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GOODS AND SERVICE TAX IN INDIA: ONE NATION, ONE TAX

Dr. Shanti Rai*

ABSTRACT

Tax reforms are an integral part of the development process of both developed and developing economies. In India various tax reforms have been undertaken by successive governments from time to time which gained momentum after the economic reforms were initiated in the early 1990's. The aim of these reforms was to introduce transparent, equitable and fair taxation system so that both direct and indirect tax payers feel the duty and the social obligation to pay the taxes. With these principals in mind government of India recently introduced Goods and Service Tax which is the most critical direct tax reform. This was introduced to remove various impediments (in the form of uncertain & unpredictable indirect tax regime) to a smooth business especially in the manufacturing sector. This is in line with ambitious "Make in India" project which is a major policy initiative of the present government at the center that would enable India to become a manufacturing hub. In this backdrop present paper aims to analyze the background of GST consisting of review of 40 years of journey to a common market, basic features of the proposed GST, major benefits and structural flaws of it. Last section offers broad conclusions of the study.

***KEYWORDS**: Indirect Tax, Reform, GST, Cascading Effect, Tax Structure, Services, Make in India.*

Introduction

Our constitution prescribes different powers to centre and states to make legislations for levying taxes on goods and services at various levels. Accordingly India has multiplicity of taxes. Under the current indirect tax structure Central and State governments are empowered to levy taxes on manufacture and retail sales respectively. Tax on manufacture includes Central excise duty, Service tax and taxes on interstate sale of goods which is levied by the centre but collected by the States. On the other hand state taxes include Sales Tax or VAT, Entry Tax on entry of goods in the state, Property Tax, Purchase Tax and Agriculture Tax. Besides multiplicity of taxes the centre has two distinct powers- the power to impose tax on inter-state sales of goods, though tax is collected and retained by the state and the power to levy tax on services. Such a system makes the entire indirect tax system a complex one. Multiplicity of taxes results in tax on tax which leads to cascading of taxes and it also created number of returns and payments by the tax payer. Moreover there are various tariff and non tariff barriers such as octroi and entry tax which hinders the free flow of trade across the country. All these issues led to the introduction of one tax i.e. GST which hopefully will mitigate number of these problems to a large extent.

As an idea, GST is unexceptionable. The constitution of India (Article 301) promised common market for India. Following this spirit of the constitution on 1st July India transitioned to a revolutionary new Indirect Tax regime that will integrate the country's $ 2 trillion economy and 1.3 billion consumers into a vast single market. In a large-complex federal system of Indian democracy introduction of GST is unprecedented in the tax history after the tax reforms of post-1991.

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* Associate Professor, Department of Economics, Avadh Girls' Degree College, Lucknow University, Lucknow, Uttar Pradesh, India.

40 Years Journey to a Common Market

The Implementation of GST in India is not an overnight thought. The seeds of it were sown in the year, 2005 itself, although even before that various initiatives were taken by various governments to reform the tax structure (both direct and indirect taxes). In the year, 1978 The Indirect Taxation Enquiry Committee headed by L K Jha, 8th Governor of the Reserve Bank of India suggested change in the taxation structure by moving to a Modified Value Added Tax (MODVAT). In 1986 V P Singh, Finance Minister in the Rajeev Gandhi government introduced MODVAT which enabled manufacturers to obtain full reimbursement for excise duty paid components and raw materials. It was expected to reduce the cascading effect of multipoint excise levies and eventually decline in overall prices. In the year 1991-92 Manmohan Singh, Finance Minister in P V Narsimha Rao's government appointed Raja Chelliah (public finance expert),to head a Tax Reforms Commission, which recommended the introduction of VAT and service tax. In 1994 for the first time services were taxed at the rate of 5%. In 1999 Empowered Committee was formed on State VAT and launch of VAT was announced with effect from April 1, 2002, but the date was shifted to 1st April, 2003 due to severe opposition from traders, especially in BJP ruled Delhi and few other states. During the tenure of Jaswant Singh as Finance Minister, a report produced by a Task Force unveiled the first design of a Goods and Service Tax (GST) suggesting a single rate of 7% for states and 5% for the Centre.

Under Prime Minister Manmohan Singh and Finance Minister P Chidambaram VAT was implemented in States on 1st April 2005.The VAT was the first comprehensive measure to bring uniformity in the tax system of the states, but because it was a state level reform and together imposed heavy tax burden upon businesses hence after the implementation of VAT next logical step was GST. In the year 2007, Chidambaram announced that GST would be introduced in April, 2010. Discussion paper on GST was released in January, 2009 by P Shome, advisor to the Finance Minister. The terms of reference of the 13th Finance Commission were broadened to include GST in 2009-10 and it suggested compensation to states. In 2011 Finance Minister Pranab Mukherjee introduced The Constitution (115th Amendment)Bill for the GST framework and a team was set up to lay down road map for GST headed by Yashwant Sinha, which submitted its report in 2013. But due to severe opposition from BJP ruled states the UPA government failed to get the proposed law through parliament and the bill lapsed. Then a committee headed by Infosys CEO Nandan Nilekani recommended The Goods and Services Taxation Network (GSTN) in order to provide IT infrastructure and services for implementation of the GST. In the year, 2014-15 Arun Jaitley, Finance Minister in Prime Minister Modi's government introduced the Constitution Amendment Bill in December, 2014 which was approved by Lok Sabha in 2015. Later on after the approval of Rajya Sabha GST council started functioning. GST council initially fixed April 1st as the rollout date, but subsequently deferred. Finally GST came into effect on 1st July, 2017.

GST-A Comprehensive Tax Reform

Undoubtedly GST is a comprehensive indirect tax reform which ushers in an era of 'one nation, one market' which has been brought about by the deletion of Entry 52 in the Constitution which gave the states the power to levy entry tax on goods entering their territory. It will be levied on consumption of goods and services throughout India and it is based on the input tax credit method. It would be levied and collected at each stage of sale or purchase of goods or services starting from the manufacturer or import and till the last retail level. Once it is in force, GST will subsume at least 17 state and federal taxes. Keeping in view federal structure of the country, where both the centre and the states/UTs have the powers to levy and collect taxes through appropriate legislation, GST is proposed to be a dual levy where the Central Government will levy and collect Central GST(CGST) and the State/UTs will levy and collect State/UTs GST(SGST/ UTGST). The Centre will also levy and collect Integrated GST (IGST) for inter-state supply of goods and services but such tax shall be apportioned between the Centre and the states. The CGST and SGST will be levied and collected simultaneously on every transaction of supply of goods and services except goods which are outside the purview of GST and transactions which are below the prescribed thresholds. Under the GST regime, tax liability arises when the taxable person crosses the turnover threshold of Rs. 20 lakh. In case of Northeastern and 'Special Category' states threshold limit is Rs. 10 lakh. The SGST will be chargeable only when the supplier and recipient are both located within a state but such condition is immaterial for the purpose of CGST. Both CGST and SGST will be levied on the same price unlike state VAT which is levied on the value of goods inclusive of CENVAT.

For the effective implementation of GST a technological system created by GSTN has been introduced. All tax returns are required to be submitted online. The technological system developed by Infosys has been tested and has been found satisfactory. A two- month relaxation period is given for the submission of tax return. As far as revenue losses are concerned the states have been guaranteed a revenue growth of 14% on the revenues collected by them in 2015-16 as per the agreement reached between the Centre and the states in the GST Council. The Centre will compensate the losses in case of any revenue shortfall and it has also guaranteed 14% growth of revenue for a period of five years, which has been built into the Constitution Amendment Bill.

The Empowered Committee of the Finance Minister suggested two guiding principles for GST rates- First, it should be citizen friendly and second, it should maintain adequate revenue for the Central and states governments. Keeping in view these principles the GST Council has approved four main tax slabs- 5 %, 12 %, 18 % and 28 % that aims to lower tax incidence on essential items and to keep the highest rate for luxury and demerits goods. Under GST, the government has fixed GST rates on 1,211 goods and 500 services in the range of five to 28 per cent. The lowest rate of 5 per cent will be on items of mass consumption which are used particularly by common people. The second and third category of standard rates of 12 and 18 per cent will accommodate most of the goods and services. The fourth slab of 28 per cent is levied mainly on white goods such as refrigerators, washing machines etc. Gold and rough diamonds do not fall under the current rate slab and will be taxed at 3% and 0.25% respectively while luxury goods such as SUVs and sin goods such as pan masala, tobacco & aereated drinks face a cess. Certain items such as alcohol, petrol, diesel and natural gas will be exempt under the GST. In addition to these, the GST Council has also classified certain items under the 0 per cent tax rate, implying that GST will not be levied on them (See box).

GST Rates in 2017

No Tax (0%)

- **Goods**: This list includes items of daily use such as wheat, rice, milk, eggs, fresh vegetables, meat, fish, sindoor, bindi, stamps, judicial papers, printed books, newspapers, bangles, handloom, bones and horn cores, bone grist, bone meal, kajal, children's' picture, drawing or colouring books, human hair.
- **Services:** Grandfathering service has been exempted under GST. A low budget holiday may get cheaper as hotels and lodges with tariff below Rs 1,000 are in this category. Rough precious and semi-precious stones will attract GST rate of 0.25 per cent.

5% tax

- **Goods:** Food items such as fish fillet, packaged food items, cream, skimmed milk powder, branded paneer, frozen vegetables, coffee, tea, spices, pizza bread, rusk, sabudana, cashew nut, cashew nut in shell, raisin, ice, apparel below Rs 1000 and footwear below Rs 500 ,Some items in the fuel category like bio gas, kerosene and coal, items from the health industry like medicine, insulin and stent, agarbatti (incense sticks), kites, postage or revenue stamps, stamp-post marks, fertilizers, first-day covers and lifeboats are included in this category.
- **Services**: Transport services as railways & airways and small restaurants will also be under the 5% category.

12% tax

- **Goods**: Yet another category of edibles like frozen meat products, butter, cheese, ghee, dry fruits in packaged form, animal fat, sausage, fruit juices, namkeen and ketchup & sauces, cell phones, cutlery items like spoons, forks, ladles, skimmers, cake servers, fish knives, Ayurvedic medicines and all diagnostic kits and reagents, utility items like tooth powder, umbrella, sewing machine and spectacles and indoor game items like playing cards, chess board, carom board and other board games like ludo and apparel above Rs 1000 will attract 12 per cent tax.
- **Services:** Non-AC hotels, business class air ticket, state-run lottery, work contracts will fall under 12 per cent GST tax slab.

18% tax

- **Goods:** Another set of consumables like- biscuits, flavoured refined sugar, pasta, cornflakes, pastries and cakes, preserved vegetables, jams, sauces, soups, ice cream, instant food mixes, curry paste, mayonnaise and salad dressings, mixed condiments and mixed seasonings and mineral water, footwear costing more than Rs 500 , items like printed circuits, camera, speakers and monitors, printers (other than multi function printers), electrical transformer, CCTV, optical fiber are priced at 18 per cent tax under GST. Other items in this slab include bidi leaves, tissues, envelopes, sanitary napkins, note books, steel products, kajal pencil sticks, headgear and its parts, aluminium foil, weighing machinery (other than electric or electronic weighing machinery), bamboo furniture, swimming pools and padding pools.
- **Services:** AC hotels that serve liquor, telecom services, IT services, branded garments and financial services.

28% tax

- **Goods:** Chewing gum, molasses, chocolate not containing cocoa, waffles and wafers coated with choclate, pan masala and aerated water, bidi, paint, wallpaper, ceramic tiles, personal care items like deodorants, shaving creams, after shave, hair shampoo, dye and sunscreen are in the highest tax slab.
- **Services:** Private-run lotteries authorized by the state, hotel with room tariffs above Rs. 7500, 5-star hotels, race club betting, cinema will attract 28% tax slab under GST.

Major Benefits of GST

The virtues of the GST need to be acknowledged. Now one tax will subsume many taxes and it will integrate the entire value chain for the purpose of taxation. So both the Centre and the states will concurrently charge duty on the entire value chain, thus creating cleaner dual VAT which would minimize the disadvantages of completely centralized system. This will definitely reduce non-compliance because traders are going to declare more transactions in order to avail the credits earlier (self-policing incentive inherent in GST). This is most important transformational aspect of GST. Earlier the trader cheated because he was not eligible for many credits except VAT credits. So he used to buy from someone who was also exempted from VAT. But now if they will not declare their transactions, they will lose various credits e.g. credits of central duties paid on input goods, central duties paid on input services and duties paid on countervailing duty on imports. This would also encourage these producers to buy raw materials from different registered dealers and would bring in more and more suppliers under the tax net. So compliance will take place because of self interest. This will be facilitated through the GSTIN number which is essential for carrying out any business activity in India. According to GST expert V S Krishnan, 'GSTIN number consists of 15 digits, where first two digits are state numbers and the next 10 digits are income tax PAN. By incorporating PAN in the GSTIN number the direct and indirect data bases are linked which will reduce human interface between the taxpayer and the tax administration and thus will help in reducing corruption'. Another significant benefit of GST related to tax governance is-dual monitoring structure of the GST. This dual monitoring would create desirable tax competition and cooperation between Centre and State authorities. If one fails to detect tax evasion there is the possibility that the other authority may detect it. Moreover a common base and common rates will further facilitate administration as far as collection of taxes on inter-States sales is concerned. At the same time various exceptions will also provide the requisite fiscal autonomy to the States.

The resources of the Central and State governments are going to increase because tax base has become more buoyant. GST experts firmly believe that the poorer states are going to get far higher revenue because they are destination states or consumption states. This is the reason why Bihar passed the legislation first. There are estimates to show that the revenue of UP and Bihar may grow at 25% which is far higher than the guaranteed rate of 14%.On the other hand richer states like Maharashtra will gain because they are service tax hubs like Pune and Mumbai. They may lose on Central Sales Tax (CST) but they will gain on services. Just like Maharashtra Karnataka has the Bangalore and Tamil Nadu has Chennai as service tax hub. According to government data Maharashtra collects Rs. 15000 crore from Octroi but its collection from service tax will be around Rs. 20,000 to 25,000 crore(Indian Express, June 23, 2017) Thus all the states will gain after GST although the poorer states will grow at a faster rate in terms of growth of revenue. This way GST addresses the issue of equity in some manner.

GST will also facilitate 'Make in India' campaign of the Modi Government by introducing single tax platform. Current value chain from raw material to retail is fractured for the purpose of taxation along State lines. The manufacturing part of the value chain is taxed by the Centre and the trading part is taxed by the states, thus it is not integrated. The Central Sales Tax (CST) on inter-State sales of goods, various intra-State taxes and extensive countervailing duty exemptions that favor imports over domestic production are some of the taxes in the current system which creates distortions. Now all these distortions will be eliminated with the introduction of GST which will subsume most of the other taxes. Besides it GST would be applied on imports as well hence the negative protection favoring imports against domestic manufacturing would be eliminated.

Another transformational aspect of GST is related to the abolition of Entry 52, which is entry tax. Constitution of India (Article 301) promised a common market for India, but in spite of it we don't have one common market. In the pre-GST regime our country remained divided and fragmented with inter-state barriers in the form of entry tax. It has been estimated by the economists that 16% of a trucks time carrying goods is spent at check posts. Now with the abolition of entry tax goods can freely move across state borders.

Under the proposed GST central government would set up five-member authority to look into the indulgence in profiteering by the traders and it has the power to impose a penalty, order e reduction in final prices and cancel the registration. As per Section 171 of the CGST/SGST, any reduction in tax rate on goods and services or any benefit of ' input tax credit' must be passed on to the customers by the traders through appropriate reduction in prices. Failure to do so would mean the trader is indulging in 'profiteering'. This system of reward (benefit of input tax credit) and punishment in- built in the proposed GST is going to benefit both the producers and Consumers.

The Design Flaws

- GST is no mean achievement but concerns over basic structure, the issue which is more serious, must be addressed now. Being a value added tax GST is definitely going to help the economy in the long run but according to Bibek Debroy (member Niti Ayog) this happens only if there is a real value added tax with a single rate or not more than two rates, one for the essentials like food and medicines and another for the rest as in other countries. The original GST was structured this way. But current GST has rates of 0,.25,3,12,18,28 and many higher rates depending upon the cesses that may be imposed on so called sin goods. Excluding the exempted list with 0% tax rate we have 5 rates which, according to Yoginder K Alagh, will bring back large part of the messiness of the past as interested groups of traders will then lobby for transfer from one rate to the other and the simplicity of the GST is lost.
- Multiplicity of rates along with various exemptions create hindrance in the path of gains that GST is supposed to bring in like efficiency, lower compliance cost, greater tax revenue, lower collection costs etc. Empirical cross country evidence on VAT suggests that such gains happen when all items are included and there are no more than two or three rates. Roughly 300 items in the centre's list and 80 items in the state list have 0% rates and we have 5 different rates. Thus, according to Bibek Debroy, GST council has deviated quite a bit from this goal in working out compromise solutions and lost an opportunity to really have a very wide GST base which was the recommendation of the Thirteenth Finance Commission. GST expert V S Krishnan accepted that we have lost an opportunity to really have wider tax base. In 2015-16 such concessions/ exemptions on excise duty had a revenue impact of Rs. 2, 24,940 crore. Government figures for September 2015 further reveal that 1,36,365 indirect tax cases were pending before the courts out of which 40,967 cases were before Supreme Court(Bibek Debroy) Primary reason behind these tax disputes is differences in rates across items. GST should have eliminated classification disputes, but it does not. Mr. Virappa Moily asked 'Is Kitkat chocolate or biscuit'?, because chocolate and biscuits have different rates. Similarly Parachute oil is 'coconut oil' or 'hair oil'? Is McDonald's McSwirl ice cream or a dairy product? There are several such examples and matters where courts will have to adjudicate because of differences in rates, even people will approach Supreme Court which will be requested to answer such questions in due course.
- There are several classifications that defy reason. Washing machines and refrigerators are taxed higher as luxury items whereas essentials such as tampons and sanitary pads are treated as semi-luxury items. Similarly many products for the differently-abled like crutches, calipers, hearing aids, Braille paper, typewriters and wheelchairs would attract a GST of 5%, on which no tax was levied earlier(since 2006). Earlier the proposed range was from 5 to 18% which was brought down to 5% after the interventions of the finance ministers of Kerala and Tripura. In comparison, items used to embellish your body will attract less and in some cases no GST. So kajal, kumkum, bindi, bangles are not taxes at all, and gold and rough diamond will attract a GST of just 3% and 0.25% respectively. Similar is the insensitivity in taxing agriculture while paying lip service to the cause of farmers. Tractors and other agriculture appliances are being taxes at 12%, tractor tyres and tubes, engines and other parts are taxed at 28%. A tax rate of 28% has been imposed on pesticides and 18% on construction of cold storage for preservation of vegetables, fruits and food grains. Fertilizer was taxed at 12% initially but after the protests by the opposition parties it has been reduced to 5%. Similarly man- made fibre and yarn is taxed at 18% while the end product is taxed at 5% which will be death knell for textile traders because nearly 80% of them are medium, small, micro and non-integrated textile players. The logic behind this entire scheme is incomprehensible.
- Under proposed GST states and the Centre will divide the tax base into 90: 10 for turnover under Rs.15 million and 50:50 for turnover over Rs. 15 million. But what will be the procedure to decide whether one's tax authority will be the state government or the central government is not clear which is going to create lot of confusion in the near future. Thus some experts believe that GST should have been under one unified authority.
- As far as returns are concerned GST should have introduced fewer returns. In its current form GST requires businessmen to file three returns a month and an annual return. Thus they have to file total 37 returns. If the business is run in different states where the tax authority is state government then in that case number of returns must be multiplied by the number of states in which business is located.

- GST should have reduced the discretion of the tax administrator, particularly 'Anti-profiteering Authority' who will check whether input tax credits availed by a registered person have been proportionately passed to the customers or not. This authority has the power to impose a penalty, order a reduction in final prices and cancel the registration of any person that indulges in 'profiteering'. If the statements by officials at the highest level are to be believed, then in extreme cases traders will be sent to jail. According to Yogendra K. Alagh this took away all the elegance of the GST. He further believes that 'Markets work with supply elasticity, not the danda'.

Conclusion

Introducing GST in a democratic country like India with federal structure is no mean achievement. Few countries, probably 6 to 7, have the GST although figures of about 140-160 countries having GST are floating around. Of the countries that have the GST, Canada and India are probably the only ones that have some kind of federal structure (Bibek Debroy). As an idea GST is unexceptionable and it is a right step in the direction of making India a common market as envisaged in the Constitution of India (Article 301). It is also expected to provide relief to both the producers and consumers by providing comprehensive coverage of input tax credit. GST will also lead to resource and revenue gain for both Centre and States through widening of tax base and improved tax compliance. Undoubtedly there are certain structural flaws like multiple rates and exemptions, differential treatment of goods viss-a vis service (as discussed above) the need is to deal with it as soon as possible. Finance Minister is expected to deal with it in the second round. Actually GST should have been given a trial run of two- three months before it was actually rolled out. This trial run would have boosted the confidence of the businesses. Anyway GST is in the infant stage, which must be carefully nurtured for full advantages of it in the near future.

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