Concept Note on Goods & Service Tax (GST)

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1. Introduction

The Constitution (One Hundred and Twenty-Second Amendment) Bill, 2014, seeks to amend the Constitution of India to facilitate the introduction of Goods and Services Tax (GST) in the country. The proposed amendments in the Constitution will confer powers both to the Parliament and the State legislatures to make laws for levying GST on the supply of goods and services on the same transaction.

2. Rationale behind moving towards GST:

2.1 Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas.

2.2 This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry. Firstly, there is no uniformity of tax rates and structure across States. Secondly, there is cascading of taxes due to ‘tax on tax’. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice-versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this ‘tax on tax’.

2.3 The introduction of GST would mark a clear departure from the scheme of distribution of fiscal powers envisaged in the Constitution. The proposed dual GST envisages taxation of the same taxable event, i.e., supply of goods and services, simultaneously by both the Centre and the States. Therefore, both Centre and States will be empowered to levy GST across the value chain from the stage of manufacture to consumption. The credit of GST paid on inputs at every stage of value addition would be available for the discharge of GST liability on the output, thereby ensuring GST is charged only on the component of value addition at each stage. This would ensure that there is no ‘tax on tax’ in the country.

2.4 GST will simplify and harmonise the indirect tax regime in the country. It is expected to reduce cost of production and inflation in the economy, thereby making the Indian trade and industry more competitive, domestically as well as internationally. It is also expected that introduction of GST will foster a common or seamless Indian market and contribute significantly to the growth of the economy.

2.5 Further, GST will broaden the tax base, and result in better tax compliance due to a robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an in-built mechanism in the design of GST that would incentivize tax compliance by traders.

3. Salient features of proposed GST:

3.1 Dual GST: Both Centre and States will simultaneously levy GST across the value chain. Tax will be levied on every supply of goods and services. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The input tax credit of CGST would be available for discharging the CGST liability on the output at each stage. Similarly, the credit of SGST paid on inputs would be allowed for paying the SGST on output. No cross utilization of credit would be permitted.

3.2 **Inter-State Transactions and the IGST Mechanism:** The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. The IGST mechanism has been designed to ensure seamless flow of input tax credit from one State to another. The inter-State seller would pay IGST on the sale of his goods to the Central Government after adjusting credit of IGST, CGST and SGST on his purchases (in that order). 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 output tax liability (both CGST and SGST) in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST.

3.3 **Destination-Based Consumption Tax:** GST will be a destination-based tax. This implies that all SGST collected will ordinarily accrue to the State where the consumer of the goods or services sold resides.

3.4 **Central Taxes to be subsumed:**

- i. Central Excise Duty
- ii. Additional Excise Duty
- iii. The Excise Duty levied under the Medicinal and Toiletries Preparation Act
- iv. Service Tax
- v. Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- vi. Special Additional Duty of Customs-4% (SAD)
- vii. Cesses and surcharges in so far as they relate to supply of goods and services.

3.5 **State Taxes to be subsumed:**

- i. VAT/Sales Tax
- ii. Central Sales Tax (levied by the Centre and collected by the States)
- iii. Entertainment Tax
- iv. Octroi and Entry Tax (all forms)
- v. Purchase Tax
- vi. Luxury Tax
- vii. Taxes on lottery, betting and gambling
- viii. State cesses and surcharges in so far as they relate to supply of goods and services.

3.6 All goods and services, except alcoholic liquor for human consumption, will be brought under the purview of GST.

- i. <u>Petroleum and petroleum products</u> have been constitutionally included as ‘goods’ under GST. However, it has also been provided that petroleum and petroleum products shall not be subject to the levy of GST till notified at a future date on the recommendation of the GST Council. The present taxes levied by the States and the Centre on petroleum and petroleum products, viz. Sales Tax/VAT and CST by the States, and excise duty the Centre, will continue to be levied in the interim period.
- ii. Taxes on <u>tobacco and tobacco products</u> imposed by the Centre shall continue to be levied over and above GST.
- iii. In case of <u>alcoholic liquor for human consumption,</u> States would continue to levy the taxes presently being levied, i.e., State Excise Duty and Sales Tax/VAT.

3.7 **GST Council:** In the GST regime, a Goods and Services Tax Council is being created under the Constitution. The GST Council will be a joint forum of the Centre and the States. This Council would function under the Chairmanship of the Union Finance Minister and will have Minister in charge of Finance/Taxation or Minister nominated by each of the States & UTs with Legislatures, as members. The Council will make recommendations to the Union and the States on important issues like tax rates, exemption list, threshold limits, etc. The recommendations made by this Council will act as benchmark or guidance to Union as well as State Governments. One-half of the total number of Members of the Council will constitute the quorum of GST council. Every decision of the Council shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting in accordance with the following principles:-

- i. The vote of the Central Government shall have a weightage of one-third of the total votes cast, and
- ii. The votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast in that meeting.

This is to protect the interests of each State and the Centre when the Council takes a decision and is in the spirit of co-operative federalism.

3.8 **Floor rates of GST with band:** GST rates will be uniform across the country. However, to give fiscal autonomy to the States and the Centre, there will a provision of a tax band over and above the rate of the floor rates of CGST, SGST and IGST. Initially, the rates of CGST, SGST and IGST are expected to be closely aligned to the Revenue Neutral Rates (RNR) of the Centre and the States.

3.9 **Goods and Services Tax Network (GSTN):** A not-for-profit, Non-Government Company called Goods and Services Tax Network (GSTN), jointly set up by the Central and State Governments will provide shared IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders.

3.10 **GST Compensation:** Due to a shift from origin based to destination based indirect tax structure, some States might face drop in revenue in the initial years. To help the States in this transition phase, the Centre has committed to compensate all their losses for a period of 5 years. Accordingly, clause 19 has been inserted in the Constitution (122nd) Amendment Bill, 2014 to provide for compensation to States by law, on the recommendation of the Goods and Services Tax Council, for loss of revenue arising on account of implementation of the goods and services tax for a period of five years.

4. Salient features of the Constitution (122nd) Amendment Bill, 2014: The salient features of the GST Bill as introduced in the Lok Sabha are as follows:-

- i. subsuming of various Central indirect taxes and levies such as Central Excise Duty, Additional Excise Duties, Excise Duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955, Service Tax, Additional Customs Duty commonly known as Countervailing Duty, Special Additional Duty of Customs, and Central Surcharges and Cesses so far as they relate to the supply of goods and services;
- ii. subsuming of State Value Added Tax/Sales Tax, Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States), Octroi and Entry tax, Purchase Tax, Luxury tax, Taxes on lottery, betting and gambling; and State cesses and surcharges in so far as they relate to supply of goods and services;
- iii. dispensing with the concept of ‘declared goods of special importance’ under the Constitution;
- iv. levy of Integrated Goods and Services Tax on inter-State transactions of goods and services;
- v. levy of an additional tax on supply of goods, not exceeding one per cent. in the course of inter-State trade or commerce to be collected by the Government of India for a period of two years, and assigned to the States from where the supply originates;
- vi. conferring simultaneous power upon Parliament and the State Legislatures to make laws governing goods and services tax;

- vii. coverage of all goods and services, except alcoholic liquor for human consumption, for the levy of goods and services tax. In case of petroleum and petroleum products, it has been provided that these goods shall not be subject to the levy of Goods and Services Tax till a date notified on the recommendation of the Goods and Services Tax Council.
- viii. compensation to the States for loss of revenue arising on account of implementation of the Goods and Services Tax for a period which may extend to five years;
- ix. creation of Goods and Services Tax Council to examine issues relating to goods and services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government. It is further provided that every decision of the Council shall be taken by a majority of not less than three-fourths of the weighted votes of the members present and voting in accordance with the following principles:—
- a. the vote of the Central Government shall have a weightage of one-third of the total votes cast, and
- b. the votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast in that meeting.
- x. levy of an additional non-vatable tax on supply of goods of not more than 1% in the course of inter-State trade or commerce, for a period not exceeding 2 years, or such other period as the GST Council may recommend, to protect the interests of the producing/manufacturing States. This additional tax on supply of goods will be levied and collected by the Government of India, over and above the IGST levied under the proposed Article 269A (1). This tax shall be assigned to the States from where such supplies originat

Information Source: Department of Revenue, Ministry of Finance, Government of India.