



Towards the GST

An Approach Paper

April 2013



Introduction

FICCI has been seeking expeditious implementation of a comprehensive Goods and Services Tax (GST) in India. FICCI believes that introduction of the GST will make Indian trade and industry more competitive both domestically as well as internationally, and contribute significantly to the growth of the economy. FICCI is of the view that the introduction of GST affords the country an opportunity to embrace a modern consumption tax with appropriate focus on fostering efficiency, reduced cost of compliance and ease of administration together with the real prospect of enhanced tax revenues. The country cannot afford to lose this opportunity.

FICCI had set up a Task Force on GST under the Chairmanship of Mr Harsh Mariwala, a Past President of FICCI, to deliberate on the proposed tax reforms, formulate FICCI's response to the evolving tax regime and present its views to the Central and State Governments and other institutions. Towards this end, FICCI has been engaging with the Union Government, the State Governments, the Empowered Committee of Finance Ministers of State Governments and other stakeholders, including the Thirteenth Finance Commission as also the Standing Committee of Parliament attached to the Ministry of Finance. The Task Force on GST and the FICCI Secretariat have been closely monitoring the developments on the introduction of the GST.

The Empowered Committee of the State Finance Ministers (EC) had released the first discussion paper on the Goods and Services Tax in India in November, 2009. The Department of Revenue had come out with its comments on each of the recommendations of the EC in the Discussion Paper. Both documents are available on the website of the Ministry of Finance (www.finmin.nic.in). In the meanwhile, the Economics and Research division of FICCI had also brought out a document titled "Goods and Service Tax - One Tax One Nation" in June, 2012, explaining the GST and its impact on India's GDP. This document is available on FICCI's website.

The Constitution Amendment Bill

After taking into consideration the reactions received from various stakeholders and consultations with the EC, the Government introduced the Constitution (One Hundred and Fifteenth Amendment) Bill, 2011, (the Bill) in the Lok Sabha in March, 2011. The Bill proposes to amend the Constitution so as to confer simultaneous powers to the Parliament as well as to the State Legislatures to make laws for levying the Goods and Services Tax on every transaction of either the supply of goods or the provision of services or both. The Bill provides for subsuming various Central and State indirect taxes and levies specified therein in the proposed GST. The Bill also envisages the levy of an integrated GST on inter-state transactions of goods and services. The Bill was referred to the Standing Committee of Parliament attached to the Ministry of Finance for its examination.

In response to a public notice issued by the Lok Sabha Secretariat, FICCI had submitted its views and suggestions to the Parliamentary Standing Committee vide its letter dated 24th June, 2011. While welcoming the progress made towards the introduction of the GST, it was represented by FICCI that the GST should be extended to all sectors of the economy without exception. Consequently, it was

recommended that significant sectors of the economy such as petroleum and natural gas, real estate, alcohol and power generation should be covered by the proposed GST. Indeed, the philosophy of the tax reform process in India so far has been to broadbase the tax (expand the base) and as a corollary, moderate the tax rates. This is how it should be and the recommendation on expanded coverage of the GST fully fits in with this philosophy. It was also, inter-alia, represented that the Centre and the States should be prohibited from imposing any new and additional tax on transactions of goods and services (in addition to GST) and that, as a corollary, the taxing powers of the municipalities and the local area administrations should be abolished in due course of time.

The Parliamentary Standing Committee on Finance invited FICCI to present its views on the Bill. A delegation of FICCI accordingly appeared before the Committee in June, 2012 and orally placed its views on the Bill before the Committee. At the request of the Committee, additional written submissions were forwarded to the Committee by FICCI in July, 2012. In these submissions, FICCI placed its views, inter-alia, on the Impact of Introduction of GST on GDP, Black Money, Exports, Employment, Revenues of Central and State Governments etc. before the Committee. It also provided its comments on the merits of a single GST vis-à-vis a dual GST, as was proposed in the Bill. The Parliamentary Standing Committee has not yet submitted its report on the Bill to the Lok Sabha.

Recent Developments

The Union Finance Minister had met the Chairman of the Empowered Committee (EC) of State Finance Ministers and it was decided that two Committees would be set up to deliberate upon (a) the compensation package for the States in lieu of CST, and (b) the GST architecture. As a follow on, in February 2013, three other panels comprising of officials from the Central and State Governments have been formed to deliberate on the following aspects of the GST and submit their finding within 3 months.

GST Panel 1

- (a) Determination of the Revenue Neutral Rate of GST
- (b) Place of Provision of Services Rules

GST Panel 2

- (a) GST on Inter-State supplies
- (b) GST on Imports

GST Panel 3

- (a) Dual Administrative Control
- (b) Threshold limits and other exemptions including list of common exempted items

It may be noted that the Parliamentary Standing Committee has not yet furnished its report on the Constitution Amendment Bill. Unfortunately also, in the process followed so far for finalising the architecture of the GST, industry's involvement on a formal basis is missing. Under these circumstances FICCI feels that as a leading representative of Indian industry, it is appropriate and

indeed obligatory for us to share our thoughts on various aspects of the GST positively and proactively with the Government of India and the EC, so that these may be considered and deliberated upon, before finalising the dual GST in all its dimensions.

Accordingly, this Approach Paper sets out FICCI's views on some key aspects of the GST.

1. Option for the States to stay out or opt out of the GST

It is understood that the Centre and the States may proceed with implementing the GST irrespective of the fact that some States may opt not to come on board at the time of its introduction. Further, it is understood that States may also be given the option to opt out of the GST at a point of time subsequent to their introducing the GST.

It will be appreciated that simultaneous operation of the existing VAT regime and the new GST regime negates the objective of a common market in goods and services. It will also impose considerable hardship on the industry. Further it would lead to some peculiar issues such as taxability of inter-state transactions where, under the existing tax regime, the originating State is empowered to collect tax whereas, under the GST regime, it will be the consuming State which would demand taxes based on the destination principle. Further, the dual compliance requirements under the two regimes would lead to complexities and increased costs of compliance.

It is therefore recommended that if any of the States wish to remain outside the ambit of the GST for some period of time, the CST should, in any case, be replaced by the IGST. In other words, the recommendation is that in any case, no origin based tax such as the CST should continue to be in the statute post the introduction of a destination based consumption tax such as the GST. Moreover, once these States join in later, they cannot continue to retain the option of withdrawing from the GST at a subsequent date.

2. Rates of tax

Goods versus Services: There should be a uniform rate of GST applicable on both goods and services. This will put an end to interpretative disputes on what are "goods" and what are "services". For example, in the existing tax regime, there are divergent views between the tax-authorities and the tax-payers on whether software, customised or otherwise, should be taxed under VAT or Service Tax. Moreover, a common rate will also do away with the cumbersome and dispute prone method of segregation of works-contracts between the goods portion and the services element in order to determine the tax liability.

Number of Rates: The tax structure should be simple and should have minimal rates. FICCI is of the view that (a) there should be one Standard Rate (RNR) applicable on all goods and services; (b) a common list of goods and services under a Concessional Rate (e.g., for basic necessities like grains, pulses, cereals, edible oils and public utilities); and, (c) a common list of exempted goods and services.

Band of Rates: Some States seem to be in favour of a band of rates in the GST regime - in line with the practice adopted by the European Union and perhaps elsewhere - in order to have flexibility

in the rate structure. Adoption of a band of rates is undesirable since the resultant differential tax rates between neighbouring tax jurisdictions create tax arbitrage opportunities and encourage clandestine trade. In the European Union, smuggling of goods like mineral oils, cigarettes, alcohol, perfumes and the like have reached alarmingly high levels with huge revenue losses for the member countries. FICCI therefore recommends that a uniform rate of GST be adopted for a category of goods or service as against a band. If the band is completely unavoidable, the recommendation would then be that the band be a very narrow one in range, not extending beyond two percentage points.

3. Classification of Goods and Services

- (i) Classification of goods should be uniform across the Centre and the States. Differences in classification and consequently, applicability of different rates of tax – as is the case under VAT, leads to avoidable litigation and lock-up of tax revenues. FICCI is of the view that the internationally accepted Harmonised System of Nomenclature (HSN) be adopted for classification of goods under the GST. It would be pertinent to note that the HSN has been adopted for the Central Excise Tariff and the Customs Tariff (as also the import policy and maintenance of foreign trade statistics) and logically, the same should be adopted for the GST as well. Further, on imports, the Basic Customs duty will be determined by Customs Authorities on the basis of the HSN code. The GST on import of the same goods should obviously be with reference to the same HSN, especially as it is expected to be collected by the same Customs Authorities.
- (ii) Insofar as services are concerned, the Negative list of Services – implemented with effect from 1st July 2012 has obviated the need for classification since almost all services are now under the Service Tax net.

4. Threshold Limits

- (i) As far as threshold limits are concerned, it is understood (as per the First Discussion Paper on GST issued by the EC) that different threshold levels are proposed for the CGST - Goods (Rs. 1.50 crore p.a.), CGST-Services (appropriately high) and SGST (Rs. 10 lakhs p.a.). In addition, a Composition Scheme has been suggested with a gross turnover limit of Rs. 50 lakhs p.a.
- (ii) FICCI believes that different threshold levels may cause confusion amongst the trade and also encourage unethical practices. Ideally, the threshold level should be uniform across goods and services and be the same for both CGST and SGST. A sufficiently high threshold level will enable ease of tax administration since the tax will be collected from only those taxpayers who have a sizeable turnover (and thus, tax liability). A high threshold level will also ensure that small and marginal traders do not face any hardship on account of the rigorous record-keeping and compliance requirements anticipated under the GST.
- (iii) A large segment of trade and industry comprising of micro, small and medium scale enterprises will require time to transition to the GST. Suitable threshold limits and composition schemes should be incorporated in the statutes to provide relief to the MSME sector.

- (iv) Accordingly, FICCI recommends that a uniform threshold limit be set and further that this limit for registration under both the CGST and the SGST be set at a gross turnover of approximately Rs. 50 lakhs p.a. Thereafter, a composition Scheme could be introduced for annual gross turnover between Rs. 50 lakhs and Rs. 1 crore.

5. Exemptions

■ Area Based Exemption Schemes

- (i) Exemptions from indirect taxes like Central Excise and VAT have been extended to industry under various schemes of the Central and the State Governments. These schemes serve the twin objectives of development of industrially backward areas as well as encouragement to industries that are considered to be critical for the economic development of the country.
- (ii) Based on the nature of exemptions and the time period for which such exemptions have been granted, industry has made significant investments across the country. Accordingly, it is for consideration whether these exemption schemes should be grandfathered to continue up to their legislated lives. This could be done by granting exemption from the GST, where the current exemption is for both Central Excise and VAT, or by granting exemption from the CGST, in cases where the existing exemption is from Central Excise, and exemption from the SGST, if the existing exemption is from VAT. More importantly, in order to ensure that there is no break in the GST chain, conversion of the exemption schemes to cash refund schemes must be carried out so as to ensure that the grandfathering of these benefits do not impact the GST value added chain. FICCI, therefore, recommends that all existing exemption schemes be converted into cash refund schemes for the remaining duration of their validity or for the remaining portion of the underlying investment value.

■ Uniform Exemptions under Central and State GST

- (i) It is necessary to bring uniformity in the list of goods which are exempted and in the list of merit goods under both Central Excise and State VAT in order to ensure smooth transition. These lists need to be aligned across all States before the introduction of the GST, so that the rate changes are uniform at the time of transition. FICCI strongly recommends therefore that these lists be standardised across the CGST and the SGST prior to their coming into force.

6. Neutralisation of Taxes / Prevention of Tax Cascading

- (i) In a GST regime, full neutralization of input taxes must be guaranteed in order to remove tax cascading. The efficiency of neutralization would, to a large extent, ensure the success of this fiscal policy imperative. Accordingly, the common list of exempt goods and services should be kept to a minimum and wherever required or desirable, goods and services should be “zero” rated. This will ensure that the tax chain is not broken and that all input taxes are recouped. Consequently, input tax credit of GST on goods and services must be allowed to all tax-payers without any restrictions like nexus of inputs to output or disallowances on account of stock-transfers. Obtaining refunds in the existing VAT regime is a long drawn process

and assesseees have to follow cumbersome procedures and frequently engage in litigation with the Commercial Tax Department/Central Government Tax administration. In order to avoid such cash lock up under GST, an automatic refund system should be put in place for input taxes related to all “zero” rated goods and services. Further, it is recommended that all unutilised input tax credits at the end of the fiscal year should be either refunded in cash or be allowed to be carried forward to the next financial year, at the option of the assessee. This is in line with global best practices.

7. Uniform Laws and Simple Tax Administration

- (i) To ensure seamless implementation of GST and full compliance with the provisions of the GST, including on documentation, all Invoices, Returns, Forms, Challans, Accounting Codes and so on must be uniform across the country. In addition, the procedures and documentation for collection and payment of tax, movement of goods, returns, assessments, etc., under GST must be simple, transparent and assessee friendly with reliance on private records rather than on maintenance of voluminous statutory records.
- (ii) FICCI also recommends an expeditious release of the draft GST Tax code by both the Centre and the States so as to allow industry to assimilate and suggest changes / modifications.
- (iii) Multiple jurisdictions and multiple filing of returns are undesirable under GST. Assesseees should be required to submit one composite return covering CGST, SGST and IGST and be subjected to one common jurisdiction with uniform assessment proceedings. It is recommended that the jurisdiction and consequently, assessment, scrutiny, audit, etc. be the responsibility of a single authority, representing both the Centre and the States.
- (iv) Under the prevailing tax regime assesseees are subjected to audits by the central tax authorities, i.e., Central Excise and Service Tax Audit. At the State level, VAT was supposed to usher in an era of self-assessment and audit of a few assesseees on a sample basis. The reality is that whilst the Department has continued with “scrutiny-assessment” and audit of almost all assesseees, over and above this, most VAT laws require audit of assesseees’ records by an independent Chartered Accountant. Under the GST, the concept of a risk based audit should be introduced based on international practices and audit by the Department should only be conducted in cases of any attempted tax evasion. The assesseees with proven track record should be given the facility of self-assessment.

8. Unified adjudication and appellate Authority

- (i) It is expected that there will be uniform provisions for both SGST and CGST with respect to classification, valuation, input credits etc. Any dispute that may arise would typically encompass both CGST and SGST. Hence, there cannot be separate adjudication of the same dispute by the Central Government and State Governments. It is hence imperative that the existing adjudication mechanisms be unified to handle the litigation and the decisions of such authorities be made binding on both the administrations.

- (ii) A professional administration of taxes and uniformity in approach is mandatory – this will minimise the scope for diverse interpretations and proceedings and simultaneously, aid the evolution of a uniform fiscal law across the country. This is critical if the GST is to succeed.

9. GST network & removal of check posts / elimination of entry permits

- (i) The current system of entry permits/way bills not only increases transaction costs but also delays the business cycle. The GST Network is expected to facilitate the introduction of online information input at each check post and thereby eliminating the cumbersome procedure of entry permits/way bills.
- (ii) The GST Network (GSTN) will need to be a robust automated system for registrations, movement of goods, returns and payments. However, before the advent of the GST, current systems should be revamped in order to create databases for procedures such as registrations that can be replicated in the GSTN. It is therefore desirable that States adopt common GSTN based procedures for registration, payment etc.

10. Transitional Issues

There is currently no understanding on how transitional issues will be dealt with upon the introduction of the GST. For a seamless changeover to the GST, it is vital that information on transitional provisions be placed in the public domain well in advance to enable industry and policy-makers to engage in determining the best way forward. Further, the IT solution service providers can also make modifications in the ERP and MIS systems in order to ensure easy adaptability of the GST. Particularly, the following issues need to be addressed as on the date of changeover to the GST:

- (i) treatment of accumulated Cenvat and VAT credits in the hands of the tax-payers.
- (ii) treatment of tax-paid inventory – both with manufacturers as well as with trade.
- (iii) taxability of un-invoiced services.
- (iv) taxability of continuing contracts
- (v) taxation of transactions that straddle the date of implementation of GST – both in respect of domestic transactions as well as imports.

FICCI recommends the following measures to resolve the aforesaid issues:-

- (i) As far as accumulated credits of taxes are concerned, it is recommended that these be converted to deemed GST credits. Credits of all central taxes can be deemed to be CGST credits while credit of State / Local level taxes can be deemed to be SGST credits.
- (ii) Embedded taxes in inventories could also be dealt with in a similar manner – all central taxes embedded in inventory could be deemed to be CGST credits and State/Local taxes as SGST credits.
- (iii) As far as inventories of finished goods in the hands of trade are concerned, the GST laws may provide for a one-off window of, say, three months from the date of implementation of

GST wherein goods can be sold at the pre-GST MRP. This will ensure equitable treatment of goods – on which excise duty and VAT have been paid – remaining unsold at the time of implementation of GST.

In the event this is not possible, credit of embedded excise duty may be allowed on the basis of certified stock in hand and a declaration from the manufacturer – endorsed by the manufacturer’s jurisdictional excise office – with respect to the excise duty per unit paid by the manufacturer at the time of clearance of goods.

- (iv) In case of un-invoiced services, the same to be taxed at the rate of Service Tax prevailing prior to GST in case the service was completed before implementation of GST. In case of continuous services, the portion completed before GST implementation to be taxed at the Service Tax rate and the services provided thereafter to be taxed at the Standard Rate of GST.

In respect of transactions that straddle the date of implementation of GST, embedded taxes (Central Excise and/or VAT) should be allowed as CGST/SGST credits, as the case may be, and all forward transactions thereafter should be under GST. Similarly, in respect of imports, all goods reaching Indian ports before implementation of GST should be subjected to CVD and SAD (as applicable), with credit of such CVD and SAD extended to the importer under CGST and SGST respectively.

Conclusion

The above points that have been discussed in the Approach paper are illustrative and not exhaustive. However, these points are of critical importance as they are fundamental to the effective introduction and implementation of the dual GST. It is now well-recognized and understood that the GST is a necessary condition if the country has to go back to double digit GDP growth. It is hence of utmost importance that the GST that is to be introduced is well thought-out and is introduced only upon the Central Government and the State Governments being fully and completely ready and prepared. Industry is a key stakeholder and FICCI, as a leading representative of industry, is ready and keen to engage with the authorities at all levels in order to ensure that the GST is business friendly and is introduced in a manner that it becomes a “win-win” for everyone. It is, therefore, FICCI’s hope and request that all aspects of GST are fully and adequately discussed and debated before they are incorporated in the statutes. We hope further that FICCI will be provided ample opportunities to engage with the Empowered Committee as well as the Central Government as soon as the final recommendations of the 3 panels are debated and discussed. In order for a fundamental fiscal reform such as the GST to succeed, it is imperative that all stakeholders are fully on board and are in agreement with the underlying proposals. FICCI is ready to partner with the Empowered Committee and the Central Government as well as any other stakeholders in order to bring about a modern GST, in line with the international best practices, within shortest possible time.



Federation of Indian Chambers of Commerce and Industry
Federation House, 1 Tansen Marg, New Delhi - 110 001
Ph: 011-23738760-70; Fax: 011-23320714; Email: ficci@ficci.com
www.ficci.com