

# GST- A Paradigm change in existing taxation system of India

**\*Mallappa Puttatammanavar, Asst Professor of Commerce, Govt First Grade College – Shikaripura**

## Abstract

India introduced the Goods and Services Tax (GST) on 1 July 2017 after a decade of preparation. Ideally, GST should reduce tax and drive the market by enabling businesses to invest, reflecting consumer choices. The basic GST structure poses challenges. It differentiates between goods and services contrary to GST's essence. Too many rates contest the desirable single- or double-rate structure. There is wide variation among rates. Too many taxpayers have been brought in from the bottom, which will challenge the tax administration adversely. Registration is required in every state where a dealer is trading. This enables the central administration and that of each state to scrutinise the same taxpayer, but comprises a compliance challenge for small taxpayers. Going forward, teething problems in information technology affecting filing of returns should be corrected. There is no monitoring cell to check the GST's impact on revenue or inflation. GST was intended to be introduced on a revenue-neutral basis. The possibility of reduction in GST rates should be considered if post-introduction revenue has shifted up the pre-introduction collection trend. There should be no significant short-run adverse impact on GDP if cascading elements of the earlier tax structure are reduced under GST. These matters need monitoring and correction.

Petroleum has to be brought in to the GST base quickly to reduce its cascading effects. Judging from the weekly posts by the Chairperson, CBEC, it is apparent that the top administration is trying to handhold taxpayers, ease compliance, and control remaining elements of corruption.

**Keywords:** *GST, input tax credit, India, value added tax, State Finance, CBEC, Centralised Processing Centre.*

## Introduction

India's Goods and Services Tax (GST) was introduced after a decade of preparation, the first government paper having been completed on 31 December 2007 by the Union Ministry of Finance in cooperation with the Empowered Committee of State Finance Ministers. Over the following decade, several modifications were considered and made at both levels of government and a draft Constitutional Amendment Bill proposed by the Ministry of Finance to Parliament. This was examined by the Parliamentary Finance Committee whose suggestions were then incorporated and the Bill finalised, but was not introduced in Parliament as general elections approached. With the advent of a new Central government, the Bill successfully passed in Parliament and state Assemblies. GST was finally introduced on 1 July 2017.<sup>1</sup> This paper traverses selected pre-

introduction discussions as well as post-introduction efforts and remaining issues with respect to GST. It also attempts a critical analysis of the structure and administration of GST. To begin with, the ideal structure of a GST needs some elaboration. Recall that a GST should be structured such that 'tax on tax', or cascading, should be done away with. This occurs when an input is taxed but is not given credit against the tax on output that the inputs help produce. The more cascading is left in the tax system the more is the number of 'exemptions' from a GST. This is because an exemption means that the output is not taxed so that no credit can be taken on the tax paid on inputs in the previous stage of production or distribution. Thus, one objective of a GST is to keep exemptions at a minimum.

This objective could be viewed also as a reflection of keeping the GST base as broad as possible. Another objective of a GST is to keep the number of tax rates as low as possible so that there is no significant mismatch between output and input rates. For example, if the output GST rate is lower than the input GST rate, too much credit will be accumulated that cannot be taken against the output tax. And it becomes a difficult 'fitment' exercise to arrive at a menu of rates such that anomalies are minimised. In India, GST was a political compact of fiscal federalism between the Centre and the states. Few countries have achieved this. Brazil introduced a conjoint value added tax (VAT) at three levels of government – central, state and municipal – in the mid-1960s though today it has become fractured, narrow in base, and is not managed well. Canada also has a similar federal GST but it is a small economy in terms of the number of taxpayers compared to India, is highly computerised reflecting its financial resources, and has very little tax evasion. Australia is a third country, but there it is collected at the central level and then shared with the provinces. Thus, today, India stands apart in having successfully introduced a GST simultaneously at both central and state levels of government. While this comprises a significant step forward in the progress of taxation, it has to be examined how close the structure and administration are to the optimal, and how quickly can the GST system be expected to stabilise.

### **Objective:**

This paper seeks

1. To examine benefits of GST on Indian economy
2. To explore making GST a simple tax reform for enforcement

### **Ideal GST structure**

The Union Finance Minister, Arun Jaitley, called GST the 'single biggest tax reform since Independence', in Parliament on 20 December 2014. However, it is clear that while some of the conditions for an ideal GST are met, others are not. The main motivation for GST was trade facilitation and enhancing ease of doing business. It was not to be only revenue protecting or propelling. The purpose was to have a single tax to subsume all central- and state-level indirect taxes. GST subsumes the central excise duty, service tax, state VAT, central sales tax, countervailing duty/special additional duty of customs, octroi and entry tax, purchase tax, luxury tax and tax on lotteries, betting and gambling. However, there are four state taxes that are excluded from GST: tax on petroleum products, electricity duty, tax on alcohol for

human consumption and stamp duty on immovable property. Petroleum products represent  $\frac{1}{4}$  to  $\frac{1}{2}$  of different states' revenues. To maintain that, states were opposed to including it in the GST base.

But they are also a high cost of production for several services and industries for which no input tax credit (ITC) is being given. Putting it in the GST base would have ensured a non-cascading channel and reduced GST's inflation impact. Since the GST Council (the key decision-making body that will take all important decisions regarding GST with representation from the Central government as well as all the state governments) retains an enabling provision to tax it, there is hope that in the future petroleum could be included in the GST base. As listed above, another tax that was excluded from the GST base was stamp duty on real estate transactions. Had it been included, its cascading effect would have been minimised. However, its exclusion could be explained through the good revenue that it fetches in its exclusive form to various states. For example, to give a range, in Maharashtra it is 20 per cent of own revenues and in Bihar it is 12 per cent. Thus, under GST, for real estate business, the tax base includes cost of construction materials and services provided by architects and contractors. But land value is excluded, i.e. stamp duty cannot be set off and, therefore, will cascade. The success of GST is based on an information and communications technology (ICT) network for efficient working of a clearing house set up by the Centre for distribution to the states. It was announced on 22 September 2015 that Infosys would be in charge of setting up and administering the system. Though the financial cost of using the private sector was criticised in some quarters, it was actually a good decision to aim for the most efficiently run system possible to be acquired. With regard to another criticism, namely that the private sector would have access to confidential data, it needs to be pointed out that Infosys has been involved in running the Centralised Processing Centre (CPC) for income tax and no breach of confidence has appeared.

To operate in India, an organization must register with various tax authorities and obtain permits that identify registration numbers at various stages of the business cycle and by different parties such as federal and state governments. The India Goods and Services Tax (GST) law subsumes many of the earlier taxes into itself and provides for different registration, accounting and reporting requirements. Every entity liable to tax under this law requires it to register with the GST Tax Authority and acquire a Goods and Services Tax Identification Number (GSTIN) which is fifteen alphanumeric characters in length. The GST structure includes the following:

**Intra State CGST + SGST** – A sum of the respective central and state taxes in place of the earlier central and state taxes and levies for Intra State supply of goods and services.

Note: You may use tax code SGST in respect of UTGST provided separate GL Accounts are setup to store UTGST amounts.

**Inter State IGST** – A central tax in place of the central and state taxes with the consuming state to get a share of the revenue of this.

Imports into India – Basic customs duty as existing + IGST in place of the earlier CVD and SAD.

Exports and Deemed Exports from India – Pay IGST @ 0% with input tax credit or pay GST and get a refund.

For all sales orders, quotes, counter sale orders shipped within the state, State GST (SGST) / UTGST and Central GST (CGST) should be calculated. For all sales orders, quotes, counter sale orders shipped outside the state, Integrated GST (IGST) should be calculated based on the receiving state.

Every GST entity is required to file GST returns in the prescribed format for a given tax period. It is mandatory to file a nil return in case there is no business activity during the said period of tax return.

### **Centre-state administration of GST: The GST Council**

The structure of the GST Council is unique. It comprises the union finance minister as chairperson; the union minister of state in charge of revenue or finance as member; and the minister in charge of finance or taxation or any other minister nominated by each state government as members. The Centre has a one-third voting share and the states two-thirds. The Council will recommend rates/bands, exemptions, thresholds, a model GST law, principles of levy, an integrated GST (IGST) apportionment and the principles to govern place of supply. However, a Dispute Settlement Authority had been dropped from the original 2011 Constitution Amendment Bill. If each state had its own authority, it was realised that the common market would face severe challenges. Finally, a compromise was reached so that the GST Council would establish a mechanism to adjudicate any dispute arising out of its recommendations. Since disputes can be between: (a) the Centre versus one or more states; (b) the Centre and states versus one or more states; and (c) state versus state, the final position implies there will be a standing mechanism to resolve disputes. While the council is an excellent construct, it must be admitted that the states have been somewhat guided by a revenue goal. In the initial stage, the council also made several rate changes. This may reflect teething problems so that, after correcting for rate anomalies, the council should quickly revert to considering genuine policy improvements.

If the general rate of GST is  $x$  per cent, then the achievement of a revenue intake of  $\frac{1}{2}x$  per cent of GDP is not impossible. The revenue achievement of  $\frac{1}{2}x$  per cent of GDP should be possible if: (1) the GST base is broad with few exemptions, (2) the general GST rate is not impeded by too many accompanying lower rates, (3) tax administration is transparent, (4) social norms do not erode taxpayers' tax compliance and (5) their compliance cost is not high. GST revenue productivity of  $\frac{1}{2}x$  per cent has been observed in Chile and New Zealand whose GST bases have been proverbially broad. In most countries, GST revenue hovers between  $\frac{1}{3}x$  per cent and  $\frac{1}{2}x$  per cent of GDP. The strategy for countries that have an  $x$  per cent GST rate should invariably be to design the GST structure and enhance its administration in a way that the achievement of  $\frac{1}{2}x$  per cent of GDP in revenue is feasible. This has been referred to as the Shome Productivity Index of the GST in reflection of his observing this trend in a number of Latin American countries. However, a reformed tax cannot be meant for the authorities' revenue collection alone. Whether the Centre or the states, GST is not for garnering revenue through higher rates or administrative constraints on economic productivity. A reformed tax is one that reduces production

distortions and administrative hurdles, thus clearing the way for higher productivity of goods and services. That, in turn, will produce more and add up to a higher GDP. In turn, this should then generate more revenue for the authorities. It is important for the authorities to ensure at both levels of government – through the GST Council – that capturing revenue does not become the first goal of GST.

### **GST POST-INTRODUCTION**

It has been over one and half months since the GST regime was introduced. Whether the disruptions experienced in the transition are temporary or reflect the GST's structural flaws will reflect the government's problem-solving agility. One major test will come when the digital backbone, the GST Network, is called on to deal with a large number of simultaneous submissions – but that is awaited sometime in the future. Some improvements are already apparent. Logistics costs may be on the decline. The crossing points between several states manifested in long queues of trucks appear to be dissipating unique technologies, a large company can maintain or develop a competitive edge.

**Policy improvement** On the policy side, therefore, GST has the potential to make far-reaching positive changes to the structure of the Indian economy. It may, as time passes and as it is fine-tuned, reduce costs in the supply chain. This would lead to greater efficiency in business decision-making that would actually reflect consumer preferences since relative price signals would no longer get distorted.

**Can GST be an administrative success?** On the administrative side, with a good GST, businesses should find it easier to operate in a level playing field. Ideally, the design of GST should simplify processes for the productive sector and reduce the discretionary powers of tax officials. As good news spreads, GST will attract global investors looking to make genuine investment in India. We have to give GST some time for a full assessment, which perhaps can be undertaken in December 2017 or April 2018, in order to come to an intelligent view on what was achieved and what has to be improved.

### **Removing tax uncertainty**

It is evident that GST is an imperfect structure, with too many different tax rates, for, in the final analysis, it was a compromise between the Centre and states. Hence, to continue to unlock potential gains from GST, governments at both the state and central levels – as represented in the GST Council – must have a clearer sense of the direction in which modifications to GST need to be made. There is no doubt that some changes in rates were needed.

Hiking cess on bigger cars corrected an anomaly since the earlier CENVAT+excise had not been fully reflected in the new structure. Thus, given the way the GST rates, including the cesses on various goods and services, were calculated, the effective duty rate on bigger cars and SUVs fell from 52-55 per cent in the excise-cum-VAT days to 43 per cent under GST while that on hybrid vehicles above four metres in length rose from around 30 per cent to 43 per cent – to that extent, if the government policy is to encourage the use of hybrid vehicles, this needed to be fixed. This has now been corrected, with the GST Council agreeing to hike the cesses on bigger cars/SUVs, thus restoring the edge hybrid vehicles had in terms of tax rates. A similar anomaly had led duty rates on cigarettes to come down dramatically post-

GST. The GST Council was quick to hike rates and, in the bargain, provided around Rs 5,000 crore extra in the cess account to compensate states in cases of a fall in their revenues after the GST implementation. However, alterations are being introduced in every GST Council meeting. The 20th meeting of the GST Council, held on 5 August 2017, decided to increase the cess on luxury cars and sports utility vehicles from 15 per cent to up to 25 per cent. This was a necessary modification. The council also slashed the tax rate for textile subcontracting – 'job work' – to 5 per cent from a high of 18 per cent. Even this could be justified. GST is at the initial stage in Indian economy. It will take some time to experience its effects on Indian economy. GST mechanism is designed in such a way that it is expected to generate good amount of revenue for both central and state government. Regarding corporate, businessmen and service providers it will be beneficial in long run. It will bring transparency in collection of indirect taxes benefiting both the Government and the people of India.

### **GST Road ahead**

With completion of two year since the launch, the anniversary of Goods & Services Tax (GST) will be celebrated with Hon'ble Union Minister of State of Finance and Corporate Affairs Shri Anurag Thakur on 1st July. The event will be attended by government officials along with partners from the trade and industry.

The one nation and one tax system has faced many bumps since its launch and is expected that GST 2.0 will reach another level of milestone in coming years. The new reforms include new return system, single cash ledger, Single Refund Disbursing and E-invoicing system. The new system is yet to be tested and introduced.

Tax reforms will include bringing power, oil and gas, land and liquor under the rate structure slab which will lead to tax credibility across all sectors. FICCI said that the GST Council should reflect about joining the present band of GST rates to three in line along the international standards. GST also needs to focus on the need for a 'Zero GST Rating' for healthcare sector. Now the focus is on reaching the main motive behind GST which is to simplify indirect taxes.

GST is a distinct advantage for Indian economy as it has supplanted multi-layered, complex aberrant duty structure with a straightforward, straightforward and innovation driven assessment routine. It has coordinated India into a solitary, regular market by breaking hindrances to between State exchange and trade. By taking out falling of assessments and diminishing exchange costs, it will improve simplicity of working together and give a stimulus to 'Make in India' crusade

In a milestone for the Indian indirect tax structure, the Constitution (122nd Amendment) Bill, 2014, commonly known as the GST or Goods & Services Tax Bill, was passed by the Lok Sabha on May 6. Indian industry compliments the finance minister and the Empowered Committee of state finance ministers for successfully undertaking the challenging task of working out the modalities of the Bill and for steering it through the Lok Sabha.

One of the most critical reform measures for the Indian economy today, the GST has been eagerly anticipated by industry since 2007 when it was first mooted as a progression of the Value-Added Tax. It has many advantages for the economy as a whole as well as for different sections of society, including consumers, manufacturers, traders, and the central and state governments. Bringing it to this stage was not an easy process and required long and intense discussions among the central and state governments as it represents a fundamental change to the way the federal taxation structure was laid out in the Constitution.

## GST appraisal

The Indian market is considered to be among the largest in the world, and as such offers huge opportunities for a demand-driven growth strategy. However, the current indirect tax regime includes multiple central, state and local taxes such as excise duty, service tax, central sales tax, Octroi, value-added tax, entertainment tax, purchase tax and so on, leading to different taxation structures in different states. The national market thus is fragmented and goods travelling from one part of the country to another face many hurdles at the state borders, making transportation costlier, delayed and inefficient.

The GST aims to replace multiple taxes on goods and services, except alcohol for human consumption. Petroleum products shall not be subject to levy of GST till notified at a future date on the recommendation of the GST Council.

Through GST, India would transition to a single unified market. Inter-state barriers to trade would be dismantled, leading to faster movement of goods across the country, with no long queues at state checkpoints. For domestic manufacturers, this would be a big boon as it would lower costs, reduce time taken to destination and ultimately greatly add to competitiveness of Indian manufactured goods. Such efficiency would also sharpen our edge in the global markets and facilitate higher exports.

GST will reduce the cost of compliance and litigation as also broaden the tax base. It would enable producers and traders up and down the supply chain to pay taxes only on the value added by them. With the availability of seamless credit through the value chain, the cascading of taxes on cost of goods and services would be obviated. In addition, since the GST would be placed on the IT infrastructure termed as the GST Network, tax administration could become more transparent and time-bound.

## Conclusion

GST, in its current form, has been a step up for the Indian tax authorities. There are, however, structural challenges that remain. There also are administrative challenges as well as issues of compliance cost in particular for small taxpayers who have been brought under the GSTnet. While it is a commendable move to expand the taxpayer base, the move to audit small taxpayers at both central and state levels will tend to increase the compliance burden on such taxpayers. The authorities have to maintain keen vigilance to ensure tax compliance, passing on benefits from producer to consumer while, at the same time, not burdening taxpayers with additional compliance costs. The need for such perspicacity will be carefully observed by experts and reflected in whether the ease of paying taxes improves with time. And, since GST is known to be a revenue productive tax, the revenue trend of GST will also continue to be of interest to observers who remain alert to India's taxation policy and administration. To make GST successful, it remains a responsibility also of the taxpayer, in fulfilling his role, to fully comply with the tax. If there are doubts, the department is offering assistance at the field level and this should be taken advantage of. This could represent the greatest opportunity for government-citizen co-operation and it is hoped that the process will reach a proper height of success. However, the work of improving GST

will remain important in the future. Structural deficiencies will need to be eradicated or corrected. Thesevere aspects of tax administration should be eased. Cases of serious tax evasion should be pursued to the end. And every care should betaken to minimise disputes among the authorities and between taxpayersand the tax administration..

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