

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

New Delhi, 19 July 2005

To

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

Subject: **Compensation to the States/ UTs, in case of loss of revenue, on account of introduction of Value Added Tax (VAT) – Revised Consolidated Instructions**

Madam/ Sir,

I am directed to refer to the earlier instructions of this Department on the above subject, communicated vide letters F.No.21/1/2004-ST(Pt.II) dated 03 Feb. 2005, F.No.34/67/2005-ST, dated 01 June 2005 and F.No.34/114/2004-ST(Pt.I), dated 20 June 2005, and to mention that the matter has been reconsidered in the light of difficulties expressed by the States/ UTs and after careful examination, it has been decided to issue the following revised consolidated instructions on this subject, in supersession of all the previous instructions:

**Modalities for calculating revenue loss and the compensation to be paid to the States on account of introduction of VAT:**

2. The detailed modalities for calculating the revenue loss and the compensation to be paid to the States on account of introduction of VAT shall be as follows:
  - (a) The year 2004-05 shall be adopted as the base year for the purpose of calculations.
  - (b) The tax revenues to be taken into account for this purpose would include the net-of-refunds revenues of General Sales Tax as well as other State Taxes like purchase tax, entry tax (other than entry tax in lieu of local octroi), turnover tax as well as surcharges on any of these taxes, which are to be subsumed in VAT. However, the revenues from these taxes shall be taken into consideration, only to the extent to which these are subsumed in VAT and from the date from which these are subsumed. Accordingly, it is clarified that the tax revenues from items of commodities like petrol, diesel, ATF, liquor, lottery tickets, which have been kept outside VAT and are subject to 20% Floor Rate of Tax should be excluded from the calculations, since tax on these items (whether under general sales tax law or any other law) has not been subsumed in VAT. Similarly, in case of luxury tax, the Hon'ble Supreme

---

Court has held that levy of "luxury tax on goods" is beyond the legislative competence of the States and therefore, the tax revenues from "luxury tax on goods" should be excluded from calculations, since the question of subsuming such tax in VAT does not arise.

- (c) For calculating the average annual growth rate of tax revenues, for the purpose of computing projected revenues for the year 2005-06 and onwards, the tax revenues for the period from 1999-2000 to 2004-05 shall be taken into account. The annual growth rate would be worked out for each year, starting with the growth rate for the year 2000-01 over the year 1999-2000. Thereafter, 3 best growth rates shall be selected and simple arithmetic average of these 3 growth rates shall be taken, to arrive at the average annual growth rate. However, in case of 3 newly-formed States, namely, Uttaranchal, Chhattisgarh and Jharkhand and also their respective parent States, namely, Uttar Pradesh, Madhya Pradesh and Bihar, the relevant period for calculation of the growth rates shall be 2001-02 to 2004-05, since the newly formed States came into existence w.e.f. 01 November 2000. For the purpose of these calculations, initially, AG certified figures for the years up to 2003-04 and the figures certified by the Finance Secretary of the State concerned for the year 2004-05 shall be taken and necessary adjustments will be made in due course on receipt of AG certified figures for the year 2004-05.
  - (d) On the basis of the base year net revenues and the average annual growth rate calculated as above, the projected revenues for the years 2005-06, 2006-07 and 2007-08 shall be calculated. The difference between such projected revenues and the actual revenues would be the loss on account of introduction of VAT, for which compensation will be paid to the States @ 100% of such loss during 2005-06, 75% of loss during 2006-07 and 50% of the loss during 2007-08.
  - (e) The compensation shall be paid to the States on monthly basis, in the form of special grant-in-aid. For this purpose, the projected net revenues, on cumulative basis, shall be worked out till the end of each month during the year 2005-06 and subsequent years on the basis of the actual revenues during 2004-05 during the corresponding period and by applying the average annual growth rate. Such projected cumulative revenue shall be compared with the actual cumulative revenue at the end of each month. If there is a net cumulative loss, it will be compensated.
  - (f) The payment of compensations shall be contingent upon the States complying with the design of VAT (including the Convergence Parameters), as finalized by the Empowered Committee (EC). The reference date for this purpose shall be the date of approval of the compensation package by the Union Government, i.e., 27 January 2005. Thus, the package would cover the decisions taken by the EC upto 27 January 2005, like those relating to Foodgrains and Tea.
3. In order to facilitate the above calculations, the States/ UTs shall furnish required information in the enclosed Proforma-I, II and III.

---

**Treatment of Deviations from the approved VAT design:**

4. In case a State/ UT makes some deviations from the approved design, as mentioned in Para 2(f) above, the revenue loss on account of such deviations shall not be covered by this compensation package and suitable adjustments in the amount of compensation to be paid to the State/ UT shall be made. However, this would be subject to the following exceptions/ clarifications:

- (a) The industrial/ agricultural inputs may be taxed at 4%, even if they were inadvertently placed at 12.5% earlier. As a guiding rule, as long as at least 50% of the commodity is used as input, it may be taxed at 4%.
- (b) The changes approved by the EC in the rates of Salt and Khadi have been accepted.
- (c) The States/ UTs may exempt CSD canteens from payment of VAT.
- (d) Regarding the threshold limit for small dealers, as already decided by the EC, if any State/ UT fixes threshold limit above the agreed amount of Rs. 5 lakhs, the revenue loss on that account shall be borne by the State/ UT concerned.

5. In order to facilitate the calculation of revenue loss on account of deviations in VAT rates, the States/ UTs shall furnish information in the enclosed Proforma-IV, covering the commodities/ items where there have been deviations from the approved VAT rates. In cases where the item has been fully exempted from VAT as a result of deviation, the tax collection figures for 2004-05 (under sales tax regime) may be furnished in Column 5 and 6 of the Proforma, along with information regarding rate of sales tax, prevailing at that time. However, if the item was exempt earlier as well, the States may give their own assessment of likely revenue loss. Similarly, where the deviations are in respect of parameters other than VAT rates, the States should furnish an assessment of revenue loss on account of such deviations.

**Procedure for submission and settlement of the Compensation Claims:**

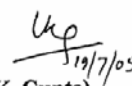
6. The revised procedure shall be as follows:

- (a) The States/ UTs shall submit the compensation claims every month to this Department (with a copy to the AG of the State/ UT concerned), with provisional figures of revenue collection certified by the Finance Secretary of the State. The Finance Secretary of the State shall also furnish information on the revenue adjustment to be made on account of deviations, as stated in Para 4 and 5 above. On submission of this information, ad-hoc release of the compensation shall be made to the State. Further, in cases where there is some delay in a State/ UT furnishing the information on deviations, due to some genuine difficulties, release of ad hoc compensation may still be considered, pending submission of such information, subject to the State/ UT assuring to submit the same within a period of three months.

- (b) Separately, the AG of the State concerned shall verify the data furnished by the Finance Secretary of the State/ UT in respect of total revenue collections, in due course, when the requisite data becomes available to the AG's office and advise this Department about differences in the figures, if any. On receipt of such advice from the AG, suitable adjustment shall be made in the compensation amount, to be paid in the next month. Here, it is clarified that, in view of the fact that the Accountants General (AGs) maintain only total tax collection data and not the commodity-wise data, the AG certification will not be required wherever commodity-wise data is to be furnished. This will also apply to the information in respect of deviations as well as information in respect of items of commodities, which are outside VAT (and are subject of 20% Floor Rate of Tax).
- (c) In case, there is a disagreement between the AG's office and the State Government, the matter may be brought to the notice of this Department, which will then be placed before the Committee on VAT Compensation, constituted by the Government of India under chairmanship of the Secretary, Expenditure and further appropriate action in such cases shall be taken on the advice of the Committee.
4. I am further directed to request you to kindly to take further necessary action accordingly.

Thanking you,

Yours faithfully,

  
(L. K. Gupta)  
Director (ST)

Tel: 011-2309 2878

**Copy to:**

1. The Accountants General (A&E) of the States/ UTs concerned.
2. The Director (Accounts)/ Director (SRA), O/o C&AG, New Delhi.
3. Sh. Ramesh Chandra, Member Secretary, EC of State Finance Ministers, C-405, Delhi Secretariat, I.P. Estate, New Delhi-110002
4. The Commissioners, Sales Tax/ Commercial Tax/ VAT of the States/ UTs concerned.

**Proforma-I**

**Computation of Actual Revenues (Net of refunds)**

Name of the State/ UT:

(Rs. Crore)

S. No	Item of Tax	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	Date of Subsuming the Tax in VAT (for S. No. 2 to 6)
1.	<b>State/ General Sales Tax:</b> a) Total Tax Revenue b) Tax Revenue from items outside VAT c) <b>Net Tax Revenue (a-b)</b>							
2.	Purchase Tax							
3.	Entry Tax (not in lieu of Octroi)							
4.	Turnover Tax							
5.	Surcharge							
6.	Other related Taxes, to be subsumed in VAT							
	<b>Total</b>							

**Notes:**

1. The Central Sales Tax collections should be excluded from the calculations, since the package covers State Sales Tax only.
2. In case of S. No. 1, only the "Net Tax Revenue" should be considered for the purpose of calculations. The AG's Certificate may be furnished for "Total Tax Revenue" only. In case of the "Tax Revenue from items outside VAT", information furnished by the State Government shall suffice.

**Certificate:**

Certified that the figures upto 2003-04 are certified by the Accountant General of the State. Original Certificate of the Accountant General is enclosed. The figures for 2004-05 are as per accounting records of the State Government/ UT and are true to the best of my knowledge. The AG certified figures for 2004-05 shall be submitted in due course.

**Finance Secretary**

**Proforma-II**

**Computation of Average Annual Growth Rate of Total Tax Revenues**

Name of the State/ UT:

(Rs. Crore)

Year	Total Tax Revenue	Computation of Annual Growth Rates		3 years selected by State/ UT (Please indicate)	Average Annual Growth Rate of 3 selected years
		Years	Growth Rate		
1	2	3	4	5	6
1999-00					
2000-01		2000-01/ 1999-00			
2001-02		2001-02/ 2000-01			
2002-03		2002-03/ 2001-02			
2003-04		2003-04/ 2002-03			
2004-05		2004-05/ 2003-04			

**Notes:**

1. In Column 2, the total tax revenue of only those taxes, which have actually been subsumed in VAT, will be taken into account.
2. In Column 6, the Average Annual Growth Rate would be the simple arithmetic average of Annual Growth Rates of 3 best years selected/ indicated by the States in Column 5.

**Proforma-III**  
**Computation of Projected Total Tax Revenues, Actual Tax Revenues and the Loss to be compensated**

Name of the State/ UT: \_\_\_\_\_ (Rs. Crore)  
 Year : 2005-06/ 2006-07/ 2007-08

Month	Total Tax Revenue during 2004-05		Projected Tax Revenue during 2005-06/ 2006-07/ 2007-08 (cumulative upto the month)	Actual Tax Revenue during 2005-06/ 2006-07/ 2007-08 (Cumulative upto the month)			Loss during 2005-06/ 2006-07/ 2007-08 (Cumulative upto the month)	Amount of Compensation to be paid (100%, 75% or 50% of Loss, as applicable)			
	During the month	Cumulative upto the month		Total Tax Revenue	Tax Revenue from items outside VAT	ITC under VAT adjusted against CST, if any		Net Tax Revenue	Total Compensation Due upto the month	Compensation upto last month	Net Amount Payable for the month
1	2	3	4	5	6	7	8(5-6-7)	9(4-8)	10	11	12(10-11)
April											
May											
June											
July											
August											
Sept.											
October											
November											
December											
January											
February											
March											

**Note:** Regarding Actual Tax Revenue (Columns 5 to 8), it may be noted AG reconciliation will be necessary only in respect of "Total Tax Revenue" shown in Column 5. Regarding information in Column 6 and 7, information furnished by the State Government shall suffice. The Compensation shall be based on the "Net Tax Revenue" in Column 8. In Column 7, information may be given regarding VAT Input Tax Credit adjusted against CST by dealers, if any.

**Certificate**

Certified that the design of VAT (including the Convergence Parameters), as finalized by the Empowered Committee, has been fully complied with, subject to deviations indicated in Proforma IV.

**Finance Secretary**

**Information on Deviations**

Year:

S. No.	Item/ Commodity	VAT Rate		Tax Collection from the Item/ Commodity	
		As approved by EC (originally)	As adopted by the State/ UT	During the month of.....	Cumulative during the year
1	2	3	4	5	6

**Notes:**

- 1. In column 3, the VAT rate mentioned should be the VAT rate originally approved by the EC at the time of finalization of compensation package and **not** the revised VAT rate, decided by the EC.
- 2. In case a State/ UT finds it difficult to compile and furnish actual tax collection in respect of very small items of commodities (in terms of revenue involved), such State/ UT may furnish information based on their assessment of revenue loss on the basis of NSS data or any other appropriate basis.