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A COMPARATIVE ANALYSIS OF GST AND VAT: WHICH ONE IS BETTER?

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ABSTRACT

This study deals with the historical tax reform in the era of Indian economy. The author has tried to investigate the several facets of the Goods and Service Tax, beginning with the background and the various justifications for the same. The author also tried to find out the vision of the government to implement GST and why it is necessary to implement it without prior preparations. Historical testimony was collected and analyzed to provide a validate decision and supporting literatures were explored. For testimony, various implied models including dual concept were discussed in detail. Further, the authors tried to measure the differences between Pre & Post- GST era with empirical data. Finally, future implications were outlined with a critical evaluation.

KEYWORDS: *Goods and Service Tax, Historical Tax Reform, Pre & Post- GST Era.*

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Introduction

Backdrop

GST (Goods and Service Tax)is a value added tax (consumption-based tax) levied on manufacturing, services and sales which will substitute all indirect taxes levied by state and central government. Before implementing GST in India, it was assumed that it will enhance the economic growth and the gross domestic production of the country. Implementation of GST in all the States of the country except Jammu and Kashmir itself was a landmark step for the government which encompasses through various stages. If we compared our GST with other countries we found that in most of the countries there is a single taxation levied on goods and services. The proposed GST will act as a revolve to reduce unemployment in the country. It was assumed thatGST will bring back the efficiency in the tax system and it will restrict the leakages. Fiscal motives to implement the proposed GST shall be: (i) To expand the fiscal space and improve economic viability of the government by way of increasing public expenditure under the targeted revenue constraints; (ii) To eliminate the definitional separation between goods and services; and (iii) To achieve efficiency in tax system and envisage the powers and responsibilities of taxation authority.

The government was trying hard to implement GST from the last many years in the country but it was very difficult to adjust the sharing ratio between the Central government and State government. It was decided and recommended by the GST committee that 100 percent of the revenue losses would be compensated by the Central Government in a phase manner i.e. 100 percent for 3 years and 75 percent and 50 percent for the next 2 years. The key objectives of theGST reforms are: (i) Expanding the current tax base by including more economic services to the GST purview and shortening the list of exemptions; (ii) To avoid multi-stage taxation and achieve targeted tax compliance by minimizing additional tax burden; (iii) To enhance the competitiveness of Indian business firms to the level of International organizations by removing hidden taxes; and (iv) To establish a unique national market for various goods and services by unifying the tax rates and tax structure across the country. This paper endeavors to focus on understanding the conceptual framework of goods and service tax and its probable impact on the revenue of the government.GST is believed to be a crucial tax reform after independence for stimulating economic growth. Moreover, GST will enhance sales tax revenues to the government; minimize the tax burden of end-users and make imports/exports business competitive. Indian states are confused whether it will reduce their tax revenue and whether they will get proper compensation from the central government against the revenue loss.

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Historical Background

In the year 2000, the then Prime Minister of India Shri Atal Bihari Vajpayee started the discussion on Goods and Services Tax (GST) by setting up an empowered committee which was headed by AsimDasgupta who was the Finance Minister in the West Bengal Government. At the time of introduction of FRBM Act, 2003, Kelkar suggested GST as an advanced version of VAT. P Chidambaram had mentioned in his budget speech for the financial year 2006-07 about the need and relevance of GST law. The responsibility of preparing a draft report for the introduction of GST was given to the Empowered Committee of state finance ministers. In 2008, the empowered committee finalized the views over GST and submitted a detailed road titled "A model and roadmap for Goods and Services Tax (GST) in India.The UPA government aimed to introduce GST on April 1, 2010. Opposition parties did not allow them to pass the bill. The Lok Sabha officially passed the Goods and Service Tax Bill, 2014, on May 6, 2015 and the Rajya Sabha passed it in August 2016. On May 20, 2017 the GST council fixed four different tax rates under GST (5%, 12%, 18% and 28%).

Inferred Models of Goods and Service Tax

Generally, GST consists of three models: Central GST (CGST), States GST (SGST) and Dual GST - Non-concurrent dual GST and Concurrent dual GST.

- **CGST:** In this model the Union Government will have the responsibility to levy and collect major portions of the country's tax revenue. State governments have little scope to impose tax on various goods and services.
- **SGST:** Under SGST model, the state governments alone have the responsibility to levy and collect GST and the central government withdraws its authority from imposing GST or VAT completely. Central government will cover its revenue loss due to the renunciation of SGST taxable area by way of adjusting its fiscal transfers to state governments. State governments can use SGST to improve their revenue capacity as well as fiscal management.
- **Non-Concurrent Dual GST:** In Non-Concurrent Dual GST model, GST on services can be imposed and collected by the center only, while the tax on goods can be imposed by the respective state governments only. State governments as of now have the authority to impose tax on sale and consumption of goods, and the center imposes taxes on all services. In case of inter-state services, there is no need for any special effort for levying a unified center tax. This non-concurrent dual GST model was not acceptable to both the states as well as the center. Hence, central government has shown its strong desire to implement concurrent dual GST.
- **Concurrent Dual GST – Indian Model of GST:** Concurrent dual GST comprises both CGST and SGST and is levied on common tax base. Indian GST is an example of concurrent dual GST. In this model, GST will be imposed and collected byboth the governments simultaneously. SGST shall be regulated by the state governments and CGST by the central government. All kinds of goods and services without any distinction will be included in this proposed GST regime, except for a few exceptions.

Key Features of Indian Dual GST

The key features of proposed Indian dual GST are:

- **Single Registration:** A unique registration number can be allotted to each taxpayer on the basisof their PAN. Tax can be identified, imposed and collected by using this PAN-linked registration card. Additional three digits can be added to the existing PAN to identify registration for CGST and SGST.
- **Uniform Method:** Net banking should be used for tax payments. Other modes of paymentmechanisms are not allowed. Collection procedures of both CGST and SGST are almost similar, except additional information on the tax payment challan. Amount of SGST can be paid through CGST challan and vice versa.
- **One Common Return:** The taxpayer need to file one common tax return for both CGST andSGST. One copy of tax return should be given to the concerned state tax administration and second copy to be produced before central government authority. Online submission (e-filing) to concerned authorities is highly appreciated.
- **Classification of Goods and Services:** Based on Harmonized System of Nomenclature (HSN), goods and services can be classified for CGST and SGST.

- **Regulation and Administration:**State governments are responsible for collecting CGST on behalf of centralgovernment from dealers whose gross turnover is less than the threshold limit of ₹1.5 crores under CENVAT and this amount should be transferred to the center. By doing so, the center can minimize the administrative resources and related expenses. Threshold limit can be further categorized based on gross sales. ICAI gives broad idea about the threshold limit of GST. “An amount of ₹10-20 lakh can be allowed common for both goods and services. If total turnover of goods is up to ₹1.5 crores exclusively assigned to state government then total turnover of services up to ₹1.5 crores can be assigned to center. If the total turnover is above the threshold limit of ₹1.5 cr it can be assigned to both center and state for the administration of CGST and SGST respectively”.

Past Researches

Ehtisham Ahmed and Satya Poddar (2009) in his research paper on “Goods and Service Tax Reforms and Intergovernmental Consideration in India” and found that GST introduction will provide simpler and transparent tax system with increase in output and productivity of economy in India. But the benefits of GST are critically dependent on rational design of GST.

Ahmad (2009) the authors of this document discussed the proposed GST in India, in particular regarding the location of supply rules for services to be approved and how to apply dual GSTs. The authors discussed options to introduce dual GST in India, such as dual GST, national GST or main GST. A better option under simultaneous double GST was the option that GST applies to both goods and services. Other options determine whether CST belongs to goods and services, but the state only applies to products. This option also recommended a single return using both CGST and SGST details and PAN-based subscriptions. Given the difficulty of identifying the countries in which SGST can pay for services, another variant of Dual GST is that the Center collects the SGST and then allocates it as a scientific basis. On the other hand, ITC is available in some provinces. In the province of Quebec, the figure is treated as zero, so the ITC can be saved. However, there are certain limitations to the recovery of the ITC. This dual system has caused many problems. The paper discussed these issues with different baselines / treatments given to the same product under GST and QST / PST and concluded that it would be desirable to apply the same tax base under all taxes in federal scenarios. In this article, the authors pointed out that the introduction of GST in India would lead to benefits such as higher energy efficiency, more economic prosperity, more exports and an increase in GDP. It also suggests that taxes should be low, that indirect taxes should be included in the GST and that exceptions should hardly be present. This paper examines the impact of GST on import, tax collection and export.

Schenk (2009) the authors study the American VAT system for VAT on financial services in comparison with the universally applicable GST / VAT. Since VAT is difficult to quantify via financial services, it is difficult to levy VAT. GST / VAT can be imposed if financial service costs are imposed, but it is very difficult to assess the services included in interest expenses of financial institutions. This is because interest income also has a part of the income that borrowers and borrowers have to borrow money together. This part, however, is very difficult to isolate and identify. For this reason, most economies are exempt from financial services (leading to an increase in ITC costs) or zero-funding. Finally, this document recommends higher costs due to exemptions from financial services. Thus, if the recipient is subject to tax under the GST, if the ITC is partially authorized (approximately 75%).

Keating (2010) 11 GST applies ambiguous evasion / avoidance provisions in Australia and New Zealand under the GST Act in both countries. The author compares the anti-fraud provisions of the two countries, examines their effectiveness and assesses whether the taxpayer has successfully avoided the law. The author suggests that if the interpretation of the law is stated on the basis of the court judgment in New Zealand, it will be difficult for the evaluator to avoid the law.

Benedict (2011) The author wants to examine the legal provisions for financial services in accordance with the Australian GST Act and to check whether the provisions are correctly interpreted according to the original purpose of the legislation and how the identified concerns can be remedied. The author also discusses the provisions in Australia for the taxation of financial provisions and the legality of the legislator’s tax on financial services. State exporters do not impose an indirect sales tax. However, the import exchange reports all its income and currently taxes its state. In this system, compliance is easier and GST remains a destination based load. Another option discussed is that, just like in Canada, one center will distribute the GST federal government for share-based weekly sales. However, this model can be very difficult to deal with problems. The responsibility of both CGST and SGST is another model presented in this document. The report also discusses that it is clear that the introduction of GST will certainly increase tax standards, reduce tax costs in product prices and increase exports in general. Also with regard to compliance, this document states that registration, return, etc. are PAN-based and separate from each other and from center and state. This article concludes that the introduction of GST in the Indian economy would be beneficial.

Pinki, Supriya Kamma and Richa Verma (2014) in their research on “Goods and Service Tax- Panacea For Indirect Tax System in India” and concluded that the new government in India is positive towards implementation of GST and it is beneficial for India, as well as for consumers in long run if its implementation is backed by strong IT infrastructure.

Rashid et al. (2014) in this paper the authors study impact of GST in Malaysia since it is proposed to introduce GST in Malaysia in 2015. The GST is being introduced mainly so as to increase the revenue collections of the government and reduce the deficit. The authors have studied the impact of the introduction of this GST and its relation to certain indicators like the consumer price index and the structural balance. For this the relation between these factors and the GST are studied for Singapore, Thailand and Indonesia so that whilst implementing GST in Malaysia the administration can adopt the best practice. The paper recommends transparency in implementing GST and review of the rates/base of GST after 5 years and rectification based on the 5 year experience.

Impact of GST on Indian Economy

GST is one such mission which is expected to provide the much needed stimulant for economic growth in India by transforming the existing basis of indirect taxation towards free flow of goods and services within the economy and also eliminating the cascading effect of tax on tax. In view of the important role that India is expected to play in the global economy in the years to come, the expectation of GST being introduced is high not only within the country but also the neighboring countries and in developed economies of the world. Impact of GST in Indian economy can be observed in the following areas:

- **Increased FDI**

India in particular is the major attractive destination for investment by the foreign investors, it was assumed that the flow of foreign investments may increase once the GST is implemented as the present complicated multiple tax laws are one of the reasons foreign companies are wary of coming to India in addition to prevalent corruption.

- **Growth in Overall Revenue**

As per the statistical data reveled by the Central Government, India could generate a revenue of $ 15 billion per annum by implementing Goods and Service Tax as it would promote exports, raise employment and boost growth.

- **Reduce Tax Burden**

This double taxation prevents manufacturers from producing to their optimum capacity and related growth. GST would take care of this problem by providing tax credits to the manufacturer.

- **Input Tax Credits**

GST provides credits for the taxes paid by producers earlier in the goods/services chain. This would encourage these producers to buy raw material from different registered dealers and would bring in more and more vendors and suppliers under the purview of taxation.

- **Exports**

GST also removes the customs duties applicable on exports. Our competitiveness in foreign markets would increase on account of lower cost of transaction. A National Council of Applied Economic Research study suggests that GST could boast India’s GDP growth by 0.9 to 1.7 per cent.

- **Gross Domestic Product (GDP)**

In terms of growth impact of GST implementation, the near term could be a mess, with adjustment costs for the private sector grappling with inter-sector implications, and the central government trying to compensate states for revenue loss. If the GST rate is set at around the 17-18 per cent, service producers would face an increased tax burden while manufacturers would see a fall. That could cause manufacturers not to pass through benefits and service providers to pass on costs. This would lower consumption and overall growth. At present, the effective indirect tax rates on services and goods are 15 per cent and 22.5 percent, respectively.

- **Inflation**

Initially, the implementation of the GST in the near-term could bring some upturn in inflation; however, the effect should be transitory. The service tax rate could shoot up from the current level of 15 per cent. Under the GST tax regime, this tax rate goes up to 18 per cent. This has led to fears that inflation could rise in the short-term. A revenue-neutral rate (RNR) of 15 per cent with a low rate of 12 per cent and a standard rate of 18 per cent would have a negligible inflation impact. But a higher RNR with a lower rate of 12 per cent and a standard rate of 22 per cent meanwhile would have a 0.3-0.7 percentage point impact on aggregate inflation. Consumer Price Inflation (CPI) could rise by 0.2 percentage points, if the GST rate is kept at 18 per cent. If the rate is set at 22 per cent, CPI could increase by 0.7 percentage points.

- **Foreign Exchange**

The GST will be welcome news for the Indian rupee (INR). So far, the currency has yet to see a GST boost. It is believed that GST will lead to wider foreign direct inflows of investment and a narrow current account deficit-factor that should help the INR to eventually outperform other Asian and emerging market currencies.

Empirical Evidences: A comparative study of VAT and GST

To understand the post- GST situation better, we conducted an empirical study which involved a plethora of businessmen who had migrated to GST regime. The data was collected in the months of June- August 2018. The area was in and around Jaipur City. Hypotheses were developed to verify the differences between pre- GST and post- GST based on four bases: Convenience; Technology; Timeline; Support (from authority).

Table 1: (T-Test for differences between Pre- GST and Post- GST)

Bases	t-Value	Sign. Level (2-tailed)	Null Hypothesis
Convenience	-2.525	0.012*	**Rejected**
Technology	2.799	0.005**	**Rejected**
Timeline	1.543	0.124	Accepted
Support	-9.845	0.000**	**Rejected**

It was clear from Table-1 that both the regimes differed heavily with respect to Convenience, Technology and Support. But, timeline had no impact which meant that both the regimes are having similar timeline. Further, for Convenience & Support, GST was the winner. But, technology was the problem. As a new concept, it might need some time to take off. Overall GST is gaining momentum rapidly among the businessmen as they too feel that it is the future of the country.

Future Implications of GST

Implementation of GST in India was more focused towards the campaigns launched by Government of India. Campaigns like Make in India, Start-up India, Digital India and Skill India helps the government to attain its mission of New India 2022. The National Democratic Alliance (NDA) Government was more focused to change the bureaucratic environment of the country which will encourage the investors both domestic and foreign.Goods and Services Tax helps to improve the ratings of investment in India globally. It is very early to measure the implications of GST in the future but following points may highlight its impact on Indian Economy:

- **Reduction in Prices:**It will give a thrust to the existing tax-credit system, which will drive tax efficiency for manufacturers, wholesalers and also for consumers of goods and services. Input tax credit scheme under GST will decrease the overall cost incurred by the manufacturer which will reflect as price reduction in various inflation indices in the long-term.GST could have a negative impact on service sector, which contributes over 50% of Indian GDP. The existing rate of Service Tax is 15% which would surge to 18% in Goods and Service Tax system.

- **Pricing and Profitability:** The subsequent tax expenditure after GST would have a direct impact on the Margins and Price Bands which would be re-examined and a reduction in prices will have a direct impact on consumer demand.
- **Government Revenue:** Despite the expected change in pricing, the government is expected to set GST at revenue neutral rate, so there might be no significant change in Government Revenue but on the other hand, Central Government is trying to make GST registration compulsory which will increase the number of retailers and tax payers than existing one in the system.
- **Increase in Cash Flows:** Goods and Service Tax is set to boost cash flows through the removal of concept of excise duty. Being a consumption-based tax, GST would now be collected at the time of sale/supply over current tax predicament being collected at the production/removal of goods.
- **Recompense Location Bias:** This would enable uniformity through states and would not let investors discriminate states on basis of tax advantage. The only thing that would drive investor's capital will be profitability, cash flows, and performances promoting smaller businesses and entrepreneurship without location bias.
- **Uniform Per Capita Taxation:** As mentioned above, Goods and Service Tax being destinationbased tax would allow poverty stricken states like Bihar to increase its tax revenue. As GST would be paid to states where the consumption of goods takes place, the state's tax revenue would be driven by population (more the population, more the consumption) rather than number of businesses/industries. This would ultimately increase the per tax capita of consumption dominant state.
- **Tax Evasion:** Being a destination based tax system, Goods and Service Tax Framework would reduce tax evasion by large extent and will promote the manufacturers and retailers to use bills and invoices.

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