Will GST really prove to be a panacea for all ills in indirect tax system? – 04-02-2014

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MUCH of us would like to believe that the GST is the one panacea for all the ills that afflict the Central and State indirect tax systems. At least, the lack of GST is being cited as one major reason for justifying the double taxation involving levy of both VAT and Service tax in respect of many transactions. The fact remains that the substantive and the procedural laws related to Central indirect taxes like Central excise and Service tax and the State VAT law remain very different posing serious challenges to the introduction of GST.

For writing this piece, I have gone by the statutory provisions contained in the Karnataka Value Added Tax Act, 2003. I am sure, most other States have similar provisions and consequently this piece would be relevant even in respect of the VAT laws of the other States.

Let's take the penalty related provisions. Most of the practitioners who deal with the Central indirect taxes like Central excise and Service tax spend considerable time on concepts involving *mens rea* on issues concerning imposition of penalty. In fact, both the direct tax laws and the indirect tax laws have provisions requiring the Department to prove *mens rea*for imposition of penalty for violation of the statutory provisions. Even under the Income Tax Act, we have the much famed Section 271(1)(c) which accepts lack of *mens rea* as a sustainable defence against the Department's attempts to levy penalties. Under the KVAT law, we have no such provisions. The imposition of penalty @ 10% of the short levy of VAT is mandatory under Section 72 of the KVAT Act, 2003, as the Legislature has used the words 'shall'. Hence, the concept of '*mens rea*' being a condition precedent for imposition of penalty does not exist under the VAT law. It would be interesting to see how this issue gets resolved under the GST regime. Of course, assessees would be better off paying 10% as penalty rather than risk paying penalty of up to 200% of the tax amount involved and subjecting themselves to the whims and fancies of adjudicating and lower appellate authorities.

Let's take the manner in which appellate proceedings are handled under the VAT law. Unlike the Central indirect tax administration, the Joint Commissioner of Commercial Taxes, who is the first appellate authority under the KVAT law, works under the administrative jurisdiction of the Commissioner of Commercial Taxes of the State, who is the superior authority. More importantly, under Section 62(6) of the KVAT Act, 2003, the Joint Commissioner is empowered even to enhance the tax levies, on an appellate proceeding. Thus, assuming that an assessee, being aggrieved by the order of the Deputy Commissioner being the re-assessing authority of the VAT levy to the tune of, let's say, Rs 50 lakhs, goes on appeal to the Joint Commissioner, the said Joint Commissioner hearing the appeal could enhance the VAT levy, to let's say, Rs 100 lakhs, after following the due procedure of issuing a proposition notice and hearing the hapless appellant. Of course, the appellant in this case (and in most cases) would have been much better off by just accepting his fate and not going on appeal. Most of TIOL readers might find it difficult to believe that a provision empowering an Appellate Authority to enhance the VAT levy in an appellate proceeding by taking up issues that are not in appeal, could exist in the VAT law. In effect, the Appellate Authority could become an assessing authority. And, to top it all… the appellate order passed by the Joint Commissioner can be revised or set aside by the Additional Commissioner or the Commissioner of Commercial Taxes, under Section 64 of the KVAT Act, 2003. Does this look like a horror story for the TIOL reader?

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One of the oft-repeated words in the Central indirect tax administration is the 'show cause notice'. People like me could perhaps be repeating the word SCN several times during the course of a working day. I have no doubt that invocation of Lord *Shiva*'s name for an equal number of times would guarantee me *moksha* (salvation). Be that as it may … the concept of SCN based proceedings is largely absent under the VAT law. A so-called 'Endorsement' or a 'Proposition Notice' is issued to the assessee asking for responses to be submitted in 7 days' time. The concept of 30 days' being given to respond to a notice is absent under the VAT law. In most cases, the Re-assessing officer would travel much beyond the issues raised in the SCN, to the detriment of the hapless assessee and pass orders levying VAT that could match the sales turnover of the assessee.
The law related to pre-deposit is also substantively different under the VAT law. In Karnataka, there is a compulsory pre-deposit of 30% (which was reduced from 50% last year) of the tax confirmed including the penalty, for obtaining a stay. There is also a requirement for the balance 70% of the amount to be deposited in the form of a guarantee. Compare this draconian requirement with the system that we have, in respect of Central indirect tax administration, wherein, in many cases, the requirement of pre-deposit is mandatory. Due to the requirement of the pre-deposit, many assessees who have good cases to defend before the higher judicial forums find it 'commercially wiser' to complete cases at the adjudication level itself. To a large extent, very unfortunately, the principles of 'natural justice' are largely absent under the State VAT law.

Yet another area in respect of which there is a huge difference in the substantive law is limitation. The concept of normal period and extended period of limitation are absent under the VAT law. Under Section 40 the KVAT Act, 2003, with effect from 1-4-2012 assessments can be re-opened up to a period of 5 years even when all the facts are known to the Commercial Taxes Department.

The list of significant differences between the Central law and the VAT law can go on and on … the fact remains that the VAT law has largely remained regressive over the years and it is highly unlikely that the States would want to let go of the unlimited powers that its officers enjoy, under the VAT law.

When the VAT regime was introduced in 2005 it was assured that except for some small changes in the procedural law, the substantive VAT law would be similar across the States. Even the fundamental requirement of having uniform peak VAT rates has not been achieved. In Karnataka, we have a peak VAT rate of 14.5% while many other States are continuing with the original peak rate of 12.5%.

Before concluding …

It is not as if that the VAT law only has regressive and highly obnoxious provisions. The VAT law scores in respect of input tax credit, with a near perfect seamless system, with credit being available on most inputs except for a small list of goods like cars & stationery on which credit is denied. The provisions related to refund of unutilized input tax credit are also taxpayer friendly. Compare this with the CENVAT Credit Rules, 2004 which has seen unprecedented litigation due to unclear and ever changing provisions and an extremely unfriendly and perverse Central indirect tax administration which has been the assigned the responsibility of implementing these rules. Of course, there is not much to talk about the VAT related bureaucracy either and consequently there is an absolute comparability between the Central laws and the VAT law.

Over the last 8 or 9 years since it was introduced, the VAT law has attained a lot of certainty inasmuch as litigation has drastically come down over the last few years. One reason for this is that the State Governments have largely stuck to the initial version of the VAT law that was introduced in 2005. Compare this with the Service tax law which has been changing every now and then leading to huge uncertainties.

It would remain to be seen if the GST would address these huge difference in the substantive law, as they exist between the Central indirect tax laws and the State VAT laws. The attempt should be to incorporate the taxpayer friendly and fair provisions that exist under the two laws, while drafting the GST law.One does hope that the GST law would not incorporate the worst features of the Central indirect tax laws and the VAT law, to the detriment of the tax payer.

Is this too much that a tax payer can ask for?

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