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Theme 219

TAX REFORMS IN INDIA - GOODS & SERVICES TAX (GST) Part -II

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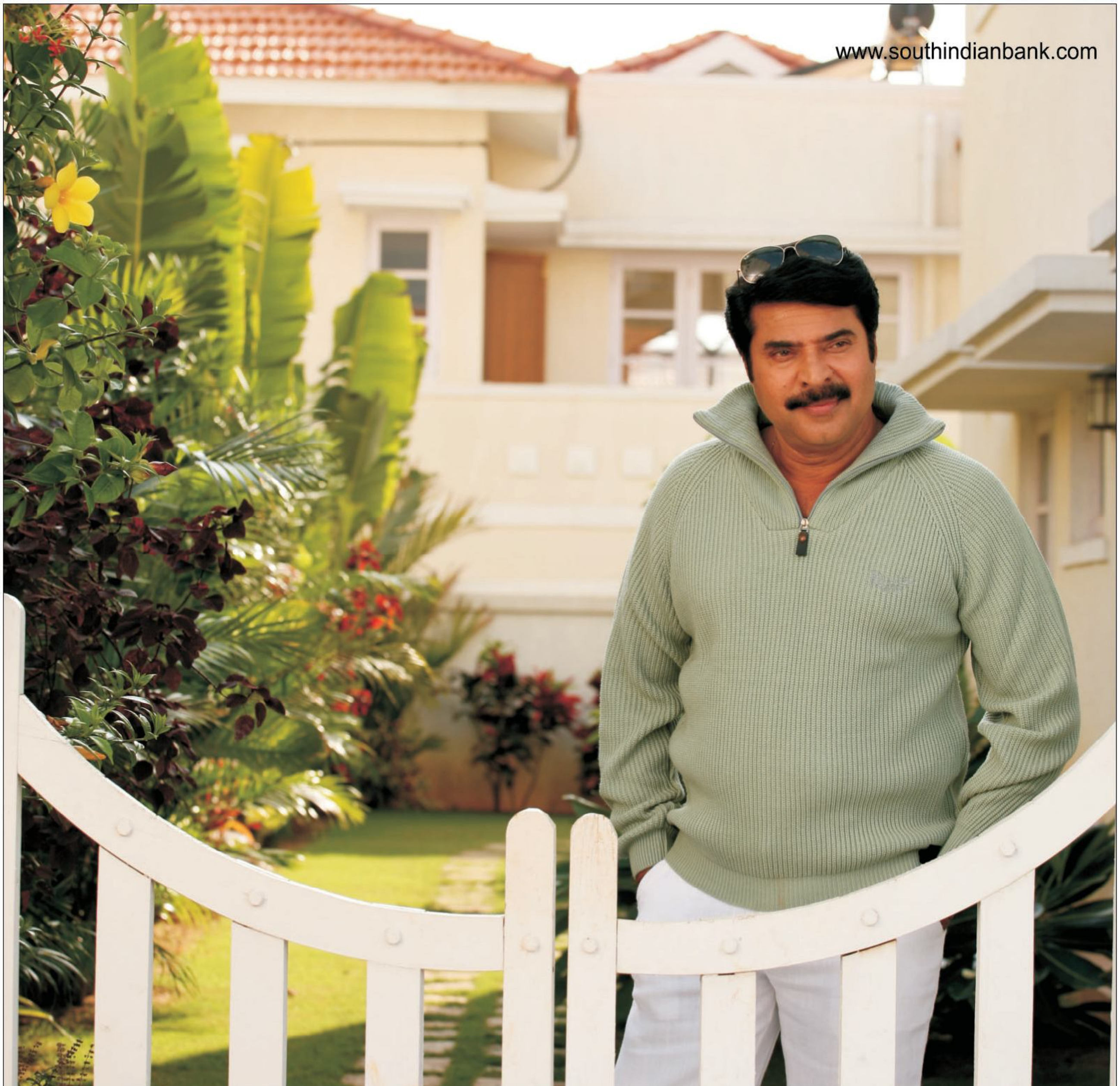

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Theme No. 219 : TAX REFORMS IN INDIA – GOODS & SERVICES TAX (GST) Part - II

Goods and Services Tax (GST) will be a significant breakthrough towards a comprehensive reform in the domain of indirect taxes in the country. Value Added Tax (VAT) was a major improvement over the pre-existing central excise duty at the national level and the sales tax system at the state level. GST is expected to be a further improvement over VAT.

Prior to the introduction of VAT in the Centre and in the States, there was a burden of multiple taxation in the pre-existing Central excise duty and the State sales tax systems. Before any commodity was produced, inputs were first taxed, and then after the commodity got produced with input tax load, output was taxed again. This was causing a burden of multiple taxation (i.e. "tax on tax") with a cascading effect. When VAT is introduced in place of Central excise duty, a set-off is given, i.e., a deduction is made from the overall tax burden for input tax. In the case of VAT in place of sales tax system, a set-off is given from tax burden not only for input tax paid but also for tax paid on previous purchases. With VAT, the problem of "tax on tax" and related burden of cascading effect are thus removed.

In India, VAT was introduced at the Central level for a selected number of commodities in terms of MODVAT with effect from March 1, 1986, and in a step-by-step manner for all commodities in terms of CENVAT in 2002-03. Subsequently, after Constitutional Amendment empowering the central government to levy taxes on services, service taxes were also added to CENVAT in 2004-05. All the states in India have now implemented state-level VAT.

GST is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods and services at a national level. Integration of goods and services taxation would be a world class tax system as in other major economies and would improve tax collections.

What is GST and what is the justification of GST?

GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point up to the retailer's level. It is essentially a tax only on value addition at each stage. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

Central VAT (CENVAT) and state VAT aimed to remove the cascading effect of 'tax on tax' and were definitely an improvement over the previous excise/ sales tax regime. But still these are found incomplete. Cenvat was not extended to include the chain of value addition in the distributive trade below the stage of production. Also several central taxes were not included in Cenvat. GST aims to cover indirect taxes comprehensively and also integration of goods and services taxes and to capture value addition in the distributive trade. Similarly, in the present state-level VAT scheme, CENVAT load on the goods has not been removed and hence the cascading effect would remain. Also, several state taxes such as luxury tax, entertainment tax etc. are not subsumed in the state VAT presently. Further, there has not been any integration of VAT on goods with tax on services at the state level. The burden of central sales tax (CST) on inter-state movement of goods needs to be phased out with introduction of GST. Thus all major central and state taxes will get subsumed into GST which will reduce the multiplicity of taxes, and thus bring down the compliance cost.

What are the salient features of the proposed GST model?

Consistent with the federal structure of the country, the GST will have two components: one levied by the Centre – referred to as Central GST (CGST), and the other levied by the states – referred to as state GST (SGST). A dual GST will be in keeping with the constitutional requirement of fiscal federalism. This dual GST model would be implemented through multiple statutes – one for CGST and SGST statute for every state. GST would be applicable to all transactions of goods and services except the exempted goods and services and transactions which are below the prescribed threshold limits. The CGST and SGST are to be paid to the accounts of the centre and the states separately. The taxes paid against the CGST shall be allowed to be taken as input tax credit (ITC) for the CGST and could be utilized only against payment of CGST. The same principle will be applicable for the state GST. The administration of the central GST would be with the Centre and of state GST with the states.

How can the burden of tax, in general, fall under GST?

The final net burden of tax on goods and services under GST would fall in general. Since there would be a transparent and complete chain of set-offs, this will help widening the coverage of tax base and improve tax compliance. This will lead to higher generation of revenues which may in turn lead to the possibility of lowering average tax burden.

GST will give more relief to industry, trade and agriculture through a more comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of several central and state taxes in the GST and phasing out CST. As the burden of tax on goods would in general fall under GST, it would benefit the consumers. It is also proposed to raise the minimum threshold of turnover for applicability of GST and this will protect the interest of the small traders. The proposed GST regime will reduce the cost of locally manufactured goods and services. This will increase the competitiveness of goods and services in the international market and give boost to exports.

How would a particular transaction of goods and services be taxed under CGST and SGST?

The central GST and the state GST would be levied simultaneously on every transaction of supply of goods and services. Further, both would be levied on the same price or value unlike state VAT which is levied on the value of 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 state.

Which Central and State taxes are proposed to be subsumed under GST?

The central taxes proposed to be subsumed under the CGST include central excise duty, additional excise duties, service taxes, additional customs duty (commonly known as countervailing duty), special additional duty of customs, surcharges and cesses. The state taxes to be subsumed under SGST include VAT / sales tax, entertainment tax excluding those levied by local bodies, luxury tax, taxes on lottery, betting and gambling, state cesses and surcharge and entry tax.

How will imports be taxed under GST?

Both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the state where the imported goods are consumed. Full and complete set-off will be available on the GST paid on import of goods and services.

How will be inter-state transactions of goods and services be taxed under GST?

An Integrated GST (IGST) model is proposed to be adopted for taxation of inter-state movement of goods and services. The centre would levy IGST which would be CGST plus SGST on all inter-state transactions of taxable goods and services. The inter-state seller will pay IGST on value addition after adjusting 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 liability in his own state. The centre will transfer to the importing state the credit of IGST used in payment of SGST. There will be a central agency to act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

Why does introduction of GST require a Constitutional Amendment?

The Constitution provides for delineation of power to tax between the centre and states. The centre is empowered to tax services and goods up to the production stage and the states have the power to tax sale of goods. The centre has no power to levy tax on sale of goods and the states have no power to levy tax on supply of services. GST being a tax on 'supply of goods and services', it is required to amend constitution. Also, the constitution does not empower the states to impose tax on imports.

Even though the merits of the GST regime are well accepted, the implementation may be delayed as it requires constitutional amendment and more deliberations are required for a consensus on GST rates, devolution of taxes and compensation to states.

Goods & Services Tax (GST) Model for India

It is important to take note of the significant administrative issues involved in designing an effective GST model in a federal system with the objective of having an overall harmonious structure of rates. Together with this, there is a need for upholding the powers of Central and State Governments in their taxation matters.

Salient features of the GST model

i. The GST shall have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States (hereinafter referred to as State GST). Rates for Central GST and State GST would be prescribed appropriately, reflecting revenue considerations and acceptability.

ii. The Central GST and the State GST would be applicable to all transactions of goods and services made for a consideration except the exempted goods and services.

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

iv. Since the Central GST and State GST are to be treated separately, input tax credits (ITC) for set-off are allowed for the respective taxes.

v. 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 and services under the Integrated GST (IGST) model.

vi. Uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislation for Central GST and State GST.

vii. The administration of the Central GST to the Centre and for State GST to the States would be given. This would imply that the Centre and the States would have concurrent jurisdiction for the entire value chain.

viii. The present threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. A uniform State GST threshold across States is desirable and, therefore, it is considered that a threshold of gross annual turnover of Rs.10 lakh both for goods and services for all the States and Union Territories may be adopted with adequate compensation for the States where lower threshold had prevailed in the VAT regime.

(*Discussion Paper on Goods and Services Tax in India*)

Your comments and feedback on this publication may be sent to Staff Training College, The South Indian Bank Ltd., Thrissur 680 001 or by E.mail: ho2099@sib.co.in

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