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EXEMPTIONS AND INCENTIVE SCHEMES UNDER GST

The Legislation for each of the principal taxes that will get replaced on transition to the Goods and Services Tax ('GST') regime (viz. Central Excise duty, Service tax, Central Sales tax and state-level VAT) provide for exemptions / concessions from the duty / tax in various situations. Apart from *de minimis* exemptions, the exemptions available under such principal taxes can broadly be categorized into area based exemptions, end-user based exemptions and product / service specific or sector specific exemptions.

It is well recognized that exemptions in GST regime are distortionary, and affect the free flow of tax credits, and, an ideal GST would require minimum exemptions¹. However, these exemptions have been necessitated by various considerations over a period of time (such as providing boost to a particular sector, achieving regional development, encouraging infrastructure, public health, etc.) Also, many of such exemptions are time-bound with a sunset clause, and for which businesses have made significant investments. It may be expected that under the GST regime certain of these considerations may continue to be relevant and the exemptions would not be completely taken away, atleast not immediately.

Whether and to what extent these exemptions will continue on the switchover to GST, and, the mechanism for allowing any ongoing exemptions / concessions is of significant concern for the industry. We provide our insight on the impact in relation to different types of exemptions:

PRODUCT / SERVICE SPECIFIC OR SECTOR SPECIFIC EXEMPTIONS

- It is unlikely that the product / service specific or sector specific exemptions providing concessional rate of duty or nil rate of duty would continue under GST regime. The example of such exemption under the present tax structure is exemptions to health care services from service tax. The effect of such exemptions under GST regime would extend beyond their impact on the effective rate and create distortion in availment of tax credits. As an illustration, if rate of CGST is say 10% and concessional rate of CGST (say 4%) is made applicable on manufacture of specific goods, this will distort the credit flow with accumulation of credit with the manufacturer as inputs will be procured at tax cost of 10% and final product is taxed at a much lesser rate.
- Where such exemptions are to be continued, the same could be converted into scheme of cash refund subsequent to collection of tax, which would not affect the credit flow.

END USER BASED EXEMPTIONS

- The end user based exemptions may continue given that value chain remains largely unaffected. The example of such exemption are supplies made to mega power project, supplies to Export Oriented Unit (EOU) / Special Economic Zone (SEZ), exemption from central excise duty on goods used for manufacture of fertilisers. Such end user based exemptions could be converted to a scheme where refund is granted to end users so as to prevent distortion in credit flow.

EXEMPTIONS IN NATURE OF ABATEMENT

- The exemptions which allow for abatement may continue or such abatements may be brought through valuation provisions under GST regime. Unless works contract are treated as a single supply, the exemptions / abatements similar to those presently existing to mitigate double taxation may have to be continued in some form, perhaps by way of abatement.

AREA BASED EXEMPTIONS

- The area based exemptions are currently provided by Centre (e.g. for industries set up in North-East region, Himachal Pradesh, etc.) and States (e.g. 'Package Scheme of Incentives') with a sunset clause and are either in the nature of outright exemption from tax, deferment of tax liability or refund of tax paid. Given the Government's commitment towards balancing regional development, the transition to GST may not lead to untimely withdrawal of such concessions, and such concessions would be allowed to continue until its expiry. However, it is likely that the mechanism of such concessions may be changed to a deferral scheme or could be operated through cash refund scheme, which would not impact the chain of credits. However, amount of refund of duty/taxes to be given i.e. 100% or part, and whether such refund would be time bound is a significant factor for consideration. Where there is substantial change in benefit before expiry of scheme, the impacted parties will have to examine whether doctrine of promissory estoppel can be invoked.

¹ The Empowered Committee of State Finance Ministers in the First Discussion Paper on GST extended similar views.

EXEMPTIONS SCENARIO UNDER CONCURRENT TAXATION BY CENTRE AND STATE

- Presently, there is no uniformity in exemptions granted under the Central laws with the State VAT laws, and the number of goods presently exempted under the Central Excise law is more than the number of goods exempted under State VAT laws, further the goods exempt under different State VAT laws differ. Where under the Constitution the power to legislate and levy CGST and SGST are separately with the Central and the State Governments respectively², unless any alignment / consensus is achieved on the exemption list, there could be a situation that under the coincident taxation regime, - (a) a product is chargeable to CGST and not to SGST; and, (b) the product is chargeable to SGST in one State and not in another State.

The grant of exemptions has been an important consideration for many business operations. With the change in the list of exemptions and the mechanism of such exemptions it would be important for the businesses to re-evaluate their business models, cash flows, price points and profitability.

² As per the Constitution (One Hundred and Twenty-Second Amendment) Bill, 2004 introduced in Lok Sabha on December 14, 2014, the Centre and State will separately have powers to legislate and levy CGST and SGST respectively.