

**PRESS RELEASE**

Text of the D.O. letter dated 10.9.2014 addressed by **Selvi J Jayalithaa**, Hon'ble Chief Minister of Tamil Nadu to **Shri Arun Jaitley**, Hon'ble Union Minister of Finance, Corporate Affairs and Defence, New Delhi is reproduced below:-

"You may kindly recall that when I met you on 3.6.2014 I had handed over a letter along with a background note highlighting some of the crucial financial issues pertaining to Tamil Nadu, including the proposed Goods and Services Tax.

Subsequent to that, a revised draft Constitution Amendment Bill was circulated on 20.6.2014 which addressed some of the concerns that States, including Tamil Nadu, had. I understand that the provisions relating to Declared Goods have been removed and alcoholic liquor for human consumption has been kept outside GST. Further, the provisions relating to Advisory Committees for dispute resolution have also been deleted.

It has been brought to my notice that during the recent meeting of the Empowered Committee of State Finance Ministers held on 20.8.2014, consensus was reached amongst the States on some more issues including that the threshold limit for levy of GST on goods and services should be fixed at Rs.10 lakhs; the threshold limit for compounding scheme should be fixed at Rs.50 lakhs with a floor rate of tax at 1%; and that the Exemption list under GST should be common for both CGST and SGST. I do hope that the Government of India would accede to all these points. Besides this, I would also suggest that States should be allowed to grant exemption on all goods of local importance without any restrictions. Further, to avoid dual control, States should be vested with the control of dealers having a turnover up to Rs.1.5 crores both for intra-State and inter-State supply of goods and services, whereby the Centre can avoid expanding its administrative machinery while collecting CGST from such dealers.

The proposal of the Government of India to bring petroleum products under the ambit of the Goods and Services Tax is another area of concern which would seriously diminish the limited revenue resources of the States. The proposed system of dual levy wherein the States will also be empowered to continue the existing levy of tax on the sale of petroleum products in addition to the levy of GST is not acceptable, as a portion of the tax on petroleum products would still be eligible for Input Tax Credit. I would also like to point out that Tamil Nadu has strong misgivings about the latest suggestion of the Government of India that the GST component of the levy on petroleum products can be at a very low rate or even

zero-rated for an initial period of at least 3 years to avert any possible sudden revenue loss to the States. There is no certainty that, in a period of three years, the revenue gain on account of levy of tax on services and on import of goods would be substantial enough to offset the revenue loss on account of bringing petroleum products under the ambit of GST nor is there any guarantee that GST will not be prematurely imposed on petroleum products. Since the resources of the States are already limited, I strongly urge that Petroleum and Petroleum products should be kept completely outside the ambit of GST.

Tamil Nadu is presently levying higher taxes on tobacco and tobacco products at rates of tax ranging from 14.5% to 20%. Considering the health hazards involved in tobacco consumption, the Government of India is presently urging all the States to levy higher VAT on tobacco and tobacco products. However, the draft Constitution Amendment Bill does not include enabling provisions for States to levy higher taxes on tobacco and tobacco products, on par with the Central Government. I, therefore, urge that States should also be empowered to levy higher taxes on tobacco and tobacco products on par with powers proposed to be vested with the Centre to levy Excise Duty on tobacco and tobacco products in the draft Bill.

The threshold limit for levy of GST; the goods and services which are to be exempted; the rates including floor rates with bands; the taxes to be subsumed under GST are some of the crucial factors for determining the Revenue Neutral Rate (RNR). The "Place of Supply of Service Rules" which are to be framed will also play a vital role in estimating the tax revenue from services to the States. Without finalizing these important elements, it may not be feasible to accurately calculate the State-wise Revenue Neutral Rates. In any case, the cumulative nominal rate of GST (CGST+SGST) cannot be fixed very high, as it would appear regressive and this is bound to keep the GST rate well below the Revenue Neutral Rate (RNR) for a State like Tamil Nadu. Hence, there is bound to be huge revenue loss for Tamil Nadu.

It cannot be denied that manufacturing States like Tamil Nadu stand to permanently lose substantial revenue if GST is implemented, due to the sudden shift of levy from the point of origin to the point of destination. In addition to the revenue loss arising out of phasing out of CST and transfer of Input Tax Credit on inter-State Sales and inter-State Stock transfers, the State also stands to lose substantial revenue arising out of subsumation of other taxes such as Entertainment Tax, Luxury Tax, Entry Tax on Vehicles and Betting Tax.

In this context, I understand that the Gujarat Government has proposed that States should be allowed to make an upfront deduction of 2% of the total output IGST amount levied on all the dealers in the State in a given tax period. They have also proposed a further 2% deduction from IGST to be credited to a "Compensation Fund" maintained by the Government of India. You had mentioned this proposal to me in the course of our discussions on 3.6.2014. I have had the matter examined in detail. While this suggestion would take care of the revenue loss due to the phasing out of CST, however, Tamil Nadu stands to lose substantial revenue on account of transfer of Input Tax Credit on inter-State sales and inter-State stock transfers, which the State presently retains to the extent of 3% in respect of inter-State sales and 5% in respect of inter-State stock transfer. Hence, it is suggested that all the States may be permitted to retain the entire 4% of the CGST part of the IGST on all inter-State sales without crediting any amount to a compensation fund. This will enable a substantial reduction in the compensation payable to the States. At the same time, since it could come out of the CGST part of the IGST, it would not place the destination State at any disadvantage with regard to revenue flow.

Hence, I am of the view that an independent compensation mechanism and methodology for revenue losses suffered by the States is an essential prerequisite for implementation of GST. It is understood that officials of the Government of India have suggested a separate legal provision for compensation, as part of the enabling GST Legislation. I am of the opinion that a mere legal provision will not serve the interests of the States. A compensation mechanism should be enshrined in the Constitution itself and not reduced to an instrument of Union policy which may change from time to time.

**May I also reiterate my views that, before the enactment of the Constitutional Amendment Bill on GST is taken up, the Government of India should strive for a broad consensus on the important issues relating to GST like compensation period and methodology, revenue neutral rates, floor rates with bands, commodities to be excluded from GST, IGST Model and clarity on dual administrative control, so that the genuine apprehension of the States over loss of fiscal autonomy and permanent revenue loss are allayed?"**

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