THE CONSTITUTION (ONE HUNDRED AND TWENTY SECOND AMENDMENT) BILL, 2014

COMMENTS AND SUGGESTIONS

The industry welcomes the introduction of the Constitution (One Hundred and Twenty Second Amendment) Bill (the Bill) for introduction of the Goods and Services Tax (GST), a game changer indirect tax reform in India. A well-designed GST would simplify and rationalize the current indirect tax regime, eliminate tax cascading and put the Indian economy on high growth trajectory. The current tax system suffers from significant distortions and compliance issues. Further, taxation of complex transactions and situations that are emerging in the current environment has become a challenge. GST provides the right opportunity to address the current distortions and anomalies and replace them with an efficient tax system.

Some of the provisions of the Bill, however, will not be in the best interests of the industry and the economy and need a review. In the paragraphs below, we have outlined the concerns and suggestions of AMCHAM's members on these provisions for consideration by the government.

Clause 2: New Article 246A

The proposed Article 246A intends to grant concurrent powers to the Union and State legislatures to make laws with respect to GST. The power to make laws in respect of supplies in the course of inter-State trade or commerce will be vested only in the Union parliament.

Article 246A does not specify that the power to make laws and levy goods and service tax will be based on recommendations made by the GST Council (except certain petroleum goods that are proposed to be kept out of the GST initially).

It may be noted that the proposed new Article 269A of the Bill, dealing with inter-state trade or commerce, specifically provides that GST on inter-State supplies shall be levied, collected and apportioned between the Union and States based on the recommendations of the GST Council. However, Article 246A does not provide for the recommendations of the GST Council to be taken into consideration while making GST laws and levying GST. Consequently, the recommendations of the GST Council would not, in any manner, affect the constitutional right of the states.

Since the Bill does not propose any constitutional mechanism to make the recommendations of the Council binding on the Union and the States, a State may ignore the recommendations of the GST Council and may frame laws in any manner and levy GST at whatever rate it deems fit.

Suggestion

Article 246A, in line with the proposed Article 269A must be amended to specify that the power to make laws and levy goods and service tax would be within the framework of recommendations of the GST Council.

Clause 10: Amendment of Article 270

The Statement of Objects and Reasons states the taxes, both at the Central and State levels, which will be subsumed under GST regime. It also states that all cesses and surcharges relating to supply of goods and services will be subsumed under the GST.

Article 270 of the current Constitution empowers the Union Parliament to levy a cess for any specific purposes, which shall be levied and collected by the Government of India and distributed in a manner recommended by the Finance Commission. Using these powers, the Government of India imposes many cesses such as Automobile Cess, Textile Cess, Sugar Cess, and Tea Cess.

Similarly, the existing Research & Development Cess (R&D Cess) payable on the import of technical knowhow is a cost to businesses. In the existing service tax regime, the service tax payable on payment of royalties / technical knowhow is reduced to the extent of R&D Cess paid. However, no credit of the R&D Cess is available to the businesses.

The R&D Cess, being a central levy should be subsumed in the Central GST. This will simplify the overall tax regime and compliances. Further, for agriculture purchases, a mandi tax is levied in many of the States.

However, the phrase “cess levied for specific purposes” has not been amended by the Clause 10 of the Constitution (122 Amendment) Bill which proposes to amend Article 270. This means that the powers under Article 270 are likely to continue over and above the GST even though the Statement of Objects and Reasons to the Bill states that cesses at both Central and State level will be subsumed.

The cess levied for specific purposes will remain as a tax outside the GST, with no credit available to the industry for the same. The consequential costs will have to be borne by the concerned industry sectors.

Suggestions

It is suggested that appropriate amendments be made to the Bill so as to repeal Article 270 of the current Constitution. The industry sectors currently paying cess under Article 270 should not be asked to pay any tax other than the GST.

Alternatively, the GST Council should recommend, vide its powers under Article 279A(4)(a) that the special cesses collected will be subsumed in GST on the date of commencement of the GST.

Clause 12: Article 279A - Recommendations of the GST Council should be binding on Centre and States

It has been acknowledged by the States themselves that a harmonized GST design and structure is the prerequisite for GST implementation. In the First Discussion Paper on GST, the Empowered Committee of State Finance Ministers had recognised the need for an appropriate mechanism that will be binding on both the Centre and the States by stating as follows:

“An appropriate mechanism that will be binding on both the Centre and the States would be worked out whereby the harmonious rate structure along with the need for further modification could be upheld, if necessary with a collectively agreed Constitutional Amendment” (para 3.2).

Even the Report of the Task Force on Indirect Taxes headed by Dr. Vijay Kelkar states, in the context of the then proposed VAT:

"It is recommended that for the stability and continuity of VAT, a VAT Council or a permanent suitable alternative vested with adequate powers to take steps against discriminatory taxes and practices and eliminate barriers to free flow of trade and commerce across the country should be explored."

Suggestion

It is suggested that the definition of "goods and services tax" may be amended as follows:

"goods and services tax means any tax on supply of goods or services or both except taxes on the supply of the alcoholic liquor for human consumption levied pursuant to the recommendations of the GST Council."

Clause 14: Amendment of Article 366

Clause 14 of the Bill proposes to insert a new clause 12A in article 366 of the Constitution to define "goods and services tax" as follows:

"goods and services tax" means any tax on supply of goods or services or both except taxes on the supply of the alcoholic liquor for human consumption.

a) The word 'any' may expand the scope of GST

The word 'any' has the potential of expanding the scope of the provision and could mean that any tax other than GST which is levied on supply of goods or services will also fall within the definition of 'goods and services tax'.

Suggestion

It is suggested that the word 'any' should be removed from the definition.

b) Element of value addition is missing from the definition

The above definition does not include the essential feature of GST, i.e., it is a value-added tax that reduces the aggregate quantum of tax payable by a merchant on

selling his goods and services (output tax) to the extent of the aggregate quantum of tax suffered by him while buying goods and services (input tax).

If this distinguishing aspect of GST is not built into its definition, the power to levy GST may be used to levy a traditional sales tax (which could even be multi-point) without allowing set-off of input taxes, with the added power (to the States) to tax services. Such a situation would defeat the stated objective of GST, that is, "to remove cascading of taxes and provide a common national market for goods and services". This scenario is not inconceivable, especially since the proposed scheme leaves it entirely to the discretion of the individual States to choose the manner of levying GST.

Suggestion

It is suggested that the definition of goods and services tax be modified suitably as:

> ***"goods and services tax means a value added tax payable on supply of goods or services or both, other than sale of alcoholic liquor for human consumption, as reduced by the tax payable on the purchases of goods or services or both acquired for use in the business of making the taxable supply of goods and services."***

c) Definition of 'Supply' of Goods in Article 366

Article 366(12A) defines "goods and services tax" as a tax on "supply of goods or services…" GST is a tax on the value received or receivable for every transaction in goods and services. A transaction in goods not involving any consideration should not be taxable. The only circumstance in which a tax on non-sale transaction is contemplated is inter-State stock-transfer of goods, for which the Centre has the power under entry 92B of the Union List (inter-State consignment tax). However, it is foreseeable that, if the need arises, States may want to construe "supply" to include mere movement of goods from one place to another without involving a sale.

The definition of supply of goods will be crucial particularly in situations such as captive consumption, inter-unit transfers and circumstances wherein job work is undertaken by ancillary industries which serve the final goods industries.

Suggestion

It is suggested that a new clause should be introduced under Article 366, defining the term "supply" as "*supply means supply of goods or services or both, for valuable consideration."*

Taking into account the suggestions given by AMCHAM for clauses 12, 12A and 14, the definition of 'goods and services tax' may be modified to read as:

"goods and services tax means a value added tax payable on supply of goods or services or bothfor valuable consideration, other than sale of alcoholic liquor for human consumption, as reduced by the tax payable on the purchases of goods or services or bothacquired for use in the business of making the taxable supply of goods and services."

Clause 18: Additional 1% tax on inter-State supply of goods

The Bill proposes an additional tax of one percent on supply of goods in the course of inter- state trade or commerce which will be levied and collected by the Union of India for a period of 2 years or such other period as the GST Council may recommend. We understand that this tax will apply to inter-state sales as well as branch/stock transfers between two locations of the same entity. It will be assigned to the States from where the supply originates, and will remain non-creditable against the GST.

AMCHAM is strongly of the view that the additional 1% levy is detrimental to the industry and defeats the objectives of GST, i.e., to remove the cascading of taxes, reduce complexities in the tax system and enable the industry to have efficient supply chains that are driven not by the tax system but by genuine business requirements.

The following issues need urgent consideration:

1. Extension of the 1% tax to inter-state branch/stock transfers would impact all sectors of the industry and the impact would compound where goods back and

forth from one State to another prior to their sale. An entity may produce the same goods in various locations for reasons of availability of raw materials and manpower, and for supply chain efficiencies. It may acquire raw materials and other production inputs in one State and then transfer them to its production units in other States. The output from multiple locations may then be agglomerated in common distribution centres (including mother depots) for ease of marketing. The entity may also produce the same goods from a single location or multiple plants in various centres.

If the 1% is extended to branch/stock transfers, it would apply all such inter-state movements of raw materials and finished products prior to the sale of the products to another entity. Its cumulative burden would far exceed the statutory rate of 1%.

Under the agglomeration arrangements, it is not uncommon for the goods to be shipped back from the mother depot to a distribution centre in the State where they were originally produced. It would be anomalous in the extreme to apply the 1% tax twice in such cases. Under the current CST law, the taxing authorities ensure that such transfers do not suffer additional tax, if the assessee proves that the transfer is not in the course of a sale. Given that one-to-one nexus cannot be maintained for agglomerated goods, the VAT authorities limit the application of tax to net shipment of goods to a State on a global reconciliation basis.

2. Even the service industries would be severely impacted by the tax. In telecom sector, for example, the operators maintain depots to store parts and supplies, which are then transferred to the site for installation at the site or for repairs and maintenance of the network. Where the parts and supplies are procured from another State, the 1% tax would apply on their procurement and then again when they are transferred from the storage depot to another State. These situations are true for the other industries too, whether manufacturing or services industries.

   Application of the tax to all such movements would be extremely detrimental to production efficiency and severely distort the supply chain for both production inputs and outputs.

3. The tax could apply to even office equipment, supplies, marketing brochures, and product samples where they are transferred from one location of the entity to another. The transfers could be temporary or for an indefinite duration. Consider, for example, an entity which is conducting a sales promotion event for distributors at a holiday resort in another State. It transfers to that State audio-visual equipment, display materials, product samples, and souvenirs, mementos, and gifts to be given to participants in the event. If such transfers were to be viewed as supplies in the course of inter-state trade or commerce, they could attract the tax. Such an outcome would clearly be undesirable and unintended.

4. The additional cost burden of the tax will be a direct hit for the domestic manufacturers and will be against the spirit of 'Make in India'. It will apply to domestic manufacturers only and not to goods imported directly into the destination state – a serious competitive disadvantage to the domestic manufacturers.

5. Clause 18 provides that the tax will be levied for a period of 2 years or such other period as the GST Council may decide. The States would undoubtedly demand its extension for a longer period. Given the experience of the most recent negotiations, the Centre could succumb to such pressures. The resulting uncertainty of the tax tenure will make the GST more fractured in design than expected.

6. We understand that the objective behind levying the 1% additional tax is to provide compensation to the States for any losses under the GST regime. However, the Constitution (A) Bill already contains a provision for compensating the States for any losses under GST for five years. It would result in no net revenue gain to the States where they indeed suffer a revenue loss under the GST and are recipient of compensation from the Centre. It would effectively mean an extra profit to the States who gain revenues from the GST. If so, it does not serve its intended purpose.
7. Application of tax to branch transfers would necessitate complex transfer pricing (TP) rules for valuation of such supplies. The TP rules for international transactions have proven to be very controversial in India and the Indian tax administration has earned the dubious label of 'Tax Terrorism". Extension of

these rules to domestic supplies would spawn unprecedented complexity and has the potential of making it a nightmare for both tax administration and taxpayers.

8. It was for reasons such as the above that the application of the current CST has been limited to inter-sales sales, even post the 46th Amendment of the Constitution in 1986, empowering the Union to tax inter-state consignment of goods by entry 92 B of List I of the Seventh Schedule.

9. We understand that consideration is being given to extending the IGST to inter-state consignments and other forms of self-supplies (i.e., supplies between two units/divisions of the same entity). Even though the IGST would be creditable against the output GST, we are equally concerned about the complexity of this provision. Application of the 1% tax to consignments thus cannot be viewed as a simple extension of the IGST. In our view, application of IGST to self-supplies could be even more challenging especially in the case of supplies of services. There is no international jurisdiction that applies GST to self-supplies in the manner proposed for India.

Suggestions

In light of the above, AMCHAM requests as follows:

- Clause 18, imposing an additional 1% origin based tax, should be removed.

- If at all the additional 1% has to be levied, the following should be considered:

  - The application of 1% levy should be limited to inter-state sales of goods. Branch/stock transfers or consignments within the same legal entity should remain outside the scope of this tax.

  - The revenue compensation formula should be adjusted so that it does not result in superfluous revenue gain to the States who suffer no revenue loss under the GST, or in double compensation for the revenue loss from the subsuming of the CST. For example, the Centre could levy the additional 1% tax on inter-state sales (excluding branch/stock transfers), which is not

creditable against the GST. The revenues from the tax would be kept in a separate pool (not part of the Consolidated Fund of India). These revenues should be allocated to only those states who suffer a revenue loss under the GST. They should not accrue to the origin states even where they suffer no revenue loss under the GST.

Taxability of Petroleum products

Petroleum products are separately enumerated in clause (b) of the proposed Article 279A, in the proposed entry 84 of the Union List and in the proposed entry 54 of the State List. However, it is not clear if Aviation Gasoline and liquefied natural gas will be liable to GST.

Suggestion

It should be clarified if Aviation Gasoline and liquefied natural gas will be liable to GST.

Exclusion of real estate and petroleum from GST

We understand that the Bill, at present, excludes real estate from GST. The petroleum sector too has been excluded until its inclusion is decided by the GST Council.

Both real estate and petroleum are the key and most fundamental inputs for the businesses. Exclusion of these sectors from the GST levy and continuing with the current taxation regime for these sectors will significantly increase the cost of doing business and will fuel a price rise.Keeping these sectors out would also increase the compliance costs for the businesses due to multiple tax rules. The complicated tax regime will result in administrative difficulties for both industry and governments.

Real estate

If real estate is excluded from the GST purview, it would mean that credit would notbe available for the inputs**used in construction of factories, offices, civil structures and even plant and machinery which may be considered a part of real property,** being attached to land.

Moreover, the real estate sector is a significant contributor to the gross domestic product and a contributor to growth. It serves as a foundation for virtually all industrial and commercial activity. Hence excluding real estate from the scope of GST would result in a major erosion of the tax base, causing distortion and denying the full economic benefits of the GST structure envisaged originally. Internationally, in the modern VAT jurisdictions such as Australia, New Zealand, Canada and South Africa, land and property supplies are inseparable and indistinguishable from supplies of other goods and services and India should also follow suit.

Petroleum

Currently, industries are using diesel for generating power required to operate the plant in the absence of adequate continuous power from the state grid. Furnace Oil and LPG are also used as inputs in manufacture of certain products. In the absence of usage of any alternate source of energy in generating power or in the manufacture, exclusion of Petroleum products in the initial phase of introduction of GST will cause financial hardship to the industry.

Suggestion

The real estate and petroleum sectors should be brought under the GST umbrella.

Use of terminology “Economic activity” instead of “Trade and commerce”

The Bill uses the expression “Trade and Commerce” under various clauses. The Supreme Court has held in the case of State of Punjab V Bajaj Electricals [1968 AIR 739 SC] that

“Trade in its primary meaning is exchange of goods for goods or goods for money; in its secondary meaning it is repeated activity in the nature of business carried on with a profit motive, the activity being manual or mercantile, as distinguished from liberal arts, learned professions or agriculture”.

Thus, the expression “Trade and Commerce” does not encompass professions or vocations which are intended to be covered and taxed under GST. For this reason, the GST legislations of other countries employ the expression “economic activity” in place of “Trade and Commerce”.

Suggestion

It is suggested that the term "Trade and commerce" used in the Bill may be replaced with the term "Economic activity" to avoid any dispute/ ambiguity in future. Further, it would propagate the activities (goods as well as services) proposed to be covered under GST.

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