

# A STUDY ON PROPOSED GOODS AND SERVICES TAX [GST] FRAMEWORK IN INDIA

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## 1.0 HISTORY OF TAXATION

### What is Tax?

The word tax is derived from the Latin word ‘*taxare*’ meaning ‘to estimate’.

“A tax is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority” and is any contribution imposed by government whether under the name of toll, tribute, impost, duty, custom, excise, subsidy, aid, supply, or other name.” (Black’s Law Dictionary)

Funds provided by taxation have been used by states and their functional equivalents throughout history to carry out many functions. Some of these include expenditures on war, the enforcement

of law and public order, protection of property, economic infrastructure (roads, legal tender, enforcement of contracts, etc.), public works, social engineering, and the operation of government itself. Most modern governments also use taxes to fund welfare and public services. These services can include education systems, health care systems, pensions for the elderly, unemployment benefits, and public transportation. Energy, water and waste management systems are also common public utilities. Governments use different kinds of taxes and vary the tax rates. This is done to distribute the tax burden among individuals or classes of the population involved in taxable activities, such as business, or to redistribute resources between individuals or classes in the population.

Taxation has **four main purposes or effects**: Revenue, Redistribution, Repricing, and Representation.

The main purpose is revenue: taxes raise funds to spend on roads, schools, hospitals, and on other indirect government functions like market regulation or legal systems.

The second purpose is redistribution, which means transferring wealth from the richer sections of society to poorer sections.

A third purpose of taxation is repricing of certain goods to increase or decrease their consumption. Taxes are levied to discourage consumption of certain items like say tobacco.

A fourth effect of taxation has been representation, where the citizens by paying taxes demand accountability in return from the rulers or governments. Several studies have shown that direct taxation (such as income taxes) generates the greatest degree of accountability and better governance, while indirect taxation tends to have smaller effects.

## **History of Taxation**

The first known system of taxation was in Ancient Egypt around 3000 BC - 2800 BC in the first dynasty of the Old Kingdom. Records from that time show that the pharaoh would conduct a biennial tour of the kingdom, collecting tax revenues from the people. Other records are granary receipts on limestone flakes and papyrus. Early taxation is also described in the Bible. In Genesis (chapter 47, verse 24 - the New International Version), it states "But when the crop comes in,

give a fifth of it to Pharaoh. The other four-fifths you may keep as seed for the fields and as food for yourselves and your households and your children." Joseph was telling the people of Egypt how to divide their crop, providing a portion to the Pharaoh. A share (20%) of the crop was the tax.

The history of taxation can be briefly described country wise as follows:

### **i. Egyptian Taxes**

The first known taxation system was in ancient Egypt. The Pharaoh would collect taxes twice a year from the Egyptians. One of the most commonly taxed items in the ancient world was cooking oil, which was actually taxed throughout Egyptian history because of shortages. Egyptian taxes eventually became so widely known that they were even mentioned in the bible, "When the crop comes in, give a fifth of it to Pharaoh."

### **ii. Athens, Greece**

To the Athenians in Greece, war was a lifestyle, and a pricey one at that. As such, Athenians taxed their citizens for war costs with a tax they called "eisphora." The most historic factor of this tax was that it exempted no one, which many consider the first democratic taxation system, as after the wars the money was often refunded to the people. There is also some documentation of a tax put on foreigners (or any individual without an Athenian mother and father), called "metoikion."

### **iii. Salt Tax in India**

Salt has been taxed in India for centuries. However, in 1835 the British East India Company raised the import taxes drastically after they began to impose rule over Indian provinces. The salt tax was raised and lowered by multiple leaders and events, and was not repealed until 1946.

### **iv. Rome and Caesar**

Taxes called "portoria" were first levied in Rome on imports and exports to the city. Caesar Augustus, who is now considered a genius tax strategist of his time, gave individual cities the job

of collecting taxes. He also raised sales taxes on slaves from 1% to 4%, and created a tax to raise retirement funds for soldiers of the army.

#### **v. Great Britain**

The occupation of the Roman Empire may have sparked the flame for first taxes in England. During the 11th century Lady Godiva's husband, Leofric, Earl of Mercia, said he would lower taxes were she to ride through the streets naked on a horse. Lady Godiva made the now famous ride and lowered taxes for her people.

#### **vi. The French Revolution**

Before the French Revolution, civil unrest laid heavily on the shoulders of high taxes for lower classes. While clergymen and nobles were exempt to taxes, peasants and regular wage earning workers were not. The tax gap also left lower class citizens unable to pay court fees, making justice unaffordable except by those wealthy enough to afford it. While the true cause of the French Revolution is still being debated today, many Historians feel these high and unfair taxes were a large contributing factor to the civil unrest.

#### **vii. United States**

The history of taxation in the United States began when it was composed of colonies ruled by the British Empire, French Empire, and Spanish Empire. After independence from Europe the United States collected poll taxes, tariffs, and excise taxes. The United States imposed income taxes intermittently until 1895 when unapportioned taxes on interest, dividends and rents were ruled unconstitutional. The advent of the 16th Amendment to the United States Constitution modified the apportionment requirement in 1913, and since then the income tax has become one of the means of funding the Federal Government.

#### **viii. India**

In India, the tradition of taxation has been in force from ancient times. It finds its references in many ancient books like 'Manu Smriti' and 'Arthashastra'. There was a perfect admixture of direct taxes with indirect taxes and they were varied in nature. India's history of taxation suggests existence of a large and composite taxable population. With the advent of the moguls in India the

country witnessed a sea of change in the taxation system of India. Although, they also practiced the same norm of taxation but it was more homogeneous in structure and collection. The Islamic rulers imposed *jizya*. It was later on abolished by Akbar. However, Aurangzeb, the last prominent Mughal Emperor, levied *jizya* on his mostly Hindu subjects in 1679. Reasons for this are cited to be financial stringency and personal inclination on the part of the emperor, and a petition by the *ulema*. His subjects were taxed in accordance with the property they owned. Government servants were exempt, as were the blind, the paralyzed, and the indigent. Its introduction encountered much opposition, which was, however, abolished. *Jizya* is a per capita tax levied on a section of an Islamic state's non-Muslim citizens, who meet certain criteria. From the point of view of the Muslim rulers, *jizya* was a material proof of the non-Muslims' acceptance of subjection to the state and its laws, "just as for the inhabitants it was a concrete continuation of the taxes paid to earlier regimes." In return, non-Muslim citizens were permitted to practice their faith, to enjoy a measure of communal autonomy, to be entitled to Muslim state's protection from outside aggression, to be exempted from military service and the Zakat as obligatory upon Muslim citizens. The period of British rule in India witnessed some remarkable change in the whole taxation system of India. Although, it was highly in favor of the British government and its exchequer but it incorporated modern and scientific method of taxation tools and systems. In 1922, the country witnessed a paradigm shift in the overall Indian taxation system. Setting up of administrative system and taxation system was first done by the Britishers.

Broadly, there are two types of Taxes viz. Direct and Indirect taxes.

- a) Direct Tax – It is the tax paid to the government directly by the assessee. The Income Tax, Wealth Tax and Corporate Tax are classical examples of direct taxes in India.
- b) Indirect tax - When the taxes are paid indirectly, it comes under the purview of indirect taxes. It is the tax that is levied on goods or services rather than on persons or organizations. The excise duty; customs duty, sales tax and service tax are examples of indirect taxes.

Taxes in India are levied by the Central Government and the State Governments. Some minor taxes are also levied by the local authorities such the Municipality or the Local Council. The authority to levy a tax is derived from the Constitution of India which allocates the power to levy

various taxes between the Centre and the State. An important restriction on this power is Article 265 of the Constitution which states that "No tax shall be levied or collected except by the authority of law". Therefore each tax levied or collected has to be backed by an accompanying law, passed either by the Parliament or the State Legislature.

Article 246 of the Indian Constitution, distributes legislative powers including taxation, between the Parliament and the State Legislature.

“Article 246. - Subject-matter of laws made by Parliament and by the Legislatures of States.-

(1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List").

(2) Notwithstanding anything in clause (3), Parliament, and, subject to clause (1), the Legislature of any State also, have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution referred to as the "Concurrent List").

(3) Subject to clauses (1) and (2), the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution referred to as the "State List").

(4) Parliament has power to make laws with respect to any matter for any part of the territory of India not included in a State] notwithstanding that such matter is a matter enumerated in the State List.”

Schedule VII enumerates these subject matters with the use of three lists –

- **List - I** entailing the areas on which only the parliament is competent to makes laws
- **List - II** entailing the areas on which only the state legislature can make laws, and
- **List - III** listing the areas on which both the Parliament and the State Legislature can make laws upon concurrently.

Separate heads of taxation are provided under lists I and II. There is no head of taxation in the Concurrent List (Union and the States have no concurrent power of taxation). The list of thirteen Union heads of taxation and the list of nineteen State heads are given below:

<b>Sl.No.</b>	<b>Parliament</b>
1.	Taxes on income other than agricultural income (List I, Entry 82)
2.	Duties of customs including export duties (List I, Entry 83)
3.	Duties of excise on tobacco and other goods manufactured or produced in India except (i) alcoholic liquor for human consumption, and (ii) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in (ii). (List I, Entry 84)
4.	Corporation Tax (List I, Entry 85)
5.	Taxes on capital value of assets, exclusive of agricultural land, of individuals and companies, taxes on capital of companies (List I, Entry 86)
6.	Estate duty in respect of property other than agricultural land (List I, Entry 87)
7.	Duties in respect of succession to property other than agricultural land (List I, Entry 88)
8.	Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freight (List I, Entry 89)
9.	Taxes other than stamp duties on transactions in stock exchanges and futures markets (List I, Entry 90)
10.	Taxes on the sale or purchase of newspapers and on advertisements published therein (List I, Entry 92)
11.	Taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce (List I, Entry 92A)
12.	Taxes on the consignment of goods in the course of inter-State trade or commerce (List I, Entry 93A)
13.	All residuary types of taxes not listed in any of the three lists (List I, Entry 97)

<b>Sl.No.</b>	<b>State Legislature</b>
1.	Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues (List II, Entry 45)

2.	Taxes on agricultural income (List II, Entry 46)
3.	Duties in respect of succession to agricultural income (List II, Entry 47)
4.	Estate Duty in respect of agricultural income (List II, Entry 48)
5.	Taxes on lands and buildings (List II, Entry 49)
6.	Taxes on mineral rights (List II, Entry 50)
7.	Duties of excise for following goods manufactured or produced within the State (i) alcoholic liquors for human consumption, and (ii) opium, Indian hemp and other narcotic drugs and narcotics (List II, Entry 51)
8.	Taxes on entry of goods into a local area for consumption, use or sale therein (List II, Entry 52)
9.	Taxes on the consumption or sale of electricity (List II, Entry 53)
10.	Taxes on the sale or purchase of goods other than newspapers (List II, Entry 54)
11.	Taxes on advertisements other than advertisements published in newspapers and advertisements broadcast by radio or television (List II, Entry 55)
12.	Taxes on goods and passengers carried by roads or on inland waterways (List II, Entry 56)
13.	Taxes on vehicles suitable for use on roads (List II, Entry 57)
14.	Taxes on animals and boats (List II, Entry 58)
15.	Tolls (List II, Entry 59)
16.	Taxes on profession, trades, callings and employments (List II, Entry 60)
17.	Capitation taxes (List II, Entry 61)
18.	Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling (List II, Entry 62)
19.	Stamp duty (List II, Entry 63)

**Some of the important Central taxes are:**

- Customs duty – Tax on imports
- CENVAT – tax on manufacture
- Service Tax – tax on specified services

**Some of the important State taxes are:**

- Central Sales Tax (CST) –tax on inter-State sale of goods
- State Value Added Tax/State Sales Tax -tax on intra-State sale of goods
- Works Contract Tax -tax on contracts involving sale of goods and services

- Entry Tax -tax on entry of goods into a State
- Other local levies

## **Direct Taxes Developments**

Over the years, direct taxes have had a major impact on economic policies, creation of savings and the trend of investment. There was no proportion in terms of the impact of direct taxes on the economy and their relative share in total tax revenues. The system of direct taxes was very much complex and inefficient because of the combination of high marginal rates of personal income and wealth taxes. The corporate tax rate was pretty high. This all led to large scale tax evasion.

However over the years, the government has tried to streamline these taxes and have also gradually reduced the direct tax rates. Several incentives and exemptions have been given to encourage the taxpayers to make prompt payment of these taxes and to reduce tax evasion. Easy payment of taxes has also been enhanced by giving options of electronic filing of returns and other online facilities to the taxpayers.

## **Growth in Direct Tax Collection during the Financial Year 2009-2010**

The net direct tax collections grew by 5.77 per cent during the first two months of the current fiscal year (2009-2010). It was Rs 24,158 crore compared to Rs 22,840 crore at the same time last year. Corporate tax grew at 5.56 per cent (Rs 8578 crore against Rs 8126 crore), while personal income tax (including FBT, STT and BCTT) grew at 5.92 per cent (Rs 15,559 crore as against Rs 14,690 crore). Overall refund outgo during the period increased by 26.19 per cent (Rs 11,375 crore as against Rs 9014 crore), while refunds to non corporate taxpayers grew by 61.7 per cent (Rs 2,149 crore against Rs 1,329 crore).

### **Main Direct Tax reforms in 2009**

- IT Return forms to be more user friendly
- Centralised tax processing centre at Bangalore
- Share of direct taxes gone up by 56%

- New direct tax code proposed to be brought in 45 days

Proposed Direct Tax Code: On 12th August, 2009, Finance Minister Shri Pranab Mukherjee released the Draft Direct Taxes Code which promises to promote voluntary tax compliance and an equitable and progressive tax regime by eliminating distortions in the tax structure, introducing moderate levels of taxation, expanding the tax base and simplifying the drafting language. Based on the inputs from the public, the Government will finalize the Draft Taxes Code Bill for presentation in the winter session of Parliament, 2009. The new law is proposed to be effective from 1st April, 2011.

#### Salient Features of the Code

The Code aims to consolidate and amend the law relating to all direct taxes, that is, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax so as to establish an economically efficient, effective and equitable direct tax system. This new system will also facilitate voluntary compliance and help increase the tax-Gross Domestic Product (GDP) ratio. Another objective is to reduce the scope for disputes and minimize litigation.

Briefly, the salient features of the Code are as under:-

- Single Code for direct taxes: All the direct taxes have been brought under a single Code and compliance procedures unified. This will eventually lead to a single unified taxpayer reporting system.
- Use of simple language: With the expansion of the economy, the number of taxpayers is expected to increase significantly. Large number of these taxpayers will be small paying moderate amounts of tax. Therefore, it is necessary to encourage voluntary compliance and also to lower the cost of compliance.

For this, simple language has been used in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law. Each sub-section is a short sentence intended to convey only one point. All directions and mandates, to the extent possible, have been conveyed in active voice. Similarly, the provisos and explanations have been eliminated since they cannot be comprehended by non-experts. The various conditions

contained in a provision have also been nested. Bearing in mind the fact that a tax law is essentially a commercial law, extensive use of formulae and tables has been made.

- Reducing the scope for litigation: As far as possible, an attempt has been made to avoid ambiguity in the provisions that invariably gives rise to diverse interpretations. Power has been delegated to the Central Government/Board to avoid protracted litigation on procedural issues.
- Flexibility: The structure of the statute has been developed in a manner which can accommodate the changes in the structure of a growing economy without resorting to frequent amendments. Therefore, as far as possible, the essential and general principles have been reflected in the statute and the matters of detail are contained in the rules/Schedules.
- To ensure that the law can be reflected in a Form: For most taxpayers, particularly the small and marginal category, the tax law is what is reflected in the Form. Therefore, the A-10 structure of the tax law has been designed so that it is capable of being logically reproduced in a Form.
- Consolidation of provisions: To facilitate a better understanding of tax legislation, provisions relating to definitions, incentives, procedure and rates of taxes have been consolidated. Further, various provisions have also been rearranged to make it consistent with the general scheme of the Act.
- Elimination of regulatory functions: Traditionally, the taxing statute has also been used as a regulatory tool. However, with regulatory authorities being established in various sectors of the economy, the regulatory function of the taxing statute has been withdrawn. This has significantly contributed to the simplification exercise.
- Providing stability: At present, the rates of taxes are stipulated in the Finance Act of the relevant year. Therefore, there is a certain degree of uncertainty and instability in the prevailing rates of taxes. Under this Code, all rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the Code itself thereby eliminating the need for an annual Finance Bill. The changes in the rates, if any, will be done through appropriate

amendments to the Schedule brought before Parliament in the form of an Amendment Bill.

## **Indirect Tax System in India**

**Indirect Taxes** are taxes that are levied on goods or services and include taxes like Excise Duty, Customs Duty, Service Tax, and Securities Transaction Tax. In India, there are a number tax laws and regulations enforced by central or state governments, in order to control indirect taxation.

Some of the indirect taxes levied by the centre include customs, excise and central sales tax and while some of those levied by the states and civic bodies include passenger and goods tax, electricity duty and octroi.

Nearly all activities ranging from manufacturing to those required for final consumption are subject to indirect taxation. Activities related to trading, imports, and services are also included in this list. As a result Indirect Tax has an impact on all business areas.

At present the Indirect Taxes in India are under a transformation due to the changing fiscal reforms of the Indian government. Many new acts and laws are being introduced replacing the old laws and all related issues, which have become redundant.

In recent years, the Indian government has undertaken significant reforms of the indirect taxation system. This includes the initiation of a region-based and state-level VAT on goods. However, in order to remove barriers to inter-state trading and to attain a secured market for the activities related to services and goods more reforms are needed. Some of the reforms that can be introduced for a better indirect taxation system in India are -

- The serialized set of Indirect Taxes so far activated at the central and state levels should be amalgamated and treated as a single tax.

- The integrated Indirect Tax should be neutral at all levels such that chances of fraudulence would be minimized
- The Central Sales Tax, which obstructs easy trading between different states, should be terminated in order to boost inter-state trade

By the year 2010 the Indian government has planned to activate a Goods and Services tax neutral at all levels in order to fulfill these objectives. The government can undertake either an introduction of a national VAT or a system, which would permit both a state VAT, or a central VAT. Along with this if the government also can incorporate a central VAT that can be rebated, on the trade across the boundary lines, and then there would be minimum chances of fraudulence.

### **Indirect Taxes (Highlights of Finance Act (2) of 2009)**

- As per the Ministry Of Finance there has been significant development in planning for introducing the goods and services tax (GST) from April 1 2010.
- The sales tax model will have a Central GST and State GST.
- As a first step the rate of central sales tax (CST) has been reduced to 2 per cent w.e.f. 1<sup>st</sup> June 2008. The general rate of central value added tax (CENVAT) has been decreased from 16 per cent to 14 per cent across all goods.

## **2.0 REFORMS IN INDIRECT TAXATION**

### **Major Milestones in Indirect Tax reform**

1974	Report of LK Jha Committee suggested VAT
1986	Introduction of a restricted VAT called MODVAT

1991	Report of the Chelliah Committee recommends VAT/Goods & Services Tax (GST) and recommendations accepted by Government
1994	Introduction of Service Tax
1999	Formation of Empowered Committee on State VAT
2000	Implementation of uniform floor sales tax rates (1%, 4%, 8% & 12%) Abolition of tax related incentives granted by States
2003	VAT implemented in Haryana in April, 2003
2004	Significant progress towards a Central VAT/ Sept 2004 GST – Integration
2005-06	VAT implemented in 26 more states
2007	First GST Study Released By Mr.P.Shome in Jan 2007
2007	FM announces for GST in Budget Speech
2007	CST Phase out Starts in April 2007
2007	Joint Working group formed by EC in May 2007
2007	WG Submits its report in November 2007
2008	EC finalizes its view on GST structure in April 2008
2009	GST proposed to be implemented from 1.4.2010

**Developments in some of the indirect taxes are given below:**

**A) Customs Duty**

Customs regulation in India is through the Customs act. The Customs act came into existence in 1962 at a time when the “License Quota Permit Raj” system existed in the country. It came into

existence to check illegal imports and exports of goods. All imports into the country would be charged a duty, to give protection to the Indian industries and to check the amount of imports with a view to secure the exchange rate of the country.

Customs duty on goods imported or exported from India are levied according to the Tariff Act 1975. To monitor imports and exports, the Central government has the authority to inform the ports and airports for the unloading of the imported goods and loading of the exported goods, the location for clearance of goods imported or exported, the routes by which above goods may pass by land or inland water into or out of Indian ports.

[Customs Duties](#) include both import and export duties. However to boost competitiveness of exports, [export duties](#) form a nominal part of revenue, while import duties constitute a major part. According to the custom laws, the following are the various types of duties which can be charged.

**Basic Customs Duty:** All goods [imported](#) into India are chargeable to a rate of duty popularly known as basic customs duty, which are indicated in the First Schedule of the [Customs Tariff Act, 1975](#) and are amended from time to time under [Finance](#) Acts. The duty may be fixed on ad-valorem basis or specific rate basis. The duty may be a percentage of the value of the goods or at a specific rate. The Central Government has the power to reduce or exempt any good from these duties.

#### **Additional Custom Duty:**

**Additional duty of customs** equal to the, excise duty leviable on like goods produced or manufactured in India. This is levied under **Section 3 of Customs Tariff Act, 1975**. This is usually referred to as "countervailing duty" (CVD). However, the correct description of this duty is Additional Duty of Customs. In order to determine the applicable rate, it is essential to obtain the correct classification of the goods under the Central Excise Tariff Act, 1986. The duties under the Central Excise Tariff are on ad valorem basis. However, specific rates have been prescribed for some items. If a like product is not manufactured or produced in India, the excise

duty that would be leviable on that product had it been manufactured or produced in India is the duty payable. If the product is leviable at different rates, the highest rate among those rates is the rate applicable. Such duty is leviable on the value of goods plus basic custom duty payable. e.g. If the customs value of goods is Rs. 5000 and rate of basic customs duty is 10% and excise duty on similar goods produced in India is 20%, CVD will be Rs.1100/-. Importantly, the value for the purpose of computing additional duties of Customs is the **total** of the assessable value (generally the transaction value - roughly equal to the c.i.f. value) and the basic customs duty.

A manufacturer, importing goods to be used as inputs for manufacture of other goods, would generally be eligible for obtaining credit (called CENVAT credit) equal to the additional duty of customs paid on the imported goods. This duty amount is eligible for credit under input duty Central Excise Rules, 1944. This credit can be used for paying central excise duties on the product manufactured.

### **Special Additional Duty of custom (SAD)**

**Special additional duty** is specified under **Section 3A of the Customs Tariff Act, 1975**. The rate of special additional duty are specified by the Central Government, by notification in the Official Gazette, having regard to the maximum sales tax, local tax or any other charges for the time being leviable on a like article on its sale or purchase in India. Presently, the rate is 4%. The amount of Special Additional duty is computed by applying this rate on value, which is equal to the total of the assessable value, the basic customs duty and the additional duty of customs described above

**Export Duties:** Under this Act, goods exported from India are chargeable to export duty at the rates specified in the Customs Tariff Act, 1975, which can be amended from time to time under Finance Acts.

**Auxiliary Duty of Customs:** This duty is levied under the Finance Act and is leviable on all goods imported into the country at the rate of 50 per cent of their value. However this statutory

rate has been reduced in the case of certain types of goods into different slab rates based on the basic duty chargeable on them.

**Cesses:** Cesses are chargeable on some specified articles of exports like coffee, coir, lac, mica, tobacco (unmanufactured), marine products cashew kernels, black pepper, cardamom, iron ore, oil cakes and meals, animal feed and turmeric. These cesses are [collected](#) as parts of Customs Duties and are then passed on to the agencies in charge of the administration of the concerned commodities.

**Anti Dumping Duty:** International sellers may at times export goods into India at prices which would be less than the prices they would be charging in their domestic market. The reason for this is to capture the Indian markets, which is against the interest of the Indian industry. This is known as dumping and in order to avoid such dumping, Central Government can impose, under section 9A of Customs Tariff Act, anti-dumping duty up to margin of dumping on such articles, if the goods are being sold at less than its normal value.

Levy of such [anti-dumping duty](#) is permissible as per WTO agreement. Anti dumping action can be taken only when there is an Indian industry producing 'like articles'. Countries which are signatories to the GATT or countries with "Most Favored Nation Status" cannot be charged dumping duty.

Some other types of Custom duties are

Education cess on customs duty

Protective Duties

Countervailing Duty on Subsidized goods

Safeguard Duty

National Calamity Contingent Duty

**Additional Duty of Excise**

Section 3 of the Additional duties of Excise (goods of special importance) Act, 1957 authorises the levy and collection in respect of the goods described in the Schedule to this Act. This is levied in lieu of sales Tax and shared between Central and State Governments. These are levied under different enactments like medicinal and toilet preparations, sugar etc. and other industries development etc.

### **The Excise Duty levied under the Medicinal and Toiletries Preparation Act**

It is an act to provide levy of duty of Excise Duty on Medicinal and

Toiletries Preparation containing alcohol, opium, Indian hemp, or other narcotic drugs or narcotic

### **Changes made vide Finance Act, 2009 in Custom Duty**

- Peak rate of Customs duty maintained at 10%.
- Custom duty on certain life saving drugs reduced from 10% to 5%.
- Customs duty on bio-diesel reduced from 7.5% to 2.5%.
- Mobile phone accessories to become cheaper
- Custom duty on LCD panels halved.
- Customs duty on gold and silver import increased

### **B) Excise Duty**

Central excise duty is an indirect tax which is charged on such goods that are manufactured in India and are meant for domestic consumption. The taxable fact is "manufacture" and the liability of central excise duty arises as soon as the goods are manufactured. The tax is on manufacturing, it is paid by a manufacturer, which is then passed on to the customer.

The term "excisable goods" means the goods which are specified in the First Schedule and the Second Schedule to the Central Excise Tariff Act 1985.

The term "manufacture" refers to any process

- Related or supplementary to the combination of a manufactured product.
- Which is specified in relation to any goods in the Section or Chapter Notes of the First Schedule to the Central Excise Tariff Act 1985 as amounting to manufacture or
- Which in relation to the goods specified in the Third Schedule involves packing or repacking of such goods in a unit container or labeling or re-labeling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer.

**Three different types of Central Excise Duties exist in India. They are listed below:**

### **1) Basic Excise Duty in India**

Excise Duty, imposed under section 3 of the 'Central Excises and Salt Act' of 1944 on all excisable goods other than salt produced or manufactured in India, at the rates set forth in the schedule to the Central Excise tariff Act, 1985, falls under the category of Basic Excise Duty In India.

### **2) Additional Duty of Excise**

Section 3 of the 'Additional Duties of Excise Act' of 1957 permits the charge and collection of excise duty in respect of the goods as listed in the Schedule of this Act. This tax is shared between the Central and State Governments and charged instead of Sales Tax.

### **3) Special Excise Duty**

According to Section 37 of the Finance Act, 1978, Special Excise Duty is levied on all excisable goods that come under taxation, in line with the Basic Excise Duty under the Central Excises and Salt Act of 1944. Therefore, each year the Finance Act spells out that whether the Special Excise

Duty shall or shall not be charged, and eventually collected during the relevant financial year.

### **Changes made vide Finance Act, 2009 - Excise Duty**

- The general rate of CENVAT on all manufacturing goods has been brought down from 16 per cent to 14 per cent.
- Excise duty on two and three wheelers reduced from 16% to 12%
- Excise duty on pharmaceuticals down from 16% to 8%
- Excise duty on certain variety of printing and writing paper down from 16% to 8%

### **C) 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. Apart from sales tax, certain states also imposes additional charges like works contracts tax, turnover tax and purchaser tax. Thus, sales tax acts as a major revenue-generator for the various State Governments.

Sales tax is an indirect form of tax, wherein it is the responsibility of the seller of the commodity to collect and recover the tax from the purchaser. Generally, sale of imported items and sales by way of export are not included in the range of commodities which requires payment of sales tax. Moreover, luxury items (like cosmetics) are levied heavier sales tax rates. Central Sales Tax (CST) Act that falls under the direction of the Central Government takes into account all the interstate sales of commodities.

Thus, sales tax is to be paid by every dealer on the sale of any commodity, made by him during inter-state trade or commerce, irrespective of the fact that no liability to pay tax on the sale of goods arises under the tax laws of the appropriate state. He is to pay sales tax to the sales tax authority of the state from which the movement of the commodities commences. However, from

April 01, 2005, most of the states in India have supplemented sales tax with a new Value Added Tax (VAT).

The practice of VAT executed by State Governments is applied on each stage of sale, with a particular apparatus of credit for the input VAT paid. VAT in India can be classified under the following tax slabs:

- 0% for essential commodities
- 1% on gold ingots and expensive stones
- 4% on industrial inputs, capital merchandise and commodities of mass consumption
- 12.5% on other items
- Variable rates (state-dependent) are applicable for petroleum products, tobacco, liquor etc.

Central Sales tax to be reduced to 2% from April 08

#### **D) Service Tax**

**Constitutional Provision:** Article 265 of the Constitution stresses that no service tax in India shall be charged or collected other than by the concerned authority. Schedule VII divides this subject into three different sections

- Union list (only Central government has power of legislation).
- State list (only State government has power of legislation).
- Concurrent list (both central and state government can pass legislation).

An amendment (95th amendment) in 2003 was made to enable the Central government to decide the method of charging service tax and the means of collection of proceeds by the central government and state government. Subsequently a new article 268 A has been introduced for levy of service tax by Central government.

## **Creation of DGST**

The department of Director General (Service Tax) was created in 1997 to handle the huge workload resulting due to the increasing importance of service tax. The Director General (Service Tax) is in charge of the department and his role and authority are:

- Ensure the formation of efficient establishment and infrastructure under various central excise commissionerate to monitor the collection and assessment of service tax.
- To evaluate the workforce needed for proper and effective execution of service tax.
- To create a data base for the collection of service tax and to observe the revenue collection from service tax.
- To look into the proper functioning of service tax cells and perform any other function as would be required from time to time.

The modus operandi with respect to service tax came into existence from 1st July 1994. Its applicability is to the entire nation other than Jammu and Kashmir

The scope of the service tax has since been expanded continuously by subsequent Finance Acts and as on date 109 services are covered

## **E) Value Added Tax**

VAT is the indirect tax on the consumption of the goods, paid by its original producers upon the change in goods or upon the transfer of the goods to its ultimate consumers. It is based on the value of the goods, added by the transferor. It is the tax in relation to the difference of the value added by the transferor and not just a profit.

Across the globe, VAT is payable on the goods and services, which are part of the national GDP. It means that tax is applicable at every stage of the value added of the goods.

## **VAT In India**

Post liberalization, it can be said that Value Added Tax in India is one of the most important constituent of tax reforms. VAT can also be referred to as a multi point destination based system of taxation, such that tax is charged at every step of transaction in the supply chain. VAT is actually a state subject in India, acquired from Entry 54 of the state list, for which states are sovereign in making decisions. With the help of tax departments in their respective states, state governments ensure the levy of VAT. The Central government is instrumental in guiding the state government with respect to execution of VAT.

The department of revenue under the Ministry of Finance is given the power to have control with respect to direct and indirect taxes, through two statutory boards, i.e. Central Board OF Direct Taxes (CBDT) and the Central Board Of Customs and Central Excise (CBEC). The sales tax division of department of revenue is responsible for levying VAT. India had a problem of double taxation. Goods were taxed before manufacture once and then again after manufacturing. To avoid such double taxation, which had a negative impact on the economy, VAT was introduced.

### **Method of Collecting VAT**

VAT can be collected in two different methods. In method one, tax is charged both on the basis of the tax which is paid on purchase and the tax that is payable on the sale (shown separately in the invoice). Finally the difference between the tax paid on purchase and the tax paid on sale according to the invoice is VAT.

In the other method tax is collected and charged on the cumulative value of the tax paid on sale and purchase, by applying the rate of tax applicable to the goods. Which means the difference between the sale price and purchase price is VAT.

### **Benefit of VAT**

**The chief benefit for execution of VAT is:**

- Reduces tax evasion.
- Multiple taxes such as turnover tax, surcharge on sales tax, additional surcharge etc have been put an end to.
- Advocated an internal system of self assessment for VAT liability.
- Tax structure becomes easier and more visible.
- Enhances tax compliance and results in higher revenue growth.
- Encourages competitiveness of exports.

## **F) Stamp Duty**

Stamp duty is a tax, collected by the various State Governments and is charged on various documents or instruments. It must be paid in full and on time failing which it attracts penalty. A stamp duty paid instrument or document is considered a proper legal instrument or document and can be admitted as evidence in courts.

## **3.0 INTRODUCTION TO GST**

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. In simple terms, GST may be defined as a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider may claim the input credit of tax which he has paid while purchasing the goods or procuring the service

### **Origin**

Goods and Services Tax also known as the Value Added Tax (VAT) or Harmonized Sales Tax (HST) was first devised by a German economist during the 18th century. He envisioned a sales tax on goods that did not affect the cost of manufacture or distribution but was collected on the final price charged to the consumer. Thus it did not matter how many transactions the goods went through, the tax was always a fixed percentage of the final price. The tax was finally adopted by France in 1954. Maurice Lauré, Joint Director of the French Tax Authority, the

*Direction générale des impôts*, was the first to introduce VAT on April 10, 1954. Initially directed at large businesses, it was extended over time to include all business sectors.

Personal end-consumers of products and services cannot recover VAT on purchases, but businesses can recover VAT on the materials and services that they buy to make further supplies or services directly or indirectly sold to end-users. In this way, the total tax levied at each stage in the economic chain of supply is a constant fraction of the value added by a business to its products, and most of the cost of collecting the tax is borne by business, rather than by the state. VAT was invented because very high sales taxes and tariffs encouraged cheating and smuggling.

Value added taxation avoids the cascade effect of sales tax by only taxing the value added at each stage of production. Value added taxation has been gaining favor over traditional sales taxes worldwide. In principle, value added taxes apply to all commercial activities involving the production and distribution of goods and the provision of services. VAT is assessed and collected on the value added to goods in each business transaction. Under this concept the government is paid tax on the gross margin of each transaction.

### **Benefit of Goods and Services Tax**

- ✓ Eliminates cascading effect of taxes across all supply chain by reducing cost of doing business and makes the economy competitive.
- ✓ Eliminates multiplicity of taxes, rates, exemptions and exceptions.
- ✓ Eliminates dual taxation of the same transaction (e.g. VAT & Service tax on EPC (engineering, procurement and construction) contracts.
- ✓ Reduces cost of production.
- ✓ Achieves, uniformity of taxes across the territory, regardless of place of manufacture or distribution.
- ✓ Provides, greater certainty and transparency of taxes.
- ✓ Ensures tax compliance across the economy.
- ✓ Augments and creates buoyancy in the economy.

### **Background of Goods and Services Tax (GST) in India**

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. The tax base is fragmented between the Centre and the States. Services, which make up half of the GDP, are not taxed appropriately. In many situations, the existing tax structure has cascading effects. These problems lead to low tax-GDP ratio, besides causing various distortions in the economy. In this context, the Kelkar Task Force had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle.

Value-added tax (VAT) is a modern and progressive system of sales tax. It brings in the system of self-assessment giving rise to transparency and mutual trust. It is charged and collected by dealers on the price paid by the customer. The empowered committee released a White Paper on VAT on 17<sup>th</sup> January 2005. This was the uniform basis the States agreed to adopt to avoid competition between States. VAT replaced [sales tax](#) on 4th January 2005. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but the States have a liberty to set their own valuations for the VAT levied in their own territory.

The effort to introduce the new tax regime was reflected, for the first time, in 2006-2007 Union Budget Speech. The then Finance Minister Mr. P. Chidambaram 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. He proposed 1st April 2010 as the date for introducing GST. The present rates for service tax and CENVAT, that is most proximate to the global GST rate, and the continuous steps towards phasing out of Central Sales Tax (CST), clearly hints at the endeavor on the part of Government of India. Subsequently the Empowered Committee of State Finance Ministers agreed to work with the Central Government to prepare a roadmap for introducing a national level GST with effect from 1st April 2010. In May 2007 Empowered Committee (EC) of State Finance Ministers in consultation with the Central Government, constituted a Joint Working Group (JWG), to recommend the GST model. The mandate of the Working Group was as follows:

- GST should be so designed that it should be revenue neutral to the Centre and the States.

- Interests of the Special Category, North-Eastern States and Union Territories are to be especially kept in mind.
- The Group will examine different models and ensure that the power of levy, collection and appropriation of revenue must be vested with the Centre and the States by examining the pros and cons.
- The various models would have to ensure that double taxation is avoided.
- The suggested models should take into account the problems faced during Inter-State transactions and possible revenue loss.
- Focus on treatment of zero-rated goods and services and Non-VAT items.
- The interests of the Centre, States, Trade, Industry, Agriculture and Services to be adequately represented.

Within 7 months of its constitution that is in November 2007, JWG presented its report on the GST to the Empowered Committee. The Committee has accepted the report on GST submitted by the Joint Working Group. The Committee has sent its recommendations to the Government of India in the form of 'A Model and Roadmap for Goods and Services Tax in India' dated April 30, 2008, which includes outline of the GST design proposed. The views of Empowered Committee are being examined in the Ministry of Finance for a suitable response to the Committee so that further working out details is facilitated.

Some of the recommendations given by the Joint Working Group with regard to Goods and Services Tax are as follows:

- i. GST should have two components, a Central tax and a single uniform state tax across the country.
- ii. A tax over and above GST may be levied by the states on tobacco, petroleum and liquor.
- iii. The GST may not have a dual VAT structure but a quadruple tax structure. It may have four components, namely
  - (a) a central tax on goods extending up to the retail level;
  - (b) a central service tax;
  - (c) a state-VAT on goods, and

(d) a state-VAT on services.

Given the four-fold structure, there may be at least four-rate categories- one for each of the components given above. In this system the taxpayer may be required to calculate tax liability separately for the different rates of tax.

- iv. The JWG report suggested that states must tax intra-state services while inter-state services must remain with the Centre.
- v. Petroleum products, including crude, high-speed diesel and petrol, may remain outside the ambit of GST.
- vi. The report had also mooted elimination of the area-based and sectoral excise duty exemptions that are being given by the Centre.
- vii. Central cess like education and oil cess may be kept outside the dual GST structure to be introduced from April 2010. Besides central cess, the EC of State Finance Ministers has also recommended to keep purchase tax and octroi, which are collected at state and local levels, outside the GST framework.
- viii. The working group had suggested including cess and surcharges, which are levied for specific purposes on taxes at central and state levels, and had suggested to meet the specific requirement through budgetary allocation.
- ix. The report has also recommended keeping stamp duty, which is a good source of revenue for states, out of the purview of the GST. Stamp duty is levied on transfer of assets like houses and land.
- x. It has also suggested keeping levies like the toll tax, environment tax and road tax outside the GST ambit, as these are user charges.
- xi. The draft report has recommended that if the levies are in the nature of user chargers and royalty for use of minerals, and then they must be kept out of the purview of the proposed tax.

All these developments in the Indian tax Scenario, is quite evident of the governments incessant effort towards the successful introduction and implementation of the GST regime.

The First Discussion Paper on Goods and Services Tax in India by the Empowered Committee of State Finance Ministers was released on November 10, 2009.

## **Need For Goods and Services Tax in India**

There is a saying in Kautilya'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.

Firstly, while the present system allows for multiplicity of taxes being collected through an inefficient and non transparent system, the introduction of GST is likely to rationalize it and thereby plug the loop holes in this system. This will enable the government to stop pilferage and rationalize the overall taxation regime. While many areas are either under-taxed or non-taxed or over-taxed, the GST will help reduce overall tax burden of many organizations.

Introduction of an integrated Goods and Services Tax (GST) to replace the existing multiple tax structures of Centre and State taxes is not only desirable but imperative in the emerging economic environment. Increasingly, services are used or consumed in production and distribution of goods and vice versa. Separate taxation of goods and services often requires splitting of transactions value into value of goods and services for taxation, which leads to greater complexities, administration and compliances costs.

Further, Indian economy is getting more and more globalised. In recent times, a number of Free Trade Agreements (FTAs) have been signed, which will allow imports into India duty free or at very low duties. Hence, there is need to have a nation-wide simple and transparent system of taxation to enable the Indian industry to compete not only internationally, but also in the domestic market. Integration of various Central and State taxes into a GST system would make it possible to give full credit for inputs taxes collected. GST being a destination-based consumption tax based on VAT principle, would also greatly help in removing economic distortions caused by present complex tax structure and will help in development of a common national market.

A basis pre-requisite for introduction of GST meaningfully is that both the Centre and the State should replace existing taxes like Excise, State Sales Tax/ VAT, CST, Entry Tax and all other cascading-type Central/ State levies on goods and services. Any losses on account of abolition

of multiple taxes are likely to be balanced by the additional GST revenues that will obtain from taxation of services and from access to GST on imports. Moreover, India would obtain full efficiencies of a single national VAT, while retaining a federal structure. This would also be the logical conclusion of the efforts that have been made in the country during last 2 decades in moving towards VAT.

The benefits of GST legislation will be uniformity of laws across the board, greater transparency, neutrality in tax rates on various products; credit availability on interstate purchases and reduction in compliance requirements. If GST is implemented in the true spirit, it will have many positives for the stakeholders and will lead to a better tax environment.

Introducing GST will do more than simply redistribute the tax burden from one sector or group in the economy to another. The introduction of the GST brings about a macroeconomic dividend as it reduces the overall incidence of indirect taxation and therefore the overall tax burden by removing the many distortionary features of the present sales tax system. There are four important macroeconomic channels through which this happens:

- a) First, the failure to tax all goods and services distorts consumption decisions; it weakens the signaling power of relative prices. GST reduces these distortions and enables all economic agents to respond more effectively to price signals.
- b) Second, the unrefunded taxation of capital goods discourages savings and investment and retards productivity growth. This is perhaps the most important gain through introduction of GST in an emerging economy like India.
- c) Third, for a given constellation of exchange rates and price levels, violation of the destination principle places local producers at a competitive disadvantage, relative to producers in other jurisdictions.
- d) Fourth, differences in tax bases of different States and the Central government greatly increase costs of doing business. The GST based tax reform provides a real policy opportunity to do something about this problem without waiting for prior and sweeping political economy changes.

If we compare the GDP of countries like USA, China and Japan, they are significantly much higher than that of India. In fact, the GDP of few nations suggests that India has miles to go to achieve the level of the developed nations.

<b>GDP of Nations</b>	
<b>Country</b>	<b>GDP in Trillion US Dollars</b>
USA	13.84
Japan	4.3
Germany	2.81
Britain	2.14
France	2.05
Italy	1.79
Canada	1.27
China	6.99
India	1

The ongoing economic down turn and slowdown of economy across the world has, however, given India a golden opportunity to stake claim and get a cushioned berth in the world order. To achieve this, the country nevertheless needs to increase its GDP to at least twice that of the present level.

The direct taxation regime has been by and large undergoing annual fine tuning and as a result the revenue receipt in this account has considerably increased. However, reform on such scale in indirect taxes has not been done so far.

Indirect taxes are therefore urgently required to be rationalized and unified. If the GST is introduced in letter and spirit, it would certainly increase the volume of tax collection. This will provide a great stimulus to our gently moving economy, which has, of late, arrived at a level playing field vis-a-vis many major economies of the world.

### **Why GST is the preferred tax structure?**

The implementation of GST would ensure that India provides a tax regime that is almost similar to the rest of the world. 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.

Implementation of GST will also remove several roadblocks in the existing taxation system in India. Some of these are:

- a) **Tax cascading** – The Goods and Services Tax Act will overcome the problem of tax-cascading through input tax credit mechanisms. Under this system, sellers or vendors of goods and services are eligible to avail tax credits on the amount of GST paid to eligible procurements. Manufacturers can avail credits for the GST paid to procure inputs, capital goods and services used in the manufacturing process. In the same way, wholesalers and retailers can avail credits for the GST paid on procurement of stock. But the final customer who purchases the product for consumption will not be able to avail and utilize any tax credit.

Tax cascading can be understood by the following example. A tax is applied on a particular product at each stage and no credit is available, then tax will be charged at each stage whenever a good or service changes hands. In other words, tax is applied several times and is charged even on the tax which forms part of the inputs. The following taxes will be applied to the product:

- While purchasing inputs i.e. raw materials for the product, the manufacturer pays sales tax.
- When a wholesaler purchases the product from the manufacturer, then he pays tax on procurement of the product.
- When the retailer purchases the product from the wholesaler, the wholesaler again charges tax.
- Lastly, the customer purchases the product from the retailer; the retailer again charges a tax.

This layering of sales tax will significantly increase the final sales price as each party in the supply chain increases the price of the product to recover the tax they paid. The cascading effect will increase then tax is paid on tax.

There are a large number of products and range of services that are outside the ambit of CENVAT and service tax. The exempted sectors are not allowed to claim any credit of the input tax. In the same way, under the state VAT, no credits are allowed for the inputs procured and used towards exempted sectors. Non-eligibility for availment of credits leads to tax cascading. Due to large number of exemptions, the effect of tax cascading in India is significantly high.

- b) **Complexity** – Presently in India, for taxing sale of goods, there is Central Sales tax and respective VAT Acts for each state and Union territory. The Goods and Services Tax will remove this complication by having a unified code for implementation of State GST in different states. The GST will not only subsume a large number of indirect taxes but also solve the classification issues by introducing only one or two rates of tax. Other than this there would be categories that are exempted or zero rated.

Presently the activities in a supply chain are subject to several taxes. For example – the manufacture of goods is subject to excise duty and sale of these manufactured goods is subject to state VAT or CST. The GST will ensure uniform single tax across the entire supply chain.

- c) **Double taxation** – The GST will not make any difference between goods and services as GST will be levied at each stage in the supply chain. This will help in solving the problem of double taxation. The issue is not only between the taxes of customs duties, excise duties and service tax but also between service tax and VAT. The issue of double taxation was addressed by the Honorable Supreme Court in the case of BSNL vs. UOI (2006(3)SCC-1), wherein the Court held that the same activity cannot be regarded as both goods and services and hence both service tax and VAT should not be applicable on the same set of transactions. The implementation of GST will resolve the dilemma of a large number of assesseees who are not sure of application of the type of tax on certain specified transactions like software development, sale of sim cards by telecom operators, online

subscription of newspapers, value added services provided by telecom operators, right to distribute movies etc.

- d) **Composite contracts** – There are a large number of works contracts which involve the supply of goods and services which are available to customers under different supply chain arrangements. Such situations arise in a gap or overlapping in taxation of goods and services as the States do not have the power to impose tax on services and the Centre does not have the power to impose tax on sale of goods within the state. In such cases, a comprehensive solution can be provided only by implementation of GST.

The introduction of GST along with prudent accounting policies, transparency and supported by a robust electronic controls will bring down the peak rates of taxation and enhance revenue growth. This can be understood by the following table by comparing the present rates of tax and the proposed GST.

<b>Goods from producer to wholesaler</b>	<b>Present taxes (Rs.)</b>	<b>GST (Rs.)</b>
Cost of production	80,000	80,000
- Producers margin of profit	20,000	20,000
Producer's price	1,00,000	1,00,000
- Central Excise duty at 14%	14,000	Nil
- VAT at 12.5%	14,250	Nil
- Central GST at (expected rate) 12%	Nil	12,000
- State GST at (expected rate) 8%	Nil	8,000
Total price	1,28,250	1,20,000
<b>Goods from wholesaler to retailer</b>	<b>Present taxes (Rs.)</b>	<b>GST (Rs.)</b>
Cost of goods to wholesaler	1,14,000	1,00,000
- Profit margin at 5%	5,700	5,000

Total	1,19,700	1,05,000
- VAT at 12.5%	712.5	Nil
- Central GST (expected rate )12%	Nil	600
- State GST at (expected rate) 8%	Nil	400
Total price	1,20,412.5	1,06,000
<b>Goods from retailer to final consumer</b>	<b>Present taxes</b>	<b>GST (Rs.)</b>
	<b>(Rs.)</b>	
Cost of goods to retailer	1,20,412.5	1,06,000
- Profit margin at 10%	12,041.25	10,500
Total	1,32,453.75	1,16,500
- VAT at 12.5%	1,505.15	Nil
- Central GST (expected rate )12%	Nil	1,050
- State GST at (expected rate) 8%	Nil	840
Total price to the final consumer	1,33,958.9	1,18,390
Tax component in the price to the final consumer	30,467.65	22,890
Final price exclusive of taxes	1,03,491.25	95,500

From the above example it is quite clear that due to multiplicity of taxes, the final price to the consumer is much higher. Therefore the implementation of GST is only going to benefit the consumers, producers, wholesalers and retailers in the long run.

#### **4.0 GLOBAL EXPERIENCES IN GOODS AND SERVICES TAX**

The Goods and Services Tax (GST) also known as the National VAT (Value Added Tax) has been introduced in more than 150 countries. Most of the countries have a unified GST system. Brazil and Canada follow a dual system where GST is levied by both the Union and the State

governments. France was the first country to introduce GST system in 1954. The standard GST rate in most countries ranges between 15-20%. Most of the sectors are taxed except for few exemptions. The United States of America does not have a national level VAT.

## **1. AUSTRALIA**

The GST (Goods and Services Tax) is a value added tax on the supply of goods and services in Australia, including items that are imported. In most cases, GST does not apply to exports of goods or services, or other items consumed outside Australia.

It was introduced by the Howard Government on 1st July 2000, replacing the previous Federal wholesale sales tax system and designed to phase out a number of various State and Territory Government taxes, duties and levies such as banking taxes and stamp duty. The basic premise of the new tax was to broaden the tax base, which was heavily biased toward the provision of services.

Prior to the GST, Australia operated a Wholesale Sales Tax (WST) which imposed a tax on wholesales of goods. The WST was implemented in the 30's when Australia had an economy dominated by goods. Over the years however, Australia's economy evolved to be more services based, and the GST served to strip the unfair tax advantage that service providing businesses had over suppliers of goods.

The GST is levied at a flat rate of 10% on most goods and services, apart from GST exempt items, and input taxed goods and services.

GST is administered by the Tax Office on behalf of the Australian Government, and is appropriated to the states and territories.

### **Registration under GST**

Not every business in Australia needs to register for GST. A company should register for GST if both the following conditions are satisfied:

- a) The company is carrying on a business and
- b) The annual turnover will exceed \$75,000

If the company is not registered under the GST, if it meets the GST turnover threshold, then the company will be liable for 1/11<sup>th</sup> of its income (plus penalties).

### **Charge GST**

A business is liable to charge GST if is registered under GST and it makes a taxable supply.

A business makes a taxable supply when:

- It is registered;
- There is a supply for consideration;
- The supply is connected with Australia and
- The supply is not GST – free or input taxed.

### **Claim back GST**

If the business is registered, then the GST can be claimed back on any creditable acquisition or creditable importation. This term is similar to claiming credit of amount of GST paid.

A creditable acquisition (or creditable importation) is made if the business:

- Acquires something for a creditable purpose; and
- that something is a taxable supply; and
- consideration is given for that something; and
- it is registered.

Some common creditable acquisitions include:

- Computers;
- Trading stock;
- Travel expenses;
- Motor vehicles and their running costs;
- and anything that is required to run the business.

Creditable purpose is something that is acquired for the purpose of the enterprise.

The GST can be claimed back when submitting the Business Activity Statement (BAS). The Business Activity Statement (BAS) is a form submitted to the Australian Taxation Office by all businesses to report their taxation obligations. BAS is similar to the returns that are filed under India's taxation system.

### **Submission of Business Activity Statement**

If the turnover is less than \$2,000,000 and is a small business entity, then it can elect to lodge the Business Activity Statement (BAS) either monthly, quarterly, or annually.

If the turnover is more than \$2,000,000 then it must be lodged monthly in the Australian Taxation Office.

### **Maintenance of Records**

To claim the GST back on a creditable acquisition, there must be a valid tax invoice from the supplier.

There is an exception for individual items costing less than \$75.

Generally, the tax invoice should contain the following

- supplier's name and ABN (Australian Business Number);
- description of the goods or service purchased; and
- The price including the GST paid.

These invoices should be kept for a period of 5 years.

### **GST Free Supplies**

There are a small number of supplies that are GST free.

If a GST free supply is made, then GST cannot be charged, but the GST paid can be claimed back.

GST supplies include:

#### **Health and Medical Care**

- Services by medical practitioners and pathologists;
- Services by allied health practitioners such as physiotherapists, naturopaths, nurses and optometrists;
- Hospital treatment;

- Disability services;
- Medical aids and appliances;
- Pharmaceuticals;
- Health insurance.

### **Educational Supplies and Childcare**

- School and university fees
- Certain course materials
- Student accommodation
- Professional and trade courses
- Approved childcare

### **Fresh Food and Beverages**

- food and ingredients for food for human consumption
- beverages for human consumption and ingredients for such beverages
- goods to be mixed with or added to food for human consumption (including condiments, spicings, seasonings, sweetening agents or flavorings)
- fats and oils marketed for culinary purposes
- any combination of any of the above

Items specifically excluded from the definition of food are:

- live animals, except crustaceans and molluscs
- unprocessed cow's milk
- unprocessed or untreated grain, cereal or sugar cane which is unchanged in form, nature or condition
- cultivated plants that can be consumed as food for humans without processing or treatment

In effect, the exclusions mean that food will not generally be excluded from the GST until they have been processed or treated in some way. So sale of products by primary producers to processors or treaters will be subject to GST.

### **Other GST-Free Supplies**

- Sale of a "going concern"
- a grant of crown land

- certain sales of farm land
- water, sewerage and drainage;
- cars for disabled people

### **Input taxed Supplies**

There are a small number of supplies that are Input-taxed.

If an input taxed supply is made, then GST cannot be charged and GST paid also cannot be claimed back.

Input-taxed supplies include:

- Financial supplies
- Residential premises for rent
- Sales of residential premises (but not new homes)
- food at school tuckshops (optional);
- fundraising activities of charities (optional)
- certain transactions involving precious metals

When a supply is both a GST-free supply and an input-taxed supply, it is treated as the former.

## **2. CANADA**

The Canadian **Goods and Services Tax (GST)** is a multi-level value-added tax introduced in Canada on January 1, 1991, by Prime Minister Brian Mulroney and finance minister Michael Wilson. The GST replaced a hidden 13.5% Manufacturers' Sales Tax (MST).

### **Harmonised Sales Tax**

In Canada, the Harmonized Sales Tax combines the Goods and Services Tax (GST) and Provincial Sales Tax (PST) into a single sales tax.

In 1997, the provinces of Nova Scotia, New Brunswick and Newfoundland and Labrador and the Government of Canada merged their respective sales taxes into the Harmonized Sales Tax (HST). In those provinces, the current HST rate is 13%. HST is administered by the

federal government, with revenues divided among participating governments according to a formula. All other provinces continue to impose a separate sales tax at the retail level only, with the exception of Alberta, which does not have a provincial sales tax. Ontario proposed in its 2009 Budget to harmonize its 8% retail sales tax with the GST effective July 1, 2010. In July, 2009, the province of British Columbia announced plans to also merge the PST and GST effective July 1, 2010. In PEI and Quebec, the provincial taxes include the GST in their base. The three territories of Canada (Yukon, Northwest Territories and Nunavut) do not have territorial sales taxes. The government of Quebec administers both the federal GST and the provincial Quebec Sales Tax (QST). It is the only province to administer the federal tax.

The HST is composed of the GST and the 8% provincial tax and applies to the same base of goods and services that are taxable under GST. HST follows the same general rules as GST.

GST/HST registrants continue to collect GST on taxable supplies (other than zero-rated supplies) of goods and services made in Canada outside the participating provinces. On supplies made in the participating provinces, they collect HST. All GST registrants are automatically registered for HST.

### **Levy of GST**

GST is imposed at 5% in Part IX of the Excise Tax Act. GST is levied on supplies of goods or services made in Canada and include most products, except certain politically sensitive essentials such as groceries, residential rent, and medical services, and services such as financial services.

### **Payment of GST**

Almost everyone has to pay GST/HST on purchases of taxable supplies of goods and services (other than zero-rated supplies. Some sales or supplies are exempt from GST/HST. Although the consumer pays the tax, businesses are generally responsible for collecting and remitting it to the government. Businesses that are required to have a GST/HST registration number are called registrants.

Registrants collect the GST/HST on most of their sales and pay the GST/HST on most purchases they make to operate their business. They can claim a credit, called an input tax credit (ITC), to recover the GST/HST they paid or owe on the purchases they use in their commercial activities.

### **Untaxed items**

The tax is a 5% tax imposed on the supply of goods and services that are made in Canada, except certain items that are either "exempt" or "zero-rated".

For tax-free i.e., "zero-rated" sales, GST is charged by suppliers at a rate of 0% so effectively there is no GST collected. However when a supplier makes a zero-rated supply, it is eligible to recover any GST paid on purchases used in making the particular supply. This effectively removes the cascading tax from the particular goods and services.

Common zero-rated items include basic groceries, prescription drugs, inward/outbound transportation and medical devices. Certain exports of goods and services are also zero-rated.

For tax-exempt supplies, the supply is not subject to GST and suppliers do not charge tax on their exempt supplies. Furthermore, suppliers that make exempt supplies are not entitled to recover GST paid on inputs acquired for the purposes of making the exempt good or service. Tax-exempt items include long term residential rents, health and dental care, educational services, day-care services, legal aid services, and financial services.

### **3. BRAZIL**

The Tax on Circulation of Goods and Services (ICMS) is the main State tax, and is due on operations involving circulation of goods (including manufacturing, marketing, and imports) and on interstate and inter-municipal transport and communications services. ICMS is non-cumulative, and thus tax due may be offset by credits arising from the purchase of raw materials, intermediary products, and packaging materials which allows the taxpayer to record input tax credits from the ICMS paid on the purchase of raw materials, intermediary products, packaging materials. Tax credits for goods destined to become fixed assets may be

accepted, subject to certain restrictions. Rates applied to interstate commerce are 7% or 12%, depending on the destination. Export goods are exempted from ICMS.

#### **4. NEW ZEALAND**

Goods and Services Tax (GST) is a Value Added Tax introduced in New Zealand on October 1, 1986 at 10%, and later increased to 12.5% on June 30, 1989. End users pay this tax on all liable goods and services directly, in that it is included in the purchase price of goods and services.

GST registered organisations only pay GST on the difference between GST-liable sales and GST-liable supplies (i.e. pay GST on the difference between what they sell and what they buy: income less expenditure). This is accomplished by reconciling GST received (through sales) and GST paid (through purchases) at regular periods (typically every 2 months, with some qualifying companies opting for 1 month or 6 month periods), then either paying the difference to Inland Revenue Department (IRD) if the GST collected on sales is higher, or receiving a refund from IRD if the GST paid on purchases is higher.

Unlike most similar taxation regimes, there are few exemptions - all types of food are taxed at the same rate, for example. Exceptions that are present include rents collected on residential rental properties, donations and financial services.

The headline price must always be GST-inclusive in advertising and stores. The only exceptions are for businesses which claim a mainly wholesale client-base. Otherwise, displaying a prominent GST-exclusive price (i.e. larger and more obvious than the GST-inclusive price), is illegal.

#### **5. SINGAPORE**

Goods and Services Tax was introduced in Singapore on April 1, 1994, at 3%, but later increased to 4% on 1 January 2003, and 5% on 1 January 2004. It was raised again to 7% on 1 July 2007. Singapore's GST is a broad-based consumption tax levied on import of goods, as well as nearly all supplies of goods and services. The only exemptions are for the sales and

leases of residential properties and most financial services. Export of goods and international services are zero-rated.

With an ageing population, Singapore's income tax base is expected to decline. With a broad-based GST, the taxation burden will be more evenly spread among the population. Thus, the GST was introduced as part of a larger exercise to put in place a tax structure to see the country into the future.

In Singapore, the tax is broad based which include all essential goods like water, electricity, rice, etc. Hence, a low income worker who would not pay income taxes would have to pay GST on his daily living expenses. This can be a burden especially during times of high inflation when the 7% tax is paid on the increasing price of daily essentials.

GST is a self-assessed tax. Businesses are required to continually assess the need to be registered for GST.

Registering for GST is compulsory when:

- the turnover of the business is more than \$1 million for the past 12 months; or
- If the company is currently making sales and can reasonably expect the turnover of the business to be more than \$1 million for the next 12 months.

## **6. EUROPEAN UNION**

The European Union Value Added Tax ("EU VAT") is a value added tax encompassing member states in the European Union Value Added Tax Area. Joining in this is compulsory for member states of the European Union. As a consumption tax, the EU VAT taxes the consumption of goods and services in the EU VAT area. The EU VAT's key issue asks where the supply and consumption occurs thereby determining which member state will collect the VAT and what VAT rate will be charged.

Each Member State's national VAT legislation must comply with the provisions of EU VAT law as set out in Directive 2006/112/EC. This Directive sets out the basic framework for EU

VAT, but does allow Member States some degree of flexibility in implementation of VAT legislation. For example different rates of VAT are allowed in different EU member states. However Directive 2006/112 requires Member states to have a minimum standard rate of VAT of 15% and one or two reduced rates not to be below 5%. Some Member States have a 0% VAT rate on certain supplies- these Member States would have agreed this as part of their EU Accession Treaty, (for example, newspapers and certain magazines in Belgium). The current maximum rate in operation in the EU is 25%, though member states are free to set higher rates.

VAT that is charged by a business and paid by its customers is known as "output VAT" (that is, VAT on its output supplies). VAT that is paid by a business to other businesses on the supplies that it receives is known as "input VAT" (that is, VAT on its input supplies). A business is generally able to recover input VAT to the extent that the input VAT is attributable to (that is, used to make) its taxable outputs. Input VAT is recovered by setting it against the output VAT for which the business is required to account to the government, or, if there is an excess, by claiming a repayment from the government.

The VAT Directive (prior to 1 January 2007 referred to as the Sixth VAT Directive) requires certain goods and services to be exempt from VAT (for example, postal services, medical care, lending, insurance, betting), and certain other goods and services to be exempt from VAT but subject to the ability of an EU member state to opt to charge VAT on those supplies (such as land and certain financial services). Input VAT that is attributable to exempt supplies is not recoverable; although a business can increase its prices so the customer effectively bears the cost of the 'sticking' VAT (the effective rate will be lower than the headline rate and depend on the balance between previously taxed input and labour at the exempt stage).

## **7. DENMARK**

In Denmark, VAT is generally applied at one rate, and with few exceptions is not split into two or more rates as in other countries (e.g. Germany), where reduced rates apply to essential goods such as e.g., foodstuffs. The current standard rate of VAT in Denmark is 25%. That makes Denmark one of the countries with the highest value added tax, alongside Norway and

Sweden. A number of services are not taxable, for instance public transportation of private persons, health care services, publishing newspapers, rent of premises (the lessor can, though, voluntarily register as VAT payer, except for residential premises) and travel agency operations.

## **8. FINLAND**

In Finland, the standard rate of VAT is 22%. In addition, two reduced rates are in use: 17%, which is applied on food and animal feed, and 8%, which is applied on passenger transportation services, cinema performances, physical exercise services, books, and pharmaceuticals, entrance fees to commercial cultural and entertainment events and facilities. Supplies of some goods and services are exempt under the conditions defined in the Finnish VAT Act: hospital and medical care; social welfare services; educational, financial and insurance services; lotteries and money games; transactions concerning bank notes and coins used as legal tender; real property including building land; certain transactions carried out by blind persons and interpretation services for deaf persons. The seller of these tax-exempt services or goods is not subject to VAT and does not pay tax on sales. Such sellers therefore may not deduct VAT included in the purchase prices of his inputs.

## **9. NORWAY**

In Norway, VAT is split into three levels: 25% is the general VAT, 14% for foods and restaurant take-out (food eaten in a restaurant has 25%), 8% for person transport, movie tickets, and hotel stays. Books and newspapers are free of VAT, while magazines and periodicals with a less than 80% subscription rate are taxed.

## **10. ICELAND**

In Iceland, VAT is split into two levels: 24.5% for most goods and services but 7% for certain goods and services. The 7% level is applied for hotel and guesthouse stays, licence fees for radio stations (namely RÚV), newspapers and magazines, books; hot water, electricity and oil for heating houses, food for human consumption (but not alcoholic beverages), access to toll roads and music.

## **11. SWEDEN**

In Sweden, VAT is split into three levels: 25% for most goods and services including restaurants bills, 12% for foods (incl. bring home from restaurants) and hotel stays (but breakfast at 25%) and 6% for printed matter, cultural services, and transport of private persons. Some services are not taxable for example education of children and adults if public utility, and health and dental care, but education is taxable at 25% in case of courses for adults at a private school. Dance events (for the guests) have 25%, concerts and stage shows have 6%, and some types of cultural events have 0%.

## **5.0 SALIENT FEATURES OF PROPOSED GST IN INDIA**

### **Dual GST Model**

Different models of GST are implemented across the globe. Many countries have a unified GST system. However, countries like Brazil and Canada follow a dual system wherein GST is levied by both federal and state or provincial governments. In India, a dual GST is being proposed wherein a central goods and services tax (CGST) and a state goods and services tax (SGST) will be levied on the taxable value of a transaction. The implementation of the dual GST structure in India is the most practical decision.

Dual GST is required in India because India is a federal country where both Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in line with the Constitutional requirement of fiscal federalism.

In this model the Central GST and State GST will operate in a parallel fashion. Importantly, there will be no distinction between goods and services for the purpose of the tax with a common legislation applicable to both. It is expected that the proposed concurrent dual GST system would preserve and protect the fiscal powers and at the same time rationalize the indirect tax structure by subsuming a plethora of central and local taxes into a consolidated levy.

With a central VAT (Cenvat) and a state VAT already in place, it appears that the proposed dual rate structure would merely fine tune the present system.

In simple terms, the excise duty (and allied levies) and service tax would comprise the Central GST and the State GST would comprise of State VAT, State Service Tax (new levy) and few more local levies.

Central GST may not have any significant impact as CENVAT Credit of Excise duty and Service Tax available at present would be continued.

The State GST is likely to encompass local levies like entry tax, luxury tax, Entertainment tax, and other cess on goods besides the proposed service tax levy. Input tax hitherto not available on entry tax (in certain States) and other levies will be a positive development.

The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits. Further, both would be levied on the same price or value unlike State VAT which is levied on the value of the goods inclusive of CENVAT. While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, SGST would be chargeable only when the supplier and the recipient are both located within the State.

So on one invoice there will be two taxes – a central tax and the state tax. Both will be levied hopefully on identical values. So if a person is buying something for Rs 100 and suppose the central tax rate is say 6% and the state tax rate is 7% – there will be a tax of Rs 6 at the center level and tax of Rs 7 at the state level – and will have to pay tax of 13% in total. So even though there are two calculations it is really one tax of 13% in one sense.

As the dual GST is expected to be a simple and transparent tax structure with only one or two rates of taxes, the result would be a reduction in the number of taxes at the Central and state levels, cut in effective tax rate for many goods, removal of the current cascading effect of taxes,

reduction of transaction costs for taxpayers through simplified tax compliance, and increased tax collections due to wider tax base and better compliance. Being a consumption-based tax, dual GST will result in better revenue collection for states with higher consumption of goods and services. The backward and less-developed states would see fall in collections. The Centre is expected to put in place a mechanism to compensate states for any revenue loss due to GST.

### **Rate of Tax**

Determining a revenue neutral rate for GST will be a colossal task in itself because all the states would be required to reach a consensus on it. Presently, in India, the excise duty as well as the state VAT has multiple rates, with a typical 8 per cent/16 per cent two-rate structure for excise and a typical 4 per cent/12.5 per cent two-rate structure for the state VAT.

It has been decided to adopt a two-rate structure -a lower rate for necessary items and items of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items.

For Central GST relating to goods, there might be a two-rate structure, with conformity in the levels of rate with the State GST. For taxation of services, there may be a single rate for both Central GST and State GST.

The cumulative incidence of the excise duty and the state VAT at present works out to around 22 per cent to 24 per cent of the retail sales price. There is an expectation that under the GST, the aggregate incidence of the tax should be significantly lower.

There is much debate on the likely aggregate rate of the GST and there appears to be a consensus that it may approximate 20 per cent. However, recent debate suggests that a further reduction in the aggregate rate of GST is being contemplated. It is also possible that several other design elements of the GST can undergo changes. The additional benefit, apart from the reduction in rate, of the model is that the base on which the federal and state GST will be charged will be uniform and this will ensure that there is no cascading of taxes.

### **Input tax credit**

The proposed dual Goods and Service tax (GST) system would be designed in such a manner that the Central GST chain and the State GST chain would be independent of each other. This would imply that a dealer would not be able to use the input tax credit available under the Central GST chain in the State level GST chain. The Central GST chain is likely to integrate the existing excise duty and service taxes levied at the central level. The State level GST chain is likely to integrate the current State-level VAT, other local levies and services tax on certain specific services on which States may get the powers to levy service tax. There will be full input tax credit in the Central GST chain and also in the State level chain but there would be no usability of Central GST into the State-level GST chain. Input tax credit would be allowed only at one chain and no carry forward of the credit from one chain to the other would be allowed. The structure would only address the cascading effect only in the respective chain and not in the parallel one.

Cross utilization of credit of CGST between goods and services would be allowed. Similarly, the facility of cross utilization of credit will be available in case of SGST.

### **Threshold limit**

A threshold of gross annual turnover of Rs.10 lakh both for goods and services for all the States and Union Territories will be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime.

After taking into consideration the interest of small traders and small scale industries and to avoid dual control, it has been decided that the threshold for Central GST for goods will be Rs.1.5 Crore and the threshold for services should also be appropriately high.

### **Selective Concessions/Exemptions**

While a linear tax structure with few exemptions would be ideal, the GST structure is likely to continue with sector specific concessions and exemptions. It was observed by Dr.Shome (erstwhile advisor to the finance minister), 'that shades of policy interventions is a fact of life and we have to weave such positive suggestions in the framework and that by 2010, we will have a structure that will overhaul all taxes into one, of course with some exemptions.'

No tax will be payable on goods and services which shall be declared as exempted supplies and for such supplies, the assessee will not be able to claim any input tax credit. However certain supplies may be classified as zero rated goods and services thereby making it eligible to input tax credit.

### **Service Tax under GST**

Service Tax is levied at 10.3% (inclusive of Education Cess) percent tax on more than 100 services. States do not levy or collect service taxes at present, but get a share from the Centre's collections. It is proposed that states will keep the entire collection from certain services from this year. States would also tax another set of proposed new services, collect and appropriate as part of compensation for central sales tax phase-out in 2010. Since there would be issues on taxing cross border services it is expected that the State GST would only include services that are essentially of "Local Nature". It has also been reported that Service tax rate under Central GST and State GST is likely to be uniform.

Though State Service Tax proposed to be levied on new local services would add to the cost, a redeeming feature is that Input Tax Credit would be eligible on the State Service Tax and a host of other levies like Entry Tax, Electricity Tax, and Luxury Tax etc that would be integrated under State GST. Of course, the service should qualify as an eligible Input Service.

### **Tax Base for Dual GST Levy**

Though nothing has been explicitly said on the tax base for the State GST, it has been reported that the dual GST Structure would ensure that there is no double taxation and it would help trim the present cascading effect of tax to benefit industry and consumers. So there is a likelihood that the levy of Central GST and State GST would be on the same tax base as only this can help trim the present cascading effect of tax.

### **Implications of GST on imports and exports**

Imports would be subject to GST. Both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax

revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

Exports, however, will be zero-rated, meaning exporters of goods and services need not pay GST on their exports. GST paid by them on the procurement of goods and services will be refunded subject to certain conditions, limitations and procedures.

### **System of Zero rating**

The system of zero rating ensures that the benefit of zero rating is availed only after satisfaction of the condition that the tax is paid in the importing state. The dealer in the importing state will capture the inter-state procurements in the periodic return and pay the relevant tax on such procurements. In case the liability to pay tax is not discharged within the stipulated time, zero rating will be reversed and then the seller in the exporting state will be required to pay the tax. For the successful implementation of the system of zero rating with pre-payment, a reliable mechanism should be put in place to identify inter-state transactions and thereby ensure that there is no evasion of taxes.

Exports would be zero-rated. Similar benefits may be given to Special Economic Zones (SEZs). However, such benefits will only be allowed to the processing zones of the SEZs. No benefit to the sales from an SEZ to Domestic Tariff Area (DTA) will be allowed.

### **Taxation of certain goods**

Certain goods like alcoholic beverages, tobacco and petroleum are subject to higher rate of taxes as it attracts multiple taxes like excise duties, licence fees, cess, inter-state import and export fees etc. This is mainly done to discourage the consumption of such products.

Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT can be continued to be levied on alcoholic beverages as per the existing practice. In case it has been made Vatable by some States, there will be no objection to that. Excise Duty, which is presently being levied by the States will also not be affected.

Tobacco products will be subjected to GST with Input Tax Credit (ITC). Centre may also be allowed to levy excise duty on tobacco products over and above GST without ITC.

Petroleum products, i.e. crude, motor spirit (including ATF) and HSD would be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. Whether natural gas will be within the purview of GST or not has not yet been decided.

### **Inter-state transactions of Goods and Services**

Integrated GST (IGST) model for taxation of inter-state transaction of goods and services has been adopted. According to this model, Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST.

The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

The major advantages of this model are:

- ✓ Maintenance of uninterrupted input tax credit chain on inter State transactions.
- ✓ No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.
- ✓ No refund claim in exporting State, as ITC is used up while paying the tax.
- ✓ Self monitoring model.
- ✓ Level of computerization is limited to inter-State dealers and Central and State Governments should be able to computerize their processes expeditiously.
- ✓ As all inter-State dealers will be e-registered and correspondence with them will be by e-mail, the compliance level will improve substantially.

- ✓ Model can take 'Business to Business' as well as 'Business to Consumer' transactions into account.

### **Composition/Compounding Scheme**

Composition/Compounding Scheme for the purpose of GST will have an upper ceiling on gross annual turnover and a floor tax rate with respect to gross annual turnover. In particular, there would be a compounding cut-off at Rs. 50 lakh of gross annual turnover and a floor rate of 0.5% across the States. The scheme would also allow option for GST registration for dealers with turnover below the compounding cut-off.

### **Taxpayer Identification number**

Each taxpayer will be allotted a PAN inked taxpayer identification number with a total of 13 to 15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-based system for Income tax, facilitating data exchange and taxpayer compliance.

### **Documentation and compliance**

Due to the dual structure of the GST, the assesseees will be required to maintain separate accounts for Central GST and State GST. There will be one periodical return for both CGST and SGST with one copy each to be submitted to the respective GST authority.

### **Taxes to be subsumed under the GST**

Taxes or levies to be subsumed will be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services. It should be part of the transaction chain which commences with import / manufacture/ production of goods or provision of services at one end and the consumption of goods and services at the other. The subsumation should result in free flow of tax credit in intra and inter-State levels. The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST. Revenue fairness for both the Union and the States should also be considered.

The following central taxes will be subsumed under the GST:

- i. Central Excise Duty
- ii. Additional Excise Duties
- iii. The Excise Duty levied under the Medicinal and Toiletries Preparation Act
- iv. Service Tax
- v. Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- vi. Special Additional Duty of Customs - 4% (SAD)
- vii. Surcharges
- viii. Cesses

The following state taxes will also be subsumed under the GST:

- i. VAT / Sales tax
- ii. Entertainment tax (unless it is levied by the local bodies).
- iii. Luxury tax
- iv. Taxes on lottery, betting and gambling.
- v. State Cesses and Surcharges in so far as they relate to supply of goods and services.
- vi. Entry tax not in lieu of Octroi

### **Harmonization of laws and administration**

The need for Centre-State and inter-State harmonization is vital under the Dual GST. The ultimate goal would be a unified base and one set of rules for the two taxes.

There are different mechanisms for achieving this harmonization. Some of them are:

- a. In Australia, the GST is imposed and administered as a single unified tax levied by the national government. All the revenues from the tax are then distributed to the states. The tax is a federal tax that is distributed to the States under a political agreement. The revenues are distributed as grants to the States, taking into account factors such as fiscal capacity and need of individual States.
- b. In Canada, the Harmonized Sales Tax (HST) is levied in three of the ten provinces. The tax is levied and administered under a unified law by the national government. Under the

Canadian system, provincial participation in the HST is elective and not mandatory. The tax is levied at the national rate of 5 percent which is increased by 8% percent in those provinces which have elected to participate in it. The revenues attributable to the supplementary rate of 8 percent are then distributed among the participating provinces on the basis of a statistical calculation of the tax base in those provinces (which approximates the revenues they would have collected if they had levied a separate tax of their own).

- c. In the European Union, the model of GST is quite different from the Australian and Canadian models. The focus in the EU model is on minimization of distortions in trade and competition, and not on harmonization of administration. Thus, the VAT base (subject to continuing derogations) is harmonized, as are the basic rules governing the mechanism and application of VAT (time of supply, valuation, place of supply etc). The administration is largely a matter for the member states to decide (but must respect the basic principles such as neutrality).

In India the Central Sales Tax offers an interesting model of the harmonization mechanism. The CST law is central, but the tax is administered and collected by the States. Indeed, this appears to be most suitable model for India. The GST law for both the Centre and the States would be enacted by Parliament under this model. It would define the tax base, place of taxation, and the compliance and enforcement rules and procedures. The rates for the State GST could be specified in the same legislation, or delegated to the State legislatures. The legislation would empower the Centre and the States to collect their respective tax amounts, as under the CST.

### **Key features of GST – An overview**

- i. Harmonized system of nomenclature (HSN) to be applied for goods. (As international trade increased, need was felt to have universal standard system of classification of goods to facilitate trade flow and analysis of trade statistics. Hence, International convention of Harmonized System of Nomenclature (HSN), called Harmonized Commodity Description and Coding System, was developed by World Customs Organization (WCO). This is an International Nomenclature standard adopted by most of the Countries to

ensure uniformity in classification in International Trade. HSN is a multipurpose 8 digit nomenclature classifying goods in 5019 groups of goods.)

- ii. Uniform return & collection procedure for central and state GST.
- iii. PAN based Common TIN registration. (The Tax Payer's Identification Number (TIN) is new unique registration number that is used for identification of dealers registered under VAT. It consists of 11 digit numerals and will be unique throughout the country. TIN is used for identification of dealers in the same way like PAN is used for identification of assesses under Income Tax Act.)
- iv. Turnover criteria to be prescribed for registration under both central goods and services tax (CGST) and state goods and services tax (SGST).
- v. TINXSYS to track transactions. (Tax Information Exchange System (TINXSYS) is a centralized exchange of all interstate dealers spread across the various States and Union territories of India. TINXSYS is an exchange authored by the Empowered Committee of State Finance Ministers (EC) as a repository of interstate transactions taking place among various States and Union Territories. TINXSYS will help the Commercial Tax Departments of various States and Union Territories to effectively monitor the interstate trade.)
- vi. Tax Payment will be by exporting dealer to the account of receiving state.
- vii. Credit will be allowed to the buying dealer by receiving state on verification.
- viii. Submission of declaration form is likely to be discontinued.
- ix. Area based exemptions will continue up to legitimate expiry time both for the Centre and the States.
- x. Product based exemptions to be converted into cash refund.
- xi. Limited flexibility to be given to Centre and States for exceptions like natural disasters etc.

- xii. Simplified structure to reduce transaction cost.
- xiii. Separate rules and procedures for the administration of CGST and SGST.
- xiv. Specific provisions for issues of dispute resolution and advance ruling.

## **6.0 IMPACT OF GST ON VARIOUS SECTORS**

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. This reform will solve many critical issues in the long run.

According to a recent study on the impact of GST, India could gain as much as \$15 billion annually once the GST is in place. Discounting these flows at a modest 3 per cent per annum, the present value of the GST will work out to about half a trillion dollars.

GST will give more relief to industry, trade and agriculture through a more comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of several Central and State taxes in the GST and phasing out of CST. The transparent and complete chain of set-offs which will result in widening of tax base and better tax compliance may also lead to lowering of tax burden on an average dealer in industry, trade and agriculture.

The subsuming of major Central and State taxes in GST, complete and comprehensive setoff of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports.

The impact of Goods and Services Tax on certain sectors are discussed hereunder.

### **Food Industry**

The application of GST to food items will have a significant impact on those living under subsistence levels. It would have a major impact on the poor. But at the same time, a complete exemption for food items would drastically shrink the tax base. Food includes a variety of items,

including grains and cereals, meat, fish, and poultry, milk and dairy products, fruits and vegetables, candy and confectionary, snacks, prepared meals for home consumption, restaurant meals, and beverages.

In India while food as such is exempt from the CENVAT, many of the food items including food grains and cereals attract the state VAT at the rate of 4%. 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. Even if food is within the scope of GST, such sales would largely remain exempt due to small business registration threshold. 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.

### **Housing and Construction industry**

In some countries in Europe, supply of land and real property are excluded from the scope of tax whereas in Australia, New Zealand, Canada and South Africa, housing and construction services are treated like any other commodity. 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. 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.

In India the construction and housing sector need to be included in the GST tax base because construction sector is a significant contributor to the national economy.

### **FMCG sector**

Despite the economic slowdown, India's Fast Moving Consumer Goods (FMCG) sector has grown consistently during the past three to four years, reaching a size of \$25 billion (Rs 120,000 crore) at retail sales in 2008. Implementation of the proposed Goods and Services Tax (GST) and opening of Foreign Direct Investment (FDI) are expected to fuel growth further and raise the industry's size to \$47 billion (Rs 225,000 crore) by 2013 and \$95 billion (Rs 456,000 crore) by 2018, according to a new FICCI-Technopak report. The FMCG sector is also one of the major contributors to the exchequer with \$6.5 billion (Rs 31,000 crore) paid through direct and indirect taxes. Implementation of GST will have several benefits for the FMCG sector including uniform, simplified and single point taxation and thereby reduced prices.

### **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 the overall GST rate low. The inclusion of the rail sector in the tax regime which will do away with most of the indirect taxes should be done if the government wants to provide a level playing field to road and air transportation sector. 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.

### **Financial services**

In most of the countries Goods and Services Tax is not charged on financial services. For example in New Zealand, almost all goods and services are covered under the GST except that of financial services. The reason behind this is that the charge for services provided by financial intermediaries like banks and insurance companies is generally not precise, i.e. the fee is taken as a margin that is hidden in interest, dividends, annuity payments or such other financial flows from the transactions. If the fee was not a hidden one, then it would be easy to charge the service to tax.

In China, financial services are taxable under their business tax, which is a tax on turnover with no tax credits allowed on inputs. Because it is a turnover tax, it can be applied to the total spread

for margin services, with no need to allocate the spread between borrowers and depositors. Israel and Korea also apply tax in such alternative forms.

Under the Service Tax, India has followed the approach of bringing virtually all financial services within the ambit of tax where the consideration for them is in the form of an explicit fee. It has gone beyond this by bringing selected margin services (where the consideration is the spread between two financial inflows and outflows) within the Service Tax net. The following are principal examples of such taxable margin services:

- Merchant discounts on credit/debit card transactions are taxable as a consideration for credit card services, as are any explicit fees or late payment charges collected from the card member.
- In foreign currency conversion transactions without an explicit fee, tax applies to a deemed amount of consideration equal to 2% of the amount converted.
- The tax applies to that portion of life insurance premiums that represents a cover for risks.

In some countries, transactions in gold, silver and other precious metals are also treated as part of the financial sector, given that these metals are often bought as investments, and not for consumption and hence they are exempted from tax.

As there are no compelling reasons to exempt financial services from the purview of GST, it would be advisable to continue the same approach as followed under the Service Tax provisions.

### **Information Technology Enabled Services**

For the purpose of taxing e-commerce or software, it is essential to define the kind of property. Intangible property means property that can be moved but cannot be touched and felt. It can be further divided into Intellectual Property Rights and Others like Goodwill, Interest, and Receivables. The medium through which the software is transmitted determines the nature of goods. If it is through electronic form, then it is considered as intangible property, but if it is any other type of medium, then it would be tangible property. Depending on the type of goods and their place of supply, the tax implications vary in the countries that already have GST. E-

commerce and other such transactions are the toughest to tax and need the highest probability of tax planning.

India has been struggling with the taxation of e-commerce. In spite of various judicial pronouncements and laws, the tax implications are still not very clear. Presently, the packaged and customized software is taxed on the basis of the intent of the parties. To be in sync with the best international practices, domestic supply of software should also attract GST on the basis of mode of transaction. Hence, if the software is transferred through electronic form, it should be considered as Intellectual Property and regarded as a service. If the software is transferred on media or any other tangible property, then it should be treated as goods and subject to GST.

### **Impact on small enterprises**

The impact of GST on small enterprises is of great concern. 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. Given the possibilities of input tax credit, not all small enterprise may seek the turnover tax option. The third category of small enterprises above the turnover threshold will need to be within the GST framework. Possible downward changes in the threshold in some States consequent to the introduction of GST may result in obligations being created for some dealers. In such cases suitable provisions could be made to provide direct assistance to the affected small enterprises if considered desirable. In respect of Central GST, the position is slightly more complex. Small scale units manufacturing specified goods are allowed exemption of excise up to a turnover of Rs 1.5 crores. These units, which may be required to register for payment of GST, may see this as an additional cost.

## **7.0 Synopsis of the First Discussion Paper on Goods and Services Tax in India by the Empowered Committee of State Finance Ministers**

The Empowerment Committee of State Finance Ministers under the dynamic leadership of Dr. Asim Dasgupta has released its draft white paper on Goods and Services Tax (GST) on

November 10, 2009. It is 53 pages of well-drafted document preceded by a 4 pages of foreword by Dr. Asim Dasgupta Chairman of Empowerment Committee and State Finance Minister of West Bengal. It is a very positive development because it is the first official document which has come in the public domain on GST. It outlines the broad structure of GST.

**Background:**

- An announcement was made by Shri P. Chidambaram, the then Union Finance Minister in the Central Budget (2007-2008) to the effect that GST would be introduced from April 1, 2010
- The Empowered Committee of State Finance Ministers, on Shri P. Chidambaram's request, would work with the Central Government to prepare a road map for introduction of GST in India.
- After this announcement, the Empowered Committee of State Finance Ministers decided to set up a Joint Working Group (May 10, 2007), with the then Adviser to the Union Finance Minister and the Member-Secretary of Empowered Committee as Co-convenors and the concerned Joint Secretaries of the Department of Revenue of Union Finance Ministry and all Finance Secretaries of the States as its members.
- This Joint Working Group, after intensive internal discussions as well as interaction with experts and representatives of Chambers of Commerce and Industry, submitted its report to the Empowered Committee (November 19, 2007).
- This report was then discussed in detail in the meeting of Empowered Committee (November 28, 2007).
- On the basis of this discussion and written observations of the States, certain modifications were made and a final version of the views of Empowered Committee at that stage was prepared and was sent to the Government of India (April 30, 2008).
- The comments of the Government of India were received on December 12, 2008 and were duly considered by the Empowered Committee (December 16, 2008).

- It was decided that a Committee of Principal Secretaries/ Secretaries of Finance/ Taxation and Commissioners of Trade Taxes of the States would be set up to consider these comments, and submit their views.
- These views were submitted and were accepted in principle by the Empowered Committee (January 21, 2009).
- Consequent upon this in-principle acceptance, a Working Group, consisting of the concerned officials of the State Governments was formed who, in close association with senior representatives of the Government of India, submitted their recommendations in detail on the structure of GST.
- An important interaction has also recently taken place between Shri Pranab Mukherjee, the Union Finance Minister and the Empowered Committee (October 19, 2009) on the related issue of compensation for loss of the States on account of phasing out of CST.
- The Empowered Committee has now taken a detailed view on the recommendations of the Working Group of officials and other related matters.
- This detailed view of the Empowered Committee on the structure of GST is now presented in terms of the First Discussion Paper

### **The Empowered Committee of State Finance Ministers**

The Empowered Committee of State Finance Ministers was constituted by the Ministry of Finance, Government of India on the basis of resolution adopted in the Conference of the Chief Ministers. It has been registered as a society on August 17, 2004 under the Societies Registration Act XXI of 1960, having its registered office at Delhi Secretariat, Indraprastha Extension, Delhi 110 002.

The Empowered Committee of State Finance Ministers was constituted for the purpose of evolving and overseeing a consensus of uniform floor rates of sales tax and then to have reforms in state level taxes

An Empowered Committee of State Finance Ministers (Constituted By the Ministry of Finance, Government of India On the Basis of Resolution Adopted in the Conference of the Chief Ministers on November 16, 1999) was constituted on 17th July 2000.

The terms of reference of the Committee were:

- a) To monitor the implementation of uniform floor rates of sales tax by States and Union Territories;
- B) To monitor the phasing out of the sales tax based incentive schemes;
- C) To decide milestones and methods for States to switch over to VAT and
- D) To monitor reforms in the Central Sales Tax system existing in the country.

Initially, the Empowered Committee consisted of Finance Ministers of only nine States as its members. Subsequently, five more State Finance Ministers were inducted into this Committee. In a meeting of Empowered Committee held on 26.6.2004, it was decided that the Empowered Committee should be enlarged and all State Governments and UTs with legislature be made its members. Accordingly, a notification had been issued to include the remaining States as its members.

The Empowered Committee of State Finance Ministers consists of Finance Ministers of 28 states in India, and of Delhi and Pondicherry. Dr. Asim Dasgupta, the Finance Minister of West Bengal is the current Chairman and Mr. Ramesh Chandra is the first Member Secretary of the Empowered Committee.

The Ministry of Finance, Department of Revenue, consults this Committee, before taking decisions on important issues concerning State Sales Tax/ VAT, and CST.

### **Structure of the Discussion Paper**

The whole discussion paper has been divided into four parts.

- Section 1: This section is contained in 15 paragraphs in pages 1 to 11. It begins with a brief reference to the process of introduction of VAT at the Centre and the States and also indicates the precise points where there is a need for further improvement. This section also shows how the GST can bring about this improvement. Therefore, it sets the background for justification of GST
- Section 2. This is a short section of two paragraphs. It describes the process of preparation for GST.
- Section 3: this section is the heart of the discussion paper. It presents in detail the comprehensive structure of the GST model.
- Section4: For illustrating this GST model further, there is in the end an Annexure on twenty Frequently Asked Questions and Answers.

### **Section 1: Introduction:**

#### **Prior to Introduction of VAT in India**

- Prior to the introduction of VAT in the Centre and in the States, multiple taxation existed in the pre-existing Central excise duty and the State sales tax systems. Before any commodity was produced, inputs were first taxed, and then after the commodity got produced with input tax load, output was taxed again. Moreover, in the sales tax structure, when there was also a system of multi-point sales taxation at subsequent levels of distributive trade, then along with input tax load, burden of sales tax paid on purchase at each level was also added, thus aggravating the cascading effect further.

#### **Introduction of VAT**

- When VAT is introduced in place of Central excise duty, a set-off is given, i.e., a deduction is made from the overall tax burden for input tax.
- In the case of VAT in place of sales tax system, a set-off is given from tax burden not only for input tax paid but also for tax paid on previous purchases.

- With VAT, the problem of “tax on tax” and related burden of cascading effect is thus removed.
- Furthermore, since the benefit of set-off can be obtained only if tax is duly paid on inputs (in the case of Central VAT), and on both inputs and on previous purchases (in the case of State VAT), there is a built-in check in the VAT structure on tax compliance in the Centre as well as in the States, with expected results in terms of improvement in transparency and reduction in tax evasion.
- For these beneficial effects, VAT has now been introduced in more than 150 countries, including several federal countries.
- In Asia, it has now been introduced in almost all the countries.

### **Introduction of VAT at the Central Level**

- In India, VAT was introduced at the Central level for a selected number of commodities in terms of MODVAT with effect from March 1, 1986, and in a step-by-step manner for all commodities in terms of CENVAT in 2002-03.
- Subsequently, after Constitutional Amendment empowering the Centre to levy taxes on services, these service taxes were also added to CENVAT in 2004-05.
- Although the growth of tax revenue from the Central excise has not always been especially high, the revenue growth of combined CENVAT and service taxes has been significant.

### **Introduction of VAT in the States**

- Introduction of VAT in the States has been a more challenging exercise in a federal country like India, where each State, in terms of Constitutional provision, is sovereign in levying and collecting State taxes. (Entry 54 of the State List (List II) and Entry 92A of Union List (List I) of the Constitution)
- Before introduction of VAT, in the sales tax regime, apart from the problem of multiple taxation and burden of adverse cascading effect of taxes as already mentioned, there was also no harmony in the rates of sales tax on different commodities among the States.
- Not only were the rates of sales tax numerous (often more than ten in several States), and different from one another for the same commodity in different States, but there was also

an unhealthy competition among the States in terms of sales tax rates – so-called “rate war” – often resulting in, revenue-wise, a counter-productive situation.

- It is in this background that attempts were made by the States to introduce a harmonious VAT in the States, keeping at the same time in mind the issue of sovereignty of the States regarding the State tax matters.
- The States started implementing VAT beginning April 1, 2005.
- After overcoming the initial difficulties, all the States and Union Territories have now implemented VAT.
- The Empowered Committee has been monitoring closely the process of implementation of State-level VAT, and deviations from the agreed VAT rates has been contained to less than 3 per cent of the total list of commodities.

### **Empowered Committee of State Finance Ministers**

- The first preliminary discussion on State-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers.
- Thereafter, in a significant meeting of all the Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha, the then Union Finance Minister, two important decisions, among others, were taken.
- First, before the introduction of State-level VAT, the unhealthy sales tax “rate war” among the States would have to end, and sales tax rates would need to be harmonised by implementing uniform floor rates of sales tax for different categories of commodities with effect from January 1, 2000.
- Secondly, on the basis of achievement of the first objective, steps would be taken by the States for introduction of State-level VAT after adequate preparation.
- For implementing these decisions, a Standing Committee of State Finance Ministers was formed which was then made an Empowered Committee of State Finance Ministers.

### **Justification for GST**

#### **Shortcomings in the structure of VAT at the Central level**

- The shortcoming in CENVAT of the Government of India lies in non-inclusion of several Central taxes in the overall framework of CENVAT, such as additional customs duty, surcharges, etc., and thus keeping the benefits of comprehensive input tax and service tax set-off out of reach for manufacturers/ dealers.
- No step has yet been taken to capture the value-added chain in the distribution trade below the manufacturing level in the existing scheme of CENVAT.
- The introduction of GST at the Central level will not only include comprehensively more indirect Central taxes and integrate goods and service taxes for the purpose of set-off relief, but may also lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade and increased compliance.

### **Shortcomings in the existing State-level VAT structure**

- There are, even now, several taxes which are in the nature of indirect tax on goods and services, such as luxury tax, entertainment tax, etc., and yet not subsumed in the VAT.
- Moreover, in the present State-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under State VAT, and contributing to that extent a cascading effect on account of CENVAT element. This CENVAT load needs to be removed.
- Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be integration of VAT on goods with tax on services at the State level as well, and at the same time there should also be removal of cascading effect of service tax.
- In the GST, both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point up to the retailer's level is established which reduces the burden of all cascading effects.
- However, for this GST to be introduced at the State level, it is essential that the States should be given the power of levy of taxation of all services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment will be made for giving this power also to the States.

- Moreover, with the introduction of GST, burden of Central Sales Tax (CST) will also be removed. The GST at the State-level is, therefore, justified.

## **SECTION 2: Preparation for GST**

While making preparation for GST, it was also necessary, to phase out the CST, because it did not carry any set-off relief and there was a distortion in the VAT regime due to export of tax from one State to other State. The Empowered Committee accordingly took a decision to phase out CST on the understanding with the Centre that, since phasing out of CST would result in a loss of revenue to the States on a permanent basis; an appropriate mechanism to compensate the States for such loss would be worked out. The rate of CST has already been reduced to 2% and will be phased out with effect from the date of introduction of GST on the basis of such GST structure which, with necessary financial support to the States, should adequately compensate for the loss of the States on a permanent basis.

## **SECTION 3: GST Model**

A dual GST structure with defined functions and responsibilities of the Centre and the States is recommended, whereby the harmonious rate structure along with the need for further modification could be upheld, if necessary with a collectively agreed Constitutional Amendment.

### **Salient features of the proposed model are as follows:**

- (i) The GST shall have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States and Union Territories (UTs) (hereinafter referred to as State GST). Rates for Central GST and State GST should be prescribed separately, reflecting revenue considerations and acceptability.
- (ii) The Central GST and the State GST should be applicable to all transactions of goods and services. HSN classification for goods should be used both for the Central GST and the State GST. A classification for services should be evolved by examining international practices, keeping, at the same time, in view the particular characteristics of India's services sector.
- (iii) The Central GST and the State GST should be credited to the accounts of the Centre and states separately.

(iv) Since the Central GST and State GST are to be treated separately, taxes paid against the Central GST shall be allowed to be taken as input tax credit (ITC) for the Central GST and could be utilized only against the payment of Central GST. The same principle will be applicable for the State GST.

(v) Cross utilization of ITC between the Central GST and the State GST should not be allowed.

(vi) Ideally the problem related to credit accumulation on account of refund of GST , in the particular cases where input tax exceeds output tax, should be avoided both by the Centre and the States.

(vii) Procedures for collection of both the Central GST and State GST should be uniform.

(viii) Under the proposed model, the productive / distribution chain for goods with regard to manufactures having gross turnover of more than Rs. 1.5 crores would belong to both the Centre and the State. However, keeping in view the prevailing tax payer bases and the availability of the administrative machinery with the Centre and States, the remaining tax payers for goods will be assigned exclusively to the States for the purposes of registration, collection, ITC matters etc for both the Central GST and the State GST.

(ix) The present thresholds prescribed in the state VAT Acts below which VAT is not applicable (which varies from state to state), may also be adopted under the GST.

(x) The taxpayer would need to submit one periodical return (i.e., the same document), with one copy given to the Central GST authority, the other to the State GST authority concerned.

(xi) Each taxpayer should be allotted a PAN based taxpayer identification number, with two additional digits to distinguish between states, and another digit to distinguish between the Central GST and the State GST, i.e. a total of 13 digits. This would bring the GST PAN based system in line with the prevailing PAN based system for Income tax, Excise duty and Service tax, facilitating data exchange and tax payer compliance.

(xii) Keeping in mind the need of tax payer's convenience, functions such as assessment, enforcement, scrutiny and audit should be undertaken by the authority which is collecting tax, with information sharing between the Centre and the States.

(xiii) Composition /Compounding Schemes for the purpose of GST should be designed keeping in view the present threshold limits followed by different states under VAT.

### **Constitutional Amendments, Legislations and Rules for administration of CGST and SGST**

It is essential to have Constitutional Amendments for empowering the States for levy of service tax, GST on imports and consequential issues as well as corresponding Central and State legislations with associated rules and procedures. With these specific tasks in view, a Joint Working Group had been constituted (September 30, 2009) comprising of the officials of the Central and State Governments to prepare, in time bound manner draft legislation for Constitutional Amendment, draft legislation for CGST, a suitable Model Legislation for SGST and rules and procedures for CGST and SGST. Simultaneous steps have also been initiated for drafting of legislation for IGST and rules and procedures. As a part of this exercise, the Working Group will also address the issues of dispute resolution and advance ruling.

### **Central and State Taxes to be subsumed under GST**

The various Central, State and Local levies were examined to identify their possibility of being subsumed under GST. While identifying, the following principles were kept in mind.

- (i) Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.
- (ii) Taxes or levies to be subsumed should be part of the transaction chain which commences with import/ manufacture / production of goods or provision of services at one end and the consumption of goods and services at the other.
- (iii) The subsumation should result in free flow of tax credit at intra and inter State levels.
- (iv) The fees that are not specifically related to supply of goods & services should not be subsumed under GST.
- (v) Revenue fairness for both the Union and the states individually would need to be attempted.

### **(a) On application of the principle, it is recommended that the following Central Taxes should be subsumed under the Goods and Services Tax:**

- (i) Central Excise Duty
- (ii) Additional Excise Duties
- (iii) Service tax
- (iv) Additional custom duty, commonly known as countervailing duty (CVD)
- (v) Surcharges

(vi) Ideally, Cesses should also be merged with the GST. However, keeping in view the specific needs of the concerned Ministries, it was decided that for the time being these levies may not be included in the GST.

**(b) Following State taxes and levies should be subsumed under GST.**

- (i) VAT / Sales tax
- (ii) Entertainment tax (unless it is levied for the local bodies)
- (iii) Luxury tax
- (iv) Taxes on lottery, betting and gambling.
- (v) State Cesses and Surcharges in so far as they relate to supply of goods and services.
- (vi) Entry tax not in lieu of octroi

**Entertainment Tax**

**Entertainment tax in India** signifies the tax paid by the entertainment industry in India. The entertainment tax in India is usually applicable for large-scale entertainment shows, private festivals that are sponsored, movie tickets, video game arcades, and amusement parks among others.

Entertainment activities include commercial movie/theater shows, games, amusement parks, exhibitions, celebrity stage shows, any kind of sports such as horse racing, and exhibitions. The entertainment tax department looks after the tax payable for the entertainment activities being performed in various places across the country. The entertainment tax department is located in Delhi and works under the stipulation of The Delhi Entertainment and Betting Tax Act, 1996. The organizers or proprietors of the entertainment shows are responsible for the entertainment tax in India.

They collect the tax from the sponsors and deposit it to the Government of India. One of the highest revenue earning sectors from tax in entertainment industry is cinema. With every ticket, a certain amount of tax is tagged which is paid while buying the movie tickets and is included in the price of the tickets. The entry tickets to any cinematographic exhibitions have the entertainment tax included in it, which is 25-30 percent.

The entertainment department is a major source of revenue for the Government of India. It also has a great contribution towards the publicity of Indian arts that portrays ancient culture and

various sports. This is done by granting tax-free benefits to the same. The organizers of any entertainment shows will have to seek the permission of the Entertainment Tax Department before putting up any commercial shows. The entertainment tax in India is levied upon the organizers or proprietors depending on the kind of shows being organized. There are a range of tax schemes for various entertainment programs. These are as follows:

- Tax schemes designed for amusement parks
- Tax-paid programs
- Programs based on tax exempted sectors
- Tax programs on cable television networks
- Tax for various invitee programs
- Tax on entertainment betting
- Tax on video parlors

To alleviate the tax generating program, a series of technologies has been introduced in the entertainment tax department. For example, the computerized ticket booking system has been incorporated for booking movie tickets along with the online data transmission in the entertainment industry. The more advanced the entertainment industry is becoming the tax rate is increasing at a proportional rate.

#### **State Taxes proposed to be kept outside the preview of GST**

Some of the States are levying purchase tax, octroi or entry tax in lieu of octroi. Ideally all these should also be subsumed under GST. However, keeping in view the specific requirements of the concerned States and the interest of the local bodies, it was decided that for the time being these taxes may not be included in the GST.

**Tax on items containing Alcohol:** Considering the requirements of several States, alcoholic beverages may not be brought under the GST.

**Tax on Tobacco products:** Tobacco products should be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST without ITC.

**Tax on Petroleum Products:** In view of the requirements of the States as well as the Centre, out of the basket of petroleum products, Crude, Motor Spirit (including ATF) and HSD may be kept

outside GST, as is the prevailing practice in India.

**Taxation of Services:** With regard to taxation of services, it is proposed that the States should be given the power to levy taxes on all services. Regarding the collection of services taxes, the States may collect taxes on services of intra-state nature both for Central GST and State GST. Similarly the Centre may collect tax for services of interstate nature both for Central GST and State GST. An arrangement to transfer the Central portion of GST on inter-state services to the Centre, and the State portion of the GST on the inter-state services collected by the Centre to the States, may be worked out based on the destination principle.

### **Number of Tax Rates**

Considering the economic reality of the country and the fact that certain categories of goods and services may need to be taxed at a rate lower than the standard rate, it is recommended that there should be standard and a lower rate. A significant lower rate could be assigned for precious metals, jewellery, stones and diamonds.

**Rates of Central GST and State GST:** Rates of Central-GST and State-GST: The required rate of tax has to be worked out in accordance with the tax base. The calculations would have to be done separately for the Centre and the States on the basis of a transparent methodology jointly worked out by the Centre and the States.

**Zero Rating of Exports:** Export should be zero- rated. Similar benefits may be given to SEZs. However, such benefits should only be allowed to the processing zones of the Special Economic Zones (SEZ). No benefit to the sales made from a SEZ to Domestic Tariff Area (DTA) should be allowed.

### **Inter-State Transaction of Goods**

The following mechanism has been proposed to be put in place to deal with inter-state transactions of goods, based on the existing vast banking network that widely utilizes information technology (IT):

- (a) The seller in the exporting State (say State A) collects GST for inter-State GST transaction from the importer i.e. the purchasing dealer in the importing State (say State B). This GST is collected at the applicable rates for both the Central and the State GST.
- (b) The seller makes a monthly deposit of the GST collected for inter-state transaction in a designated bank to the credit of the respective State Government, i.e. State B in present case. The seller would provide details of all transactions, including details of purchasing dealers, to the bank.
- (c) This information would be available also to the State B Government automatically through a GST portal where the bank of State A uploads the information.
- (d) The purchasing dealer in State B claims ITC on the basis of a digitally signed (by the bank of State A) invoice /challan when the files his tax return. The State B grants ITC on the basis of the credit received by it from the bank.
- (e) The Central and state authorities can access information regarding all inter-state dealers/ transactions and tax payment from the GST portal.
- (f) If the State B purchaser is a non-dealer, then the money deposited in the State B Government account will remain with that Government since ITC will not be claimed by the purchaser.

The advantages of this system are:

- (1) There are no paper declaration forms;
- (2) Cross checking by the administration is not required;
- (3) There is a safe transaction with little possibility of revenue loss for the importing or exporting states;
- (4) Fund transfers from one government to another is not required; and
- (5) Revenue of the importing State is not subject to control of the exporting State.

### **Tax Exemptions**

Various tax exemptions have been granted both by the Centre and States to achieve objectives of promoting a particular sector or to reduce tax burden on a particular segment of society in the interest of fairness or to promote a particular economic activity etc. Tax exemptions have the

effect of narrowing the tax base and increasing the administrative and compliance cost of GST. Therefore, it is felt that exemptions should be minimized. Direct and transparent subsidies, instead of tax exemptions, are more efficient way to achieve the targeted objective. It is recommended that apart from a dual rate GST structure at the Central and the State levels, there should be a common exemption list. Further, specific provisions to provide limited flexibility to the States within a set of prescribed criteria may need to be incorporated, as in the prevailing VAT structure, in order to accommodate exemption of goods of local importance. Similar limited flexibility would need to be provided to the Centre to address exceptional situations such as natural disasters.

### **Special Industrial Area Scheme**

All states have discontinued their incentive schemes for industries with effect from January 1, 2000. However, incentives granted earlier have continued. Similarly, the Central Government needs to discontinue the practice of area/ industry based tax incentives. After the introduction of GST, the exemption schemes should be converted, if at all needed, into cash refund schemes after collection of tax. The burden of incentives must fall only on the particular State or the Centre granting the incentives, while the GST scheme should remain unaffected.

### **Advance Ruling**

Advance ruling and dispute resolution authorities should be set up by the Centre and States to ensure uniformity and fairness in decision-making.

### **Joint Authority and Legislation**

The authority to amend the common exempted list and the common composition scheme should rest with a joint authority of Central and State Governments to ensure that no single State or Central Government amends either of these unilaterally.

### **IT Infrastructure**

The success of the GST largely depends upon IT infrastructure available for collection, compilation and exchange of data at the shortest possible time. IT infrastructure with national coverage and extensive reach is critical for the successful implementation of GST. For this, an initiative at the Central Government level needs to be taken in order to put in place a strong IT infrastructure.

The introduction of Discussion paper on GST by Empowered Committee leads to an conclusion that there will remain a tri structure tax regime in the GST model wherein the tax will be levied as Central GST or State GST or Inter-State transactions of GST i.e. IGST. Each of these will be administered by different authorities, taxpayer will have to deposit the tax collected separately, cross adjustment of tax credit between CGST and SGST not allowed, taxpayers are required to file the returns to these authorities separately etc.

The following issues are yet to be answered even after the release of the Discussion paper

1. Does Exemption of 1.5 Crores in CGST for goods equally apply to dealers?

As GST will cover in its scope the levy of excise and VAT therefore the exemption limit of 1.5 Crores specified in the discussion paper will extend its hands to dealers also or the same will be limited to the manufacturers. If the second view is opted then the definition of Manufacture will be rolled back in the GST tax regime.

2. What is the Service tax threshold exemption limit under CGST?

The Empowered Committee has not specified the threshold exemption limit applicable to services under CGST. However they have clarified that the same will be in conformity with the existing threshold exemption of Rs. 10 Lakhs.

3. IGST (Inter-state transaction of GST) levy will be equal to CGST plus SGST, thus the same will be single rates. Are separate records are to be maintained in this respect also?

It has been clarified that the IGST credit will be allowed to be set off against IGST, CGST or SGST payable by the taxpayer. In the current scenario CST is levied on interstate sale of goods, but the dealers aren't allowed to avail the credit of the same and they are emphasizing on the scenario to buy the goods from within the state so as to avail the credit of VAT.

However in this new tax regime the IGST will be levied at the rate which will be equal to CGST plus SGST, this leads to a new issue that IGST will be levied at a single compound rate or two different rates i.e. CGST and SGST will be levied differently or not.

If the rear view is adopted then the question arises that the credit of the IGST will be allowed to be set off against both CGST and SGST separately or cross adjustments will be allowed. If the cross adjustment is allowed then the taxpayers availing exemption of 1.5 Crores under CGST will be willing to purchase goods and sale them outside the state as in that situation they will be getting the full credit of IGST thus benefiting them utmost. This scenario changes the complete situation as it exists presently. This difficulty is yet to be sorted and clarified by the Government.

#### 4. Non-subsuming of Stamp Duty and Basic Customs Duty under the GST tax regime

Discussion paper on GST has clarified that the Stamp Duty and Basic Customs Duty will continue to be levied separately and shall not be subsumed under GST taxonomy.

#### 5. GST not to be levied on Petroleum Products?

As far as petroleum products are concerned, the discussion paper has clarified that the basket of petroleum products, i.e. crude, motor spirit (including ATF) and HSD would be kept outside GST. Sales Tax will be continued to be levied by the States on these products with prevailing floor rate and similarly, Centre will also continue its levies.

#### 6. Reduction of non Cenvatable duty on imports

In the present scenario Basic Customs duty along with Customs education cess and Customs Secondary and higher education cess are charged on the value of the imports which are non

Cenvatable but in the GST tax regime only Basic Customs duty will be leviable which will be non Cenvatable rest all levies will be covered under GST. This will lead to cheaper imports.

7. The dual GST model would be implemented through multiple statutes one for CGST and SGST statute for every State.

Different statutes will govern the SGST levy. This will lead to non uniformity in the tax structure at state levels. Further, there may be complexities for smooth implementation of GST across the nation.

8. No Special Industrial Area Scheme benefits under GST

Government has clarified that after introduction of GST, the Special Industrial Area Schemes, providing exemptions, remissions etc. would continue up to legitimate expiry time both for the Centre and the States but no new exemption, remission etc. or continuation of earlier exemption, remission etc. would be allowed.

9. Only refund scheme to exporters and no other incentives

Under GST tax regime the exporters will be allowed only to refund claims for exports made by them. No other incentive will be allowed to them.

## **8.0 ISSUES/ CHALLENGES IN IMPLEMENTATION OF GOODS AND SERVICES TAX IN INDIA AND SUGGESTIONS FOR EFFECTIVE IMPLEMENTATION OF GST**

### **Hurdles in Implementation of GST in India**

For the industry, a transition into any new tax regime is usually fraught with several challenges and issues. While some of these are one time-short term issues, some others are long term and recurring and could have a lasting impact on the business. With GST in the anvil, it would be prudent for the industry to identify and understand some of these potential issues. Such an

understanding is imperative for timely implementation of measures to overcome these issues and avoid potential disruptions they could cause to the business.

Bringing about an integration of all taxes levied on goods and services in a federal polity with sharp distribution of legislative powers is a Herculean task to say the least. The Constitution of India demarcates taxing powers in a two-tier structure wherein levies on production and international imports are with the Union and post-production levies rest with the states. The Centre levies duties of excise on manufactures and import/countervailing duties on international imports apart from levying a tax on services under various taxing and the residuary entry in the Union List. The states levy VAT on goods sold or entering in the state under various entries of the state list. Even if all Union-level levies are integrated into a single levy and all state level levies culminate in a single State level levy; this may still have two levies and the resultant cascading and administrative burdens may nevertheless remain to an extent, though this may go a long way in harmonizing levies. A harmonized, integrated and fully fledged GST calls for the following:

- (i) Constitutional Amendment - Implementation of GST calls for effecting widespread amendments in the Constitution and the various constitutional entries relating to taxation. The various levies of the Union and the states are also to be harmonized. The States do not have the powers to levy a tax on supply of services while the Centre does not have the power to levy tax on the sale of goods. In the current scenario it is difficult to visualize constitutional amendments of such far reaching implications going through, more so in view of the fact that sharing of legislative powers is such an essential element of our federal polity and it may be perceived to be a basic feature of the Constitution.

The Constitution provides for an elaborate procedure for effecting a Constitutional Amendment. The procedure to be followed depends on the nature of Constitutional Amendment. The ordinary procedure to pass a Constitutional Amendment involves, firstly introduction of the amendment bill in either house of the Parliament, secondly the bill being passed in each house by a majority of total membership of the house and a majority of not less than 2/3rd of the members of that house present and voting and lastly obtaining the Presidential Assent.

However with respect to the implementation of GST, the Constitutional Amendment involves rearrangement of powers in the Seventh Schedule to the Constitution. Since the Amendment affects the “Entrenched Provisions”, the Constitution requires a ratification of not less than half the number of states apart from the abovementioned ordinary procedure, to pass a valid Amendment.

- (ii) IT Infrastructure: The Government needs to develop/set up proper infrastructure to implement GST, especially IT infrastructure.
- (iii) Design and Structure - No less significant is the issue of an appropriate design and structure of GST. For instance, how the issue of inter-state movement of goods and services may be addressed. The phasing out of CST may go a long way in addressing the issue of inter-state trade and commerce in goods but the crucial issue regarding services originating in one state and being consumed in other state still remains.
- (iv) Sharing of resources - Another contentious issue that is bound to crop up in this regard is the manner of sharing of resources between the Centre and the states and among the states as also the basis of their devolution. Taking away the powers of taxation of goods by the States will not be favoured by them.
- (v) Efficient administration - Apart from all these, there has to be robust and integrated machinery dedicated to the task of tracking flow of goods and services across the country and rendering accurate accounting of levies associated with such flow of goods and services. No meaningful risk management system can work without efficient tax administration software.
- (vi) Taxation issues - The contentious issue of taxing financial services and e-commerce is to be appropriately addressed and integrated.
- (vii) Determination of Revenue Neutral Rate (RNR): At present States are charging VAT rates 0%, 4%, 12.5% and 20% besides other levies and thus the average rate of tax comes to 17%. Similarly, Centre is charging Central Excise duty @ 14%, CST 2%, Service Tax 10%. The combined effect of all the taxes taken together comes to an average rate of tax @ 27.5%. The proposed GST rate is mooted @ 20% both for the Central GST @ 12% and the State GST @ 8%. Assuming that

the States may agree on the implementation of GST based on compensation being given to them like what was decided at the time of introduction of VAT i.e. 1<sup>st</sup> April, 2005, the Centre may suffer loss while satisfying the needs of about 30 states.

## **SUGGESTIONS FOR EFFECTIVE IMPLEMENTATION**

Some suggestions for better administrative machinery to handle the implementation of Goods and Services Tax Act in India are:

- Standardization of systems and procedures.
- Uniform dispute settlement machinery.
- Adequate training for both tax payers and tax enforcers.
- Re-organization of administrative machinery for GST implementation.
- Building information technology backbone – the single most important initiative for GST implementation.
- Uniform Implementation of GST should be ensured across all states (unlike the staggered implementation of VAT) as many issues might arise in case of transactions between states who comply with GST and states who are not complying with GST.

