Indirect Tax Reforms in India And A Way To The Lead For GST

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Abstract*- VAT is a development over the existing union excise duty at the central level and over the sale tax at the state level while GST is a further enhancement over the existing VAT which is yet to be implemented most probably in the coming financial year as promise made by our union finance minister. The new GST will ensure the greater uniformity in the tax rates throughout the country and will end the cascading effects. The objective of this paper is to trace the progress of India's indirect tax reforms from an origin-based CST to a proposed destination based GST*

Keywords- GST, VAT, MODVAT, CENVAT, ITC, TRC, CASCADING EFFECT.

I. INTRODUCTION

Taxes are not a new phenomenon; they are as old as civilization itself. The history of Indian taxation goes back to ancient period when we found certain reference about taxes in many old book like Arthshastra written by Kotilya popularly known as Chankya. This book provides very valuable information regarding how to govern and rule. According to Arthshastra, in ancient time taxes were levied and collected in both cash and kind. Taxation Policy has been a widely debated issue all over the world and a large number of studies have been conducted covering different aspects of indirect taxes. Indirect taxes are also known as commodity taxation. The impact and incidence of indirect taxes may be on different persons and that's why the burden of indirect taxes can be shifted. A fixed proportion of the taxes collected by the Centre devolve tothe states, based on the recommendations of the Central Finance Commission.

Reforming the tax system is critical to achieve fiscal consolidation, minimize distortions and to create stable and predictable environment for the market to function. In many developing countries, tax policy was directed to correct fiscal imbalances. In other words the transition from centralized planning to market oriented economy required wide ranging tax reforms to replace public enterprise with taxes as principal source of revenue. On the other hand globalization emphasized the need to minimize both inefficiency and compliance cost of tax system. In the initial years, the tax policy was directed to increase the level of savings, transfer available savings for investment as envisaged by plan strategy and the need to ensure a fair distribution of income, to correct inequalities arising from the oligopolistic market structure, exchange control and administered price determination.

Firstly, the sale tax is levy on commodities which in most cases, are subject to excise duties. As excise duty and sale tax are levied by the different layers of government, it becomes difficult to determine judiciously the impact of these levies on production, investment and the consumers. No attempt to rationalize commodity tax system can succeed if the centre and the states act independently without co-ordination among themselves. A closely related problem is the taxation of inputs and capital goods, by the central and state governments, through excise duty and sale tax respectively. The taxation of inputs and capital goods contribute to cascading (tax on tax) and vertical integration of firms.

Differential rates of sales tax on the same set of commodities in different states often lead to uneconomic diversion of trade and production centers. It was very common people make purchase from the low tax states and sale them in higher tax states so long as the cost of transporting goods are lower than the tax differential. This distorts natural selection of production centers based on geographical advantage. Such misallocation of resources undermines economic efficiency and thereby retards developmental efforts. Over all different rate of sale tax in different states (multipoint, double-point and single-point) with different procedures and rules cause difficulty for the traders, consumers and tax authorities and which further lead to corruption and litigation.

Excise duty is associated with the production of goods in India and is meant for domestic consumption. By the middle of 1970s, the structure of excise duty was highly complex and distortionary and was a mix of specific and Ad-Valorem taxes. On the later alone there were 24 different rates varying from 2% to 100. The tax GDP ratio was quite low which are now in comfortable position. But with the implementation of the recommendations of TRC the regime of excise duties was made simplified and rationalised. Beside reduction in number of tax rates, the tax has been progressively converted from specific to Ad-Valorem levy.

Under the constitution the state government has the power to levy and collect taxes on sale or purchase of goods within its territory according to the rules framed by it. As per the CST (Central Sale Tax) Act 1956, this prevailed prior to the introduction of VAT different states used
to levy different rate of tax on wide range of goods with diverse procedure and rules for its collection. However the central government has intervened by preventing the states taxing in the course of inter-state trade and commerce.

II. FUTURE OF GST MODEL FOR INDIA

GST is similar to VAT and can be termed as National Level VAT on goods, with one difference, in GST not only goods but services are also included and rate of tax on both goods as well on services will be the same. Most countries have a unified GST system I.e a single rate of tax applicable throughout the country. However in many federal countries like Brazil and Canada a dual GST system is working where GST is levied by both central and state governments. Almost all countries of the Europe have also adopted a dual GST system. Adoption of GST is one of the pre-condition for a country who wants to join the (EU) European Union. As far India is concerned we have adopted a dual GST system because of the federal nature of our constitution in which the power has been divided between the centre and states. Thus in India under the dual

GST system both centre and states will have the power to levy taxes on the sale of goods and services.

III. THE STATES OF FINANCIAL SYSTEM AND GOOD AND SERVICE TAX

When GST will be introduced it will replace the most of taxes. Till date the centre has the monopoly power to tax services and state have the power to tax the sale of good. Now states will have to surrender their power to tax the goods and share the central tax and certainly this will be a very tough bargaining 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 the central level and then it will be shared by the states. Thus GST will curtail the power of states to tax the goods and services and this curtailment will affect their economy and autonomy and that’s why many states are not in favour of GST. This will be a major hurdle in the way of central government while introducing the GST.

IV. GST BENEFITS IN INDIA

In India the GST will have two components one is levied by the centre, hereafter referred to as (CGST) central goods and service tax and other is levied by the state hereafter referred to as state goods and service tax (SGST). However the rate of CGST and SGST would be decided later on by keeping in view the revenue consideration and acceptability. The combined rate is expected to be 14 to 16 per cent. Currently it is the subject matter of discussion before the empowered committee (committee of state finance ministers). CGST and SGST would be applicable to all transactions of goods and services except a small negative list which are kept outside the purview of GST and the many transactions which are below the prescribe threshold limit. Commodities among negative list are alcohol, cigarettes, cigar, tobacco, LPG, Petrol, and Diesel etc.

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. 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. Although on most of 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.

Imports will be levied the same taxes as domestic goods and services adhering to the destination principle. In case of imported goods and services the custom duties will remain outside the purview of GST. Thus the applicable basic custom duties will be continue to be levied on imported goods and services. In addition both CGST and SGST are expected to be levied on imported goods and services. 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 of goods and services.

In case of intra-state transactions (with in the state) the seller has to collect both CGST & SGST from the purchaser and amount of CGST has to be deposit in the account of central government and the amount of SGST has to be deposit in the account of state government. In case of inter-state transactions (among different states) centre would levy IGST Inter State Goods and Services Tax which would be equals to the (CGST+SGST) on all inter-State transactions of taxable goods and services. However the amount of SGST would be transfer to the consumer state i.e purchasing state.

Presently the inter-state transactions are subject to CST central sale tax which is origin based. However the GST will work under a destination base / consumption based concept and hence tax on inter-state transactions will accrue to the destination state.

It is expected that GST regime would lower the prices of goods and services. GST is expected to foster the economic efficiency by lowering the cost of supply of goods and services by way of input credit mechanism and reducing the cascading effects. Further in context of India it is expected that aggregate incidence of dual GST will be lower than the present incidence of the multiple indirect taxes in force. The combined GST is expected to be in the range of 14-16%. Today services are taxed at 10% and the combined incidence of indirect taxes on most of goods is around 20%. At present the goods and services are taxed separately but in GST the difference will be vanished.

V. CONCLUSION

There has been significant progress in the tax regime since implementation of modified value added tax (MODVAT) 1986 and Value added tax (VAT) 2005. Encouraged by the successful implementation of VAT the Government of India now decided to launch GST which would replace a number of indirect taxes presently being levied by centre and state governments and is intended to remove cascading effects of taxes and would provide a common national market for

goods and services. The GST at the Central and the State level are expected to give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, subsuming of several taxes in the GST and phasing out of CST.

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