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GOODS AND SERVICES TAX: A CRITICAL ANALYSIS

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ABSTRACT
The paper is about the 'Goods and Services Tax – A Critical Analysis' which is a topic of national and political debate today. GST is being considered as one of the biggest tax reforms after independence. The paper explains in detail the basic concept of GST its advantages and the main problems in implementing it. The paper also provides various suggestions for the major problems highlighted in the paper.

KEYWORDS
GST, tax reforms.

INTRODUCTION
Introduction of Goods and Services Tax (GST) will be an important step towards a widespread indirect tax reforms in India. The tax reform is being introduced through the Constitution (122nd Amendment) Bill, 2014. The Bill seeks to amend the Constitution to introduce the Goods and Services Tax (GST), and impose concurrent powers on the centre and states to do so. Goods and Service Tax (GST) is a comprehensive tax levy on manufacture, sale and consumption of goods and service at a national level under which no distinction is made between goods and services for levying of tax. It will mostly substitute all indirect taxes levied on goods and services by the Central and State governments in India. (List of indirect taxes charged by central and state governments in India has been attached in appendix -1).

GST is a tax on goods and services under which every person is liable to pay tax on his output and is entitled to get input tax credit (ITC) (Appendix -2) on the tax paid on its inputs (therefore a tax on value addition only) and ultimately the final consumer shall bear the tax".

According to the proposed legislation there would be a "Dual GST" in India, i.e. taxation power will lie with both the Centre and the State to levy the taxes on the Goods and Services.

The scheme was supposed to be implemented in India from 1st April 2016, however it may get delayed since the NDA government does not have majority in Rajya Sabha.

OBJECTIVES
Following are the main objectives of the paper:
1. To understand the basic concept and need of GST
2. To compare and contrast the present taxation system with GST
3. To understand the economic benefits and impact of GST
4. To understand the problems in implementing GST
5. To suggest suitable measures for smooth and effective implementation of GST

NEED OF GST
India has a federal system of governance, and the right to impose taxes is given both to central and state governments. At present the Centre is empowered to tax services and goods upto the production stage, the States have the power to tax sale of goods. The Central government cannot charge sales tax however; it has the power to levy tax on services. Thus, the Constitution does not vest express power either in the Central or State Government to levy a tax on the 'supply of goods and services'. Moreover, the Constitution also does not empower the States to impose tax on imports. Since both Centre and State have separate powers of taxation, both have a separate set of documents which may or may not match with each other. This loophole gives the right to central and state goverernments to decide whether documents of manufacturers and/or wholesalers shall be accepted for tax credits or not while deciding on the retail price of the product. In many cases, state governments refuse to accept tax credits for taxes paid by manufacturers and wholesalers in other states. Hence manufacturers, wholesalers and retailers have to keep in touch with the latest rules and regulations formulated in this regard, and maintain a substantial set of machinery to keep up with these rules. This increases the transaction cost of bearing higher taxes. In both situations, the consumer has to pay higher taxes, since tax is paid not on value added by the retailer, but on the final output value of the product at the retail end.

In addition, state governments too have to maintain a substantial administrative machinery to ensure that these rules are strictly enforced. All in all, this is a highly cumbersome process.

Therefore, it is essential to have Constitutional Amendments for empowering the Centre to levy tax on sale of goods and States for levy of service tax and tax on imports and other consequential issue.

COMPARISON OF PRESENT TAXATION SYSTEM WITH GST
GST is expected to simplify the whole procedure and make India a single unified market, thereby removing a lot of complications in paying and collecting taxes therby making it a much simpler process. It is also expected to make it easier for the administration to certify that the taxes have been paid properly. And for the consumer, it may benefit through reduction in prices, incentivizing greater consumption.

To understand how GST shall work, we shall go through two sets of calculations. Part I will show tax calculations in the non-GST era – i.e. when GST is not in force. Part II will explain the tax calculation when GST is in force. The figures have been simplified for easy understanding.

TABLE-1: WHEN GST IS NOT IN FORCE

Stage of product	Cost of input	Profit Margin	Value of output	Excise Duty	Selling Price	VAT	Invoice Value	Tax Credit	Tax Paid
Manufacturer	500	200	700	84	784	98	882	-	182
Wholesaler	784	78.4	862.4	-	862.4	107.8	970.2	98	9.8
Retailer	862.4	86.24	948.64	-	948.64	118.58	1067.22	107.8	10.78

Source: Calculations done on hypothetical data

a. Profit Margin has been assumed to be 40% for manufacturer and 10% for wholesaler and retailer both
b. Excise duty has been assumed to be 12% of output
c. VAT has been assumed to be 12.5%.

In this case the total tax charged from the consumer is Rs. 202.58 (182+9.8+10.78) which is 21.35% of selling price.

TABLE-2: WHEN GST IS IN FORCE

Stage of product	Cost of input	Profit Margin	Value of output	Excise Duty	CGST	SGST	Selling Price	Tax Credit	Tax Paid
Manufacturer	500	200	700	-	84	84	868	-	168
Wholesaler	700	70	770	-	92.4	92.4	954.8	168	16.8
Retailer	770	77	847	-	101.64	101.64	1050.28	184.8	18.48

Source: Calculations done on hypothetical data

CGST and SGST have been assumed to be 12% each.

In this case the total tax charged from the consumer is Rs. 203.28 which is 19.35% of selling price.

Thus we find that the tax burden on consumer is less when GST is in force. This also reduces the selling price of the product. However, this is a very simple example where we have not taken into account the local taxes charges by state governments like octroi, local municipal tax etc. Once that factor is also accounted the tax burden on consumer in Part – 1 will increase further. With the implementation of GST these local taxes will cease to exist.

MODEL OF GST

- The GST shall have two components: one levied by the Centre (referred to as Central GST or CGST), and the other levied by the States (referred to as State GST or SGST). Rates for Central GST and State GST would be approved appropriately, reflecting revenue considerations and acceptability.
- The CGST and the SGST would be applicable to all transactions of goods and services made for a consideration except the exempted goods and services.
- Cross utilization of ITC (Input Tax Credit) both in case of Inputs and capital goods between the CGST and the SGST would not be permitted except in the case of inter-State supply of goods and services (i.e. IGST).
- The Centre and the States would have concurrent jurisdiction for the entire value chain and for all taxpayers on the basis of thresholds for goods and services prescribed for the States and the Centre.
- Existing CST (Central state tax, tax on interstate movement of goods) shall be discontinued.
- Center would levy IGST (cumulative rate for CGST and SGST) on all inter-state transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services.
- The ITC of SGST, CGST shall be allowed as applicable.
- Since ITC of SGST shall be allowed, 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 SGST liability (while selling the goods in state itself). Thereafter, the Centre will transfer to the importing State the credit of IGST used in payment of SGST.
- The relevant information shall be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective state governments or central government to transfer the funds.

Some Specific points for specific products (being high revenue generating products)

- This tax may or may not apply to alcohol, petroleum and tobacco products. Since the government is yet to build a firm consensus on this issue. Many states are opposed to the idea of bringing these products under GST for fear in loss of revenues. In case they are not put under GST, they will be continued to be taxed as per the existing practices.
- Manufacturing state (the state in India in which the goods are manufactured) may be allowed to levy an additional tax percent (say 1%) on supply of goods initially for a period of two years or as the GST Council may decide.
- PAN based identification number will be allowed to each taxpayer to have integration of GST with Direct Tax.
- The taxpayer would need to submit periodical returns, in common format as far as possible, to both the CGST authority and to the concerned SGST authorities.
- GST on export would be zero rated
- Both CGST and SGST will be levied on import of goods and services into India. The incidence of tax will follow the destination principle i.e. SGST goes to the state where it is consumed. Complete set-off will be available on the GST paid on import on goods and services.

Indirect taxes that will be included under GST:

STATE TAXES WHICH WILL BE SUBSUMED IN SGST

- VAT/Sales Tax
- Entertainment Tax (unless it is levied by local bodies)
- Luxury Tax
- Taxes on lottery, betting and gambling.
- State cess and surcharges to the extent related to supply of goods and services.
- Entry tax not on in lieu of octroi.

Central Taxes which will be subsumed in CGST

- Central Excise Duty.
- Additional Excise Duty.
- The Excise Duty levied under the medical and Toiletries Preparation Act
- Service Tax.
- Additional Customs Duty, commonly known as countervailing Duty (CVD)
- Special Additional duty of customs(SAD)
- Education Cess
- Surcharges

Taxes that may or may not be subsumed due to no consensus between the Central and State Governments:

- Stamp Duty
- Vehicle Tax
- Electricity Duty
- Entertainment Tax (levied by local bodies)
- Basic customs duty and safeguard duties on import of goods into India

ECONOMIC BENEFITS OF GST

The Finance Commission had commissioned a study by NCAER to assess the impact of GST on GDP growth and exports, according to which, implementation of a comprehensive GST across goods and services is expected, ceteris paribus, to provide gains to India's GDP somewhere within a range of 0.9 to 1.7 per cent. This will be possible due to the following reasons:

1. **One of the main benefits of Goods & Service Tax (GST)** would be to eliminate the doubly taxation i.e. cascading effects of taxes on production and distribution cost of goods and services. The exclusion of cascading effects i.e. tax on tax till the level of final consumers will significantly improve the competitiveness of original goods and services in market which leads to beneficial impact to the GDP growth of the country.

2. **Exports:** When factors of production like raw material and overheads move fom on state to another, they are taxed by their respective state governments. This leads to an increase in their prices. Many a times the manufacturer does not get tax credit for the various taxes he has paid since they are paid to different state governments. This affects the international competitiveness of the product. GST is expected to simplify the tax regime.
3. **Allocation of factors of production:** GST would lead to efficient allocation of factors of production. The overall price level would go down. It is expected that the real returns to the factors of production would go up. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital. The GST will bring about a qualitative change in the tax system by redistributing the burden of taxation equitably between manufacturing and services.
4. **Eliminates the multiplicity of taxation: Reduces transaction costs and unnecessary wastages**: A single registration and a single compliance will suffice for both SGST and CGST provided government produces effective IT infrastructure and integration of states level with the union. The reduction in the number of taxation applicable in a chain of transaction will help to reduce the paper work and clean up the current mess that is brought by existing indirect taxation laws. This will help the business community to decide their supply chain, pricing modalities and in the long run helps the consumers being goods competitive as price will no longer be the function of tax components but of innovation.
5. **Reduces the corruption:** The taxes will be simplified by merging number of other taxes like Motor vehicles tax, goods and passengers tax, entertainment tax, entry tax like Octroi etc. As the no. of taxes reduces so does the number of visits to multiple department thus reducing corruption in various government departments.
6. **Rail Sector:** There have been suggestions for including the rail sector under the GST umbrella to bring about significant tax gains and widen the tax net so as to keep overall GST rate low. This will have the added benefit of ensuring that all inter–state transportation of goods can be tracked through the proposed Information technology (IT) network.
7. **Information Technology enabled services:** At present, if the software is transferred through electronic form, it should be considered as Intellectual Property and regarded as a service and if the software is transmitted on media or any other tangible property, then it should be treated as goods and this classification is full of litigation. As GST will have uniform rate for Goods and Services and no concept of state revenue being VAT or central revenue being service tax and hence, the reduction in litigation**.**
8. **Transport Sector:** Truck drivers spend more than half of their time while negotiating check post and tolls (The Economist November 8, 2014 page 67). At present there are more than 600 check points and more than ton types of taxes in road sector. After the introduction of GST, the time spend by the road transport industry in complying with laws will reduce and service is going to be better which will boost the goods industry and thus the taxes also.
9. **Common market:** Helps creating a national market by removing inter-state trade barriers. There will be a common market in the absence of CST (Central Sales Tax) and entry tax. At present, goods are being sold mostly within the state in order to avoid paying the CST which is not credited at the stage of manufacture or in course of trading. Good quality products being manufactured in one part of the country will find more market in the farthest part of the country because there will be no CST and no entry tax
10. **Invoicing will be simpler:** At present, the invoices are more detailed since taxes on goods and services are written separately for one transaction. With the introduction of GST only one rate will be written.
11. **Common exemptions between Centre and states:** Now the exemptions given by the Centre and the states being different, the final price becomes different in different states. In the GST regime, exemptions will be common between the Centre and the states which will make the rates of duty same all over India.
12. **Problem of identification will go:** At present, identifying a commodity like whether it is rubber or resin, paper or board, ash dominate the proceedings since rates of duty are different. These controversies will be over.

If implemented in its truest sense GST is expected to put India's fiscal system on the cutting edge of the world market economies. According to a report (Refer to point 6 of References) even a 2% reduction in costs increases profits by over 20%. This will attract investments. Hence it is very important that GST is implemented in an ideal manner with one rate and covers all goods and services with minimum exemptions.

PROBLEMS IN IMPLEMENTING GST

1. **Administrative mechanism:** The basic essence of GST lies in integrating the revenue collection services of all the 28 states and all seven union territories of the country. It requires an extremely powerful Central Service agency acting as one GST collection agent. Even today the manpower and the IT infrastructure are not at par kept up with the rising number of tax payers or the increased documentation. The indirect tax administration faces several problems regarding tax collection, record maintenance, document management, logistics, recovery of arrears, litigation, an aging workforce, information technology lacunae and a general apathy towards the population, with its limited assessee base. This base is supposed to swell into an excess over 50 lakhs (Refer to point 4 of References) if GST becomes operational. Hence the success of GST depends a lot on the preparedness of the administrative machinery.
2. **Intentions:** GST is being considered as the biggest tax reform since independence. But the government has still not reached a consensus on various taxes with the states. Agricultural states like Punjab and Haryana collect a lot of revenue from purchase tax on agricultural products. These states do not want Purchase tax to be included in GST. Similarly, Maharashtra does not want Octroi to be included in GST. Further some states like Tamil Nadu, Karnataka and West Bengal do not want alcohol, tobacco and petroleum to be included in GST. Latest discussions reveal that the 200 items at state level and another 100 items at centre level will be kept out of the GST bracket (appendix- 4). To make GST successful it is very important that the government keeps minimum items out of the ambit of GST.
3. **Financial impact on states**: Implementing GST will have a lot of a huge financial impact on the states. GST is designed in such a way that the consuming states will collect revenue. Hence manufacturing states will lose a big share of their income. This would also affect the autonomy of a state to face an economic challenge (a drought, a flood or a crop failure) or initiate a new social welfare scheme (Arogyasri, Mid-Day Meals, special sub-plans for weaker and scheduled sections). Further Municipal Corporations and Panchayats are also going to be divested of their powers to collect taxes as GST intends to subsume Octroi, Entry Taxes, Betting tax, Cesses and surcharges. The government is yet to come out with a sound plan to ensure that states do not suffer as a result of GST.

SUGGESTIONS

1. Before the government actually brings GST in force it is very important to ensure that the administration of the country both at the central and state level is fully prepared. The preparedness should not only be in terms of knowledge of the new Act but also about how to implement it. For those who are not comfortable in using information technology, special training sessions should be organized.
2. The GST Council is yet to be formed. The government should clearly frame rules settlement of disputes for all –CGST, SGST and IGST. It would be better if separate dispute settlement authorities are set at the state level for speedy resolution. Further a fixed time span should be set for the settlement of each case so that cases do not remain pending for years.
3. The government can also settle cases using information technology wherein all the parties can submit their pleas online and personal attendance is not compulsory. This can be done specially in cases where IGST dispute is involved. This will further help in saving time.
4. It is very important that the government puts the loss to each state as a result of implementing GST on paper. Moreover, the plan to ensure the financial autonomy of each state should be put in place first. This means how will the respective state governments recover that loss has also to be finalized. It would not be fair if the Centre promises that it will compensate for the loss for the first one or two years. The Centre and the States should mutually come to an agreement on creating finances for each state in the long run. This is because financial independence of states is very important for smooth functioning of state machinery. Moreover, there are many departments or schemes which are run by respective state governments and are not financed by the Centre. We already have the Delhi AAP government fighting for statehood since there is a lack of finances to pay even the municipality workers. In case there is lack of finances to states we may see separate states imposing separate taxes to recover funds. This will spoil the spirit of GST.

5. For successful implementation of GST, it is very important that minimum items are kept out of the GST basket. Further the GST Council, after its formation, should come up with a full proof plan of bringing the items that are being kept out of the GST basket as for now into the ambit of GST. This information should also be put in public domain. Every effort should be made to stick to the planned guidelines. We need to put in untiring efforts to ensure that investor confidence specially the Foreign Direct Investors does not trickle.
6. The general public at large is mainly unaware of the impact of GST. The government, national and the local media should start educating the public about the new law at least 6 months before the law is put in place. The public should be educated about the changes in the prices of basic commodities that may happen once the new law comes in place. The business community needs to be educated about the changes the new law will bring and about the new set of documents they need to prepare. This is important because it is always better to have an informed change.

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APPENDICES

APPENDIX-I

Article 246 (SEVENTH SCHEDULE) of the Indian Constitution, distributes legislative powers including taxation, between the Parliament and the State Legislature. 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 of Seventh Schedule of Indian Constitution. There is no head of taxation in the Concurrent List (Union and the States have no concurrent power of taxation). Any tax levied by the government which is not backed by law or is beyond the powers of the legislating authority may be struck down as unconstitutional. The thirteen heads List-I of Seventh Schedule of Constitution of India covered under Union taxation, on which Parliament enacts the taxation law, are as under:

- Taxes on income other than agricultural income;
- Duties of customs including export duties;
- 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);
- Corporation Tax;
- Taxes on capital value of assets, exclusive of agricultural land, of individuals and companies, taxes on capital of companies;
- Estate duty in respect of property other than agricultural land;
- Duties in respect of succession to property other than agricultural land;
- Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freight;
- Taxes other than stamp duties on transactions in stock exchanges and futures markets;
- Taxes on the sale or purchase of newspapers and on advertisements published therein;
- 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;
- Taxes on the consignment of goods in the course of inter-State trade or commerce.
- All residuary types of taxes not listed in any of the three lists of Seventh Schedule of Indian Constitution.

The nineteen heads List-II of Seventh Schedule of the Indian Constitution covered under State taxation, on which State Legislative enacts the taxation law, are as under:

- 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;
- Taxes on agricultural income;
- Duties in respect of succession to agricultural income;
- Estate Duty in respect of agricultural income;
- Taxes on lands and buildings;
- Taxes on mineral rights;
- 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;
- Taxes on entry of goods into a local area for consumption, use or sale therein;
- Taxes on the consumption or sale of electricity;
- Taxes on the sale or purchase of goods other than newspapers;
- Taxes on advertisements other than advertisements published in newspapers and advertisements broadcast by radio or television;
- Taxes on goods and passengers carried by roads or on inland waterways;
- Taxes on vehicles suitable for use on roads;
- Taxes on animals and boats;
- Tolls;
- Taxes on profession, trades, callings and employments;
- Capitation taxes;
- Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling;
- Stamp duty.

Provisions have been made by 73rd Constitutional Amendment, enforced from 24th April, 1993, to levy taxes by the Panchayat. A State may by law authorise a Panchayat to levy, collect and appropriate taxes, duties, tolls etc. Similarly, the provisions have been made by 74th Constitutional Amendment, enforced from 1st June, 1993, to levy the taxes by the Municipalities. A State Legislature may by law authorise a Municipality to levy, collect and appropriate taxes, duties, tolls etc.

APPENDIX -II

Input tax credit is the amount of tax paid by the dealer on purchases for which the dealer is entitled to claim a credit. The input tax credit has to be claimed in the tax period in which a dealer records tax invoice and can be adjusted against tax liability of the dealer on all the sales effected during the said tax period. It will be available for the taxable goods purchased for the purpose of:

1. Sale or resale within the State
2. Sale in the course of inter state trade or commerce
3. Sale in the course of exports
4. Use as raw materials, processing materials or processing materials in the manufacture of taxable goods
5. Use as packing of goods
6. Sale to SEZ/EOU
7. Transfer outside the State

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