Goods and Service Tax (GST): Its Impact and Effect on the Economy

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Abstract

The Goods and Services Tax (GST) is a Value Added Tax (VAT) to be implemented in India which has been approved by the President Mr. Pranab Mukherjee posts its passage in the Parliament (Rajya Sabha 3rd Aug 2016 and Lok Sabha on 8th Aug 2016) and ratification by more than 50% of the legislatures. The tentative date which is decided by the ministry is the next financial year i.e. April 2017. All the indirect taxes levied on goods and services by the Central and State governments of India will be replaced by GST. According to federal regime of India, the GST will be implemented with the mutual consent of the central and state governments as the Central GST and the State GST respectively. Thus, cascading effect will be eliminated, exports will be zero-rated and imports will be levied the same taxes as domestic goods and services adhering to the destination principle.

Keywords: GST, Indirect Taxes, Cascading Effect, Dual GST

Introduction

Indirect taxes are transaction based business taxes and have multifaceted relation with trade and commerce. Indirect taxes on goods and services led to multiplicity due to federal structure of India. According to economic liberalization of India, the indirect tax mechanism should be transparent, reduce duplicity and also ease the cascading effect of taxes at various levels. During past two decades central government and state government has taken up significant reforms in the area of indirect taxes such as permitting inter-sectoral credit of taxes paid on goods and services under the Central indirect tax laws, implementation of State VAT, etc.

In order to line up the indirect tax structure with global standards, the Central Government recommended the implementation of Goods and Services Tax (GST) in India. An Empowered Committee (EC) of State Finance Ministers and the Central Government decided to work together to formulate the outlines of the GST regime in India. EC and Union Finance Minister decided a broad framework of GST which was during November 2009 brought out in the form of discussion paper. Since then due to various reasons the proposed implementation of GST has suffered lot of hindrances, the most important among them is that the state and central government was not able to agree upon same things regarding the GST framework and the sluggish progress in respect of the constitutional amendments.

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History in Parliament and Empowered Committee

In 2000, empowered committee was started by Mr. Atal Bihari Vajpayee and his government for the discussion on Goods and Service Tax. The major task of designing the GST model and overseeing the IT back-end process was headed by Asim Dasgupta, Finance Minister, and Government of West Bengal.

Considering the introduction of GST, it would be a major enhancement over the pre-existing central excise duty at the national level and the sales tax system at the state level, GST will be a further important breakthrough and the next coherent step towards a broad indirect tax reform in the country. An announcement was made by Palaniappan Chidambaram, the Union Finance Minister, during the central budget of 2007–2008 keeping the overall objective in view that GST would be introduced from April 1, 2010 and that on his request the Empowered Committee of State Finance Ministers would work with the Central Government to prepare a road map for introduction of GST in India. Now it expected that GST will be applicable in the beginning of the new financial year April, 2017.

Goods and Service Tax

Goods and Services Tax is anticipated to transmute the fortunes of the Indian economy. Goods and service tax is a value added tax which will supersede all indirect taxes imposed on goods and services by the Indian Central and State regimes. If Goods and Service Tax came into operation, exports will be zero-rated and imports will be levied the same taxes as domestic goods and services adhering to the destination principle.

Goods and service tax is a tax in which seller of goods and the service provider at time of sale of commodities and furnishing services to the customer can demand for input credit of tax which he has paid while buying the goods and procuring of services. The rate of tax on most of the goods and services remains unchanged but as per the essentiality of the nation some goods or services can be adjudged as "exempted" or "zero rated". The whole system is built up in such a way that it evades the cascading effect and ultimately the burden of all the tax is on the final consumer. Exports would be zero rated in such system and also to make export more competitive, all the taxes paid on purchasing and manufacturing of goods including taxes paid on raw material would return to exporters.

Goods and Service tax is almost similar to VAT (Value Added Tax) which is presently applicable in most of the states and can be termed as National level VAT on Goods and Services with only one variance or dissimilarity, that in this system not merely commodities but also services are being affected and the rate of taxation on goods and services are mostly the same.

But finally GST Bill has been passed in the parliament and president has given its consent with more than 50% of the state agreement and thus GST is now a law and is going to be introduced in the country after 13 years long journey since it was first discussed in the report of the Kelkar Task Force on indirect Taxes.

Various Discussions on Goods and Service Tax

The Finance Minister P. Chidambaram in his Budget 2006 said that: "According to P. Chidambaram country should move towards a national level goods and services which should be shared among Central and State government. He declared 1st April, 2010 as the date of introducing GST and also added that the foundation of GST will be that the rate of taxation on goods and services remains the same countrywide and government must progressively converge the service tax rate and CENVAT rate. P. Chidambaram also proposes to take one step towards achievement in that year by increasing the service tax rate from 10 to 12 percent. He also added that the net impact will be very small since service tax paid can be credited against service tax payable or excise duty payable."

"On 23rd February 2013, Pranab Mukherjee in New Delhi said "By August there would be IT network for Goods and Service Tax", India will shortly reveal an IT stage to integrate central and state indirect tax regime. As per Pranab Mukherjee (Finance Minister) they were working with state government so that good and service tax will be implemented or applicable as soon as possible. He said by the end of 2013 GSTN, which is an IT network being formed to ensure that centre and state tax system would be combined.

"New Assocham President in New Delhi on 26th July 2013 said "GST DTC will spur growth"

"Dropping economic growth which declined to a decade low of 5 per cent last fiscal will revive with the help of early applicability of Goods and Service tax and Direct Taxes Code", newly elected Assocham President Rana Kapoor said. In medium term, GST individually can increase India's GDP by 0.9 % to 1.7 % and in long run between 325 billion (USD) and 637 billion (USD). It will definitely boost the country's economy.

"On 27th Sep 2016, Finance Minister Arun Jaitley said "reasonably possible to meet April 1st deadline for GST".

Lauding the progress achieved so far on GST implementation , Finance Minister on this day exuded confidence that it is Reasonably Possible To Meet April 1 Deadline to roll out the new indirect tax regime.

"On 4th Oct. 2016, RBI gives thumbs up to 18 per cent GST Rate". Acc to Monetory Policy Report by RBI, the implementation of the much awaited Goods and Service tax with 18 per cent GST rate would not have any material impact on CPI inflation. But if the rate is increased to 22 per cent, the impact on aggregate inflation would be in the range of 0.3-0.7 per cent concentrated in selected groups like healthcare.

Analysis and Interpretation

GST in India- Salient Features

- The GST in India would be a dual GST which would comprise of
  - Central GST('CGST')
  - State GST ('SGST')

There are various indirect taxes that would subsume at both central and state level.

The taxes that will subsume
At Central Level are:-

1. Central excise duty
2. Addition excise duty
3. Service Tax
4. Additional customer duty commonly known as countervailing duty
5. Special addition duty of customs

At State Level are:-

1. Value Added Tax/Sales Tax
2. Entertainment Tax (other than tax levied by the local bodies), Central Sales Tax (levied by the centre and collected by states.
3. Purchase Tax
4. Octroi and Entry Tax.
5. Luxury Tax
6. Tax on lottery, betting and gambling

- Both CGST and SGST would simultaneously apply to intra state taxable transactions in the value chain.
- Inter State transactions would be subject to Inter state Goods and Service Tax ('IGST')
- CGST and IGST would be levied through a central legislation while the SGST would be levied through legislations of individual states.
- The basic features of the laws such as chargeability, taxable event, taxable person, valuation provisions, and basis of classifications would be uniformed across the state, to the extent possible.
- The distinction between the taxable events such as manufacture of goods, sale of goods or provisions of services would have very limited relevance.
- CGST and SGST would be paid separately to the central and the respective state governments.
- IGST would be paid to the central government who would operate as a clearing house for this purpose.
- Cross credit between goods and services would be available. However, no cross credit between CGST and SGST would be allowed.
- Accordingly, both CGST and SGST can be utilised towards payment of CGST and SGST respectively, except on interstate transactions and also can be utilised towards payment of IGST and vice-versa.
- Destination state would get the revenue and thus accordingly, the state government of the originating state would pay the central government an amount to the extent of the CGST credit utilised in payment of IGST.
- Similarly, the central government would pay the state government of the recipient state an amount equal to the IGST utilised in payment of SGST.
- Exports would be zero rated, while the imports would attract both CGST and SGST, in addition to the customs duty.
- The place of supply rules would have to be framed from determination of appropriate state to levy tax, particularly in the case of provision of services of interstate nature.
- Administration of CGST and SGST would be with respective governments.
- Each tax payer would have to submit both CGST and SGST returns to both the authorities.

Table 1: Cascading Effect

Particulars	Manufacturer	Wholesaler	Retailer
Purchase	100	144	197
Profit	20	20	20
Total Value	120	164	217
Vat @20%	24	33	43
Net Value	144	197	260

Impact of GST on Individuals

With the implementation of GST, every individual will be benefitted as in this system, both Central and State GST will be collected at the point of supply. Thus, under this regime, taxes on different stages of production and distribution can become a pure 'pass through' and tax cost would be essentially being incurred on final consumption only.

This means that the cascading effect will be removed i.e. tax on tax which an individual has to bear at the final stage will be removed and equal tax regiment at each stage would be balanced and the final tax burden would not fall on an individual. As a result revenues will be effectively accrued to the state in which consumption will take place.

GST will affect practically all aspects of an Individual's life style. Some of them are:

- If he goes to a medium sized restaurant, all food and drinks including cigarettes etc. will be subject to GST.
- When a person checks into a hotel, there will be no more government tax of 5% but a GST rate.
- Petrol stations, toll gates, parking lots, all will charge GST and the final consumer is the one who absorbs it.
- Anyone who walks into a small coffee shop to have a drink or buys a burger from a burger stall will not have to pay GST as these outlets will probably have a sales turnover which is below the prescribed threshold.
- In addition, a number of services which are considered to be essential will be exempted from GST.

Impact of GST on Overall Economy

- Increase in GDP growth by 1.4 to 1.7% (Annual increase Rs.70,000 Crores at current level)
- Overall cost of indigenous goods may reduce by 10% leading to reduction in price of manufactured goods
- Significant reduction in tax compliance and administration cost due to simple uniform structure
- The present taxable events such as "Manufacture" in case of Central Excise and "Sale" in case of VAT or CST will lose relevance
- Post introduction of GST, the tax exemptions/ remissions etc. related to industrial incentives would be converted into cash refund schemes.

The Cascading Effect

The hypothetical example with a manufacturer, wholesaler and retailer shown in table 1 explained the cascading effect and VAT rate is assumed to be 20%. The manufacturer will purchase the goods worth Rs. 100. Then the manufacturer will add his profit of Rs 20 and then VAT rate applicable will be 20% which will add up the cost to Rs 144. Now as there is cascading effect applied in this case therefore the wholesaler will not get any VAT Credit. And for him the actual value of goods will be Rs 144. Now he will make some value additions i.e. of Rs 20 and then pay VAT of Rs 33 which will add up the cost to Rs 197. Now as in this case no VAT credit is allowed therefore tax is charged on Rs 164. Now this Rs 164 includes Rs 24 which was charged by manufacturer. In this condition VAT is charged on VAT. This is called cascading effect.

- If GST would be introduced ,Cascading Effect would be eliminated from the system and this can be further explained with the help of example given below :-

Table 2: Hypothetical example showing the calculations of GST

Stage of supply chain	Purchase value of input	Profit	Value at which supply of goods and services made to next stage	Rate of GST	GST on output	Input tax credit	Net GST= GST on output - input tax credit
Manufacturer	100	30	130	20%	26	20	26-20 = 6
Whole seller	130	20	150	20%	30	26	30-26 = 4
Retailer	150	10	160	20%	32	30	32-30=2

Working of GST

With the help of a hypothetical example, shown in table 2, let us consider a manufacturer, a whole seller and a retailer. Suppose GST rate is 20%, where the manufacturer makes profit of Rs.30 on his purchases worth Rs.100 of input of goods and services used in the manufacturing process. The manufacturer will pay net GST of Rs. 6 after setting-off Rs. 20 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 26. Further manufacturer sells the goods to the wholeseller. Now the wholeseller sells the same goods after making profit of (say), Rs. 20, he pays net GST of only Rs. 4, after setting-off of Input Tax Credit of Rs. 26 from the gross GST of Rs. 30 to the manufacturer. Similarly, the retailer sells the same goods after a profit of (say) Rs. 10; he pays net GST of only Re.2, after setting-off Rs.30 from his gross GST of Rs. 32 paid to wholeseller. Thus, the manufacturer, wholeseller and retailer will have to pay only Rs. 12 (= Rs. 6+Rs. 4+Re. 2) as GST on the profit along the entire value chain from the producer to the final seller(retailer), after setting-off GST paid at the earlier stages. The overall burden of GST on the goods and services is thus reduced.

Impact of GST on Industries

Telecom

In examination of present indirect tax regime the prevailing tax rate on telecom industry is low i.e. 15%, which might climb to 18-20% under GST. However to gain the credibility there should be a free flow of credit under various taxes such as VAT/CST and portion of custom duty

From consistency point of view, there should be an outlook change for telecom administrators as they will be required to embrace State wise consistence as against unified/centralised compliances being right now applicable, which bringing about heavy burden on the telecom administrators.

E–Commerce

The e-commerce organizations need to give a new or improved form to the present models, as the present VAT rate arbitrage followed in the law may not be applicable in GST. However the difficulties right now confronted by the e-business organizations in undertaking inter - state exchange of products owing to trade restrictions might be ease out under the GST administration. Under GST, tax will be collected from E-commerce companies at source.

Automobile

It is being assumed that tax rate for automobile sector might drop from 25%-40% to 18%-20% under GST which effect the price of final product. GST will remove the burden from automobile sector as it brings various taxes (VAT/CST, Entry Tax, and Octroi) under single bracket. Overall GST will have a favorable effect on automobile tax.

Real Estate

GST will reduce the burden on real estate business also as it subsumed the VAT and service tax while the stamp duty continue the same way as in current scenario. It also removes the inefficiencies of credit by cross utilization.

Banking

In comparison with current indirect tax regime, there would be an increase in rate from 15% to 18%-20% under GST regime. The major impact area for the sector shall be from a compliance perspective, where there is a likelihood of significant increase from centralized compliance to decentralized state wise compliance.

Consumer Goods

From 25%-27% to 18%-20% there is a likely possibility that the rates applicable to this sector of economy will be decreased. With coupled reduction in multiplicity of taxes and cross utilization of credit, for the end consumer it shall witness a positive impact on the prices in this sector.

Contentious Issues in Early Phase

The problem why GST is not getting acceptance are mainly about protecting the potencies of states in taxation matters. Other related issues are the structure of tax rates, the intention of the Federal regimes to redistribute the resources from richer states to poorer states or more productive regions to poorer regions through central transfers in the phase of concessions and the single prevalent market which can be of great assistance for the economic system of the nation as a whole.

Some food grains engendering states and mineral affluent states get considerable revenue from the purchase tax which is a tax on the agriculture engender purchased from the farmers. These states want to omit the purchase tax from the GST. Purchase tax is similar to sales tax, but is lodged into the government by the purchaser instead of the vendor. Most of this produce is exported to other states. So these states believe that tax income generated from purchase tax is in fact exporting the tax load on the local population to the other states and thus is not regressive for their state.

State governments will be affected adversely if any change will be made in the tax structure as indirect taxes are the major source of income for the state government. The effects of GST will not be uniform as some state may have negative impact from it while other may have positive impact. So, when the tax structure is designed due care should be given to these differential impacts (Kavita Rao 2008). In case state's revenue declines they want an assurance of reimbursement from the federal regime.

Implementation Strategy

Under the federal structure of India applicability of uniform policies is very delicate issue. Significance of indirect taxes in the working of state governments also making it more complicated. Strategy should be formulated to achieve the consensus for implementation of GST because India could achieve the VAT system functioning only through the agreement. Even if one of the states refuses to comply with it, the whole purpose of GST will be defeated.

Administratively it would have been much better to have only one system of taxation but GST is supposed to have three components i.e. Central GST, State GST and Interstate GST due to federal state issue about sharing of power. World over there have been only few example where dual VAT System is being implemented otherwise only single federal VAT system is commonly practice. Although two taxes will be charged in dual GST system but there will be uniformity about chargeability, classifications, assessment system, registration etc.

Further there will be consistency of assessment rates over the states which will diminish unhealthy competition. It is proposed to have just a few levels of tax rates all through the nation country with federal government imparting certain percentage and state imparting certain percentage. Due to this uniform assessment rates the states won't have the capacity to change the tax rate freely in their budget as the rate must be considered collectively.

Progress Regarding Implementation of GST

Though there have been a lot of problems regarding implementation of goods and service tax, there is great improvement in its progress of implementing it

1. IT Infrastructure

One of the greatest progresses is regarding the IT infrastructure.

- States as well as centre agreed to setup a clearing house to resolve tax collections and credits under the National Securities Depository Ltd.(NSDL) as a Special Purpose Vehicle (SPV).
- The clearing house, a key part of the GST architecture, is expected to ease the creation of the common market, ensure that each state gets its share of revenue and also provide useful tax information to the authorities.
- The proposal envisages a standard electronic return, which each of the estimated 8 million establishments will be required to file every month.

- Centralized /integrated systems integrating payments, returns, refunds and tracking of interstate movement of goods and services – end to end tracking with proper re-conciliation and exception reports for enforcement agencies for assessment.

2. Transparency

As this is the New Indirect Tax Regime, everything would be transparent. Everything would be uniform and online.

Registration process:

- For Existing dealer: No Fresh registration required under GST for payers who are already registered in VAT/Central Excise/Service TAX
- For New dealers: To get registered under GST, single application is to be filed online.

Note:

- The registration number would be a PAN based
- Each dealer to be given unique ID GSTIN

Return Filling Procedures

- A common return would be filed which would serve the purpose of both central and state Government.
- There are eight forms provided for in the GST business processes for filing the returns. Most of the average tax payers would be using only four forms for filing their returns. These returns are for suppliers, return for purchases, monthly and annual returns.
- Quarterly tax return has to be filed by small tax payers who have opted for composition scheme.

Exemptions under GST

- Levies on petroleum products
- Levies on alcoholic products
- Taxes on lottery and betting
- Basic custom duty and safeguard duties on import of goods into India
- Entry taxes levied by municipalities or panchayats
- Entertainment and luxury taxes
- Electricity duties/taxes
- Stamp duty on immovable properties
- Taxes on vehicles

Conclusion

In order to gain the full benefits of the GST it is imperative that the following are achieved:

- Either all or maximum number of indirect taxes that are presently levied on a commercial transaction are covered under GST with eligibility of credit.
- There is uniformity in the definition and classification of goods and services and the rates of taxation.
- Threshold exemptions be continued to support and provide incentive to small businesses.
- A proposed increment of 1.5% to India's GDP.

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