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Goods and Services Tax: A Study

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Abstract: Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavor to generate tax revenues to support government expenditure on public services and infrastructure development. Cascading tax revenues have differential impacts on firms in the economy with relatively high burden on those not getting full offsets.

Value added tax was first introduced by Maurice Laure, a French economist, in 1954. The tax was designed such that the burden is borne by the final consumer. Since VAT can be applied on goods as well as services it has also been termed as goods and services tax (GST). During the last four decades VAT has become an important instrument of indirect taxation with 130 countries having adopted this, resulting in one-fifth of the world's tax revenue.

India currently has a dual system of taxation of goods and services, which is quite different from dual GST. Taxes on goods are described as VAT at both Central and State level. It has adopted value added tax principle with input tax credit mechanism for taxation of goods and services, respectively, with limited cross-levy set-off.

The Constitution (One Hundred and Twenty-Second Amendment) Bill, 2014, seeks to amend the Constitution of India to facilitate the introduction of Goods and Services Tax (GST) in the country. The proposed amendments in the Constitution will confer powers both to the Parliament and the State legislatures to make laws for levying GST on the supply of goods and services on the same transaction.)

RATIONALE BEHIND MOVING TOWARDS GST

Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas.

"This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry. Firstly, there is no uniformity of tax rates and structure across States. Secondly, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice-versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this tax on tax."[1]

"The introduction of GST would mark a clear departure from the scheme of distribution of fiscal powers envisaged in the Constitution. The proposed dual GST envisages taxation of the same taxable event, i.e., supply of goods and services, simultaneously by both the Centre and the States. Therefore, both Centre and States will be empowered to levy GST across the value chain from the stage of manufacture to consumption. The credit of GST paid on inputs at every stage of value addition would be available for the discharge of GST liability on the output, thereby ensuring GST is charged only on the component of value addition at each stage. This would ensure that there is no 'tax on tax' in the country."[2]

GST will simplify and harmonize the indirect tax regime in the country. It is expected to reduce cost of production and inflation in the economy, thereby making the Indian trade and industry more competitive, domestically as well as internationally. It is also expected that introduction of GST will foster a common or seamless Indian market and contribute significantly to the growth of the economy.

Further, GST will broaden the tax base, and 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.

SALIENT FEATURES OF THE PROPOSED GST

- Dual GST

[1] Concept Note on GST, Department of Revenue, Government of India, Ministry of Finance, 22 December 2016.
[2] Ibid.

"Both Centre and States will simultaneously levy GST across the value chain. Tax will be levied on every supply of goods and services. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The input tax credit of CGST would be available for discharging the CGST liability on the output at each stage. Similarly, the credit of SGST paid on inputs would be allowed for paying the SGST on output. No cross utilization of credit would be permitted."[3]

- Inter-State Transactions and the IGST Mechanism

  "The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. The IGST mechanism has been designed to ensure seamless flow of input tax credit from one State to another. The inter-State seller would pay IGST on the sale of his goods to the Central Government after adjusting credit of IGST, CGST and SGST on his purchases (in that order). The exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The importing dealer will claim credit of IGST while discharging his output tax liability (both CGST and SGST) in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST."[4]

- Destination-Based Consumption Tax

  It will be a destination based tax which impliesthat all SGST collected will ordinarily accrue to the State where the consumer of the goods or services sold resides.

- "Central Taxes to be subsumed

  i. Central Excise Duty
  ii. Additional Excise Duty
  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. Cesses and surcharges in so far as they relate to supply of goods and services.

- State Taxes to be subsumed

[3] Ibid.
[4] Ibid.

i. VAT/Sales Tax
ii. Central Sales Tax (levied by the Centre and collected by the States)
iii. Entertainment TaxOctroi and Entry Tax (all forms)
iv. Purchase Tax
v. Luxury Tax
vi. Taxes on lottery, betting and gamblingState cesses and surcharges in so far as they relate to supply of goods and services.

All goods and services, except alcoholic liquor for human consumption, will be brought under the purview of GST."[5]

- Petroleum and petroleum products have been constitutionally included as 'goods' under GST. However, it has also been provided that petroleum and petroleum products shall not be subject to the levy of GST till notified at a future date on the recommendation of the GST Council. The present taxes levied by the States and the Centre on petroleum and petroleum products, viz. Sales Tax/VAT and CST by the States, and excise duty the Centre, will continue to be levied in the interim period.
- Taxes on tobacco and tobacco products imposed by the Centre shall continue to be levied over and above GST.
- In case of alcoholic liquor for human consumption, States would continue to levy the taxes presently being levied, i.e., State Excise Duty and Sales Tax/VAT.

- GST Council

  In the GST regime, a Goods and Services Tax Council is being created under the Constitution. The GST Council will be a joint forum of the Centre and the States. This Council would function under the Chairmanship of the Union Finance Minister and will have Minister in charge of Finance/Taxation or Minister nominated by each of the States & UTs with Legislatures, as members. The Council will make recommendations to the Union and the States on important issues like tax rates, exemption list, threshold limits, etc. The recommendations made by this Council will act as benchmark or guidance to Union as well as State Governments. One-half of the total number of Members of the Council will constitute the quorum of GST council. Every

[5]GST, Concept & Status- November 2016,http://www.cbec.gov.in/htdocs-cbec/gst/gst-ovw, 23 December.

decision of the Council shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting in accordance with the following principles:-

- The vote of the Central Government shall have a weightage of one-third of the total votes cast, and
- The votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast in that meeting.

This is to protect the interests of each State and the Centre when the Council takes a decision and is in the spirit of co-operative federalism.

- Floor rates of GST with band

  "GST rates will be uniform across the country. However, to give fiscal autonomy to the States and the Centre, there will a provision of a tax band over and above the rate of the floor rates of CGST, SGST and IGST. Initially, the rates of CGST, SGST and IGST are expected to be closely aligned to the Revenue Neutral Rates (RNR) of the Centre and the States.

- Goods and Services Tax Network (GSTN)

  A not-for-profit, Non-Government Company called Goods and Services Tax Network (GSTN), jointly set up by the Central and State Governments will provide shared IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders.

- GST Compensation

  Due to a shift from origin based to destination based indirect tax structure, some States might face drop in revenue in the initial years. To help the States in this transition phase, the Centre has committed to compensate all their losses for a period of 5 years. Accordingly, clause 19 has been inserted in the Constitution (122nd) Amendment Bill, 2014 to provide for compensation to States by law, on the recommendation of the Goods and Services Tax Council, for loss of revenue arising on account of implementation of the goods and services tax for a period of five years

The Constitution (122 Amendment) Bill, 2014

On 19th December 2014, the Constitution (122th Amendment) Bill, 2014 was introduced in the Lok Sabha. On May 6th, 2015 the said bill was passed by the Lok Sabha and was referred to Rajya Sabha to a Select Committee whose report was submitted on July 22, 2015 on the bill. On August 3, 2016 Rajya Sabha passed the bill with the proposed amendments. The details of the bill are as followed:

Additional tax up to 1% on interstate trade

- "2014 Bill(Clause 18): An additional tax of up to 1% on the supply of goods will be levied bycenter in the course of inter-state trade or commerce. The tax will be directly assigned to the states from where the supply originates. This will be for two years or more, as recommended by the GST Council."[6]
- This provision was deleted by the 2016 Amendment.
- The Select Committee, 2015 had ruled that the provision for the 1% additional tax will probably lead to cascading of taxes.

Compensation to states

- "2014 Bill(Clause 19): Parliamentmay, by law, provide for compensation to states for any loss ofrevenues, for a period which may extend to five years. This would be based on the recommendations of the GST Council." [7]Therefore the Parliament can decide:

  (I) should it provide compensation;

  (II) The period of time for which compensation should be provided, 5 years.

- Under the 2016 Amendment it is provided that the parliament shall by law provide for compensation for any loss ofrevenues, for a period of five years. This would be based on the recommendations of the GST Council. This implies that compensation must be provided for a full five-year period.
- This amendment was consistent with the recommendation of the select committee.

Dispute resolution

- 2014 Bill (Clause 12): The GST Council may decide upon the modalities to resolve disputesarising out of its recommendations.
- Under the 2016 Amendment the GST Council shall establish a mechanism to adjudicate any disputearising out of its recommendations. Disputes can be between: (a) the center vs. one or more states; (b) the center and states vs. one or more states; (c) state vs. state. This implies there will be a standing mechanism to resolve disputes.

[6]Goods and Services Tax (GST): Key changes made by the 2016 amendments to the Constitution (122nd Amendment) Bill, 2014, prsindia.org, 22 December 2016.

[7] Ibid.

- The Select Committee did not recommend anything regarding this issue.

Integrated GST

- "Replacement of the term IGST(Clause 12): Under the 2014 Bill, the GST Council would makerecommendations on the apportionment of the Integrated Goods and Services Tax (IGST). However, the term IGST was not defined. The 2016 amendments replace this term with goods and services tax levied on supplies in the course of inter-state trade or commerce."[8]
- "Apportionment of Integrated GST(Clause 9): This is a technical change in relation to theapportionment of the IGST. It clarifies that the states' share of the IGST shall not form a part of the consolidated fund of India."[9]

Inclusion of CGST and IGST in tax devolution to states

- 2014 Bill(Clause 10):The GST collected and levied by the center, other than states' share ofIGST, (CGST and center's share of IGST) shall also be distributed between the center and states.
- 2016 amendments**:** The amendments state that the CGST and the center's share of IGST will bedistributed between the center and states. This is just a restatement of the provisions in the 2014 Bill in clearer terms.

IMPACT OF GST ON DIFFERENT SECTORS

The GST Act which is hoped to be implemented from Aril 1, 2017 aims to replace dual set of taxes that is center and state with a single system of taxes. The different sectors will have to conduct a cost benefit analysis in order to accommodate the newest tax regime. The impact on different sectors on implementation of GST would be as follows:

Real Estate

Transfer of (completed) properties may continue to be outside the purview of GST and be liable only to applicable stamp duties. In case this sector is brought within the ambit of GST, it is likely to result in transparency, which will significantly reduce tax evasion through more efficient transaction-tracking methods, and improved enforcement and compliance. Since GST may be levied on a single value, the current issue of levying tax on tax (VAT on central excise duty) is likely to be removed.

At present, developers pay various non-creditable taxes on supplies. GST may replace these multiple

[8] Ibid.
[9] Ibid.

taxes with a single tax; credit on supplies may also be available, thus reducing costs for all players. However, if real estate output is exempted, then input GST credit could be a substantial cost for the sector, resulting in blockage of credit and higher costs to end consumers.

Financial services

"In India, most of the banking and financial services are exposed to service tax, at the rate of 14.5 percent, while GST is expected to be 18 percent to 20 percent. Thus, services are likely to get costlier. GST may make things cumbersome as financial service providers may be required to adhere to compliances across multiple states instead of the current single, centralized registration compliances. Also, as GST is a destination-based tax, it might be a challenge to determine the destination of certain services (at present, services are taxed at the place of rendering the service). This may lead to a difficulty in determining state GST, central GST or inter-state GST on B2B and B2C transactions. Interest on loans, trading in securities, foreign currency and retail services are also expected to fall within the ambit of GST. Recommendations by the banking industry suggest that such services and income should not come under GST. It is still to be seen whether these recommendations will be accepted. Overall, it appears that imposing GST on banking and financial services may become a challenge and India, if successful, will chart a new course, which could well become a model for the rest of the world."[10]

Travel, tourism and hospitality

India's travel, tourism and hospitality industries have multiple taxes, levied by both the center and the states. It is expected that under GST, supplies of hotels and restaurants will be subjected to a single tax.

At present, no credit is available on input services related to renovation or construction of hotels and resorts. This is expected to change under GST. R&D cess, payable on franchise fees and technical know-how, is likely to be subsumed under GST, thus simplifying compliance procedures and reducing multiple taxes. However, it is unclear whether various benefits available under the existing Foreign Trade Policy will continue under GST. If such benefits are provided, input credit may not be available, resulting in higher costs.

On the whole, GST is likely to eliminate multiplicity of taxes and lack of credits. However, it may also lead to increase in tax rates.

[10] Rajya Sabha Passes GST Bill: How will it impact various sectors, http://www.forbesindia.com/article/real-issue/rajya-sabha-passes-gst-bill-how-it-will-impact-various-sectors/43877/1, 23 December

Health care

"One of the major concerns of this industry is the current inverted duty structure that adversely affects domestic manufacturers, cost of inputs being higher than output. This discourages investment in this industry. GST may either remove the inverted duty structure or allow refund of accumulated credit. This would be a boon for this industry and can act as its growth catalyst. The current cascading tax structure on import duty makes it expensive for the industry to import machinery. GST is likely to reduce this cost.

This sector enjoys several tax exemptions and benefits. It is still not clear whether these benefits will continue under GST. Health insurance and diagnostic centers, which are mainly service-oriented, may fall under higher tax rates, thereby making such services more expensive for consumers."[11]

Alcoholic beverages

Alcohol will come under state excise and VAT, though alcohol which is meant for human consumption is proposed not to come under GST regime, inputs are likely to fall under the ambit of GST. Consequently, there may be blockage of input credit, leading to increased production cost and inefficiency in production and distribution. Higher input costs and its cascading effect on taxes may push prices upwards, and may also hit exports.

Restaurants and bars serving alcohol, and selling both GST and non-GST products, may be required to undertake dual compliance (for GST and non-GST products).

Education

The Education sector is generously exempted from various taxes and are given considerable benefits. The services which the school and colleges provide are either not taxed or are listed in the negative list. The GST is not likely to bring any changes in this aspect, however if it does the education sector can avail of input credit or CENVAT credit on the duty paid on purchase of inputs and services. These are likely to bring down the final cost for the industry.

[11] Ibid.

Conclusion

The taxation of goods and services regime in India is characterized by cascading and distortionary tax on production of goods and services which results in miss allocation of resources, disturbing the productivity which ultimately leads to slower economic growth.

A tax regime which could be ideal collects tax at various stages namely manufacturing, supply, wholesale, retailing and finally at the ultimate consumption. This tax is based on add-on value the manufacturer, supplier and retailer at each stage of the supply chain. The tax which is paid on each stage is calculated on the amount added rather than the total amount.

It has been argued by the critiques that value added process is similar to VAT that is value added services and as VAT was already there in the Indian economy what was the need for introduction of GST.

However under the VAT system, the rates and regulations will vary across different states and therefore there is always a practice by different states to cut their rates so as to attract various investments which result in lowering the government revenue. Significantly under the new tax system there will be uniform tax system across the states and the tax revenue will be divided between different states and centers according to their consumption cycle. More so VAT was earlier only there for services and not for goods.

The Goods and Services Tax (GST) is believed to be the single most powerful tax reform that India will see. The objective is to break down state boundaries and to end the headache of multiple taxes. So Central Excise Duty, VAT, Service Tax, Swachh Bharat Cess, Octroi, Luxury Tax, Special Additional Duty, Entry Tax and so on will be substituted with one GST.

For sale within a state, currently we pay VAT, Excise Duty and Sales Tax. But under the new system, we will only pay a State GST (SGST) and Central GST (CGST). For sale outside the state, we pay a Central Sales Tax, Excise and a whole host of other local taxes. Under the new GST system of taxation, we will pay a fixed Integrated GST (IGST) which will be collected by the Centre. For example, a phone manufactured in Tamil Nadu and sold in Punjab will cost the same anywhere, as it would – should the phone were to be sold within Tamil Nadu.

Under the current regime, hypothetically speaking, a 100 rupee phone manufactured in Chennai sent in a truck to Chandigarh through six states with each state levying tax plus the central taxes will cost 130 rupees by the time it reaches its destination. But Under GST, assuming the revenue neutral rate to be 18%, a 100 rupee phone manufactured in Chennai sent in a truck to Chandigarh will cost just 118 rupees by the time it reaches because we will pay one Integrated GST (IGST) to the Central government.

So GST aims to make India one unified market, provided all states implement GST and all states comply with the same rates. So while it is a tall order, it will need every state to come together to make it happen.

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