

Introduction of GST in India

K Jose Cyriac, IAS

Additional Secretary, Revenue
Ministry of Finance, Govt of India

9th October 2009

Constitutional Provisions on Centre-State Fiscal Balance

- Direct Tax – Income Tax levied by the Centre
- Tax on manufacturing levied by Centre
(Central Excise)
- Tax on sales levied by the State
(Sales Tax or State VAT)
- Tax on inter-State sale & Declared Goods
Central Sales Tax - Central law – but collected & retained by the State
- Tax on services levied by the Centre
(Service Tax)
- Tax on Exports & Imports levied by the Centre
(Customs Duty & Export Duty)

Volume of Tax Collected 2007-08

Centre

Income Tax –	Rs 3,14,000 cr
Customs Duty –	Rs 1,04,000 cr
Central Excise –	Rs 63,864 cr (excl.petroleum)
Service Tax –	Rs 51,133 cr
CVD -	Rs 53,293 cr
Cesses	<u>Rs 12,893 cr</u>
Sub-total -	Rs 181,183 cr

States

Sales Tax/VAT –	Rs 108,340 cr (excl. non-VAT)
CST (X4/3) –	Rs 31,181 cr
Others -	<u>Rs 7,627 cr</u>
Sub-total -	Rs 147,148 cr

Tax Cascading

Manufacturer 1		Manufacturer 2	
Raw materials	50	Raw materials	125
Labour	30	Labour	45
Others	10	Others	15
Profit	10	Profit	15
Total ex-factory	100	Total ex-factory	200
Central Excise@12%	12	Central Excise @12%	24
Sale Price	112	Sale Price	224
Sales Tax @12%	13	Sales Tax @12%	27
Total paid by M2	125	Total sale price	251
Total tax paid 12+13+24+27=76 Sale price excl. tax : 251-76=175		Effective tax rate : $76 / 175 = 43\%$	

Value Added Tax

Tax payable only on the value addition at each stage

			Centre CX @12%	State VAT@12%
Manufacturer-1	Basic Cost	70	Centre	
	Value Addition	30		
	Total	100	12	13.4
Manufacturer-2	ValueAddn.+ Taxes	50	6	
	Total	150	18	
Sales Dealer 1	Basic Cost	150		18-13.4= 4.6
	ValueAddn.+ Taxes	40		4.8
	Total	190		
Sales Dealer 2	ValueAddn.+ Taxes	60		7.2
	Total	250		30
Service Provider	Basic Cost	250		
	ValueAddn.+ Taxes	50		
	Total	300	36-18=18	
	(66/234 = 28%)	66	36	30

Central VAT & State VAT

- Easy to give ITC within same jurisdiction. CENVAT is in operation for 10-15 years now.
- Centre can give ITC for Central Excise and even for Service Tax; but cannot do so when there is a sale of good, which is in the State's domain.
- State can give ITC for Sales Tax within the State, but cannot do so against Central Excise paid to Centre and Sales Tax paid to other States.
- Even if some mechanism for giving ITC between Centre & States is evolved, there has to be uniformity of rates.
- If rates are made uniform across all States, there will be a number of States which will lose revenue. They have to be compensated.

State VAT

- Empowered Committee of State Finance Ministers set up in 1999. West Bengal State FM is Chairman. All State FMs and the Centre are represented on it.
- Uniform rates of tax were negotiated and introduced in all States in stages. 12.5%, 4%, 1% & exempted items. Petroleum products, liquor, goods of local importance, etc were exempted. There are deviations.
- Compensation from the Centre (100%, 75% & 50% in first 3 years) promised to States losing revenue, based on historical growth rate of each State (Total compensation paid/payable : Rs 20,000 cr)
- State VAT introduced from 1.4.2005. TN & UP were the last to join. Now, all States have joined.

Reduction of CST

- Till 1.4.2007, a uniform CST rate of 4% for all inter-State sales.
- To be reduced to 0% by 1.4.2010, when GST is introduced.
- Reduced from 4% to 3% w.e.f. 1.4.2007
- Loss of States to be compensated mainly by non-monetary measures :
 - (1) Introduction of VAT on tobacco
 - (2) Abolition of Form D
 - (3) Centre setting apart revenue from certain specified services for the State
- Any shortfall to be made good by the Centre by way of Budgetary allocations.

Further Reduction of CST

- CST further reduced from 3% to 2% from 1.6.2008.
- States are to increase basic VAT rate from 4% to 5%
- States are also to introduce VAT on textiles.
- Since these could not be done by the States, the compensation package has been re-negotiated.
- Reduction from 2% to 1% on 1.4.2009 has not been done, because of trade malpractices (as reported by States) and the economic downturn. Present idea of EC is to reduce CST from 2% to 0% on introduction of GST by 1.4.2010.

Goods & Services Tax (GST)

The EC has been discussing GST for about 2 years now. There is a broad consensus between Centre & States on the policy areas relating to GST to be introduced by 1.4.2010.

- (1) This will be a dual GST – there will be Central GST portion (CGST) and a State GST portion (SGST) eg. if GST is 17%, CGST can be 9% & SGST 8% and so on. There could also be multiple rates.
- (2) GST will subsume Central Excise, State VAT and Service Tax. It will also subsume all cesses & surcharges (by Centre & the States), Entry Tax not in lieu of Octroi, Entertainment tax levied & collected by the State Government, etc. It will not subsume levies by local self-Governments (Panchayats & Urban Local Bodies), petroleum, etc. For liquor, tobacco, etc States could impose an additional tax, over and above the GST. Final view yet to be taken by the EC.

GST – Basic Features

(3) All transactions will be taxed – manufacture, sales, service etc. ITC will be given at each stage.

			CGST@9%	SGST@8%
Manufacturer-1	Basic Cost	70		
	Value Addition	30		
	Total	100	9.00	8.00
Manufacturer-2	Value Addition	50	4.50	4.00
	Total	150		
Sales Dealer 1	Value Addition	40	3.60	3.20
	Total	190		
Sales Dealer 2	Value Addition	60	5.40	4.80
	Total	250		
Service Providr	Value Addition	50	4.50	4.00
	Total	300	27	24
			(9%)	(8%)

Rates indicated are for illustration only. Final rates have not yet evolved .

GST – Basic Features – Contd...

- (4)** Centre will give ITC only for CGST and the State only for SGST. Cross utilisation of ITC between CGST & SGST shall not be allowed, except for inter State sales (IGST).
- (5)** Centre will legislate, levy & administer the CGST portion on its own and the States the SGST portion on their own.
- (6)** To avoid deviations by the States, there shall be a mechanism, wherein the rates and other relevant parameters will be decided upon by the Centre & the States. The rates can thereafter not be changed by the Centre or any of the States, without approval of the same mechanism. A Constitutional mechanism will be introduced.

GST – Basic Features – Contd...

- (7)** Destination principle for inter State sales of goods. For services, the rules are yet to be formulated; sub-Working Group has been constituted.
- (8)** Administration of CGST will be Centre's responsibility; Administration of SGST will be the responsibility of each State – Concurrent jurisdiction for entire value chain and all taxpayers will cause difficulties. A solution will have to be found for this.

GST – Important Issues to be addressed

- (1) **Rates** : A revenue neutral model has to be evolved. Fairly simple for the Centre, but difficult when it comes to each State. However, what the new base will be is difficult to calculate, mainly because one has to capture the sum of all value additions at each stage of the billions of transactions.
- (2) Single rate or multiple rates?
- (3) non GST items, Exempted items & 0% rate items.

GST – Compensation Mechanism

When rates are made uniform across all States and input tax credit is given for all transactions (manufacture or sale or service), some States will lose, while some will gain. How will losing States be compensated?

One method is through the mechanism of the XIII Finance Commission.

GST – Inter State transactions

- One of the problem areas is inter-State transactions and giving ITC across States.
- The entire input tax paid in the preceding transactions will have to be paid by the origin State to the destination State.
- IGST- Inter State GST- adjustment of tax payable against CGST & SGST by dealer.
- An IT based clearing house mechanism is to be evolved.

GST- Rules for appropriation of Service tax

- Presently, Centre is collecting the entire Service Tax. So, no need to evolve any rules; eg. telephone companies
- When States also levy service tax, the rules of taxation need to be decided upon.
 - eg. (1) Phone companies
 - (2) Transport carriers
 - (3) Architect

GST – Dispute Resolution Mechanism

- Likely disputes between States and perhaps between Centre & the States have to be resolved. A mechanism has to be evolved.
- Presently, for CST, there is a CST Appellate Tribunal, under a ret'd. Supreme Court Judge. This may have to be strengthened with regional benches, as the number of cases will be large.

GST – Constitutional Amendment required

- Centre will henceforth levy CGST on sales. States will levy SGST on manufacture and service. This will require Constitutional amendment.
- Entries in the Constitution empowering Centre & States to levy taxes, cesses, etc being subsumed will have to be amended.
- Fixing of rates, from which neither the Centre nor the States can deviate, will also require Constitutional amendment.
- A Joint Working Group of officers from the Centre & the States have been constituted. Time given 4 weeks.

GST – Way Forward

- Sub-Working Groups have given reports on (1) Items which require special rates (2) Mechanism for inter-State transactions & (3) Rules for inter-State services. On most of the items, consensus has emerged. Remaining items to be finalised.
- Rates to be finalised, between the Centre & the States
- Constitutional amendment – easy, if there is consensus
- Model legislations
- IT infrastructure
- Dispute Resolution Mechanism
- Compensation Mechanism

Thank you