

FIRST STEP TO GOODS AND SERVICES TAX

A Beginners Guide TO GST

**“There is only one thing that is constant in Tax system and
that is CHANGE”
So better be ready....**

-By CA Harcharan Singh

<http://ca-recentupdates.blogspot.com/>

(Assisted by CA Kabir)

LATEST ON GST

Under pressure from states the centre has prepared a fourth draft of constitutional amendment Bill for introduction of GST. In the proposed bill the finance ministry has dropped some key proposals in the third draft and switched back to second.

The third draft had proposed setting up a GST council by act of parliament, instead of president's order proposed in second draft. The bill is to be tabled in parliament by the end of budget session, it will describe the responsibility and role of council to be headed by union finance minister

IT system once developed all over the country will provide the foundation on which GST can be rolled out in a systematic and planned way

GST may kick off in 2013 with three rates initially for moving to a single rate GST regime of 16% for the centre as well as the states.

To begin within the next year the centre will adopt a three rate formula. It is proposed that the rate for taxation of services be fixed at 8%, a dual rate regime for goods was recommended at the meeting of empowered meeting of state finance ministers. The centre plans to keep a lower rate of 6% for certain goods and maintain standard rate of 10% in first year.

In case states agree to formula the GST rate will be 20% since state and centre both will levy 10% each on goods. For products which will attract lower rate the total GST burden will be 12% assuming centre and state levy 6% each.

PROPOSED GST RATES

(in percent)

		Central GSt	State GST	Total Liability
April 2013	Goods (Lower Rate)	6	6	12
	Goods (Standard Rate)	10	10	20
	Services	8	8	16
	Goods (Lower Rate)	6	6	12
	Goods (Standard Rate)	9	9	18
	Services	8	8	16
	Goods (Standard Rate)	8	8	16
	Services	8	8	16

Cash subsidy to replace area based incentives in GST

The excise duty exemptions given to industrial units will be converted into a subsidy scheme in the proposed GST regime. All the industries that enjoy area based exemptions will have to pay taxes in the new Indirect tax regime. They will, however, be entitled to receive cash refund from the government for the unexpired period of their tax holiday.

To understand the change first thoroughly understand the present laws of Indirect taxes.**VALUE ADDED TAX (VAT):-**

Before knowing about GST lets understand basic concept of GST. The basic thrust of GST is VAT. Taxation of inputs, like raw materials, components and other intermediaries had a number of limitations. In production process, raw material passes through many processes stages till a final product is made. Thus, output of the first manufacturer becomes input for second manufacturer and so on. When the inputs are used in the manufacture of product 'X', the cost of the final product increases by the cost of the inputs and the tax paid on such inputs. As the duty on the final product is on ad valorem basis and the final cost of product 'X' includes the cost of inputs, inclusive of the duty paid, duty charged on product 'X' leads to double taxation of raw materials. In other words, the tax burden goes on increasing as raw material and final product passes from one stage to other because, each subsequent purchaser has to pay tax again and again on the material which has already paid tax. This is called cascading effect or double taxation. This very often distorted the production structure and did not allow the correct assessment of the tax incidence. Therefore, the Government tried to remove these defects of the Central Excise System by progressively relieving inputs from excise and countervailing duties. An ideal system to realize this objective would have been to adopt value added taxation (VAT). However, on account of some practical difficulties it was not possible to fully adopt the value added taxation.

Hence, Government evolved a new scheme, 'MODVAT' (Modified Value Added Tax). MODVAT Scheme which essentially follows VAT Scheme of taxation. i.e. if a manufacturer X purchases certain components (raw materials) from another manufacturer Y for use in its product. Y would have paid excise duty on components manufactured by it and would have recovered that excise duty in its sales price from X. Now, X has to pay excise duty on product manufactured by it as well as bear the excise duty paid by the supplier of raw material Y. Under the MODVAT scheme, a manufacturer can take credit of excise duty paid on raw materials and components used by him in his manufacture. It amounts to excise duty only on additions in value by each manufacturer at each stage.

But all this was at central level; introduction of VAT at state level was not an easy task. Before introduction of VAT, in the sales tax regime, apart from the problem of multiple taxation and burden of adverse cascading effect, there was also no harmony in the rates of sales tax on different commodities among the States. Due to different rate from one another for the same

commodity in different States there was an unhealthy competition among the States in terms of sales tax rates called “rate war” – often resulting in, revenue-wise, a counter-productive situation.

Overcoming all initial difficulties and complexities the States started implementing VAT beginning April 1, 2005. All the States and Union Territories have now implemented VAT. The Empowered Committee of state finance ministers formed to mechanize a harmonized system of VAT has been monitoring closely the process of implementation of State-level VAT, and deviations from the agreed VAT rates has been contained to a negligible per cent of the total list of commodities.

The rate of growth of tax revenue has increased dramatically from the average annual rate of growth in the pre-VAT five year period after the introduction of VAT.

INTRODUCTION TO GOODS & SERVICES TAX (GST):-

GST is a single tax proposed to be implemented in India. GST will work like structure of Vat i.e. tax will be paid at every stage of production cycle with setoff available for tax paid on procuring goods or services. In simple words GST is a consumption based levy. Destination principle would be applicable in normal course. In an ideal GST, all the credit of taxes paid on purchase of inputs, input services and capital goods are seamlessly allowed for set-off against the tax payable on subsequent sale of goods that are either sold as such or sold upon conversion, or in the context of services, are supplied.

Goods & Service Tax (GST) as the name suggests, is a tax on supply of goods or services. Every person manufacturing, supplying goods or rendering any kind of services will be liable to pay GST which they will charge from their customer. The persons liable to pay GST will be allowed to take credit of GST paid by them on their purchase of goods or services.

In India a dual structure of GST will be introduced i.e. GST will be levied by central and state government on every transaction. This concept has been discussed in detail afterwards.

WHY THERE IS A NEED FOR GOODS & SERVICES TAX?

The goods and service tax (GST) is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at a national level. Integration of goods and services taxation would give India a world class tax system and improve tax collections. The introduction of goods and services tax will lead to the abolition of taxes such as

At Central level

- Central Excise Duty
- Service Tax
- Additional Excise Duties
- CVD (levied on imports in lieu of Excise duty)
- SAD (levied on imports in lieu of VAT)
- Excise Duty levied on Medicinal and Toiletries preparations,
- Surcharges and cesses
- Central Sales Tax

At State level

- VAT /Sales tax
- Entertainment tax (unless it is levied by the local bodies)
- Luxury Tax
- Taxes on lottery, betting and gambling
- Entry tax not in lieu of Octroi
- Cesses and Surcharges
- Turnover tax
- Tax on consumption or sale of electricity
- Taxes on transportation of goods and services

It would also eliminate the cascading effects of multiple layers of taxation. GST will facilitate seamless credit across the entire supply chain and across all states under a common tax base. It will allow continuous and uninterrupted chain of credits throughout the supply chain eliminating the burden of cascading effects of taxes.

Even though Vat has been introduced, there are many state taxes, few of those mentioned above that are not subsumed in VAT. While introducing service tax government realised that there is a need to give setoff of service tax to manufacturers as mostly all goods require material as well as some services in their production, but what about the traders, they also require many types of services in selling their goods but they are not getting setoff for service tax paid and this is adding to cost of products.

Moreover when manufacturers sell their goods they charge VAT on their selling price inclusive of excise and this leads to tax on tax which needs to be eliminated. For example:

Particulars	Existing Structure	GST Structure
From manufacturer to retailer		
Cost	10000	10000
Profit 20%	2000	2000
Total	12000	12000
Excise 10%	1200	-
	13200	12000
VAT 12.5% on 13200	1650	-
Central GST 12% on 12000		1440
State GST 8% on 12000		960
Final Selling price to Retailer	14850	14400
From retailer to final customer		
Cost of Goods	14850	14400
Profit 10%	1485	1440
Total	16335	15840

VAT 12.5%	2042	-
Central GST 12%	-	1901
State GST 8%	-	1267
Less: Set off of tax paid to Manufacturer	(1650)	(2400)
Selling Price to customer	16727	16608
Tax component in selling price	3242	3168

Rates given above are just used for explaining

VAT Rs.165 includes RS.15 VAT on Excise of Rs.120. With introduction of GST this cost of Rs.15 will be reduced to nil.

Now we talk about service provider, when a service provider renders a service it has to purchase many types of goods like stationary, computers and many other types of goods on which they pay state VAT as applicable but are not allowed to avail credit of that which adds to their cost and ultimately adds to cost of final customer. This is the essence of GST, and this is why GST is not simply VAT plus service tax but an improvement over the previous system of VAT and disjointed service tax.

It would end the long standing distortions of differential treatments of manufacturing and service sector. At present, 'goods' suffer two levies (Excise and VAT) whereas 'taxable services' suffer only one levy i.e. service tax. This leads to distortion, distortion arises because the relative prices of services would be lower as compared to goods.

Even, as current tax system treats goods and services differently, in certain cases there is double taxation. Talking about the most popular one, which is restaurant service, the government has brought it under the net of service tax recently. Now we have to pay VAT for food purchased and service tax on the same amount of bill. (There is some relaxation in terms of amount on which service tax will be charged) Another example can be the construction industry.

We can summarise by saying that benefits of GST are as under:-

- Many types of taxes will be subsumed into GST.
- GST will improve tax collections and compliance.
- GST will facilitate seamless credit across the entire supply chain.
- Eliminate the burden of cascading effects of taxes.
- It would end distortions of differential treatments of manufacturing and service sector.
- It would reduce cost of goods and services to some extent.
- GST will provide greater certainty and transparency of taxes.
- Will ensure uniformity of taxes all over the country
- Will eliminate dual taxation of the same transaction
- There would be fewer exceptions.

GST is projected as solutions to all these problems.

SYSTEM OF GST PROPOSED TO BE IMPLEMENTED IN INDIA:-

A Dual system of GST will be implemented in India. This means GST will have two components

- One levied by Centre (Central GST or CGST)
- Other levied by States (State GST or SGST)

In India both center and states have power to levy taxes to perform various responsibilities according to the division of powers prescribed in the Constitution for which they need to raise resources. Therefore, a dual system is best suited for India. Many other countries also follow dual system of GST, some of them are mentioned above.

The Central GST and the State GST would be applicable to all transactions of goods and services made for a consideration except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits. The CGST and SGST will be paid to accounts of center and state respectively. The part related to both shall be mentioned separately in invoice.

Since, the amounts of CGST and SGST are paid to different departments therefore; the input tax credit (ITC) for CGST can only be utilized for payment of CGST and respectively for SGST. It is same system as it presently prevails for VAT and excise. A taxpayer or exporter would have to maintain separate details in books of account for utilization or refund of credit.

Threshold Limit:- A threshold of gross annual turnover of Rs.10 lakh both for goods and services for all the States and Union Territories will be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime.

After taking into consideration the interest of small traders and small scale industries and to avoid dual control, it has been decided that the threshold for Central GST for goods will be Rs.1.5 Crore and the threshold for services should also be appropriately high.

Rate Structure:- Deciding a rate and obtaining consensus of all states over it is most difficult task. It has been decided to adopt a two-rate structure -a lower rate for necessary items and items of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items.

The exact value of the SGST and CGST rates, including the rate for services, will be made known duly in course of appropriate legislative actions.

Taxes not to be subsumed under GST:-

Purchase tax: Some of the States felt that they are getting substantial revenue from Purchase Tax and, therefore, it should not be subsumed under GST. The difficulties of the food grains producing States and certain other States were taken into consideration as substantial revenue is being earned by them from Purchase Tax and it was, therefore, felt that in case Purchase Tax has to be subsumed then adequate and continuing compensation has to be provided to such States. This issue is still being discussed.

Tax on items containing Alcohol: Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT can be continued to be levied on alcoholic beverages as per the existing practice. Excise Duty, which is presently being levied by the States, may not be also affected.

Tax on Tobacco products: Tobacco products would be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST without ITC.

Tax on Petroleum Products: As far as petroleum products are concerned, it was decided that the basket of petroleum products, i.e. crude, motor spirit (including ATF) and HSD would be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. A final view whether Natural Gas should be kept outside the GST will be taken after further discussions.

Taxation of inter-State supplies of goods and services

Taxation of inter-State supplies of goods and services would be governed by the IGST model. According to IGST Model Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services.

The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house

mechanism, verify the claims and inform the respective governments to transfer the funds.

Let us understand this with help of an example:-

Like a Dealer X sells goods to Y in Punjab he will have to pay IGST which will be sum of CGST and SGST. Here let us take CGST Rs.8 and SGST Rs.7. Now X can use credit of CGST or SGST available with him. If X uses credit of CGST in paying IGST then not a problem because centers credit is used for paying centers tax but if SGST is used the Delhi government will pay the amount of SGST used in payment of IGST to the central government.

Now the buyer in Punjab will book the credit of IGST paid. Similar to case above if Y uses this credit to pay CGST then it's not an issue but if this credit is used in discharging SGST liability then central government will pay to the Punjab government the amount of IGST used to pay SGST.

Advantages of this model:-

- No interruption in credit chain on Interstate transactions as it is there in present scenario, the credit of CST paid is not available to buyer.
- No refund claims to be monitored as ITC can be used for paying tax. There will be less blockage of funds.
- Self monitoring model.
- Model can take 'Business to Business' as well as
- 'Business to Consumer' transactions into account.
- As all inter-State dealers will be e-registered and correspondence with them will be by email.
- With all this in place the compliance level will improve substantially.

Composition/Compounding Scheme under GST

Composition/Compounding Scheme for the purpose of GST will have an upper ceiling on gross annual turnover and a floor tax rate with respect to gross annual turnover. In particular, there would be a compounding cut-off at Rs. 50 lakhs of gross annual turnover and a floor rate of 0.5% across the States. The scheme would also allow option for GST registration for dealers with turnover below the compounding cut-off.

Zero Rating of Exports

Exports would be zero-rated. Similar benefits may be given to Special Economic Zones (SEZs). However, such benefits will only be allowed to the processing zones of the SEZs. No benefit to the sales from an SEZ to Domestic Tariff Area (DTA) will be allowed. There are some more issues proposed in relation to zero rating of exports which will be disclosed with time.

GST on Imports

The GST will be levied on imports with necessary Constitutional Amendments. Both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

Special Industrial Area Scheme

After the introduction of GST, the tax exemptions, remissions etc. related to industrial incentives should be converted, if at all needed, into cash refund schemes after collection of tax, so that the GST scheme on the basis of a continuous chain of set-offs is not disturbed. Regarding Special Industrial Area Schemes, it is clarified that such exemptions, remissions etc. would continue up to legitimate expiry time both for the Centre and the States.

Any new exemption, remission etc. or continuation of Earlier exemption, remission etc. would not be allowed.

In such cases, the Central and the State Governments could provide reimbursement after collecting GST.

COST OF IMPLEMENTING GST:-

It is often said that there are no freebies in this world. Implementation of GST is no exception. Surprising though it may seem, but implementation of GST entails a cost both for the Government as well as for the corporate.

The biggest stake holder in implementation of GST is the government. The costs incurred by government in its implementation are majorly social costs. The three areas where this expenditure is normally incurred are design, drafting and enactment, administration, and compliance.

The Australian Taxation Journal has estimated that the recurrent social cost of introducing GST in Australia ranged near about \$1.9 billion to \$ 2.2 billion (year 2001-02) but actual cost incurred was \$4.5 billion.

It is clear from the estimates that the Government will have to engage in some estimation of the finances required for the social cost and appropriate budgetary allocation will need to be made for the same.

HISTORY OF GST:-

1. FRANCE:-

France was the first country ever to introduce GST in 1954. High sales taxes were the reason behind smuggling that encouraged introduction of GST.

The dual system of GST was introduced and was implemented under two-fold system, Central Goods & Services Tax (CGST) and State Goods & Services Tax (SGST).

As the name suggests CGST was an alternative for all central taxes like service tax & excise whereas, SGST included all state levied taxes.

End customers were not allowed GST credit but all producers, traders and service providers in supply chain were allowed credit who used the goods or services bought to produce or sell to end customers.

Exemptions were given on:-

Transactions with government officials

Transactions with diplomatic missions

Transactions relating to exports

Goods and services specifically listed are exercised by the government.

2. CANADA:-

The GST was introduced in Canada on January 1, 1991, by then Prime Minister Brian Mulroney and his finance minister Michael Wilson. The GST replaced 13.5% Manufacturers' Sales Tax.

The tax is a 5% tax imposed on the supply of goods and services that are purchased in Canada but there are certain items that are either "exempt" or "zero-rated".

For tax-exempt supplies, the supply is not subject to GST and suppliers do not charge tax on their exempt supplies. Suppliers that make exempt supplies are not allowed to recover GST paid on inputs acquired for the purposes of making or supplying the exempt good or service. Tax-exempt items include long term residential rents, health and dental care, educational services, day-care services, legal aid services, and financial services.

Goods are zero rated to remove cascading effect of tax. To zero rate the goods government charge 0% GST on them and allow them GST paid on purchases made. Common zero-rated items include basic groceries, prescription drugs, inward/outbound transportation and medical devices. Certain exports of goods and services are also zero-rated.

3. AUSTRALIA:-

The GST (Goods and Services Tax) is a value added tax on the supply of goods and services in Australia, including items that are imported. In most cases, GST does not apply to exports of goods or services, or other items consumed outside Australia. It was introduced by the Howard Government on 1st July 2000, replacing the previous Federal wholesale sales tax system and designed to phase out a number of various State and Territory Government taxes, duties and levies such as banking taxes and stamp duty. The basic premise of the new tax was to broaden the tax base, which was heavily biased toward the provision of services.

Prior to the GST, Australia operated a Wholesale Sales Tax (WST) which imposed a tax on wholesales of goods. The GST is levied at a flat rate of 10% on most goods and services, apart from GST exempt items, and input taxed goods and services.

Critics have argued that the GST is a regressive tax, which means tax will consume a higher proportion of income of low income grouped families, compared to those earning large incomes. Due to the corresponding reductions in personal income taxes, state banking taxes, federal wholesales tax and some fuel taxes that were implemented when the GST was introduced, people were effectively paying no extra tax.

The preceding months before the GST became active saw a spike in consumption as consumers rushed to purchase goods that they perceived would be substantially more expensive with the GST. Once the tax came into effect, consumer consumption and economic growth declined such that by the first fiscal quarter of 2001, the Australian economy recorded negative economic growth for the first time in more than 10 years. Consumption soon returned to normal however. The Government was criticized by small business owners over the increased administrative responsibilities of submitting Business Activity Statements (BAS) on a quarterly basis to the Australian Taxation Office.

3. HONG KONG:-

Goods and Services Tax (GST) was a proposed Value Added Tax in Hong Kong. Consultation over a period of nine months was launched on 19, July 2006 and stirred considerable controversy.

It launched a fierce debate amongst local taxpayers, lawmakers, journalists, politicians, who hotly debated the need for the tax, and the shape any taxes should take. The plan to levy GST was dropped on 5, December 2006.

The GST would be levied at a flat rate of 5%. The government would undertake to decrease or eliminate other taxes to make it revenue neutral.

4. SINGAPORE:-

Before 1986, Singapore's corporate income tax rate and top marginal personal income tax rate both stood at 40%. Singapore's government decided that it needed to shift from direct to indirect taxes to sustain global competition in attracting investors and to sustain its economic growth.

Goods and Services Tax was introduced in Singapore on April 1, 1994, at 3%, the present rate is 7% which was revised on 1 July 2007. Singapore's GST is a broad-based consumption tax levied on import of goods, as well as nearly all supplies of goods and services. The only exemptions are for the sales and leases of residential properties and most financial services. Export of goods and international services are zero-rated.

Some critics consider GST to be a regressive tax. To maintain the progressive nature of total taxes and transfers on individuals, Singapore reduced income tax on lower-income earners, as well as instituted direct transfer payments to lower-income groups, resulting in an overall lower tax burden for most Singaporean households.

In 2010, 84.2% of all GST paid was collected from foreigners and the top 40% of Singaporean households, while the bottom 20% of households contributed only 4% of all GST paid.

5. NEW ZEALAND:-

Goods and Services Tax (GST) is a value added tax introduced in New Zealand on October 1, 1986 at 10%. It was raised to 15% on 1, October 2010. End-users pay this tax on all liable goods and services directly included in purchase price of goods and services.

GST registered organizations only pay GST on the difference between GST-liable sales and GST-liable supplies (i.e. pay GST on the difference between what they sell and what they buy: income less expenditure). This is accomplished by reconciling GST received (through sales) and GST paid (through purchases) at regular periods (typically every 2 months, with some qualifying companies opting for 1 month or 6 month periods), then either paying the difference to Inland Revenue Department (IRD) if the GST collected on sales is higher, or receiving a refund from IRD if the GST paid on purchases is higher.

Businesses exporting goods and services from New Zealand are entitled to "zero-rate" their products - effectively, they charge GST at zero percent. This permits the business to claim back the input GST but the eventual, non-New Zealand based consumer does not pay the tax

There are very few exemptions - all types of food are taxed at the same rate. Exceptions include rents collected on residential rental properties, donations and financial services.

Because businesses claim back their input GST, the GST inclusive price is usually irrelevant for business purchasing decisions, other than in relation to cash flow issues.

Consequently, wholesalers often state prices exclusive of GST, but must collect the full, GST-inclusive price when they make the sale and account to the IRD for the GST so collected.

The headline price must always be GST-inclusive in advertising and stores. The only exceptions are for businesses which claim a mainly wholesale client-base. Otherwise, displaying a prominent GST-exclusive price (i.e. smaller than the GST-inclusive price), is illegal.

6. NORWAY:-

In Norway, VAT is split into three levels: 25% is the general VAT for most goods, 14% for foods and other related stuff, 8% for person transport, movie tickets, and hotel stays. Books and newspapers are free of VAT.

7. ICELAND:-

In Iceland, VAT is split into two levels: 25.5% for most goods and services but 7% for certain goods and services. The 7% level is applied for hotel and guesthouse stays, license fees for radio stations, newspapers and magazines, books; hot water, electricity and oil for heating houses, food for human consumption (but not alcoholic beverages), access to toll roads and music.

8. SWEDEN:-

In Sweden, VAT is split into three levels: 25% for most goods and services including restaurants bills, 12% for foods (incl. bring home from restaurants) and hotel stays (but breakfast at 25%) and 6% for printed matter, cultural services, and transport of private persons.

Some services are not taxable for example education of children and adults if public utility, and health and dental care, but education is taxable at 25% in case of courses for adults at a private school. Dance events (for the guests) have 25%, concerts and stage shows have 6%, and some types of cultural events have 0%.

For reference of reader's the white paper on GST, i.e. first discussion on GST is given below. My book is summarizes important parts of this First Paper in a easy language.

THANK YOU FOR READING

Suggestions and complaints are welcome.

caharcharansingh@yahoo.com

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On
Goods and Services Tax
In India**



सत्यमेव जयते

**The Empowered Committee
Of
State Finance Ministers**

**New Delhi
November 10 , 2009**

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Foreword

If the Value Added Tax (VAT) is considered to be a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will be a further significant breakthrough - the next logical step - towards a comprehensive indirect tax reform in the country.

Keeping this overall objective in view, an announcement was made by Shri P. Chidambaram, the then Union Finance Minister in the Central Budget (2007-2008) to the effect that GST would be introduced from April 1, 2010 and that the Empowered Committee of State Finance Ministers, on his request, would work with the Central Government to prepare a road map for introduction of GST in India. After this announcement, the Empowered Committee of State Finance Ministers decided to set up a Joint Working Group (May 10, 2007), with the then Adviser to the Union Finance Minister and the Member-Secretary of Empowered Committee as Co-convenors and the concerned Joint Secretaries of the Department of Revenue of Union Finance Ministry and all Finance Secretaries of the States as its members. This Joint Working Group, after intensive internal discussions as

well as interaction with experts and representatives of Chambers of Commerce and Industry, submitted its report to the Empowered Committee (November 19, 2007).

This report was then discussed in detail in the meeting of Empowered Committee (November 28, 2007). On the basis of this discussion and written observations of the States, certain modifications were made and a final version of the views of Empowered Committee at that stage was prepared and was sent to the Government of India (April 30, 2008). The comments of the Government of India were received on December 12, 2008 and were duly considered by the Empowered Committee (December 16, 2008). It was decided that a Committee of Principal Secretaries/Secretaries of Finance/Taxation and Commissioners of Trade Taxes of the States would be set up to consider these comments, and submit their views. These views were submitted and were accepted in principle by the Empowered Committee (January 21, 2009). Consequent upon this in-principle acceptance, a Working Group, consisting of the concerned officials of the State Governments was formed who, in close association with senior representatives of the Government of India, submitted their recommendations in detail on the structure of GST. An important interaction has also recently taken place between Shri Pranab Mukherjee, the Union Finance Minister and the Empowered

Committee (October 19, 2009) on the related issue of compensation for loss of the States on account of phasing out of CST. The Empowered Committee has now taken a detailed view on the recommendations of the Working Group of officials and other related matters. This detailed view of the Empowered Committee on the structure of GST is now presented in terms of the First Discussion Paper, along with an Annexure on Frequently Asked Questions and Answers on GST, for discussions with industry, trade, agriculture and people at large.

The Discussion Paper is divided into four sections. Since GST would be further improvement over the VAT, Section 1 begins with a brief reference to the process of introduction of VAT at the Centre and the States and also indicates the precise points where there is a need for further improvement. This section also shows how the GST can bring about this improvement. With this as the background for justification of GST, Section 2 then describes the process of preparation for GST. Thereafter, Section 3 presents in detail the comprehensive structure of the GST model. For illustrating this GST model further, there is in the end an Annexure on Frequently Asked Questions and Answers.

This Discussion Paper has been the result of truly collective efforts on the basis of hardwork of all the

concerned officials of the States, the officials of Empowered Committee Secretariat and the Adviser and officials of the Union Finance Ministry, the counsel and active participation of Finance Ministers and concerned Senior Ministers of the States at each stage, and the encouragement and advice of the Union Finance Minister.

With the release of this First Discussion Paper and the Annexure on Frequently Asked Questions and Answers, we now sincerely invite interaction with the representatives of industry, trade, agriculture and common people. This interaction and campaign will immediately start at the national level and at the State levels. As a part of this interaction, we look forward to receiving the views of industry, trade, agriculture as well as consumers in a time-bound manner.

Asim Kumar Dasgupta
Chairman,
Empowered Committee of
State Finance Ministers
&
Minister of Finance & Excise,
Government of West Bengal

New Delhi,
November 10, 2009

1. Introduction

1.1 Introduction of the Value Added Tax (VAT) at the Central and the State level has been considered to be a major step – an important breakthrough – in the sphere of indirect tax reforms in India. If the VAT is a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will indeed be a further significant improvement – the next logical step – towards a comprehensive indirect tax reforms in the country.

1.2 Keeping this objective in view, an announcement was made by the then Union Finance Minister in the Central Budget (2007-08) to the effect that GST would be introduced with effect from April 1, 2010 and that the Empowered Committee of State Finance Ministers, on his request, would work with the Central Government to prepare a road map for introduction of GST in India. After this announcement, the Empowered Committee of State Finance Ministers decided to set up a Joint Working Group (May 10, 2007), with the then Adviser to the Union Finance Minister and Member-Secretary of the Empowered Committee as its Co-convenors and concerned four Joint Secretaries of the Department of Revenue of Union Finance Ministry and all Finance Secretaries of the States as its members. This Joint Working Group got itself divided into three Sub-Groups and had several

rounds of internal discussions as well as interaction with experts and representatives of Chambers of Commerce & Industry. On the basis of these discussions and interaction, the Sub-Groups submitted their reports which were then integrated and consolidated into the report of Joint Working Group (November 19, 2007).

1.3 This report was discussed in detail in the meeting of the Empowered Committee on November 28, 2007, and the States were also requested to communicate their observations on the report in writing. On the basis of these discussions in the Empowered Committee and the written observations, certain modifications were considered necessary and were discussed with the Co-convenors and the representatives of the Department of Revenue of Union Finance Ministry. With the modifications duly made, a final version of the views of Empowered Committee on the model and road map for the GST was prepared (April 30, 2008). These views of Empowered Committee were then sent to the Government of India, and the comments of Government of India were received on December 12, 2008. These comments were duly considered by the Empowered Committee (December 16, 2008), and it was decided that a Committee of Principal Secretaries/Secretaries of Finance/Taxation and Commissioners of Trade Taxes of the States would be set up to consider these comments, and submit their views. These views were submitted and were accepted in principle by the Empowered Committee (January 21, 2009). As

a follow-up of this in-principle acceptance, a Working Group consisting of the concerned officials of the State Governments was formed who, in association with senior representatives of Government of India, submitted their recommendations in detail on the structure of GST. An important interaction has also recently taken place between Shri Pranab Mukherjee, the Union Finance Minister and the Empowered Committee (October 19, 2009) on the related issue of compensation for loss of the States on account of phasing out of CST. The Empowered Committee has now taken a detailed view on the recommendations of the Working Group of officials and other related matters. This detailed view is now presented in terms of the First Discussion Paper, along with an Annexure on Frequently Asked Questions and Answers on GST, for discussion with industry, trade, agriculture and people at large. Since the GST at the Centre and States would be a further improvement over the VAT, a brief recalling of the process of introduction of VAT in India is worthwhile.

Value Added Tax at the Central and the State level

1.4 Prior to the introduction of VAT in the Centre and in the States, there was a burden of multiple taxation in the pre-existing Central excise duty and the State sales tax systems. Before any commodity was produced, inputs were first taxed, and then after the commodity got produced with input tax load, output was taxed again. This was causing a burden of multiple taxation (i.e. “tax on tax”)

with a cascading effect. Moreover, in the sales tax structure, when there was also a system of multi-point sales taxation at subsequent levels of distributive trade, then along with input tax load, burden of sales tax paid on purchase at each level was also added, thus aggravating the cascading effect further.

1.5 When VAT is introduced in place of Central excise duty, a set-off is given, i.e., a deduction is made from the overall tax burden for input tax. In the case of VAT in place of sales tax system, a set-off is given from tax burden not only for input tax paid but also for tax paid on previous purchases. With VAT, the problem of “tax on tax” and related burden of cascading effect is thus removed. Furthermore, since the benefit of set-off can be obtained only if tax is duly paid on inputs (in the case of Central VAT), and on both inputs and on previous purchases (in the case of State VAT), there is a built-in check in the VAT structure on tax compliance in the Centre as well as in the States, with expected results in terms of improvement in transparency and reduction in tax evasion. For these beneficial effects, VAT has now been introduced in more than 150 countries, including several federal countries. In Asia, it has now been introduced in almost all the countries.

1.6 In India, VAT was introduced at the Central level for a selected number of commodities in terms of MODVAT with effect from March 1, 1986, and in a

step-by-step manner for all commodities in terms of CENVAT in 2002-03. Subsequently, after Constitutional Amendment empowering the Centre to levy taxes on services, these service taxes were also added to CENVAT in 2004-05. Although the growth of tax revenue from the Central excise has not always been specially high, the revenue growth of combined CENVAT and service taxes has been significant.

1.7 Introduction of VAT in the States has been a more challenging exercise in a federal country like India, where each State, in terms of Constitutional provision, is sovereign in levying and collecting State taxes. Before introduction of VAT, in the sales tax regime, apart from the problem of multiple taxation and burden of adverse cascading effect of taxes as already mentioned, there was also no harmony in the rates of sales tax on different commodities among the States. Not only were the rates of sales tax numerous (often more than ten in several States), and different from one another for the same commodity in different States, but there was also an unhealthy competition among the States in terms of sales tax rates – so-called “rate war” – often resulting in, revenue-wise, a counter-productive situation.

1.8 It is in this background that attempts were made by the States to introduce a harmonious VAT in the States, keeping at the same time in mind the issue of sovereignty of the States regarding the State tax matters.

The first preliminary discussion on State-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers. Thereafter, in a significant meeting of all the Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha, the then Union Finance Minister, two important decisions, among others, were taken. First, before the introduction of State-level VAT, the unhealthy sales tax “rate war” among the States would have to end, and sales tax rates would need to be harmonised by implementing uniform floor rates of sales tax for different categories of commodities with effect from January 1, 2000. Secondly, on the basis of achievement of the first objective, steps would be taken by the States for introduction of State-level VAT after adequate preparation. For implementing these decisions, a Standing Committee of State Finance Ministers was formed which was then made an Empowered Committee of State Finance Ministers.

1.9 Thereafter, the Empowered Committee has met regularly. All the decisions were taken on the basis of consensus. On the strength of these repeated discussions and collective efforts, involving the Ministers and the concerned officials, it was possible within a period of about

a year and a half to achieve nearly 98 per cent success in the first objective, namely, harmonisation of sales tax structure through implementation of uniform floor rates of sales tax.

1.10 After reaching this stage, steps were initiated for systematic preparation for introduction of State-level VAT. In order again to avoid any unhealthy competition among the States which may lead to distortions in manufacturing and trade, attempts have been made from the very beginning to harmonise the VAT design in the States, keeping also in view the distinctive features of each State and the need for federal flexibility. This has been done by the States collectively agreeing, through discussions in the Empowered Committee, to certain common points of convergence regarding VAT, and allowing at the same time certain flexibility to accommodate the local characteristics of the States. In the course of these discussions, references to the Tenth Five Year Plan Report of the Advisory Group on Tax Policies & Tax Administration (2001) and the report of Kelkar (Chairman) Task Force were helpful.

1.11 Along with these measures, steps were taken for necessary training, computerization and interaction with trade and industry. While these preparatory steps were taken, the Empowered Committee got a significant support from Shri P. Chidambaram, the then Union

Finance Minister, when he responded positively in providing Central financial support to the States in the event of loss of revenue in transitional years of implementation of VAT.

1.12 As a consequence of all these steps, the States started implementing VAT beginning April 1, 2005. After overcoming the initial difficulties, all the States and Union Territories have now implemented VAT. The Empowered Committee has been monitoring closely the process of implementation of State-level VAT, and deviations from the agreed VAT rates has been contained to less than 3 per cent of the total list of commodities. Responses of industry and also of trade have been indeed encouraging. The rate of growth of tax revenue has nearly doubled from the average annual rate of growth in the pre-VAT five year period after the introduction of VAT.

Justification of GST

1.13 Despite this success with VAT, there are still certain shortcomings in the structure of VAT both at the Central and at the State level. The shortcoming in CENVAT of the Government of India lies in non-inclusion of several Central taxes in the overall framework of CENVAT, such as additional customs duty, surcharges, etc., and thus keeping the benefits of comprehensive input tax and service tax set-off out of reach for manufacturers/dealers. Moreover, no step has yet been taken to capture the value-added chain in the distribution trade below the

manufacturing level in the existing scheme of CENVAT. The introduction of GST at the Central level will not only include comprehensively more indirect Central taxes and integrate goods and service taxes for the purpose of set-off relief, but may also lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade and increased compliance.

1.14 In the existing State-level VAT structure there are also certain shortcomings as follows. There are, for instance, even now, several taxes which are in the nature of indirect tax on goods and services, such as luxury tax, entertainment tax, etc., and yet not subsumed in the VAT. Moreover, in the present State-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under State VAT, and contributing to that extent a cascading effect on account of CENVAT element. This CENVAT load needs to be removed. Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be integration of VAT on goods with tax on services at the State level as well, and at the same time there should also be removal of cascading effect of service tax. In the GST, both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level is established which reduces the burden of all cascading effects. This is the essence of GST, and this is why GST

is not simply VAT plus service tax but an improvement over the previous system of VAT and disjointed service tax. However, for this GST to be introduced at the State-level, it is essential that the States should be given the power of levy of taxation of all services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment will be made for giving this power also to the States. Moreover, with the introduction of GST, burden of Central Sales Tax (CST) will also be removed. The GST at the State-level is, therefore, justified for (a) additional power of levy of taxation of services for the States, (b) system of comprehensive set-off relief, including set-off for cascading burden of CENVAT and service taxes, (c) subsuming of several taxes in the GST and (d) removal of burden of CST. Because of the removal of cascading effect, the burden of tax under GST on goods will, in general, fall.

1.15 The GST at the Central and at the State level will thus give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of several taxes in the GST and phasing out of CST. With the GST being properly formulated by appropriate calibration of rates and adequate compensation where necessary, there may also be revenue/ resource gain for both the Centre and the States, primarily through widening of tax base and possibility of

a significant improvement in tax-compliance. In other words, the GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the Central Government and the State Governments. The GST may, indeed, lead to the possibility of collectively positive-sum game.

2. Preparation for GST

2.1 Keeping this significance of GST in view, an announcement was made by the then Union Finance Minister in the Union Budget, as mentioned before, to the effect that GST would be introduced from April 1, 2010, and that the Empowered Committee of State Finance Ministers would work with the Central Government to prepare a road map for introduction of the GST. After this announcement, the Empowered Committee, as stated earlier, had set up a Joint Working Group which submitted a report on a model and road map for GST. After accommodating the views of the States appropriately on this report, the views of the Empowered Committee on the model and road map were sent to the Government of India on 30th April, 2008. The comments of the Government of India were received on 12th December, 2008. These comments were duly considered by the Empowered Committee in its meeting held on 16th December, 2008 and it was decided that a Committee of Principal Secretaries/Secretaries (Finance/Taxation) and

Commissioners of Trade Taxes should consider the comments received from the Government of India and submit its views and also work out the Central GST and State GST rates. The Committee held detailed deliberations on 5th and 6th January, 2009, and submitted its recommendations to the Empowered Committee. The Empowered Committee considered these recommendations in its meeting held on 21st January, 2009 and accepted them in principle. The Empowered Committee also decided to constitute a Working Group consisting of Principal Secretaries/ Secretaries (Finance/Taxation) and Commissioners of Trade Taxes of all States/UTs to give their recommendations on (a) the commodities and services that should be kept in the exempted list, (b) the rules and principles of taxing the transactions of services including the transactions in inter-State services, and (c) finalization of the model suggested for inter-state transaction/movement of goods including stock transfers in consultation with the State Bank of India and some other nationalized banks. It was also decided that the senior representatives from the Government of India may also be associated. The Working Group deliberated on the issues on 10th February, 2009 and decided to form three Sub Working Groups to deliberate each item in depth. The Reports of the Working Group on the three issues have already been received, and the Empowered Committee has taken a view on these recommendations for concluding the details of GST structure.

2.2 While making this preparation of GST, it was also necessary, as mentioned earlier, to phase out the CST, because it did not carry any set-off relief and there was a distortion in the VAT regime due to export of tax from one State to other State. The Empowered Committee accordingly took a decision to phase out CST on the understanding with the Centre that, since phasing out of CST would result in a loss of revenue to the States on a permanent basis, an appropriate mechanism to compensate the States for such loss would be worked out. The rate of CST has already been reduced to 2% and will be phased out with effect from the date of introduction of GST on the basis of such GST structure which, with necessary financial support to the States, should adequately compensate for the loss of the States on a permanent basis. With these steps at preparation in mind, it is important now to turn to the proposed model of GST.

3. Goods & Services Tax Model For India

3.1 It is important to take note of the significant administrative issues involved in designing an effective GST model in a federal system with the objective of having an overall harmonious structure of rates. Together with this, there is a need for upholding the powers of Central and State Governments in their taxation matters. Further, there is also the need to propose a model that would be easily implementable, while being generally acceptable to stakeholders.

Salient features of the GST model

3.2 Keeping in view the report of the Joint Working Group on Goods and Services Tax, the views received from the States and Government of India, a dual GST structure with defined functions and responsibilities of the Centre and the States is recommended. An appropriate mechanism that will be binding on both the Centre and the States would be worked out whereby the harmonious rate structure along with the need for further modification could be upheld, if necessary with a collectively agreed Constitutional Amendment. Salient features of the proposed model are as follows:

(i) The GST shall have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States (hereinafter referred to as State GST). Rates for Central GST and State GST would be prescribed appropriately, reflecting revenue considerations and acceptability. This dual GST model would be implemented through multiple statutes (one for CGST and SGST statute for every State). However, the basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. would be uniform across these statutes as far as practicable.

(ii) The Central GST and the State GST would be applicable to all transactions of goods and services made

for a consideration except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.

(iii) The Central GST and State GST are to be paid to the accounts of the Centre and the States separately. It would have to be ensured that account-heads for all services and goods would have indication whether it relates to Central GST or State GST (with identification of the State to whom the tax is to be credited).

(iv) Since the Central GST and State GST are to be treated separately, taxes paid against the Central GST shall be allowed to be taken as input tax credit (ITC) for the Central GST and could be utilized only against the payment of Central GST. The same principle will be applicable for the State GST. A taxpayer or exporter would have to maintain separate details in books of account for utilization or refund of credit. Further, the rules for taking and utilization of credit for the Central GST and the State GST would be aligned.

(v) Cross utilization of ITC between the Central GST and the State GST would not be allowed except in the case of inter-State supply of goods and services under the IGST model which is explained later.

(vi) Ideally, the problem related to credit accumulation on account of refund of GST should be avoided by both the Centre and the States except in the cases such as exports,

purchase of capital goods, input tax at higher rate than output tax etc. where, again refund/adjustment should be completed in a time bound manner.

(vii) To the extent feasible, uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislation for Central GST and State GST.

(viii) The administration of the Central GST to the Centre and for State GST to the States would be given. This would imply that the Centre and the States would have concurrent jurisdiction for the entire value chain and for all taxpayers on the basis of thresholds for goods and services prescribed for the States and the Centre.

(ix) The present threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. A uniform State GST threshold across States is desirable and, therefore, it is considered that a threshold of gross annual turnover of Rs.10 lakh both for goods and services for all the States and Union Territories may be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime. Keeping in view the interest of small traders and small scale industries and to avoid dual control, the States also considered that the threshold for Central GST for goods

may be kept at Rs.1.5 crore and the threshold for Central GST for services may also be appropriately high. It may be mentioned that even now there is a separate threshold of services (Rs. 10 lakh) and goods (Rs. 1.5 crore) in the Service Tax and CENVAT.

(x) The States are also of the view that Composition/ Compounding Scheme for the purpose of GST should have an upper ceiling on gross annual turnover and a floor tax rate with respect to gross annual turnover. In particular, there would be a compounding cut-off at Rs. 50 lakh of gross annual turn over and a floor rate of 0.5% across the States. The scheme would also allow option for GST registration for dealers with turnover below the compounding cut-off.

(xi) The taxpayer would need to submit periodical returns, in common format as far as possible, to both the Central GST authority and to the concerned State GST authorities.

(xii) Each taxpayer would be allotted a PAN-linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-based system for Income tax, facilitating data exchange and taxpayer compliance.

(xiii) Keeping in mind the need of tax payer's convenience, functions such as assessment, enforcement,

scrutiny and audit would be undertaken by the authority which is collecting the tax, with information sharing between the Centre and the States.

Central and State Taxes to be subsumed under GST

3.3 The various Central, State and Local levies were examined to identify their possibility of being subsumed under GST. While identifying, the following principles were kept in mind:

(i) Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.

(ii) Taxes or levies to be subsumed should be part of the transaction chain which commences with import/ manufacture/ production of goods or provision of services at one end and the consumption of goods and services at the other.

(iii) The subsumation should result in free flow of tax credit in intra and inter-State levels.

(iv) The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST.

(v) Revenue fairness for both the Union and the States individually would need to be attempted.

3.4 On application of the above principles, it is recommended that the following Central Taxes should be, to begin with, subsumed under the Goods and Services Tax:

- (i) Central Excise Duty
- (ii) Additional Excise Duties
- (iii) The Excise Duty levied under the Medicinal and Toiletries Preparation Act
- (iv) Service Tax
- (v) Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- (vi) Special Additional Duty of Customs - 4% (SAD)
- (vii) Surcharges, and
- (viii) Cesses.

Following State taxes and levies would be, to begin with, subsumed under GST:

- (i) VAT / Sales tax
- (ii) Entertainment tax (unless it is levied by the local bodies).
- (iii) Luxury tax
- (iv) Taxes on lottery, betting and gambling.
- (v) State Cesses and Surcharges in so far as they relate to supply of goods and services.
- (vi) Entry tax not in lieu of Octroi.

Purchase tax: Some of the States felt that they are getting substantial revenue from Purchase Tax and, therefore, it should not be subsumed under GST while majority of the States were of the view that no such exemptions should be given. The difficulties of the foodgrains producing States and certain other States were appreciated as substantial revenue is being earned by them from Purchase Tax and it was, therefore, felt that in case Purchase Tax has to be subsumed then adequate and continuing compensation has to be provided to such States. This issue is being discussed in consultation with the Government of India.

Tax on items containing Alcohol: Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT can be continued to be levied on alcoholic beverages as per the existing practice. In case it has been made Vatable by some States, there is no objection to that. Excise Duty, which is presently being levied by the States may not be also affected.

Tax on Tobacco products: Tobacco products would be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST without ITC.

Tax on Petroleum Products: As far as petroleum products are concerned, it was decided that the basket of petroleum products, i.e. crude, motor spirit (including

ATF) and HSD would be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. A final view whether Natural Gas should be kept outside the GST will be taken after further deliberations.

Taxation of Services : As indicated earlier, both the Centre and the States will have concurrent power to levy tax on all goods and services. In the case of States, the principle for taxation of intra-State and inter-State has already been formulated by the Working Group of Principal Secretaries/Secretaries of Finance/Taxation and Commissioners of Trade Taxes with senior representatives of Department of Revenue, Government of India. For inter-State transactions an innovative model of Integrated GST will be adopted by appropriately aligning and integrating CGST and SGST. The working of this model is elaborated below.

3.5 Inter-State Transactions of Goods and Services

The Empowered Committee has accepted the recommendations of the Working Group of concerned officials of Central and State Governments for adoption of IGST model for taxation of inter-State transaction of Goods and Services. The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and

services with appropriate provision for consignment or stock transfer of goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

The major advantages of IGST Model are:

- a) Maintenance of uninterrupted ITC chain on inter-State transactions.
- b) No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.
- c) No refund claim in exporting State, as ITC is used up while paying the tax.
- d) Self monitoring model.
- e) Level of computerization is limited to inter-State dealers and Central and State Governments should be able to computerize their processes expeditiously.

- f) As all inter-State dealers will be e-registered and correspondence with them will be by e-mail, the compliance level will improve substantially.
- g) Model can take 'Business to Business' as well as 'Business to Consumer' transactions into account.

3.6 GST Rate Structure

The Empowered Committee has decided to adopt a two-rate structure –a lower rate for necessary items and goods of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items. For upholding of special needs of each State as well as a balanced approach to federal flexibility, and also for facilitating the introduction of GST, it is being discussed whether the exempted list under VAT regime including Goods of Local Importance may be retained in the exempted list under State GST in the initial years. It is also being discussed whether the Government of India may adopt, to begin with, a similar approach towards exempted list under the CGST.

The States are of the view that for CGST relating to goods, the Government of India may also have a two-rate structure, with conformity in the levels of rate under the SGST. For taxation of services, there may be a single rate for both CGST and SGST.

The exact value of the SGST and CGST rates, including the rate for services, will be made known duly in course of appropriate legislative actions.

3.7 Zero Rating of Exports

Exports would be zero-rated. Similar benefits may be given to Special Economic Zones (SEZs). However, such benefits will only be allowed to the processing zones of the SEZs. No benefit to the sales from an SEZ to Domestic Tariff Area (DTA) will be allowed.

3.8 GST on Imports: The GST will be levied on imports with necessary Constitutional Amendments. Both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

3.9 Special Industrial Area Scheme

After the introduction of GST, the tax exemptions, remissions etc. related to industrial incentives should be converted, if at all needed, into cash refund schemes after collection of tax, so that the GST scheme on the basis of a continuous chain of set-offs is not disturbed. Regarding Special Industrial Area Schemes, it is clarified that such exemptions, remissions etc. would continue up to legitimate expiry time both for the Centre and the States. Any new exemption, remission etc. or continuation of earlier exemption, remission etc. would not be allowed.

In such cases, the Central and the State Governments could provide reimbursement after collecting GST.

3.10 IT Infrastructure

After acceptance of IGST Model for Inter-State transactions, the major responsibilities of IT infrastructural requirement will be shared by the Central Government through the use of its own IT infrastructure facility. The issues of tying up the State Infrastructure facilities with the Central facilities as well as further improvement of the States' own IT infrastructure, including TINXSYS, is now to be addressed expeditiously and in a time bound manner.

3.11 Constitutional Amendments, Legislations and Rules for administration of CGST and SGST

It is essential to have Constitutional Amendments for empowering the States for levy of service tax, GST on imports and consequential issues as well as corresponding Central and State legislations with associated rules and procedures. With these specific tasks in view, a Joint Working Group has recently been constituted (September 30, 2009) comprising of the officials of the Central and State Governments to prepare, in a time bound manner a draft legislation for Constitutional Amendment, draft legislation for CGST, a suitable Model Legislation for SGST and rules and procedures for CGST and SGST. Simultaneous steps have also been initiated for drafting

of a legislation for IGST and rules and procedures. As a part of this exercise, the Working Group will also address the issues of dispute resolution and advance ruling.

3.12 Harmonious structure of GST and the States' autonomy in a Federal Framework

As a part of the exercise on Constitutional Amendment, a special attention would be given, as mentioned earlier in para 3.2, to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the States' autonomy in a federal structure.

3.13 Dispute Resolution and Advance Ruling

As a part of the exercise on drafting of legislation, rules and procedures for the administration of CGST and SGST, specific provisions would also be made to the issues of dispute resolution and advance ruling.

3.14 Need for compensation during implementation of GST

Despite the sincere attempts being made by the Empowered Committee on the determination of GST rate structure, revenue neutral rates, it is difficult to estimate accurately as to how much the States will gain from service taxes and how much they will lose on account of

removal of cascading effect, payment of input tax credit and phasing out of CST. In view of this, it would be essential to provide adequately for compensation for loss that might emerge during the process of implementation of GST for the next five years. This issue may be comprehensively taken care of in the recommendations of the Thirteenth Finance Commission. The payment of this compensation will need to be ensured in terms of special grants to be released to the States duly in every month on the basis of neutrally monitored mechanism.

3.15 With the release of this First Discussion Paper and the Annexure on Frequently Asked Questions and Answers on GST, interaction with the representatives of industry, trade and agriculture would begin immediately at the national level, and then also simultaneously at the State levels. Similarly awareness campaign for common consumers would also be initiated at the same time. As a part of the discussion and campaign, the views of the industry, trade and agriculture as well as consumers are being sought in a structured and time bound manner.

Annexure

Frequently Asked Questions and Answers on GST

Question 1 : What is the justification of GST ?

Answer : There was a burden of “tax on tax” in the pre-existing Central excise duty of the Government of India and sales tax system of the State Governments. The introduction of Central VAT (CENVAT) has removed the cascading burden of “tax on tax” to a good extent by providing a mechanism of “set off” for tax paid on inputs and services upto the stage of production, and has been an improvement over the pre-existing Central excise duty. Similarly, the introduction of VAT in the States has removed the cascading effect by giving set-off for tax paid on inputs as well as tax paid on previous purchases and has again been an improvement over the previous sales tax regime.

But both the CENVAT and the State VAT have certain incompleteness. The incompleteness in CENVAT is that it has yet not been extended to include chain of value addition in the distributive

trade below the stage of production. It has also not included several Central taxes, such as Additional Excise Duties, Additional Customs Duty, Surcharges etc. in the overall framework of CENVAT, and thus kept the benefits of comprehensive input tax and service tax set-off out of the reach of manufacturers/dealers. The introduction of GST will not only include comprehensively more indirect Central taxes and integrate goods and services taxes for set-off relief, but also capture certain value addition in the distributive trade.

Similarly, in the present State-level VAT scheme, CENVAT load on the goods has not yet been removed and the cascading effect of that part of tax burden has remained unrelieved. Moreover, there are several taxes in the States, such as, Luxury Tax, Entertainment Tax, etc. which have still not been subsumed in the VAT. Further, there has also not been any integration of VAT on goods with tax on services at the State level with removal of cascading effect of service tax. In addition, although the burden of Central Sales Tax (CST) on inter-State movement of goods has been lessened with reduction of CST rate from 4% to 2%, this burden has also not been fully phased out. With the introduction of GST at the State level, the additional burden of CENVAT and services tax would be comprehensively removed,

and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level would be established which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax. This is the essence of GST. Also, major Central and State taxes will get subsumed into GST which will reduce the multiplicity of taxes, and thus bring down the compliance cost. With GST, the burden of CST will also be phased out.

Thus GST is not simply VAT plus service tax, but a major improvement over the previous system of VAT and disjointed services tax – a justified step forward.

Question 2. What is GST? How does it work ?

Answer : As already mentioned in answer to Question 1, GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point upto the retailer's level. It is essentially a tax only on value addition at each stage, and a supplier at each stage is permitted to set-off, through a tax credit mechanism, the GST paid on the purchase of goods and services as available for set-off on the GST to be paid on the supply of goods

and services. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

The illustration shown below indicates, in terms of a hypothetical example with a manufacturer, one wholeseller and one retailer, how GST will work. Let us suppose that GST rate is 10%, with the manufacturer making value addition of Rs.30 on his purchases worth Rs.100 of input of goods and services used in the manufacturing process. The manufacturer will then pay net GST of Rs. 3 after setting-off Rs. 10 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 13. The manufacturer sells the goods to the wholeseller. When the wholeseller sells the same goods after making value addition of (say), Rs. 20, he pays net GST of only Rs. 2, after setting-off of Input Tax Credit of Rs. 13 from the gross GST of Rs. 15 to the manufacturer. Similarly, when a retailer sells the same goods after a value addition of (say) Rs. 10, he pays net GST of only Re.1, after setting-off Rs.15 from his gross GST of Rs. 16 paid to wholeseller. Thus, the manufacturer, wholeseller and retailer have to pay only Rs. 6 (= Rs. 3+Rs. 2+Re. 1) as GST on the value addition along the entire value chain from the producer to the retailer, after setting-off GST paid at the earlier stages. The overall burden of GST

on the goods is thus much less. This is shown in the table below. The same illustration will hold in the case of final service provider as well.

Table

Stage of supply chain	Purchase value of Input	Value addition	Value at which supply of goods and services made to next stage	Rate of GST	GST on output	Input Tax credit	Net GST= GST on output – Input tax credit
Manufacturer	100	30	130	10%	13	10	$13 - 10 = 3$
Whole seller	130	20	150	10%	15	13	$15 - 13 = 2$
Retailer	150	10	160	10%	16	15	$16 - 15 = 1$

Question 3: How can the burden of tax, in general, fall under GST ?

Answer : As already mentioned in Answer to Question 1, the present forms of CENVAT and State VAT have remained incomplete in removing fully the cascading burden of taxes already paid at earlier stages. Besides, there are several other taxes, which both the Central Government and the State Government levy on production, manufacture and distributive trade, where no set-off is available in the form of input tax credit. These taxes add to the cost of goods and services through “tax on tax”

which the final consumer has to bear. Since, with the introduction of GST, all the cascading effects of CENVAT and service tax would be removed with a continuous chain of set-off from the producer's point to the retailer's point, other major Central and State taxes would be subsumed in GST and CST will also be phased out, the final net burden of tax on goods, under GST would, in general, fall. Since there would be a transparent and complete chain of set-offs, this will help widening the coverage of tax base and improve tax compliance. This may lead to higher generation of revenues which may in turn lead to the possibility of lowering of average tax burden.

Question 4 : How will GST benefit industry, trade and agriculture ?

Answer : As mentioned in Answer to Question 3, the GST will give more relief to industry, trade and agriculture through a more comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of several Central and State taxes in the GST and phasing out of CST. The transparent and complete chain of set-offs which will result in widening of tax base and better tax compliance may also lead to lowering of tax burden on an average dealer in industry, trade and agriculture.

Question 5 : How will GST benefit the exporters?

Answer : The subsuming of major Central and State taxes in GST, complete and comprehensive set-off of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports. The uniformity in tax rates and procedures across the country will also go a long way in reducing the compliance cost.

Question 6 : How will GST benefit the small entrepreneurs and small traders?

Answer : The present threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. The existing threshold of goods under State VAT is Rs. 5 lakhs for a majority of bigger States and a lower threshold for North Eastern States and Special Category States. A uniform State GST threshold across States is desirable and, therefore, the Empowered Committee has recommended that a threshold of gross annual turnover of Rs. 10 lakh both for goods and services for all the States and Union Territories may be adopted with adequate compensation for the States (particularly, the States in North-Eastern

Region and Special Category States) where lower threshold had prevailed in the VAT regime. Keeping in view the interest of small traders and small scale industries and to avoid dual control, the States considered that the threshold for Central GST for goods may be kept at Rs.1.5 crore and the threshold for services should also be appropriately high. This raising of threshold will protect the interest of small traders. A Composition scheme for small traders and businesses has also been envisaged under GST as will be detailed in Answer to Question 14. Both these features of GST will adequately protect the interests of small traders and small scale industries.

Question 7 : How will GST benefit the common consumers?

Answer : As already mentioned in Answer to Question 3, with the introduction of GST, all the cascading effects of CENVAT and service tax will be more comprehensively removed with a continuous chain of set-off from the producer's point to the retailer's point than what was possible under the prevailing CENVAT and VAT regime. Certain major Central and State taxes will also be subsumed in GST and CST will be phased out. Other things remaining the same, the burden of tax on goods would, in general, fall under GST and that would benefit the consumers.

Question 8 : What are the salient features of the proposed GST model?

Answer : The salient features of the proposed model are as follows:

- (i) Consistent with the federal structure of the country, the GST will have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States (hereinafter referred to as State GST). This dual GST model would be implemented through multiple statutes (one for CGST and SGST statute for every State). However, the basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. would be uniform across these statutes as far as practicable.
- (ii) The Central GST and the State GST would be applicable to all transactions of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.

- (iii) The Central GST and State GST are to be paid to the accounts of the Centre and the States separately.
- (iv) Since the Central GST and State GST are to be treated separately, in general, taxes paid against the Central GST shall be allowed to be taken as input tax credit (ITC) for the Central GST and could be utilized only against the payment of Central GST. The same principle will be applicable for the State GST.
- (v) Cross utilisation of ITC between the Central GST and the State GST would, in general, not be allowed.
- (vi) To the extent feasible, uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislation for Central GST and State GST.
- (vii) The administration of the Central GST would be with the Centre and for State GST with the States.
- (viii) The taxpayer would need to submit periodical returns to both the Central GST authority and to the concerned State GST authorities.

- (ix) Each taxpayer would be allotted a PAN-linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-based system for Income tax facilitating data exchange and taxpayer compliance. The exact design would be worked out in consultation with the Income-Tax Department.
- (x) Keeping in mind the need of tax payers convenience, functions such as assessment, enforcement, scrutiny and audit would be undertaken by the authority which is collecting the tax, with information sharing between the Centre and the States.

Question 9 : Why is Dual GST required ?

Answer : India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism.

Question 10 : How would a particular transaction of goods and services be taxed simultaneously under Central GST (CGST) and State GST (SGST)?

Answer : The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits. Further, both would be levied on the same price or value unlike State VAT which is levied on the value of the goods inclusive of CENVAT. While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, SGST would be chargeable only when the supplier and the recipient are both located within the State.

Illustration I : Suppose hypothetically that the rate of CGST is 10% and that of SGST is 10%. When a wholesale dealer of steel in Uttar Pradesh supplies steel bars and rods to a construction company which is also located within the same State for , say Rs. 100, the dealer would charge CGST of Rs. 10 and SGST of Rs. 10 in addition to the basic price of the goods. He would be required to deposit the CGST component into a Central Government account while

the SGST portion into the account of the concerned State Government. Of course, he need not actually pay Rs. 20 (Rs. 10 + Rs. 10) in cash as he would be entitled to set-off this liability against the CGST or SGST paid on his purchases (say, inputs). But for paying CGST he would be allowed to use only the credit of CGST paid on his purchases while for SGST he can utilize the credit of SGST alone. In other words, CGST credit cannot, in general, be used for payment of SGST. Nor can SGST credit be used for payment of CGST.

Illustration II: Suppose, again hypothetically, that the rate of CGST is 10% and that of SGST is 10%. When an advertising company located in Mumbai supplies advertising services to a company manufacturing soap also located within the State of Maharashtra for, let us say Rs. 100, the ad company would charge CGST of Rs. 10 as well as SGST of Rs. 10 to the basic value of the service. He would be required to deposit the CGST component into a Central Government account while the SGST portion into the account of the concerned State Government. Of course, he need not again actually pay Rs. 20 (Rs. 10+Rs. 10) in cash as it would be entitled to set-off this liability against the CGST or SGST paid on his purchase (say, of inputs such as stationery, office equipment, services of an artist etc). But for paying

CGST he would be allowed to use only the credit of CGST paid on its purchase while for SGST he can utilise the credit of SGST alone. In other words, CGST credit cannot, in general, be used for payment of SGST. Nor can SGST credit be used for payment of CGST.

Question 11 : Which Central and State taxes are proposed to be subsumed under GST?

Answer : The various Central, State and Local levies were examined to identify their possibility of being subsumed under GST. While identifying, the following principles were kept in mind:

- (i) Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.
- (ii) Taxes or levies to be subsumed should be part of the transaction chain which commences with import/ manufacture/ production of goods or provision of services at one end and the consumption of goods and services at the other.
- (iii) The subsumation should result in free flow of tax credit in intra and inter-State levels.

- (iv) The taxes, levies and fees that are not specifically related to supply of goods & services should not be subsumed under GST.
- (v) Revenue fairness for both the Union and the States individually would need to be attempted.

On application of the above principles, the Empowered Committee has recommended that the following Central Taxes should be, to begin with, subsumed under the Goods and Services Tax:

- (i) Central Excise Duty
- (ii) Additional Excise Duties
- (iii) The Excise Duty levied under the Medicinal and Toiletries Preparation Act
- (iv) Service Tax
- (v) Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- (vi) Special Additional Duty of Customs - 4% (SAD)
- (vii) Surcharges, and
- (viii) Cesses.

The following State taxes and levies would be, to begin with, subsumed under GST:

- (i) VAT / Sales tax
- (ii) Entertainment tax (unless it is levied by the local bodies).
- (iii) Luxury tax
- (iv) Taxes on lottery, betting and gambling.
- (v) State Cesses and Surcharges in so far as they relate to supply of goods and services.
- (vi) Entry tax not in lieu of Octroi.

Purchase tax: Some of the States felt that they are getting substantial revenue from Purchase Tax and, therefore, it should not be subsumed under GST while majority of the States were of the view that no such exemptions should be given. The difficulties of the foodgrain producing States was appreciated as substantial revenue is being earned by them from Purchase Tax and it was, therefore, felt that in case Purchase Tax has to be subsumed then adequate and continuing compensation has to be provided to such States. This issue is being discussed in consultation with the Government of India.

Tax on items containing Alcohol: Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT could be continued to be levied on alcoholic beverages as per the existing practice. In case it has been made Vatable by some States, there is no objection to that. Excise Duty, which is presently levied by the States may not also be affected.

Tax on Tobacco products: Tobacco products would be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST with ITC.

Tax on Petroleum Products: As far as petroleum products are concerned, it was decided that the basket of petroleum products, i.e. crude, motor spirit (including ATF) and HSD would be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. A final view whether Natural Gas should be kept outside the GST will be taken after further deliberations.

Taxation of Services : As indicated earlier, both the Centre and the States will have concurrent power to levy tax on goods and services. In the case of States, the principle for taxation of intra-State and inter-

State has already been formulated by the Working Group of Principal Secretaries/Secretaries of Finance/Taxation and Commissioners of Trade Taxes with senior representatives of Department of Revenue, Government of India. For inter-State transactions an innovative model of Integrated GST will be adopted by appropriately aligning and integrating CGST and IGST.

Question 12 : What is the rate structure proposed under GST ?

Answer : The Empowered Committee has decided to adopt a two-rate structure –a lower rate for necessary items and items of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items. For upholding of special needs of each State as well as a balanced approach to federal flexibility, it is being discussed whether the exempted list under VAT regime including Goods of Local Importance may be retained in the exempted list under State GST in the initial years. It is also being discussed whether the Government of India may adopt, to begin with, a similar approach towards exempted list under the CGST.

For CGST relating to goods, the States considered that the Government of India might also

have a two-rate structure, with conformity in the levels of rate with the SGST. For taxation of services, there may be a single rate for both CGST and SGST.

The exact value of the SGST and CGST rates, including the rate for services, will be made known duly in course of appropriate legislative actions.

Question 13: What is the concept of providing threshold exemption for GST?

Answer : Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

- a) It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them.
- b) The compliance cost and compliance effort would be saved for such small traders.
- c) Small traders get relative advantage over large enterprises on account of lower tax incidence.

The present thresholds prescribed in different State VAT Acts below which VAT is not applicable varies

from State to State. A uniform State GST threshold across States is desirable and, therefore, as already mentioned in Answer to Question 6, it has been considered that a threshold of gross annual turnover of Rs. 10 lakh both for goods and services for all the States and Union Territories might be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime. Keeping in view the interest of small traders and small scale industries and to avoid dual control, the States also considered that the threshold for Central GST for goods may be kept Rs.1.5 Crore and the threshold for services should also be appropriately high.

Question 14 : What is the scope of composition and compounding scheme under GST?

Answer : As already mentioned in Answer to Question 6, a Composition/Compounding Scheme will be an important feature of GST to protect the interests of small traders and small scale industries. The Composition/Compounding scheme for the purpose of GST should have an upper ceiling on gross annual turnover and a floor tax rate with respect to gross annual turnover. In particular there will be a compounding cut-off at Rs. 50 lakhs of the gross

annual turnover and the floor rate of 0.5% across the States. The scheme would allow option for GST registration for dealers with turnover below the compounding cut-off.

Question 15 : How will imports be taxed under GST ?

Answer : With Constitutional Amendments, both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

Question 16 : Will cross utilization of credits between goods and services be allowed under GST regime?

Answer : Cross utilization of credit of CGST between goods and services would be allowed. Similarly, the facility of cross utilization of credit will be available in case of SGST. However, the cross utilization of CGST and SGST would generally not be allowed except in the case of inter-State supply of goods and services under the IGST model which is explained in answer to the next question.

Question 17 : How will be Inter-State Transactions of Goods and Services be taxed under GST in terms of IGST method ?

Answer : The Empowered Committee has accepted the recommendation for adoption of IGST model for taxation of inter-State transaction of Goods and Services. The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information is also submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

The major advantages of IGST Model are:

- a) Maintenance of uninterrupted ITC chain on inter-State transactions.

- b) No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.
- c) No refund claim in exporting State, as ITC is used up while paying the tax.
- d) Self monitoring model.
- e) Level of computerisation is limited to inter-State dealers and Central and State Governments should be able to computerise their processes expeditiously.
- f) As all inter-State dealers will be e-registered and correspondence with them will be by e-mail, the compliance level will improve substantially.
- g) Model can take 'Business to Business' as well as 'Business to Consumer' transactions into account.

Question 18 : Why does introduction of GST require a Constitutional Amendment?

Answer : The Constitution provides for delineation of power to tax between the Centre and States. While the Centre is empowered to tax services

and goods upto the production stage, the States have the power to tax sale of goods. The States do not have the powers to levy a tax on supply of services while the Centre does not have power to levy tax on the sale of goods. Thus, the Constitution does not vest express power either in the Central or State Government to levy a tax on the 'supply of goods and services'. Moreover, the Constitution also does not empower the States to impose tax on imports. Therefore, it is essential to have Constitutional Amendments for empowering the Centre to levy tax on sale of goods and States for levy of service tax and tax on imports and other consequential issues.

As part of the exercise on Constitutional Amendment, there would be a special attention to the formulation of a mechanism for upholding the need for a harmonious structure for GST along with the concern for the powers of the Centre and the States in a federal structure.

Question 19: How are the legislative steps being taken for CGST and SGST ?

Answer : A Joint Working Group has recently been constituted (September 30, 2009) comprising of the officials of the Central and State Governments to prepare, in a time-bound manner a draft legislation for Constitutional Amendment.

Question 20: How will the rules for administration of CGST and SGST be framed?

Answer : The Joint Working Group, as mentioned above, has also been entrusted the task of preparing draft legislation for CGST, a suitable Model Legislation for SGST and rules and procedures for CGST and SGST. Simultaneous steps have also been initiated for drafting of legislation for IGST and rules and procedures. As a part of this exercise, the Working Group will also address to the issues of dispute resolution and advance ruling.