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## **FROM THE PRESIDENT'S DESK**

Since its launching in the year April 2005, 22 issues of the Indian Journal of Public Audit and Accountability have since seen the light of the day and this one is the 23<sup>rd</sup> in the chain. It was conceived with the objective of disseminating ideas on public audit and accountability. We have had issues on assorted subjects as well as issues dedicated to specific themes. This issue is devoted to the subject of Goods and Service tax which is the hottest topic in the economic firmament of India. GST has generated over the years lot of heat and dust and even after its introduction in 1<sup>st</sup> July 2017 continues to give rise to fierce debate over its impact on Indian economy, federalism, state government finances etc. The present issue has contributions from authors on aspects of budgetary implications, impact on federalism, Goods and service taxation network, impact on accounting, audit perspectives, and GST as seen by the successive Finance Commissions beginning with Thirteenth. We have also added at the end the 101<sup>st</sup> amendment Act 2016 and the Compensation to the States Act 2017 for ready reference.

I am sure the issue will present an objective and balanced view on GST to answer the questions being debated currently and will trigger interest in the readers for further study and analysis. We acknowledge with gratitude the pain taken by the learned authors and I hope in future also they will continue to write for us.

**AJIT PATNAIK**

## EDITORIAL

Edmund Burke wrote long ago-‘The disposition to preserve and the ability to improve, taken together would be my standard of a statesman’. No wiser words have ever been spoken about statecraft in the history of nations. Burke had said this in the context of the violent changes brought about by the French Revolution in his ‘Reflections on the French Revolution’. The words ring a sound of time-tested relevance when we see a climate of uncertainty in the tax collections, apprehensive States about fall in share of revenue, a faltering IT backbone, high tax rates, a complicated tax filing in the GST which was introduced on 1<sup>st</sup> July 2017. Did the wisdom lay in avoiding a hurried introduction and going with the recommendation of the 14<sup>th</sup> FC that transition to GST may be designed over the medium and long term? The World Bank in its report also has highlighted these issues like fall in tax collections of States and high compliance burden for firms. GST has much to recommend itself- a common unified market with uniform rates over the length and breadth of the country, reduction in the number of multiplicity of indirect taxes, removal of cascading effect due to input tax credit resulting in lower prices for consumers, reduction in compliance costs, a model of cooperative federalism in the institution of GST Council etc. The Economic Survey 2017-18 has compared it to a new planet ‘swims into his ken’ for a star-gazing poet like a new luminous star on the financial horizon of India. The most disturbing concern is of the States regarding shrinking of their tax jurisdiction and reduction in tax collection which may impact their share of indirect taxes and the consequent effect on their elbow room to run welfare schemes of their choice. Tamilnadu and Maharashtra have increased their own entertainment tax, Motor Vehicle tax etc. All these raising the question whether GST is anti -federal in spirit notwithstanding all proclamations from the mount on cooperative federalism. One of the articles in the issue has analysed this aspect of collaborative federalism.

There are conflicting projections regarding revenue collections and resultant budgetary implications. As the article on

'Budgetary Implications of GST' avers government is sanguine that GST will help widen the tax base with the removal of the transitional difficulties in due course and when the systems of invoice matching, reverse charge and the e-way bill comes in, the same will create fiscal space for rationalization of tax rates. No tax system of the size, reach and dimensions of GST can succeed without a sound and functioning IT backbone. GSTN provides the necessary IT support to provide a uniform interface for the taxpayer and also creates a shared infrastructure between the Union and the States. As the article stresses when we are introducing a complex system, there are likely to be many teething problems and the system will stabilize in due course conferring the benefits of simple tax assessment and compliance, reduction in tax evasion and elimination of harassment of honest taxpayers. Another article highlights the issues relating to changes in financial accounting and reporting consequent on introduction of GST relating to impact on revenue, impact on inventory, impact on construction contracts, impact on chart of accounts etc. which CBIC, Ministry of Corporate Affairs, ICAI have to look into. To incorporate necessary changes in the accounting system, Audit of GST by CAG needs close examination in CAG office. The article on audit has suggested high-tech audit of GSTN and also the performance and transaction audit of revenue collection and the process. Another author has analyzed the recommendations like compensation to States of successive Finance Commissions on GST beginning with Thirteenth Finance Commission, the Fifteenth Finance Commission terms of reference which includes *inter-alia* impact of GST on State finances.

**AJIT PATNAIK**  
**Editor-in-Chief**

## **BUDGETARY IMPLICATIONS OF THE GOODS AND SERVICE TAX**

**DR. SUBHASH CHANDRA PANDEY\***

*The Indian GST is expected to represent a leap forward in creating a much cleaner dual VAT which would minimize the disadvantages of completely independent and completely centralized systems. A common base and common rates (across goods and services) and very similar rates (across States and between Centre and States) will facilitate administration and improve compliance while also rendering manageable the collection of taxes on inter-state sales. At the same time, the exceptions—in the form of permissible additional excise taxes on sin goods (petroleum and tobacco for the Centre, petroleum and alcohol for the States)—will provide the requisite fiscal autonomy to the States. Indeed, even if they are brought within the scope of the GST, the states will retain autonomy in being able to levy top-up taxes on these “sin/demerit” goods.*

### **Introduction**

1. The implementation of Goods and Services Tax (GST) in a country of India's size and complexity is undoubtedly one of the biggest tax reforms in the world. The only comparison in scale may be with the European Common Market where sovereign nations came together to introduce a common fiscal and monetary regime. Similarly, the GST unites India into a common market across State borders.

2. The idea of integrating the national market on the lines of the EU model had been intermittently discussed in several official

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committees of which particular mention may be made of the Bhairon Singh Shekhawat Committee (1995), which in a way sowed the seeds of first introduction of State level VAT in 2005 and now the dual GST in 2017.

3. It was forcefully argued in these deliberations that when fully sovereign nations of Europe could come together to coordinate their tax policies and eliminate fratricidal tax competition among themselves, the States in India should be persuaded not to fragment the national common market and indulge in the sales tax rate wars to the detriment of public exchequer. Through CENVAT and MODVAT mechanisms, the governments tried to minimize the cascading effect of taxes, i.e., tax on tax getting compounded in the value addition chain from raw material to finished products.

4. The goods & services tax (GST) is currently levied/imposed in about 160 countries. Preferred design<sup>1</sup> of GST

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<sup>1</sup>There are three possible variants of VAT, depending upon what macro-aggregate the government wants to tax: gross income, net income or consumption. A **gross product type VAT** treats both consumption and capital formation as final uses of the good; hence capital goods purchased by the dealer would not be treated as inputs. Input tax credit will not be available on taxes paid on capital goods. An **income type VAT** would give credit for tax paid on current inputs and tax paid on capital goods to the extent attributable to depreciation of capital goods, in any given year. Credit for tax on capital goods will therefore be spread over the life of the capital good. A **consumption type VAT** goes a step further in that only final consumption is treated as the final use of a good; full credit, therefore, is given for taxes paid on capital goods as well, in the year of purchase. The consumption base has been a much favoured tax base from both the perspective of economic neutrality and ease of administration. It is also the only VAT that is equivalent to a retail sales tax, in that it restricts the burden of the tax to final consumption goods. In effect, the tax is only on the pure value added within the production stage in question. Consumption VATs are also the easiest to compute—all taxes previously paid on purchases from other firms to be simply subtracted from taxes due on sale. No distinction needs to be drawn between capital goods and other inputs, and no depreciation need be computed. Consumption, it is argued, is also a broad measure of the ability to pay taxes, much like income. Furthermore, it excludes savings from the base, hence does not discourage investment.



worldwide has been a multi-point tax collected at each point of the supply chain (manufacturer, distributor and retailer), so that it is hard for anyone in the chain to avoid or evade the tax. By not reporting a transfer of goods/services, he can only avoid additional tax payable on his own value added but miss the chance to recover the tax he paid explicitly or implicitly to the inputs he sources from his own suppliers and service providers.

5. It was amusing to see wide tax rate differentials across State borders prompting one to refill fuel tank at this or that petrol pump across State border. Physically connecting surplus regions with deficit regions with broad tax homogeneity can be a great boost to overall national welfare. In fact, not just an integrated Indian market but an integrated SAARC and ASEAN market holds the potential of making this populous and under-developed region into an economic powerhouse.

#### **Salient features of GST**

6. The Constitution of India, which is a Union of States, originally provided for a division of legislative powers between the Parliament and the State Legislatures with co-extensive executive powers of the Union government and the State governments. In the pre-GST regime, the manufacturing of goods (except alcoholic liquor for human consumption, opium, narcotics etc.), imports and services were taxed by the Central government and manufacturing of alcoholic products and transactions of post-manufacture sales and purchases were taxed by the State governments. In the case of inter-State sales, the Centre has the power to levy a tax (the Central Sales Tax) but, the tax is collected and retained entirely by the States from where the goods move out.

7. Through the 101<sup>st</sup> Constitutional Amendment Act 2016, which received the assent of the President of India on 8th September, 2016, both the Union and the States were empowered to make laws with respect to goods & services. Of course, the Parliament continues to have exclusive power to make laws with respect to goods and services tax where the supply of goods, or of services, or both takes place in the course of inter-State trade or

commerce. This significant Amendment requiring special majority in both the Houses of Parliament and ratification by majority of States was the result of a grand bargain between these governments arrived at after protracted negotiations spanning over a decade. In terms of this Act, the Constitutional amendments were to be enforced with effect from such date as the Central Government may notify. Section 12 of the Act was notified for enforcement w.e.f. 12<sup>th</sup> September 2016 and the remaining Sections were brought into force w.e.f. 16<sup>th</sup> September, 2016.

8. The new tax regime contemplated levy of three new taxes, viz., Central GST, State GST and Integrated GST on goods and services with effect from July 1, 2017. The GST rates, rules and regulations are governed by the Goods and Services Tax Council, which comprises of the Finance Ministers of the Union, all the States and the two Union Territories with Legislature. All Goods and Services were divided into five tax slabs - 0%, 5%, 12%, 18% and 28% so as to approximate the total incidence of various pre-GST taxes. In addition, a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold jewellery. In addition, a cess of 22% or other rates on top of 28% GST applied on few items like aerated drinks, luxury cars and tobacco products. The cess proceeds are meant to compensate the States against revenue losses benchmarked to 2015-16 collections with a growth of 14% per annum.

9. Alcoholic liquor for human consumption is outside the GST tax net and continue to be governed by pre-GST tax laws. Five key petroleum products like crude oil, high speed diesel, motor spirit (petrol), natural gas and aviation turbine fuel are part of the GST law but shall be taxable with effect from a future date to be decided by the GST Council and till such eventuality continue to be taxed as per the pre-GST laws as transitional arrangement. Tobacco and Tobacco products are covered by GST but as an exception are also subject to *Central Excise duty on these products*.

10. The GST is a dual GST with the Centre and States simultaneously levying it on a common tax base. The GST to be levied by the Centre on intra-State supply of goods and / or

services would be called the Central GST (CGST) and that to be levied by the States/ Union territory would be called the State GST (SGST)/ UTGST. Similarly, Integrated GST (IGST) will be levied and administered by Centre on every inter-state supply of goods and services.

11. GST is a destination based tax on consumption of goods and services, which levied at all stages right from manufacture up to final consumption with credit of taxes paid at previous stages available as setoff. In a nutshell, only value addition by each economic agent in the value addition chain will be taxed and ultimate and full burden of tax is to be borne by the final consumer. The benefit of tax proceeds would accrue to the taxing authority which has jurisdiction over the place of consumption which is also termed as place of supply. While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, SGST would be chargeable only when the supplier and the recipient are both located within the State.

12. The GST would replace the following taxes: (i) taxes currently levied and collected by the Centre: a. Central Excise duty b. Duties of Excise (Medicinal and Toilet Preparations) c. Additional Duties of Excise (Goods of Special Importance) d. Additional Duties of Excise (Textiles and Textile Products) e. Additional Duties of Customs (commonly known as CVD) f. Special Additional Duty of Customs (SAD) g. Service Tax h. Central Surcharges and Cesses so far as they relate to supply of goods and services (ii) State taxes that would be subsumed under the GST are: a. State VAT b. Central Sales Tax c. Luxury Tax d. Entry Tax (all forms) e. Entertainment and Amusement Tax (except when levied by the local bodies) f. Taxes on advertisements g. Purchase Tax h. Taxes on lotteries, betting and gambling i. State Surcharges and Cesses so far as they relate to supply of goods and services The GST Council shall make recommendations to the Union and States on the taxes, cesses and surcharges levied by the Centre, the States and the local bodies which may be subsumed in the GST.

13. It is important to note that the GST not only affects Union Excise Duties and Service Tax but also the Customs as in the GST

regime of consumption based taxation, even imported goods and services are subject to GST. It is a well-accepted proposition in tax theory that achieving neutrality of incentives between domestic production and imports requires that all domestic indirect taxes also be levied on imports. So, if a country levies a sales tax, VAT, or excise or GST on domestic sales/production, it should also be levied on imports. In India, this is achieved through the CVD/SAD which is levied on imports to offset the impact of the excise duty levied on domestically manufactured goods. However, CVD/SAD exemptions act perversely to favour foreign production over domestically produced goods; that is, they provide negative protection for Indian manufacturing. The amended Constitution now provides that the supply of goods, or of services, or both in the course of import into the territory of India shall be deemed to be supply of goods, or of services, or both in the course of inter-State trade or commerce. Therefore, the imports are treated as deemed inter-State supplies and thus attract levy of Integrated GST.

14. The following table shows a macro view of the uniqueness of the Indian model of GST among major federal economies of the world:

**Table 1: Comparison of Federal VAT Systems**

Nature of VAT	Country Examples	Disadvantages
Independent VATs at Centre and States	Brazil, Russia, Argentina	Differences in base and rates weaken administration and compliance. Inter-state transactions difficult to manage.
VAT levied and administered at Centre	Australia, Germany, Austria, Switzerland, etc.	State government relieved of responsibility of raising taxes which also takes away fiscal discretion of States
Dual VAT	Canada and India today	A combination of the above two and hence limits both their disadvantages
“Clean” dual VAT	India’s GST	Common base and common or similar rates facilitate administration and compliance, including for inter-state transactions, while continuing to provide some fiscal autonomy to States

*Source: World Bank (2015)*

### **Fiscal impact on GST: Baseline scenario**

15. The roots of GST lies in the government’s desire to improve woefully low Tax: GDP ratio by plugging tax leakages in the entire value addition chain of goods and services. India has lowest level of Tax/GDP ratio among 51 major countries in the world who have PPP GDP above 100 billion \$. In 2013-14, the year preceding the change of government, the revenue deficit of the Central government was 3.3 per cent of GDP, fiscal deficit was 4.8 per cent of GDP and tax/GDP ratio was 10.03 per cent of GDP.

16. To get a perspective on the recent trends in Tax: GDP ratio and the relative contribution of different taxes with reference to taxes and duties collected by the Central government, we may refer to the following tables on the profile of combined tax revenue of the Central and State governments in 2015-16 as extracted from

Statement No. 2 of the Combined Finance and Revenue Accounts  
for the year 2015-16

Year	Gross Tax Revenue	
	Amount	% of GDP
2009-10	624527.2	10.2
2010-11	793307.7	10.9
2011-12	889118.0	10.6
2012-13	1036460.4	11.0
2013-14	1138995.5	10.9
2014-15	1245136.63	10.0
2015-16	1455891.07	10.7

Note:-Gross Tax Revenue refers to the taxes collected by the central government, net of refunds to taxpayers, but without deducting the share of tax proceeds that is to be transferred to the States under a Constitutional arrangement.

**Direct and Indirect Taxes**

(Rs in crore)

Year	Direct taxes	% growth over previous year	Direct taxes as % to Gross tax receipts	Indirect taxes	% growth over previous year	Indirect taxes as % to Gross tax receipts	Total Gross tax	% growth over previous year
2009-10	377593.6		61.6	246933.61		40.3	613020.73	
2010-11	445995.1	18.1	56.9	347312.61	40.7	44.3	783847.76	27.9
2011-12	493987.4	10.8	56.1	395130.57	13.8	44.9	880802.19	12.4
2012-13	558989.5	13.2	54.3	477470.98	20.8	46.4	1028741.9	16.8
2013-14	638595.9	14.2	56.5	500399.6	4.8	44.2	1130905.61	9.9
2014-15	695792.65	9.0	55.9	549343.10	9.8	44.1	1245136.63	9.3
2015-16	742012.24	6.6	51.0	713878.83	30.0	49.03	1455891.07	16.9

**Components of Tax Revenue**

*(Rs in crore)*

Year	Corporation Tax	Income Tax	Customs	Union Excise	Service Tax	Other Taxes
2009-10	244725.07	122417.24	83323.71	102991.37	58422.15	12647.66
2010-11	298687.89	139102.2	135812.51	137700.94	71015.91	10988.25
2011-12	322816.17	164525.33	149327.5	144900.97	97508.96	10039.07
2012-13	356326.01	196843.5	165346.22	175844.91	132601.23	9498.53
2013-14	394677.85	237870.42	172085.42	169455.14	154780.49	10126.18
2014-15	428924.74	258374.44	188016.18	189038.48	167969.42	12813.37
2015-16	453228.33	280394.45	210338	287148.55	211414.57	13367.17

**Components of Tax Revenue as per cent of gross tax receipts**

*(Rs in crore)*

Year	Corporation Tax	Income Tax	Customs	Union Excise	Service Tax	Other Taxes
2009-10	39.2	19.6	13.3	16.5	9.4	2.0
2010-11	37.7	17.5	17.1	17.4	9.0	1.4
2011-12	36.3	18.5	16.8	16.3	11.0	1.1
2012-13	34.4	19.0	16.0	17.0	12.8	0.9
2013-14	34.7	20.9	15.1	14.9	13.6	0.9
2014-15	34.4	20.8	15.1	15.2	13.5	1.0
2015-16	31.1	19.3	14.4	19.7	14.5	1.0

**Contribution of individual taxes in the combined tax revenue of Central and State and UT governments: 2015-16**

**Rs. in crore**

<b>(a) Taxes on Income and Expenditure</b>	
Corporation Tax	453,197
Taxes on Income Other than Corporation Tax	279,346
Taxes on Agricultural Income	54
Hotel Receipts Tax	83
Interest Tax	49
Collection Under Fringe Benefit Tax	(46)
Other Taxes on Income and Expenditure Land Revenue	5,317
<b>Total (a) Taxes on Income and Expenditure</b>	<b>738,000</b>
<b>(b) Taxes on Property and Capital Transactions</b>	

Land Revenue	10,804
Stamps and Registration Fees	96,208
Estate Duty	1
Taxes on Wealth	1,079
Securities Transaction Tax	7,350
Taxes on Immovable Property Other than Agricultural Land	1,341
<b>Total (b) Taxes on Property and Capital Transactions</b>	<b>116,782</b>
<b>(c) Taxes on Commodity and Services</b>	
Customs	210,338
Union Excise Duties	286,860
State Excise	106,600
Taxes on Sales, Trade etc.	552,519
Taxes on Vehicles	46,900
Taxes on Goods and Passengers	23,370
Taxes and Duties on Electricity	31,259
Service Tax	207,491
<b>Total (c) Taxes on Commodity and Services</b>	<b>1,465,337</b>
<b>Total Tax Revenue</b>	<b>2,320,119</b>

17. One of the reasons why it has taken so long to arrive at a consensus on GST is that expectedly there are gainers and losers in any tax reform which changes the *status quo ante* and the negotiations get closed when all parties to it are least dissatisfied from the agreed outcome. A theoretician may prescribe a single rate of tax on all goods and services in the interest of simplicity of tax administration but simplicity alone is not the guiding factor in deciding tax policy. The equity aspect of fair distribution of incidence of tax burden is far more important at least in the short run till the taxpayers are gradually convinced and prepared for a gradual convergence of multiple tax rates.

18. A lot of preparatory work on GST implementation therefore has been focused on the policy makers' search for a 'revenue-neutral rate', a mean tax rate that will at least protect government's current revenue collections, if not improve it. Adding to the complication is the fact that over the years the indirect tax system at both the Central and State level has targeted more and more on



petroleum products, alcoholic liquor for human consumption, tobacco products and passenger cars. Since the incidence of pre-GST levies and extent of resource mobilization through taxation of these few commodities by the Central and State governments is pretty high contributing to more than half the total tax collection, the difficulties of bringing all goods and services in the GST net and subjecting them all to a single tax rate is quite fathomable. Whether on public health considerations or environmental considerations or revenue consideration, there will always be a case for taxing polluting fossil fuels and intoxicants more than other items of consumption.

19. In practice, there will be a structure of rates, but for the sake of analytical clarity and precision but also to facilitate comparisons across methodologies, it is more useful and appropriate to think of the RNR as a single rate. It is a given single rate that gets converted into a whole rate structure, depending on policy choices about exemptions, what commodities to charge at a lower rate (if at all), and what to charge at a very high rate. The following table summarizes the projected RNRs considered by a Committee( December, 2015) led by Dr. Arvind Subramanian, Chief Economic Adviser, which were arrived at by following three different estimation methodologies:

**Summary of approaches to estimating RNR**

<b>Approach</b>	<b>GST Base (in lakh crore)</b>	<b>RNR (per cent)</b>
Macro	59.9	11.6
ITT	39.4	17.7
DTT	58.2	12.0

ITT= Indirect Tax Turnover  
DTT=Direct Tax Turnover

20. Because identifying the exact RNR depends on a number of assumptions and imponderables; because, therefore, this task is as much soft judgement as hard science; and finally also because the prerogative of deciding the precise numbers will be that of the future GST Council, the Subramanian Committee chose to recommend a range for the RNR rather than a specific rate. For the

same reason, the Committee has decided to recommend not one but a few conditional rate structures that depend on policy choices made on exemptions, and the taxation of certain commodities such as precious metals.

**Summary of Recommended Rate Options (in per cent)**

	RNR	Rate on precious metals	"Low" rate (goods)	"Standard" rate (goods and services)	"High/Demerit" rate or Non-GST excise (goods)
Preferred	15	6	12	16.9	40
		4		17.3	
		2		17.7	
Alternative	15.5	6	12	18.0	40
		4		18.4	
		2		18.9	

Source: Committee's calculations.

Note : All rates are the sum of rates at center and states

21. In the absence of publicly available data on collection of taxes from different goods and services, changing profile of tax rates and exemptions, and just initial 5 months aggregated data being available, it is hazardous to estimate potential revenue gains and losses from GST implementation in the short, medium and long term, either for individual goods/services or even at aggregate level for all goods and services. Nevertheless, the available information is analyzed below.

#### **Impact of GST on Budget: Current scenario**

22. When the current year's Budget was presented by the Union Finance Minister on 1st February, 2017, the modalities for implementing the new tax regime were still being worked out and there would have been obvious uncertainties and so the Budget estimates of indirect tax revenues did not include any estimates on account of GST. Customs, Excise and Service Tax are the three Central taxes that are directly affected by GST. (GST's impact on income tax is rather tenuous and not readily quantifiable and hence not subject to any serious academic study.) As seen from the following extracts from Budget 2017-18, the tax revenue estimates were probably based on expected trends and buoyancies in pre-GST tax regime:

(₹ करोड़) (In ₹ crore)

	2015-2016 वास्तविक Actuals	2016-2017 बजट अनुमान Budget Estimates	2016-2017 संशोधित अनुमान Revised Estimates	2017-18 बजट अनुमान Budget Estimates
<b>REVENUE RECEIPTS</b>				
<b>1. Tax Revenue</b>				
<b>Gross Tax Revenue</b>	<b>1455648</b>	<b>1630888</b>	<b>1703243</b>	<b>1911579</b>
Corporation Tax	453228	493924	493923	538745
Taxes on Income	287637	353174	353174	441255
Wealth Tax	1080	...	...	...
Customs	210338	230000	217000	245000
Union Excise Duties	288073	318669	387369	406900
Service Tax	211414	231000	247500	275000
Taxes on Union Territories	3878	4121	4277	4679
<b>Less - NCCD transferred to the NCCF/NDRF</b>	<b>5690</b>	<b>6450</b>	<b>6450</b>	<b>10000</b>
<b>Less - State's share</b>	<b>506193</b>	<b>570337</b>	<b>608000</b>	<b>674565</b>
<b>1a Centre's Net Tax Revenue</b>	<b>943765</b>	<b>1054101</b>	<b>1088793</b>	<b>1227014</b>

23. That the Budget 2017-18 did not really factor GST into account is an important point to note in the context of any discussion on GST revenues and their comparison with the Budgeted revenues. As on 10<sup>th</sup> January, 2018, the provisional monthly accounts of only upto November 2017 are available which show that the pace of revenue mobilization is same

	April- November 2017	April- November 2016	% of BE17-18	% of BE16-17
Gross Tax collection	1087,911	933,280	57	57
Personal and Corporate Income Tax	465,012	408,933	47	48
Customs, Union Excise Duties, Service Tax and GST	602,417	508,924	65	65
Of which GST##	276,661			

##Central GST Rs.85,424 crore, Integrated GST Rs.159,721 crore and GST Compensation Cess Rs.31,516 crore.

24. In terms of gross and net ups and downs in monthly collections of different taxes has been only a marginal decrease in terms of revenue collection as percentage of Budget. By November 2016, the net tax collection of the Central government (excluding the share of Central taxes transferred to States) was 59% of the

Budget 2016-17 and by November 2017, the corresponding figure was 57% of the Budget 2017-18. The real issue of concern is that a substantial sum of tax revenue currently retained in the Central government account will have to be transferred to States either under the Finance Commission's award for pre-GST taxes or under the scheme of GST regime such as by way of GST Compensation Cess or the IGST credits adjusted towards settlement of State GST claims.

25. Prior to introduction of GST, there were about 80 lakh manufacturers, suppliers, sellers and service providers registered with Central Excise, Service Tax or State VAT authorities. By December 25, 2017, as many as 99.01 lakh had registered under GST in different States, of which 16.60 lakh were 'composition dealers' who expect their annual turnover to be less than a prescribed threshold<sup>2</sup> and choose to pay GST at flat rates on the declared turnover without any itemized reckoning and record keeping. They are not allowed to claim Input Tax Credit on inward supplies. As a concession, the 'Composition dealers' have been allowed to file returns every quarter, instead of monthly as is the norm for general GST dealers.

26. The progress of GST implementation till December 25, 2017 was as follows. As many as 53.06 lakh returns for November were filed with total collection for the month of December 2017 being Rs.80,808 crore. Of this Rs.13,089 crore was CGST, Rs.18,650 crore was SGST, Rs.41,270 crore was IGST and Rs.7,798 crore was Compensation cess. Further, Rs.10,348 crore was transferred from IGST to CGST account and Rs.14,488 crore was transferred from IGST to SGST account by way of settlement of funds on account of cross utilization of IGST credit for payment of CGST and SGST, respectively, or due to inter State B2C transactions. Thus, a total amount of Rs.24,836 crores was transferred from IGST to CGST/SGST account by way of settlement. Thus, the total collection of CGST and SGST for the month of December, 2017 (upto 25<sup>th</sup> December) is Rs. 23,437

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<sup>2</sup> Rs. 50 lakhs in Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura and Himachal Pradesh and Rs.75 lakhs in other States

crore and Rs. 33,138 crore respectively, including transfers by way of settlement.

27. Top Five States with highest GST collections by November 2017 were as follows:

State	Central GST	Integrated GST	State GST	Cesses	Total
Maharashtra	13654	17183	18701	3702	53240
Karnataka	5197	8520	7736	3110	24563
Tamil Nadu	5739	7605	8739	2062	24145
Gujarat	5464	9020	7375	1150	23009
Haryana	2890	10878	4627	1449	19844
Collection through imports		90038		2604	92642
<b>Grand Total</b>	<b>59,048</b>	<b>190,519</b>	<b>87,888</b>	<b>30,224</b>	<b>367,679</b>

Source: Lok Sabha; Figures in Rs crore; Data upto November 30, 2017.

### **Extent of tax compliance**

28. The extent of tax compliance may be gauged from the pace of GST Returns filed<sup>3</sup>. Total number of GSTR 3B returns filed for the months of July, August, September, October and November has been 58.7 lakh, 58.9 lakh, 57.3 lakh, 50.1 lakh and 53.06 lakhs, respectively. As on December 25, 2017, there were as many as 99.01 lakh registered GST ‘dealers’ in different States. (A company is expected to separately register in each of the State where it carries out taxable transactions in goods/services). In the pre-GST regime, there were about 72 lakh registered businesses under Central Excise, VAT and Service tax. Of the total GST registrations, 16.60 lakh were ‘composition dealers’ who have been allowed to file returns quarterly instead of monthly. That partly explains the large gap between the number of registered GST dealers and the number of return filers. The government is averse to coercive measures to enforce compliance particularly in the

<sup>3</sup>Combined Finance and Revenue Accounts for the year 2015-16 [http://cag.gov.in/sites/default/files/cfra\\_account\\_files/CFRA\\_Vol\\_1\\_2015\\_16.pdf](http://cag.gov.in/sites/default/files/cfra_account_files/CFRA_Vol_1_2015_16.pdf)

initial phase of GST implementation and has been urging all dealers to register and file returns voluntarily. Facilitation is being extended to those who are willing to do so but are facing difficulties in complying with the requirement.

#### **Reasons for revenue slowdown**

29. Barring a blip in the month of September, the GST collection has seen a consistent downslide. Main reasons for downward trend of tax revenue under GST could be attributed to the following factors.

30. **Poor compliance:** As per the latest figures as on 25<sup>th</sup> December, 2017, out of the 99.01 lakh taxpayers, only 53.06 lakh returns have been filed for November. Tax compliance may not be up to the mark as key features of GST, such as invoice matching, e-way bills, as well as reverse charge mechanism have been postponed. The leakage in compliance has been a constant feature since the rollout of the new tax regime and the government is hoping to plug it with the introduction of e-way bills, slated in February. An e-way bill will have to be generated for all movement of goods - within or outside a state - amounting to more than Rs.50,000 by prior online registration of the consignment. Karnataka, Rajasthan and Uttarakhand already have the system in place. Nine more states and one union territory are likely to have the e-way bill system since February.

31. Because of the first time requirement of paying IGST on transfer of goods from one State to another State even within the same company, there was an additional cash flow of IGST in the first 3 months. As and when the final transaction of these goods takes place, the credit for IGST is being utilized for payment of SGST and CGST and therefore, the inflow of new taxes is low.

32. The tax administration of GST is now based on self-declared Tax Return, in which the assessee decides on his own how much tax liability he has and claims input tax credit as per his own calculations. Since implementation of some of the main features of GST such as, matching of returns, e-way bill as well as reverse charge mechanism have been postponed the tax compliance may not be up to the mark.

33. **Reduction in GST rates:** As part of rationalisation of the lists of items falling under the 28% GST rate, more than 200 items have been offloaded in November. In November, the GST Council cut rates on more than 210 items, 180 of which were in the highest slab of 28 per cent. The move meant that only 50 items were left in the topmost slab. The council in fact went beyond the recommendations of the fitment committee which had suggested keeping 62 items in the highest bracket. The rationalisation has naturally resulted in lower revenues. The slashing of GST rates is likely to cause revenue shortfall of Rs 20,000-crore which has to be funded by the Central government because the States have been given revenue protection guarantee for five years. Lower GST revenue is a double fiscal risk for the Centre due to the resultant compensation which the Centre needs to pay to the States.

34. **Quarterly filing for small traders:** In October, the GST Council had decided to allow taxpayers with Rs 1.5 crore to file quarterly returns instead of the then existing monthly filing. Hence, it is expected that the revenue collection will step up in December, which coincides with a quarter-end. More than 16.50 lakh composition dealers, who are also eligible for quarterly filings, will pay their taxes in December.

35. Since the overall incidence of taxes on most of the commodities have come down under GST, it would naturally have some implication on the revenues of the Government.

36. Reduced economic activity in some sectors is compounding the problem caused by non-compliance in active sectors.

37. The government has allowed businesses and traders to sell their pre-GST stocks (pre-dating July 1) until December 31 with stickers showing the revised price, taking into account the tax changes. The relief comes after manufacturers, traders and the industry sought more time to exhaust their pre-GST stocks. The earlier deadline was to expire on September 30. This has to be appreciated in the context of large-scale discounted sales resorted by manufacturers and traders during April-June 2017 to liquidated their existing inventories amidst uncertainties of potential impact of GST on existing stocks. In a way, this was also possibly

encouraged by some State governments because of the revenue protection guarantees under the GST regime.

38. There are *prima facie* reasons to believe that the composition scheme meant to ease life for small businesses is being misused. For July-September, around 10 lakh entities had opted for the composition scheme for GST where only the turnover details have to be disclosed and tax is paid at a flat rate. Of these, around 6 lakh filed returns till December 25. But the total amount mopped up from these entities for the three-month period added up to as much as Rs.251 crore, translating into an average annual turnover of Rs.8 lakh. It is apt to note that the threshold for registering for GST is an annual turnover of Rs.20 lakh. A cross-reconciliation between GST and of presumptive income tax for small businesses can reveal extent of tax evasion/avoidance.

39. It needs further investigation whether the exemptions and concessions for small businesses under the GST scheme are being misused for tax evasion. It is apt to note that over 40% of 54 lakh businesses which filed GST returns in July claimed 'nil' tax liability and paid no tax at all. Of the remaining 60 per cent or 32 lakh businesses that filed returns, many did not have a cash liability as they opted to use the credits available for service tax or excise that they had paid before GST kicked in on July 1. Close to 70 per cent of the 32 lakh businesses which had a tax liability paid anywhere between Re 1 and Rs.33,000 in taxes. In contrast, just around 0.3 per cent, which is a little over 10,000 companies accounted for almost two-thirds of the GST mopped up by the government in July. In the pre-GST regime, there were about 72 lakh registered businesses under Central Excise, VAT and Service tax. The total registrations had shot up to 99.01 lakhs by 25<sup>th</sup> December. While some increase can be explained by the requirement of a company being required to separately register in each of the State where it carries out taxable transactions in goods/services, there is a sizeable number of new businesses registered and there are as many as 16.60 lakh 'composition dealers'. Also, many entities which were earlier out of the tax net or evading taxes are now being forced to register to claim and pass on input tax credit. Nevertheless, the possibility that some of the new registrations



(about 27 lakhs) *may* not be bonafide cannot be ruled out and the extent would be uncovered only when anti-evasion investigations and enforcement kicks in full measure.

### **OUTLOOK ahead**

40. A large number of registered GST dealers have not filed returns and the government would likely to believe that this is not attempt at willful evasion but due to transitional difficulties. The government is averse to coercive measures to enforce compliance particularly in the initial phase of GST implementation and has been urging all dealers to register and file returns voluntarily. Facilitation is being extend to those who are willing to do so but are facing difficulties in complying with the requirement. A whole network of GST Seva Kendras, helplines and field visits is in place. It is hoped that initial resistance and difficulties would soon be behind us just as it happened with replacement of sales tax with VAT. Positive contribution of State level VAT on State finances is now well documented and that should give us similar confidence about the outcome of GST.

41. Aspects like invoice matching, reverse charge and e-way bills are yet to be fully put in place. These were postponed to give both the industry and the tax administration more time. While the government will roll out e-way bills next month and make it mandatory from February to track consignments moving in trucks, the GST Council will decide on the reintroduction of the two other tools when it meets on January 18.

42. Although tax collections are not as buoyant as the government would have liked to see, the government is hoping that GST will help widen the base as the transitional difficulties are ironed out and the systems of invoice matching, reverse charge and the e-way bills kick in. That would create fiscal space in the future for further rationalization of tax rates.

## **GST – COOPERATIVE FEDERALISM OR SEED OF FUTURE DISCORD**

**AJIT PATNAIK\***

*Introduction of GST will impact the States fiscally and also in some ways has made inroads into their financial autonomy. The new bull in the finely crafted, delicately balanced federal financial scheme of distribution by the Constitution is the GST Council introduced by the 101<sup>st</sup> amendment. If a democratically elected State government cannot make any changes in the tax rates or tax laws or announce exemptions, it is definite scissoring of State financial powers.*

2017 is the annus mirabilis in the history of financial evolution in India. On the midnight of 1st July 2017, India was witness to a watershed in the centre-state financial relations. The country embraced the Goods and service tax, heralding the dawn of one tax, one economy and one nation. In 2000, with the introduction of the service tax as per the 88th constitution amendment act, the last major change had been effected. The scale and dimensions of the changes with the introduction of the Goods and service tax is unprecedented. India saw plethora of indirect taxes with multifarious rates, acts, rules all getting subsumed in the wide sweep of the new blanket tax. India also saw opening of new horizons in federal practice with the cooperative efforts which saw a GST Council being brought into existence representing both the Centre and the States carrying forward the spirit of ‘cooperative federalism’ as Granville Austin had spoken of Indian Constitution. It is evolving the way of ‘cooperative federalism instead of economic nativism’.

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Article 1(1) of the Constitution reads –‘India, that is Bharat, shall be a Union of States.’ The Indian polity has two sets of government, a constitutionally prescribed distribution of powers between the Centre and the States, supremacy of the Constitution and the final authority of the Courts to interpret the constitution which are essential features of a federal constitution. However, it has many unitary features as it is an indestructible Union of destructible States where the State boundaries can be redrawn without the consent of a state unlike US Constitution which is an indestructible union of indestructible States. There is no equality of State representation, no double citizenship, no division of public services, and no dual system of Courts. D.D. Basu has stated that ‘the Constitution of India is neither purely federal nor purely unitary but is a combination of both. It is a Union or composite state of a novel type 1. The cooperative federalism has been defined in the context of American Constitution as..’ the practice of administrative cooperation between general and regional governments, the partial dependence of the regional governments upon payments from general governments and the fact that the general governments by the use of conditional grants, frequently promote developments in matters which are constitutionally assigned to the regions.’ In India, the allocation by the Centre to states a share of the taxes collected through Finance Commission, grants and allocation of funds through Planning Commission (now disbanded) are the pointers to existence of a cooperative federalism.

The founding fathers of the constitution had the firm conviction that a federation to be successful must give adequate financial powers to both the Centre and the States to pursue their own charted plans for progress without waiting for centre to fill their resources tanks; otherwise the states will be reduced to the status of vassal states making it a federation in name only. Hence they incorporated adequate provisions in the constitution to make it a real federation. The financial relations between the centre and the states is governed by articles 246, Seventh Schedule (three lists), 268-273 (distribution of revenue between union and states) 275, 282 (grants-in-aid), 280 (Finance Commission), 292 (borrowings), 360 (financial emergency), FRBM Act etc. The articles relating to

inter-state trade and commerce are in articles 301, 302, 303, 304. Art 301 states that commerce and intercourse throughout the territory of India shall be free and Art 303 prohibits Parliament and state legislatures to make any preferential or discriminatory law in regard to the States. Articles 302 and 304, state that reasonable restrictions can be imposed by parliament and State legislatures in public interest.

The distribution of taxation powers, before the 101<sup>st</sup> amendment has been enshrined in Part 11 Article 246 of the Constitution. The seventh schedule in the true spirit of federalism contains 3 lists giving the constitutional scheme of distribution of powers. List 1 with 14 items contains the powers of the Centre. List 1 includes items like Customs, Corporation tax, surcharge on income tax etc. List 2 contains 19 items incorporating the taxation powers of the States. The items included are land revenue, taxes on land and buildings and mineral rights, taxes on road vehicles, on consumption of electricity, sales tax etc. The concurrent list where both the Centre and the States have joint authority does not contain any taxation clause. There are duties like Stamp duties on bill of exchange etc. which are levied by the Union but collected and appropriated by the States. Certain taxes and duties like duties on succession to property other than agricultural land which are levied and collected by the Union but assigned to the States within which leviable. Taxes like tax on income other than agricultural income are levied and collected by the union but distributed between the Union and the States. US and Australia have only the federal list and the residuary powers are with the States.

The 101<sup>st</sup> amendment which became law in September 2016 after signature by the President, makes significant changes in the scheme of distribution of powers between the Centre and the States 2. As per existing distribution of taxation powers before September 2016 Union had the powers to levy tax on the manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.) while the States had the power to levy tax on sale and purchase of goods within the boundaries of the State. On inter-state sales, the Union had the power to levy the tax (the Central Sales Tax), which was collected and appropriated

by the States. It could not be placed in the concurrent list as central law would have prevailed over state law. It was not also possible to keep CGST in central list and SGST in the state list as they were dealing with the same tax *i.e.* GST. Hence, the Constitution was required to be amended to concurrently empower the Union and the States to levy and collect GST. GST is a composite tax on supply of goods or services or both, except on supply of liquor for human consumption and five petroleum products viz. petroleum crude, motor spirit(petrol),high speed diesel, natural gas and aviation turbine fuel. It is a consumption based single tax on supply of goods and services from the manufacturer to the consumer, replacing 17 indirect taxes-8 central (Central excise duty, service tax etc.), 9 state (state vat, sales tax, entry tax etc.) and 23 cesses of the Union and the states. Central GST and State GST/UTGST are charged on transactions with in a state/UT and Integrated GST is levied on inter-state supply of goods and services and imports. IGST levied and collected by the Centre, is to be shared between the centre and the states. Each manufacturer /seller/business entity will be able to avail input tax credit. The GST (Compensation to the States) Act 2017 provides for compensation to the states by levy of a cess incase the switch to GST results in overall loss of revenue for them with 2015-16 revenues as the base year revenues with 14% nominal annual growth 3.

Most notably, it provides for formation of a GST Council in Article 279A (1) with the Finance Minister (as the Chairman), Union Minister of State, Revenue and the state finance ministers of 29 states and 2 union territories with legislature (Delhi and Puducherry).The decisions of the Council are to be taken at a meeting by a majority of not less than  $\frac{3}{4}$ <sup>th</sup> of the weighted votes of the members present and voting. The Union and the States have a weightage of  $\frac{1}{3}$ <sup>rd</sup> and  $\frac{2}{3}$ <sup>rd</sup> respectively. The Council has the functions to make recommendations regarding taxes, cesses etc. to be levied by the centre and the states, goods and services that may be subjected to or exempted from the GST, model GST laws, principles of levy, the rates including floor rates with bands of GST etc.

The benefits from introduction of GST are unified common national market for India, reducing corruption and leakage, simplifying complex tax structure and unifying rates across the country, give a filip to 'make in India' by making less the bias in favour of imports, mitigation of cascading effect due to input tax credit, reduction in the multiplicity of indirect taxes, reduction in compliance costs, benefit to consumer in the shape of lower prices, widening of tax base, increase of revenue, etc. However, GST is not an unmixed blessing especially in regard to its impact on state autonomy apart from other disadvantages like compensation to States, cascading effect in Petroleum products etc.

GST Council is a shining example of a harmonious federal structure where the centre and the states have in a spirit of give and take taken the decisions regarding GST by the method of consensus as prescribed by Art 279 A(6) unlike a competitive federal structure with strong centrifugal forces where the States fight tooth and nail to preserve their constitutionally assigned sphere. The GST Council is to establish a mechanism to adjudicate dispute between Centre and the States and the states inter se as per Article 279A(11). The laws relating to GST have been same across the Country and it has been extended even to Jammu and Kashmir. There are common definitions and procedures, common compliance mechanism, common GSTN platform, joint capacity building programmes, joint implementation committee, cross empowerment of officers of centre and states etc.

A moot point which needs to be referred to is whether Articles 302 and 304 which refer to the power of the Central and State governments to impose 'restrictions' in case of Centre and 'reasonable restrictions' in case of States on trade and commerce need revision to promote greater 'accommodative federalism'. US Constitution in Article I section 8 clause 3 empowers the Congress 'to regulate commerce with foreign nations, and among the several states, and with the Indian tribes.' The Supreme Court has upheld restrictions imposed by states as in the case *Shree Mahavir Oil Mill vs. State of Jammu and Kashmir*.(1996). Perhaps, this will need wider consultations and intervention of Supreme Court before a view emerges on this.

The new bull in the finely crafted, delicately balanced federal financial scheme of distribution by the Constitution is the GST Council introduced by the 101<sup>st</sup> amendment. Punchchi Commission 2010 in its report on GST had commented that introduction of GST will impact the States fiscally and also in some ways make inroads into their financial autonomy due to ‘possible accentuation of vertical imbalances’ with the Centre gaining access to the taxation of consumption’ and had recommended that revenue neutral rates be ‘worked out with care’<sup>4</sup>. GST rates had to be in the range of 15 to 15.5% to achieve the Revenue Neutral Rate as the Committee headed by Chief Economic Affairs had pointed out. However in the 5 rates of GST ranging from 0 to 28% implemented, States are likely to suffer substantial reduction in revenue. If a democratically elected State government cannot make any changes in the tax rates or tax laws or announce exemptions, it is definite scissoring of State financial powers. States had complete autonomy over Sales tax which accounted for 80% of their revenue and VAT had 4 rates which they could manipulate. States may be compensated for loss of revenue but the States cannot be compensated for loss of political autonomy to fix rates. Of course, one may argue that since the states are dancing to the tune of some pressure groups, it will help curb populism. However, the logical extension of this argument strikes against the fundamental democratic hypothesis- ‘no taxation without representation’. As has been seen some of the States like Tamil Nadu and Kerala have been progressive in going for welfare schemes and have attained the comparable Organisation for Economic Cooperation and Development status in health sector. Such states will find it difficult to tax and provide higher standards of living in their states. GST is in keeping with the neo-liberal economic thought as it works towards a regime of nil or minimum exemptions. States with reduced revenue will perforce have to work in this direction. In Canada where GST was introduced in 1991, the Provinces have right over direct taxes while the federal government has right over indirect taxes. In India, the GOI has right over direct taxes and also over part of indirect tax collections. The World Bank Report on India Development Update 2018 has also stated that state administrations have been experiencing difficulties in the initial days and also there is lack of

clarity on discontinuation of local taxes, where taxes like entertainment tax are levied over the GST as in Tamilnadu 5.

Every tax system in its revenue actualization is a direct resultant of the state of the economy. GST will also depend on Indian economy attaining the projected GDP growth of 8 % keeping in view the constraints of world economic situation, oil prices and domestic macro-economic stabilization with its twin balance sheet problem of bank NPA and debt ridden company balance sheets. In 2017-18, the fiscal deficit has already crossed the 3% GDP-FD target. States will also be burdened with outgo due to pay commission and farm loan waivers. The 14<sup>th</sup> Finance Commission had stated that the fiscal burden should be treated as an investment which is certain to yield substantial gain in the short and long run 6. will the centre be able to provide compensation in case of fall in revenue of the states keeping in view the overall like tax collection scenario in the emerging economic situation? GST has curtailed the States powers to raise revenue by taking political risks by raising taxes for welfare schemes. A super body without any electoral backing having no political responsibility has usurped the power of the elected representatives. The Economic Survey 2016-17 had stated that Indian States are more diverse than States within the US and hence require greater freedom of tax and regulatory manoeuvre 7.

K C Wheare, the eminent constitutional authority had commented that India is a quasi federal state, more a unitary state with subsidiary federal features rather than a federal state with subsidiary unitary features. GST has further buttressed this unitariness. The Rajmanner Committee (1971) and the "Opposition Conclave" (1977) had recommended greater delegation to the States of financial resources. It has also been commented on the TOR of XV FC which is loaded in favour of the Union Government - "Unless a balanced view is taken by the XV-FC, these TOR have the potential to convert an already hierarchical union - State fiscal relation into a relation of command and control" 8. The Supreme Court in Bommai's case (1994) had commented that federalism in India is not a matter of administrative convenience but of principle... 9. The Tamilnadu



government was against introduction of GST. Francis Bacon had advised long ago that there is 'surely no greater wisdom than well to time the beginnings and onsets of things' and not to 'shoot off before the time'. 14<sup>th</sup> FC had recommended the transition to GST may be designed over the medium and long term 10. Perhaps there lay the wisdom in avoiding a transition with violent jerks, to forestall any future State resistance. Also floor rates with a band could have been fixed leaving the states to fix rates which could have been more in keeping with federal spirit and more acceptable to States. However, as the Economic Survey 2016-17 had averred GST Council will have to take up these challenges to 'to take India from a good GST to an even better one' 11.

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## GOODS & SERVICES TAX NETWORK (GSTN) SYSTEM

### GOVIND BHATTACHARJEE\*

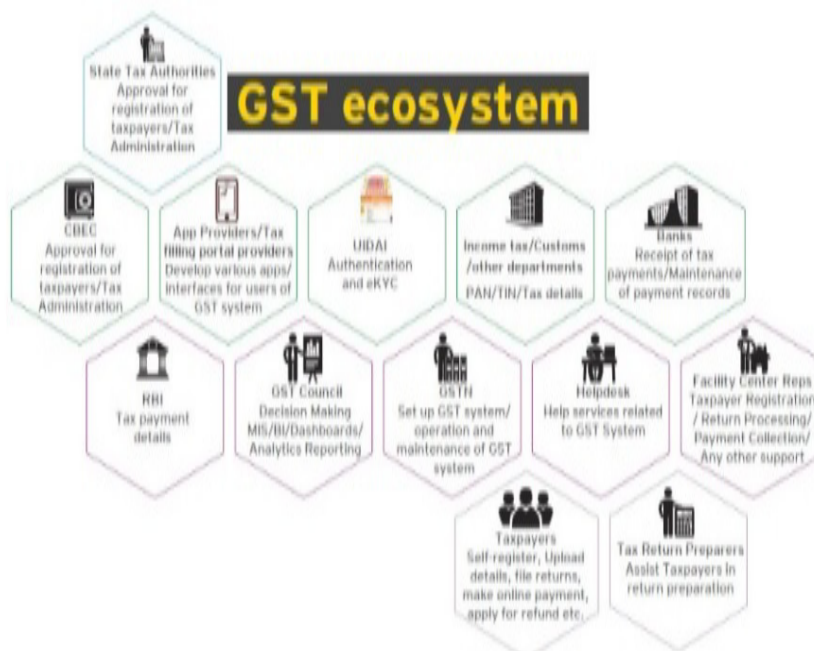
*GST System is arguably one of the most complex IT Systems in the world – in terms of scale, size and complexity. To give an idea about the complexity involved in the process, just consider this: Under GST, the buyer's returns will be auto populated by data from seller's returns and invoices uploaded by him. The software will have to match the data automatically from the returns and uploaded invoices and accept/reject/modify these invoices. GST system does not allow duplicate invoice upload. Synchronization between taxpayer's IT system and GST system will pose further challenges, and all these challenges will add to cost of administration and compliance, as service providers called GST Subidha Providers (GSPs) will charge the taxpayers for their services.<sup>1</sup>*

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<sup>1</sup>[http://www.gstn.org/ecosystem/pdf/GSP\\_Implementation\\_Framework\\_V\\_3.0.pdf](http://www.gstn.org/ecosystem/pdf/GSP_Implementation_Framework_V_3.0.pdf), accessed 16/10/2017.

The GST Ecosystem is shown in the diagram below:



Source: <http://www.ey.com/in/en/services/tax/ey-india-tax-insights-in-the-gst-regime-technology-can-help-create-a-credible-deterrence-for-tax-evaders-an-exclusive-interview-with-prakash-kumar>, accessed 21/09/2017.

At the heart of the GST system sits the Goods and Services Tax Network (GSTN) as the technology backbone for GST, powered by the software built by Infosys. GSTN is a not-for-profit private limited company which was incorporated in March, 2013, with an authorised capital of Rs. 10 crore only, which are shared by the Government of India (24.5%), all States and UTs of Delhi and Puducherry and the Empowered Committee of State Finance Ministers (24.5%), the balance 51% being contributed by private financial institutions.<sup>2</sup> Thus private players own 51% share in the GSTN, and the rest is owned by the government. The GSTN has also been given a non-recurring grant of Rs. 315 crores. The contract for developing this vast technological backend was awarded to Infosys in September 2015.

<sup>2</sup>10% each by HDFC, HDFC Bank, ICICI Bank, NSE Strategic Investment Co. and LIC Housing Finance Ltd (11%).

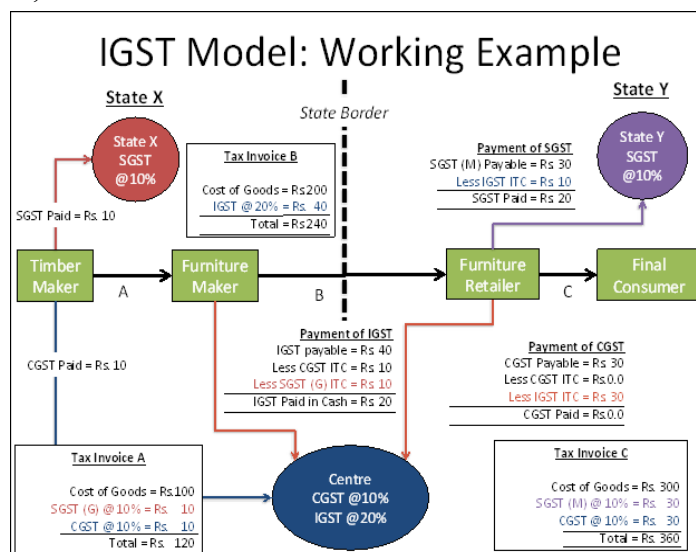
Expenses of the GSTN are to be shared equally between the central and the State Governments. The Central Government will have control over the composition of the Board, mechanisms of special resolution and shareholders agreement, and agreements between the GSTN and other state governments. Also, the shareholding pattern is such that the Government shareholding at 49% is far more than that of any single private institution.

To state briefly, GSTN will establish a uniform interface for the taxpayer and also create a common and shared IT infrastructure between the Centre and States to deal with all GST invoices, returns, registrations, payments and refunds. It is to be a Trusted National Information Utility (TNIU), providing secure, reliable, efficient and robust IT backbone for the smooth functioning of GST and for handling perhaps the most complex of all tax systems in the world covering the Union and the 29 states of India as well as two Union Territories with legislatures.

GSTN is responsible for creating the IT infrastructure to migrate nearly 90 lakh existing entities registered with the Excise or Service Tax departments, and with VAT departments in the States, onto one single digital platform. Each of the States has a different format for VAT, and to integrate all these into a common compatible structure before migrating data has truly been a monumental task. GSTN has validated the existing business entities from the old databases using their permanent account numbers (PANs) and found 90 percent of them active. Almost 30 percent of these entities registered showed a turnover of under Rs 5 lakh, which meant that they could still claim the VAT credit, but lying below the GST threshold turnover of Rs 20 lakhs has no liability to pay the tax. With more registrations expected, GSTN will expand its capacity gradually to 1.5 crore entities. Each taxpayer is allotted a 15 digit GST Identification Number (GSTIN) which will be essential for any transaction. The new entities are required to register online. Over time, the GSTN is expected to be globally the largest commercial, real-time taxation software used anywhere.

GSTN is to manage the entire IT system of the GST portal, which is the master database of GST and will provide all necessary services to the taxpayers— from registration to payment of taxes

and filing of returns. From registration to invoicing, filing of returns, payments and refunds – everything in GST will be handled by GSTN through the GST Identification Number (GSTIN) which is a unique number based on a taxpayer's PAN. Every taxpayer will receive the GSTIN once he/she is registered with the GSTN common portal. GSTN is equipped to handle 3 billion invoices per month, apart from return filing for about 90 lakh taxpayers. GSTN portal will maintain all tax details which can be used by the government to track every financial transaction pertaining to GST. GSTN will provide a common interface for the taxpayers, while at the same time creating a shared IT infrastructure between the Centre and States. The infrastructure is extremely complex and sophisticated; without this it would not have been possible to create an efficient settlement mechanism for the States and the Centre, especially in relation to the IGST for inter-state trade, considering the huge volume of pan-India transactions. IGST will also be levied on all imports. A change from the present regime would be that the States where imported goods are consumed will now gain their share from the IGST paid on imported goods. A working model of IGST, as released by the Press Information Bureau, is shown below:

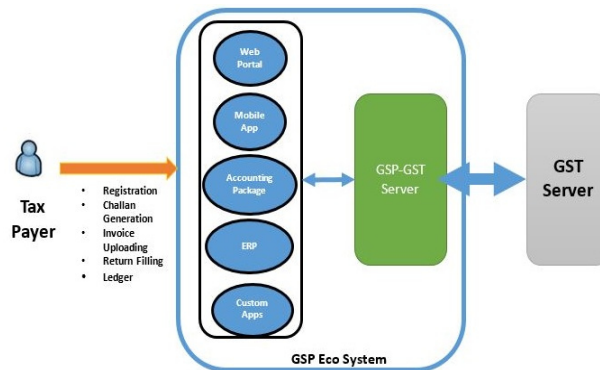


Source: <http://pib.nic.in/newsite/PrintRelease.aspx?relid=148240> accessed 22/09/2017.

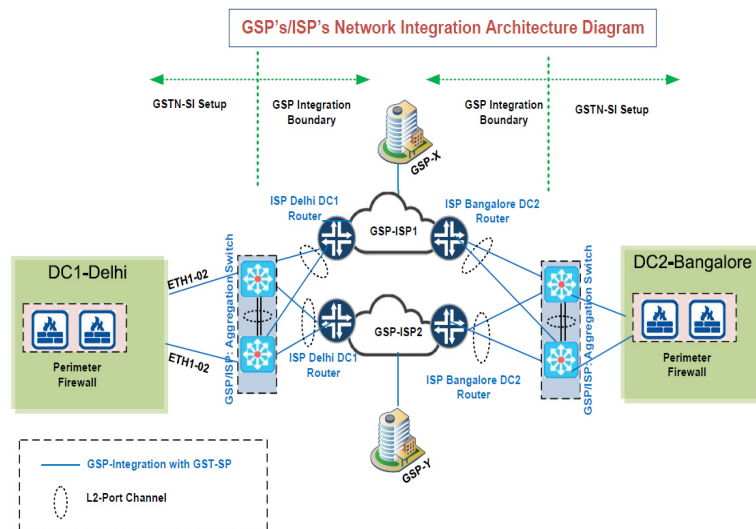
Complexity of any tax structure has multiple facets – technical, structural as well as operational. A crucial part of the administrative and compliance costs of GST will concern the technological backbone of the new tax regime, the GST Network (GSTN). As already stated, GSTN is a non-profit non-Government company in which the Centre, States and some private banks and financial institutions are the stakeholders, but it will operate through multiple agencies whose services would not be free to the taxpayer for providing G2B (Government to Business) services. GSTN will develop the IT infrastructure of the “GST System” and provide the interface through which taxpayers will interact with the Government, for registration, uploading of invoices, filing of returns, and other purposes. This will constitute what in Computer parlance is known as the “front-end” interface of the system, while the back-end interface will enable interactions between the GST system and tax authorities in the Central and State Governments including CBEC for approval of registration, scrutiny of returns and assessment of taxes, refunds of credits, etc.

All payments, uploading of invoices and filing of returns will have to be done electronically by all taxpayers only through the GST portal. Access to and use of technology is therefore crucial for all taxpayers registered with the GST Network, without which they cannot conduct business. But recognising that many taxpayers – especially those belonging to the MSMEs, may have no access to improved IT infrastructure necessary for billing, accounting, inventory management, invoicing, etc. or may not have any familiarity with IT system at all, GSTN has created an ecosystem of service providers who are called GST Suvidha Providers (GSP) for providing innovative solutions (Portal, Mobile App, Enriched API) who will act as enablers for the taxpayers to comply with the provisions of the GST law through its web portal. GSPs will play a very important role in making the GST rollout smooth and convenient for taxpayers, and in bridging the gap between the taxpayer’s IT systems and the GST system. 34 companies have been identified and notified as GSPs last December (2016), which include accounting software companies, ERP solution providers, IT companies, the big four accounting firms and certain other companies providing accounting and billing solutions. Further, the continuously evolving laws, rules, return

formats make it even more complex and challenging as it has to instantly adapt and implement these changes requiring it to be robust and flexible at the same time. The GSP ecosystem and its architecture for integration into the GST system are shown in the two diagrams below:



Source: <http://www.gstn.org/ecosystem/>, accessed 22/09/2017



Source: Guidelines & Architecture for GSP/ISP Integration with GST System, [www.gstn.org](http://www.gstn.org), accessed 25/09/2017

GST is an API (Application Program Interface) - driven software in which the APIs are available for developer community

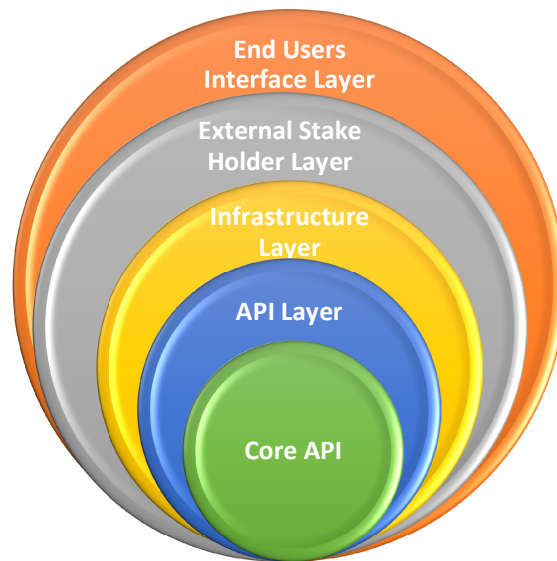
to build Mobile Apps, Portals, Custom Application, etc. It is an open platform for innovation which uses open source technologies, frameworks, and standards. Moreover, it has a service-oriented architecture (SOA) which is a software design where all functionalities are available as services and provided by application components via a communication protocol over a network. An SOA architecture is independent of vendors, products and technologies. A service is can be accessed remotely and acted upon and updated independently, such as retrieving a credit card statement online. It has essentially four properties: (1) It logically represents a business activity with a specified outcome; (2) It is self-contained; (3) It is a black box for its consumers and (4) It may consist of other underlying services also. An SOA architecture integrates a number of distributed, separately-maintained and deployed software components, which can communicate and cooperate over a network, especially an IP network, enabled by specific technologies and standards that facilitate such communication. The architecture is fully secure, reliable and scalable.

Security of the software and its privacy are ensured through symmetric and asymmetric cryptography, use of digital signature and e-sign, secure communication with outside world using MPLS/VPN/SSL and advance SOC (Security Operation Center) with a properly defined security policy. Scalability is ensured through massive scaling using SEDA (Staged Event Driven Architectures), Micro Service Architecture and Messaging System, among others. With usage of advance monitoring tools to provide proactive alerts, the NOC (Network Monitoring Center) connected with monitoring tools enables remote monitoring. The architecture is designed for zero data loss and is fully protected against unauthorized access/modification of data. The architecture provides for Data Driven Decision Making, use of Big Data Technologies to handle and process large amount of data as well as use of Business Intelligence and Analytics to provide better services to stakeholders.

The GSTN has been designed based on layered architecture. Each layer provides an abstraction to the layer below and provides



some specific features using principle of loose coupling. GST Core System constitutes its heart; all the business logic and business rules are implemented at this layer, besides implementation for digital signature solution, security of data etc. API Layer is the interface of the GST Core System; it protects the GST core System at the layer above.



Source: Joshi, Bhuvan, “GST Network, A technical; Introduction”, *Aarthika Chrache*, Vol 1 No 2 Jan-Jun 2017, Fiscal Policy Institute, Bengaluru

The Layer-description is given in the table below.

layer name	brief description	items implemented in the layer
Application Programme Interface Layer	Protects GST Core System	All security majors like License Key Validation, Authentication and Coarse Grained Authorization; Throttling, metering, auditing, access management etc.
Infrastructure Layer	Backbone of the system which provides infrastructure support for hosting APIs and other applications; provides physical as well as	Deployment infrastructure like Application Server, Web server, Messaging Infrastructure, physical well as virtual Storage Infrastructure etc. All network and communication

layer name	brief description	items implemented in the layer
	virtualized server along with required API and Application deployment; also provides interface for external stakeholders to connect to GST System.	infrastructure for GST System;
External Stakeholders Layer	Provides all public API's. This will be hosted by the GST partner, i.e. GST Suvidha Provider (GSP).	Access to all public APIs to external stake holders in a controlled and secure manner.
End User Interface Layer	Interface of GST system for the end users like tax payers, tax consultants, tax officials etc.	Applications like Web Portal, Mobile Apps, Mobile-based Web Application etc. GST system will provide some of the applications, like Web Portal, for both Mobile and Desktop. GSP and their partners using public APIs are also free to provide any of above or any other application to end users.

GSTN had previously objected to audit by the Comptroller and Auditor General of India. At the core were issues of access to the GSTN's own books, the GST tax data and the information technology (IT) infrastructure created by the GSTN. However, clearing the air on audit of GSTN, the Union Finance Minister had clarified in June 2017 that the Comptroller and Auditor General of India will audit the Goods and Services Tax Network (GSTN).

It is obvious that any meaningful audit of the GSTN must focus intensively on the Application Programme Interface Layer so as to derive an assurance about the system as a whole. For network auditing, there are the ISACA (Information Systems Audit and Control Association) standards and guidance available (1202 Risk Assessment and Planning, 1205 Audit Evidence, 2208 Audit sampling, 2401 Audit Reporting and 1402 Follow Up Activities). The ICAI Auditing Standards like SA 315 (Standard on Auditing), SAE 3402 (Standard on Assurance Engagements) should also be useful in this context. Audit of End User Interface layer that provides the user interface would also be important from the usability and security angles.

GSTN is expected to simplify the process of tax assessment and appropriation. As could only be expected in implementing such a complex system, there are many teething problems and taxpayers and traders are suffering as a result. Timely refund is a major issue, because here taxpayers/ traders have to pay tax upfront and claim the input tax credit adjustments/ refunds later. Till they get their refunds, their money remains blocked and it adds to the business cost by way of interest and also affects their working capital flow. A part of the problem arises from the fact that the users are not yet fully conversant with the system and the details entered by the buyers and suppliers do not often match. Till the time the GSTN system stabilizes and develops the necessary robustness, these and other teething problems are likely to continue. The Government and the GST Council are aware of the problems and are talking appropriate decisions from time to time to alleviate the suffering of the traders and dealers as well as consumers, and addressing the implantation glitches as far as possible. But unless there has to be a meaningful convergence on enforcement and compliance between government and business community at large, things will not start running smoothly only through government intervention. The success of GST will obviously depend on the effectiveness of GSTN because all transactions between various stakeholders, including common people, will be accounted for on this platform. Using software as the backbone of GST is also a serious attempt to gradually nudge the informal sector to move into the formal stream.

In the long run- and by 'long run' I don't mean an indefinite period of time but only 2-3 years - GSTN will certainly make the process of tax assessment and compliance much simpler and be able to curtail tax evasion and corruption, and to eliminate harassment of ordinary and honest taxpayers by tax inspectors. It alone has the potential of putting an end to the Inspector Raj.

## AUDIT OF GOODS AND SERVICES TAX

**NANDINI Y. KAPDI\***

*Audit plays a crucial role in the tax administration. An independent check on the demand, Assessment, collection and accounting ensure that statutory provisions are being followed and taxes are collected accurately. In the context of GST Act, audit has been given a pride of place. Audit has been envisaged at the first point of Return, second point of Department and at the last level, audit of CAG of India.*

Indirect Taxes attach themselves to the cost of the supply of goods/services and are transaction-specific and not person-specific. Over the course of years, India was viewed as a country with a plethora of both State and Central taxes with cascading effect in the sphere of indirect taxes. Secondly, the structure involving multiple taxes and rates was not in accordance with global practices. Thirdly, high cost of tax compliance and double taxation led to increase in the price of goods and services. Fourthly, there was lack of uniformity in the provisions and interpretation of different laws and fifthly, high cost of collection led to lower tax yields to the Government. In order to simplify the indirect taxation regimen, the Goods and Services Act was passed in April 2017 and received Presidential assent on 12 April 2017. An enabling amendment to the Constitution in the form of 101st Constitutional Amendment Act, 2016 was passed and it came into effect from 16th September, 2016. This Constitutional Amendment made the following changes:

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\* Smt. Nandini Y. Kapdi is former IA&AS Officer (1977) and retired as Pr. Accountant General – Gujarat

- Conferring simultaneous power upon Parliament and the State Legislatures to make laws governing goods and services tax;
- Subsuming of various Central indirect taxes and levies such as Central Excise Duty, Additional Excise Duties, Service Tax, Additional Customs Duty commonly known as Countervailing Duty, and Special Additional Duty of Customs;
- Subsuming of State Value Added Tax/Sales Tax, Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States), Octroi and Entry tax, Purchase Tax, Luxury tax, and Taxes on lottery, betting and gambling;
- Dispensing with the concept of ‘declared goods of special importance’ under the Constitution;
- Levy of Integrated Goods and Services Tax on inter-State transactions of goods and services;
- GST to be levied on all goods and services, except alcoholic liquor for human consumption. Petroleum and petroleum products shall be subject to the levy of GST on a later date notified on the recommendation of the Goods and Services Tax Council;
- Compensation to the States for loss of revenue arising on account of implementation of the Goods and Services Tax for a period of five years;
- Creation of Goods and Services Tax Council to examine issues relating to goods and services tax and make recommendations to the Union and the States on parameters like rates, taxes, cesses and surcharges to be subsumed, exemption list and threshold limits, Model GST laws, etc. The Council shall function under the Chairmanship of the

Union Finance Minister and will have all the State Governments as Members.

GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

Keeping in mind the federal structure of India, there will be two components of GST – Central GST (CGST) and State GST (SGST). Both Centre and States will simultaneously levy GST across the value chain. Tax will be levied on every supply of goods and services. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The input tax credit of CGST would be available for discharging the CGST liability on the output at each stage. Similarly, the credit of SGST paid on inputs would be allowed for paying the SGST on output. No cross utilization of credit would be permitted.

However, the cross utilization of CGST and SGST would be allowed in the case of inter-State supply of goods and services under the IGST model. In case of inter-State transactions, the Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supplies of goods and services under Article 269A (1) of the Constitution. The IGST would roughly be equal to CGST plus SGST. The IGST mechanism has been designed to ensure seamless flow of input tax credit from one State to another. The inter-State seller would pay IGST on the sale of his goods to the Central Government after adjusting credit of IGST, CGST and SGST on his purchases (in that order). The exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The importing dealer will claim credit of IGST while discharging his output tax liability (both CGST and SGST) in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. Since GST is a

destination-based tax, all SGST on the final product will ordinarily accrue to the consuming State.

### **Threshold for Audit:**

Every registered taxable person whose turnover during a financial year exceeds the prescribed the limit of Rs 2 Crore shall get his accounts audited by a Chartered Accountant or a Cost Accountant. Audit under GST is the process of examination of records, returns and other documents maintained by an assessee. The purpose is to verify the correctness of turnover declared, taxes paid, refund claimed and input tax credit availed, and to assess the compliance with the provisions of GST.

The dealer shall electronically file:

1. An annual return using the Form GSTR 9B along with the reconciliation statement by 31st December of the next Financial Year,
2. Audited copy of the annual accounts,
3. Reconciliation statement, reconciling the value of supplies declared in the return with the audited annual financial statement,
4. Any other particulars as prescribed.

Audit by Tax Authorities:

The Commissioner of CGST/SGST (or any officer authorized by him) may conduct audit of a taxpayer. The audit will be completed within 3 months from date of commencement of the audit. The Commissioner can extend the audit period for a further six months with reasons recorded in writing. On conclusion of audit, the officer will inform the taxable person the findings with reasons and the assessee's rights and obligations within 30 days. If the audit results in detection of unpaid/short paid tax or wrong refund or wrong input tax credit availed, then demand and recovery actions will be initiated.

### **Special Audit**

The Assistant Commissioner may initiate special audit, considering the nature and complexity of the case and interest of revenue. If he is of the opinion during any stage of scrutiny/enquiry/investigation that the value has not been correctly declared or the wrong credit has been availed then special audit can be initiated.

Special audit can be conducted even if the tax payer's books have already been audited before.

The Assistant Commissioner (with the prior approval of the Commissioner) can order for special audit (in writing). The special audit will be carried out by a chartered accountant or a cost accountant nominated by the Commissioner. The auditor will have to submit the report within 90 days. This may be further extended by the tax officer for 90 days on an application made by the taxable person or the auditor. The taxable person will be given an opportunity of being heard in findings of the special audit. If the audit results in detection of unpaid/short paid tax or wrong refund or input tax credit wrongly availed then demand and recovery actions will be initiated.

### **Audit by the Comptroller and Auditor General of India (CAG):**

The Comptroller and Auditor General of India (CAG) is vested with the power of auditing all expenditure and revenue and submit a Report to the Parliament/State Legislature. This Constitutional provision is further enabled by the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971 and the regulations made there under. CAG's power to audit the revenue receipts of both the Central and State Governments emanates from S. 16 and S. 18 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971.

**S. 16 states-** It shall be the duty of the Comptroller and Auditor-General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly and to satisfy himself that



the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

**S.18 states-**The Comptroller and Auditor-General shall in connection with the performance of his duties under this Act, have the authority

1. to inspect any office of accounts under the control of the union or of a State, including treasuries, and such offices responsible for the keeping of initial or subsidiary accounts, as submit accounts to him;
2. to require that any accounts, books, papers and other documents which deal with or form the basis of or an otherwise relevant to the transactions to which his duties in respect of audit extend, shall be sent to such place as he may appoint for his inspection;
3. to put such questions or make such observations as he may consider necessary, to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which it is his duty to prepare.
4. The person in charge of any office or department, the accounts of which have to be inspected and audited by the Comptroller and Auditor-General, shall afford all facilities for such inspection and comply with requests for information in as complete a form as possible and with all reasonable expedition.

Audit of receipts includes an examination of the systems and procedures and their efficacy in respect of:

1. identification of potential tax assessees, ensuring compliance with laws as well as detection and prevention of tax evasion;

2. pursuit of claims with due diligence and that these are not abandoned or reduced except with adequate justification and proper authority;
3. prompt investigation of losses of revenue through fraud, default or mistake including, if required, through the review of other similar cases;
4. exercise of discretionary powers in an appropriate manner including levy of penalties and initiation of prosecution;
5. appropriate action to safeguard the interests of the Government on the orders passed by departmental appellate authorities;
6. any scheme as may be introduced by the Government from time to time;
7. any measures introduced to strengthen or improve revenue administration;
8. amounts that may have fallen into arrears, maintenance of records of arrears and action taken for the recovery of the amounts in arrears;
9. other ancillary and non-assessment functions including expenditure incurred by the departments;
10. achievement of targets, accounting and reporting of receipts and their cross verification and reconciliation with the accounts records;
11. amounts of refunds, rebates, drawbacks, remissions and abatements to see that these are correctly assessed and accounted for; and
12. any other matter, as may be determined by the Comptroller and Auditor General.

The scope of audit of receipts includes examination of integrity of data, information and documents which form the basis of a policy. The purpose of audit is to establish the validity of information furnished in the tax return and to ensure correctness of valuation, availing of correct input credit, classification and

effective rate of tax applied after taking into consideration the admissibility of exemption notification availed etc.,

**Access to assessment files and records and computerized database:**

1. The audit officer shall have access to individual assessment files as may be necessary subject to provisions of applicable laws and rules. The department concerned shall provide access to the assessment records and also any computerised systems including the databases maintained by it in hard copy or/and electronic form.
2. As regards third party records and additional information thereon, provisions in this regard in Chapter 12 refer.

**Follow up action on systemic faults or high risks pointed out by Audit:**

Where the audit officer points out systemic faults or identifies high risks, the department should take appropriate action to address these faults and mitigate the risks so identified.

The department shall furnish within six months of the close of each financial year, an annual statement to the Accountant General (Audit) containing the details of follow up action taken on audit observations, including recoveries, in respect of accepted paragraphs included in the audit reports laid before Parliament or legislature till the end of that financial year.

The results of audit are conveyed to the Parliament/state Legislature by means of an Audit Report.

**CAG's audit in the context of GST Act:**

Audit is a dynamic process. CAG, the Supreme Audit Institution of India has been evolving, adapting and modifying its audit processes in accordance with the changes in law and procedure. In the earlier context, there were clear divisions as to Central and State taxes. Indirect tax audit was divided into Sales Tax Revenue audit (STRA), Central Excise Revenue Audit (CERA), Customs Revenue Audit (CRA) and Service Tax

Revenue Audit. Jurisdictions of these branches were clearly demarcated. Each had been a specialized branch of revenue audit and Audit Reports presented accordingly. As the revenue administration evolved, so did CAG audit. With its well-considered approach, CAG audit made important suggestions on policy matters which had been carried out successfully resulting in plugging loopholes and preventing leakage of revenue. Crores of rupees have been recovered as tax at the instance of CAG audit. An important part of revenue audit has been the erudite comments of CAG audit on various judicial pronouncements and their implication on tax revenue. Managerial audit of revenue administration has resulted in several policy and administrative changes over the years.

CAG's audit of the revenue receipts of Central and State Governments has played a highly crucial role in the tax regime of the country. With the passage of GST Act, CAG's audit jurisdiction remains as before. Being the sole, independent Constitutional authority, the CAG will continue to audit the various components of GST, which are State GST, Central GST and Integrated GST.

Unlike earlier times when incidence of tax was clearly differentiated as manufacture, sale, import etc., now incidence of tax is integrated to include, manufacture and sale of goods, import of goods and rendering of service. Although there are provisions for audit by the chartered/Cost Accountant and audit by the departmental authorities, an independent post audit by the Constitutional authority is essential to ensure that the tax receipts are correctly assessed, collected and accounted for and to assure the Parliament/ State Legislature accordingly.

CAG's audit uses sound principles for identifying risk parameters and uses sampling techniques for selection of offices/cases for audit. The criteria for audit will be based on the Rules and regulations framed by the Department and the GST Council. The detailed procedure of audit would remain the same. From vouching the correctness of the data and verifying detailed calculations it ensures that input credits are correctly availed at each stage and the tax is correctly paid. Secondly, CAG's audit

goes into the examination of compliance to rules and regulations. At a macro level, CAG's audit examines the total performance of the concerned office with reference to the criteria of economy of operations, efficiency of tax collection and effectiveness of the implementation of the GST Act. The CAG also comments on the cost of collection, amount of tax under dispute, refunds etc.

Prior to large scale computerization of the tax records, CAG's audit would examine the actual hard copy files in the tax offices. However, with digitalization, CAG's audit too has appropriately developed techniques for audit through the computer and around the computer. Highly advanced computer based auditing techniques are used by CAG audit.

#### **Digital audit:**

GST digital audit can be a major weapon against all the tax defaulters prevailing in our country. India's biggest tax regime i.e. Goods and Services Tax (GST) has been implemented in the country from the 1st July 2017.

Basically, the Digital audit under GST means auditing the data under GST based on a data-driven platform, which is independent of time, place and person. Digital Audit will create an environment of the zero-paper trail and go completely paperless from day one, which emphasizes the key features of the platform i.e. digitally-filed audit and real-time monitoring.

News Reports have mentioned that a data warehouse will be created by CAG team with data of assesses being collected from various sources such as the Goods and Services Tax Network, Commercial Taxes Departments of all states and UTs and the Central Board of Excise and Customs. For bringing such a big revolution of Digital Audit, and for auditing in a comprehensive manner, data will also be collected from other departments such as the Income Tax department, e-commerce, Medical Council of India, agricultural committees and other regulatory bodies under India. The data warehouse will also include the audit objections raised by departmental officers during field inspection. GST digital

audit system will be launched by March 2019, which will be fully based on near to real-time peer review, and a digital audit report.

### **IT network for GST- Goods and Services Tax Network (GSTN)**

Goods and Services Tax Network (GSTN) is a Section 8 (under new companies Act, not for profit companies are governed under section 8), non-Government, private limited company. It was incorporated on March 28, 2013. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions. The Company has been set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of the Goods and Services Tax (GST). The common GST Portal developed by GSTN will function as the front-end of the overall GST IT ecosystem. The IT systems of CBEC and State Tax Departments will function as back-ends that would handle tax administration functions such as registration approval, assessment, audit, adjudication etc.

Creation of common and shared IT infrastructure for functions facing taxpayers has been assigned to GSTN and these are filing of registration application, filing of return, creation of challan for tax payment, settlement of IGST payment (like a clearing house), generation of business intelligence and analytics. All statutory functions to be performed by tax officials under GST like approval of registration, assessment, audit, appeal, enforcement etc. will remain with the respective tax departments.

Under GST, there will be common return for CGST, SGST and IGST, eliminating the need to file separate tax returns with Central and state GST authorities. Checking of claim of Input Tax Credit (ITC) is one of the fundamental pillars of GST, for which data of Business to Business (B2B) invoices have to be uploaded and matched. The Common GST Portal created and managed by GSTN will do this matching on the basis of invoice level data filed

as part of return by all taxpayers. Similar exercise will be done for inter-state supplies where goods or services will move from the state of origin to the state of consumption and so will the taxes. The claim of IGST and its utilization will be settled based on returns filed at the Common GST portal.

**Access to Data:**

The design of GST systems is based on role based access. The taxpayer can access his own data through identified applications like registration, return, view ledger etc. The tax official having jurisdiction, as per GST law, can access the data. Data can be accessed by audit authorities as per law. No other entity can have any access to data.

**CAG's Audit:**

Being substantially funded by the government during the period 2013-16, the C&AG has conducted the expenditure audit of GSTN for FY 2013-14, 2014-15 and 2015-16. This is done under the audit of Grants in aid.

**Audit of GSTN by the CAG:**

Audit of GSTN will be done by the CAG and new guidelines are being finalized by CAG authorities. With the IT revolution in the country erstwhile Sales Tax, Central Excise, Customs and Service Tax departments were already computerized to a large extent and CAG audit had successfully done the audit of the System and made useful comments from design of the System to the ultimate efficacy of tax collection. Under the GSTN set up CAG will resort to large scale data analytics as per news reports.

While the introduction of GST has been welcomed, systems and procedures would still need corrections as various departments need to adjust their specific rules of procedure. Audit at the Chartered/Cost accountants level and the Departmental level is a right step both in terms of compliance and financial audit. But, the audit by the CAG with its years of experience will look at both the micro and macro scenario and will comment on the systems and procedures with reference to economy, efficiency, and

effectiveness. The Supreme Audit Institution will also have to certify the final revenue collection figures. No new challenge is envisaged before the CAG except for the huge data analytics for which the Supreme Audit Institution is already well prepared.

References: Official websites of CAG of India, GST Council, ICAI, and news paper reports.



## **GOODS & SERVICES TAX (GST): IMPACT ON ACCOUNTING AND FINANCIAL REPORTING**

**K. P. SHASHIDHARAN\***

*Transition to GST requires migrating existing service tax, VAT and central excise registrations to GST. Accounting must incorporate necessary changes due to GST implementation. As GST payments and return filings are to be state wise, entities have to put appropriate system in place to incorporate necessary changes to the accounting system and state-wise reconciliations of periodic GST filings in different states. MIS may be redesigned in line with GST rules.*

Introduction of a single destination based consumption tax, known as Goods and Service Tax (GST) with effect from 1st July 2017 is a revolutionary indirect tax reform making a paradigm shift in India's tax regime. Prime Minister Modi aptly explained, GST is good, simple tax system.

GST is mother of all indirect tax reforms since independence in India. GST aims to amalgamate a number of cascading Central and State taxes into a single tax structure, making one nation one market and one indirect tax regime a reality. GST removed double taxation with fewer rates and exemptions, making taxation transparent, further easing of doing business in India, to make Indian products globally and domestically more competitive than ever before.

In the federal structure of the Indian Constitution, the taxation powers are distributed between Centre and States. While

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\* Shri K.P. Shashidharan, IA&AS is a former Director General, CAG Office and an alumnus from the London School of Economics, UK

Centre levies duty on manufacture except alcohol for human consumption, services tax, CST (retained by originating States) on inter-State sales; State levies VAT on intra-State sales, Entry tax / Octroi/ Luxury tax, etc. Therefore, 101st Constitutional Amendment Act was passed on 08.09.2016 for assigning concurrent powers to Centre and States to levy GST on all supplies.

### **Salient Features of GST**

Key features of the reform include concurrent jurisdiction for levy and collection of GST by the Centre and States as per Article 246A; Centre to levy and collect IGST on supplies in the course of inter-State trade or commerce including imports in line with Article 269A; Payment of compensation for loss of revenue to States for five years on recommendation of GSTC; and GST on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel to be levied from a later date on recommendations of GSTC.

### **Inclusion of Oil and Natural Gas in GST**

The GST subsumed most of the Central and State indirect taxes into a single tax. But, crude oil, natural gas, diesel, petrol and ATF are excluded. The Confederation of Indian Industry (CII) wanted the five products to be included in GST to avoid high tax incidence. VAT and CST rules continue to apply to the excluded products. The related sectors continue to incur huge GST impact on all inputs without any set-off, as sale of crude oil and natural gas are subject to OIDA (Oil Industry Development Act) Cess, Central Sales Tax Hitherto, fertiliser manufacturers, power producers, automobile manufacturers and other industries were buying these products by paying CST of 2 per cent against Form-C. After introduction of GST, credit on VAT paid on petroleum products, including natural gas, is not available. In the post GST regime, there has been an increased tax cost on the products.

Till now, fertiliser manufacturers, power producers, automobile manufacturers and other industries were buying natural gas and other petroleum products by paying 2 per cent CST against Form-C being purchased in other states. However, after the

introduction of GST, credit on VAT paid on petroleum products, including natural gas, is not available and the amendment of the CST Act has significantly altered interstate sale of products. This has resulted in stranded input tax credit and higher costs for oil companies. Excise collections on these products collected by the Centre increased from about ₹99,000 crore in 2014-15 to about ₹2,43,000 crore in 2016-17. The VAT collected by States and Union Territories enhanced from ₹1,37,000 crore in 2014-15 to ₹1,66,000 crore in 2016-17. Petroleum products account for about 40 per cent of States' revenue. Dual structure being thought about as a workaround — excise and VAT being allowed to continue even after GST could be a step forward towards an eventual transition into GST. It will allow oil companies to get input tax credit. GST has potential impact on cash flow, pricing, working capital, supply chain and ERP systems transforming business operations significantly.

### **Impact on Accounting and Financial Reporting**

Transition to GST involves changes in financial accounting and reporting too. This article focuses on some areas where financial accounting and reporting need to undergo changes on transition to GST framework. The GST impacts not only the taxation structure, but also the entire gamut of business financial processes, accounting and financial reporting. Changes in taxation require different treatment in accounts.

#### **i) Impact on Revenue**

Revenue recognition under the Indian Accounting Standards (IND AS) is based on the point of levy. For instance, excise duty is included in revenue since it is production-based tax, whereas sales tax and VAT, being levied at the time of sales is not taken into account while calculating revenue. GST is a consumption-based or destination based tax. This implies that all tax components are levied at the point of supply and accordingly the states will collect taxes at the place of consumption. This can create anomalies while projecting revenue under GST structure. Companies may find volatility in the reported revenue, which may not reflect their true

financial status. Experts recommend that companies may find non-GAAP reporting may be useful in these cases to correctly portray their earnings.

Under Ind AS revenue is measured at fair value, which is measured on the basis of consideration received or receivable after trade discounts and rebates; but GST will be recorded on the invoice value. Ind AS 18 recognizes revenue when the goods are delivered after sales to the purchaser, but GST recognizes transaction invoice value without any consideration to the accounting revenue. Ind AS requires the split between revenue and interest income where extended credit terms are offered to a buyer; but revenue under GST is on purchase invoice value, creating a difference in recording revenue under GST and in accounts. Application of fair value concept creates difference in accounting of treating notional guarantee commission income when a parent company provides financial guarantee to its subsidiary, but GST regime the treatment can be different.

**ii) Impact on Risk and Rewards**

Revenue recognition is taken into account from sale of goods under Ind AS 18 only when risk and rewards of ownership is transferred to the buyer. Timing of risk transfer and recording revenue under GST may differ as raising a voucher is good under GST.

**iii) Impact on Barter Transactions**

Under Ind AS guidance, when goods or services of similar nature and value are swapped, the transaction is not considered for revenue generation. GST requires companies to evaluate such barter exchanges of goods and services for assessing GST liability.

**iv) Impact on Construction Contracts**

In case of construction contracts, Ind AS specify percentage completion method, which would not be in order under GST regime.

**v) Impact on Presentation of Gross Revenue and Net Revenue**

As per Schedule III of the Companies Act, 2013 sales must be disclosed inclusive of excise duty. GST being a tax on supply of goods, does not accept this treatment. In the circumstances, the management needs to explain vide not the impact on revenue.

**vi) Impact on Inventory - Cost of Purchases**

Accounting principles say that cost of purchase of inventory includes purchase price, import duties, and other taxes other than recoverable from government, handling charges and other related acquisition costs. Currently various indirect taxes such as Luxury Tax, Octroi, Entry Tax, CST do not fall into the tax credit, but under GST, organizations can get input tax credit for payment of these taxes. Here also, AS can differ on how to treat such tax credits in accounts. According to the standard accounting principles, refundable taxes are not to be taken as an expense. The cost incurred in the acquisition of asset are considered as an asset leading to reconfiguring in inventory valuation and asset capitalization rules to ensure that the tax credits are correctly entered in the accounting system.

Excise duty is included in the cost of inventory but GST takes into account input tax credit. This difference in treatment in GST regime and Ind AS may necessitate notes to accounts quantifying the impact. GST brings input tax credits to business. In the pre GST regime, entities do not get tax credit for indirect taxes like luxury tax, Octroi, Entry tax or CST. Under GST scheme, all these indirect taxes are subsumed into GST. This enables organizations to be eligible for tax credit. Transition to GST hence necessitates companies to reconfigure their inventory valuation, asset capitalization and expense recording rules in their accounting system in line with GST rules to ensure that tax credits are accounted.

### **vii) Impact on Property, Plant and Equipment**

Cost of purchase price includes import duties and non-refundable purchase taxes, after deducting trade discounts and rebates. Under GST, the cost of fixed assets capitalized may need revision to the extent of recoverable tax credit.

### **viii) Impact on Chart of Accounts**

An important area which needs changes in post GST regime is the Chart of Accounts (COA). Currently, there are many tax-related general ledger (GL) codes in the chart of Accounts utilized for financial reporting. In GST regime, the new COA will have to be changed keeping in view the category of business, rules related to availing of credit and place of supply etc. leading to relatively simpler accounting.

Chart of accounts (COA) records each type of asset, liability, equity, revenue, and expense, providing a listing of every account in an accounting system. COA is based on certain parameters like type of business, credit rules, and the place of supply. As various tax-related General Ledger (GL) codes related to different transactions are used in the COA for financial reporting. ERP system needs to be fine-tuned, incorporating the requisite changes to avert financial reporting errors and minimize any impact on the accounting system after transitioning to the GST.

The treatment of GST in financial statements and chart of accounts will be different. Therefore, the accounting software or ERP system in companies will have to factor the requisite changes in revenue reporting, and accounting of input tax credit. ICAI, CBEC and Ministry of Corporate Affairs may possibly go over the Ind AS provisions and if need be consider to amend certain provisions in the light of GST reforms. The corporate houses may have to evaluate the changes needed in their ERP system in line with GST reforms to make correct accounting transactions and make financial reporting true and fair with correct revenue recognition.

### **ix) Impact on Carry Forward**

A key challenge that companies may face is how to carry forward tax credits. Experts contend that since these tax-credits

will be carried forward state wise, IT system of companies may have to reconfigure for effecting tax compliance for transactions originating before the GST transition and reversing the entries post transition for transactions like sales returns and receipt of purchases after transition. Thus treatment of carry forward and set off under Ind AS and GST regime are different.

### **Way Foreword: Actionable Areas**

GST is going to impact accounting, financial statement preparation, GST compliance filing. GST implementation may result in write off of certain tax credits accumulated in particular states and not probable to be set off. Another issue is carry forward of tax credits. Tax accounting and compliance issues need to be factored in IT systems.

CBEC, ICAI, Ministry of Corporate Affairs, and GST council may think over issues of GST tax reforms and its impact on accounting and financial reporting of firms and provide right solution to make the accounts and financial statements error free, and reflecting the true and fair state of affairs of the entity.

Tax experts are expected to bring emerging accounting and financial reporting issues to the concerned for timely solution. It may take some time for GST reforms to be fully implemented and the requisite changes carried out by the entities in the ERP systems to reflect in the accounts. Most of the complexities in transactions may have to be identified during the course of implementation and issues resolved. If any changes are required in Ind AS due to GST tax regime, those have to be done expeditiously.

When Ind AS is able to reflect the true and fair state of affairs of the company and account correctly all the transactions under GST implementation, corporate house must factor the requisite changes in their ERP or IT systems for enabling proper financial accounting and reporting. In case of SMEs and MSMEs who come under the purview of GST framework, CBEC is expected to provide free Excel sheet or software after factoring all the requisite changes.

## GST: A JOURNEY THROUGH FINANCE COMMISSIONS

ANKEETA GUPTA\*

*Goods and Services Tax (GST), as the biggest tax reform in India post-Independence, has converted the economy into a single market i.e. one nation, one market and one tax. It is expected to be a win-win situation for all the stake holders. The journey of the introduction of GST has been quite long. It took nearly ten years, since it was announced for the first time in Budget Speech of 2007-2008. The Government also referred the matter to successive Finance Commissions who have given their recommendations on the concept and way forward for implementation.*

The Union may have to initially bear an additional fiscal burden arising due to the GST compensation. This fiscal burden should be treated as an investment which is certain to yield substantial gains to the nation in the medium and long run. We also believe that GST compensation can be accommodated in the overall fiscal space available with the Union Government. In our assessment of Union finances, we were unable to explicitly factor in the quantum of compensation required in the event of introduction of GST during our award period for the reasons cited above. However, we recognise that States should be provided with the assurance of compensation by the Union.

This paper attempts to cover the concept of GST (Section I), the Constitutional Amendment for introduction of GST (Section II) and the Recommendations of the previous Finance Commissions (Sections III & IV). The last section would analyze the terms of reference of the Fifteenth Finance Commission regarding GST.

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## **I. Goods and Services Tax**

The introduction of the Goods and Services Tax (GST) is expected to be a game changer in the field of indirect tax reforms in India. Amalgamation of a large number of Central and State taxes into a single tax, is expected to mitigate ill effects of cascading or double taxation in a major way as well as pave the way for a common national market. Other anticipated advantages include reduction in the overall tax burden on goods, which is currently estimated to be around 25%-30%. It may facilitate economic growth and shift towards formal economy. The new tax regimen would be easier to administer because of its transparent and self-policing character.

The idea of moving towards GST was first mooted by the then Finance minister in the Budget speech for 2007-08. Initially, it was proposed that GST would be introduced from 1<sup>st</sup> April 2010. The Roadmap and structure for GST was to be provided by the Empowered Committee of State Finance Ministers. In addition, the Joint Working Groups of officials having representatives of the states as well as the Centre were set up to examine various aspects of GST, specifically on exemptions and thresholds, taxation of services and taxation of interstate supplies. Based on discussions among the stakeholders, the EC released its First Discussion paper on GST in November 2009. This spelt out features of the proposed GST and has formed the basis for discussion between the Centre and the states.

The Thirteenth and Fourteenth Finance Commissions were specifically requested to give recommendations regarding the Goods and Services Tax. Their terms of reference and recommendations are discussed in the succeeding Paragraphs.

Fiscal powers between the Centre and the States are clearly demarcated in the Constitution of India with almost no overlap between the respective jurisdictions. Indirect taxes levied by the Centre include Service Tax, Customs Duty, Excise Duty (including on medicinal preparations) and Central Sales Tax. State levies include Sales Tax/ VAT, Entertainment Tax/ Luxury Tax, Entry

Tax and Betting Tax. The Centre has the powers to levy tax on the manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.) while the States have the powers to levy tax on sale of goods. In case of inter-states sales, the Centre has the powers to levy a tax (the Central Sales Tax) but, the tax is collected and retained entirely by the originating States. As for services, it is the Centre alone that is empowered to levy Service Tax. Since the States are not empowered to levy any tax on the sale or purchase of goods in the course of their importation into or exportations from India, the Centre levies and collects this tax in addition to the Basic Customs Duty. Introduction of GST, therefore, required amendments in the Constitution so as to empower the Centre and the States concurrently to levy and collect GST.

The pre-GST Indirect Taxes regime was considered to be complex. With multiple tax rates exemptions and irrational structure of levies on one hand and multiple compliances on the other it posed a challenge both for the tax payer and the tax administrator. The cascading effect of the taxes was proving to be a disincentive both for the industry and trade and was resulting in higher prices for the end consumer. It put Indian suppliers at a competitive disadvantage in the international markets.

The basic objective of tax reform was to address the problems of the existing system and to establish an economically efficient system that was simple to administer. Another important consideration was degree of fiscal autonomy of the Centre and the States. At the same time harmonization of Centre and State Taxes as well as harmonization of tax laws and administrative procedures was needed to simplify compliances and ensure enforcement.

The assignment of concurrent jurisdiction to the Centre and the States for the levy of GST required a unique institutional mechanism that would ensure that decisions about the structure, design and operation of GST are taken jointly by the two. To address all these and other issues, the constitution Amendment Bill was passed by the Lok Sabha and Rajya Sabha. Further, the Bill after ratification by the required number of States and the assent of the President on 8th September, 2016, has been enacted as the 101st

Constitution Amendment Act, 2016. The GST Council has also been notified w.e.f. 12<sup>th</sup> September,2016.

The salient features of GST are as under:

- i. GST is applicable on ‘supply’ of goods or services as against the present concept on the manufacture of goods or on sale of goods or on provision of services.
  - ii. It is based on the principle of destination-based consumption taxation as against the present principle of origin-based taxation.
  - iii. It is a dual GST with the Centre and the States simultaneously levying tax on a common base. GST to be levied by the Centre would be called Central GST(CGST) and that to be levied by the States would be called State GST (SGST).
  - iv. An Integrated GST (IGST) would be levied on inter-state supply (including stock transfers) of goods or services. This shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by Law on the recommendation of the GST Council.
  - v. CGST, SGST & IGST would be levied at rates to be mutually agreed upon by the Centre and the States. The rates would be notified on the recommendation of the GST Council. The GST Council has decided that GST would be levied at four rates viz. 5%, 12%, 16% and 28%. In addition to these rates, a cess would be imposed on “demerit” goods to raise resources for providing compensation to States as States may lose revenue owing to the implementation of GST.
- GST would replace the following taxes currently levied and collected by the Centre: -
    - a) Central Excise Duty
    - b) Duties of Excise (Medicinal and Toilet Preparations)

- c) Additional Duties of Excise (Goods of Special Importance)
  - d) Additional Duties of Excise (Textiles and Textile Products)
  - e) Additional Duties of Customs (commonly known as CVD)
  - f) Special Additional Duty of Customs(SAD)
  - g) Service Tax
  - h) Cesses and surcharge in so far as they relate to supply of goods and services.
- State taxes that would be subsumed within the GST are:-
    - a) State VAT
    - b) Central Sates Tax
    - c) Purchase Tax
    - d) Luxury Tax
    - e) Entry Tax (All forms)
    - f) Entertainment Tax and Amusement Tax (except those levied by the local bodies)
    - g) Taxes on advertisements
    - h) Taxes on lotteries, betting and gambling
    - i) State cesses and surcharges in so far as they relate to supply of goods and services.
  - GST would apply on all goods and services except Alcohol for human consumption.
  - GST on five specified petroleum products (Crude, Petrol, Diesel, ATF& Natural Gas) would be applicable from a date to be recommended by the GSTC.
  - Tobacco and tobacco products would be subject to GST. In addition, the Centre would have the power to levy Central Excise duty on these products.

- A common threshold exemption would apply to both CGST and SGST. Tax payers with an annual turnover not exceeding Rs.20 lakh (Rs.10 Lakh for special category States) would be exempt from GST. For small taxpayers with an aggregate turnover in a financial year upto 50 lakhs, a composition scheme is available. Under the scheme a taxpayer shall pay tax as a percentage of his turnover in a State during the year without benefit of Input Tax Credit. This scheme will be optional.
- The list of exempted goods and services would be kept to a minimum and it would be harmonized for the Centre and the States as well as across States as far as possible.

Thus, new framework as envisaged in the Constitution is expected to provide a paradigm shift to the growth and development of the economy. GST would replace among others Central Excise Duty and Service Tax currently levied and collected by the Centre which contribute a very significant percentage of Union revenues. State taxes that would be subsumed within the GST include State VAT, Central States Tax etc. which account for a significant share of state tax receipts. Therefore, concerns regarding revenue neutrality have to be addressed. Accordingly, revenue neutrality for next five years with an assured rate of growth has already been promised to the States.

## **II. Constitution Amendment Act**

The GST Constitutional (122<sup>nd</sup> Amendment) Bill 2014 became the GST Constitutional (101<sup>st</sup> Amendment) Act 2016 on 8<sup>th</sup> September 2016 after Presidential assent. The Amendment Act confers simultaneous powers on Parliament and State Legislatures to make laws for levying GST simultaneously on every transaction of supply of Goods and Services. These amendments would also subsume a number of indirect taxes presently being levied by Central and State Governments as already described in the Section I above.

The amendment Act contains 20 amendments. Most important ones are listed below:

New Article 246A Inserted – Special Provision with respect to Goods and Services Tax

Section 2 of the Amendment Act makes enabling provisions for the Union and States with respect to the GST legislation making it a concurrent power. It further specifies that Parliament has exclusive power to make laws with respect to GST on interstate transactions.

Accordingly, as per these provisions, the CGST and SGST Act shall be made by Central Government and State Governments respectively, while the IGST Act shall be made by Central Government only.

#### **Amendment of Article 268**

Section 6 of the Amendment Act seeks to amend Article 268 of the Constitution to omit the duties of excise on medicinal and toilet preparations from the purview of the power of the Government of India in view of the proposed imposition of goods and services tax on goods and services.

#### **Omission of Article 268A**

Section 7 of the Amendment Act seeks to omit article 268A of the Constitution which empowers the Government of India to levy taxes on services. As tax on services has been brought under GST, such a provision would no longer be required.

Insertion of New Article 269A – levy and collection of Goods and Services tax in course of inter-state trade or commerce

Section 9 of the Amendment Act seeks to insert a new article 269A which provides for Goods and Services Tax on supplies in the course of inter-State trade or commerce which shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council. It also provides that Parliament made, by law, formulate the principles for determining the place of supply, and when a supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

### **Amendment of Article 270**

Section 10 of the Amendment Act provides that Goods and Services Tax levied and collected by the Government of India, shall also be distributed.

### **Amendment of Article 271**

Section 11 of the Amendment Act provides that goods and services on which GST is levied shall not be subject to any surcharge under article 271. Thus, it puts restrictions on the powers of Parliament to levy surcharge on the GST.

### **Insertion of New Article 279A – Goods and Services Tax Council**

The present section has inserted the provisions for GST Council. The Goods and Services Tax Council shall consist of the following members, namely:

- a) The Union Finance Minister: Chairperson;
- b) The Union Minister of State in charge of Revenue or Finance: Member.
- c) The Minister in charge of Finance or Taxation or any other Minister nominated by each State Government: Members.

Further the Goods and Services Tax Council shall make recommendations to the Union and the States on –

- a) The taxes, cesses and surcharges levied by the Union, the States and the local bodies which may be subsumed in the Goods and Services Tax.
- b) The goods and services that may be subjected to or exempted from the Goods and Services Tax.
- c) Model Goods and Services Tax Laws, principles of levy, apportionment of integrated Goods and Services Tax and the principles that govern the place of supply.
- d) The threshold limit of turnover below which goods and services may be exempted from Goods and Services Tax.

- e) The rates including floor rates with bands of goods and services tax.
- f) Any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster.
- g) Special provision with respect to the States of Arunachal Pradesh, Assam, Jammu & Kashmir, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- h) Any other matter relating to the goods and services tax, as the Council may decide.

#### **Amendment of Article 366**

The Section 14 of the Amendment Act specifies the definition of 'Goods and Services Tax', 'Services' and 'State'. As per the definitions, only alcoholic liquor for human consumption has been excluded from the ambit of GST Constitutionally.

#### **Amendment of Seventh Schedule**

Section 17 seeks to make the consequential amendments in Union List and State List Entries.

#### **Compensation to States**

Section 18 of the Amendment Act provides for the Mandatory Compensation to States for five years for loss of revenue on account of introduction of Goods and Services Tax.

Briefly stated the Amendment Act provides powers to both Union and states to legislate on GST which is a landmark change in the cooperative federalism. Further, section 9 of the Amendment Act provides for levy and collection of GST in course of Inter State Trade or Commerce. It also provides for apportionment of the same between Union and States. Setting up of GST council chaired by the FM is also a major game changer. Now the rates of various taxes are determined by the GST council rather than the Tax Administrators of the Union and States. The dual GST has given the Centre and the States concurrent indirect taxation powers. It is a paradigm shift in tax policy.



### **III. Thirteenth Finance commission**

Terms of reference of 13th Finance Commission provided that the commission would consider the impact of the proposed implementation of Goods and Services Tax with effect from 1<sup>st</sup> April 2010 including its impact on the country's foreign trade. The Commission recognised the need to holistically examine the issues relating to GST and after detailed deliberations with states and commissioning of specific studies recommended as under:

Both the Centre and the states should conclude a Grand Bargain to implement the model GST. The Grand Bargain comprises five elements: (i) the design of the model GST; (ii) the operational modalities; (iii) the proposed agreement between the Centre and states; (iv) the disincentives for non-compliance (v) the implementation schedule (vi) the procedure for claiming compensation.

Any GST model adopted must be consistent with all the elements of the Grand Bargain. To incentivise implementation of the Grand Bargain this Commission recommends the sanction of a grant of Rs. 50,000 crore which will taper down to Rs. 40,000 crore and Rs. 30,000 crore if GST is implemented after 1.4.2013 and 1.4.2014 respectively. The EC should be given formal authority.

#### **Model GST Law:**

A model GST would not distinguish between goods and services. It should be levied at a single positive rate on all goods and services. Exports should be zero-rated. Tax compliance costs should be low and tax credits should be available seamlessly across tax jurisdictions.

For the GST to be purely consumption based, all related indirect taxes and cesses should be subsumed into it. Thus, the Central GST portion would subsume the following taxes:

- i. Central excise duty and additional excise duties
- ii. Service Tax

iii. Additional Customs Duty (Countervailing Duty)

iv. All surcharges and cesses

No exemptions should be allowed other than a common list applicable to all states as well as the Centre, A threshold of Rs. 10 lakh and a composition limit of Rs. 40 lakh have been agreed upon by the EC for SGST in the first discussion draft. It is desirable that these limits be applied to CGST as well. Under the GST regime, dealers with turnovers between Rs. 10 lakh and Rs. 40 lakh will have to pay both CGST and SGST. Imports from outside the country would be subject to GST on the destination principle.

### **Operational Modalities**

To reduce compliance costs and increase collection efficiency, all state GST laws should be harmonised. The model for taxing inter-state sales finally adopted should provide clarity on the jurisdiction of states while facilitating inter-state trade and stock transfers. Given the volume of such transactions, this system necessarily has to be IT-based. An effective, efficient and uniform system for redressal of anomalies in the legislation should be put in place. Prompt refunds form the core of an effective GST framework, especially as cross-utilisation of input tax credit across CGST and SGST, are not envisaged.

### **Agreement between Centre and States**

States are equally apprehensive that the Centre may unilaterally raise tax rates without consulting them. The Constitution does not envisage sharing of tax bases. Taxation powers are listed either in the State List or in the Central List, but not in the Concurrent List. For the first time since the Constitution was enacted, a tax base is proposed to be shared between the Centre and the states. It is, thus, necessary that a firm arrangement be put in place for implementing the GST to prevent deviations from the agreed upon model by either the Centre or the states.

It may be noted that many of the recommendations of the Thirteenth Finance Commission regarding Central Taxes being subsumed in GST, No exemptions, threshold levels for dealers,

harmonization of all State GST laws did get reflected in the Amendment Act to the Constitution in true spirit.

#### **IV. Fourteenth Finance Commission**

The terms of reference of 14<sup>th</sup> Finance commission required the Commission to consider the impact of the proposed Goods and Services tax on the finances of Centre and States and the mechanism for compensation in case of any revenue loss. The Commission took into account the views of the previous Finance Commission and noted the submission of the Union Government that progress in implementation of GST during the award period of the FC XIII did not happen owing to the long process of building consensus between the Unions and States, along with the time required in undertaking the necessary constitutional amendments.

Recommendations of the commission are listed below:

- i. Our mandate is to examine the impact of the proposed GST on the finances of the Union and States and suggest a mechanism of compensation in case of any revenue loss. There are several challenges and many unresolved issues. In the absence of clarity on the design of GST and the final rate structure, we are unable to estimate revenue implications and quantify the amount of compensation in case of revenue loss to the States due to the introduction of GST.
- ii. Introduction of GST in the country may lead to revenue losses for a few years to some States, as GST marks a shift from an origin-based system of indirect taxes to a destination-based system. However, as GST will broaden the tax base, result in better tax compliance, and lead to higher growth in the economy, it is expected that the revenue earnings of the States will stabilise in a few years. Therefore, to ensure that the States do not face undue financial hardship in the initial years, the Union Government may compensate the States on a tapering basis for a period of five years for the revenue losses calculated as the difference between projected and actual revenues.

We have, in this regard, the precedent of VAT. In the case of VAT, compensation was provided to the States for three years, at 100 per cent in the first year, 75 per cent in the second year, and 50 per cent in the third year. In our view, it will be appropriate to keep this precedent as the basis for compensation for GST also. However, given the scale of reform and the apprehensions of revenue uncertainty raised by the States, the revenue compensation, in our view, should be for five years. It is suggested that 100 per cent compensation be paid to the States in the first, second and third years, 75 per cent compensation in the fourth year and 50 per cent compensation in the fifth and final year.

- iii. The Commission recommends that a GST Compensation Fund be set up by the Union to compensate the States for their revenue losses. States have been demanding that the GST Compensation Fund must be created constitutionally. This insistence on an appropriate institutional arrangement arises from considerable doubts that States have about the Union discharging its obligations. However, the Union Government noted that since the compensation would be a temporary feature, there appears to be no requirement of creating the Fund through a Constitutional provision. We, recommend the creation of an autonomous and independent GST Compensation Fund through legislative actions in a manner that it gives reasonable comfort to States, while limiting the period of operation appropriately.
- iv. There is merit in the universal application of GST in order to have a comprehensive base and, in the long run, all goods and services should be brought under the ambit of GST. In particular, exclusion of any goods from the ambit of GST through Constitutional guarantee is not desirable. This could lead to leakages of revenues due to disruption of tax credit chain and audit trails and would continue to have the problem of cascading. Further, the origin-based distortionary CST presently levied on inter-State sales of goods would have to be dispensed with once universalisation is achieved. We, therefore, recommend that

the Constitutional legislative and design aspects of the GST enable transition towards universal application of GST over the medium to long term, while making necessary provisions for smooth transition through temporary arrangements.

The GST finally got implemented in September 2016 i.e. during the period of award of the 14<sup>th</sup> Finance Commission. It may also be noted that many of the recommendations of the Finance commission finally got incorporated in spirit in the 101<sup>st</sup> Constitution Act e.g. the dual GST, Central and State Taxes to be subsumed in GST, operational modalities, arrangement for compensation to states etc.

#### **V. Terms of Reference of Fifteenth Finance Commission**

The Gazette Notification for setting up the 15<sup>th</sup> Finance Commission led by Sh. N.K. Singh was issued in November 2017. A perusal of the Terms of Reference of the 15<sup>th</sup> Finance Commission clearly indicates a paradigm shift in the approach arising partly out of the changes in policy environment in recent past.

As per the notification issued referred to above, the Commission shall make recommendations, inter-alia regarding:

The distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I, Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

It further envisages that while making its recommendations, the commission shall have regard, among other considerations, to various aspects of macro economy which inter alia includes:

The impact of the GST, including payment of compensation for possible loss of revenues for 5 years, and abolition of a number of cesses, earmarking thereof for compensation and other structural reforms programme, on the finances of Centre and States;

It further envisages that the commission may consider proposing measurable performance based incentives for States, at the appropriate level of Government, specified areas which include:

Efforts made by the States in expansion and deepening of tax net under GST;

The Commission shall make its report available by 30th October, 2019, covering a period of five years commencing 1st April, 2020.

It may be mentioned that 101<sup>st</sup> Amendment Act to the Constitution relating to GST largely relates to Ch. 1 of Part XII of the Constitution of India as brought out in Section II of the paper. Further, omission of erstwhile Article 268 and 268A, amendments to other Articles and insertion of new Articles regarding definition of Goods and Services, distribution of GST levied and collected by Union Government between Union and States etc. would have implications for the final recommendations of the fifteenth Finance Commission.

In this context, it is worth noting that in first few months of implementation of the GST, the revenue collections have been far below the targets. By the time the Finance Commission submits its report information for two financial years post GST implementation would be available. However, this may not provide enough evidence for suggesting any major changes.

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**EXTRAORDINARY**

**PART-II SECTION-I**

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NEW DELHI, TUESDAY, FEBRUARY 28, 2017

**MINISTRY OF LAW AND JUSTICE**

**(Legislative Department)**

*New Delhi, the 8th September, 2016/Bhadra 17, 1938 (Saka)*

The following Act of Parliament received the assent of the President on the 8<sup>th</sup> September, 2016, and is hereby published for general information:—

THE CONSTITUTION (ONE HUNDRED AND FIRST  
AMENDMENT) ACT, 2016

[*8th September, 2016.*]

An Act further to amend the Constitution of India

BE it enacted by Parliament in the Sixty-seventh Year of the Republic of India as follows:—

1 (1). This Act may be called the Constitution (One Hundred and First Amendment) Act, 2016.

(2) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the commencement of that provision.

(2) After article 246 of the Constitution, the following article shall be inserted, namely:—

"246A. (1) Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of every State, have power to make laws with respect to goods and services tax imposed by the Union or by such State.

(2) Parliament has exclusive power to make laws with respect to goods and services tax where the supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

*Explanation.*—The provisions of this article, shall, in respect of goods and services tax referred to in clause (5) of article 279A, take effect from the date recommended by the Goods and Services Tax Council.’’.

3. In article 248 of the Constitution, in clause (1), for the word "Parliament", the words, figures and letter "Subject to article 246A, Parliament" shall be substituted.

4. In article 249 of the Constitution, in clause (1), after the words "with respect to", the words, figures and letter "goods and services tax provided under article 246A or" shall be inserted.

5. In article 250 of the Constitution, in clause (1), after the words "with respect to", the words, figures and letter "goods and services tax provided under article 246A or" shall be inserted.

6. In article 268 of the Constitution, in clause (1), the words "and such duties of excise on medicinal and toilet preparations" shall be omitted.

7. Article 268A of the Constitution, as inserted by section 2 of the Constitution (Eighty-eighth Amendment) Act, 2003 shall be omitted.

8. In article 269 of the Constitution, in clause (1), after the words "consignment of goods", the words, figures and letter "except as provided in article 269A" shall be inserted.

9. After article 269 of the Constitution, the following article shall be inserted, namely:—

“269A. (1) Goods and services tax on supplies in the course of inter-State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.



*Explanation.*—For the purposes of this clause, supply of goods, or of services, or both in the course of import into the territory of India shall be deemed to be supply of goods, or of services, or both in the course of inter-State trade or commerce.

- (2) The amount apportioned to a State under clause (1) shall not form part of the Consolidated Fund of India.
- (3) Where an amount collected as tax levied under clause (1) has been used for payment of the tax levied by a State under article 246A, such amount shall not form part of the Consolidated Fund of India.
- (4) Where an amount collected as tax levied by a State under article 246A has been used for payment of the tax levied under clause (1), such amount shall not form part of the Consolidated Fund of the State.
- (5) Parliament may, by law, formulate the principles for determining the place of supply, and when a supply of goods, or of services, or both takes place in the course of inter-State trade or commerce”.

**10.** In article 270 of the Constitution,—

- (i) In clause (1), for the words, figures and letter "articles 268, 268A and 269", the words, figures and letter "articles 268, 269 and 269A" shall be substituted;
- (ii) After clause (1), the following clauses shall be inserted, namely:—

“(1A) The tax collected by the Union under clause (1) of article 246A shall also be distributed between the Union and the States in the manner provided in clause (2).

(1B) The tax levied and collected by the Union under clause (2) of article 246A and article 269A, which has been used for payment of the tax levied by the Union under clause (1) of article 246A, and the amount apportioned to the Union under clause (1) of article 269A, shall also be distributed between the Union and the States in the manner provided in clause (2).”.

**11.** In article 271 of the Constitution, after the words “in those articles”, the words, figures and letter “except the goods and services tax under article 246A,” shall be inserted.

**12.** After article 279 of the Constitution, the following article shall be inserted, namely:—

“279A. (1) The President shall, within sixty days from the date of commencement of the Constitution (One Hundred and First Amendment) Act, 2016, by order, constitute a Council to be called the Goods and Services Tax Council.

(2) The Goods and Services Tax Council shall consist of the following members, namely:—

- (a) the Union Finance Minister Chairperson;
- (b) the Union Minister of State in charge of Revenue or Finance Member;
- (c) the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government Members.

(3) The Members of the Goods and Services Tax Council referred to in sub-clause (c) of clause (2) shall, as soon as may be, choose one amongst themselves to be the Vice-Chairperson of the Council for such period as they may decide.

(4) The Goods and Services Tax Council shall make recommendations to the Union and the States on—

- (a) the taxes, cesses and surcharges levied by the Union, the States and the local bodies which may be subsumed in the goods and services tax;
- (b) the goods and services that may be subjected to, or exempted from the goods and services tax;
- (c) model Goods and Services Tax Laws, principles of levy, apportionment of Goods and Services Tax levied on supplies in the course of inter-State trade or commerce under article 269A and the principles that govern the place of supply;

- (d)* the threshold limit of turnover below which goods and services may be exempted from goods and services tax;
  - (e)* the rates including floor rates with bands of goods and services tax;
  - (f)* any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster;
  - (g)* special provision with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
  - (h)* any other matter relating to the goods and services tax, as the Council may decide.
- (5) The Goods and Services Tax Council shall recommend the date on which the goods and services tax be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.
- (6) While discharging the functions conferred by this article, the Goods and Services Tax Council shall be guided by the need for a harmonised structure of goods and services tax and for the development of a harmonised national market for goods and services.
- (7) One-half of the total number of Members of the Goods and Services Tax Council shall constitute the quorum at its meetings.
- (8) The Goods and Services Tax Council shall determine the procedure in the performance of its functions.
- (9) Every decision of the Goods and Services Tax Council shall be taken at a meeting, by a majority of not less than three-fourths of the weighted votes of the members present and voting, in accordance with the following principles, namely:—
- (a)* The vote of the Central Government shall have a weightage of one third of the total votes cast, and
  - (b)* The votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast,

in that meeting.

(10) No act or proceedings of the Goods and Services Tax Council shall be invalid merely by reason of—

- (a) Any vacancy in, or any defect in, the constitution of the Council; or
- (b) Any defect in the appointment of a person as a Member of the Council; or
- (c) Any procedural irregularity of the Council not affecting the merits of the case.

(11) The Goods and Services Tax Council shall establish a mechanism to adjudicate any dispute —

- (a) Between the Government of India and one or more States;  
or
- (b) Between the Government of India and any State or States on one side and one or more other States on the other side;  
or
- (c) Between two or more States,

Arising out of the recommendations of the Council or implementation thereof.”.

**13.** In article 286 of the Constitution,—

(i) In clause (1),—

(A) For the words "the sale or purchase of goods where such sale or purchase takes place", the words "the supply of goods or of services or both, where such supply takes place" shall be substituted;

(B) In sub-clause (b), for the word “goods”, at both the places where it occurs, the words “goods or services or both” shall be substituted;

(ii) In clause (2), for the words "sale or purchase of goods takes place", the words "supply of goods or of services or both" shall be substituted;

(iii) clause (3) shall be omitted.

**14.** In article 366 of the Constitution,—

(i) After clause (12), the following clause shall be inserted, namely:—

‘(12A) “goods and services tax” means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption;’;

(ii) After clause (26), the following clauses shall be inserted, namely:—

‘(26A) “Services” means anything other than goods;

(26B) “State” with reference to articles 246A, 268, 269, 269A and article 279A includes a Union territory with Legislature;’.

**15.** In article 368 of the Constitution, in clause (2), in the proviso, in clause (a), for the words and figures “article 162 or article 241”, the words, figures and letter “article 162, article 241 or article 279A” shall be substituted.

**16.** In the Sixth Schedule to the Constitution, in paragraph 8, in sub-paragraph (3),—

(i) In clause (c), the word "and" occurring at the end shall be omitted;

(ii) In clause (d), the word "and" shall be inserted at the end;

(iii) After clause (d), the following clause shall be inserted, namely:—

"(e) taxes on entertainment and amusements."

**17.** In the Seventh Schedule to the Constitution,—

(a) In List I—Union List,—

(i) For entry 84, the following entry shall be substituted, namely:—

"84. Duties of excise on the following goods manufactured or produced in India, namely:—

- (a) petroleum crude;
- (b) high speed diesel;
- (c) motor spirit (commonly known as petrol);
- (d) natural gas;
- (e) aviation turbine fuel; and
- (f) tobacco and tobacco products.";

(ii) entries 92 and 92C shall be omitted;

(b) in List II—State List,—

(j) entry 52 shall be omitted;

(ii) for entry 54, the following entry shall be substituted, namely:—

"54. Taxes on the sale of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption, but not including sale in the course of inter-State trade or commerce or sale in the course of international trade or commerce of such goods.";

(iii) entry 55 shall be omitted;

(iv) for entry 62, the following entry shall be substituted, namely:—

"62. Taxes on entertainments and amusements to the extent levied and collected by a Panchayat or a Municipality or a Regional Council or a District Council."

**18.** Parliament shall, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for a period of five years.

**19.** Notwithstanding anything in this Act, any provision of any law relating to tax on goods or services or on both in force in any State immediately before the commencement of this Act, which is

inconsistent with the provisions of the Constitution as amended by this Act shall continue to be in force until amended or repealed by a competent Legislature or other competent authority or until expiration of one year from such commencement, whichever is earlier.

**20.** (1) If any difficulty arises in giving effect to the provisions of the Constitution as amended by this Act (including any difficulty in relation to the transition from the provisions of the Constitution as they stood immediately before the date of assent of the President to this Act to the provisions of the Constitution as amended by this Act), the President may, by order, make such provisions, including any adaptation or modification of any provision of the Constitution as amended by this Act or law, as appear to the President to be necessary or expedient for the purpose of removing the difficulty:

Provided that no such order shall be made after the expiry of three years from the date of such assent.

(2) Every order made under sub-section (1) shall, as soon as may be after it is made, be laid before each House of Parliament.

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EXTRAORDINARY  
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NEW DELHI, TUESDAY, FEBRUARY 28, 2017

**MINISTRY OF LAW AND JUSTICE  
(Legislative Department)**

*New Delhi, the 12th April, 2017/Chaitra 22, 1939 (Saka)*

The following Act of Parliament received the assent of the President on the 12th April, 2017, and is hereby published for general information:—

**THE GOODS AND SERVICES TAX (COMPENSATION TO  
STATES) ACT, 2017**

No. 15 OF 2017

[12th April, 2017.]

An Act to provide for compensation to the States for the loss of revenue arising on account of implementation of the goods and services tax in pursuance of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016.

BE it enacted by Parliament in the Sixty-eighth Year of the Republic of India as follows:—

1. (1) This Act may be called the Goods and Services Tax (Compensation to States) Act, 2017.
- (2) It extends to the whole of India.
- (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.
2. (1) In this Act, unless the context otherwise requires,—
  - (a) “Central tax” means the central goods and services tax levied and collected under the Central Goods and Services Tax Act;



- (b) “Central Goods and Services Tax Act” means the Central Goods and Services Tax Act, 2017;
- (c) “Cess” means the goods and services tax compensation cess levied under section 8;
- (d) “Compensation” means an amount, in the form of goods and services tax compensation, as determined under section 7;
- (e) “Council” means the Goods and Services Tax Council constituted under the provisions of article 279A of the Constitution;
- (f) “Fund” means the Goods and Services Tax Compensation Fund referred to in section 10;
- (g) “Input tax” in relation to a taxable person, means,—
- (i) Cess charged on any supply of goods or services or both made to him;
- (ii) Cess charged on import of goods and includes the cess payable on reverse charge basis;
- (h) “Integrated Goods and Services Tax Act” means the Integrated Goods and Services Tax Act, 2017;
- (i) “Integrated tax” means the integrated goods and services tax levied and collected under the Integrated Goods and Services Tax Act;
- (j) “Prescribed” means prescribed by rules made, on the recommendations of the Council, under this Act;
- (k) “Projected growth rate” means the rate of growth projected for the transition period as per section 3;
- (l) “Schedule” means the Schedule appended to this Act;
- (m) “State” means,—
- (i) For the purposes of sections 3, 4, 5, 6 and 7 the States as defined under the Central Goods and Services Tax Act; and
- (ii) For the purposes of sections 8, 9, 10, 11, 12, 13 and 14 the States as defined under the Central Goods and Services Tax Act

and the Union territories as defined under the Union Territories Goods and Services Tax Act;

(n) “State tax” means the State goods and services tax levied and collected under the respective State Goods and Services Tax Act;

(o) “State Goods and Services Tax Act” means the law to be made by the State Legislature for levy and collection of tax by the concerned State on supply of goods or services or both;

(p) “Taxable supply” means a supply of goods or services or both which is chargeable to the cess under this Act;

(q) “Transition date” shall mean, in respect of any State, the date on which the State Goods and Services Tax Act of the concerned State comes into force;

(r) “Transition period” means a period of five years from the transition date; and (s) “Union Territories Goods and Services Tax Act” means the Union Territories Goods and Services Tax Act, 2017.

(2) The words and expressions used and not defined in this Act but defined in the Central Goods and Services Tax Act and the Integrated Goods and Services Tax Act shall have the meanings respectively assigned to them in those Acts.

3. The projected nominal growth rate of revenue subsumed for a State during the transition period shall be fourteen per cent. per annum.

4. For the purpose of calculating the compensation amount payable in any financial year during the transition period, the financial year ending 31st March, 2016, shall be taken as the base year.

5. (1) Subject to the provision of sub-sections (2), (3), (4), (5) and (6), the base year revenue for a State shall be the sum of the revenue collected by the State and the local bodies during the base year, on account of the taxes levied by the respective State or Union and net of refunds, with respect to the following taxes,

imposed by the respective State or Union, which are subsumed into goods and services tax, namely:—

- (a) The value added tax, sales tax, purchase tax, tax collected on works contract, or any other tax levied by the concerned State under the erstwhile entry 54 of List-II (State List) of the Seventh Schedule to the Constitution;
- (b) The central sales tax levied under the Central Sales Tax Act, 1956;
- (c) The entry tax, octroi, local body tax or any other tax levied by the concerned State under the erstwhile entry 52 of List-II (State List) of the Seventh Schedule to the Constitution;
- (d) The taxes on luxuries, including taxes on entertainments, amusements, betting and gambling or any other tax levied by the concerned State under the erstwhile entry 62 of List-II (State List) of the Seventh Schedule to the constitution;
- (e) The taxes on advertisement or any other tax levied by the concerned State under the erstwhile entry 55 of List-II (State List) of the Seventh Schedule to the Constitution;
- (f) The duties of excise on medicinal and toilet preparations levied by the Union but collected and retained by the concerned State Government under the erstwhile article 268 of the Constitution;
- (g) Any cess or surcharge or fee leviable under entry 66 read with entries 52, 54, 55 and 62 of List-II of the Seventh Schedule to the Constitution by the State Government under any Act notified under sub-section (4),

Prior to the commencement of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016:

Provided that the revenue collected during the base year in a State, net of refunds, under the following taxes shall not be included in the calculation of the base year revenue for that State, namely:—

- (a) Any taxes levied under any Act enacted under the erstwhile entry 54 of List-II (State List) of the Seventh Schedule to the

Constitution, prior to the coming into force of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016, on the sale or purchase of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption;

(b) Tax levied under the Central Sales Tax Act, 1956, on the sale or purchase of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption;

(c) Any cess imposed by the State Government on the sale or purchase of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption; and

(d) The entertainment tax levied by the State but collected by local bodies, under any Act enacted under the erstwhile entry 62 of List-II (State List) of the Seventh Schedule to the Constitution, prior to coming into force of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016.

(2) In respect of the State of Jammu and Kashmir, the base year revenue shall include the amount of tax collected on sale of services by the said State Government during the base year.

(3) In respect of the States mentioned in sub-clause (g) of clause (4) of article 279A of the Constitution, the amount of revenue foregone on account of exemptions or remission given by the said State Governments to promote industrial investment in the State, with respect to such specific taxes referred to in sub-section (1), shall be included in the total base year revenue of the State, subject to such conditions as may be prescribed.

(4) The Acts of the Central Government and State Governments under which the specific taxes are being subsumed into the goods and services tax shall be such as may be notified.

(5) The base year revenue shall be calculated as per sub-sections (1), (2), (3) and (4) on the basis of the figures of revenue collected and net of refunds given in that year, as audited by the Comptroller and Auditor-General of India.

(6) In respect of any State, if any part of revenues mentioned in sub-sections (1), (2), (3) and (4) are not credited in the Consolidated Fund of the respective State, the same shall be included in the total base year revenue of the State, subject to such conditions as may be prescribed.

6. The projected revenue for any year in a State shall be calculated by applying the projected growth rate over the base year revenue of that State.

*Illustration.*—If the base year revenue for 2015-16 for a concerned State, calculated as per section 5 is one hundred rupees, then the projected revenue for financial year 2018-19 shall be as follows—

$$\text{Projected Revenue for 2018-19} = 100 (1 + 14/100)^3$$

7. (1) The compensation under this Act shall be payable to any State during the transition period.

(2) The compensation payable to a State shall be provisionally calculated and released at the end of every two months period, and shall be finally calculated for every financial year after the receipt of final revenue figures, as audited by the Comptroller and Auditor-General of India:

Provided that in case any excess amount has been released as compensation to a State in any financial year during the transition period, as per the audited figures of revenue collected, the excess amount so released shall be adjusted against the compensation amount payable to such State in the subsequent financial year.

(3) The total compensation payable for any financial year during the transition period to any State shall be calculated in the following manner, namely:—

(a) The projected revenue for any financial year during the transition period, which could have accrued to a State in the absence of the goods and services tax, shall be calculated as per section 6;

(b) (The actual revenue collected by a State in any financial year during the transition period shall be—

- (i) The actual revenue from State tax collected by the State, net of refunds given by the said State under Chapters XI and XX of the State Goods and Services Tax Act;
- (ii) The integrated goods and services tax apportioned to that State; and
- (iii) Any collection of taxes on account of the taxes levied by the respective State under the Acts specified in sub-section (4) of section 5, net of refund of such taxes,

As certified by the Comptroller and Auditor-General of India;

(c) The total compensation payable in any financial year shall be the difference between the projected revenue for any financial year and the actual revenue collected by a State referred to in clause (b).

(4) The loss of revenue at the end of every two months period in any year for a State during the transition period shall be calculated, at the end of the said period, in the following manner, namely:—

(a) The projected revenue that could have been earned by the State in absence of the goods and services tax till the end of the relevant two months period of the respective financial year shall be calculated on a *pro-rata* basis as a percentage of the total projected revenue for any financial year during the transition period, calculated in accordance with section 6.

*Illustration.*—If the projected revenue for any year calculated in accordance with section 6 is one hundred rupees, for calculating the projected revenue that could be earned till the end of the period of ten months for the purpose of this sub-section shall be  $100 \times (5/6) = \text{Rs.} 83.33$ ;

(b) The actual revenue collected by a State till the end of relevant two months period in any financial year during the transition period shall be—

(i) The actual revenue from State tax collected by the State, net of refunds given by the State under Chapters XI and XX of the State Goods and Services Tax Act;

(ii) The integrated goods and services tax apportioned to that State, as certified by the Principal Chief Controller of Accounts of the Central Board of Excise and Customs; and

(iii) Any collection of taxes levied by the said State, under the Acts specified in sub-section (4) of section 5, net of refund of such taxes;

(c) The provisional compensation payable to any State at the end of the relevant two months period in any financial year shall be the difference between the projected revenue till the end of the relevant period in accordance with clause (a) and the actual revenue collected by a State in the said period as referred to in clause (b), reduced by the provisional compensation paid to a State till the end of the previous two months period in the said financial year during the transition period.

(5) In case of any difference between the final compensation amount payable to a State calculated in accordance with the provisions of sub-section (3) upon receipt of the audited revenue figures from the Comptroller and Auditor-General of India, and the total provisional compensation amount released to a State in the said financial year in accordance with the provisions of sub-section (4), the same shall be adjusted against release of compensation to the State in the subsequent financial year.

(6) Where no compensation is due to be released in any financial year, and in case any excess amount has been released to a State in the previous year, this amount shall be refunded by the State to the Central Government and such amount shall be credited to the Fund in such manner as may be prescribed.

**8. (1)** There shall be levied a cess on such intra-State supplies of goods or services or both, as provided for in section 9 of the Central Goods and Services Tax Act, and such inter-State supplies of goods or services or both as provided for in section 5 of the Integrated Goods and Services Tax Act, and collected in such manner as may be prescribed, on the recommendations of the Council, for the purposes of providing compensation to the States for loss of revenue arising on account of implementation of the goods and services tax with effect from the date from which the

provisions of the Central Goods and Services Tax Act is brought into force, for a period of five years or for such period as may be prescribed on the recommendations of the Council:

Provided that no such cess shall be leviable on supplies made by a taxable person who has decided to opt for composition levy under section 10 of the Central Goods and Services Tax Act.

(2) The cess shall be levied on such supplies of goods and services as are specified in column (2) of the Schedule, on the basis of value, quantity or on such basis at such rate not exceeding the rate set forth in the corresponding entry in column (4) of the Schedule, as the Central Government may, on the recommendations of the Council, by notification in the Official Gazette, specify:

Provided that where the cess is chargeable on any supply of goods or services or both with reference to their value, for each such supply the value shall be determined under section 15 of the Central Goods and Services Tax Act for all intra-State and inter-State supplies of goods or services or both:

Provided further that the cess on goods imported into India shall be levied and collected in accordance with the provisions of section 3 of the Customs Tariff Act, 1975, at the point when duties of customs are levied on the said goods under section 12 of the Customs Act, 1962, on a value determined under the Customs Tariff Act, 1975.

9. (1) Every taxable person, making a taxable supply of goods or services or both, shall—

- a) pay the amount of cess as payable under this Act in such manner;
- b) furnish such returns in such forms, along with the returns to be filed under the Central Goods and Services Tax Act; and
- c) apply for refunds of such cess paid in such form,

As may be prescribed.



(2) For all purposes of furnishing of returns and claiming refunds, except for the form to be filed, the provisions of the Central Goods and Services Tax Act and the rules made thereunder, shall, as far as may be, apply in relation to the levy and collection of the cess leviable under section 8 on all taxable supplies of goods or services or both, as they apply in relation to the levy and collection of central tax on such supplies under the said Act or the rules made thereunder.

**10.** (1) The proceeds of the cess leviable under section 8 and such other amounts as may be recommended by the Council, shall be credited to a non-lapsable Fund known as the Goods and Services Tax Compensation Fund, which shall form part of the public account of India and shall be utilised for purposes specified in the said section.

(2) All amounts payable to the States under section 7 shall be paid out of the Fund.

(3) Fifty per cent. of the amount remaining unutilised in the Fund at the end of the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance fifty per cent. shall be distributed amongst the States in the ratio of their total revenues from the State tax or the Union territory goods and services tax, as the case may be, in the last year of the transition period.

(4) The accounts relating to Fund shall be audited by the Comptroller and Auditor-General of India or any person appointed by him at such intervals as may be specified by him and any expenditure in connection with such audit shall be payable by the Central Government to the Comptroller and Auditor-General of India.

(5) The accounts of the Fund, as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be laid before each House of Parliament.

**11.** (1) The provisions of the Central Goods and Services Tax Act, and the rules made thereunder, including those relating to

assessment, input tax credit, non-levy, short-levy, interest, appeals, offences and penalties, shall, as far as may be, *mutatis mutandis*, apply, in relation to the levy and collection of the cess leviable under section 8 on the intra-State supply of goods and services, as they apply in relation to the levy and collection of central tax on such intra-State supplies under the said Act or the rules made thereunder.

(2) The provisions of the Integrated Goods and Services Tax Act, and the rules made thereunder, including those relating to assessment, input tax credit, non-levy, short-levy, interest, appeals, offences and penalties, shall, *mutatis mutandis*, apply in relation to the levy and collection of the cess leviable under section 8 on the inter-State supply of goods and services, as they apply in relation to the levy and collection of integrated tax on such inter-State supplies under the said Act or the rules made thereunder:

Provided that the input tax credit in respect of cess on supply of goods and services leviable under section 8, shall be utilised only towards payment of said cess on supply of goods and services leviable under the said section.

**12.** (1) The Central Government shall, on the recommendations of the Council, by notification in the Official Gazette, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:—

(a) The conditions which were included in the total base year revenue of the States, referred to in sub-clause (g) of clause (4) of article 279A of the Constitution, under sub-section (3) of section 5;

(b) The conditions subject to which any part of revenues not credited in the Consolidated Fund of the respective State shall be included in the total base year revenue of the State, under sub-section (6) of section 5;

(c) The manner of refund of compensation by the States to the Central Government under sub-section (6) of section 7;

(d) The manner of levy and collection of cess and the period of its imposition under sub-section (1) of section 8;

(e) The manner and forms for payment of cess, furnishing of returns and refund of cess under sub-section (1) of section 9; and

(f) Any other matter which is to be, or may be, prescribed, or in respect of which provision is to be made, by rules.

**13.** Every rule made under this Act by the Central Government shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

**14.** (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, on the recommendations of the Council, by order published in the Official Gazette, make such provisions, not inconsistent with the provisions of this Act, as appear to it to be necessary or expedient for removing the difficulty:

Provided that no order shall be made under this section after the expiry of three years from the commencement of this Act.

(2) Every order made under this section shall, as soon as may be after it is made, be laid before each House of Parliament.

1. In this Schedule, reference to a “tariff item”, “heading”, “sub-heading” and “Chapter”, wherever they occur, shall mean respectively a tariff item, heading, sub-heading and Chapter in the First Schedule to the Customs Tariff Act, 1975 (51 of 1975).

2. The rules for the interpretation of the First Schedule to the Customs Tariff Act, 1975 (51 of 1975), the section and Chapter Notes and the General Explanatory Notes of the First Schedule shall, so far as may be, apply to the interpretation of this Schedule.

S. No.	Description of supply of goods or services	Tariff item, heading, sub-heading, Chapter, or supply of goods or services, as the case may be	The maximum rate at which goods and services tax compensation cess may be collected
1	2	3	4
1	Pan Masala.	2106 90 20	One hundred and thirty-five per cent. <i>ad valorem</i>
2	Tobacco and manufactured tobacco substitutes, including tobacco products	24	Four thousand one hundred and seventy rupees per thousand sticks or two hundred and ninety per cent. <i>ad valorem</i> or a combination thereof, but not exceeding four thousand one hundred and seventy rupees per thousand sticks plus two hundred and ninety per cent. <i>ad valorem</i> .
3	Coal, briquettes, ovoids and similar solid fuels manufactured from coal, lignite, whether or not agglomerated, excluding jet, peat (including peat litter), whether or not agglomerated.	2701, 2702 or 2703	Four hundred rupees per tonne.
4	Aerated waters.	2202 10 10	Fifteen per cent. <i>ad valorem</i>
5	Motor cars and other motor vehicles principally designed for the transport of persons (other than motor vehicles for the transport of ten or more persons, including the driver), including station wagons and racing cars	8703	Fifteen per cent. <i>ad valorem</i>
6	Any other supplies		Fifteen per cent. <i>ad valorem</i>

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