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Role of Proposed Goods and Services Tax (GST) in Indirect Tax Reform in India

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Abstract

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. The paper highlights the background, objectives of the proposed GST and the impact of GST in the present tax scenario in India. The paper further explores various benefits and opportunities of GST. Finally, the paper examines and draws out a conclusion.

Key Words: *GST, CGST, SGST, VAT, INPUT CREDIT*

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Introduction

India as world's one the biggest democratic country follows the federal tax system for levy and collection of various taxes. Different types of indirect taxes are levied and collected at different points 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 further significant breakthrough towards a comprehensive indirect tax reform in the country. Goods and Services Tax (GST) is a comprehensive tax levy on manufacture, sale and consumption of goods and services at the national level. GST is similar to the VAT system which is a value added tax on goods with an Input Tax Credit (ITC) mechanism but GST also includes services. Thus GST would be applicable on supply of goods and services as against the present concept of tax. GST is a value 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 all the services of retailer or the chain behind him is taxed apart from the actual value of production of the goods. The proposed GST is likely to change the whole scenario of current indirect tax system. It is considered as biggest tax reform since 1947. Currently, in India complicated indirect tax system is followed with imbrications of taxes imposed by union and states separately. GST will unify all the indirect taxes under an umbrella and will create a smooth national market. Experts say that GST will help the economy to grow in more efficient manner by improving the tax collection as it will disrupt all the tax barriers between states and integrate country via single tax rate. GST was first introduced by France in 1954 and now it is followed by 140 countries. Most of the countries followed unified GST while some countries like Brazil, Canada follow a dual GST system where tax is imposed by central and state both. In India also dual system of GST is proposed including CGST and SGST.

Objectives of the Study

1. To know the impact of GST on current indirect taxation system in India
2. To know various benefits of implementation of GST in India

Literature Review

Since it is one of the contemporary issue in the Indian government so very less work has been done in this regard which provide great scope of further studies with suggestions of new reforms and analysis of their impact on Indian economy. The efforts of few have been briefed out below:

Nitin Kumar (2014) in his paper titled "Goods and Services Tax in India: Away forward" explained the concept and features of GST. He has rightly pointed out that GST is an extension of present VAT that will make the tax system broad and inclusive. He has concluded that economic distortion caused by present tax structure can be removed by implementing GST and it will help to develop common national market.

Nitisha Gupta (2014) in her paper titled "Goods and Service Tax: Its impact on Indian Economy" found that integration of goods and services taxation would give India a world class tax system and tax collections will be improved. She stated implementation of GST will create business friendly environment as price level and inflation rates would come down over a period of time due to uniform tax rates. She explained how GST will work in India? She concluded that GST may lead to collective gain for industry, trade, agriculture and common consumers as well as for the Central Government and the State Government.

Sharma Manpreet & Neha (2014) in their paper titled "A Study on Goods and Services Tax in India" explained the benefits and current status of GST in India. They explained the current scenario of GST in India and various shortcomings of GST. They concluded that implementation of GST would reduce the problem of cascading effect, distortion and tax evasion to maximum extent possible.

Girish Garg (2014) analyzed the impact of GST on Indian Tax Scenario in his paper titled "Basic Concepts and Features of Goods and Service Tax in India". He explained various objectives, challenges, opportunities, salient features and benefits of GST. He concluded by explaining the impact of GST on food industry, FMCG industry, housing and construction industry and financial services.

Methodology

The research is an exploratory research and the data collection is done mainly form the secondary sources such as statistical data available on the official web site of Finance Ministry of India, the books published on GST and various contemporary news articles, journals and papers. 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. has been used for determining the tax liability in of GST at proposed rates of tax.

Drawbacks of Present Indirect Taxation System in India

The indirect tax reform has to address following aspects to realize full economic potential of India:

1. **Multiplicity of Taxes:** Taxes by Union Government, State Governments and the Local Governments have resulted in difficulties and harassment to the tax payer. He has to contact several authorities and maintain separate records for each of them.
2. **Lack of Co-ordination:** Our Federal Finance system allows Union and States levy taxes independently at different rates. There is no co-ordination between the taxes to allow a well-organized, planned and co-ordinated tax system to evolve.
3. **Bias in Incidence of Taxes:** According to indirect taxation enquiry committee, "The burden of the urban households was distinctly higher than the rural households in the corresponding expenditure class". Urban population is taxed far higher than the rural rich.
4. **Complexity and Corruption:** A provoking feature of the Indian tax system is its complexity. Both direct and indirect tax laws are highly complex. This provides enough scope for avoiding and evading taxes.
5. **Lack of Built-in Elasticity:** Income from taxation does not increase automatically in India in proportion to increase in national income. Hence, the government is compelled to increase taxes every year to maintain a constant tax income ratio.
6. **Administrative Inefficiency and Corruption:** A baneful feature of the Indian tax system is the lack of administrative efficiency. Corruption exists in the administrative machinery from top to bottom. Such a system encourages the spirit of corruption among the tax payers also.

India's Current Indirect Tax System – A Snapshot

Table 1

	Goods		Services
	Centre	State	Centre
Tax	Excise Duty	VAT	Service Tax
Tax Base	Only Manufacturing	Full Value Chain (up to retail)	Everything except services in the negative list
Number of Tax Rates	8	3+	11
Standard Tax Rate	12%	12.5% to14.5%	14%
Low Tax Rate	6%	4.5% to 5%	4.10%
Proportion of base taxed at			
Standard Rate	59.2%	28.5%	65.2%
Lower Rate	39.6%	67.0%	34.8%
Proportion of Collections From			
Standard Rate	84.9%	32.8%	86.2%
Lower Rate	11.1%	54.8%	13.8%
Average Tax Rate			
Base-weighted	8.4%	7.5%	9.4%
Collection-weighted	11.7%	9.6%	11.2%
Threshold Limit	Rs. 15 million	Rs. 0.5 to 1 million	Rs. 1 million
Number of Exemptions	300	90	-
Revenue loss due to exemptions	Rs. 1.8 trillion	1.5 trillion	-

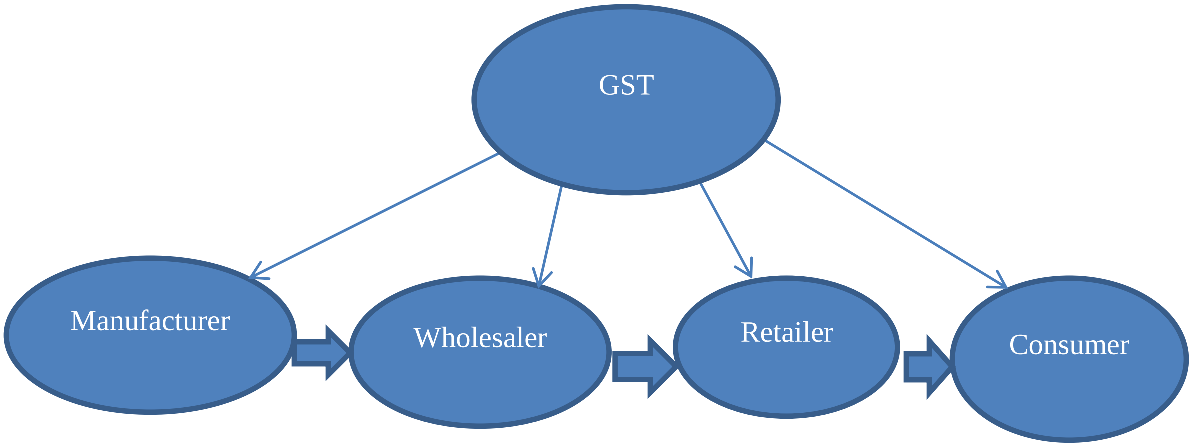
Source: Report of the CEA Panel on GST Rates, RCML Research

Road Map to Goods and Services Tax (GST) in India

Time	Events
2004	Dr. Kelkar II Task force recommended need for National GST
Jan, 2007	First GST stuffy released by Dr. Shome in January
Feb , 2007	FM announced implementation of GST by 2010 and Set up EC
April, 2007	Phasing out process of GST Started
May, 2007	Joint Working Group (JWG) Constituted by Empowered Committee
Nov ,2007	Report of JWG discussed by Empowered Committee
Nov ,2007	13th Finance Commission constituted by President
April, 2008	Recommendations report is sent by EC to Government
Dec , 2008	The Govt. submitted its comments on EC report
Nov , 2009	Release of First Discussion paper by EC
Dec, 2009	13th Finance Commission submitted its report
April 1, 2010	Introduction of GST missed its first deadline
March 22, 2011	The Constitution (115th Amendment) Bill, 2011 introduced (this lapsed due to dissolution of Lok Sabha)
August 2013	Submission of report by Standing Committee on Constitution (115th Amendment) Bill, 2011
Dec 19, 2014	The Constitution (122nd Amendment) Bill, 2014 introduced
Feb 24, 2015	14th Finance Commission Report tabled before Parliament
May 6,2015	Constitution (122nd Amendment) Bill, 2014 passed in Lok Sabha
May 12,2015	Constitution (122nd Amendment) Bill, 2014 referred to Select Committee of Rajya Sabha
April 1, 2016	Implementation of GST (target date as per Budget)

Applicability and Mechanism of GST

Figure 1



Key Features of the Proposed GST Regime

1. **Destination-Based Tax:** The GST is a destination-based tax and will be levied at the point of consumption only. The current regime is an origin-based regime, with taxes levied at the point of origin of goods/supply of services.
2. **Goods vs. Services:** The current system taxes goods and services separately. The proposed GST regime will not differentiate between goods and services with both being subject to one tax. Besides, it will also empower states to tax services, which are currently only subject to taxation by the Centre.
3. **Dual GST (CGST+SGST):** A dual structured GST is proposed to be levied on the supply of goods and services. The 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.
4. **Inter-State Trade:** The Centre would levy the Integrated Goods and Services Tax (IGST) on the inter-state supply of goods and services. The inter-state seller would pay IGST on the sale of goods to the Centre.
5. **Taxes to be Subsumed:** All major indirect taxes levied by the Centre and the States will be subsumed in the CGST and the SGST.
6. **Input Tax Credit:** 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 (across CGST and SGST) would be permitted. With respect to the IGST, input tax credit would be permitted to the interstate seller on IGST, CGST and SGST (in that order) on his purchases.

7. **Additional Tax Levy:** The CAB allows the Centre to levy of an additional tax on supply of goods, not exceeding 1%, in the course of inter-state trade or commerce for a period of two years (period may be extended on recommendations of the GST Council). The proceeds from this levy will be distributed among the States from where the supply originates.
8. **Compensation to States:** Manufacturing States are expected to lose revenue owing to the destination-based principle of the GST. As per the Constitution Amendment Bill, the Centre, for a period of five years, will provide compensation to the States for loss of revenue due to GST implementation.
9. **Tax Base:** As per the CAB, all goods and services (except alcohol for human consumption) will be brought under the GST purview. While petroleum/petroleum products have been included in the framework, GST would be levied only upon the Council's recommendations, implying that present taxes (excise duty, sales tax, CST) would continue to be levied on these products. For tobacco and tobacco products, taxes imposed by the Centre would be levied over and above the GST.
10. **GST Rates:** The States will be able to fix their SGST rates in a band above the floor rate (bands and floor rates will be recommended by the GST council). So the GST rate will not be uniform across the country, but will vary from state to state (although in a narrow range).

Taxes to be subsumed in GST

Central GST	State GST
• Central Excise Duty (CENVAT) • Additional Excise Duties • Service Tax • Countervailing Duty (CVD) • Special Additional Duty of Customs (SAD) • Surcharges and Cesses levied by Centre • Central Sales Tax	• Sales Tax • Entertainment Tax • Luxury Tax • Taxes on Lottery, Betting and Gambling • Octroi and Entry Tax • State Cesses and Surcharges • Purchase Tax

Source: RCML Research

Taxes to be left out of GST

• Basic Customs Duty • Export Duty • Road & Passenger Tax • Toll Tax • Property Tax • Stamp Duty • Electricity Duty • Entertainment Tax levied by local bodies

Source: RCML Research

Impact of GST on Pricing of Products as Compared to Current Scenario

There is a clear difference between the price of the product calculated under VAT system and the price of the product calculated under the proposed Goods and Services Tax (GST) system. Let us take an Example to understand this clearly:

Table 2

Present Tax System	GST System
Product Sold from Mumbai to Nagpur Price = Rs. 1000 VAT @ 10% Rs. 100 Product Sold from Nagpur to Chennai Cost = Rs. 1100 Profit = Rs. 1000 Sell Price = Rs. 2100 CST @ 10% = Rs. 210 Total Cost of Product = Rs. 2310	Product Sold from Mumbai to Nagpur Price = Rs. 1000 CGST @ 5% Rs. 50 SGST @ 5% Rs. 50 Product Sold from Nagpur to Chennai Cost = Rs. 1100 Profit = Rs. 1000 Sell Price = Rs. 2100 IGST @ 10% = Rs. 110 = Rs. 210 - CGST- SGST Total Cost of Product = Rs. 2210

Source: www.finmart.com

In the above example, you can note that the tax paid on the sale within the state can be claim against the tax paid on sale outside state in GST system, which is not possible in the current tax system. The credit of CGST cannot be taken against the SGST and the credit of SGST cannot be taken against the CGST but both credits can be taken against IGST.

How Does GST Will Work?

Let us understand the working of GST of a manufactured commodity from point of view of a manufacturer, wholesaler, retailer and final consumer:

Assuming GST Rate @ 10%

Table 3

Stage of Supply Chain	Purchase Value of Input	Value Addition	Value of Supply	Rate of GST	GST on Output	ITC	Net GST = GST on Output - ITC
Manufacturer	100	30	130	10%	13	10	13-10 = 3
Wholesaler	130	20	150	10%	15	13	15-13 = 2
Retailer	150	10	160	10%	16	15	16-15 = 1

Source: Author's views.

Manufacturer: Manufacturer makes a value addition of Rs. 30 on his purchase worth Rs. 100 of input of goods and services used in manufacturing process. The manufacturer will then pay net

GST of Rs. 3 (13-10) after setting-off Rs. 10 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 13. The manufacturer sells the goods to the wholesaler.

Wholesaler: When the wholesaler sells the same goods after making value addition of Rs. 20, he pays net GST of only Rs. 2(15-13), after setting-off of Input Tax Credit of Rs. 13 from the gross GST of Rs. 15 to the manufacturer. The wholesaler sells the goods to retailer.

Retailer: When the retailer sells the same goods after value addition of Rs. 10, he has to pay net GST of only Rs. 1 (16-15), after setting-off Input Tax Credit of Rs. 15 from his gross GST of Rs. 16 to the wholesaler. The retailer sells the goods to consumer. Thus the manufacturer, wholesaler and retailer have to pay only Rs. 6 (i.e. Rs. 3+ Rs. 2 +Rs. 1) as GST on the value addition along the entire value chain from producer to the retailer after setting-off GST paid at the earlier stages. So finally consumer has to pay 160+160*10% = Rs. 176 For goods he bought or services he has hired/enjoyed.

Current Indirect Tax System and GST Regime – Key Differences

Basis of Difference	Current Indirect Tax System	Proposed GST Regime
Goods vs. Services	Differentiation between goods and services – they are taxed separately	No differentiation between goods and services; both subject to one tax
Powers of Taxation	Only the Centre can tax services	Both the Centre and States can tax services
Incidence of Taxation	Origin-based (Central Government excise duty on production and States' Sales Tax at sales stage)	Destination-based (Value added tax at point of consumption only)
Number of Indirect Taxes	Multiple (central excise, sales tax, entry taxes, CST, services tax)	One composite GST with a dual structure (CGST + SGST)
Tax Rates	Different tax rates on product across different states	Single tax rate to apply on all goods and services
Exemptions	More than 300 for centre and 90 for states	Fewer exemptions envisaged
Set-offs	Input credit set-off not available across different taxes, for instance, set-off not available for excise against state sales tax	Seamless flow of input tax credits (except in the case of the proposed 1% additional levy)

Proposed GST Model for India

GST is similar to VAT and can be termed as National Level VAT on goods, with one difference, in GST not only goods but services are also included and rate of tax on both goods as well on services will be the same. Most countries have a unified GST system i.e. a single rate of tax applicable throughout the country. However in many federal countries like Brazil and Canada a dual GST system is working where GST is levied by both central and state governments. Almost all countries of the Europe have also adopted a dual GST system. Adoption of GST is one of the pre-condition for a country who wants to join the (EU) European Union. As far India is concerned we have adopted a dual GST system because of the federal nature of our constitution in which the power has been divided between the centre and 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.

Benefits of GST Implementation

- It will make the taxation system more transparent and simple and easy to understand.
- It will reduce the overall cost of goods and services to final consumer as cascading effect of taxation will be overcome.
- It will facilitate free flow of goods and services and thereby reducing overall transaction cost.
- Since GST is not levied on goods and services which are exported so it provides an incentive to EOUs, SEZs and EPZs and GST will be levied on goods or services imported into the country with destination principle where the imported goods or services are consumed that state will enjoy the tax revenue.
- Since intermediaries in the supply chain can claim the tax credit which will reduce the cost of doing business.
- It will reduce the scope of corruption in the economy as a whole.
- It will increase the tax base as more firms will come under the tax regime which ultimately increases the tax revenue collection for the government.
- GST will guarantee the consistency of taxes over the states, irrespective of place of production or consumption.

- The normal taxation rate on organizations will fall which will decrease the expenses of Indian goods and services and make them competitive in the global market and ultimately GDP would increase.
- The taxation burden will be divided equitably between manufacturing and services, through a lower tax rate by increasing the tax base and minimizing exemptions.
- For paying GST, 13/15 digit PAN-linked identification in line with income tax will be allotted which will ease the tax payment system.

Conclusion

Due to dissilient environment of Indian economy, it is demand of time to implement GST. Consumption and productions of goods and services is undoubtedly increasing and because of multiplicity of taxes in current tax regime administration complexities and compliance cost is also accelerating. Thus, a simplify user -friendly and transparent tax system is required which can be fulfilled by implementation of GST. Its implementation stands for a coherent tax system which will colligate most of current indirect taxes and in long term it will lead to higher output, more employment opportunities and flourish GDP by 1-1.5%. It can also be used as an effective tool for fiscal policy management if implemented successfully due to nation-wide same tax rate. Its execution will also results in lower cost of doing business that will make the domestic products more competitive in local and international market. No doubt that GST will give India a world class tax system by grabbing different treatment to manufacturing and service sector. But all this will be subject to its rational design and timely implementation.

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