Application of Value Added Tax in Goods & Services Tax: Issues & Concerns

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Abstract

The research paper is mainly focused on how the VAT structure has been used to include the GST structure. The researcher will, first, analyse the history of both VAT and GST. Then, the differentiation between GST and VAT would be observed. There can be an assumption that there is very little difference between VAT and GST but the Indian legislature has been endeavouring for a long time to introduce some effective methods of indirect taxing which will benefit both, the Government and the taxpayer. A major change after the introduction of GST has been the removal of the cascading effect which was there in the VAT model. However, it can be observed that the GST model introduced is somewhat based on the VAT model. The researcher will also explore the European model of VAT and GST; how these models have been developed over time; how the Indian model of GST and VAT is similar to that of the European model and the different case laws decided by the European Court. The researcher will focus on the basic difference in interpretation of the Courts. The basic difference that VAT is a consumption-based tax whereas GST is a supply-based tax will be elaborated further.

I. Introduction

As the name suggests, a value-added tax (VAT) implies a tax on the value addition. In the context of an indirect tax, VAT on a business implies a tax on value addition by the business. Thus, a VAT model presupposes the determination of value added by the business to assess the tax base. There are a number of models to determine such a valuation. However, what is common among these models is that the value of the supplies used by the business is excluded, by deduction method, credit method or otherwise, such that the tax imposed on the business is directly proportional to the value added. The VAT model, therefore, ensures against the cascading effect of taxes by ruling out the taxes paid by a business on its input supplies from being considered for assessing the levy on its output supplies.

VAT model has another critical facet which is the levy of tax at all stages of value addition. Barring cases which are specifically excluded (on account of *de minimis* threshold or for other policy reasons), value addition at each level of the supply chain is subject to levy under the VAT model. The levy, therefore, is multi-staged unlike a single-point tax which applies only on a pre-identified point of supply. The aforesaid aspects entail a number of allied features of a VAT model. Firstly, the provision of credit/deduction of tax on input supplies ensures that the business remains neutral from the tax system. Thus, the business choice of any supply's source, etc., is not influenced by the tax system. This feature is also known as the principle of fiscal neutrality. Secondly, a typical VAT system permits collection of tax from the recipient of output supplies, *i.e.,* the consumer, and thus the incidence of tax is given by the consumer. Thus, the VAT system is generally associated with tax based on consumption. Thirdly, a value-added tax model presupposes "border-adjustable taxes", i.e. the ability of VAT system "to rebate these taxes on

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exports and impose them on imports."[2]Thus, "destination" based principle of taxation usually accompanies, though not as a mandatory rule, a VAT model.

II. Appraising the Policy Rationale for Adoption of Vat Model in GST Design

A VAT model appears to be the craved choice for the indirect tax regime in India. The White Paper on VAT, which was the precursor of the switch-over from sale tax/purchase tax model to State levying both on VAT models, positioned the latter as a superior model, inter alia stating as under.[3]Not only will the VAT include full set-off for input tax and tax on previous purchases, but it will also reduce the burden of several of the existing taxes, such as turnover tax, sales tax surcharge, additional surcharge, special additional tax, etc. Therefore, Central Sales Tax will also be phased out. As a result, the overall tax burden and the cost, in general, will be rationalized and will fall. In addition, VAT would replace the existing inspection system with an integrated self-assessment system by traders and producers. The tax structure is going to be simpler and more transparent. This will significantly improve tax compliance and will also lead to an increase in the revenue of the state.

Right from the conception of the idea, GST was envisaged as a value-added tax. The first Discussion Paper propounded the rationale for GST on the following terms. Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be an interrogation of VAT on goods with taxes on services at the state level as well; at the same time, there should be a deletion of the cascading effect of service tax. In GST, both the cascading effects of CENVAT and service tax are removed with a set-off, and a continuous set-off chain is established from the point of the original producer and the service provider up to the level of the retailer which reduces the burden of all the cascading effects. That's the nature of GST, and that's why GST is not just a VAT and a service tax, but an upgrade over the old VAT or the disjointed service tax regime.

GST is an expense on products and ventures with far-reaching and constant chain of set-off advantages from the maker's point and the specialist organization's point up to the retailer's level. It is, basically, a duty on esteem expansion at each stage, and a provider at each stage is allowed to set-off, through an expense credit instrument, the GST paid on the acquisition of the merchandise and ventures as is accessible for set-off. Along these lines, the last customer will just bear the GST charged by the last vendor in the inventory network, with set-off advantages at all past stages.

The finer nuances of the value-added tax regime were also addressed by the Task Force on GST in its Report in the following terms:[4]For successive taxpayers who are able to subtract input tax on transactions and compensate for production tax on revenues, the value-added tax system is based on tax collection in a structured cycle- a company in the supply chain is involved in the process of managing and collecting tax, turning over the proportion of tax relating to the sales profit, or the disparity between the VAT paid to distributors and the VAT charged to consumers.

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[2] Alan Schenk & Oliver Oldman, Value Added Tax- A Comparative Approach 18 (Cambridge University Press, 2007).

[3] Empowered Committee, A White Paper on State-level Value Added Tax (2005)

[4] 13th Finance Commission, Report of the 'Task Force on GST' (Dec. 15, 2009).

In fact, many nations with a value-added tax system enforce taxes at each and every level which, usually, require all but the final customer to automatically subtract taxes on transactions. These characteristics give value-added taxes their main economic advantage, neutrality. The total ability to subtract taxation on production by way of a supply chain, except for the consumer at the end, guarantees tax transparency (regardless of the quality of the item), a chain of the distribution system and the methods applied to distribute it.

Globally, VAT is based on the concept of destination which helps the tax to preserve its independence in global exchange. This VAT on goods is usually paid at a similar period as the duties levied by Customs, however, the payment is deferred in some countries until it is recorded on the next VAT return of the importer. Deductible of foreign VAT, including input tax deduction on domestic supply, guarantees fairness and does not hinder global trade.

Upon consideration of the competing variables, the Task Force on GST also suggested the adoption of "a consumption type value-added tax based on destination principle where exports will be zero-rated and all imports will be subject to the levy like the other goods and services domestically produced and consumed" as in its view a "the most sophisticated way for removing inequalities and regulating demand is a value-added tax on each and every service and goods, whereby, 'all the various phases of production and distribution can be understood as a pure tax pass-through,' so tax classification can, basically, be interpreted as a mere revenue pass-through, and taxation, ultimately, can 'stay' on final sales within the taxing authority."

The Task Force on GST extended another rationale for the adoption of a VAT model for GST, which is its ability to align informal economy into the mainstream on account of the disincentives it creates for the dealings with the informal economy. This aspect was addressed in its report in the following terms:

The switchover to GST also entails the taxation of all goods and services in the formal sector. To the extent of purchases made from the informal sector by producers in the formal sector, no input tax credit would be available. Consequently, the value addition of the informal sector on such inputs would be recaptured when used in the formal sector. Similarly, to the extent purchases are made from the formal sector by the informal sector, they will be GST borne and since no output tax will be payable by the informal sector, the tax will apply on the producer. Therefore, a comprehensive consumption oriented, destination-based GST will also result in a higher tax burden on the informal economy than the present level. Hence, the switch over to a 'flawless' GST will improve horizontal equity.

Albeit not directly, the Parliamentary Standing Committee on Finance also noted the salient features of the GST design as a value-added tax model in its report in the following terms:[5]The institution of GST is a logical climax of the process of reformation of tax which includes the switch to CENVAT, the levy of service tax and the formation of state VAT from sales tax. The tax base would be integrated by removing many of the taxes imposed by both the Center and the States and allow input tax credit to flow smoothly through the value chain of goods and services. This would remove numerous taxes, tax cascading, and in-toto streamlining of the system of indirect taxation. Consistently, input tax credit will result in lower costs of goods and services.

[5] Parliament's Standing Committee on Finance, 73 Report (Aug. 7, 2013).

The Rajya Sabha Select Committee also acknowledged this design of GST in its report[6], even though it did not adopt a proposal to formally define GST as "a multi-stage destination-based value-added tax on supply of goods, or services, or both, and levied as per the framework recommended by the GST Council."

The aforesaid discussion clearly reveals that at a policy level, there was unanimity that the GST regime would be premised on a value-added tax model. Furthermore, the salient features of the VAT model for the GST regime were also acknowledged with consensus. However, there is nothing in the text of the 2011 Amendment Bill, the 2014 Amendment Bill or the Constitution Amendment Bill which explains the nature of the new legislative field of "goods and services tax" inserted in the constitution exception for a definition which provides that it would be a "tax on supply". There is no indication as to the attributes of the GST. Is it fatal? Does this imply that GST is not a value-added tax? The answer is in negative. The role of the legislature is to legislate. It is the role of the judiciary to determine, inter alia, the competence of a legislation, the subject-matter of the legislation and the constitutional empowerment leading to its enactment.[7]

This system ensures that the consumer should pay the final tax but a good tax credit system guarantees that there is no repeating of taxes. GST will unify all taxes to establish a single system across the country to avoid charging various taxes such as excise duty and sales tax at the federal level and VAT at the state level. Integrating different taxes into a GST system will result in an effective credit cross-use. The contemporary tax production system and the purpose of GST is tax consumption. GST includes tax on each point of sale and purchase in the value-added supply chain. With respect to tariffs, it does not make any difference for goods and services. It also provides full credit for input tax. It's a tax based on consumption. It is a tax made on supply of goods and supply of services. Supply of goods means the right is transferred to the person to use the goods and in case of services, to utilize the services. Tax is levied on the addition of values. Thus, the tax is calculated on the total value and after that, a credit of input tax is paid and it is given till the goods or services are supplied to the person who gets the final product or services, who does not even benefit from the input and pays the full cost of goods or services. The proposed tax on goods and services (GST) is viewed as India's largest single indirect tax overhaul and is supposed to implement a simplified tax structure, a seamless credit chain. For online marketplaces, the principle of ' one levy, one market ' on which GST is centred should be a welcome step. In order to create transparency about the treatment of transactions in the online marketplace, sector-specific provisions must be incorporated in the GST process. This is very significant, but it's just the first of the two measures. The next key step is for the government to meet with these requirements. Businesses will have to pursue the ' full-of-business ' strategy for GST impact assessment and execution, whereby, the company and tax consultation teams work together to provide consumers with a streamlined product that encompasses all the business aspects they want.

On July 19, 1976, the Indian government had set up the Indirect Tax Enquiry Committee under the chairmanship of Sri L.K Jha to study the entire Indian Indirect Tax Process structure. The

[6]GST will broaden the tax base, and result in better tax compliance due to robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an in-built mechanism in the design of GST that would incentivize tax compliance by traders.

[7]Federation of Hotels & Restaurants Assn. of India v. Union of India, (1989) 3 SCC 634.

committee conducted a comprehensive study of the occurrence of Indian Indirect Taxes, the issue of multiplicity of rates, etc., and proposed a collection of 4 Excise Rates, implementation of Value Added Tax (VAT) at the manufacturing level, named MANVAT, to address the problem of the cascading impact of Excise Taxation.[8]

III. Deriving the Principles from European Community's VAT Regime

The concept of VAT is elaborately addressed in the European Community's VAT regime. The First Council Directive "on the harmonization of legislation of Member States concerning turnover taxes"[9] recognized that "a system of value-added tax achieves the highest degree of simplicity and neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production, distribution and the provision of services".[10]In this background, the First Council Directive specifically stipulated the following:[11]

The principle of the common value-added tax system involves applying a general tax on the consumption of goods and services which is exactly proportional to the price of goods and services, regardless of the number of transactions that take place in the production and distribution process before the tax is charged. VAT is measured on the price of the goods or services at the level applicable to those goods or services and shall be paid on each purchase upon elimination of the amount of value-added tax specifically incurred by the different cost components. The aforesaid is a crucial manifestation of two critical principles underlying the VAT regime. These are as follows:

(1) The tax must be based on "the number of transactions which take place in the production and distribution process before the stage at which tax is charged."

(2) The exact proportion principle is achieved by charging the VAT, inter alia, *"*after deduction of the amount of value-added tax borne directly by the various cost components".

(3) The current legal regime of the European Community, i.e., the Council Directive, "on the common system of VAT"[12], adopts the same principles[13] to exemplify this aspect much further when it states as under: Achieving the goal of establishing an insider market presumes that the Member States have adopted an enactment on turnover taxes that does not worsen trade constraints and create obstacles for the free flow of goods and services. Therefore, it is important to reach such a congruity with respect to the enactment on turnover taxes through a system (VAT) that will eradicate, as far as possible, factors that can affect market conditions, whether at a national or a local level.

(4) A VAT scheme enjoys the best efficiency and fairness when the tax is levied as broadly as possible and when identical goods and services in each Member State have the same tax burden, without giving thought about the production or distribution chain.

(5) Even if there is no harmony between the rates and the exemptions, the usual system of VAT should neutralize the competition, so that same goods and services carry similar tax burden within the territory of each Member State, without any second thought about the production and

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[8] Indirect Tax Enquiry Committee, 1976.

[9] Harmonisation of legislation of member states concerning turnover taxes, First Council Directive 67/227/EEC (1967).

[10]Preamble, Goods & Services Tax Act, 2017.

[11] Tarun Jain, Goods and Service Tax- Constitutional Law and Policy 307, (EBC Publication, 2018).

[12] Directive 2006/112/EC (1967).

[13] Id. art. 1(2).

distribution chain.
In the aforesaid context, the European Court culled out the "essential characteristics of VAT" stating, inter alia, as under;[14]

> "VAT generally applies to transactions involving goods or services; it is proportionate to the price of those goods or services, irrespective of the number of transactions taking place; it is charged at each stage of the production and distribution process; and finally, it imposes on the value added of goods and services, the tax payable on a transaction calculated after deduction of the goods and services."

The attributes of this design can, thus, be enumerated as under:

1. This tax is, basically, levied on transactions relating to goods and services.
2. The tax is "proportional to the price of those goods or services" and such proportionality is not disturbed by the "number of transactions which take place".
3. Even though the "tax is charged at each stage of the production and distribution process", it is, in actuality, levied only on the value added to the goods or services by the supplier as the tax is payable by the supplier "after deduction of the tax paid on the previous amount".

Therefore, insofar as the supplier or the business subject to VAT is concerned, VAT imposition is solely determined by its ability to deduct the tax paid on the previous transaction. This is achieved by the deduction method or the input-tax credit mechanism which is a pivotal mechanism for the operation of VAT. The VAT system "precludes the application of a taxation arrangement wherein VAT is determined only once on the price of the first market stage" in view of the "fundamental principle which underlines the VAT system that VAT applies to each transaction by way of production or distribution after deduction of the VAT which had been levied directly on transactions relating to inputs."[15]

In the European context, since the idea is to impose tax only on the value added by the supplier, businesses have been held entitled to deduct the tax paid on input supplies even if at a later date, the supplier is exempted from taxes. The entitlement to tax must not be retroactively withdrawn as they are "contrary to the principle of legal certainty w.r.t. the rights and obligations of taxable persons," and more importantly, it would be contrary to the principle that VAT should be neutral with regard to the tax burden on businesses".[16]

Upon application of these principles and other related principles, the European Court has declared that a tax which is applied only once in a supply chain, is without a right of deduction of such tax and which forms part of the supply chain is not a value-added tax.[17] It has also been declared that a tax that was "not intended to attach to all economic transactions" and instead, is charged once and applies "only to a specific service" does not exhibit the characteristics of a VAT.[18]It does not, however, follow that there cannot be a system of exemption, thereby, rendering the supplier without a right to deduction of input tax. As the European Court held,[19]

[14] Fazenda Publica v. Solisnor- Estaleiros Navais SA, (1997) ECR I-05053.
[15]BP Supergas Anonimos Etairia Geniki Emporiki- Viomichaniki kai Antiprossopeion v. Greek State, ECLI:EU:C:1995:223.
[16] Intercommunale voor zeewaterontizilting (INZO) v. Belgian State, ECLI: EU: 1996:67.
[17] Wissenlink en Co. BV v. Finanzant Paderborn, ECLI:EU:C:1989:324.
[18]GIL Inssurance Ltd. v. Commissioners of Customs & Excise, ECLI:EU:C:2004:252.
[19] Belgocodex SA v. Belgian State, ECLI:EU:C1998:589.

the system of exemption is, legally, a part of the VAT regime and cannot be found at fault with it even if they are "contrary to the principle of fiscal neutrality, since it breaks the chain of deductions and increases the fiscal charge".[20]

1. GST: A Tax Based on a VAT Model

The aforesaid reflections under the EEC VAT regime have been echoed by Indian courts as well, though, not with the same resonance. According to the Supreme Court, Value-Added Tax implies "a general tax that applies, in principle, to all commercial activities involving the production of goods and provision of services. VAT is a consumption tax as it is borne by the consumer."[21] Reflecting upon the rationale of the shift from the sales tax/purchase tax regime to VAT regime in the State legislation, a number of High Courts have also endorsed this basic design of a VAT model.[22]Noting the nuance of a "value-added tax", as contrasted with "turnover taxes", the Supreme Court had delineated the economic understanding of the concepts in the following terms:[23]

It appears to be quite intriguing that 'Value Added Tax', famously referred to as VAT, is imposed in some Western countries as an addition to sales tax. Professor Paul A. Samuellson explains the difference between 'Value Added Tax' or income and consumption tax on revenue in his novel[24] as follow; Every transaction is taxed under a turnover tax. Although VAT is different because it does not levy tax on the miller's flour for the part of the value that came from the wheat bought from the farmer.[25] Instead, it taxes him only on the wage and salary cost of milling and on the interest, rent, royalty, and profit coast of the milling stage of production. (That is, the costs of raw materials used in the earlier stages are subtracted from the miller's selling price by calculating the value of 'value added' and the VAT tax on value added.)

Further, the VAT model has been declared to work on the principle of equivalence[26] which operates inter se the levy of VAT on goods and services, i.e., "just as exercise duty is a tax on value addition on goods, service tax is on value addition by rendition of services".[27] Thus, in a VAT model, there is no conceptual distinction between the supply of goods and services, and a tax on rendition/consumption of services is also a value added tax.

The GST legislation adopted the VAT model and sought to relieve businesses of taxes on their input supplies by following the "credit system".[28] Thus, the GST legislation provides for determination of value addition of a business by way of granting credit for the taxes on the value addition to built-in input supplies used by the business for providing its output supplies. As the

[20] "The input tax credit is in the nature of "concession" granted." Jayam & Company v. Comm, (2016) 15 SCC 125.
[21] All-India Federation of Tax Practitioners v. Union of India, (2007) 7 SCC 527.
[22] Sony India (P) Ltd. v. CTT, 2015 SCC Online Del 10811.
[23] State of Karnataka v. B. Raghuram Shetty, (1981) 2 SCC 564.
[24] Economics 168 (10th ed., 1976).
[25] State of Karnataka v. B. Raghurama Shetty, 1981 AIR 1206.
[26] All India Federation of Tax Practitioners v. Union of India, (2007) 7 SCC 527; Assn. of Leasing & Financial Service Companies v. Union of India, (2011) 2 SCC 352.
[27] "Service tax is a "consumption tax is being not a charge on business but on consumer and is leviable on service provided" and thus it is a value added tax." ShubhTimb Steels Ltd. v. Union of India, 2010 SCC Online P&H 1186.
[28] Central Goods & Service Tax Act, 2017, §16 illustration.

Government has endeavoured to explain, GST "follows a multi-stage collection mechanism" where the "tax is collected at every stage of transaction".[29] Out of the various types of VAT models, the GST legislation has adopted "invoice-based" VAT regime in as much as the availability of credit of input taxes is stipulated and if the business "is in possession of tax invoice or debit note issued by a supplier registered under this Act."[30]By this mechanism the GST regime aims to attain the global principle enshrined in the First Discussion Paper, i.e., GST would "essentially be a tax on value addition to each stage" wherein the "supplier can, at each point, set the GST charged on the purchase of goods and services as available for set-off on the GST payable on the supply of goods and services through means of a tax credit system," and, therefore, only the GST charged by the last dealer in the supply chain along with set-off benefits at all previous stages will be borne by the final consumer. However, the right to deduction, i.e., the credit of input taxes under the GST legislation, is not unconditional and is subject to a number of "conditions and restrictions".[31]

By bringing within its scope all suppliers of goods and services excepting those who are specifically excluded (on account of tax threshold or for other policy reasons), the GST legislation retains the avowed characteristic of VAT, thereby characterizing GST as a multi-staged tax covering within its scope value addition [32] and zero-rated exports[33], and thus, also adopting the destination-based principle which generally accompanies VAT model. This reveals that the tax charged under the GST legislation is indeed a tax on value addition, even though in its current form it may not be able to provide for levy of tax in a way that's "exactly proportional" to the value added by each stage of the supply chain, principally on account of the restrictions and conditions imposed on the availability of credit of input taxes.

2. Fiscal Neutrality: Deriving the Concept from European Community's Value Added Tax Regime

The GST legislation reflects a marked shift of parliamentary stand vis-à-vis value-added taxes. It is for the first time that the concept of input tax credits has been legislated in a parliamentary enactment. Until now, the provisions to permit deduction of tax paid on inward supplies were left to the discretion of the executive government and were rolled out in the form of subordinate legislation.[34] By contrast, the concept of input tax deduction has received the attention of State Legislature for more than a decade and drawing from the White Paper on VAT,[35] the state Value Added Tax legislation themselves provided for input tax deduction. However, on account of the illustration under Section 16 of the Central Goods and Services Tax Act, 2017, it is for the first time that taxable persons are conferred a legislative right to such deduction under parliamentary laws. Owing to the diverse rules and the distinguished setting of the credit rules under the existing legislation, the development of jurisprudence on the subject in India does not reveal a consistent policy-laden approach. However, the European Community's VAT regime has addressed the issue in detail and therefore, it is expedient to examine the state-of-affairs arising

[29]Press release on July 11, 2017, available at http://pib.nic.in/newsite/PrintRelease.aspx?relid+161273.
[30] Central Goods & Services Tax Act, 2017, § 16(2)(a).
[31]Id., at § 16 illustration.
[32] Integrated Goods & Services Act, 2017, §§ 5(1), 7(2) & 7(4).
[33] Id., at §16 (1)(a).
[34] CENVAT Credit Rules, 2004.
[35] Empowered Committee, White paper on State-level Value Added Tax (2005).

from the legal position expounded by the European Court.

The Sixth Council Directive, for "the harmonization of laws of the Member States relating to turnovers taxes- Common System of value-added tax: uniform basis of assessment"[36] specifically enacted the right to deduct whereby the taxable person was "entitled to deduct from the tax which he is liable to pay", *inter alia,* the "value-added tax due or paid within the territory of the country in respect of goods and services supplied or to be supplied to him by another taxable person." [37] The current legal regime of the European community, i.e., the Council Directive declares that "the common system of value-added tax,"[38] similarly, offers a legal right to deductions to the taxable person.

Such is the importance assigned to these provisions that "the right of taxable persons to deduct VAT due or paid on goods purchased and services received as inputs from the VAT which they are liable to pay" is declared as "a fundamental principle of the common system of VAT establish by the EU law" which is "an integral part of the VAT scheme and, in principle, may not be limited"[39] The rationale for such protection of the right is the underlying conceptual foundation that the "deduction system is intended to relieve the trader entirely of the burden of VAT payable or paid in the course of all his economic activities"[40] On such a premise it has been held that the "question whether the VAT paid to the public purse is irrelevant to the right to a taxable person to deduct input VAT."[41] It is, now, a settled legal position under the EU law that "the principle of fiscal neutrality precludes treating similar goods and supplies of services which are, thus, in competition with each other, differently for VAT purposes".[42]

The decision of the European Court in Rompelman[43]enlists a number of key attributes of this design. The decision (1) indorses the right to deduction as a basic element of the European Communities' Value Added Tax regime, (2) clarifies that the tax system permits the levy only after the deduction of the tax on the various components comprising the supply and, (3) limits the right to deduction only to taxable persons, thus, ensuring that the tax is borne by the consumers of the supply. By, inter alia, these tenets, the decision expounds that the tax system "ensures that they are themselves subject to VAT and are taxed in a wholly neutral way" and thus*,* the concept of fiscal neutrality emerges as a foundational element of the value-added tax system. In this case, therefore, the European Court upheld the claim of input tax deduction on account of "acquisition of a right to the future transfer of property rights, in part, of a building yet to be constructed, with a view to let such premises in due course" as according to the European Court, "the principle that VAT should be neutral as regards the tax burden on a business requires that the first investment expenditure incurred for the purpose of and with the view to commence a business must be regarded as an economic activity" and it "would be contrary to the principle if such activity did not commence until the property was actually

[36] Sixth Council Directive 77/388/EEC (1977).
[37] Constitution of India, art. 17.
[38] Directive 2006/112/EC (2006).
[39]Compass Contract Services Ltd. v. Commissioners for Her Majesty's Revenue and Customs, ECLI:EU:C:2017:454.
[40] Bonik Eood v. Direcktor, ECLI: EU: C: 2012: 774.
[41] Id. at para 28.
[42] Commissioners for Her Majesty's Revenue and Customs v. Ranks Group Plc. ECLI: EU: C: 2011:608.
[43] D.A. Rompelman v. Minister van Financien, ECLI: EU: C: 1985:74.

exploited, that is to say, until it began to yield taxable income". In short, the European Court invoked the principle of fiscal neutrality to uphold the right to deduction in respect of pre-commencement input supplies.

The decision in Fini[44]presents a vital insight into the expanded contours of this right to deduct. Fini was a partnership firm constituted with the object of running a restaurant. For this purpose, it took a premise on lease for 10 years in the year 1988. It closed the restaurant business in 1993 but owing to the set terms, the lease expired in 1998. During this period, Fini remained registered under tax provisions and "continued to deduct input tax paid by it on the costs incurred in relation to the lease in question, namely the rent, heating, electricity and telephonic charges." The deduction was disputed by the tax authorities. Relying upon its earlier decision, the European Court affirmed the legal position that (1) preparatory acts must be regarded as economic activities, (2) any person performing such preparatory acts would, consequently, be regarded as a taxable person and, (3) "entitlement to deduct is retained, even if it is subsequently decided, in view of the results of profitability study, not to move to operational phase but to put the company into liquidation, with the result that the economic activity envisaged does not give rise to a taxed transaction".

It is, however, noteworthy that the principle of fiscal neutrality does not come in the way of differential rate fixation for supplies. The European Court acknowledges that "the principle of fiscal neutrality precludes treating similar supplies of services, which are, thus, in competition with each other, differently for VAT purposes" but, "as the Court has repeatedly made clear, that the principle does not extend the scope of a reduced rate in the absence of a clear wording to that effect"[45] Meaning, thereby, that those subjected to higher incidence of tax on account of differential rates cannot invoke the principle of fiscal neutrality so as to claim the concessional tax effect.

IV. Conclusion

To conclude it can be said that GST which had been introduced two years back is a better form of VAT, which is beneficial for both the consumer and the Government. The basic aim of the Government was to enact taxation legislation which will lead to a win-win situation. The cascading effect which was there in the case of VAT was removed with GST and the taxation was made based on the supply of goods and services. The various models of VAT created confusion and were not beneficial for all. The European taxation system has observed that the GST model, which is a better form of VAT, removes cascading effect or the repetition of taxes. It is a destination-based tax which will be uniform and would reduce the burden of paying tax at numerous places. The GST in India also uses the VAT model and has applied the credit system. It can be said that the VAT model has been improved and is presented in a better way to collect indirect tax, which is why the application of VAT is found in the GST model of India.

[44] Fini H. S. Skatteministeriet, ECLI: EU: C: 2005:128.
[45] Etat Belge v. Oxycure Belgium SA, ECLI: EU: C: 2017:189.