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### **TAX REFORMS: INTRODUCTION OF GOODS AND SERVICES TAX**

#### **Introduction**

The Kelkar Task Force on the implementation of Fiscal Responsibility and Budget Management (FRBM) Act, 2003, had pointed out that the existing system of taxation on goods and services suffers from many problems and, therefore, suggested a comprehensive Goods and Services Tax (GST). The proposed GST system is targeted to be a simple, transparent and efficient system of indirect taxation which involves taxation of goods and services in an integrated manner, as the blurring of line of demarcation between goods and services has made separate taxation of goods and services untenable. Since GST is a progressive step in the direction of tax reforms, introduction of the GST to replace the existing tax structure with multiplicity of Central and State taxes is being considered imperative in the emerging economic environment.

Increasingly, services are used or consumed in the production and distribution of goods and *vice versa*. Separate taxation of goods and services often requires splitting of transaction value into the value of goods and services for the purpose of taxation, which leads to complexities in the tax administration and also increases the tax compliance costs. GST, being a destination-based consumption tax based on VAT principle<sup>1</sup>, would greatly help not only in removing economic distortions caused by the present complex tax structure but also in the development of a common national market.

Goods and Services Tax (GST) once introduced will become a nationwide comprehensive tax levies on

manufacturing, sales and consumption of goods as well as services. This tax will be leviable at each point of sale of goods or provision of services, in which, at the time of sale of goods or providing the services, the seller or service provider can claim the input tax credit<sup>2</sup> which he has paid while purchasing the goods or procuring the services. On most of the goods and services, the rate of tax remains the same but as per the necessity of the nation some goods or services can be declared as "exempted" or "zero-rated".

#### **Proposal for GST: A Brief Historical Perspective**

In the Indian context, initial discussions on GST started in the year 2000 under the aegis of an Empowered Committee headed by Shri Asim Dasgupta. Later, the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003 headed by Dr. Vijay L. Kelkar suggested for an All India Goods and Services Tax (GST) which would help achieve a common market, widen the tax base, improve the revenue productivity of domestic indirect taxes and enhance welfare through efficient resource allocation.

A proposal to introduce a national level Goods and Services Tax (GST) was first mooted in the Budget Speech for the financial year 2006-07. Since the proposal involved reform/restructuring of not only indirect taxes levied by the Centre but also by the States, the responsibility of preparing a design and road map for the implementation of GST was assigned to the Empowered Committee of the State Finance Ministers (EC). In April, 2008, the EC submitted a report titled "*A Model and Roadmap for Goods and Services*

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VAT which stands for Value Added Tax is a multi-stage tax levied at each stage of the value addition chain, with a provision to allow Input Tax Credit (ITC) on tax paid at an earlier stage, which can be appropriated against the VAT liability on subsequent sale. The VAT system of taxation thus, makes provision for eliminating the multiplicity of taxes.

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<sup>2</sup> Input Tax Credit is the amount of tax paid by the manufacturer/dealer on purchases for which the dealer is entitled to claim a credit during the sale after value addition to the purchased item/product. He is entitled to claim input tax credit in the tax period in which a dealer records tax invoice and can be adjusted against the tax liability of the manufacturer/dealer on all sales effected during the said period.

*Tax (GST) in India*" containing broad recommendations about the structure and design of GST. Based on the inputs from the Government of India and States, the Empowered Committee released its first Discussion Paper on Goods and Services Tax on 10 November 2009.

In order to take the GST related work further, a Joint Working Group consisting of officers from the Central as well as the State Governments was constituted. This was further trifurcated into three Sub-Working Groups to work separately on draft legislations required for the introduction of GST, process/forms to be followed in GST regime and development of IT infrastructure needed for smooth functioning of the proposed GST system. In addition, an Empowered Group for development of IT systems required for Goods and Services Tax regime was set up under the chairmanship of Dr. Nandan Nilekani.

### **Justification for GST in India**

There was a burden of "tax on tax" in the pre-existing Central Excise Duty of the Government of India and sales tax system of the State Governments. The introduction of Central VAT (CENVAT) has removed the cascading burden of "tax on tax" to a great extent by providing a mechanism of "set-off" for tax paid on inputs and services upto the stage of production, and, thus, has been an improvement over the pre-existing Central Excise Duty. Similarly, the introduction of VAT in the States has removed the cascading effect by giving set-off for tax paid on inputs as well as tax paid on previous purchases and has again been an improvement over the previous sales tax regime.

But both the CENVAT and the State VAT have certain incompleteness. The incompleteness in CENVAT is that it has yet not been extended to include chain of value addition in the distributive trade below the stage of production. It has also not included several Central taxes, such as Additional Excise Duties, Additional Customs Duty, Surcharges, *etc.* in the overall framework of CENVAT, and thus kept the benefits of comprehensive input tax and service tax set-off out of the reach of manufacturers/dealers. The introduction of GST will not

only include comprehensively more indirect Central taxes and integrate goods and services taxes for set-off relief, but will also capture certain value addition in the distributive trade.

Similarly, in the present State-level VAT scheme, CENVAT load on the goods has not yet been removed and the cascading effect of that part of tax burden has remained unrelieved. Moreover, there are several taxes in the States, such as, Luxury Tax, Entertainment Tax, *etc.* which have still not been subsumed in the State level VAT. Further, there has also not been any integration of VAT on goods with tax on services at the State level with removal of cascading effect of service tax. In addition, although the burden of Central Sales Tax (CST) on inter-State movement of goods has been lessened with the reduction of CST rate, this burden has also not been fully phased out. With the introduction of GST at the State level, the additional burden of CENVAT and services tax would be comprehensively removed, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level would be established which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax.

Thus GST is not simply VAT plus service tax, but it shows a major improvement over the previous system of VAT and disjointed services tax, and hence is a justifiable step forward.

### **Proposed Model of GST**

Consistent with the federal structure of the country, the GST may have two components: one levied by the Centre referred to as Central GST or CGST and the other levied by the States referred to as State GST or SGST. This dual GST model would be implemented through multiple statutes—one for CGST and others for SGST in respective States. 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 salient features of the proposed GST are given in Box 1.

#### **BOX-1**

#### **SALIENT FEATURES OF THE PROPOSED GST**

- 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.

The Central GST and the State GST are to be paid to the accounts of the Centre and the States separately.

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 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.

Cross utilisation of input tax credit between the Central GST and the State GST would, in general, not be allowed.

To the extent feasible, uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislations for Central GST and State GST.

The administration of the Central GST would be with the Centre and for State GST with the respective States.

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

Each taxpayer would be allotted a PAN-linked taxpayer identification number. 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.

Keeping in mind the need of taxpayers 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.

Earlier Attempt to Make Law on GST: Constitution Amendment Bill, 2011

To implement the proposed Goods and Services Tax, amendment to the Constitution conferring simultaneous powers on Parliament as well as the State Legislatures including every Union Territory with Legislature to make laws for levying goods and services tax on every transaction of supply of goods or services or both becomes emergent as the Constitution of India does not confer any concurrent taxing powers to the Union and

the States. In the light of this, the Constitution (One Hundred and Fifteenth Amendment) Bill, 2011 was introduced in the Lok Sabha on 22 March 2011. The Bill was referred to the Departmentally Related Standing Committee on Finance which presented its report to the House on 07 August 2013. As far as the status of the Bill is concerned, the Bill has lapsed with the dissolution of the Fifteenth Lok Sabha. However, the Bill is likely to be introduced in the near future. Some of the salient features of the Constitution (One Hundred and Fifteenth Amendment) Bill, 2011 are given in the Box-2 below.

## **BOX-2**

### **SALIENT FEATURES OF THE CONSTITUTION (ONE HUNDRED AND FIFTEENTH AMENDMENT) BILL, 2011**

The Bill defines GST as any tax on the supply of goods or services.

Bill deletes several taxes in the Union List and State List, as well as Article 268A, which provides for the levy of tax on services. Under the Bill, these taxes will be subsumed by GST.

The Bill allows both Parliament and State Legislatures to frame laws regarding GST. Unlike items in the Concurrent List, laws framed by State Legislatures on GST will not be overridden by laws made by Parliament.

Taxes on imports and inter-state trade shall be collected by the Central Government. The distribution of these taxes between the Centre and the States shall be determined by the Parliament.

The following goods will be exempted from the purview of GST: (a) petroleum crude; (b) high speed diesel; (c) petrol; (d) natural gas; (e) aviation turbine fuel; and (f) alcohol for human consumption. States shall have the power to levy taxes on these items, except in the case of imports and inter-state trade. Unlike these goods, tobacco and tobacco products are not exempted from GST. However, the Central Government may still impose excise duty on them.

- State Legislatures will have the power to levy certain taxes to the extent collected by Panchayats or Municipalities. These include octroi, entertainment tax and amusement tax.
- Stamp duties mentioned in the Union List shall be levied by the Centre and collected by the States.
- The Bill empowers Parliament to establish a GST Dispute Settlement Authority. The Authority will adjudicate disputes referred to it by a State or the Central Government. Appeals against orders of the Authority shall lie with the Supreme Court.

A GST Council will be established within 60 days of enactment of the Bill. The GST Council shall make recommendations to the Centre and States on: (a) taxes which may be subsumed; (b) goods and services which may be exempted; (c) a threshold limit of turnover for application of GST; (d) rates of GST; and (e) other related matters.

### Reason behind Proposing a Dual GST Model

India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislations. 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.

- All the dealers/business entities will have to pay both the types of taxes on all the transactions.
- A dealer must get registered under CGST as it will make him entitled to claim Input Tax Credit of CGST thereby, attracting buyers under business-to-business transactions.
- Importers have to register under both CGST and SGST as well.

### Taxable Persons/Entities under GST

- It will cover all types of persons carrying on business activities, *i.e.* manufacturers, job-workers, traders, importers, exporters, all types of service providers, *etc.*
- If a company is having four branches in four different States, all the four branches will be considered as taxable entities under each of the jurisdictions of State Governments concerned.

### Subsuming of Central and State Taxes under GST

One of the guiding motives behind the introduction of GST is to enable the free flow of tax credit in intra and inter-state levels. For this purpose, several Central and State Taxes will be identified to be subsumed under GST, though with some exception. These taxes include as given in Box-3.

<b>BOX-3</b>	
<b>TAXES SUBSUMED UNDER GST</b>	
<b>Central Taxes</b>	<b>State Taxes</b>
< Central Excise Duty	VAT/Sales tax
< Additional Excise Duties	Entertainment tax (unless it is levied by the local bodies)

The Excise Duty levied under the Medicinal and Toiletries Preparation Act	Luxury tax
Service Tax	Taxes on lottery, betting and gambling
Additional Customs Duty, commonly known as Countervailing Duty (CVD)	State Cesses and Surcharges in so far as they relate to supply of goods and services, and
Special Additional Duty of Customs - 4% (SAD)	Entry tax not in lieu of Octroi.
Surcharges, and	
Cesses.	

### Taxes that May or May not be Subsumed under GST

There are a few other indirect taxes that may or may not be subsumed under the proposed GST regime as there is no consensus among States, and between the Centre and the States. These taxes include purchase tax, stamp duty, vehicle tax, electricity duty and other entry taxes and octroi.

As far as beverages/items containing alcohol are concerned, these may be kept out of the purview of GST. Sales Tax/VAT could be continued to be levied on alcoholic beverages as per the existing practice. In case, it has been made vatable by some States, there may not be any objection to their stance. Excise Duty, which is presently levied by the States may also not be affected.

With regard to petroleum products, the Empowered Committee opined that the basket of petroleum products, *i.e.* crude, motor spirit (including the Aviation Turbine Fuel) and High Speed Diesel may be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies.

However, the Centre is of the opinion that keeping petroleum out of GST could lead to leakage of revenue due to disruption of audit trails. Therefore, Centre has proposed to the States that the present structure of taxes on petroleum may be allowed to continue temporarily even though petroleum may not be constitutionally kept out of GST. This would imply that the States would retain the power to levy and collect sales tax/VAT on petroleum, even though petroleum products would be under the ambit of GST. The related rates could be appropriately decided (or zero-rated) by the GST Council in such scenario.

### Rate Structure under GST System

It is proposed to adopt 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. For taxation of services, there may be a single rate for both CGST and SGST. The exact value of the SGST and CGST rates, including the rate for services may, however, be known duly in course of appropriate legislative actions.

### GST on Exports and Imports

GST on exports will be zero-rated. Both CGST and SGST will be levied on import of goods and services into the country and shall be collected by the Central Government. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State(s) where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

### GST in Special Economic Zones (SEZs)<sup>3</sup>

Tax benefits would be given to the SEZs. However, such benefits will only be allowed to their processing zones. No benefits will accrue to them with regard to the sales from an SEZ to Domestic Tariff Area (DTA)<sup>4</sup>.

### Simultaneous Levy of CGST and SGST

The Central GST and the State GST would be levied simultaneously on every transaction of supply 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. Further, both would be levied on the same price or value unlike State VAT which is presently levied on the value of the goods inclusive of CENVAT. While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, SGST would be chargeable only when the supplier and the recipient are both located within the particular State.

<sup>3</sup> Special Economic Zones (SEZs) are designated areas in a country that possess special economic regulations that are different from other areas in the same country. Moreover, these regulations tend to contain measures that are conducive to foreign direct investment. Conducting business in a SEZ usually means that a company will receive tax incentives and the opportunity to pay lower tariffs. India has specific laws for its SEZs which are guided by the SEZ Act of 2005.

<sup>4</sup> Domestic Tariff Area (DTA) is area within India which is outside the Special Economic Zones.

## Inter-State Transaction and GST

Under the GST regime, a new statute known as Integrated Goods and Services Tax (IGST) will come into place. The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services.

The inter-state seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. 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 in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds. The following are the advantages of the IGST Mode:

Maintenance of uninterrupted ITC chain on inter-State transactions.

No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.

No refund claim in exporting State, as ITC is used up while paying the tax.

Self monitoring mode.

Level of computerization is limited to inter-State dealers and Central and State Governments should be able to computerize their processes expeditiously.

As all inter-state dealers will be e-registered and correspondence with them will be by e-mail, the compliance level will improve substantially.

Model can take 'Business to Business' as well as 'Business to Consumer' transactions into account.

### Tax Invoice under the GST System

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 input credit could be claimed. Normally, a tax invoice must bear the name of the 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.

### Benefits of GST

The following benefits are expected to outpour with the implementation of GST:

- **GDP Gains:** Detailed study by the Task Force has estimated that GST will provide gains to India's GDP from 0.9%-1.7%.
- **Reduction in Cascading Taxes:** Under GST, the tax is effectively paid not on the value of the output, but on the value added to the output at that particular stage. Since set-offs are only available once tax is paid, incentives for compliance increase as each person in the chain ensures that the previous person has paid the tax.
- **Reduction in Prices of Goods:** The prices of goods are estimated to decline as cascading effect of taxes may be eliminated.
- **Gain in Export & Import:** Export-oriented industries would become internationally more competitive as entire taxes in supply chain would be refunded/zero-rated. Import-substituting industries would also become competitive as prices of Indian commodities would reduce.

### IT-Infrastructure during the GST Regime

For successful implementation of the Goods and Services Tax (GST) in the country, an in-built IT-based settlement mechanism for transfer of credits to avoid the cascading effect of taxes will be crucial. In this context, Goods and Services Tax Network-Special Purpose Vehicle (GSTN—SPV) has been set up to provide a robust IT-infrastructure and service backbone to capture, process and exchange the information amongst the stakeholders (including tax payers, States and Central Government, Banks and RBI). On 28 March 2013, GSTN-SPV was incorporated as a non-Government, not for profit, private limited Company registered under the Companies Act, 1956, with 49% equity held by the Government and 51% held by the non-Government institutions. The Centre and the States hold equal stakes in equity, *i.e.* 24.5% each and retain strategic control over the company. GSTN-SPV has an authorized equity share capital of Z 10 crore. GSTN-SPV is the first experiment of its kind in the federal structure.

Given the sensitivity of the role of GSTN-SPV and the information that would be available with it, the strategic control over GSTN-SPV has been ensured with the Government through measures such as composition of the Board, mechanisms of Special Resolution and Shareholders Agreement, induction of Government officers on deputation, and agreements between GSTN-SPV and the Governments. Also, the shareholding pattern ensures that the Centre individually and the States collectively are the largest stakeholders at 24.5% each. In combination, the Government shareholding at 49% far exceeds that of any single private institution. After implementation of GST, the GSTN-SPV would render the following services:—

- (i) provide common registration, return filing and e-payment services for the tax payers;
- (ii) ensure integration of the common GST Portal with the existing tax administration systems of the Central/State Governments and other stakeholders;
- (iii) facilitate, implement and set standards for providing services to the tax payers through common GST portal;
- (iv) build efficient and convenient interfaces with tax payers to increase tax compliance;
- (v) assist tax authorities in plugging tax evasion and improving the transparency of the tax administration system;
- (vi) carry out research, study best practices and provide training to the stakeholders; and
- (vii) deliver any other service of relevance to the Government and other stakeholders.

### Some Challenges of the GST System

Certain difficult areas with respect to the implementation of the GST may be as follows:

- **Constitutional Amendments:** The Constitution provides for delineation of power to tax between the Centre and States. While the Centre is empowered to tax services and goods upto the production stage, the States have the power to tax sale of goods. The States do not have the powers to levy a tax on supply of services while the Centre does not have power to levy tax on the sale of goods. Thus, the Constitution does not vest express power either in the Central or State Governments to levy a tax on the 'supply of goods and services'. Moreover, the Constitution also does not empower the States to impose tax on imports.

- **Drafting and Implementation of Central GST and State GST Laws:** After the constitutional amendment providing for GST, it will become essential to draft corresponding Central and State legislations with associated rules and procedures. Simultaneously, it would also be emergent to take steps in the direction of drafting of a legislation for Integrated Goods and Services Tax and the related rules and procedures.
- **Agreement on GST Rates among States and Centre:** The present threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. However, a uniform State GST threshold across States will be desirable for the implementation of the Goods and Services Tax. Thus, as a part of the exercise on constitutional amendment, a special attention will be needed to be paid to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the States' autonomy in a federal structure.
- **Compensation to be given by the Centre to States Incurring Revenue Losses on Implementation of GST:** It would be a humongous task to estimate accurately as to how much the States will gain from service taxes and how much they will lose on account of removal of cascading effect, payment of Input Tax Credit and phasing out of Central Sales Tax. In view of this, it would be essential to provide adequately for compensation for the loss that might emerge during the process of implementation of GST.
- **Implementation of IT Resources:** IT is very crucial to the implementation of GST and with GST, proper implementation of IT resources in every nook and corner of the country stands as a huge challenge. It would be required to put in expeditiously serious efforts and in a time bound manner in tying up the State infrastructural facilities with the Central facilities as well as further improvement of the States' own IT infrastructure.

### Summing Up

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 maximise its economic efficiency and minimize distortions and impediments to efficient allocation of resources, specialization, capital formation and international trade.

Implementation of a comprehensive GST across goods and services is expected, *ceteris paribus*, to increase India's GDR. The additional gain in GDP, originating from the GST reform, would be earned during all years in future over and above the growth in GDP which would have been achieved otherwise. It would even lead to efficient allocation of factors of production thus, keeping down the overall price level. In sum, implementation of a comprehensive GST in India is expected to lead to efficient allocation of factors of production thus, leading

to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital.

"A well designed destination-based GST on all goods and services is the most elegant method of eliminating distortions and taxing consumption. Under this structure, all different stages of production and distribution can be interpreted as mere tax pass-through, and the tax essentially 'sticks' on final consumption within the taxing jurisdiction." (Kelkar, 2009).

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