



**NATIONAL LAW SCHOOL
OF INDIA UNIVERSITY**
Bangalore

**“GOODS AND SERVICES TAX IN INDIA:
A REMEDY TO ALL PROBLEMS ?”**

**DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE OF LL.M.
(BUSINESS LAWS)**

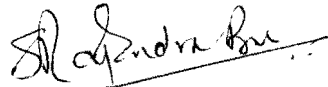
**UNDER THE GUIDANCE OF HONOURABLE MR. JUSTICE
S. RAJENDRA BABU, FORMER CHIEF JUSTICE OF INDIA**

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2010

CERTIFICATE

This is to certify that the dissertation entitled "**GOODS AND SERVICES TAX IN INDIA: A REMEDY TO ALL PROBLEMS ?**" submitted by **AJITESH MOHAN**, (ID No. 308) in partial fulfilment of the requirements for the award of degree **LL.M (Business Laws)**, is a product of the candidate's own work carried out by him under my guidance and supervision. The matter embodied in this dissertation is original and has not been submitted for the award of any other degree in any other University.



(Hon'ble Mr. Justice S. Rajendra Babu)

Date: 24.05.2010

Supervisor

Place: NLSIU, Bangalore

DECLARATION

I, Ajitesh Mohan, do hereby declare that this dissertation titled “Goods and Services Tax in India: A Remedy to All Problems ?”, is the result of the research undertaken by me in the course of my LL.M. (Business Laws) Programme at the National Law School of India University (NLSIU), Bangalore, under the guidance and supervision of Hon’ble Mr. Justice S. Rajendra Babu.

This work is my original work, except for such help taken from such authorities as have been referred to at the respective places for which necessary acknowledgements have been made.

I further declare that this work has not been submitted either in part or in whole, for any degree or diploma at any other University or institution.

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LIST OF ABBREVIATIONS

ACES :	Automation in Central Excise and Service Tax
ASEAN:	Association of South-East Asian Nations
CENVAT :	Central Value Added Tax
CGST :	Central Goods and Services Tax
CII :	Confederation of Indian Industries
CST :	Central Sales Tax
CVD :	Countervailing Duty
EC :	European Community
EU :	European Union
GST :	Goods and Services Tax
HSD :	High Speed Diesel
ICAI :	Institute of Chartered Accountants of India
IGST :	Integrated Goods and Services Tax
IMF :	International Monetary Fund
IT :	Information Technology
ITC :	Input Tax Credit
LTU :	Large Taxpayers Unit
MODVAT :	Modified Value Added Tax
MRP :	Maximum Retail Price
NCAER :	National Centre for Applied Economic Research
OECD :	Organization for Economic Co-operation and Development
PAN :	Permanent Account Number
SAD :	Special Additional Duty
SGST:	State Goods and Services Tax
SIM :	Subscriber Identity Module
TINXSYS :	Tax Information Exchange System
VAS :	Value Added Services
VAT :	Value Added Tax
WST :	Wholesale Sales Tax
WTO :	World Trade Organization

LIST OF CASES

- All India Federation of Tax Practitioners v. Union of India, AIR 2007 SC 2990
- Bharat Sanchar Nigam Ltd. v. Union of India, (2006) 3 SCC 1
- Gujarat Ambuja Cements Ltd. v. Union of India, AIR 2005 SC 3020
- Hoechst Pharmaceuticals v. State of Bihar, AIR 1983 SC 101
- Keshavananda Bharathi v. State of Kerala, AIR 1973 SC 1461
- Laghu Udyog Bharati v. Union of India, AIR 1999 SC 2596
- Minerva Mills v. Union of India, AIR 1980 SC 1789
- R.M.D.C. (Mysore) Pvt. Ltd. v. State of Mysore, AIR 1962 SC 594
- S.R. Bommai v. Union of India, AIR 1994 SC 1918
- State of Uttar Pradesh v. Synthetics and Chemicals Ltd., (1991) 4 SCC 139
- Tata Iron and Steel Co. Ltd. v. State of Bihar, AIR 1958 SC 452
- Tika Ram v. State of Uttar Pradesh, AIR 1956 SC 676
- Union of India v. Delhi Cloth and General Mills, AIR 1963 SC 791

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EXECUTIVE SUMMARY

In view of the federal structure of the Governance in India, there is multiplicity of taxes on goods and services. Excise duty on manufacture, customs duty on imports and exports, and service tax on services are levied by Central Government. On the other hand, VAT, Entry tax, octroi, and duty on liquor are levied by the State Governments. Besides, there are plethora of taxes such as cesses, surcharge, stamp duty, entertainment tax and road tax.

Such multiplicity of taxes distorts the tax structure and brings in complexities. Reforms in taxes are of course a continuous process. CENVAT which was that time termed as 'MODVAT' was introduced in 1986 in Central Excise to avoid cascading effects of excise duties. Introduction of State VAT started in 2005 and now most of the States have implemented State VAT.

The Goods and Services Tax (GST) is a logical consequence of State VAT. Idea of national GST was first mooted by Kelkar Task Force in 2004. A task force was formed under the Chairmanship of Shri Vijay Kelkar on Implementation of Fiscal Responsibility and Budget Management (FRBM) Act. The Kelkar Committee submitted its report in July 2004. The Committee strongly recommended fully integrated GST on national basis.

A beginning was made by proposing integration of service tax and excise duty. The then Finance Minister Shri P. Chidambaram, in his budget speech of 2004 proposed a major

step towards integrating the tax on goods and services. To give effect to this proposal, CENVAT Credit Rules were introduced in 2004.

The task of designing and implementing the GST was taken up by the Empowered Committee of State Finance Ministers, headed by Shri Asim Dasgupta, which had also designed State VAT. The Empowered Committee appointed various working groups and discussed issues relating to the proposed national GST.

When it was initially proposed as a national GST in 2004, it was projected as a solution to all ills of taxation. It was envisaged that there will be a simple single point GST. All Central and State taxes will be merged in national GST. Over the years, the basic idea of 'one single tax' has been considerably diluted and various compromises have been made. Now, it is going to be a dual GST, i.e., both at the Centre and the State levels.

The first discussion paper was released by the Empowered Committee on 10-11-2009. The discussion paper threw light on the detailed view of the Empowered Committee on the structure of GST. Over the last few months, we have witnessed a number of disputes between the Centre and the various States, over different aspects of GST. For the introduction of GST, a number of constitutional amendments are also required. As a result, the GST regime which was supposed to be introduced on 1-4-2010, has now been proposed to be introduced on 1-4-2011.

RESEARCH METHODOLOGY

SCOPE

This dissertation is an attempt to introduce the concept of Goods and Services Tax (GST), which will soon be introduced in India. The proposed tax scheme is intended at subsuming all the prevailing indirect taxes in our system, and have a single indirect tax, covering goods as well as services. The background and meaning of GST has been discussed, and the working of this system has also been explained. Some salient features of this scheme have also been mentioned. A brief reference has also been made to the GST systems in Canada and Australia. The dissertation also tries to explain the need for GST, by discussing our existing indirect tax regime, and the shortcomings thereof. It also goes through our Constitutional setup as regards the financial powers, and also discusses the amendments required for introduction of GST. The dissertation also discusses the design of the proposed GST by going through the various models working in different systems, and also suggests a suitable model for our own system. Introduction and implementation of GST in India is bound to face a number of serious challenges. This dissertation also discusses them. It tries to explain the benefits of this system of taxation, and makes suggestions for its effective implementation.

OBJECTIVE

The objective of this research is to introduce and explain the concept of GST, which will very soon form an integral part of our day to day life. It also aims to suggest some improvements in the proposed structure of GST.

RESEARCH QUESTIONS

- What exactly is the proposed system of GST ?
- How is it going to work in our system ?
- What are the justifications behind its introduction ?
- Is it going to solve all the problems of our existing system ?
- What are the constitutional amendments that are to be made for its introduction ?
- What should be the design of the GST system in our country ?
- Is dual GST the only way to go ?
- What are the various challenges that GST implementation is going to face ?
- Is the new system going to work successfully in our country ?

HYPOTHESIS

“The proposed Goods and Services Tax is the best available alternative to minimize the complexities of our existing system, and to give a strong push to our economy to compete with the other economies all over the world.”

CHAPTERISATION

The dissertation is divided into six chapters. The first chapter introduces the meaning and the background of the GST. The second chapter looks at the justifications behind the introduction of this scheme. The third chapter deals with the constitutional aspects of introducing GST. The fourth chapter looks at the different possible models of GST, and suggests a suitable one for our system. The fifth chapter discusses the various challenges

faced for the introduction and implementation of GST. The sixth and final chapter gives certain suggestions and concludes the dissertation.

SOURCES

The researcher confines to secondary data available on the said topic. A list of selected bibliography is given at the end of this dissertation.

METHOD OF ANALYSIS

The researcher has mainly followed the descriptive and historical style of research. However, at some points, the researcher has also used analytical methodology to examine different aspects of GST.

MODE OF CITATION

A uniform mode of citation is used throughout the research.

CHAPTER – 1

MEANING AND INTRODUCTION

The later half of the twentieth century has been witness to the transformation of the turnover and sales taxes to value added taxes (VAT). This trend which began in France in 1954 has been emulated with success in both the developed and developing countries¹ and also at supra-national levels such as the EC-VAT. The assistance offered by IMF to a number of developing countries in designing and set-up their indirect tax structures on a VAT model² has only reinvigorated this shift.

India's tryst with VAT is no different story. The shift to VAT from sales tax has so far done well, both for the States and industry on the counts of rising collections³ and smoothening of interface respectively. The positive feedback from this successful transition has not only aggravated the strength of the factors fuelling the reform drive but also accentuated the movement towards redefining of the indirect tax landscape on a broader scale in its quest for simplification and harmonization.

¹ Cnossen, Sibbren *Global Trends and Issues in Value Added Taxation*, International Tax and Public Finance, Vol. 5, pp. 399-428 (1998) and OECD, *Consumption Tax Trends*, (Paris: OECD, 1999).

² Such as (i) the Draft Tax Codes for use as reference material in preparation of legislative acts and application of laws (<http://www.imf.org/external/np/leg/tlaw/2000/eng/preface.htm>), and (ii) Program for Technical Assistance on Drafting of Legislation on Fiscal Issues (<http://www.imf.org/external/np/leg/ta/eng/index.htm>).

³ *Economic Survey of India 2007-08*, paragraphs 3.50 – 3.51, 3.60 and Table 3.12. (Available at <http://indiabudget.nic.in/es2007-08/chapt2008/chap34.pdf>).

The carvings for a comprehensive tax on goods and service are, however, not new. With the introduction of 'Service Tax' in 1994, cross-linking of the credit mechanism between taxes on goods and services became inevitable to avoid the fallouts of cascading effect and double taxation thereon. Though there has been a partial alignment on that front under the 'CENVAT Credit Rules', the existing rules are limited in scope as they cover only the duties of excise. The taxes on sale of goods being beyond their coverage and in the absence of a mechanism for availability of credit across different State taxes, the citizens not only end up paying tax on tax but also have to bear its inflationary ramifications.

Given this backdrop, India aspires to merge the major indirect taxes (State level VAT, excise duty and service tax) into a generic 'Goods and Service Tax' (GST). GST is a comprehensive value-added tax on goods and services. France was the first country to introduce this system in 1954. Today, it has spread to over 150 countries. It is a part of the proposed tax reforms that center around evolving an efficient and harmonized consumption tax system in the country. Presently, there are parallel systems of indirect taxation at the central and state levels. Each of the systems needs to be reformed to eventually harmonize them. Through a tax credit mechanism, GST is collected on value-added goods and services at each stage of sale or purchase in the supply chain.

What is GST ?

Goods and Service Tax is a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider can claim the input credit of tax which he has paid while purchasing the goods or procuring the service. On most of the goods and services the rate of tax remains the same but as per the necessity of the nation some goods or services can be declared as “exempted” or “Zero rated”. The whole system is developed in such a way that it avoids the cascading effect and the final consumer bears the burden of all the tax. Generally, in such a system Exports are zero rated and all the taxes paid while purchasing and manufacturing the goods including the taxes paid on raw material and services are returned to the exporter to make the exports competitive. The sellers or service providers collect the tax from their customer, who may or may not be the ultimate customer, and before depositing the same to the exchequer, they deduct the tax they have already paid. This is simply very similar to VAT which is at present applicable in most of the states and can be termed as National level VAT on Goods and Services with only one difference that in this system not only goods but also services are involved and the rate of tax on goods and services are generally the same⁴.

How will it work ?

Generally, the dealers registered under GST (Manufacturers, Wholesalers and retailers and service providers) charge GST on the price of goods and services from their customers and claim credits for the GST included in the price of their own purchases of

⁴ Halakhandi, Sudhir, *Goods and Services Tax: An Introductory Study*, The Chartered Accountant, April 2007, p. 1595

goods and services used by them. While GST is paid at each step in the supply chain of goods and services, the paying dealers don't actually bear the burden of the tax because GST is an indirect tax and ultimate burden of the GST has to be taken by the last customer.

This is because they include GST in the price of the goods and services they sell and can claim credits for the most GST included in the price of goods and services they buy. The cost of GST is borne by the final consumer, who can't claim GST credits, i.e. input credit of the tax paid. The GST can be divided into following sections to understand it better:

1. Charging Tax: The dealers registered under GST (Manufacturers, Wholesalers and Retailers and Service Providers) are required to charge GST at the specified rate of tax on goods and services that they supply to customers. The GST payable is included in the price paid by the recipient of the goods and services. The supplier must deposit this amount of GST with the Government.

2. Getting Credit of GST: If the recipient of goods or services is a registered dealer (Manufacturers, Wholesalers and Retailers and Service Providers), he will normally be able to claim a credit for the amount of GST he has paid, provided he holds a proper tax invoice. This "input tax credit" is set off against any GST (output), which the dealer charges on goods and services, which he supplies, to his customers.

3. Ultimate Burden of Tax on Last Customer: The net effect is that dealers charge GST but do not keep it, and pay GST but get a credit for it. This means that they act essentially as collecting agents for the Government. The ultimate burden of the tax falls on the last and final consumer of the goods and services, as this person gets no credit for the GST paid by him to his sellers or service providers.

4. Registration: Dealers will have to register for GST. These dealers will include the suppliers, manufacturers, service providers, wholesalers and retailers. If a dealer is not registered, he normally cannot charge GST and cannot claim credit for the GST he pays and further can not issue a tax invoice.

5. Tax Period: The tax period will have to be decided by the respective law and normally it is monthly and/or quarterly. On a particular tax period, which is applicable to the dealer concerned, the dealer has to deposit the tax if his output credit is more than the input credit after considering the opening balance, if any, of the input credit.

6. Refunds: If for a tax period the input credit of a dealer is more than the output credit then he is eligible for refund subject to the provisions of law applicable in this respect. The excess may be carried forward to next period or may be refunded immediately depending upon the provision of law.

7. Exempted Goods and Services: Certain goods and services may be declared as exempted goods and services and in that case the input credit cannot be claimed on the

GST paid for purchasing the raw material in this respect or GST paid on services used for providing such goods and services.

8. Zero Rated Goods and Services: Generally, export of goods and services are zero-rated and in that case the GST paid by the exporters of these goods and services is refunded. This is the basic difference between Zero rated goods and services and exempted goods and services.

9. Tax Invoice: Tax invoice is the basic and important document in the GST and a dealer registered under GST can issue a tax invoice and on the basis of this invoice the credit (Input) can be claimed. Normally a tax invoice must bear the name of supplying dealer, his tax identification nos., address and tax invoice nos. coupled with the name and address of the purchasing dealer, his tax identification numbers, address and description of goods sold or service provided⁵.

Salient Features

The First Discussion Paper on the proposed GST⁶ gives out the basic features of the GST structure and implementation aspects. Some of these details were already known and few others helped to clarify some details of the proposed design. Some of the salient features of the proposed GST reforms are:

⁵ *Ibid.*

⁶ Released on November 10, 2009.

(i) The reform entails a dual GST – one at the central level (CGST) and another at the state level (SGST). Each taxpayer will be allotted a PAN-linked taxpayer identification number with 13/15 digits. The dual GST will be implemented through multiple statutes – one for CGST and one for each SGST. The new tax system would have a broader base to include wholesale and retail trade in the case of the CGST and all services in the case of the SGST. The basic features of the acts, including definitions and the classification system, are expected to be uniform among the various state statutes “as far as practicable”. To the extent feasible, a uniform procedure will be followed for the collection of both CGST and SGST⁷.

(ii) There will be separate tax administrations at the centre and in the states. Input tax paid on CGST will be credited against the output tax on CGST and those on SGST will be credited against the SGST. Cross-utilisation of input tax credit (ITC) between CGST and SGST will not be allowed. Thus, there will be some cascading in the tax system⁸.

(iii) The CGST will have a threshold of Rs 1.5 crore. The threshold for the SGST is proposed at Rs 10 lakh, which would be uniform for all states and union territories. A simplified tax at 0.5% of the turnover will be levied for dealers with a turnover up to Rs 50 lakh. In the case of CGST, however, the threshold is proposed to be kept at Rs 1.5 crore in the interest of small traders and small-scale industries⁹.

⁷ <http://www.taxguru.in/goods-and-service-tax/analysis-of-first-discussion-paper-on-goods-and-services-tax-in-india.html>

⁸ http://www.caclubindia.com/mobile/articles/display_article_list_mobile.asp?article_id=3649

⁹ http://www.taxmann.com/TaxmannFlashes/flashart22-3-10_5.htm

(iv) The CGST will subsume central excise duty, additional excise duty, excise duty on medicinal and toilet preparations, service tax, additional customs duty (countervailing excise duty), special additional duty on customs, surcharge cesses and surcharges. The SGST would subsume VAT/sales tax, entertainment tax, luxury tax, taxes on lottery, betting and gambling, state cesses and surcharges and entry tax not in lieu of octroi. A majority of the states would like to have the purchase tax also subsumed under the SGST, whereas some states which receive substantial revenue from such taxes do not want it to be subsumed. The decision of the Empowered Committee is that in case it is subsumed, the centre should give “adequate and continuing” compensation¹⁰.

(v) Alcoholic beverages will be kept out of the CGST. The states can continue to levy sales tax/VAT as per the existing practice in addition to levying state excise duties. However, tobacco products will be included in the SGST with proper input tax credit. In addition, the central government can levy excise duty.

(vi) The prevailing practice in regard to the taxation of crude, motor spirit (including aviation turbine fuel) and high speed diesel (HSD) will continue and these items will be kept outside the SGST and the tax would continue to be levied on these products with a floor rate. A final view on whether natural gas should also be kept outside the SGST will be taken after further deliberations by the Empowered Committee. Thus, cascading on account of this will continue. Since, on an average, states receive over 30% of sales tax revenue from these products and as these are largely marketed through the public sector oil marketing companies, administering the tax on these items is easy and compliance of

¹⁰ <http://www.thehindubusinessline.com/mentor/2009/12/28/stories/2009122850580700.htm>

the tax is high. Surely, the states have decided to live with distortions in the interest of revenue¹¹.

(vii) States will have concurrent powers to levy the tax on services. In the case of services of an inter-state benefit span, if these are intermediate services, a model of integrated GST (IGST) has been introduced to ensure seamless trade while making the system destination-based. However, if these are in the nature of final consumption, it is not clear how the revenues will be apportioned between the states where the service is produced, transacted and consumed.

(viii) The important feature of the GST scheme is the mechanism to ensure a common market. To ensure seamless trade across the country, the discussion paper puts forth the IGST model. In this model, the inter-state seller of goods and services will pay the IGST, which will be equal to the total of CGST and SGST after taking credit of the input taxes to the central agency, to be created especially to administer the IGST. The exporting state credits the input tax revenue to the account of the importing state. The central agency will credit the SGST collected by it to the account of the importing State and the importing dealer will collect the SGST on his sales after taking credit of the tax already paid and the chain will continue. The process not only ensures seamless trade and uninterrupted ITC chain but also enables the levy to be destination-based. Although the discussion paper goes to a considerable distance to provide conceptual clarity on a number of issues the available information on the proposed GST system brings out some inadequacies. It is well known that in all federal fiscal systems, tax assignment has to strike a compromise

¹¹ <http://www.capitalmarket.com/CMEdit/SFArtDis.asp?SFSNO=1583&SFESNO=91>

between fiscal autonomy and tax harmony and some inefficiency may have to be accepted. However, there are others which hopefully, after due consideration will be ironed out¹².

GLOBAL SCENARIO

The system of a value added tax was first introduced in France in 1954. Over the years, many countries have changed their existing systems to a VAT or a GST. Most of the countries have a unified GST system. Brazil and Canada follow a dual system where GST is levied by both the Union and the State governments¹³. The standard GST rate in most countries ranges between 15-20%. Most of the sectors are taxed except for few exemptions. Let us now look at how this system is working in two major jurisdictions, Canada and Australia.

Canada

Canada is one of about 150 countries that impose a consumption tax or “value added tax” on goods and services, having introduced its Goods and Services Tax (GST) in 1991. This 7% federal tax applies on most goods and services supplied in Canada. Visitors to Canada (for up to 60 days) can apply to have their tax refunded, while Aboriginals are exempt from payment.

¹² Rao, M. Govinda, *Goods and Services Tax: Some Progress Towards Clarity*, Economic & Political Weekly, Vol. XLIV No. 51, December 19, 2009, p. 8.

¹³ Adukia, Rajkumar S., *A Study on Proposed Goods and Services Tax framework in India*, e-book (online version), p. 36

A small number of goods and services in Canada are exempt, such as used residential housing; most health, medical and dental services; day care; music lessons; and certain goods and services provided by non-profit organizations, governments, and other public service bodies. Still other goods and services are “zero rated” or taxable at 0% such as basic groceries, prescription drugs, exports, and any property or service that is for the use of the Governor General.

Unlike Canadian laws governing income tax, the thrust of GST laws is on the tax collectors rather than the taxpayers. That’s because the merchants or service providers who sell goods and services are in charge of collecting GST payments and remitting them to the Canadian federal government. Hence, GST law deals in large part with registering under the Act, filing returns and calculating tax credits.¹⁴

Australia

GST in Australia is a Value Added Tax on the supply of goods and services in Australia. It was introduced by the Federal Government with the A New Tax System (Goods and Services Tax) Act 1999, taking effect from July 1, 2000. The basic premise of the new tax was to broaden the tax base, which was heavily biased towards the provision of services.

Prior to the GST, Australia operated a Wholesale Sales Tax (WST) which imposed a tax on wholesales of goods. The WST was implemented in the 30's when Australia had an economy dominated by goods. Over the years however, Australia's economy evolved to

¹⁴ <http://www.canadian-lawyers.ca/understand-your-legal-issue/tax/1025006/>

be more services based, and the GST served to strip the unfair tax advantage that service providing businesses had over suppliers of goods. The GST is levied at a flat rate of 10% on most goods and services, apart from GST exempt items, and input taxed goods and services.

GST is charged on all taxable supplies, except GST free supplies, that include supplies relating to Health and Medical Care, Educational Supplies and Childcare, Fresh Food and Beverages, etc.¹⁵

¹⁵ <http://www.gstaustralia.com.au/>

CHAPTER – 2

JUSTIFICATIONS

The need for the introduction of GST in our country was being felt for quite some time. The reasons behind this are numerous. To understand these reasons, and the need for GST, we first need to know about the prevailing system of indirect taxes in our country, and the shortcomings thereof. Only then would we be able to objectively analyze the justifications behind this reform in our indirect tax system.

India's Indirect Tax Regime

The starting point of this reference is the Constitution of India ('Constitution') which entails a federal set-up in so much that the powers to make laws are concerned¹⁶. The scope and distribution of the legislative powers between the 'Parliament' (Federal Legislature) and 'State Legislatures' (Provincial Legislatures) is provided for in Schedule VII to the Constitution, which is comprised of three lists. List – I entails the subjects whereupon the Parliament has the sole domain to make laws, List – II entails the subjects whereupon the State Legislatures alone can make laws, and List – III identifies the subjects whereupon both Union and State Legislatures are competent to makes laws. All residuary and unlisted areas fall within the domain of the Union Parliament¹⁷ while in

¹⁶ Article 246 of the Constitution

¹⁷ Entry 97, List – I and Article 248 of the Constitution. See also *Hoechst Pharmaceuticals Ltd. v.State of Bihar*, AIR 1983 SC 101: (1983) 4 SCC 45.

case of List – III matters laws enacted by the Parliament carry precedence and apply to the extent of conflict with State laws¹⁸.

These three lists also prescribe the extent of taxation powers between the Parliament and State Legislatures *inter se*¹⁹. The ‘taxes on the sale or purchase of goods’²⁰ and ‘taxes on the entry of goods into a local area for consumption, use or sale therein’²¹ are within the sole legislative domain of the State Legislatures. The legislative competence with respect to a number of other indirect taxes is also vested into the State Legislatures²². The tax on inter-state sale and purchase of goods are subject to a Parliamentary law²³ but the levy is administered and the collections thereto appropriated by the States.

Originally, the taxes on the sale of goods were levied in terms of the respective State Sales Tax/Trade Tax enactments (subject to the Central Sales Tax Act, 1956) and the ‘entry of goods’ was subject to tax under the respective State Entry Tax enactments and this scenario prevailed till the reform process set in whereupon these levies were replaced by VAT. The levy of tax on provisioning of services was introduced for the first time in

¹⁸ Article 254 of the Constitution. The Supreme Court of India has formulated certain principles namely the doctrine of (i) ‘repugnancy’, (ii) ‘pith and substance’, (iii) ‘occupied field’, and (iv) ‘severability’, to examine to examine the extent of conflict and declaration of inconsistency. See *Tika Ram v. State of Uttar Pradesh*, AIR 1956 SC 676: 1956 SCR 393 (on ‘repugnancy’ and ‘occupied field’); *State of Uttar Pradesh v. Synthetics & Chemicals Ltd.*, (1991) 4 SCC 139: (1991) 3 SCR 64 (on ‘pith and substance’); *R.M.D.C. (Mysore) Pvt. Ltd. v. State of Mysore*, AIR 1962 SC 594: (1962) 3 SCR 230 (on ‘severability’).

¹⁹ See Report of the ‘Sarkaria Commission on Centre-State Relations’ (‘Sarkaria Commission’) paragraphs 10.2.14 – 10.2.16 delineating the allocation of taxation powers.

²⁰ Entry 54, List II

²¹ Entry 52, List II

²² Such as the ‘taxes on advertisements’ [Entry 55, List – II], ‘taxes on vehicles’ [Entry 57, List – II], ‘taxes on profession, callings and employments’ [Entry 60, List – II], ‘taxes on luxuries, including taxes on entertainments, amusements, betting and gambling’ [Entry 62, List – II], etc.

²³ Central Sales Tax Act, 1956. See also *Tata Iron & Steel Co. Ltd. v. State of Bihar*, AIR 1958 SC 452: (1958) SCR 1355.

1994²⁴ and has been subjected to persisted vigorous legal challenges²⁵. The Act prescribes a list of services²⁶ subject to levy and to be liable to tax, the activity in question must be covered under the definition of one of the enumerated services. This tax is levied and appropriated by the Central Government.

In contrast to these transactional taxes, the Parliament imposes a duty of 'excise'²⁷ upon 'manufacture'²⁸ of goods. As a general rule, the levy is upon a value which is determined in accordance with the statutorily prescribed methodology²⁹ whereas in certain cases it is upon the final price at which the product is sold to the consumer³⁰. Such duty paid on manufacture is available as credit to the next stage manufacturer, but not to a seller or dealer in goods³¹. Thus there is no interaction between the manufacturing stage of commodities and selling stage in as much as the availability of the credit of the duty on inputs is concerned.

²⁴ Under Chapter V of the Finance Act, 1994.

²⁵ The constitutional validity of this levy has been subject to persistent challenge and judicial scrutiny. See *Laghu Udyog Bharati v. Union of India*, AIR 1999 SC 2596: (1999) 6 SCC 418; *Gujarat Ambuja Cements Ltd. v. Union of India*, AIR 2005 SC 3020: (2005) 4 SCC 214; and *All India Federation of Tax Practitioners v. Union of India*, AIR 2007 SC 2990: (2007) 7 SCC 527. The Constitution was amended in 2003 to insert Entry 92C in List – I to provide for 'taxes on services' as a subject matter of legislation for the Parliament.

²⁶ The definitions of these taxable services are provided under Section 65(105) of Chapter V, Finance Act, 1994.

²⁷ Under Central Excise Act, 1944. However the levy of excise duties on (i) alcoholic liquors for human consumption, (ii) opium, and (iii) other narcotic drugs and narcotics are reserved for the State. [Entry 51, List – II].

²⁸ Defined in Section 2(f), *ibid.* See *Union of India v. Delhi Cloth and General Mills*, AIR 1963 SC 791:[1963] Supp (1) SCR 586.

²⁹ Section 4, *ibid.*

³⁰ Section 4A, *ibid.* These valuation rules are popularly known as 'MRP based valuation' as MRP connotes the 'Maximum Retail Price' at which the product can be sold to the consumers.

³¹ The eligibility to obtain credit depends upon the status of the person, in terms of CENVAT Credit Rules 2004, Rule 3 of which allows only the 'manufacturer or producer of final products or a provider of taxable services' to take credit of the duty paid on inputs or capital goods used for manufacture or providing taxable services.

The Current Taxes and their Shortcomings

The principal broad-based consumption taxes that the GST would replace are the CENVAT and the Service Tax levied by the Centre and the VAT levied by the states. All these are multi-stage value-added taxes. The structure of these taxes today is much better than the system that prevailed a few years ago, which was described in the Bagchi Report³² as “archaic, irrational, and complex – according to knowledgeable experts, the most complex in the world”. Over the past several years, significant progress has been made to improve their structure, broaden the base and rationalize the rates. Notable among the improvements made are:

- the replacement of the single-point state sales taxes by the VAT in all of the states and union territories,
- reduction in the Central Sales Tax rate to 2%, from 4%, as part of a complete phase out of the tax,
- the introduction of the Service Tax by the Centre, and a substantial expansion of its base over the years, and
- rationalization of the CENVAT rates by reducing their multiplicity and replacing many of the specific rates by ad valorem rates based on the maximum retail price (MRP) of the products.

These changes have yielded significant dividends in economic efficiency of the tax system, ease of compliance, and growth in revenues.

³² Reform of Domestic Trade Taxes in India, National Institute of Public Finance and Policy, 1994

The State VAT eliminated all of the complexities associated with the application of sales taxes at the first point of sale. The consensus reached among the States for uniformity in the VAT rates has brought an end to the harmful tax competition among them. It has also lessened the cascading of tax.

The application of CENVAT at fewer rates and the new system of CENVAT credits has likewise resulted in fewer classification disputes, reduced tax cascading, and greater neutrality of the tax. The introduction of the Service Tax has been a mixed blessing. While it has broadened the tax base, its structure is complex. The tax is levied on specified services, classified into one hundred different categories. This approach has spawned many disputes about the scope of each category. Unlike goods, services are malleable, and can and are often packaged into composite bundles that include taxable as well as non-taxable elements. Also, there is no standardized nomenclature for services, such as the HSN for goods.

The design of the CENVAT and state VATs was dictated by the constraints imposed by the Constitution, which allows neither the Centre nor the States to levy taxes on a comprehensive base of all goods and services and at all points in their supply chain. The Centre is constrained from levying the tax on goods beyond the point of manufacturing, and the States in extending the tax to services. This division of tax powers makes both the CENVAT and the state VATs partial in nature and contributes to their inefficiency and complexity.

The principal deficiencies³³ of the current system, which need to be the primary focus of the next level of reforms, are discussed below:

A. Taxation at Manufacturing Level

The CENVAT is levied on goods manufactured or produced in India. This gives rise to definitional issues as to what constitutes manufacturing, and valuation issues for determining the value on which the tax is to be levied. While these concepts have evolved through judicial rulings, it is recognized that limiting the tax to the point of manufacturing is a severe impediment to an efficient and neutral application of tax. Manufacturing itself forms a narrow base.

Moreover, the effective burden of tax becomes dependent on the supply chain, i.e., the taxable value at the point of manufacturing relative to the value added beyond this point³⁴. It is for this reason that virtually all countries have abandoned this form of taxation and replaced it by multi-point taxation system extending to the retail level³⁵.

Australia is the most recent example of an industrialized country replacing a tax at the manufacturing or wholesale level by the GST extending to the retail level. The previous tax was found to be unworkable, in spite of the high degree of sophistication in administration in Australia. It simply could not deal with the variety of supply chain arrangements in a satisfactory manner.

³³ Poddar, Satya and Ehtisham Ahmad, *GST Reforms and Intergovernmental Considerations in India*, Working Paper No. 1/2009-DEA, p. 4

³⁴ See Ahmad and Stern (1984) for the definition of effective taxes and applications to India. Bagchi (1994) provides estimates of effective excise tax rates, which are shown to vary from less than one percent to more than 22%.

³⁵ For example, these were precisely the reasons for the replacement of the federal manufacturers' sales tax by the Goods and Services Tax in 1991. See Canada Department of Finance (1987), and Poddar, Satya and Nancy Harley (1989).

B. Exclusion of Services

The States are precluded from taxing services. This arrangement 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. While these problems have been addressed by amending the Constitution to bring such transactions within the ambit of the State taxation³⁶ (by deeming a tax on them to be a tax on the sale or purchase of goods), services per se remain outside the scope of state taxation powers. This limitation is unsatisfactory from two perspectives.

First, the advancements in information technology and digitization have blurred the distinction between goods and services. Under Indian jurisprudence, goods are defined to include intangibles, e.g., copyright, and software, bringing them within the purview of state taxation. However, intangibles are often supplied under arrangements which have the appearance of a service contract. For example, software upgrades (which are goods) can be supplied as part of a contract for software repair and maintenance services.

Software development contracts could take the character of contracts for manufacturing and sale of software goods or for rendering software development services, depending on the roles and responsibilities of the parties. The so-called 'value-added services (VAS) provided as part of telecommunication services include supplies (e.g., wallpaper for mobile phones, ring tones, jokes, cricket scores and weather reports), some of which

³⁶ The Constitution (46th Amendment) Bill 1982 amended Article 366 (29A) of the Constitution to deem a tax on six items to be a tax on the sale or purchase of goods.

could be considered goods. An online subscription to newspapers could be viewed as a service, but online purchase and download of a magazine or a book could constitute a purchase of goods. This blurring also clouds the application of tax to transactions relating to tangible property. For example, disputes have arisen whether leasing of equipment without transfer of possession and control to the lessee would be taxable as a service or as a deemed sale of goods.

The traditional distinctions between goods and services (and for other items such as land and property, entertainment, and luxuries) found in the Indian Constitution have become archaic. In markets today, goods, services, and other types of supplies are being packaged as composite bundles and offered for sale to consumers under a variety of supply-chain arrangements. Under the current division of taxation powers, neither the Centre nor the States can apply the tax to such bundles in a seamless manner. Each can tax only parts of the bundle, creating the possibility of gaps or overlaps in taxation.

The second major concern with the exclusion of services from the state taxation powers is its negative impact on the buoyancy of State tax revenues. With the growth in per capita incomes, services account for a growing fraction of the total consumer basket, which the states cannot tax. With no powers to levy tax on incomes or the fastest growing components of consumer expenditures, the States have to rely almost exclusively on compliance improvements or rate increases for any buoyancy in their own-source revenues. Alternatives to assigning the taxation of services to the states include assigning

to the states a share of the central VAT (including the tax from services), as under the Australian model.

C. Tax Cascading

Tax cascading occurs under both Centre and State taxes. The most significant contributing factor to tax cascading is the partial coverage Central and State taxes. 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.

While no recent estimates are available for the extent of tax cascading under the Indian tax system (although see Ahmad and Stern 1984 and 1991, and Bagchi for earlier work), it is likely to be significant, judging by the experience of other countries which had a similar tax structure. For example, under the Canadian manufacturers' sales tax, which was similar to the CENVAT, the non-creditable tax on business inputs and machinery

and equipment accounted for approximately one-third of total revenues from the tax. The extent of cascading under the provincial retail sales taxes in Canada, which are similar to the State VAT, is estimated to be 35-40% of total revenue collections. A priori, one would expect the magnitude of cascading under the CENVAT, service tax, and the State VAT to be even higher, given the more restricted input credits and wider exemptions under these taxes³⁷. The Service Tax falls predominantly on business to business (B2B) services and is thus highly cascading in nature.

Tax cascading remains the most serious flaw of the current system. It increases the cost of production and puts Indian suppliers at a competitive disadvantage in the international markets. It creates a bias in favor of imports, which do not bear the hidden burden of taxes on production inputs. It also detracts from a neutral application of tax to competing products. Even if the statutory rate is uniform, the effective tax rate (which consists of the statutory rate on finished products and the implicit or hidden tax on production inputs) can vary from product to product depending on the magnitude of the hidden tax on inputs used in their production and distribution. The intended impact of government policy towards sectors or households may be negated by the indirect or hidden taxation in a cascading system of taxes.

D. Complexity

³⁷ Kuo, C.Y., Tom McGirr, Satya Poddar, *Measuring the Non-neutralities of Sales and Excise Taxes in Canada*, Canadian Tax Journal, 38, 1988, provides estimates of tax cascading under the Canadian federal manufacturers' sales tax and the provincial retail sales taxes.

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. Their administration leaves a lot to be desired. 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. There are several factors contributing to this unsatisfactory state of affairs.

The most significant cause of complexity is, of course, policy related and is due to the existence of exemptions and multiple rates, and the irrational structure of the levies. These deficiencies are the most glaring in the case of the CENVAT and the Service Tax. The starting base for the CENVAT is narrow, and is being further eroded by a variety of area-specific, and conditional and unconditional exemptions. A few years ago the Government attempted to rationalize the CENVAT rates by reducing their multiplicity but has not adhered to this policy and has reintroduced concessions for several sectors/products.

The key problem with the service tax is the basic approach of levying it on specified services, each of which generates an extensive debate as to what is included in the base. Ideally, the tax base should be defined to include all services, with a limited list of exclusions (the so-called "negative list"). The Government has been reluctant to adopt this approach for the fear that it could bring into the tax net many services that are politically sensitive.

The complexities under the State VAT relate primarily to classification of goods to different tax rate schedules. Theoretically, one might expect that the lower tax rates would be applied to basic necessities that are consumed largely by the poor. This is not the case under the State VAT. The lowest rate of 1% applies to precious metals and jewellery, and related products—hardly likely to be ranked highly from the distributional perspective. The middle rate of 4% applies to selected basic necessities and also a range of industrial inputs and IT products. In fact, basic necessities fall into three categories – exempted from tax, taxable at 4%, and taxable at the standard rate of 12.5%. The classification would appear to be arbitrary, with no well accepted theoretical underpinning. Whatever the political merits of this approach, it is not conducive to lower compliance costs. Most retailers find it difficult to determine the tax rate applicable to a given item without referring to the legislative schedules. Consumers are even less aware of the tax applicable to various items. This gives rise to leakages and rent seeking.

Another source of complexity under the State VAT is determining whether a particular transaction constitutes a sale of goods. This problem is most acute in the case of software products and intangibles such as the right to distribute/exhibit movies or time slots for broadcasting advertisements.

Compounding the structural or design deficiencies of each of the taxes is the poor or archaic infrastructure for their administration. Taxpayer services, which are a lynchpin of a successful self-assessment system, are virtually nonexistent or grossly inadequate under

both central and state administrations. Many of the administrative processes are still manual, not benefiting from the efficiencies of automation. All this not only increase the costs of compliance, but also undermines revenue collection.

Need for GST

In his budget speech on February 28, 2006, the then Union Finance Minister Dr. P. Chidambaram, emphasizing on the need for GST, said, *“It is my sense that there is a large consensus that the country should move towards a national level Goods and Services Tax (GST) that should be shared between the Centre and the States. I propose that we set April 1, 2010 as the date for introducing GST. World over, goods and services attract the same rate of tax. That is the foundation of a GST. People must get used to the idea of a GST. Hence, we must progressively converge the service tax rate and the CENVAT rate. I propose to take one step this year and increase the service tax rate from 10 per cent to 12 per cent. Let me hasten to add that since service tax paid can be credited against service tax payable or excise duty payable, the net impact will be very small.”*³⁸

Although the government has failed to meet its target of introducing GST on April 1, 2010, still we cannot ignore the need and importance of the proposed GST. Let us one by one look at some factors that reiterate the need for a GST.

³⁸ <http://indiabudget.nic.in/ub2006-07/bs/speecha.htm>

(1) World class tax system: Currently, around 154 countries are having a GST in their system. Time and again, it has been proved that it is probably the most efficient system for indirect taxes. The World Trade Organization (WTO) has also expressed that GST is the way to go. Expressing the importance of simplification and rationalization of tax structure in India, a report on the analysis of a potential Free Trade Agreement between the European Union and India, says, *“Tax structure among the states needs to be simplified, rationalized and streamlined to a large extent so that inter-state differences are minimized. Value Added Tax (VAT) system (allowing a common tax rate in all the states) needs to be adhered by all state governments so that differences in sales tax rates in different states do not prohibit trade and commerce. Over time, instead of several taxes, India could move towards a uniform goods and services tax (GST). Simplification of state legislation and tax bureaucracy would impart more transparency and predictability into the system, leading to an increase in revenue generation, as tax evasion could be minimized and other discrepancies in the tax system eliminated”*³⁹.

The OECD⁴⁰ Guidelines on International VAT/GST (February 2006) also expresses the need for a uniform VAT/GST regime world over for carrying out international trade in an unfettered manner. The Guidelines, under paragraph 5 of Chapter 1 state:

“For the international trade in goods there is a commonly held principle that exports should be exempted and imports should be taxed. This is relatively simple to apply, although even here, complexities of globalization mean that problems can arise.

³⁹ Gasiorek, Michael et al, *Qualitative Analysis of a Potential Free Trade Agreement between the European Union and India – Main Report*, Centre for the Analysis of Regional Integration at Sussex, p.65

⁴⁰ Organization for Economic Co-operation and Development

However, for the international trade in services and intangibles there are no such commonly held principles. Thus, the variations by governments in the application of consumption taxes to this increasing trade have led to obstacles to business activity and distortions of competition significant enough to justify the design of common principles. There is also a shared view, both by governments and business, that the neutrality principle described above should be kept as an objective in the design and implementation of VAT/GST Guidelines.”

On May 25, 2007, at the WTO Trade Policy Review Meeting for India in Geneva, in his reply on behalf of India, Mr. G.K. Pillai said, “A decision has since been taken to integrate all taxes into a single Goods and Services Tax (GST) with full input tax credit for all taxes. Introduction of GST based on VAT principle in line with international best practices is the ultimate goal of indirect tax reforms in India. The design and structure of GST is to be finalized through a process of consultations between the Union and State Governments. The target date for introduction of GST is 1.4.2010”⁴¹. Thus, the importance of GST in meeting the international standards in indirect taxation can never be undermined.

(2) Respite from Tax Cascading: The GST is a distinctive type of tax as it taxes only the monetary value added to a product at different stages of the production process. The significance of such a methodology is that it overcomes the problem of cascading tax that can plague an economy. It is worthwhile to understand the concept of tax cascading. In a hypothetical situation wherein the tax is applied on Product X at each stage and no credit

⁴¹ http://www.inrnews.com/realestateproperty/india/sez/wto_views_on_sez_rebutted_8_bi.html

is available, tax will be charged at each stage whenever a good or service exchanges hands. In other words, tax is applied multiple times and is charged even on the tax which forms part as the inputs. The taxes in such a hypothetical situation will be applicable as follows:

- The manufacturer of Product X purchases number of inputs such as raw materials and equipment during the production process. While purchasing these inputs, the manufacturer pays sales tax.
- When a wholesaler purchases Product X from the manufacturer, the wholesaler pays tax on procurement of Product X.
- Thereafter, retailer purchases product X from the wholesaler and the wholesaler again charges tax.
- Finally, the ultimate consumer purchases the product from the retailer. The retailer again charges a tax.

This layering of sales tax significantly increased the final sales price as each party in the supply chain increases the price of the product to recoup the tax they paid. The cascading effect increases further when tax is paid on tax.

Value-added taxes, such as GST or VAT, overcome the problem of tax cascading through input tax credit mechanisms. Under this system, sellers or vendors of goods and services are eligible to avail tax credits of the amount of GST paid on eligible procurements. Manufacturers avail credits for the GST paid to procure inputs, capital goods, and services used in the manufacturing process. Similarly, wholesalers and retailers avail credits for the GST paid on procurement of stock. However, the final consumer, who

purchases the product for consumption as opposed to using it as input for production or distribution, will not be able to avail and utilize any tax credit⁴².

(3) Double Taxation: The GST will make no differentiation between Goods and Services as the GST is levied at each stage in the supply chain. This ensures to resolve the problems of double taxation. Today, the challenge exists not only within federal taxes of customs duties, excise duties and service tax but also between the federal and State taxes of service tax and VAT. The problem of double taxation was addressed by the Supreme Court of India in the landmark decision of *Bharat Sanchar Nigam Ltd. v. Union of India*⁴³. The Supreme Court had held that the same activity cannot be regarded as both goods and services and hence both service tax and VAT should not be applicable on the same set of transaction. The Supreme Court resolved the paradox of double taxation by following a real or dominant intent theory. The issue was resolved by means of determining the real intent of the contracting parties as to whether they intended to engage in the supplies of goods or the provision of services and then charge the transaction to just one tax. The Supreme Court held that once the intent was determined, the transaction would be charged to one of the two taxes⁴⁴.

However, in spite of the ruling in the aforesaid case, there has been a lot of confusion whether to treat specified activities as goods or services. Implementation of GST will resolve the dilemma of a large number of assesseees who are not sure of application of the type of tax on certain specified transactions mentioned below:

⁴² Rastogi, Abhishek A., *Guide to Goods and Services Tax*, Taxmann, 2010, p.11

⁴³ 2006 (3) SCC 1

⁴⁴ *Supra*, n. 42, p. 13

- Software development and other software products.
- Sale of SIM cards by telecom operators.
- Intangibles such as the right to distribute/exhibit movies, time slots for broadcasting advertisements, copyrights.
- Value added services rendered by telecom operators such as ringtones and cricket scores.
- Online subscription to newspapers.
- Leasing of equipment without transfer of possession and control.

(4) Tax Harmonization: Tax harmonization is a key element and its presence ensures a suitable framework for efficient exercise of taxation powers by both Centre and State. All jurisdictions would be worse off without harmonization and accordingly it should not be viewed as constraining the fiscal autonomy of the Centre or the States. The Central Sales Tax Act which is presently prevalent in India provides a very useful model for tax harmonization. The CST is a tax applicable on inter-state sales of goods and is based on the origin principle. The tax laws are enacted by Union Parliament but the States collect and administer the tax.

Whenever there are different tax rates, a lot of disputes arise due to classification. India witnessed a hoard of classification dispute because there were multiple tax rates in Central Excise Tariff Act and Customs Tariff Act. It is thus suggested that under the GST regime, the tax be levied comprehensively on all goods and services at a single rate to reduce complexity and attain economic neutrality.

Under the unified tax structure, the ideal situation is to have a moderate tax rate and a broad tax base. In various countries where the tax had been levied on a lower on a narrow base, subsequent changes in the base were felt necessary to minimize anomalies and distortions. Accordingly, it is imperative to get the correct structure right from the inception. In India, the service tax base has been significantly widened in the recent past by including wide number of services under the gamut of service tax. With respect to Customs duties, India has taken significant strides towards reaching its aim of achieving equivalency with the rates in ASEAN countries and reduced the Customs duty rates to a large extent. However, India is yet to introduce any environmental taxes or levies⁴⁵.

With the rollout of GST, it is expected that the tax base will be further broadened. The various possibilities to achieve that objective include:

- Negative list for services
- Location based exemption benefits for Excise not to be extended further
- Taxing items under the GST which are presently exempted.
- Covering items under the GST which are non-taxable.

⁴⁵ *Ibid.*, p. 15

CHAPTER – 3

CONSTITUTIONAL FRAMEWORK

Legislative Powers

Part XI of the Indian Constitution deals with the Relations between the Union and the states. Article 245 deals with the distribution of legislative powers between States and Union whereby it states that Union Parliament will have power to make laws applicable to whole of India whereas Legislative Assembly will have power to make laws applicable only within the state which has enacted the law.

Similarly, Article 246 demarcates the domain within which the Union and state can enact laws. Article 246 has to be read along with seventh schedule of the Constitution. Article 246 mentions that Union Parliament has all the power to make laws applicable within India on those subject matters which are incorporated in List I of the Seventh Schedule; State legislature has power to make laws applicable within the state on such subjects which are incorporated in List II of the Seventh Schedule; and both the Union and the state can legislate on any subjects that are incorporated in List III of the Constitution. These three lists are also called Union List, State List and Concurrent List respectively. In the matters which are enumerated in Concurrent list, though both state and Union will have the power to legislate, the law made by the Union Parliament prevails over laws made by state in case of conflict of laws made by state and Union.

Within this constitutional framework, Union can make laws on areas of national defence, naval, military and air forces etc. on administrative fronts as these subjects are enumerated in Union List – List I of Seventh Schedule. On the issues of fiscal legislations, Union has been entrusted to frame laws on inter-state trade and commerce (Entry No.42), banking (Entry No.45), stock markets (Entry No.48), taxes on income other than agricultural income (Entry No.82), duties of exports including export duties (Entry No. 83) etc.

Similarly, within this constitutional framework, State can make laws on areas of police, public orders, prison, criminal justice procedures etc. on administrative fronts as these subjects are enumerated in State List – List II of Seventh Schedule. On the issues of fiscal legislations, State has been entrusted to frame laws on betting and gambling (Entry No. 34), laws on duties of excise on liquor and narcotic drugs (Entry No. 51), taxes on the entry of goods in the local areas (Entry No. 52), taxation on the consumption and sale of electricity (Entry No. 53) and taxes on the sale or purchase of goods other than newspapers (Entry No. 54) etc.

As mentioned above, List – III, i.e., concurrent list has also been incorporated in the Constitution which gives power to make laws to both Union and the State. The laws on price control (Entry No. 34), Weights and Measures (Entry No. 33-A), the laws on electricity (Entry No. 38), and Stamp Duties (Entry No. 44) etc. are the some of the areas where both Union and the States have power to legislate.

With respect to taxation, Indian Constitution provides extra safeguards and conditions. Part XII of the Constitution deals with Finance, Property, Contracts and Suits and Article 265, under Chapter XII, clearly mentions,

“265. No tax shall be levied or collected except by authority of law.”

Therefore, in the matter of taxation, both Union and the State can levy and collect tax after passing an appropriate legislation on the subject.

As the constitution presently demarcates the power between Union and States to formulate even the fiscal legislation on areas of taxation, the main issue that remains to be resolved at priority is integrating these powers at a level which has power to issue GST. In our constitutional framework, the duty of excise (on manufacture of goods), the duty of customs (on imports and exports of goods brought to and out of India), Central Sales Tax (tax on inter-state sale of goods), and Service tax (on delivery and consumption of intangible services) are levied by Union, whereas sales tax on sale of goods within a state, excise duties on alcohol and opium, various cess like mining cess and seigniorage⁴⁶ fees, octroi charges on goods entering to State and entry tax on good brought within local areas are levied and collected by State. Some duties like stamp duties etc. are collected by State though even Union has power to make laws on such subjects like Stamp duties being the subject matter under Concurrent List (List – III) of Seventh Schedule of Constitution. Therefore, any GST which tries to levy taxes on various such areas should

⁴⁶ The profit that results from the difference in the cost of printing money and the face value of that money.

first clear the hurdle of constitutional allocation of power among states and Union to make laws pertaining to various fiscal heads.

Constitutional Amendments

There is a serious need of constitutional amendments for bringing GST alive in India. What are those changes that are required to be brought within constitution depends on what are the subject matters, duties and levies that would be subsumed in GST.

There are deliberations on the matter and mainly two reports have been released outlining what GST would look like and what it may contain within its ambit. We shall discuss those reports as a main theme of our discussion and form any opinions based on the views opinioned in those reports.

The two reports that form the basis of our further assumptions, discussions, postulates and propositions are:

A. First Discussion Paper on Goods and Services Tax in India released by The Empowered Committee of State Finance Ministers released on November 10, 2009 at New Delhi (hereinafter referred as '*First Discussion Paper*');

B. Report of the task force on Goods and Services Tax, released by Thirteenth Finance Commission released on 15th December, 2009 (hereinafter referred as '*Second Paper*').

The first discussion paper was released by the empowered committee of State Finance Ministers. The empowered committee comprised of State Finance Ministers of all states and was headed by Asim Kumar Dasgupta (Chairman, Empowered Committee of State Finance Ministers), also a minister of Finance & Excise, Government of West Bengal.

The report in its very first page makes a comparative claim that VAT being an improvement against then existing state level sales taxes; GST will be a further significant breakthrough, the next logical step, towards, a comprehensive indirect tax reform in the country.

As per the discussion in Para 3.4 of First Discussion Paper in page 19 of the Report, the following central level duties have been recommended to be subsumed in GST at the initiation of GST in India:

- A. Central Excise Duty;
- B. Additional Excise Duties;
- C. The Excise Duty levied under the Medicinal and Toiletries Preparation Act;
- D. Service Tax;
- E. Additional Customs Duty, commonly known as Countervailing Duty (CVD);
- F. Special Additional Duty of Customs – 4% (SAD);
- G. Surcharges; and
- H. Cesses

Similarly, the following state level duties have been recommended to be subsumed in GST:

- A. VAT/ Sales Tax;
- B. Entertainment Tax (unless it is levied by the local bodies like Municipality or Village Panchayat);
- C. Luxury Tax;
- D. Taxes on lottery, betting and gambling;
- E. State Cesses and Surcharges in so far as they relate to supply of goods and services;
- F. Entry Tax not in lieu of Octroi;

After going through the proposed list of taxes which are to be subsumed in GST, the following constitutional amendments should be effected before introduction of GST:

1. The State should be empowered to levy and collect duty of excise (chargeable on manufacture of goods);
2. The State should be empowered to levy and collect service tax on provisions of services;
3. The Union should be empowered to levy taxes on such activities which are currently in the State List.

Above three are the basic requirements to make GST implementable in India and this requires substantial constitutional amendments in various Articles of Indian Constitution

as well as List I, II, and III in Seventh Schedule be amended. Regarding the requirement of Constitutional Amendment, the First Discussion Paper in Para 1.14⁴⁷ underlines the necessity of constitutional amendments. While outlining the introduction of service tax⁴⁸, the Report states that a suitable constitutional amendment should be brought giving power to state to tax all services, which till now, is only with Union.

⁴⁷ 1.14 In the existing State-level VAT structure there are also certain shortcomings as follows. There are, for instance, even now, several taxes which are in the nature of indirect tax on goods and services, such as luxury tax, entertainment tax, etc., and yet not subsumed in the VAT. Moreover, in the present State-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under State VAT, and contributing to that extent a cascading effect on account of CENVAT element. This CENVAT load needs to be removed. Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be integration of VAT on goods with tax on services at the State level as well, and at the same time there should also be removal of cascading effect of service tax. In the GST, both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level is established which reduces the burden of all cascading effects. This is the essence of GST, and this is why GST is not simply VAT plus service tax but an improvement over the previous system of VAT and disjointed service tax. However, for this GST to be introduced at the State level, it is essential that the States should be given the power of levy of taxation of all services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment will be made for giving this power also to the States. Moreover, with the introduction of GST, burden of Central Sales Tax (CST) will also be removed. The GST at the State-level is, therefore, justified for (a) additional power of levy of taxation of services for the States, (b) system of comprehensive set-off relief, including set-off for cascading burden of CENVAT and service taxes, (c) subsuming of several taxes in the GST and (d) removal of burden of CST. Because of the removal of cascading effect, the burden of tax under GST on goods will, in general, fall.

⁴⁸ Article 265 of the Constitution lays down that no tax shall be levied or collected except by the authority of law. Therefore, every taxing activity should be backed by proper legislation. Service tax was introduced in India for the first time in 1994 under Finance Act, 1994. The Act was enacted by Union under Article 246 and under Article 248 of Constitution of India read along with Entry 97 of List I in Seventh Schedule of Constitution and was made applicable whole of India except State of J & K. The Entry 97 mentions, "*Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.*"

Therefore, taxes on services, not being under any entry in List II and III, was the subject matter covered by Entry 97 of List I, which is also called 'Residuary Entry'. However, later, the Union felt to give a strong constitutional backing to the levy and collection of service tax and hence, Article 268A has been inserted into the Constitution of India for Service Tax levy by Union Government, and collected and appropriated by the Union Government and the State Government as prescribed under the law made by the Parliament. Similarly, Entry 92C has been introduced in the Constitution in Entry - I of Seventh Schedule whereby Union is empowered to enact law on taxation of services. These Constitutional amendments were brought by the Constitution 88th Amendment Act, which came in effect from 15th January, 2004. Not only for the taxes but for cesses which are imposed on amount of service tax collected by Union, constitutional amendments were brought in Article 270 authorizing the levy of collection of cesses on service tax vide 88th Amendment of Constitution.

While discussing the GST on imports, the First Discussion Paper in Para 3.8⁴⁹ emphasizes on the need of Constitutional Amendments empowering states to tax imports of goods and services into India. Under the present constitutional set up, imports and exports of goods into and from India is governed by Customs laws of India and only the Union is empowered to tax. Similarly, any taxation of imports and exports of services also vest in the Union.

In reply to Question No. 18 in Page 52 of the Report⁵⁰, the First Discussion Paper underscores the essentiality of constitutional amendments for empowering Union to levy tax on sale of goods, which essentially means empowering Union to levy tax on sale of goods within a state and sale of goods outside state.

With respect to Constitutional issues, and the amendments required, the second Paper also outlines some of the issues and suggests how it can be streamlined. While making its

⁴⁹ **3.8 GST on Imports:** The GST will be levied on imports with necessary Constitutional Amendments. Both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

⁵⁰ **Question 18 : Why does introduction of GST require a Constitutional Amendment?**

Answer : The Constitution provides for delineation of power to tax between the Centre and States. While the Centre is empowered to tax services and goods upto the production stage, the States have the power to tax sale of goods. The States do not have the powers to levy a tax on supply of services while the Centre does not have power to levy tax on the sale of goods. Thus, the Constitution does not vest express power either in the Central or State Government to levy a tax on the 'supply of goods and services'. Moreover, the Constitution also does not empower the States to impose tax on imports. Therefore, it is essential to have Constitutional Amendments for empowering the Centre to levy tax on sale of goods and States for levy of service tax and tax on imports and other consequential issues. As part of the exercise on Constitutional Amendment, there would be a special attention to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the powers of the Centre and the States in a federal structure.

suggestion in Para 11.10⁵¹, the Second Paper stresses on flawless GST mechanism and suggests constitutional amendments in such a way that enables both the Centre and the States to exercise concurrent jurisdiction over the taxation of all goods and services, and creation of the proposed Council of Finance Ministers as constitutional body at the helm of the affairs of managing, and implementing GST uniformly across the states. The Council is recommended to be responsible for any modification in the initial design of the dual GST and regulating the indirect tax system in the country.

While deliberating on the first suggestion, the emphasis is on removing all the entries relating to taxation which would be brought to GST from List – I and List – II of the Seventh Schedule and inserting all such entries and a consolidated entry of ‘Taxes on Goods and Services’ in List – III, Concurrent List under Seventh Schedule. This gives concurrent jurisdiction to the state and the union to tax goods and services. However, this amendment may not work well as there is likelihood of conflicts among the union and the states and ‘the law made by union prevails over the state’ concept may destroy the whole purpose of GST. In any case, entries under Schedules are not the empowering blocks under Constitution to authorize union or states to enact laws, the empowerment must come through appropriate Articles. Hence, there would be necessity of suitable constitutional amendments in Articles 245, 246, 248 and 268A.

⁵¹ **11.10** Further, in order to implement the ‘flawless’ GST it would be necessary to undertake constitutional amendments to enable both the Centre and the States to exercise concurrent jurisdiction over the taxation of all goods and services, creation of the proposed Council of Finance Ministers and assignment of part of the GST proceeds to the third-tier of government. These amendments must, inter alia, provide that the taxation of goods and services by both the Centre and the States should be a consumption-type, destination based GST.

In its recommendation, the Second Paper also highlights the necessity of amendments of Article 287 and Article 288 of the Constitution so as to enable Union and States to levy of GST on supply of electricity to Government at all levels like any other normal goods⁵².

The Approach

The Constitution provides for an elaborate procedure for effecting a Constitutional Amendment. The procedure to be followed depends on the nature of Constitutional Amendment. The ordinary procedure to pass a Constitutional Amendment involves, firstly introduction of the amendment bill in either house of the Parliament, secondly the bill being passed in each house by a majority of total membership of the house and a majority of not less than 2/3rd of the members of that house present and voting and lastly obtaining the Presidential Assent⁵³. However with respect to the implementation of GST, the Constitutional Amendment involves rearrangement of powers in the Seventh Schedule to the Constitution. Since the Amendment affects the "Entrenched Provisions"⁵⁴, the Constitution requires a ratification of not less than half the no. of states apart from the abovementioned ordinary procedure, to pass a valid Amendment. In this context it is imperative to answer few questions that are likely to arise in passing the aforementioned Constitutional Amendment.

⁵² Dahal, Rajib, *Goods & Service Tax in India: Concept & Constitutional Framework*, Social Science Research Network. (Electronic copy available at <http://ssrn.com/abstract=1596522>)

⁵³ Article 368

⁵⁴ *Ibid.*

Firstly, it is not disputed that GST regime will imply a national levy replacing the power of the States to levy sales tax. If that be the scenario, then is the procedure laid down in Article 368, requiring ratification of only half the no. of states, sufficient to take away all the 28 States' power to levy sales tax? In other words can the interest of 28 States be jeopardized at the consent of merely 14 States?

Secondly, considering that the answer to the abovementioned question is in the affirmative; will the scheme of single national levy in the guise of GST suit Indian conditions? The Empowered Committee, the ICAI⁵⁵, the CII⁵⁶ etc have answered this question in the negative. On a detailed study conducted by various organizations, there is a consensus to the opinion that India should work on a dual system wherein, CENVAT and tax on few services shall be levied by the Centre and VAT and tax on rest of the services be levied by the States thereby phasing out CST completely. Considering the above resultant reworking in the policy the obvious question that would arise is, is the object behind the implementation of GST defeated? In other words, will a dual policy of the above nature facilitate efficiency and reduce complications that are present in the existing tax regime? At this juncture it is definitely not possible to answer this question in the negative.

Thirdly, overcoming the both the aforementioned hurdles if the Constitutional Amendment is passed, will it survive the test of Doctrine of Basic Structure? It is a well-settled law that no Constitutional Amendment can claim immunity from judicial review

⁵⁵ The Institute of Chartered Accountants of India

⁵⁶ Confederation of Indian Industries

and that it has to pass the test of Basic Structure.⁵⁷ Doctrine of Basic Structure is considered as the highest watermark of judicial creativity. Though the Hon'ble Supreme Court has listed out the basic features of the Constitution, it is well settled that it has to be determined on a case-to-case basis.⁵⁸ In this background it is imperative to mention here that distribution of powers between the Centre and State marks the federalist nature of our Constitution, which in turn is a basic feature of our Constitution.⁵⁹ In this background it can't be said with certainty that the Constitutional Amendment will survive the test of Basic Structure since it seeks to strengthen the Centre by reducing the States as mere agents to collect tax on behalf of the Centre.⁶⁰

⁵⁷ *Minerva Mills v. Union of India*, AIR 1980 SC 1789

⁵⁸ *Keshavananda Bharathi v. State of Kerala*, AIR 1973 SC 1461

⁵⁹ *Ibid.* Also in *S.R. Bommai v. Union of India*, AIR 1994 SC 1918

⁶⁰ Divakar, Kavitha, *Goods and Services Tax: The Road Ahead*, The Institute of Chartered Accountants of India, 28/03/2008.

CHAPTER – 4

THE DESIGN

Different countries adopt different models for taxing goods and services to suit their own situations. Vast majority of countries, during last 50 years, have moved to destination based system for taxation of goods and services. Some start at the origin and follow the goods through its journey from origin to destination e.g. countries in the European Union, Australia, Canada whereas some levy tax at retail level (e.g. USA). More than 100 countries have adopted Value Added Tax (VAT) system with input tax credit mechanism covering transactions from origin (manufactured or imported into the country) to destination (final consumption). The VAT system adopted by countries varies from what could be described as “classic” VAT system encompassing all transactions of sale/supply of goods and services in the economy at all levels, from manufacturing to consumption, to modified versions applicable only to select goods and/or services, applied upto different stages of value chain.⁶¹ The design of model depends a great deal on the nature of activities in the economy, level of growth of economy, sizes of businesses, political structure, constitutional powers, stage of advancement of the economy and like. No one model can be said to be ideal for all countries. Thus, India will have to design its own model to suit its own requirements especially, given the federal structure of governance and the provisions of Constitution.

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http://www.eircicai.org/admin/resources_files/_EIRC_a37d434c990d376974fd6e4b93133cc802db14cc.pdf

India's Current Model

India currently has a mixed system of taxation of goods and services; it is not "classic" VAT or GST system although the taxes on goods are described as "VAT" at both Central and State level on goods and it has adopted value added tax principle with input tax credit mechanism for taxation of goods and services. Until introduction of Modvat (now CENVAT) Scheme in 1986 in Central Excise Duty, that duty was an origin based single point taxation system on manufacture of goods with some exceptions where set off scheme was used to reduce cascading effect of taxes. At that time, at State level, variety of schemes were used like origin based single point system, multi point system with set off, last point (retail level) system and so on. This was, again, not standard even within a state. States adopted different systems for different commodities too. Even now, with introduction of State VAT, there is combination of origin based (Central Sales Tax) and destination based multi point system of taxation. CENVAT is only at manufacturing level and does not go upto retail level.⁶²

Similarly, there was no union level tax on services till introduction of Service Tax in 1994 although, there was and there continues selective levy by States of Service Tax on specified services like entertainment tax, electricity duty. Even now, Union Service Tax is not comprehensive; it is levied on large number of select services and there is no comprehensive Service Tax at State Level. The "VAT" at Union as well as State Level is on goods only except that at the Union level there is input tax credit mechanism between CENVAT and Service Tax.

⁶² *Ibid.*

Principal differences between the current structure and classic VAT are:

- Two separate VAT systems operate simultaneously at two levels, Centre and State, and tax paid under one is not available as set off (input tax credit) against the other;
- Tax on services and on goods is under separate legislations at Centre Level;
- There is no comprehensive taxation of services at the State level – few services are taxed under separate enactments;
- Imports in the country are not subjected to VAT.

Current structure of indirect taxes is, thus, in a sense, dual one where tax on activity of manufacture and provision of services is collected by Union Government and that on sale of goods is collected by State Governments. Finance Commission determines the overall and individual share of states in the taxes collected by Union. The overall share of states in taxes at present is 30.5 %⁶³ of the total taxes collected by Union Government from all taxes, i.e., direct and indirect.

GST – Alternative models and issues

Design of a GST model involves three key components:

- Determination of the system – origin based, destination based, single point, multi point and so on.

⁶³ Recommendations of the Twelfth Finance Commission

- Identification of activities and/or goods and services to be covered under each system.
- Determination of level of government imposing and collecting GST.

There is a fair degree of consensus in India so far as system is concerned; we have adopted and are moving towards consolidation of goods and services tax under destination based multi point system of taxation. Also, there is fair degree of consensus so far as coverage of activities and goods and services are concerned; we will, like most other countries, continue to have customs duty which would not be rebatable and rest of the principal taxes i.e. CENVAT, State VAT and Service Taxes would form part of proposed GST.

Few other issues remain to be addressed like whether stamp duty should also become part of GST, which are other taxes being levied by each of the states and to determine whether they should become part of GST or remain out of it. Stamp duty, being more in the nature of tax on property, rather than on transaction, ought to remain outside GST as is the position in other countries. However, to the extent, stamp duties are imposed on agreements involving sale of goods and/or provision of services (e.g. agreement for works contract in the State of Maharashtra), the same ought to be removed. Similar other issue relates to octroi duty which is currently levied by various municipalities and, in some cases, by states on entry of goods in the local area for use, consumption or sale therein. This also ought to be merged with GST and a mechanism to transfer resources to local authorities from out of the total revenues of the states needs to be worked out.

There is a third key component on which consensus building is in progress. This component of the design is relevant for a country having federal structure of governance (e.g. Canada, Brazil or, for that matter, even European Union).

There are three alternatives in this context:

- GST at Union Government Level only (Alternative I)
- GST at State Government Level only (Alternative II)
- GST at both, Union and State Government Levels (Alternative III)

Canada has GST at Union Level extending to all goods and services covering all stages of value addition. In addition, there is tax at province (state) level in different forms which include VAT, Retail Sales tax and so on. European Union (EU) nations (each one is independent nation but, part of a Union and have agreed to adopt common principles for taxation of goods and services) have adopted “classic” VAT. If we consider EU as a country equivalent and member nations as state equivalents, EU has only State Level VAT with special rules for intra-community (inter-member state) transactions.⁶⁴

In Indian context, an additional dimension is added by the provisions of Constitution which specifically reserve power to impose tax on specific activities to specific level of government e.g. tax on import of goods can be imposed by Union government only

⁶⁴ *Supra*, n. 61

whereas tax on sale of goods involving movement of goods within the state can be imposed by State Governments only.

The Analysis

ALTERNATIVE I: GST AT UNION LEVEL ONLY

This Model envisages principal indirect taxes on goods and services to be levied by Union Government only. No such taxes to be levied by State Governments leading to only one GST throughout the country.

Pros

- Ideal structure from business perspective – greater stability and facilitation of decision making – also, businesses will have to deal with only one tax authority and comply with only one tax- there will be significant reduction of compliance costs.
- Excellent from consumer perspective as the consumer will know exactly how much is the indirect tax burden in the goods and service consumed by it.
- Cascading effect can be removed to a large extent as there will not be taxes at two levels leading to improved competitiveness.
- Feel good factor for any one doing business with the country.

Cons

- Near impossibility of achieving the structure – will require modification of Constitution.
- States may not agree to give up power of taxation and depend on the Union for resources.
- Entire infrastructure developed for taxation at both levels will have to undergo huge change.

ALTERNATIVE II: GST AT STATE LEVEL ONLY

This Model envisages levy of GST by State Governments only meaning only State specific GST across the country and no GST by Union Government.

Pros

- Reduction of cascading effect of taxes as there will not be tax at two levels.

Cons

- Amendment(s), will be required in Constitution which may be supported by industrial and large states and opposed by smaller states which do not have significant source of revenues.
- Businesses will have to comply with tax laws of each State – not worse off than current situation but not better off as well except that they will not have to deal with Central Level taxation which is the current position. At the same time, decision making will be impacted and may affect business stability.

- Governments, both local and Union will not find it workable as it will require complete change in its finances and allocation of resources - entire distribution of taxes will need to undergo changes - Centre can retain entire direct tax collection and States may retain indirect taxation collection . But, that too will not be workable as revenue collection by each state will vary depending on the level of activities in each state and need for support to states – redistribution of taxes will become an issue.
- There may be unhealthy competition among states using local tax structure as a tool to attract investments within the states, which may be at the cost of other states. This could lead to retaliatory measures by other states.
- Entire infrastructure for taxation will have to undergo change as States will need additional resources, whereas, Union’s infrastructure will be freed up.

ALTERNATIVE III: GST AT BOTH LEVELS

This model envisages GST at two levels operating parallelly – one, at Union Level and another at State Level.

Pros

- Achievable in the short term.
- No significant change required in the current structure of indirect taxation although, some amendments may be required to the Constitution.
- Partial removal of cascading effect of taxes.

- No change required in infrastructure of tax departments at the Union and State levels.

Cons

- Not ideal model – tax would continue to be at two levels and compliance costs may not reduce significantly.
- Constitutional amendments may be required – principal one being extension of CENVAT to the consumer level and granting authority to states to impose taxes on Services.
- Uncertainty of states changing laws, rates of taxation and like will continue affecting business sentiments.
- Taxation of services at state level especially services provided nation wide (e.g., telecommunication service, transportation service) will pose challenge.

SUGGESTED GST MODEL

I suggest that Alternative III - GST at two levels – Union and State operating parallelly be adopted to begin with this reform process. Although, it is not an ideal Model, I recommend the same to kick start the move to GST as:

- It is the most workable model especially taking into consideration the changes required in the Constitution and achievability in the short term.
- This Model builds on the current structure of taxation of goods and services and does not envisage drastic changes in the broad mechanism for levy and collection of taxes.

- It results in allocation of taxes between Union and States and between states based on fair and transparent criteria of consumption within a state.

Systems of GST

Apart from the GST models, it is important to understand the systems of GST as well. The various prevalent systems of GST primarily revolve around issues pertaining to availment of credits and payment of taxes. The three systems prevalent internationally are:

(1) Invoice System: In the invoice system, the GST (Input) is claimed on the basis of invoice and it is claimed when the invoice is received, it is immaterial whether payment is made or not. Further the GST (Output) is accounted for when invoice is raised. Here also the time of receipt of payment is immaterial. One may treat it as mercantile system of accounting. In India the present system of sales tax on goods is an invoice system of VAT and here it is immaterial whether the taxpayer is following the cash basis of accounting or mercantile basis of accounting. The advantage of invoice system is that the input credit can be claimed without making the payment. The disadvantage of the invoice system is that the GST has to be paid without receiving the payment.⁶⁵

(2) Payment System: In the payment system of GST, the GST (Input) is claimed when the payment for purchases is made and the GST (Output) is accounted for when the payment is made. In this system, it is immaterial whether the assessee is maintaining the

⁶⁵ *Supra*, n. 42, p. 101

accounts on cash basis or not. The advantage of cash invoice system is that the Tax (output) need not be deposited until the payment for the goods and/or services is received. The disadvantage of the payment system is that the GST (input) cannot be claimed without making the payment. The Taxes on services in India are based on this payment system since service tax is payable on receipt basis and further CENVAT credit is only allowable when payment of the service is made. In some countries, this system is also adopted for small traders to keep them away from the complexities of the Invoice system, which is purely a mercantile system.⁶⁶

(3) Hybrid System: In hybrid system the GST (Input) is claimed on the basis of invoice and GST (Output) is accounted for on the basis of payment, if allowed by the law. In some countries the dealers have to put their option for this system or for a reversal of this system before adopting the same. This system is the most beneficial one from the aspect of the assessee as the credit can be taken immediately on receipt of an invoice but the tax needs to be discharged only after the payment for the supplies is received.

It always depends on the law of the country, which decides the system of GST to be followed by the dealers.

⁶⁶ *Ibid.*

CHAPTER – 5

THE CHALLENGES

It must be understood that that the actual challenge is not of drafting a model GST but of its proper implementation and smooth transition from the extant regime. India's march towards globalization necessitated widespread economic changes in Indian financial system, capital market, insurance sector, foreign exchange regulations, etc. with a view to attract more investments in the manufacturing and service sectors. From both domestic and foreign investment perspective a suitable reform in Indirect tax was required to do away with the multiplicity of taxes thereby reducing cumbersome compliance, high cost of transaction and nagging uncertainty in tax liability for a business. Simple taxation regime will not only relieve the business from being a tax-driven model but also give it a space to grow on its own.

Issues relating to the model of the GST system have been discussed in the previous chapter. Apart from other issues, some specific issues relating to the design of the system will also be discussed in this chapter. The dual GST model proposed for India comprises of Central GST and State GST being administered simultaneously on supply of goods and services. In its wake, Government has several challenges to tackle. Most concerns express about the implementation of GST can broadly be divided into three categories:

A. Design Issues

B. Operational Issues

C. Infrastructural Issues

Let us now one by one take up the different challenges under these broad categories.

A. Design Issues

What should be the design of the GST ? The broad framework of GST is now clear. This is on the lines of the model approved by the Empowered Committee of the State Finance Ministers. The GST will be a dual tax with both central and State GST component levied on the same base. Thus, all goods and services barring a few exceptions will be brought into the GST base. Importantly, there will be no distinction between goods and services for the purpose of the tax with a common legislation applicable to both.

However a number of issues remain to be resolved. These are presently under the consideration of the Empowered Committee under the Chairmanship of Dr Asim Dasgupta, the distinguished Finance Minister of West Bengal. These issues include :

(1) The rate structure and value

The primary concern of all State governments is protection as well as enhancement of existing revenue streams. There are three parameters which need to be balanced here – one is the range of taxes presently being levied which will be subsumed into the GST. This will determine the tax base of the GST. The other two parameters are the number of rates and the numerical value of these rates which will be applied to this base .

All indirect taxes on the supply of goods and services would need to be subsumed into the GST. The Empowered Committee in its road map of Dec 2008 has indicated which taxes which will qualify. The Finance Commission had appointed a Task Force to advise the Commission on the implementation of GST. For the purpose of computing the Revenue Neutral Rate the Task Force assumed that apart from VAT, stamp duty, vehicle tax, taxes on goods and passengers, taxes and duties on electricity, entertainment tax, entry tax, luxury tax, taxes on lotteries, betting and gambling, purchase tax as well as all State cesses and surcharges will be subsumed into the State GST. Central Sales tax will stand abolished. From the government of India side, Central excise, additional excise duties, service tax, Additional Customs duty (CVD), and all cesses and surcharges (other than educational cess) will be subsumed into the Central GST.⁶⁷

There appears to be agreement that the best option would be a bare minimum number of rates, at best two, preferably one. We assume that a single rate structure will find favour with a very limited set of exemptions available for basic food grains as well as basic education and health services. This single rate will ensure low compliance costs, obviate classification disputes, and ensure uniformity of approach amongst all players. But to be attractive, a single rate cannot be too high. At the same time, the rate must be high enough to address the concerns of States regarding revenue neutrality.

⁶⁷ www.allindiantaxes.com/doc/c3e32b3d.doc

Using data from about 18.25 lakh business entities for the year 2007-08, the Task Force had generated very interesting data relating to the GST rate which will maintain the same level of income for the centre and States respectively in a minimal exemption regime. Their preliminary calculations suggest that Revenue Neutral Rate will be substantially below the combined Central and State rates. It is necessary that these and similar calculations which may have been made by other stakeholders be published for debate and examination. States also need to satisfy themselves that not only will the GST rate applied be revenue neutral nationally but also individually and wherever this is not initially so, adequate compensation provisions are made. This public scrutiny will thus ensure that a reasoned view is taken on the rate to be applied as well as on the exemption regime which should be adopted.⁶⁸

(2) Rules of supply for goods and services

While CST will be abolished in the GST regime, the treatment of inter state sales will need to be carefully thought through. It would be necessary to guard against tax arbitrage where local sales which will be taxed could be shown as inter state sales which will not. The CST Act provided for documentation to attest the interstate nature of the sales. A number of models have been examined by the Empowered Committee which will serve as alternatives. Since the final model adopted would have a direct bearing on the ease of inter state trade transactions as well as the compliance cost, it would be very beneficial that all trade and industry associations involve themselves in this choice through voluntary submissions of their views to the Empowered Committee.

⁶⁸ *Ibid.*

Putting in place the Rules of Supply for the inter state provision of services will be demanding. Services produced and consumed within the same State would not pose a problem as far as the appropriation of taxation proceeds is concerned. However, some services may be supplied from one State, consumed in another and paid for in a third State. A set of rules to determine the taxation jurisdiction and appropriation would need to be worked out. There is adequate international precedent for this but here again, trade and industry associations could take proactive steps to suggest possible options.⁶⁹

(3) The framework for exemptions, threshold and composition

The existing sales turnover thresholds for VAT taxation vary widely across States. Some small States have specified a threshold turnover of Rs 2 lakhs per annum. Larger States have stipulated Rs 40 lakhs per annum. The turnover range for composition eligibility is equally diverse. The list of exempted goods also differs across States. To allow for uniform treatment of inter state transactions nationally, it may be necessary that these variations be bridged so that tax cascading is eliminated. However, the concerns of smaller States need to be kept in mind. For this reason, perhaps such convergence could be targeted over a certain period of time rather than immediately.⁷⁰

B. Operational Issues

⁶⁹ fincomindia.nic.in/writereaddata/html_en_files/FICCI121009.pdf

⁷⁰ www.goodsandservicetax.in/news/view-gst-feed.asp?ID=23

(1) Common Approach

For GST to be successful, all States and the Centre should implement it in a similar fashion. Only this will bring about the national common market which is one of its goals. This will be possible when there will be a common law, a common assessment procedure and perhaps even a common return. The Empowered Committee can provide the required leadership to engender this uniformity of approach between all the States amongst themselves and also with the Union government.⁷¹

(2) Sharing of information

Recent experience relating to revenue collections from the Central Sales Tax have raised the issues relating to tax arbitrage. It appears that local sales under the VAT regime are being shown as lower taxed CST sales leading to revenue loss. Some States have expressed concerns and referred to tax evasion in developed countries which have a VAT in place. They have sought reassurance that revenue leakage would be effectively checked in the GST system. Apart from putting in place a comprehensive IT network, sharing of tax related information and coordination amongst all the States will be crucial for this. Perhaps the Empowered Committee could set up a coordination mechanism to address such concerns. Trade and industry bodies also have a strong role to play in curbing such malpractices.⁷²

⁷¹ www.servicetaxcounsellor.com/20.10.2009.pdf

⁷² *Ibid.*

C. Infrastructural Issues

(1) IT Infrastructure

A simple system for inter-state verification of dealers and transactions is essential to ensure tax compliance and check avoidance. It will also be essential for enforcing the rules of supply discussed earlier. Given the volume of such transactions, this system necessarily has to be IT based. The present system Tax Information Exchange System (TINXSYS) does not appear to be fully operational across all States. There are asymmetric benefits to States in putting in place such infrastructure and this appears to be affecting their incentives to do so. We need to put in place a system which will uniformly incentivize all States to participate in and contribute to the verification system. Or alternatively, one central agency could be charged with maintaining this system. Both the alternatives available are challenging, but this needs to be done.⁷³

(2) Check posts

Most States have put in place a system of check posts on its road borders. Apart from other verifications which may take place, these check posts verify and document inter-state sales of goods carried by the vehicles which cross these borders. These details are then cross verified with the VAT returns of the importing dealers. The need for such an arrangement to continue in the GST regime has been emphasized, especially in view of the abolition of CST and the possibility of tax arbitrage. However, the fact remains that such check posts by the very nature of their operations, generate enormous delays in road

⁷³ *Supra*, n. 69

traffic, sometimes upto three hours per check post. A freight truck travelling by road between Delhi and Chennai will need to cross five State borders and ten check posts. Delivery times for goods may be extended significantly because of delays at check posts. The arrangement also encourages rent seeking behavior.

It may be difficult to eliminate check posts given the valid concerns of State governments which may extend beyond collection of taxes and movement of goods to vehicle fitness examination, prevention of trafficking, collection of local cesses, etc. But what appears to be egregious is that the same vehicle has to pass through two check posts while crossing one border – the exporting States check post and the importing States check post. Both these check posts are often located within a couple of kilometers of each other and a vehicle driver has to spend considerable time in both. Perhaps, it may be possible for both the States to put up a combined check post. Officials of both States could sit together and conduct their verifications in one check post. Or one State could handle traffic on one direction and the other State in the other direction. But essentially there would be only one check per border for a goods vehicle. Such an arrangement will significantly reduce travel time. The Finance Commission is prepared to support creation of such check posts if the respective State governments are willing to operate jointly.⁷⁴

(3) Impact on small enterprises

⁷⁴ *Supra*, n. 70

The impact of GST on small enterprises is often cited a concern. On the State GST component, the position will be exactly the same as under the present VAT regime. There will be three categories of small enterprises in the GST regime. Those below the threshold need not register for the GST. Those between the threshold and composition turnovers will have the option to pay a turnover based tax or opt to join the GST regime. Given the possibilities of input tax credit, not all small enterprise may seek the turnover tax option. The third category of small enterprises above the turnover threshold will need to be within the GST framework. Possible downward changes in the threshold in some States consequent to the introduction of GST may result in obligations being created for some dealers. In such cases suitable provisions could be made to provide direct assistance to the affected small enterprises if considered desirable . In respect of Central GST, the position is slightly more complex. Small scale units manufacturing specified goods are allowed exemption of excise upto a turnover of Rs 1.5 crores. These units, which may be required to register for payment of GST, may see this as an additional cost.⁷⁵

Other Challenges

Apart from these three broad categories, there are many more challenges in the way of the effective implementation of GST. Some of these challenges have been discussed here.

(1) Revenue Sharing Arrangement

⁷⁵ *Ibid.*

Presently most of the States need substantial share in the central taxes apart from revenue raised at their own level under constitutional power. This is due to imbalance economic development and other reasons. The dual GST model will off set certain industry from Centre to States thereby reducing revenue generation for the Centre. Accordingly, the Centre will have to depend on the revenue from the revenue-rich States to share with revenue-low States. The challenge is multi-fold – proper revenue accounting and collection, technological up-gradation, revamping banking channel for State-wise revenue allocation, political support, etc. Due to the inherent need of different States for revenue, any new tax regime to be successful, it must ensure that the States get their requisite revenue for proper governance and development. With the growth of economy, the need for revenue would be constantly on the rise and the Central Government will have to do a balancing act between the revenue-rich States and revenue-low States by properly sharing the revenue as per their needs. Over a period of time the States may demand a constitutional arrangement for revenue sharing mechanism.⁷⁶

(2) Effective Credit Mechanism

If for any reason the proposed dual GST model does not allow credit of State GST in respect of inter-State transactions, it will lead to increase in cost and cascading effect of multi-stage taxation and give rise to lopsided market in Indian economy. The challenge for the Government is to introduce a seamless mechanism of credit across India. The success of dual GST model will depend on effective credit mechanism to avoid cascading effect of multi-stage taxation in the supply chain. The credit mechanism is the lifeline of GST. As far as Central GST is concerned, there is no difficulty in giving credit of Central

⁷⁶ <http://www.caclubindia.com/forum/goods-and-service-tax-58223.asp>

GST anywhere in India as is evidenced by success of the present CENVAT scheme. But, in case of State GST presently there are issues in giving credit in relation to inter-State transactions. If the new tax regime is going to convert India into an economic union, then Federal structure should not come in the way of giving credit. The challenge is to treat both the Centre GST and State GST as one receipt or kitty to make way for credit across India in a seamless manner. Government should make full fungibility of credit of State GST. Moreover, the credit should be allowed for all inputs, raw materials, capital goods, input services and all business expenses treating the business entity as a unit since GST is a broad based tax. It is therefore essential to define input and input services liberally so that the credit mechanism is litigation-free. Otherwise a single litigation issue at any point of supply chain will affect all the following points in the supply chain.⁷⁷

(3) Tax Administration

GST has more to do with a better administration than the concept. Conceptually, it entails taxation of any value addition. The scheme of GST is only successful if there is a better administration of the taxes. Thus, the proposed reform is not of the law, but of the administration. If the administration infrastructure is not present there will be a pitfall. Thus, it is important that the administrators learn from the other countries that have already implemented the GST. No policy exists until it is implemented, and the manner of implementation determines the impact. To put in the words of *Casanegra de Jantscher*⁷⁸, “*tax administration is tax policy*”.

⁷⁷ finmin.nic.in/TFC/Chapter5.pdf

⁷⁸ American tax and finance expert and author.

For the successful implementation of GST, it is imperative to have an efficient and robust tax administration. Although various improvements have been recently made in the tax design and administration over the past few years such as Large Taxpayer Unit (LTU) Scheme and Automation in Central Excise and Service Tax (ACES), the systems at both central and state levels remain complex. The tax systems suffer from substantial compliance gaps, except in the highly organized sectors of the economy.

At the time of implementation of GST, steps should be taken to achieve the following common objectives:

- Simple design of tax forms
- Easy procedure for registration and filings
- Minimum record keeping requirements
- Facilitation of voluntary compliance
- Improvement of the organizational capability of the tax administration
- Strengthening of the legal system
- Reduction of unethical practices
- Automation and electronic filing

Thus, the administrative reforms are critical to a successful implementation. Reforms in tax administration should be examined within the following practical areas:

- Functions and staffing
- Process re-engineering and administrative organization
- Roles and skills

- Talent and task
- Mindset and the work place
- Recent international trends in tax administration.

While the administrators review the areas of functions in the field of audit, dispute resolution, management of resources, it is only advisable that no decisions are taken in haste just to meet a deadline. It is also advisable that the industry be well consulted before taking any final decisions, as was done by Canada in its successful implementation.⁷⁹

(4) Dealing with Transitional Issues

There are a large number of customs duty exemption notifications governing various schemes under Foreign Trade Policy which are intrinsically linked to the system of extant regime under customs and central excise. The benefit is quantified in terms of customs or central excise duties as applicable presently. The transition to GST will affect such schemes and a great amount of uncertainty will hover over all these areas for businesses leading to confusion and administrative issues. A large number of bonds executed by the importer and exporters with the Government will have to be suitably amended for changed liability in view of new GST. The challenge for the Government is to make the transition a smooth exercise. The Government should devise special provisions to deal with such exigencies. In case of offence or non-fulfillment of conditions of Foreign Trade Policy or Customs exemption notifications or de-bonding, the liability should be worked

⁷⁹ *Supra*, n. 42, p. 18

out in a given manner so as to avoid the need to refer to past provisions under Customs or Central Excise Acts.⁸⁰

(5) Job Work

In case of jobbing activities, the job worker should be allowed credit of raw materials/inputs consumed by him for value-added supply for payment of GST. In case the job worker's activity results in finished goods, the challenge is to allow credit of job worker's GST to the principal. The job worker will be paying GST on his job charges. The principal will sell the finished goods at a price which will include the job charges paid to the job worker. Thus, the principal should be allowed to take credit of job worker's GST for payment of GST against his own supplies. Such special provisions should be incorporated in the GST of Union and States.⁸¹

(6) Inter-State Trade

In case of destination based principle of taxation, the recipient State will have to levy the tax as per the law of the dispatching State. This is bound to create problems if there is no uniform law and rates across India. This requires tax collected by the recipient State to be credited to the exporting State. For the Governments it would be a challenge to allocate revenue to the respective States without proper administrative and supervisory machinery. The banks as an intermediary can play a key role in collection and transfer of revenue to respective States in Dual GST model. The person collecting the tax on his supply in case of inter-State transactions should deposit the tax in the account of the State

⁸⁰ www.bdoindia.co.in/.../GST%20in%20India-The%20Challenges%20Ahead-%20BDO%20Haribhakti.pdf

⁸¹ *Ibid.*

where the supply has been made. Then on the basis of revenue reports of the respective Governments, the banks can allocate the revenue to the respective States or the Central Government, as the case may be. The banking system needs to be revamped for this purpose. The challenge can be met by proper training, up gradation of tax administration with technological interface.⁸²

The rules for 'place-of-supply' would need to be supplemented with a new mechanism for reporting and monitoring of inter-State transactions and for collection of tax on them. The Trade Information Exchange System, already developed for the Empowered Committee, can be a valuable tool for monitoring of such transactions.⁸³

(7) Explosion of Assesseees

The dual GST model will widen the tax net by taxing every economic supply in the distribution network. This will lead to an explosion of assesseees. The new GST regime requires a paradigm shift in taxation. It will not only add a new flavour to GST but will also align India with global tax system. This new regime will see India as one economic entity with uniform tax structure. It will necessitate some of the businesses to restructure their distribution network to reduce additional tax burden on the consumer with a view to be price competitive. Though it will generate revenue in a neutral and transparent way, the Government will have to ensure that the ultimate consumer is not burdened with tax beyond his capacity.⁸⁴

⁸² *Ibid.*

⁸³ *Supra*, n. 42. p. 152

⁸⁴ *Supra*, n.80

CHAPTER – 6

REALITY CHECK

The deliberations over introduction of the GST regime in India have so far centered mostly around the conflict between the Centre and the States. This conflict has a lot to do with the government's failure to introduce the scheme by the proposed deadline of April 1, 2010. But, it is politically naïve to think about success without hurdles. Ours is a federation and each State has a different type of tax structure. States levy octroi, entry tax, stamp duty, municipal tax etc. It is heartening to believe that the states would agree and not levy these taxes in addition to GST otherwise the very concept of a common Indian market with unified and simplified tax structure would be thwarted⁸⁵.

But a lot remains to be done. First, consensus is required on a uniform tax rate. Second, some states have asked whether a GST-supporting IT and administrative infrastructure will be up and running in time. Third, states have to streamline their tax structure as a preparatory step while central sales tax on inter-state movement of goods will need abolishing if GST is to facilitate India's economic integration. In addition, states will need reassuring on the issue of reimbursement⁸⁶ for any revenue loss⁸⁷.

⁸⁵ <http://www.merineews.com/catFull.jsp?articleID=15771209>

⁸⁶ Under the GST structure, the tax would be collected by the states where the goods or services are consumed, and hence losses could be heavy for producer states. The Centre would need to compensate them for loss of revenue.

⁸⁷ <http://timesofindia.indiatimes.com/Opinion/Editorial/EDITORIAL-COMMENT--Prepare-For-Launch/articleshow/4649871.cms>

The Exemptions

The Task Force recommends that there should be minimum exemptions. However, if it is considered necessary to provide exemptions, the Centre and the States should draw up a common exemption which should be restricted to the following:

- (a) All public services of Government (Central, State and municipal/ panchayati raj) including Civil administration, health services and formal education services provided by Government schools and colleges, Defence, Para-military, Police, Intelligence and Government Departments. However, public services will not include Railways, Post and Telegraph, other commercial Departments, Public Sector enterprises, banks and Insurance, health and education services;
- (b) Any service transaction between an employer and employee either as a service provider, recipient or *vice versa*;
- (c) Any unprocessed food article which is covered under the public distribution system should be exempt regardless of the outlet through which it is sold; and
- (d) Educational services provided by non-Government schools and colleges; and
- (e) Health services provided by non-Government agencies.⁸⁸

The Expectations

The GST has set in a lot of expectations among various sections. The mood of the industry also seems to be quite upbeat. Let us one by one look at the expectations some of these sections have from the GST scheme.

⁸⁸ Report of the Thirteenth Finance Commission's Taskforce.

(1) Consumers and Manufacturers

At the very outset it must be understood that GST is not simply a tax issue but has an impact on the whole supply chain. In terms of the applicable legislation on date, the Central Sales Tax (CST) is not integrated with VAT. Thus, the CST paid on inter-State procurement is not eligible as a credit and continues to be a cost of doing business till the time it is completely phased out. Similarly, manufacturers are unable to avail themselves of credit of miscellaneous taxes, such as entry tax, octroi, etc., and these become added costs along the supply chain. Under GST, manufacturers would be entitled to input tax credit of all inputs and capital goods purchased from within the State as well as inter-State, from a registered dealer for setting off the output tax liability on the sale of their finished products. Similarly, distributors would also be able to pass on the duty burden to their customers. This would ensure that there is no cascading effect of taxes and would result in a reduction in the cost of doing business⁸⁹.

This is likely to result in a reduction in the prices of commodities in the long run as manufacturers and distributors would pass on the benefits of the lower costs of carrying on their businesses to the consumers. As discussed, under GST, all goods and services would be subject to tax, unless specifically exempted. Further, it is also anticipated that the number of exemptions would be significantly reduced. Accordingly, the total revenue collections can definitely be expected to go up. Another significant point is that small businesses would be kept out of the purview of GST. Hence, the cost of administration is

⁸⁹ <http://www.gstindiaexperts.com/faq.php>

also expected to go down while compliance would go up. Thus, GST promises to have a positive impact on all stakeholders⁹⁰.

(2) Retailers

The retail sector expects that the GST regime will help in streamlining taxes. The single-tax regime will benefit the retail sector and bring majority of transactions under the tax net. As a consequence, retail prices of number of items in various categories are likely to fall. It is believed that traders, including retailers, would be one of the biggest beneficiaries of this harmonized system of taxation. Although retail sector has succeeded in evolving as an organized revenue generating sector, it still continues to be fraught with some inherent challenges posed by the current indirect tax regime.

Inability to offset the input excise duty (on procurement of goods) and service tax (on procurement of services, viz.. rentals, freight, advertisement, other business related services) against the output tax (possible only value added tax), leads to cascading of taxes. Given that the output VAT can be (currently) discharged only through utilising the input VAT, the input service tax (largely on account of rentals) becomes a cost in the system. The ability to pass on this additional cost to the final consumers depends on market dynamics and therefore, may lead to reduction in margins. This issue of inability to offset the input taxes should get resolved once GST is introduced in India. This is for the reason that under GST, in the form in which it is currently contemplated, taxes on

⁹⁰ *Ibid.*

services would be available for set off against taxes on goods, (albeit cross credit between Central GST and State GST is not envisaged).⁹¹

The levy of entry tax without the ability to offset against output VAT adds to the tax burden. It is expected that introduction of GST would address these issues since the 'First Discussion Paper on Goods and Services Tax in India' released on November 10, 2009 has, inter alia, proposed that the basis of classification would be uniform across all States (as far as practicable) and that all taxes and levies that are on supply of goods / services should be subsumed in GST.⁹²

To summarise, introduction of GST would benefit the retail trade in India to a great extent in the form of release of blocked input taxes, ability to take business decisions based on commercial considerations, rationalization of prices and reduction of state level compliances. Overall, the organized retail sector will be positively impacted with the proposed introduction of GST and the players should be mindful and prepared to reap the benefits.

(3) Foreign Trade

A study conducted by the National Centre for Applied Economic Research (NCAER) recognised that the current tax regime is adversely impacting export competitiveness of the country. As per the study, the proposed GST regime will be beneficial for India's foreign trade engagement with the rest of the world. According to the study, a distortion

⁹¹ <http://www.financialexpress.com/news/impact-of-gst-on-retail-should-be-examined/556863>

⁹² *Ibid.*

free indirect tax regime like GST could boost exports in the range of 3.2-6.3%. At the same time, imports are expected to gain in the range between 2.4-4.7%. The study also said that for the GST rate to be revenue neutral, it has to be in the range of 6.2-9.4%, depending on exemptions given to various sectors. According to the economic think tank, the proposed GST regime will also boost India's output by adding 0.9-1.7% to India's GDP growth rate, which would be seen in the years after the new indirect tax regime is in place. In sum, implementation of a comprehensive GST in India is expected to lead to efficient allocation of factors of production thus leading to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital.⁹³

Productivity of sectors that are likely to improve in the GST regime include textiles and ready-made garments; minerals (other than coal), petroleum, gas and iron ore, organic heavy chemicals, industrial machinery for food and textiles as well as beverages. But output of sectors like natural gas and crude petroleum; iron ore, coal tar products, and nonferrous ores will decline. Moreover, the study said that imports of textiles and ready-made garments; minerals (other than coal), crude petroleum, gas and iron ore; and beverages will decrease.⁹⁴

NCAER also recognised that the current indirect tax regime, especially in the states, have been eating in to the competitiveness of Indian exporters. While much of the taxes paid on intermediate purchases by the business firms get rebates there still exist components which do not get this benefit. While the Central indirect taxes including customs and

⁹³ <http://www.expressindia.com/latest-news/GST-regime-to-boost-foreign-trade/554997/>

⁹⁴ *Ibid.*

excise duties get nearly fully reimbursed, the state-level taxes do not get full offsets. According to the study, since all state and central level taxes will be subsumed within the GST, exporters would be able to fully offset indirect taxes on inputs.⁹⁵

A Reform for Economic Growth

According to the NCAER Report, Implementation of a comprehensive GST would lift India's roughly \$1.15 trillion economy by between 0.9 per cent and 1.7 per cent, on top of whatever growth would otherwise be achieved. As per government panel reports, the GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the central Government and the state Governments. It is also being said that the GST may, indeed, lead to the possibility of collectively positive-sum game⁹⁶.

The benefits of GST may be better understood through a simple example. If a producer (under the present tax net) purchases an input good which costs Rs 100, and manufactures an additional amount of Rs 40, he/she would have to pay 12.5% Value Added Tax (VAT) on the net sum cleared from the factory, excise of 8% on the cost of production and 2% Central Sales Tax when goods are transported inter-state. This excludes service tax and various other state-specific taxes like entry tax and purchase tax, depending on the nature of the sector and the state in question. Even in the best scenario (taking only intra-state transactions), the total tax payable would be Rs 16.2 and if the entire tax is passed through, the best price for the commodity becomes Rs 156.2. On the

⁹⁵ *Ibid.*

⁹⁶ http://www.businessworld.in/bw/2010_01_06_How_Does_The_Proposed_GST_Work.html

other hand, under a GST system assuming a 16% consolidated tax rate (8% by the Centre and 8% by the state), the total tax would amount to Rs 6.2 (22.4 - 16 input credit) and the product price to Rs 146.2. Hence, the manufacturer, even under the best pricing scenario, will save at least around 7% of the total cost of production.⁹⁷

There is a saying in Kautilaya's *Arthshastra*, the first book on economics in the world, that the best taxation regime is the one which is "liberal in assessment and ruthless in collection". The proposed GST seems to be based on this very principle. Dr. Vijay Kelkar, Chairman of the Thirteenth Finance Commission, is optimistic on the basis of his meticulous calculation about the encouraging outcome of this proposed tax regime in terms of amount of collection. According to him, the value of GST collected post reform will be about US \$500 billion – or half a trillion dollar. If it proves true, it is going to bring about a silent revolution in the history of economic development of the country.⁹⁸

The recent moves towards GST represent a path-breaking process towards redefining the Indian taxation system to a more rational and efficient revenue set-up. The proposition of lowering tax rates corresponding with higher tax receipts appears to have relevance in Indian fiscal history, and, implementing GST would certainly help support economic growth. If the GST is introduced in letter and spirit, it would certainly increase the volume of tax collection. This will provide a great stimulus to our gently moving economy, which has, of late, arrived at a level playing field *vis-à-vis* many major economies of the world.

⁹⁷ <http://in.biz.yahoo.com/100302/50/bav625.html>

⁹⁸ <http://www.igovernment.in/site/GST-for-GDP-gains>

Distant Dream or Close Possibility ?

In 2006 the then Finance Minister Mr. Chidambaram expressed the desire of the Government to introduce Goods and service Tax from 1st April 2010, but certainly the GST mentioned at that time was not exactly the same as it is going to be introduced at present. The GST, mentioned by Mr. Chidambaram was a National Goods and Services Tax in which the Central excise, service tax and VAT were to be replaced by a single National level GST. The tax in that system had to be collected by the central government and it was to be shared by central government with the states⁹⁹.

Now what is going to be introduced is a compromised dual GST in which both the Central and State government will impose and collect tax under the nomenclature of Central Goods and service Tax (CGST) and State Goods and service Tax (SGST) and every transaction of sale and/or supply will be under dual taxation.

The proposed date of April 1, 2010 has already passed, and we seem to be nowhere near the introduction of the scheme. As we know, the main hurdle is the lack of unanimity among states on what taxes should be subsumed in GST and what should be left out. Many states are vehemently opposing the inclusion of some state-level taxes-sales tax, purchase tax, entertainment tax, electricity tax, and octroi tax-in GST. The sales tax is collected directly by a normal shop and deposited in the treasury. The purchase tax is collected by a purchaser and then deposited in the treasury like when the Food

⁹⁹ <http://www.forum4finance.com/2010/01/13/gst-%E2%80%93-still-a-long-way-to-go/>

Corporation of India procures food grains from farmers. They are essentially same, except that the agent is different.¹⁰⁰

States like Punjab and Haryana, which get a lot of revenues from the purchase tax, say they will lose revenue heavily if this tax is subsumed in the GST. There is a similar problem with octroi which at the moment is levied only in Maharashtra with all other states having abolished it. Maharashtra, which is strongly resisting the inclusion of octroi in GST, argues that it would not be possible for Mumbai to function without this revenue input. As admitted by government officials, this issue has not even been discussed seriously.¹⁰¹

At the heart of the disagreements, according to Dr. Vijay Kelkar, is that states and Union territories might incur considerable revenue losses in their bid to accept execution of the new tax regime. The states are also looking for compensation for a phased reduction of CST for the previous fiscal. There are also sharp differences over the model of GST with states divided between a dual and a single GST. The Empowered Committee has agreed to a dual structure of the proposed indirect tax regime which some states agree to. They favour a lower GST rate for items of mass consumption, a regular rate for other goods and a nominal charge of 1 per cent on precious metals.¹⁰²

The other hurdle, according to Mr. Govind Rao, member of the Economic Advisory Council to the Prime Minister, is that the rollout of GST cannot take place without constitutional amendments which are pending. In a GST regime, explains Rao, the Centre

¹⁰⁰ <http://indiatoday.intoday.in/site/Story/69541/Divided+house.html?complete=1>

¹⁰¹ *Ibid.*

¹⁰² *Ibid.*

should have the power to levy taxes beyond the manufacturing state, and the states should be empowered to levy taxes on services. At this particular moment, the Centre cannot go beyond the manufacturing state and state cannot levy taxes on services. To enable that, there is a need to amend the Constitution, and two-thirds of the states have to endorse that amendment.¹⁰³

According to Dr. Kelkar, the problem with creating the convergence is in the states, many of which do not have a sophisticated information technology network in place. The present Tax Information Exchange System does not appear to be fully operational across all states. For instance, in Jammu and Kashmir and Himachal Pradesh, even transactions relating to VAT have been handled manually. Now the states have been asked to give their reports on their requirements and as of now the requests add up to an expenditure of Rs 1,000 crore. The Centre will pay 75 per cent of the bill and the rest will have to be raised by the states.¹⁰⁴

Since a lot of work was yet to be done, it was almost expected that the Finance Minister Dr. Pranab Mukherjee, in his 2010 budget speech, would propose April 1, 2011 as the new date for introduction of the scheme. The Empowered Committee Chairman Mr. Asim Dasgupta has also expressed his confidence about introducing GST on April 1, 2011. But with so many hurdles still to be crossed, and the States not ready to take a backward step, it would be interesting to see whether the proposed regime will see the light of the day even on the new proposed date or not.

¹⁰³ *Ibid.*

¹⁰⁴ *Ibid.*

The Best Bet ?

More than 130 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. It is interesting to note that there are over 40 models of GST currently in force, each with its own peculiarities. 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. At the same time, it must be noted that GST is a more structured and transparent form of indirect taxation. It has proven itself as the most efficient and effective method of providing revenues that government need, while encouraging economic growth and efficiency.¹⁰⁵

In the preceding chapters, we have seen the extent and the magnitude of benefits that the GST regime can bring. The Empowered Committee describes the GST as “a further significant improvement – the next logical step towards a comprehensive indirect tax reform in the country.” Indeed, it has the potential to be the single most important initiative in the fiscal history of India. It can pave the way for modernization of tax administration - make it simpler and more transparent – and significant enhancement in voluntary compliance.

¹⁰⁵ <http://www.gstindiaexperts.com/faq.php>

At present, we are facing some obstacles in the introduction of this system in our economy. The biggest obstacle that is being faced is regarding the sharing of revenue between the Centre and the States. Over the past few months, there has been a series of confrontations between the two parties over the issue. Neither is ready to compromise. Another obstacle is regarding the constitutional arrangement. Before implementing the GST scheme, a number of constitutional amendments are required to be made. But looking at the positive mood of most political parties regarding the implementation of GST, we can hope that this obstacle would be crossed without too many difficulties. But again, these need to be ratified.

The obstacles that are there, are more political than economic. And in the interest of the country's economic growth, hopefully, all stakeholders would have a convergence of views in the days to come. Introduction of GST would place our indirect tax regime in uniformity with other systems all over the world. This would encourage seamless trade in the global arena. As a result, the economic strength of India would grow manifolds. Thus, looking at all these factors, in the present situation, GST is indeed the best bet.

Conclusion and Suggestions

The April 1, 2010 deadline has passed. Now we need to wait one more year, before we can see what exactly does the GST structure look like. The complexities in the existing tax regime in India certainly calls for a change in the scheme. And under the present circumstances, the suggested dual structure may just work out well to both suit the Indian conditions, and overcome the existing complexities and difficulties.

After going through the proposals made in the First Discussion Paper, it is must that certain constructive suggestions are made. It is suggested that there should be a common tax base for both Centre and the States. The threshold for goods and services should be common between Centre and State on one hand and between goods and services on the other. There should be a uniform threshold for goods and services for both SGST and CGST. This annual turnover threshold could be Rs.10 lakh or even more than that. Another important suggestion that I would like to make is that there should be a uniform registration system throughout the country and this registration system should enable easy linkage with Income Tax database through use of PAN number. Apart from the taxes that are proposed to be subsumed under GST, electricity duty, Octroi, purchase tax and taxes levied by local bodies should also be subsumed.

Alcoholic beverages should also be brought under the purview of GST in order to remove the cascading effect on GST paid on inputs such as raw material and packaging material. There should be a single rate of SGST both for goods and services. Also, there should be one CGST rate both for goods as well as services. Having different rates for goods and services would imply that the distinction between goods and services should continue, which is totally against the very principle of GST.

The introduction and the effective implementation of GST would mean that the cascading nature of our indirect tax regime would no more be there. This would be a significant boost for our economy. Moreover, it would make India well-equipped to compete with the world economy on a level playing field. Hence, it is extremely important that the GST regime is introduced in India at the earliest, and thus, my hypothesis is proved right.

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