

August 2016

## THE GIST OF GST

### THE CONSTITUTION (122ND AMENDMENT) BILL, 2014

#### 1. INTRODUCTION

The Constitution (122<sup>nd</sup> Amendment) Bill, 2014 (the “**Bill**”) paving the way for the implementation of the unified goods and services tax regime (the “**GST**”) has been passed by the Rajya Sabha on 3<sup>rd</sup> August 2016, with amendments re-tabled and passed by the Lok Sabha on 8<sup>th</sup> August 2016.

The Bill now has to be ratified by the legislatures of not less than one-half of the States before the Bill is presented to the President for assent.

The passage of the Bill through parliament is a landmark in India’s history of economic reforms and implementation of the GST will be the most significant economic reform in India’s independent history and perhaps the largest wholesale restructuring of an indirect tax system ever.

The Bill paves the way for the GST, creating the single largest tax market in the world, by merging a multitude of indirect taxes such as excise, service tax, value added tax *octroi* and a other taxes into a single tax.

Under the Bill, the Center will be able to levy an integrated GST on the inter-state supply of goods and services.<sup>1</sup> The revenue under the GST regime will be shared between the Centre and the States and the Centre will compensate the States for any loss of revenue for a period of up to 5 (five) years.<sup>2</sup>

GST will simplify and *harmonise* the indirect tax regime in the country. It is expected to boost production by reduction of the cost of production and inflation in the economy, thereby making Indian business more competitive, domestically as well as internationally.

#### 2. PRESENT REGIME

Presently, the Constitution empowers the Central Government to levy a number of indirect taxes on the manufacturing and supply of goods and services. These taxes include excise duty, sales tax, service tax, *octroi*, customs duty and other taxes. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods.

The tax regime for goods and services is disjointed, which poses a burden of “*tax on tax*”, or the “*cascading*” of taxes whereby the government levies a tax not only on the value addition on a product, but also on the tax already levied on the product.

<sup>1</sup> Clause 9 of the Bill, inserting Article 269A of the Constitution

<sup>2</sup> Clause 19 of the Bill

### 3. KEY PROVISIONS OF THE BILL

The Bill paves the way for the wholesale merger of the existing indirect tax regime into a *single market* through a new indirect tax regime, merging levies such as excise, sales tax and service tax.

Notably, the Bill excludes the taxing of alcohol for human consumption<sup>3</sup> and 5 (five) petroleum products (petroleum crude, high speed diesel, petrol, natural gas and aviation fuel).<sup>4</sup> The Goods and Services Tax Council (*discussed below*) will decide when GST will be levied on these petroleum products at a future date.

#### 3.1 Powers of State and Union to frame GST laws

The Bill inserts a new article in the Constitution providing powers to the legislature of every State to make laws with respect to the GST imposed by the Union or such State. It provides the Parliament with the exclusive power with respect to GST where the supply of goods or services takes place in the course of *inter-State* trade or commerce.<sup>5</sup>

#### 3.2 Goods and Services Tax Council

The Bill sets out the framework for a Goods and Services Tax Council and the President shall, by order, constitute a Council to be called the Goods and Services Tax Council.<sup>6</sup>

##### (a) Composition of the Goods and Services Tax Council

The Goods and Services Tax Council shall consist of the Union Finance Minister as a chairperson, and its members shall include the Union Minister of State in charge of Revenue or Finance and the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government.

The vice-chairperson of the Goods and Services Tax Council shall be chosen, from amongst themselves, by the members nominated by the State Government.

##### (b) Functions of the Goods and Services Tax Council

The purpose of the Goods and Services Tax Council is to recommend:

- (i) taxes, surcharges and cesses to be merged under the GST;
- (ii) model GST laws, principles of levy, apportionment of GST levied on supplies in the course of inter-State trade or commerce and principles that govern the place of supply;
- (iii) goods and services which may be subjected to or exempted from GST;
- (iv) the threshold limit of turnover below which goods and services may be exempted from GST;
- (v) rates including floor rates with bands of GST;

<sup>3</sup> Clause 14 of the Bill, amending Article 366 of the Constitution

<sup>4</sup> Clause 17 of the Bill, amending the 7<sup>th</sup> Schedule of the Constitution

<sup>5</sup> Clause 2 of the Bill, inserting Article 246A of the Constitution

<sup>6</sup> Clause 12 of the Bill, inserting Article 279A of the Constitution

- (vi) special rates to raise additional resources during any natural calamity;
- (vii) special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- (viii) any other matters relating to the GST.

**(c) Quorum and Voting**

The quorum for the meetings of the Goods and Services Tax Council shall constitute at least 50 per cent of the total members being present.

Every decision of the Goods and Services Tax Council shall be taken by a *three quarter* majority (75 per cent) of members present in voting. Given that the Centre will have one third of the votes and the States will have two thirds of the vote, this effectively means that unanimity will be required.

**(d) Resolution of disputes**

The Goods and Services Tax Council shall establish a mechanism to adjudicate any dispute arising out of its recommendations. Disputes can be between: (i) the Centre and one or more states; (ii) the Centre and States on one side and one or more States on the other; (iii) one or more States.

**3.3 Integrated GST**

The Bill inserts a new article (Article 269A) in the Constitution relating to the levy and collection of the GST. It provides that Centre may levy and collect GST on supplies in the course of inter-State trade or commerce and the tax collected will be divided between the Centre and the States in a manner to be provided by Parliament, by law, on the recommendations of the Goods and Services Tax Council.

It should be noted that the amount apportioned to a State shall not form a part of the consolidated fund of India.

The Parliament may, by law, formulate the principles for determining the *place* of supply, and *when* a supply of goods or services takes place in the course of inter-State trade or commerce.

The Bill also states that the supply of goods or services in the course of import into India shall be deemed to be supply of goods or services in the course of inter-State trade or commerce.<sup>7</sup>

**3.4 Restrictions as to imposition of tax on the supply of goods or services**

The Constitution currently imposes a restriction on the States to impose taxes on the *sale* or *purchase* of goods where such sale or purchase takes place:

- (a) outside the state; or
- (b) in course of the import of the goods into or exports of the goods out of India.

However, the Bill amends this provision to restrict the imposition of tax on the supply of goods and services and not on its sale.<sup>8</sup>

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<sup>7</sup> Clause 9 and 10 of the Bill

### 3.5 Compensation to States

Under the provisions of the Bill, Parliament shall, on the recommendation of the Goods and Services Tax Council, provide compensation to states for any loss of revenue from the date of introduction of the GST for a period of 5 (five) years.<sup>9</sup>

### 3.6 Transitional Provisions

The Bill provides that, any provision of any law relating to the tax on goods or services in force in any State, which is *inconsistent* with the provisions of the Constitution as amended by the Bill shall continue to be in force until amended or repealed by a competent legislature or other competent authority or until expiration of 1 (one) year from the time when the Bill comes into force, whichever is earlier.<sup>10</sup>

#### IndusLaw View

Clearly, the passage of the Bill is an enormous achievement to pave the way forward for the implementation of the GST, *harmonizing* a system of indirect taxation by merging all indirect taxes into one tax.

It seeks to settle the issues of the present indirect tax structure by enlarging the tax base, increasing compliance, eliminating the cascading of taxes and preventing economic disturbances caused by different inter-state taxes.

The Bill, however, should not be confused for the actual GST itself, which is currently in the form of a draft model law. Although the Bill sets out the framework for a single GST, this does not mean that there will be a *single* law. On the contrary, to implement the Bill (assuming that half of India's States consent to it), the Center and *each* State will need to pass further legislation, as recommended by the Goods and Services Tax Council, formulating the GST.

Noticeably, the Bill excludes alcohol and defers applicability to key petroleum products, which will mean that the existing convoluted tax (and the cascading of tax) will continue to apply to these products, somewhat contradicting the idea of creating a single tax market applying to all goods and services.

In particular, excluding petroleum products will mean that input tax credits may not be available in relation to the cost of manufacture of certain goods.

Furthermore, while the future GST will be beneficial for the large-scale sector (it will provide a single market from which to buy raw materials from any part of the country) the small-scale sector that produces and sells locally, is unlikely to benefit from a single market.

Since both Parliament and the State legislatures have the power to legislate on GST, the potential for conflict and the complexity that will arise as a result thereof, remains to be seen. Throw into that mix the ambit and decision making process of the Goods and Services Tax Council and it should become clear that there will be ample scope for diverging views.

Given the broad mandate given to the Goods and Services Tax Council, it is possible that future exemptions or other dispensations given to particular States will somewhat complicate and erode the idea of a single GST.

Though the Bill has been passed, many steps still need to be taken to fully implement and realise a unified indirect tax structure. Much of this will depend upon the co-operation and cohesion between the Center and India's many States.

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<sup>8</sup> Clause 13 of the Bill, amending Article 286 of the Constitution

<sup>9</sup> Clause 19 of the Bill

<sup>10</sup> Clause 20 of the Bill

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