



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

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New Delhi



Honourable Chairman, Empowered Committee, my colleague Finance Ministers from different States and Officials from the Government of India, the State Governments and the Empowered Committee.

Within a very short period of two months we are meeting consecutively for the third time to discuss the proposed Constitutional amendment and other issues related to the introduction of GST in the country. Very critical aspects relating to fiscal autonomy of the States and GST design have emerged during past two meetings. Let me clarify again that while Gujarat welcomes every positive move for progressive tax reforms, it is necessary to safeguard States' interests as enshrined under the Constitution and protect the interests of consumers, traders and industry. **Therefore, Gujarat does not support the proposed Constitutional amendment in its present form.** This would de-stabilize balance between source of revenue and duties between Centre and States and would adversely affect the financial health of States and deprive them of a very important means of governance. I have put forth the observations of the State on various important aspects

of the proposed constitutional amendment earlier and so I would like not to repeat the same points again but I would certainly take this opportunity to draw the attention of my fellow Ministers mainly on protection of fiscal autonomy and flexibility available to the States at present; upfront compensation model to ensure that compensation issues do not arise in future; and the need for IT preparedness for GST.

2. Protecting the Autonomy of the States : Our preliminary comments on the proposed Constitutional amendment have already been shared with the esteemed members of Empowered Committee in the earlier meeting. I would reiterate that fiscal autonomy and flexibility made available to the States by the founding fathers of the Constitution is a cornerstone of the federal polity of the country. By introducing amendment in the form of proposed new Article 246 (A) Centre is entering in the domain of tax on sale of goods, which hitherto is exclusive area of the State Governments. In turn, it is proposed to share revenue from the services, which is a small part of overall revenue of Central Government. The implications of Article 246(A) are not clear, but certainly it severely limits powers of the States with very little in return. I sincerely urge my colleagues in the Empowered

Committee to discuss at length implications of this specific amendment on the autonomy of the States and also seek views of the Central Government as to what could be done in the cases where conflict takes place between legislation made by the State and that of the Centre.

At present, the States have flexibility to levy additional tax, surcharge or Cess, except on declared goods, exempt partly or fully from payment of tax any goods of local importance, increase rate of tax than the agreed floor rates, disallow or reduce ITC on certain items under VAT, levy entry tax and purchase tax, disallow / reduce ITC in case of branch transfer / consignment / stock transfer under VAT. In addition, there is also the discretion to reduce rate of tax on inter-state transactions of sale under section 8(5) of Central Sales Tax Act, 1956.

In the proposed GST regime :

All the above powers of the States are likely to be taken away as per the present design of GST.

All supplementary taxes like entry tax, entertainment tax, luxury tax, etc. are going to be subsumed under GST, leaving very little flexibility with the States for additional resource mobilization for local developmental needs.

Any GST model should not have any adverse impact on States' revenues as it would immediately impact the developmental programmes of the State.

The proposed Constitutional amendment severely restricts autonomy of the States and the implications of proposed Article 246(A) are unclear. **Therefore, the proposed amendment to the Constitution is not acceptable to us.**

3. Upfront Compensation Model : In view of obvious lacuna in the model proposed by the Union Government and also our experience in obtaining our legitimate claims as per CST Compensation Scheme, Gujarat has proposed alternative model of "Upfront Compensation" as a part of GST scheme.

As you would appreciate, this model has the merit of being simple and practical. It will completely eliminate contentious issues of States seeking compensation from the Centre. The present status of pending Compensation for 2010-11 and the indecision on 'D' form reinforce the need for such a model of upfront compensation.

Additionally, the dealers will not be required to deal with two separate authorities as the tax administration of the States will handle the entire collection of GST. The Centre

can gain by redeploying its staff for Direct Tax collection thus bringing down the cost of tax collection.

Thus, it will lead to a win-win situation. Consumers, traders/dealers, State Government and Central Government all stand to gain. The EC may therefore consider finalizing this model as the recommended model. The Central Government may be requested to draft the Constitutional amendment to give effect to this model.

Since our model has already been circulated by the EC Secretariat, I request you to offer your comments and send the queries, if any. **I look forward to personally discussing this model in greater detail in next meeting of EC.**

4. CST Compensation : You would recall that EC has unanimously recommended continuing extant formula of August 22, 2008 for CST compensation for 2010-11. It was also unanimously agreed to request Government of India to settle the outstanding D-Form claims. I am extremely anguished to learn that the Joint Working Group has, in its meeting held on September 9, 2010 chosen to re-open these two issues. I therefore, request you to resolve in the EC meeting to request Government of India to take a quick decision on compensation formula for 2010-11 and also settle all pending D-Form claims at the earliest.

5. IT preparedness : Nobody has a dispute that a quality IT system is a sine qua non for effective implementation of any tax regime and the same stands true for GST. However, we cannot switch-over to a new system unless the legacy system is reasonably at high level of IT application. Therefore, it is critical to develop database of individual States and also ensure systems in one State can interact seamlessly with systems of other State. For this, optimum use of TINXSYS and State level mission mode projects should be made. Unless we are able to track transactions across the States efficiently in the present system, there is no way we will be able to do GST transactions seamlessly where the scale is much larger and the system would be more sophisticated. Each of the States should have system to cross verify other States' query and develop response system for its resolution. For this, a detailed study should be undertaken regarding server capacity, bandwidth requirements, concurrent users etc. Therefore, emphasis should be on upgrading database of individual States and working out a system of cross-verification of transaction rather than trying to bring a uniform system across the States, which perhaps can at best be a distant target.

I further say that 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 all the States as regards IT preparedness. It is required to work out the minimum IT requirement, set up the benchmarks and identify the gaps with respect to the present status in all the States. Details of the study of the present status of the IT infrastructure in various States may be put in the public domain and efforts should be made to make TINXSYS more effective and useful.

At this stage of development, when the GST model is not finalized, the Empowered Group on IT and other Sub-working Groups should avoid developing IT system for processes based upon the model prepared by the Government of India. Instead, they should concentrate upon the issues I have just highlighted. That would make State systems robust and amenable to the smoother transition at a future date.

6. Conclusion : Now it is imperative that Centre resolves all the issues related to CST compensation and as discussed earlier the second discussion paper that is overdue may be finalized and placed in public domain. As I have mentioned earlier, EC should also commission

a study regarding impact of GST on prices of essential articles of use, carry out an assessment of likely income from service tax so that we can have a good statistical model that could form basis for future GST framework.

I reiterate that it would not be useful to dwell at this stage upon a Constitutional amendment until issues of autonomy and fiscal flexibility of the State are reasonably addressed. Also there has to be a time frame for development of IT capacities of each States so that legacy system itself becomes efficient and powerful. There is a need to discuss all the alternative models, which are now placed on the table and EC has onerous responsibility of picking up a model, which serves the interests of both States and Centre and consolidates cooperative federalism. Only after the model has been finalized that we would be able to build processes and necessary Constitutional amendment, if required, around it.