. Commission a study of impact on inflation of GST on prices;
- E. Identify income from service tax that would accrue to the States;
- F. VAT on imports may be introduced and states may be given powers to collect the same;
- G. Initiate the process of drafting Act, Rules and procedures;
- H. Discuss transitional issues.

I would reiterate that before we launch upon the process of Constitutional amendment, **a consensus needs to be evolved, which should take into account financial autonomy of the State, the revenue loss, impact on public at large and ease of implementation. Constitutional amendment is an irreversible process and before it is set in motion, we owe it to the people of India that to ensure that there are no hindrances in implementation and the ultimate outcome is a win-win situation for all.**