

Goods and Services Tax: A Law Reform or Law Restatement

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On a cursory glance, the proposed Goods and Services Tax (hereinafter referred as 'GST') purports to be the most significant post-independence tax reform. However, a trip down the history of indirect taxation does not allow one to present a straightjacket view. The primary reason is that the essential concepts of GST have been a part of the road previously visited by the existing State VAT. The authors of this issue of Law & Policy Brief argue that GST shares features of both reform and restatement, the latter of the already existing objectives promoted by the State VAT structure at a central level and reform in connection with the mechanism to meet these objectives.

INTRODUCTION

The existing indirect tax system has an exclusive division of fiscal powers, according to which the Central Government levies Excise Duty on manufacture (hereinafter referred as CENVAT) and Service Tax on the supply of services and the State Government levies sales tax or VAT on the sale of goods within the State. Additionally, Central Sales Tax is levied on inter-state sale of goods by the Central Government, but collected and retained by exporting states. In other words, the Center is not empowered to levy tax on goods beyond the point of manufacture, and the State is not granted powers to tax the services. This division of taxing powers leads to a system of multiple taxes at the Center and State on the same goods and makes both CENVAT and State VAT partial in nature. This results in tax on tax, i.e. tax cascading effect as no credit is available for the Excise Duty and Service Tax paid at the stage of manufacture while paying the State VAT, and vice versa.

The introduction of GST would mark a clear departure from the above-mentioned problems of the indirect taxation by developing a common Indian market and

reducing the cascading effect of tax on the cost of goods and services. It will impact the tax structure, tax incidence, tax computation, tax payment, compliance, credit utilization and reporting, which will completely change the current indirect tax system. Therefore, it is a pertinent question to ask, whether such a change by GST is a reform or restatement or a combination of both.

1. WHY LAW RESTATEMENT?

An in-depth study of the proposed GST structure shows restatement of the cardinal objectives of the State VAT regime. An attempt to remove the cascading effect of taxes was one of the primary rationales behind the shift from the Sales Tax to State VAT and still remains the primary reason for the shift from the existing indirect tax structure to the proposed GST regime. The cardinal objective of GST is to simplify and harmonize the indirect tax regime and remove the cascading effect of taxation. The proposed GST structure is a vision to adopt a comprehensive VAT on an all-India basis. Thus, we witness restatement of cardinal objective of the State VAT regime on a larger canvas, i.e. GST, wherein the objectives that

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were adopted by State VAT will be implemented under GST. Such implementation, aims to overcome the problems that were recognized during the shift from Sales Tax to State VAT for which no solution could be provided due to the differentiated taxing powers of the Center and the States under the Indian Constitution.

1.1. Cascading Effect of Tax

The initiative to eradicate tax cascading effects dates back to the 1994 report of the National Institute of Public Finance and Policy prepared by Amaresh Bagchi (hereinafter referred as 'Bagchi Report') wherein lies the roots of the State VAT regime. Thereafter the VAT regime replaced the State Sales Tax in 2005 under the then Chairman of the Empowered Committee of State Finance Ministers on VAT, Dr. Asim Dasgupta. While the Bagchi Report may have been implemented, however, it should be kept in mind that Amaresh Bagchi clearly recognized that it is not to be the perfect or the first best solution to the problems of domestic trade tax regime in a multi-government framework. Nonetheless, the vision to effectively eradicate the problem of tax cascading effects and also the recognition of its demerits in a multi-government framework became the reason for the change to proposed GST. It seems like the problems were recognized long before the so-called revolutionary GST.

The main objective of Article 301 of the Constitution of India mandates free flow of trade, commerce and intercourse throughout India. Despite that, the government at Center and States used flexibilities provided in Article 302 and 304 to levy multiple taxes, which led to fragmentation of the Indian market. Replacing the existing complex multilayer indirect tax system by GST on all goods and services is imperative for India's growth and competitiveness. Therefore, the true rationale behind this revolutionary change is not a mere replica of something already known. Nevertheless, to provide a solution to the problems of a multi-government framework of taxation, GST restates the existing objectives in a different and a wider context, the vision of which was actually recommended way back in 1994.

1.2. Input Tax Credit

The essence of VAT is to provide set-off for the tax paid earlier, through the concept of input tax credit. The input tax credit means setting off the amount of input tax against the output tax. The reason for introduction of CENVAT at the Center and VAT at the State was to ensure elimination of the cascading effect of taxes. This system is restated in the GST regime by broadening the horizons of already existing input tax credit.

1.3. Scheme of Compensation

The Scheme of Compensation to address revenue losses incurred by the States as a result of shift to the VAT regime is substantially similar to the GST regime, under which, the Center has proposed to aid the States by means of compensation for the revenue loss if any incurred by them for a period of five years. The compensation scheme for the first three years will be 100%, in the fourth year it will be 75% and in the fifth year it will be 50%. Undertaking such a scheme in a manner as such is a restatement of the already existing policy, which again is the motivation behind GST.

2. WHY LAW REFORM?

Reformative aspect of GST is witnessed in its mechanism to incorporate a comprehensive VAT system in India. There is a remodeling of the entire indirect tax structure to give effect to the VAT system on an all India basis. A significant reform shall also be exhibited in the constitution by amending the existing bifurcation of the taxing powers between the Center and the State. The reform is envisaged in the mechanism of implementation and not at the macro scale of objectives and motives, which had already been present in the State VAT structure. The present structure recognizes the problems that a multi-governmental framework has but the mechanism to deal with this issue is set forth by GST. Thus, it is a major reform in the mechanism of implementation procedure.

2.1. New Tax Base

One of the major reforms to address the lacuna identified by Amaresh Bagchi in the 1994 report of National Institute of Public Finance and Policy is expected to overcome by the new proposition of broadening the tax base under the GST regime. The Center would have the power to levy GST on all goods upto the point of retail or final consumption, which under the existing system is restricted as Center can levy tax only upto the manufacturing stage. Additionally, the Center would also have the power to levy GST on some services such as amusement, gambling, betting, hospitality, lotteries; which in the existing system are within the domain of the States. Further, the State would have the power to levy GST on all services, which in the existing system is restricted. At the Central Level GST shall subsume Central Excise Duty, Additional Excise Duties, Excise Duty levied under Medicinal and Toilet Preparations (Excise Duties) Act, Service Tax, Additional Duty of Customs and Central Surcharges and Cesses. At the State Level it shall subsume the State Value Added Tax/sales Tax, Entertainment tax, CST, Octroi and Entry

tax, Purchase tax, Luxury tax, taxes on lottery, betting and gambling and State Cesses and surcharges. Thus, broadening the tax base and bringing about better tax compliance due to integration, reduced cost and efficiency by a robust IT infrastructure under GSTN.

2.2. Taxable Event

A way forward from the existing tax structure has been witnessed in the mechanisms introduced under GST. The proposed GST regime envisages changing the taxable event from 'sale', 'manufacture', 'entry', and 'provision of service' etc. to mere 'supply'. This explains how GST shall subsume various Central and State taxes as mentioned earlier. This principle seems to be used more to give effect to the destination principle by providing credits for the taxes paid from the stage of manufacture to consumption. Further, the definition of 'supply' apart from broadening the 'taxable event', has gone on to include within its ambit, all supply made with consideration and five selective supplies made without consideration that being permanent transfer or disposal of business assets, temporary application of business asset to a private or non-business use, services put to a private or non business use, self supply of goods or services and assets retained after deregistration.

2.3. What is IGST?

With phasing out CST and thereby removing its lacunas, Integrated Goods & Service Tax (hereinafter referred as 'IGST') would act as a bridge for passing on the input tax credit as a part of the value of supplies of goods and services between states. In this structure the dealer would be required to determine upfront whether a supply occurs in inter-state trade or commerce. IGST is a good example of a single agency administering dual levies. Each transaction of supply would attract two levies Central Goods & Service Tax (hereinafter referred as 'CGST') and State Goods & Service Tax (hereinafter referred as 'SGST'). In a transaction involving inter-state supply, IGST would have to be charged. The principle to harmonize dual levies has been adopted by IGST. The IGST mechanism has been designed to ensure seamless flow of input tax credit from one State to another. The inter-state seller, on the sale of his goods, would pay IGST to the Central Government after adjusting credit of IGST, CGST and SGST on the purchases respectively. The exporting State will transfer to the Center the credit of SGST used in payment of IGST. The importing dealer will claim credit of IGST while discharging his output tax liability (both CGST and SGST) in his own State. The Center will transfer to the importing State the credit of

IGST used in payment of SGST. Thus forming an integrated chain to provide credit at each stage without making it burdensome for the taxpayer. Such was not the case in the previous system with the CST being levied in inter-state transaction as no credit was provided for the tax paid at the earlier stage. Thus, this again becomes a significant shift to a more integrated and comprehensive system.

2.4. Destination-Based Tax Regime

A significant and notable reform under the proposed GST regime is the concept of 'consumption tax' under the 'destination principle'. In the existing indirect tax structure, it is witnessed that a complex mix of origin and destination based tax regime is followed. The Excise Duty prior to the implementation of MODVAT previously and CENVAT with Service Tax was origin based single point levy. Although with the emergence of MODVAT and thereafter CENVAT with Service Tax, it has become multi-point but it still stays restricted to the manufacturing level and does not extend to retail or consumption stage. Further, CST follows origin-based concept wherein the tax is collected by the exporting State and no credit is available in the importing State for the taxes paid in the exporting State leading to tax cascading effect and becomes a major impediment for the free flow of trade and market. Thus a newfangled approach of destination based tax regime is going to have its birth with GST.

In the ideal destination based taxation, the component of CGST and SGST under the inter-state trade and commerce should be levied and collected by the importing State to bring the taxation of goods and services imported equivalent to taxation of goods and services produced in the State. However under the proposed Indian model of GST, in case of inter-state sales, the power to levy and collect tax has been given to Center under the nomenclature of IGST (aggregating to CGST and SGST), which is to be collected in the exporting State, thus giving a preliminary view of being origin based. Nonetheless, to enable it to be destination-based taxation, credit is given to the consumer in other State. Therefore, although the supply is taxed at the origin, the central government operates as a clearinghouse and compensates the consuming State according to the destination principle (i.e. transferring the amount to the importing State so that the credit maybe allowed by the importing State to the dealer of the importing State of the taxes paid in the exporting State as IGST) ensuring IGST in effect be destination based. Thus, such a tax structure shall enable free flow of trade and market and increases competitiveness.

Further, in case of intra-state sales, the principles adopted remains destination based as the transaction is originated and completed or goods are produced and consumed in the same territory. Therefore revenue accrues to the same State government where goods are produced and consumed. CGST and SGST are thus levied on the sale and thereafter a credit is provided for the respective taxes earlier paid on resale. In this way, providing an integrated chain of credit system. It would allow uninterrupted credit chain without any apparent exclusion. Taxes paid on input goods or services against CGST shall be utilised as input tax credit against tax liabilities under the CGST and the same principle applies to SGST. Cross utilization of input tax credit between the CGST and SGST would not be allowed except in case of inter-state supply of goods and services.

2.5. Dual Administration

Another underlying reform to the GST is the concept of dual structure of administration, which has its roots in the recommendations given by the Kelkar Committee. The dual structure shall have the taxes levied and collected by the Union government (CGST) and respective State governments (SGST). The dual GST model would be implemented and governed by one CGST/IGST statute applicable across the country, SGST statute for each State and common rules determining valuation, place of supply, place of origin etc. This implies that the Center and the States would have concurrent jurisdiction for the entire value chain and the basic principles of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc., shall be uniform across State statutes. CGST and SGST would be comprehensively applicable to all goods and services upto the final consumer (retail level) reflecting the tax base of a typical consumption VAT. This mechanism thus becomes an essential administrative tool to meet the objective already known in the history of indirect taxation and road path already set under the nomenclature of GST.

2.6. GST Network

GSTN is envisaged to provide shared IT infrastructure and service to the Central and State Governments, taxpayers and other stakeholders on a common PAN-based taxpayer ID. GSTN via common portal shall be set-up to provide three core services, which would ease compliance – registration, return and payment. The key benefits that this changing paradigm is envisaged to bring for a taxpayer are: one stop-shop for all GST-related compliance reporting, one return under GST, simplified

and uniform formats. Further the key benefits for the tax authorities are end-to-end automation, quick availability of past data, processed inputs and standard reports.

CONCLUSION

Stemming from the debate, whether GST is a law restatement or law reform, it is understood that GST is a restatement because the cardinal objectives of GST are similar to that of VAT and a reform because of the new mechanisms devised for GST to simplify and harmonise the indirect tax regime in the country. Thus, both reform and restatement form an equally important position in the proposed GST and it is impossible to establish reform without restatement or vice-versa.

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