Additional Instructions on VAT Compensaton

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

New Delhi, dated the 3rd 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 19th 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 01st 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 01st April 2007, the consolidated guidelines on the CST compensation were issued vide
F.NO.284/2007-ST dated 22nd 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
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.

Accordingly, in light of the above mentioned decision, "Revised Consolidated Instructions" on the VAT compensation circulated vide F.No.34/67/2005-ST dated 19th 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 national 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."

This is for your kind information.

Thanking you,

Yours faithfully,

(Arvind Kumar)

Under Secretary to the Govt. of India.