

Levy of Goods and Services Taxes from

1 April 2010:

Preparedness of Taxable Persons

A Presentation by

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Privileges of membership of an Organised Society

**"Taxes, after all, are the dues that we pay for the
privileges of membership in an organised society"**

Attributed to
FRANKLIN D. ROOSEVELT,
Speech, 21 October 1936

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Descriptive vs. Normative approach to Law

Coleman distinguishes between theoretical *Explanations* which tell us why things, such as enacted statutes, are as they are, and theoretical *Justifications* which seek to defend or legitimate certain kinds of things, such as choice out of enactment alternatives. He says that such distinction leads to a mistaken view that explanation is a descriptive activity, whereas justification is normative. To quote:

“In fact both are norm-governed. Explanations are regulated by norms of descriptive and predictive accuracy, while justifications are regulated by the appropriate **moral** norms...In addition both...are subject to a range of formal norms...like simplicity, coherence, elegance and consilience”

From
Coleman J.L., ‘ **The Practice of Principle: In Defence of a Pragmatic Approach to Legal Theory**’,
Oxford University Press, 2003 (p.3)

Law-making, Compliance, Enforcement and Justice

Peter Drucker, the management guru, is reported to have said that **leaders ought to do right things** and **managers ought to do things right**. What he said in relation to business entrepreneurs and their managers may equally be valid in relation to political entrepreneurs who make laws and those who are required to administer such laws and /or render justice, or to comply with such laws.

It follows that law makers ought to **make right laws**, and those who are required to comply with the laws made or to render justice in enforcing the laws ought to **interpret the laws rightly** on the occurrence of specific facts and circumstances that may require such compliance or enforcement.

Norm vs. Expediency

“ It has been conventional to assume a lack of rationale other than fiscal expediency in the levy of sales taxes”

From
Sullivan, Clara S., ' **Concepts of Sales Taxation** ' in
Bird and Oldman (Eds.), '**Readings on Taxation in Developing Countries**', 1964 (p.320)

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What does 'fiscal expediency' imply?

Fiscal expediency implies

- (1) a disciplined political choice from various alternative levels of public expenditure on providing access for public goods and services and subsidised 'merit' goods and services according to **universal entitlements** and on other services required to be provided according to the assignment of expenditure responsibilities by the Constitution, after estimation, prioritisation and phasing in one or more accounting periods;
- (2) ascertaining the levels of net revenues estimated to accrue by way of borrowing, non-tax revenues such as user-charges for access to public goods and services, direct tax proceeds, indirect tax proceeds and devolution/reservation; and
- (3) balancing the mismatches between (1) and (2) above by iterations of possible alternatives

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Law & Economics and **Efficiency as a moral Concept**

According to Fletcher, the terms 'optimum' and 'efficient' are now common parlance in law. To Quote: "Though they are loathe to identify their theories as 'normative' as opposed to 'positive' and scientific, the advocates of efficiency (from the law & economics tradition) espouse a **new morality for the law**"

Considering the ideal of *voluntary* exchanges of goods and services in a frictionless market, he observes that such voluntary trade "makes the world better off so far as it makes at least one of the parties better off and it makes no one worse off". This is the definition of a '*Pareto-superior*' move. The equilibrium reached after exhausting all Pareto-superior moves, is the Pareto-optimal state of the economy.

Referring to the contributions of Nicholas Kaldor and Cecil R.Hicks modifying the Pareto principle, Fletcher notes that if a move benefits the economy as a whole more than some who may be worse off, it may still be justified as collectively efficient in improving optimality in the allocation of resources in the economy.

From
George P.Fletcher, '**Basic Concepts of Legal Thought**', 1996,pp.155-171

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Efficiency as a moral Concept (Continued)

Fletcher notes, "for those who believe in market efficiency, subsidies are an evil". He christens the principle that "**the function of law should be to eliminate the natural subsidy** that occurs when industries cause harmful side-effects ('externalities') and they are not legally liable; the function of the liability is to insure that each industry pays its way", Pigovian Efficiency.

He goes on to point out that Pigovian Efficiency principle presupposes that we can determine which enterprises cause which injuries and that according to Ronald Coase, this is not necessarily so.

According to Coase, **the only relevant economic question for a transaction to take place is the relative value of the transaction to the respective parties, and not the provisions of law**, as long as there is no transaction cost to be borne by either party.

From
George P.Fletcher, '**Basic Concepts of Legal Thought**', 1996,pp.155-171

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Ronald Coase and Law's Irrelevance

“The late Professor Ronald Coase stated a counterfactual hypothesis that led to a revolution in legal thinking. This hypothesis, despite being against fact, produces an extraordinary hurdle for legal analysis, but is an enormously powerful tool. The counterfactual hypothesis is that *in an ideal world* , all activity would be the optimal one. Changing the law would lead only to the adjustments that would return all activity to the optimal. Therefore, in such an ideal world, legal change and, by extension, law would be irrelevant....Jurists in *law and economics* can use it to show that legal change is desirable. **If a jurist can show that a new rule would lead to activity nearer the optimal than the current rule, this constitutes proof that at least that legal change must occur.**”

From
Nicholas L. Georgakopoulos, ‘*Principles and Methods of Law and Economics*’, 2005(p.95)

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Jurisprudence of Law and Economics

“The development of an economic approach to legal practice has been the most important jurisprudential development in the last third of the twentieth century. Economic analysis has been offered as both a positive and normative jurisprudence: as an analysis of important features of existing legal practices and as an ideal against which these practices ought to be evaluated. For some, economic analysis has a narrow explanatory range (in various fields of private law, corporations and taxation, and anti-trust law, for example), while others make broader claims for its ability to illuminate any area of law. Finally, there is a difference between those who focus on one **explanation** and those who focus on **prediction**, but all offer positive economic analysis of law based on the concept of **economic efficiency** as defined in **welfare economics** and applied to law by Coase, Posner, Calabresi and others”

From
Jules L.Coleman, ‘*Law, Economic Approach to*’ in *Rotledge Encyclopedia of Philosophy* 2000

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Institutions and Organisations

“ The efficiency of markets is determined by **minimizing transaction costs**, but it is impossible to eliminate them, which leads to the issue of comparative economic **organisation.....**The **new institutional economics** makes a distinction between the institutional environment and the institutions of governance. The institutional environment is defined jointly by the **rules of the game** (the formal constraints: constitutions, laws and property rights) and the **conditions of embeddedness** (the informal constraints: sanctions. taboos. customs . traditions and codes of conduct). The **institutions of governance** are market, quasi-market, and hierarchical modes of contacting, more generally of managing transactions and seeing the economic activity through to completion. The interaction between the institutional environment and governance mechanisms determines the **economic efficiency of exchange** and incentives for investments in durable assets, both physical and human. Policy reforms refer to changes in certain elements of institutional environment, which , in turn, influence micro-level governance mechanisms with feed back effects on the institutional environment...”

From
Murali Patibandla, ‘**Evolution of Markets and Institutions: A Study of an Emerging Economy**’,2006,p.3

Constitution of India and the ‘institution’ of autonomy

- Is it a strict requirement of the Constitution that, subject to constitutional assignment to States, all tax revenues received by the Government of India by accrual according to law are to be credited to the Consolidated Fund of India and, subject to reservation if any, all tax revenues received by a State Government by accrual or devolution are to be credited to the Consolidated Fund of the State?
- Is it a strict requirement of the Constitution that, while tax-bases may be defined by law relating to matters listed in the Concurrent List, rates of levy may not be specified except by or in accordance with the law enacted in terms of the appropriate Entry in the Union or State List as the case may be?
- Is it a strict requirement of the Constitution that no moneys out of any Consolidated Fund shall be appropriated except in accordance with law and for the purposes and in the manner provided in the Constitution?
- Is it a strict requirement of the Constitution that the Legislature of a State is not competent to allow appropriation of moneys from the Consolidated Fund of India and, unless there is failure of constitutional machinery in a State, Parliament is not competent to allow appropriation of moneys from the Consolidated Fund of the State?
- If so, is ‘autonomy’ in the exercise of its power to allow appropriation of moneys from the Consolidated Fund of a State or of India, as the case may be, by the Legislature of a State or Parliament, a **basic and formal requirement** of the Constitution?

Fundamentals of Good Governance: Welfare, Justice and Equity

Extracts from the Constitution of India, Part IV Directive Principles of State Policy

37. Application of the principles contained in this Part. (The provisions contained in this Part shall not be enforceable by any court, but) the principles therein laid down are nevertheless *fundamental in the governance of the country* and it shall be the **duty of the State** to *apply these principles in making laws*.

38. State to secure a social order for the promotion of welfare of the people.

(1) The State shall strive to promote the **welfare** of the people by securing and protecting as effectively as it may, a social order in which **justice**, social, economic and political, shall inform all the **institutions of national life**.

(2) The State shall, in particular, strive to **minimise the inequalities in income**, and endeavour to **eliminate inequalities in status, facilities and opportunities**, not only amongst **individuals** but also amongst groups of people residing in different **areas** or engaged in different **vocations**

Can we infer that these principles imply a policy of 'inclusive' Growth?

Welfare, and a Hierarchy of Needs

According to behavioural psychologist Abraham Maslow , human motivation is all about needs satisfaction, which he neatly described as a hierarchy:

- 1. Survival- food, warmth**
- 2. Safety- security, protection**
- 3. Belongingness- social acceptance**
- 4. Esteem- social recognition**
- 5. Self-actualisation- creativity, spirituality**

It may be argued that law should recognise a universal norm of a matrix of **minimum needs as a basic parameter of welfare to be secured to every individual. In the case of a Union of States, the contents of minimum needs to be met have to be **cooperatively** determined.**

Legislative Competence:

Formal and Informal Constraints

The Constitution envisages **formal constraints** on the legislative competence of State Legislatures by limiting the scope of legislation to matters enumerated in the 'State List' and 'Concurrent List' of the Seventh Schedule [Art.246(2)&(3)] and the territorial extent [Art 245(2)] and making such legislation inapplicable in case it is repugnant to any provision enacted by Parliament [Art 246((2)&3)]

If supply of goods and services is defined to include sale or deemed sale of goods, Art 286 read with the Central sales Tax Act,1956 envisages **further formal constraints** on the legislative competence of the States in terms of Entry 54 of the State List.

If two or more States agree that, in respect of any matter in which each of them has legislative competence and the Parliament has not, such matter (e.g., a 'floor rate' of tax on sale of goods within such States) needs to be regulated by Parliament, the Constitution envisages formal constraints on the legislative competence of such States [Art.252]

The 'basic design' in paragraphs 2.1 to 2.20 of the "White Paper" brought out by the Empowered Committee of State Finance Ministers on 17 January 2005 envisages on the other hand **informal constraints**, subject to exceptions, agreed to on behalf of State Governments.

Are the stipulations made in the White Paper an enactment that places legally enforceable constraints on legislative competence of States?

Fiscal Responsibility and prudent Budget Management as necessary preconditions for realizing 'autonomy'

In its Report of July 2004 (pp.4-7), the Taskforce on the Implementation of the Fiscal Responsibility and Budget Management Act, 2003 ('Kelkar Committee') suggested the following principles to guide strategies for fiscal consolidation and tax reforms and preconditions for formulating a proposal for levy of GST:

(1) Fiscal Consolidation

- (i) Fiscal consolidation should be revenue-led
- (ii) Fiscal consolidation should be front-loaded
- (iii) Capital expenditure should be enhanced to counterbalance the contractionary effects of the fiscal consolidation, but expenditures should be conditional on **institutional reform** to ensure that the expenditure is well utilised
- (iv) The reform efforts on revenue expenditure should be further intensified

(2) Tax Reform

1. Widening the tax base; 2. Few rates, low rates; 3. Enhancing the equity of the tax system; 4. **Shift to non-distortionary consumption taxes to increase efficiency in production and enhance international competitiveness of Indian goods and services**; 5. Enhancing the neutrality between present consumption and future consumption; 6. Enhancing neutrality of the tax system to the form of organisation; 7. Enhancing the neutrality of the tax system to sources of finance; 8. Establishing an effective and efficient compliance system, and, 9. Focus on **buoyancy** rather than immediate sources of tax revenue

Fiscal Responsibility and prudent Budget Management as necessary preconditions for realizing 'autonomy' (Continued)

(3) **Proposal of a "Grand Bargain" to precede levy of GST** " The Taskforce proposes a 'grand bargain' whereby all States will have the power to tax *all* services concurrently with the Centre. Consequently, both central and state government would exercise concurrent but independent jurisdiction over common or almost common tax bases extending over *all goods and services*, and in both cases, going up to the final consumer. At the same time, both Centre and States would be required –under the proposed bargain- to abide by the following principles:

1. In addition to zero rate , the number of rates to be three:

	Per cent	
	Centre	State
Floor	6	4
Standard	12	8
Higher	20	14

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Fiscal Responsibility and prudent Budget Management as necessary preconditions for realizing 'autonomy' (Continued)

2. Centre and states should agree on a commonality of exemption lists and threshold limits, and common lists for the levy of excise on goods with negative externalities such as petroleum

3. Imports (to be) charged a two-part levy representing the central GST and the state GST

4.(To minimize costs of compliance) the centre and states should synchronise their administrative procedures and IT infrastructure.

5. *In order to handle calculations and funds transfer to States, there is a need of a nation-wide **clearing house mechanism**. The computation of the final liability should be based on the invoice credit method, whereby credit would be allowed for tax paid on all intermediate goods or services on the basis of the invoice issued by the supplier. The Centre and the States should **cooperate** in establishing this clearing house in order to transfer funds accurately, without incurring complex administrative overheads or compliance costs*

6. Withdrawal of all cascading taxes including octroi, central sales tax and other state level taxes(other than State excise ?)

7. Central excise and services taxes to be subsumed in a central levy to be called Indian Goods and Services Tax. **The States would have to introduce corresponding legislation for taxation of goods and services to subsume the existing state-level cascading taxes"**

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Fiscal Responsibility and Please Effect

Income-elasticity of revenue that accrues from the levy of any tax in any period is the ratio of the rate of change of yield of that tax in that period to the rate of change of Gross Domestic Product.

Income-elasticity of expenditure on a public service in any period may be defined similarly.

The difference in the elasticities of tax-revenues accruing to, and expenditures to be incurred in any year by, a government acting autonomously is the 'elasticity gap'. Can that government plan its expenditure in such a manner that the income-elasticity of expenditure is not more than the income-elasticity of revenues?

The hypothesis that this has not been possible in developing countries is referred to as "PLEASE EFFECT"

**Attributed to Stanley Please, 'Savings through Taxation-Mirage, or Reality',
In The Fund and Bank Review, 'Finance and Development', Vol IV, No.1, March 1967**

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Budget Management and Micawber's Equation

"Annual income twenty pounds, annual expenditure nineteen nineteen and six, result happiness; Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery"

Attributed to
Mr. MICAWBER,
A character in Charles Dickens, 'David Copperfield'

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Options discussed by Satya Poddar and Ehtisham Ahmad

Noting that the Empowered Committee of State Finance Ministers describes the GST as “a further significant improvement- the next logical step- towards a **comprehensive indirect tax reforms in the country**”, Satya Poddar and Ehtisham Ahmad , after referring to options such as ‘Concurrent dual GST’, ‘National GST’,and ‘State GSTs’, conclude-

“ Opportunities for a fundamental reform present themselves only infrequently, and thus need to be pursued vigorously as and when they do become available. As the choice made today would not be reversible in the near future, one needs a longer-term perspective. Achieving the correct choice is then a political economy balancing act that takes into account the technical options and the differing needs and constraints of the main partners. Fortunately, there is a very **substantial consensus among all stakeholders** in the country for a genuine reform. In the circumstances, **an incremental or timid response** would be neither politically expedient, nor would it serve the needs of India of the 21st century. Experience of countries with modern VATs, such as New Zealand, Singapore and Japan suggests that a **GST with single rate and comprehensive base can be a win-win proposition for taxpayers and the fisc alike**”

From **Satya Poddar and Ehtisham Ahmad, ‘GST Reforms and Intergovernmental Considerations in India’**, Working Paper No.1/2009-DEA, Dept of Economic Affairs, Ministry of Finance, Government of India, March 2009

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Options discussed by Satya Poddar et al. (Continued)

According to Satya Poddar et al., the main options for VAT assignment include (i) Concurrent Dual GST, (ii) National GST, (iii) State GSTs, which require an amendment to the Constitution, and (iv) Non-concurrent Dual VATs that does not need any amendment to the Constitution.

Concurrent Dual GST Subject to subsuming central service tax in levying GST, and to defining ‘place of supply’ appropriately, the authors note that this model, which is favoured by the Government of India and the Empowered Committee of State Finance Ministers, has the following notable features:

- (1) There would be a **single registration**, based upon PAN for direct taxation
- (2) States would collect state GST from all ‘dealers’; and central GST from ‘dealers’ with gross turnover below the current registration threshold of Rs. 1.5 Crores under CENVAT; and **transfer central GST so collected to the Government of India**
- (3) **Procedure for collection of central and state GST would be uniform**. There would be one common tax return for both taxes, **with one copy given to the central authority and the other to the relevant state authority**
- (4) other taxes on **consumption** of goods and services levied by the Union, States or local authorities will be subsumed under the central or state GST

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Options discussed by Satya Poddar et al. (Continued)

National GST The authors designate this as the best option. They note the variety of models of single levy of this type, including those prevailing in Australia, China, Canada, Austria, Germany and Mexico. They refer to the desirability of some control of sub-national entities over tax rates in achieving accountability and hard budget constraints and to the apprehension of too much centralisation of taxation powers. They also note that empirical evidence shows that discretionary use of broad-based consumption taxes for social, political or economic policy purposes is limited and that extending the consensus achieved by the States in case of the design of state-level taxes to the Union could fundamentally alter the balance of interests. They are however of the opinion:

“ These concerns can be addressed partially through suitable administrative arrangements and centre-state agreements. The tax design could be made subject to joint control of the Centre and the States. The States would necessarily lose the flexibility of inter-state variation in tax design, but that is also the perceived strength of this option. Given that the Centre does not have machinery for the administration of such a tax, the States would presumably play a significant role in its administration. The revenue-sharing formula could also be mandated to be based on the destination principle, as under the Canadian HST”

Options discussed by Satya Poddar et al. (Continued)

State GSTs This option, now prevalent in the USA, is rejected by the authors, since complete withdrawal of the Union from the field of general consumption taxation, even if it enables avoidance of fiscal transfers to the States to compensate for the reduction of central revenues, is likely to –

- (1) lead to serious impairment of central revenues in the future
- (2) be non- revenue-neutral in case of some States, the incremental revenues benefiting higher-income States and the reduction in fiscal transfers impacting lower-income States adversely
- (3) affect adversely the ability of the States in levy of taxes on the supply of goods and services in a harmonised manner
- (4) it would be impractical to bring ‘inter-state’ services within the ambit of the State GST, without coordinating support from the Centre

Options discussed by Satya Poddar et al. (Continued)

Non-concurrent Dual VATs This option has been mentioned by the authors only to be rejected. This envisages levy of tax on supply of goods by States only and levy of tax on supply of services by the Union only. It is noted by the authors that this would not address the following deficiencies in the current system of taxation :

- (1) Exclusion of services from State taxation has a negative impact on the buoyancy of State tax revenues
- (2) With States not allowing input-tax credit for service tax paid, there is likely to be considerable cascading of taxes
- (3) The resulting system of taxation is likely to continue to be complex

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction

Of the Options discussed by Satya Poddar and Ehtisham Ahmad, the authors prefer the option designated 'National GST' and would have commended it for adoption in pursuance of their conclusion about the need to take a long term view. They have held back such a recommendation since they feel that it is appropriate to let every State have some control over tax rates to ensure accountable sub-national governance and hard budget constraints. They envisage a significant role for the States to administer such a tax and incorporation of the destination principle in revenue sharing.

It is submitted that the option could have been slightly modified with a view to provide a unique primary GST jurisdiction at destination for every taxable person in the manner stipulated in subsection (2) of section 9 of the Central Sales Tax Act, 1956-with a provision relating to assignment of an appropriately levied central GST to an appropriately defined destination State [instead of to the origin State as in subsection (3) of section 9 of the Central sales Tax Act, 1956] and to reservation as envisaged in Article 271 of the Constitution, of the proceeds of a central surcharge as accruing to the Union.

It is then easy to see that, subject to appropriate constraints in a modified Article 286, a destination State may, subject to prior-stage central tax credit (less central surcharge), levy a further tax at such rate as it may deem appropriate so that it is not lower than the central rate inclusive of surcharge and is not so high as to persuade taxable persons to leave the State.

Let us discuss how the restrictions on the legislative competence of the States and the principles of tax assignment to States have evolved and may evolve in future to enable efficiency in the exchange of goods and services and find out if there is another option.

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

Ironically, there were no restrictions similar to those in Article 286 of the Constitution of India on the legislative competence of Provinces in the Government of India Act, 1935 enacted by the British Parliament; and restrictions on the legislative competence of State legislatures were envisaged not by alien rulers but the freedom fighters newly elected to the Constituent Assembly.

The story that had led to this avoidable development can not be understood unless we assume that the political entrepreneurs representing the interests of the erstwhile Provinces and those representing the Government of India acted immaturely in 1948 and, by not recalling the consequences of subjugation by aliens that befell the native rulers who did not value the importance of mutual cooperation, forgot the **lessons of history**.

The pity is that the political entrepreneurs representing the States and the Union still do not see the importance of cooperating 'autonomously'! The political entrepreneurs representing the Union avoid the establishment of an All-India Taxation Council in terms of Article 263 of the Constitution (an institution that would help evolve cooperative solutions on a continuing basis similar to the institution envisaged even by the alien rulers in section 135 of the Government of India Act, 1935). The political entrepreneurs representing the States quote a price for compromising the autonomy of the States which is priceless, by demanding compensation as a condition for cooperation.

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

In '*The Evolution of Cooperation*', Robert Axelrod asks "Under what conditions will cooperation emerge in a world of egoists without central authority?" and concludes that "the evolution of cooperation requires that individuals have a sufficiently large chance to meet again so that they have a stake in their future interaction. If this is true, cooperation can evolve in three stages:

1. The beginning of the story is that cooperation can get started even in a world of unconditional defection. The development cannot take place if it is tried only by scattered individuals who have no chance to interact with each other. However, cooperation can evolve from small clusters of individuals who base their cooperation on **reciprocity** and have even a small proportion of their interaction with each other.
2. The middle of the story is that a strategy based on **reciprocity** can thrive in a world where many different kinds of strategies are being tried.
3. The end of the story is that cooperation, once established on the basis of **reciprocity**, can protect itself from invasion by less cooperative strategies...."

If an option such as **assignment of single rate comprehensive central GST on all business-to-business transactions fully to destination State subject to reservation of a central surcharge** is the strategy to be adopted, reciprocity may be on negotiating the rate of central GST and the rate of central surcharge. **Cooperation on the basis of compensation is not based on reciprocity**. Exercise of authority to amend the Constitution otherwise than on the basis of cooperation confounds the roles of the head of the central government in leading the deliberations in Parliament while exercising its constituent power and in advising the President on the exercise of his functions, as head of the Union Executive.

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

The history of indirect taxation since 1935 in India reveals **lack of cooperation on the part of the political entrepreneurs representing the national and sub-national entities on the basis of reciprocity**. It also reveals the exercise of powers to amend the Constitution to stipulate restrictions on the legislative competence of State legislatures without there being any prior consensus as to the extent of such restrictions as may be justified in the **public interest**. Let us try and draw **lessons from history** so that by applying those lessons we are able to discern a manner of levy of indirect taxes- having no economic incidence on business-to-business transactions and an incidence on business-to-consumer transactions which does not distort consumer prices- that may be evolved through cooperation between potential collecting governments on the basis of **reciprocity**.

Digression: A Peek into History

- The history of levy of taxes on the sale of goods in India begins when the legislature of the Central Provinces and Berar passed an Act entitled 'the Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938' which provided that "there shall be levied and collected from every *retail* dealer a tax on **the retail sales** of motor spirit and lubricants at the rate of five per cent on the value of such sales" (emphasis added). This was in exercise of the legislative competence of the Provincial legislature according to sub-section (3) of section 100 of the Government of India Act, 1935 read with Entry 48 in the Provincial List of matters in the Seventh Schedule to that Act. At the time of the enactment a duty of excise on motor spirit imposed by the Motor Spirits (Duties) Act, 1917 was being levied and continued as a levy by the Federal Legislature in terms of its legislative competence under clause (1) of section 100 of the Government of India Act, 1935 read with Entry 45 of the Federal list of matters in the Seventh Schedule to the Act. Relying upon definitions of 'excise duty' by some economists and on the decisions of Courts in other countries, the following question of law was referred by the Governor General-in-Council to the Federal Court under section 213 of the Government of India Act, 1935 for the opinion of the Federal Court: "Is the Central Provinces and Berar Sales of Motor Spirits and Lubricants Taxation Act, 1938, or any of the provisions thereof and in what particular or particulars or to what extent *ultra vires* the Legislature of the Central Provinces and Berar?"
- **The unstated reason for referring the question for the Court's opinion could not have been anything other than the reluctance of the alien political entrepreneurs ruling over the Indian Empire on behalf of the Crown to share the authority to govern with the 'native' political entrepreneurs who had been popularly elected to make laws for the Provinces.** The judges were however independent. Holding unanimously that the impugned Act was not *ultra vires* the Provincial Legislature, the Honourable Judges noted that *the question is one of possible limitations on a legislative power and not of possible limitations on the meaning of the expression 'duties of excise' and that tax on retail sale to the consumers is in pith and substance not an excise duty.*

From the narration of facts in the decision of the Federal Court *in the matter of the Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938* as reported in (1945) 1STC 1(FC)

A Peek into History (Continued)

Subsequently on an appeal by a provincial government to the Federal Court on a question of law relating to the levy of provincial sales tax on the 'first sale' by a manufacturer of groundnut oil in the province, after referring to the decision in the *Central Provinces Case*, the Federal Court held that a **tax levied on the first sale of goods** must in the nature of the thing be a tax on the sale by the manufacturer or producer, but it is levied upon him *qua* seller and not *qua* manufacturer or producer. If a tax payer who pays sales tax is also a manufacturer or producer of commodities subject to a central duty of excise he may have to pay two taxes but the two taxes are economically separate and distinct imposts. The same principle was therefore also likely to apply if the duty of excise is levied and collected from the manufacturer by a Province instead of by the Government of India.

From *The Province of Madras vs. Boddu Paidanna and Sons*
as reported in (1945) 1 STC 104 (FC)

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A Peek into History (Continued)

The decisions of the Federal Court laid down the law for the taxability of **retail as well as non-retail sale of goods** by an Act of the provincial legislature, irrespective of whether or not the tax-payer-seller was a domestic producer. A number of Provinces had so defined the term 'sale' as to include within its sweep all sales of goods which were actually within their respective territories at the *time* when the relevant agreement to buy or sell came into being, irrespective of the *place/places* where the other ingredients of the contract of sale were consummated. The Taxation Enquiry Commission (chaired by John Matthai, the then Union Finance Minister and appointed on April 1, 1953 to examine, *inter alia*, the **incidence** of central, state and local taxation on the various classes of people, and to make recommendations with regard to modifications required in the then prevailing system of taxation and to fresh avenues for taxation), noted that many Provinces (or, States, after the commencement of the Constitution on 26 January 1950), prompted by revenue needs had by 1948-49 started levying taxes on goods 'exported' to other Provinces/States, because the goods were within the Province/State when the contract of sale was made.

From the Report of the Taxation Enquiry Commission, Ministry of Finance, 1954
(the 'Matthai Commission Report'), Vol 3, Chapter II, p.23

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A Peek into History (Continued)

Since institutions such as the 'Inter-State Council' referred to in article 263 of the Constitution for cooperative evolution of policies were yet to take shape, a Conference of the Finance Ministers of the Provincial Governments had been convened by the Government of Indian Dominion and a committee of officials was appointed to investigate the possibility of achieving a certain degree of uniformity in regard to taxation of inter-state trade in certain essential commodities, raw materials, manufactured articles etc., which were of *all-India importance*. The recommendations of the officials' committee were then considered by a Conference of Provincial Finance Ministers in October, 1948. No agreement could however be reached by the Provincial Finance Ministers. This led to the matter being referred to the Drafting Committee of the Constitution. The Drafting Committee recommended the incorporation of some provisions in the Constitution restricting the powers of the States in respect of the levy of sales tax in the course of foreign trade, inter-state trade and on essential commodities.

From
The Matthai commission Report

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A Peek into History (Continued)

The Taxation Enquiry Commission notes that these provisions were considered at a Conference of Provincial Chief Ministers and Finance Ministers. The proposed provisions were opposed by many Provinces on account of the anticipated loss, by denial of accruals of revenues (which, but for the proposed provisions, ought to accrue to them legitimately according to valid law), owing to the exclusion, from the purview of state taxation, of transactions taking place as a result of foreign trade and inter-state trade. It is unclear as to why cooperation was not extended by the Provinces/ States to the levy of a central tax if the proceeds of collection of tax levied on the inter-state transactions could be constitutionally assigned to the States of final consumption for collection along with collecting tax on the retail sales of goods in their respective territories since the legislative competence of the Provinces to levy and collect such taxes at retail level was not controversial; and why in spite of restricting the legislative competence to tax transactions in the course of foreign trade, the Union did not propose a central levy the proceeds of which could be distributed to the States according to law. The Constituent Assembly, owing to lack of mature cooperation, had to vote to include in article 286 of the Constitution *restrictions on the legislative competence of every State* in the following language:-

"286. Restrictions as to imposition of tax on the sale or purchase of goods (1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place-

(a) outside the State; or

(b) In the course of the import of the goods into, or export of the goods out of, the territory of India

Explanation:- For purposes of sub-clause (a), a sale or purchase shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of **consumption** in that State, notwithstanding the fact that under the general law relating to sale of goods the property in the goods has by reason of such sale or purchase passed in another State.

(2) Except in so far as Parliament may by law otherwise provide, no law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of any goods where such sale or purchase takes place in the course of inter-state trade or commerce:

Provided that the President may by order direct that any tax on the sale or purchase of goods which was being lawfully levied by the Government of any State immediately before the commencement of this Constitution shall, notwithstanding that the imposition of such tax is contrary to the provisions of this clause, continue to be levied until the thirty-first day of March 1951.

(3) No law made by the Legislature of any State imposing, or authorising the imposition of, a tax on the sale or purchase of any such goods as have been declared by Parliament by law to be essential for the life of the community shall have effect unless it has been reserved for the consideration of the President and has received his assent"

No law levying a tax on the sale or purchase of goods in the course of inter-State trade or commerce was however made by Parliament in 1950, even though clause (2) of article 286 referred to the concept of sale or purchase in the course of inter-state trade or commerce. Also no law levying any tax on sale or purchase of goods in the course of import into India and in the course of export out of India was also made by the Parliament in 1950 (or thereafter so far).

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A Peek into History (Continued)

The uncooperative stance of the Provincial Finance Ministers and Chief Ministers has had the result of leading to the enactment of complex statutes that had to classify categories of transactions to be included in, or excluded from, the relevant tax bases on the basis of 'legal fictions' based on artificial and **sophisticated non-market criteria** as 'sale or purchase in the course of inter-state trade or commerce', 'sale or purchase within a State', 'sale or purchase outside a State', 'sale or purchase in the course of import into India', 'sale or purchase in the course of export out of India', 'inter-state or intra-state sale or purchase also deemed to be in the course of export out of India', 'sale or purchase by transfer of documents of title to the goods, during the period of movement of goods from one State to another in pursuance of an inter-state sale or purchase'; and also unavoidably a relatively simple criterion 'movement of goods from one State to another otherwise than in pursuance of a prior agreement for sale or purchase' (well understood by potential tax evaders in the markets in India). **This was done in consultation with the Law Commission in an ingenious way by splitting the contracts- in- process(of performance) for sale of goods into various processing stages referred to in the general law relating to sale of goods, such as specificity, ascertainment, appropriation, assent, movement, and delivery to a carrier or bailee and by creating legal fictions based on the completion of one or more of such stages.** As if the categories so identified were not enough, *departing from the general law relating to sale of goods*, some more categories of transactions that may be logically taken to be provision of services but are *deemed* by an amendment of the Constitution to be **sale of goods by the service-provider and purchase of goods by the recipient of service** were added in 1983 to somehow augment the revenues of the States by enabling them to levy taxes on such transactions 'within' their respective territories, just because the transactions also involved the transfer, delivery or supply of goods as part of the transaction. In case of levy of tax on sales of goods other than "sale of goods within a State" however, the definition of 'sale' in the Central Sales Tax Act, 1956 was left unamended till 2002, in spite of the forty-sixth amendment in 1983.

Please see Second Report of the Law Commission, Constitution (46th amendment) Act, 1982 and Finance Act, 2002

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A Peek into History (Continued)

The Taxation Enquiry Commission goes on to note how the restrictions on the legislative competence of the States led to reduction of state revenues in almost all States and how they provided perverse incentives to tax-evaders to evade state taxes by suitably engineering documentation relating to feigned inter-state transactions so as to show that the amounts of consideration receivable/received in respect of the transactions as documented could not be taken as taxable under the State law.

As regards restrictions on legislative competence of States to levy taxes on foreign trade transactions, the Supreme Court in the first *Trivancore-Cochin Case* held as under:

- (a) Sales or purchases which themselves occasion the export or the import are within the clause 'in the course of', and are therefore exempt under article 286(1) (b)
- (b) (i) Sale by export involves a series of integrated activities commencing from the contract of sale with the foreign buyer and ending with the delivery of goods to a common carrier;
- (ii) The sale and the resultant export form part of a single transaction;
- (iii) Of these two activities, whichever happens first can be regarded as happening in the course of the other.
- (c) Even if the sale is in the State before the commencement of the journey, the sale is nevertheless in the course of export;
- (d) It is erroneous to say that sales 'in the course of' mean sales in which property passes during the actual movement, because, to put it that way would rob the exemption of its usefulness, i.e., exemption from a State levy.

Subsequently in the second *Trivancore-Cochin Case* it was held as under:

- 1) Sales and purchases which themselves occasion the export or import of the goods out of or into the territory of India, fall within article 286(1)(b) and are exempt from State taxation.
- 2) But purchases in the State by the exporter for the purpose of export as well as sales by an importer after the goods have crossed the customs barrier are not within the exemption.
- 3) Sales in the State by the exporter or importer by transfer of shipping documents while the goods are beyond the customs barrier are within the exemption.
- 4) The word 'course' and the expression 'in the course of' not only imply a period of time during which the movement is in progress, but postulate also a 'connected relation'.
- 5) Therefore the sale in the course of export out of the country should be understood as a sale taking place not only during the activities directed to the end of exportation of the goods out of the country, but also as part of or connected with such activities. The time alone was not determinative.

From (1952) 3 STC 434(SC) and (1953) 4 STC 205 (SC)

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A Peek into History (Continued)

As noted by the Taxation Enquiry Commission, in cases not involving foreign trade, the Supreme Court had to consider the legislative competence of a State in levying a tax on the sale or purchase of goods, when the goods had been delivered for consumption in a State, in *State of Bombay vs. United Motors (India) Ltd.*, wherein, delivering the majority judgment, it was held:

“...the Explanation envisages sales or purchases under which out-of-State goods are imported into the State. That is the essential element which makes such a transaction inter-State in character. But the transaction is turned into an intra-State transaction in the delivery-cum-consumption State by operation of the legal fiction which blots out from our view the inter-State element altogether. The statutory fiction completely masks the inter-State character of the sale or purchase which, as a collateral result of such masking, falls outside the scope of clause (2). The operation of clause (2) stands excluded as a result of the legal fiction enacted in the Explanation, and the State in which the goods are actually delivered for consumption can impose tax on inter-State sales or purchases”

In *Poppatal Shah vs. State of Madras*, the Supreme Court had held that it would be quiet competent (for the Provincial Legislatures)to enact a legislation imposing taxes on transactions concluded outside the Province, provided that there was **sufficient and a real nexus between the transactions and the taxing Province**

Referring to the decision in the *United Motors Case*, the Taxation Enquiry Commission noted:

“This decision of the Supreme Court has been interpreted by the State Governments as giving them power to tax non-resident dealers on their sales of goods to consumers or dealers within their respective territories. Several States issued notices for payment of tax to dealers in other States. They also demanded that all exporting non-resident dealers should get themselves registered under their own Sales Tax Acts and submit returns of their transactions should make periodical payments and should have their tax assessed in the same manner as the registered dealers within their own territory. This created difficulties for the trade and industry, as it meant that an exporting dealer had to register himself and be liable to tax not only of his own State but also of all States to which he exported his goods.”

From (1953) 4STC 133(SC), (1953) 4 STC 188(SC), and the Matthai Commission Report, Vol 3, Chapter II, pp26-27

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A Peek into History (Continued)

The Taxation enquiry Commission did not have occasion to notice that the decision in the *United Motors case* was subsequently reversed by the Supreme Court in *Bengal Immunity Co Ltd vs. the State of Bihar*. It noted that some State Governments had already opened offices in other States for the collection of returns and taxes from non-resident dealers. There were many representations made to various State Governments and the Government of India by associations of traders and industrial units as to the difficulties faced by them in complying with the law as declared by the Supreme Court. Though it was possible to establish an Inter-State Council in terms of article 263 to investigate the problems faced by the tax payers in complying with the various State laws relating to levy of taxes on the sale or purchase of goods, the Taxation Enquiry Commission which had been appointed to address many wide-ranging terms of reference on all taxes continued its enquiry and had a Conference of officials convened in November 1953. There was no unanimity among the officials about enacting and enforcing possible State laws for levy of state taxes on the purchases (instead of sales) made by the resident dealers. It is unclear whether the possibility of practically classifying agreements for the sale or purchase of goods into well-understood categories of ‘retail’ and ‘non-retail’(depending on whether the buyer is a consumer or a trader) was examined as an alternative to classifying such agreements artificially into many categories including ‘inter-state’ and ‘intra-state’. There was also a great deal of criticism from the State Governments on the substantive and procedural provisions contained in the Essential Goods (Declaration, and Regulation of Tax on Sale or Purchase) Act, 1952.

The famous jurist H.M.Seervai notes that the decision in the *Bengal Immunity Case* was by a majority of 4 to 3, one of the judges going back on his earlier views. He is of the view that for reasons given in the judgement of Venkatarama Aiyer, J., with which Jagannadhadas, J. concurred, the majority judgment, overruling a recent judgment, and holding that clause (2) of article 286 imposed an independent ban on the legislative competence of the States, was clearly wrong

From (1955) 6STC 446(SC) and H.M. Seervai, ‘Constitutional Law of India’, Fourth Edition, Vol.3, p.2451

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A Peek into History (Continued)

It may be argued that the Taxation Enquiry Commission's recommendations relating to reforms (that is to say, change of institutional environment) were what Douglas C. North would designate as having been, '**path-dependent**'. They were made *without cooperatively examining the implications of practically classifying agreements for sale or purchase of goods as 'retail' and 'non-retail', on the basis of the status of the buyer (whether a 'consumer' or a 'trader')*. Neither the Conference of Provincial Chief Ministers and Finance Ministers nor the Constituent Assembly had foreseen the possibility of classifying sales and purchases of goods into the well-understood categories of "retail" and "non-retail" to put in place a new system of levies based on such a classification that would, **without any significant constitutional restraint on the legislative competence of the States**, have accommodated the '**nexus principle**' enunciated by the Courts, avoided inter-state 'tax incidence export' and also ensured minimum administrative and compliance costs in enforcement.

What is **path dependence**?

A Peek into History (Continued)

Recalling the article of Paul David, '*Clio and the Economics of QWERTY*', wherein (in pursuit of his query "Why does the topmost row of letters on your personal computer keyboard spell out QWERTYUIOP, rather than something else?"), Douglas C. North notes, "David attempts to explain how the particular organisation of letters on the typewriting key board became standardised and fixed and to explain what accidental set of happenings appears to have caused this result to persist, even in the face of more efficient alternatives". The article on the evolution of technology, according to North, drew the attention of economic historians to the issue of *path dependence*.

Taking this idea and the argument that small historical events can lead one technology to win over another, developed by W.Brian Arthur in '*Self-reinforcing Mechanisms in Economics*', Douglas North proceeds to extend the resultant argument about technological change to institutional change . He notes that the **perceptions of the actors play a more central role** in institutional than in technological change because ideological beliefs influence the subjective construction of the models that determine choices; and concludes that **long-run economic change is the cumulative consequence of innumerable short-run decisions by political and economic entrepreneurs** that both directly and indirectly (via external effects) shape performance; and that although the specific short-run paths are unforeseeable, **the overall direction in the long-run is more predictable and more difficult to reverse**.

From

Douglas C. North, '*Institutions, Institutional Change and Economic Performance*', 1990, pp. 92-104
Please see also, Paul A. David, '*Clio and the Economics of QWERTY*', IN the American Economic Review, Vol.75. No.2. May 1985, pp.332-337 ;and

W.Brian Arthur, '*Self-reinforcing Mechanisms in Economics*' in Philip W. Anderson et al.(eds), 'The Economy as an Evolving Complex System', 1988

A Peek into History (Continued)

Historians may possibly conclude that the path dependence might have been because of a mental construct of the political entrepreneurs at the State level not to cooperate with the political entrepreneurs at the Union level since **the latter had after all replaced the alien regime which tried to deny the Provinces the legislative competence even to levy a tax on retail sale of goods**; and of a mental construct of the political entrepreneurs at the Union level to **'strengthen' the Union as much as possible (including in respect of the relation of the Union to the States) in the context of the social upheavals witnessed prior to political independence in 1947 and a subsequent war in 1948**. There appears to have been no realisation on the part of the political entrepreneurs that 'autonomy' of a State within the confines of a Constitution has, in addition to the 'vertical' dimension (vis-à-vis the Union) of capacity to take decisions autonomously on public expenditures in the discharge of its functions *within the confines of revenues that accrue/devolve according to the Constitution*, a 'horizontal' dimension, namely **the requirement to cooperate with other States (and the Union) that are 'autonomous' too**. It would appear that the political entrepreneurs representing the States had not learnt the lessons of history of subjugation by aliens faced by the erstwhile rulers in the Indian subcontinent owing to lack of cooperation among them; and as such were unable to propose cooperatively, **alternative solutions to the problems of compliance and administration, without there being any significant restrictions on their legislative competence**. The decision of the Constituent Assembly was eventually based on an **imitation of an alien regime of the Empire of India** (which was presumably perceived by the political entrepreneurs at the Union level, to have been strong, and *as such* had gone on to *classify the transactions on the basis of the need to somehow restrict the legislative competence of Provincial Governments elected to office by the 'natives'*, even though according to the 'independent' decisions of the Courts it turned out that the Provincial Governments were quite competent-subject only to the 'nexus principle' enunciated by the Courts).

Is such a conclusion appropriate?

A Peek into History (Continued)

The Frenchmen are good in mathematics and are brainy. Mr. Maurice Laurie, Joint Director of *Direction Générale des Impôts* (the French Tax Authority) introduced the system of collecting taxes on a 'value-added' basis on 10th April 1954 in France.

The restrictions spelt out in Article 286 of the Indian Constitution no doubt came into effect earlier on 26th January 1950, but the Indians are also supposed to be good in mathematics and could have easily innovated the method of collecting taxes on a value-added basis in 1950. Having provided for the 'consumption' principle of collection of sales taxes by States, all that was to be done by the political entrepreneurs representing the Union was to provide that occurrence of such ingredients of any contract of sale which took place outside the consumption State will constitute a taxable event for the levy of a central tax, that shall stand assigned to the consumption State to be collected by the same authority that collects the state tax, subject to ensuring that the requisite amount of central tax is deposited in advance by the buyer in a public account of the consumption State when he places the order for **non-retail** supply including supply from out of State, and credit (as in case of a VAT) is allowed for such advance tax paid in determining the amount payable in respect of **retail** sale in the State leading to actual consumption. The silence of Parliament in the matter of enactment of a statute levying such a central tax from 1950 to 1956 led to avoidable problems of administration and compliance discussed by the Matthal Commission and the Supreme Court in the *United Motor and Bengal Immunity* cases.

Can there be any other explanation for such **tacit legislation** of Parliament defining the legislative competence of the Legislatures of consumption States, subject only to the nexus principle guiding such legislative competence?

A Peek into History (Continued)

The Matthai Commission went on to make its recommendations for the amendment of Article 286 and for the enactment of a statute to levy a central tax. This was examined in consultation with the Law Commission. Though the amended versions of article 286 and article 269 left it to the Parliament to formulate principles for the determination as to whether a transaction was exigible to central or state tax and the principles of distribution of the proceeds of the central tax, subsection (3) of section 9 of the Central Sales Tax Act, 1956 enacted by Parliament introduced the principle of assignment of the proceeds of the central tax to the 'origin' States. This had to be buttressed by recourse to classifying transactions without regard to simple and well-understood market criteria such as 'business-to-business' (or non-retail) and 'business-to-consumer' (or retail); and to various legal fictions in sections 3, 4 and 5 of the Act. While the VAT technology of prior-stage tax credit was recognized in section 15, giving up the principle of collection of the tax at destination led to the concept of declared goods as enumerated in section 14 and additional restrictions on the legislative competence of the States in section 15.

More significantly the desertion of the destination principle of collection led to the need to insert subsection (3) of section 5 relating to some inter-state and intra-state transactions being deemed to be in the course of export; subsection (2) of section 6 exempting the values added by sales in transit during inter-state movement of goods; section 6A relating to evidence of movement otherwise than as a result of sale; and eventually to provisions for resolution of disputes arising out of conflicting decisions of tax authorities of two different States on the same transaction.

A Peek into History (Continued)

Article 286 was amended in 1956 to read as under:

“ **286. Restrictions as to imposition of tax on the sale or purchase of goods** (1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place-

(a) outside the State; or

(b) in the course of the import of the goods into, or export of the goods out of, the territory of India

(2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1)

(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of, a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, to be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify”

Clause (3) was also inserted in Article 269 to read as under:

“Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce”

A Peek into History (Continued)

A central tax to be levied on the consideration received by a service-provider for services provided by him was not thought of before 1994. As a result, and in the light of the law laid down by the Supreme Court in *Gannon Dunkerley's Case* and some subsequent decisions restricting the legislative competence of State legislatures by holding that the concepts in the general law relating to sale of goods is relevant in decisions on the competence of State legislatures (and to plug some loopholes in tax dodgers avoiding taxes by surreptitiously availing the incentive of non-levy on inter-state consignments), the Constitution was amended in 1982 and some transactions that may logically be services were defined by inserting clause (29A) in Article 366 by 'deeming' such transactions to be sale of goods by the service-provider and purchase of goods by the recipient if the transaction involved the transfer, delivery or supply of goods also.

Clause (3) of Article 286 was also amended so that it read:

" Any law of a State shall, in so far as it imposes, or authorises the imposition of,-

- (a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-state trade or commerce; or
- (b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or subclause (d) of clause (29A) of Article 366.

be subject to such restrictions and conditions I regard to the system of levy, rates and other incidents of the tax as Parliament by law specify

However the definition of 'sale' in the Central sales Tax Act,1956 was not amended till 2002

A Peek into History (Continued)

Buoyancy of revenues accruing to the Union by levy of duties of excise on goods other than petroleum products was found by the Kelkar Committee to be far less than unity and as such the rate of growth of revenues on this account has been considerably less than the rate of growth of GDP

The central excise revenues accruing to the Government of India not having an income-elasticity of more than one, it is not surprising that the devolution of revenues in terms of the pre- 2000 provisions of Article 272, which provided as under were found inadequate to fund the requirements of States:

" 272.Taxes which are levied and collected by the Union and may be distributed between the Union and the States

Union duties of excise other than duties of excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied and collected by the Government of India, but, if Parliament by law so provides, there shall be paid out of the Consolidated Fund of India to the States to which the law imposing the duty extends, sums equivalent to the whole or any part of the net proceeds of that duty , and those sums shall be distributed among the States in accordance with such principles of distribution as may be formulated by such law.

The Article was repealed, Article 269 was amended and the provisions in Article 270 relating to distribution of Union tax on incomes other than agricultural income were amended to read as under in clauses (1) and (2):

" 270.Taxes levied and distributed between the Union and the States. (1) All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268 and 269 respectively, surcharge on taxes and duties referred to in article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States in the manner provided in clause (2)

(2) Such percentage, as may be prescribed, of the net proceeds of any such tax or duty in any financial year shall not form part of the Consolidated Fund of India, but shall be distributed among those States within which that tax or duty is leviable in that year, and shall be distributed among those States in such manner and from such time as may be prescribed in the manner provided in clause (3)

A Peek into History (Continued)

Since all the taxes and duties referred to in the Union List are covered by the provisions relating to distribution in Article 270, Article 269 has been amended to exclude references to taxes other than taxes on inter-state consignments and sale or purchase of goods. Article 268 has been retained. An Article 268A relating to levy of central service tax has been inserted by section 2 of the Constitution (Eighty-eighth Amendment) Act, 2003, but this is yet to come into force.

There is a provision for reservation of a part of revenues collected by way of a surcharge for the purposes of the Union in Article 271 which reads as under:

“**271. Surcharge on certain duties and taxes for purposes of the Union.** Notwithstanding anything in articles 269 and 270, Parliament may at any time increase any of the duties or taxes referred to in those articles by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part of the Consolidated Fund of India

I am not aware of any occasion on which the provisions of Article 271 have been invoked.

A Peek into History (Continued)

Our peek into the relevant legislative history may end with the note that there has been a limited use of Article 263 in establishing regional inter-State Councils and there is nothing significant from their deliberations for the economy in India as a whole.

We conclude, first that **law is relevant as long as there is need to minimise transaction costs;**

Secondly, **history of legislation is relevant as an aid to ascertain the intention of the Legislature.**

Let us see how

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

Before we consider an option that provides not only for collection at destination in order to avoid incidence of the levy of indirect taxes on any supplier of goods and/or services and to limit the incidence only on the prices payable by domestic consumers, but also for avoiding the concurrent jurisdiction of more than one primary tax authority over the transactions of any taxable person, we need to note **the likely interpretation by the Courts on the possible provisions of any statute or statutes** that may be enacted to levy a central and a set of state Goods and Services Taxes in pursuance of the norm of predictive accuracy

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

Francis Bennion expounds the ideas of 'social mischief' and 'legal mischief' in the context of the well-known 'Mischief Rule' of interpretation of statutes based upon the following resolution of the Barons of the Exchequer in *Heydon's Case*.

" That for sure and true interpretation of all statutes in general (be they penal or beneficial, restrictive or enlarging of the common (i.e., pre-existing) law, four things are to be discerned and considered:

- 1) What was the common law before the making of the Act;**
- 2) What was the mischief and defect for which the common law did not provide;**
- 3) What remedy the Parliament hath resolved and appointed to cure the disease of the commonwealth; and**
- 4) The true reason of the remedy**
and then the office of all the judges is always to make such construction as shall-
 - a) Suppress the mischief and advance the remedy, and**
 - b) Suppress subtle inventions and evasions for the continuance of the mischief *pro bono commodo* (for private benefit), and**
 - c) Add force and life to the cure and remedy according to the true intent of the makers of the Act *pro bono publico* (for the public good)" (emphasis/translations in brackets added)**

From Francis Bennion, in '*Statutory Interpretation*', 1984, pp.638-641, relying on (1584) 3 Co Rep 7a

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

“The **social mischief** to which an Act is directed is a factual situation, present or shortly expected, which Parliament desires to remedy (if and so far as law can provide a remedy for it). This may range from something obviously wrong...to the possibility of improving an already neutral or even beneficial state of affairs”

“A **legal mischief** is a condition which constitutes a defect in law, or is regarded by Parliament as constituting such a defect. Either the law is defective in not providing, to the fullest extent which is possible for a law, some remedy for a corresponding social mischief (or alleged social mischief), or there is a purely legal defect in the law without a corresponding social mischief”

From Francis Bennion, ‘Statutory Interpretation’, 1984, pp.638-639

It is easy to discern from the history of legislation and judicial decisions that the social mischief that called for remedy before 1956 was that the application of the nexus principle required the taxable persons to comply with **the requirements of more than one primary tax jurisdiction making compliance practically impossible..** After the levy of an origin based services tax on a select services, in addition to the origin-based central sales tax at non-zero rates, the political entrepreneurs seem to discern a legal defect in **the extant law not being able to address the problem of distortions in the market prices** for which a remedy needs to be found. Bennion (p648) also observes, “Where the mischief is a legal defect consisting of some feature considered obsolete, Parliament may provide for **phasing out the mischief** rather than abolishing it summarily. This enables the people affected to grow used to the change gradually”.

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An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

It is to be appreciated that in enacting the Central Sales Tax Act, 1956 as the instrument to make the restrictions and provisions in Articles 286 and 269 of the Constitution effective, Parliament took note of **the ‘mischief’ of non-existence of a one-to-one relationship of administration and compliance between a person who was liable and a primary tax authority who had jurisdiction over taxable events related to such person owing to the ‘nexus’ principle enunciated by the Courts.** It provided for the establishment of such one-to-one correspondence, by resorting to many sophisticated non-market concepts and by levy of a central tax to be collected by the primary tax authority at the ‘origin’ from whose jurisdiction goods ‘moved’ and by **stipulating that the said authority shall be the same as the authority who had jurisdiction to collect state taxes from the same person.** In the process, and since it is conceivable that the concept of ‘prior-stage tax credit’ as in a system of collection of tax on a ‘value-added basis’ is inconsistent with ‘origin’-based levies, the Parliament found that there would be a **second ‘mischief’ of resultant incidence of the central tax on goods used as raw materials in domestic production process on which it may not be possible for the ‘consumer’ to be given any relief in the market price payable by him.** Hence Parliament conceived of the concept of ‘goods of special importance in inter-state trade or commerce’ (defined as ‘declared goods’) on levying state taxes on sale or purchase of which, it was found necessary to stipulate more restrictions on the legislative competence of the State legislatures. Parliament went on to **stipulate that in case declared goods that are sold in the course of inter-state trade or commerce had already suffered levy of state tax in an earlier transaction, such state tax shall be ‘reimbursed’ to the person selling the same subsequently in the course of inter-state trade or commerce,** thus effectively providing for prior-stage state tax credit as in the case of collection of tax on a value-added basis. It is therefore essential to discern a defect in the continuance of the Central Sales Tax Act, 1956 to provide for the collection of the central tax by the authorities of the State at the ‘origin’, in spite of reforms leading to ‘destination’-based Goods and Services Taxes, as a ‘legal mischief’ that needs to be remedied

CA Institute, Bangalore Branch, 10 October
2009

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An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

Now let us consider an option of division of legislative competence based on the following (or any other similar)provisions of an amended Article 286 (and other corresponding changes in the Constitution) as under:

286. Restrictions as to imposition of tax on supply of goods and services

- (1) No law of a State shall impose, or authorise the imposition of a tax-
 - (a) on non-retail supply of goods and services; and
 - (b) on the supply of goods and services made in the course of import into, or export out of, the territory of India
- (2) Neither Parliament nor the Legislature of any State shall by law levy a tax on supply of goods and services except-
 - (a) at a rate to be applied to the monetary value of the goods and services so supplied; and
 - (b) by providing for collection of such tax on a value added basis
- (3) No law of a State shall levy a tax on retail supply of goods and services at a rate lower than the rate at which tax is levied by Parliament on non-retail supply of corresponding goods and services
- (4) Parliament may by law formulate principles for determining when a supply of goods and services-
 - (a) is non-retail supply of goods and services; or
 - (b) is made in the course of import into, or export out of, the territory of India
- (5) The President may by notification in the Official Gazette declare, for purposes of clause (3), correspondence between-
 - (a) the nomenclature of goods referred to in any law made by Parliament levying a tax on the supply of goods in the course of import into, or export out of, the territory of India and on the non-retail supply of goods; and
 - (b) the nomenclature of goods referred to in any law made by the Legislature of a State levying a tax on the retail supply of such goods

Explanation:- (1) In this Article-

- (a) "Supply of goods and services" means either supply of goods made in pursuance of an agreement to purchase or to sell such goods or supply of services made in pursuance of an agreement to receive or to provide any service, whether or not the provision of such service involves the transfer, delivery or supply of goods also
- (b) "Retail supply of goods and services" means supply of goods and services other than non-retail supply of such goods and services, supply of such goods and services in the course of import into the territory of India and supply of such goods and services in the course of export out of the territory of India; and
- (c) "Collection of tax on value-added basis" means collection in any period specified in the law referred to in clause (2), of the tax payable after allowing a deduction of the amounts by way of tax paid by the taxable person referred to in such law on the supply of goods and services made to him during such period
 - (2) The law made by the Legislature of a State levying a tax on the retail supply of goods may zero rate but not exempt any such supply, if the law made by Parliament zero rates tax on the non-retail supply of corresponding goods

An Option that provides for collection at Destination and for unique Primary Tax Authority Jurisdiction (Continued)

Let us assume that –

1. All indirect subsidies have been discontinued and ascertaining the unique identity of individuals entitled to subsidised goods and services is possible.
2. The classification of transactions of exchange of goods as inter-state and intra-state has been discontinued and a classification based on simple market criteria as 'retail' and 'non-retail' is possible in pursuance of appropriate amendments to the Constitution.
3. The Central Sales Tax Act, 1956 has been repealed and a Central Goods and Services Act has been enacted-
 - (a) providing for the registration of suppliers of goods and/or services on the basis of strict conditions of eligibility, out of those registered under at least one state GST Act and functioning genuinely; and providing that as long as their registration under the central GST Act is current, they are eligible to prior-stage tax credit on the consideration payable/paid by them for supplies made to them in any prescribed period; and for issuing tax-credit vouchers to those to whom they make supplies of goods and/or services; and
 - (b) providing for assignment of the proceeds of the central GST, except for central surcharge if any, to the State of destination indicated by the recipient in his order for supply.

Then it is possible to provide that the primary authority having jurisdiction over the taxable person under the State GST Act shall also be the primary central GST authority. While the surcharge may be initially fixed so that Government of India does not lose out, it may be phased out subject to further agreements with the States so as to achieve minimum distortion at the destination market prices

To sum up...

Benjamin Cordozo, the well-known US Judge, says that **law, as a traveller, should be ready for the morrow**. While the draft of the Direct Tax Code that is scheduled to be effective from 1 April 2011 is open for public debate, the draft/drafts of the statutes for the levy of indirect taxes and the requisite amendments of the Constitution scheduled to be effective one year earlier are not yet drafted. Are we ready for the 'morrow'?

Adam Smith, the famous philosopher, says " There are two different occasions upon which we examine our own conduct, and endeavour to view it in the light in which the **IMPARTIAL SPECTATOR** would view it; first, when we are about to act (just as the political entrepreneurs are); and secondly, after we have acted. **Our views are apt to be partial in both cases; but they are apt to be most partial when it is of most importance that they should be otherwise**"

A significant decision is about to be taken by the political entrepreneurs otherwise than on the basis of cooperation born out of reciprocity; without establishing a forum for evolving such cooperation as envisaged in the Constitution; and without the benefit of an appropriate empirical survey similar to the one in 1978 which preceded the reform of law relating to excises on the production of goods other than alcohol and narcotics.

If the reforms are growth-enhancing they should facilitate and not deter more transactions by economic entrepreneurs by tax-induced transaction costs. Organisations representing suppliers of all tradable goods and services need to cooperatively plan an empirical survey of the incidence of the existing, proposed or any ideal levy on the transaction costs likely to be faced by them in taking decisions to pursue or not pursue possible transactions. **This will enable them to be prepared to respond to proposals for levy of GST as and when such response is called for. If prior-stage tax-credit is assured at the hands of a unique primary tax authority, the rates of levy on business-to- business transactions of supply of goods and services are irrelevant. What is relevant is the manner of compliance and administration.**