GST

Answers to Some Basic Questions

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Introduction

The Goods and Services Tax (GST), one of the most ambitious tax reforms to have been initiated in India, is now a reality and it is important that its different aspects are understood properly. While many of its implications will be known with the passage of time, we present answers to some basic questions that many may have.

Q1

What is GST?

You, I and everyone pay taxes when we purchase some goods and services. Some of us also pay income taxes when we earn above a certain threshold. The latter is known as direct taxes since we cannot shift the burden of the tax to another person or entity. The former is known as indirect taxes since the burden of taxes can be shifted, say, from businesses to the final consumer.

Until now we had a number of indirect taxes that were levied on various goods and services, beginning from the stage of production to final sale. So for example, there were taxes for manufacturing of goods (Central Excise Duty), on sale of goods (Sales Tax), on services provided by service providers (Service Tax), and so on.

The Goods and Services Tax (GST) subsumes almost all such indirect taxes (except for some taxes levied by municipalities and gram panchayats) and replaces them by one indirect tax: the **GST.**

TAXES SUBSUMED UNDER GST

Central Taxes

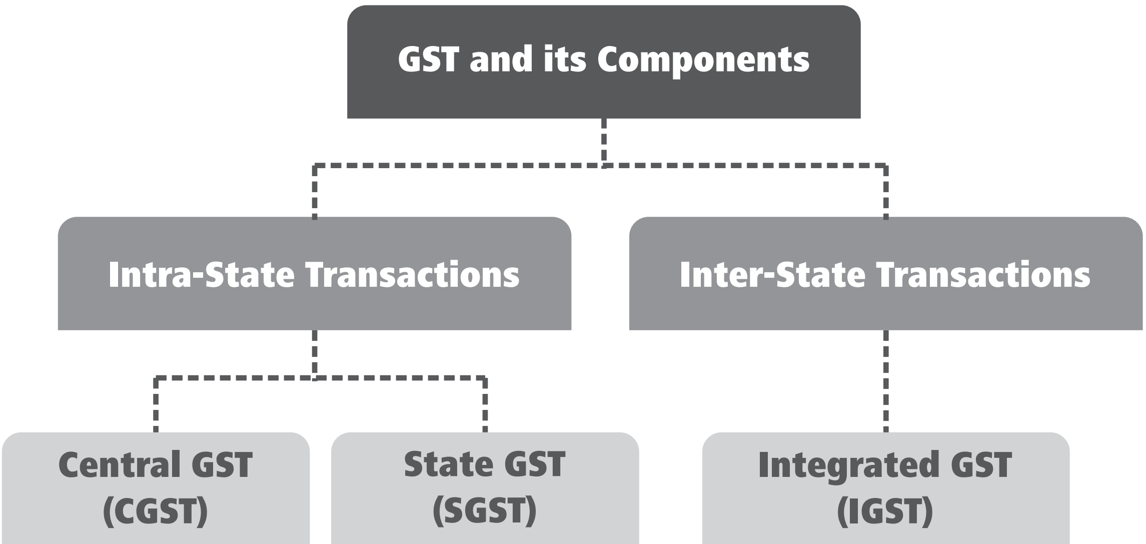
1. Central Excise Duty
2. Additional Excise Duties
3. Excise Duty levied under the Medicinal and Toiletries Preparation Act
4. Service Tax
5. Additional Customs Duty, commonly known as Countervailing Duty (CVD)
6. Special Additional Duty of Customs
7. Surcharges and cesses (In India, cess is applied on a specific commodity or service and is imposed as an addition to an existing tax. The revenue that is raised from it is also meant to meet certain specified objectives, such as Swachh Bharat cess. Surcharge is an additional charge levied on any tax, but revenue from surcharge can be spent for any purposes).

State Taxes

1. State VAT/ Sales tax
2. Central Sales Tax
3. Entertainment tax (other than those levied by local bodies, such as municipalities)
4. Purchase Tax
5. Luxury Tax
6. Taxes on lottery, betting and gambling
7. Taxes on Advertisements
8. Entry Tax (All forms)
9. State Cess and Surcharges (to the extent these taxes relate to supply of goods and services).

GST will be levied on the value added (explained below) at different stages through which a product passes until it reaches its final destination – the consumer. Since the final tax is to be paid by the end consumer and collected at the destination, GST is a destination-based tax on consumption.

GST, though a single tax, comprises two components: a central GST (CGST) and a State GST (SGST), for transactions taking place ***within a State.*** Likewise, for transactions ***within a Union Territory (UT) without legislation,*** GST comprises the CGST and a Union Territory GST (UGST). For inter-State supply of goods and services, the Integrated GST (IGST) will be levied and the revenue generated would be collected by the Centre.



This means that of, say, a 12 percent GST, 6 percent goes to the Centre and the other 6 percent goes to the State (or the Union Territory).

Salient features of the GST model adopted in India

- The Goods and Services Tax Council, of which the Union finance minister and the finance ministers of all States are members, decides the rules, the rates, threshold limit, etc.
- GST is to be levied on all goods and services, except for goods and services that are exempt; alcoholic liquor for human consumption, real estate, electricity that do not fall within the ambit of the GST; and the transactions which are below the prescribed threshold limit
- Petroleum and petroleum products are outside the purview of GST for the time being but shall be subject to the levy of GST at a later date notified on the recommendation of the Goods and Services Tax Council
- Manufacturers, traders or service providers whose annual turnover is less than Rs. 20 lakh (Rs. 10 lakh in the case of northeastern and special category states) need not register for GST
- Traders who carry out inter-State transactions will have to register for GST even if their annual turnover is below Rs. 20 lakh
- Manufacturers, traders and restaurants whose aggregate turnover in the preceding financial year did not cross Rs. 75 lakh (Rs. 50 Lakh in some States) can opt for the Composition scheme. Under the Composition scheme eligible entities need not pay tax at normal rate but can pay at a prescribed percentage of her/his turnover every quarter. The tax rates under this scheme are as follows: for traders - 1% of the turnover; for manufacturers - 2% of the turnover; and for restaurants - 5% of the turnover
- Imports will continue to attract Customs Duty, which is not subsumed in GST. Imports will also attract IGST, as they are being treated at par with inter-state movement of goods and services
- Exports are zero rated, which means no tax will be levied on them
- The administration of the Central GST would be with the Centre and that for State GST with the States
- The Central GST and State GST are to be deposited into the accounts of the Centre and the States separately
- Those depositing the tax would need to submit periodical returns to the concerned GST authorities
- Compensation will be provided to the States for a period of first five years if there is any loss of revenue compared to the pre-GST period, arising on account of implementation of the Goods and Services Tax

Q2

How is GST different from the previous indirect tax system?

Simplifies the indirect tax system

With regard to the system of indirect taxes, before the passage of the GST Bill, the Constitution of India clearly demarcated the taxation powers of the government at different levels– the Centre, States and Local Bodies. Thus, the Centre had the power to levy taxes on manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.), imports and services, but not on sale of goods. The States on the other hand had the right to levy taxes on sale of goods but not on services or imports. For inter-state movement of goods there was Central Sales Tax, which was levied by the Centre but the revenue was collected by the State from where the goods were being supplied. In addition to these there were a number of other taxes that were levied. The tax rates also varied from state to state.

This division of taxes had given rise to a complex maze of taxes. The complexity of taxes, in turn, made tax compliance harder for tax payers as well as provided opportunities for tax evasion.

GST, by bringing almost all Centre and State level taxes and levies on various goods and services, under one umbrella, into a single tax, ***has the potential to make the taxation system simpler.*** So, instead of different kinds of taxes levied depending on whether a good is at the stage of manufacture or distribution, now only GST will be levied at all stages.

Reduces 'cascading effect of taxes'

The large number of taxes also meant that a product was taxed several times beginning from the stage of production to the final sale of the good. So, taking the example of a bar of soap, first Central Excise Duty was levied at the factory gate, then sales tax levied when the bar of soap moved from manufactures to wholesalers, then again State VAT and some other taxes when it reached the retail shop. Thus, at every stage of the supply chain, some tax or the other was levied, leading to "cascading" of taxes, i.e. tax levied on the price of a product include the taxes paid in earlier stages. The cascading of taxes in turn added to the cost of products.

To reduce the problem of cascading of taxes, the Value Added Tax (VAT) was introduced both at the level of the Centre and States at different points of time. The idea behind the VAT is that *it is a tax levied only on the 'value added'* at each of stage of a supply chain with the provision to set-off taxes paid on inputs.

To ensure that only the value added at each stage of the supply chain is taxed, the mechanism of ***Input Tax Credits (ITC)*** was brought in, by which taxes already paid on inputs could be deducted from the taxes to be paid on the price of the output.

However, a major problem with VAT was that the provision of setting-off taxes was not available across the entire supply chain. Thus, for example, sellers could claim ITC only against State VAT paid

> ***Value added*** is the difference between the sale price of a firm's product and the cost of raw materials consumed in production.
>
> Or, price of finished product (100) - cost of raw material (50) = Value added (50).

on previous purchases, but not against Central Excise Duty or Service Tax already embedded in the product. This meant that Central VAT (CENVAT) on certain commodities remained included in the value of goods taxed under State VAT. Because the same set of goods was being taxed repeatedly – once by the Centre and then by the State - it did not fully remove the cascading burden of taxes.

GST is also a tax like the VAT, with the difference that under GST the mechanism of ITC will be available at every stage of the supply chain beginning from production to final retail sales of both goods and services. Thus, unlike earlier whereby ITC for Central VAT was not allowed against State VAT, GST removes such restrictions and allows for seamless flow of ITC *across the entire value chain*. ***GST,*** therefore, with its system of comprehensive and continuous mechanism of tax credits ***can significantly reduce the problem of 'cascading' of taxes".***

The cost of inputs or raw materials used in the process of production/ supply includes the taxes paid by the supplier of the raw material. The system of **Input Tax Credit (ITC)** ensures that taxes already paid on inputs can be deducted from the taxes to be paid on the price of the output. In short, the ITC means that when paying tax on the output, the supplier can subtract or set-off the taxes already paid on inputs.

Q3

Why did India adopt a model with dual GST?

The Constitution of India provides for fiscal federalism in keeping with the quasi-federal nature of the country. In accordance with the spirit of fiscal federalism, both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform, for which they need to raise resources. As is known, States in any case face paucity of resources and need to depend on transfers from the Centre to perform responsibilities according to the division of powers prescribed in the Constitution. Adopting a model with a single GST, instead of a dual GST, would have meant that all taxes would have been collected by the Centre and then distributed among the States. This would have increased centralisation of taxes and would not have been acceptable both on the grounds of the Constitutional provision and on revenue considerations. Hence, a dual GST is according to the Constitutional requirement of fiscal federalism.

The GST can in fact impact fiscal federal relations in the country in different ways. One view is that the GST brings about a fundamental reordering of fiscal federal relations of India to one of ***cooperative federalism***. On one hand both the Centre and the States have had to give up their exclusive domain of taxation. On the other hand, both have gained access to some taxes that they did not have earlier. Also, the structure of the GST Council is such that States, which have a two-thirds vote share in the Council, are critical partners in decision making. While the Centre has the veto power with one-third vote share, it would still need the support of a number of States to reach a three-fourths majority needed for passing through a decision. So, Constitutionally, the Centre and the States are evenly matched as one cannot take any decision without the support of the other.

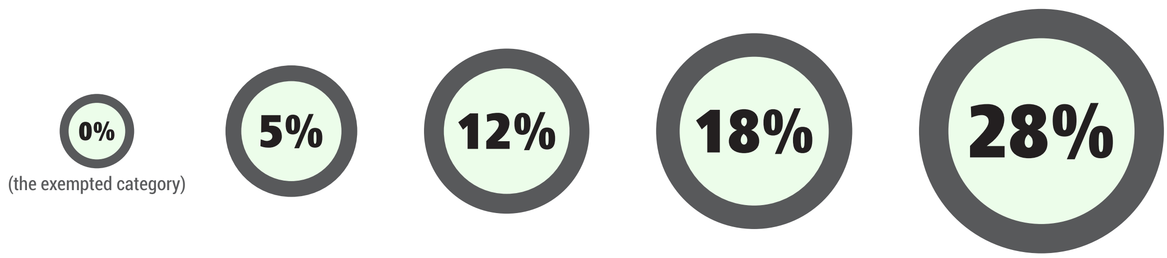
The other view is that GST, in particular the feature of having a uniform tax rate across the whole country, ***reduces the autonomy*** of the States to tax as they like in order to meet the specific revenue needs of their States, without prior approval of the GST Council. Given this background, a dual GST seems to have been adopted to protect federalism and ensure that tax administration and collection stays with the States as well as with the Centre.

Q4

What are the reasons for having multiple tax rates? What are the possible advantages and disadvantages of having multiple tax rates?

According to some experts, an 'ideal' GST has only one or two rates, apart from a zero rate, and very few exemptions. A number of developed countries have a single GST rate. India has, however, adopted a GST model with multiple tax rates for different categories of goods and services.

There are five broad GST slabs/rates that are to be levied on different categories of goods and services. These are:



In addition to these there are two more tax rates of:

- 0.25%on unworked diamonds, precious and semi-precious stones; and
- 3% on gold, silver, coin, etc.

Further, cesses are to be levied over and above the peak rate on certain goods such as tobacco and related products, aerated beverages, luxury cars etc.

A GST model with multiple rates was decided upon to ensure that the transition to GST does not:

- Result in large decline in revenue collections from the current levels;
- Or, lead to high levels of inflation.

If, for instance, only one or two high tax rates were chosen for all goods, it could have led to a large number of mass consumption goods being taxed at higher rates than at present, pushing up prices. Also, since GST is an indirect tax, it would have adversely affected the poor most. Having a low single rate or few low rates too would have been problematic as it could have led to a significant decline in revenues.

The advantages of having multiple rates are that:

- It helps to maintain revenue collections.
- It can help keep a check on prices of goods and services.

The disadvantages of having multiple rates are that:

- The tax system becomes more complicated, diluting the objective of GST to simplify taxation, at least to some extent.
- It also opens up the possibility of classification disputes among various goods and services as well as leave scope for tax evasion.

Q5

Why have some goods/services been kept outside the ambit of GST and what could be the repercussions?

As mentioned earlier, a number of crucial goods/services have been kept out of the ambit of GST. While alcohol for human consumption, electricity, real estate will remain out of GST, petroleum products are out of GST temporarily and the GST Council will decide when to bring it under GST. Until then, all these will continue to be covered by Central Excise Duty and VAT.

Reasons for not including in GST:

One of the main reasons for keeping these goods/services out of GST is that tax collected from these forms anywhere between 40% - 50% of the total tax revenue earned by various States. Since it is not clear how GST will impact State revenue, these have been left out of the ambit of GST so that States and the Centre have the leeway to raise additional resources through these.

Possible repercussions:

Keeping these out of the GST, however, can dilute several purported benefits of GST

- For instance, petroleum products are what is known as "universal intermediaries", as they affect costs of all goods and services either because these need to be transported or because petroleum products come in as direct inputs. Therefore, if taxes on these are increased in order to raise revenue, it can lead to an increase in prices of all other goods and services.
- Both alcohol and real estate are known generators of black money. So keeping them out of the purview of GST means that the possibility of reducing suspicious transactions will be that much less.

Q6

What are the possible impacts of GST on different stakeholders?

How GST will affect various stakeholders such as the government (including State governments), businesses and consumers is difficult to foresee clearly at this point of time and hence we discuss some of the ***possible*** impacts.

Government

For the government, one of the main issues is how the adoption of GST would impact tax revenue.

At the overall level, it is expected that revenue collection will go up with the implementation of GST. This is because GST is expected to improve compliance as each transaction will have to be uploaded online to avail the benefit of ITC. The chain of tax credits in turn would make it difficult to conceal all transactions. Also, it is believed that businesses/dealers/retailers will have fewer incentives to evade taxes as they know that they can offset the tax paid at one stage in the next stage. This should then help bring more number of people/enterprises in the tax net, including those that were not paying taxes earlier. The combination of improved compliance and a larger number of people/enterprises paying taxes is expected to improve revenues.

For the Central government, doing away with specific cesses such as the Swachh Bharat cess, *Krishi Kalyan* cess (a major chunk of which is imposed and collected from services), could result in a significant loss of revenue from these sources. At the same time, it will now get access to a part of the indirect tax revenue generated by States.

For State governments the impact of GST on revenue may depend on their level of economic prosperity

Given that GST is a destination-based consumption tax, the revenue earned on supply of goods and services goes to the State where the final sale happens. As a result, there are apprehensions that producing States from where goods and services originate could lose revenue. This is particularly so because of the withdrawal of the Central Sales Tax (CST) on inter-state movement of goods which that the producing States collected and kept. So, unlike earlier, whereby Maharashtra would earn the tax revenue for goods produced in Maharashtra, under the GST regime Bihar will earn the tax revenue if the final consumption takes place in Bihar.

It is, however, not clear, how much the States such as Bihar, Uttar Pradesh, that are net consumers (that is they import goods and services from other states more than they export) stand to gain. This is owing to the fact that producing States are also more prosperous because of more economic activity and generally have higher levels of consumption as well. By the same logic, poorer States with lower purchasing power are likely to have lower levels of consumption; hence the gain in tax revenue may not be much.

At the same time, the producing States will now also get to tax services, which they could not earlier. Since consumption of services increases with purchasing power, the better-off States may gain more than poorer States.

Businesses

It is expected that GST will increase compliance and a number of businesses, which earlier did not have to pay taxes, will now come under the tax net. Other than this, the impact of GST may be very different for big business houses on the one hand and small and marginal enterprises on the other.

*For **big businesses,*** the move to a uniform tax rate can help:

- Make the supply chain more efficient;
- Reduce transportation time and hence costs for inter-state movement of goods and services; and
- Reduce overall costs of business because of reduction of cascading of taxes.

*For other **small businesses** (many of which are in the informal sector),* the GST provides the benefit of not having to pay taxes under GST if their annual turnover is less than Rs. 20 lakh (Rs. 10 lakh in the case of northeastern and special category states). This is to help small businesses avoid the challenges of having to file regular returns, maintain invoices and others documents. **There is still possibility of small businesses facing some other challenges:**

- Small firms (those below the threshold) may be pushed to register under GST by their clients. This is because clients of small firms will not be able to get ITC for things supplied by firms which do not register themselves in the GST Network.
- But conforming to the compliance requirements under GST – paying the required taxes, hiring people to file returns periodically, the need to use information technology, etc. – can increase their costs and even make many of them unviable.

Consumers

The impact of GST on consumers will depend significantly on:

- **How tax rates differ from the present rates**

For consumers GST may be a mixed bag in terms of the impact it has on prices of goods. A number of basic consumption goods such as unbranded food products, like food grains, pulses, fruits, vegetable, etc. along with education and health care services, have been kept in the zero tax bracket with other items being placed at tax rates of 5 per cent, 12 per cent and 18 per cent and 28 per cent. Thus, taxes may be lower for some goods and for some others it might go up.

When it comes to services, which form a large chunk of GDP, since tax on several services is set to rise their prices may also go up.

- **Whether reduction in costs are passed on to the consumers**

There is evidence from the days of VAT that decline in costs arising out of ITC are not necessarily passed on to the consumers in the form of lower prices. To counter this problem, the GST Bill has introduced the Anti-profiteering clause, to ensure that gains made by manufacturers– either because of a lower tax rate or higher input tax credits, or both– are passed on to the consumers. It remains to be seen how this clause is implemented and what impact it has on prices.

- **Whether costs/prices of products left out of the ambit of GST increase**

Another aspect to be taken into account is the price implication of keeping several petroleum products (which act as universal intermediates), electricity, out of the purview of GST. For example, in the case of the final output of petroleum products which are out of the GST, the amount of GST that petroleum companies will pay on their inputs (such as hiring of rigs and purchase of equipment and services for crude oil production and refining) cannot be offset against the tax levied on the final products. Any increase in cost of these industries will be passed on to the consumers and hence can pose an inflationary threat.

About CBGA

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