Legislative Brief

The Constitution 115th Amendment Bill, 2011 (GST)

The Constitution (One Hundred and Fifteenth) Amendment Bill, 2011 was introduced in the Lok Sabha by the Minister for Finance on March 22, 2011. The Bill was referred to the Standing Committee on Finance (Chairman Shri Yashwant Sinha) on March 29, 2011.

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Highlights of the Bill

- The Bill seeks to amend the Constitution to provide for the introduction of a Goods and Services Tax (GST).
- The Bill allows both Parliament and state legislatures to frame laws with respect to GST. Parliament will have the exclusive power to levy GST on imports and inter-state trade.
- The Bill creates a Goods and Services Tax Council consisting of state Finance Ministers, the Union Finance Minister, and Union Minister of State for Revenue to make recommendations with respect to GST.
- The Bill provides for a Dispute Settlement Authority to settle disputes between states or between states and the Union with regard to GST. Appeals from the Authority lie with the Supreme Court.
- The Bill exempts certain commodities from GST, including petroleum products and alcoholic liquor for human consumption.

Key Issues and Analysis

- The GST Council will recommend harmonised tax rates, and disputes regarding these rates will be adjudicated by the Dispute Settlement Authority (with appeal to the Supreme Court). This structure, in which executive and judicial bodies determine tax rates, may impinge on the rights of legislatures.
- The Bill seeks to amend the Constitution to provide that Parliament and state legislatures may both frame laws with regard to GST without providing for Parliamentary supremacy.
- The GST Council shall make all decisions by "consensus". It is unclear whether this may be interpreted as majority or unanimity.
- The exclusion of certain commodities from GST is contrary to the recommendations of the Thirteenth Finance Commission and Department of Revenue.
- The Bill constitutionally requires a "Union Finance Minister" and "Union Minister of State in charge of Revenue". This could undermine the flexibility of the Prime Minister in forming a Council of Ministers.

PART A: HIGHLIGHTS OF THE BILL[1]

Context

Goods and services are taxed by both the centre and the states. These taxes include excise tax, sales tax, customs duty, service tax, and octroi. As per the Constitution, some of these taxes are levied by both the centre and the states, whereas others are levied by only one of the two. For taxes imposed by states, rates may vary across different states. Over the years, there have been attempts to harmonise the existing system of taxation.

The Value Added Tax (VAT) for excise was introduced by the centre in 1986 (first as MODVAT and then as CENVAT), and later by states. All states have now adopted VAT to replace state sales tax. Prior to the introduction of VAT, producers faced a burden of 'multiple taxation' (tax on both inputs used and the output produced). Under VAT, this problem was sought to be addressed as the tax paid on the inputs is deducted from the tax of the output produced.[2]

The discussion paper released by an Empowered Committee of State Finance Ministers notes that though VAT has been a success, certain shortcomings remain. Among these is the exclusion of several central taxes, customs duties, state taxes such as luxury tax, entertainment tax, and service taxes from VAT.[2] These problems are sought to be addressed through the introduction of a Goods and Services Tax (GST). This tax would replace VAT and other indirect taxes presently levied and subsume them under a harmonised system. According to a Working Paper by the Ministry of Finance, GST will result in greater administrative efficiency, simplified and increased compliance and enforcement, reduction in economic distortions due to inter-state differences, and ease of information sharing across states.[3]

Key Features

The Bill amends the Constitution to enable both Parliament and state legislatures to frame laws for the introduction of a GST. It creates a GST Council to make recommendations on the working of the GST to the centre and states. It also creates a Dispute Settlement Authority to resolve disputes between states or between states and the centre.

Levy of Goods and Services Tax

- The Bill defines GST as any tax on the supply of goods or services.[*]
- The Bill deletes several taxes in the Union List and State List, as well as Article 268A, which provides for the levy of tax on services. Under the Bill, these taxes will be subsumed by GST. In addition, the Bill allows both Parliament and state legislatures to frame laws regarding GST. Unlike items in the Concurrent List, laws framed by state legislatures on GST will not be overridden by laws made by Parliament.
- Taxes on imports and inter-state trade shall be collected by the central government. The distribution of these taxes between the centre and the states shall be determined by Parliament.
- The following goods are exempted from the purview of GST: (a) petroleum crude, (b) high speed diesel, (c) petrol, (d) natural gas, (e) aviation turbine fuel, and (f) alcohol for human consumption. States shall have the power to levy taxes on these items, except in the case of imports and inter-state trade. Unlike these goods, tobacco and tobacco products are not exempted from GST. However, the central government may still impose excise duty on them.
- State legislatures will have the power to levy certain taxes to the extent collected by Panchayats or Municipalities. These include octroi, entertainment tax, and amusement tax.
- Stamp duties mentioned in the Union List shall be levied by the centre and collected by the states.

Goods and Services Tax Council

- A GST Council will be established within 60 days of enactment of the Bill. The GST Council shall make recommendations to the centre and states on: (a) taxes which may be subsumed, (b) goods and services which may be exempted, (c) a threshold limit of turnover for application of GST, (d) rates of GST, and (e) other related matters.
- The Bill states that while making its recommendations, the GST Council will be guided by the need for a harmonised structure of GST and a harmonised national market for goods and services.

[*]GST will subsume the following: CENVAT; service tax; central excise duty; additional excise duties; excise duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955; service tax; additional customs duty (countervailing duty or CVD); special additional duty of customs (SAD); central surcharges and cesses; state VAT; state sales tax; entertainment tax not levied by local bodies; luxury tax; taxes on lottery, betting, and gambling; tax on advertisements; state cesses and surcharges related to supply of goods and services; and entry tax not levied by local bodies.

- The GST Council will consist of: (a) the Union Finance Minister, (b) Union Minister of State in charge of Revenue, and (c) Minister in charge of finance or taxation (or any other nominated minister) of each state.
- All decisions of the GST Council at a meeting shall be made with consensus of all the members present.

Goods and Services Tax Dispute Settlement Authority

- The Bill empowers Parliament to establish a GST Dispute Settlement Authority. The Authority will adjudicate disputes referred to it by a state or the central government. The dispute must be related to a deviation from the recommendations of the GST Council that (a) results in a loss of revenue to a state or the centre, or (b) affects the harmonised structure of GST. The Authority will consist of a Chairperson (a former Supreme Court judge or High Court Chief Justice) and two other members.
- Appeals against orders of the Authority shall lie with the Supreme Court.

PART B: KEY ISSUES AND ANALYSIS

Impact of introducing a GST

Reduced cascading of taxes

Prior to the introduction of VAT, producers faced a burden of 'tax on tax'. Producers procured input items upon which taxes would have been paid. After production, the output value (inclusive of input costs) was taxed. As a result, the tax paid on inputs was again taxed at the output stage. This cascading effect continued further down the chain of production, resulting in a high tax burden on retail consumers and less competitive exports. The introduction of VAT mitigated this effect by providing for an input tax "set-off" (credit for tax paid on inputs). Effectively, tax is paid not on the value of the output, but on the value added to the output at that particular stage. Since set-offs are only available once tax is paid, incentives for compliance increase as each person in the chain ensures that the previous person has paid the tax.[2]

However, the existing VAT regime is incomplete. Many taxes are not included within VAT.[†] These taxes continue to have a cascading effect. Certain sectors are also exempt from VAT.[‡] Exempt sectors cannot claim set-offs for VAT paid on inputs, which leads to cascading.[3] In addition, under state VAT, input tax set-offs are not provided for CENVAT and service tax paid on inputs, which also causes cascading. Introducing a GST would eliminate such cascading of taxes by including all taxes, and all goods and services, under a VAT regime with set-offs across state and central jurisdictions.[2]

Simplification and harmonisation

Under the Constitution, states do not have the power to tax services. In many cases it is difficult to classify a product as either a good or service, particularly due to recent advancements in technology. In addition, certain goods and services are bundled as a single product. Distinguishing between goods and services complicates the taxation of these products.[3] Under GST, this distinction will no longer be required.

The existence of exemptions and multiple tax rates (different rates exist across products and across states) has given rise to a complex system. This results in economic distortions from inter-state differences, difficulty of information sharing between governments, lower compliance, proliferation of disputes, and higher administrative costs.[3] A system for the harmonisation of tax rates for all goods and services would reduce such distortions.

Redistribution of tax revenue across states

Currently, some taxes are levied by states, some by the centre, and some by both. Introduction of a GST will change these mechanisms and may lead to redistribution of tax revenue across states as well as between the centre and the states.

Federalism and the basic structure of the Constitution

Clause 2

Federalism has been held to be one of the basic features of the Constitution.[4] The Constitution provides three lists in the Seventh Schedule: the "Union List" (exclusive domain of Parliament), the "State List" (domain of state legislatures) and the "Concurrent List" (both). On Concurrent List subjects, when there is an inconsistency between laws made by

† Several central taxes are not covered under CENVAT, including additional excise duty, additional customs duty, and central surcharges and cesses. In addition, CENVAT applies only at the production stage, and does not extend to the retail sale of goods. State VAT does not include the following: entertainment tax; luxury tax; taxes on lottery, betting, and gambling; tax on advertisements; state cesses and surcharges; and entry tax.[2] With some exceptions (amusement tax, entertainment tax and entry tax levied by panchayats and municipalities), these taxes will be subsumed under GST.

‡ Exemptions under CENVAT and service tax include: oil and gas production and 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.

Parliament and laws made by state legislatures, laws made by Parliament shall prevail. This structure gives supremacy to the legislative power of Parliament in all cases except the State List.

This Bill gives both the centre and states equal power to make laws related to GST (without Parliament's law overriding the state law). The question is whether this change in the nature of legislative powers exercised by the centre and states affects the basic structure of the Constitution. On this issue, the Task Force on GST opined that a "dual levy imposed concurrently by the centre and the states, but independently" (the form of GST provided by the Bill) will promote cooperative federalism.[5]

Potential conflict between legislative, judicial, and executive bodies

Clause 12

Under the Constitution, the power to impose taxes is vested with Parliament and state legislatures.[6] The GST Council, however, will look at taxes imposed from the point of view of their harmonisation under the GST regime. The Bill creates a structure through which an executive body (the GST Council) recommends tax rates, and judicial bodies (the GST Dispute Settlement Authority and the Supreme Court) decide the tax rates if any dispute is caused by a state deviating from the GST Council's recommendations. This may impinge on the right of legislatures to determine tax rates. The Supreme Court has ruled that courts cannot advise the executive or adjudicate on the wisdom, correctness or suitability of a policy. They may only consider its legality.[7]

Decisions of the GST Council by "consensus"

Clause 12

All decisions of the GST Council shall be made by "consensus" of all members present. However, the Bill does not define consensus. P. Ramanatha Aiyar's Concise Law Dictionary defines consensus as "agreement of opinion on the part of all concerned." However, Black's Law Dictionary defines consensus as "a general agreement." The Oxford English Dictionary definition includes "the majority view". In the case that consensus is not equivalent to unanimity, a state may be forced to comply with a recommendation of the GST Council even if it is not in agreement with it.

Exclusion of certain goods from GST

Clause 14

The Bill explicitly excludes the following goods from the purview of the GST: (a) petroleum crude, (b) high speed diesel, (c) petrol, (d) natural gas, (e) aviation turbine fuel, and (f) alcohol for human consumption. Both the Thirteenth Finance Commission and Department of Revenue have recommended that petroleum products be included within the purview of the GST. Petroleum products are inputs for many products and services, and exempting them will lead to tax cascading.[8]

The Thirteenth Finance Commission has recommended bringing a dual levy system for petroleum products, tobacco, and alcoholic liquor. This would entail subjecting such products to the GST while allowing states and the centre to levy an additional excise.[9] Under the Bill, only tobacco products are subject to such a treatment (the centre may levy excise).

Definition of Ministers

Clause 12

The Constitution does not mention any specific ministers other than the Prime Minister and Council of Ministers. The Bill explicitly names the "Union Finance Minister" and "Union Minister of State in charge of Revenue" as members of the GST Council. As a result, these offices would be constitutionally required. This could undermine the flexibility of the Prime Minister to form a Council of Ministers that best suits the needs of the government and the country at that time.

Notes

1. This Brief has been written on the basis of the Constitution (One Hundred and Fifteenth Amendment) Bill, 2011, which was introduced in the Lok Sabha on March 22, 2011 by the Finance Minister Shri Pranab Mukherjee.
2. First Discussion Paper on Goods and Services Tax in India, Empowered Committee of State Finance Ministers, November 2009.
3. Poddar, Satya and Ehtisham Ahmad. GST Reforms and Intergovernmental Considerations in India. Working Paper No.1/2009-DEA. Department of Economic Affairs, Ministry of Finance. March 2009.
4. SR Bommai v. Union of India (1994); Kuldip Nayar v. Union of India (2006).
5. Report of the Task Force on Goods and Services, Thirteenth Finance Commission. December 2009.
6. Articles 109, 114, 198, 204 of the Constitution.
7. Directorate of Film Festivals & Ors v. Gaurav Ashwin Jain & Ors (2007). AIR 2007 SC 1640.
8. Comments on First Discussion Paper on Goods and Services Tax (2009). Department of Revenue, Ministry of Finance.
9. Chapter 5, "Goods and Services Tax", Volume I: Report. Thirteenth Finance Commission. December 2009.