

Goods And Service Tax - An Introductory Study

The Finance Minister Mr. P. Chidambaram has declared that Goods and Service Tax will be introduced in India in 2010. This article focuses on how this tax system will work, and discusses the problems likely to be faced by the Central Government while introducing this tax. It also briefly touches upon the Present state level VAT and Central Service Tax.

The Union Finance Minister Mr. P. Chidambaram has given indication that the country will have Goods and Service Tax (GST) regime in 2010. With successful introduction of VAT in almost all the states and continuous increase in number of services under the service tax net, nobody should have any doubt of the Finance Minister's seriousness about GST. The Finance Minister in his Budget speech in 2006 had said:

"It is my sense that there is a large consensus that the country should move towards a National Level Goods and Service Tax (GST) that should be shared between the Centre and the states. I propose that we set April 1, 2010 as the date of introducing GST. World over, Goods and Services attract the same rate of Tax. This is the foundation of GST. People must get used to the idea of a GST. We must progressively converge the service tax rate and Cenvat rate. I propose to take one step this year and increase the service tax rate from 10 per cent to 12 per cent. Let me hasten to add that since service tax paid can be credited against service tax payable or excise duty payable, the net impact will be very small."

What Is GST?

Goods and Service Tax is a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider can claim the input credit of tax which he has paid while purchasing the goods or procuring the service.



— CA. Sudhir Halakhandi

(The author is a member of the Institute. He can be reached at sudhir@halakhandi.com)

On most of the goods and services the rate of tax remains the same but as per the necessity of the nation some goods or services can be declared as "exempted" or "Zero rated". The whole system is developed in such a way that it avoids the cascading effect and the final consumer bears the burden of all the tax. Generally, in such a system Exports are zero rated and all the taxes paid while purchasing and manufacturing the goods including the taxes paid on raw material and services are returned to the exporter to make the exports competitive.

The sellers or service providers collect the tax from their customer, who may or may not be the ultimate customer, and before depositing the same to the exchequer, they deduct the tax they have already paid.

This is simply very similar to VAT which is at present applicable in most of the states and can be termed as National level VAT on Goods and Services with only one difference that in this system not only goods but also services are involved and the rate of tax on goods and services are generally the same.

How GST Will Work

Generally, the dealers registered under GST (Manufacturers, Wholesalers and retailers and service providers) charge GST on the price of goods and services from their customers and claim credits for the GST included in the price of their own purchases of goods and services used by them. While GST is paid at each step in the supply chain of goods and services, the paying dealers don't actually bear the burden of the tax because GST is an indirect tax and ultimate burden of the GST has to be taken by the last customer.

This is because they include GST in the price of the goods and services they sell and can claim credits for the most GST included in the price of goods and services they buy. The cost of GST is borne by the final consumer, who can't claim GST credits, i.e. input credit of the tax paid.

The GST can be divided into following sections to understand it better:

1. **Charging Tax:** The dealers registered under GST (Manufacturers, Wholesalers and Retailers and Service Providers) are required to charge GST at the specified rate of tax on goods and services that they supply to customers. The GST payable is included in the price paid by the recipient of the goods and services. The supplier must deposit this amount of GST with the Government.
 2. **Getting Credit of GST:** If the recipient of goods or services is a registered dealer (Manufacturers, Wholesalers and Retailers and Service Providers), he will normally be able to claim a credit for the amount of GST he has paid, provided he holds a proper tax invoice. This "input tax credit" is setoff against any GST (Out Put), which the dealer charges on goods and services, which he supplies, to his customers.
 3. **Ultimate Burden of Tax on Last Customer:** The net effect is that dealers charge GST but do not keep it, and pay GST but get a credit for it. This means that they act essentially as collecting agents for the Government. The ultimate burden of the tax falls on the last and final consumer of the goods and services, as this person gets no credit for the GST paid by him to his sellers or service providers.
 4. **Registration:** Dealers will have to register for GST. These dealers will include the suppliers, manufacturers, service providers, wholesalers and retailers. If a dealer is not registered, he normally cannot charge GST and cannot claim credit for the GST he pays and further can not issue a tax invoice.
 5. **Tax Period:** The tax period will have to be decided by the respective law and normally it is monthly and/or quarterly. On a particular tax period, which is applicable to the dealer concerned, the dealer has to deposit the tax if his output credit is more than the input credit after considering the opening balance, if any, of the input credit.
 6. **Refunds:** If for a tax period the input credit of a dealer is more than the output credit then he is eligible for refund subject to the provisions of law applicable in this respect. The excess may be carried forward to next period or may be refunded immediately depending upon the provision of law.
 7. **Exempted Goods and Services:** Certain goods and services may be declared as exempted goods and services and in that case the input credit cannot be claimed on the GST paid for purchasing the raw material in this respect or GST paid on services used for providing such goods and services.
 8. **Zero Rated Goods and Services:** Generally, export of goods and services are zero-rated and in that case the GST paid by the exporters of these goods and services is refunded. This is the basic difference between Zero rated goods and services and exempted goods and services.
 9. **Tax Invoice:** Tax invoice is the basic and important document in the GST and a dealer registered under GST can issue a tax invoice and on the basis of this invoice the credit (Input) can be claimed. Normally a tax invoice must bear the name of supplying dealer, his tax identification nos., address and tax invoice nos. coupled with the name and address of the purchasing dealer, his tax identification nos., address and description of goods sold or service provided.
- The working of GST with respect to manufacturer, dealer and consumer can be seen in the illustrations given on next page:
- The manufacturers will get the input credit of all the taxes paid by them on the raw material and also on the services. Let us assume the

rate of GST at 16% and a plastic manufacturing company has consumed the following goods and services while producing the goods, which they are able to sell at Rs. 100 lakh plus tax: -

Description	Amount	Rate Of Tax	Tax Paid
Raw material	Rs. 50 lakh	16%	Rs. 8.00 lakh
Stores and spares	Rs. 10 lakh	16%	Rs. 1.60 lakh
Services	Rs. 15 lakh	16%	Rs. 2.40 lakh
Total Input Tax			Rs. 12 lakh

Now the "Output Tax" i.e. the tax charged from the purchaser is as under:

Description	Amount	Rate Of Tax	Tax Collected
Sale	Rs. 100 lakh	16%	Rs. 16.00 lakh
Total Output Credit			Rs. 16.00 lakh

The net tax payable by Manufacturer is as under: -

Description	Amount
Total output tax.	Rs. 16.00 lakh
Total input tax.	Rs. 12.00 lakh
Net GST payable	Rs. 4.00 lakh

If the goods are sold to a trader by this manufacturer and the trader also used some of the services amounting to **Rs. 5 lakh** on which he has paid service tax amounting to Rs. 0.80 lakh, then his input tax is as under:

Description	Amount	Rate of Tax	Tax Paid
Goods Sold	Rs. 100 lakh	16%	Rs. 16.00 lakh
Services	Rs. 5 lakh	16%	Rs. 0.80 lakh
Total Input Tax			Rs. 16.80 lakh

Now the dealer sold the goods to the consumers by adding his profit of Rs. 10 lakh and in that case his output tax will be as under:

Description	Amount
Goods Sold	Rs. 115.00 lakh
Add: Tax @ 16%	Rs. 18.40 lakh
Total	Rs. 133.40 lakh

The net tax payable by the dealer is as under:

Description	Amount
Total output tax.	Rs. 18.40 lakh
Total input tax.	Rs. 16.80 lakh
Net GST payable	Rs. 1.60 lakh

Now through this system we have presumed that the goods of Rs. 115 lakh are sold to the customers then the Government in that case has got the tax in the following form:

Description	Amount
From the sellers of raw material	Rs. 8 lakh
From the suppliers of stores and spares	Rs. 1.60 lakh
From the service providers of the services consumed by the manufacturer	Rs. 2.40 lakh
From the manufacturer	Rs. 4.00 lakh
From the service providers of the services consumed by the dealer	Rs. 0.80 lakh
From the dealer	Rs. 1.60 lakh
Total GST received	Rs. 18.40 lakh

See, this is exactly equal to the amount that has to be borne and ultimately paid by the last customer on Rs. 115 lakh @ 16% i.e. Rs. 18.40 lakh.

Apparently the system is very much similar to the present system of VAT but the implementation of this system will certainly have some unique problems compared to VAT.

In a very simple manner the overall system of GST can be seen as under with the help of this table:

Rs. in lakh			
Description	Output Credit	Input Credit	Net Tax
Raw Material Supplier	8	Nil	8
Stores supplier to manufacturer	1.6	Nil	1.6
Service provider to manufacturer	2.4	Nil	2.4
Service provider to trader	0.8	Nil	0.8
Manufacturer	16	12	4
Trader	18.4	16.8	1.6
Total	47.2	28.8	18.4

The Net GST payable by the Manufacturer and Trader can be seen as under with the help of Figure 1:

Figure 1.

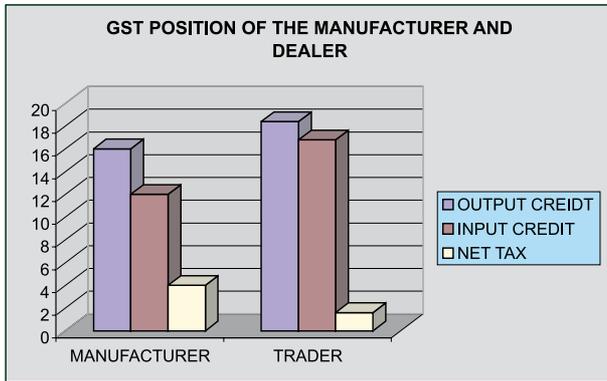


Fig. 1: Showing the output credit, input credit and Net tax payable by the Manufacturer and the Dealer.

The Net component of Tax to the consumer can be seen in Figure 2:

Figure 2.

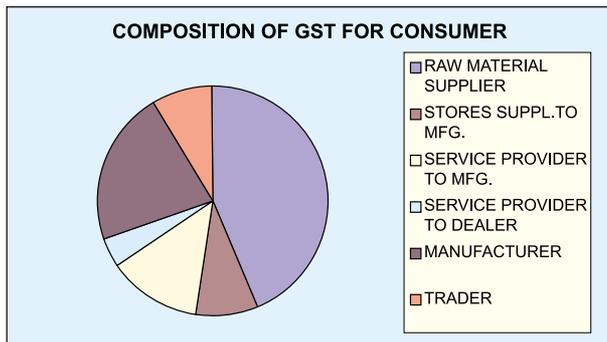


Fig.2: Showing how the tax borne by the ultimate consumer is deposited by various dealers at different stages.

Systems of GST

Internationally, there are three systems in vogue:

- (a) Invoice System
- (b) Payment System
- (c) Hybrid System

(a) Invoice System: In the invoice system, the GST (Input) is claimed on the basis of invoice and it is claimed when the invoice is received, it is immaterial whether payment is made or not. Further the GST (Output) is accounted for when

invoice is raised. Here also the time of receipt of payment is immaterial.

One may treat it as mercantile system of accounting. In India the present system of sales tax on goods is an invoice system of VAT and here it is immaterial whether the taxpayer is following the cash basis of accounting or mercantile basis of accounting.

The advantage of invoice system is that the input credit can be claimed without making the payment. The disadvantage of the invoice system is that the GST has to be paid without receiving the payment.

(b) Payment System: In the payment system of GST, the GST (Input) is claimed when the payment for purchases is made and the GST (Output) is accounted for when the payment is made. In this system, it is immaterial whether the assessee is maintaining the accounts on cash basis or not.

The advantage of cash invoice system is that the Tax (output) need not be deposited until the payment for the goods and/or services is received. The disadvantage of the payment system is that the GST (input) cannot be claimed without making the payment.

The Taxes on services in India are based on this payment system since service tax is payable on receipt basis and further Cenvat credit is only allowable when payment of the service is made.

In some countries, this system is also adopted for small traders to keep them away from the complexities of the Invoice system, which is purely a mercantile system.

(c) Hybrid System: In hybrid system the GST (Input) is claimed on the basis of invoice and GST (Output) is accounted for on the basis of payment, if allowed by the law. In some countries the dealers have to put their option for this system or for a reversal of this system before adopting the same.

These three systems can be summarised as under:

Description	Input Credit	Output Credit
Invoice system	On receipt of invoice	On issue of Invoice
Payment system	On making the payment	On receiving the payment
Hybrid system	At the option of dealer to be declared in advance	At the option of dealer to be declared in advance

It always depends on the law of the country, which decides the system of GST to be followed by the dealers.

GST and Present System of VAT

In principle, there is no difference between present tax structure under VAT and GST as far as the tax on goods is concerned because GST is also a form of VAT on Goods and services. Here at present the sales tax, with an exception of CST, is a VAT system and in case of service tax the system also has the Cenvat credit system hence both sales tax and service tax are under VAT system in our country. At present the goods and services are taxed separately but in GST the difference will be vanished.

The overall system of GST is very much similar to the VAT, which can be considered as first step towards GST. Let us see the VAT implementation schedule of various states:

States	Date of Imposition of VAT	Number of States
1. Haryana	1-4-2003	1
2. Andhra Pradesh, West Bengal, Kerala, Karnataka, Orissa, NCT Delhi, Tripura, Bihar, Arunachal Pradesh, Sikkim, Punjab, Goa, Mizoram, Nagaland, Jammu and Kashmir, Manipur, Maharashtra, Himachal Pradesh, Assam and Meghalaya.	1-4-2005	20
3. Uttaranchal	1-10-2005	1
4. Rajasthan, Gujarat, MP and Chhatisgarh, Jharkhand.	1-4-2006	5
5. Uttar Pradesh and Tamil Nadu	Still not decided	2

All the states have their own VAT Laws comprising VAT acts and VAT rules and these acts and rules are formulated on the basis of "White Paper on VAT" issued by the empowered committee of states' Finance Ministers on VAT headed by Dr. Asim Das Gupta, the Finance Minister of West Bengal.

Due to the fact that the taxpayers are already using the Vatable sales tax and service tax system there may be a possibility that GST will be a matter of settlement between the Centre and the states and like VAT, the possibility of any resistance from the tax payers is somewhat less.

Service Tax

In our country, the goods are taxable since long but the same cannot be said for services. Till 1994 there was no tax on services and this tax was introduced by the then Finance Minister and present Prime Minister Dr. Manmohan Singh. The logic behind this tax was "When goods are taxable why not service?" It is also a central tax and along with central excise it is governed on the system of VAT and the service tax suffered and paid can be claimed as Cenvat credit against central excise and service tax or vice versa.

There is no separate Service Tax Act and Service Tax Department in India and taxes on services in our country are governed by some of the provisions of Finance Act – 1994 and Service Tax Rules – 1994 and the department concerned is Central Excise department.

In our country the whole service sector is not taken under the service tax net and instead a selective approach is adopted. In 1994 only three services were brought under service tax net and the number has been increasing every year since then. Today, the number of services under the service tax net is touching almost 100.

Rate of Service Tax

The rates of service tax at various stages of time have been as under:

Period	Rate of Tax
1-7-1994 to 13-05-2003	5%
14-05-2003 to 09-09-2004	8%
10-09-2004 to 17-04-2006	10.2% (including 2% Education cess)
From 18-04-2006	12.24% (including 2% Education cess)

When GST will be introduced, the service tax provisions as contained in Finance Act – 1994 and Service Tax Rules – 1994 will be replaced by the provisions of a Central Goods and Service Tax Act and Rules.

GST and Income Tax

GST is basically an indirect tax but since the last burden of this tax is borne by the ultimate consumer hence for a consumer it is a tax on him. If a person pays income tax of Rs. 10,000 on his income and Rs. 2500 on services and goods consumed by him the total burden of tax on him is Rs. 12500 during the year.

Now in some countries the GST has been made deductible from the income tax of the ultimate consumer but this has been done only on experimental basis and only in the case of small income group assesses. If this approach is adopted in India, then the person mentioned above will get the credit of Rs.2500.00 and have to pay income tax of Rs.7500.00 only to make his total tax in tune of Rs.10000. However, this is a very remote possibility in our country. But theoretically this may be a good point of study.

It is Essentially a Centralised System

The GST will work only as a centralised taxation system with collection of all the Tax going to the Central Government and then shared by the states. And this will be a big problem when GST will be introduced in India because the country has the federal system of economy in which the states also have the power to collect tax and that

is the main base of their economic autonomy.

How this system will work in a centralised system can only be understood from the announcement of the Finance Minister, so let us once again see the relevant portion of the speech.

“It is my sense that there is a large consensus that the country should move towards a National Level Goods and Service Tax (GST) that should be shared between the Centre and the States.”

This particular peculiarity of the GST has made it totally different from the VAT and this can only be a national level tax and can be successfully managed by the central power and the total collection of the same can be shared by the states.

VAT has also been introduced in our country without abolishing the CST (Central Sales Tax) and even lowering the CST rates have been postponed several times. The basic reason behind this has been that some of the states collecting major share of CST are not ready to compromise with their economic autonomy. VAT principally is also a central tax but in our country it has been introduced with some compromises and states have agreed on it, though with some initial hesitation, because their economic autonomy was not touched. There is psychological difference between the collection of Tax by the states themselves and sharing the centrally collected tax.

Best Time to Introduce GST

Financial Secretary of Hong Kong Government Henry Tang Ying-yen has recently said:

“The GST offers us the best option to broaden our tax base and we should grasp this opportunity to introduce it when the circumstances are favourable and while the economy is enjoying steady growth with only mild inflation.”

When VAT was introduced in India, most of the burden of introduction and implementation of VAT was shared by the Empowered Committee of the Finance Ministers of the states but when GST

will be introduced it is only the Union Finance Minister who has to take most of the burden on his shoulders. There may be a clash of interest of the Centre with the states hence the task will not be that easy.

The serious process of discussion of the GST is yet to be started hence at present it cannot be ascertained what the initial reaction of the states will be. But even after the Centre's clear indication about GST, the states continue to demand for more power to tax.

Why GST

When we have VAT in almost the whole country and the system of central excise and service tax is well equipped with the Cenvat credit, then why is there a need of GST? Well, this is needed to match the international phenomenon. It is needed to reduce the burden of Central excise.

The introduction of GST will certainly change the Federal system of Governance in our country in which states also have the right to collect taxes on goods.

The State Economy and GST

At present the Tax structure of the country is as under:

Taxes: Central Government	Taxes: State Government
1. Central excise and Customs	1. VAT (Sales Tax on Goods)
2. Direct Tax: Income Tax including corporate income Tax and others	2. Tax on interstate sales (CST)
3. Service Tax	3. Local Taxes

When GST will be introduced it will replace the Central excise, services tax, VAT and CST. Till date the Centre has the monopoly power of the tax on services and states have the power to tax the sale of goods. Now the states will have to surrender their power to tax the goods and share the central tax and certainly this will be a very tough bargain for them.

The states are demanding that they should be given power to tax the services also but in GST they will actually lose their power to tax even the goods. The tax will be collected at Central level and then it will be shared by the states.

The Budget (Estimates) for the Year 2005-2006 of 13 states are being presented herewith and it will give an indication how these states may react when the actual steps will be taken to implement GST because some of the states are collecting their own taxes to support their economy very well but the same thing cannot be said for the others. There is clear financial and economic disparity in the country. These reactions from the states will depend on how the GST will curtail their power to tax and how this curtailment will affect their economy and autonomy.

Vital Figures of States' Economy					
(Budgeted Estimates for 2005-06)					
(Rs. Crore)					
Name Of State	Total Receipt	Own Collection Of Tax*	Share In Central Taxes	Central Grant	Total Receipt From Centre**
1. Andhra Pradesh	35976	19981	6688	4904	11592
2. Assam	13314	3198	3074	5978	9052
3. Bihar	18719	3983	10481	3949	14430
4. Gujarat	23217	14173	3263	2505	5768
5. Haryana	12037	8217	1022	882	1904
6. Karnataka	29218	18680	3760	2688	6448
7. Madhya Pradesh	19848	8924	5841	2875	8716
8. Maharashtra	50429	35498	4749	4697	9446
9. Orissa	12693	4010	4160	3462	7622
10. Rajasthan	20538	9599	5330	3148	8478
11. Tamil Nadu	30251	20651	4672	2827	7499
12. Uttar Pradesh	42668	18291	17046	5084	22130
13. West Bengal	21340	10795	6706	2898	9604

*State sales tax, Central Sales Tax, Other collection (related to sale of goods including sales tax on petroleum products and lubricants, state excise and other local taxes.)
 ** Share in central taxes and grant from Centre.

The larger the own collection of tax, the more difficult it will be for the states to accept the GST. This will be a major hurdle, which the Central Government will have to cross while introducing the GST. □