सत्यमेव जयते

GOVERNMENT OF GUJARAT

# SPEECH OF
# SHRI SAURABH PATEL
## HON'BLE FINANCE MINISTER

## During the meeting of
## EMPOWERED COMMITTEE OF
## STATE FINANCE MINISTERS

DECEMBER 11, 2014

NEW DELHI

GOVERNMENT OF GUJARAT

# SPEECH OF
# SHRI SAURABH PATEL
## HON'BLE FINANCE MINISTER

**Hon'ble Chairman of the Empowered Committee, my colleague Finance Ministers from different States, Officials of the Government of India, various States and the Empowered Committee,**

I must recall that the discussion on various aspects of GST has been going on in the Empowered Committee of the State Finance Ministers since 2007. The First Discussion Paper on the proposed GST regime was released by the Empowered Committee on November 10, 2009. The Empowered Committee has met about 54 times between 2007 and 2014 to deliberate upon crucial aspects of the proposed GST design and has expressed its concerns on many important issues. Discussions have also taken place

with Hon. Union Finance Minister many times earlier also. Various sub committees constituted by the Empowered Committee have been deliberating and debating on various crucial aspects of the GST and also have submitted their reports to the Empowered Committee for further deliberations by all the States. **The States have time and again expressed their concerns through all these forums mainly about the fiscal autonomy and the adverse implications on the revenues of the States due to introduction of the GST regime.**

We have just received a draft of the 122nd Constitutional Amendment Bill from the Empowered Committee and I regret that many of the concerns raised by the States have not been reflected in the draft.

I would like to briefly highlight the main concerns of the States once again and also make some concrete suggestions to address the concerns of the States:

**Loss of fiscal autonomy of the States**

By introducing an 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 the exclusive area of the State Governments. In turn, it is proposed that States would gain the power to share revenue from the services.

However, the States would lose their fiscal autonomy which was continued when we moved from Sales tax regime to VAT regime. This includes flexibility to fix lower rates to encourage certain sectors such as labour intensive industries,

fix higher rates from luxury goods to augment revenues or to grant exemption to goods of local importance. The States also enjoy the powers to put in place mechanisms to augment their revenues. States have the freedom to decide threshold limits, and criteria for permitting composition. Innovations such as grant of deemed registration, issuance of e-permits and simplification of procedures are left to the States in VAT regime. Much of this flexibility would be lost in the proposed GST regime. 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. This would impact both tax revenue and tax administration.

**Uneven impact on revenues of the State and Centre**

The Empowered Committee has prepared the estimates of the revenues of the Centre and that of the States which are to be subsumed into the GST. It is apparent that only about 30% of all Tax revenues of the Centre would be subsumed into GST. The mainstay of Direct taxes at the Centre would remain untouched by the GST reform. On the other hand, the mainstay of most States in terms of revenue are the indirect taxes of which VAT is the largest component in most States. Therefore almost 65% of the total tax revenues of the States are getting subsumed into GST. If petroleum is to be subsumed into GST, this proportion would be much larger. The impact of GST and attendant loss of fiscal autonomy is therefore much more significant for the States.

In Gujarat, which does not have any significant revenues from excise, the share of State tax revenues to be subsumed, would reach 81% of the State's tax revenues.

**Loss of revenue to the States and Centre**

The loss of revenues due to the subsumation of taxes and the removal of cascading effect would impact the States and to some extent the Centre. However, the loss due to abolition of CST would be an additional loss for the States. This additional loss would be larger for those States that have a larger manufacturing sector and are net exporting States in terms of interState trade. The loss due to abolition of CST is almost 60% of the loss to the States.

On the other hand, the Centre which has been taxing only the manufacture of goods would now have a larger tax base since it would tax the entire value chain from manufacture to consumer. At present Centre taxes manufacturers with an annual turnover of over Rs. 1.5 crore; the Centre will now start taxing manufacturers and traders with an annual turnover of only Rs.10 lakhs. This is a great widening of the tax base for the Centre.

The States are projected to extend their taxable base from goods to services. However, much of the services are already being taxed by States through other State taxes such as entertainment tax, luxury tax etc. Moreover most of revenue from service tax is expected to be washed out in B2B transactions. Hence the expansion of tax base for the States in GST regime is far more limited and uncertain.

**Uncertainty over RNR and additional revenues from services**

As per the report of NIPFP, RNR for the State is derived at **13.91%** and RNR for the Centre is derived at **12.77%**. Thus, the gross RNR comes at **26-27%**. The calculation of RNR, which in turn has been used to determine the extent of loss of revenues for the States, appears unrealistic. I will elaborate with reasons as follows.

The RNR, that has been worked out for each State on an assumption regarding additional revenues from services, is doubtful. We have been told that our losses due to abolition of CST and removal of cascading effect would be made good by the additional revenues from tax on services. I have been requesting the Centre and the Empowered Committee since last two years to let us know what would be this additional revenue in respect of each State. I am yet to get an answer. The consumption of services in each State is not yet worked out. Even if that were available, the implication of Place of Supply Rules that differentiate between B2B services and B2C services would alter the taxable base of services in that State.

**The RNR would turn out to be higher for those States where the tax revenues from services do not accrue in the projected quantity.**

Moreover today States obtain revenues by withholding input tax credit in certain cases based on specific rules. **That revenue is ignored for calculation of RNR. If we take that revenue into consideration, the RNR would be even higher.**

On the other hand, the RNR computed for the Centre appears to be flawed. Even today the Central excise and Service tax are integrated. The Centre is widening its tax base. The current rates of Central excise and service tax are around 12%. How then can the estimated RNR on a wider tax base be near about 13%? It should be somewhat lower than the current tax rates. We are yet to get a clarification on the details of the amount of Rs. 46218 crore included in the central revenues to be subsumed. Without this amount being taken into account, the RNR for the Centre comes to about 9.69% on the same taxable base, as used for the States.

**Hence it appears that the RNR for the States would be far higher and much less for the Centre than that computed. This expectation is also borne out by the relative values of the revenues to be subsumed by Centre and the States.**

## Concerns of manufacturing States

As a nation, we are looking to increase the contribution of the manufacturing sector in the economy. Our Honorable Prime Minister has launched the Make in India campaign. Even the Twelfth Five Year Plan document (2012-17) sets a target to increase the contribution of the manufacturing sector from 15 % to 25% to national GDP by 2025. In the GST regime, the abolition of CST and the implementation of the destination principle would result in severe losses to manufacturing States that are also net exporting States.

**Significant loss of revenues to the net exporting or manufacturing States:**

Gujarat has always proudly contributed to the national economy. With just 5% of the country's population and 6% of the land area, the State has contributed 11% to the primary sector output, 17% to manufacturing output and almost 24% to nation's export earnings. Over the last two decades, we have invested heavily in creating robust infrastructure in roads, connectivity, ports, power and skill development. These investments are bearing fruits in the form of a sustained high growth rate, comparatively high per capita incomes and low levels of unemployment in the State.

At present, a big proportion of the total Commercial (i.e. VAT and Non-VAT) tax revenue of several Exporting States comes from CST proceeds on the inter-State sales and purchases. As per the proposed IGST model, tax on supplies of goods and services from the Exporting States (i.e. all Manufacturing States like Maharastra, Gujarat, Hariyana etc.; Agriculture surplus States like Panjab, Andhra Pradesh, Kerala etc.; Mineral rich States like Odisha, Chhattisgadh, West Bengal, Rajasthan, Madhya Pradesh, etc.; or Service surplus States like Maharastra, Karnataka etc.) would finally flow to the actual consuming State thereby leaving no tax revenue to the exporting States. This would seriously dis-incentivize a net Exporting State which has provided excellent physical and social infrastructure for agriculture, mining, manufacturing or services sectors to flourish in the State.

There is serious apprehension among the States on the possibility of suffering revenue losses after the implementation of GST. Huge revenue loss due to abolition of CST would result into higher RNR and dependency of the net-Exporting States for GST Compensation from the Centre.

Therefore, stability and growth in own tax revenue is a matter of great concern for such States. With the loss of CST revenues and the transfer of State tax revenues from exporting to importing States based on the destination principle, not only will the manufacturing States become unable to earn returns on the public investments already made by them, but the **incentive to States to make further infrastructure investments required for the manufacturing sector will also be lost.**

In the context of the destination principle, I would like to refer to the discussions held on 26th November, 2014, wherein it has proposed to plough back the proceeds of the auctions of the coal blocks to the respective State over a period of time thereby **enabling the coal rich States to earn revenue from the natural resources located in their States.** Though the policy seems contrary to the principle of destination based taxation, it **protects the revenue concerns of the States rich in mineral resources** which (themselves) consume less, but supply huge quantity of raw material to the industrial development of the country. Some **similar solution** could also be considered to address the concerns of the manufacturing States.

Therefore, **we must build in a mechanism within the proposed GST regime that will continue to encourage the manufacturing States and sustain their revenues.** But the proposed GST structure does not seem to address the above important aspects.

**Options for protecting the State revenues**

**I would like to propose certain options which could be explored for protecting the permanent revenue losses to be suffered by the States :**

**Option 1: Amendment in the proposed Article 269A:**

**Certain % of IGST can be credited to the account of the exporting States with allowing full ITC to the dealers in the importing States.** Because of the proposed modification, the IGST Input tax credit chain will not be affected as the importing dealer in the importing State gets full tax credit as also the importing State gets full revenue. Accordingly, the Central Government revenues would be curtailed to the extent of percentage retained by the Exporting State from IGST revenue, but is not likely to result in net loss to the Central revenues.

**Option 2: Continuation of CST:**

Continue Article 269 and allow the States to levy 2% CST on the inter-State sales. At present, the total revenue from CST (@4%) is Rs. 78,182.50 Crore which is 25.61% (year 2011-12) in the total revenue of the States subsumed in GST regime. Out of total estimated amount of GST compensation, more than 60% amount is pertaining to phasing out of CST.

Therefore, if CST is allowed to be levied to the exporting State, it would considerably reduce the burden of compensation to the Centre. It will reduce the value of average RNR of all the States without increasing the value of RNR of the Centre.

**Option 3: Amendment in Article 269:**

Amend Article 269 thereby allowing the Exporting States to collect CST on all inter-State supplies (i.e. sale/ consignment/ Branch Transfer) @ 1 %. The Committee set up on the GST Compensation Fund under the Chairpersonship of Additional Secretary (Revenue), GOI has considered to levy Cess on CGST to finance the GST Compensation Fund to provide for the losses on account of implementation of GST. If such a cess can be levied by the Centre on CGST, the States should also be allowed to levy non VATable CST on the inter-State supply of goods and services.

**Option 4: Levy of Cess on Manufacturing:**

Amend the State List thereby allowing the States to levy Cess on the goods manufactured within the State and on the goods imported within the territory of State. Such Cess would not be subject to ITC i.e. non-VATable.

**Option 5: Allow State to levy Entry Tax on the entry of goods within the State:**

Power to levy entry tax should be retained in the State List. It would reduce the losses to some extent incurred by the States.

**I would also like to cite a few suggestions/ recommendations made by the States/Empowered Committee which have not been considered while drafting the revised draft of the 122nd Constitutional Amendment Bill:**

1. To exclude petroleum products including natural gas from the ambit of the GST.
2. To exclude the provision of Declared Goods.
3. To authorize the State Governments to administer the Goods and Service Tax on supplies in the course of inter-State trade or commerce.
4. To retain power to levy octroi and entry tax in lieu of octroi.
5. To subsume cess/surcharge levied by GOI in GST.
6. To levy higher rates for demerit goods.
7. Tobacco and tobacco products being sin goods should either be kept outside the purview of GST or the States should be given the power to levy tax over and above SGST as that of the Centre.
8. GST compensation Fund under the administrative control of GST council to provide for a built in compensation mechanism.
9. To convene extraordinary meeting of GST council.