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Towards GST Regime In India

Shruti Garg

sas14818@gmail.com

Abstract: The Lok Sabha has passed the Constitution (122nd Amendment) Bill,2014 on 6th May,2015 that seeks to bring in the Goods and Services Tax(GST), with the Hon'ble Finance Minister assuring the States that the Centre would compensate any revenue losses suffered by them over the next five years. GST is a domestic trade tax that will be levied in the form of a value added tax on all goods and services -in practice with some exemptions. It marks the transition from an existing origin-based taxation regime to a destination-based taxation regime. The introduction of GST is expected to remove the cascading effect of taxes by moving to a common tax base and subsuming various state and central taxes into Central Goods and Service Tax (CGST) and State Goods and Service Tax (SGST). The Empowered Committee describes the GST as "a further significant improvement –the next logical step - towards a comprehensive indirect tax reforms in the country." A common tax structure for goods and services in India is necessary for improving supply chain efficiencies and rationalizing business objectives. The only question that needs to be answered is when this will become a reality. Whenever it happens, it will come with a set of challenges that if addressed at the right time can take the economy to new heights.

Keywords: cascading effect, efficiency, federalism, input tax credit.

1. Introduction

Tax policies play an important role on the economy through their impact on both efficiency and equity. A desirable tax system should be able to enhance economy's competitiveness by enabling efficient allocation of productive resources thereby resulting in increase in growth and increase in real income of a country. A good tax system should keep in view issues of income distribution and, at the same time, also endeavor to generate tax revenues to support government expenditure on public services and infrastructure development (JAIN, A.2013). India has witnessed substantial reforms in indirect taxes over the past two decades with the replacement of State sales taxes by Value Added Tax (VAT) in 2005 marking a watershed in this regard (BANDYOPADHYAY,S.2011). Indirect taxes on goods and services at the state level constitute 85 percent of own tax revenue of the state governments of which sales tax alone accounts for 61 percent. In our country the goods are taxable since long but the same cannot be said for services. Lately most of the developing countries have focused on moving towards VAT and have benefited, thus indicating that other countries too would gain from its adoption. Prior to VAT implementation, the tax structure was considered problematic primarily due to the "cascading effect of taxes" whereby an item is taxed more than once from the production to the final retail sales stage. A change in regime in recent times from cascading types sales taxes to taxes based on input-tax credit within taxation of goods, as well as the adoption of a uniform rates of tax, has resulted in buoyant revenues (RAO,R.K.2008).

The Kelkar Task Force on implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 had pointed out that although the indirect tax policy in India has been steadily progressing in the direction of VAT principle since 1986, the existing system of taxation of goods and services still suffers from many problems, thereby, creating the need for a better tax-system. The effort to bring about the new tax regime was reflected, for the first time, in 2006-2007 Union Budget Speech when the then Finance Minister remarked that there is a large consensus that the country must move towards a national level GST that must be shared between the center and the states and proposed 1st April 2010 as the date for introduction of GST. It will be one of the most significant tax reforms in the fiscal history of India which will affect prices, business processes and investments in all segments of the economy and would act as a catalyst for promoting manufacturing in the country, thereby, supporting the 'Make in India' program of the Government.(ERNST & YOUNG 2015). The proposed GST regime constitutes the next step towards comprehensive reforms of indirect taxes in India. It would be the final step or a step in the right direction, depending on how the country chooses to define the constituents of this new regime (RAO,R.K.2008).

2. About GST

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Over the past several years, significant progress has been made to improve tax structure, broaden the base and rationalize the rates. Notable among the improvements made,as pointed out by AHMAD,E. & PODDAR,S.(2009) are:

- the replacement of the single-point state sales taxes by the VAT in all of the states and union territories,
- reduction in the Central Sales Tax rate to 2%, from 4%, as part of a complete phase out of the tax,
- the introduction of the Service Tax by the Centre, and a substantial expansion of its base over the years, and
- rationalization of the CENVAT rates by reducing their multiplicity and
- replacing many of the specific rates by ad valorem rates based on the maximum retail price (MRP) of the products.

These changes have yielded significant dividends in economic efficiency of the tax system, ease of compliance, and growth in revenues.

The introduction of GST in India is not an entirely new initiative, but it is to rectify certain basic implementation problems of VAT so that the tax system would be more beneficial for the economy and can function more smoothly (BANDYOPADHYAY,S.2011). GST will bring about a change in the tax system by redistributing the burden of taxation equitably between manufacturing and services (NANDAN NILEKANI). GST also known as the Value Added Tax (VAT) or Harmonized Sales Tax (HST) was first devised by a German economist Maurice Laure during the 18th century. It is a broad based and a single comprehensive tax levied on goods and services consumed in an economy.It is levied at every stage of the production-distribution chain with applicable set offs in respect of the tax remitted at previous stages. Basically,its a tax on final consumption. In other words, GST is a tax on goods and services, leviable on each point of sale or provision of service, in which at the time of sale the seller or service provider can claim the input credit of tax which he has paid while purchasing the goods or procuring the service (JAIPARKASH). GST will be more progressive due to exemption of food articles, inclusion of informal sector and higher taxes on luxury goods. This also will improve the adequacy and stability of the state resources du to broader tax base (DEOL,R.S.). While a single, unified GST would have been be a preferred option, in keeping with our federal structure, a concurrent dual GST model has been envisaged, with a Central Goods and Services Tax (CGST) and States Goods and Services Tax(SGST) being levied,in parallel, on the taxable value of every transaction through the supply chain(JAIN, B.) CGST and SGST would be applicable to all transactions of goods and services except a small negative list which are kept outside the purview of GST and the many transactions which are below the prescribe threshold limit. Commodities among negative list are alcohol, cigarettes, cigar, tobacco, LPG, Petrol, and Diesel etc (JAIPARKASH). It is proposed that GST will be destination based, i.e., in case of inter State transaction no tax will be applicable in the originating State and tax will be payable in the State of consumption (JAIN, B.).

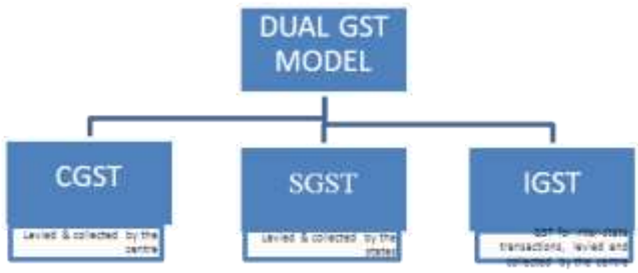

Figure 1: The dual GST model

A system of dual GST has been proposed because India, being a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation, has to work on the principle of division of powers between the centre and the states prescribed in the Constitution. The dual GST model would give adequate flexibility to the States to levy taxes on a comprehensive base of goods and services at all points in the supply chain. Thus, fiscal autonomy of the States would be maintained.(JAIN,B.)

3. SALIENT FEATURES OF PROPOSED GST AS PER CONSTITUTIONAL BILL

There is a saying in Kautilaya's Arthshastra, the first book on economics in the world, that the best taxation regime is the one which is "liberal in assessment and ruthless in collection". The proposed GST seems to be based on this very principle (Adukia,R.S.). The proposed Bill, which seeks further to amend the Constitution, *inter alia*, provides for—

•Dual GST Model: CGST and SGST
•Integrated GST (IGST) for inter-state transactions
•Input Tax Credit
•PAN based taxpayer ID – facilitating data exchange and taxpayer compliance
•Applicable on all transactions of goods and services made for consideration, other than exempted goods and services.
•Multiple indirect taxes to be subsumed at the Central and State level
•Harmonious Tax Rates in States
•Goods and Services Tax Network (GSTN): A Special Purpose Vehicle (SPV) being set up for providing shared IT infrastructure and services to Central and State Governments, tax payers and other stakeholders for implementation of GST
•GST Council comprising FMs of all States and headed by Union FM to take all major decisions relating to taxes to be subsumed, rates and exemptions
•Implemented through multiple statutes at the Central and State level, while maintaining uniformity across basic features such as chargeability, definitions, measures of levy, classification
•Concurrent jurisdictions of Centre and States for the entire value chain and for all taxpayers
•No cross utilization of Input Tax Credit (ITC) permitted between SGST and CGST
•Taxpayer required to maintain separate CGST and SGST details in books of account
•Single Return form for both SGST and CGST
(SAXENA,A.)

3.1 CENTRAL & STATE TAXES TO BE SUBSUMED

Table1:Central & State taxes to be included in GST

Central taxes	State taxes
1. Central excise duty	Value Added Tax/ Sales tax
2. Additional excise duties	Entertainment tax (unless it is levied on local bodies)
3. Service tax	Luxury tax
4. Excise duty under Medicinal & Toiletries Preparation Act	Tax on lottery, betting and gambling
5. Additional duty of Customs (levied on imports in lieu of value added tax or central sales tax)	Entry tax not in lieu of Octroi
6. Surcharges and Cess	State surcharges and cess in so far as they relate to supply of goods and services
7. Countervailing duties (on imports in lieu of excise duty	

(Source: BANDYOPADHYAY,S.2011)

3.2 IGST MODEL

The scope of this model as noted by Jain,B. is as follows:-

- ✓Centre to levy IGST on all inter-State transactions.
- ✓IGST equal to CGST + SGST.
- ✓Appropriate provisions to be made for consignment or stock transfer of goods and services.
- ✓Inter-State Seller to pay IGST on value addition after adjusting available credit of IGST, CGST, SGST on his purchases.
- ✓ Exporting State to transfer to Centre the credit of SGST used in payment of IGST
- ✓Importing dealer to claim credit of IGST while discharging his output tax liability in his own State.
- ✓Centre to transfer to the importing State the credit of IGST used in payment of SGST

3.3 GSTN MODEL

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Figure 2: The desirable features of GSTN (Source: Empowered Group on IT Infrastructure on GST headed by Shri Nandan Nilekani "The IT Strategy for GST")

4. BENEFITS OF GST

Potential benefits of implementation of GST are as follows:-

•Reduce distortion of prices due to tax policies

•Foster a common market across the country

•Distribute the burden of taxation equitably between manufacturing and services

•Lower the tax rate by broadening the tax base and reducing exemptions

•Reduce the burden on the taxpayer by eliminating cascading of taxes at multiple levels

•Simplify inter-state commerce

•Encourage compliance, and discourage non-compliance (SAXENA, A.)

5. IMPACT OF GST ON VARIOUS SECTORS OF THE ECONOMY

Introduction of GST will greatly improve the quality of the indirect tax system and, therefore, make it possible to have higher resources on a sustainable basis, which will make the fiscal situation more sustainable. It would be worthwhile to assess its positive impacts on various development areas in India.

5.1**Agriculture**: Through a comprehensive and wider coverage of input and service taxes set-off, subsuming of several Central and State taxes in the GST and phasing out of CST, it is expected that the GST could increase the prices of agricultural produce between 0.61 and 1.18 per cent and this would be a boon to millions of farmers in India (THIRTEENTH FINANCE COMMISSION,2009).

5.2 **Manufacturing**: It is estimated that the implementation of GST would reduce the overall prices of all manufacturing sectors between 1.22 and 2.53 percent (THIRTEENTH FINANCE COMMISSION, 2009).

5.3 **MSME**: There will be three categories of small enterprises in the GST regime. Those below the threshold need not register for the GST. Those between the threshold and composition turnovers will have the option to pay a turnover based tax or opt to join the GST regime. The third category of small enterprises above the turnover threshold will need to be within the GST framework. Keeping in view the interest of micro, small and medium enterprises and to avoid dual control, the States consider that the threshold for Central GST for goods may be kept at Rs.1.5 crore and the threshold for services should also be appropriately high (EMPOWERED COMMITTEE OF FINANCE MINISTERS, 2009).

5.4 **Housin**g: The GST provides for including within its scope the transactions in real estate. Therefore, for a registered real estate builder, all taxes on inputs (including that on land) will be off-set against the tax payable on the constructed property which will reduce cost of housing to the extent of embedded taxes and hence will benefit the poor (VASANTHAGOPAL).

5.5 **Food**: Given the exemption of food from CENVAT and 4% VAT on food items, the GST under a single rate would lead to a doubling of tax burden on food. Hence certain measures need to be taken in this regard (ADUKIA,R.S.).

5.6 **FMCG** : India's Fast Moving Consumer Goods (FMCG) sector has grown consistently during the past and Foreign Direct Investment (FDI) is expected to fuel growth further. Implementation of GST will have several benefits for the FMCG sector including uniform, simplified and single point taxation and thereby reduced prices (ADUKIA,R.S.).

5.7 **International trade**: The economic theory suggests that the destination-based feature of GST does not affect exports and imports. Exchange rates adjust to nullify the effects on imports and exports of moving to GST. However, the evidence from 136 countries in 2000 brings out contradiction between commonly believed view that GST encourages exports versus GST has no effect on trade pattern of a country (NCAER 2009). The evidence that the GST implementation by a country impedes international trade is based on two undesirable reasons: a) GSTs were generally imposed heavily on traded sectors; and b) governments often failed to provide adequate GST rebates for exports. However, there has not been much work on empirical relationship between VAT usage and export and import performance (DESAI AND HINES, 2002). While exports can be expected to register an increase, imports are likely to decrease. The gains in exports are expected to vary between 3.2 and 6.3 percent and imports are expected to gain somewhere between 2.4 and 4.7 per cent (THIRTEENTH FINANCE COMMISSION, 2009).

5.8 **Inflation**: It is anticipated that, other things remaining the same, this would encourage manufacturers and distributors to reduce the prices of their produce and ultimately benefit the consumers. Hence, a 'flawless' GST would be viewed as pro-poor and not regressive (VASANTHAGOPAL).

5.9 **GDP:** The implementation of a 'flawless' GST across goods and services is expected to induce India's Gross Domestic Product somewhere within a range of 0.9 to 1.7 per cent.

6. CONTENTIOUS ISSUES

There are some challenges which need to be addressed with utmost care while implementing GST:-

- Two main reservations of the States: 1•Loss of Revenue 2•Loss of Autonomy
- Many states want commodities such as petroleum and alcohol to be outside the purview of GST
- States fear that they will lose substantial revenue on account of GST being a destination based consumption tax
- At what level should the tax be levied , exclusively by the Centre or only by the States, or by both?
- What should be its design, the base and the rates and the system of implementation?
- How will the system be harmonized, in case the tax is levied at more than one level?

7. CONCLUSION

"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).The transition to GST will have to be managed in a phased manner and will require proactive and timely planning. If GST is to be a success, there should be uniformity of approach across all states as well as strong disincentives for noncompliance with agreed framework.(JAIPARKASH). Implementation of changes will have to be managed through robust program management across various company stakeholders in the entire value chain (ERNST & YOUNG 2015). Apart from various other policy instruments, India must pursue taxation policies that would maximise its economic efficiency and minimise distortions and impediments to efficient allocation of resources, specialisation, capital formation and international trade.(NCAER 2009) Although there are many hurdles to be crossed before the implementation of GST the Central government reiterated its commitment towards the adoption of a 'flawless' GST for the survival of the India's economy in the face of increasing international competition consequent to globalization and liberalization (VASANTHAGOPAL). It will foster a common market across the country, reduce compliance costs and promote exports. It can provide a fiscal base for local bodies to enable them to fulfill their obligations (NANDAN,N.). It is expected that aggregate incidence of dual GST will be lower than the present incidence of the multiple indirect taxes in force. The combined GST is expected to be in the range of 14-16% (JAIPARKASH). With the introduction of GST, all the cascading effects of CENVAT and service tax would be removed with a continuous chain of set-offs from the producer's point to the retailer's point, 12 other major Central and State taxes would be included in GST and Central Sales Tax (CST) will also be phased out, the final net burden of tax on goods, under GST is expected to fall (BANDYOPADHYAY,S.2011). It will also improve the international cost competitiveness of native goods and services. Further it will also encourage an unbiased tax structure that is neutral to business processes and geographical locations (ADUKIA,R.S.).

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