



# FOR A MESS OF POTAGE: THE GST'S PROMISE OF INCREASED REVENUE TO STATES COMES AT THE COST OF THE FEDERAL STRUCTURE OF THE CONSTITUTION

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**Abstract** The Constitution (101st Amendment) Act, 2016 which provides a framework for the levy of Goods and Services Tax in India has re-cast India's federal structure in a manner that is fundamentally damaging to the basic structure of the Constitution of India. It has made the States' fiscal policies subject to the control and veto of the Union Government in the GST Council. It has also not given aggrieved States any effective remedy against the decisions of the GST Council, as the dispute settlement mechanism will be constituted by the very GST Council against which a State has a grievance. When challenged in court, the 101st Amendment Act might not withstand scrutiny on grounds of violating the basic structure of the Constitution of India.

## I. INTRODUCTION

The Constitution (101<sup>st</sup> Amendment) Act, 2016, (“the 101<sup>st</sup> Amendment Act”) is a radical re-structuring of the constitutional basis for taxation by the Union and State Governments in India. Enacted to create a constitutional framework to introduce the Goods and Services Tax (GST), the 101<sup>st</sup> Amendment Act grants new powers to the Union Parliament and State Legislative Assemblies, and also creates institutions that have a significant bearing on the federal character of the Constitution.

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The Constitution, as it was when initially brought into force, had a particular vision in respect of taxation of goods and services supplied within India; while customs duty and excise on manufacture were within the scope of the legislative powers of the Union Parliament,<sup>2</sup> taxation of sale and movement of goods was within the exclusive purview of the States.<sup>3</sup> The demarcation of Union and State taxing powers in List I and List II of the Seventh Schedule was precise and clear, leaving little room for any overlap in the kind of taxes that the Union could impose and those that a State could impose. List III or the “Concurrent List” contains no taxing entries, suggesting that the constitutional scheme of taxation was to allot two separate, exclusive spheres of taxation for the Union and the States.<sup>4</sup> That States should have independent taxing powers is a necessary feature of a federal polity, and mere plenary legislative power, in the absence of the power to impose taxes and raise revenue, would be meaningless.<sup>5</sup>

With the coming into force of the GST regime, both the Union and the States will ostensibly have the power to tax the supply of goods and services. The 101<sup>st</sup> Amendment Act takes away neither the Union’s nor the States’ taxing power but instead gives them the power to impose taxes on supply of goods and supply of services respectively.

This is a fundamental change from the earlier, exclusive spheres of taxation reserved for the Union and the States under the constitutional scheme. This change has implications for the federal character of India’s polity that must be examined in some depth. More so in light of the fact that the federal character of the Constitution of India has been held to be a basic feature of the Constitution of India by the Supreme Court in *S.R. Bommai v. Union of India*,<sup>6</sup> and therefore cannot be abrogated by a constitutional amendment.

I argue in this paper that the 101<sup>st</sup> Amendment Act fundamentally upsets the federal structure of the Constitution, and therefore is an abrogation of the basic structure of the Constitution. I say this for two reasons: one, the GST Council

<sup>2</sup> INDIA CONST. Entries 83 and 84, List I, Seventh Schedule. No separate entry for Service Tax existed in the Constitution at the time it was enacted. Though the Supreme Court in *T.N. Kalyana Mandapam Assn. v. Union of India*, (2004) 5 SCC 632 held that such service tax as a subject matter was within the “residuary power” of the Union, Entry 92C was introduced into List I by the Constitution (88<sup>th</sup> Amendment) Act, 2004 to clarify that the Union had the exclusive power to impose a service tax.

<sup>3</sup> INDIA CONST. Entries 54 and 52, List II, Seventh Schedule.

<sup>4</sup> This is not to say that the Union and the State can never tax the same subject matter or transaction. The Supreme Court’s judgments following *Federation of Hotel & Restaurant Assn. of India v. Union of India*, (1989) 3 SCC 634 allow the State and the Centre to tax the same subject matter but different “aspects” of it. Whether or not the aspect theory has any place in Indian constitutional law, given the clear division of powers between Union and the States is also a matter to be examined, but outside the scope of this paper.

<sup>5</sup> Nirvikar Singh, *Fiscal Federalism*, in THE OXFORD HANDBOOK OF THE INDIAN CONSTITUTION 521, 521 (Sujit Choudhary, Madhav Khosla & Pratap Bhanu Mehta eds.).

<sup>6</sup> See *S.R. Bommai v. Union of India*, (1994) 3 SCC 1.

makes States subordinate to the Union in matters of taxation when they have never been in such a position under the Constitution and; two, a State aggrieved by the decisions of the GST Council has no effective legal remedy. I argue therefore, that the structure of the GST Council is a violation of the basic structure of the Constitution, and could therefore be struck down by the Supreme Court when challenged.

In order to expand upon the above argument, this paper is divided into three parts.

The first part will examine the concept of federalism as enshrined in the Constitution of India and the aspects of it which constitute a “basic feature” of the Constitution. In doing so, this part will refer to the history of federalism in India, theories of what federalism is, and the jurisprudence of the Supreme Court (which heavily examines the Constituent Assembly debates to arrive at its conclusions) to distil certain core elements of federalism as a basic feature of the Constitution.

The second part will be an analysis of the 101<sup>st</sup> Amendment Act and its features, pointing out how it violates the principles of federalism discussed in the previous part. In doing so, this part will compare the 101<sup>st</sup> Amendment Act with its previous iterations to point out what has changed and why these changes affect the constitutional validity of the 101<sup>st</sup> Amendment Act. Further, this section will also briefly mention how countries with a federal Constitution, which have implemented a GST, namely Australia and Canada, did so within their federal framework.

The final part will be a summary of the arguments presented, and the possible consequences of the 101<sup>st</sup> Amendment Act as it stands.

The focus of this paper is purely doctrinal, focussing specifically on the institutional design of the Goods and Service Tax Council (GST Council) and the dispute resolution mechanism contained within it; whether it meets the “basic structure” test laid down by the Supreme Court and what possible difficulties in implementation are likely to arise in light of its structure. This paper is not concerned with the fiscal wisdom of a GST in India or whether a GST *per se* violates the Constitution. There are numerous practical difficulties in the implementation of the GST which other authors have highlighted,<sup>7</sup> but these are beyond the scope of this paper. This paper is also not intended to be a comparative study of the GST as implemented in other countries.

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<sup>7</sup> See M.G Rao, *Goods and Services Tax: A Gorilla, Chimpanzee or a Genus like 'Primates'?* Vol. XLVI No. 7 ECONOMIC AND POLITICAL WEEKLY 43 (2011). See also Satish S and Kartik Dedhia, *The Challenges of Implementing GST*, FORBES INDIA (Feb. 26, 2016)<http://forbesindia.com/article/budget-2016/the-challenges-of-implementing-gst/42491/1>.

## II. FEDERALISM AS A BASIC FEATURE OF THE CONSTITUTION OF INDIA

### A. Historical antecedents

The roots of the Indian Constitution's federal character lie in the Government of India Act, 1919 and the subsequent Government of India Act, 1935.<sup>8</sup> The Government of India Act, 1935 first introduced the concept of separate legislative powers for the "Centre" and the "Provinces", with a Federal Court empowered to adjudicate any disputes arising out of situations in which the Centre or the Provinces exceed their powers.<sup>9</sup> The Constitution of India, far from discarding this structure, builds upon it, re-distributing powers to some extent, arguably giving greater autonomy to the sub-national units and finding more equitable ways of distributing revenue between the national and sub-national units.

As far as taxation is concerned, the actual list of subjects of taxation reserved for States is remarkably similar to the Government of India Act, 1935. The 13 taxing entries in List II of the Seventh Schedule of the Government of India Act, 1935 are reproduced without much change in List II of the Seventh Schedule of the Constitution of India. The only additional subjects under which States could levy taxes under the Constitution are: taxes on mineral rights, taxes on consumption and sale of electricity, and taxes on vehicles.

### B. Is the Indian Constitution federal in character?

The Constitution of India describes India as a Union of States.<sup>10</sup> Even though the Constitution allows for the creation of new States, renaming existing States, and alteration of boundaries of States by Parliament through a regular law, the States themselves are indestructible.<sup>11</sup> The Union Parliament can, through a constitutional amendment, also remove a State from the list of States and merge it with another, such as for instance States such as the Punjab and Erstwhile Patiala States Union (PEPSU) which has now been merged into Punjab.<sup>12</sup> New States have been carved out several times over the years on a linguistic basis (such as Karnataka) or for better representation of tribal peoples (such as Jharkhand). The Centre appoints Governors to States and has the power to dismiss State Governments under Article 356 on the recommendations of the Governor — a much used and abused power. When Emergency is declared in India, Article 250 permits Parliament to even legislate on subjects earmarked for the States. Under Article 254, where there is any conflict between a Union law and State law made

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<sup>8</sup> See generally Rohit De, *Constitutional Antecedents*, in THE OXFORD HANDBOOK OF THE INDIAN CONSTITUTION 26-9 (Sujit Choudhary, Madhav Khosla, & Pratap Bhanu Mehta eds.).

<sup>9</sup> Section 204, Government of India Act, 1935.

<sup>10</sup> INDIA. CONST. art. 1 cl. 1.

<sup>11</sup> INDIA. CONST. art. 3.

<sup>12</sup> States Reorganisation Act, 1956.

on the same subject matter in the Concurrent List, the Union law will prevail. All of these cast doubt on the claim that the Indian Constitution enshrines the principles of federalism.

Does this necessarily mean that we cannot describe India as a “federal” country? Given the greater tilt towards the Union, there has been a serious debate in the years after the Constitution came into force as to whether India is a federal polity at all.<sup>13</sup> Decades of actually working the Constitution, not to mention the judgments of the Supreme Court, have meant that the present common consensus is that India is a federal country, but one where the Union has a greater share of the powers than the States.<sup>14</sup> A federal state is not an abstract ideal nor just the opposite of a unitary state – it is any polity where there is a division of legislative and executive powers (or political sovereignty) between the national and sub-national units.<sup>15</sup>

A federal division of powers can lie on a spectrum ranging from purely unitary states, such as England to federal States, such as the United States where the bulk of legislative powers vests with the States. Merely because certain powers can be exercised in exceptional situations, does not mean that a polity ceases being “federal” conceptually.<sup>16</sup>

The common consensus that India’s Constitution is federal in character cannot be dismissed. Some features of India’s federalism are undeniable:

- a. The States have plenary legislative power derived from the Constitution and not from a law made by the Union Parliament.<sup>17</sup>
- b. The States have their own fields of legislation and a common one with the Union.<sup>18</sup>
- c. The States have the constitutional power to levy tax and raise revenue for their functioning.<sup>19</sup>
- d. The Constitution guarantees the States freedom to spend their revenue as they see fit.<sup>20</sup>
- e. The States’ executive powers are plenary.<sup>21</sup>

<sup>13</sup> For a summary of this debate, see M.P. Singh, *The Federal Scheme*, in THE OXFORD HANDBOOK OF THE INDIAN CONSTITUTION 464-6 (Sujit Choudhary, Manav Khosla, & Pratap Bhanu Mehta eds.).

<sup>14</sup> *Id.*

<sup>15</sup> Singh, *supra* note 13, at 464-6.

<sup>16</sup> Singh, *supra* note 13, at 464-6.

<sup>17</sup> See *Maharaj Umeg Singh v. State of Bombay*, AIR 1955 SC 540 : (1955) 2 SCR 164.

<sup>18</sup> INDIA. CONST. art. 246. cl. 2 & 3. INDIA. CONST. List II & III, Seventh Schedule.

<sup>19</sup> INDIA. CONST. Entries 45-63, List II of Seventh Schedule delineate the subject matters on which the State has the power to levy taxes on.

<sup>20</sup> INDIA. CONST. art. 202.

<sup>21</sup> See *N.K. Chauhan v. State of Gujarat*, (1977) 1 SCC 308.

### C. The concept of the basic structure doctrine and federalism as part of the basic structure

The federal character of the Constitution being a basic feature of the Constitution of India was hinted at by the Supreme Court in *Kesavananda Bharati v. State of Kerala*,<sup>22</sup> where the Supreme Court first articulated what came to be known as the “basic structure doctrine”. While holding that constitutional amendments could be struck down by the Supreme Court for violating the basic features of the Constitution, the majority in *Kesavananda Bharati* also enumerated the features of the Constitution that they considered “basic” without exactly going into depth as to what they meant by each of these features. Of the majority in this case, CJI Sikri,<sup>23</sup> Shelat Grover,<sup>24</sup> and Jaganmohan Reddy JJ.,<sup>25</sup> explicitly identify the “federal character” of the Constitution as one of the basic features of the Constitution. The others in the majority, H.R. Khanna, K.S. Hegde and AK Mukherjea JJ.,<sup>26</sup> do not mention it explicitly but concede that the basic features enumerated by them are not exhaustive and can be expanded upon. The controversial “View by the majority” which nine of the thirteen judges signed on to as the definitive summary of the main findings of the case also does not list out the features which are considered to be part of the “basic feature or framework” of the Constitution.<sup>27</sup>

While the basic structure doctrine was accepted as law by the Supreme Court in its subsequent judgment in *Indira Nehru Gandhi v. Raj Narain*,<sup>28</sup> there was some scepticism about its scope. On the question as to whether the “basic structure doctrine” could be applied in a context outside the amendment of the Constitution, in *State of Karnataka v. Union of India*,<sup>29</sup> a seven judge bench of the Supreme Court of India while dealing with a dispute between the Congress-led Government in Karnataka and Janata Party led Union Government, doubted whether the basic structure doctrine could be used to strike down regular Government decisions or to interpret the Constitution in a particular manner.<sup>30</sup> Holding that a Commission of Inquiry headed by former Supreme Court Judge appointed by the Union Government to inquire into allegations against the Chief

<sup>22</sup> See *Kesavananda Bharati v. State of Kerala*, (1973) 4 SCC 225.

<sup>23</sup> See *Kesavananda*, (1973) 4 SCC 225, 366 (Sikri, J.).

<sup>24</sup> See *Kesavananda*, (1973) 4 SCC 225 (Shelat & Grover, JJ.).

<sup>25</sup> See *Kesavananda*, (1973) 4 SCC 225 (Reddy, J.).

<sup>26</sup> See *Kesavananda*, (1973) 4 SCC 225 (Hegde & Mukherjea, JJ.).

<sup>27</sup> Full text of the “View of the majority” is extracted in T.R. Andhyarujina, *THE KESAVANANDA BHARATI CASE: THE UNTOLD STORY OF STRUGGLE FOR SUPREMACY BY SUPREME COURT AND PARLIAMENT* 51 (Universal Law Publishing, 2011). Scholars have debated the legal validity of this “view of the majority” and until, Andhyarujina’s book was published, no authoritative copy of it even existed in the public domain as the leading law reports which published the *Kesavananda Bharati* judgment had either not reproduced it at all or had done so incorrectly. See *Id.*, at 51-8.

<sup>28</sup> See *Indira Nehru Gandhi v. Raj Narain*, (1975) Supp SCC 1.

<sup>29</sup> See *State of Karnataka v. Union of India*, (1977) 4 SCC 608.

<sup>30</sup> See *State of Karnataka*, (1977) 4 SCC 608, 673 (Beg, CJI).

Minister of Karnataka, the Supreme Court rejected a challenge based on the ground that this was contrary to the basic structure of the Constitution.

Likewise, when the power of the President was used to invoke Article 356 on the ground that the Congress ruled State Governments had “lost legitimacy” in light of electoral reverses, in 1977, the Supreme Court refused to review the imposition of such President’s Rule through its judgment in *State of Rajasthan v. Union of India*.<sup>31</sup> Although an argument was raised that the policy to dismiss State Governments was contrary to the basic structure of the Constitution, the Supreme Court did not think so, and held that it was perfectly acceptable within the framework of the Constitution.<sup>32</sup> In fact, CJI Beg’s judgment seems sceptical about the whole notion of India’s constitution being federal, pointing out the high level of “control” that the Union tends to exercise over the States.<sup>33</sup>

#### D. Bommai and federalism as basic structure

The Supreme Court in *Bommai* dispelled scepticism on both fronts – it asserted that the federal character of the Constitution was a basic feature of the Constitution and that it could be used in contexts beyond testing the constitutional validity of amendments. The case came to court following the dismissal of six State Governments by the Union Government in the late 80s and early 90s.<sup>34</sup> These dismissals were challenged by the respective States in court and the cases eventually worked their way up to the Supreme Court and were ultimately decided in 1994. A nine-judge Bench of the Supreme Court held that the *State of Rajasthan* case had been decided wrongly, holding that the decision of the President to impose “President’s Rule” on a State could be judicially reviewed and listed out the narrow grounds on which President’s Rule could be imposed. It therefore held the imposition of President’s Rule invalid in the context of three States, but it also upheld the dismissal of three State Governments on the ground that their actions in helping *kar sevaks* was an abrogation of secularism; also a basic feature of the Constitution.<sup>35</sup>

Six opinions were delivered between the nine judges<sup>36</sup> who heard the *Bommai* case of which at least three went into some depth in examining the federal

<sup>31</sup> See *State of Rajasthan v. Union of India*, (1977) 3 SCC 592.

<sup>32</sup> See *State of Rajasthan*, (1977) 3 SCC 592, 620-624 (Beg, CJI).

<sup>33</sup> See *State of Rajasthan* (1977) 3 SCC 592, 623 (Beg, CJI).

<sup>34</sup> These states were Karnataka, Meghalaya, Nagaland, Madhya Pradesh, Rajasthan and Himachal Pradesh. The first three had been dismissed owing to defections and alleged loss of support of Chief Minister whereas the latter three had been dismissed in light of the respective State Government’s support for *kar sevaks* in the events leading up to the Babri Masjid demolition and communal violence that followed.

<sup>35</sup> See *S.R. Bommai*, (1994) 3 SCC 1, 296.

<sup>36</sup> The *Bommai* case was decided by a majority of 6:3 on the main issue of justiciability of the imposition of President’s Rule in a State. Ahmadi, J.S. Verma, and Yogeshwar Dayal, JJ. disagreed with the majority on the point with Ahmadi, J. giving detailed reasons for disagreeing

character of the Indian Constitution. Ahmadi, J. (who was in the minority on the issue of the scope of Article 356) describes the Constitution as “quasi-federal”,<sup>37</sup> while Sawant and Kuldip Singh, JJ. (part of the majority) did not use a specific label in describing India’s federalism, even though they held that “democracy” and “federalism” are part of the basic structure of the Constitution.<sup>38</sup> Ramaswamy, J. while agreeing that federalism is a basic feature of the Constitution, used the terms “federal” and “quasi-federal” to describe the relations of States inter se and the relations of State and Union respectively.<sup>39</sup> Jeevan Reddy and Agrawal, JJ. noted that the federal character of the Constitution is not just a “convenience” but in fact a principle born out of a “historical process” and an understanding of the “ground realities”.<sup>40</sup> They recognize that the federal character of the Constitution does indeed have a bias towards the Union without necessarily rendering the States mere “appendages” to the Union.<sup>41</sup>

As to what federalism actually means in the context of the Constitution of India, the judges in the majority take different approaches to expand upon it. Sawant and Kuldip Singh, JJ. list out eleven features of the Indian constitution given by constitutional scholar H.M. Seervai to argue that India was a genuine federal constitution.<sup>42</sup> Of relevance here is this attribute of federalism which is cited with approval:

“The view that unimportant matters were assigned to the States cannot be sustained in face of the very important subjects assigned to the States in List II, and the same applies to taxing powers of the States, which are made mutually exclusive of the taxing powers of the Union so that ordinarily the States have independent source of revenue of their own. The legislative entries relating to taxes in List II show that the sources of revenue available to the States are substantial and would increasingly become more substantial. In addition to the exclusive taxing powers of the States, the States become entitled either to appropriate taxes collected by the Union or to a share in the taxes collected by the Union”.<sup>43</sup>

For Ramaswamy, J. also, the “essence of federalism” is the division of legislative and executive powers of a State between the Union and the States. He is of the view that each is sovereign within its own sphere to the extent of the power

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with the majority on the question of use of Article 356 violating the basic structure of the Constitution.

<sup>37</sup> See S.R. Bommai, (1994) 3 SCC 1, 75. (Ahmedi, J.).

<sup>38</sup> See S.R. Bommai, (1994) 3 SCC 1, 112 (Sawant and Kuldip Singh, JJ.).

<sup>39</sup> See S.R. Bommai, (1994) 3 SCC 1, 156 (Ramaswamy, J.).

<sup>40</sup> See S.R. Bommai, (1994) 3 SCC 1, 215 (Jeevan Reddy and Agrawal, JJ.).

<sup>41</sup> See S.R. Bommai, (1994) 3 SCC 1, 216 (Jeevan Reddy and Agrawal JJ.).

<sup>42</sup> See S.R. Bommai, (1994) 3 SCC 1, 112 (Sawant and Kuldip, JJ.).

<sup>43</sup> H.M. Seervai, CONSTITUTIONAL LAW OF INDIA, 301 (N.K Tripathi ed., 4<sup>th</sup> ed. 1994).

that has been given to it under the Constitution.<sup>44</sup> As far as the constitutional status of the Union and the States go, he sees them as co-equal in their respective spheres, but to the extent that certain powers have been given to the Union vis-à-vis the State, “Indian federalism”, in his view is unlike the federalism in Australia, Canada or the United States of America.<sup>45</sup>

Reddy and Agrawal, JJ. also state that “within the powers allotted to them, States are supreme”. They acknowledged that the Union cannot be allowed to whittle down the power of the States through the process of interpretation of the Constitution. At the same time, they noted that the Constitution has made the Union more powerful than the States when it comes to certain matters, including the matter of taxation, though this is accompanied by an obligation to turn over a part of the tax proceeds to the States under the mechanism provided under the Constitution.<sup>46</sup>

All the judges in the majority acknowledged that the Indian constitution is a federal one, and that the federal structure of the Constitution is a basic feature of the Constitution. All of them agreed that within the constitutional spheres allotted to them, States are sovereign and constrained only by the express limitations imposed on them by the Constitution. Sawant and Kuldip Singh, JJ. go on to identify fiscal independence (as pointed out by Seervai) as one of the features of federal character of the Indian Constitution, while Reddy and Agrawal, JJ. noted that the Constitution couples the Union’s greater tax powers with an obligation to turn over some to the States. What cannot be denied from examining the majority judgments in *Bommai* is the conclusion that the core of the federal character of the Indian Constitution is found in the fact that the legislative and executive powers of the States are vested in them by the Constitution, limited only by the Constitution itself and not the Union Government.

It is arguable that though the Supreme Court has recognized the federal character of the Constitution as a “basic feature”, the ultimate basis of the decision was the principle that judicial review can never be entirely excluded from the decisions of constitutional functionaries.<sup>47</sup> Nevertheless, the extremely narrow grounds on which President’s Rule under Article 356 has been held permissible is a reiteration of the federal character of the Constitution. These grounds are a recognition that federalism, where the Union cannot interfere in the functioning of a State Government, is a basic feature of the Constitution and may only be abrogated for narrow, exceptional reasons, as articulated in the Constitution itself and not at the pure discretion of the Governor or the President, acting on the advice of the Union Government.

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<sup>44</sup> See S.R. Bommai, (1994) 3 SCC 1, 158 (Ramaswamy, J.).

<sup>45</sup> See S.R. Bommai, (1994) 3 SCC 1, 158 (Ramaswamy, J.).

<sup>46</sup> See S.R. Bommai, (1994) 3 SCC 1, 215 (Reddy & Agrawal, JJ.).

<sup>47</sup> Singh, *supra* note 13, at 463.

While the basis of what constitutes federalism was articulated in the context of the use of Emergency powers under Article 356, the analytical framework it provides to understand the core of what constitutes “federalism” still holds. The consensus among constitutional law scholars is that India’s federalism on the spectrum is perhaps closer to the unitary state than to a federal polity like the United States, where far greater powers vest in the sub-national units.<sup>48</sup> Nonetheless, the judicial position remains that the federal structure of the Constitution, in so far as it divides political sovereignty between the States and the Union, guaranteeing the independence of action of both within the spheres allotted to them, is a basic feature that cannot be done away with by amendment.

In the specific context of taxation, the Supreme Court’s judgment in *State of W.B. v. Kesoram Industries Ltd.*<sup>49</sup> is also relevant. Here, the Supreme Court re-iterated the powers of the State Governments in imposing taxes on mineral rights, even though the power to regulate and control such minerals was vested with the Union. The court read the relevant entries of List I and List II of the Seventh Schedule harmoniously, holding that the Union’s power to regulate and control could not be said to have deprived the State of its power of taxation on that subject. It premised this harmonious interpretation on the federal structure of the Constitution, acknowledging that there definitely was a bias in favour of the Union in the federal structure. The Court nonetheless states that interpretation of the Constitution should avoid “whittling down” the powers of the State.<sup>50</sup>

The Supreme Court in *Kesoram* does not explicitly discuss whether federalism is a basic feature of the Constitution (since no constitutional amendment was involved), but nonetheless operates on the assumption that judicial interpretation of the Constitution must work towards reinforcing rather than weakening the federal structure of the Constitution.<sup>51</sup>

A cumulative reading of these cases suggests the following propositions:

- a. Though there is a strong bias towards the Union, there is no doubt that the Constitution of India envisages a federal polity.
- b. The federal structure of the Constitution is a basic feature of the Constitution that cannot be abrogated by amendment.
- c. The division of powers between the Union and States is an essential feature of this federal character.
- d. The political sovereignty of States is inviolate under the Constitution, save for exceptional circumstances where constitutional rule is itself not possible.

<sup>48</sup> A comparison that Ahmadi J makes to say that the Indian Constitution is not “federal” in the same sense as the American Constitution. See S.R. Bommai, (1994) 3 SCC 1, 72.

<sup>49</sup> See *State of W.B. v. Kesoram Industries Ltd.*, (2004) 10 SCC 201.

<sup>50</sup> *Kesoram Industries*, (2004) 10 SCC 201, 289.

<sup>51</sup> *Kesoram Industries*, (2004) 10 SCC 201, 289.

- e. States' power to levy taxes and cesses by laws is plenary and part of the federal character of the Constitution.

What the 101st Amendment Act does, however, in the way in which the GST Council is structured, is to abrogate States' political sovereignty when it comes to the levy of taxes. As I argue in the next part, it renders States subservient to the Union in the matter of taxation, giving the Union the power to dictate taxation laws and the policies of a State.

### III. CONSTITUTIONAL INFIRMITY OF THE 101<sup>ST</sup> AMENDMENT ACT

#### A. Legal problems with GST Council

The 101st Amendment Act which creates the constitutional framework for the GST also creates a GST Council to resolve issues of implementation. This Council comprises of the Union Finance Minister as Chairperson, the Union Minister for State for Finance or Revenue, and all Finance Ministers from the respective State Governments.<sup>52</sup> It has the power to issue "recommendations" on a range of matters outlined in Article 279A(4) of the Constitution. Decisions of the GST Council are taken by super-majority of three fourths of the weighted votes of members present and voting,<sup>53</sup> but each State and the Union don't necessarily have the same voting power. The Union alone has one-third of the votes, while all the States together have two-thirds of the total votes.<sup>54</sup>

Before getting into the two main problems with the structure of the GST Council, it is necessary to address one issue – whether the "recommendations" of the GST Council are in fact binding upon the Union and States.

There is scope for confusion over whether the "recommendations" of the Council are binding, since legally, a "recommendation" (in contrast with the word "prescription") would mean that it is non-binding on the parties concerned.<sup>55</sup> Explanation to Article 246A, Article 269A(1), clauses (4), (5) and (11) of Article 279A(4), and Section 18 of the 101<sup>st</sup> Amendment Act use the term "recommendations" or some variation of the same in the context of the GST Council. This would suggest that the Union and the States are still free to disregard the recommendation of the GST Council if they so choose.

However, a closer examination suggests that this is not so. It is a well-accepted canon of construction that words must interpreted in the context in which they

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<sup>52</sup> INDIA. CONST. art. 279A. cl. 1.

<sup>53</sup> INDIA. CONST. art. 279A. cl. 9.

<sup>54</sup> INDIA. CONST. art. 279A. cl. 9(a).

<sup>55</sup> See *Naraindas Indurkha v. State of M.P.*, (1974) 4 SCC 788 where the Supreme Court made the distinction between "recommendation" and "prescription" in the context of school syllabus.

occur<sup>56</sup> and in line with the intent of the legislature.<sup>57</sup> The use of “recommendation” may be an instance of poor drafting as the intent in introducing the GST Council is quite clearly to make the recommendations binding. Two reasons can be forwarded for this: *one*, if the GST Council can’t make binding recommendations, the entire structure of the GST will collapse, as each State will have a different and possibly conflicting tax levy and collection mechanism. The GST, as envisioned, is supposed to be uniform, with second order benefits to flow out from such uniformity. The Union Finance Minister, Mr. Arun Jaitley, in his speech introducing the 101<sup>st</sup> Amendment Bill in the Rajya Sabha said,

The merits of the system itself are that it would convert India into one uniform economic market with a uniform tax rate, bring about a seamless transfer of goods and services across the country, enable us to check evasion and, therefore, enlarge the revenue, as far as the Centre and the States are concerned.<sup>58</sup>

The uniform rates promised by the GST would go out of the window if the GST Council can’t ensure uniformity in rates.

*Two*, the fact that there is a dispute resolution mechanism provided for in Article 279A(11) suggests that the recommendations are supposed to be binding – if they were merely recommendatory and non-binding, no legal obligations would arise out of them, and there would be no dispute to address as the State or the Union would be free to disregard the recommendations. If the intent was to make the recommendations non-binding there would be no need to have a dispute settlement body to enforce compliance of recommendations.

Given that the “recommendations” of the GST Council are actually binding on the States, the manner in which the decisions are taken by the GST Council is constitutionally defective for two broad reasons.

*First*, recommendations of the Council are made on the basis of a three-fourths majority of the members of the Council according to Article 279A(9). However, as mentioned not all members of the Council have an equal vote in the Council. The votes are weighted with the Union Government’s vote having the weight of one-third of the total votes cast and *all* the States together having two-thirds of the total votes. With the requirement for majority being three-fourths of the votes cast, this effectively gives the Centre a veto over all “recommendations” of the Council as it is mathematically impossible to attain the required three-fourths majority if the Union does not vote for it.

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<sup>56</sup> See *Yedida Chakradhararao v. State of A.P.*, (1990) 2 SCC 523.

<sup>57</sup> See *Pratap Singh v. State of Jharkhand*, (2005) 3 SCC 551.

<sup>58</sup> Arun Jaitley, Speech to the Rajya Sabha (Aug. 3, 2016) <http://164.100.47.5/newdebate/240/03082016/14.00pmTo15.00pm.pdf>.

Considering once again the kinds of subjects that the GST Council has the power to make binding recommendations on, it implies that the Union Government has veto power over the law making functions of the States – a concept entirely alien to the federal structure of the Constitution of India.

Such a mechanism which allows the Union to determine and direct the tax policies of a State through a binding “recommendation” of the Council is unlikely to pass the “basic structure” test in that it could amount to a violation of the Constitution’s basic feature of federalism. It directly infringes and violates one of the fundamental tenets of the Constitution’s federal structure – the political sovereignty of the States.

Curiously, this particular feature of the GST Council is of relatively recent vintage. The earlier version of the 101<sup>st</sup> Amendment Act, the Constitution (115<sup>th</sup> Amendment) Bill, 2011 mandates that decisions of the GST Council be taken on the basis of consensus of all parties.<sup>59</sup> However, this was changed on the basis of a report of the Parliamentary Standing Committee which recommended a change on the basis that consensus may be difficult to achieve between the Union and the States.<sup>60</sup> The basis for doing so is a “suggestion” made during a meeting of the Empowered Committee of State Finance Ministers in 2013. However, it was never clarified in the report if this was a suggestion made by the Empowered Committee itself or one of the suggestions made at the meeting by a party.<sup>61</sup> Only the view of the Chairman of the Empowered Committee of State Finance Ministers is reproduced to this effect and it has never been made clear if this was the decision of the Empowered Committee or his personal opinion.<sup>62</sup> Immediately after that the Report says that it would be preferable to have a consensus based decision making,<sup>63</sup> but in the ultimate recommendation to the Government, it suggests the present voting format.

The 115<sup>th</sup> Amendment Bill which proposes that decisions of the GST Council be taken by consensus arguably provides for a more constitutionally appropriate method as it treats the Union and the States as equals instead of placing one above the other. There is no logic or rationale given by anyone for why the consensus requirement was replaced by the majority system with a veto for the Union, save for a cursory line in the Standing Committee Report that sometimes consensus may be difficult. Even the dissent note by the member from the All India Anna Dravida Munnetra Kazhagam party, in the report of the Select

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<sup>59</sup> Proposed Article 279A(8) Constitution (115<sup>th</sup> Amendment) Bill, 2011 <<http://www.prsindia.org/uploads/media/Constitution%20115/Constitution%20115,%2022%20of%202011.pdf>>.

<sup>60</sup> STANDING COMMITTEE ON FINANCE, 15TH LOK SABHA, SEVENTY THIRD REPORT ON THE CONSTITUTION (ONE HUNDRED FIFTEENTH AMENDMENT) BILL, 2011 <<http://www.prsindia.org/uploads/media/Constitution%20115/GST%20SC%20Report.pdf>>.

<sup>61</sup> *Id.*, at 61.

<sup>62</sup> STANDING COMMITTEE ON FINANCE, *supra* note 60, at 35.

<sup>63</sup> STANDING COMMITTEE ON FINANCE, *supra* note 60, at 37.

Committee considering the 101<sup>st</sup> Amendment Act in its Bill form, which criticizes the voting structure in the GST Council, is not referred to or responded to at all.<sup>64</sup>

*Second*, the supremacy of the Union over the States in the GST Council is re-affirmed by the manner in which disputes arising out of the recommendations of the GST Council are resolved. The 101<sup>st</sup> Amendment Act leaves it to the GST Council itself to set up the manner in which disputes will be resolved. The 101<sup>st</sup> Amendment Act does not provide for any other separate procedure by which the dispute settlement mechanism must be decided upon leaving one to conclude that this too will be subject to the rule of super-majority, with the Union continuing to enjoy a veto over the decisions of the GST Council. In effect, the Union, which dominates decision making in the GST Council, will also decide how these decisions may be challenged by aggrieved States. Given its veto, it can be safely assumed the Union will never have a grievance against any recommendation of the GST Council and it may, at best, use this dispute settlement mechanism to enforce the decisions of the Council against States. A State that is unhappy with a GST Council recommendation is therefore left with little or no effective legal remedy.

Apart from compounding the subordinate position of the States under the GST Council, the dispute settlement mechanism could also fall afoul of the Supreme Court's judgment in *Supreme Court Advocates-on-Record Assn. v. Union of India*,<sup>65</sup> where the Court struck down the Constitution (99<sup>th</sup> Amendment) Act, 2015 for the reason, *inter alia*, that the Government, which was the largest litigant had a say in the appointment of judges.<sup>66</sup> With the Supreme Court's jurisdiction over decisions of the GST Council having been excluded by implication (specifically its jurisdiction under Article 131 in relation to inter-State or Union-State disputes), it is likely that this might be seen to be an abrogation of judicial review under the Constitution – a basic feature that has been responsible for all constitutional amendments struck down so far.

Irrespective of whether the Supreme Court is ultimately going to hold the 101<sup>st</sup> Amendment Act as being constitutionally valid or otherwise, the fact remains that the GST, in order to be functional, requires a massive, coordinated effort on the part of the Union and the States. This requires both the Union and the States to be on the same page as regards the benefits and drawbacks of the GST and its operation. A GST Council which is riven by distrust between parties and suspicion about the motives of the other is unlikely to perform this coordination function with any real effect. The GST Council, as presently structured, seems to deprive States of a real say in the decision making around the GST.

<sup>64</sup> See SELECT COMMITTEE ON THE CONSTITUTION (ONE HUNDRED AND TWENTY SECOND AMENDMENT) BILL, 2014, REPORT OF THE SELECT COMMITTEE ON THE CONSTITUTION (ONE HUNDRED AND TWENTY SECOND AMENDMENT) BILL, 2014 <http://www.prsindia.org/uploads/media/Constitution%20122nd/Select%20comm%20report%20-GST.pdf>.

<sup>65</sup> *Supreme Court Advocates-on-Record Assn. v. Union of India*, (2016) 5 SCC 1.

<sup>66</sup> *Supreme Court Advocates -on-Record Assn.*, (2016) 5 SCC 1, 497.

## B. A comparative perspective on the GST

Two federal systems which have adopted the GST, Canada and Australia, provide interesting contrasts in terms of how the GST was incorporated into the federal structure. Whereas Canada and Australia adopted a GST in 1991<sup>67</sup> and 2000<sup>68</sup> respectively, neither Canada nor Australia amended their respective Constitutions to adopt the GST and it is quite interesting to examine why.

The Canadian example would not be particularly relevant for India since the power to impose a GST would be entirely within the legal competence of the federal Parliament as the Provincial Legislatures have power only to impose direct taxes and not indirect taxes.<sup>69</sup> There is no question of an incursion on any Provincial power since the exclusive competence to enact the GST was with the Parliament. This was confirmed by the Supreme Court of Canada in *Goods and Services Tax, In re*<sup>70</sup> which held that Part IX of the Excise Tax Act, 1985 was constitutionally valid and did not in any way infringe the powers of the Provincial legislatures under the Canadian Constitution. It found however that there was some encroachment which was “necessarily incidental” but not in a manner which affected the constitutional validity of the GST.<sup>71</sup>

More relevant for the Indian experience perhaps is the Australian Constitution, where save for the power to impose customs and excise duty, the power to levy taxes is concurrent between the Commonwealth and the States.<sup>72</sup> The GST however is levied only by the Commonwealth Government and not by the States. This does not mean that the States have no say in the GST. On the contrary, Section 1-3 of the A New Tax System (Goods and Services Tax) Act, 1999 makes it clear that the Commonwealth will maintain the rate and base for the GST in accordance with the Agreement on Principles for the Reform of Commonwealth-State Financial Relations (“the Agreement”). Furthermore, the same section goes on to confirm that revenue from the GST will go to the States and the sub-national units.

The Agreement itself was entered into in 1999 and lists out what sort of taxes are being given up by both, the Commonwealth and the States and Territories.<sup>73</sup> It also provides for a revenue sharing arrangement between the Commonwealth and the States and territories of revenues arising out of the levy of the GST.<sup>74</sup>

<sup>67</sup> By introducing part IX of the Excise Tax Act, 1985.

<sup>68</sup> A New Tax System (Goods and Services Tax) Act, 1999.

<sup>69</sup> See Sections 91 and 92, The Constitution Acts, 1867 to 1982.

<sup>70</sup> *Goods and Services Tax, In re*, 1992 SCC OnLine Can SC 64 : (1992) 2 SCR 445.

<sup>71</sup> Nathalie J. Chalifour, *Making Federalism Work for Climate Change: Canada's Division of Powers over Carbon Taxes*, 22 NATIONAL JOURNAL OF CONSTITUTIONAL LAW, 119 (2008).

<sup>72</sup> Section 90, Commonwealth of Australia Constitution Act, 1900.

<sup>73</sup> Part 2 [5], Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, 1999.

<sup>74</sup> Part 2 [7-9], Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, 1999.

Relevant in the context of India's GST structure is Part 3 which deals with the Management of the GST Rate and the GST Base.<sup>75</sup> Any changes to the rate or the base have to be on the basis of the unanimous support of the State and Territory Governments and cannot be done by the Commonwealth Government alone, even though it has the plenary power to enact the GST legislation.

Of course the structure of the GST in both these federal nations have been designed keeping their respective constitutional schema in mind, and it would be hazardous to suggest that India should have adopted either of these models in framing the GST law. More so, because the GST in India is envisaged as something which both Union and States will impose. Nonetheless, it is important to note that the GST does not necessarily require the sub-national units to be in a subordinate position vis-à-vis the federal government when it comes to their taxing powers. Through the introduction of the GST, States/provinces have not lost their taxing powers or become subordinate to the Union either in Canada or in Australia, nor do they have to exercise it in accordance with the Union's wishes. It is not therefore a necessary requirement of a GST that the federal unit gains control over the fiscal policies of the sub-national units.

#### IV. CONCLUSION

Save for a few stray articles,<sup>76</sup> there has not been much public debate about the structure of the GST Council and its problems. It is likely that the issue may come to the fore when the States actually attend a meeting of the GST Council and realise that the voting system is stacked against them and in favour of the Union.<sup>77</sup> With the present voting structure, there is no reason for the Union to take on board all States and it is quite likely that proposals relating to the rate of the GST, the exemptions and collection mechanism are likely to cause much disagreement. More so, since there's already been much public disagreement between so-called "producer States" and "consumer States" with the former taking a view that a GST is fundamentally against their interests.<sup>78</sup> It is quite likely that a legal

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<sup>75</sup> Part 3 [31-2], Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, 1999.

<sup>76</sup> See, Nilakantan RS, *The GST could sound the death knell for federalism in India*, THE WIRE, Aug. 5, 2016 <http://thewire.in/56732/gst-killing-federalism/>. Alok Prasanna Kumar, *The Bill that will doom the GST*, BLOOMBERG QUINT, Aug. 5, 2016 <http://www.bloomberquint.com/opinion/2016/08/03/the-bill-that-will-doom-gst>.

<sup>77</sup> Something of this nature seems to have occurred going by the complaints of the Kerala Finance Minister at the very first GST Council meeting: Express News Service, *Kerala Finance Minister worried about GST Council's agenda*, NEW INDIAN EXPRESS Sept. 21, 2016. <http://www.newindianexpress.com/states/kerala/Kerala-Finance-Minister-worried-about-GST-councils-agenda/2016/09/21/article3626366.ece>.

<sup>78</sup> The concerns of "producing states" has been articulated here: A Sarvar Allam, *GST and the States: Sharing Tax Administration*, Vol. LI No 31 ECONOMIC AND POLITICAL WEEKLY, (2016) <http://www.epw.in/journal/2016/31/web-exclusives/gst-and-states-sharing-tax-administration.html>.

challenge could arise against the GST given the lopsided structure of voting that will leave some State aggrieved.

The legal challenge to the 101st Amendment Act, as this paper has outlined, will not be without firm legal basis. Given the effort that it took to get thus far on GST, it is quite unlikely that another round of constitutional amendments will be made by the Government to rectify the legal defects in the 101st Amendment Act pointed out here. It is quite likely that when challenged, the effort will be to defend the amendment legally in court.

That said, the 101st Amendment Act does not entirely foreclose the possibility of the States having a say in the decision making process in the GST Council. The Union still needs a majority of the States present and voting to agree with it in order to be able to take the decisions it wishes to in the context of the GST Council. Arguably this still provides some space for States to bargain with the Union and might save the 101st Amendment Act from being struck down. However, this risks creating “winners” and “losers” among the States in respect of the decisions taken by the GST Council. The “losers”, the ones who may be adversely affected by a decision of the Council, will still have no effective remedy against the decisions of the GST Council given that the same decision making structure which went against them will also decide how their grievances will be addressed.

Whether the provisions of the 101st Amendment Act are struck down by the Supreme Court or not, the concerns for the federal structure of the Constitution will not go away. The success of the GST, in practice, requires high levels of co-ordination and trust between the Union and the States. This is a task that cannot be taken for granted. The present framework raises some questions, namely: Will States which feel that their interests have been crushed by a brute majority not try and throw further spanners into the works? Is the GST not likely to be mired in litigation, not between the assessee and State, but between State and State, and State and Union over the manner in which it is to be operated?

To re-iterate: India’s federal character is not one of “administrative convenience” or mere accident. It is the result of specific historical circumstances leading up to the enactment of the Constitution. Indeed, as Ramaswamy J. recognized in his judgment in *Bommai*, a federal government was the Constitution makers’ attempt at finding an effective way to govern a country as vast and diverse as India.<sup>79</sup> In attempting a large scale (and probably necessary) reform of indirect taxation, it would seem as if the federal character of the Constitution has been needlessly tampered with by the Union. If unchecked by the Court, this could have grave repercussions for the future of India’s federal polity.

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<sup>79</sup> See S.R. Bommai, (1994) 3 SCC 1, 156 (Ramaswamy, J.).



## GSTN- THE NEW NETWORK

—Karthik Sundaram\*

**Abstract** A robust IT infrastructure holds the key to the successful implementation of GST in India. Much like the GST scheme, the GST Network has also been the subject of much critique. The author in this article discusses two major concerns that have been voiced with the structure of the GSTN. First, the structure and functioning of the GSTN as a NIU has been discussed along with the possibility of interference by non-governmental bodies. Second, the author has dealt with the privacy concerns emerging from such a large scale collection of data by GSTN. This has been analysed in the backdrop of the debate surrounding whether the right to privacy is a fundamental right at all. The article concludes with suggestions on how these two concerns could be best addressed without compromising on the effectiveness of the GSTN.

### I. INTRODUCTION

After a long and arduous journey, the efforts towards implementation of the Goods and Services Tax (hereinafter ‘GST’) regime in India have borne fruit, and India will see the implementation of GST in 2017. Per the terms of the Constitution (101<sup>st</sup> Amendment) Act which has amended the Constitution of India w.e.f. 16<sup>th</sup> September, 2016, GST is required to be implemented latest by 16<sup>th</sup> September, 2017. GST is expected to be a transformational change in the indirect tax landscape of India; the introduction of which is greatly expected to benefit the Indian economy.

GST seeks to facilitate the development of a common national market in India. Thus, the backbone of administration of the GST regime by the tax authorities will be the GST related information technology infrastructure, which seeks to integrate all transactions on a pan India basis, to facilitate an integrated tax administration at both the central and state level.

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It is in this context that the present article seeks to discuss the need and basis for setting up the GST Network (hereinafter ‘GSTN’), which will in turn set up and provide the IT backbone for the effective functioning of the GST regime. Since the GSTN is a Section 25 company<sup>1</sup> set up as a ‘public-private partnership’ and the GSTN will have access to a significant amount of tax related data relating to individuals, businesses and companies, some ‘right to privacy’ issues have also been raised in such context.

In addition to the above, various concerns have also been raised as regards the shareholding pattern of the GSTN, and the role of private entities as stakeholders in GSTN. Some concerns have also been raised as to whether a security clearance from the Ministry of Home Affairs is required for private entities which are a part of GSTN. Issues have also been raised by the Department of Revenue and the Department of Expenditure in the Ministry of Finance on the constitution of the GSTN, the expenses incurred by the GSTN, and whether the GSTN can actually be managed more effectively by the Central Board of Excise and Customs (hereinafter ‘CBEC’), or other departmental bodies.<sup>2</sup> The Select Committee on non-government shareholding of GSTN by private banks had in fact recommended that the Government take steps to ensure that non-governmental financial institution shareholding be limited to public sector banks or public sector financial institutions given that: (i) public sector banks have more than 70% share in total credit lending in India; and (ii) GSTN’s work is of strategic importance to the country and that the firm would be a repository of sensitive data on business entities across the country.<sup>3</sup>

This article primarily seeks to deal with the thought process behind setting up the GSTN and the issues relating to data security and the right to privacy.

## II. SETTING UP OF NATIONAL INFORMATION UTILITIES AND OF GSTN AS A NATIONAL INFORMATION UTILITY

The then finance minister in his budget speech of 2010–2011 had announced the setting up of a Technology Advisory Group for Unique Projects (hereinafter ‘TAGUP’). As conceived by the TAGUP, National Information Utilities (hereinafter NIU) would be private companies with a public purpose. Although companies would be profit-making, they would not have a profit maximising objective. As conceived, an NIU would make available essential infrastructure for public service. It was thought that such institutions would make it possible for government

<sup>1</sup> Registered under Section 25 of the Companies Act, 1956.

<sup>2</sup> *DoE red flags large expenditure by GST-Network*, THE INDIAN EXPRESS, (June 26, 2016), <http://indianexpress.com/article/india/india-news-india/doe-red-flags-large-expenditure-by-gst-network-2876711/> (July 6, 2016).

<sup>3</sup> Sumit Dutt Majumder, GST IN INDIA 419-420 (2<sup>nd</sup> ed., 2016).

functions to be carried out efficiently, and allow feasible projects to be designed, thus fostering economic development. Like public-private partnerships in the infrastructure space, NIUs as conceived, are to function in a manner so as to have a net positive effect on society. The idea itself is not a new one, although the concept of NIUs has been further developed. Successful examples in the Indian context itself exist in the form of National Security Depository Limited, National Payments Corporation of India, and the Centre for Railway Information Systems.

The NIUs have been envisaged to be primarily responsible for technology-related aspects of implementation. They are bound by tight service level agreements, and are subjected to periodic audits. The NIUs would be designed in a manner so that strategic control is retained with the government at all times. To facilitate this, it was decided that no single private entity would own more than 25% of the shares in an NIU, and that institutions which have a direct conflict of interest (such as, IT companies) would not be permitted to be shareholders. The TAGUP had also recommended that the Government-NIU relationship should be defined through an agreement which would outline the broad project goals, placement of tasks, financials, service level agreements, and most importantly, embody the spirit of partnership. The agreement as contemplated covers the following specific areas – (a) scope of work; (b) activities to be undertaken by NIUs; (c) obligations of the government and NIUs; (d) financial arrangement; (e) service level agreement; and (f) business continuity plan upon exit.

It was in this backdrop that the Information Technology Group of the Empowered Committee of Finance Ministers on GST recommended that the GSTN be set up as a NIU for managing the IT systems for GST implementation, including the Common GST Portal. Therefore, much thought and deliberation has gone into setting up of the GSTN as an NIU for the effective implementation of GST in India.

### **III. THE CONSTITUTION AND FUNCTIONS OF GSTN**

The GSTN has been set up as a Section 25 not-for-profit company, in which the Government of India and State Government hold 49% of the shareholding, and the balance 51% is held by corporations and banks such as LIC, ICICI, HDFC etc. In line with the recommendations of the TAGUP, no software company has any shareholding in GSTN.

GSTN has been set up as a company to primarily provide IT infrastructure and services to the central and state governments, tax payers and other stakeholders for implementation of GST. The key work of GSTN will be to:

- a) provide common registration, return, and payment services to the tax payers;

- b) partner with other agencies for creating an efficient and user-friendly GST eco-system;
- c) encourage and collaborate with GST Suvidha Providers to roll out GST applications for providing simplified services to the stakeholders;
- d) carry out research, study best practices, and provide training and consultancy to the tax authorities and other stakeholders.
- e) provide efficient backend services to the tax departments of the central and state governments on request;
- f) develop Tax Payer Profiling Utility for central and state tax administration;
- g) assist tax authorities in improving the tax compliance and transparency of the tax administration system; and
- h) deliver any other services of relevance to the central and state governments and other stakeholders on request.

The common GST portal is to be a pass-through device for information, while enhancing it with intelligence to plug leakages. It would also act as a tax booster, matching the input tax credits in the returns to detect tax evasion. It can also integrate with various other systems at Ministry of Corporate Affairs and Central Board of Direct Taxes for verification of PAN or other corporate information, and perform data mining and pattern detection to detect tax fraud. It would send this information as alerts and reports to the respective tax authorities. It would also compute inter-state settlement, netting IGST across states.

If one looks at the Central GST ('CGST')/State GST ('SGST') enactments, it is clear that 'Input Tax Credit' (hereinafter 'ITC') related records will be required to be maintained on an electronic credit ledger. The ITC can be availed by the purchasing dealer only subsequent to payment of GST by the selling dealer. The GST system will be designed to capture mismatches between the records of the selling dealer and the purchasing dealer. It will ensure that all taxes are fully paid, and there are no leakages in tax revenue, and that the ITC is allowed only after full payment of taxes to the respective governments. Thus, the fulcrum of GST will be the IT infrastructure since all registrations, returns and records are required to be maintained in electronic form. Hence, the GSTN is significant in the scheme of a successful GST.

#### **IV. GSTN AND THE RIGHT TO PRIVACY**

With the debate surrounding the introduction of GST in India, the setting up and functioning of the GSTN has also been subject to much critique. In some quarters the structure and functioning of the GSTN is viewed with circumspection, as it creates a basis for the storage of a large quantum of tax and other

related financial information with non-governmental parties. This creates a potential for misuse of such data and concerns regarding invasion of the right to privacy.

In this part of the article, the author seeks to address the issue of the actual contours of the right to privacy in India, and how it will play out in the context of functioning of the GSTN.

## V. WHETHER THE RIGHT TO PRIVACY IS A FUNDAMENTAL RIGHT

The issue of whether the right to privacy is a fundamental right or not as guaranteed under the Indian Constitution has been referred to a larger bench of the Supreme Court for consideration in *K.S. Puttaswamy v. Union of India*.<sup>4</sup> While making such reference, the Supreme Court has observed that it is better that the *ratio decidendi* of *M.P. Sharma v. Satish Chandra*<sup>5</sup> and *Kharak Singh v. State of U.P.*,<sup>6</sup> is scrutinized, and the jurisprudential correctness of the subsequent decisions of this Court where the right to privacy is either asserted or referred be examined and authoritatively decided by a bench of appropriate strength. Both *M.P. Sharma* case and *Kharak Singh* case, which were decisions rendered by a 8 judge bench and 7 judge bench of the Supreme Court respectively, were rendered in the context of issues such as power of search and seizure and police regulations dealing with domiciliary visits. Both have held that the right to privacy is not a fundamental right under the Indian Constitution. Albeit rendered by smaller benches, later decisions of the Supreme Court such as *Gobind v. State of M.P.*,<sup>7</sup> *People's Union for Civil Liberties (PUCL) v. Union of India*,<sup>8</sup> and *R. Rajagopal v. State of T.N.*,<sup>9</sup> (wherein the Court had for the first time linked the right to privacy to Article 21 of the Constitution), have taken the view that the 'right to privacy' is a fundamental right under the Indian Constitution. In fact, in *District Registrar and Collector v. Canara Bank*,<sup>10</sup> the Supreme Court struck down a provision of the Andhra Pradesh Stamps Act which allowed the collector or 'any person' authorised by the collector to enter any premises to conduct an inspection of any records, registers, books, documents in the custody of any public officer, if such inspection would result in discovery of fraud or omission of any duty payable to the government, by holding that it failed the tests of reasonableness enshrined in Articles 14, 19 and 21 of the Constitution (including the right to privacy of a citizen *qua* his financial records).

<sup>4</sup> *K.S. Puttaswamy v. Union of India*, (2015) 8 SCC 735.

<sup>5</sup> *M.P. Sharma v. Satish Chandra*, AIR 1954 SC 300.

<sup>6</sup> *Kharak Singh v. State of U.P.*, AIR 1963 SC 1295 : (1964) 1 SCR 332.

<sup>7</sup> *Gobind v. State of M.P.*, (1975) 2 SCC 148 : (1975) 3 SCR 946.

<sup>8</sup> *People's Union for Civil Liberties (PUCL) v. Union of India*, (1997) 1 SCC 301.

<sup>9</sup> *R. Rajagopal v. State of T.N.*, (1994) 6 SCC 632.

<sup>10</sup> *District Registrar and Collector v. Canara Bank*, (2005) 1 SCC 496.

Therefore, there are conflicting Supreme Court decisions on the issue of whether or not the right to privacy is a fundamental right under the Indian Constitution. While the more recent decisions of the Supreme Court take a view that such ‘right to privacy’ is indeed a fundamental right, the conflict on the correct legal position will be resolved only when the larger bench of the Supreme Court answers the reference made in *K.S. Puttaswamy*.

Various jurisdictions across the globe have well articulated privacy policies which spell out the requirements for protection of personal data, and prevent harm to an individual whose data is at stake. In the Indian context, the report of the group of experts on privacy<sup>11</sup> (hereinafter ‘the Report’) headed by Former Justice A.P. Shah which was presented in October, 2012 had set out various recommendations for consideration by the government while formulating the proposed framework for a Privacy Act. The Report is premised on the fact that right to privacy has emerged and evolved as a fundamental right through various Supreme Court decisions, while this position is itself in question before the Supreme Court in *K.S. Puttaswamy*. In fact, the 2014 version of the Right to Privacy Bill which has still not been enacted, proceeds on the presumption that the right to privacy is a fundamental right guaranteed under Article 21 of the Constitution of India.

Therefore, to put it succinctly, the position as regards the right to privacy in India is as under:

- There are conflicting Supreme Court decisions on whether the right to privacy is indeed a fundamental right, and the matter is pending decision before a larger bench of the Supreme Court;
- Though the government has sought to enact a Right to Privacy Act which will statutorily provide for such right, exceptions to the right of privacy, situations where access to data with authorization will not constitute an invasion of the right to privacy, and offences and consequential penalties, the proposal is still at the stage of a Bill of Parliament and has not seen the light of the day.
- In terms of the extant legislation, only the Information Technology Act, 2000 (hereinafter ‘IT Act’) contains some provisions regarding data protection as opposed to data privacy. For instance, Section 43A of the IT Act provides that “*where a body corporate, possessing, dealing or handling any sensitive personal data or information in a computer resource which it owns, controls or operates, is negligent in implementing and maintaining reasonable security practices and procedures and thereby causes wrongful loss or wrongful gain to any person, then such body corporate shall be liable to pay damages by way of compensation to the person so affected.*” Further section 73A also provides for penalties

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<sup>11</sup> Planning Commission, Report of the Group of Experts on Privacy (2012).

including imprisonment for wilful disclosure of personal informational secured under a lawful contract without authorization of such person disclosing the information, or in breach of such lawful contract.

The Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011, provides for detailed rules as regards the security practices and procedures related to sensitive personal data or information. The term 'sensitive personal data or information' as defined under Rule 3 of the said Rules does not appear to cover tax related information.

Therefore the IT Act and the rules framed thereunder though it contains provisions related to data protection are not geared to protect the use of tax related information.

The right balance between the individual's right to privacy and the larger public interest should be achieved by the data protection framework. While personal information relating to the individual must be strictly protected from unauthorized access, there may be a need for government agencies to access or share this data for purposes of national security, economic offenses, tax evasion and other specified circumstances. Hence, authorized sharing of information under specified circumstances *ipso facto* should not be considered as a violation of an individual's right to privacy. However, detailed processes, systems, and guidelines need to be put in place to ensure that authorized access and sharing is within the parameters set by law.

## **VI. VIEWS OF THE EMPOWERED COMMITTEE ON DATA SECURITY IN THE CONTEXT OF GSTN**

The EC has not been unaware of the concerns surrounding data security. The issue has been examined by the EC while deciding the final structure of the GSTN. The suggestions/clarifications given by EC on data security are as under:

- provisions regarding data security will be addressed by incorporating related provisions in the Articles of Association of the company entrusted with GSTN.
- the Chairman of the GSTN will be appointed by the government and no single private entity will own more than 10% of equity, while the Centre and the States will own 24.5% equity each. Thus, ultimate control will vest with the government.
- the GSTN will be bound to follow the internationally accepted security and safety measures for preventing data leakage. A proposal was also mooted to appoint a chief information security officer on deputation by the government to look into the matters related to information security.

- audits of GSTN would be conducted by the independent auditors, including the professional personnel designated for carrying out technology reviews and giving suggestions thereupon.
- an overarching IT security management framework comprising Plan-Do-Check-Act (PDCA) cycle to be employed to ensure data security and confidentiality.<sup>12</sup>

## VII. RECOMMENDATIONS OF THE TAGUP ON DATA SECURITY

The TAGUP in its report dated 31<sup>st</sup> January, 2011 has made certain recommendations regarding data protection in the context of NIUs, which may serve as useful guidelines for designers of IT systems till such time as a formal legislation on privacy is passed. Some of the recommendations are enumerated below:

- The solution architecture of a project should be designed for data protection and privacy from the ground up.
- The privacy framework for a project should be defined early on, which transforms the legislation on privacy into implementable rules for IT systems.
- The design of the solution architecture should ensure that any Personal Identifiable Information (PII) is stored safely, and that access is carefully monitored. Stringent penalties must be in place to address the issue of unauthorized access of personal data by outside agencies as well as by personnel within the organization. Strict protocols and processes must be in place to detect such access in order that they are dealt with swiftly and in a deterrent manner. This is not only desirable from a privacy perspective, but also from a security perspective.
- Anonymization of data is an important aspect of privacy. Data should be carefully anonymized when released publicly, or when shared with other organizations that do not require access to PII, as allowed within the data protection and privacy framework.
- Careful thought should be given to anonymization, since naive approaches to deidentifying data are prone to attacks that combine the data with other publicly available information to re-identify individuals.
- Data retention and usage policies should be well-defined, especially for PII. In case the legal framework of the project provides for it, an individual should be able to access data stored in the IT system about themselves, after appropriate authentication of their identity.

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<sup>12</sup> Sumit Dutt Majumder, *supra* note 3, at 408.

- The right balance between the individual's right to privacy and the larger public interest should be achieved by the data protection framework. While personal information relating to the individual must be strictly protected from unauthorized access, there may be a need for government agencies to access or share this data for purposes of national security, economic offenses, tax evasion and other specified circumstances. Hence, authorized sharing of information under specified circumstances, ipso facto, should not be considered as a violation of an individual's right to privacy. However, detailed processes, systems and guidelines need to be put in place to ensure that authorized access and sharing is within the parameters set by law.

The design of GSTN is based on "role based access." The taxpayer can access his own data through identified applications like registration, return, view ledger, etc. The tax official having jurisdiction as per the GST law as well as the audit authorities can access the data. No other entity can have any access to the data on GSTN.<sup>13</sup>

### VIII. CONCLUSION

While there has been some thought and effort on ensuring 'data security', ensuring the right to privacy though the issue whether it is in the nature of a fundamental right or will remain a statutory right remains open at this time, much more requires to be done. Further, on the issue of balancing the right to privacy with larger public interest, mere policy guidelines/statements without a substantive statutory framework cannot achieve the desired result. Mere policies cannot guarantee rights or ensure their enforcement.

Given the importance of the GSTN as an NIU, and the role which NIUs may play in the future given the digital transformation of India, it is the suggestion of the author that it is important that the setting up and functioning of NIUs be governed by a statutory framework specific to NIUs. The government should consider the introduction of a comprehensive legislation specific to NIUs which could *inter alia* contain provisions on issues such as, setting up and constitution of NIUs, shareholding pattern, data security, right to privacy, exceptions thereto and enforcement thereof, co-relation between right to privacy and larger public interest, sharing of tax and other information between government agencies, etc. A statutory framework would not only guarantee rights but also enable enforcement of the same, as a right without a remedy is but no right at all.

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<sup>13</sup> GOODS AND SERVICES TAX NETWORK (March 25, 2017, 8:00 PM) <http://www.gstn.org/index.php/about-us#concern>.



## GST AND E- COMMERCE

—Sumit Dutt Majumder<sup>1</sup>

**Abstract** This article was written in February, 2017. Since then the Central Goods and Services Tax Bill (CGST) has been passed by Parliament and has been notified in April, 2017. The article explores the interplay between India’s upcoming Goods and Services Tax (GST) regime and its growing e-commerce sector. It does so by mapping the major features of the GST regime and the e-commerce sector. Thereafter, by analysing the Model GST Law circulated by the Central Board of Excise and Customs, it voices the major concerns of the e-commerce players and argues that Law must be re-thought to prevent a regulatory overburden.

First, I briefly comment on various aspects of the Goods and Services Tax (GST), then e-commerce, and finally on treatment of e-commerce by GST.

### I. STRUCTURE OF GST

GST is a tax on the *supply* of goods and services, and not on their manufacture like Central and State Excise, or provision of services like Service Tax, or sale of goods like State VAT, etc. It is a destination-based consumption tax. India has decided to adopt a Dual GST model wherein both the Centre and the States would levy and collect GST on a common tax base. It will be done in a pre-determined manner such that a taxpayer would have an interface with only one of the two tax administrations – the Centre or the State. GST will subsume seventeen current indirect taxes of the Centre and the States - the principal ones being Excise, Countervailing Duty of Customs, Service Tax of the Centre, and State VAT. Supplies within a particular state will have two components – Central GST (CGST) and States GST (SGST), which will be administered by the Centre and the States respectively. In the case of interstate supplies, the tax would be known as Integrated GST (IGST), and it would basically be a summation of CGST and

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<sup>1</sup> Mr. Sumit Dutt Majumder is the former Chairman, Central Board of Excise Customs and author of the book GST in India - Its Travails, Tribulations and Challenges Ahead.

SGST. Being a destination based tax, the States' shares of IGST would accrue to the destination state.

In the GST regime, there would be a multipoint levy throughout the supply chain with the full credit of input taxes paid at each stage of Business to Business (B2B) transactions. Consequently, there will be no cascading of tax. Secondly, the replacement of multiple tax authorities with only two tax authorities i.e. Centre and the States will bring down compliance costs. Thirdly, the subsuming of interstate Entry Tax in the GST, and elimination of interstate trade barriers will make India a common economic market. It will also drastically reduce the travel time of goods, and lower the logistics cost of movement of goods across the states. Essentially, a substantial reduction of cost of goods will result in the lowering of inflation.

Besides, being a destination based consumption tax, GST will enhance the revenue of states which are industrially backward but have high consumption. The extra revenue would enable these states to spend more on the development of roads and other infrastructure (including power plants), thus attracting industries which would lead to equitable distribution of industries across the country, and give a boost to the country's manufacturing base.

## II. CONSTITUTIONAL AMENDMENT

After the Union Finance Minister in his Budget Speech of 2006 made an announcement about India's proposal to introduce GST, the Empowered Committee of State Finance Minister's (EC), which also had representatives from the Central Government, was tasked with providing a structure of GST which would be agreeable to both the Centre and the States. The EC recommended the aforesaid Dual GST mode. This necessitated an amendment of the Constitution of India so as to empower both the Centre and the States to levy and collect GST in terms of the proposed structure. After years of negotiations between the Centre and States, in August 2016, both Houses of the Parliament cleared the Bill for a constitutional amendment. An important feature of the Constitution (One Hundred and First Amendment) Act, 2016 was the creation of the GST Council which will be chaired by the Union Finance Minister. The Finance Ministers of all the States will be members of the Council. The Council will make recommendations to the legislatures regarding issues related to policy and implementation of GST, including the tax rates and exemptions. The Council has since met nine times, and is on its way to steering the implementation of GST. The roll-out date has been announced to be 1<sup>st</sup> July, 2017.

### III. CHALLENGES AND COMPROMISES

GST will essentially be a joint venture between Centre and the States. Success of a joint venture depends on the happiness of both the partners. Keeping this in mind, the Centre has made a number of compromises with the States. On demand from the States, the essential inputs like petroleum and its products have been kept outside the ambit of GST; so has been the case of Alcohol, which is a State subject, although other demerit goods like Tobacco and Cigarettes (Central subjects) are within the ambit. The threshold exemption has been kept at an annual turnover of Rupees twenty lakhs. Small tax payers with turnover up to Rupees fifty lakhs can opt for Composition Levy. The States have also been allowed to vary their GST rates within a band. Most importantly, the Centre also agreed to compensate the States fully for the first five years in case of loss of their revenue. Although these compromises have impaired the shine of a good GST, they were considered necessary to bring the States on board and make them happy.

A seamless flow of Input Tax Credit for both intra-state and inter-state supplies would be the hallmark of GST. Implementation of IGST for taxing inter-state supplies would also be a challenge. It is essential to understand basic concepts like the Scope of Supply, Place and Time of Supply, Taxable Event and Taxable Person, Flow of Credit etc., and follow procedural provisions relating to Registration, Payment, Filing of Returns, Claim of Refund, Audit and Enforcement etc. **Follow up Legislations**

Implementation of GST will have to be preceded by a few legislations - the CGST Act and the IGST Act to be passed by the Parliament, and the SGST Acts to be passed by the respective State Legislatures. Draft Model GST Laws were placed in the public domain, and based on the response from the stakeholders, these model laws have been revised and the final template is expected to be revealed soon. Based on the agreed template, all the aforesaid laws are expected to be cleared by Parliament and State Legislatures by the end of March 2017. Thereafter, three months would be available for completing preparations by the taxpayers and the taxmen, the target date being 1<sup>st</sup> July, 2017.

### IV. GST NET – IT INFRASTRUCTURE

Having regard to the enormity of the job, GST has been proposed to be backed by a robust IT infrastructure called GST Net. The GST Net portal will provide an interface between the taxpayers and the two tax authorities, and facilitate basic functions in the tax collection process like Registration, Self-Assessment and Payment of tax, and Filing of Returns. The functions of GST Net would also include forwarding the Returns to the network of Central and State authorities, matching of tax payment details with the banking network, running the ‘matching engine’ for matching of invoices relating to the output supply and

corresponding input supply to ensure proper availment of credit, providing various MIS reports and analysis of taxpayer's profiles, etc. The GST Net would also integrate the common GST portal with the IT systems of Centre and States for Audit, Refunds, Adjudication etc., and build an interface for taxpayers.

## V. GST RATES

As for the GST rates, there will be four rates - the standard rate of 18%, the two reduced rates of 12% and 5% for items of use by common man and the poor, and a peak rate of 28% for the demerit goods like Tobacco & Cigarettes, Aerated Water, Luxury Cars, etc. In addition, there will be a Central Cess on some of the demerit goods. Besides these, two small lists of goods would be exempted and zero-rated. The list of exemptions will be common for the Centre and the States. The Council has not yet decided which specific goods will fall in the four aforementioned rate groups.

## VI. PREPARATORY STEPS

Now that the contours of GST have taken shape, both the taxpayers and the taxmen have been preparing hard for GST. The ERP (Enterprises, Resource, Planning) of taxpayers are being reworked keeping in mind the requirements of law and procedure. Their IT software is also being customized for appropriate link ups with the GST Net. For the tax authorities, GST will bring about a huge change in functioning of field formations. The emphasis would now be on Audit, Enforcement and Dispute Resolution. The tax administrations would have to restructure and reorganize themselves to suit the requirements of business operations in the GST regime.

## VII. IMPACT OF GST

Summing up, GST will not merely be an indirect tax reform; it will impact the economy in various aspects. It will change the way in which business is done in India. Issuing of invoice, payment through banks, and maintenance of records would be compulsory for availment of credit. Further, all the records of receipt and supply would be maintained electronically. GST would also impact the fortunes of tax professionals, consultants, lawyers, and law firms. As for the economic sectors, almost all sectors including Manufacturing, Service, Trading and Retailing, Logistics and Transportation, Telecommunication, Information Technology, Banking and Financial Services, and E-commerce are going to benefit from GST. GST will give a fillip to the Government's two laudable concepts: 'Make in India' and 'Digital India'. Thus, GST in India would be a win-win proposition for all sectors of the economy including e-commerce, in spite of not being perfect because of constraints of a joint venture between the Centre and the thirty-one States, ruled by different political parties.

## VIII. E-COMMERCE

Now, a few words on e-commerce. Broadly speaking, e-commerce is the business of buying and selling goods and services on the Internet. It is also associated with conducting any transaction involving the transfer of ownership or rights to use goods or services through a computer mediated network. Driven by a young demographic profile and increasing Internet penetration, the growth in e-commerce has been phenomenal. According to a joint ASSOCHAM–Forrester Study Paper, India’s e-commerce revenue is expected to jump from \$30 billion in 2016 to \$120 billion in 2020, at the annual growth rate of 51%.<sup>2</sup> Starting with a traditional ‘stock and sell’ model, the e-commerce companies have transformed themselves into a multi-model platform. Therefore, today it can be said that e-commerce means “*use of electronic communication and digital information processing technology in business to create, transform, and redefine relationship for value creation between or among organisations, and between organisations and individuals*”.<sup>3</sup> Indian e-commerce industry is unique because of its sheer number of transactions, complexity and the employability of the unorganised sector.

E-commerce keeps evolving itself in various new formats for different types of transactions. There are many models for making supplies through e-commerce. Some of the important models are briefly discussed below:

### A. Direct Sales Model

This model is adopted by the entities which were already doing business through physical stores. They now sell their goods directly through their portals (e-commerce route). Direct Sale Portals of Titan, Nike, etc. fall in this category.

### B. Inventory Model

In this model, the e-commerce operator acts like a mega retailer. He buys the goods from the seller, manages the inventory on his premises, and sells it to the end-buyers. e.g. Jabong.

### C. Marketplace Model

A popular model is the Marketplace Model where the e-commerce companies provide a meeting point for the sellers and buyers through their portal. In this

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<sup>2</sup> India’s e-commerce sector to see \$120 billion revenue by 2020: Assocham-Forrester report, THE ECONOMIC TIMES, (May 8, 2016) <http://economictimes.indiatimes.com/industry/services/retail/indias-e-commerce-sector-to-see-120-billion-revenue-by-2020-assochem-forrester-report/article-show/52172120.cms>.

<sup>3</sup> E. Lallana et al, *ePrimer: An Introduction to eCommerce*, Philippines DAI-AGILE, 2, (2000).

model, the end customer in Business-to-Consumer (B2C) transactions can book an item, order for it, and then cancel it as well, or even return the goods through an online Portal or App. In a pure marketplace model, the e-commerce operator would not be involved in any activity other than providing a platform to the sellers to display their goods and facilitating buyers to view and place orders to buy those goods. E.g. Naaptol, E-bay etc.

#### **D. Managed Marketplace Model**

In the Marketplace Model, the supply of the goods is dependent on the efficiency of the seller, over which the e-commerce operator does not have direct control. In the Inventory Model, the operator can fulfil the supply commitments at his own level of efficiency, but the operator will have to invest in the inventory. The Managed Marketplace Model attempts to get the best of both these models. Here, the operator not only creates a marketplace, but also gets involved in other aspects of the sale contract, and handles parts of the supply chain of goods as well e.g. Amazon India.

#### **E. Fulfilment Model**

This model is a particular type of Managed Marketplace Model where the goods are shipped and stored by the sellers in warehouses of the e-commerce operators even before the sale takes place. Once purchase orders are received, the goods are packed and dispatched by the e-commerce operator under intimation to the seller. The e-commerce operator neither makes payment to the seller, nor owns the inventory. Although he does not invest in inventory, he has to invest in storage, transport and logistics. Thus, he cuts down capital investment, and has better control over supply of goods. Today, most of the e-commerce operators have adopted this mode. E.g. Flipkart, Snapdeal, etc.

#### **F. Hybrid Model**

It is becoming increasingly difficult for the large e-commerce operators to have a single model for all the sellers and all types of goods because of the sheer volume and variety. This compels the large operators to adopt a mix of aforesaid models for different sellers and different types of goods. e.g. Myntra.

### **IX. TRENDS DRIVING E-COMMERCE IN INDIA**

The key trends driving e-commerce in India have been explained in a CII-Deloitte Report.<sup>4</sup> The first trend has been reported to be the **Government**

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<sup>4</sup> Confederation of Indian Industry, *e-Commerce in India - A Game Changer for the Economy*, (2016).

**initiatives** in embracing and leveraging e-commerce digital platforms. Besides launching of e-market platform to connect farmers with the 'mandi's of different states to sell agro commodities, the other flagship initiatives from the Government include Digital India, Start-up India, Make in India, Skill India, etc. The second trend is the phenomenal increase in **internet penetration** owing to major improvements in the telecom infrastructure. This has facilitated the fast growth of e-commerce. The third trend has been the **widespread adoption of smartphones** which turned out to be the most favoured medium of e-commerce. Almost 70-75% of their online traffic comes from mobile applications of smartphones. **Evolution of new digital payment solutions** has been reported to be the fourth trend. Some such initiatives are the launch of e-wallets, different digital payment products, Unified Payments Interface (UPI) by the Reserve Bank of India, etc. The fifth trend has been an increasing incidence of **partnership of e-commerce operators with the Third Party Logistics Service Providers (3PLS)** like India Post in order to reach the hinterlands of the country. Last but not the least, the e-commerce operators' **expectations that GST would enhance their growth** because of its structure and operational efficiency; Logistics Service providers can leverage seamless '**hub-and-spoke**' models for delivery, resulting in lower costs and fewer bottlenecks.

## X. GST'S TREATMENT OF E-COMMERCE

### A. Current Indirect Tax System for E-commerce

The current indirect taxation system comprising Service Tax on provision of services, State VAT on sale of goods, and Central Sales Tax on inter-state sale of goods is not geared to recognize and accommodate the evolving business models of e-commerce. The Central Government has been collecting the Service Tax on the services provided by various e-commerce operators. During the 2015-16 Budget, the tax base was further widened by bringing in the concept of 'aggregator' and taxing the services provided by him. An aggregator has been defined as a person who owns and manages a web-based software application. By means of the application and a communication device, he enables a potential customer to connect with the persons providing services of a particular kind under the brand name or trade name of the aggregator. Soon thereafter, the liability for collecting and depositing Service Tax was shifted to the Aggregator, thus enabling a reverse charge mechanism, which allows charging Service Tax from the receiver instead of the provider of service.

In the existing indirect taxes, there are no specific provisions for e-commerce operators to pay taxes on sale of goods, or make any tax deductions from the payments made by them to the actual sellers of the goods. But many states have started prescribing Returns to be filed by the e-commerce operators with information relating to supplies made through their portal. Attempts by some states

to equate e-commerce companies operating through the 'Marketplace Model' as dealers, and collect State VAT from them have not succeeded; this has reference to the Kerala High Court judgment in *Flipkart Internet (P) Ltd. v. State of Kerala*<sup>5</sup>.

Currently, the e-commerce sector faces many difficulties, particularly in the following issues of indirect taxation. On classification issues, the challenge is a categorization of the offerings in e-commerce as 'goods' - inviting the payment of VAT/CST, or as 'services' - inviting the payment of Service Tax. Both State VAT/CST authorities and Service Tax authorities want to exercise their right over digital transactions like downloads of software, music, e-books, etc., leading to disputes and endless litigation. On the issue of compliance costs, the difficulties arise particularly in inter-state movement of the offerings of e-commerce operators. These relate to compliance of the requirements of statutory forms, way-bills, road-permits, registration of e-commerce market place entity for entry/sale of their offerings into a State etc.

There are many challenges in the management of supply chains. The shipments and returns across the country involve a lot of paperwork and other compliance costs. Further, at present, the sourcing, distribution, and warehousing strategies are designed by the companies from the perspective of minimizing the tax liability. Besides, in view of non-uniform tax (VAT, Entry Tax, etc.) structure across the States, the pricing of the goods and calculation of margins are a challenge at present. Further, there is a lack of clarity on taxation and documentation management for typical e-commerce sector transactions such as e-wallet (advance deposits by the consumers), cash-on-delivery (payment collected at the doorstep of the consumer), gift vouchers, drop-shipment (direct delivery of goods from the e-commerce company vendor to the e-commerce company customer), etc.

Conventionally, indirect taxation revolves around the physical presence and the physical movement of goods across jurisdictions. But e-commerce models are different because the supply of goods is happening across internet networks. Since it is difficult to establish and track the physical movement of goods and the millions of transactions, the possibility of pilferage and revenue leakages is high. However, problems in taxation are faced mostly in models wherein the e-commerce operator does not buy or sell the goods directly from the sellers but claims to only facilitate the sale. In these cases, the sale is being claimed to have happened between the seller and purchaser with the e-commerce operator being only a service provider to the seller. The operator charges a commission from the seller for each sale. In these cases, the seller is declaring the sale of goods in his returns while the E-commerce company only declares the total amount of "services" provided to the seller and pays tax on it. Thus, the e-commerce company completely dissociates itself from the act of sale of goods. However, as mentioned

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<sup>5</sup> *Flipkart Internet (P) Ltd. v. State of Kerala*, 2015 SCC OnLine Ker 31723 : (2015) 11 TMI 159.

before, some States have prescribed filing of information return by the e-Commerce companies operating on the marketplace or managed marketplace model, thereby receiving information about sales which have taken place through their portal.

## XI. GST LEGISLATION ON E-COMMERCE

From a taxation point of view, it is important that the online ordering and subsequent delivery of goods and services are taxed consistently and fairly. It is also important that the small traders not be adversely affected because of inconsistency in taxation practices. In the GST era, the challenge is tracking and taxing inter-state sales. The matter of incidence of CST on inter-state trade through e-commerce is already in litigation in a number of Indian states.

While the first draft Model GST Laws (MGL) of June, 2016 had retained the concept of aggregators, it has been dispensed with by the Revised Model GST Law published in November, 2016. Chapter XIV of the Revised MGL deals with e-commerce. Certain definitions relating to e-commerce have been given in Section 2 of the Revised MGL. The term ‘electronic commerce’ has been defined as the “*supply of goods and/or services including digital products over digital or electronic network*”.<sup>6</sup> The term ‘electronic commerce operator’ has been defined as “*any person who owns, operates or manages digital or electronic facility or platform for electronic commerce*”.<sup>7</sup> In the first draft MGL the definition of ‘e-commerce operator’ covered only the platform players. It had separately provided for an ‘aggregator’ in similar lines with the existing Service Tax provisions. Companies like Uber, Ola, OYO Rooms, etc. could fall under this category. As mentioned, the concept of aggregator has been dropped in the Revised MGL, and instead, the definition of e-commerce operator has been expanded to cover all kinds of e-commerce operators that include: Providers of a platform where supply and invoicing are done by the actual supplier (e.g. Amazon), Suppliers of their own goods/services online (e.g. Fabindia), and Entities which raise invoices for supply of others’ services (e.g. Google Play.)

There is only one section, i.e. Section 56 in the revised MGL which deals with Tax Collection at Source (TCS). It has twelve clauses. Every e-commerce operator providing a platform to facilitate the supply of goods and/ or services is required to collect tax at source while making payments to vendors, and file a statement giving details of the transactions. The vendors would then be eligible to utilize this tax amount to pay their output tax liability. Monitoring the businesses that supply goods and services *via* e-commerce operators appears to be the basic intention of the GST Council.

<sup>6</sup> Central Board of Excise and Customs, GST Council Secretariat, Section 2(41), Model GST Law (2016).

<sup>7</sup> Central Board of Excise and Customs, GST Council Secretariat, Section 2(42), Model GST Law (2016).

The most critical concern is that every vendor on the e-commerce platform will need to register, regardless of threshold, in every state where he supplies a good or service. The scheme of one central registration valid for the entire country is absent in the structure of GST. This will pose a great obstacle for small and occasional dealers who otherwise wish to increase their sales through e-commerce. The platform players would also be impacted since such dealers may decide to refrain from availing their services for effecting sales of the supplies. Further, it is not clear whether, for the purposes of depositing tax collected at source, the e-commerce operators would also be required to obtain registration in every state where the suppliers using their platform are situated.

Under the current indirect tax provisions, the vendors selling goods via e-commerce can not avail credit on Service Tax. The revised MGL has provided in Section 56(5) that the supplier using the facility provided by the e-commerce operator will be entitled to claim credit. Naturally, this will entail following the procedure of registering at each state of supply, and complying with the provisions relating to 'place of supply' in the cases of inter-state supplies.

The issue of multiple registrations depending upon the 'places' (read as states) of supply will be relevant for overseas suppliers as well. Currently, they discharge Service Tax through centralized registration either by themselves or through a representative.

## **XII. CONCERNS OF E-COMMERCE SECTOR**

The concerns of e-commerce sector regarding TCS can be summed up as follows:

Although the tax collected by the e-commerce operator and paid by the vendors would be available as credit to be utilized later for payment of output tax, it is estimated by a major e-commerce operator that at the current scale of business, around Rs.400 crores of capital a year, will get locked in the system and will not be accessible to sellers. This is likely to deter the sellers from transacting online on the platforms of the e-commerce operators. Secondly, TCS may also enhance tax costs since many such suppliers who are below the threshold do not pay VAT, Entry Tax or Service Tax on date. The small-scale and start-up suppliers would suffer since the threshold of Rs. 20 Lakhs for GST would not apply to such transactions in terms of the provisions of Para 6 of Schedule V of the Revised MGL. Thirdly, TCS would be a compliance hazard, especially in cash-on-delivery scenarios. Fourthly, IT and other systems will need to be restructured to ensure compliance with strict disclosure requirements as prescribed in the MGL. Finally, all the aforesaid responsibilities will put a huge accounting and manpower burden on the e-commerce operators. Given the fact that there are now lakhs of sellers facilitating millions of transactions on these e-platforms, all these concerns have

brought the major e-commerce operators including Amazon, Flipkart, Snapdeal, Paytm, Grofers, and Zomato, etc. together. Recently, in the second week of February, they voiced their GST concerns jointly.<sup>8</sup> Given that India's e-commerce revenue has been growing at an annual rate of 51%, it is hoped that the GST Council would mitigate their concerns by dropping the idea of TCS, and finding some other simpler way of monitoring businesses that supply goods and services via e-commerce operators.

GST must be beneficial to every sector of the economy. E-commerce being a comparatively new initiative which is growing at a commendable rate deserves to be dealt with deftly in the GST regime.

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<sup>8</sup> Yuvraj Malik, *Flipkart, Amazon, Snapdeal oppose tax collection at source under GST*, LIVEMINT, (February 9, 2017) <http://www.livemint.com/Politics/BZ9IUhcfkbofMcxIFAEo0K/Flipkart-Amazon-Snapdeal-flag-concerns-over-TCS-in-GST-d.html>.



# INTEGRATED GOODS AND SERVICES TAX (IGST)

—CA. Upender Gupta\*

**Abstract** The new regime of Goods and Services Tax as proposed to be brought in by inserting Art. 269A into the Constitution aims to simplify the process of paying indirect taxes, thereby boosting the economy. The article discusses the taxation models adopted worldwide like Origin-based Taxation, Deferred Payment and Reverse Charge, Dual VAT with deferred payment, Compensating VAT, Viable Integrated VAT, Prepaid VAT or the Split Payment Method and goes on to explain why the IGST model is best suited to Indian conditions. The advantages offered by this model for both the tax payers and the tax administrators have been highlighted along with certain essential requirements in the administrative set-up for the model's effects to be fully felt. The author finally argues that the IGST model has the potential to drastically reduce procedural barriers and create a common market, allowing the economy to flourish.

## I. IGST MODEL OF TAXATION

Goods and Services Tax, colloquially known as GST has been hailed as the single biggest reform that the indirect tax landscape of India will witness since independence. It has been proclaimed as a game changer, a reform that will act as a catalyst for the growth of Indian economy and put it on a higher trajectory. This reform proposes to do away with a large number of taxes levied on different economic activities by the Central and State Governments. Presently the Central Government levies tax on manufacture (Central Excise duty), provision of services (Service Tax), inter-state sale of goods (Central Sales Tax levied by the Centre but collected and appropriated by the States) and the States levy tax on retail sales (VAT), entry of goods in the State (Entry Tax), Luxury Tax, Purchase Tax, etc. All these taxes are proposed to be subsumed in a single tax called

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\* Commissioner (GST), CBEC, Ministry of Finance, GOI.

the Goods and Services Tax (GST) which will be levied on supply of goods or services or both at each stage of the supply chain starting from manufacture or import till the last retail level. GST is proposed to be a dual levy where the Central Government will levy and collect Central GST (hereinafter “CGST”) and the State will levy and collect State GST (hereinafter “SGST”) on intra-State supply of goods or services. The Centre will also levy and collect Integrated GST (hereinafter “IGST”) on inter-State supply of goods or services. There is also a proposal to levy non-VAT-able Additional Tax not exceeding 1% on inter-State supply of goods. This tax would be levied and collected by the Centre and assigned to the originating State.

Before the IGST Model and its features are discussed, it is pertinent to understand how inter-state trade or commerce is regulated in the present indirect tax system. It is important to note that presently the Central Sales Tax Act, 1956 regulates the inter-state trade or commerce (hereinafter “CST”) the authority for which is constitutionally derived from Article 269 of the Constitution.<sup>1</sup> Article 269 reads as follows:

Article 269:

- (1) Taxes on the sale or purchase of goods and taxes on the consignment of goods shall be levied and collected by the Government of India but shall be assigned and shall be deemed to have been assigned to the States on or after the 1st day of April, 1996 in the manner provided in clause (2).

Explanation.—For the purposes of this clause,—

- (a) the expression “taxes on the sale or purchase of goods” shall mean taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce;
  - (b) the expression “taxes on the consignment of goods” shall mean taxes on the consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce.
- (2) The net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Union territories, shall not form part of the Consolidated Fund of India, but shall be assigned to the States within which that tax is leviable in that year, and shall be distributed among those States in accordance with such principles of distribution as may be formulated by Parliament by law.

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<sup>1</sup> INDIA CONST. Article 269.

- (3) Parliament may by law formulate principles for determining when a sale or purchase of, or consignment of, goods takes place in the course of inter-State trade or commerce.

CST, which has been in force for a number of decades in India, is now disclaimed as being the single greatest obstacle to the growth of inter-state trade in the country. CST can be said to be a major reason for India still being a political union rather than an economic union. Not only is it non-VAT-able [i.e. credit of CST is not available as Input Tax Credit (hereinafter referred to as “ITC”) for payment of other taxes], but the fact that it is administered through forms and archaic procedures, and regulated through check posts and *nakas*, has made it a big deadwood for the capacity and capability of India’s competitiveness in the international market. Another negative feature of CST is the opportunity it provides for ‘arbitrage’ because of the huge difference between tax rates under VAT and CST being levied on intra-State sales and inter-State sales respectively. In the proposed scenario, the IGST Model has emerged as a beacon of light in the field of darkness encompassing the sub-national VAT and has the capacity to positively influence the dynamics of inter-State trade in a manner unfathomable earlier.

To explain, if GST can be viewed as a body, its heart would definitely be the taxation of inter-State supplies. Worldwide, wherever the GST, commonly known as ‘VAT’, has been introduced, countries with federal set-ups having sub-national entities have been using different models to deal with the intricacies of trade taking place across sub-national entities. A large number of models are already in vogue for handling supplies, which take place in the course of inter-sub-national trade or commerce. Some of the key models being presently used by various tax administrations across the world are as follows:

- (i) Origin-based taxation: In this model, tax is paid at the point of origin with no further credit. This model fails to meet the requirements of a common single market and leads to large number of refund claims.
- (ii) Deferred Payment and Reverse Charge: In this model, sales to registered buyers outside the State are zero-rated and tax is paid by the recipient on reverse charge basis at the entry point. The model is used in the EU and leads to considerable leakages (carousel frauds). The model requires massive exchange of information between the taxpayers located in the originating and destination locations.
- (iii) Dual VAT with deferred payment: Here a single tax administration (normally central) collects the central as well as state tax. The remaining attributes are more or less same as in the previous model. The system is the most popular globally and is applicable in Canada, Australia, Germany and many other federations. The system works well when tax is collected

by the central government, which has the power to enforce it both at the point of origin as well as destination.

- (iv) **Compensating VAT (C-VAT):** This model allows taxation of all inter-State sales as a federal levy at a specific rate. If the states have variable rates, the C-VAT rate could be taken as the lowest, average or the highest of the applicable rates. C-VAT paid on inter-state sales is available as ITC from the federal taxes only, or refunded when the proof of their subsequent taxation in the destination state is produced. This model works well only when the state rate is relatively much lower, thereby permitting its credit entirely from the federal tax from the possible value addition at the next stage. Thus, if the federal rate is 18% and the state rate is 5% it is possible to impose CVAT at the rate of 5% and allow its credit from 18% tax rates applicable at next stage if the value addition is up to 20% at the next stage.
- (v) **Viable Integrated VAT (VIVAT):** In this model all Business to Business sales (B2B sales), whether intra-State or inter-State are subjected to a specific rate. Since tax paid on B2B sale is mostly eligible as ITC, it helps in maintaining the tax chain, which is settled through a clearing house mechanism. However the method suffers from the disadvantage of treating intra-State and inter-State sales differently. Moreover, it requires knowing the status of the buyer at the time of sale. It also suffers from the disadvantage of the possibility of revenue reaching the wrong State as inter-State B2C (Business to Customer) revenue is retained at origin.
- (vi) **Prepaid VAT (P-VAT):** Under this model, the buyer has to deposit the tax directly with the destination state and send the proof of payment to the seller. The liability of the seller is deemed to have been discharged on furnishing the proof of tax payment by the buyer. If the seller does not show the proof of payment of tax to the Destination State, he has to personally discharge the liability. This method allows immediate ITC as soon as the payment of tax is made and does not leave the buyer at the mercy of the supplier discharging the liability.
- (vii) **Split Payment Method (SPM):** In this model, the buyer pays the tax to a blocked bank account with the tax authorities' bank, which can only be used by the seller for discharging his tax liability. The chain of payments is thus completed while at the same time final payment by the ultimate seller ensures that the payment is credited in the destination state. In other words, the tax account is kept segregated at all stages and thus the amount of tax is available for reaching the destination state quite easily.

A question may be posed as to why India chose to develop a new model of taxation despite the existence of numerous other pre-existing models. To understand this, it is important to know the various parameters on the basis of which

a sub-national VAT system needs to be evaluated. The following factors are the major touchstones of judging a good sub national VAT system:

- (i) State autonomy in tax-setting: The system should help preserve tax-setting power for sub-national governments. This is of great importance in India as State governments are permitted to have the power of actual tax collection in their respective jurisdictions.
- (ii) Destination principle: The revenue on the final consumption should belong to the Destination State. Moreover the revenue should be available to the Destination State as soon as the taxable event is completed and taxes are paid by the supplier.
- (iii) Compliance symmetry: The business transactions within the State and across different States should be treated identically.
- (iv) Proper tax incentive to the administration collecting the tax: The implementation of the proposed model should not require additional manpower. Additionally, it should not make an administration responsible for the collection of tax when the benefit thereof would actually accrue to some other State.
- (v) Avoid predatory competition amongst States: While maintaining the State's autonomy, the system should not permit the States to do mutual harm by exporting taxes to the Destination State or engage in tax wars to stake claim on the tax base of other States.
- (vi) Preserve the ITC chain: It should be ensured that the ITC chain not break as the breakage will compromise the twin objectives of establishing a single common market and removing cascading.
- (vii) Minimise cost of compliance for taxpayers: The purpose of GST and its consequent impact on GDP growth will be compromised if the system adds significantly to the cost of compliance.

It is important to note that the models under use globally suffer from the following drawbacks:

- (i) Lacks compliance symmetry i.e. different treatment to B2B and B2C sales – models are only designed to handle B2B sales;
- (ii) B2C sales are taxed in originating State thereby violating destination principle;
- (iii) Leads to increase in compliance costs which in turn –
  - a) results in blockage of funds;
  - b) refunds of State VAT portion in exporting State and that of federal taxes in importing;

- c) delays in availability of ITC to buyers;
- d) results in lack of incentives to States for tax collection; and
- e) fails to check tax evasion as taxes are mostly paid on reverse charge basis and not by the supplier at the time of sales.

Thus it may not be incorrect to say that the models discussed above have certain imperfections that make them unworkable in a federal set-up like India, especially since India is going to have Dual GST model. Therefore, the IGST model was adopted to fit into the Indian economic and political matrix. The IGST model is an ode to Indian ingenuity and innovativeness as it tries to overcome the pitfalls associated with the various models discussed above and tries to achieve the objectives of harmonised sub-national VAT. For understanding IGST Model, it is important to look at the constitutional framework for taxation of inter-State supplies which is provided in the proposed Article 269A of the Constitution (122nd) Amendment Bill.<sup>2</sup> The relevant provision is as follows:

Proposed Article 269A:

- (1) Goods and services tax on supplies in the course of inter-State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Explanation— For the purposes of this clause, supply of goods, or of services, or both in the course of import into the territory of India shall be deemed to be supply of goods, or of services, or both in the course of inter-State trade or commerce.

- (2) Parliament may, by law, formulate the principles for determining the place of supply, and when a supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

It is discernible from a plain reading of the proposed Article that:

- (i) IGST would be levied on the supply of goods and/or services that take place in the course of inter-State trade or commerce;
- (ii) It would be levied and collected by the Central Government;
- (iii) The collected IGST would be apportioned between the Union and the States in the manner as may be provided by the Parliament by law on the recommendations of the Goods and Services Tax Council;
- (iv) Imports would also be subjected to IGST; and

<sup>2</sup> The Constitution (122nd) Amendment Bill, 2014, Article 269A.

- (v) Parliament would lay down the principles for determining the Place of Supply Rules (hereinafter referred to as “POSR”) that would determine the character of supply i.e. whether inter-State or intra-State.

Some of the features of this Model are considered to have the potential to revolutionise the inter-State trade or commerce. These are:

- (i) IGST would be leviable on any supply of goods and/or services that would take place in the course of inter-State trade or commerce;
- (ii) There is no difference in the treatment of Business to Business (B2B) supplies or Business to Consumer (B2C) supplies;
- (iii) It would be a stand-alone tax that would be paid by the supplier in the exporting State. The supplier can utilise the ITC of CGST as well as that of SGST paid by him at the time of intra-State procurement and that of IGST paid by him at the time of inter-State procurement for discharging the liability of IGST;
- (iv) The purchaser in the importing State would be able to take full ITC of IGST paid by the supplier in the exporting State;
- (v) The purchaser can utilise the said ITC for discharging his tax liabilities on account of IGST, CGST and SGST associated with his supplies whether inter-State or intra-State;
- (vi) The IGST would be permitted to be utilised for payment of IGST, CGST and SGST in that order;
- (vii) The exporting State would transfer the amount of SGST utilised by the supplier for payment of IGST to the Central Government;
- (viii) The Central Government would transfer the amount of IGST utilised for payment of SGST to the concerned importing State;
- (ix) The Central Government would also transfer the SGST portion of IGST paid by the taxpayer in the exporting State on B2C inter-State supplies to the importing State.
- (x) The transfer of funds would be carried out by the Central Government on the basis of information contained in the periodical returns submitted by the taxpayers;
- (xi) Central Government would act as a clearing house for transfer of funds between the exporting State and Centre on the one hand and between the Centre and importing State on the other hand.

The essential requirements for the successful working of the proposed IGST Model cannot be overemphasised, particularly when the ITC of taxes paid in one State are allowed to be utilised by the taxpayer located in other State(s).

The model would work with inbuilt system-based validations and checks on all aspects of availment and utilisation of ITC as well as that of tax payments. There are certain other requirements for successful working of the model that are as follows:

- (i) Uniform e-registration of taxpayers;
- (ii) Common e-return for all types of taxes namely CGST, SGST & IGST;
- (iii) Common periodicity of returns for a class of taxpayers if not for all;
- (iv) Uniform cut-off dates for filing of e-returns;
- (v) Mandatory reporting of supply and purchase invoice details prior to or along with filing of e-returns;
- (vi) System based verification of returns;
- (vii) Well laid down Place of Supply Rules for determining the nature of supply.

The IGST Model scores over the presently used models elsewhere in the world in many ways. This model appears to be a win-win situation for the taxpayers as well as for the tax authorities. Some of the advantages of this model are as listed below:

- (i) For Taxpayers:
  - a) Maintenance of uninterrupted ITC chain on inter-State supplies for taxpayers located across States;
  - b) No refund claim for suppliers in exporting State, as entire ITC is allowed to be used while paying the tax;
  - c) No substantial blockage of funds for the inter- State supplier or recipient;
  - d) No cascading as full ITC of IGST paid by supplier is allowed to the recipient in the Destination State;
  - e) Suppliers are required to pay taxes in the State where they are located and they are not required to obtain registration in Destination State only for payment of taxes;
  - f) Tax reaches the Destination State through clearing house mechanism based on the information contained in the periodical returns submitted by the taxpayers;
  - g) Model handles Business to Business as well as Business to Consumer supplies.

(ii) For Tax Administrations:

- a) Upfront tax payments by suppliers in the exporting State;
- b) No refund claims on account of inter-State supplies;
- c) Proper tax incentive to the administration for collecting the tax;
- d) Avoids predatory competition amongst States;
- e) Tax gets transferred to Importing State in accordance with the Destination principle;
- f) Self-monitoring model as taxes are paid upfront and full ITC is allowed to taxpayers located across the States;
- g) Results in improved compliance levels;
- h) Effective fund settlement mechanism between the Centre & States.

Overall it can be said that the introduction of GST in the country would open up new vistas in the field of indirect taxation in the country. It would be the first time when both the governments, that is, Central and State, would have taxation powers over the entire supply chain- thereby ending the fractured mandate of taxation that has been the bane of indirect taxation for so long. Additionally, GST would create a common national market by freeing the inter-State trade from the chains of forms and anachronistic procedures and more importantly from cascading of taxes that has been contributing towards increasing the cost of carrying out business without any resultant benefits. The choice of IGST Model for dealing with inter-State supplies points towards one objective- the creation of a common national market and unleashing the chained energy of the Indian manufacturing capacity. It is said that India has the potential to be the leading economy of the world and the advent of GST can play a crucial role in this regard.

Disclaimer- The views expressed in this article are solely the author's and are not representative of the Government's stand.



## TRANSCRIPT OF THE IX NLSIR SYMPOSIUM ON “GOODS AND SERVICES TAX: THE CHANGING FACE OF FISCAL FEDERALISM IN INDIA”

### I. SESSION I: CONSTITUTIONAL CHALLENGES AND CONCERNS

The opening session of the Symposium began with a framework presentation by Mr. Aradhya Sethia, a IVth year student of National Law School of India University, Bangalore. The framework presentation foregrounded the debate on the constitutionality of the 122<sup>nd</sup> Constitution (Amendment) Bill, 2014 (hereinafter “the GST Bill”). He divided this inquiry into three sections—*first*, an identification of the broad values that have been envisaged under the GST Bill and the status of those values under the Constitution; *second*, the alleged conflict between the GST Bil and the Basic Structure of the Constitution, and consequently, *third*, whether, if passed, the Bill can be deemed to be in contravnetion of the Basic Structure. Mr. Sethia also noted that the Bill incorporated provisions (in Clauses 18 and 19) which would not amend the Constitution. He noted this drafting peculiarity and questioned the validity of these clauses.

The first panel speaker was Mr. N. Venkatraman. He organised his exposition by framing three questions: (1) What is wrong with the present idirect tax regime? (2) What does the GST attempt to do? (3) What constitutional issues resultantly arise? With respect to the first question, he began by describing the structures of, and differences between, the direct tax and the indirect tax regime. Whereas Customs, Excise, Service tax, and Central Sales Tax are levied by the Union government, states only have monopoly over intra-state sales (VAT). Consequently, the Central Government’s taxing powers currently greatly outweigh that of the states. In this context, he highlighted two major issues: the classification of transactions into ‘sales transactions’ and ‘service transactions’, and the problem of classification of a sales transaction as ‘inter-state’ or ‘intra-state’. In his opinion, the nebulous nature of the two classifications is the primary cause of the high rate of pendency in courts and tax tribunals.

Mr. Venkatraman used two situations to exemplify his point. *First*, while identifying a transaction as a sale or service, he referred to transactions relating to intangible rights such as copyright and trademark. If one granted the right to use for say, five years, the Constitution would declare it a sale under Article 366(29A). On the other hand, if he retained the right to use, but allowed permissive use by various people, granting them limited rights, such that rights are not conferred exclusively on any person, then that transaction would only be subject to service tax. Due to the subtlety of the distinction, the same transaction is frequently taxed as both sale and service.

*Second*, Mr. Venkatraman referred to entry tax for online transactions, most of which are inter-state. He noted that the advantage of e-commerce is that if one makes purchases locally, the transaction will be subject to VAT; if the purchase is inter-state, then customers save money (as rate of sales tax is only 2%). This results in a 'tax war' where the online seller has an advantage. In an attempt to protect local dealers, various states have attempted to tax these transactions through the levy of entry tax. For example, if the local rate is 5.5% and import rate is 4%, states impose entry tax of 1.5% so that it matches the local rate. He referred to Constitution bench judgments which have upheld this sort of taxation. The problem arises here because in some states, in case of an inter-state sale through a physical dealer, the transaction is not subject to entry tax, however, if the transaction were virtual, entry tax liability is attracted. In his opinion, this situation was *prima facie* absurd.

Mr. Venkatraman argued that these absurdities are capable of resolution by the introduction of the GST regime, which would integrate and subsume all extant systems of taxation. He explained the proposed dual levy (of CGST and SGST), and stated that it was a major leap that would integrate both goods and service transactions. It does so by removing the relevance of the distinction between goods and services in law and by providing for the joint exercise of powers of taxation by the states and the union, which, he asserted, was an extremely progressive step. He referred to the proposal to introduce a new article – Article 246A – which uses the phrase "goods and services tax", and empowers both the Union and State to concurrently tax. Mr. Venkatraman drew a delicate distinction between 'concurrently' and 'simultaneously'. In case of the latter, it means that both the Centre and the states have power to carry out an activity, and can do so *at the same time*. In case of the former however, the Centre and the State need not exercise of power at the same time, although both are so empowered. In the case of simultaneous exercise, there can be no conflict. In the case of concurrent exercise of power, conflict leads to the predominance of the Centre. Mr. Venkatraman stated that this distinction is very important and is the reason behind the decision to not incorporate GST into List III in the VII Schedule of the Constitution. Article 246A, instead of referencing any list, grants both the State and the Centre simultaneous powers of taxation. He pointed out that this

grant of the 'power of taxation' was different from 'field of taxation', which finds place in the VII Schedule.

Finally, Mr. Venkatraman discussed the GST Council, which has been granted constitutional status (unlike the empowered committee, which was merely an advisory body). He directed attention to the differential voting power granted: 1/3 to the Union, and 2/3 to the states and to the fact that the decision of the GST Council would only be recommendatory. Mr. Venkatraman argued that making the decision recommendatory was an unnecessary compromise, and that even if the Council's decisions had been granted mandatory status, the basic structure of the Constitution would not be impugned. He substantiated this by pointing to the space provided for the states to participate and mold decision making. In his opinion, this constituted a sufficient protection of fiscal federalism. He finished his speech on a progressive note, calling for a national, rather than parochial, approach to fiscal and economic policies.

The second panelist was Mr. Sudhir Krishnaswamy. He began by discussing the issue of fiscal federalism, which in his opinion, does not find support anywhere in the Constitution. While it may find articulation in the work of constitutional bodies, as well as the support of the principles of equity and efficiency such as under Article 280, Mr. Krishnaswamy argued that it was not a constitutional principle. In his mind, it could only be considered as an institutional principle, or as a way of organising vertical (centre-state) and horizontal (state-state) relationships. Mr. Krishnaswamy then elaborated the core norms of fiscal federalism as an institutional principle.

These norms entail, *first*, that the power to tax and collect revenues must follow functions allocated to the tier of government. This is described as 'form follows function', a doctrine which he finds surprisingly absent from Indian discourse. He noted that stakeholders in Indian polity have not asked why one tier of government is granted certain fields of taxation. Even though decentralisation is projected as a desirable policy, he pointed out how this has heretofore been restricted to administration alone; taxes are not decentralised. Therefore, although the local government carries out a lot of core functions important to the citizenry, it collects the least amount of tax.

*Second*, Mr. Krishnaswamy referred to fiscal balance as a virtue of fiscal federalism. There must be a vertical balance between federal and state units, as well as a horizontal balance between states. Although balance is often used synonymously with parity, this does not translate in India to equal sharing of revenue between the Centre and the states or to states receiving per-capita equal amounts of revenue. Mr. Krishnaswamy argued that in India, we have struggled with the horizontal dimension. While reports, such as the last Financial Commission Report, have spent a lot of time on the vertical dimension, they barely focus on the horizontal dimension. Mr. Krishnaswamy pointed out that the GST Bill also

does not address this adequately, particularly given the legal uncertainty regarding Clauses 18 and 19 of the GST Bill.

*Third*, fiscal federalism is also concerned with equity and efficiency. Mr. Krishnaswamy began by describing how the GST system envisages equity not only between states, but also equity in terms of an overall lower incidence of tax, which would be good for all sections of society. He argued that the GST Bill does not capture this adequately. The resulting regional disparities in revenue collection, which will become very visible under the GST regime, could have significant impacts on nation-building efforts. He referred to Canada, which, post-GST reforms, had to deal with an intensification of the secessionist movement in Quebec. He felt that constitutional lawyers should help expand the debate, and move from a purely market-based approach to one that also takes into account political forces.

Mr. Krishnaswamy also noted certain other lacunae in the draft of the GST Bill. *First*, he argued that Mr. Venkatraman's thesis on the distinction between 'concurrent' and 'simultaneous' exercise of power stems not from Article 246 but from Article 248 of the Constitution. Mr. Krishnaswamy stated that this distinction being drawn was the most plausible explanation of the strange blurring of lines between the source of taxing power and the field of taxation by the GST Bill. Regardless, Mr. Krishnaswamy posited the belief that it is Article 248 that requires amending.

*Second*, he examined the Clauses 18 and 19 of the GST Bill, which, without amending the text of the Constitution, have substantive legal outcomes and affect rights and obligations. As an amending act, Mr. Krishnaswamy stated that the GST Bill has no independent force over and above changes to the Constitution. Therefore, once the Bill is passed, and the amendments to the Constitution made, the validity of Clauses 18 and 19 may be highly questionable.

*Third*, regarding the need for the GST Council, Mr. Krishnaswamy argued that unlike other constitutional dispute resolution bodies such as the National Development Council, the GST council had a specified decision making process. Mr. Krishnaswamy raised the question as to why this was so, and why the decisions were to be only recommendatory. Finally, he questioned the exclusion of the judicial review of these decisions.

The third panelist was Mr. Alok Prasanna Kumar. He began by examining the right of states to levy taxes. He stated that under the Indian constitutional scheme, the states were not mere appendages to the Centre, but are sovereign in their own fields of taxation, and that while fiscal federalism may not be a part of the Basic Structure, 'federalism' certainly was. Therefore, clear demarcations of power, a principle essential to federalism, were necessary. Under the Indian constitutional design, states were meant to have the power to tax simultaneously.

Consequently, the distinction between 'concurrent' and 'simultaneous' assumes importance.

Mr. Kumar then chose to focus on some key issues with the constitution and functioning of the GST Council. *First*, the 2009 version of the GST Bill had stated that the Council would recommend based on consensus. The 2014 Bill on the other hand envisages decisions by majority vote. Where decision is by consensus, there is a role of state governments, however, under the present scheme he highlighted that it appears that the states would be "bound" by the majority decision. He then questioned whether this would indeed be a recommendation or in fact a decision. He pointed out how the Bill itself is unclear because it uses the word 'decision' in the beginning of the Bill, but subsequently uses 'recommendation' under Article 269A and in Clause 18. In his view, it appeared that the GST Council would arrive at a 'decision'. This is based on the fact that the Bill envisages the potential of disputes between the Centre and the states. If the GST Council was only making recommendations that would not be binding on the states, then the question of disputes would not arise. On that basis, he argued that the word 'recommendation' was a reflection of an oversight in drafting.

The *second* issue pointed out by Mr. Kumar is the manner in which the GST Council would take said decisions. He referred to the combination of the grant of 1/3<sup>rd</sup> votes to the Centre, and the requirement of 3/4 majority to show how the Centre by definition can never be in the minority. This effectively grants it a veto right. Mr. Kumar argued that the standing committee on GST has not examined this at all, although he approved the dissenting note by Navneetha Menon.

*Third*, Mr. Kumar pointed out how the states have no remedies against the decision of the Centre emerging out of the GST Council. He stated that as per the statements of the Centre, the states cannot find redressal even under Article 131. This, according to Mr. Kumar, significantly affects federalism, potentially even harming the basic structure of the Constitution.

He concluded his presentation by stating that although a strong case may be made out in favour of GST, the issues in implementation that it poses are serious. In its current form it institutionalises an adversarial relationship between the Centre and the states, which would only further a pernicious trend in such relations.

After the conclusion of Mr. Kumar's speech, panelists responded to each other's presentations. Mr. Venkatraman addressed the question of fiscal federalism raised by Mr. Krishnaswamy. Stating that fiscal federalism was a constitutional guarantee, Mr. Venkatraman referred to Part XIII of the Constitution, which disallows fiscal barriers or tariff walls. Withal, responding to Mr. Kumar, Mr. Venkatraman argued that the GST or the GST Council was not capable of eroding the power of states. Taking a more optimistic political view, Mr.

Venkatraman argued that federalism would not be eroded by the functioning of the GST Council. He also argued that the shift to a destination-based taxation system might disincentivise state investments in infrastructure and states may not as actively encourage production within its territory. Finally, on the issue of judicial review, he pointed out that writ jurisdiction under Article 226 could never be barred, given the decision of the Supreme Court in *L Chandra Kumar v. Union of India*<sup>1</sup>. Taking the example of the GST Council, he pointed out how while the decision itself may not be capable of challenge, the decision-making process was always assailable. He concluded his speech by arguing that a Centre-heavy GST Council is desirable as it would promote an unified economic policy, which is suitable for accelerated economic development.

Mr. Sudhir Krishnaswamy had three responses. *First*, he argued in favour of cooperative federalism, which he feels is uniquely valuable for the democratic process. *Second*, he stated that partisanship or an adversarial approach is in fact desirable in the GST Council. From the early 2000s, the debates on GST have been based on partisanship, and that is the very foundation on which the empowered committee system worked. He believed that the process of give and take that this resulted in was to be independently valued. *Third*, he reiterated his point on fiscal federalism. While some aspects of it (such as in Chapter XIII) may find resonance in the Constitution, its core values have not been constitutionalised.

Mr. Kumar restricted his response to two issues. *First*, he stated that given the vast differences in development goals that different states have, a consensus-based approach to the GST Council's decision making process would be ideal. *Second*, on the question of unified economic policy, he referred to the statement of Mr. Y.V. Reddy that states are ultimately equipped with the best understanding of their fiscal situation. He concluded by stating that any GST regime needs to have more respect for the federal structure.

## II. SESSION II: UNDERSTANDING THE DUAL GST SYSTEM

The second session of the Symposium was intended to examine the possible issues that may arise as part of a system of dual levy and collection under the GST regime. Mr. Alok Prasanna, the moderator, opened the session on the Dual System or 'System of Simultaneous Taxation' by raising three primary issues: *first*, what would the implications of this proposed Dual System on the taxation regime in India be; *second*, how would the exclusion of goods such as petroleum products and alcohol, affect the goals/benefits which the GST Bill promises to achieve; and *third*, how an input credit taxation system would be introduced and implemented in the country.

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<sup>1</sup> (1997) 3 SCC 261.

Ms. Mathavi Senguttuvan, a student at the NLSIU, then made a framework presentation, explaining in brief the various issues to be discussed. She spoke about how implementation of the proposed Dual GST model in India would be carried out through the enactment of three categories of taxes: CGST and IGST by the Central Government and SGST by the State Government. In simple terms, there would be separate entries showing the imposition of CGST and SGST if the transaction counted as *intra-state* supply of goods and services and one entry showing the imposition of IGST if the transaction was an *inter-state* supply of goods and services.

She highlighted that the authority of the Union to levy taxes on goods such as alcohol, tobacco, and petroleum under the GST Bill was excluded because of the insistence of states that such products be excluded from the GST dual regime. In analysing the proposed system as the mirror of the current system, Ms. Mathavi submitted that the inclusive power of the GST Bill would subsume indirect taxes such as excise duty, service, central sales tax, VAT, octroi, etc. within it. This effectively amounts to a rehashing of the existing indirect taxation laws under the garb of creative nomenclature. Another instance of this 'mirroring' of the present structure is with reference to the input tax credit mechanism, which will allow for the setting off of one union tax against another and one state tax against another.

The first panelist to speak was Dr. Govind Rao. He started off with the history of the GST Bill and how the whole idea of a GST started. It was the Raja Chelliah Tax Reform Committee of 1991 that first proposed to broaden the tax base and to include the service sector in the tax net within the VAT System. The recommendations of the Chelliah Committee were taken forward by Vijay Kelkar Committee in 2002, which recommended the installation a full-fledged GST in India.

He considered two primary recommendations. The first was to tax all services that formed part of the economy and provide credit for goods against services (and vice-versa), while the second was to give concurrent powers of taxation to the states, based on 'Place of Supply' rules that take away the power of the Centre to levy inter-state taxes.

He spoke of how progress on the GST had remained stalled for the last fifteen years, and of the existence of "a tyranny of the status quo": those who would gain from reforms were not grateful, and those who would lose out tend to be vengeful in their opposition. His primary concerns, as he laid out, were to effectively lay out the effects the GST Bill would have on the economy; what sort of changes it would bring about; and the structure that was likely to emerge out of the same. To that end, he spoke of how a GST could be equated with a VAT on goods and services using a destination-based system of taxation, and marvelled

at the concern for state autonomy in this regard, when no such qualms had been displayed when VAT itself was introduced.

In a system of taxation, he stated, fiscal autonomy and tax harmonisation would be permanently conflicting, particularly when one considered the three costs to minimise. The collection cost, compliance cost and distortions to the economy could all be positively correlated with variations across the states, with trade diversions and variations in industrial growth looming. The compromise would be to introduce a measure of uniformity, while providing certain tax handles to the states.

Apart from the US, most countries in the world have moved over to the GST model of taxation. Even in the US, discussions on the efficacy of doing so along with proposals for a Retail Sales Tax that emulates many features of the GST dominate. However, there was a considerable degree of variation that arose as regards the level of uniformity and harmonisation that existed across and within nations, such as Germany, Switzerland, Canada, the EU and Brazil. Australia for instance, when introducing the GST, reduced state autonomy and determined taxation and levying through the Commonwealth Grants Commission, bringing about a degree of harmonisation.

Moving on to a comparative analysis of how GST systems could be implemented, he praised Canada for achieving uniformity and a considerable amount of harmonisation. However, he did point out differences in how various Canadian territories acted as regards GST, such as Alberta not levying taxes and relying only on oil revenue, Quebec having its own traditional VAT mechanism, with other regions having greater commonalities with each other. Having made these comparisons, he noted the situation in the EU, which is regarded as insufficiently tackling uniformity in that cross-border trade has led to significant problems. No country within the region had one rate of taxation, except for Denmark. Withal, he stressed that the example of Brazil ought to cause the greatest caution. Brazil has a federal GST which discriminates between provinces, and combines an Origin as well as Destination-based system of taxation, thus affecting both uniformity and harmonisation.

The benefits of a properly implemented GST system would be immense, as it would simplify the taxation regime, make it more transparent, broaden the tax base and collection, introduce neutrality via removal of import and export dues, improve export competitiveness, and create a common market. A Destination-based system was also spoken of highly, as it would create more responsive and localised mechanisms, as people in poor states would no longer be taxed, for instance, on the basis of industrialised Maharashtra's tax regime for goods made in the latter state.

Dr. Rao then spoke of the principle of 'separation of taxation', as created by the Union, State and Concurrent Lists in the Constitution, and emphasised that these were not to be considered mere economic differentia. As a policy device, they had been deliberately put into the Constitution, and now the status quo would mean both the Centre and the States would be unwilling to give up their power of levying taxes. He spoke of the delay in properly taxing services as an expansion of the tax base, which in his opinion, was inserted in the Union List far too late.

He stated that a dual levy of taxes was easily possible, given the current state of technology, while the objective would be to keep the two systems *parallel* without creating undefined interface between them. In his understanding, given the nature of a transaction, the base price of a product and the CGST on it could be determined separately from the SGST, and the IGST would anyway combine them and look at the destination of the product concerned to determine the respective rates.

He then moved on to the issue of goods excluded from the ambit of the GST, and spoke of alcohol and petroleum products, in respect of which there are specific entries in the Constitution, the power of taxation over which was given to the States, not the Union. While there could be an excise duty on the consumption of alcohol, a concern over potential sumptuary levies by the states as well as the effect of continual changes politically, such as the introduction of Prohibition in various states, would remain.

For petroleum, which has singular value as a revenue item, the states are characterised by various differences arising out of a potential loss of revenue, with the current variable rate structure allowing for greater control over business and easy revenue. Therefore, the Bill's response is to treat it differently from other products with a provision that over a period of time, the GST Council will decide on the status of a separate duty on petroleum.

Moving on to the question of GST as a potential 'game-changer' with regard to the economy, Dr. Rao criticised the terms of reference utilised by the 13<sup>th</sup> Finance Commission, which was to look into the potential effects of its levy on the economy, and the compensation mechanism which had to be developed to compensate the states for lost revenue. He stated that the Commission assumed that perfect implementation of the GST would be carried out, relied on insufficient data by looking at the Input-Output Coefficient from 2002-03, which was before the VAT came in; all of which could help account for the 1.6-2% economic growth that would be added by the GST Bill. More importantly, such analysis ought to have been left for when the structure and states' agreement could be reliably known, for without both, looking into what the tax could do was patently impractical, and highly speculative.

Dr. Rao was followed by Ms. Parthasarathy, who highlighted the remarkably quick evolution of changes to the GST framework. In her opinion, among other things, the excise duties that existed would change as states would modify their transfer of property rules depending upon just how taxation was altered. GST, obviously, would be on the supply of goods or services or both, but transactions would have to be taxed differently, for example, at the point the transaction was invoiced.

What would be subsumed under the GST would be key transaction taxes under Centre and State laws, while customs duties and a wide variety of cesses, surcharges and State taxes would continue right alongside the local levy of municipal taxes. This would create a wide variance in the manner of taxing different transactions. On the other hand, services such as luxury taxes, Service Tax, VAT should in fact be subsumed within the law.

The tax rate for GST was intended to be revenue neutral, in that it would not affect the revenue that was to be earned via the earlier tax system. The original system proposed a 12% rate, with the Centre getting 5%, and the States getting 7%. While there was some controversy over a report that suggested a revenue neutral rate (RNR) would entail a 27% rate, it was only one among about 20 simulated rates, with projections based on variations in the goods included within the GST.

Currently, 18% is seen as a suitable compromise, accounting for variations in excise, VAT, and various cesses, as well as the ability to arrange for crediting mechanisms. The effective rate of service tax, she stated, would probably not rise significantly. The 1% tax on inter-state transactions would be, in Ms. Parthasarathy's opinion, be scrapped or withdrawn. She further stressed that the market's realities should be accounted for in a multi-tier rate structure, where essentials would have a 0% tax rate; materials such as bullion and precious metals and gold would be taxed at 1%; and a lower rate for 'almost-essentials', going up till 18% for certain goods.

With services, on the other hand, a single tax rate is proposed, though the Bill recognises individual states' power to calibrate and decide their specific rates of taxation within a narrow band. However, this would still allow for potential rate arbitrage, and the alteration of distribution and supply chains based on the taxation policy applied to the business. An instance of this could be seen in the current system, where FMCG companies moved to regional warehousing not to be closer, but due to a 4% CST being levied on inter-state transactions.

Right now, an individual only needs to know the rate in the 'state of origin'. If this were to be changed to the destination rate is to be taken, one will have to know the IGST for all conceivable transactions, which would lead to a rise in compliance costs unless a single IGST rate can be achieved. Other issues are

diversion of trade (such as by warehousing to avoid CST), labelling and transaction-source manipulation (such as claiming the customer was provided a service from a corporate office in Delhi rather than Karnataka), which could arise to take advantage of the variations that may exist as regards IGST and other rates of taxation. She stressed that fiscal autonomy should not come at the cost of business, given that the current system has been remarkably effective at scaring investors.

She also referred to the planned credit pools, in terms of the CENVAT, the CENVAT Service Tax and the Central Excise Tax, as well as the benefits of a centralised compliance mechanism. She regarded the creation of an IGST credit pool to be of some importance, given the benefits that would flow out of a combination of it and existing systems. The importance of understanding how this would affect commerce in actuality was emphasised, and the same was illustrated by how severely this would affect a service provider when compared with the effect on a manufacturer.

To end her presentation, she spoke of the problem of dealing with the chain of taxation, and how the GST could perhaps introduce even greater complexity and the potential for surrounding litigation, given the disparate and multifarious parties who had to be taken into account. Problems may arise, particularly for service providers, while contracting with a party with branches across the nation, in which case Service Tax might be paid in Bangalore, which is also the location of billing, but for which tax and contract values might have to be determined for other states.

The next speaker in the discussion was Mr. V. Raghuram, who decided to forego a presentation on the subject in favour of evaluating the discussion on GST and his contributions to it in the previous 10 years. He began by questioning whether there was an all-encompassing definition of 'taxation' in the Indian context. He spoke of the ever-expanding scope of Article 366 of the Constitution.

To illustrate this, he spoke of the case of *State of West Bengal v. Kesoram Industries Ltd*<sup>2</sup>, which dealt with the issue of whether a State Government could charge a cess on the royalty that was charged by the Central Government. The background to the dispute was that of the letting out of mines, in which the centre claimed a royalty. The disputed claim was opposed because of the claim of the party being charged that the cess would be a tax on an already existing tax. Four judges of the SC, as part of a 5-judge bench, stated that royalties would merely constitute a profit share. Justice Sinha, dissenting, stated that the definition of 'tax' in the Constitution was an inclusive one, and that essentially, anything imposed under any statute became a tax, which would render the cess a tax

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<sup>2</sup> (2004) 10 SCC 201.

on a tax and thus inapplicable. This apparently runs contrary to the ratio of the 7-judge bench in *India Cement Ltd. v. State of T.N.*<sup>3</sup>.

Agreeing with Mr. Rao's circumspect understanding of how much the GST would change things, Mr. Raghuram spoke of how the change could potentially expand the bureaucratic hurdles that already surrounded the payment of taxes in this country, such as a multiplicity of jurisdictions seeking taxes on one particular body or item, and thus scrutinising accounts.

He questioned the Rajya Sabha's purported aim to cover everything that is not a good under the definition of 'services', and spoke of the possibility of transactions that were neither a good nor a service, such as profit transactions such as the sale of immovable property, and so on. Whether or not such transactions would be covered by the GST Bill could not be said.

One legislative issue in the Amendment would be the determination of who had the power to actually fix the rate of taxation. While the GST Council may provide a rate, the same would remain a recommendation, thus raising the questions of whether the States could move away from such a recommendation, or refuse to change policies, and so on. If not dealt with suitably, there might exist a threat of truant State Governments using their own interests to justify a split from the national effort to have a GST.

The states, as was evidenced by the NEET controversy, are already seeking to defy the orders of the SC, which created doubts about their future compliance with the decisions of the GST Council. Even assuming everything could be sorted out as regards the rate, there would remain a question of what in fact was a good or a service, and whether or not a differential rate would be charged on the same. For example, delineating the sale of a book from the transmission of a soft copy of the book over the Web would be needed. In the *TCS* case, the SC had held that anything that was capable of abstraction and consumption becomes a good, and the same need not be tangible to obtain and retain its status as a good. The UK definition, in this respect, seeks to simplify things, deeming that any article that undergoes physical sale is a good, and anything sold on the internet is a service, with the rate for sale of goods being different from the rate of supply of services.

The next problem would be of not having a fixed establishment itself, particularly for B2B transactions and with no finality on transferal. The efficacy of 18% as the RNR Rate still had to be seen, though given that the compensation planned for the states is intended to cover their losses, it would seem that even the Centre does not expect the rate to act as such.

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<sup>3</sup> (1990) 1 SCC 12.

Earlier, the Central Government would stop at manufacturing and at first sale point, and then transferred control to the states (retailers and distributors were never under CG control). This would change when the GST comes in, and the CG will go into every aspect of an economic transaction, and the retailer and wholesaler will also be under the CG's net.

### **III. SESSION III: INTEGRATED GOODS AND SERVICES TAX (IGST)**

Ms. Sakhi Shah, a student of NLSIU, Bangalore, began the session with a framework presentation. She started with a numerical example to explain the concept of Integrated Goods and Services Tax. The example was of a transaction worth Rs. 100 that originated in Karnataka on which CGST and SGST of Rs. 10 each was levied. The goods were then sold to a dealer in Maharashtra at a price of Rs. 200. If the rate of IGST were 20%, then tax levied would be Rs. 40. The credit for IGST can be used to offset both the SGST and CGST liability in the next stage of the transaction. For instance, if the good is further sold in Maharashtra, then CGST and SGST will have to be paid but since tax has already been paid earlier, it can be used as input tax credit. IGST is collected by the Central Government, and then shared with the state where the final consumption takes place. It, therefore, prevents a cascading effect, gives revenue to the state where final consumption occurs, and ensures that there is administrative convenience at low cost.

She then highlighted three issues to be debated in the session. *First*, sharing of taxes between the Centre and the states, which is to be covered by the Model bill on IGST. As per the bill, the onus to collect taxes lies on the Centre, and the subsequent sharing is to be determined by the Centre-dominated GST Council. *Second*, logistical concerns like determining the place of supply of services like telecommunication services. *Third*, as a result of the bill, a lack of incentives for manufacturing states such as Gujarat. Therefore, the Centre advanced a proposal to allow an additional 1% tax to be given to the relevant manufacturing state. This then becomes a production tax and not a consumption tax. However, the GST Council is to determine this, and it is possible that states may not be comfortable with this arrangement.

Mr. P.V. Srinivasan spoke thereafter and started by explaining the pre-GST regime of taxation for inter-state sales. For the purpose of service tax, which is a union levy collected and administered by the Centre, the whole of India except for the state of Jammu and Kashmir constituted a single taxable territory. Customs duty is also levied by the Centre, which is then apportioned between states. In the current scenario, these different kinds of taxes do not have a set-off mechanism for each other. So, VAT, Service Tax, Entry Tax are all taxed more or less independently.

He then looked at the taxation system in Europe, where when goods and services are imported, the state into which they are imported, collects tax through reverse charge mechanism and the state from which they are exported transfers credit. As a consequence, business benefits but there are issues of cash flow for the state. Mr. Srinivasan was of the opinion that India did not adopt this approach since the administration of the GST through this mechanism would be administratively onerous.

He stated that IGST protects a seamless chain of credit. In foregrounding the IGST, he emphasised two issues: the taxable event and the destination state. In case of IGST, the taxable event is the supply of goods and services. Currently, the rate of IGST and its method of taxation have not been outlined in the Amendment bill. However, citing discussion papers on the subject, he averred that the IGST rate would amount to the arithmetical sum of CGST and SGST rates of the destination state. The dealer in destination state will have to collect the tax levied and transfer it to the government.

To explain further, Mr. Srinivasan made use of an example of a dealer in Karnataka who sells a pen worth Rs. 100 to another dealer in Maharashtra. Here, the IGST charged will be according to the Maharashtra schedule to determine CGST and SGST in Maharashtra. If CGST and SGST in Maharashtra is 10% each, then the resulting IGST is 20%. The dealer has to be aware that the destination state is Maharashtra and upload his invoice on the GST network stating this fact. The system will detect the rate of charge in Maharashtra, and accordingly, IGST will be levied and the tax will be apportioned to the state.

However, if the rates of SGST are not uniform across states, IGST for two states will not be the same. Therefore, IGST could vary from state to state, as it would depend on the SGST rates applicable in destination states. This further gives rise to the concern that the GST Bill intended to respond to, that of uniformity in rates of taxation. He suggested that to ensure uniformity in IGST, the Centre should negotiate with the states to have a Central Schedule that would specify one singular rate.

He then went on to explain that GST is a value added tax, which means that the output will be taxed and the amount of input tax can be set-off. The dealer, therefore, need not segregate the supply that has been made to avail the credit. IGST output tax can be set-off against IGST input tax too, and the same can be paid in cash. This input credit may have been accumulated through intra-state supplies as well. The hierarchy of set-off is such that input IGST has to be used first, then input CGST, then input SGST, while a one-to-one correlation is not required for each entry. The IGST credit can be used for settling CGST and SGST too. The order would be that CGST credit could be used to set-off CGST, and then IGST. Similarly, for SGST credit, SGST is to be used first, and then IGST. However, CGST cannot be used to set-off SGST, and *vice versa*.

All transactions involving an inter-state sale will have to be filed as monthly returns and subsequently, as annual returns. The GST Network will then make a settlement for the apportionments to be made to the relevant states. Mr. Srinivasan informed the audience that no other country is currently using IGST as a levy for taxes in a federal set-up. He commended the system as a revolutionary that inconveniences no one, preserves the destination system, and has mechanisms for seamless apportionment of revenue. He said that the IGST network, *per se*, is a settlement mechanism, rather than a tax collection mechanism.

Additionally, he said that currently for imports into India, Basic Customs Duty (BCD), Countervailing Duty (CVD) and Special Additional Duty (SAD) are levied. Under the GST Bill, the CVD and the SAD are to be subsumed under the CGST, while the BCD shall continue to operate independently. This means that an import will be charged under IGST and the tax liability will be discharged according to the destination of the import.

He stressed upon the fact that supply, and not sale, was the main event of concern under the GST. This will be regulated by the 'Place of Supply' Rules, which will be determined by the Parliament on the recommendation of the GST Council. The physical location of the goods will determine the place of supply, and if there is no physical movement of the goods, it will be ascertained on the basis of constructive delivery. Similarly, where the construction or assembly of goods takes place will be deemed to be the place of supply. However, determining the place of supply of services is less simple. Therefore, governments evolve proxies or 'anchors' to determine the place of supply. The recipient's location is where the supply would be deemed to have taken place. If the place of recipient is unknown, the location of the supplier or the location of the performance of services is to be used. Where services are related to an immovable property, the location of the immovable property would be the place of supply. For telecommunication services, the place of supply could either be the location of the registered number or the place where the person is using the services. However, where the supplier and the consumer are transient, place of supply would be difficult to determine. Here, a proxy would again need to be devised for ascertaining the place of supply. Throughout, he highlighted that the law had not yet matured on this issue since this would be the first time the state would deal with sub-national division of services.

After this, Mr. Upender Gupta began his speech with a rebuttal to Ms. Shah's claim that GST council would ineluctably be biased toward the Centre. He claimed that GST is based on co-operative federalism. The State and the Centre would have to participate together. He also added that the budget making process will undergo a huge change with the introduction of GST. This is so because all indirect tax proposals are required to be recommended by the GST Council by a 75% majority, with the states having 67% of total voting power. Hence, no individual state or all the states put together can carry any proposal through in the

GST Council. Withal, the same logic applies to the Centre. Hence, only when the Centre and the state cooperate can they achieve their objectives.

Mr. Gupta then rebutted Mr. Srinivasan's claim about the possibility of different IGST rates in different states. He said the concern would not arise as IGST is to be levied on imports too. This is so because imports will be treated as inter-state supplies irrespective of the state where the import is being made, with the rate for taxing imports to be decided by the Centre. Therefore, it would be essential to have a single rate of IGST for imports and domestic supplies.

Mr. Gupta also added that, in his mind, IGST would be a third levy and not just a settlement system between the centre and the states. It is a levy that would derive power from Article 269A. He then explained the system of classification of goods and services under the GST system. He explained that the HSN codes as used under the excise regime would be used under GST as well. The taxable event would no longer be sale or provision of service, but would instead be the supply. Further, GST will be an origin based tax.

The pre-GST system led to huge arbitrage due to the difference in VAT and CST rates. People preferred showing intra-state sales as inter-state sales. Although goods would be sold locally, it would be shown that they were sold in another state.

Mr. Gupta suggested that GST would solve the problems highlighted earlier due to the following reasons:

*First*, the taxable event would be supply, which in scope is broader than sale. It would include every transfer, including stock transfers. In the present system based on Form F, people open depots in other states and show sales as stock transfers to avoid paying tax. In a GST regime, IGST will be levied on all inter-state transfers. This will ensure that an input tax credit chain is maintained.

Mr Gupta also discussed the additional tax which will be paid to manufacturing states in the initial years to compensate them for the consumption based nature of the GST. This additional tax is only on goods and would be levied under the constitutional amendment itself. Mr Gupta also clarified that since no state is self-sufficient in terms of production, and consumption takes place in all states, there would be no overwhelming loss or gain to any state.

Mr. Gupta then moved on to give a list of the various models of taxation that exist around the world like the origin based system, deferred payment system, and reverse charge mechanism, dual VAT with deferred payment, compensating VAT, viable integrated VAT, prepaid VAT and the split payment method. He highlighted that the problem with most models is that they treat business-to-business and business-to-consumer transactions differently.

*Second*, tax is paid by the recipient in these models, and since the supplier is not paying the taxes, tax payment invariably gets delayed. Some of these models also mandate that supplies will be zero rated i.e. only taxpayer in Maharashtra pays tax when he receives the goods or makes the sale for the first time after having received the goods. The dealer shows local sales as inter-state since there is no incentive to declare receipts as the dealer will then have to pay tax.

He then moved on to explain the modalities of IGST, which according to him was the best of the models available to India. *First*, it would bring about uniform registration. There is already e-registration in five states as of now. Now, registration will be valid for all activities. *Second*, there will be a common return for CGST, IGST and SGST which will show credit utilisation and other details. *Third*, there will be common periodicity of returns for a class of taxpayers, i.e., *n* number of a class of normal taxpayers, compounding taxpayers, small taxpayers. After having fixed the periodicity, uniform cut-off dates for filing would be fixed. While filing the return, all the information including supply and purchase invoice details would have to be provided. The return will be verified by the system, and will have to contain the registration number of recipient, and place of supply.

Mr Gupta also discussed the logic behind the hierarchy of set-offs of the IGST, CGST and SGST. He explained that IGST and CGST are central levies. Hence, when you allow set-off of central levy only, there are no issues. In cross utilisation, however, there has to be a transfer of funds from the Centre to the state. If cross utilisation wasn't allowed, SGST would have been payable in cash to the state. But now, the state will get money only when the Centre will transfer the relevant amount to the concerned state.

Then he explained the working of IGST in case of Business-to-Consumer supplies through an example. With no input tax credit, a dealer in Karnataka sells to an individual in Maharashtra. The dealer in Karnataka will pay IGST. He will declare the place of supply in the return as Maharashtra, but Maharashtra will get money only when the SGST will be calculated and that amount will then be transferred to the state. There may be some time lag in payment and in the availment of credit. Further, Business-to-Business transactions are not eligible to input tax credit in all supplies, not unlike the CENVAT rules, where transactions involving sale of mobile phones are not entitled to 100% service tax payment and credit on taxes. The surplus remaining in the IGST pool will be apportioned in proportion. Under the IGST model, the rationalisation of the system is enabled by the fact that the taxpayer simply has to file his return. The funds will not be transferred on a taxpayer-wise basis, but on a net basis.

Hence, he concluded that the GST was a salutary proposition although a perfunctory understanding might result in the conclusion that the Centre is being unfairly advantaged. It must be noticed that for services, states get nothing under the current model. They will now be given a stake in this revenue.

There are also advantages for the tax administration like up-front tax payments by suppliers in exporting states, no refunds on account of interstate supplies, and a self-monitoring model that secures improved compliance levels.

The session was then opened for questions. The first question was whether professionals who travel from one state to the other for provision of services, will also be covered. It was clarified by Mr. Gupta that though doctor would be exempt, the situation of other professionals like Chartered Accountants going outstation was unclear. Subsequent enactment of rules would thus have to clarify this.

Another question raised was regarding the relevance of Article 366 (29A) under the GST. Mr. Gupta suggested that it would be ideal to remove the Article, as the GST regime only provides for limited exemptions. Further, the Centre will anyway declare certain services to be deemed services after the passage of the Act.

This led to another question as to why the exemptions have been provided. Mr Gupta answered the question by saying that they had an option of a good system with exemptions or waiting for a perfect system without exemptions. In his mind, one ought to choose the former.

#### **IV. SESSION IV: PROCEDURAL HURDLES AND CONCERNS IN IMPLEMENTING GST**

Mr. Karthik Ranganathan introduced the four speakers, and the session commenced with Mr. Arbind Modi's speech.

Mr. Modi started by explaining the need for systems of tax administration. He explained that tax administration systems comprised a set of procedural rules for voluntary compliance and also to facilitate enforcement. He explained that the foremost consideration while designing rules should be the optimisation of voluntary compliances, which comes with the lowest administration costs. He stressed that a poor tax administration can undo the benefits of even the best design tax policy.

He then went on to raise some key issues of concern with regard to the design of the GST administration:

*First, Registration:* He indicated that multiple registrations for the purpose of GST may lead to complications and also increase the cost of compliance for the tax payer. This may also give rise to fragmented reporting, and further create inefficient externalities.

*Second, Reporting:* He indicated that there are concerns about how much information is collected by the government. Currently, the tax authorities demand compendious information, which creates inefficiency.

*Third, Collections of tax:* He averred that the frequency of collection of taxes should, in order to reduce compliance costs, be kept low. Moreover, there should be no need for separate payments through different recovery agents, as is the case currently.

*Fourth, Processing of tax returns:* He suggested that tax returns should not be processed by multiple authorities but only under the aegis of a single, centralised authority.

*Fifth, Refund:* He emphasised the need to resolve the issue of refunds. Under the current model, the process is byzantine. Citing the example of Australia, where the average time taken to process refunds is 3 days—the corresponding average in India is 90 days—he averred that this process required urgent steps toward streamlining, or working capital would continue to be blocked and the taxpayer would continue to suffer a higher interest burden.

*Sixth, Audit:* He stressed that the current duality in auditing often led to multiple investigations and consequent wastage of public resources.

Mr. Modi was followed by Mr. Hiregange who started by explaining that indirect taxation was tied with procedure, which permits unnecessary intervention by administrators.

He identified certain key issues with respect to registration under the proposed GST regime. He first explained that in order to motivate taxpayers to register, the registration process would have to be further simplified. He also pointed out that while the GST mandates registration and that customers will not get credit should this not be done, the Supreme Court has in the past held registration to be a mere procedural formality.

Moving on to the black-listing of dealers, he said that around 10% of tax payers were non-compliant. If a dealer falls within some margin, he will be black-listed and this would have a consequent effect on the market. Since the blacklisting of a dealer would work retrospectively, even his customers would be hurt. If the supplier defaults the buyer is affected, as he is not given credit. This domino effect in GST could render it unworkable.

He also raised the concern that in rural areas, accounts are usually made six months after the year gets over, and the accounting mandates of the GST do not fully account for such issues.

The next speaker, Mr. Jatin Christopher, explained expressed the belief that the duality of administration and procedure in the GST would create hurdles and reduce compliance levels. He also pointed out that the GST model was flawed since it depends on the validation of sales by customers. If 20% of one's sale value is not validated by the customer, then it can put one out of business. He also alluded to the oppressive levels of information required under the current system, even while acknowledging the recent steps taken by the Government to alleviate this situation.

Mr. Karthik Sundaram, the concluding speaker, discussed the context in which GST's procedures must be viewed. He explained that since technology and infrastructure would form the backbone of a future GST regime, it carried an infinite potential of streamlining processes. He also discussed the GST Network's constitution and stated that involving private players would ensure lesser bureaucratic monopoly over the service, whose main aim is only to give back-end support to the Government. He emphasised the need to outsource such functions to improve efficiency.

He also addressed concerns pertaining to data security and privacy. He opined that there was no definitive right to privacy in the context of taxation and that, in any event, the right to privacy would have to be balanced against concerns of public interest. He stated that the Articles of Association of the GSTN adequately balanced this. They require secrecy and limit the access to data to the government. Withal, the sharing of information would be with regard to business activities, not personal information.

This was followed by a question and answer session. The first question pertained to the need for a GSTN, and it was clarified that a separate GSTN was required to ensure that experts could be hired at competitive rates to improve the efficiency of tax administration.

Next, a question was asked about whether the GSTN would be immune to a leak along the lines of the leak at Mossack Fonseca? Here, the speakers acknowledged that the possibility of such a leak always existed, but clarified that if less unnecessary information was demanded, then the vulnerabilities at stake would stand substantially reduced. Moreover, they averred that provision for compensation in this respect should be made.

In response to a question on the overall procedural integrity of the GST, the speakers emphasised that it was essential to have a good design in the first attempt as efforts to mobilise consensus around another constitutional amendment would prove impossible.