Legislative Brief

The Constitution (122nd Amendment) Bill, 2014 (GST)

The Constitution (122nd Amendment) Bill, 2014 was introduced in Lok Sabha on December 19, 2014. It was passed in that House on May 6, 2015.

It was referred to a Select Committee of Rajya Sabha on May 14, 2015. The Committee is scheduled to submit its Report by the end of the first week of the Monsoon session.

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Highlights of the Bill

- The Bill amends the Constitution to introduce the goods and services tax (GST).
- Parliament and state legislatures will have concurrent powers to make laws on GST. Only the centre may levy an integrated GST (IGST) on the interstate supply of goods and services, and imports.
- Alcohol for human consumption has been exempted from the purview of GST. GST will apply to five petroleum products at a later date.
- The GST Council will recommend rates of tax, period of levy of additional tax, principles of supply, special provisions to certain states etc. The GST Council will consist of the Union Finance Minister, Union Minister of State for Revenue, and state Finance Ministers.
- The Bill empowers the centre to impose an additional tax of up to 1%, on the inter-state supply of goods for two years or more. This tax will accrue to states from where the supply originates.
- Parliament may, by law, provide compensation to states for any loss of revenue from the introduction of GST, up to a five year period.

Key Issues and Analysis

- An ideal GST regime intends to create a harmonised system of taxation by subsuming all indirect taxes under one tax. It seeks to address challenges with the current indirect tax regime by broadening the tax base, eliminating cascading of taxes, increasing compliance, and reducing economic distortions caused by inter-state variations in taxes.
- The provisions of this Bill do not fully conform to an ideal GST regime. Deferring the levy of GST on five petroleum products could lead to cascading of taxes.
- The additional 1% tax levied on goods that are transported across states dilutes the objective of creating a harmonised national market for goods and services. Inter-state trade of a good would be more expensive than intra-state trade, with the burden being borne by retail consumers. Further, cascading of taxes will continue.
- The Bill permits the centre to levy and collect GST in the course of inter-state trade and commerce. Instead, some experts have recommended a modified bank model for inter-state transactions to ease tax compliance and administrative burden.

PART A: HIGHLIGHTS OF THE BILL[1]

Context

The Constitution provides for the division of taxation powers between the centre and states. Currently, indirect taxes are imposed on goods and services. These include excise duty, sales tax, service tax, octroi, customs duty etc. Some of these taxes are levied by the centre and some by the states. For taxes imposed by states, the tax rates may vary across different states.

The concept of Value Added Tax (VAT) was introduced for central excise duty in 1986 (first as MODVAT and then as CENVAT). Prior to this, excise duty was levied on both inputs used and the output produced.[2] This meant that an amount paid as tax on the input was subject to taxation again at the output level (with limited set offs). This was applicable to each intermediate good in the manufacturing process. This 'tax on tax' led to cascading of taxes. This problem was sought to be addressed by the VAT regime under which tax paid on the inputs is deducted from the tax payable on the output produced. Similarly, sales tax also had a cascading effect through the distribution chain. All states have now adopted the concept of VAT for state sales tax.

The issue of cascading taxation was partly addressed through the VAT regime. However, certain problems remained. For example, several central and state taxes were excluded from VAT. Sectors such as real estate, oil and gas production etc. were exempt from VAT. Further, goods and services were taxed differently, thereby making the taxation of products complex. Some of these challenges are sought to be overcome with the introduction of the Goods and Services Tax (GST).

The GST regime intends to subsume most indirect taxes under a single taxation regime. GST is a value added tax levied across goods and services. This is expected to help broaden the tax base, increase tax compliance, and reduce economic distortions caused by inter-state variations in taxes.[3]

In 2011, the Constitution (115th Amendment) Bill, 2011 was introduced in Parliament to enable the levy of GST. However, the Bill lapsed with the dissolution of the 15th Lok Sabha. Subsequently, in December 2014, the Constitution (122nd Amendment) Bill, 2014 was introduced in Lok Sabha. The Bill was passed by Lok Sabha in May 2015 and referred to a Select Committee of Rajya Sabha for examination.

Key Features

The Bill enables Parliament and state legislatures to frame laws on GST. The GST Council, that includes representatives from the centre and all states, will make recommendations on the implementation of GST.

Scope of GST

- GST is applicable on the supply of goods or services.
- Alcoholic liquor for human consumption is exempt from GST.
- Initially, GST will not apply to: (a) petroleum crude, (b) high speed diesel, (c) motor spirit (petrol), (d) natural gas, and (e) aviation turbine fuel. The GST Council will decide when GST will be levied on them.
- Tobacco and tobacco products will be subject to GST. The centre may also impose excise duty on tobacco.

Levy of GST

- Both, Parliament and state legislatures will have the power to make laws on the taxation of goods and services. A law made by Parliament in relation to GST will not override a state law on GST.
- The central government will have the exclusive power to levy and collect GST in the course of interstate trade or commerce, or imports. This will be known as Integrated GST (IGST).
- A central law will prescribe the manner in which the IGST will be shared between the centre and states, based on the recommendations of the GST Council.

Additional tax on supply of goods

- An additional tax of up to 1% on the supply of goods will be levied by centre in the course of inter-state trade or commerce. The tax will be collected by the centre and directly assigned to the states from where the supply originates.

- This tax will be levied for two years, or for a longer period as recommended by the GST Council. The central government may exempt certain goods from such additional tax.
- The principles for determining the place of origin from where the supply of such goods takes place will be formulated by a law of Parliament.

GST Council

- The GST Council will consist of: (a) the Union Finance Minister (as Chairman), (b) the Union Minister of State in charge of Revenue or Finance, and (c) the Minister in charge of Finance or Taxation or any other Minister, nominated by each state government. All decisions of the GST Council will be made by three-fourth majority of the votes cast; the centre shall have one-third of the votes cast, and the states together shall have two-third of the votes cast.
- The GST Council will make recommendations on: (a) taxes, cesses, and surcharges to be subsumed under the GST; (b) goods and services which may be subject to, or exempt from GST; (c) the threshold limit of turnover for application of GST; (d) rates of GST; (e) model GST laws, principles of levy, apportionment of IGST and principles related to place of supply; (f) special provisions with respect to the eight north eastern states, Himachal Pradesh, Jammu and Kashmir, and Uttarakhand; and (g) related matters.
- The GST Council may decide the mechanism for resolving disputes arising out of its recommendations.

Compensation to states

- Parliament may, by law, provide for compensation to states for revenue losses arising out of the implementation of GST, based on the recommendations of the GST Council. Such compensation could be for a maximum of five years.

PART B: KEY ISSUES AND ANALYSIS

Impact of introducing an ideal GST regime

The idea behind GST is to subsume all existing central and state indirect taxes under one value added tax, which will be levied on all goods and services. No good or service is exempt, and there is no differentiation between a good or service, whether as an input or as a finished product. Under GST, tax paid on inputs is deducted from the tax payable on the output produced. This input credit set off operates through the manufacturing and distribution stage of production. The tax is collected only at the place of consumption. This design addresses cascading of taxes.

Table 1 below explains how GST works. It takes the example of a manufacturer who pays excise, and a retailer who pays sales tax, and explains taxation under the current structure and the GST regime.

Table 1: Comparison of tax under the current indirect tax system and the GST regime

Transaction	Current system	GST
Cost of raw material	100	100
Tax on raw material	10	10
Value added by manufacturer	20	20
Tax payable by manufacturer	2 (CENVAT: 10% of 20)	2 (GST: 10% of 20)
Retailer's cost	132	132
Retailer's margin	20	20
Tax payable	15.2 (Sales Tax: 10% of 152)	2 (GST: 10% of 20)
Final price paid incl.taxes	167.2	154
Of which taxes	27.2	14

In this example, the cost of the raw material is 100. The manufacturer and retailer add Rs 20 value each. The tax rate is assumed to be 10% for all taxes.

Current tax regime: Both Excise and Sales Tax are a VAT system, but the set off for taxes paid is not applicable across these taxes. Therefore, sales tax is applicable to the excise duty (CENVAT) paid. Thus, tax paid is 12 (excise) plus 15.2 (sales tax). Note the 'tax on tax' effect where the final selling price not only has two taxes, but also a tax-on-tax.

GST regime: There is a single tax with input credit. This means that each person pays tax only on the value added by him. Consequently, the total tax is less, resulting in a lower price of the good.

Several expert committees have examined the features of the current indirect tax regime against those envisaged in an ideal GST system. We present this in the Table below:[3, 4,5] Note that the GST in the proposed Bill differs from the ideal GST outlined in Table 2. These differences include exemptions of certain goods and the inclusion of a 1% additional (origin based) tax. The effect of these deviations is discussed in the following sections.

Table 2: Features and impact of current system with an ideal GST regime

	Current regime of indirect taxes	An ideal GST structure
Features	Goods and services taxed separately*	No differentiation between a good and a service; both subject to one tax
	VAT applies at manufacturing stage (CENVAT i.e. excise duty) as well as at sales stage (state VAT i.e. sales tax).	VAT applies at point of consumption. Set-off on the inputs gets credit through the production and distribution stages.
	Input credit set-off not available across different taxes. For example, set off not available for CENVAT against state VAT.	Input tax credit available across state and central tax jurisdictions.
	Some taxes (CENVAT, service tax) levied at the stage of production, while some (state VAT) levied on sale.	Follows a destination based principle where tax is collected on final consumption.
	Many indirect taxes not included in central and state VAT.**	Subsumes all indirect taxes under one tax.
	Different tax rates levied across products and across states.	Single tax rate to apply on all goods and services.
	Certain sectors exempt from VAT.***	No goods or services are exempt from GST.
	Intra-state transactions get input credit set off but not inter-state transactions.	Input credit set off to be available across intra-state and inter-state transactions.
Impact	Cascading of taxes across manufacturing and distribution chain increases cost of products making them uncompetitive.	Eliminates cascading by providing for input credit set off at all stages of production.
	Limited incentive for tax compliance	Encourages voluntary compliance. A person in the supply chain gets credit only when tax is paid by previous person.
	Distinguishing between goods and services complicates the taxation of certain products e.g. computer software.	Single tax to apply to both goods and services, hence distinguishing between the two not necessary.
	VAT does not apply uniformly across sectors and goods. Sectors such as oil and gas production, real estate exempt.	No exemptions. All sectors, goods and services subject to GST that broadens tax base.
	States' levy of entry tax/octroi when goods pass through states result in bottlenecks at borders, raising inventory costs.	Facilitates inter-state trade as transactions across state and municipal jurisdictions are free from tax.
	Different tax rates across states leads to economic distortions.	Single national tax rate reduces distortions.
	Complex tax structure leads to higher administrative costs.	Single tax reporting structure as all indirect taxes subsumed.

Sources: Report of the Task force on GST, 13th Finance Commission; Report of the Fourteenth Finance Commission, Chapter 13, 'Goods and Services Tax'; First Discussion Paper on Goods and Services Tax in India, The Empowered Committee of State Finance Minister; PRS.

Notes: * Service tax cannot be levied by states. It is levied by the centre.
**CENVAT does not include additional excise duty, additional customs duty, central surcharges and cesses. State VAT does not include luxury tax, entertainment tax, taxes on lottery, advertisements, entry tax etc. CENVAT applies only at the manufacturing stage, and does not extend down to the distribution stage till the retail sale of goods.
***Exemptions under CENVAT and service tax include: oil and gas production, mining, agriculture, wholesale and retail trade, real estate construction, and other services. Under state VAT, all services, real property, agriculture, oil and gas production, and mining are exempt.

Exemptions under GST

Clauses 12, 14 (i)

The Bill excludes alcoholic liquor for human consumption from the purview of GST. Further, GST will apply to five petroleum products i.e. (a) petroleum crude, (b) high speed diesel, (c) motor spirit (petrol), (d) natural gas, and (e) aviation turbine fuel at a later date, to be decided by the GST Council.

Petroleum products are inputs for several other goods and exempting them from the purview of GST could lead to cascading of taxes. This is because the input tax credit would no longer be available on such products. This disruption in the tax credit chain would distort the GST structure and could also lead to leakages of revenues.[6]

The 13th Finance Commission and the Department of Revenue had recommended that all petroleum products and alcohol be brought under GST.[7, 8] The Commission had suggested that states could impose an additional levy on petroleum products and alcohol, in addition to GST.[8]

Additional 1% tax deviates from the objective of GST

Clause 18

The Bill states that the centre may levy an additional tax of up to 1%, on the supply of goods in the course of inter-state trade for two years or longer, as recommended by the GST Council. This tax will be collected by the centre and accrue directly to the states from where the supply of the good originates.

This provision may impede a key objective of GST. The GST regime aims to create a harmonised national market for goods and services, and the Bill reinforces this objective.[9] Such a harmonised national market is enabled by levying one tax rate across states to ensure free movement of goods whether within a state, or from one state to another. The levy of the additional tax distorts the creation of a national market, as a product made in one state and sold in another would be more expensive than one made and sold within the same state.

Also, the 1% tax will result in cascading of taxes. This effect will be magnified if the production and distribution chain passes through several states, and if the 1% additional tax applies at each state.[10] The burden of the cascading tax will be borne by the final consumer of the product.

Alternatives to the IGST

Clause 9

The Bill permits the centre to levy and collect GST in the course of inter-state trade and commerce, called the Integrated Goods and Services Tax (IGST). Such tax will be apportioned between the centre and the states in a manner to be decided by a law made by Parliament.

The Task Force set up by the 13th Finance Commission had suggested an alternative to the IGST.[5] The Commission had recommended a modified bank model with regard to inter-state transactions. Under this model, the seller levies GST on the buyer state, and deposits the tax collected to a nodal bank. The nodal bank then credits payment to the consuming state. This model was recommended, given that inter-state transfers under GST should be designed (i) to avoid any distortions or cascading effects, and so that (ii) tax accrues to the state where the final consumer is located.[5] The Standing Committee examining the Constitution (115th Amendment) Bill, 2011 had recommended the modified bank model as an alternative to the IGST as it would simplify tax compliance and ease administrative burden in inter-state transactions.[11]

Comparison of the recommendations of various bodies

A proposal for introduction of GST has been under consideration since 2007. The Empowered Committee of State Finance Ministers presented its views in 2009.[2] The 13th and 14th Finance Commission also made recommendations in relation to the introduction of GST, in 2009 and 2015 respectively.[6,8]

Table 3: Comparison of recommendations of various bodies on introducing a GST regime

	Empowered Committee (2009)	13th Finance Commission (2009)	14th Finance Commission (2015)
Coverage	▪ All transactions of goods and services (except exempted goods, and transactions below threshold limits).	▪ Most goods and services, including petroleum products, natural gas, alcohol and tobacco.	▪ Universal application of GST over the medium and long term.
Products on which tax in addition to GST may be levied	▪ Tobacco.	▪ High speed diesel, motor spirit, aviation turbine fuel, alcohol and tobacco.	Not addressed.
Goods to be exempt from GST	▪ Petroleum products, i.e. motor spirit, aviation turbine fuel, high speed diesel. ▪ Alcoholic beverages.	▪ Unprocessed food items ▪ Public services (excludes railways, public sector enterprises) ▪ Service transactions ▪ Health and education services.	No specific recommendations.
Integrated GST (in interstate trade)	▪ Centre to levy CGST plus SGST. ▪ The Modified Bank Model to be followed.	▪ Tax collected by the consuming state. ▪ Inter-state transactions to be zero rated.	Not addressed.
Compensation to states	▪ Compensation for five years. ▪ Could be special grants to be released to the states every month. ▪ Based on a neutrally monitored mechanism.	▪ Compensation for five years. ▪ To be based on devolution formula. ▪ Fund to be under the GST Council.	▪ Independent compensation fund for a limited period. ▪ Compensation to states to be (i) 100% in the first 3 years; (ii) 75% in the fourth year; and (iii) 50% in the fifth and final year.

Sources: The Empowered Committee of State Finance Ministers, November 2009; Report of the 13th Finance Commission, December 2009; Report of the 14th Finance Commission, February 2015; PRS.

Comparison of the 2014 Bill with the 2011 Bill on introduction of GST

The Table below compares the provisions of the 2014 Bill with the 2011 Bill and the recommendations of the Standing Committee on the 2011 Bill.

Table 4: Comparison of the 2014 Bill, 2011 Bill and the recommendations of the Standing Committee

	Constitution (115th Amendment)Bill, 2011	Standing Committee recommendations on 2011 Bill	Constitution (122nd Amendment) Bill, 2014
Coverage of GST	All goods or services *except*: ▪ Alcoholic liquor for human consumption. ▪ Petroleum crude, high speed diesel, motor spirit, natural gas, aviation turbine fuel. ▪ Centre to impose additional levy on tobacco.	▪ No recommendation on goods to be exempt. ▪ Goods exempted from GST should not be specified in the Constitution Amendment Bill as this would make the GST regime rigid.	All goods and services, *except*: ▪ Alcoholic liquor for human consumption. ▪ GST is to be levied on petroleum crude, high speed diesel, motor spirit, natural gas, aviation turbine fuel at a later date. ▪ Centre to impose additional levy on tobacco.
Integrated GST	▪ Only centre to levy and collect tax. ▪ Tax collected to be divided between the centre and the states.	▪ Instead, the Modified Bank Model recommended by 13th Finance Commission to be considered.	▪ Same as 2011 Bill.
Additional Tax (in interstate trade)	No provision.	Not addressed.	▪ Tax (up to 1%) on the supply of goods in inter-state trade will be given to supply states, for two years or more.
Compensation to states	No provision.	▪ An automatic and permanent GST Compensation Fund under the GST Council could be created.	▪ Parliament may provide for compensation to states for a maximum of five years.
GST Council	▪ Functions: Recommendations on taxes to be subsumed, exempted goods, threshold limits, rates. ▪ Decisions: By consensus.	▪ Functions: Should include floor rates, special provisions for some states. ▪ Decisions: 3/4th weighted votes; 1/3 weightage to centre, 2/3 to states.	▪ Functions: Also includes model GST laws, principles of levy and place of supply, apportionment of IGST. ▪ Decisions: Standing Committee recommendations incorporated.
Dispute Resolution	▪ GST Dispute Settlement Authority to determine disputes between centre and states. ▪ Parliament may restrict jurisdiction of all courts other than Supreme Court.	▪ Omit GST Dispute Settlement Authority. ▪ GST Council to decide upon the modalities to resolve disputes.	▪ Standing Committee recommendations incorporated.

Sources: The Constitution (122nd Amendment) Bill, 2014; The Constitution (115th Amendment) Bill, 2011; 73rd Report, The Constitution (115th Amendment) Bill, 2011, Standing Committee on Finance, 2013; PRS.

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1. This Brief is based on the Constitution (122nd Amendment) Bill, 2014 that was introduced in Lok Sabha on December 19, 2014 and passed by it on May 6, 2015.
2. First Discussion Paper on Goods and Services Tax in India, Empowered Committee on State Finance Ministers, November 2009.
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5. Report of the Task force on GST, 13th Finance Commission, December 15, 2009.
6. Report of the 14th Finance Commission, Chapter 13, 'Goods and Services Tax', February 24, 2015.
7. Comments of the Department of Revenue on the First Discussion Paper on GST, January 2010.
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11. 73rd Report, The Constitution (115th Amendment) Bill, 2011, Standing Committee on Finance, August, 2013.