How to Operationalise Indian Model of GST

Background

The NDA Government led by Atal Bihari Vajpayee by setting up an Empowered Committee in 2000 initiated discussions on Goods and Services (GST) as an alternative tax to indirect taxes. The Committee was Chaired by Asim Dasgupta, the then Finance Minister of Government of West Bengal. It was entrusted with the task of designing a GST model to suit to Indian context. In 2003 a Task Force on implementation of FRBM Act headed by Vijay Kelkar had suggested adoption of a comprehensive Goods and Services Tax (GST) based on VAT principles. The Task Force felt that the existing system of taxation of goods and services still suffers from many problems even after the adoption of VAT.

In his Budget speech for FY 2007-08, Finance Minister P.Chidambaram proposed to introduce a national level GST with effect from April 1, 2010. This was a significant break –through and a logical step towards a comprehensive indirect tax reforms. Following this, an Empowered Committee of State Finance Ministers (EC) was constituted to prepare a design and a roadmap for the successful implementation of GST. In May 2007 a Joint Working Group was set up by the EC. After intensive discussion with experts and representatives of Chamber of Commerce and Industry, it submitted a report on GST in Nov 2007. Based on this report, the EC, in April 2008 drafted and submitted its final report titled "A Model and Roadmap for Goods and Services Tax (GST) in India" to the Government. A dual GST model was proposed by the EC.

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To implement GST, a Constitutional Amendment is required. In this regard, the UPA Government brought a Constitutional Amendment Bill in Lok Sabha in 2011, but was unsuccessful in getting it passed. The newly formed NDA Government modified that Constitutional Amendment (122^{nd}) Bill and introduced in the Lok Sabha in December 2014. The Lok Sabha cleared the Bill on May 6, 2015. But the Bill is yet to get approved by the Rajya Sabha. Once the Rajya Sabha clears the Bill the same should be ratified by a minimum of 50 per cent of states. The Government intends to implement the GST nation- wide with effect from April 1, 2016. With delay in passing the Bill, the deadline seems to be unachievable. The debate over GST has intensified at political circles, corporate world and academia. The global investors and the domestic manufacturers are worried with the suspected further delay in the implementation of the much needed GST. At this backdrop, the key issues of discussion are how GST would operate once it is implemented? In what respect it would be an improvement over existing taxes? What are its pros and cons? The paper is an attempt to explore answer to these key issues.

Salient Features of the Proposed GST

GST is a comprehensive tax levy on sale and consumption of goods and services at the national level under which no distinction is made between goods and services for levying tax (Constitutional Amendment Bill, 2014).

GST will substitute all existing indirect taxes levied on goods and services by the Central and State Governments.

To provide more fiscal freedom to the states, five petroleum products and alcohol for human consumption have been kept out of GST ambit. On those exempted goods the existing taxes as applicable would be continued to levy by the State governments.

With respect to tobacco and tobacco products, Centre may levy an additional tax over and above the GST.

The Bill proposes a Dual GST Model for India, wherein the GST could be levied by the center and the states concurrently. The Central GST (CGST) would subsume all existing central indirect taxes including central excise duty, additional excise duty, excise duty levied under the Medical and Toiletries Preparation Act, services tax, additional customs duty, special additional duty of customs (SAD), education cess and surcharges. The State GST (SGST) will subsume the following state indirect taxes: VAT, state entertainment tax, luxury tax, tax on lottery, betting and gambling and entry tax not in lieu of octroi.

Only the Central Government is empowered to levy tax on inter-state transactions. Under the proposed GST, the Central Government will levy Inter-state Goods and Services Tax (IGST) on the inter-state movement of goods and services. This replaces existing Central Sales Tax (CST). The tax collected will be divided between the Central and the State Government concerned.

The Bill also proposes to levy an additional tax not exceeding 1 per cent on inter-state trade in goods. This tax will be levied by the Central Government to mobilise funds to compensate the states for 2 years for the loss of revenue resulting from transition to GST. However, considering the current political scenario, the possibility of this additional levy appears to be very remote.

The Bill proposes to set up a GST Council consisting of Finance Minister as Chairman, Union Minister of State in charge of revenue/finance, Finance Ministers or any nominated representative by each state government. The Council is entrusted with smooth sailing of GST including fixing a Revenue Neutral Rate of GST, rate of additional tax over GST on inter-state transactions and time duration of such additional tax etc.

International Experience

GST was first introduced by France way back in 1954. Since then almost 150 countries across the world have embraced GST in one or the other form. Most of the countries have unified GST regime. New Zealand seems to be the most pure GST system with very few exemptions. New Zealand introduced GST in 1986. In the post GST implementation, the revenue mobilization in New Zealand was 45 per cent higher than expected. According to analysts such unprecedented growth in tax collection was due to improved tax compliance after the introduction of GST. Singapore also levies a single GST rate. In contrast, Indonesia follows multiple GST with six different rates for different items. Further, it has more than 30 categories of exemptions. Only that GST model which has uniform rate and minimum exemptions are will be advantageous. In case of China, GST is applied only to goods and a very few select services viz, provision of repairs, replacement and processing. Very few countries such as Canada and Brazil have dual GST model. It is noteworthy that the proposed GST for India is also in the similar dual GST line. Transition of Canada from Sales tax to GST increased potential GDP by 24 per cent. Analysts estimate that increase in GDP was the result of improved factor productivity and elimination of tax cascading after GST implementation. The Canadian experience is the indicative of the potential benefits of GST to the Indian economy.

Need for GST in India

Owing to several factors and reasons, the current indirect taxation is not adequate enough to accelerate the growth. Some of such circumstances are noted here. The current indirect tax structure, in spite of transition to VAT in 2005, gives way for tax cascading and does not permit exempted sectors to claim input tax credit for either CENVAT or CST.

The taxable event under excise duty is manufacturing. It leaves manufacturing expensive. Again the same product is taxed on the sale of the same product. Several times of tax levy on the same product adversely affects the output and has detrimental impact on the price modeling.

Multiplicity of taxes and different tax rates for different products and different rates for different services have made Indian tax administration very complex. Further, for the same product, different taxes are levied at different states. This severely affected the ease of doing business. Separate tax registration for each kind of tax and requirement of many return submissions raised operational cost. Such complexities give way for corruption in tax administration and also to large scale tax evasion.

Under the current laws, states cannot levy tax on services- the plum area to raise revenue as they grow at fastest rate. The CST is not been able to effectively track inter-state service transactions and brings each one of the service under tax.

Thus, there is urgent necessity to simplify Indian indirect taxes and widen their base by covering all goods and services with no exemption or minimum exemption. For the success of the various macroeconomic reform programs of India including the Make in India and such other initiatives, indirect tax reform is the pre-condition. To attract foreign direct investment and to lure in global corporate giants to work with India, elevating Indian taxation policy to the global standards is essential.

What is the Right GST Rate?

GST rates are not uniform across the globe. The GST raters of some countries are given in Table-1. The global GST rate averages at 16.4 percent.

Table 1 :

GST Rates in Major Countries.

Country	Rate of GST (%)
Australia	10
France	19.6
Canada	5
Germany	19
Singapore	7
New Zealand	15
Malaysia	6
Denmark	25
Global Average	16.4

Source: Wikipedia

Given the Indian context, what is the ideal rate at which GST can be levied? A few committees were set up by the Government to look into the issue and recommend a suitable GST rate. However, there are glaring differences in their recommended GST rate. The Finance Ministry drafted a 3 slab GST rates- 12 percent for identified essential goods, 20 percent for other goods and 16 percent for services. Later, a Task Force on GST of the 13th Finance Commission in 2010 recommended a combined GST rate of 12 percent. The Government felt that 12 percent would be low to reach revenue neutrality level. So, in 2014 a Sub-Panel of Empowered Committee was constituted for arriving at ideal GST rate. The Panel suggested Revenue Neutrality Rate (RNR) of 26.68 percent. Finance Minister Arun Jaitley shrugged off this rate saying "27 percent would be very high".

Sumit Dutt Majumdar, former CBEC Chairman believes that GST rate should be 21 percent to start with. For Govinda Rao, former Director of NIPFP, 20 percent appears to be an acceptable rate of GST. In an unofficial disclosure to the media, an official of the Ministry of Finance states, "in the earlier stages of the rollout, we would have to keep the rate between 20 and 23 percent". This range seems to be more feasible. To arrive at political concensus, 17-18 percent seems to be certain.

Operationalising the Indian GST Model

Introduction of the GST framework to India is considered as the most significant reform since 1991. Once the GST is implemented, how this tax framework would operate is awaited to see. Let us try to understand the operation of the most likely mode of GST. This is based on the provisions of the Constitutional Amendment (124th) Bill 2014, tabled and cleared in the Lok Sabha in May 2015.

A tyre manufacturing company of Mysore procures raw materials at Rs.1 crore. The company also incurs a manufacturing cost of Rs.20 lakhs and keeps a profit of Rs.30 lakhs. It appears that the GST rate will be pegged at somewhere around 20 percent. To elaborate our case, assume that the GST is levied at 20 percent. Given this situation what is the tax liability of the manufacturer?

Table 2 :

Measuring GST

Particulars	**Value of Item**	**GST**
Material Costs	1 crore	20 lakhs
Manufacturing Costs	20 lakhs	-
Profit	30lakhs	-
Sales Price	1.5 crore	30lakhs
Input Tax Credit	-	20 lakhs
Balance GST Payable	**-**	**10 lakhs**

The proposed GST is segregated into two parts such as Central GST (CGST) and State GST (SGST). The CGST will be levied by the central government while the revenue mobilsed under SGST goes to state exchequer. The 20 percent GST is inclusive of both taxes say 10 percent of CGST and 10 percent of SGST. It is pertinent to note that both CGST and SGST would be applicable to all transactions in goods and services except exempted items. The Centre and the States will have concurrent jurisdiction for the entire value chain.

It is widely believed across business houses that GST is more cost effective than existing indirect taxes. How far it is a fact? To learn more on this, let us see how GST would operate at various stages of supply chain in comparison with existing multiple indirect tax regime (Refer Table- 3).

Table 3 :
A Comparison of GST with Current Indirect Taxes.

Particulars	Current Indirect Taxes	GST
I. Manufacturer to Wholesaler		
Cost of Production	10,000.00	10,000.00
Add: Profit	3,000.00	3,000.00
Manufacturer Price	13,000.00	13,000.00
Add: Excise Duty @ 12%	1,560.00	-
Total Value	**14,560.00**	**13,000.00**
Add: VAT @ 12.5 %	1,820.00	-
Add: CGST @ 10%	-	1,300.00
Add: SGST @ 10 %	-	1,300.00
Invoice Value	**16,380.00**	**15,600.00**
II. Wholesale to Retailer		
Less: ITC to Wholesaler	1,820.00	2,600.00
CGST	-	1,300.00
SGST	-	1,300.00
Cost to Wholesaler	14,560.00	13,000.00
Add: Profit @ 10%	1,456	1,300.00
Total Value	**16,016.00**	**14,300.00**
Add: VAT @ 12.5%	2,002.00	
Add: CGST@10%	-	1,430.00
Add: SGST@10%	-	1,430.00
Invoice Value	**18,018.00**	**17,160.00**
III. Retailer to Consumer		
Less: ITC to Retailer	2,002.00	2,860.00
CGST	-	1,430.00
SGST	--	1,430.00
Cost to Retailer	16,016.00	14,300.00
Add: Profit @ 10%	1,601.60	1,430.00
Total Value	**17,617.60**	**15,730.00**
Add: VAT @ 12.5%	2,202.20	
Add: CGST @10%	-	1,573.00
Add: SGST @ 10%	-	1,573.00
Price to Consumer	**19,819.80**	**18,876.00**
Consumer Savings	-	**943.80**

If the GST is around 20 percent or below, the consumer has to spare lesser price for the product in comparison with the existing taxes. This GST measuring methodology is applicable in the case of sale of the item in one state and re-sale in the same state. During the event of sale and re-sale of the item within the same state, there arises no question of credit transfer with the Central Government and the State Government. This is because the input tax credit comes from the same state government to whom the output tax goes. In the example (refer Table-3), the Karnataka State Government levies SGST of Rs.1,300 per pair of tyres when they are sold by the Mysore based tyre manufacturer to the Bangalore based wholesaler. The tax burden is on the wholesaler since he is the buyer. However, when the wholesaler sells the same pair of tyres to a retailer of Bangalore, the wholesaler receives the input tax credit of Rs.1,300 from the Karnataka State Government.

For any inter-state transactions, the GST Bill proposes to levy Integrated GST (IGST) which would replace Central Sales Tax (CST). Let us take an example to analyse the operation of GST in the case of inter-state transaction. Mr. X is a registered dealer in soaps from Bangalore. He purchases 100 soaps from a soap manufacturer in Mysore at Rs. 10 per soap. In this case, the item moves within the state. Both CGST and SGST are applicable on the sale as discussed earlier. Tax collection via CGST and SGST goes to Central Government and Karnataka State Government respectively.

Later, soaps are resold from Bangalore to Chennai. This is being an inter-state transaction, IGST will be levied at 20 per cent. The entire tax proceeds goes to Central Government. At this juncture very interesting to learn is whether there is any input tax credit? If so how is it credited? Against IGST levied on the re-sale of soaps from Bangalore to Chennai, the dealer gets both the CGST and SGST input tax credits. Though SGST has not gone to the Central Government, the input credit is claimed by the dealer (this is missing in the existing CST). This amounts to a loss to the Central Government. To compensate this loss the state government concerned (Karnataka in our case) transfers SGST input tax credit to the central government.

The tax liability of Mr. X in case of inter-state sales of soaps is presented in Table 4.

Table 4 :

Application of GST when Goods are sold within the State but Resold Outside the State.

Particulars	**Sales within State**	**Inter-State Sales**	**Total**
Qty. of Soaps Sold	100	100	
Price/soap	10.00	10.00	
Value of Soap Sold	1,000.00	1,000.00	2,000.00
Tax			
CGST @10%	100.00	-	100.00
SGST @ 10%	100.00	-	100.00
IGST @ 20% *	-	200.00	200.00
Total Tax Amount	**200.00**	**200.00**	**400.00**
Less: Input Tax Credit	200.00	-	200.00
CGST	100.00	-	
SGST	100.00	-	
Balance Tax Payable		200.00	**200.00**

*** Note:** The proposed Bill authorizes the Central Government to levy an additional tax of not exceeding 1 percent on the on the value of the inter-state transactions over and above the IGST. This will be levied for a period of not more than two years or as decided by the GST Council to raise fund to compensate the loss incurred by the State Government due to the adoption of GST.

Though the total tax amount is Rs. 400, the dealer Mr. X is liable to pay only Rs.200. Since he has already paid an input tax of Rs.200, that amount is credited by the Central Government to him. It is inclusive of CGST of Rs.100 and also SGST of Rs.100. The balance Rs. 200 is his tax liability.

Now let us assume another case of inter-state transaction under which the Mysore soap factory sells soaps in Chennai and it is resold from

Chennai to Madurai. How GST would be measured and input tax credit would be granted in such an event when goods are sold outside the state, and again resold in that state? Refer Table-5 to avail answer.

Table 5 :

Application of GST When a Good is Sold Inter-State but Resold within the State.

Particulars	Inter-State Sales	Intra-state Sales	Total
Quantity of Soaps	100	100	
Price/soap	10.00	10.00	
Value of Soap Sold	1,000.00	1,000.00	2,000.00
Tax			
CGST @10%	-	100	100.00
SGST @ 10%	-	100	100.00
IGST @ 20%	200	-	200.00
Total Tax Amount	**200.00**	**200.00**	**400.00**
Less: Input Tax Credit	200.00	-	200.00
CGST	100.00	-	
SGST	100.00	-	
Balance Tax Payable		200.00	**200.00**

It is evident that IGST has gone to the Central Government, but still the input tax credit of Rs.100 is claimed against SGST. As this leads to loss of revenue to the Government of Tamil Nadu, the Central Government compensates the Tamil Nadu Government by transferring the credit of Rs.100.

How would be imported goods taxed under GST? Mr.X from Mysore imported goods for Rs.30,000. Since GST retains Basic Customs Duty (BCD) on the imported items, it is levied at 10 percent. Mr. X also incurred expenses to produce final salable goods from the imported item. The goods are be sold in Karnataka at Rs.60,000 plus GST as applicable. Table-6 shows his tax liability under GST regime.

Table 6 :
GST on Imported Goods

Particulars	**Amount (Rs)**
Import Cost	30,000.00
Add: Basic Customs Duty (BCD)@ 10%	3,000.00
Import Cost after BCD	33,000.00
Add: CGST @ 10%	3,000.00
Add: SGST @ 10%	3,300.00
Import Cost after GST	39,600.00
Sales Value (before tax)	**60,000.00**
(a) Add: CGST @ 10%	6,000.00
(b) Add: SGST @ 10%	6,000.00
Sales Value after GST	**72,000.00**
Less: Input Tax Credit	6,600.00
(c) CGST	3,300.00
(d) SGST	3,300.00
Tax Payable	
CGST	(a) - (c) 2,700.00
SGST	(b)- (d) 2,700.00
Tax Balance Payable	**5,400.00**

There may be a case in which goods will be imported to one state and later resold in another state. In such cases of inter-state transaction of the imported goods the same procedure of calculating GST and crediting input tax is applicable as that of inter-state transaction of the domestic goods.

It is pertinent to note the following:

- The GST is applicable to all goods and services at uniform rate except for exempted items.
- Tobacco products are subject to GST and the Government may levy an additional tax over and above the GST rate.

- Manufacturing states may be allowed to levy an additional tax (as decided by the GST Council) on supply of goods. This is to compensate the revenue loss such states incur with the adoption of GST.
- GST will not cover firms/entrepreneurs whose gross annual turnover is less than 1.5 crore and they will be exempted from GST payment.
- The rate of GST for exports will be zero. But Basic Customs Duty (BCD) will be continued to levy.

Benefits of GST

The discussion on the proposed GST in the previous sections brings to the light certain advantages over the existing multiple indirect tax system.

Eliminates tax cascading: VAT eliminated tax cascading to some extent, but not completely. GST being proposed to levy only at the stage of sale, it avoids 'tax on taxes', thereby making product more competitive.

Simplifies tax procedure: Since GST is a single slab tax at uniform rate for an array of indirect taxes, the assesse is relived from the requirement of multiple registrations and filing of several tax returns to different departments. The GST necessitates the assesse to make single registration and file one tax return. This eases the ease of doing business.

Price reduction: It is widely believed that GST would give some respite to the consumers by making products cheaper. But how far GST will influence the price modeling depends on the actual GST rate. GST less than 20 percent is sure to make manufactured goods more price competitive.

Rise in Government revenue: If not in the short run, may be in the long run, with the global experience, it can be said that the Government exchequer would bourgeon. Minimum exemptions and wide tax base are essential conditions to fetch more revenue. It is also widely expected that GDP would grow by an additional 1.5 – 2 percent.

Eliminates complexities: By eliminating multiplicity of indirect taxes and by considering sale as the taxable event, GST reduces complexities and transactions cost.

Export Promotion: As India is on the threshold of accelerating growth through manufacturing exports, zero rate GST on export makes Indian goods very competitive in the global market. It is a big boost factor for export traders.

Key Issues and Concerns

Article 246 A of the proposed Bill authorizes every state legislature to enact GST law for the state jurisdiction. The real implementation of the GST, thus, lies with the states concerned. The fate of GST depends on political aspirations of different states.

Since there is no consensus as well as clarity regarding the GST rate, the fear of inflation still persists.

With the implementation of GST, services sector, the engine of Indian growth, appears to be badly affected. The current rate of services tax levied by the Central Government is at 14 percent. If the GST is levied at the rate of 20 percent as widely expected, there will be an additional 6 percent tax burden on services making them expensive.

As the small entrepreneurs with annual turn over less than the threshold limit of Rs.1.5 crore are not covered under GST, they do not enjoy the benefit of input tax credit. This enhances their cost of production.

Under the existing tax structure, retail sector would be levied by only state government. But transition to GST means retailers are obliged to pay Central GST in addition to State GST. Now, with additional tax burden retail outlets may not be as price competitive as they were without GST.

GST being a destination based tax, it is pertinent to track accurately as to where the items are moving. However, tracking the flow of services and levy tax on inter-state transaction appears to be very challenging.

Amidst such challenges, India has to move forward, sooner than later, with GST implementation, if it has to keep up the trust of the global investors community.

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