
Taxing Services - First Bone of Contention - How should GST Council arrive at compromise?

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THE last GST Council meeting on September 30, 2016, was quite significant in many respects. It was indeed a learning experience for all the stake-holders who had set a very good example of cohesive and harmonious federalism at its first meeting when several decisions were taken without much contention or cacophony. But the second meeting last Friday proved otherwise - less of spirit of federalism and more of the Union of States!! Let me delve deeper into the issues to explain the twin phraseologies

. For the GST Council Secretariat headed by the Revenue Secretary Dr Hashmukh Adhia, it was nothing less than a rude shock when the detailed minutes of the First Meeting created **piercing noise**

over the issue of division of power between the Union and the State to have control over assessment of services up to Rs 1.5 Crore. Dr Amit Mitra and others raised the voice that this issue was not deliberated upon at length and there was no consensus arrived at. When the voice of many State Finance Ministers became shrill, it was decided to leave this issue open and that part of the minutes which had the pertinent details were left unapproved. So, the message for the Revenue Secretary was that it is not so easy to push through certain ideas at a federal body where the States happen to be quite emotional and sensitive after having 'contributed' their fiscal autonomy to a basket of 'pooled sovereignty'. Therefore, the Secretariat needs to be doubly sure before putting any issue in the minutes to be adopted and approved by the Council.

Let's examine the first bone of contention between the Union of India and the States from a constitutional angle. The new Article 246A clearly vests powers in both the Union and the States to levy tax on both the goods as well as the services. So, in simple words, the legal rights have been vested in both the constitutional creatures to tax services

. Now, the question, whether the Union should exclusively tax services up to Rs 1.5 Crore or there should be a dual control, is largely not a question of constitutional or legal dispute **but of tax administration**.

Going by the nature of the first dispute it is quite evident that like in the rest of the world where the VAT system has been adopted, India is not going to be any different. Most disputes in VAT system are generally going to be about tax administration or control thereof. The Centre's plea that the States have no experience in dealing with the assessment of services and therefore, they need to be trained for a few years first, does not seem to be cutting much ice because of some valid reasons. One, there are many services which the States have been taxing in their own little way such as entertainment tax. Secondly, going by the Model GST Laws, intangible property means any property other than tangible property. This means all intangible properties are deemed service. In other words, some of the settled issues like software and IPRs which are today treated as goods and subjected to VAT, would be out of States' domain.

I guess even if some of the States did not realise the implication of a simplistic division of powers at the first meeting where an impression was gathered by the GST Council Secretariat that there was a consensus on the proposal to allow the Centre to retain Services and let the States retain VAT assessees, a close analysis by some of the members of the technical committees raised the alarm among the States on this issue. That is how a quick pass through event got stuck at the second meeting. In fact, Dr Amit Mitra, who apparently accepted the proposal at the first meeting, decided to rake up the issue at the second meeting. In fact, he also recalled the statement of the Union Finance Minister made at Kolkata after the meeting of the Empowered Committee where an impression was made that the States would be exclusively manning all service tax assessees up to Rs 1.5 Crore.

But, more than anything, it is no doubt a constitutional right of the Centre to tax services but the **same right cannot be denied to the States**. Therefore, the issue actually boils down to the level of tax administration where a healthy understanding is required and if need be, a division of power is the only solution. This is also a question of utilising the existing manpower. Some voices of protest from VAT officers federation can already be heard from some quarters. The ground reality is that the States put together had more than 30,000 VAT officers who must be utilised properly. The fact that the small businesses are largely under-administered, and the avowed objective of the GST system is to widen the tax base, a way out lies in arriving at a compromise where both the States and the Centre jointly man the administration without harassing small businesses which promise a significant jump in the tax base. A bumper result could be realised out of an almost-failed Income Declaration Scheme by the CBDT only because the tax officials could put pressure on small time businesses which generate nothing

but only cash. A large scale survey and search finally did the job to save the face of the Prime Minister who also backed this scheme through his **'Maan ki Baat'**. The greatest challenge for the GST regime is going to be **to widen the tax base; manning of full value chain and an efficacious tax administration structure. Both the Centre and the States need to leverage their strengths to provide efficient tax administration and enjoy the promised fruit of the new system**. Such a compromise is much needed if one analyses the statistics of small taxpayers which constitute about 92% of the total service tax base. Similarly, about 70% of VAT assesseees are very small and they need to be groomed and brought into tax net by proper administration rather than the existing extortion-raj. Since the real catalyst is going to be the technology-driven processes, such noble objectives can easily be achieved over a period of time.

Let's envision a situation where the bonhomie between the Centre and the States disappears and the GST Council finally goes for a voting. As per Clause 9 of Article 279A of the Constitutional Act, 2016, the Centre shall have one-third weighted votes and the States shall have two-thirds. A decision can be taken only if it is supported by three-fourths. If we take total weighted votes as WT and WC as weighted vote of the Centre and WS as weighted votes of the States, the simple formula would be **WT = WC + WS**

. Any proposal in the Council would sail through only if WT is either equal or greater than three-fourths. Let's now presume that at the time of meeting only 25 States were present along with the Centre and, in voting, the Centre and 20 States vote in favour of a proposal, it can be calculated as $WT = 1/3 + [20/25 \times 2/3]$. This would mean $WT = 13/15$ which is greater than $3/4$ th. In other words, any proposal which goes for voting in the Council has to be backed by a minimum of 19 States before it sails through. **So, any number less than 19** would result in a stalemate which may hurt the interest of not only the Centre and the States but also GST assesseees. So, it makes it very clear that no amount of political spin is going to help either the State Exchequers or the Central kitty unless both develop and stick to a politics of consensus, a truly federal spirit rather than acting as a union of States. So, the winner is going to be the **Consensus Federalism** rather than divisive politics.

Yet another historic decision which was taken by the GST Council was to completely do away with the concept of exempted items. It may sound like a rude shock for most Indians but it is going to be a reality now. Whether it is **area-based exemption of Central Excise or rebate scheme or refund scheme or VAT subsidy scheme**

, all would vanish in thin air in the new regime. But, it does not mean that there would be no incentive for underdeveloped sectors or backward areas. The decision is to allow each State or the Centre to identify such sectors or tax payers and refund the tax collected from them after making adequate **budgetary allocations**

. The key benefit of such a system would be a seamless credit chain. Since exemption breaks such a chain, there would not be a situation now to cause such distortions. However, a new methodology would be worked out to refund the tax collected from the exempted sectors either through direct transfer of cash or some other method. It has to be watched how the mechanics are going to be worked out.

So far, it has been a good going for the GST Council. The actual challenge is going to be the necessity to develop a consensus for a lower GST rate which becomes a possible goal to be realised. With exemption lists guillotined, the tax base would certainly explode to a new number and there would be huge buoyancy in the revenue kitty. To avoid inimical protests or feeling towards the new system and also to contain the dragon of inflation, it would be more desirable to make a beginning **with a lower Standard rate in the range of 16%** rather than 18 % or 20%. Once the new system settles down and the GST Council would have the one-year statistics of revenue collections, it can always revise the rate upward. It would be more desirable if the economy is allowed to expand and grow before it is made to contribute to the revenue kitty. Let's hope fiscal pragmatism rather than irresistible craving for immediate gains prevails over our politicians!