Goods & Services Tax

Transformation Towards a New Regime in Indirect Taxes

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India is all set for a whole new transformation in indirect tax structure. The new tax reforms will bring new opportunities and challenges for various stakeholders. This paper critically examines the implications of Goods and Services Tax for business, government, consumer, economy, small scale industries and electronic commerce.

Introduction

Indirect Taxes are those taxes and duty whose incidence and burden falls on different person. These taxes play an important role in the economy of a country. Indirect taxes form a major source of revenue both for the central as well as for the state. Since indirect taxes treats rich and poor equally, these are often criticised by economist for being regressive. India is planning to have transformation in the indirect tax structure by introducing Goods and Services Tax (GST). The proposed introduction of Goods and Services Tax (GST) is one of the biggest tax transformations, India is planning to have.

Recently, the Government has released the draft model of GST law for public comments.
The model law provides a draft of Central GST (CGST) Act, State GST (SGST) Act and Integrated GST (IGST).

This paper critically examines the draft model law, identifies the implications of the said law both for the government and for the industry.

Need for the study

The Indian indirect tax system is moving towards transformation. The proposed new regime of GST will bring opportunities and implications for the business, government, consumers, and economy. It is therefore imperative for commerce academicians to examine the need, implications and problems of proposed tax structure.

Objectives of the study

The study is undertaken to accomplish the following objectives:-

To identify the problems associated with the present indirect tax structure in India and need for new tax regime.

To analyse model and structure of proposed Goods and Services Tax (GST).

To critically examine the implications, pros and cons of GST on business, consumer, government, economy, small scale business and e-commerce industry.

Research methodology

The nature of present study is qualitative. The methodology used is extensive content analysis. The ministry of finance, GOI, issued a model GST bill for public comments. The model bill is studied and critically examined in light of above mentioned objectives.

Present structure of Indirect taxes in India

Presently, the structure of indirect taxes consists of various taxes levied by central or state. Table 1 lists some major indirect taxes levied by centre and state.

Table 1: Present structure of indirect taxes

Levy by Center	**Levy by State**
Excise duty	**Value Added Tax**
Service Tax	**Entertainment Tax**
Central Sales Tax	**Entry Tax & Octroi**
Custom duty	**Luxury tax**

Short comings of present tax structure

The present system is very complex consisting of multiple taxes levied by centre and state. It comprises of multiple events for taxation, for e.g., excise duty is levied on manufacturing while sales tax is levied on sales and service tax is levied on provision of service.

The businesses were required to have multiple registration s, multiple filing of returns, multiple administrations and therefore higher compliance burden and cost.

The biggest drawback of present tax structure is cascading effect i.e. tax on tax. This is because of multiplicity of taxes levied by central and state governments for which credit is not admissible. States do not give credit of duty of excise paid to the center/other states and vice-versa. Another problem is of double taxation i.e. same value is taxed twice. For instance the food in restaurants got taxed twice. It attracts state VAT on the whole amount while central service tax on 40% of amount.

Contents of Model GST

Model GST law comprises of 25 Chapters which deals with various issues under GST as enumerated in table 2.

Table 2: Contents of Model GST

Chapter No.	Title	Contents in Brief
I	Preliminary	Definitions, meaning and scope of supply
II	Administration	Powers & appointment of officers
III	Levy of / Exemption from Tax	Levy and collection of GST, composition levy, taxable person
IV	Time and Value of Supply	Time and value of supply of goods and services

V	Input Tax Credit	Manner of taking ITC, manner of recovery of excess credit
VI	Registrations	Registration requirement, procedure
VII	Tax Invoice, Credit and Debit Notes	Tax invoices, credit notes, debit notes
VIII	Returns	Furnishing details of inward and outward supplies, annual returns
IX	Payment of Tax	Payment of tax, interest and penalty, TDS
X	Refunds	Refund of tax, interest, consumer welfare fund
XI	Accounts and Records	Books of accounts, other records, period of retention
XII	Assessment	Self assessment, provisional assessment, scrutiny
XIII	Audit	Requirement of audit, special audit
XIV	Demands and Recovery	Tax not paid/short paid/erroneously refunded, recovery procedures
XV	Inspection, Search, Seizure and Arrest	Powers to inspect, search, seize and arrest
XVI	Offences and Penalties	General penalties, confiscation of goods
XVII	Prosecution and Compounding of Offences	Prosecution, cognizance of offence, compounding of offence
XVIII	Appeals and Revision	Constitution of national appellate tribunal
XIX	Advance Ruling	Authority for advance ruling
XX	Settlement of Cases	Settlement of cases
XXI	Presumption as to Documents	Presumption as to documents in certain cases
XXII	Liability to pay in certain cases	Liability to pay in case of transfer of business, amalgamation, merger, liquidation, etc.
XXIII	Miscellaneous Provisions	GST compliance rating, power to collect statistics, draw of samples
XXIV	Repeal and Saving	Avoidance of repetitive appeal
XXV	Transitional Provisions	Migration of existing tax payers to GST

Introduction to Goods and service tax (GST)

Goods and service tax is a destination based tax on supply of goods or services.

GST law shall have 31 legislations, one Central GST, 29 State GST and one Integrated GST

CGST @ 9% and SGST @ 9% shall be levied on intra state (within the state) supplies of goods or services in India.

IGST @ 18% shall be levied on interstate (across the state) supplies of goods or services in India.

Table 3 shows availability of Input tax Credit (ITC) on GST liability. The cross utilization of CGST and SGST is not permitted. However, cross utilization of IGST with CGST and SGST is permissible.

Table 3: Availability of Input Tax Credit

Input Tax Component	**Output Tax Liability**		
	Central GST	**State GST**	**Integrated GST**
Central GST	**Available**	**N.A.**	**Available**
State GST	**N.A.**	**Available**	**Available**
Integrated GST	**Available**	**Available**	**Available**

Under GST the taxable event is 'supply' of goods and services. The GST is levied on the 'transaction value' of goods and services. Hence, GST is a multi point taxation system whereby GST would be levied each time when manufacturer supplies goods to wholesaler, wholesaler supplies them to retailer, and retailer supplies to final consumer.

Table 4 compares the current system with the proposed GST with regard to manufacturer, wholesaler, retailer and final consumer.

Table 4: Comparison of current and proposed system

Particulars	**Current System**	**Proposed GST**
Manufacturer		
Cost of Production	1,00,000	1,00,000
Add: Excise Duty@12.50%	12,500	-
Add: GST@18%	-	18,000

Total	1,12,500	1,18,000
Wholesaler		
Cost of goods	1,12,500	1,18,000
Add: Value Added	30,000	30,000
Less: Input Tax Credit	-	18000
Base Price	1,42,500	1,30,000
Add: VAT@12.50%	17,810	-
Add: GST@18%		23,400
Total	1,60,310	1,53,400
Retailer		
Cost of goods	1,60,310	1,53,400
Add: Value Added	20,000	20,000
Less: Input Tax Credit	17,810	23,400
Base Price	1,62,500	1,50,000
Add: VAT@12.50%	20,310	-
Add: GST@18%	-	27,000
Final Price	1,82,810	1,77,000
Conclusion		
Total Value Addition	1,50,000	1,50,000
Total Taxes	32,810	27,000
Effective rate of tax	21.87%	18.00%

In the current system effective tax rate is 21.87% even though the rate of excise duty and VAT is lower at 12.50%. This is because in the present system the input credit is not given by the state on the duty and taxes paid to center and/or other states. In GST the effective tax rate shall be the rate of GST itself i.e. 18%. This is because of availability of input tax credit at every stage of supply chain.

This means that GST is good for consumers as it may reduce the prices and the inflation but it also means loss of revenue for the government. The tax neutral rate of GST would be higher than 21%.

Implications for the business

Business would be required to get registered in every such State in which he is liable to pay GST. The GST bill requires furnishing of only single return. Hence the compliance burden and compliance cost would be lower.

GST would also lower the cascading effect of the taxes. It would lower the price, reduce working capital requirement and increase their global competitiveness.

Implications for the consumer

Consumers are concerned about the impact of GST on final price (inclusive of all taxes) of goods and services after GST. GST would reduce the prices of goods though the impact would vary from product to product. However services would become costly as the rate of tax will be increased from present 15% to proposed 18%.

Since a consumer typically spends more on goods as compared to services and most of the consumer used services like education, healthcare etc. are exempt, the overall impact would be reduction in inflation.

But the reduction in inflation would be visible only after 1-2 years when the businesses would recognise the benefits of GST and pass its benefits to the consumer.

Implications for the Government and Economy

By the use of IT enabled infrastructure, input tax credit would be provided only if the transaction of supplier and buyer matches. Hence, government would be in better position to control leakages. GST would also discourage non-accounted transactions as the benefit of credit would not be available for such transactions. This would reduce the size of parallel black economy. Since many transactions which are currently not accounted would be properly accounted in GST, this would increase the growth rate of GDP.

Implications for Small and Medium Enterprises (SMEs)

To relieve small business units from compliance burden and its cost, law provides an exemption from the compliance based upon annual turnover of the business.

Currently the small scale exemption limit is Rs 10 lacs for Service tax and Rs 150 lacs for central excise duty and it is around 20 lacs for VAT for most of the states. This exemption limit is based upon the fact that gross margins are higher in service industry followed by retail business and manufacturing industry.

In model GST bill, the exemption limit prescribed is that of Rs 5 Lacs in north eastern states and Rs 10 lacs for rest of India. The limit is common for service industry, retail and manufacturing industry.

Though there would not be any significant impact on service industry but it would have deep rooted implications for retail business and manufacturing industry.

The average net margin in retail business is around 15%. A trader having annual turnover of say Rs 12 Lacs would be earning Rs 1,80,000 p.a. He would be required to follow all

procedural compliances regarding payment of taxes, returns, assessment, etc. The compliance cost and compliance burden would be huge for such small trader.

In case of SME manufacturer, the limit is reduced from annual turnover of Rs 150 lacs to Rs 10 lacs. This would increase the compliance burden for small scale manufacturers. The cost of compliance could be 2-3% of turnover. This could significantly reduce the net profit margins of these entities. In case where entities are operating at thin margins of less than 5%, there business would become unviable.

The bill needs to be revised. The government should specify 3 different limits, one each for service industry, retail business and manufacturer.

Implications for E-Commerce

In India, e-commerce business is growing rapidly. Many e-commerce operators like flipkart, amazon, snapdeal, etc. are providing online platform to sellers across the country to sell their products online. In consideration these operators charges the service commission from the sellers.

In the model bill, it is proposed that the e- commerce operator will collect tax at source from the payment made to the supplier. The operator would be required to make payment of such tax collected at source to Government and file periodical returns for the same. This would result in additional compliance burden for the e-commerce operators. This can also lead to potential credit accumulation issues for the persons making supplies using the e-commerce platforms.

Table 5 shows an illustration of the amount of tax to be collected at source by the e-commerce operator.

Table 5: Illustration on Tax Collection at Source

Particulars	Amount (Rs)
Price of an article	2000
Less: e-commerce operator margin @ 5%	(100)
Consideration payable to supplier	1900
GST collected at source @ 18%	340
Net consideration payable to supplier	1900
GST payable to government	340

Table 6 shows an illustration of the credit accumulation for the supplier. The net profit of the supplier is Rs 200 while the refund due from the government is Rs 300. This means not only the entire profit but also some part of the cost is due from government. Supplier has to meet compliance for the refund. Supplier has to face issues like uncertainty with regard to admissibility of claim, amount actually refunded, and delay in refund. The interest provided by government on delayed refunds is far less than the cost of capital of the supplier. Supplier would also face liquidity issues, credit issues and working capital problems.

Table 6: Illustration on Credit Accumulation

Particulars	Amount (Rs)
Net consideration	1900
Cost of the article	1700
GST payable on consideration @ 18%	340
GST paid on cost (ITC) @18%	300
GST paid by operator (TCS) @ 18%	340

Refund due from the government	300
Net profit	200 (1900-1700)

It is therefore proposed that this requirement should be dispensed off.

Conclusion

The transformation is a journey not the destination. The GST could solve many problems of the present system. GST could significantly decrease cascading effect. GST would also reduce compliance burden and cost for the business.

GST would also benefit consumer by way of lowering of prices. However, its impact might be visible only after a year or so because industry needs time to realise and pass the benefits of GST to consumers.

GST would increase the GDP growth rate by way of ease of business, simplification in procedures and incentive for accounting of transactions.

However, the proposed GST could increase burden on small scale industries as the exemption limits are lowered. It could also create credit accumulation issues for small suppliers using online platforms.

Reference

Model GST law issued by ministry of finance, GOI, June 2016 accessed from http://www.finmin.nic.in/reports/ModelGSTLaw_draft.pdf.