

TOWARDS GOODS AND SERVICE TAXATION – ISSUES AND CONCERNS

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This paper is structured into three parts. The first part outlines the basic concept of GST, its evolution in India, flagging major issues involved in its implementation in the Indian context. The second part makes an inter-regime comparison between the earlier system of state sales tax, the existing system of VAT and the proposed system of GST. The implications are illustrated by working out the calculations at various stages of a transaction (*refer power point presentation attached*). The third part attempts to map the major areas of concern and level of preparedness of the state from the point of view of Revenue, Administration and Compliance.

PART I **GOODS AND SERVICE TAXATION IN INDIA**

According to scholars, it was Maurice Laure, Joint Director of the French Tax Authority who first introduced VAT in 1954, although German industrialist Dr. Wilhelm von Siemens proposed the concept in 1918. During the last six decades, more than 140 countries have adopted VAT, which has become the most important mechanism of indirect taxation. VAT is a multipoint system of taxation with set off facility (input tax credit) for the tax paid on purchases. It is a system of taxation that does away with pyramiding and cascading, and where the ultimate burden passed on and borne by the final consumer, hence it is also called consumption tax. As this principle of VAT can be applied on goods as well as services, it has also been termed Goods and Services Tax (GST). As indicated, the worldwide attraction of VAT system lies in its inherent advantage i.e., Input Tax Credit (ITC). The registered taxpayer will avail credit/set-off for the tax paid on the purchase of goods/ services against the output tax on sales that is to be remitted to government.

In the Indian context, though discussions about introduction of VAT in the area of state domestic taxation system started in India switched by the early 1990's, it took more than a decade to arrive at a consensus on its introduction, the first phase of which was realised in 2005. It took another 2 years for all the other states to join the VAT bandwagon.

Goods and Services Taxation (GST) is a second generation reforms in indirect Taxation in India. Even before VAT was introduced in the states, the Union government followed VAT principles in levying excise duties. At present the situation is that both Union and state governments follow VAT principles in levying respective taxes in their domain: Union government in the case of excise duties at the manufacturing level and taxes on services, and the states with regard to tax on sales.

In the GST context, all the major taxes now levied and collected by Union and states will get converged under a single umbrella, and is founded on the principles and systems of Value Added Taxation (VAT). There are different systems and methods of implementation of GST in the world, based on the nature of the federal structure. While some countries like China, Australia have adopted unitary system of GST, other countries like Canada, Brazil have gone in for a system of federal GST.

In India, the consensus between Union and State governments is that a system of Dual GST would be the best solution for the country. In the proposed Dual GST system, both goods and services that pass through the supply chain are taxed under VAT principles both by the Union Government in the form of Central Goods and Services Tax (CGST) and by the State Government in the form of State Goods and Services Tax (SGST).

The following are the Central Taxes to be subsumed under Dual GST:

- (i) Central Excise Duty
- (ii) Additional Excise Duties
- (iii) Service Tax
- (iv) Additional Customs Duty (Countervailing Duty – CVD)
- (v) Special Additional Duty of Customs
- (vi) Surcharges
- (vii) Various Cesses

The following are the State Taxes that are to be subsumed under Dual GST:

- (i) VAT/ Sales Tax
- (ii) Entertainment Tax (unless it is levied by local bodies)
- (iii) Luxury Tax
- (iv) Taxes on lottery, betting and gambling
- (v) State cesses and surcharges on goods and services
- (vi) Entry tax.

Major Issues

Some of the major areas – statutory, technological, governmental and public consensus - where initiatives have not been made or final decisions/consensus have not been reached are the following:

- **Model Act, Rules and Forms** For a seamless rollout of a system like GST, it is imperative that the model Act and Rules both the Union and State Governments are prepared well in advance and discussed threadbare at all levels and with all the stakeholders.
- **Uniform Nomenclature, Classification and Coding of Goods and Services:** A comprehensive Schedule consisting of common and uniform nomenclature, classification and coding for goods and services applicable for the Union and States should be framed to suit the seamless functioning of dual GST. The list should be framed in line with the internationally accepted classification and coding by the Government of India in consultation with expert bodies. The Schedule should also consist of the list of exempted goods and services and a separate state list to address state-specific goods and services with their local nomenclature.
- **Integrated E-platform:** This has to necessarily include nationwide networking and real time data transfer between the state departments and between states and the Central agencies. Another important area of intervention is related to legacy data from all the sources at the state and central level.
- **Governance Mechanism** At present the tax governance at the state and the Union level remain as two separate domains. But in the GST context, there are many areas where, to avoid duplication and to enhance efficiency, certain crucial areas of administrative activities need to be shared between Union and the states. Such areas include registration, allotment of dealer ID, Investigation, Intelligence etc.
- **Dissemination** There should be a national level public dissemination and outreach programme through all media, addressing all the stakeholders like tax payers about compliance issues, the consumers about the price/inflation impact, tax practitioners and legal personnel about the modalities and procedures

PART B
INTER-REGIME COMPARISON:
SALES TAX, VALUE ADDED TAX AND GOODS & SERVICES TAX

Given below is a model scenario of how a transaction will be treated under different regimes of taxation: sales tax, value added tax and goods and service tax. This illustration is worked out by calculating the tax implications at five stages of a transaction, viz.

- Raw Materials Supplier,
- Manufacturer,
- Wholesaler and
- Retailer &
- Consumer

The tax and price impact are worked out at each stage. Along with this the same transaction is analyzed from the point of view of Revenue also.

Assumptions:

The model scenario is prepared considering the following assumption

1. All stages of the transaction occur within the state i.e, all the purchases and sales are made within the state.
2. The rate of taxes at all stages and for all regimes (Central Excise Duty, Sales Tax, Value Added Tax and Goods and Service Tax) are assumed to be 10 per cent
3. The expenses & profit/loss or value addition remain the same under all regimes, in order to isolate the tax effect and to facilitate inter-regime comparison
4. All taxpayers at different stages in all the three regimes of the transaction are registered taxpayers and are liable to pay tax under purview of Union and State Government
5. Only Goods purchased and sold are considered for the calculation, hence services are excluded

SALES TAX REGIME

(Refer Tables A, B, C, D, E & F in the power point presentation attached)

This is the tax system that existed till the introduction of VAT in almost all the states in 31 March 2005. Majority of the goods under the sales tax system followed a single point system taxed at the first sale point, which means that goods are taxed at the first point of its sale within the state and the subsequent sales of the same goods are totally exempted.

a. Stage 1: Raw Material Supplier

Let us assume that a raw material supplier purchases a non-taxable crude raw material for Rs. 500, and sells it at Rs. 800 after allowing for his expenses and profit (Rs. 300). As it is the first sale within the state, he sells it at Rs. 880 which is inclusive of 10 % tax.

b. Stage 2: Manufacturer

In the case of the Manufacturer, the purchase price is Rs.880 (Rs 800 + tax Rs. 80). He sells the goods manufactured out of it at a unit cost of Rs. 1380, which is inclusive of all his expenses and profit of Rs.500. As it is a manufactured item, it attracts central excise duty, and as a good which is entirely different from the goods sold by the raw materials supplier earlier, it also attracts sales tax of 10 % at this level. So the manufacturer collects 10 % central excise duty i.e., Rs.138 and a sales tax of 10 % i.e. Rs. 151.80 (where the tax is arrived at after including the central excise duty along with the sale price). Altogether the sale price to the wholesaler will be Rs. 1669.80. Here the manufacturer remits the central excise duty to the central government and sales tax to state government.

c. Stage 3: Wholesaler

The purchase price of the wholesaler is Rs.1669.80 and after adding his expenses and profit, it is sold at a selling price of Rs. 1869.80. As it is considered second sale of the same goods, no tax is imposed at this stage in the sales tax regime.

d. Stage 4: Retailer

The transactions at this level also follow the same pattern of the wholesaler. At this stage, adding expenses and profit of Rs.100, he sells the goods to the consumer at Rs. 1969.80.

e. Stage 5: Consumer

The consumer buys the goods at Rs. 1969.80. Though tax element is not apparent at this stage, the sale price includes within it the central excise duty and the sales tax levied at two levels.

f. Government

Central Government - Under this system, from this series of transactions the total tax revenue derived is Rs 138 remitted as excise duty by the manufacturer only.

State Government - On the same, the state government earns tax revenue of Rs. 151.80 collected at two stages, that is, tax remitted by raw material supplier and the manufacturer.

STATE VALUE ADDED TAX REGIME

(Refer Tables A, B, C, D, E & F in the power point presentation attached)

Though the sales tax regime was single point taxation to a great extent, there was an element of pyramiding and cascading in it which leads to various distortions. Pyramiding results from the tax paid at the purchase point becoming part of the cost price, which results in tax on tax (cascading) on the tax imposed at the later stages. For instance, under sales tax regime, in the case of the Manufacturer, the tax paid at the purchase point (Rs. 80) automatically becomes part of the cost and also the sale price (pyramiding effect). When the goods are sold, the tax at that stage will include tax on the tax element included in the cost price also (Cascading), ie, Rs.8 (10 % of Rs. 80).

With the introduction of VAT, these problems were avoided to a large extent. VAT is a multi-point taxation system with input credit set off for tax paid on purchases made by the registered dealer.

Let us examine how the above transaction at different stages will figure under the VAT regime

a. Stage 1: Raw Materials Supplier

As it is the first sale point, the purchase, sales and tax figures of the Stage 1 of the sales tax regime remain the same here.

b. Stage 2: Manufacturer

Under this regime, the tax paid on purchases is termed 'input tax', and as it is eligible for set off or credit, such tax element is not added onto the sale price, thus avoiding pyramiding effect.

However, for excise duty calculation, 10 % of Rs. 1380 is taken. But while calculating value added tax on sales, the sale price will be taken as Rs. 1300 plus the excise duty of Rs.138. So, the sales price will be Rs. 1581.80, which includes central excise and output tax. The excise duty collected (Rs. 138) will be remitted to Central government, and value added tax Rs. 63.80, which is the difference between output tax and input tax (Rs. 143.80 – Rs.80) will be remitted to the state government.

c. Stage 3: Wholesaler

Since VAT is a multipoint tax, the wholesaler will also get input tax credit. So, here the net tax liability (output tax – input tax) will be Rs. 20 only

d. Stage 4: Retailer

The same VAT trail with input tax credit continues at the retail stage also. The net tax remitted to state government is Rs. 10

e. Stage 5: Consumer

The final price will be Rs. 1911.80, from which it is possible to know the exact state VAT paid on that commodity by the consumer.

f. Government

Central Government - Under this system also, the total tax revenue derived is Rs. 138 remitted as excise duty by the manufacturer.

State Government – As VAT is a multipoint tax, the state government collects tax at all stages of the transaction, right from the stage of Raw Material Dealer to Retailer. The total tax revenue under VAT would be Rs. 173.80.

GOODS AND SALES TAX REGIME

(Refer Tables A, B, C, D, E & F in the power point presentation attached)

The following calculations have been made on the basis of the dual GST system proposed to be introduced in India.

a. Stage 1: Raw Materials Supplier

As GST is imposed by central and state governments at all stages on the same tax base, the GST trail also starts from the first sale point itself. So, in this instance, the raw material supplier will collect and remit CSGT and SGST at the rate of 10 % to the concerned authorities. Hence, the tax liability at this stage would be Rs. 80 each under CGST and SGST.

b. Stage 2: Manufacturer

Applying the same principle of VAT under GST, here the Manufacturer can avail input tax credit paid on purchases both under CGST and SGST streams. The corresponding input tax under CGST and SGST will be set off against the respective output tax under CGST and SGST. So, the net tax of Rs. 50 each will be remitted to central and state government.

c. Stage 3: Wholesaler

Under dual GST, there is no difference between a manufacturer and wholesaler/retailer from the tax point of view. Hence, the wholesaler will also pay a net tax of Rs. 20 each under CGST and SGST.

d. Stage 4: Retailer

Like the Manufacturer and the Wholesaler, the retailer will also follow the same system under GST, and remit Rs. 10 each under CGST and SGST.

e. Stage 5: Consumer

The final price will be Rs. 1920, and it is possible for the consumer to know all the tax components inherent in the final price.

f. Government

Both Central and State governments will earn a revenue of Rs. 160 each in this example, as the rate of tax for CGST and SGST has been taken as 10 %.

Price Dimension

From the consumer point of view, the final price will be less under the VAT system compared sales tax (which decreases from Rs. 1969.80 to Rs. 1911.80), due to avoidance of pyramiding and cascading in state taxes.

In the GST scenario, compared with state VAT, if the same tax rates are applied, there will be a marginal increase of Rs. 8.20. This is due to the extension of the tax imposed by the central government from the manufacturing to the retail also. For the policy makers this price factor has to be kept in mind while finalizing the tax rates CGST and SGST.

Revenue Dimension

For Union Government

Under the Sales Tax and VAT scenarios, the excise duty of the central government remains the same. But under GST, there is an increase (Rs. 138 to Rs. 160) in CGST due to the extension of central taxing powers from the manufacturing to the retail level.

For State Governments

But in the case of state government, an increase in revenue is registered after the switchover from sales tax to VAT regime (From Rs. 151.80 to 173.80 in our example). If we apply the same rates for CGST and SGST, there will be a considerable decrease in revenue for the state (from 173.80 to Rs. 160) consequent to the shift from VAT to SGST. Obviously, at the policy making level, the SGST rate should be fixed at a rate higher than CGST, so that it will compensate for such loss of revenue for the state. As the tax base of CGST has expanded under GST regime, lowering the rate will not affect their tax revenue; it is also imperative that CGST rates be lesser than SGST in order to maintain the same price levels. It is advisable that CGST be fixed at a rate lesser than SGST so as to maintain the same revenue and price levels under the earlier tax regime of the Union and the states.

PART C
GOODS AND SERVICE TAXATION [GST]
& SUB-NATIONAL ISSUES

The major concerns of the states/union territories which are to be discussed, deliberated and finalized by the states before rolling out the dual GST system along with the Union Government are outlined below.

1. **Re-organization of State Tax Administration:** In the process of switchover to GST, the present organizational structure, hierarchy, duties and responsibilities, nature & content of job description for each cadre are to be reexamined. The effective implementation of Dual GST demands state-of-the-art administration, for which a deliberate re-organization of the existing administrative set up is necessary. On the one hand, the effective implementation of GST is dependent upon a revamping of the present system of tax administration at the state level; on the other, this transition at the national level, should also be perceived and converted as an opportunity for re-engineering of the tax regime.
2. **Taxing of Services by States:** The Dual GST system proposes a new taxing power to states i.e., taxing of services also along with the existing system of taxation of goods. As far as the states are concerned, the identification of various Services (other than statutorily exempted services) within each state, their sources, potential revenue, tax collection methods, etc are new areas to be explored and integrated into the present mechanisms of tax administration and policy. The state machinery should seriously initiate the first steps towards this so as to be adequately prepared for the introduction of GST.
3. **Inter- State Transactions of Goods and Service:** The success of Dual GST is to treat India as a seamless unit in terms of indirect taxation. Presently there are breaks in the VAT trail wherever there are inter-state sales of goods or stock transfers. This system is proposed to be replaced by a new model called IGST (Integrated GST) whereby the VAT trail will not be broken even in the case of inter-state transactions. In the GST context, each state should estimate their potential revenue gain/loss/blockages, the methods of taxing inter-state transaction of services, reconciliation issues among states, issues relating to real time electronic exchange of data between the states etc. A comprehensive data base on inter-state movement of goods is also indispensable to develop a just rationale for calculating compensation packages for the states.

4. **Tax Rate - Revenue Neutral Rate.** The Dual GST ultimately boils down to the issue of tax rates at the Union and State level. It is rare that a single rate for Union and a single rate for States, both for goods and services, will be adopted or will become acceptable. Rather, it will probably be multiple rates (two or three rates) for Union and States that will be acceptable. As of now, neither the empowered Committee of State Finance Ministers, nor the Union Government have not come to a final conclusion about the rates. In this context States have to take the initiative to calculate the Revenue Neutral Rates applicable to them taking into account various permutations and combinations of rates for goods and services. A comprehensive data base and a baseline study for RNR of each state under different rates are imperative, as they have a direct bearing on their power to negotiate with the Union for compensation packages for the years immediately following the introduction of GST.
5. **Draft Model of State specific GST Act, GST Rules with all forms:** As a prelude to the smooth transition to GST there should be detailed discussions and debates on the draft GST Act, Rules and Statutory forms amongst all the stake holders especially the taxpayers. But as of now neither the union nor any of the states have come out with a draft GST Act, Rules and forms in the public domain. It is high time that each state starts with the venture of drafting their GST Act, Rule & forms. Since the Dual GST presupposes uniform State Specific GST Act, GST Rules and Forms, the empowered Committee should take the lead in drafting a Model State specific Act, Rules and Forms and supply to each state for their comments.
6. **E-Governance & Tax Administration:** Each State is in different stages in their process of shifting from manual to a computerized system of tax administration and compliance. Some States like Kerala had achieved 100% e-governance in filing of returns and remittance of tax and are marching ahead in the process of e.governance in other areas also, like registration, return scrutiny, check post administration etc. But in the case of some other states, they have only initiated the process of switching over to e-platforms. The success of Dual GST depends on the resilience of the e.governance systems in tax administration at the national level. It is the right time for each state to conduct a Social Audit on their initiatives in E.Governance and based on the results of the study take necessary steps to proceed further in their process of E.Governance. A Comprehensive Office Manual under the GST regime is indispensable for effective administration. The preparation of such Manual should be initiated at state level in consultation with the Empowered Committee or such other councils formed under GST

7. **Threshold limits ,Small traders & Special type dealers**

A consensus has been arrived at regarding the threshold limit for GST, the fixation of which has to be sensitive to the specificities at the state level and the compliance cost under the new system. During initial years, GST may result in an increase in compliance cost. Therefore, for a smooth transition, the aspirations of small and marginal dealers should also be taken into consideration. An attractive exemption threshold limit with a composition scheme for such dealers should be introduced.

Special Dealers include works contractors, Annual Maintenance Contractors, IT Software dealers, who deal with a mixed bag of goods and services and also engage in inter-state, inter-country transactions. Treatment of such dealers under GST should be studied in depth from the Revenue, Administration and Compliance points of view.

8. **Invoice Tracking System**

One of the major areas of limitation in the implementation of VAT has been input tax credit, where various cases of evasions and frauds have been detected. This lacuna can be plugged only when invoice-to-invoice cross verification between dealers is made possible through e-platforms. Only a very few states like Kerala have put in place mechanisms for such cross verification through e-platforms. This has to be extended to all the states even before the introduction of GST and should be given top priority during the implementation.

9. **Awareness programmes**

There should be focused efforts to launch awareness programmes about GST through various media in order to sensitize the stakeholders and to create a favourable public opinion

10. **Training to the officials**

To make a smooth and effective transition to GST, it is imperative that intensive training programmes are organised to equip the officials. It has to be done once the Act and Rules are passed and before and during the implementation of GST.

Conclusion: This paper attempts to outline the major unresolved issues with regard to the implementation from the state's perspective. Each of these issues should be discussed threadbare and with stakeholders at all levels. This has to be done at the state level in consultation with the Empowered Committee and a consortium that includes academia, tax practitioners & lawyers, politicians, tax payers and officials to arrive at a consensus on these issues in order to enable a smooth and hassle-free transition to GST regime.