GST Explained

GST Introduction

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How sales tax used to work?

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- **Example 1**
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- **Stage 1 -** Imagine a shirt manufacturer. He buys raw material worth Rs 10,000, for which he pays a sales tax of 10% i.e Rs.1000.
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- He manufactures shirts by adding value of Rs.5000 including profit.
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- **Stage 2 -** While calculating the total cost, the manufacturer will include 10,000 + 1000 + 5000 and fix the price as 16,000.
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- The customer buying will pay 16,000 + 10% sales tax i.e 1,600 resulting in the final cost of 17,600.
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- 1600 = Rs.1000 as tax on 10,000 (collected for the 2^{nd} time) + Rs.100 as tax on 1000 (tax on tax) + Rs.500 as tax on 5000 (tax on value added)
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- So the total tax collected by the government in both the stages is 2,600.
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What were the flaws in it?

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- It collected the sales tax of Rs.1000 on initial Rs.10,000 goods twice.
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- It also had cascading effect i.e collected Rs.100 as tax on tax.
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- This also increased the final price of the product, making it difficult for the end customer to pay.

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- Unlike direct taxes, higher indirect taxes like sales tax will affect the poor more than the rich.
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- To avoid the higher tax, people used to transact without invoice hence resulting in higher tax evasion.
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How did VAT solve the problem?

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- VAT is sales tax introduced with the promise of reimbursing the seller with the tax he paid at the earlier stages.
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- **Example 2** – After application of VAT in **stage 2** of Example 2, while calculating the total cost of the product, the seller includes 10,000(raw material) + 5000 (value added) only. He leaves out 1000 paid as tax in the previous stage because it will be reimbursed by the government.
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- So the customer buys at the cost of 15000 + 10% VAT i.e 16,500.
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- Here the tax government is 1500.
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- Thus the VAT successfully reduced the tax rate and removed the cascading effect.
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- The tax is reimbursed by input tax credit.
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- It is the credit manufacturer's received for paying input taxes towards inputs used in the manufacture of products. Similarly, a dealer is entitled to input tax credit if he has purchased goods for resale.
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- Input tax credit = Tax collected by the Seller - Tax paid by the Seller.
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- e.g A seller paid Rs.2000 as tax for buying 200 units of pen. He sold 100 units in a month and collected only Rs.1000 tax from the customer. So Input tax credit is 2000 – 1000 = 1000. So the seller will be having Rs.1000 in his credit. Next time when he pays tax this amount is subtracted.
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What are CENVAT and MODVAT?

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- VAT removed the cascading effect only in sales tax.
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- The cascading effect continued in other indirect taxes like excise duty, service tax etc.
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- So to remove this MODVAT was introduced. It works in the same principle like VAT and provides input credit to Central Excise Duty.
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- Later CENVAT replaced MODVAT and it provides input credit to Central Excise Duty along with the Service Tax .
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What is the need for GST?

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- Input credit facilities were available for few types of taxes.
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- Electricity, Petrol, Advertisements were not included in State VAT resulting in continuation of cascading effects in these areas.
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- The input credit facilities available for CENVAT and State VAT cannot offset each other resulting in maintaining multiple accounts and multiple credits.
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- Different tax rates were applied across states resulting in complication of business transactions.
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What is GST?

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- GST is one indirect tax for the whole nation, which will make India one unified common market.
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- It is a single tax on the supply of goods and services, right from the manufacturer to the consumer.
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- It is a destination based tax i.e will be collected at the state where the goods

are sold instead of the manufacturing states.
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- In India, GST Bill was first introduced in 2014 as The Constitution (122nd Amendment) Bill.
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- This got an approval in 2016 and was renumbered in the statute by Rajya Sabha as The Constitution (101st Amendment) Act, 2016.
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- The provisions are -
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1. Central GST to cover Excise duty, Service tax etc, State GST to cover VAT, luxury tax etc.
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2. Integrated GST to cover inter-state trade. IGST per se is not a tax but a system to co-ordinate state and union taxex.
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3. **Article 246A – States have power to tax goods and services.**
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4. **Article 279A** - GST Council to be formed by The President to administer & govern GST. It's Chairman is Union Finance Minister of India with ministers nominated by the state governments as its members.
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5. The council is devised in such a way that the centre will have $1/3^{rd}$ voting power and the states will have $2/3^{rd}$.
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6. The decisions will be taken by $3/4^{th}$ majority.
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What are the taxes that are currently exempted in GST?

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- Custom duty will be still collected along with the levy of IGST on imported goods.
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- Petroleum and tobacco products are currently exempted.
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- Excise duty on liquor, stamp duty and electricity taxes are also exempted.
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What are the advantages of GST?

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- It makes the taxation simple.
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- It promotes exports. Zero rated exports i.e full tax credit will be given for exports.
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- No/Less cascading effects.
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- It will increase job creation and promote MSMEs. Currently, Big Companies make their spare parts themselves to avoid indirect taxes in between manufacturing. Now these businesses will be delegated to smaller MSMEs.
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What are the challenges?

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- SCGT and CGST input credit cannot be cross utilized.
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- Manufacturing states loses revenue on a bigger scale.
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- High rate to tax to compensate the revenue collected now from multiple taxes i.e High Revenue Neutral Rate.
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GST Bills

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Why in news?

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- Goods and Services Tax (GST) is proposed to be implemented ad a new, consolidated indirect tax regime from July 1, 2017.
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- Lok Sabha passed four Bills, relating to the implementation of the GST.
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What are the new bills passed?

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- The Central GST Bill, the Integrated GST Bill, the GST Compensation Bill, and the Union Territory GST Bills are the four new bills.
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- The fifth legislation i.e the State GST Bill, will be passed by the Assemblies of each of the States and the Union Territories with legislature.
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What were the objections made to the bill?

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- The disempowerment of Parliament in setting tax rates as GST council will be formed for this purpose.
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- There is still need for several tax rates when the principle is to be of ‘one nation, one tax’. The ceiling rates are expected to be 0%, 5%, 12%, 18% and 28%.
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- The reduction in the fiscal autonomy of the States.
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- The uncertainty over the addition of petroleum products, land etc. under GST.
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- Concerns raised by banks and insurance companies over the need for multiple registrations under GST.
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- The levy of additional cess.
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- The law allows the States leeway to depart from a recommended SGST rate. Therefore, the challenges ahead lie in GST Council’s leadership skills to carry everyone along.
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- The monthly filing of GST returns is ‘auto-populated’ — which means that a registered supplier must upload all details of his transactions, with the tax element.

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- Such humongous data gathering has not been attempted elsewhere, and the software should be tested.
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- The capacity of State tax authorities, so far used to taxing goods and not services, to deal with the latter is an unknown quantity.
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- The success of GST depends on political consensus, technology and the capacity of tax officials to adapt to the new requirements.
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What is the justification of the government?

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- **Parliamentary power -** The recommendation of the rates will come from the Council but the GST Council has been given the power to only make a recommendation regarding the model law.
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- The Constitutional amendment gave that power in Article 279A. The plenary power to frame legislation can only be with Parliament or the state legislative assemblies.
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- **State Autonomy -** The Council has two-thirds voting by the States and one-third by the Centre.
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- But the states and the Centre must be guided by the federal nature of the agreement between the Centre and the states.
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- If every state decided not to act on the GST Council's recommendations and set a different rate, then the implementation of GST become practically very difficult.
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- **Multiple Rates -** If there was only a single rate, then the GST regime would be a highly regressive one as luxury goods would then be taxed at the same rate as necessities.
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- **Real Estate** - The Council had taken a decision that the aspect of bringing the real estate sector under GST would be reviewed in the first year of rollout.
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- **Petroleum Products -** The Constitution provides that these items would attract GST, though the rate has been kept at zero.

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- Going forward, it would require only an executive decision on setting a rate on petroleum products.
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- **Multiple Registrations -** A clause has been provided that can provide an exemption in exceptional circumstances and the GST Council will take a call on it.
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GST Principles

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What is the issue?

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- Items are to be assigned to the different GST slabs and the exact amounts of the cesses will be decided.
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- The actual rate structure has already become overly complicated and has to be addressed.
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What should be the GST’s principle?

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- The guiding principle cannot be to minimize departures from the status quo.
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- Instead, the principle must be to make GST facilitate compliance, minimize inflationary pressures, be a buoyant source of revenue, and command support from the public at large.
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- The GST is a consumption tax, so any differentiation of rates should be minimal and should be linked to protecting the consumption basket of the poor while imposing a greater burden on the rich.
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- GST should not to be coupled with multiple objectives like such as

employment, industrial policy, and social engineering.
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- Another general point and one that will pose a communication challenge is this: today's headline tax rate is not the actual tax burden felt by the consumer. What you see is NOT what consumers get.
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- So, if the government imposes a GST rate that seems greater than today's rate (excise plus VAT combined), it does not necessarily follow that the tax burden has gone up. The reason is that today there are a lot of embedded taxes (the so-called cascading).
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- **Tax Structure -** The top rate has been proposed to be at 28%. This can be reduced to a combined rate of 20%.
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- If this is not feasible and multiple rates of 18% and 28% are here to stay, the number of goods that are placed in the 28% slab must be kept at an absolute minimum.
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- The bulk of consumer goods that are currently envisaged to be in the 28% category should be moved to the 18% category.
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- The 28% slab should include only the demerit goods like air-conditioners and cars.
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- Centre should bargain to lower the compensation threshold (from say 14% to 12%) if states insist on placing goods in the lower rate slabs.
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- Our tax policy and system must minimise the differentiation between a good from a service. A single rate will also avoid misclassification between services. If services are also allocated between the different rates, the result will be a messy system with multiple categories for both goods and services.
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- **Textiles and Clothing -** If India is to become a serious clothing exporter the GST must provide for a simple structure. All textiles and clothing products should be subject to the standard 18% tax.
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- **Gold -** Gold should be treated like any other item of luxury consumption. The government should to repeat its resolve shown in levying 1% excise duty.

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- But the argument that high tax can lead to evasion has some merit in the case of a high value product such as gold.
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- Currently, even though the total headline tax on jewellery is 2%, the effective burden faced by consumers is about 10-12% because of cascading and non-availability of input tax credits.
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- So there would be no increase in burden if the GST rate is set at 12% (with free flow on input tax credits). It would not make any sense if gold and gold products were taxed at anything below a GST rate of 12%.
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- **Tobacco products -** Today most tobacco products are taxed at very high rates reflecting their potential to cause cancer and other diseases.
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- Bidis on the other hand attract very low taxes in some states on the grounds that bidis are made in the small-scale sector and lead to livelihoods for millions.
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- This is a classic case of multiple objectives leading to distortionary taxation. In consumption, bidis are no less harmful than cigarettes.
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- So, the GST as a consumption tax should treat the two similarly.
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- The objective of helping bidi workers should be addressed through other fiscal tools such as subsidies.
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- Some states such as Karnataka and Rajasthan that tax bidis heavily others like West Bengal have low levels. This should be uniform.
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- **CVD and SAD exemptions** - Currently, numerous exemptions are granted on Countervailing Duty (CVD) and Special Additional Duty (SAD) levied on imports which favour imports over domestic production.
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- Under the GST, both will be combined and a uniform IGST will be applied on imports. If any import IGST exemptions are allowed under the GST (to mimic the current CVD and SAD exemptions) that would make a mockery of the PM’s Make in India initiative.
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- GST suffers from weaknesses largely related to the exemption of so many items from its scope like alcohol, petroleum, electricity, land and real estate, health and education. In order to minimize the damage, at least the structure of rates on those products not excluded should be low, simple, and efficient.
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