AN EMPIRICAL ANALYSIS ON GOODS AND SERVICE TAX IN INDIA:
POSSIBLE IMPACTS, IMPLICATIONS AND POLICIES

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ABSTRACT
Goods and Services Tax is a broad based and a single comprehensive tax levied on goods and services consumed in an economy. GST is levied at every stage of the production-distribution chain with applicable set offs in respect of the tax remitted at previous stages. It is basically a tax on final consumption. In simple terms, GST may be defined as 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 may claim the input credit of tax which he has paid while purchasing the goods or procuring the service. India, being one of the largest democracies in the world, has to follow the convention of welfare state. The federal structure of the country provides a relatively powerful government at the centre accompanied by 28 state governments. All of them require finance to govern the country and the states. After introduction of Value Added Tax (VAT) from 2005, the country is going to experiment with Goods and Services Tax (GST) from April 1, 2013. This paper puts an attempt to explore the impacts, implications and policies of introduction of GST in India.

INTRODUCTION
Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavor to generate tax revenues to support government expenditure on public services and infrastructure development. Cascading tax revenues have differential impacts on firms in the economy with relatively high burden on those not getting full offsets. This argument can be extended to international competitiveness of the adversely affected sectors of production in the economy [1]. Such domestic and international factors lead to inefficient allocation of productive resources in the economy. This results in loss of income and welfare of the affected economy. Value added tax was first introduced by Maurice Laure, a French economist, in 1954.

The tax was designed such that the burden is borne by the final consumer. Since VAT can be applied on goods as well as services it has also been termed as goods and services tax (GST). During the last four decades VAT has become an important instrument of indirect taxation with 130 countries having adopted this, resulting in one-fifth of the world’s tax revenue. Tax reform in many of the developing countries has focused on moving to VAT. Most of these countries have gained thus indicating that other countries would gain from its adoption. For a developing economy like India it is desirable to become more competitive and efficient in its resource usage. Apart from various other policy instruments, India must pursue taxation policies that would maximize its economic efficiency and minimize distortions and impediments to efficient allocation of resources, specialization, capital formation and international trade.

With regard to the issue of equity it is desirable to rely on horizontal equity rather than vertical equity. While vertical equity is based on high marginal rates of taxation, both in direct and indirect taxes, horizontal equity relies on simple and transparent broad-based taxes with low variance across the tax rates. Traditionally India’s tax regime relied heavily on indirect taxes including customs and excise. Revenue from indirect taxes was the major source of tax revenue till tax reforms were undertaken during nineties [2]. The major argument put forth for heavy
reliance on indirect taxes was that the India’s majority of population was poor and thus widening base of direct taxes had inherent limitations. Another argument for reliance on indirect taxes was that agricultural income was not subjected to central income tax and there were administrative difficulties involved in collecting taxes. The broad objectives of this study refer to analyzing the impacts, implications and policies of introducing comprehensive goods and services tax (GST) on economic growth and international trade; changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectoral level.

**ORIGIN OF GST**

Goods and Services Tax is a broad based and a single comprehensive tax levied on goods and services consumed in an economy. GST is levied at every stage of the production-distribution chain with applicable set offs in respect of the tax remitted at previous stages. It is basically a tax on final consumption. In simple terms, GST may be defined as 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 may claim the input credit of tax which he has paid while purchasing the goods or procuring the service. Goods and Services Tax also known as the Value Added Tax (VAT) or Harmonized Sales Tax (HST) was first devised by a German economist during the 18th century.

He envisioned a sales tax on goods that did not affect the cost of manufacture or distribution but was collected on the final price charged to the consumer. Thus it did not matter how many transactions the goods went through, the tax was always a fixed percentage of the final price. The tax was finally adopted by France in 1954. Maurice Lauré, Joint Director of the French Tax Authority, the Direction générale des impôts, was the first to introduce VAT on April 10, 1954. Initially directed at large businesses, it was extended over time to include all business sectors. Personal end-consumers of products and services cannot recover VAT on purchases, but
businesses can recover VAT on the materials and services that they buy to make further supplies or services directly or indirectly sold to end-users.

In this way, the total tax levied at each stage in the economic chain of supply is a constant fraction of the value added by a business to its products, and most of the cost of collecting the tax is borne by business, rather than by the state [3]. VAT was invented because very high sales taxes and tariffs encouraged cheating and smuggling. Value added taxation avoids the cascade effect of sales tax by only taxing the value added at each stage of production. Value added taxation has been gaining favor over traditional sales taxes worldwide. In principle, value added taxes apply to all commercial activities involving the production and distribution of goods and the provision of services. VAT is assessed and collected on the value added to goods in each business transaction. Under this concept the government is paid tax on the gross margin of each transaction.

**BACKGROUND OF GOODS AND SERVICES TAX (GST) IN INDIA**

The Kelkar Task Force on implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 had pointed out that although the indirect tax policy in India has been steadily progressing in the direction of VAT principle since 1986, the existing system of taxation of goods and services still suffers from many problems. The tax base is fragmented between the Centre and the States [4]. Services, which make up half of the GDP, are not taxed appropriately. In many situations, the existing tax structure has cascading effects. These problems lead to low tax-GDP ratio, besides causing various distortions in the economy. In this context, the Kelkar Task Force had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle. Value-added tax (VAT) is a modern and progressive system of sales tax.

It brings in the system of self-assessment giving rise to transparency and mutual trust. It is charged and collected by dealers on the price paid by the customer. The empowered committee
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released a White Paper on VAT on 17th January 2005. This was the uniform basis the States agreed to adopt to avoid competition between States. VAT replaced sales tax on 4th January 2005. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but the States have a liberty to set their own valuations for the VAT levied in their own territory [5]. The effort to introduce the new tax regime was reflected, for the first time, in 2006-2007 Union Budget Speech. The then Finance Minister Mr. P. Chidambaram remarked that there is a large consensus that the country must move towards a national level GST that must be shared between the center and the states. He proposed 1st April 2010 as the date for introducing GST.

The present rates for service tax and CENVAT, that is most proximate to the global GST rate, and the continuous steps towards phasing out of Central Sales Tax (CST), clearly hints at the endeavor on the part of Government of India. Subsequently the Empowered Committee of State Finance Ministers agreed to work with the Central Government to prepare a roadmap for introducing a national level GST with effect from 1st April 2010. In May 2007 Empowered Committee (EC) of State Finance Ministers in consultation with the Central Government, constituted a Joint Working Group (JWG), to recommend the GST model. The mandate of the Working Group was as follows: GST should be so designed that it should be revenue neutral to the Centre and the States. Interests of the Special Category, North-Eastern States and Union Territories are to be especially kept in mind. The Group will examine different models and ensure that the power of levy, collection and appropriation of revenue must be vested with the Centre and the States by examining the pros and cons.

The various models would have to ensure that double taxation is avoided. The suggested models should take into account the problems faced during Inter-State transactions and possible revenue loss. Focus on treatment of zero-rated goods and services and Non-VAT items [6]. Within 7 months of its constitution that is in November 2007, JWG presented its report
on the GST to the Empowered Committee. The Committee has accepted the report on GST submitted by the Joint Working Group. The Committee has sent its recommendations to the Government of India in the form of ‘A Model and Roadmap for Goods and Services Tax in India’dated April 30, 2008, which includes outline of the GST design proposed. The views of Empowered Committee are being examined in the Ministry of Finance for a suitable response to the Committee so that further working out details is facilitated.

NEED FOR GOODS AND SERVICES TAX IN INDIA

Firstly, while the present system allows for multiplicity of taxes being collected through an inefficient and non transparent system, the introduction of GST is likely to rationalize it and thereby plug the loop holes in this system. This will enable the government to stop pilferage and rationalize the overall taxation regime. While many areas are either under-taxed or non-taxed or over-taxed, the GST will help reduce overall tax burden of many organizations. Introduction of an integrated Goods and Services Tax (GST) to replace the existing multiple tax structures of Centre and State taxes is not only desirable but imperative in the emerging economic environment. Increasingly, services are used or consumed in production and distribution of goods and vice versa [7]. Separate taxation of goods and services often requires splitting of transactions value into value of goods and services for taxation, which leads to greater complexities, administration and compliances costs.

Further, Indian economy is getting more and more globalised. In recent times, a number of Free Trade Agreements (FTAs) have been signed, which will allow imports into India duty free or at very low duties. Hence, there is need to have a nation-wide simple and transparent system of taxation to enable the Indian industry to compete not only internationally, but also in the domestic market. Integration of various Central and State taxes into a GST system would make it possible to give full credit for inputs taxes collected. GST being a destination-based consumption tax based on VAT principle, would also greatly help in removing economic
distortions caused by present complex tax structure and will help in development of a common national market. A basis pre-requisite for introduction of GST meaningfully is that both the Centre and the State should replace existing taxes like Excise, State Sales Tax/ VAT, CST, Entry Tax and all other cascading-type Central/ State levies on goods and services.

Any losses on account of abolition of multiple taxes are likely to be balanced by the additional GST revenues that will obtain from taxation of services and from access to GST on imports. Moreover, India would obtain full efficiencies of a single national VAT, while retaining a federal structure. This would also be the logical conclusion of the efforts that have been made in the country during last 2 decades in moving towards VAT. The benefits of GST legislation will be uniformity of laws across the board, greater transparency, neutrality in tax rates on various products; credit availability on interstate purchases and reduction in compliance requirements. If GST is implemented in the true spirit, it will have many positives for the stakeholders and will lead to a better tax environment.

WAY FORWARD TO GST
Despite the success of VAT, there are still certain shortcomings in the structure of VAT both at the Central and at the State level. The shortcoming in CENVAT 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 [8]. 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. The existing State-level VAT structure also has certain weaknesses. For instance there are
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 up to 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 [9]. 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.
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 setoff, inclusion 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. After this announcement, the Empowered Committee submitted a report on a model and road map for GST.

The Empowered Committee also took steps 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.

The introduction of GST along with prudent accounting policies, transparency and supported by a robust electronic controls will bring down the peak rates of taxation and enhance revenue growth. This can be understood by the following table by comparing the present rates of tax and the proposed GST.
### Goods from producer to wholesaler

<table>
<thead>
<tr>
<th>Present taxes (Rs.)</th>
<th>GST (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of production</td>
<td>80,000</td>
</tr>
<tr>
<td>Producers margin of profit</td>
<td>20,000</td>
</tr>
<tr>
<td>Producer’s price</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Central Excise duty at 14%</td>
<td>14,000</td>
</tr>
<tr>
<td>VAT at 12.5%</td>
<td>14,250</td>
</tr>
<tr>
<td>Central GST at (expected rate) 12%</td>
<td>Nil</td>
</tr>
<tr>
<td>State GST at (expected rate) 8%</td>
<td>Nil</td>
</tr>
<tr>
<td>Total price</td>
<td>1,28,250</td>
</tr>
</tbody>
</table>

### Goods from wholesaler to retailer

<table>
<thead>
<tr>
<th>Present taxes (Rs.)</th>
<th>GST (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods to wholesaler</td>
<td>1,14,000</td>
</tr>
<tr>
<td>Profit margin at 5%</td>
<td>5,700</td>
</tr>
<tr>
<td>Total</td>
<td>1,19,700</td>
</tr>
<tr>
<td>VAT at 12.5%</td>
<td>712.5</td>
</tr>
<tr>
<td>Central GST (expected rate) 12%</td>
<td>Nil</td>
</tr>
<tr>
<td>State GST at (expected rate) 8%</td>
<td>Nil</td>
</tr>
<tr>
<td>Total price</td>
<td>1,20,412.5</td>
</tr>
</tbody>
</table>

### Goods from retailer to final consumer

<table>
<thead>
<tr>
<th>Present taxes (Rs.)</th>
<th>GST (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods to retailer</td>
<td>1,20,412.5</td>
</tr>
<tr>
<td>Profit margin at 10%</td>
<td>12,041.25</td>
</tr>
<tr>
<td>Total</td>
<td>1,32,453.75</td>
</tr>
<tr>
<td>VAT at 12.5%</td>
<td>1,505.15</td>
</tr>
<tr>
<td>Central GST (expected rate) 12%</td>
<td>Nil</td>
</tr>
<tr>
<td>State GST at (expected rate) 8%</td>
<td>Nil</td>
</tr>
<tr>
<td>Total price to the final consumer</td>
<td>1,33,958.9</td>
</tr>
</tbody>
</table>

**Tax component in the price to the final consumer**

<table>
<thead>
<tr>
<th>Present taxes (Rs.)</th>
<th>GST (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax component in the price to the final consumer</td>
<td>30,467.65</td>
</tr>
<tr>
<td>Final price exclusive of taxes</td>
<td>1,03,491.25</td>
</tr>
</tbody>
</table>

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**BENEFIT OF GST TO INDUSTRY, TRADE AND AGRICULTURE**

The present forms of CENVAT and State VAT have remained imperfect in fully removing 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 specific 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-offs from the producer’s point to the retailer’s point, other major Central and State taxes would be included in GST, and Central Sales Tax (CST) will also be phased out, the final net burden of tax on goods, under GST is expected to fall. According to some economists, 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 [10]. This may lead to higher generation of revenues, which may in turn lead to the possibility of lowering of average tax burden. Hence, the GST is expected to 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.

**BENEFIT OF GST TO THE EXPORTERS**

It has been argued that the inclusion of major Central and State taxes in GST, complete and comprehensive setoff of input goods and services and phasing out of Central Sales Tax (CST) would help in reducing the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market (by reducing the cost of inputs). It can be expected that the uniformity in tax rates and procedures across the country via GST would also be helpful in reducing the compliance cost.

**BENEFIT OF GST TO THE SMALL ENTREPRENEURS AND SMALL TRADERS**

A general argument is that the cost of administering the tax on small entrepreneurs in any tax regime is fairly high. Hence, considerable cost could be saved if an exemption threshold can be made where potential taxpayers with turnovers less than this threshold level would be exempted
from the regime. However, in case where certain small traders would be exempted from the tax net by providing a threshold, there might be a tendency for other traders to underestimate their turnover in order to exploit the benefit of not paying taxes. Therefore, it is proposed that there be another threshold, below which the dealers can opt for a compounded tax based on the turnover. The Empowered Committee of State Finance Ministers had suggested a cut-off at Rs 50 lakh and a floor rate of 0.5 per cent across the States.

This implies, dealers having annual turnover (gross) below this cut-off would have the provision of paying a compounded levy of one percent tax on his turnover, which would be much lower than the GST rate (16 percent). The present lower limit prescribed in different State VAT Acts below which VAT is not applicable varies from one State to the other. The existing threshold of goods under State VAT is Rs. 5 lakhs for a majority of bigger States and a lower threshold is operating for North Eastern States and Special Category States [11]. Hence for a coherent tax structure, a uniform State GST threshold across States is desirable. 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. 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.

**BENEFIT OF GST TO THE COMMON CONSUMERS**

It has been argued that, 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 incorporated in GST and Central Sales Tax or CST will be phased out. Due to this enhanced transparency and rationalization of tax structure, the burden of tax on goods would fall under GST and that would benefit the consumers by lowering the overall tax burden on goods consumed by them.

CONCLUSION

For the industry, a transition into any new tax regime is usually fraught with several challenges and issues. While some of these are one time-short term issues, some others are long term and recurring and could have a lasting impact on the business. With GST in the anvil, it would be prudent for the industry to identify and understand some of these potential issues. Such an understanding is imperative for timely implementation of measures to overcome these issues and avoid potential disruptions they could cause to the business.

REFERENCES


