

Destination based GST : Impact on state revenue due to ambiguities in legislation

Jenny Thekkekara

Associate Professor, Gulati Institute of Finance and Taxation, Thiruvananthapuram

1. Introduction

Goods & Services Tax (GST) is a destination based tax and the purpose of GST law is enshrined in such a way so as to enabling the destination state to receive the tax on supply of goods or services or both. But there are certain ambiguities in the provisions of The Integrated Goods and Services Tax Act, 2017 (IGST Act) and The Central Goods and Services Tax, Rules 2017/ State Goods and Services Tax, Rules 2017 (CGST/SGST Rules), which go in contrary to this objective. Hence in order to curb such ambiguities certain amendments are proposed in section 10 of the IGST, Act. 2017.

Constitution of India provides for the power to levy various taxes by the Central and State governments. Article 265 of the Indian Constitution states that, "No tax shall be levied or collected except by authority of law". This article contains the most important principle about levy and collection of tax. The term 'law' in this article means a statute law which means an enactment of the competent legislature. Accordingly no levy can be imposed either by executive action or by a resolution of the House. A tax could only be imposed by a law, which is valid by conformity to the criteria laid down by different articles of the Constitution.

A tax law shall be valid only if it satisfies the following conditions

- i. The law should be one within the legislative competence of the legislature being covered by the legislative entries in Schedule VII, Article 246A and 269A of the Constitution.
- ii. The law should not be one prohibited by any particular provision of the Constitution.
- iii. The law or the relevant portion thereof should not be inconsistent with the fundamental rights guaranteed by the Constitution.

From the Article it is clear that not only levy but matters pertaining to collection of tax also should be under the authority of law. It provides that no tax shall be levied or collected except by authority of law. The words 'levy' and 'collection' are used in the Article in a comprehensive manner and they are intended to include and cover the entire process of taxation commencing from levy of tax to the collection of tax. The article enjoins that every stage in this entire process must be authorised by law. 'Levy tax' means to impose or assess to impose or collect tax under the authority of law. It is a unilateral act of superior legislative power to declare the subjects and rates of taxation and to authorise the collector to proceed to collect tax. The levy of tax is generally a legislative function, assessment is a quasi-judicial function and collection is an executive function. The expressions 'levy', 'assessment' and 'collection' embrace in their broad sweep all the proceedings which can possibly be imagined for raising money by the exercise of the power for taxation.

Therefore, each tax levied or collected has to be backed by an accompanying law, passed by Parliament or by State Legislatures. Hence Article 265 mandates for enacting law for implementation of GST. As a result three Acts were passed, two by the Parliament and one by respective State Legislature.

Constitutional amendment for GST

A federal constitution postulates distribution of the legislative powers between the Union and the States. Different subjects on which they can make laws are identified and both have to operate from the fields allotted to them. The boundaries are well demarcated and provisions are made in the Constitution prescribing the manner by which the legislative powers granted to them are to be exercised. Articles 245 to 255 and Article 269A of the Constitution deal with the respective powers of the Union Parliament and the State legislatures and the subjects assigned to each of these legislatures with reference to legislation. The division of power is in respect of territory as well as subject matter.

The subject matter of laws made by the Parliament and the State Legislatures were dealt by Article 246 only, prior to the 101st Constitutional Amendment Act. The subjects for legislation have been enumerated in three lists in the Seventh Schedule to the Constitution. List I or the Union List, List II or the State List, List III or the Concurrent List. The Union Parliament and the State Legislatures have exclusive powers of legislation in regard to the

subjects in List I and List II respectively. Both the Union and the States can make laws in respect of the subjects enumerated in List III.

The 101st Constitutional Amendment Act was enacted on 8th September 2016 with the purpose of implementing Goods and Service Tax (GST). The primary object of implementing GST was to eliminate multiplicity of taxes on goods and services, its cascading effect and increased compliance cost. The taxable event under GST is supply and GST is levied on the supply of Goods or Services or both.

GST on intra state supply of goods or services, the Centre and the appropriate State shall concurrently levy Central GST (CGST) and State GST (SGST) respectively and on inter state supply of goods or services where the Centre will levy Integrated GST (IGST).

Concurrent legislative power for centre and states - Article 246 A

Till the introduction of the 101st Constitutional Amendment Act there was strict demarcation of legislative powers, in tune with the Federal nature of our Constitution as in Articles 246 side by side the VIIth schedule of the Constitution.

The salient feature of Article 246A, introduced by 101st Constitutional Amendment Act is that in the case of GST on intrastate transactions, both Parliament and State legislatures can enact laws to levy tax concurrently.

Article 269A, introduced by 101st Constitutional Amendment Act provides for Parliament's exclusive power to enact law for levy of GST on transactions in the course of inter state trade or commerce.

Ambiguity in provisions of CGST/SGST and IGST Acts

The CGST and IGST Acts by the Parliament and the SGST Acts by different State Legislatures are not all exhaustive and are with ambiguity in levying of taxes on various transactions, which, in turn have become a subject of judicial review and interpretation. There are loopholes in these Acts which need immediate legislative actions to clear them off. Otherwise the same would end up in such a situation that the destination based States, being deprived of receiving their share of eligible tax thus annulling the very purpose of GST. The revenue loss happens to the destination based States, in certain situation due to the ambiguity in legislative enactment.

Courts are to interpret the existing provisions and cannot don the role of the law maker. If at all there are loopholes in taxing statutes the courts are not fill it up but it is for the legislature to act upon to cure the defects.

The purpose of Goods and Services Tax Act was to enable the destination State to receive the tax on supply of goods or services or both. But there are certain ambiguities in the provisions of Integrated Goods and Services Tax Act, 2017 (IGST Act) and Central Goods and Services Tax, Rules 2017/ State Goods and Services Tax, Rules 2017 (CGST/SGST Rules), which go in contrary to this objective. One such instance is the case decided by the High Court of Kerala in KUN Motors Co. Pvt. Ltd. Vs. State of Kerala (2019) 27 KTR 301(Ker).

Case law

The first appellant KUN Motor Co. Ltd. is a dealer in Motor Vehicles in Puducherry and the second appellant, a resident of Thiruvananthapuram in Kerala who purchased a Fancy Motor Car from the Puducherry dealer. A temporary registration was taken from Motor Vehicles Department Puducherry by the second appellant along with insurance coverage. The second appellant entrusted the logistics division of the dealer for transporting the car to Kerala.

The invoice issued by the dealer to the second appellant for the purchase of the car was an IGST invoice. The dealer issued the IGST invoice to the second appellant, by following Rule 59 of the CGST/SGST Rules which stipulate that while furnishing details of outward supplies, the dealer is to furnish invoice wise details of all inter state supplies with an invoice value of more than two and a half lakh rupees made to an unregistered person {Rule 59 (2) (a) (ii)}. The Validity of this IGST invoice was one of the matters in question in the present case decided by the Hon'ble High Court of Kerala.

The dealer also issued an invoice showing collection of IGST towards transportation charges of the Car. This was not a subject matter for consideration by the High Court, as the same was good in law as per GST Law.

Major question of law

Whether the issuance of IGST invoice by the dealer to the second appellant for purchase of the car was good in law?

Findings of the court

When a person residing in one state purchases goods from another state for his own use, the supply with respect to the transaction terminates at the time when the person takes possession of the goods so purchased at the State of purchase.

As per section 10(1) (a) of the IGST Act, "where the supply involves movement of goods, whether by the supplier or the recipient or by any other person, the place of supply of such goods shall be the location of the goods, at the time at which the movement of goods terminates for delivery to the recipient".

The court held that, in the present case, the supply of the goods - Car is an intra-state supply as the movement was terminated at Puducherry, as the second appellant - the purchaser is a person not required to take registration as per GST Law.

The court pointed out that the provisions of section 7 & section 8 of the IGST, Act (which deals with inter state supply & intra state supply) are always subject to Section 10 of the IGST Act, 2017.

Accordingly the Court held that, movement of goods, after the termination of sale and coming into effect of the delivery of goods sold, the sale is an intra-state supply, whether it be inside the state or outside the state. It also says that it is the prerogative of the purchaser who owns the goods, with whom the property in such goods vests and such movement would not be one that which is occasioned by the sale transaction or supply thereon.

The court reviewed sections 7 & 8 of the IGST Act and its readability with regard to section 10 of the IGST Act. Section 10 of the IGST Act is the one which provides for the determination of the place of supply of goods. Section 7, section 8 & section 10 of IGST Act are the corresponding provisions which would determine the nature of supply of goods whether it is inter state or intra state.

Inter state supply Vs. Intra state supply

The nature of supply of goods whether inter state or intra state transaction is determined on the basis of section 7 & section 8 of the IGST Act. Nature of supply is not a question of fact, but it is an application of law to the fact situation, to identify the right kind of tax applicable to a transaction. Therefore it is section 7 which determines what is "inter state supply" of goods or services, which is liable to tax under the IGST Act.

Section 7 of the IGST Act deals with inter state supply. This provision is subject to the provisions of section 10 of the IGST Act (which determines place of supply of goods) because any interpretation or application of section 7 of the IGST Act cannot be in derogation of the place of supply of goods contemplated by section 10 of the IGST Act. Place of supply is important to determine the kind of tax (i.e. CGST/SGST or IGST) that is to be applied on a transaction.

When the location of supplier and place of supply are in two different states, then it will be inter state supply and the IGST Act is the one which is applicable for such transactions.

Section 8 of IGST Act provides that when the location of supplier and the place of supply are in the same state, then it will be an intra-state supply and CGST/SGST Acts are applicable to these transactions.

Place of supply is a legal term and therefore the meaning assigned to it in law under section 10 of IGST Act must be followed.

The court held in KUN Motors case that 'the nature of the transaction whether it is inter-State or intra-State supply is to be decided from the provisions in the statute and not by the intention or understanding of the parties to the transaction'.

So the legal position is that in order to determine the place of supply of goods, what is relevant is that the movement of goods should be occasioned by the transaction of supply. In such circumstances the location of supply would be the location of the goods, at the time at which the movement of goods terminates for delivery to the recipient. In short the location of the supply would be fixed as the place where the goods are delivered so as to apply section 7 or section 8 of IGST Act, 2017.

The legal position accepted by the court in KUN Motors case, is that a transaction which terminates with the supply within a State is an intra-State supply. And hence CGST and SGST shall be applicable for such supply. So the IGST invoice issued by the dealer in the present case is not good in law as such legal binding is not provided on the dealer as per GST law.

It is assumed that the dealer issued the IGST invoice in accordance with the directive in Rule 59(2) (a) (ii) (CGST/SGST Rule, 2017) with regard to filing of invoice wise details of inter state supplies worth more than Rupees Two and a half lakh made to an unregistered person (Form GSTR 1 - outward supply)

The legal ratio in the cases decided before coming into force of GST law is applicable to inter state and intrastate transactions, in the absence of specific provisions in GST law.

In T.Bapputty Vs Government of Kerala (1961) 12 STC 722 (Ker). The court held that inter state movement contemplated should be closely linked with the sale of the goods and is not intended to cover later movements undertaken for the better enjoyment of the goods after the title has passed. If the owner moved his own goods to outside the State for better enjoyment to what has been earlier acquired, the movement would not in the commercial sense form part of the flow or course of trade and therefore would not be inter state. The same situation as in the case on hand.

If the dealer disputes the sales as the one taking place inside the state the onus of proving that it is inter state is on the revenue. (Commissioner of Sales Tax Vs. Suresh Chand Jain (1988) 70 STC 45 (SC); 1988 AIR 1197

Even if the buyer is moving the goods outside the State while such movements are under the contract of sale, the sale is inter state. (State of Bihar Vs Tata Engineering and Locomotive Co. Ltd (1971) 27 STC 127 (SC).

If the buyer is taking the goods outside the State of sale independent of the contract of sale, the sale is an intrastate one. (Commercial Tax Officer Vs Poddar Spinning Mills (1987) 67 STC 359 (Raj).

The mere fact that buyer was from outside the State and moved the goods outside the State is not sufficient to constitute it as inter state sale. (Commissioner of Sales Tax Vs. Poddar Spinning Mills (1987) 67 STC 359 (Raj)).

The position may be illustrated as follows:

When a dealer or manufacturer within the State 'X' purchases goods for the purpose of further sale or manufacture within 'X' State from an outside State 'Y', the dealer transports it to his/her manufacturing unit or dealership in 'X' State then the transaction occasions the movement of goods. In such sales, the sale occurs outside 'Y' State, the place of supply of goods is in 'X' State since the transaction of sale occasions the movement of goods from 'Y' State to 'X' State and the supply is terminated in 'X' State; whether the movement is by the supplier or the recipient himself. It is an inter state supply.

But, when a person (consumer) residing in 'X' State goes to 'Y' State and purchase goods for his own use, the supply with respect to the transaction terminates on the individual taking possession of the goods in 'Y' State. The movement of the goods, after such sale is terminated and delivery is effected, whether it be inside the 'Y' State or to outside the 'Y' State, then it would be the prerogative of the purchaser, who owns the goods, in whom the property in such goods vests and such movement would not be that occasioned by the sale transaction or the supply thereon. This is a situation as in section 10(1) (c) of the IGST Act - which provides that, "where the supply does not involve movement of goods, whether by the supplier or the recipient, the place of supply shall be the location of such goods at the time of the delivery to the recipient;

The principles of interpretation of fiscal statutes are stated by various decisions of the court that, in fiscal statutes one must have regard to the letter of the law and not to the spirit of the law. While construing taxing statutes it is not the function of the court to give to the words a strained and unnatural meaning and that the subject can be taxed only if the Government satisfies the court that the case falls strictly within the provisions of the law. The general rule is that a fiscal statute should be construed strictly, that is the words of the statute should clearly impose the tax upon the tax-prayer. If the statute contains a loop-hole it is not the function of the court to close it by a strained construction in reference to the supposed intention of the legislature. The legislature must then step in to resolve the ambiguity

The most important points in interpreting a taxing statute is that a taxing statute should be strictly construed and in a taxing statute the court should look at the letter of the law and no subject shall be taxed unless the case falls strictly within the letter of the law.

Rule 59 (2) (a) (ii) of CGST/SGST Rules 2017 is in total contradiction to section 10 of the IGST Act, 2017.

From the above rules it can be seen that there is a contradiction in the provisions of section 10 (1) (a) of the IGST Act and Rule 59 (2) (ii) of the CGST/SGST Rules 2017. Therefore even if delivery is terminated within the State of Supply and if the value of the invoice is more than rupees two and a half lakh rupees made to the unregistered persons, then the supplier is compelled to issue IGST invoice treating it as an inter state supply. As the dealer had to issue the IGST invoice in accordance with the directive in Rule 59 (2) (a) (ii) (CGST/SGST Rules, 2017) with regard to filing of invoice wise details of inter state supplies worth more than rupees two and half lakh made to an unregistered person, in Form GSTR-1 outward supply. But as per the provisions of section 8 read with section 10 (1) (a) of the IGST Act, it is an intra-state supply. Therefore, Court held in KUN Motors Co. Pvt. Ltd. Vs. State of Kerala (2019) 27KTR 301(Ker) that it's an intrastate Supply.

The above ambiguity will create litigations and will lead to revenue loss to the destination state. So in order to resolve the above ambiguity an amendment may be made in section 10 of the IGST Act by inserting a proviso in section 10 by way of a deeming provision. In the case of transactions to unregistered persons, where the address given in the invoice is a State other than the State which has effected the supply, it shall be deemed to be an inter state supply, even if the supply terminates within the State of supply.

It is pertinent to note that there is no provision whatsoever made out either in the CGST/SGST or IGST Act or corresponding Rules which stipulate the dealer to the issuance of an IGST invoice to unregistered purchaser. What provoked the dealer in the present case to issue an IGST invoice is a condition laid down in Rule 59(2) (a) (ii) of CGST/SGST Rules 2017, mandating the dealer to furnish invoice wise details of inter state supplies with invoice value more than two and a half lakh rupees made to an unregistered person.

Conclusion

This being the position, the decision of the High Court of Kerala in KUN Motors Co. Pvt. Ltd. Vs. State of Kerala (2019) 27 KTR 301(Ker) has made out a situation that there will be a flood gate of litigations between States and Union Territories in India with regard to revenue loss in GST regime as GST is a destination based tax. Hence legislators need to throw immediate attention so as to bring necessary amendment to section 10 of the IGST Act, 2017 clearing the ambiguity through a deeming provision, which provides that "if the address of the recipient, shown in the invoice given to an unregistered person is in a State other than the State which has effected the supply, then it shall deemed to be an inter state supply".