RGICS

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The Constitution (One Hundred and Fifteenth Amendment) Bill, 2011 (in light of Goods and Services Tax (GST))

Economics Cluster

CONTENT

PART I : Need For GST in India: UPA Initiative

The effort to introduce GST in India for the first time was seen in the UPA regime in 2006-2007 Union Budget speech made by the then Finance minister P. Chitambaram stating that there is a national level consensus on introducing GST. He further stated that GST will be introduced on 1April 2010. The Empowered Committee of State Finance Ministers agreed to work with the Central Government to prepare a roadmap for introducing a national level GST with effect from 1st April 2010. In May 2007 Empowered Committee (EC) of State Finance Ministers in consultation with the Central Government, constituted a Joint Working Group (JWG), to recommend the GST model. (PIB, 2009). However, GST could not be implemented due to Modi's protest. This was so because of complex sharing of power between centre and state as mentioned in the constitution which further requires its amendment.

The introduction of Goods & Services Tax (GST) is a significant step. It is expected to spur economic growth as well as integrate states. GST, is an amalgamation of large number of Central and State taxes into a single tax. It is expected to reduce the overall tax burden of consumers on goods. According to the Economic Survey for 2013-14, there is consensus that the Goods and Services Tax (GST) will be a major milestone for indirect tax reform in India. Replacing all existing indirect taxes by the GST will

- create a national market
- eliminate cascading taxes
- align taxation of imports and exports

This in turn will improve the competitiveness of production and export from India. India's complex tax system suffers from problems in both structures and administration. Uneven and high tax rates and uneven tax treatment of similar economic activities have induced distortions in the behaviour of firms and households (Economic Times, 2014). The present system allows for multiplicity of taxes being collected through various inefficient channels. **Thus there exists variety of reasons to define the need of GST in India.** Introduction of GST, is likely to enable government to stop pilferage and rationalize the overall taxation regime. It is even imperative in the emerging economic environment. Separate taxation of goods and services often requires splitting of transactions value into value of goods and services for taxation, which leads to greater complexities, administration and compliances costs, but GST will overcome these setbacks. (Study of GST, 2010)

In 2000, Vajpayee Government started discussion on GST by setting up an empowered committee. The Kelkar Task Force on implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 had pointed out that the tax base is fragmented between the Centre and the States. Services, which make up half of the GDP, are not taxed appropriately. In many situations, the existing tax structure has cascading effects. These problems lead to low tax-GDP ratio, besides causing various distortions in the economy. In this context, the Kelkar Task Force had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle.(Study on GST, 2010).

Lastly with rising global forces and signing of Free Trade Agreements (FTAs), the need for nation-wide simple and transparent system of taxation is further enhanced. This taxation system supposedly enables the Indian industry to be competitive both internationally and domestically.

Apart from this macro dimension, there also exist some key micro problems with the current taxation system in India which further makes the demand for GST more significant. These can be categorized as follows:

- **Taxation at Manufacturing Level** i.e. CENVAT is levied on goods manufactured or produced in India which gives rise to issues as to what constitutes manufacturing, and valuation issues for determining the value on which the tax is to be levied which through judicial proceedings has been observed to be a severe impediment to an efficient and neutral application of tax.
- **Exclusion of Services from state taxation** has posed difficulties in taxation of goods supplied as part of a composite works contract involving a supply of both goods and services, and under leasing contracts, which entail a transfer of the right to use goods without any transfer of their ownership. Though these problems have been addressed by amending the Constitution to bring such transactions within the purview of the State taxation, services per se remain outside the scope of state taxation powers.
- **Tax Cascading -** Oil and gas production and mining, agriculture, wholesale and retail trade, real estate construction, and range of services remain outside the ambit of the CENVAT and the service tax levied by the Centre. The exempt sectors are not allowed to claim any credit for the CENVAT or the service tax paid on their inputs. Similarly, under the State VAT, no credits are allowed for the inputs of the exempt sectors, which include the entire service sector, real property sector, agriculture, oil and gas production and mining. Another major contributing factor to tax cascading is the Central Sales Tax (CST) on inter-state sales, collected by the origin state and for which no credit is allowed by any level of government.
- **Complexity** -In spite of the improvements made in the tax design and administration over the past few years, the systems at both central and state levels remain complex. They are subject to disputes and court challenges, and the process for resolution of disputes is slow and expensive. At the same time, the systems suffer from substantial compliance gaps, except in the highly organized sectors of the economy (The Economic Times, 2013).

The indirect tax system is currently mired in multi-layered taxes levied by the Centre and state governments at different stages of the supply chain such as excise duty, central sales tax (CST) and value-added tax (VAT). In GST, all these will be brought under a single regime. GST being a destination-based consumption tax based on VAT principle. Tax reform in India can improve the ease of doing business and promote efficiency and productivity growth and will help removing economic distortions caused by the present complex tax structure.

In order to introduce GST in India, VAT was introduced to put back pre-existing central excise duty and diverse sales taxation across the states. However there were numerous inadequacies in the state-level VAT structures. Presently, several indirect taxes like luxury tax, entertainment tax etc. are yet to be included in different state VAT structures in India. GST must look forward to conquering the shortcomings of the VAT structure. (Business Today, 2014)

Part II: GST vis-a-vis Centre - State Financial Relations

Currently, in the constitution, the power of centre and states are clearly demarcated. The Centre has the powers to levy tax on the manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.) while the States have the powers to levy tax on the sale of goods. In the case of inter- State sales, the Centre has the power to levy a tax (the Central Sales Tax) but, the tax is collected and retained entirely by the States. As for services, it is the Centre alone that is empowered to levy service tax. Since the States are not empowered to levy any tax on the sale or purchase of goods in the course of their importation into or exportation from India, the Centre levies and collects this tax as additional duties of customs. This duty counterbalances excise duties, sales tax, State VAT and other taxes levied on the like domestic product. Introduction of the GST would therefore require amendments in the Constitution so as to concurrently empower the Centre and the States to levy and collect the GST. Thus arises the need for a unique institutional mechanism that would ensure that decisions about the structure, design and operation of GST are taken jointly by the two. For it to be effective, such a mechanism also needs to have Constitutional force. (Status of GST, GOI, 2014)

Part III: Constitution (One Hundred and Fifteenth) Amendment Bill, 2011

To address these issues, the Constitution (115th Amendment) Bill was introduced during UPA time in the Lok Sabha on 22.03.2011. The Bill provides for a levy of GST on all goods or services except for the specified goods. The tax shall be levied as Dual GST separately by the Union and the States. The Parliament would have exclusive power to levy GST on inter-State trade or commerce (including imports) in goods or services. The Central Government will have the power to levy excise duty in addition to the GST on tobacco and tobacco products.

A GST Council would be constituted comprising the Union Finance Minister, the Minister of State (Revenue) and the State Finance Ministers to recommend on the GST rate, exemption and thresholds, taxes to be subsumed and other features. This mechanism would ensure some degree of harmonization on different aspects of GST between the Centre and the States as well as among States.

The bill could not be passed during the session and the subsequent session. Major roadblock for the UPA government with respect to introduction of GST was, taking the states on board. The states are worried on two counts

- losing their fiscal autonomy
- compensation for revenue loss on account of phasing out of CST, which is now collected and retained by the states.

Thus for example, Maharashtra, earns more than 13,000 crore annually from octroi. Gujarat, on the other hand, earns about 5,000 crore from the CST. Agrarian states such as Punjab and Haryana earn more than 2,000 crore from purchase tax. Each of these states fear that they will lose these revenues once these levies get subsumed under GST (Hindustan Times, 2013). There are also structural issues. R Kavita Rao, professor with the National Institute of Public Finance and Policy (NIPFP) feels there are genuine worries for states such as Jharkhand mopping up as much on the services front as they lose CST, given the structure of their economy. Rao points out GST would mean a standard rate for goods and services. Assuming the classification of commodities remains unchanged, the finance minister has proposed a lower rate for goods at 6% and 8% for services. An NIPFP study indicates, for instance, that for Jharkhand to get the same amount of revenue it got in FY08, the state needs to impose an 18.98% standard rate of tax on goods. Even a 10% tax rate would mean revenue loss. “Such states need to be given flexibility for a higher tax rate,” she says. The Centre has already pruned CST from 4% to 2% with the assurance of compensating the loss during the phasing-out period. However, with the delay in GST implementation, the Centre is now refusing any further compensation. “One way to hasten the GST implementation process would be for the Centre to sweeten the deal for the states, as against its current approach of tightening the purse strings,” says Rao.

The NDA government has proposed to discuss the first tranche of compensation to states for their revenue loss from the phasing out of central sales tax (CST). This came on the back drop of states demanding five-year compensation package

from the Centre at the time of UPA government in 2011, when it introduced a Constitution Amendment Bill in the Lok Sabha towards the introduction of the GST. The Finance Minister has assured parliament that the government will seek to move the amendments this year itself, besides already assuring states that he would clear their compensation dues of about Rs.34,000 crore ($5.5 billion) over a three-year period. The Empowered Committee of State Finance Ministers resolved in August to lower the threshold limit for imposing GST on companies from a turnover of Rs.25 lakh (Rs.2.5 million) to Rs.10 lakh (Rs.one million).The empowered group also asked that states be given the legal powers to collect tax from businesses with annual turnover of up to Rs.1.5 crore (Rs.15 million).As per their recommendation, GST would not be imposed on businesses with an annual turnover of less than Rs.10 lakh. Currently, the threshold for Value Added Tax (VAT) is Rs.10 lakh in most states On the vexed issue of dual control of traders by both the central and state governments, the demand was for legal powers to collect tax from businesses with an annual turnover of up to Rs.1.5 crore. Those below the turnover threshold of Rs.1.5 crore would pay their taxes to states, which would subsequently pass on to the central exchequer (SME Times, 2014).

Recent Developments on GST

In 2013, under UPA regime four Committees have been constituted by the Empowered Committee of State Finance Ministers (EC) to deal with the various aspects of work relating to the introduction of GST. (Status of GST, GOI, 2014) The Committees are:

- The Committee on the Problem of Dual Control, Threshold and Exemptions in GST Regime;
- The Committee on Revenue Neutral Rates for State GST & Central GST and Place of Supply Rules (A Sub-Committee has been constituted to examines issues relating to the Place of Supply Rules);
- The Committee on IGST & GST on Imports (A Sub- Committee has been set up to examine issues pertaining to IGST model);
- The Committee to draft model GST Law (Three Sub-Committees have been constituted to draft various aspects of the model law).

The first three Committees have submitted their interim reports and final reports are awaited.

Recently under NDA regime, on November 12, 2014, a meeting of EC was held. Post meeting, Committee chairman Abdul Rahim Rather said the Centre had written to the Committee suggesting that the threshold annual turnover for levying GST should be increased to Rs.25 lakh (Rs.2.5 million) from Rs.10 lakh (Rs.one million). Rather also said the final call on the threshold figure will be decided by the GST Council. (Business Standard, 2014)

Part IV: Impact of GST in India: An assessment

Positive Impact

GST if implemented is expected to benefit the growth of the nation not just by benefiting the producers, but also consumers as well as the government. Following are the benefits of implementing GST in India.

- **Simpler tax structure:** As multiple taxes on a product or service are eliminated and a single tax comes into place, the tax structure is expected to be much simpler and easier to understand. Paperwork will become simpler and there will be a reduction in accounting complexities for businesses. A simple taxation regime can make the manufacturing sector more competitive and save both money and time
- **Increased tax revenues:** A simpler tax structure can bring about greater compliance, thus increasing the number of tax payers and in turn tax revenues for the Government. The current state of the Indian economy demands fiscal consolidation and reduction in fiscal deficit. A recent report by CRISIL states that GST is the country's best bet to achieve fiscal consolidation. As there is not much scope to reduce Government expenditure, increasing tax revenues is the best alternative to improve the fiscal health.
- **Competitive pricing:** GST will eliminate all other forms of indirect taxing. This will effectively mean that the tax paid by the final consumer will come down in most cases. Lower prices will help in boosting consumption, which is again beneficial to companies. The biggest positive of GST is that goods and services will be taxed on a common basis
- **Boost to exports:** When the cost of production falls in the domestic market, Indian goods and services will be more price-competitive in foreign markets. This can bode well for exporters, who compete with manufacturers abroad facing a lower cost structure. The exact rate of tax levied under GST will obviously be clear only when the final announcement will be made.
- **Benefit to the Corporate** - It will be beneficial for India Inc. as the average tax burden on companies will fall. Reducing production costs will make exporters more competitive
- **Benefit to Industry** - Manufacturing sector in India is one of the highly taxed sectors in the world. A complex and high taxation structure has the tendency to render products uncompetitive in the international market or consume large portions of the cost arbitrage available in manufacturing set-ups in low cost economies such as India. GST when enforced would eliminate complexities in the present taxation structure and consequently prevent the loss of nearly 50% of the advantage of lower manufacturing costs that India has over the western nations.
- **Benefit to government**- Approximately $ 15 billion a year of profits are predicted by the government with the implementation of GST as it is speculated to bring about raise in employment, promotion of exports and consequently a significant boost in overall economic growth.
- **Benefit to Consumers & Producers**- With the collection of both the central and state taxes proposed to be made at the point of sale , both components will be charged on the manufacturing costs and the individual will benefit from lowered prices in the process which will subsequently lead to increase in consumption thereby profiting companies.
- Another positive aspect of this proposal is that it is aimed at equitable division of tax burden between the manufacturing and services. "GST will be the biggest reform after 1991 and its implementation alone would add 1.5-2

percentage point to India's GDP growth. It will provide a tremendous stimulus and can solve several issues like inflation and fiscal deficit" - Mr. Adi Godrej Chairman of the Godrej Group (Economic Times,2013).

Negative Impact

Apart from these there had been some shortcomings of GST which were mainly identified by Report of Task Force on Implementation of GST. Following are the shortcomings:

- Not using the correct accounting method may result in discrepancies in tax computation and compliance
- Incorrectly claiming GST credits on bank fees
- Incorrectly claiming GST credits on government charges --such as land tax, council rates and water rates.
- Incorrectly claiming a GST credit on the 'total cost' of a business insurance policy.
- Not remitting GST on some government grants and incentives which are received inclusive of GST
- GST is not paid on the sale of cars and equipment including the trade of motor vehicles.
- Incorrectly claiming GST credits on wages and superannuation payments.
- Incorrectly claiming GST credits on GST-free purchases such as basic food items, exports and some health services.
- Claiming the entire GST credits on a car purchased for more than the luxury car limit.
- Incorrectly claiming an upfront GST credit on assets financed through a commercial hire purchase (CHP).
- Incorrectly claiming GST credits on payments for Yellow Pages advertising where the business chooses to pay for the cost of advertising by installments.
- Claiming a GST credit when the business does not have a valid tax invoice at the time of lodging the Business Accounting Standards. (Economic Times , 2013)

Part V: Annexure

Is GST an improvement over VAT?

Though there are certain positives and negatives of implementing GST, but GST as a reform to indirect taxation regime is an improvement over the previous existing taxation system mainly VAT and other service taxes in India.

Following are the salient features of GST (Status of GST, GOI, 2014) which proves it be an improvement over VAT or other service taxes:

1. GST would be applicable on supply of goods or services as against the present concept of tax on the manufacture or on sale of goods or on provision of services.
2. GST would be a destination based tax as against the present concept of origin based tax.
3. It would be a dual GST with the Centre and the States simultaneously levying it on a common base. The GST to be levied by the Centre would be called Central GST (CGST) and that to be levied by the States would be called State GST (SGST).
4. CGST and SGST would be levied at rates to be mutually agreed upon by the Centre and the States.
5. GST would replace the following taxes currently levied and collected by the Centre:

- Central Excise duty
- Duties of Excise (Medicinal and Toilet Preparations)
- Additional Duties of Excise (Goods of Special Importance)
- Additional Duties of Excise (Textiles and Textile Products)
- Additional Duties of Customs (commonly known as CVD)
- Special Additional Duty of Customs (SAD)
- Service Tax
- Cesses and surcharges

6. State taxes that would be subsumed within the GST are:

- State VAT
- Central Sales Tax
- Luxury Tax
- Entry Tax (other than those in lieu of octroi)
- Entertainment Tax (not levied by the local bodies)
- Taxes on advertisements
- Taxes on lotteries, betting and gambling
- State cesses and surcharges insofar as they relate to supply of goods or services

7. Credit of CGST paid on inputs may be used only for paying CGST on the output and the credit of SGST paid on inputs may be used only for paying SGST. In other words, the two streams of input tax credit cannot be mixed except in specified circumstances of inter-State sales.
8. GST would apply to all goods and services barring a few to be specified.
9. Tobacco and tobacco products would be subject to GST. In addition, the Centre could continue to levy Central Excise duty and the States to levy sales tax / VAT.
10. A common threshold exemption would apply to both CGST and SGST. Dealers with a turnover below it would be exempt from tax. A compounding option (i.e.to pay tax at a flat rate without credits) would be available to small dealers below a certain threshold. The threshold exemption and compounding provision would be optional.
11. The list of exempted goods and services would be kept to a minimum and it would be harmonized for the Centre and the States as far as possible.
12. Exports would be zero-rated.
13. An Integrated GST (IGST) would be levied on inter-State supply of goods or services. This would be collected by the Centre so that the credit chain is not disrupted. Accounts would be settled periodically between the Centre and the State to ensure that the SGST used for payment of IGST is transferred to the destination State where the goods or services are eventually consumed.
14. Import of goods or services would be treated as inter-State supplies and therefore, would be subject to IGST in addition to the applicable customs duties.
15. The laws, regulations and procedures for levy and collection of CGST and SGST would be harmonized to the extent possible.

International Scenario

More than 140 countries have introduced GST in some form. It has been a part of the tax landscape in Europe for the past 50 years and is fast becoming the preferred form of indirect tax in the Asia Pacific region. While countries such as Singapore and New Zealand tax virtually everything at a single rate, Indonesia has five positive rates, a zero rate and over 30 categories of exemptions. In China, GST applies only to goods and the provision of repairs, replacement and processing services. It is only recoverable on goods used in the production process, and GST on fixed assets is not recoverable. There is a separate business tax in the form of VAT.

New Zealand : When the GST was introduced in New Zealand in 1987, it yielded revenues that were 45 per cent higher than anticipated, in large part due to improved compliance. Its more neutral and efficient structure could yield significant dividends to the economy in increased output and productivity.

Canada : The GST in Canada replaced the federal manufacturers' sales tax which was then levied at the rate of 13 per cent and was similar in design and structure as the CENVAT in India. It is estimated that this replacement resulted in an

increase in potential GDP by 1.4 per cent, consisting of 0.9 per cent increase in national income from higher factor productivity and 0.5 per cent increase from a larger capital stock (due to elimination of tax cascading). (Maritimegetaway)

Singapore : Goods and Services Tax was introduced in Singapore on April 1, 1994, at 3%, but later increased to 4% on 1 January 2003, and 5% on 1 January 2004. It was raised again to 7% on 1July 2007. Singapore's GST is a broad-based consumption tax levied on import of goods, as well as nearly all supplies of goods and services. The only exemptions are for the sales and leases of residential properties and most financial services. In Singapore, the tax is broad based which include all essential goods like water, electricity, rice, etc. Hence, a low income worker who would not pay income taxes would have to pay GST on his daily living expenses. This can be a burden especially during times of high inflation when the 7% tax is paid on the increasing price of daily essentials. (Study of GST, 2010)

European Union : The European Union Value Added Tax ("EU VAT") is a value added tax encompassing member states in the European Union Value Added Tax Area. Joining in this is compulsory for member states of the European Union. As a consumption tax, the EU VAT taxes the consumption of goods and services in the EU VAT area. The EU VAT's key issue asks where the supply and consumption occurs thereby determining which member state will collect the VAT and what VAT rate will be charged. (Study of GST, 2010)

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