

# Goods and Service Tax - An Overview

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We all have heard about Goods & Services Tax. It is one of the many legislations that are pending in the list of changes that we might expect in times to come. But GST is something totally different from all these. This tax is a consolidation of many indirect taxes already levied in India, thereby drastically overhauling the system of indirect taxes in India.

## The need for GST

We begin by elaborating on the important concept of - cascading effect of taxes. It is also, logically, referred to as "taxes on taxes". It is simple to illustrate - say A sells goods to B after charging sales tax, and then B re-sells those goods to C after charging sales tax. While B was computing his sales tax liability, he also included the sales tax paid on previous purchase, which is how it becomes a tax on tax.



This was the case with the sales tax few years ago. To overcome this, VAT system was introduced whereby every next stage dealer used to get credit of the tax paid at earlier stage against his tax liability. This reduced an overall liability of many traders and also helped to reduce inflationary impact on the prices.

Similar concept came for the duty on manufacture - Central Excise Duty - much before it came for sales tax. The CENVAT credit scheme (earlier known as MODVAT) was also a welcome move for trade and industry where credit of excise duty paid at the input stages was allowed to be set-off against the liability of excise on removal of goods. With effect from 2004, cross utilisation of credit between excise duty and service tax was also permitted. To a large extent, the problem of cascading effect of taxes is resolved by these measures.

However, there are still problems in the system that have not been solved till date. We shall talk about these problems now. The credit of Input VAT is available against Output VAT. In the same manner, the credit of input excise/service tax is available for set-off against output liability of excise/service tax. However, the credit of VAT is not available against excise and vice versa. We all know that VAT is computed on a value which includes excise duty. In the same manner, CENVAT credit is allowed only for the Excise duty paid on inputs, and not on the VAT paid on the input raw material. This shows that there is a tax on tax!

Excise duty and service tax are levied by the Central Government, while VAT is levied by the State Government, which is one of the reasons why such a cross-utilisation of credits is not allowed. However, this does not constitute a valid reason that justifies the cascading effect of taxes. For common man, it makes no difference if a tax is levied by the Centre or the State - a tax is a tax, and there is a tax on tax. GST is being proposed to be introduced to combat this problem, among many others.

## The Present System of Indirect Taxes

Let us first understand the various indirect taxes that are presently being levied by the Central & State Governments.

| Ref. | Tax                 | Levy by | Levied on                       | Credit can be Set-off against | Covered by GST |
|------|---------------------|---------|---------------------------------|-------------------------------|----------------|
| 1    | Central Excise duty | Centre  | Manufacture                     | 1,2                           | Yes            |
| 2    | Service Tax         | Centre  | Providing services              | 1,2                           | Yes            |
| 3    | Customs             | Centre  | Import                          | -                             | No             |
| 4    | CVD* under Customs  | Centre  | Import (compensating Excise)    | 1,2                           | Yes            |
| 5    | SAD* under Customs  | Centre  | Import (compensating Sales Tax) | 1                             | Yes            |
| 6    | CST                 | Centre  | Inter-State sales               | -                             | Yes            |
| 7    | VAT                 | State   | Sales within a state            | 7                             | Yes            |

(\* CVD - Countervailing Duty; SAD - Special Additional Duty)

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The GST shall subsume all the above taxes, except the Basic Customs Duty that will continue to be charged even after the introduction of GST. Other indirect taxes, such as stamp duties etc. shall also continue. India shall adopt a Dual GST model, meaning that the GST would be administered both by the Central and the State Governments. This makes it the first tax of its kind in India!

### The Dual GST Model

We begin by explaining the dual GST model and the taxes levied on each kind of transaction. See these abbreviations before we understand them-

SGST - State GST, collected by the State Govt.

CGST - Central GST, collected by the Central Govt.

IGST - Integrated GST, collected by the Central Govt.

Now look at the chart given below:

| Transaction            | NEW system   | OLD system              | Comments                                                                                                                                             |
|------------------------|--------------|-------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| Sale within the state  | SGST<br>CGST | VAT &<br>Excise/<br>ST* | Under the new system, a transaction of sale within the state shall have two taxes, SGST - which goes to the State; and CGST which goes to the Centre |
| Sale outside the state | IGST         | CST &<br>Excise/<br>ST* | Under the new system, a transaction of sale from one state to another shall have only one type of tax, the IGST - which goes to the Centre           |

\* It is worth mentioning here that the levy of Excise is not dependent on the levy of VAT/CST, as they are governed by different laws.

SGST, CGST and IGST are the taxes that shall be levied under the new system of GST. How this shall operate, and how can we have cross utilisation of credits can be seen in the discussion that follows -

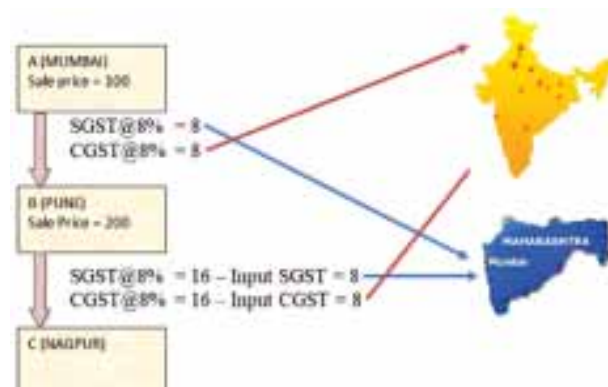
### How GST operates?

CGST and SGST rates have been assumed to be 8%.

#### Case 1: Sale in one state, resale in the same state

In the example illustrated below, goods are moving from Mumbai to Pune. Since it is a sale within a state, CGST and SGST will be levied. The collection goes to the Central Government and the State Government as pointed out in the diagram. Then the goods are resold from Pune to Nagpur. This is again a sale within a state, so CGST and SGST will be levied. Sale price is increased so tax liability will also increase. In the

case of resale, the credit of input CGST and input SGST is claimed as shown; and the remaining taxes go to the respective governments.

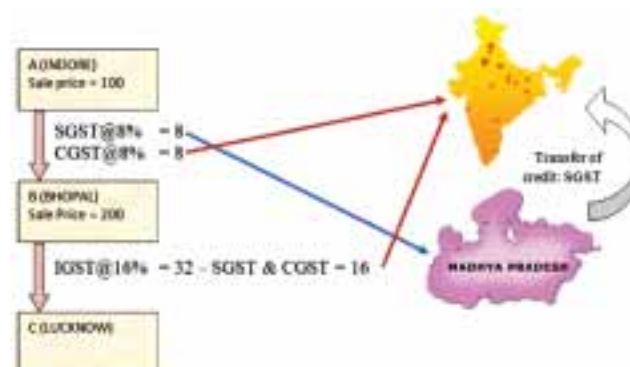


Rate of IGST has been assumed to be 16%.

#### Case 2: Sale in one state, resale in another state

In this case, goods are moving from Indore to Bhopal. Since it is a sale within a state, CGST and SGST will be levied. The collection goes to the Central Government and the State Government as pointed out in the diagram. Later the goods are resold from Bhopal to Lucknow (outside the state). Therefore, IGST will be levied. Whole IGST goes to the central government.

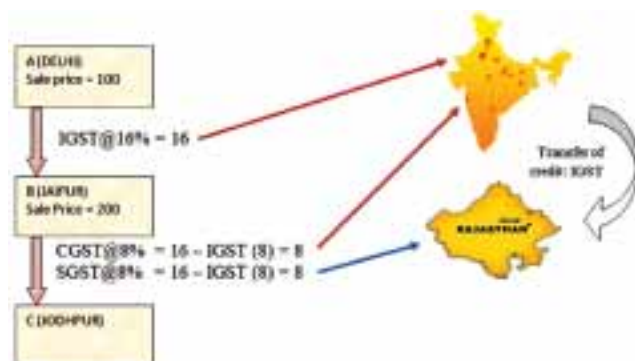
Against IGST, both the input taxes are taken as credit though SGST being a state levy is not collected by the Central Government. **This is the crux of GST.** Since this amounts to a loss to the Central Government, the state government compensates the central government by transferring the credit to the central government.



#### Case 3: Sale outside the state, resale in that state

In this case, goods are moving from Delhi to Jaipur. Since it is an interstate sale, IGST will be levied. The collection goes to the Central Government. Later the goods are resold from Jaipur to Jodhpur (within the state). Therefore, CGST and IGST will be levied.

50% of the IGST can be set off against CGST and the remaining 50% IGST can be set off against SGST which is taken as a credit. It is important to note that though IGST is not collected by the state government, still its credit is claimed against SGST. Since this amounts to a loss to the State Government, the Central government compensates the State government by transferring the credit to the State government.



### Advantages of GST

Apart from full allowance of credit, there are several other advantages of introducing GST in India:

- **Reduction in prices:** Due to full and seamless credit, manufacturers or traders do not have to include taxes as a part of their cost of production leading to reduction in prices. However, if the government seeks to introduce GST with a higher rate, this benefit might be lost.
- **Increase in Government Revenue:** This might seem to be a little vague. However, even at the time of introduction of VAT, the public revenue actually went up instead of falling because many people resorted to paying taxes rather than evading the same. However, the government may wish to introduce GST at a Revenue Neutral Rate, in which case the revenue might not see a significant increase in the short run.
- **Less compliance and procedural cost:** Instead of maintaining big records, returns and reporting under various different statutes, all assesseees will find comfort under GST as the compliance cost will be reduced. It should be noted that the assesseees are, nevertheless, required to keep record of CGST, SGST and IGST separately.

### Points to Ponder: Food for Thought

The GST is a very good type of tax. However, for the successful implementation of the same, we must be

cautious about a few aspects. Following are some of the factors that must be kept in mind about GST:

- Firstly, it is required that **all the states implement the GST** together and that too, at the same rates. Otherwise, it will be really cumbersome for businesses to comply with the provisions of the law. Further, GST will be very advantageous if the rates are same, because in that case taxes will not be a factor of consideration in deciding location for making investment decisions, and people will be able to focus on profitability.
- For smooth functioning, it is important that the GST legislation clearly sets out the **taxable event**. Presently, the CENVAT credit rules, the Point of Taxation Rules are amended/ introduced for this purpose only.
- Since GST is a destination based tax. It should be clearly identifiable as to where the goods are moving. This will be difficult in case of services, because it is not easy to identify where a service is provided, thus, this problem should be properly dealt with.
- More awareness about GST and its advantages need to be made, and Chartered Accountants will have to take the onus to assume this responsibility.

### GST: Way Forward!

Presently, lot of speculations are going on as to when the GST will actually be implemented in India. Looking into the political environment of India, it seems that more time will be required to ensure that everybody is satisfied. The states are confused as to whether the GST will hamper their revenues. Although the Central Government has assured the States about compensation in case the revenue falls down, still a little mistrust can be a severe drawback!

Sooner or later, the GST will surely knock the doors of India. And when that happens, we as future torch bearers of the profession are required to be prepared and fully equipped with our knowledge regarding GST. *Forewarned is forearmed*. Thus, we must be ready to deal with GST and many other changes that are going to take place in India.

Charles Darwin had very correctly pointed out that

*The ones who are going to be the winners, are not those who are the strongest, or those who are the fastest; but those who are the most adaptive to changes...* ■