

GOODS AND SERVICES TAX

Model in the making..

By

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HEADS OF DISCUSSION

- Concept
- Authorities involved in the decision making process.
- Constitutional background and amendments required
- Various possible models
- Challenges in decision making
- Impact on business under different models
- Conclusion

CONCEPT

- Existing System of Indirect Taxes:
 - Customs Duty on Imports
 - Excise Duty on Manufacture of Goods
 - Service Tax on rendering of services
 - VAT on sale of goods and deemed sales
 - Central Sales Tax on Interstate sales
 - Entry Tax, Octroi on entry of goods in state
 - Luxury Tax on services in Hotel and Restaurants.
 - Entertainment Tax

CONCEPT

- GST
 - All indirect taxes to subsume in one taxation law effective April 2010 : GST.
 - Taxes on property and Taxes on Income being part of direct taxes continue to coexist.
 - No other tax on a transaction is levy-able in any other form. Transaction tax – Better terminology
 - All transactions for all goods or services shall be liable to tax without discrimination, except the rate of tax.

CONCEPT

- ◆ Area based exemptions to promote a state or region shall go.
- ◆ Person based exemptions shall go. Eligible persons shall apply for refunds.
- ◆ GST shall operate in VAT mode.
- ◆ All trade barriers to be removed, so that taxes on all inputs be eligible to credit / setoff against output tax. This is like making the country as single free market.

Various Authorities

- State Governments
- Central Government - Finance Ministry
- Commission on centre-state relations
- Interstate council of India
- Empowered Committee of State Finance Ministers
- Thirteenth Finance Commission

Constitutional Background

- Implementation of GST shall depend upon suitable amendments in the constitution of India.
- Constitution permits states and centre to levy, collect and appropriate taxes.
- List I (Union List) to the Seventh Schedule to the constitution enumerates matters on which Parliament has exclusive power to make laws.

- List II (State List) enumerates matters, exclusively in the domain of the states. Sales Tax on sale / purchase of goods lies in this list.
- List III is the concurrent list empowering both to levy tax on a subject.
- In terms of a residuary clause in the List I, the power to tax services could fall upon the central government.
- Article 268A was inserted in the constitution on May 8th, 2003.

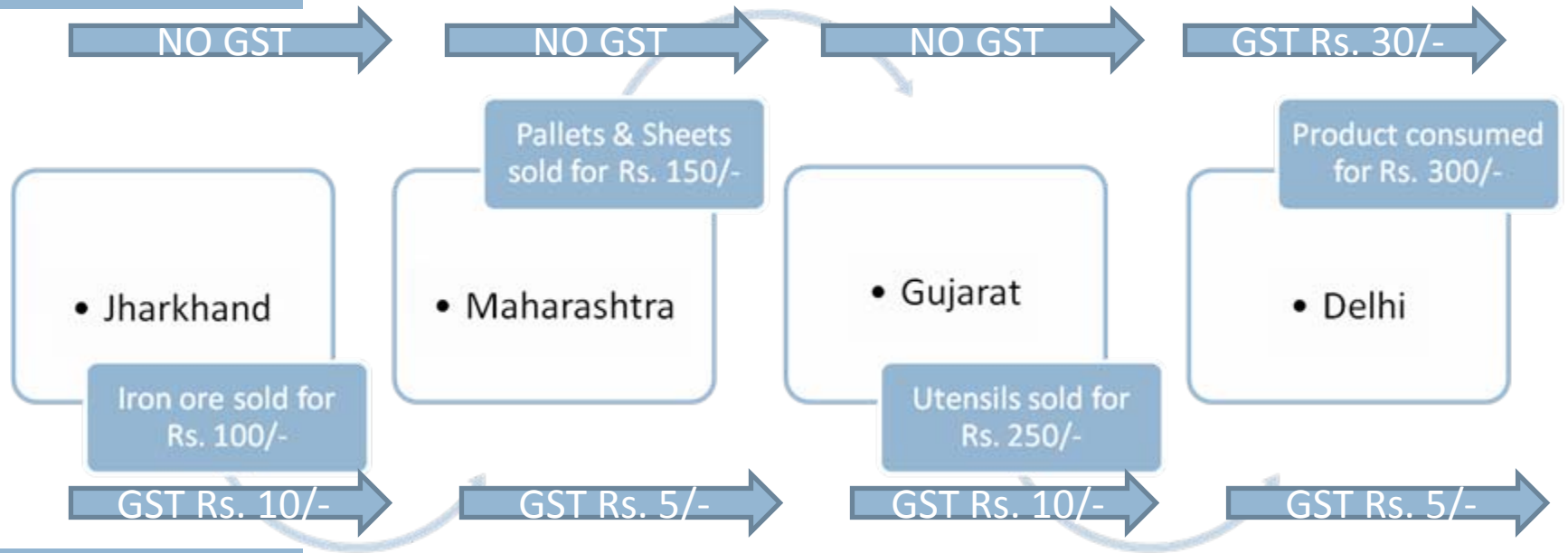
- Article 268A is subject to ratification by a requisite number of states and provides:
- Taxes on services shall be levied by the GOI and such proceeds shall be collected and appropriated by the Centre and the states.
- Parliament shall have exclusive power to formulate law for collection and appropriation of the proceeds for any financial year, amongst the states and the centre.
- Consequently, entry 92C “Taxes on Services” was inserted in List I.

- Thus GST is proposed to be a single law to tax subjects that lie in different lists as far as powers to levy and collect taxes are concerned.
- Without suitable amends in the constitution, the levy of GST as a single tax is not possible.

Possible Models

- Models may vary in terms of:
 - Various laws that get subsumed in GST
 - Manner of Implementation
 - Single Chain – Inter state VATable
 - Dual Chain – Separate chains for states and Centre with zero interstate / inter-chain VATability.
 - Nature of items included in the respective chains
 - Machinery for Levy, Collection & Appropriation

MODEL-I



MODEL-II

State	Model – I (Interstate variability)	Model – II (Not-Vatable)
• Jharkhand	• 0	• 10
• Maharashtra	• 0	• 5
• Gujarat	• 0	• 10
• Delhi	• 30	• 5

- The Joint Working Group (JWG) of Empowered Committee (EC) laid down various recommendations. Few of them are:
 - **The** committee has suggested that GST, when it rolls out on 1 April 2010, have two components - a Central tax and a single uniform state tax across the country;
 - **A** tax over and above GST may be levied by the states on tobacco, petroleum and liquor; may likely help the report find favour with the states; This is however against the spirit of GST and has a cascading impact.
 - States must tax intra-state services while inter-state services must remain with the Centre.

- **The GST** may not have a dual VAT structure but a quadruple tax structure. It may have four components, namely
 - a central tax on goods extending up to the retail level;
 - a central service tax;
 - a state-VAT on goods, and
 - a state-VAT on services.
- Given the four-fold structure, there may be at least four-rate categories- one for each of the components given above. In this system the taxpayer may be required to calculate tax liability separately for the different rates of tax;

- **The** report had also mooted elimination of the area-based and sectoral excise duty exemptions that are being given by the Centre.
- **Proposed** GST rate is 20%
- **Central** cess like education and oil cess may be kept outside the dual GST structure to be introduced from April 2010. Besides central cess, purchase tax and octroi, which are collected at state and local levels is also proposed to be outside the GST framework;
- **There** is no clarity on the collection machinery and the method and formula of appropriation.

- **Both**, state and centre have a strong tax collection and administrative machineries and one of these may be left redundant .
- **The** report has also recommended keeping stamp duty, which is a good source of revenue for states, out of the purview of the GST. Stamp duty is levied on transfer of assets like houses and land;
- **It** has also suggested keeping levies like the toll tax, environment tax and road tax outside the GST ambit, as these are user charges; and

- **The** levies which are in the nature of user chargers and royalty for use of minerals must also be kept out of the purview of the proposed tax.
- The report is contradictory to the report of the Kelkar Task Force (KTF) in as much as KTF recommendations vouched for implementation of a single union GST and this poses a lot of constitutional hurdles demanding many amendments to the existing articles of our constitution.
- The EC report reflects unwillingness of the states to lose to the power of the centre.

Dual Chain / GST

- Model A
 - Common code of law with defined revenue share for state and centre and a common and independent administrative machinery.
 - State GST : Local Taxes on manufacture and sale of goods along with tax on identified localized services. 77 Services have been so identified of which 44 are still out of service tax list.
 - Central GST : Tax on remaining nature of transactions.

- Interstate transactions to be taxed at special rates with facility of input credit against state VAT of destination state.
- Registration requirement in each state to avail input credit.

- Model B

- Separate but uniform code of law for each state with a single code for central GST. Defined revenue share for state and centre and a separate administrative machinery for each state.
- State GST : Local Taxes on manufacture and sale of goods along with tax on identified localized services. 77 Services have been so identified of which 44 are still out of service tax list.
- Central GST : Tax on remaining nature of transactions.

- Retail interstate transactions to be taxed at central GST. Wholesale interstate business to be at zero rate against forms.
- National Tax Tribunal to be fully activated for all dispute settlements.

Challenges in Dual Chain Model

- Rendering of services can not be equated to selling of goods in terms of:
 - Transfer of property.
 - Movement from one state to another.
 - Storage and stocks
- Services are normally produced, delivered and rendered at the same time.
- Thus defining the basis of tax shall be a critical issue.

- If the criteria of tax continues to distinguish between goods and services, taxing them at different rates, the existing controversies shall continue .
- A new series of classification disputes may arise for borderline items of the two chains.
- Indivisible Work contract transactions involving multiple states shall continue to be vexed.
- Analytical data between goods & services may be lost.

- Import & Export of services are already vexed issues and become more complicated when individual state interest shall be involved.
- Taxes on Petroleum products as a policy have been kept high with no VAT or CENVAT availability. This results in cascading effect on taxes. Shall have to be curbed.
- Need for multiple registrations in all states shall continue for omnipresent enterprises. This is not a cost effective model.

- States can be classified in to:
 - Industrial
 - Agricultural & Mining
 - Trading
 - Consuming
- The GST model shall have to account for the classification differences of the states. Financially equitable solutions may be Politically inequitable.

- In the absence of a robust electronic control of transactions, the system shall malfunction.
- With two chains facilitating inter chain credit the complexity shall grow many fold. With a 70% rural area and a higher rural population this target is difficult to achieve.

Challenges in Single Chain Model

- The nature of constitutional changes required in this case alter the fundamental shape of the constitution.
- Analytical data between goods & services may be lost.
- In the absence of a robust electronic control of transactions, the system shall malfunction. With a 70% rural area and a higher rural population this target is difficult to achieve.
- Economy for small units may be disrupted.

Impact on Business

- Booster to TAX : GDP ratio. Barrier Free input credit availability across goods and services and across states and UT's shall give unbeatable competitive advantage to a VAT chain constituent over the "Parallel Economy" constituent.
- Exports become cheaper and competitive.
- Cascading impact of taxes shall reduce thereby bringing down prices and boosting sales.

THANKS

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