

Questions about the GST cess

As part of the Goods and Services Tax (GST) reforms that have been implemented in the country, a new levy called the GST Compensation Cess has been introduced to make good apprehended losses to States in the first five years of GST implementation. The Cess has been introduced through the GST (Compensation to States) Act, 2017 and is levied on inter- and intra-State supply of notified goods such as aerated drinks, coal, tobacco, automobiles and the ambiguous category of 'other supplies'. The proceeds of the cess will be distributed to loss-incurring States on the basis of a prescribed formula. The schedule to the Act mentions the maximum rates of the cess, which extend to 290%. The levy would be over and above the four GST slabs of 5%, 12%, 18% and 28%.

The cess has been making headline news due to frequent changes in the rates, the latest being the increase in the rate of luxury, mid-sized cars and sport utility vehicles. While the policy flip-flop on the tax rates reveals the ad hoc implementation of the cess, there is much to say about the legal validity of the Act in terms of legislative competence and conformity with the Constitution.

A cess is a levy for a specific purpose which may bear the characteristics of a tax or a fee. The quintessential feature of a cess is that it is levied for a 'specific purpose' and the proceeds are earmarked as such. Under Article 270 of the Constitution, a cess tax has special privilege as the proceeds can be retained exclusively by the Union and need not be shared with States. The object of granting this special status is to ensure expenditure for a specific purpose, as is evident from the Fourth Finance Commission Report.

A cess must have an earmarked purpose and the contributor and beneficiary must be relatable. In the past, cesses were imposed by the Central government to raise finances for specific industries and labour welfare within chosen industries. If compensating State governments is considered to be a specific purpose, any general revenue raising measure can be considered to be backed by an earmarked purpose. Once the money is transferred to State governments, it can be used to fund just about any scheme and may even be used merely to adjust the respective State government's fiscal deficit. Further, there is no relation between the persons contributing to the cess and the recipients, the State governments. All these factors make the cess look more like an additional tax or surcharge which becomes problematic as surcharge on the GST is prohibited under Article 271.

Section 18 of the 122nd Constitution Amendment Bill, 2014 proposed a 1% additional tax to compensate States but this was withdrawn while enacting the Amendment Act. The version of Section 18 adopted in the Amendment Act, 2016 merely says that Parliament shall, on the GST Council's recommendations, provide for compensation to States for a period of five years. There is no provision for an additional tax. As per Article 279A(4)(f), the GST Council's power to recommend a special rate is confined to raising additional resources during any natural calamity or disaster. The cess cannot be justified under such power. Moreover, pursuant to the 101st Constitution Amendment Act, 2016, Article 271 has been amended to state that an additional tax/surcharge cannot be imposed over and above the GST tax rates. Thus it appears that by enacting the cess, Parliament is seeking to do indirectly that which cannot be done directly, which amounts to it being a colourable piece of legislation.

The goods identified in the Act, such as aerated drinks, coal, tobacco, automobiles and the ambiguous category of "other supplies", do not form a distinct category or class deserving the liability to pay the cess so as to compensate States, and it is doubtful it will succeed if tested under the anvil of the right to equality under Article 14. While the sin goods argument is alluring, it is erroneous, looking at misfits such as coal and aerated drinks and the uncovered sin goods

including luxury goods, jewellery, gadgets and the like. Similarly, “other supplies” leaves much to the unfettered discretion of the government.

The cess reflects the same lack of coherence as the GST regime in general, the appeasement measures being weighed down by the legal entanglements created therein. It also raises the question as to whether the targeted goods have been chosen merely because of their inelasticity — less dependence of demand on price change — ensuring the generation of not just adequate but also surplus funds for the government. While the Delhi High Court has granted relief to a coal trader against implementation of the Act, it remains to be seen if the legislation will be tested by courts on legislative competence and colourable action.

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