



Union Finance Minister’s speech to the Empowered Committee of State Finance Ministers

Introduction

In a significant move towards timely implementation of ‘Goods and Services Tax’ (‘GST’) from April 2011, the Empowered Committee (‘EC’) of State Finance Ministers met on 21 July 2010 to discuss various issues relating to GST. Further, Mr. Nandan Nilekani made a presentation where he proposed a detailed road map and strategy for putting in place the requisite IT infrastructure.

The Union Finance Minister (‘FM’) Mr. Pranab Mukherjee also addressed the Empowered Committee (‘EC’) of State Finance Ministers and certain senior officials of the State governments on several important matters. In order to bring all states on board, the Central Government appears to have conceded to the demands of States on several issues, such as multiple rate structure, compensation for loss of revenue. These, coupled with other proposals about the IT infrastructure required for GST, rationalization of exemptions, etc., have again raised hopes of transitioning to the new reformed regime in near future.

The Highlights of the speech are outlined below:

- **Rate structure**

The FM suggested following rates for CGST during the first 3 years with an objective to have a single rate of GST for goods and services:

Period	Goods		Services
	Lower rate	Standard rate	
Year 1	6%	10%	8%
Year 2	6%	9%	8%
Year 3	8%	8%	8%

The FM has requested the States to replicate the above structure for SGST as well.

KPMG Comments

- For goods, this rate structure seems to be quite reasonable in light of the current tax regime, as well as international benchmarks. The prevailing effective tax incidence on most consumer products is more than 20%, with excise duty of 10.3% (typically on 65 to 70% of the MRP) and VAT of 12.5% or more. In addition, businesses would also have savings on their purchases, which could also be passed on to consumers. Overall, the impact should be positive.
 - Services would be subject to GST at 16% if the States agree to levy SGST at 8% as recommended by the FM. This would mean that for end consumers (telephone, insurance, DTH etc.), cost of services could go up, as the current service tax rate is only 10%. However, the incremental impact should be less than 6% points as the service providers may pass on some of the savings on procurements (such as central sales tax) to the customers.
 - There would only be a cash flow impact on Business-to-Business services, as the incremental tax should be available as a set-off and hence would not be a cost.
 - While a multiple rate structure is probably inevitable, a 2% point rate difference between goods and services would mean that the classification of certain items (e.g. intangibles) as goods or services would continue to be relevant under GST. One would hope that the GST law would provide absolute clarity on the distinction between goods and services, to ensure that there is no ambiguity over classification. The differential rate structure could also pose a challenge of simplifying the tax regime for composite contracts (i.e. works contracts), which is currently also a matter of concern.
- **Exemption threshold and composition for small dealers**
 - Threshold for both goods and services at INR 1 million for CGST and SGST.
 - Composition to be made available to small dealers upto an agreed common limit under both CGST and SGST to bring simplification and improve compliance.

KPMG Comments

Though initially it may disappoint small dealers (specially the SSI units currently availing excise exemption), it is an important move

towards widening the GST net. The Government should simplify the compliances for such dealers to the extent possible, to increase the acceptability of this proposition. It is not clear as to how the CGST would be administered, given the quantum jump in the number of businesses which would come within the ambit. The Central Government may be constrained to give part administration to States, at least to begin with.

- **Compensation to States**

In line with the Thirteenth Finance Commission's recommendations, States would be compensated for initial four years for loss of VAT and Purchase tax revenues. For the further period, special reference be made to the next Finance Commission.

KPMG Comments

This should remove the apprehension of the States that GST would adversely affect their revenues and facilitate consensus and speedy implementation.

- **Exemptions**

Exemptions under Central Excise to be aligned with current exemptions under VAT which would ensure alignment of CGST and SGST exemptions.

KPMG Comments

- Currently, over 300 products are exempt from Excise duty. The Centre has agreed to prune down the list of existing excise exemptions, and align it with the list of 99 items currently exempt under VAT. This would imply that the existing exemptions available to various infrastructure projects (e.g. power, roads, etc.), mobile phones, certain IT products etc. could be withdrawn. Also, certain items which are currently exempt under VAT laws but not under Excise could be cheaper.
- Given the importance of infrastructure projects for the nation, the Government would need to devise alternative ways to ensure that GST does not push up the cost of these projects excessively.
- There was no discussion on existing service tax exemptions. Currently, Service tax applies on notified services and many services are not fully covered, such as education, healthcare, infrastructure etc. It remains to be seen as to whether the Government would impose GST on all services, with few exceptions or whether the existing scheme of levying tax on select services would continue.

- **IT Infrastructure**

EC requested to approve setting up of Empowered group under Mr Nandan Nilekani to decide upon IT infrastructure of Centre and the States to facilitate simplification and reduce government-taxpayer interface.

KPMG Comments

While this is certainly a welcome move, success of GST would hinge upon the level of IT preparedness at the time of transition. The industry would hope that the technology would be an enabler in doing business, post GST and the Government would consider initiatives such as e invoicing, e audits etc., in addition to e filings.

- **Other**

Purchase tax likely to be subsumed under GST.

KPMG Comments

This is a major achievement, as purchase tax would have been more of an aberration in the GST regime, and could also have acted as a precedent for other States to follow at a later stage.

Closing comments

Finance Minister's speech is very encouraging, and shows government's commitment towards this important initiative. The FM today has addressed major points of disputes in a forthright manner. The repeated assurances by him on compensation to the States would address a major concern they had. If the Central Government is able to move the Bill for amendment of the constitution in the monsoon session of the parliament, then 1 April 2011 would be attainable.

Though there is still a lot of ground to be covered, nonetheless, we seem to be much closer to GST now than what many of us thought earlier.

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