Economics: Goods and Services Tax in India

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Abstract

GST is a broad based, single, comprehensive tax levied on goods and services at each point of sale of goods or service, in which, the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or availing the service; the final consumer will thus bear only the GST charged by the last dealer in the supply chain. With the introduction of GST, major Central and State taxes will get subsumed into GST which will reduce the multiplicity of taxes. Thus it marks a major improvement over the previous system of VAT. Although there are many hurdles to be crossed before the implementation of GST the Central government has reiterated its commitment towards the adoption of a 'flawless' GST for the survival of the India's economy. This paper analyses the analyses the positive impact GST will have on various sectors and the challenges the government will have to tackle before implementing GST. It also discusses the model of GST proposed by Empowered Committee.

KEYWORDS: Goods And Services Tax (GST); Empowered Committee; Thirteenth Finance Commission; CGST; SGST

I. INTRODUCTION

Goods and Service Tax (GST) is a comprehensive tax levy on manufacture, sale and consumption of goods and services. GST is a tax on goods and services with value addition at each stage having comprehensive and continuous chain of set-of benefits from the producer's/ service provider's point up to the retailer's level where only the final consumer should bear the tax.

GST is a valued added tax on goods and services that is paid by the final consumer while the retailer will be taking credit of the tax he has paid while buying goods for retailing. So in this allthe services of retailer or the chain behind him is taxed apart from the actual value of production of that good. This can be explained by a hypothetical example by supposing that there is a chain of manufacturer, wholesale dealer and the retailer and GST is 10%. Suppose the manufacturer purchases the inputs worth $100 for producing a good worth $140. He will pay net GST of $4 by taking the tax credit of $10 on the inputs. Similarly the wholesaler who buys this good and sells it for $150 will pay net GST of $2 and the retailer who sells it for $170 will pay net GST of $2 by taking the tax credit for his purchase which comes out to be $15.

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.

This Paper is divided into following Sections: Section 2 analyses the positive impact GST will have on various sectors. Section 3 discusses the model of GST proposed by Empowered Committee. Section 4 analyses the challenges the government will have to tackle before implementing GST.

II. BENEFITS AND POSITIVE IMPACT OF GST

Goods and Services Tax (GST) when implemented,will have positive impact on the various development areas in India.

Agriculture

Through a comprehensive and wider coverage of input and service taxes set-off, subsuming of several Central and State taxes in the GST and phasing out of CST, it is expected thatthe GST could increase the prices of agricultural produce between 0.61 and 1.18 per cent and this would be a boon to millions of farmers in India (Thirteenth Finance Commission,2009)[1].

Manufacturing Industry

The incidence of the present multistage taxation increases the manufacturing cost of most of the production units in India. But a flawless GST can help this sector to reduce their cost to the extent of almost 50 per cent. This will help them to compete with their counterparts in the west. “Even a two percent reduction in production cost will increase profits by over 20 per cent, giving headroom for reducing prices and benefitting end-users”(Kelkar,Vijay,2009).It is estimated that the implementation of GST would reduce the overall prices of all manufacturing sectors between 1.22 and 2.53 percent (Thirteenth Finance Commission, 2009).

Poverty Reduction

At present, primary food articles like rice and wheat are liable to tax by many States either by way of purchase tax or sales tax at a lower rate. But under the GST, all food items covered under the public distribution system including rice and wheat are proposed to be exempted. As a result primary food articles like rice and wheat would be exempted from GST. Since expenditure on food constitutes a large proportion of the total consumption expenditure of the poor, the GST is designed as a poverty reduction initiative. Like food, basic health and education services are also intended to be fully exempted. In any case, as at present, these services will continue to be exempted from tax

[1]Thirteenth Finance Commission (2009) Report of the Task Force on Goods and Services Tax, New Delhi.

and therefore no additional burden will arise on account of the switchover to GST[2] (Thirteenth Finance Commission (2009).

GDP

The implementation of a 'flawless' GST across goods and services is expected to induce India's Gross Domestic Product (here after referred to as 'GDP') somewhere within a range of 0.9 to 1.7 per cent. Again, these additional gains in GDP would be earned during ever year over and above the growth in GDP which would have been achieved otherwise.

Employment

It is seen that the implementation of GST would result in increased income and output in various sectors of the economy. On account of this increase in higher growth, there will be large scale employment opportunities in various areas like the skilled, semi-skilled and unskilled categories.

Factors of Production

It is also estimated that the implementation of a flawless GST in India would result in efficient allocation of factors of production thus leading to gain in factors of production, i.e.land, labour and capital. The gains in real returns to land range between 0.42 and 0.82 per cent. Wage rate gains vary between 0.68 and 1.33 per cent. The real returns to capital would gain in the range of 0.37 and 0.74 percent (Thirteenth Finance Commission, 2009)

Price Level

Though there is an allegation that GST is a regressive tax as it minimizes the number of tax rates to even a single (dual) rate, the subsuming of major Central and State taxes in GST,continuous chain of set-off of input goods and services and phasing out of CST the commitment of taxes on goods would come down under GST. It is anticipated that, other things remaining the same, this would encourage manufacturers and distributors to reduce the prices of their produce and ultimately benefit the consumers. Hence, a 'flawless' GST would be viewed as pro-poor and not regressive.

III. PROPOSED GST MODEL FOR INDIA

The Empowered Committee of State Finance Ministers [3](EC) had constituted a Joint Working Group to give recommendations regarding the model to be adopted for GST. The Joint Working Group has recommendeddual GST system because of the federalnature of our constitution in which the power has been divided between the centreand states. Thus in India under the dual GST system both centre and states will have the power to levy taxes on the sale of goods and services.

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[2]Dr. R. Vasanthagopal, GST in India: A Big Leap in the Indirect Taxation System, *International Journal of Trade, Economics and Finance, Vol. 2, No. 2, April 2011*

[3]Empowered Committee of State Finance Ministers (2008) A Model and Roadmap for Goods and Services Tax in India, New Delhi.

In India the GST will have two components one is levied by the centre, hereafter referred to as (CGST) central goods and service tax and other is levied by the state hereafter referred to as state goods and service tax (SGST). CGST and SGST would be applicable to all transactions of goods and services except a small negative list which are kept outside the purview of GST and the many transactions which are below the prescribe threshold limit. Commodities among negative list are alcohol, cigarettes, cigar, tobacco, LPG, Petrol, and Diesel etc.Alcoholic beverages would be kept out of the purview of GST[4].

Many Taxes has been subsumed under Goods and Service Tax. Central Excise Duty, Additional Excise Duties, CENVAT, Additional Custom Duties popularly known as Countervailing Duty,Service tax, all central cesses and surcharges has been subsumed in to CGST. While VAT, CST, Sale Tax, Purchase tax, Luxury Tax, Lottery Tax, Entertainment Tax, Taxes on betting and gambling, Electricity duty, Octroi, all statecesses and surcharges has been merged in to SGST. Since GST is levied on domestic consumer of final goods andservices so zero rate of exported goods and services are possible. Similar benefits may be given to Special Economic Zones (SEZs).

There with be a two-rate structure –a lower rate for necessary items and items of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items. Government is considering pegging the revenue neutral rate of GST at a rate between18% to 22%. This represents the aggregate of CGST and SGST payable on the transaction.

Imports will be levied the same taxes as domestic goods and services adhering to the destination principle. In case of imported goods and services the custom duties will remain outside the purview of GST. Thus the applicable basic custom duties will be continue to be levied on imported goods and services. In addition both CGST and SGST are expected to be levied on imported goods and services. Full and complete set-off will be available on the GST paid on import of goods and services.

In case of intra-state transactions (with in the state) the seller has to collect both CGST & SGST from the purchaser and amount of CGST has to be deposit in theaccount of central government and the amount of SGST has to be deposit in the account of state government.

In case of inter-state transactions (among different states) centre would levy IGST Inter State Goods and Services Tax which would be equals to the (CGST+SGST) on all inter-State transactions of taxable goodsand services. However the amount ofSGST would be transfer to the consumerstate i.epurchasing state. Presently the inter-state transactions are subject to CST -central sale tax which is origin based. However the GST will work under a destination base / consumption based concept and hence tax on inter-state transactions will accrue to the destination state.

[4]Empowered Committee of Finance Ministers (2009). First Discussion Paper on Goods and Services Tax in India, The Empowered Committee of State Finance Ministers, New Delhi.

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	Ceses	

IV. CHALLENGES IN IMPLEMENTING GST

There are many challenges which the Government has to face in introducing GST.

The dual GST model will widen the tax net by taxing every economic supply in the distribution network. This will lead to **rapid increase in assesses**. It will require some of the businesses to restructure their distribution network to reduce additional tax burden on the consumer with a view to be price competitive. Though it will generate revenue in a neutral and transparent way, the Government will have to ensure that the ultimate consumer is not burdened with tax beyond his capacity.

One of the main challenge in introducing in GST is **defining the place of supply** in respect of certain services and intangible properties. In the existing tax regime, place of supply is not a big issue because service is taxed by the Centre and the place of levy does not affect revenue receipts. In GST, however, the place of supply will have to be clearly defined to avoid disputes among states in case of inter-state transactions. Time of supply will explain the point at which tax would be levied - invoice date, due date or payment date. Currently, different taxes are levied by the Centre and the states at various stages. The service tax is levied on the receipt of payment, excise duty is imposed by the fifth of following month and sales tax is levied when the sale happens. These variations will be eliminated in GST.

The Constitution of India provided powers to the Union and the States to levy and collect taxes as per Union, State and Concurrent List. The challenge is whether this can be treated as the basic structure of the Constitution thereby restricting the Government from bringing about any change in this structure. In order to enable the Centre and the State Governments to levy GST, the **Constitution of Indiarequires amendment** to provide for powers to levy and collect GST both by the Union and the States. However, in a landmark decision, the UPA Government has resolved to amend the Constitution to enable states to have the same powers as the Centre in administering the proposed Goods and Services Tax (GST). For the purpose, a new Fourth List is proposed to be created in the Seventh schedule of the Constitution. The Fourth List visualizes a governing council headed by Union Finance Ministry and comprising state finance ministers as its members. The council will have overriding powers on issue of indirect taxes.

In case of destination based principle of taxation, the recipient State will have to levy the tax as per the law of the dispatching State. This is bound to create problems if there is no uniform law and rates across India. This requires tax collected by the recipient State to be credited to the exporting State. For the Governments it would be a challenge to allocate revenue to the respective States .The banks as an intermediary can play a key role in collection and transfer of revenue to respective States in Dual GST model. The person collecting the tax on his supply in case of inter-State transactions should deposit the tax in the account of the State where the supply has been made. Then on the basis of revenue reports of the respective Governments, the banks can allocate the revenue to the respective States or the Central Government, as the case may be. The banking system needs to be improved for this purpose. The challenge can be met by proper training**, upgradation of tax administration with technological interface**.

The success of dual GST model will depend on **effective credit mechanism** to avoid cascading effect of multi-stage taxation in the supply chain. The credit mechanism is the lifeline of GST. As far as Central GST is concerned, there is no difficulty in giving credit of Central GST anywhere in India as is evidenced by success of the present CENVAT scheme. But, in case of State GST presently there are issues in giving credit in relation to inter-State transactions.

Hence, for effective implementation of GST, it is essential to provide adequate training for both tax payers and tax enforcers, building information technology backbone, setting up of uniform dispute settlement machinery and ensuring uniform implementation of GST acrossall states (unlike the staggered implementation of VAT)

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