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Goods and Service Tax (GST) In India–A Landmark Tax Reform

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Abstract

Goods and Service Tax (GST) is one of the most crucial tax reforms in India which has been pending since a long, however the greatest tax reform since independence finally got the nod of the Parliament in its monsoon session of August 2016. The history of GST in India dates back to 2006 when then union finance minister Mr. P. Chidambaram mooted the idea of GST for the first time in the parliament while presenting his Budget for the financial year 2006-07 and it was proposed that it would be implemented from 1st April 2010, but due to political issues and conflicting interests of various stakeholders, it took six years then for the parliament to pass the GST bill. The GST is a comprehensive tax system that will subsume all indirect taxes of states and central governments and unified economy into a seamless national market. It is expected to iron out wrinkles of existing indirect tax system and play a vital role in the growth of the nation. Goods and service tax is a new story of VAT which gives a widespread setoff for input tax credit and subsuming many indirect taxes from state and national level. This paper is an outcome of an exploratory research carried out to understand the concept of Goods and Service Tax (GST) which will come in force in the country from 1st April 2017. The paper presents an overview of GST concept, explains its features along with its impact in the present tax scenario. The paper further explores the advantages and challenges that would be brought about by the execution of the Good and Service Tax.

Key Words: Indirect Tax, Goods and Service Tax, Value Added Tax, Tax Structure, Federal Structure.

Introduction: 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. This argument can be extended to international competitiveness of the adversely affected sectors of production in the economy. Such domestic and international factors lead to inefficient allocation of productive resources in the economy. This results in loss of income and welfare of the affected economy. 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. Tax reform in many of the developing countries has focused on moving to VAT. Most of these countries have gained thus indicating that other countries would gain from its adoption. For a developing economy like India it is desirable to become more competitive and efficient in its resource usage.

Apart from various other policy instruments, India must pursue taxation policies that would maximize its economic efficiency and minimize distortions and impediments to efficient allocation of resources, specialization, capital formation and international trade. With regard to the issue of equity it is desirable to rely on horizontal equity rather than vertical equity. While vertical equity is based on high marginal rates of taxation, both in direct and indirect taxes, horizontal equity relies on simple and transparent broad-based taxes with low variance across the tax rates. Traditionally India's tax regime relied heavily on indirect taxes including customs and excise. Revenue from indirect taxes was the major source of tax revenue till tax reforms were undertaken during nineties. The major argument put forth for heavy reliance on indirect taxes was that the India's majority of population was poor and thus widening base of direct taxes had inherent limitations. Another argument for reliance on indirect taxes was that agricultural income was not subjected to central income tax and there were administrative difficulties involved in collecting taxes. The broad objectives of this study refer to analyzing the impacts, implications and policies of introducing comprehensive goods and services tax (GST) on economic growth and international trade; changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectorial level.

India as world's one of the biggest democratic country follow the federal tax system for levy and collection of various taxes. Different types of indirect taxes are levied and collected at different point in the supply chain. The Centre and the states are empowered to levy respective taxes as per the Constitution of India. The Value Added Tax (VAT) when introduced was considered to be a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level. Now the Goods and Services Tax (GST) will be a further significant breakthrough - the next logical step - towards a comprehensive indirect tax reform in the country.

The Good and services tax (GST) is the biggest and substantial indirect tax reform since 1947. The main idea of GST is to replace existing taxes like value-added tax, excise duty, service tax and sales tax. It will be levied on manufacture sale and consumption of goods and services. GST is expected to address the cascading effect of the existing tax structure and result in uniting the country economically. In other words, Goods and Services Tax is a broad based and a single comprehensive tax levied on goods and services consumed in an economy. GST is levied at every stage of the production-distribution chain with applicable set offs in respect of the tax remitted at previous stages. GST is basically a tax on final consumption. In simple terms, GST may be defined as a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or procuring the service. India, being one of the largest democracies in the world, has to follow the convention of welfare state.

The federal structure of the country provides a relatively powerful government at the center accompanied by 28 state governments. All of them require finance to govern the country and the states. After introduction of Value Added Tax (VAT) from 2005, the country is going to experiment with Goods and Services Tax (GST) from April 1, 2017.It is the only indirect tax that directly affects all sectors and sections of our economy and is aimed at creating a single, unified market that will benefit both corporate and the economy This paper puts an attempt to explore the impacts, implications and policies of introduction of GST in India's which is basically a tax on final consumption.

Objectives:

1. To know the basics of Goods and Service Tax and its features
2. To assess the advantages and challenges that would be brought by the execution of the Good and Service Tax.

Methodology: The present study relies primarily on secondary sources of information to analyze and infer conclusions. The study follows a descriptive and diagnostic method which are sought to examine the context for implementation of Goods and Service Tax, its advantageous and challenges. etc. Secondary data for the study were collected from government and various other recognized sources including data available in the Ministry of Finance and other published sources of information such as working papers have also been looked into. The data so collected is used for understanding the present tax structure and for calculating the tax structure in the GST regime along with credit provisions. The basic statistical concept such as forecasting etc. is used for determining the tax liability in of GST at different proposed rates of tax.

Background of Goods and Services Tax in India: The Kelkar Task Force on implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 had pointed out that although the indirect tax policy in India has been steadily progressing in the direction of VAT principle since 1986, the existing system of taxation of goods and services still suffers from many problems. The tax base is fragmented between the Centre and the States. Services, which make up half of the GDP, are not taxed appropriately. In many situations, the existing tax structure has cascading effects. These problems lead to low tax-GDP ratio, besides causing various distortions in the economy. In this context, the Kelkar Task Force had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle. Value-added tax (VAT) is a modern and progressive system of sales tax. It brings in the system of self-assessment giving rise to transparency and mutual trust. It is charged and collected by dealers on the price paid by the customer. The empowered committee released a White Paper on VAT on 17th January 2005. This was the uniform basis the States agreed to adopt to avoid competition between States. VAT replaced sales tax on 4th January 2005. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but the States have a liberty to set their own valuations for the VAT levied in their own territory.

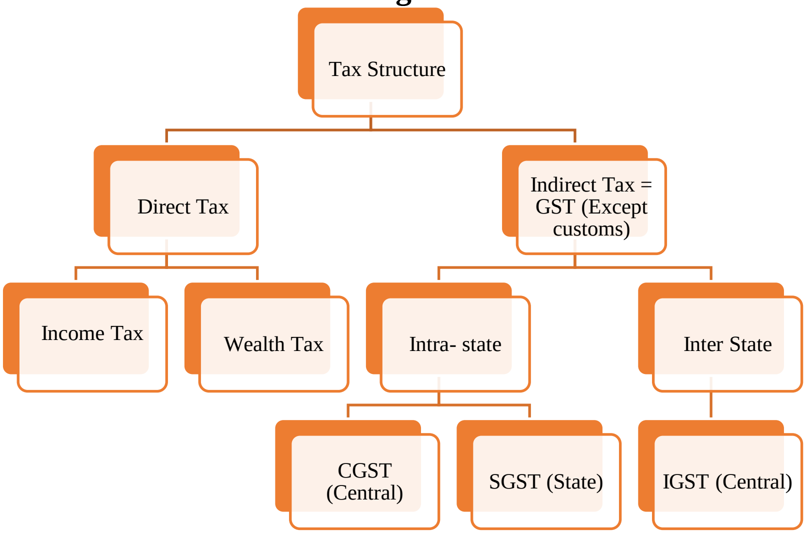
The effort to introduce the new tax regime was reflected, for the first time, in 2006-2007 Union Budget Speech. The then Finance Minister Mr. P. Chidambaram remarked that there is a large consensus that the country must move towards a national level GST that must be shared between the center and the states. He proposed 1st April 2010 as the date for introducing GST. The present rates for service tax and CENVAT, that is most proximate to the global GST rate, and the continuous steps towards phasing out of Central Sales Tax (CST), clearly hints at the endeavor on the part of Government of India. Subsequently the Empowered Committee of State Finance Ministers agreed to work with the Central Government to prepare a roadmap for introducing a national level GST with effect from 1st April 2010. In May 2007 Empowered Committee (EC) of State Finance Ministers in consultation with the Central Government, constituted a Joint Working Group (JWG), to recommend the GST model. The mandate of the Working Group was as follows: GST should be so designed that it should be revenue neutral to the Centre and the States. Interests of the Special Category, North-Eastern States and Union Territories are to be especially kept in mind. The Group will examine different models and ensure that the power of levy, collection and appropriation of revenue must be vested with the Centre and the States by examining the pros and cons.

The various models would have to ensure that double taxation is avoided. The suggested models should take into account the problems faced during Inter-State transactions and possible revenue loss. Focus on treatment of zero-rated goods and services and Non-VAT items. Within 7 months of its constitution that is in November 2007, JWG presented its report on the GST to the Empowered Committee. The Committee has accepted the report on GST submitted by the Joint Working Group. The Committee has sent its recommendations to the Government of India in the form of ‘A Model and Roadmap for Goods and Services Tax in India ‘dated April 30, 2008, which includes outline of the GST design proposed. The views of Empowered Committee are being examined in the Ministry of Finance for a suitable response to the Committee so that further working out details is facilitated.

The Concept of GST: GST is an indirect tax which will subsume almost all the indirect taxes of central government and states governments into a unified tax. As the name suggests it will be levied on both goods and services at all the stages of value addition. It has dual model including central goods and service tax (CGST) and states goods and service tax (SGST). CGST will subsume central indirect taxes like central excise duty, central sales tax, service tax, special additional duty on customs, counter veiling duties whereas indirect taxes of state governments like state vat, purchase tax, luxury tax, octroi, tax on lottery and gambling will be replaced by SGST. Integrated goods and service tax (IGST) also called interstate goods and service tax is also a component of GST. It is not an additional tax but it is a system to examine the interstate transactions of goods and services and to further assure that the tax should be received by the importer state as GST is a destination based tax.

It is a tax on goods and services with comprehensive and continuous chain of setoff benefits from the Producer's point and Service provider's point up to the retailer level. GST is expected be levied only at the destination point, and not at various points (from manufacturing to retail outlets). It is essentially a tax only on value addition at each stage and a supplier at each stage is permitted to setoff through a tax credit mechanism which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax. Under GST structure, all different stages of production and distribution can be interpreted as a mere tax pass through and the tax essentially sticks on final consumption within the taxing jurisdiction. Currently, a manufacturer needs to pay tax when a finished product moves out from the factory, and it is again taxed at the retail outlet when sold. The taxes are levied at the multiple stages such as CENVAT, Central sales tax, State Sales Tax, Octroi, etc. will be replaced by GST to be introduced at Central and State level. All goods and services, barring a few exceptions, will be brought into the GST base. There will be no distinction between goods and services. Under GST, the taxation burden will be divided equitably between manufacturing and services, through a lower tax rate by increasing the tax base and minimizing exemptions. 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. The existing CST will be discontinued. Instead, a new statute known as IGST will come into place on the inter-state transfer of the Goods and Services. By removing the cascading effect of taxes (CST, additional customs duty, surcharges, luxury Tax, Entertainment Tax, etc.),CGST & SGST will be charged on same price . The following flow chart depicts the existing tax structure in India

Chart-1: Existing Tax Structure in India



GST – Salient Features

The salient features of the Goods and Service Tax are briefly described as follows

- It would be applicable to all transactions of goods and service.
- It to be paid to the accounts of the Centre and the States separately.
- The rules for taking and utilization of credit for the Central GST and the State GST would be aligned.
- 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.
- The Centre and the States would have concurrent jurisdiction for the entire value chain and for all taxpayers on the basis of thresholds for goods and services prescribed for the States and the Centre.
- The taxpayer would need to submit common format for periodical returns, to both the Central and to the concerned State GST authorities.
- Each taxpayer would be allotted a PAN-linked taxpayer identification number with a total of 13/15 digits.

Need for GST: Introduction of a GST to replace the existing multiple tax structures of Centre and State taxes is not only desirable but imperative in the emerging economic environment. Increasingly, services are used or consumed in production and distribution of goods and vice versa. Separate taxation of goods and services often requires splitting of transaction values into value of goods and services for taxation, which leads to greater complexities, administration and compliances costs. Integration of various taxes into a GST system would make it possible to give full credit for inputs taxes collected. GST, being a destination-based consumption tax based on VAT principle, would also greatly help in removing economic distortions and will help in development of a common national market. Table-1 shown below presents the existing taxes which are subsumed under GST.

Table-1: Subsuming of Existing Taxes

Sl. No.	Subsumed under CGST	Subsumed under SGST
1	Central Excise Duty	VAT / Sales tax
2	Additional Excise Duties	Entertainment tax (unless it is levied by the local bodies).
3	Excise Duty-Medicinal and Toiletries Preparation Act	Luxury tax
4	Service Tax	Taxes on lottery, betting and gambling.
5	Additional CVD	State Cesses and Surcharges (supply of goods and services)
6	Special Additional Duty of Customs - 4% (SAD)	Entry tax not in lieu of Octroi
7	Surcharges	
8	Cesses	

Source: Prepared on the basis of available date

Advantages:

(i) *An end to cascading effects*: This will be the major contribution of GST for the business and commerce. At present, there are different state level and Centre level indirect tax levies that are compulsory one after another on the supply chain till the time of its utilization.

(ii) *Growth of Revenue in States and Union*: It is expected that the introduction of GST will the tax base but lowers down the tax rates and also removes the multiple point This, will lead to higher amount of revenue to both the states and the union.

(iii) *Reduces transaction costs and unnecessary wastages*: If government works in an efficient mode, it may be also possible that a single registration and Single compliance will suffice for both SGST and CGST provided government produces effective IT infrastructure and integration of such infrastructure of states level with the union.

(iv) *Eliminates the multiplicity of taxation*: One of the great advantages that a taxpayer can expect from GST is elimination of multiplicity of taxation. The reduction in the number of taxation applicable in a chain of transaction will help to clean up the current mess that is brought by existing indirect tax laws.

(v) *One Point Single Tax*: Another feature that GST must hold is it should be 'one point single taxation'. This also gives a lot of comforts and confidence to business community that they would focus on business rather than worrying about other taxation that may crop at later stage. This will help the business community to decide their supply chain, pricing modalities and in the long run helps the consumers being goods competitive as price will no longer be the function of tax components but function of sheer business intelligence and innovation.

(vi) *Reduces average tax burdens*: Under GST mechanism, the cost of tax that consumers have to bear will be certain, and GST would reduce the average tax burdens on the consumers.

(vii) *Reduces the corruption: It* is one of the major problems that India is overwhelmed with. We cannot expect anything substantial unless there exists a political will to root it out. This will be a step towards corruption free Indian Revenue Service.

Challenges: Bringing about an integration of all taxes levied on goods and services in a federal polity with sharp distribution of legislative powers is a Herculean task to say the least. The Constitution of India demarcates taxing powers in a two-tier structure wherein levies on production and international imports are with the Union and post-production levies rest with the states. The Centre levies duties of excise on manufactures and import/countervailing duties on international imports apart from levying a tax on services under various taxing and the residuary entry in the Union List. The states levy VAT on goods sold or entering in the state under various entries of the state list. Even if all Union-level levies are integrated into a single levy and all state level levies culminate in a single State level levy; this may still have two levies and the resultant cascading and administrative burdens may nevertheless remain to an extent, though this may go a long way in harmonizing levies. A harmonized, integrated and fully fledged GST calls for the following:

(i) Constitutional Amendment - Implementation of GST calls for effecting widespread amendments in the Constitution and the various constitutional entries to taxation. The various levies of the Union and the states are also to be harmonized. The States do not have the powers to levy a tax on supply of services while the Centre does not have the power to levy tax on the sale of goods. In the current scenario it is difficult to visualize constitutional amendments of such far reaching implications going through, more so in view of the fact that sharing of legislative powers is such an essential element of our federal polity and it may be perceived to be a basic feature of the Constitution.

(ii) IT Infrastructure: The Government needs to develop/set up proper infrastructure to implement GST, especially IT infrastructure.

(iii) Design and Structure - No less significant is the issue of an appropriate design and structure of GST. For instance, how the issue of inter-state movement of goods and services may be addressed. The phasing out of CST may go a long way in addressing the issue of inter-state trade and commerce in goods but the crucial issue regarding services originating in one state and being consumed in other state still remains.

(iv) Sharing of resources - Another contentious issue that is bound to crop up in this regard is the manner of sharing of resources between the Centre and the states and among the states as also the basis of their devolution. Taking away the powers of taxation of goods by the States will not be favored by them.

(v) Efficient administration - Apart from all these, there has to be robust and integrated machinery dedicated to the task of tracking flow of goods and services across the country and rendering accurate accounting of levies associated with such flow of goods and services. No meaningful risk management system can work without efficient tax administration software.

(vi) Taxation issues - The contentious issue of taxing financial services and ecommerce is to be appropriately addressed and integrated.

(vii) Determination of Revenue Neutral Rate (RNR): At present States are charging VAT rates 0%, 4%, 12.5% and 20% besides other levies and thus the average rate of tax comes to 17%. Similarly, Centre is charging Central Excise duty @ 14%, CST 2%, Service Tax 10%. The combined effect of all the taxes taken together comes to an average rate of tax @ 27.5%. The proposed GST rate is mooted @ 20% both for the Central GST @ 12% and the State GST @ 8%.

Key Findings and Suggestions:

- GST will widen the tax base, improve tax compliance and will remove unhealthy competition among states. It will redistribute the burden of taxation equitably among manufacturing and services.

- It ensures uniformity of tax system across the states. It will integrate the tax base and allow seamless flow of Input Tax Credit (ITC) resulting in reduced cost of goods and services.
- It will improve disclosure of economic transactions.
- It will mitigate cascading and double taxation thus enables better compliance. It will also lead to transparency in tax system resulting in difficulty of tax evasion.

The suggestions which are being drawn out from the study are as follows:

- Tax payer education or public awareness campaign need to be provisioned by Central Government. Public Workshops, training and various seminars on GST must be conducted in all states by their respective State Governments.
- States must analyze and deduce their revenue neutral rates, revenue implications as well as compensation packages.
- Government should construct a proper monitoring system for monitoring the dummy registrations and refunds problems.

Conclusion: GST is the most logical steps towards the comprehensive indirect tax reform in our country since independence. The taxation of goods and services in India has, hitherto, been characterized as a cascading and distortionary tax on production resulting in mis-allocation of resources and lower productivity and economic growth. It also inhibits voluntary compliance. It is well recognized that this problem can be effectively addressed by shifting the tax burden from production and trade to final consumption. GST is leviable on all supply of goods and provision of services as well combination thereof. All sectors of economy whether the industry, business including Govt. departments and service sector shall have to bear impact of GST. All sections of economy viz., big, medium, small scale units, intermediaries, importers, exporters, traders, professionals and consumers shall be directly affected by GST... One of the biggest taxation reforms in India – the Goods and Service Tax (GST) -- is all set to integrate State economies and boost overall growth. GST will create a single, unified Indian market to make the economy stronger. Experts say that GST is likely to improve tax collections and Boost India's economic development by breaking tax barriers between States and integrating India through a uniform tax rate. Under GST, the taxation burden will be divided equitably between manufacturing and services, through a lower tax rate by increasing the tax base and minimizing exemptions.

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