

Additional Instructions on VAT Compensation

**F.No. 34/67/2005-ST**  
Government of India  
Ministry of Finance  
Department of Revenue

New Delhi, dated the 9<sup>th</sup> June, 2009

To

The Secretaries to the Government  
of all States / Union Territories,  
Finance / Taxation Departments.

**Subject: Compensation to the States/UTs for revenue loss on account of introduction of Value Added Tax (VAT) - Additional instructions.**

Sir/Madam,

I am directed to refer to the "Revised Consolidated Instructions" earlier circulated to all States / UTs vide F.No.34/67/2005-ST dated 19<sup>th</sup> July, 2005 on the subject of Compensation to the States / UTs, in case of loss of revenue on account of introduction of Value Added Tax (VAT).

2. I am also directed to refer specifically, inter alia, to the procedure outlined at sub-para (d) of para-2 thereof, that provides for calculation of the compensable VAT revenue loss for any State / UT for any period from 01<sup>st</sup> April 2005, essentially as the difference between the projected revenue on the basis of previous trends and the net actual revenues after introduction of VAT revenue projections in that period.

3. Meanwhile, consequent to the decision for phasing out of the Central Sales Tax (CST) from 01<sup>st</sup> April 2007, the consolidated guidelines on the CST compensation were issued vide F.NO.28/4/2007-ST dated 22<sup>nd</sup> August, 2008. These had provided, that certain revenue enhancing measures, inter alia, the withdrawal of the benefit of concessional CST rate on inter-State sale to Government departments against submission of Form-D, and levy of VAT on tobacco and tobacco products be made available to offset the CST revenue loss resulting from the reduction of the CST revenue rate from 4% to 2% so far.

4. The States / UTs and the Empowered Committee of State Finance Ministers (EC) had subsequently raised the issue that the revenue benefits accruing to the States / UTs on account of withdrawal of the benefit of concessional CST rate on inter-State sale to Government departments against submission of Form-D, and on account of levy of VAT on tobacco and tobacco products were being counted for calculating the compensation due to the states for revenue loss resulting both from introduction of VAT and from phasing out of CST. It was requested further by the States / UTs that since this was resulting in undue reduction of their compensation amount, such double counting of revenue benefits from these measures was required to be removed while reckoning the compensation due to them for revenue loss resulting from introduction of VAT and from phasing out of CST.

5. On careful consideration, it has emerged that such double counting of revenue benefits for any State / UT could possibly occur only over the period of overlap of the two compensation packages for VAT and CST revenue losses respectively, i.e. from 01.04.2007 and till the date of

lapse of VAT compensation package for that State / UT (usually till 31.03.2008). It has been further considered that such double counting of revenue benefits would actually occur only if the State / UT concerned had suffered revenue losses eligible for compensation under both the compensation packages, i.e. for VAT and CST revenue losses respectively. It is further noted that these measures were specifically introduced to compensate the States / UTs on account of CST revenue loss, if any, due to phasing out of CST, by providing additional sources of tax revenue to the States / UTs.

6. Therefore, it has been decided after detailed examination that, if any State / UT becomes eligible for availing compensation for revenue losses in the same period, both due to introduction of VAT and due to phasing out of CST, the calculation procedure for reckoning the due compensation amounts be appropriately worked out such that –

- (i) the revenue benefits accruing to that State / UT, on account of withdrawal of the benefit of concessional CST rate on inter-State sale to Government departments against submission of Form-D, and on account of levy of VAT on tobacco and tobacco products, would continue to be counted while reckoning the compensation due for that period to that State / UT on account of revenue losses due to phasing out of CST ; and
- (ii) suitable adjustments be made for removal of any double counting of the accrued revenue benefits on account of these measures while reckoning the compensation due for the same period to that State / UT on account of revenue losses due to introduction of VAT.

7. Accordingly, in light of the above mentioned decision, "Revised Consolidated Instructions" on the VAT compensation circulated vide F.No.34/67/2005-ST dated 19<sup>th</sup> July, 2005 are to include in para-2 at page-2 thereof, a new sub-para (dd) after the earlier sub-para (d) and before sub-para (e), for elaboration of the procedure for calculation of actual revenue, as follows –

*"(dd) If any State / UT becomes eligible for availing compensation for revenue losses due to both the introduction of VAT and the phasing out of CST over the same period, then the net VAT revenue to that State / UT for that period shall be calculated by reducing the actual VAT revenue for that period by the amount of notional VAT revenue gains on account of withdrawal of the benefit of concessional CST rate on inter-State sale to Government departments against submission of Form-D and further by the actual amount of revenue received from levy of VAT on tobacco and tobacco products, provided that similar amounts have been adjusted from their CST compensation claims for the same period. The compensable VAT revenue loss to that State / UT would in such cases be the difference between the projected revenues and the net VAT revenue for that period."*

8. This is for your kind information.

Thanking you,

Yours faithfully,



(Arvind Kumar)

Under Secretary to the Govt. of India.