HOW GOOD IS GOODS AND SERVICES TAX

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Abstract:

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. It is basically a tax on final consumption. The Goods and Services Tax (GST) is a value added tax to be implemented in India, the decision on which is pending. GST is the only indirect tax that directly affects all sectors and sections of our economy. Ignorance of law is no excuse but is liable to panel provisions, hence why not start learning GST and avoid the cost of ignorance. Therefore, we all need to learn it whether willingly or as compulsion. The goods and services tax (GST) is aimed at creating a single, unified market that will benefit both corporate and the economy. The changed indirect tax system GST-Goods and service tax is planned to execute in India. Goods and service tax is a new story of The GST Implementation is not yet declared by government and the drafting of GST law is still under process and a clear picture will be available only after announcement of Implementation. India is a centralized democratic and therefore the GST will be implemented parallel by the central and state governments as CGST and SGST respectively. In this article, I have started with the introduction, in general of GST and have tried to highlight the objectives the proposed GST is trying to achieve. Thereafter, I have discussed the possible challenges and threats; and then, opportunities that GST brings before us to strengthen our free market economy.

Key Words: GST, Threats, Challenges & Impact

Introduction:

India’s economy has witnessed a significant economic growth in the recent past, growing by 7.3% in 2015 as against 6.9% in 2014. The size of the Indian economy is estimated to be at Rs129.57 trillion (US$ 2.01 trillion) for the year 2014 compared to Rs118.23 trillion (US$ 1.84 trillion) in 2013. The steps taken by the government in recent times have shown positive results as India’s gross domestic product (GDP) at factor cost at constant (2011-12) prices 2014-15 is Rs106.4 trillion (US$ 1.596 trillion), as against Rs99.21 trillion (US$ 1.488 trillion) in 2013-14, registering a growth rate of 7.3%. The economic activities which witnessed significant growth were ‘financing, insurance, real estate and business services’ at 11.5% and ‘trade, hotels, transport, communication services’ at 10.7%. India’s Index of Industrial Production (IIP) grew by 4.1% in April 2015 compared to 2.5% in March 2015. The growth was largely due to the boost in manufacturing growth, which was 5.1% in April compared to 2.8% in the previous month. India’s Consumer Price Index (CPI) inflation rate increased to 5.01% in May 2015 compared to 4.87% in the previous month. On the other hand, the Wholesale Price Index (WPI) inflation rate remained negative at 2.36% for the seventh consecutive month in May 2015 as against negative 2.65% in the previous month, led by low crude oil prices. India’s current account deficit reduced sharply to US$ 1.3 billion (0.2% of GDP) India’s foreign exchange reserve stood at a record high of US$ 354.28 billion in the week up to June 12, 2015 – indicating an increase of US$ 1.57 billion compared to previous week. Owing to increased investor confidence, net Foreign Direct
Investment (FDI) inflows touched a record high of US$ 34.9 billion in 2015 compared to US$ 21.6 billion in the previous fiscal year.

Taxeconsist of direct tax or indirect tax, and may be paid in money or as its labour equivalent (often but not always unpaid labour). India has a well-developed taxation structure. The tax system in India is mainly a three-tier system, which is based between the Central, State Governments and the local government organizations. In most cases, these local bodies include the local councils and the municipalities. According to the Constitution of India, the government has the right to levy taxes on individuals and organizations.

A Direct tax is a charge, which is imposed directly on the taxpayer and paid directly to the government by the persons (juristic or natural) on whom it is imposed. A direct tax is one that cannot be shifted by the taxpayer to someone else. The some important direct taxes imposed in India are as under:

Income Tax: Income Tax Act, 1961 imposes tax on the income of the individuals or Hindu undivided families or firms or co-operative societies (other than companies) and trusts (identified as bodies of individuals associations of persons) or every artificial juridical person. The types of Direct Taxes are:

- Corporation Tax
- Property Tax
- Inheritance (Estate) Tax
- Gift Tax
- Capital gains

Indirect Tax: An indirect tax is a tax collected by an intermediary (such as a retail store) from the person who bears the Economic burden of the tax (such as the customer). It is one that can be shifted by the Tax payer to someone else. An indirect tax may increase the price of a good so that consumers are actually paying the tax by paying more for the products. The some important indirect taxes imposed in India are as under:

Customs Duty: The Customs Act was formulated to prevent illegal imports and exports of goods. Besides, all imports are sought to be subject to a duty with a view to affording protection to indigenous industries as well as to keep the imports to the minimum in the interests of securing the exchange rate of Indian currency.

Service Tax: The tax is administered by the Central Government. Taxable event of the service tax is provision of services. The CENVAT credit availed by a manufacturer on the input services can also be utilised for discharging its liability towards service tax on output services and/or central excise duties. Duties of excise and the countervailing customs duty (CVD) paid on the inputs and capital goods and the service tax paid on the 'input' services can be taken as credit.

Sales Tax: Sales Tax in India is a form of tax that is imposed by the Government on the sale or purchase of a particular commodity within the country. Sales Tax is imposed under both, Central Government (Central Sales Tax) and State Government (Sales Tax) Legislation. Generally, each State follows its own Sales Tax Act and levies tax at various rates.

Excise Duty: Central excise duty is an indirect tax levied on goods manufactured in India. The tax is administered by the Central Government. The taxable event under the Central Excise Law is 'manufacture' and the liability of Central excise duty arises as soon as goods are manufactured, that is, it is not extended up to retail level. The Central Excise Officers are also entrusted to collect other types of duties levied under Additional
Duties (Goods of Special Importance) Act, Additional Duties (Textiles and Textiles Articles) Act, Cess, etc.

**Value Added Tax:** One of the significant reforms in the history of indirect tax structure in India, has been implemented by a majority of the States with effect from 1st April 2005, and this could be possible due to the joint efforts of the Central Government and the State Governments. The replacement of the State Sales Taxes by the Value Added Tax marked a substantial step forward in the reform of domestic trade taxes in India. Value Added Tax” (VAT), as its name suggests, is a tax on value addition. It is a multi-point tax, which is levied at every stage of sale. It is collected at the stage of manufacture/resale and contemplates rebating of tax paid on inputs and purchases. Despite its name, VAT is intended as tax on consumption, and is origin-based tax. In India, VAT replaced the general sales tax which was levied at State level, the only difference being the manner of levy.

**Central Sales Tax / State Value Added Tax (VAT):**
- Sales within a State (known as 'Intra-State Sales' or 'Local Sales').
- Sales from one State to another State within the domestic boundaries of India (known as ‘Inter-State Sales’ or ‘Central Sales’). Sales in the course of export from or import into India.
- While sales tax on the first head, i.e. local sales, is levied by the State Governments as per the provisions of their respective State Sales Tax Laws (presently VAT Laws), the taxability of inter-State sale under the second head is within the purview of the Central Government. Sales under the third head, i.e. in the course of export or import, though defined under the Central Sales Tax Act, are exempt from the sales tax.

India currently has a dual system of taxation of goods and services. Taxes on goods are described as “VAT” at both Central and State level. It has adopted value added tax principle with input tax credit mechanism for taxation of goods and services, respectively, with limited cross-levy set-off.

**Other Important Indirect Taxes/Duties:**
- Octroi duty
- Entry Tax
- Luxury Tax
- Research and Development Cess
- Telecom License Fees
- Turnover Tax
- Tax on Consumption or Sale of Electricity
- Taxes on Transportation of Goods and Services
- Lottery Tax
- Betting and Gambling Tax
- Stamp Duty
- Property Tax
- Toll Tax, Passenger Tax and Road Tax

GST stands for “Goods and Services Tax”, and is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. Its main objective is to consolidates all indirect tax levies into a single tax, except customs (excluding SAD) replacing multiple tax levies, overcoming the limitations of existing indirect tax structure, and creating efficiencies in tax administration.
One of the reasons to go the GST way is to facilitate seamless credit across the entire supply chain and across all States under a common tax base. The current framework allows limited inter-levy credits between CENVAT (tax on manufacture) and service tax. However, no cross credits are available across these taxes and the sales tax/VAT paid (on input) or payable (on output). Introduction of GST would thus rationalize the tax content in product price, enhance the ability of business entities to compete globally, and possibly trickle down to benefit the ultimate consumer.

Example:

A product whose base price is Rs.100 and after levying excise duty @ 12% value of the product is Rs112. On sale of such goods VAT is levied @ 12.5% and value to the ultimate consumer is Rs. 126. In the proposed GST system on base price of Rs.100 CGST and SGST both will be charged, say @ 8% each, then the value to the ultimate consumer is Rs. 116. So, in such a case the industry can better compete in global environment.

Objectives of Term Paper:

- Understand the concept of goods and services taxes.
- Analyse the impact of the implementation of goods and services tax in India.
- Study of the various frameworks and guidelines for GST by central government authorities.
- The Effects and impacts of GST on the following sectors:
  - Food Industry
  - Housing/Construction/Real Estate
  - Manufacturing Sector.
  - Rail Sector.

GST:

GST stands for “Goods and Services Tax”, and is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. Its main objective is to consolidates all indirect tax levies into a single tax, except customs (excluding SAD) replacing multiple tax levies, overcoming the limitations of existing indirect tax structure, and creating efficiencies in tax administration.

One of the main objectives of GST would be to eliminate the cascading impact of taxes on production and distribution cost of goods and services. The exclusion of cascading effects i.e. tax on tax will significantly improve the competitiveness of original goods and services which leads to beneficial impact to the GDP growth. It is felt that the GST would serve a superior reason to achieve the objective of streamlining indirect tax regime in India which can remove cascading effects in supply chain till the level of final consumers only when all such above mentioned indirect taxes are completely included in GST. It is understood that alcohol, tobacco and petroleum products will not be enclosed by GST as alcohol and tobacco are considered as Sin Goods, and governments do not like to allow free trade on these property.

The objectives of GST are:

1.Tax Cascading: Tax cascading occurs under both Centre and State taxes. The most significant contributing factor to tax cascading is the partial coverage by Central and State taxes. Oil and gas production and mining, agriculture, real estate construction, infrastructure projects, wholesale and retail trade, and range of services remain outside the ambit of the Cenvat and the Service Tax levied by the Centre. The exempted sectors are not allowed to claim any credit for the Cenvat or the Service Tax paid on their inputs. Similarly, under the State VAT, no credits are allowed for the inputs to the exempted sectors, which include the entire service sector. Another major contributing
factor to tax cascading is the Central Sales Tax (CST) on inter-State sales, collected by the Origin State for which any State Government allows no credit.  

2. **Levy of Excise Duty on Manufacturing Point:** The CETVAT is levied on goods manufactured or produced in India. Limiting the tax to the point of manufacturing is a severe impediment to an efficient and neutral application of tax. Taxable event at manufacturing point itself forms a narrow base.  

3. **Complexity in Determining the Nature of Transaction – Sale vs. Service:** The distinctions between goods and services found in the Indian Constitution have become more complex. Today, goods, services, and other types of supplies are being packaged as composite bundles and offered for sale to consumers under a variety of supply-chain arrangements. Under the current division of taxation powers in the Constitution, neither the Centre nor the States can apply the tax to such bundles in a seamless manner.  

4. **Inability of States to Levy Tax on Services:** Exclusion of services from the State taxation powers is its negative impact on the buoyancy of State tax revenues. With no powers to levy tax on incomes or the fastest growing components of consumer expenditures, the States have to rely almost exclusively on compliance improvements or rate increases for any buoyancy in their own-source revenues.  

5. **Lack of Uniformity in Provisions and Rates:** Present VAT structure across the States lacks uniformity, which is not restricted only to the rates of tax, but also extends to procedures and, sometimes, to the definitions, computation and exemptions.  

6. **Fixation of Situs – Local Sale vs Central Sale:** Whether a sale takes place in one State or another, i.e. to fix the situs of a sale transaction, is the major conflict, as its taxability affects the revenue of the State. Though CST is a tax levied by the Central Government, it is collected and retained by the collecting State.  

7. **Interpretational Issues:** Another problem arises in respect of interpretation of various provisions and determining the category of the commodities. We find a significant number of litigation surrounding this issue only. To decide whether an activity is sale or works contract; sale or service, is not free from doubt in many cases.  

8. **Narrow Base:** The starting base for the CETVAT is narrow, and is being further eroded by a variety of area-specific and conditional exemptions. Earlier the service tax was applicable on selective services but after the implementation of Finance Act, 2012 the system of comprehensive taxation of services was implemented, while excluding few services by specifying them in “negative list”. The complexities under the State VAT relate primarily to classification of goods to different tax rate Schedules. Theoretically, one might expect that the lower tax rates would be applied to basic necessities that are consumed largely by the poor. This is not the case under the State VAT. The lowest rate of 1% applies to precious metals and jewellery, and related products. The middle rate of 5% applies to selected basic necessities and also a range of industrial inputs and IT products. In fact, basic necessities fall into all three categories – exempted from tax, taxable at 5%, and taxable at the standard rate of 12.5%. Higher rate of 20% is also applicable mainly to petroleum products and liquor. However, most retailers find it difficult to determine the tax rate applicable to a given item without referring to the legislative schedules. Consumers are even less aware of the tax applicable to various items.  

9. **Complexities in Administration:** Compounding the structural or design deficiencies of each of the taxes is the poor or archaic infrastructure for their administration. Taxpayer services, which are a lynchpin of a successful self-assessment system, are virtually non-existent or grossly inadequate under both Central and State
administrations. Many of the administrative processes are still manual, not benefiting from the efficiencies of automation. All these not only increase the costs of compliance, but also undermine the revenue collection.

Central GST May Subsume the Following Indirect Taxes/Duties on Supply of Goods and Services:

- Central Excise Duties (CENVAT)
- Additional Excise Duties including those levied under Additional Duties of Excise (Goods of Special Importance) Act, 1957
- Additional Custom Duties in the nature of countervailing duties, i.e., CVD, SAD and other domestic taxes impose on imports to achieve a level playing field between domestic and imported goods although, under the GST regime all the imports will suffer a reverse charge.
- Cesses levied by the Union viz., Cess on rubber, tea, coffee etc.
- Service Tax
- Central Sales Tax – to be completely phased out
- Surcharges levied by the Union viz., National Calamity Contingent Duty, Education Cess, Special Additional Duties of Excise on Motor-Spirit and High Speed Diesel (HSD).

State GST May Subsume the Following State Taxes:

- Value Added Tax Taxes/Duties Likely to be Subsumed in GST 43
- Purchase Tax
- State Excise Duty (except on liquor)
- Entertainment Tax (unless it is levied by the local bodies)
- Luxury Tax
- Octroi
- Entry tax in lieu of Octroi
- Taxes on Lottery, Betting and Gambling

Taxes/Duties not to be Subsumed in GST:

(A) In Central GST:

- Basic Customs Duty
- Excise Duty on Tobacco products
- Export Duty
- Specific Cess
- Specific Central Cess like Education and Oil Cess.

(B) In State GST:

- Taxes on Liquors
- Toll Tax
- Environment Tax
- Road Tax
- Property Tax
- Tax on Consumption or Sale of Electricity – Not certain
- Stamp Duty – Not certain

Supply of goods and supply of services will be considered as taxable event under GST. Any economic activity, which is not supply of goods, is treated a supply of service.

Proposed Types of GST:

Assumption: That any replacement of the current taxes would be in the form of a classical VAT, which is consumption type (allowing full and immediate credit for both current and capital inputs attributable to taxable supplies) and destination based (i.e., the tax levied on the basis of the place of consumption of the goods and services, not the
place of production). Under this system, credits for input taxes are allowed on the basis of invoices issues by the vendors registered for the tax. This is the most common type of structure adopted around the world. Its superiority over other forms of consumption taxes is well accepted in India as well as other countries. The choices that remain then relate essentially to the assignment of powers to levy the tax to the Centre and the States, and the tax base and rates. In the remainder of this section we deal with the question of assignment, and then turn to the question of tax base and rates in the next section.

The main options for the VAT assignments include:

1. Concurrent Dual GST
2. National/Central GST
3. State GSTs.

All these options require an amendment to the Constitution. For the sake of completeness of discussion, we also consider an additional option, Non-concurrent Dual VAT that does not require an amendment to the Constitution. We now discuss each of these options in turn below.

Central GST:

Under this option, the two levels of government would combine their levies in the form of a single National GST, with appropriate revenue sharing arrangements among them. The tax could be controlled and administered by the Central Government. There are several models for such a tax. Australia is the most recent example of a National GST, which is levied and collected by the Centre, but the proceeds are allocated entirely to the States.

In the case of a Central GST (where all goods and services are taxed by the Central government only), the Centre will collect most of the country’s total tax revenue, leaving very little for the sub-national Governments. As against this, the present proposal is to have a dual GST.

A single national VAT has great appeal from the perspective of establishment and promotion of a common market in India. However, the States may worry about the loss of control over the tax design and rates. Indeed, some control over tax rates is a critical issue in achieving accountable sub-national governance and hard budget constraints. The States may also be apprehensive that the revenue sharing arrangements would over time become subject to social and political considerations, deviating from the benchmark distribution based on the place of final consumption. The Bagchi Report also did not favour this option for the fear that it would lead to too much centralization of taxation powers.

The key concerns about this option would thus be political. Notwithstanding the economic merits of a National GST, it might have a damaging impact on the vitality of Indian federalism.

Pros:

- If levied on a comprehensive base at a single rate, it would clear the system of virtually all economic distortions and classification disputes.
- Replacing 36 taxing Statutes (of the Centre and 35 States and Union Territories) with only one would lead to a substantial reduction in compliance costs and free up resources for other more productive pursuits.
- It would make common market for India a reality. Goods and services would move freely within India with no check-posts, internal-tax frontiers or other barriers to trade. 22 Background Material on GST
- Ideal structure from business perspective – greater stability and facilitation of
decision making.

Pros:

- Businesses will have to deal with only one tax authority and comply with only one tax - A significant reduction of compliance costs.
- Excellent from consumer perspective as the consumer will know exactly how much is the indirect tax burden in the goods and service consumed by him.
- Cascading effect can be removed to a large extent as there will not be taxes at two levels leading to improved competitiveness.

Cons:

- Near impossibility of achieving the structure – It will require drastic modification to the Constitution of India.
- It might upset the present concept of fiscal federalism, which is the cornerstone of Indian politics.
- Entire infrastructure developed for taxation at both levels will have to undergo huge change.
- States may not agree to give up the power of taxation and depend on the Union for resources.

State GST:

The second model is to have a State GST in which the States alone levy GST and the Centre withdraws from the field of GST or VAT completely. It can be a desirable option given the mismatch in resources and responsibilities of the States. In this case, the State GST will work as the redistributing mechanism. The loss to the Centre from vacating this tax field could be offset by a suitable compensating reduction in fiscal transfers to the States. This would significantly enhance the revenue capacity of the States and reduce their dependence on the Centre. The USA is the most notable example of such arrangements, where the general sales taxes are relegated to the States. However, there would be significant hurdles in adopting this option in India, and it may not be suitable here. Third, a complete withdrawal of the Centre from the taxation of inter-State supplies of goods and services could undermine the States’ ability to levy their own taxes on such supplies in a harmonized manner.

Pros:

- Reduction of cascading effect of taxes, as there will not be tax at two levels. It enhances the revenue capacity of the States and reduces their dependence of the Centre.

Cons:

- It would seriously impair the Centre’s revenues. The reduction in fiscal transfers to the States would offset this loss, but still the Centre would want to have access to this revenue source for future needs.
- Major amendments to the Constitution of India will be required.
- The option may not be revenue neutral for individual States. The incremental revenues from the transfer of the Centre’s tax collection would benefit the higher-income States, while a reduction in fiscal transfers would impact disproportionately the lower-income States.
- Businesses will have to comply with tax laws of each State – which will definitely lack uniformity and harmony. At the same time, decision making will be impacted and may affect business stability.
- A complete withdrawal of the Centre from the taxation of inter-State supplies of goods and services could undermine the States’ ability to levy their own taxes on such supplies in a harmonized manner. In particular, it would be impractical to bring inter-State services within the ambit of the State GST without a significant coordinating support from the Centre.
Governments, both States and Union will not find it workable as it will require complete change in its finances and allocation of resources - entire distribution of taxes will need to undergo changes. But, that too will not be workable as revenue collection by each State will vary depending on the level of activities in each State and need for support to States – redistribution of taxes will become an issue.

There may be unhealthy competition among the States using local tax structure as a tool to attract industry within the States. This could lead to retaliatory measures by other States.

Non-Concurrent Dual GST:

Under the concurrent dual GSTs, the Centre and State taxes apply concurrently to supplies of all goods and services. However, a framework is needed for defining the place of supply of inter-State services and for the application of State GST to them. Therefore, as suggested in the Poddar-Ahmed Working Paper, to circumvent both of these hurdles, GST on goods can be levied by the States only and on services by the Centre only. The States already have the power to levy the tax on the sale and purchase of goods (and also on immovable property), and the Centre for taxation of services. No special effort would be needed for levying a unified Centre tax on inter-State services. Under this model, while levying the VAT on services, the Centre would essentially play the coordinating role needed for the application and monitoring of tax on inter-State services. The Centre would withdraw from the taxation of goods. Even the revenues collected from the taxation of services could be transferred back to the States, partially or fully.

Within this framework, cascading could be completely eliminated by the States agreeing to allow an input credit for the tax on services levied by the Centre. Likewise, the Centre would allow an input credit for the tax on goods levied by the States. However, the said model may not be acceptable to the Centre as well as the States. Moreover, constitutional amendment would still be required in this model since the States are not presently empowered to levy sales tax on goods where movement of such goods take place in the course of inter-State trade or commerce. Therefore, the Government has already announced its intention to follow the Concurrent Dual GST.

Concurrent Dual GST:

Under this model, the tax is levied concurrently by the Centre as well as the States. Both the Central Government and the Empowered Committee appear to favor this model. Two variants of this model have been identified in public discussions so far. The initial variant, discussed in November 2007, entailed both the Centre and the States levying concurrently the GST on goods, but most of the services (except services of a local nature) remaining subject to the Centre GST only. The Central GST would thus apply to both goods and services, extending to the entire supply chain, including wholesale and retail trade. The State GSTs would largely be confined to goods only, with minor changes from the current State VATs. Under the more recent variant, both goods and services would be subject to concurrent taxation by the Centre and the States. This variant is closer to the model recommended by the Kelkar Committee in 2002. The main difference between the two variants is in the treatment of services, reflecting apprehensions about the feasibility of defining the place of supply (i.e., destination) of inter-state services. Even the more recent variant recognizes that there would be a set of inter-state services for which the place of destination would be difficult to determine. The State tax on these services would be collected by the Centre, and then apportioned among the States in some manner.
Other notable features of this variant are as follows:

- There would a single registration or taxpayer identification number, based on the Permanent Account Number (PAN) for direct taxation. Three additional digits would be added to the current PAN to identify registration for the Centre and State GSTs.
- States would collect the State GST from all of the registered dealers. To minimize the need for additional administrative resources at the Centre, States would also assume the responsibility for administering the Central GST for dealers with gross turnover below the current registration threshold of Rs. 1.5 crores under the central Excise (CENVAT). They would collect the Central GST from such dealers on behalf of the Centre and transfer the funds to the Centre.
- Procedures for collection of Central and State GSTs would be uniform. There would be one common tax return for both taxes, with one copy given to the Central authority and the other to the relevant State authority.
- Other indirect taxes levied by the Centre, States, or local authorities at any point in the supply chain would be subsumed under the Central or the State GST, as long as they are in the nature of taxes on consumption of goods and services.

This model strikes a good balance between fiscal autonomy of the Centre and States, and the need for harmonization. It empowers both levels of government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain. It also eliminates tax cascading, which occurs because of truncated or partial application of the Centre and State taxes.

**Pros:**

- This model is achievable in the short term and no significant changes are required in the current structure of indirect taxation, however, some amendments will be required in the Constitution.
- It removes cascading effect of taxes significantly. It strikes a good balance between fiscal autonomy of the Centre and States, and the need for harmonization.
- It empowers both levels of Government to apply the tax to a comprehensive base of goods and services, at all points in the supply chain.
- It requires least change in infrastructure of tax departments at the Union and State levels.
- It improves the competitive environment for company working globally, as single taxation system reduces cost to the consumer.

**Cons:**

- It is not an ideal model. It can be a temporary or transitional model since tax would continue to be levied at two levels and compliance costs may not reduce significantly.
- There will always be uncertainty since States might depart from the principles of uniformity.
- To frame a comprehensive model for taxation of inter-State transactions of goods and services and sharing of its revenue amongst the State will be a challenge.
- Background Material on GST
- Taxation of services at State level, especially services provided nationwide (e.g. telecommunication service, transportation service), will pose challenge.

Looking to the facts, it is the most workable GST model especially taking into consideration the amendments required in the Constitution of India and achievability in the short term. This Model builds on the current structure of taxation of goods and
services and does not envisage drastic changes in the broad mechanism for levy and collection of taxes.5

**Tax Base and Rates:**

The tax base and rates, within the broad structure of a consumption-type, destination-based, credit-invoice GST. Ideally, the tax should be levied comprehensively on all goods and services at a single rate to achieve the objectives of simplicity and economic neutrality. However, governments often deviate from this ideal either because of concerns about distribution of tax burden (e.g., food), or because of administrative and conceptual difficulties in applying the tax to certain sectors of the economy (e.g., health care, education, and financial services). These concerns are likely to be paramount at both Centre and State levels and their will inevitable be calls to exempt, or tax at a reduced rate, items of importance to the poor or other particular groups.

As noted earlier, reduced rates or exemptions for basic necessities may not be an efficient way of helping the poor, because of a significant spillover of their benefits to the rich. Although the rich spend a smaller proportion of their income on such goods than do the poor, because their income is higher they are also likely to spend a larger absolute amount. As a result, the rich might gain most from applying a reduced tax rate to such goods. The needs of the poor could be more effectively addressed through spending and transfer programs. Distributional concerns should be seen as part of the overall balance of all fiscal instruments and not solely for the GST. Moreover, multiple rates and exemptions increase the costs of administration and compliance. They give rise to classification disputes, necessitate additional record keeping, and create opportunities for tax avoidance and evasion through misclassification of sales.

Notwithstanding the virtues of a single-rate and comprehensive base, debates about the proper treatment of food and a variety of other items are inevitable. In what follows, we discuss some of the most critical aspects this debate, starting with a discussion of the revenue neutral tax rates in the absence of any exemptions or other preferences.6

**Tax Rates:**

In GST design for India, it has been suggested that the tax would need to be levied at a combined Centre-State tax rate of 20 percent, of which 12% would go to the Centre and 8% to the states (vide, for example, the Kelkar Task Force Report). While they fall below the present combined Centre and State statutory rate of 26.5% (Cenvat of 14%, and VAT of 12.5%), GST at these rates would encounter significant consumer resistance, especially at the retail level, and would give rise to pressures for exemptions and/or lower rates for items of daily consumption. With the notable exception of Scandinavian countries (northern European countries), where the tax is levied at the standard rate of 25%, few countries have been successful in levying and sustaining a VAT/GST at such high rates.

Successful GST models adopted by other countries had a very broad base and a relatively modest tax rate, especially at the time of inception. For example, the New Zealand GST was introduced at the rate of 10%, with a base consisting of virtually all goods and services (with the exception of financial services). The Singapore GST was introduced at 3%, but the rate has now been raised to 7% as inefficient excises and customs duties have been progressively eliminated.

GST base in India and the GST rates that would be required to replace the current indirect tax revenues of the Centre and the States.Poddar and Bagchi (2007) calculations show that if the GST were to be levied on a comprehensive base, the combined Centre-State revenue neutral rate (RNR) need not be more than 12%. This
rate would apply to all goods and services, with the exception of motor fuels, which would continue to attract a supplementary levy to maintain the total revenue yield at their current levels.

Assuming that approximately 40% of the central excise revenues and 20% of the state VAT/sales tax revenues are from motor fuels, the balance of the revenues from other goods and services that need to be replaced by the GST are Rs 89 thousand crore for the Centre and Rs 111 thousand crore for the states, making up a total of Rs 200 thousand crore.

In 2005-06, the total private consumer expenditure on all goods and services was Rs 2,072 thousand crore at current market prices. Making adjustments for sales and excise taxes included in these values and for the private consumption expenditure on motor fuels, the total tax base (at pre-tax prices) for all other goods and services is Rs 1,763 thousand crore.

These values yield a revenue neutral GST rate of approx. 11% (200 as percent of 1,763 is 11.3%). The RNR for the Centre is 5% and for the states 6.3%. Allowing for some leakages, the combined RNR could be in the range of 12%. The Centre excise duty rates have been reduced substantially (the standard rate reduced from 16% to 10%) since 2005. At the current duty rates, the Centre RNR is likely to be in the range of 3%, bringing the combined RNR to below 10%.

These estimates are by no means precise. Even so, they give a broad idea of the levels at which the rate of a national GST could be set to achieve revenue neutrality for both levels of government. Rate of GST in some countries are Australia 10%, France 19.60%, Canada 5%, Germany 19%, Japan 5%, Singapore 7%, Sweden 25%, New Zealand 15% & Pakistan 17%.

Data Analysis:

Food:

The main issue in the application of GST to food is the impact it would have on those living at or below subsistence levels. In 2005, data, food accounted for one-third of total private final consumer expenditures. For those at the bottom of the income scale, it doubtless accounts for an even higher proportion of total expenditures and incomes. Taxing food could thus have a major impact on the poor. By the same token, a complete exemption for food would significantly shrink the tax base. There are additional considerations that are pertinent to the treatment of food. In India, food is exempted from the CENVAT. Exemption under the state VAT is restricted to unprocessed food, e.g., fresh fruits and vegetables, meat and eggs, and coarse grains. Beverages are generally taxable, with the exception of milk. In the rural sector, the predominant distribution channel for unprocessed food would be either a direct sale by the farmer to final consumers or through small distributors/retailers. Even where food is within the scope of the GST, such sales would largely remain exempt because of the small business registration threshold. The large size of farm community in India, which is mostly unorganized, consideration needs to be given to whether it is advisable to exempt (with no right of input tax deduction) all unprocessed farm produce sold by them at the farm gate. In the case of cash crops (produce for further manufacturing or processing, e.g., cotton, coffee, beans, and oil seeds), it would not be in the interest of the farmers to be exempted from tax. They should thus be allowed the option of voluntary registration to pay the tax. It is recognized that an exemption for first sale at the farm gate would be difficult to administer and create inefficiencies in distribution and marketing of farm produce.

These considerations pose some difficult policy issues. Given that food is currently
exempt from the CENVAT, the GST under a single-rate, comprehensive-base model would lead to at least a doubling of the tax burden on food (from 4% state VAT to a combined GST rate of 10-12%). It would call for some tangible measures to offset the impact on the lower-income households. One would be to limit the exemption only to cereals as some of the other food items have lower distributional characteristics.

The alternative of exempting food altogether (or zero rating) would not be any better. First, the revenue neutral rate would jump from 10-12% to 18%. While the poor would pay less tax on food, they would pay more on other items in their consumption basket. Whether and to what extent they would be better off would depend on the composition of their consumption basket. The higher standard rate would, in turn, lead to pressures for exempting other items (e.g., medicines, books, LPG, and kerosene). Third, it could preclude unification of the tax rate on goods with that on services, which are currently taxable 14%. Imposition of tax rate at 18% on hitherto exempt services (e.g. passenger travel, health, and education) would encounter significant political resistance. Fourth, one cannot expect any improvement in taxpayer compliance at such high rates. To the contrary, greater visibility of the Centre tax at the retail level could have a negative impact on compliance.

A lower rate for food, instead of complete exemption should be considered. If the lower rate were to be 5%, the revenue neutral standard rate (based on 2005 rate structure) would be pushed up to 16%. This may be a reasonable compromise, provided all other goods and services are made taxable at the single standard rate of 16% or 22%. An important question is the definition of food that would be eligible for the lower rate. To keep the base broad, and limit the preference to items of consumption by the lower-income households, the lower rate should be confined to ‘unprocessed’ food items (including vegetables, fruit, meat, fish, and poultry). Excluding from the preference food pre-packaged for retail sale can further restrict its scope. This definition would not be without problems, especially where the processing value added is small. For example, if rice were taxable at 5% as unprocessed food, but flour taxable at 22% as processed food, it would encourage consumers to buy wheat and then have it processed into flour.

**Land and Real Property:**

Under the ‘old’ VATs (such as those in Europe), land and real property supplies are excluded from the scope of the tax. To minimize the detrimental impact of an exemption under a VAT, business firms are given the option to elect to pay tax on land real property supplies.

Under a modern GST/VAT (e.g., in Australia, New Zealand, Canada, and South Africa), housing and construction services are treated like any other commodity. Thus, when a real estate developer builds and sells a home, it is subject to VAT on the full selling price, which would include the cost of land building materials, and construction services. Commercial buildings and factory sales are also taxable in the same way, as are rental charges for leasing of industrial and commercial buildings. There are only two exceptions: (1) resale of used homes and private dwellings, and (2) rental of dwellings: □ A sale of used homes and dwellings is exempted because the tax is already collected at the time of their first purchase, especially for homes acquired after the commencement of the tax. If the sale were to be made taxable, then credit would need to be given for the tax paid on the original purchase and on any renovations and additions after the purchase. Except where the prices have gone up, the net incremental tax on resale may not be significant. Theoretically, this system does create a windfall for the existing homes build and acquired prior to the commencement of the tax. In practice,
the windfall is not significant, as the home construction would have attracted other taxes on construction materials and services that prevailed at the time. Residential rentals are also exempted for the same reason. If rents were to be made taxable, then credit would need to be allowed on the purchase of the dwelling and on repairs and maintenance. Over the life of the dwelling, the present value of tax on the rents would be approximately the same as the tax paid on the purchase of the dwelling and on any renovation, repair, and maintenance costs. In effect (and as with other consumer durables), payment of VAT on the full purchase price at acquisition is a prepayment of all the VAT due on the consumption services that the house will yield over its full lifetime. A resale of a dwelling is exempted for the same reason: the tax was pre-paid when the dwelling was initially acquired. Many private individuals and families own residential dwellings (including their homes and summer residences) which they may rent to others. They are generally not in the VAT system, so do not get a credit for the VAT paid when they initially acquire their new home. Nor do they claim any credit for any repairs or renovations they may have made to the existing homes. If the rental of such dwelling were subject to tax, owners should also be given a credit for the taxes paid on such costs—which would be complex, and difficult to monitor.

Thus, virtually all countries exempt long-term residential rents and resale of used residential dwelling. However, short-term residential accommodation (in hotels, for example) is normally subject to VAT. Any commissions charged by the agents and brokers for the sale or rental of a dwelling are treated as a service separate from the sale or rental of the dwelling and attract tax regardless of whether paid by the buyer or the seller.

Sale or rental of vacant land (which includes rental of car parking spaces, fees for mooring of boats and camping sites) is also taxable under the ‘modern’ VAT system. It would make sense to incorporate these concepts in the design of GST in India as well. Conceptually, it is appropriate to include land and real property in the GST base. To exclude them would, in fact, lead to economic distortions and invite unnecessary classification disputes as to what constitutes supply of real property.

In the case of commercial and industrial land and buildings, their exclusion from the base would lead to tax cascading through blockage of input taxes on construction materials and services. It is for this reason that even under the European system an option is allowed to VAT registrants to elect to treat such supplies as taxable. The State VAT and the Service Tax already apply to construction materials and services respectively, but in a complex manner. For example, there is significant uncertainty whether a pre-construction agreement to sell a new residential dwelling is a works contract and subject to VAT. Where the VAT does apply, disputes arise about the allocation of the sale price to land, goods, and services. While land is the only major element that does not attract tax, the tax rates applicable to goods and services differ, necessitating a precise delineation of the two. Extending the GST to all real property supplies, including construction materials and services, would bring an end to such disputes, simplify the structure, and enhance the overall economic efficiency of the tax.

One potential argument against the levy of GST to land and real property would be that they already attract the stamp duty. This argument can be quickly discarded as the purpose and structure of the stamp duty is quite different from that of the GST. Stamp duty is a cascading tax on each conveyance of title to real property, whereas the GST is a tax on final consumer expenditures. The GST does not impinge on commercial property transactions, after taking into account the benefit of input tax credits. It does not result in tax cascading. Under the model described above, in the case of residential
dwellings, the GST would apply to the first sale only. Thus, the two taxes cannot be viewed as substitutes. However, the application of GST to real property transactions does warrant a review of the structure and rates of stamp duties and registration fees. The rates should be lowered and the structure rationalized when the GST is introduced.

**Manufacturing Sector:**

The manufacturing sector has been a major economic driver for many developing economies across the world, however, unlike most others, India's manufacturing sector has been lackluster. The Indian government recognizes the significance of the manufacturing sector in the country's economic development and is taking prudent steps to increase the investment in this sector which is publicized through Make in India initiatives. The Goods and Service Tax regime is expected to give a boost to the Indian manufacturing sectors. It will trigger a transformational shift from complex multi-layered indirect taxation system to unified indirect taxation system. The following are the impacts on the manufacturing sector:

**Reduced Cost of Production:** Manufacturing is a very competitive industry reducing the cost of production while creating incremental value for customers remains a challenge for every business. The new GST regime will greatly reduce the cascading effect. One of the major defects of the current indirect tax regime- the non-availability of tax credit of central/union taxes over state taxes and vice versa.

**Hassle Free Supply of Goods:** Border checkpoints which are tasked with material scrutiny and location-based tax compliance negatively impact the overall production and logistics time and account for roughly 60% of a truck's transit time. These unproductive transit gours coupled with regulatory impediments reduce the efficiency of Indian manufacturers compared to their international counterparts. The new GST regime will unify the Indian market and assist the smooth flow of goods within the country. Although border checkpoints may not be done away with immediately, reduced compliance scrutiny checkpoints will reduce transport hassles.

**Supply Chain Restructuring:** Three specific aspects of GST- an additional on supply of goods, the supply of goods and services to oneself, and input tax credit on inter-state sale- may propel the need of supply chain restructuring. The additional 1% tax, envisaged as a replacement for Central Sales Tax, may not be available for credit, which will add to the cost burden in the price of products. The terminology used in the constitution bill 2015 relates to supply and does not differentiate between “supply to oneself” and “supply from one person to another”. The terminology used in constitution (122nd amendment) bill 2015 relates to supply and does not differentiate between “supply to oneself” and “supply from one person to another”. The select committee has specifically stated that the additional tax should be applicable the cases where there is consideration i.e. supply to self are not to be covered are not be covered in this ambit. Clarity regarding this is expected from the GST bill. Availability of input tax credit on interstate sale of goods and services may lead to warehouse re-engineering which can remove an extra level of warehousing in supply chain, thereby leading to greater cost benefits.

**Increased Compliance Requirements:** While new benefits to business, it also has a flip side. Taking a cue from the OECD'S guidelines for place of supply, which were released earlier this year, GST may lead to increased compliance requirements.

**Area Based Exemptions:** as GST would lead to the entire country being considered a common unified market, the current area based exemptions would become irrelevant. As we do not have a finalized GST Act in hand, whether or not these areas based
exemptions would be available is a matter of concern. If these exemptions are discontinued, those who enrolled due to this incentive would be at loss.

**GST Rate:** The GST regime may be perceived as a good indirect taxation system only if the tax rates proposed by the government do not exceed the revenue neutral rate (RNR) expectations of the industry. The expected interest rate for the manufacturing industry is proposed to be 22%.

**Rail Sector:** There have been suggestions for including the rail sector under the GST umbrella to bring about significant tax gains and widen the tax net so as to keep overall GST rate low. This will have the added benefit of ensuring that all inter-state transportation of goods can be tracked through the proposed Information technology (IT) network. In passenger railway GST would replace the service tax increasing the rate of tax on the service from 12.5% to prescribed rate of GST for services.

**Conclusion:**

The Empowered Committee and finance ministry describes the GST as “a further significant improvement – the next logical step - towards a comprehensive indirect tax reforms in the country.” The study on GST has claimed that it has the potential to be the single most important initiative in the fiscal history of India. It can pave the way for modernization of tax administration - make it simpler and more transparent – and significant enhancement in voluntary compliance. For example, when the GST was introduced in New Zealand in 1987, it yielded revenues that were 45% higher than anticipated, in large part due to improved compliance. Its more neutral and efficient structure could yield significant dividends to the economy in increased output and productivity. The Canadian experience is suggestive of the potential benefits to the Indian economy. The GST in Canada replaced the federal manufacturers’ sales tax, which was then levied at the rate of 13% and was similar in design and structure as the CENVAT in India. It is estimated that this replacement resulted in an increase in potential GDP by 1.4%, consisting of 0.9% increase in national income from higher factor productivity and 0.5% increase from a larger capital stock (due to elimination of tax cascading)

The effects are critically dependent on a neutral and rational design of the GST. A proper system of GST implementation in India is still to be framed. The discussions and propositions and illustrations of selected issues as discussed that there are many challenges that lie ahead in such a design. The issues are not trivial or technical. They require much more research and analysis, deft balancing of conflicting interests of various stakeholders i.e. the interest of the state government and central government, and full political commitment for a fundamental reform of the system.

The tax rate and base needs to be properly defined as per the concurrent dual GST regime. Propositions for various sectors needs to be redefined as illustrated in the food sector and a proper system is required in the real estate sector so that it wont affect the cost of living as well as increase the revenues of the government. There is a lot of ambiguity in the taxation system proposed for the retail and manufacturing system. Experience of countries with modern VATs, such as New Zealand, Singapore, and Japan suggests that a GST with single-rate and comprehensive base can be a win-win proposition for taxpayers and the government.

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