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INTER STATE TRANSACTION IN THE GOODS AND SERVICE TAX REGIME

Within the scheme of fiscal federalism as envisaged in the Constitution of India, the power to tax an inter-state sale transaction lies with the Centre.¹ Pursuant to this power, Central Sales Tax ('CST') is imposed on inter-state sale transactions. Even with the implementation of GST, this power would be retained by the Centre. The Constitution (One Hundred and Twenty Second Amendment) Bill, 2014 ('Amendment Bill') which is expected to be discussed in the Budget Session of the Parliament commencing on February 23, 2015, seeks to introduce Article 246A and Article 269A which allow the Centre to exclusively impose tax on the supply of goods and services occurring in the course of inter-state trade and commerce, and empowers the Parliament to make laws to that effect, including formulating principles to determine the place of supply in inter-state transactions (which would fix the taxing jurisdiction for each transaction of supply) on the basis of the recommendations of the Goods and Services Tax Council. In this background, the taxation system for inter-state supplies, envisaged under the GST Regime vis-à-vis the present system is discussed hereunder.

IGST Model of Taxing Inter-State Transactions

Under the proposed GST, the IGST model has been accepted for taxing inter-state transactions. Within the scheme of IGST envisaged,² the Centre would levy an IGST, the rate of which is likely to be equivalent to the sum of the applicable SGST rate (levied by the State) and the CGST rate (levied by the Centre). Illustratively, if the CGST rate is 10% and SGST rate is 12%, the IGST rate is likely to be 22%. Given the possibility that the SGST rate may vary from State to State (which itself would be contrary to the classical common market with a unified rate), it would be imperative that the IGST rate is constant and does not differ depending on the States involved in the inter-state transaction as it will otherwise result into an absurdity of identical goods being subject to different rates of IGST when sold in different States. Unlike CST which is an origin based taxing regime, as GST is envisaged to be a destination based taxation regime, the SGST portion of the IGST would be eventually transferred to the State where the goods/services are supplied.

One major advantage of the IGST Model over the prevalent CST model, where input tax credit is not available to the buyer, is that input tax credit chain would be uninterrupted on inter-state transactions. Under the proposed model, it is envisaged that the Central Government will act as a neutral agency and transfer the funds to the respective State Governments on the destination principle. While all details of the IGST model have not yet come into the public domain, certain key transactions would be treated differently in the GST regime as compared to the current regime.

Some significant changes (from the system hitherto) are tabulated as under:

Transactions	Present Regime	GST Regime
Sale in course of Import ('SICOI')	SICOI transactions are not liable to Sales tax (SICOI subjected to Import duty i.e. BCD + CVD + SAD)	Exemption for SICOI unlikely to continue. CVD & SAD to be subsumed in GST; BCD will continue to be levied on import in India
Sale in – transit	In-transit Sales are exempted by issuance of E-I Form in first sale & E-II Form in subsequent sales	Exemption to In-transit Sale may not exist under GST as all supplies will be taxed
Sale to drilling platforms located beyond the State limits	Judicial rulings hold that such supply of goods are not 'Inter-State sale'	No clarity yet, on the treatment to be given to such transactions under the GST regime
Supply of Goods and Services to Self	Goods: Stock transfer is not liable to tax but leads to burnout of credit	Goods: Stock transfer is likely to attract GST and also the proposed 1% additional tax. However, issues around valuation of such transfers remain

¹ This power emanates from Article 286 which specifically prohibits states from taxing sale/purchase transactions which occur outside the state and Article 246 read with Entry 92A of List I which empowers the Centre to tax such sale or purchase which takes place in the course of inter-State trade or commerce.

² The Empowered Committee of State Finance Ministers, First Discussion Paper on Goods and Services Tax in India, New Delhi, November 2009.

	Services: There is no Service tax on supply to self	Services: Service to self between States may be taxed. However, issues would arise while determining the consideration of such transfers
Supply of Services	Only the Central Government is empowered to tax supply of services. There is no concept of inter-state supply of services	Both the Central and the State Government would be empowered to tax supply of services. Additional tax of 1% proposed to be imposed on goods would not be applicable on such transactions.
Supply of Intangibles	No legislative provision specifically for determining situs of sale of intangibles. Judicial precedents have provided the basis	Important to determine place of supply in case of inter-State transaction of intangibles – it is hoped suitable provisions are specified in the Place of Supply Rules.

CST Compensation Issue

While the issue of CST compensation to States has been a roadblock for the introduction of GST, the Amendment Bill has sought to resolve this issue in two ways – **Firstly**, an additional tax is likely to be imposed on the supply of goods in the course of inter-state trade and commerce, at a rate not exceeding 1%, for a period of two years/or any other period as recommended by the GST Council. This tax would not be imposed on the supply of services. The additional tax becomes a cost in transactions, since it is not available for set-off. Unlike destination based taxation regime in GST, this additional tax is envisaged to be an origin based tax wherein the proceeds would go to the State Government from where the supply originates. **Secondly**, on the recommendation of the GST Council, the Parliament is empowered to provide compensation to the States for loss of revenue arising on account of implementation of GST (for period extending up to 5 years).

Key Concern

With the fungibility of credits under the GST regime on inter-state transactions, businesses need to re-evaluate the need for depots essentially set up in order to optimise the tax credits. Besides, with the likely introduction of the 1% additional tax on supply of goods, the differentiation between a transaction in goods and services will persist. It will be interesting to note how this additional tax would be levied on composite contracts such as works contract. Inter-state transactions in alcoholic products will have its own set of issues given the fact that they will be outside the purview of GST. The Telecom, Banking and Insurance sectors will look forward to the tax treatment of their inter-state transactions given the difficulty and litigation in most tax jurisdictions around the world in fixation of place of supply for these sectors.