The Goods and Service Tax (GST) - A Detailed Explanation

Introduction of Goods and Services Tax (GST) will indeed be an important perfection and the next logical step towards a widespread indirect tax reforms in India. GST Scheme was supposed to be implemented from 1st April 2016 but this deadline seems difficult to be met as the Constitutional Amendment Bill has been stuck in Rajya Sabha. However, the department has said that the GST can be implemented anytime in 2016 once the Bill is passed. GST implementation will lead to immense scope, opportunities and challenges for the chartered accountant professionals having expert knowledge in the subject. This article seeks to provide a quick and sound understanding of the provisions of the proposed GST law. Read on…

As per the First Discussion Paper released by the Empowered Committee of the State Finance Ministers on 10th November, 2009, it has been made clear that there would be a "Dual GST" in India, i.e. taxation power lies with both by the Centre and the State to levy the taxes on the goods and services. The scheme was supposed to be implemented in India from 1st April 2016, however it may get delayed since the NDA government does not have majority in the Rajya Sabha ('the upper house of parliament' or 'the house of States').

Further, Punjab and Haryana were reluctant to give up purchase tax, Maharashtra was unwilling to give up octroi, and all the States wanted to keep petroleum and alcohol out of the ambit of GST. Gujarat and Maharashtra want the additional one per cent levy extended beyond the proposed two years, and be raised to two per cent. Punjab wants purchase tax outside the GST ambit.

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Constitutional Amendment

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.

What is GST?

'G' – Goods
'S' – Services
'T' – Tax

"Goods and Service Tax (GST) is a comprehensive tax levy on manufacture, sale and consumption of goods and service at a national level under which no distinction is made between goods and services for levying of tax. It will mostly substitute all indirect taxes levied on goods and services by the Central and State governments in India.

GST is a tax on goods and services under which every person is liable to pay tax on his output and is entitled to get input tax credit (ITC) on the tax paid on its inputs (therefore a tax on value addition only) and ultimately the final consumer shall bear the tax".

Objectives of GST

One of the main objective of GST would be to eliminate the doubly taxation i.e. cascading effects of taxes on production and distribution cost of goods and services. The exclusion of cascading effects i.e. tax on tax till the level of final consumers will significantly improve the competitiveness of original goods and services in the market which leads to beneficial impact on the GDP growth of the country. Integration of various taxes into a GST system would make it possible to give full credit for inputs taxes collected. GST, being a destination-based consumption tax, is based on VAT principle.

Constitution of Goods and Service Tax Network (GSTN)

Goods and Services Tax Network (GSTN) is a Section 25 (not-for-profit), non-government, private limited company. The company has been set up primarily to provide IT infrastructure and services to the Central and State governments, tax payers and other stakeholders for implementation of the goods and services tax (GST).

Worldwide GST

France was the first country to introduce GST in 1954. Worldwide, almost 150 countries have introduced GST in one or the other form till now. Most of the countries have a unified GST system. Brazil and Canada follow a dual system *vis-à-vis* India is going to introduce. In China, GST applies only to goods and the provision of repairs, replacement and processing services. GST rates of some countries are given below:-

Country	**Rate of GST**
Australia	10%
France	19.6%
Canada	5%
China	17%
Germany	19%
Japan	5%
Singapore	7%
New Zealand	15%
United States	11.725%
United Kingdom	20%

Rate of GST

There would be 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 goods in general, government is considering pegging the rate of GST from 20% to 23% that is well above the global average rate of 16.4% for similar taxes, however below the revenue neutral rate of 27%.

Model of GST

- The GST shall have two components: one levied by the Centre (referred to as Central GST or CGST), and the other levied by the States (referred to as State GST or SGST). Rates for Central GST and State GST would be approved appropriately, reflecting revenue considerations and acceptability.
- The CGST and the SGST would be applicable to all transactions of goods and services made for

Cross utilisation of ITC, both in the case of inputs and capital goods, between the CGST and the SGST would not be permitted except in the case of inter-State supply of goods and services (i.e. IGST).

a consideration except the exempted goods and services.

- Cross utilisation of ITC, both in the case of inputs and capital goods, between the CGST and the SGST would not be permitted except in the case of inter-State supply of goods and services (i.e. IGST).

IGST Model (Inter-State Transactions of Goods and Services) and Input Tax Credit (ITC)

- Existing CST (Central state tax i.e. tax on inter-State movement of goods) shall be discontinued.
- Center would levy IGST (cumulative rate for CGST and SGST) on all inter-State transactions

Example: 1 (Comprehensive Comparison)		
Comparison Between Multiple Indirect Tax Laws and Proposed One Law		
Particulars	**Without GST**	**With GST**
	(₹)	
Manufacture to Wholesaler		
Cost of Production	5,000.00	5,000.00
Add: Profit Margin	2,000.00	2,000.00
Manufacturer Price	7,000.00	7,000.00
Add: Excise Duty @ 12%	840.00	-
Total Value (a)	**7,840.00**	**7,000.00**
Add: VAT @ 12.5%	980.00	-
Add: CGST @ 12%	-	840.00
Add: SGST @ 12%	-	840.00
Invoice Value	**8,820.00**	**8,680.00**
Wholesaler to Retailer		
COG to Wholesaler (a)	7,840.00	7,000.00
Add: Profit Margin@10%	784.00	700.00
Total Value (b)	**8,624.00**	**7,700.00**
Add: VAT @ 12.5%	1,078.00	-
Add: CGST @ 12%	-	924.00
Add: SGST @ 12%	-	924.00
Invoice Value	**9,702.00**	**9,548.00**
Retailer to Consumer:		
COG to Retailer (b)	8,624.00	7,700.00
Add: Profit Margin	862.40	770.00
Total Value (c)	9,486.40	8,470.00
Add: VAT @ 12.5%	1,185.80	-
Add: CGST @ 12%	-	1,016.40
Add: SGST @ 12%	-	1,016.40
Total Price to the Final consumer	**10,672.20**	**10,502.80**
Cost saving to consumer	-	169.40
% Cost Saving	-	1.59
Notes: • Input tax credit available to wholesaler is ₹980 and ₹1,680 in case of without GST and with GST respectively. • Likewise, input tax credit available to retailer is ₹1,078 and ₹1,848 in case of without GST and with GST, respectively. • In case VAT rate is also considered to be 12%, the saving to consumer would be 1.15%.		

of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services.

- The ITC of SGST, CGST shall be allowed as applicable.
- Since ITC of SGST shall be allowed, 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 SGST liability (while selling the goods in state itself). Thereafter, the Centre will transfer to the importing State the credit of IGST used in payment of SGST (Refer example 2 and 3).
- The relevant information shall be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective State governments or Central government to transfer the funds.
- *Advantages of IGST:*
    - o No refund claim in exporting State, as ITC is used up while paying the tax.
    - o Maintenance of uninterrupted ITC chain on inter-State transactions.
    - o No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.

Example –2 (Input Tax Credit)

Shiva, a registered dealer had input tax credit for CGST and SGST ₹750/- and ₹1,050/-, respectively in respect of purchase of inputs and capital goods. He manufactured 1,800 litres of finished products. 200 litres was normal loss in the process. The final product was sold at uniform price of ₹10 per litre as follows:-

Goods sold within State – 800 litres

Finished product sold in inter-State sale – 650 litres

Goods sent on stock transfer to consignment agents outside the State – 350 litres

Further, CGST and SGST rate on the finished product of dealer is 5% and 7%, respectively. Further IGST rate is 12%. Calculate tax liability of SGST and CGST to be paid after tax credit.

Solution:

Output Tax Calculation

Particulars	Sales Within State	Stock Transfer Outside State	Inter State Sales	Total
Qty. Sold	800	350	650	
Price per unit	10	10	10	
Value of Goods Sold	**8,000**	**3,500**	**6,500**	**18,000**
Tax Amount:				
Tax Amount-CGST (5%)	400	-	-	**400**
Tax Amount-SGST (7%)	560	-	-	**560**
Tax Amount-IGST (12%)	-	420	780	**1,200**

Calculation of Tax Payable

Particulars	CGST	SGST	IGST	Total
Tax Payable Amount	400	560	1200	
Less: Input Tax Credit				
CGST	400	-	350	**750**
SGST	-	560	490	**1050**
Balance Payable	-	-	360	**360**

Notes:

- There would be no treatment for normal loss.
- Input tax credit of CGST and SGST of ₹750 and ₹1,050 are paid on inputs. This input tax credit should first be utilised for payment of CGST and SGST, respectively, and balance is to be used for payment of IGST. Thus, balance available for payment of IGST is ₹350 of CGST and ₹490 of SGST and he is liable to pay balance amount of IGST of ₹360 by cash (1200-350-490 = 360). Since the credit of SGST of ₹490 has been utilised for payment of IGST, the State government will get debit of ₹490 from the Central government.

Both CGST and SGST will be levied on import of goods and services into India. The incidence of tax will follow the destination principle i.e. SGST goes to the State where it is consumed. Complete set-off will be available on the GST paid on import on goods and services.

Example –3 (Input Tax Credit)

Now, continuing with the above Example 2, suppose the dealer purchases goods interstate and have input tax credit of IGST available is ₹2,000/-. Compute the tax payable.

Solution:

Calculation of Tax Payable

Particulars	CGST	SGST	IGST	
Tax Payable Amount	400	560	1,200	
Less: Input Tax Credit				
CGST	-	-	-	
SGST	-	-	-	
IGST	400	400	1,200	**2,000**
Balance Payable	-	160.00	-	**160**

Note: Input tax credit of ₹2,000, IGST is available. This input tax credit should first be utilised for payment of IGST and balance is to be used first for payment of CGST and remaining for SGST. Likewise in this case, ₹400 and balance ₹400 are utilised for CGST and SGST, respectively. He is liable to pay balance amount of SGST of ₹160 by cash (2,000-1,200-400-560=160).

Some Specific Points for Specific Products (Being High Revenue Generating Products)

- This tax does not apply to alcohol and petroleum products. They will be continued to be taxed as per the existing practices.
- Tax on tobacco products will be subject to GST. But government can levy the extra tax percent over and above GST rate.

Other Key Points

- Manufacturing State (the State in India in which the goods are manufactured) will be allowed to levy an additional tax percent (say 1%) on supply of goods.
- PAN based identification number will be allowed to each taxpayer to have integration of GST with direct tax.
- The taxpayer would need to submit periodical returns, in common format as far as possible, to both the CGST authority and to the concerned SGST authorities.

Exemption/Composition Scheme under GST

- *Small Taxpayer:* The small taxpayers whose gross annual turnover is less than ₹1.5 crore will not be covered by GST law and not required to pay tax.
- Scope of composition and compounding scheme under GST to be provided for this purpose, an upper ceiling on gross annual turnover (say ₹50 lakh) and a floor tax rate (say 0.5%) with respect to gross annual turnover should be provided.
- Treatment for goods exempted under one State and taxable under the other to be provided.
- List of exempt items which shall be outside the purview of GST shall be provided.

GST on Export and Import

- GST on export would be zero rated.
- Both CGST and SGST will be levied on import of goods and services into India. The incidence of tax will follow the destination principle i.e. SGST goes to the State where it is consumed. Complete set-off will be available on the GST paid on import on goods and services.

Example-4 (Import)

Shri Shiva imported goods for ₹10,000/- and incurred expenses to produce final saleable goods. BCD @ 10 % was chargeable on imported goods. These manufactured goods were sold within the state at ₹45,000 plus applicable GST. Rate of CGST and SGST is 5% and 7% , respectively. Compute cost, sale value and tax payable for the transaction.

Solution: ***Calculation of Net Cost of Imported Goods***

Particulars	Amount (₹)
Cost of Goods imported	10,000
Add: Basic Customs Duty @ 10%	1,000
Cost of imported goods (including BCD)	11,000
Add: CGST on Import @ 5%	550
Add: SGST on Import @ 7%	770
Cost of imported goods (including BCD and GST) (Note below)	**12,320**

Calculation of Sale Value After Import

Particulars	Amount (₹)
Sale Value (before tax)	45,000
Add: CGST on Import @ 5%	2,250
Add: SGST on Import @ 7%	3,150
Sales Value	**50,400**

Tax Payable Calculation

Particulars	CGST(₹)	SGST(₹)
Output tax	2,250	3,150
Less: Input tax credit	-	-
CGST	550	-
SGST	-	770
Net tax payable	**1,700**	**2,380**

Note: Please note that GST shall be levied including Basic Customs Duty considering.

Example-5 (Export)

Now continuing with the above Example 4, suppose the same good is exported after 1 year of use after adding margin and modification amounting ₹10,000/- and use factor of 1 year for refund calculation is 0.20. Therefore, the refund will be 0.80 of duty amount. Compute Export Value and Refund Value.

Solution: ***Export Value Calculation***

Particulars	Amount (₹)
Cost of Imported Goods(from above example)	50,400
Add: Margin and Modification Amt.	10,000
Sale Value	60,400
Add: CGST on Export @ 5%	-
Add: SGST on Export @ 7%	-
Export Value	**60,400**

Refund Calculation

Particulars	Amount (₹)
Basic Customs Duty (BCD, from above example)	1,000.00
Refund Factor	0.80
Refund amount of BCD	800.00
Add: CGST(from above example)	550.00
Add: SGST(from above example)	770.00
Total Refund Amount	**2,120.00**

The above example withstand two basic principles of taxation laws i.e. exports are zero rated and the incidence of tax will follow the destination principle (The taxes will remain with the state where the goods are used, however use factor can be prescribed by the law.)

Indirect Taxes That Will Be Included Under GST

State taxes which will be subsumed in SGST:

- VAT/Sales tax
- Entertainment tax (unless it is levied by local bodies)
- Luxury tax
- Taxes on lottery, betting and gambling.
- State cess and surcharges to the extent related to supply of goods and services.
- Entry tax not on in lieu of octroi.

Central taxes which will be subsumed in CGST:

- Central excise duty
- Additional excise duty
- The excise duty levied under The Medical and Toiletries Preparation Act
- Service tax
- Additional customs duty, commonly known as countervailing duty (CVD)
- Special additional duty of customs (SAD)
- Education cess
- Surcharges

Taxes That May or May Not Be Subsumed Due To No Consensus Between The Central And The State Governments and various other reasons

- Stamp duty
- Vehicle tax
- Electricity duty
- Other entry taxes and octroi
- Entertainment tax (levied by local bodies)
- Basic customs duty and safeguard duties on import of goods into India

Other Benefits of GST

- ***Reduces transaction costs and unnecessary wastages:*** A single registration and a single compliance will suffice for both SGST and CGST provided government produces effective IT infrastructure and integration of states level with the union.
- ***Eliminates the multiplicity of taxation:*** The reduction in the number of taxation applicable in a chain of transaction will help to reduce the paper work and clean up the current mess that is brought by existing indirect taxation laws.
- ***One point single tax:*** There would be focus on business rather than worrying about their taxation that may crop at later stages. This will help the business community to decide their supply chain, pricing modalities and in the long run helps the consumers being goods competitive as price will no longer

be the function of tax components but function of sheer business intelligence and innovation.

- ***Reduces average tax burdens:*** The cost of tax that consumers have to bear will be certain and it is expected that GST would reduce the average tax burdens on the consumers.
- ***Reduces the corruption:*** As the number of taxes reduces so does the number of visits to multiple departments reduces and hence, the reduction in corruption.
- In all cases except a few products and States, there would be uniformity of tax rates across the States.

General Points On Various Business Sectors That Arise After GST Implementation

- ***Real Estate Industry:*** Construction and housing sector needs to be included in the GST tax base being high tax revenue generating sector and for reduction in number of tax legislations involved.
- ***FMCG Sector:*** Implementation of proposed GST and opening of foreign direct investment (FDI) are expected to fuel the growth and raise industry's size.
- ***Rail Sector:*** There have been suggestions for including the rail sector under the GST umbrella to bring about significant tax gains and widen the tax net so as to keep overall GST rate low. This will have the added benefit of ensuring that all inter–State transportation of goods can be tracked through the proposed information technology (IT) network.
- ***Information Technology Enabled Services:*** At present, if the software is transferred through electronic form, it should be considered as intellectual property (IP) and regarded as a service and if the software is transmitted on media or any other tangible property, then it should be treated as goods and this classification is full of litigation. As GST will have uniform rate for goods and services and no concept of State revenue being VAT or central revenue being service tax and hence, the reduction in litigation.
- ***Transport Sector:*** Truck drivers spend more than half of their time while negotiating check post and tolls. At present, there are more than 600 check points and more than ten types of taxes in road sector. After the introduction of GST, the time spend by the road transport industry in complaining with laws will reduce and service is going to be better which will boost the goods industry and thus the taxes also.
- ***Impact on Small Enterprises:*** There will be three categories of Small Enterprises in the GST regime.
  - o There will be three thresholds which are as follows:
    - Basic threshold for both goods and services shall be ₹10-15 lakh.
    - Gross turnover of goods upto ₹1.5 crores may be assigned exclusively to the States.
    - Gross turnover of services upto ₹1.5 crores may be assigned exclusively to the Centre.
    - Gross turnover of above ₹1.5 crores may be assigned both to the Centre (CGST) and States (SGST).
  - o Those between the threshold and composition turnovers will have the option to pay a turnover based tax *i.e.* composite tax or opt to join the GST regime.
  - o Those above threshold limit will need to be within the framework of GST. Possible downward changes in the threshold in some States consequent to the introduction of GST may result in obligation being created for some dealers.

To Sum Up

GST, being a dynamic and comprehensive legislation which shall replace most of the indirect taxes, is going to be a game-changing legislation which will have multiple fold effects in our economy. The biggest task before the government as of now is to build consensus within the States and pass the constitutional amendment Bill in Rajya Sabha and two-third of the State legislative assemblies. Further, the chartered accountants and the allied professionals are going to play the leading role in helping the business houses in transition towards this biggest reform in Indian taxation till date. ■