Chapter 7

Taxation

GST Act

Central GST Act 2017 (CGST)	CGST Act makes provisions for levy and collection of tax on **intra-state** supply of goods or services or both by the Central Government.
Integrated GST Act 2017 (IGST)	IGST Act makes provisions for levy and collection of tax on **inter-state (**i.e. different state**)** supply of goods or services or both by the Central Government.
Union Territory GST Act 2017 (UTGST)	UTGST Act makes provisions for levy on collection of tax on **intra-UT** (i.e. within UT) supply of goods and services in the Union Territories **without** legislature.
GST(Compensation to the States) Act 2017	Compensation Act provides for **compensation** to the states for loss of revenue arising on account of implementation of the goods and services tax for a period of **five years.** Government vide the notifcation **dated 24.06.2022** has extended GST Compensation Cess levy on certain goods till 31.03.2026 but not extended the GST Compensation to States which ended on 30th June 2022.
State GST Act 2017 (SGST) (Passed by each state and UT with legislature)	SGST which shall be levied and collected by the States/Union Territories with legislature on **intra**-state (i.e. within state) supply of goods or services or both.

Q.1 CDS 2021
Following the Constitution (One Hundred and First Amendment). Act, 2016, the Parliament of India enacted quite a few GST Acts in the year 2017. Which one of the following does not fall in this category ?
(a) The Central Goods and Services Tax Act (b) The Integrated Goods and Services Tax Act
(c) The Goods and Services Tax (Compensation to States) Acts (d) The State Goods and Services Tax Act

Ans
The State Goods and Services Tax Act was passed by each state not parliament.

Goods and Service Tax (GST) applicable from July 1, 2017

Road map	In 2004, Dr. **Vijay Kelkar committee** recommended the GST. The idea of moving towards the GST was first mooted in the Budget for 2006-07. Initially, it was proposed that GST would be introduced from 1st April, 2010. After the assent of the Hon'ble President on 8th September, 2016, the 101st Constitutional Amendment Act, 2016 came into existence and The GST Council was constituted on 15.9.2016 as per Article 279A as a **Constitutional body**.
Why is a Constitutional amendment needed	Currently as per Article 246, the fiscal powers between the Centre and the States are clearly demarcated in the Constitution. Introduction of the GST required amendments in the Constitution so as to simultaneously empower the Centre and the States to levy and collect this tax. New Article 246A of the Constitution empowers the Centre and the States to levy and collect the GST
What is GST	It is a **destination** based tax on consumption of goods and services. It is proposed to be levied at all stages right from manufacture up to final consumption with credit of taxes paid at previous stages available as setoff. In a nutshell, only value addition will be taxed and burden of tax is to be borne by the final consumer.

Coverage	GST is applicable to whole of India. J&K is the last state joining GST.
Indirect Taxes subsumed under GST	**(i) taxes levied and collected by the Centre:** a. Central Excise duty b. Duties of Excise (Medicinal and Toilet Preparations) c. Additional Duties of Excise (Goods of Special Importance) d. Additional Duties of Excise (Textiles and Textile Products) e. Additional Duties of Customs (commonly known as CVD) f. Special Additional Duty of Customs (SAD) g. Service Tax h. Central Surcharges and Cesses so far as they relate to supply of goods and services **(ii) State taxes:** a. State VAT b. Central Sales Tax c. Luxury Tax d. Entry Tax (all forms) e. Entertainment and Amusement Tax (except when levied by the local bodies) f. Taxes on advertisements g. Purchase Tax h. Taxes on lotteries, betting and gambling i. State Surcharges and Cesses so far as they relate to supply of goods and services
Concept of destination based tax on consumption	The tax would accrue to the taxing authority which has jurisdiction over the place of consumption which is also termed as place of supply. GST would be based on the principle of destination based consumption taxation as against the present principle of origin-based taxation. i.e. it is a consumption based tax. Tax is payable in the state where goods or services or both are finally consumed.
Applicability of GST	The GST shall be levied on all goods and services **except** alcoholic liquor for human consumption
Status of Petroleum & petroleum products	Petroleum & petroleum products would be subject to GST. However, it has been decided that five products, viz. petroleum crude, motor spirit (petrol), high speed diesel, natural gas and aviation turbine fuel would be kept out of the purview of GST in the initial years of implementation. GST Council shall decide the date from which they shall be included in GST.
Status of Tobacco and Tobacco products	Tobacco and tobacco products would be subject to GST. In addition, the Centre would have the power to levy Central Excise duty on these products
Type of GST	It would be a dual GST with the Centre and States simultaneously levying it on a common tax base. **Example-1**. If tax rate on goods is 18% and goods worth Rs. 10000/- is supplied within UP then Taxable value would be Rs. 10000 Add: Central GST @ 9% 900 Add: **State** GST @ 9% 900 Net amount payable 11800 **Example-2.** If tax rate on goods is 18% and goods worth Rs. 10000/- is supplied from UP to MP then Taxable value would be Rs. 10000 Add: Integrated GST @ 18% 1800 Net amount payable 11800
GST Council	GST Council would be constituted comprising the Union Finance Minister (who will be the Chairman of the Council), Union Minister of State (in-charge of Revenue of finance) and State Finance/Taxation Minister or any other Minister nominated by each State Government
GST Council	The GST Council shall make **recommendations** to the Union and States on important issues related to GST. E.g. taxes to be merged, tax rates, exemptions to be given etc.
Decisions be taken by GST Council	Every decision of the GST Council shall be taken at a meeting by a majority of not less than 3/4th of the weighted votes of the Members present and voting. The vote of the Central Government shall have a weightage of 1/3rd of the votes cast and

<table>
<tr><td></td><td colspan="2">the votes of all the State Governments taken together shall have a weightage of 2/3rd of the total votes cast in that meeting.

One half of the total number of members of the GST Council shall constitute the quorum at its meetings.</td></tr>
<tr><td>GST Registration exemption limit</td><td colspan="2">Every supplier shall be liable to be registered under this Act in the State or Union territory, other than special category States, from where he makes a taxable supply of goods or services or both, if his aggregate turnover in a financial year exceeds 20 lakh rupees (in case of special category States limit is 10 lakh rupees).
“Special category States” shall mean the States as specified in sub-clause (g) of clause (4) of article 279A of the Constitution. i.e. Arunachal Pradesh, Assam, J&K, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand.

<u>Notification No. 10/2019 dt 07-03-2019 effective from 1st April, 2019</u>
Any person, who is engaged in exclusive supply of goods and whose aggregate turnover in the financial year does not exceed Rs. 40 lakhs would be exempt from GST registration.

It means threshold for registration for service providers would continue to be Rs 20 lakhs and in case of Special category States Rs 10 lakhs</td></tr>
<tr><td rowspan="3">Composition scheme (i.e. to pay tax at a flat rate without input tax credits)</td><td>In case of supply of Goods</td><td>An eligible registered person whose turnover in the preceding financial year did not exceed Rs 1.5 crore can opt for Composition Scheme.

In following States, (i) Arunachal Pradesh, (ii) Manipur, (iii) Meghalaya, (iv) Mizoram, (v) Nagaland, (vi) Sikkim, (vii) Tripura, (viii) Uttarakhand; the turnover limit is Rs. 75 lakh.

They cannot issue tax invoices, i.e., collect tax from customers and are required to pay the tax out of their own pocket. Uniform Tax rate is 1% of Turnover.
They are required to file quarterly returns instead of montnly return.</td></tr>
<tr><td>In case of supply of Service</td><td>Service providers (except restaurant services with 5% Uniform tax rate) cannot opt for Composition Scheme.</td></tr>
<tr><td>In case of Inter-state supply</td><td>Composition scheme shall not be available to inter-State suppliers</td></tr>
<tr><td>Imports</td><td colspan="2">Import of goods and services would be treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties.</td></tr>
<tr><td>Exports</td><td colspan="2">Exports will be treated as zero rated supplies.
No tax will be payable on exports of goods or services, however credit of input tax credit will be available and same will be available as refund to the exporters.</td></tr>
<tr><td>Goods and Service Tax Network (GSTN)</td><td colspan="2">GSTN was registered as a not for profit, non-Government, private limited company.

• Government of India holds 24.5% equity in GSTN;
• All States hold another 24.5%;
• Balance 51% equity is with non-Government financial institutions.

The Company has been set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of GST.

Board of GSTN in its 49th Board Meeting held on 30th June, 2022 has approved the conversion of GSTN into Government Company and hence 100% of the shareholding being held by Government (50% with Union Government and 50% jointly with State Governments & UTs) in GSTN.</td></tr>
<tr><td>GST rate</td><td colspan="2">Bands of rates of goods under GST shall be 5%, 12%, 18% and 28%.

There is a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold and jewellery.</td></tr>
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	In addition, there would be a category of exempted goods (0% rate). Further, a cess would be levied on certain goods such as luxury cars, aerated drinks, pan masala and tobacco products, over and above the rate of 28% for a period of five years to compensate States for any revenue loss on account of implementation of GST. There are now only 50 items which attract the GST rate of 28%.
GSTIN or GST Identification Number	GSTIN is a 15-digit number. First Two Digits represent State Code and next 10 digit is PAN number
E-way bill	E-way bill is an electronic way bill for movement of goods which can be generated on the GSTN portal. Transport of goods of **more than Rs 50,000** in value cannot be made by a registered person without an e-way bill.
Upper cap on GST rate	The GST Council has decided to keep the upper cap higher at 40% (20% CGST and 20% SGST) so that in future in case of need to hike tax rate, there is no need to approach Parliament for a nod and the GST Council can raise it
National Anti-profiteering Authority under GST	The National Anti-profiteering Authority is tasked with ensuring the full benefits of a reduction in tax on supply of goods or services flow to the consumers by way of commensurate reduction in prices. In the event the NAA confirms there is a necessity to apply anti-profiteering measures, it has the authority to order the supplier / business concerned to reduce its prices or return the undue benefit availed by it along with interest to the recipient of the goods or services. If the undue benefit cannot be passed on to the recipient, it can be ordered to be deposited in the Consumer Welfare Fund. In extreme cases, the NAA can impose a penalty on the defaulting business entity and even order the cancellation of its registration under GST. National Anti-Profiteering Authority ceased to exist from December 1, 2022. All GST anti-profiteering related matter will be examined by Competition Commission of India.
Reverse Charge under GST	It means the liability to pay tax is on the recipient of supply of goods and services instead of the supplier of such goods or services in respect of notified categories of supply.
GSTAT	Union Cabinet, chaired by the Prime Minister has approved the creation of National Bench of the Goods and Services Tax Appellate Tribunal (GSTAT) at New Delhi. Goods and Services Tax Appellate Tribunal is the forum of second appeal in GST laws and the **first common forum** of dispute resolution between Centre and States. The appeals against the orders in first appeals issued by the Appellate Authorities under the Central and State GST Acts lie before the GST Appellate Tribunal, which is common under the Central as well as State GST Acts.

Input Tax Credit (ITC) in GST

Suppose you purchased goods worth Rs. 1000 and paid 5% GST i.e. Rs. 50 for resale.

You sold the same goods at Rs. 1200 and charged 5% GST from consumer i.e. Rs. 60.

Now your GST liability will be Rs. 10 only (60-50 ITC) i.e. You can claim ITC of Rs. 50 paid on purchase of goods.

Q.2 CDS 2017
Which one of the following statements is correct in relation to the GST Bill passed by the Rajya Sabha in August 2016?
(a) It will replace all central taxes, duties, etc., only by a single tax.
(b) It will subsume central as well as State taxes, duties, etc.
(c) GST will be levied on alcoholic liquor for human consumption at a uniform rate of 25 percent.
(d) Petroleum and petroleum products shall not be subjected to the levy of GST

Q.3 CDS 2017
Goods and Services Tax likely to be levied in India is **not a**
(a) gross value tax (b) value-added tax (c) consumption tax (d) destination-based tax

Q.4 ES 2017
Consider the following statements regarding GST :
1. The GST Bill 2014 has the purpose to improve the Value Added Tax on Goods and Services
2. It can be imposed differently in different States
3. It is a Comprehensive Tax imposed nationwide irrespective of any State concerned
4. It is a significant step in the reform of Indirect Taxation in India

Which of the above statements are correct?
(a) I, 2 and 3 (b) 1, 2 and 4 (c) 2, 3 and 4 (d) 1, 3 and 4

Q.5 Prelims 2017
What is/are the most likely advantages of implementing 'Goods and Services Tax (GST)'?
1. It will replace multiple taxes collected by multiple authorities and will thus create a single market in India.
2. It will drastically reduce the 'Current Account Deficit' of India and will enable it to increase its foreign exchange reserves.
3. It will enormously increase the growth and size of economy of India and will enable it to overtake China in the near future.

Select the correct answer using the code given below:
(a) 1 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

Q.6 CDS 2017
Why was constitutional amendment needed for introducing GST ?
(a) States were not willing to agree with the Union for introduction of GST without amendment in the Constitution.
(b) GST was to be implemented on concurrent base and Article 246 was inadequate for such a case.
(c) The Empowered Committee of Finance ministers had recommended for constitutional amendment.
(d) The GST Council had recommended for constitutional amendment so that its power enhances.

Q.7 CDS 2022
Which one of the following items is not covered under GST ?
(a) Cosmetics (b) Medical grade oxygen (c) Jewellery (d) Petrol

Q.8 NDA 2022
Who among the following is the Chairperson of the Goods and Services Tax Council?
(a) The Prime Minister of India (b) The Union Finance Minister (c) The Speaker of the Lok Sabha (d) The President of India

Harmonised System of Nomenclature Code (HSN Code)

HSN is a international product nomenclature developed by the World Customs Organization (WCO).

It comprises more than 5,000 commodity groups; each identified by a six digit code, arranged in a legal and logical structure and is supported by well-defined rules to achieve uniform classification.

The system is used by more than 200 countries and economies as a basis for their Customs tariffs and for the collection of international trade statistics. Over 98 % of the merchandise in international trade is classified in terms of the HSN.

With effect from the 1st April, 2021, it has been made mandatory for a GST taxpayer, having turnover of more than Rs 5 crore in the preceding financial year, to furnish 6 digits HSN Code (Harmonised System of Nomenclature Code), or as the case may be, SAC (Service Accounting Code) on the invoices issued for supplies of taxable goods and services.

HSN code is used to classify the goods and SAC code is used to classify different services.

E-Invoice System in GST

GST Taxpayers having aggregate annual turnover more than Rs. 5 crores in any preceding Financial Year will be required to issue e-invoice in respect of supply of goods or services or both to a **registered person** (B2B invoice).

'e-invoicing' is not generation of invoice by a Government portal.
Taxpayers will continue to create their GST invoices on their own Accounting/Billing/ERP Systems. These invoices will now be reported to 'Invoice Registration Portal (IRP)' of GST. On reporting, IRP will generate a unique 'Invoice Reference Number (IRN)', digitally signed e-invoice and QR code to the user.

Taxpayer can continue to print his **paper Invoice incorporating that IRN & QR code and** provide to buyer.

Benefits of E-Invoicing

- The basic aim behind adoption of e-invoice system by tax departments is ability to pre-populate the return and to reduce the reconciliation problems.
- Eliminate the need for manual data entry for filling GST returns as well as generation of E-way bill.
- Helps in data reconciliation of seller and buyer and reduce the mismatch error in input credit verification. When E-Invoice is given a IRN, it is automatically reflected in GST Portal account of Seller (as GST Liability) and Buyer (as GST Input credit).
- **Elimination of Fake Invoices.** Tax evasion will stop. GST collection will improve.
- Bank/Financial institutions can sanction Instant loans to Industry on the basis of E-Invoicing.
- Lesser survey/audit by tax authorities as compliance will become easier.

Methods of taxation

Regressive tax system	If tax rate is gradually reduced due to increase in income
Proportional tax system	When tax rate remain constant
Progressive tax system	If tax rate is gradually increased due to increase in income (like India)

Q.9 CDS-2015
Which one of the following represents a progressive tax structure?
(a) Tax rate is the same across all Incomes
(b) Tax rate increases as income Increases
(c) Tax rate decreases as income Increases
(d) Each household pays equal amount of tax

Q.10 SCRA-2011
Income tax in India is
(a) progressive (b) regressive (c) proportional (d) based on benefit principle

Q.11 Prelims 1996
A redistribution of income in a country can be best brought about through
(a) progressive taxation combined with progressive expenditure
(b) progressive taxation combined with regressive expenditure
(c) regressive taxation combined with regressive expenditure
(d) regressive taxation combined with progressive expenditure

Regressive expenditure- Govt spending decreases with the increase in income of people.

Building and Other Construction Workers' Welfare Cess Act, 1996

About BOCW act	It provides for levy and collection of cess at such rate not exceeding 2% but not less than 1% of the cost of construction as the Central Government may notify.
Cess rate	Central Government has notified 1% rate
Collection by State	The cess at the above rate is collected by the State Governments/ Union Territory
Utilization	Cess is utilized for the welfare of the building and other construction workers by the State Building and Other Construction Workers Welfare Boards constituted by the State Governments/Union Territory under the BOCW Act, 1996.

Finance Commission (Article 280 of Constitution)

Power of President to constitute a FC	The President shall at the expiration of every fifth year or at such earlier time as the President considers necessary, by order constitute a Finance Commission which shall consist of a Chairman and four other members to be appointed by the President.
Recommendations to President	It shall be the duty of the Commission to make recommendations to the President as to— (a) the distribution between the Union and the States of the net proceeds of taxes (commonly referred to as vertical devolution)and the allocation between the States of the respective shares of such proceeds(commonly known as horizontal devolution); (b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India; (bb) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats in the State on the basis of the recommendations made by the Finance Commission of the State; (c) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State; (d) any other matter referred to the Commission by the President in the interests of sound finance.
Article 281. Recommendations of FC before Parliament	The President shall cause every recommendation made by the Finance Commission to be laid before each House of Parliament.

Q.12 Prelims Exam 2002
Which one of the following authorities recommends the principles governing the grants in aid of the revenues to the states out of the Consolidated Fund of India?
(a) Finance Commission (b) Inter State Council (c) Union Ministry of Finance (d) Public Accounts Committee

Q.13 Prelims Exam 2011
With reference to the finance commission of India, which of the following statements is correct ?
(a) It encourages the inflow of foreign capital for infrastructure development.
(b) It facilities the proper distributor of finances among the public section undertakings.
(c) It ensures transparency in financial administration.
(d) None of the statements (a), (b) and (c) given above is correct in his context.

Q.14 Prelims Exam 2010
Who of the following shall cause every recommendations made by the Finance Commission to be laid before each House of Parliament?
(a) The President of India (b) The Speaker of Lok Sabha (c) The Prime Minister of India (d) The Union Finance Minister

Q.15 Prelims 2000
The primary function of the Finance Commission in India is to
(a) distribute revenue between the Centre and the States (b) prepare the Annual Budget
(c) advise the President on financial matters (d) allocate funds to various ministries of the Union and State Governments

Q.16 Prelims 2003
Consider the following statements:
The function (S) of the Finance Commission is/are
1. to allow the withdrawal of money out of the Consolidated Fund of India.
2. to allocate between the States the shares of proceeds of taxes.
3. to consider applications for grants in aid from States.
4. to supervise and report on whether the Union and State governments are levying taxes in accordance with the budgetary provisions.
Which of these statements is/are correct?
(a) Only 1 (b) 2 and 3 (c) 3 and 4 (d) 1, 2 and 4

Q.17 Combined Geo-Scientist 2020
Which one of the following statements about the Finance Commissions, periodically established by the Government of India, is NOT true?
(a) It recommends distribution of taxes between the Union and the states
(b) It recommends the principles governing the grants-in-aid of revenues of states
(c) It recommends measures to augment the consolidated fund of a state
(d) It recommends measures regarding the salary of government employees

The Fourteenth Finance Commission (FFC)

Chairman	Dr. Y. V. Reddy
Period	1st April, 2015 to 31st March, 2020
Major Recommendations	With regard to vertical distribution, FFC has recommended by majority decision that the the States' share in the net proceeds of the Union tax revenues be 42%. The recommendation of tax devolution at 42% is a huge jump from the 32% recommended by the 13th Finance Commission. This is the largest ever change in the percentage of devolution. FFC has taken the view that tax devolution should be primary route of transfer of resources to States. The FFC has not made any recommendation concerning sector specific-grants

Q.18 CDS 2016
Which among the following is the chairman of the 14th Finance commission
(a) C. Rangarajan (b) Vijay Kelkar (c.) Y. V. Reddy (d) Rakesh Mohan

Q.19 Prelims 2016
With reference to the Fourteenth Finance Commission, which of the following statements is/are correct?
1. It has increased the share of States in the central divisible pool from 32 percent to 42 percent.
2. It has made recommendations concerning sector-specific grants.
Select the correct answer using the code given below.
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

Q.20 CISF 2021
Which one of the following statements about the Finance Commission is not correct ?
(a) It is a Constitutionally mandated body set up under Article 280 of the Constitution of India.
(b) The 14th Finance Commission was set up in 2017 against the backdrop of the introduction of GST.
(c) Its core responsibility is to evaluate the state of finances of the Union and the State Governments.
(d) The first Finance Commission was set up in 1951.

15th Finance Commission

Constituted by	The 15th Finance Commission (FC-XV) was constituted by the President under Article 280 of the Constitution on 27 November 2017 to make recommendations for the period 2020-25.
Period	Commission will make recommendations for the five years commencing on April 1, 2020. The recommendations of the 14th Finance Commission are valid upto the financial year 2019-20.
Extension of the term (27-11-2019)	The Union Cabinet chaired by Prime Minister approved the 15th Finance Commission to submit first report for the first fiscal year viz. 2020-21 and to extend the tenure for submission of the final report covering FYs 2021-22 to 2025-26 by 30th October, 2020. The extension of the term will enable the Commission to examine various comparable estimates for financial projections in view of reforms and the new realities to finalise its recommendations for the period 2020-2026.
Chairman	Commission headed by Shri. N.K.Singh, former Member of Parliament and former Secretary to the Government of India.
Amendment in the Terms of Reference (17-07-2019)	The Union Cabinet chaired by Prime Minister has approved the proposed amendment to enable 15th Finance Commission to address serious concerns regarding the allocation of adequate, secure and non-lapsable funds for **defence and internal security** of India. Under the Terms of Reference (ToR) of the Commission, it is proposed to ensure an assured allocation of resources towards defence and internal security imperatives.
15th FC Report	In 2019, Commission was mandated to submit two reports. The First Report, was submitted to the President on 5th December 2019, provides recommendations for financial year 2020-21. The Commission submitted its final report in October 2020 which contains recommendation for the five years 2021-22 to 2025-26.
Title of 15th FC Report	The title of 15th Finance Commission's report for 2021-26 is "**Finance Commission in Covid Times**"

Recommendation for Devolution of Tax	Finance Commission makes recommendation on the distribution between the Union and the States of the net proceeds of taxes, collected by Union, under provisions of Article 280(3) of the Constitution. The distribution of these net proceeds, which constitute the divisible pool of taxes, between the Union and the States is called **vertical devolution**. The Commission has recommended an aggregate share of **41% of the net proceeds** of Union taxes (divisible pool) for the States for 2020-21 and for 2021-22 to 2025-26, compared **to 42% recommended by the Fourteenth Finance Commission**. The **reduction of 1%** devolution to states is meant to enable the Union Government to provide **for the security and other special needs of the Union Territory of Ladakh and Union Territory of Jammu & Kashmir**. **Horizontal Devolution** After determining the States' aggregate share (41%) in the divisible pool, Finance commission next task is to recommend the horizontal devolution among the States of aggregate share of 41%.
States' share in the divisible pool	11th FC (2000-05) 29.5% 12th FC (2005-10) 30.5% 13th FC (2010-15) 32% 14th FC (2015-20) 42% 15th FC (**2020-21 interim report**) 41% (1% adjusted for newly carved out UT of J & K and Ladakh) 15th FC (2021-26) 41% (1% adjusted for newly carved out UT of J & K and Ladakh)

Horizontal Devolution (Shares of States in 41%)

State	Share (per cent)
Andhra Pradesh	4.047
Arunachal Pradesh	1.757
Assam	3.128
Bihar	**10.058**
Chhattisgarh	3.407
Goa	0.386
Gujarat	3.478
Haryana	1.093
Himachal Pradesh	0.830
Jharkhand	3.307
Karnataka	3.647
Kerala	1.925
Madhya Pradesh	7.850
Maharashtra	6.317
Manipur	0.716
Meghalaya	0.767
Mizoram	0.500
Nagaland	0.569
Odisha	4.528
Punjab	1.807
Rajasthan	6.026
Sikkim	0.388
Tamil Nadu	4.079
Telangana	2.102
Tripura	0.708
Uttar Pradesh	**17.939**
Uttarakhand	1.118
West Bengal	7.523
All States	**100**

Criteria and Weights Assigned for Horizontal Devolution

Criteria	Weight (%)	
	15th FC	**14th FC**
Population (2011)	15	10
Population (1971)	0	17.5
Area	15	15
Forest & Ecology	10	7.5
Income distance	45	50
Demographic Performance	12.5	0
Tax Effort	2.5	0
Total	**100**	**100**

Need Based Criteria

Population- Many States, in their memoranda, have raised concerns over the use of population data of 2011 for devolution purpose. Their concern is that the States which have controlled their population would be at a disadvantage if the latest population data is used instead of the 1971 data.

All previous Commissions since FC-VI (award period 1974-79) have been using population data of 1971 while making their recommendations.

15th FC's ToR clearly specifies that "the Commission shall use the population data of 2011 while making recommendations."

While we agree that the Census 2011 population data better represents the present need of States, to be fair to, as well as reward, the States which have done better on the demographic front, we have assigned a 12.5 per cent weight to the demographic performance criterion.

States which have achieved lower total fertility rate (TFR) will be scored higher on demographic performance whereas States with higher TFR will be scored lower.

Area- Larger the area greater is the expenditure requirement for providing comparable services. Larger area incurs some additional administrative costs for the State.

Forest and Ecology- Forest cover maintained by States provide ecological benefits.

Equity-based Criterion

Income Distance- Poorer States with low per capita income also have higher expenditure needs to provide for comparable services. It provides higher devolution to States with lower per capita income (and lower own tax capacity).

Income distance has been computed by taking the distance of each State from the State having highest per capita GSDP.

Performance-based Criteria

The efficiency principle has been applied to reward and incentivise States to perform better, in terms of the utilisation of resources available to them.

Demographic Performance- States which have achieved lower TFR will be scored higher on demographic performance whereas States with higher TFR will be scored lower.

Tax Effort-Inclusion of tax effort as a criterion will reward the States with higher tax collection efficiency and, at the same time, will also encourage all States to be more tax efficient.

Other Recommendations of 15th Finance Commission

Recommendation for Special Grants	**No special grants recommended for 2021-26**.
Recommendation for Grants to Local Bodies to States	For the five year period 2021-26, commission recommended **grants of Rs. 4,36,361 crore** for local governments. • Of these total grants, Rs. 8,000 crore is performance-based grants for incubation of new cities and Rs. 450 crore is for shared municipal services. • In view of the current pandemic, the Commission has decided to provide grants of Rs. 70,051 crore to strengthen and plug the critical gaps in the health care system at the primary health care level. • Remaining Rs. 3,57,860 crore recommended for local bodies. (Rural local bodies Rs. 2,36,805 crore and Urban local bodies Rs. 1,21,055 crore. For the inter se distribution of grants amongst the States, the w**eightage is 90 per cent on population and 10 per cent on area.** Out of the total grants earmarked for panchayati raj institutions, **60% is earmarked for national priorities like drinking water supply and rainwater harvesting and sanitation**, while 40% is untied and is to be utilised at the discretion of the panchayati raj institutions for improving basic services.
Performance-based Incentives and Grants	**Revenue deficit grant** Commission recommended revenue deficit grants of Rs. 2,94,514 crore over our award period for seventeen States. **Sector-specific Grants** Commission also recommended grants and incentives for various **sectors**. These fall under four broad themes. The first is **social sector** where on **health (Rs. 1,06,606 crore) and education (Rs. 10,943 crore)**. Second is **Agriculture Sector and Rural Infrastructure** where commission recommended that Rs. 45,000 crore be kept as performance-based incentives for all the States for carrying out agricultural reforms during the award period and Rs. 27,539 crore for the maintenance of Pradhan Mantri Gram Sadak Yojana roads. Third is **administrative and governance reforms,** commission provided grants for judiciary for fast-track courts (Rs. 10,425 crore), for improving the quality of statistics (Rs. 1,175 crore) and for incentivising of aspirational districts and blocks (Rs. 3,150 crore). Under the fourth theme, commission developed a **performance-based incentive system for the power sector**, which is not linked to grants but opens up an additional borrowing window for States. Accordingly, commission recommended an extra annual borrowing space for the States, of the magnitude of 0.50 per cent of their GSDP for each of the first four years of the award covering the period 2021-22 to 2024-25, based on certain performance criteria in the power sector. **State-specific grants** Besides these, commission have recommended **State-specific grants** aggregating to Rs. 49,599 crore to help States address for social needs, administrative governance and related infrastructure, conservation and sustainable use of water, drainage and sanitation, preserving culture and historical monuments, high-cost physical infrastructure and tourism.
Recommendation for Disaster Relief Funds	Commission recommended the total allocation for State Disaster Risk Management Funds (SDRMF) Rs.1,60,153 to be divided into State Disaster Response Funds (SDRF 80% allocation) and State Disaster Mitigation Funds (SDMF 20% allocation).

<table>
<tr><td></td><td>Commission recommended the total allocation for National Disaster Risk Management Fund (NDRMF) Rs. 68,463 crore to be divided among NDRF and NDMF in an 80:20 ratios.</td></tr>
<tr><td>Recommendation for Defence and Internal Security</td><td>Commission recommended the constitution of a dedicated non-lapsable fund, Modernisation Fund for Defence and Internal Security (MFDIS).

The total indicative size of the proposed MFDIS over the period 2021-26 is Rs. 2,38,354 crore.

This will have four sources of incremental funding:
(i) transfers from the Consolidated Fund of India;
(ii) disinvestment proceeds of defence public sector enterprises;
(iii) proceeds from monetisation of surplus defence land; and
(iv) proceeds of receipts from defence land likely to be transferred to State Governments and for public projects in future.

The proceeds of the fund will be utilised for the following three purposes:
(i) capital investment for modernisation of defence services;
(ii) capital investment for CAPFs and modernisation of state police forces, as projected by MHA; and
(iii) a small component as welfare fund for our soldiers and para-military personnel.</td></tr>
<tr><td>Recommendation for Fiscal Consolidation Roadmap</td><td><u>For the Union Government</u>

Indicative Deficit and Debt Path for the Union Government (% of GDP)
<table>
<tr><td></td><td>2020-21</td><td>2021-22</td><td>2022-23</td><td>2023-24</td><td>2024-25</td><td>2025-26</td></tr>
<tr><td>Revenue deficit</td><td>5.9</td><td>4.9</td><td>4.5</td><td>3.9</td><td>3.3</td><td>2.8</td></tr>
<tr><td>Fiscal deficit</td><td>7.4</td><td>6.0</td><td>5.5</td><td>5.0</td><td>4.5</td><td>4.0</td></tr>
<tr><td>Total liabilities</td><td>62.9</td><td>61.0</td><td>61.0</td><td>60.1</td><td>58.6</td><td>56.6</td></tr>
</table>

<u>For the State Governments</u>
Commission recommended that the normal limit for net borrowing may be fixed at 4 per cent of GSDP in 2021-22, 3.5 per cent in 2022-23 and be maintained at 3 per cent of GSDP from 2023-24 to 2025-26 .

Indicative Deficit and Debt Path for the State Governments (% of GSDP)
<table>
<tr><td></td><td>2020-21</td><td>2021-22</td><td>2022-23</td><td>2023-24</td><td>2024-25</td><td>2025-26</td></tr>
<tr><td>Revenue deficit*</td><td>-0.1</td><td>-0.5</td><td>-0.8</td><td>-1.2</td><td>-1.7</td><td>-2.5</td></tr>
<tr><td>Fiscal deficit</td><td>4.5</td><td>4.0</td><td>3.5</td><td>3.0</td><td>3.0</td><td>3.0</td></tr>
<tr><td>Total liabilities</td><td>33.1</td><td>32.6</td><td>33.3</td><td>33.1</td><td>32.8</td><td>32.5</td></tr>
</table>
* negative values indicate surplus and positive values indicate deficit</td></tr>
<tr><td>Fiscal Architecture for Twenty-First Century India: Fiscal Rules, Financial Management and Institutions</td><td>We believe that if India wants to achieve its full potential for economic growth and development, it has to improve the quality and efficiency of public spending and financial management across all levels of government.

India's twenty-first century fiscal architecture should be built on three mutually-reinforcing pillars:
1. fiscal rules across all levels of government which set the institutional and budgetary framework for fiscal sustainability;
2. a public financial management system which provides complete, consistent, reliable and timely reporting of the fiscal indicators that are part of the first pillar; and
3. an independent assessment mechanism so as to provide assurance and advice on the working of the other two pillars.

We recommend the establishment of an independent Fiscal Council with powers to access records as required from the Union as well as the States. The fiscal council would have only an advisory role.</td></tr>
</table>

Q.21 CISF 2021
Who among the following was the Chairperson of the Fifteenth Finance Commission ?
(a) A.N. Jha (b) N.K. Singh (c) Anoop Singh (d) Ashok Lahiri

Q.22 CDS 2017
Which one of the following criteria got the highest weight for determination of shares of States in the formula given by the 14th Finance Commission? (a) Population (b) Income distance (c) Area (d) Tax effort

Q.23 CDS 2018
The 14th Finance Commission assigned different weight to the following parameters for distribution of tax proceeds to the States :
1. Income distance 2. Population 3. Demographic changes 4. Area

Arrange the aforesaid parameters in descending order in terms of their weights
a) 1-2-3-4 b) 1-2-4-3 c) 1-3-2-4 d) 4-3-2-1

Q.23A Prelims 2023
Consider the following:
1. Demographic performance
2. Forest and ecology
3. Governance reforms
4. Stable government
5. Tax and fiscal efforts

For the horizontal tax devolution, the Fifteenth Finance Commission used how many of the above as criteria other than population area and income distance?
(a) Only two
(b) Only three
(c) Only four
(d) All five

Advance Pricing Agreements

The Government has introduced the Advance Pricing Agreement (APA) Scheme through Finance Act, 2012

An APA is an agreement between the Central Board of Direct Taxes and tax payers, which determines, in advance, the **arm's length price** or specifies the manner of the determination of arm's length price (or both), in relation to an **international transaction between associated enterprises** for the period specified in the APA.

The APA Scheme endeavours to provide tax certainty to taxpayers in the field of transfer pricing through an agreement in advance.

Arm's Length Price of an international transaction between associated enterprises means **price charged independently** as if they are not associated or related.

An APA can be unilateral, bilateral, or multilateral.

Unilateral APA: an APA that involves only the tax payer and the tax authority of the country where the tax payer is located.

Bilateral APA (BAPA): an APA that involves the tax payer, associated enterprise (AE) of the tax payer in the foreign country, tax authority of the country where the tax payer is located, and the foreign tax authority.

Multilateral APA (MAPA): an APA that involves the tax payer, two or more AEs of the tax payer in different foreign countries, tax authority of the country where the tax payer is located, and the tax authorities of AEs.

General Anti Avoidance Rule (GAAR)

General Anti-Avoidance Rules (GAAR) have been codified in the Indian income tax law to counter aggressive tax planning arrangements.

These provisions, empower the Indian revenue authorities to declare an arrangement as an 'impermissible avoidance arrangement,' if the main purpose of the agreement is to obtain a 'tax benefit', and the arrangement lacks or is deemed to lack commercial substance.

Inverted duty structure

Inverted duty structure is a situation where **import duty on finished goods is low compared to** the import duty **on raw materials** that are used in the production of such finished goods.

When the import duty on raw materials is high, it will be more difficult to produce the concerned good domestically at a competitive price. Several industries depend on imported raw materials and components.

It discourages domestic value addition and encourages imports of such finished goods.

Inverted Tax Structure in the GST regime

Inverted Tax Structure refers to a situation where GST rate on inputs supplies (Purchase) is more than the GST rate on output supplies (Sales). In this case A registered person may claim a refund of unutilized input credit.

Financial Intelligence Unit – India (Ministry of Finance)

Purpose	It was set by the Government in November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions.
Function	to receive cash/suspicious transaction reports, analyse them and, disseminate valuable financial information to intelligence/enforcement agencies and regulatory authorities
Reporting	FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

Enforcement Directorate (ED)

About ED	ED is a premier financial investigation agency of the Government of India. It works under the Department of Revenue, Ministry of Finance.
Area of work	The Directorate of Enforcement is a multi-disciplinary organization **mandated with investigation** of offence of **money laundering and violations of foreign exchange laws**. The statutory functions of the Directorate include enforcement of following Acts: **1. The Prevention of Money Laundering Act, 2002 (PMLA):** It is a **criminal law** enacted to prevent money laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto. ED has been given the responsibility to enforce the provisions of the PMLA by conducting investigation to trace the assets derived from proceeds of crime, to provisionally attach the property and to ensure prosecution of the offenders and confiscation of the property by the Special court. **2. The Foreign Exchange Management Act, 1999 (FEMA):** It is a **civil law** enacted to consolidate and amend the laws relating to facilitate external trade and payments and to promote the orderly development and maintenance of foreign exchange market in India. ED has been given the responsibility to conduct investigation into suspected contraventions of foreign exchange laws and regulations, to adjudicate and impose penalties on those adjudged to have contravened the law. **3. The Fugitive Economic Offenders Act, 2018 (FEOA):** This law was enacted to deter economic offenders from evading the process of Indian law by remaining outside the jurisdiction of Indian courts. It is a law whereby Directorate is mandated to attach the properties of the fugitive economic offenders who have escaped from the India warranting arrest and provide for the confiscation of their properties to the Central Government.
H.O.	New Delhi

Q.24 CDS 2021
Which one of the following is not correct in respect of Directorate of Enforcement?
(a) It is a specialized financial investigation agency under the Department of Revenue, Ministry of Finance.
(b) It enforces the Foreign Exchange Management Act, 1999.
(c) It enforces the Prevention of Money Laundering Act, 2002 .
(d) It enforces the Prohibition of Benami Property Transaction Act, 1988 .

Directorate of Revenue Intelligence (DRI)

The Directorate of Revenue Intelligence is the **apex anti-smuggling agency** of India, working under the Central Board of Indirect Taxes & Customs, Ministry of Finance, Government of India.

It is tasked with detecting and curbing smuggling of contraband, including drug trafficking and illicit international trade in wildlife and environmentally sensitive items, as well as combating **commercial frauds related to international trade** and **evasion of Customs duty.** H.Q. is in New Delhi.

Financial Stability and Development Council (FSDC)

Set up by	Government as the apex level forum in December 2010 through gazetted notification
Purpose	to strengthening and institutionalizing the mechanism for maintaining financial stability, enhancing inter-regulatory coordination and promoting financial sector development
Responsibility of the Council	Council shall deal with issues relating to: • Financial Stability • Financial Sector Development • Inter-Regulatory Coordination • Financial Literacy • Financial Inclusion • Macro prudential supervision of the economy including the functioning of large financial conglomerates • Coordinating India's international interface with financial sector bodies like the Financial Action Task Force (FATF), Financial Stability Board (FSB) and any such body as may be decided by the Finance Minister from time to time. • Any other matter relating to Financial sector stability and development
Chairperson of Council	Union Finance Minister
Members	FSDC members include • Minister of State, in charge of Department of Economic Affairs (DEA), • the heads of **all Financial Sector Regulators** [Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Pension Fund Regulatory and Development Authority (PFRDA), Insurance Regulatory and Development Authority (IRDAI), Insolvency and Bankruptcy Board of India (IBBI) and International Financial Services Centres Authority (IFSCA)], • Finance Secretary and/or Secretary, Department of Economic Affairs (DEA), • Secretary, Department of Revenue (DoR), • Secretary, Department of Financial Services (DFS), • Secretary, Ministry of Corporate Affairs (MCA), • Secretary, Ministry of Electronics and Information Technology (MeitY) and • Chief Economic Adviser. The Division-Head, in-charge of the Financial Stability and Cyber Security Division, Ministry of Finance, Department of Economic Affairs, will be the Secretary of the Council. The Council can invite experts to its meeting if required.
Meeting	Council would meet as and when deemed necessary by the Chairperson
Secretariat	The FSDC Secretariat in DEA is the Secretariat for the Council.
FSDC Sub-Committee	The council shall have a FSDC Sub-Committee under the **chairmanship of Governor, RBI.** All members of the FSDC are also the members of the Sub-Committee. Additionally, all four Deputy Governors (DG) of the RBI and Additional Secretary, DEA, who is in charge of FSDC, are also the members of the Sub-Committee. Executive Director, RBI (in charge of financial Stability) is the Member Secretary, while the Financial Stability Unit (FSU) of RBI is the Secretariat for the Sub-committee. Sub-committee meets more often than the full Council.

Q.25 Prelims 2016
With reference to 'Financial Stability and Development Council', consider the following statements :
1. It is an organ of NITI Aayog.
2. It is headed by the Union Finance Minister.
3. It monitors macro prudential supervision of the economy.
Which of the statements given above is/are correct? (a) 1 and 2 only (b) 3 only (c) 2 and 3 only (d) 1, 2 and 3

Minimum Alternative Tax (MAT) under the Income Tax Act

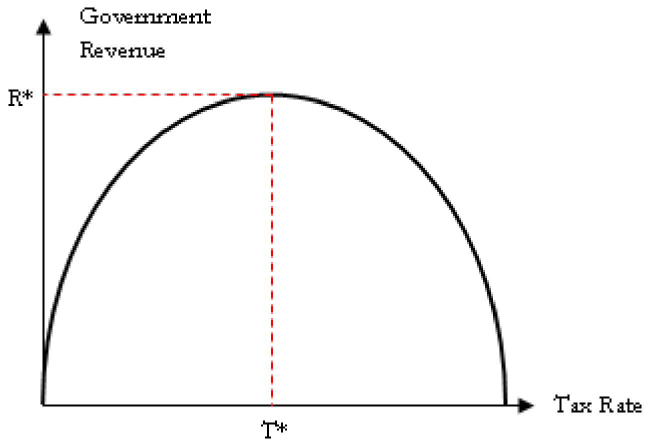
Objective of levying MAT	MAT was introduced to target those companies that make huge profits and pay the dividend to their shareholders but pay no/minimal tax under the normal provisions of the Income Tax Act, by taking advantage of the various deductions, and exemptions allowed under the Act. Now Companies have to pay a fixed percentage of their profits as Minimum Alternate Tax. The spirit behind levy of MAT is that every person participating in the economy must contribute to the exchequer.
MAT calculation	MAT is calculated at 15% (plus surcharge and cess as applicable) on the book profit (i.e. profit shown in the profit and loss account)
MAT credit	If in any year the company pays tax as per MAT, then it can claim credit of MAT paid in 15 subsequent Assessment Years.

Laffer curve

The Laffer curve is a graphic representation of the relationship between an increasing tax rate and a government's total revenues. The relationship suggests that revenues decline beyond a peak tax rate.

The shape of the Laffer curve suggests that government revenues diminish with tax rate increases beyond an optimal level denoted as T*. This is based on the theory that beyond a certain tax rate, a country's taxpayers will have a decreasing incentive to work knowing that more and more of their money is being taken by the government.

According to the *Laffer curve*, a government that wishes to maximize tax revenues must determine its optimal tax rate.



Miscellaneous

1. Cost of debt is generally lower than Cost of equity because Interest payments on debt/loans are tax-deductible. You can claim the same as business expenses under Income tax act but Dividend paid on equity are not tax-deductible.
2. Tax levied on alcohol, tobacco, cigarettes etc. are also called **Sin tax** because these are considered to be harmful for health or society.
3. Indirect taxes like **GST are regressive in nature** because they impact those on lower incomes more than high-income earners. Although everyone pays the same tax for the same product but everyone income is different and, therefore, low income earners may end up paying more as a percentage of their income than a higher income earner.

Q.26 Prelims 2022
With reference to the expenditure made by an organization or a company, which of the following statements is/are correct?
1. Acquiring new technology is capital expenditure.
2. Debt financing is considered capital expenditure, while equity financing is considered revenue expenditure.
Select the correct answer using the code given below:
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

Answers of MCQs

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
d	b	a	d	a	b	d	b	b	a	b	a	d	a	a	b	d	c
19	**20**	**21**	**22**	**23**	**24**	**25**	**26**	**23A**									
a	b	b	b	b	d	c	a	b									

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