

Potential Areas of Conflict & Litigation under GST

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Presentation Plan

- **Introduction:**
- **Likely areas of Conflict under GST between the Centre and States:**
- **Possible Areas of Litigation**

Indirect Taxes in India : Earlier Scenario

Centre's Indirect Taxes (Administered by the CBEC)

- Central Excise duty on manufacture of goods
- Service Tax on provision of services
- Special additional duty, Counter Veiling Duty (CVD) on import of goods
- Cesses and surcharges
- Customs duty on import of goods.
- Export duty on goods

State's Indirect Taxes :

- **VAT, CST and Entry Tax:** Administered by the Commercial Tax Department

Also multiple authorities and local bodies at the state level administer the following taxes :

- Octroi
- Entertainment tax,
- Luxury tax
- Taxes on lottery and gambling
- Excise on Medicine and Toiletry Products
- State Excise on liquor
- Electricity Duty,
- Stamp Duty etc.

VAT at the Central Level

Central Excise

- Before 1986, Central Excise law:
 - Denial of credit i.e. tax on tax – Cascading effect.
- Modified VAT (MODVAT) on selected commodities was introduced from 1st March, 1986 allowing ITC on these commodities.
- All commodities were covered in form of Central VAT (CENVAT) in 2003-04 and ITC was allowed.

Service tax

- Was introduced in 1994 initially on three services, now most of the services are covered through “the negative list approach”.

In 2004-05, cross utilization of ITC between Central Excise and Services were allowed.

VAT at State Level

Sales Tax Regime(prior to VAT):

- Denial of credit i.e. tax on tax – Cascading effect
- Multiple rates of taxes for commodities (In some States > 10 rates)
- Among the States also different rates for the same commodities
- In 1995: Preliminary discussion to introduce VAT in the States.
- In 1999: Uniform floor rate of sales tax in all the States
- Starting from 1.4.2005, all States have introduced VAT.
 - ITC is allowed at every stage
 - Uniform rates by and large
 - Exemptions left to the states
- Central Sales Tax is being levied on inter-state sales since 1956.
CST is levied at the concessional rate of 2% subject to certain conditions since 2008-09.
No ITC

Limitations of the Earlier Indirect Tax System

- No cross utilization of ITC of CENVAT and service tax by the States and vice versa.
- Multiple taxes on many goods and services

Result:

- Cascading of taxes
- Multiple registrations, returns, audit and compliance. Huge compliance cost for business community
- Trade barriers between the States
- Distortion of business decisions and supply decisions due to varied tax rates and varied exemptions
- High administration cost for the Centre and States
- Unhealthy competition among States in term of tax rates even under VAT regime.
- Tax evasion and leakages
- India was divided into multiple markets bringing in economic distortions.
- Adverse impact on EODB and foreign investment

Hence GST

Indirect Taxes in India : Constitution

However,

- (i) Power to tax the sale of goods with each State.
 - (ii) Power to tax manufacturing (excise) and services with the Centre.
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- GST required cross-empowering States and the Centre on their power to levy indirect tax.
 - The Constitution (Amendment) Act, 2016 makes a completely new arrangement.
 - This arrangement may cause conflict between the Centre and the State.



Centre-State Relations under GST

Pre-GST Fiscal Autonomy for the States

Fiscal Autonomy and flexibility in-

- Framing taxation policy based on local needs.
- Exempting goods of local importance from tax, e.g. diamonds, jari, etc.
- Giving exemption to sectors generating higher employment opportunities, like MSMEs.
- Fixing rate higher than floor rate on luxury items to raise resources
- Reducing, retaining or disallowing Input Tax Credit in specific cases.
- Keeping a lower rate of CST on Inter-State sales
- Levying cesses, surcharges or additional taxes in case of natural calamities

Article 246A: Impact on the Fiscal Autonomy of the State

- New Article 246A inserted : Concurrent power to levy tax on goods and services to both the Centre and the States.
 - GST is not under the Concurrent List (i.e. List III)
- Views of the Parliamentary Standing Committee (August, 2013):
 - Divergence in views amongst States regarding erosion of State autonomy. A fine balance is required between the imperatives of a common market with unified tax structure vis-à-vis the fiscal requirements of States.
 - Broad consensus on key issues relating to implementation of GST should be arrived at between the Centre and the State Governments.
 - A credible study would be required to evaluate the impact of GST on the revenue of the States.



Issues relating to Revenue implications

Constitution Amendment & Change in Taxation Principles

Amendment in Article 269:

- CST is abolished on those goods which are subsumed in GST,

New Article 269A inserted:

- Power to levy tax on inter-State supply of goods and services to the Centre (that also includes power to levy GST on import) is introduced to handle destination base GST

considerable loss to the manufacturing States.

Views of the Standing Committee (August, 2013):

- As the destination-based IGST model favors predominantly consumer States more than producer States, the revenue concerns of these States also needs to be factored in and duly addressed. The proposed model should not thus act as a dampener or dis-incentive for States with a strong manufacturing base.

Impact on Revenue of the Manufacturing States

- These concerns of manufacturing states are taken care of.
- They will need resources to maintain revenue growth for infrastructure to maintain their attractiveness as investment destinations.
- Additional revenue from GST on services and improvement in tax compliance under GST may not offset the loss of CST revenue.
- Compensation mechanism, for possible revenue loss, is limited only for 5 years.

Impact on Revenue of the States

- VAT was 70/80% of state revenue.
- After GST, important sources of revenue left for states are:
VAT (6 petroleum products), stamp duty and electricity duty

However Petroleum products, land and electricity are likely to be covered in GST.

- Manufacturing States get further disadvantaged by way of devolution of less funds as formula of devolution is based on the principle of backwardness of the States.



Creation of a new Constitutional Authority & Impact on Federal Structure of the Constitution

Insertion of New Article 279A and Formation of GST Council

- Council is Chaired by Union FM with the States as members
- It will work towards the development of a harmonised national market for goods and services.
- It shall make recommendations to the Centre and States towards:
 - (a) the taxes levied by the Centre / States / local bodies which may be subsumed in the GST;
 - (b) goods and services exempted from GST;
 - (c) Model GST Laws, principles of levy, apportionment of IGST and principles that govern the place of supply.
 - (d) the threshold limit of turnover below which GST may be exempted ;
 - (e) the rates including floor rates with bands for GST;
 - (f) rates for a specified period, to raise additional resources during any natural calamity or disaster;
 - (g) special provision with respect to special category states and
 - (h) any other matter relating to the GST

Area of Conflict: Whether Recommendation of GST Council is binding to the Centre / State?

- Whether recommendation of the Council is binding to the Parliament / State Legislature?
- Whether it would affect Federalism?

Functioning of the GST Council

- **Quorum at the meetings:** $\frac{1}{2}$ of the total number of members
- **Decisions in the GST Council:** Shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting, wherein:-
 - (a) weightage of one-third of the total votes cast: for the Central Government, and
 - (b) weightage of two-thirds of the total votes cast: for all the State Governments.
- **Resolution of disputes:** Council may establish a mechanism to adjudicate any dispute arising out of its recommendations / implementation.

Likely Conflict arising out of the Functioning of the GST Council

- Indirect veto power of the Centre.
- States also have indirect veto power.
- But....Will Party in power at the Centre and some States may unite to take decisions not in the interest of other States?
- Also, there is principle of one state one vote irrespective of the size, population and GDP of the State.
- If the state or centre do not follow the recommendation of the Council?

Bureaucracy

- Prerequisite of successful implementation: Centre and state must work together.
- Distribution of work
- Issue of cross-empowerment to avoid dual interface under the GST regime.



**Possible Areas of Litigation in GST:
Issues pertaining to Constitutional Validity**

Constitutional Validity: 1. Levy of IGST on Export of goods and services.

- Article 269A empowers the Centre to levy tax (i.e. IGST) on inter-State supply of goods or services.
- As per explanation to Article 269A (1), supply in the course of import into India shall be deemed as inter-State supply.
 - It doesn't include supply in the course of export of goods / services.
- However, as per section 7 (5) of the Integrated Tax Act, **export of goods or services is treated as supply in the course of inter-State trade or commerce. Can tax be levied on exports?**
- Secondly, as per section 2 (60) of the IGST Act, in case of export of services, if payment is not received in convertible foreign exchange, it will not be benefit of zero rating and will be taxed.

Constitutional Validity: 2. Treating certain transactions as supply of services.

As per article 366 (29A) “tax on the sale or purchase of goods” includes:.....

- (b) **a tax on the transfer of property in goods** (whether as goods or in some other form) invoked in the execution of a works contract;
- (d) **a tax on the transfer of the right to use any goods** for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
- (f) **a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods**, being food or any other article for human consumption or any drink, where such supply or service, is for cash, deferred payment or other valuable consideration, and such transfer, delivery or supply of any goods **shall be deemed to be a sale of those goods** by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;

Constitutional Validity: 2. Treating certain transactions as supply of services (Contd).

- However, as per Para 5 (f) **in Schedule II** of the GST Act, “transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration” is treated as supply of services.
- As per Para 6 **in Schedule II** of the GST Act, the following composite supplies shall be treated as a supply of services, namely:—
 - (a) works contract as defined in clause (119) of section 2; and
 - (b) supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration.

Constitutional Validity: 3. GST Compensation Act.

Mohit Minerals Pvt. Ltd. V/s. Union of India 2017 in Hon. Delhi High Court: Challenges the constitutional validity of the GST compensation Act.

- The crux of the petitioner's submission is that Section 18 of the Constitution (101st Amendment) Act does not enable the Parliament to levy any cess which stood abolished in terms of the third schedule of the Taxation Law Amendment Act.
- Further even if the purpose was to compensate the States for loss of revenue, that had to be done by some other means.

(Power of the Council, Constitution Amendment Act, section 12(4))



**Possible Areas of Litigation in GST:
Issues pertaining to Interpretation of Law**

1. Definition of Business & Scope of supply

- As per section 2 (17), **definition of business** includes any activity or transaction undertaken by any Government / local authority in which they are engaged as public authorities.
- Section 7 of the GST Act deals with the scope of supply which includes:
 - **all forms of supply** made / agreed to be made for a consideration in the course or furtherance of business
 - activities specified in Schedule I, made / agreed to be made without a consideration; and
 - activities specified in Schedule III be treated neither as a supply of goods nor a supply of services.
- Whether transactions involving allocation of grants by the Government to the Government Agency be treated as a supply?
- Whether services provided against fees by Government recruitment agencies is considered as supply?

2. Liability for Registration in GST

- As per section 22 of the GST act, supplier is liable to be registered in the State from where he makes a taxable supply of goods / services.
- Where supplier makes a taxable supply of goods / services relates to place of supply of such goods or services.
- Supplier may prefer to levy IGST, whereas the State authority would prefer his liability to register in the State and thereby levying CGST & SGST.
- For example: An architect who belongs to Delhi prepares a plan for a bungalow to be built in Mumbai shall pay IGST on such transaction.
 - As the place of supply of the said transaction is Maharashtra, can the State authority may prefer him to take registration in the state in case his supply crosses the threshold limit?

3. **Admissibility of Input Tax Credit**

Following provisions may lead to disputes:

- **As per section 16 (2) (c) of the GST Acts, input tax credit shall be admissible only in case where tax is actually paid to the government either in cash or through utilisation ITC .**
- **Addition of tax liability equivalent to availment of ITC if recipient fails to pay against the value of supply within a period of 180 days (2nd proviso to section 16 (2)).**

4. Classification of Goods and services

Classification of goods is based on HSN(Harmonised System Nomenclature)

Classification of services is based on Service Codes (expanded from earlier Service Accounts Code) under the Service Tax regime.

Rates are fixed chapter wise

Under VAT, item wise rates were fixed and HSN was not followed.

Misclassification is likely to occur due to different interpretations and understanding by the taxpayers.

5. Tax paid at Concessional Rate under the CST Act

- A per section 8 (1) read with section 8 (3) (b) of the CST Act, facility of C Form is available w.r.t. inter-state purchase of goods being intended for re-sale or for use by in the manufacture or processing of goods for sale or **in the telecommunications network or in mining or in the generation or distribution of electricity or any other form of power.**
 - The said section remains as it is and is not amended.
- **As per amendments in section 2 (d) in the CST Act w.e.f. 1.7.2017, definition of goods is restricted** and now it includes only 6 items i.e. crude oil, high speed diesel, motor spirit, aviation turbine fuel, natural gas and alcoholic liquor for human consumption.
 - Issue is raised whether a dealer can make inter-State purchase @ 2% of any of the above items (say crude oil by a refinery) against C form
 - for the manufacturing / processing of GST goods ?
 - for raw materials of which final products are both GST and Non ST goods ((say crude oil by a refinery) against C form for the manufacturing / processing of CST goods (i.e. petrol, diesel etc.) & GST goods (i.e. LSHS, Naphtha)?

6. Tax paid at Concessional Rate under the CST Act Contd.

- A writ petition is already filed by a Company in the Hon'ble HC of Karnataka.
- Interim order of the Hon'ble Court outlines the following:
- Petitioner prayed that the Commercial Tax Department should be directed to issue C Forms for inter-State procurement of High Speed Diesel from IOCL.
- Learned Counsels drew attention towards two conflicting circulars:
 - Circular issued by the Commissioner, W. Bengal to the effect that facility of issuing C Form would continue even after 1.7.2017
 - However, circular issued by the Commissioner, Odisha stated that facility of issuing C Form would not continue after 1.7.2017
- Interim order is passed directing the Department to issue C Form to carry out its regular business with the condition that the petitioner would furnish an undertaking that in case petition is dismissed and they are called upon to pay the difference of local tax over the concessional rate of tax paid by them under CST Act along with interest.



Possible Areas of Litigation in GST: Reasonableness of Law

1. Reasonableness w.r.t. Rate of Tax

- Zarmina Israrkhan V/s. Union of India (W.P.(c) No. 0034 of 2017 PIL under Article 226 before Hon'ble High Court of Delhi.
 - For levy of tax at the rate of 12% Goods & Service Tax on **sanitary napkins**
- PIL in Hon'ble Supreme Court: Nipun Malhotra V/s. Union of India
 - W.r.t. levy of GST on **equipment meant for differently abled persons**
- Petition before Hon'ble High Court at Hyderabad
 - W.r.t. Levy of 28% GST on **lime stones**.
- Petition by M/s. J. K. Mittal & Co. V/s. Union of India in Hon'ble High Court at Delhi.
 - Challenging the provision of **RCM for advocates**.
 - **Entry No 2 in the Notification No. 13 dated 30.6.17 covers services supplied by an individual advocate by way of representational services before any court, tribunal or authority under RCM.**
 - It is prayed that provision of RCM should cover all legal services provided by advocates, firms of advocates or LLPs of advocates.

2. Challenging the Reasonableness on the Constitution of Advance Ruling authority

- M/s. Nipun Singhvi has filed a writ petition 156/2017 before Hon'ble High Court of Gujarat .
 - Challenging the provision of advance ruling authority and its appellate authority
 - Pending for admission
 - PIL allowed to be converted in to SCA , order dated 22/8/17



**Possible Areas of Litigation in GST:
Likely Areas of Challenge to Administrative / Quasi-
judicial Action**

1. Determination of valuation of Supply and ITC Utilisation

- Section 15 of the GST Act deals with the value of supply which gives power to the Government to frame rules to determine the value of certain supply.
- **Rule 28: Value of supply of goods or services or both between distinct or related persons (other than through an agent)** shall be the open market value of such supply.
 - As per second proviso to the rule, where the recipient is eligible for full input tax credit, the value declared in the invoice shall be deemed to be the open market value of the goods or services.
- This provision may be used **to transfer excess credit** in one state to another State where there is liability for payment of tax.

2. Time-limit for Determination of Tax

- As per section 73 (10) of the GST Act, time-limit of 3 years is specified for determination of tax not paid / short paid or erroneously refunded or input tax credit wrongly availed / utilised for any reason other than **fraud or any wilful** - misstatement or suppression of facts.
- Section 74 (10), a time-limit is extended to 5 years in cases of **fraud or any wilful** - misstatement or suppression of facts.

3. Inspection of Goods in Movement

- Provision pertaining to inspection of goods is made under section 68 of the GST Act.
 - Rule 138 is framed and mandatory provision of e-way bill is made for every registered person who causes movement of goods of consignment value exceeding fifty thousand rupees.
- PIL filed by Shree K. K. Ramesh in the Hon'ble High Court at Chennai challenging the provision of e-way bills praying for all the goods above Rs. 5,000/.
 - Heard on 28th August, 2017 & notices have been issued to the Center and the Tamil Nadu Government.

3. Anti-profiteering Measure

- As per section 171 (1), any reduction in rate of tax on any supply of goods / services or the benefit of input tax credit shall be passed on to the recipient by way of commensurate reduction in prices.
- The Central Government has constituted an Authority to examine the issues related to anti-profiteering.
- Any action under this law may lead to litigation as such benefit will be very difficult to calculate input taxes of multiple inputs. Also increase in cost may also be result of increased cost of materials, overheads etc.

4. The Implementation of the GST Acts and system related issues

- PIL before Hon'ble Rajasthan High Court
 - Regarding hasty implementation of GST Act. and pray for deferment
- PIL before Hon'ble Madras High Court
 - Challenging the GST Act & rules and pray for postponement of implementation



THANK YOU