<u>Concept of EXEMPTIONS in Goods and Service Tax</u>

1. Introduction

I happened to meet quite a few businessmen in last few weeks and who were unable to appreciate the importance of Zero rating of goods. I made them understand the benefits of proposed scheme of “zero rating” over current scheme of “exemptions”. This made them change their status from “Anti-GST” to “Appreciating GST”. Seeing this I bring before you a complete guide to Zero rating vs. Exemptions vs. No tax Economy.

2 Zero Rating Vs Exemption

Suppliers of goods and services are either taxable or tax exempt. Theoretically exemptions are provided in order to relieve the tax payer from extra burden of taxes and make the commodity cheaper. Exemptions relieve the exempt trader’s value added from the tax, but all his purchases (including capital goods) are taxed, thereby flouting the credit chain. In other words exemption actually increases the amount of tax finally paid on goods which is the opposite effect that the exemption sought to provide. However if a commodity is exempt only at the retail level, then only the retail level is freed of GST and prices would fall marginally, although a portion of GST element would have already been charged and included in price of commodity.

If a commodity or service is zero rated, the zero rated trader’s value added is not taxed and the trader receives a credit for the tax paid on the purchase of materials and other inputs used. Zero rating, is the only way to ensure that a product is truly free of GST, since any tax paid would be credited on the last sale.

Zero Rating	**Exemption**
Actual Benefit is given	Theoretical benefit
Tax relief at all levels	Tax relief only at one level
Credit chain continues	Credit chain is broken
No tax on value added at all.	Tax on value added of a particular dealer is foregone/exempted

<u>Let us now examine the effect of 4 possible economies with the help of an example:</u>

- **a)** No tax Economy
- **b)** Full Tax Economy
- **c)** Exempted Economy
- **d)** Zero Rating Economy

Illustration

John purchased goods worth Rs.2000. He paid Rs.500 as expenses to labour. Also, profit of Rs.250 is added to these goods, He ultimately sold these goods to David. Assuming the GST rate as 10% on input and output, Calculate GST payable in respect of the following:

Case 1. No tax Economy - GST not applicable.
Case 2. Full Tax Economy - No Exemptions.
Case 3. Exempted Economy - Exemption to David.
Case 4. Zero Rating Economy - Zero Rating to David.

Solution

Case 1: No tax Economy - GST not applicable

Mr. John

Particulars	Amount (Rs.)	Input GST (Rs.)	Net Payable (Rs.)
Cost of goods purchased	2000	0	
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	2750		
Add: GST @ 10%	0	0	0
Total Selling Price	2750		

Mr. David

Particulars	Amount (Rs.)	Input GST (Rs.)	Net Payable (Rs.)
Cost of goods purchased	2750	0	
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	3500		
Add: GST @ 10%	0	0	0
Total Selling Price	3500		

Case 2: Full Tax Economy - No Exemptions.

Mr. John

Particulars	Amount (Rs.)	Input GST (Rs.)	Net Payable (Rs.)
Cost of goods purchased	2000	200[1]	
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	2750		
Add: GST @ 10%	275	200	75
Total Selling Price	3025		

[1] Assuming 10% GST was paid on inputs.

Mr. David

Particulars	**Amount (Rs.)**	**Input GST (Rs.)**	**Net Payable (Rs.)**
Cost of goods purchased	2750	275	
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	3500		
Add: GST @ 10%	350	275	75
Total Selling Price	3850		

Case 3: Exemption Economy - Exemption to David.

Mr. John

Particulars	**Amount (Rs.)**	**Input GST (Rs.)**	**Net Payable (Rs.)**
Cost of goods purchased	2000	200[2]	
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	2750		
Add: GST @ 10%	275	200	75
Total Selling Price	3025		

Mr. David

Particulars	**Amount (Rs.)**	**Input GST (Rs.)**	**Net Payable (Rs.)**
Cost of goods purchased	3025		
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	3775		
Add: GST @ 10%	0	0	0
Total Selling Price	3775		

Case 4: Zero Rating Economy - Zero Rating to David.

Mr. John

Particulars	**Amount (Rs.)**	**Input GST (Rs.)**	**Net Payable (Rs.)**
Cost of goods purchased	2000	200[3]	
Add: Labor	500		
Add: Profit	250		

[2] Assuming 10% GST was paid on inputs.
[3] Assuming 10% GST was paid on inputs.

Value of goods sold (without GST)	2750		
Add: GST @ 10%	275	200	75
Total Selling Price	3025		

Mr. David

Particulars	**Amount (Rs.)**	**Input GST (Rs.)**	**Net Payable (Rs.)**
Cost of goods purchased	2750	275	
Add: Labor	500		
Add: Profit	250		
Value of goods sold (without GST)	3500		
Add: GST @ 10%	0	0	0
Total Selling Price	3500		

Comparison between Full Tax Economy, Exempted Economy, Zero Rating Economy and No Tax Economy.

Particulars	**Full Tax Economy**	**Exemption Economy**	**Zero rating Economy**	**No Tax Economy**
SP to consumer	3850	3775	3500	3500
Total Levy of GST	350	275	275	0
Less: Refund adjustment	0	0	(275)	0
Net levy of GST	350	275	0	0

In the above example, we see that final selling price of goods is same under no tax economy and zero rating economy. Zero Rating is exemption in actual.

However we cannot even say that Zero Rating is free of all harms. Zero-rating implies build up or payout of refunds, which may entail huge administrative costs, requiring verification and disbursement of refund cheque. Furthermore, there is the issue of controlling evasion or fraud. Zero rating creates an incentive for sellers to exaggerate the values of their final sales and to correspondingly inflate the value of taxable inputs purchases, in order to avail themselves of the refund of a larger input tax element. The resources needed to cross-check such claims can impose additional and perhaps unsustainable demands on prevailing systems.

5. Conclusion

Zero rating is boon for economy and for consumers and for producers. Exemptions are bane for all stake holders.