



A STUDY OF GOODS AND SERVICE TAX IN INDIA – A SPECIAL REFERENCE TO IMPACT ON STATE GOVERNMENT REVENUE

Dr. V. B. Zodage

HOD, Accountancy

Sant Rawool Maharaj Mahavidyalaya

Kudal , Dist- Sindhudurga

Maharashtra State

I. INTRODUCTION

India has been trying to implement the Goods and Service Tax (GST) for last few years but due to political and state government autonomy issues the federal government has been unable to

make it a law. Intention to implement this was declared in 2008 and it was supposed to be in existence from April 2010. 85 percent of the revenue of state governments is generated from the indirect taxes on goods and services and sales tax alone accounts for 61 percent of the total revenue.

Since India is a federal republic so the concurrence of the state governments is required for making laws for the taxes which are source of revenue for states and local self-governments. An empowered committee of state finance ministers was formed in 2007 to develop agreement for GST and also to prepare a road map for its implementation.

II. GOODS AND SERVICE TAX

GST is a value added tax (VAT) and is supposed to subsume most of the indirect taxes existing at the level of state and federal governments. This will be a comprehensive tax for almost all goods and services. Some of the goods like crude oil, natural gas, turbine fuel, high speed diesel, and alcohol for human consumption are not included in the list due to import dependence, environmental and social reasons. Central Taxes to be subsumed under the Goods and Services Tax are Central Excise Duty, other Excise Duties, Service Tax, Customs Duties (countervailing taxes), and Surcharges. Apart from this some state taxes to be subsumed under GST are VAT /Sales tax, Entertainment tax, Luxury tax, Taxes on lottery, betting & gambling, State Cesses and Surcharges in so far as they relate to supply of goods and services and Entry tax. GST is a valued added tax on goods and services that is paid by the final consumer while the retailer will be taking credit of the tax he has paid while buying goods for retailing. So in this all the services of retailer or the chain behind him is taxed apart from the actual value of production of that good. This can be explained by a hypothetical example by supposing that there is a chain of manufacturer, wholesale dealer and the retailer and GST is 10%. Suppose the manufacturer purchases the inputs worth \$100 for producing a good worth \$140. He will pay net GST of \$4 by taking the tax credit of \$10 on the inputs. Similarly the wholesaler who buys this good and sells it for \$150 will pay net GST of \$2 and the retailer who sells it for \$170 will pay net GST of \$2 by taking the tax credit for his purchase which comes out to be \$15.

III. BACKGROUND OF GOODS AND SERVICE TAX

India is a country with population of 1240 million as per Census 2011. It has a total of 29 states and 6 union territories (under administrative control of federal government). The



states in India were formed on the basis of linguistic majorities. India has graduated from sales tax rules at state level and excise duty rule at federal level to a Value Added Tax separately for both state sales tax and federal excise duty few years back. GST will take these reforms further to common tax base and incidence of taxes and will be a major reform in indirect tax system.

Indian federal government initiated the VAT in 1986 for excise duty by introducing the MODVAT for some of the goods. This later developed into CENVAT (central VAT) which included most of the goods. In 2005 Indian federal government amended the constitution to tax the services and this tax was also included into the CENVAT. The federal government intensified its efforts to convince the states for VAT tax structure in mid-nineties and focused on the harmonization of sales tax structure through implementation of uniform floor rates of sales tax. The continuous persuasion and discussion lead to a great success in reaching at a consensus for uniform floor sales tax rates.

After this procedures were initiated for systematic introduction of state level VAT. Indian states had the sales tax system till 2005 when VAT was introduced after about 10 years of deliberations. In sales tax system the inputs for manufacturing were taxed for sales tax and when the product was produced than again whole of the selling value was taxed. So there was cascading of tax because of tax on the tax. This cascading effect becomes more prominent as the chain grows and used to have major impact till the goods reached the consumer. Value added tax structure is the solution to this cascading of tax. Apart from cascading the sales tax system had varied tax rates for various goods and it also varied from state to state making this difficult to administer and was also leading to unhealthy competition between states for more revenue.

As per the documents in ministry of Finance website the rate of growth tax revenue doubled after introduction of VAT from the annual rate of growth in pre-VAT five year period. This is linked to the self-enforcing nature of VAT. It gives the benefit of tax on inputs only if the tax payer produces the proof of the earlier paid tax. So this system has built-in check on tax compliance at the federal as well as the state level which resulted in the improvement of transparency and curtailed the tax evasion. This also helped in the curtailment of tax rate war between the states which is considered to be an unhealthy practice for the economy as a whole.

IV. CONTENTIOUS ISSUES

The issues with the GST acceptance are mainly about safeguarding the powers of states in taxation matters. Other contentious issues are the structure of tax rates, intention of Federal government to redistribute the resources from richer states to poorer states or richer regions to poorer regions through central transfers in the form of grants and the single common market which can be of great help for economy of the country as a whole. Some food grains producing states and mineral rich states get considerable revenue from the Purchase tax which is a tax on the agriculture produce purchased from the farmers. These states want to exclude the purchase tax from the GST. Purchase tax is same as sales tax but is deposited to the government by the purchaser instead of the seller. Most of this produce is exported to other states. So these states believe that revenue generated from purchase tax is

in fact exporting the tax burden on the local population to the other states and so is not regressive for their state.

Since the indirect taxes are major source of revenue for state governments so any change in this tax structure can impact the state governments adversely. Some states may have positive impact while others may have negative impact and the impacts will not be uniform. These differential impacts have to be taken care of in the tax structure design (Kavita Rao 2008). The states want a guarantee of reimbursement from the federal government in case their revenue decreases.

V. IMPLEMENTATION STRATEGY

With the federal structure of the Indian constitution the implementation of uniform policies is a very delicate issue. The importance of indirect taxes in the functioning of state governments makes it more complex. As India could achieve the VAT system functioning through consensus so the strategy should be to achieve a consensus for implementation of the GST. The whole purpose of GST will be defeated even if one of the states refuses to comply with it. Federal government is working on these principals only since the declaration of intention to shift to GST tax structure. The deliberation in the empowered committee of state finance ministers is working out a solution by consensus while addressing all the contentious issues. Administratively only one system of taxation would have been much better but due to federal state issue about sharing of power the GST is supposed to have three components which are central GST, state GST and interstate GST. World over there are very few examples where this dual system of VAT is being implemented otherwise the common practice is that of single federal VAT. Although two taxes will be charged in dual GST system but there will be uniformity about chargeability, classifications, taxable system, registration etc. Further there will be uniformity of tax rates across the states which will reduce unhealthy competition. It is proposed to have only two or three levels of tax rates uniformly throughout the country with federal government sharing certain percentage and state sharing certain percentage. Due to uniform tax rates the states will not be able to change the tax rate at will in their budget as the rate has to be decided collectively.

The registration system through-out the country should be uniform and this should enable easy linkage with Income Tax database through use of PAN (Permanent Account Number). PAN is the unique income tax account number issued to each individual who files income tax returns or even applies for this number. Purchase tax should be a part of the GST and should not be exempted. This can give a loophole to the states to impose purchase tax on any of the good like minerals, forest produce, industrial raw material etc. in addition to GST. Further purchase tax on the agriculture produce is regressive as it affects the poor people most who spend a major part of their income on food.

Government services and social services like education, health care are not taxed in present tax structure so it will be very difficult to tax them in the new tax regime. These are likely to be exempted in the short run. For developing a level playing field for both domestic, exported and imported goods the exports need to be taxed at zero rate while imports need to be taxed at GST.

As far as tax rate structure is concerned, the single rate structure will be easier to administer and will also discourage manufacturer to hide production which is taxed at higher

rate. For example, if the tax rate difference is high the manufacturer will have incentive not to disclose all his sales depending on the tax rate on inputs and outputs. On the other hand, differential tax rates can address the issues of progressivity by taxing the luxurious goods at higher rates. (Kavita Rao 2008) There are some goods which need to be taxed at a higher rate as there may be need of judicious use of some of the goods due to issues concerning environment and the public or individual health. Some of these products are carbon emitting products like petroleum products and some products like Tobacco or alcoholic products which are not good for health. They can be subject to additional excise duty. Similarly, some goods for use of higher income people can be subjected to luxury tax. The list of such products should be kept a minimum so that it does not affect the overall implementation of GST and is more accountable without any evasion of taxes. For interstate transfer products the model in discussion in India is 'zero rating model'. In this the exporting state does not charge any tax but the dealer in the importing state has to pay the tax. The dealer in the importing state has to declare all imports in the monthly return within a prescribed time. This will bring dealers purchasing from within the state and those importing from the other state at the same level and both will have to pay the same tax.

VI. IMPACT ON STATE GOVERNMENT REVENUE

The some states in India especially ruled by the opposition parties have been resisting the implementation of GST on the grounds of contentious issues discussed earlier. The foremost of that was about the financial independence of the states about their constitutionally independent revenue sources. If there is only federal level GST then the states will be financially dependent on the federal government as they will have to look for transfers of their own constitutionally allowed revenue. Richer states also fear that the federal government can transfer their own rightful revenue to poorer states in the name of equitable distribution. With the dual system of GST the states will be levying their own GST apart from the central GST and that revenue will be deposited directly to their own treasury. So the required independence of the states in the federal structure will be maintained.

States will have much broader tax base under the GST regime. The federal government is empowered to tax services and goods up to the production stage while state governments are empowered for levying sales tax on the goods sold in its territory. All the imported goods also charged with custom duty by the federal government while state charges sales tax on them. With GST states will be able to tax not only the goods but the services as well as imports. For this the federal government has planned to do the constitutional amendment to allow the states to have power to levy the VAT on services as well as allow the federal government to levy tax on the sales. This amendment is also supposed to allow the states to levy tax on imports. The broader tax base will be a major plus for states. In Canada GST the objectives of the states were to broaden the tax base, lower tax rates and remove bias against exports (Piggott & Whalley, 1998). GST as mentioned earlier is VAT on goods and services. The VAT under GST will not only be about the value addition in goods till the production but it will cover all the services required to take the good to the consumer. So the tax base will be much higher under VAT even if the pure service sector is accounted for separately. This will make the tax more progressive and will also improve the adequacy.



The Centre and the States would have concurrent jurisdiction over the entire value chain and

over all the taxpayers on the basis of common tax base for goods and services. The taxpayers will have to file returns both with the States and the Centre. Due to this there will be good improvement in the tax compliance. This will improve the revenue of the states.

It is proposed that GST will have common registration throughout the country and also it will be linked with the income tax numbers, so the cross verification of tax compliance can be possible.

This will also help in the better tax compliance. GST will be a simpler structure and will subsume a number of indirect taxes. This will be much easier to administer and possibly with much less resources and manpower. So the efficiency of tax recovery will improve. With less level of paperwork for the taxpayers and only one type of tax return, the industry, service sector and trading sector will be happy and will flourish. A substantial section of the economy in India is in the informal sector and is not in the tax net. There are a large number of unregistered manufacturing units and some of them operate from the residential areas. The share of this non tax complying sector is on decline since liberalization of the economy in 1991. This has reduced from 34% in 1999-2000 to 30.6% in 2006-07. Still this is a large section of the economy which needs to be brought into the tax net. (Kavita Rao 2008) Due to the GST and also its linkage with the income tax, the tax compliance is going to be much better which will address this non complying sector also. This not only will improve the revenue stream for the states but will also address the inhuman and hazardous working conditions in these unregistered manufacturing units. If the tax base is improved due to inclusion of this sector then there can be positive impact on GST rate so as to generate same revenue at reduced rates.

Broader tax base is pro poor and is welfare worsening as poor people are sellers of informal sector goods while rich are buyer so there will be benefits to poor household while loss to rich household (Piggott & Whalley 1998) Unprocessed agriculture goods may still be exempted from the incidence of GST which will help in improvement of progressivity of the GST as VAT regime is considered to be regressive. Also some goods like luxury goods are to be taxed higher and will be out of the ambit of GST that will make it progressive. “Under turnover tax (cascaded tax), the rich consumer is taxed more lightly than the poor consumer, because the former buys more lavishly retailed goods.” (Shoup 1988)

Manufacturing sector becomes less attractive as compared to retail sector in cascaded tax structure due to non-credit of sales taxes on the inputs. This will also encourage the vertical integration of the manufacturing sector so that they can avoid the tax on the tax. Because of this some natural monopolies can develop which can be very harmful to consumers and the market. Export oriented units give some hidden tax in cascading of tax regime. Although they are exempted from taxes for export produce but there are some inputs which they buy from local market and are not able to take the credits for taxes paid due to non-existence of such system.

VII. CONCLUSION

GST at the state level will be a major improvement in its tax base for future revenue generation. The service sector has always been on the rise and is growing at much faster pace



than the manufacturing sector. As per the 2011 data on GDP the service sector contributes about 57 % while industrial sector contributes about 28% to the GDP of India. Without GST the major tax base will be absent in the revenue stream of state governments. Further the tax compliance will improve in the GST regime due to computerization of tax payers at national level, common registration at national level and also due to linkage of the registration with the income tax records. GST will be the collective gains for industry, trade, agriculture, common consumer as well as the federal and state governments. GST will be more progressive due to exemption of food articles, inclusion of informal sector and higher taxes on luxury goods. This also will improve the adequacy and stability of the state resources due to broader tax base. This tax regime will need consent of all they state as they have to enact their own legislation apart from federal level amendments in the constitution, I think all the states should move ahead with the procedure without any further delay. As far as issue on rate structure is concerned there can be two rates one for essential items and other for non-essential items while precious metals may have special rates.

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