

THE INDIAN GST IS MOVING TOWARDS THE BEST REAL-WORLD MODEL OF THE TAX

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Abstract

Indian government has implemented various taxes at all possible levels - sales tax, excise duty, octroi, fringe benefit, countervailing duty - just to name a few, the government announced an ambitious plan to roll out a unified tax system - the Goods and Service tax - which was to combine all these taxes and simplify the entire system for the state, centre, enterprise and end consumer. The key highlight was the implementation of Dual GSTs - one by the centre and one by individual states. The new legislation will be introduced with the intention to harmonize various disparate laws to ensure effective implementation and execution of the tax system. The rates for goods will be different from that for services while necessary goods will receive the benefit of lower taxes. The Finance Minister has commented that he believes the combined rate to be in the range of 14-16%. This paper explaining in details of Goods and Services Tax (GST) what will the Impact on Prices of Goods and Services and what will the Benefits of Dual GST. The paper also summarizes the Roadmap to GST.

Keywords : GST, Dual GST, CGST, SGST, CENVAT, reduction, taxable event, collection model, Uniformity, implementation

Introduction

Goods and Services Tax (GST) is a part of the proposed tax reforms that center round evolving an efficient and harmonized consumption tax system in the country. Presently, there are parallel systems of indirect taxation at the central and state levels. Each of the systems needs to be reformed to eventually harmonize them. , Finance Minister proposed that India should move towards national level Goods and Services Tax that should be shared between the Centre and the States. He proposed to set April 1, 2010 as the date for introducing GST. World over, goods and services attract the same rate of tax. That is the foundation of a GST. The first step towards introducing GST is to progressively revising the

service tax rate and the CENVAT rate.

The goods and service tax (GST) is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at a national level. Integration of goods and services taxation would give India a world class tax system and improve tax collections. It would end the long standing distortions of differential treatments of manufacturing and service sector. The introduction of goods and services tax will lead to the abolition of taxes such as octroi, Central sales tax, State level sales tax, entry tax, stamp duty, telecom license fees, turnover tax, tax on consumption or sale of electricity, taxes on transportation of goods and services, and eliminate the cascading effects of multiple layers of taxation. GST will facilitate seamless credit across the entire supply chain and across all states under a common tax base.

The Goods and Services Tax (GST) is a comprehensive value added tax (VAT) on the supply of goods or services. France was the first country to introduce this value added tax system in 1954 devised by a public servant. In India, due to non consensus between central and state government, the proposal is to introduce a Dual GST regime i.e. Central and State GST.

What is GST ?

- GST is a Comprehensive value added tax on goods and services.
- It is Collected on value added at each stage of sale or purchase in each Supply Chain
- No differentiation between goods and services as GST is levied at each stage in the supply chain.
- Seamless input tax credit throughout the supply chain.

At all stages of production and distribution taxes are a pass through and tax is borne by the final consumer

Why GST ?

- Simple tax structure
- Only One or two rates of taxes
- Only one Return
- Increased in collection of revenue due to Simplification
- Less Transaction Cost
- Improvement in international cost.

How GST Will Work

Generally, the dealers registered under GST (Manufacturers, Wholesalers and retailers and service providers) charge GST on the price of goods and services from their customers and claim credits for the GST included in the price of their own purchases of goods and services used by them. While GST is paid at each step in the supply chain of goods and services, the paying dealers don't actually bear the burden of the tax because GST is an indirect tax and ultimate burden of the GST has to be taken by the last customer. This is because they include GST in the price of the goods and services they sell and can claim credits for the most GST included in the price of goods and services they buy. The cost of GST is borne by the final consumer, who can't claim GST credits, i.e. input credit of the tax paid. The GST can be divided into following sections to understand it better.

1. **Charging Tax:** The dealers registered under GST (Manufacturers, Wholesalers and Retailers and Service Providers) are required to charge GST at the specified rate of tax on goods and services that they supply to customers. The GST payable is included in the price paid by the recipient of the goods and services. The supplier must deposit this amount of GST with the Government.

2. **Getting Credit of GST:** If the recipient of goods or services is a registered dealer (Manufacturers, Wholesalers and Retailers and Service Providers), he will normally be able to claim a credit for the amount of GST he has paid, provided he holds a proper tax invoice. This "input tax credit" is set off against any GST (Output), which the dealer charges on goods and services, which he supplies, to his customers.

3. **Ultimate Burden of Tax on Last Customer:** The net effect is that dealers charge GST but do not keep it, and pay GST but get a credit for it. This means that they act essentially as collecting agents for the Government. The ultimate burden of the tax falls on the last and final consumer of the goods and services, as this person gets no credit for the GST paid by him to his sellers or service providers.

4. **Registration:** Dealers will have to register for GST.

These dealers will include the suppliers, manufacturers, service providers, wholesalers and retailers. If a dealer is not registered, he normally cannot charge GST and cannot claim credit for the GST he pays and further can not issue a tax invoice.

5. **Tax Period:** The tax period will have to be decided by the respective law and normally it is monthly and/or quarterly. On a particular tax period, which is applicable to the dealer concerned, the dealer has to deposit the tax if his output credit is more than the input credit after considering the opening balance, if any, of the input credit.

6. **Refunds:** If for a tax period the input credit of a dealer is more than the output credit then he is eligible for refund subject to the provisions of law applicable in this respect. The excess may be carried forward to next period or may be refunded immediately depending upon the provision of law.

7. **Exempted Goods and Services:** Certain goods and services may be declared as exempted goods and services and in that case the input credit cannot be claimed on the GST paid for purchasing the raw material in this respect or GST paid on services used for providing such goods and services.

8. **Zero Rated Goods and Services:** Generally, export of goods and services are zero-rated and in that case the GST paid by the exporters of these goods and services is refunded. This is the basic difference between Zero rated goods and services and exempted goods and services.

9. **Tax Invoice:** Tax invoice is the basic and important document in the GST and a dealer registered under GST can issue a tax invoice and on the basis of this invoice the credit (Input) can be claimed. Normally a tax invoice must bear the name of supplying dealer, his tax identification nos., address and tax invoice nos. coupled with the name and address of the purchasing dealer, his tax identification nos., address and description of goods sold or service provided. The working of GST with respect to manufacturer, dealer and consumer can be seen in the illustrations given on next page: The manufacturers will get the input credit of all the taxes paid by them on the raw material and also on the services. Let us assume the rate of GST at 16% and a plastic manufacturing company has consumed the following goods and services while producing the goods, which they are able to sell at Rs. 100 lakh plus tax.

Goods & Services Tax Model for India

It is important to take note of the significant administrative issues involved in designing an effective GST model in a federal system with the objective of

having an overall harmonious structure of rates. Together with this, there is a need for upholding the powers of Central and State Governments in their taxation matters. Further, there is also the need to propose a model that would be easily implementable, while being generally acceptable to stakeholders.

Salient features of the GST model

Keeping in view the report of the Joint Working Group on Goods and Services Tax, the views received from the States and Government of India, a dual GST structure with defined functions and responsibilities of the Centre and the States is recommended. An appropriate mechanism that will be binding on both the Centre and the States would be worked out whereby the harmonious rate structure along with the need for further modification could be upheld, if necessary with a collectively agreed Constitutional Amendment. Salient features of the proposed model are as follows:

- (i) Consistent with the federal structure of the country, the GST will have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States (hereinafter referred to as State GST). This dual GST model would be implemented through multiple statutes (one for CGST and SGST statute for every State). However, the basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. would be uniform across these statutes as far as practicable.
- (ii) The Central GST and the State GST would be applicable to all transactions of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.
- (iii) The Central GST and State GST are to be paid to the accounts of the Centre and the States separately.
- (iv) Since the Central GST and State GST are to be treated separately, in general, taxes paid against the Central GST shall be allowed to be taken as input tax credit (ITC) for the Central GST and could be utilized only against the payment of Central GST. The same principle will be applicable for the State GST.
- (v) Cross utilisation of ITC between the Central GST and the State GST would, in general, not be allowed.
- (vi) To the extent feasible, uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislation for Central GST and State GST.

(vii) The administration of the Central GST would be with the Centre and for State GST with the States.

(viii) The taxpayer would need to submit periodical returns to both the Central GST authority and to the concerned State GST authorities.

(ix) Each taxpayer would be allotted a PAN linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-based system for Income tax facilitating data exchange and taxpayer compliance. The exact design would be worked out in consultation with the Income-Tax Department.

(x) Keeping in mind the need of tax payers convenience, functions such as assessment, enforcement, scrutiny and audit would be undertaken by the authority which is collecting the tax, with information sharing between the Centre and the States.

Dual GST

Many countries in the world have a single unified GST system i.e. a single tax applicable throughout the country. However, in federal countries like Brazil and Canada, a dual GST system is prevalent whereby GST is levied by both the federal and state or provincial governments. In India, a dual GST is proposed whereby a Central Goods and Services Tax (CGST) and a State Goods and Services Tax (SGST) will be levied on the taxable value of every transaction of supply of goods and services.

Why is Dual GST required?

India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism.

Benefits of Dual GST

The Dual GST is expected to be a simple and transparent tax with one or two CGST and SGST rates. The dual GST is expected to result in –

- Reduction in the number of taxes at the Central and State level
- Decrease in effective tax rate for many goods
- Removal of the current cascading effect of taxes
- Reduction of transaction costs of the taxpayers through simplified tax compliance
- Increased tax collections due to wider tax base and better compliance

Central and State Taxes to be subsumed under GST. The various Central, State and Local levies were examined to identify their possibility of being subsumed under GST. While identifying, the following principles were kept in mind:

- (i) Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.
- (ii) Taxes or levies to be subsumed should be part of the transaction chain which commences with import/manufacture/ production of goods or provision of services at one end and the consumption of goods and services at the other.
- (iii) The subsumation should result in free flow of tax credit in intra and inter-State levels.
- (iv) The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST.
- (v) Revenue fairness for both the Union and the States individually would need to be attempted.

On application of the above principles, it is recommended that the following Central Taxes should be, to begin with, subsumed under the Goods and Services Tax:

- (i) Central Excise Duty
- (ii) Additional Excise Duties
- (iii) The Excise Duty levied under the Medicinal and Toiletries Preparation Act
- (iv) Service Tax
- (v) Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- (vi) Special Additional Duty of Customs - 4% (SAD)
- (vii) Surcharges, and
- (viii) Cesses.

Following State taxes and levies would be, to begin with, subsumed under GST:

- (i) VAT / Sales tax
- (ii) Entertainment tax (unless it is levied by the local bodies).
- (iii) Luxury tax
- (iv) Taxes on lottery, betting and gambling.
- (v) State Cesses and Surcharges in so far as they relate to supply of goods and services.
- (vi) Entry tax not in lieu of Octroi.

Certainty of implementation

The Finance Minister has made a categorical statement in Parliament that GST will be implemented on April 1, 2010. In his subsequent media interactions, he has further indicated that he is keen to implement the GST even if some of the States are not ready or willing to implement GST by this date. Accordingly, based on the present indications, as also on the basis

of our subsequent interactions with senior Government Officials, we believe that the April 1, 2010 timeline for introduction of the dual GST will be met.

Time to Plan for GST: The draft laws will clarify finer aspects of GST such as rates, classification and compliances. However, based on the material in the public domain, one can begin with spreading awareness among various stakeholders within the organization and identifying broad areas of action before the draft laws are published. Experience of VAT implementation suggests that there may not be enough lead-time available between the date of announcement of GST implementation and the actual date of GST implementation.

Taxable event: The "Taxable event" will be the supply of goods? and the supply of services?. Hence, the current taxable events such as 'manufacture of goods', 'sale of goods?' and 'rendition of services' will not be relevant under the GST regime. Applicability of both CGST and the SGST on all transactions: A transaction of 'supply of goods' will attract both the CGST & SGST as applicable on goods. Similarly, a 'supply of service' will attract both the CGST & SGST as applicable on services.

Applicability of other indirect taxes: It is proposed that the taxes to be subsumed under CGST will include Central Excise Duty (CENVAT), Service Tax and Additional Duties of Customs and the taxes to be subsumed under the SGST will include Value Added Tax, Central Sales Tax, Purchase Tax, Entertainment Tax, Luxury Tax, Octroi, Lottery Taxes, Electricity Duty and State surcharges relating to supply of goods and services.

GST collection model: GST is collected on the value added at each stage of sale or purchase in the supply chain. The tax on value addition is ensured through a tax credit mechanism throughout the supply chain. GST paid on the procurement of goods and services is available for set-off against the GST payable on the supply of goods or services. The idea is that the final consumer will bear the GST charged to him by the last person in the supply chain. It is thus a consumption based indirect tax.

Separate enactments for the Central and State GST: There will be separate enactments. The CGST will be a common code throughout India. Further, each State will legislate its own enactment to levy and collect the SGST. However, it is understood that a white paper will be released by the Federal Government/Empowered Committee of State Finance Ministers based on which each State will

legislate. The expectation is therefore is that a majority of the provisions will be uniform across the States.

Expected aggregate rate of GST: The aggregate rate of GST, across the Central and State GST, is expected to be approximately 16%. This is currently the subject matter of discussion within the Empowered Committee.

Different rates for goods and for services: It is expected that there will be one single rate of GST on services at the Central and State level and the understanding is that there would be not one but a few rates of Central and State GST for goods.

Carry forward of Input Tax Credits (ITC) and CENVAT Credit (CC) balances: Going by the precedence at the time of VAT implementation, it is believed that the accumulated ITC and CC will both be allowed to be carried forward under the GST regime, albeit upon fulfillment of prescribed conditions.

Exemptions from GST, lists of exempted goods and exempted services:- Under the GST, exemptions are expected to be minimal. Further, a common list of exemptions for both the Central and State GST with little flexibility for States to deviate there from is envisaged.

Taxation of Inter-State sale transactions: Presently, inter-State sales are subject to Central Sales Tax (CST), which is origin based. However, the GST regime would work under a destination / consumption based concept and hence the tax on inter- State sale transactions will accrue to the destination State. As a corollary, it will be zero rated in the Origin State.

Taxation of inter State supply of services: Detailed place of supply rules will be framed for such transactions. Taxation of such supplies will however continue to pose a challenge. Practices currently being followed in the European Union, Canada and Brazil are being studied. Policymakers are also looking at different options of taxing inter State supplies of services based on whether they are Business to Business (B2B) or Business to Customer (B2C)

Fresh registrations and registration of existing VAT and Service tax dealers: The position in this regard is not clear at present. However, the rules are expected to be assessee- friendly in this regard with appropriate soft-landing provisions for the transition phase.

Single return or multiple returns: It is expected that a single return will be required to be prepared by the assessee and copies filed with the Central GST and State GST authorities. The draft GST laws / Rules

will provide further details.

Process of assessment under the dual GST: The dual GST is expected to be a self assessed tax. The Tax administration would have powers to audit and re-assess the taxpayers on a selective basis.

Uniformity in classification of goods, procedures, forms etc. across the States: Based on the current discussions in the Empowered Committee, it is expected that there should be uniformity in classification of goods, procedures and forms across States.

Impact on Sectors: One can see the smaller cars getting cheaper. The current tax rate for small cars is 24%. Luxury cars should remain expensive although the current draft does not discuss this. It is unlikely India will change its stance on luxury vehicles being taxed higher as it is uncompetitive for the domestic manufacturing industry

Benefits of GST

GST benefit industry, trade and agriculture

GST will give more relief to industry, trade and agriculture through a more comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of several Central and State taxes in the GST and phasing out of CST. The transparent and complete chain of set-offs which will result in widening of tax base and better tax compliance may also lead to lowering of tax burden on an average dealer in industry, trade and agriculture.

GST benefit the exporters

The subsuming of major Central and State taxes in GST, complete and comprehensive setoff of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports. The uniformity in tax rates and procedures across the country will also go a long way in reducing the compliance cost.

GST benefit the common consumers

The introduction of GST, all the cascading effects of CENVAT and service tax will be more comprehensively removed with a continuous chain of set-off from the producer's point to the retailer's point than what was possible under the prevailing CENVAT and VAT regime. Certain major Central and State taxes will also be subsumed in GST and CST will be phased out. Other things remaining the same, the burden of tax on goods would, in general, fall under GST and that would benefit the consumers.

Conclusion

GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point upto the retailer's level. It is essentially a tax only on value addition at each stage, and a supplier at each stage is permitted to set-off, through a tax credit mechanism, the GST paid on the purchase of goods and services as available for set-off on the GST to be paid on the supply of goods and services. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

The introduction of Goods and Services Tax (GST) in India was to whether the single unified GST was the appropriate model or whether the dual GST was the more feasible and 'doable' one. In this regard, the announcement that was made sometime ago by the Empowered Committee of State Finance Ministers was that it had accepted the recommendation of the Working Group that it had set up of a dual GST. The report of the Empowered Committee on GST has been forwarded to the Finance Ministry for consideration. Nevertheless, on the 'how' of the GST, it seems clear that the recommended dual GST will have a federal part and a State part. Further, the Federal and the State GST will both consist of a goods tax and a tax on services. Thus, both taxes will apply to goods and services. Further, the Federal GST and the State GST will consist of multiple rates, insofar as they relate to goods, and will comprise a single rate, insofar as they relate to services. Full input tax credits would be available in regard to the Federal GST and the State GST. The two taxes will operate in parallel and throughout the supply chain. What is therefore required to be determined is the taxable event which gives rise to the two taxes.

It will only be by end 2008 that things will crystallize on several aspects of the GST. A balance will need to be struck between the benefit of simplicity in the chosen model of the GST and the socio-economic objectives that are sought to be achieved. Clearly, tradeoffs will have to be made. It does seem increasingly a big challenge but it is still a very real goal in the eyes of both the Central and State Government circles, regardless of the political persuasion of the parties in power. This is very positive thing in itself but the point is whether there is enough time to get the job done. There really now needs to be a strong and focused push so that the April 2010 deadline on the introduction of GST is met. All stakeholders need to work closely with the powers

that be to make this happen.

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