COVER STORY

A to Z of Goods and Services Tax

- The Goods and Services Tax (GST), the biggest reform in India's indirect tax structure since the economy began to be opened up 25 years ago, at last became a reality. In a historic move, the GST Bill has been passed by the Parliament, ending a long period of deadlock between the political parties.
- The ***Constitution (122nd Amendment) Bill***, which was passed by the Lok Sabha in May 2015, was again passed by the Lower House on 8 August 2016 after approving the changes made in it by the Rajya Sabha. Rajya Sabha passed the Bill with amendments at its sitting held on the August 3, 2016 and returned it to Lok Sabha.
- The Act was passed in accordance with the provisions of ***Article 368 of the Constitution***, and has been ratified by more than half of the State Legislatures, as required under Clause (2) of the said article.
- Describing the passage of the bill as victory of democracy, PM Narendra Modi coined the GST in a new manner -- ***'Great Step by Team India', 'Great Step towards Transformation', 'Great Step towards Transparency'***.

Timeline For GST

- GST is being introduced in the country after a 16 year long journey since an empowered committee, headed by Asim Dasgupta, was set up by the ***Atal Bihari Vajpayee government*** in 2000 to streamline the GST model to be adopted, and to develop the required backend infrastructure that would be needed for its implementation.
- It was then recommended in the report of the ***2003 Kelkar Task Force*** on implementation of FRBM Act 2003 and indirect taxes.
- A proposal to introduce a National level Goods and Services Tax (GST) by April 1, 2010 was ***first mooted in the Budget Speech for the financial year 2006-07***.

- Since then the GST has been caught in the discussions of Empowered Committee and the political parties.
- Finally, it has been passed by both the Houses of Parliament in August 2016.

What Is GST

- GST would be a ***comprehensive indirect tax*** on *manufacture, sale and consumption of goods and services* throughout India, replacing taxes levied by the central and state governments. It is one indirect tax for the whole nation, which will make India one unified common market.
- GST is a ***value added tax*** where a producer in the value chain will pay tax only on the amount of his value addition. It will have ***input tax credit mechanism*** which allows GST-registered businesses to claim tax credit to the value of GST they had paid on *previous purchase* of goods or services. This will make tax avoidance difficult and result in voluntary compliance.
- Taxable goods and services are not distinguished from one another and are ***taxed at a single rate*** in a supply chain till the goods or services reach the consumer.
- GST is a ***multi-point destination based*** tax, where taxes need to be paid at each point in value chain.
- For the GST to be purely ***consumption based***, all related indirect taxes and cesses will be subsumed into it.

How GST Will Work: An Illustration

Stage 1

- Imagine a manufacturer of, say, shirts. He buys raw material or inputs — cloth, thread, buttons, tailoring equipment — worth Rs 100, a sum that includes a tax of Rs 10. With these raw materials, he manufactures a shirt.

- In the process of creating the shirt, the manufacturer adds value to the materials he started out with. Let us take this value added by him to be Rs 30. The gross value of his good would, then, be Rs 100 + 30, or Rs 130.
- At a tax rate of 10%, the tax on output (this shirt) will then be Rs 13. But under GST, he can set off this tax (Rs 13) against the tax he has already paid on raw material/inputs (Rs 10). Therefore, the effective GST incidence on the manufacturer is only Rs 3 (13 – 10).

<u>Stage 2</u>

- The next stage is that of the good passing from the manufacturer to the wholesaler. The wholesaler purchases it for Rs 130, and adds on value (which is basically his 'margin') of, say, Rs 20. The gross value of the good he sells would then be Rs 130 + 20 — or a total of Rs 150.
- A 10% tax on this amount will be Rs 15. But again, under GST, he can set off the tax on his output (Rs 15) against the tax on his purchased good from the manufacturer (Rs 13). Thus, the effective GST incidence on the wholesaler is only Rs 2 (15 – 13).

<u>Stage 3</u>

- In the final stage, a retailer buys the shirt from the wholesaler. To his purchase price of Rs 150, he adds value, or margin, of, say, Rs 10. The gross value of what he sells, therefore, goes up to Rs 150 + 10, or Rs 160.
- The tax on this, at 10%, will be Rs 16. But by setting off this tax (Rs 16) against the tax on his purchase from the wholesaler (Rs 15), the retailer brings down the effective GST incidence on himself to Re 1 (16 –15).

Thus, the total GST on the entire value chain from the raw material/input suppliers (who can claim no tax credit since they haven't purchased anything themselves) through the manufacturer, wholesaler and retailer is, Rs 10 + 3 +2 + 1, or Rs 16.

Hence, Goods and Services Tax would be levied and collected at each stage of sale or purchase of goods or services based on the ***input tax credit method***.

How Things Work In A non-GST Regime

- In a full non-GST system, there is a ***cascading burden*** of "tax on tax", as there are no set-offs for taxes paid on inputs or on previous purchases.
- Thus, if we consider the same example as above, the manufacturer buys raw materials/inputs at Rs 100 after paying tax of Rs 10. The gross value of the shirt (good) he manufactures would be Rs 130, on which he pays a tax of Rs 13. But

since there is no set-off against the Rs 10 he has already paid as tax on raw materials/inputs, the good is sold to the wholesaler at Rs 143 (130 + 13).

- With the wholesaler adding value of Rs 20, the gross value of the good sold by him is, then, Rs 163. On this, the tax of Rs 16.30 (at 10%) takes the sale value of the good to Rs 179.30. The wholesaler, again, cannot set off the tax on the sale of his good against the tax paid on his purchase from the manufacturer.
- The retailer, thus, buys the good at Rs 179.30, and sells it at a gross value of Rs 208.23, which includes his value addition of Rs 10 and a tax of Rs 18.93 (at 10% of Rs 179.30). Again, there is no mechanism for setting off the tax on the retailer's sale against the tax paid on his previous purchase.
- The total tax on the chain from the raw material/input suppliers to the final retailer in this full no-GST regime will, thus, work out to Rs 10 + 13 + 16.30 + 18.93 = Rs 58.23. For the final consumer, the price of the good would then be Rs 150 + 58.23 = Rs 208.23. Compare this Rs 208.23 — with a tax of Rs 58.23 — to the final price of Rs 166, which includes a total tax of Rs 16, under GST.

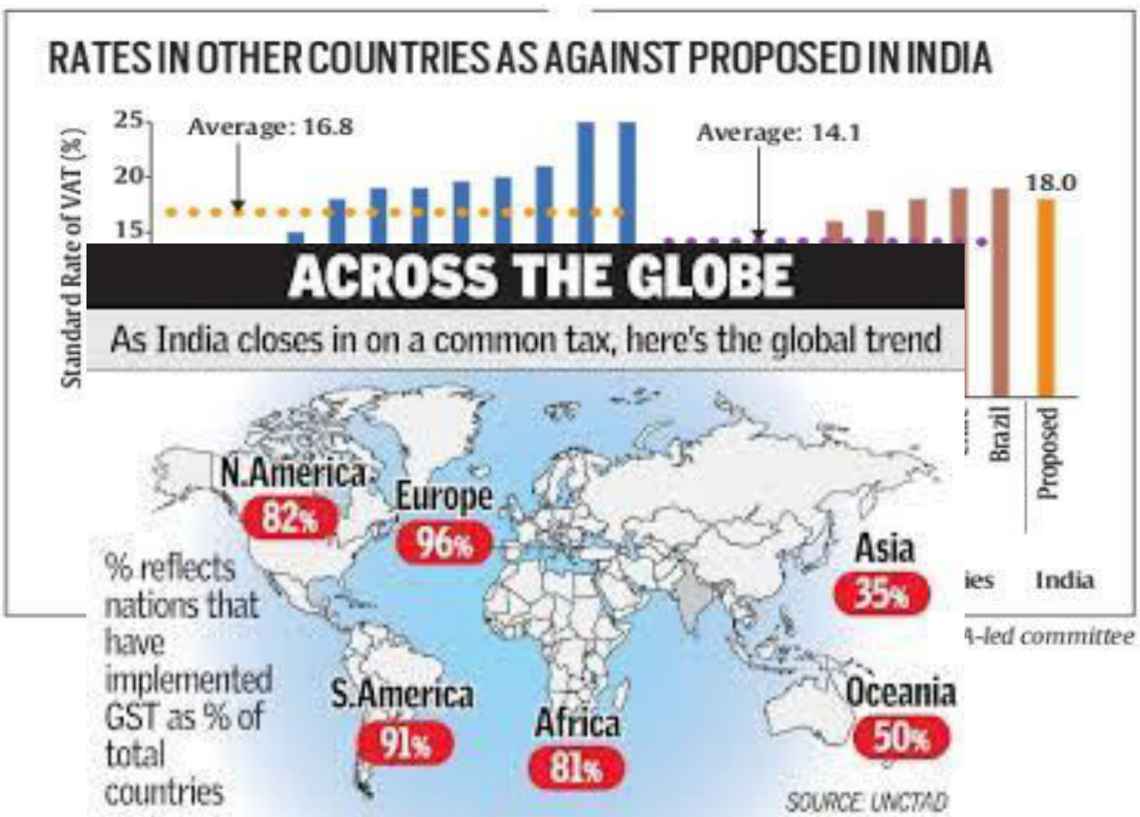
GST vs VAT: What Is the Difference?

- From above illustration, it is evident that the credits of input taxes paid at each stage is available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. 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.
- Thus, ***GST is another name of VAT.*** VAT also taxes value addition on products, eliminating cascading effect. Then, what is the difference between the two. The difference is explained below.
- The concept of Value Added Tax (VAT) was introduced for central excise duty in 1986 (first as MODVAT and then as CENVAT). Prior to this, excise duty was levied on both inputs used and the output produced. This meant that an amount paid as tax on the input was subject to taxation again at the output level (with limited set offs). This was applicable to each intermediate good in the manufacturing process. This "tax on tax" led to ***cascading of taxes***. This problem was sought to be addressed by the VAT regime under which tax paid on the inputs is deducted from the tax payable on the output produced. Similarly, sales tax also had a cascading effect through the distribution chain. All states have now adopted the concept of VAT for state sales tax.

- The issue of cascading taxation was partly addressed through the VAT regime. However, certain problems remained. For example-
    - o Several central and state taxes were excluded from VAT. Sectors such as real estate, oil and gas production etc. were exempt from VAT.
    - o Currently, we have Value-Added Tax (VAT) systems both at the central and state levels. But the central VAT or CENVAT mechanism extends tax set-offs only against central excise duty and service tax paid up to the level of production. CENVAT does not extend to value addition by the distributive trade below the stage of manufacturing; even manufacturers cannot claim set-off against other central taxes such as additional excise duty and surcharge.
    - o State VAT cover only sales. Sellers can claim credit only against VAT paid on previous purchases. The VAT also does not subsume a host of other taxes imposed within the states such as luxury and entertainment tax, octroi, etc.
    - o Goods and services were taxed differently, thereby making the taxation of products complex.
- Some of these challenges are sought to be overcome with the introduction of the Goods and Services Tax (GST). Once GST comes into effect, all central- and state-level taxes and levies on all goods and services will be subsumed within an integrated tax having two components: a central GST and a state GST. This will ensure a complete, comprehensive and continuous mechanism of tax credits. Also, GST taxes both goods and services at the same rates and so eliminates many disputes which arises due to taxing goods and services separately.

GST Across The World

- ***France*** was the first country to introduce this system in 1954. Currently, there are 160 countries in the world that have implemented VAT/GST.
- Most of the countries have a unified GST. ***Brazil and Canada*** have a dual GST model, so is the case with India.
- ***GST in China*** is applicable to only goods and the provisions of repair, replacement and processing services.
- ***US*** does not have a national level VAT.



- Continent-wise GST regime are shown below:
- GST rate globally are also shown below. From figure, it is clear that the average rate of GST in high-income countries is higher by close to 3% when compared to emerging economies.

Highlights of GST Bill

- The GST bill basically seeks to ***amends the Constitution*** to empower both the Centre and the states to levy GST. This they cannot do now, because the Centre cannot impose any tax on goods beyond manufacturing (Excise) or primary import (Customs) stage, while States do not have the power to tax services.
- GST bill, considered to be the biggest indirect tax reform in independent India, aims to transform the country into ***a uniform market*** by replacing a slew of federal and state levies. The proposed GST would subsume various central (Excise Duty, Custom Duty, Service tax, Countervailing or Additional Customs Duty, Cess, Surcharges etc.), as well as state-level indirect taxes (VAT/sales tax, purchase tax, entertainment tax, luxury tax, octroi, entry tax, etc).

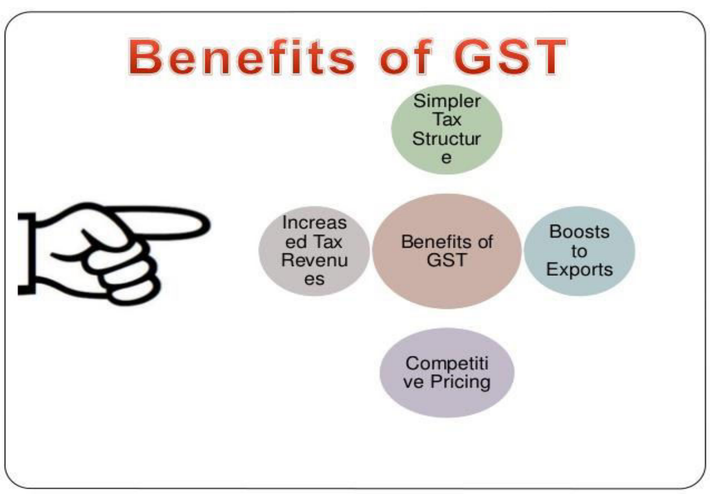
- GST will have two components—***Central GST and State GST***. Both Parliament and state legislatures will have concurrent powers to make laws on GST. Only the Centre may levy an integrated GST ***(IGST)*** on the interstate supply of goods and services, and imports. Central law will prescribe manner of sharing of IGST between Centre and states, based on GST Council's views.
- GST to be levied on all goods and services, ***except alcoholic liquor for human consumption***. Petroleum and petroleum products shall be subject to the levy of GST on a later date notified on the recommendation of the Goods and Services Tax Council.
- The model law provides for a levy of GST on ***all online sales.*** It says the e-commerce operator should collect the appropriate GST while making a payment to the supplier of goods or service sold through its portal. This provides clarity for taxation of goods sold by a supplier in one state to a consumer in another through electronic commerce.
- ***Exports would be zero-rated*** and imports would be levied the same taxes as domestic goods and services adhering to the destination principle.
- Since the Central GST and State GST are to be treated separately, 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. Cross utilization of ITC between the Central GST and the State GST would not be allowed except in the case of inter-State supply of goods and services under the IGST model.
- ***GST Council***
  - It will be set up to recommend rates of tax, period of levy of additional tax, principles of supply, threshold for exemption, floor level and bands of taxation rate, special provisions to certain states etc.
  - It will consist of the Union finance minister, Union minister of state for revenue, and state finance ministers.
  - The decisions will be made by *three-fourths majority of votes cast*; Centre shall have a third of votes cast, states shall together have two-thirds. Mechanism for resolving disputes arising out of its recommendations may be decided by the Council itself.
- The bill also provides for constitution of a ***National Goods and Services Tax Appellate Tribunal*** by Centre on the recommendation of the GST Council. The Tribunal shall be headed by a national president, with a branch in each state. The

state GST tribunal will be headed by a state President. Every appeal has to be filed within three months from the date on which the order sought to be appealed against is communicated to the person.

- A ***National GST Settlement Commission*** to be set up by the Centre has also been proposed in the draft law for settlement of cases under the proposed GST Act. The National Commission chairman will be a High Court judge and the commission will have one bench for one or more states.
- The ***authority for advance ruling*** in GST will be established in each state for taxpayers seeking advance rulings.
- The bill seeks to establish a ***Consumer Welfare Fund***, which shall be utilised by the Centre/state government for the welfare of the consumers in accordance with such rules as that government may make in this behalf.
- A ***GST Compliance Rating*** has also been proposed for every taxable person. The score will be based on his/her record of compliance with the provisions of the Act.
- The government has met a key opposition demand of scrapping 1 % additional tax on inter-state movement of goods. It has also ***agreed to compensate states for any revenue losses for five years***. The proposed 1 % tax was not in line with the key concepts of GST, as the levy would have been a cost in the entire supply chain at various supply incidences. Hence its removal is a welcome decision. Further, it would have amounted to levy of origin based taxes in a destination based framework.

Benefits of GST

For Business and Industry



- **Easy compliance**: All tax payer services such as registrations, returns, payments, etc. would be available to the taxpayers online, which would make compliance easy and transparent.
- **Removal of cascading:** A

system of seamless tax-credits throughout the value-chain, and across boundaries of States, would ensure that there is minimal cascading of taxes

- **Uniformity of tax rates and structures:** GST would make doing business in the country tax neutral, irrespective of the choice of place of doing business. It has the potential to change the e-commerce ecosystem in India.
- **Improved competitiveness:** Reduction in transaction costs of doing business would eventually lead to an improved competitiveness for the trade and industry.
- **Gain to manufacturers and exporters:** The subsuming of major Central and State taxes in GST, complete and comprehensive set-off 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.

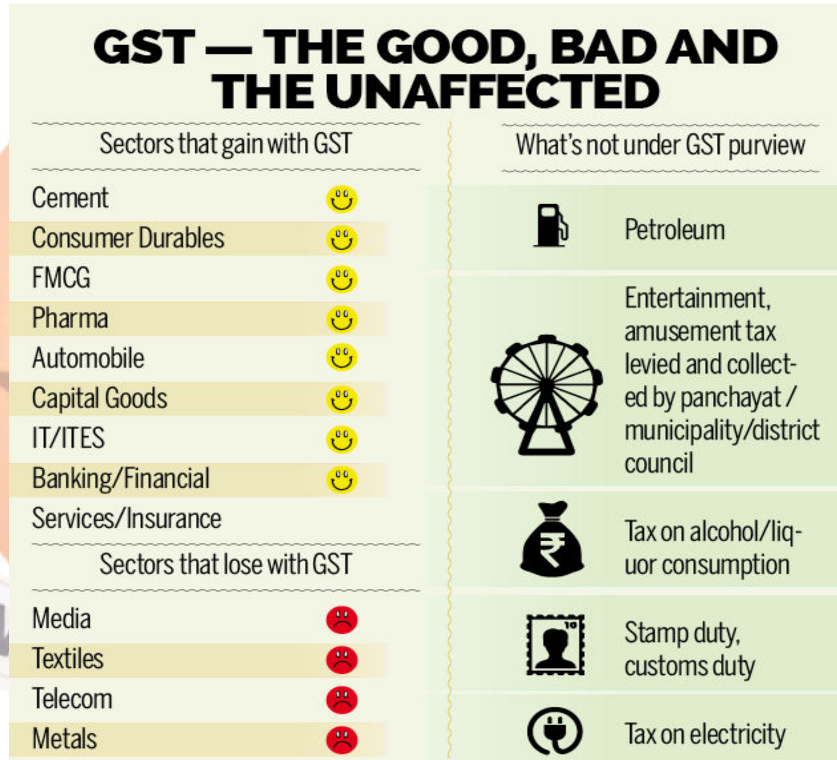
For Central and State Governments

- ***Impact On Economy****:* As the GST reaches its final stages, the historic legislation promises to unify the tax system for the nation and increase the *GDP by 2 per cent*.
- **Simple and easy to administer:** Multiple indirect taxes at the Central and State levels are being replaced by GST. Backed with a robust end-to-end IT system, GST would be simpler and easier to administer than all other indirect taxes of the Centre and State levied so far.
- **Higher revenue efficiency:** GST is expected to decrease the cost of collection of tax revenues of the Government, and will therefore, lead to higher revenue efficiency.
- **Better controls on leakage:** GST will result in better tax compliance due to a 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. If you don’t pay tax on what you sell, you don’t get credit for taxes on your inputs. Also, you will buy only from those who have already paid taxes on what they are supplying. Result will be that a lot of currently underground transactions will come overground.

For The Consumer

- For consumers the biggest advantage of GST will come in the form of a ***reduction in the overall tax burden*** on goods due to elimination of cascading effect. In CPI basket 55% items are tax-exempt, 32% are at a low rate, only 12% at a standard rate.

- While services could get more expensive, it's a mixed bag for consumers for goods. Under the GST regime, it's expected that the rates can be fixed at 18% or above. So, any goods or services for which the current rates are lower than 18%, it will become costlier or vice versa. For instance, dining out, phone bills, jewellery, online shopping etc are going to be costlier while readymade garments, LED TV, cars etc are going to be cheaper.



- **Relief in overall tax burden:** Because of efficiency gains and prevention of leakages, the overall tax burden on most commodities will come down, which will benefit consumers.

Criticism of GST Bill

1. The provisions of this Bill do not fully conform to an ideal GST regime. Deferring the levy of GST on petroleum products could lead to ***cascading of taxes***.
2. There is chance of ***rising inflation*** due to untaxed items, began to be taxed, thus hurting the consumers.
3. ***Undemocratic veto power to centre*** in the proposed GST Council. State opposed the proposal to grant FM the final say in the GST Council. Also, States are opposed to 1/3rd share of vote to centre. They are demanding the share in the ratio of 1:4 to Centre and States.
4. **Worries of Political Parties**

- *Congress Opposition:* Congress wanted a cap of 18% on the tax rate under GST.
- *Left Opposition:* Expressing serious apprehensions that the GST regime will hit the country's federal structure, CPM sought an assurance for the loss of finances to States. Terming GST as a regressive tax, CPM said GST should be kept low as it will burden the poor more as already 62 % comes from indirect taxes.
- *AIDMK Opposition:* The bill incentivizes consumption as high consuming states like Bihar, U.P would be benefited more due to destination based taxes while high producing states like Tamil Nadu and Gujarat may suffer. Arguing that Tamil Nadu is a manufacturing state, they said the state will lose substantial revenue upto the tune of Rs 9270 crore. They called this constitutional amendment Bill as invalid as it violates the states' fiscal autonomy. It also violates Article 21 of the Constitution.

5. Inter-state trade of a good would be more expensive than intra-state trade, with the burden being borne by retail consumers. Further, cascading of taxes will continue.

Challenges And Way Forward In Implementation of A New Tax Regime Under GST

1. **Building Centre-State Consensus**: India is adopting a *dual GST*, wherein the Central GST will be called CGST and state SGST. The main road block is the ***coordination among states***. Centre and states have to come to a consensus on uniform GST rates, inter-state transaction of goods and services, compensation requirements, list of exemptions, threshold limits, administrative efficiency and infrastructural preparedness to implement the new tax reform.
   - Of late, a major disagreement has arisen between the Centre and the States over <u>*Dual Control of GST*</u>. The States have demanded exclusive Single Control over the assessees having a turnover less than Rs 1.5 crore; they want to administer Central GST and States GST as well as IGST for this band of taxpayers.

- On the *compensation* which needs to be paid to the states, the amount can only be quantified after the GST rate is decided. Consultations are on with regard to the threshold limit of imposition of GST. While some states want the threshold to be Rs 10 lakh, the Centre wants it to be pegged at Rs 25 lakh so the very small businesses can be kept out. The committee headed by Arvind Subramanian, the chief economic advisor, has recommended a threshold of Rs 40 lakh since taxing small businesses is cumbersome and not at all cost-effective.
- The other issue relates to the *list of tax-exemptions* that will have to be common for Centre and States. Currently, there are around 250 exemptions in Central Excise and 98 exemptions in State VAT. Both will have to have the same number of exemptions in the GST regime.

2. **Containing Inflation:** Most of the countries implementing the GST have encountered major inflationary situations.
    - Because of this, the govt implementing it had been hit by voters in next election. Canada's Progressive Conservative Party leader, Prime Minister Kim Campbell lost the 1993 national elections because his government had become unpopular after implementing the GST. In Australia, the John Howard government narrowly scraped back into office in the 1998 election soon after implementing the GST.
    - Not only the common man but even traders, considered to be traditional BJP voters, may turn against the party. The reason: so far, they have not been paying taxes as they sell goods without bills. But GST will force them to sell goods on bills and accordingly pay taxes. This will reduce their income and spoil their budget. Now, this demands that the government keeps a tab on how prices move after implementation of GST. The government will also have to take several economic measures to ensure that the common man is not adversely affected.
    - It is also essential for the government to set up GST Monitoring Cells at different levels of implementation of GST, and also Anti-Profiteering Cells to ensure that there is no undue profiteering by a section of the trade leading to inflation, and that the tax relief in the GST regime is duly passed on to consumers, leading to a decrease in prices.
3. **Transitional Issues**: The next major challenge will be the Transitional Issues relating to various areas like Registration, Utilisation in GST regime of the existing "credits" lying under the current Central Excise, Service Tax, State VAT, etc. Both the Centre and the States have initiated Capacity Building Programs for training their employees at different levels. Similar initiatives will have to be there for the

Taxpayers, both the Small and Medium Businesses and the Corporates. Current business processes will have to be analysed and compared with the ones expected in the GST regime. The *ERP* (Enterprise Resource Planning, a kind of business data management software) of business entities will also have to be thoroughly reviewed.

4. **IT Infrastructure Challenges**: As GST is a tax on transactions, which for most business organisations is voluminous, the processes and changes required for GST compliance need to be automated and encapsulated in the IT system.

5. **Challenges For SMEs**: The India GST regime places the small and medium enterprises (SMEs) on the same footing as large-scale industries by keeping the exemption threshold very competitive (proposed at 1 million) without any tax differentiation. This poses daunting task ahead for SMEs to be ready to invest, read and change in the same way as any large-scale player, without appreciating the limited resources available with them.

Conclusion

The GST Bill seeks to address challenges with the current indirect tax regime by broadening the tax base, eliminating cascading of taxes, increasing compliance, and reducing economic distortions caused by inter-state variations in taxes. Consumers will benefit from a more transparent system of taxation, while manufacturers will benefit from easier payment and administration of their taxes. As of now no country in recent history has really implemented a perfect GST. Flaws will be there in initial points and each economy refines it as per its own experience or convenience. So many correctives have to be taken in future. This may take a few years to make it suitable to our economy.