A Primer on **Goods and Services Tax in India**

2011

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1. Introductory Remarks

India has witnessed substantial reforms in indirect taxes over the past two decades with the replacement of State sales taxes by Value Added Tax (VAT) in 2005 marking a watershed in this regard. Prior to VAT implementation, the tax structure was considered problematic primarily due to the "cascading effect of taxes" whereby an item is taxed more than once from the production to the final retail sales stage. Exporters were also becoming less competitive in the international market due to the huge input costs involved (tax burden of a commodity increases manifold as it is taxed repeatedly) through the earlier sales tax mode – reflected in higher prices of products as compared to global competitors.

To avoid this kind of a tax structure, VAT was introduced so that taxes are paid on the "value added portion" by each producer and the hurdles of the cascading effect are done away with. But shortcomings were also noticed in the VAT structure and efforts were made to further rationalise the system. For instance, a number of Central taxes like customs duty, surcharge were not included in Central Value Added Tax (CENVAT) while indirect taxes at the State level such as entertainment and luxury taxes were left out of the purview of VAT.

The major problem with VAT is that CENVAT on certain commodities remains included in the value of goods to be taxed under State VAT. Thus, the same set of goods is taxed repeatedly – once by the Centre and then by the State. Moreover, since VAT is applied on goods only (tax on services in India is a complicated issue due to various exemptions and definitional problems), there is also the task of calculating tax on services and adding it to the VAT on goods. The government has therefore recognised the need for harmonisation of goods and services tax so that both can be levied in a comprehensive and rational manner in a new taxation regime – Goods and Services Tax (GST).

While presenting the Union Budget 2007-08, former Finance Minister P Chidambaram had announced that GST would be introduced from April 1, 2010, in order to supplement the existing VAT system in India with a tax structure where goods and services tax can be unified in a comprehensive manner. The Empowered Committee of State Finance

Ministers would work with the Central government to prepare a road map for its roll out. The implementation of GST will, in all likelihood, be delayed beyond April 1, 2011 given that there is lack of consensus among the States and Centre on aspects relating to limiting fiscal autonomy of the States.

2. How was the Indian Tax Structure before Value Added Tax (VAT)?

The tax system that prevailed before VAT was subject to "multiple taxation" that can be better understood through the following illustration:

Generally, any tax is related to the selling price of a product i.e., tax is imposed on the price at which a product is sold. Suppose there are three producers in an economy – ***A***, ***B*** and ***C***. Producer ***A*** is the initial producer who does not have any input costs. Producer ***A's*** output is supplied to ***B*** and that of ***B*** is supplied to ***C***. Assuming that the output value of producer ***A*** is Rs.100 and a tax is imposed on it at a 10 % rate, ***B*** would get the output at Rs.110 (inclusive of tax at 10 %). ***A*** sells the output to ***B*** inclusive of tax, failing which ***A*** would have to pay the tax from his/her own pocket.

Producer ***A*** ⟶ Producer ***B*** ⟶ Producer ***C***

Producer ***B*** carries out further processing and his/her output value is Rs. 150. (Output value might be anything, depending on the profit and conversion considerations of producer ***B***.)

Table 1: Cascading Effect (or Tax-Upon-Tax) of Sales Tax (Amount in Rs.)

Producer/ Manufacturer	Cost of Input	Value of Output	Tax Rate	Selling Price Including Tax Rate	Tax Burden
Producer ***A***	–	100	10 %	110 (100 + 10 % of 100)	10
Producer ***B***	110	150	10 %	165 (150 + 10 % of 150)	15
Producer ***C***	165	200	10 %	220 (200 + 10 % of 200)	20

While selling the product to ***C***, ***B*** will set the price of output incorporating tax (again at the rate of 10 %). Thus, ***C*** will get the item at Rs. 165 (150 + 10 % tax on Rs.150). Supposing producer ***C*** decides the output value at Rs.200, he/she would perhaps sell the product at Rs.220 and not at Rs.200 (inclusive of 10 % tax rate, i.e., Selling Price = Rs.200 + 10 % of Rs.200)

As the stages of production and/or sales continue, each subsequent purchaser has to pay tax repeatedly on the output that has already been taxed. The important point is that the same product is being taxed more than once at different stages of production and the problem is that the tax burden on the final consumer is enormous (Table 1). This kind of a taxation system has given rise to a number of problems as follows:

- There might be a tendency to escape / evade the tax liabilities. As production and sales continue, the tax burden increases. (In the above example, ***A*** passes a tax burden of Rs.10 to ***B*** and ***B*** passes Rs.15 to ***C***.) If tax evasion increases, government tax revenue would decline.
- If tax rates are not uniform at different stages of production, it is very difficult to measure overall tax content of a product. (If more producers - ***A, B, C, D, E, F*** and ***G*** – are considered and if tax rate deviates from 10 % to 15 % and 20 % at different stages, the calculation at the final stage would be very cumbersome and increase administrative costs.) This also creates lack of transparency in the overall tax system.
- Households are subject to heavy tax burden as the taxes are passed on at every stage till the final consumer.
- Tax burden has made Indian products less competitive in the international market. As manufacturers and exporters need to pay higher tax rates at later stages of production, it would not be possible for them to sell products at lower prices in the international market. If they cannot sell the product at prices less than or similar to their international competitors, they will find that the demand for their product declines.

3. How has VAT been implemented in India?

VAT was introduced in the Indian taxation system from April 1, 2005 in an effort to address the problems associated with the earlier Sales Tax[1]. India is one of the 123 countries across the world that are following the VAT mode, which is an improvement in several respects.

In the previous example, 'value added' by ***B*** is only Rs.50 (150–100). To clarify, the price (value) set on the final product by producer ***B*** is Rs.150 (value of producer ***B's*** output), and he/she has purchased input at Rs.100 (value of output of ***A***).

[Note: It can be argued that ***B*** sells at Rs.165 and purchases from ***A*** at Rs.110 so the difference could be taken as well. This is basically the difference between selling prices of producers. The difference between the value of outputs of producer ***B*** and producer ***A*** are being calculated (i.e. taking the output values independent of taxes). Hence, the value addition on the product by ***B*** is the difference between the output value of ***B*** (which is Rs.150) and the output value of producer ***A*** which is Rs.100.]

Now, tax on producer ***B*** would be only Rs.5 (i.e., 10 % of Rs. 50) while the tax paid in reality was Rs. 15 (10 % of Rs. 150). [Note that in the former case, tax is paid on the 'value added' while in the latter, it is paid on 'selling price' as well as the difference of the tax burden in the two cases]. For practical purposes, VAT can be calculated in the following manner:

- Input tax for ***B*** is Rs.10 (i.e. tax on output of ***A***)
- Output tax for ***B*** is Rs.15 (i.e. 10 % of Rs.150)
- VAT = Output tax - Input tax = 15-10 = Rs.5

In VAT, the idea is that ***B*** will pay tax on only Rs. 50, i.e. value added by him/her. (Annexure Table I for the tax paid on the value addition by producer ***C*** and also note the column on 'Tax Burden'). This is called

[1] VAT in India was initiated at the Central level for a particular group of commodities through the Modified Value Added Tax (MODVAT) scheme on March 1, 1986. It was converted to Central Value Added Tax (CENVAT) in 2002. Likewise, State Sales Tax has been replaced by State VAT.

the “tax credit method”, which means the deduction of tax paid on inputs from tax collected on sales. There are other methods by which VAT can be calculated such as the ‘Subtraction method’ wherein the tax rate is applied to the difference between the value of output and cost of input [i.e., on the value added portion, Tax Liability = T (Value of Output-Cost of Input) where T is tax rate)]. In India, the tax credit method is generally used.

Then, it does not matter whether a product passes one or many stages, as every producer will pay tax only on value added by him/her to the product and not on the selling price of the product. (Part 1 of the Annexure)

GST would also follow the “Tax Credit Method” (Part 2 of the Annexure). However, the essence of GST is to correct certain shortcomings of VAT like bringing services under a cogent tax net, which is not possible under the VAT system. Hence, GST has been modeled as an extension of the current VAT that would make the tax system more comprehensive and smoother in its functioning.

4. What are the Problems with VAT?

The VAT system is definitely an improvement over the earlier one in the sense that it is more transparent and curbs tax evasion to some extent, thus generating more revenue for the government. Being less cumbersome, it reduces administrative costs as also eases the tax burden on the final consumer.

But despite its advantages, a number of drawbacks of VAT have become apparent, both at the Central as well as the State level.

A major problem with VAT is the way it taxes inputs and outputs. Inputs are taxed at 4 percent and outputs at 12.5 percent. Taxing inputs and outputs at different rates are problematic because what is input in one case can be output in another. For instance, sugar is an input for a restaurant but for a household it is an output.[2] Therefore, there is a potential tendency to avoid output tax as the tax is relatively higher than input tax (a margin of 8.5 percent).

Another problem is the number of exemptions for some sensitive products (e.g. exemption on food items) and different rates of taxation (e.g. luxurious items are likely to be taxed at higher rates than necessary items). Be that as it may, the VAT system cannot be blamed (at least the theoretical context), given the political set-up and implementation failures due to various legal loopholes.

The above problem is particularly evident in the case of CENVAT and service tax. Ideally, the tax base should include all types of services with a limited list of exclusions but the government is unwilling to adopt such a tax base due to apprehensions that a number of services that are politically sensitive would be subsumed under it. The prevailing CENVAT system lacks optimal design and has multiple tax rates whereby it treats goods and services separately and differentiates between commodities covered under Maximum Retail Price (MRP) and other commodities.

[2] 'Goods and Services Tax: Some Progress towards Clarity' (December 19, 2009) by M Govinda Rao, Economic & Political WEEKLY, Vol. XLIV No 51.

At the State level, the problem arises due to classification of goods under different tax schedules. In general, the expectation is that lower tax rates be applied to necessary commodities consumed by the poor. But, this is not so in State level VAT. For instance, the lowest rate of 1 percent is applicable to precious metals, jewellery and related products not consumed by the marginalized sections of society. The medium rate of 4 percent is applicable to basic necessities (and to a range of industrial inputs and IT products). As a result, it becomes difficult for retailers to determine the tax rate applicable to a particular item without referring to the legislative schedules. [3]Consumers also face a similar problem.[4]

The State VAT tax design also lacks clarity in case of taxing pharmaceuticals and works contracts. The VAT is applied in a presumptive manner rather than through a specified mechanism.

Another problem with VAT is that manufacturers can manipulate the system by false invoicing (claiming lesser value added than the actual) through an understanding among themselves in order to evade tax burden, thus generating lower tax revenue.[5]

Further, where the government takes into account the poor people, the tax system would be differentiated. On the other hand, a differentiated tax structure would complicate the administrative process and an evaluation of the impact of the tax design would become difficult due to differential rates. This is applicable in particular for VAT.

Now, there can be unending disagreements and debates regarding what should be the optimal tax policy. However, the most prominent issues that a tax system must be amenable to are:

- Simple: The tax system must be simple (the more complicated it would be, the more would be the administrative and/or compliance cost[6] and tendency towards tax evasion)

[3] In the European Union there are 3 different VAT levels: one is general (15-20%), then another for food (typically 10%), and finally for printed materials and newspapers (0-10%). The assumption is that benefits and subsidies can tackle extreme poverty and food aid is available from government, churches, and NGOs to the most needed.

[4] For a detailed discussion, See 'GST Reforms and Intergovernmental Considerations in India'(March 2009) by Satya Poddar and Ehtisham Ahmad, Working Paper No.1,Department of Economic Affairs, Ministry of Finance, Government of India, p-8.

[5] Probably, this can be tackled with computerisation to some extent; if they have to fill all records of VAT the tax administration can compare prices being recorded and see where false invoicing appears. Kenya has an automated system, and while it has been resisted by manufacturers, it is fairer as it cuts out this type of tax evasion.

[6] A compliance cost is expenditure in terms of time or money to conform to government requirements such as legislation or regulation. For example, in case of filing a tax people have the extra burden

- Conducive: The tax system should be conducive to a certain amount of revenue for the government.
- Fair and Redistributive: Fairness is key to a good tax system in which the poor would end up paying less proportionally of their revenue than the rich.
- Representative: It needs to be ensured that the poor and their interest groups can be represented in tax policy making, so that policies are being continuously improved for the benefit of the widest possible constituency of citizens. This requires transparency and the possibility to have a dialogue over tax policies with stakeholders.
- Repricing must be possible to tackle the harm or benefit of certain activities to wider society.

In this context, it is argued that there should be a harmonization in the tax laws and tax rates across the country at the Centre and State level for better compliance and enforcement of tax system.

of having to keep detailed records of all input tax and output tax to facilitate the completion of tax returns. This may necessitate them having to employ someone skilled in this field, which would be regarded a compliance cost. In fact, tax filing and administration comprises of a number of factors, like data requirements, system of tax rulings and interpretations, procedures for registration, filing and processing of tax returns, tax payments and refunds, audits etc. A rationalised tax structure is helpful in reducing the compliance cost.

5. What is the Rationale for Goods and Services Tax (GST)?

Despite the success of VAT in the context of the Indian economy, there are still certain shortcomings in the structure of VAT both at the Central and at the State level as discussed earlier.

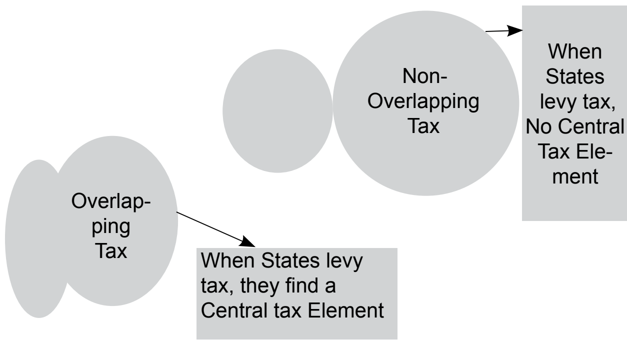
Now, the proposal for Goods and Services Tax (GST) is not to replace VAT entirely, but to complement the VAT system or to tackle certain shortcomings of the VAT system. In other words, we can say that the introduction of GST in India is not an entirely new initiative, but it is to rectify certain basic implementation problems of VAT so that the tax system would be more beneficial for the economy and can function more smoothly. So, this is an attempt to improve the existing VAT system further as also the tax system of India.

In the present State-level VAT system, there is a problem of what we may call 'tax overlapping' between Centre and State taxes. The problem is nothing but the Central Value Added Tax or CENVAT on certain commodities remains included in the value of goods to be taxed under State VAT. In Indian Constitution, taxes upon goods and services can be classified under three lists, namely Union List, State List and Concurrent List. Now, certain taxes can be levied either by the Centre or the State.

For instance, land revenue taxes can be levied by States only whereas Railways is Centre's provision and State cannot levy any tax on this. Hence, there is a complete separation of taxes on items that are preserved for either State or Union list (and there is no issue of overlapping of taxes). But, goods or services (for example, trade and commerce in food stuffs) that belong to the concurrent list are subject to tax by both Centre and States.

Now, what is the problem? The same set of goods are taxed repeatedly, once by Centre and then by State (those goods and services that are in the concurrent list). This phenomenon 'tax upon tax' is called the cascading effect which complicates the tax system (and increases administrative cost ***unnecessarily***) since the same good is taxed again. This '***CENVAT Tax Element in State-level Tax***' needs to be removed. (For this reason, there is a need for a constitutional amendment as discussed later).

Chart-I: Overlapping and Non-Overlapping Centre-State Taxes



In the VAT system, taxing service sector is practically difficult. First, due to the tremendous advancement of the information technology and digitization, the distinction between goods and services has become very complicated. In Indian context, the definition of goods is so framed that it should include intangibles like copyright and software. However, software upgrades (which are goods) can be supplied as part of a contract for software repair as well as maintenance services. Some other examples where an object can be 'services' and 'goods' simultaneously are as follows-

- An on-line subscription to newspapers could be viewed as service, but online purchase and download of a magazine or a book would be treated as a purchase of goods.
- Telecommunication services (for instance, wallpaper for mobile phones, ring tones, jokes, cricket scores and weather reports) also have similar problems, as some of them are treated as goods.

Nowadays, goods and services are being packaged as composite bundles and sold to final consumers under a range of supply-chain arrangements. Hence, there is a lacuna in the existing VAT system where the aspect of taxing services is not very clear-cut.

As pointed out by Mahesh Purohit,[7] one of the pioneers in tax policy, under the present system of VAT, services should also come under

[7] Currently he is the President and Director Foundation for Public Economics and Policy Research, New Delhi.

its net. In his words, 'Historically, India's indirect tax system is unique given that under the Constitution, the Union government has the authority to impose a broad spectrum of excise duties on production or manufacture while States are assigned the power to levy tax on the sale of goods. Due to this dichotomy of authority under the Constitution, India has been rather slow in the adoption of VAT. Today, India has adopted a model of dual VAT, replacing Union excise duty with CENVAT and sales tax with State VAT. From an economic stand point, there is hardly any difference between the taxation of commodities and that of services. Therefore, under this system of dual VAT, it is of paramount importance that in addition to goods, services also come under its net. The exclusion of services causes many administrative problems and paves the way for evasion of tax.'[8]

The current attempt of GST is also to rectify that. Under the Goods and Services Tax, each manufacturer needs to pay a GST, which is the difference of her 'output tax' and 'input tax'. Hence, it can be said, GST is a comprehensive value added tax levied on goods and services. In a GST regime, goods and services are not differentiated as they move through the supply chain.

For GST to be effective, it is essential that the ***States should be given the power of levy of taxation of all services***. 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.(In fact, the most important objective of this new initiative is to amend certain aspects of the Constitution of India in order to make it very clear which objects to be taxed by the States and Centre. Unless such amendments are made it would be difficult to operate GST in an optimal manner).

Another important objective of GST is to remove the burden of Central Sales Tax (CST). When there is a transaction across the States[9] (for example, suppose a buyer in West Bengal purchases a product from a seller from Uttar Pradesh, the tax on the product is collected by the Center (which is the Central Sales Tax or CST). [10]With the operation of GST, there is no need of CST, since there would be a continuous

[8] For a detailed discussion refer to the article in Financial express, by Mahesh C Purohit-'State VAT should include more services', 13 August,2007; URL: http://www.financialexpress.com/...vat...services/210017/ - United States

[9] This is called ***Inter-State Transaction,*** on the other hand, if the transaction is within a State (i.e. buyer and seller belongs to the same State) then it is an ***Intra-State Transaction.***

[10] In case of an ***Intra-State Transaction*** (i.e. transaction where the buyer and seller belongs to the same State), the tax is collected by the State.

chain of set-off from the original producer to the final retailer, and all the taxes would be included under a single umbrella of GST. (Actually, it would be included under the ***Integrated Goods and Services Tax or IGST*** that has been discussed in a later section). This would reduce the additional burden (administrative and compliance cost) of CST. Moreover, at present there is a massive tax evasion of CST despite of the reduction in tax rates. Apart from this, the CST becomes problematic due to:

- Absence of any 'set-off' mechanism[11]
- Unnecessary 'tax burden' across inter-State transactions

In fact, the Centre and States have decided not to reduce the Central Sales Tax (CST) rate further. Instead, the tax will be completely withdrawn once the proposed goods and services tax (GST) is introduced. Therefore, the GST at the State level can be justified for the following reasons-

- Additional power of ***levy of taxation of services*** for the States
- Removal of the cascading burdens of CENVAT and service taxes
- Inclusion of a number of taxes in the GST
- Removal of burden of Central Sales Tax (CST).

[**Annexure, Part 2** on '**How would GST work?'**]

Potential Benefits of GST:

1. Benefit for industry, trade and agriculture
2. Benefit for the Exporters
3. Benefit for the small entrepreneurs and small traders
4. Benefit for the consumers

1. Will GST benefit 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. (As we have discussed earlier, the problem is that the Central

[11] The Net tax liability of any registered dealer or manufacturer is calculated ***by deducting or setting-off*** input tax credit (i.e. the tax on the inputs and all previous purchases that she has used in order to produce her output. She is entitled to get that from Central government on claim.) from tax collected on her sales during the payment period or her 'output tax'. (Say, a month). If the Input tax credit exceeds the 'output tax', the excess credit will be carried over to the end of next financial year. If there is any excess unadjusted input tax credit at the end of second year, then the same will be eligible for refund. For further clarification, please refer to Table-3:How GST would Work

Value Added Tax or CENVAT on certain commodities remains included in the value of goods to be taxed under State VAT, which creates a cascading effect or 'tax on tax' problem).

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,*** [12]***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. 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.

2. Will GST benefit 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.

[12] For a better understanding of this part refer to the-***How GST would work?*** where the potential benefit of GST via setting-off of Input Tax Credit has been discussed and illustrated.

3. Will GST benefit 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. 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.

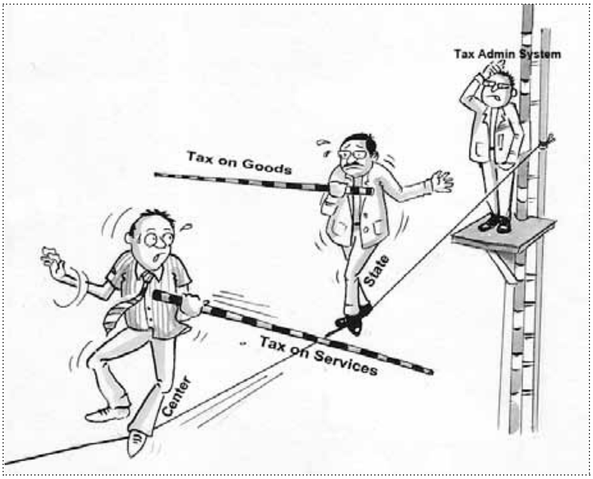
The States considered that the threshold for Central GST for goods may be kept at Rs.1.5 crore and the threshold for services should also be appropriately high. This raising of threshold will protect the interest of small traders.

4. Will GST benefit 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.

6. What are the Prominent Features of GST?

- The GST shall have two components: one levied by the Centre (hence, referred to as Central GST), and the other levied by the States (hence, referred to as State GST).
- Rates for Central GST and State GST would be prescribed appropriately, taking into account the revenue considerations and acceptability.
- This dual GST model would be implemented through a certain number of legal provisions (for every State there would be one Central GST [CGST] and State GST [SGST], and the associated legal framework).
- The Central GST and the State GST would be applicable to all transactions of goods and services except the exempted goods and services, goods that are outside the purview of GST and the transactions that are below the prescribed threshold limits.



- The Central GST and State GST are to be paid to the accounts of the Centre and the States separately.
- Each taxpayer would be allotted a ***PAN-linked taxpayer identification number*** with a total of 13 or 15 digits.

7. Why do we need Dual GST?

India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A single GST where the power to collect tax goes ***only to the Centre*** cannot be accepted both on the grounds of the constitutional provision and on revenue considerations. Hence, a dual GST would be according to the Constitutional requirement of fiscal federalism.

8. What is Central GST and State GST?

The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services (except the exempted goods and services, goods that are outside the purview of GST and the transactions that are below the prescribed threshold limits).

Moreover, both would be levied on the same price or value unlike State Value Added Tax (which is levied on the value of the goods inclusive of CENVAT and hence creates unnecessary cascading effect as discussed earlier).

While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, **SGST would be chargeable only when the supplier and the recipient are both located within the State.** We have discussed that aspect of IGST later where the transactions are taking place across the States. [**Annexure, Part 3** on **CGST and SGST**]

9. Which Central and State Taxes are proposed to be included under GST?

Various Central, State and Local levies were examined to identify their possibility of being subsumed under GST. While identifying, the following principles were kept in mind:

- Taxes to be included should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.
- Taxes to be included should be part of the transaction chain that begins with the production (or ***import*** or ***manufacturing of goods*** or ***provision of services***) at one end and the consumption of goods and services at the other.
- The inclusion of taxes should result in free flow of tax credit in intra and inter-State levels (i.e. within and across States).
- The taxes, levies and fees that are not specifically related to supply of goods and services should not be included under GST.
- ***Transparency in Revenue*** collected from the GST should be maintained by both the Centre and the States.

On application of the above principles, the Empowered Committee has recommended that the following Central Taxes should be included under Goods and Services Tax (in the first phase of GST)

1. Central Excise Duty
2. Additional Excise Duties
3. Excise Duty levied under the Medicinal and Toiletries Preparation Act
4. Service Tax
5. Additional Customs Duty, commonly known as Countervailing Duty (CVD)
6. Special Additional Duty of Customs – 4 % (SAD)
7. Surcharges
8. Cess (In India, it is supposed to be a tax or a surcharge which is

applied on a specific commodity or service and the revenue that is raised from it is also meant to meet certain specified objectives, such as education cess).

The following State taxes and levies would be, to begin with, included under GST:

1. VAT / Sales tax
2. Entertainment tax (unless it is levied by the local bodies)
3. Luxury tax
4. Taxes on lottery, betting and gambling.
5. State Cess and Surcharges (To the extent these taxes relate to supply of goods and services).
6. Entry tax not in lieu of Octroi.

Purchase tax: Some of the States felt that they are getting substantial revenue from Purchase Tax and, therefore, it should not be included under GST while majority of the States were of the view that no such exemptions should be given. For instance, the difficulty of the food grain producing States was recognized as substantial revenue is being earned by them from Purchase Tax. Therefore, it has been realized that, in case Purchase Tax has to be included under GST, adequate and continuing compensation has to be provided to such States.

Tax on items containing Alcohol: Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT could continue to be levied on alcoholic beverages as per the existing practice. In case it has been made VAT-able by some States, there is no objection to that. Excise Duty, which is presently being levied by the States may also not be affected.

Tax on Tobacco products: Tobacco products would be subject to imposition of GST. Centre may be allowed to levy excise duty on tobacco products.

Tax on Petroleum Products: As far as petroleum products are concerned, it was decided that the basket of petroleum products, i.e. crude, motor spirit (including ATF[13]) and HSD[14] would be kept

[13] ATF stands for Bureau of Alcohol, Tobacco, Firearms and Explosives commonly referred to as "the ATF", a law enforcement agency within the United States Department of Justice.

[14] HSD is normally used as a fuel for high speed diesel engines operating above 750 rpm i.e. buses, lorries, generating sets, locomotives, pumping sets etc. Gas turbine requiring distillate fuels normally make use of HSD as fuel.

outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. A final view on whether Natural Gas should be kept outside the purview of GST will be taken after further deliberations.

Taxation of Services: As indicated earlier, both the Centre and the States will have concurrent power to levy tax on goods and services. In the case of States, the principle for taxation of intra-State has already been formulated by the Working Group of Principal Secretaries /Secretaries of Finance / Taxation and Commissioners of Trade Taxes with senior representatives of Department of Revenue, Government of India. For inter-State transactions, an innovative model of Integrated GST (IGST) will be adopted by appropriately aligning and integrating CGST and IGST.

Table 2: Central and State Taxes to be included in GST

Central Taxes	**State Taxes**
Central excise duty	Value Added Tax/ Sales tax
Additional excise duties	Entertainment tax (unless it is levied on local bodies)
Service tax	Luxury tax
Excise duty under Medicinal & Toiletries Preparation Act	Tax on lottery, betting and gambling
Countervailing duties (on imports in lieu of excise duty)	Entry tax not in lieu of Octroi[1]
Additional duty of Customs (levied on imports in lieu of value added tax or central sales tax)	State surcharges and cess in so far as they relate to supply of goods and services
Surcharges and Cess	

Source: Constructed from the Report published by the Empowered Committee of State Finance Ministers

10. What is the proposed Rate Structure under GST?

The Empowered Committee of State Finance Ministers has recommended a ***two-rate structure***

1. A lower rate for essential items and items of basic importance
2. A standard rate for items in general.

Apart from these two rates, there will also be a special rate for precious metals and a list of exempted items.

The rates of GST should be revenue-neutral, i.e. the current revenue from different taxes should not be affected for both Centre and States as a result of GST. Table 4 shows the proposed rate structure which will be equally shared by Centre and State governments.

Table 3: Proposed GST Rate Structure

Items	Total GST rates (in %)	Centre	State
Goods	20	10	10
Services	16	8	8
Essential Items	12	6	6

Source: Speech of Finance Minister at the meeting with the Empowered Committee of State Finance Ministers, PIB Press Release dated 21-7-2010 URL: http://www.etaxindia.org/.../218-speech-finance-minister-meeting-empowered-committee-state-finance-ministers.html

11. What is the objective of providing Threshold Exemption under GST?

Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

- It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them. Hence, reduction of the cost of monitoring of small traders is one objective of providing the threshold exemption.
- The limit was proposed to be raised to reduce the compliance burden for small traders, small-scale industries, and administrative work for the states. As a result of providing the threshold exemption, the compliance cost and compliance effort would be saved for such small traders.

- Small traders would get relative advantage over large enterprises because of lower tax incidence because of the threshold exemption.

12. How will transactions of goods and services across States be taxed under GST?

The Empowered Committee of State Finance Ministers accepted the recommendation for adoption of Integrated GST or IGST model for taxation of inter-State transaction of Goods and Services (i.e. transactions of goods and services across States).

Box 1 provides key features of an IGST Model

Box 1: Features of an IGST model
Centre would levy IGST (which would be CGST plus SGST, i.e. IGST=CGST+SGST) on all inter-State transactions of taxable goods and services (with appropriate provision for consignment or stock transfer of goods and services). The Inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. 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 in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information is also submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds. All inter-state dealers will be e-registered and correspondence with them will be by e-mail. Model can take ‘Business to Business’ as well as ‘Business to Consumer’ transactions into account. Source: Comments of the Department of Revenue (DoR) on the First Discussion Paper on GST, Department of Revenue, Ministry of Finance, URL:http://dor.gov.in/writereaddata%5CGOODS%20AND%20SRVICES%20TAX%5Cgoo

[The possible mechanisms have been explained in **Annexure, Part 4** as **Options for taxing Goods and Services across States under GST**]

13. Why is Constitutional Amendment required to operationalise GST?

The Constitution provides for division of powers of taxation between the Centre and States. While the Centre is empowered to ***tax services and goods up to the production stage***, the States have the power to ***tax sale of goods***. However, the States ***do not have the powers to levy a tax on supply of services***. On the other hand, the Centre ***does not have any power to levy tax on the sale of goods***. Therefore, as per the constitutional rule neither Centre nor States have the power to tax 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 amend the Constitution to empower ***the Centre to levy tax on sale of goods*** and ***States for levy of service tax and tax on imports*** and other consequential issues for the smooth functioning of the GST.

14. What would be the legislative steps for CGST and SGST?

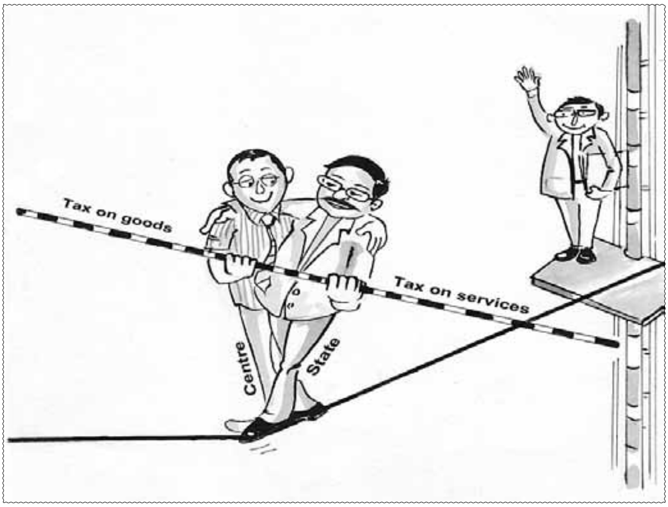
A Joint Working Group has been constituted on September 30, 2009 comprising the officials of the Central and State Governments to prepare a draft legislation for Constitutional Amendment in a time-bound manner.

The Joint Working Group has been entrusted the task of preparing –

- A draft legislation for CGST
- A suitable Model Legislation for SGST
- Rules and procedures for CGST and SGST.
- Immediate steps have also been initiated for drafting of legislation for IGST and related rules and procedures. The issue of dispute resolution would also be addressed by the Working Group.

15. What are the unresolved issues of GST?

- There is a divergence of opinion among Department of Revenue (of the Union Ministry of Finance) and Empowered Committee of State Finance Ministers regarding a number of issues in GST. While the Department of Revenue (DoR) has agreed on certain proposals, they differ on others. For instance, while the Empowered Committee has suggested keeping alcoholic items outside GST, the DoR opines it should be under GST in order to remove the cascading effect on GST paid on inputs such as raw material and packaging material. Similarly, DoR is also against the proposal of putting Purchase Tax and petroleum products outside the purview of GST.



- Disagreements also exist between the Empowered Committee and the 13th Finance Commission Task Force Report regarding the proposed GST structure. One particular area is the Integrated GST or IGST model. The Task Force has suggested an alternative Modified Bank Model for IGST. Apart from this, there are also divergence on issues like - tax base, tax rates, threshold limits, exemptions/ compounding schemes and taxation of alcohol, tobacco and petroleum products in the GST regime.
- There is also a fear of revenue loss for some States due to lower and single rate structure under the proposed GST model. The estimated GST of 12 percent rate by the Task Force has been contended by a number of States. Though the 13th Finance Commission has announced Rs.50,000 crore compensation

package for States in case of revenue loss, there is a concern raised by the States regarding their freedom to levy tax and increase the tax rates at their discretion.

- There are a few areas that lack clarity such as -
  - Effective date of GST implementation
  - Rate of GST
  - Taxation of certain key services viz. hospitals, education sector, aviation sector (which are not covered under current tax rules).
  - Taxation of Real Estate and Housing, Financial and Information Technology (IT) sectors.
  - Specification of the list of exempted goods and services.
- Regarding the Threshold Exemption, ambiguity arises since there is no uniformity. There is a divergence of opinion between the Empowered Committee and Task Force in this regard. Different thresholds have been proposed, Rs. 10 lakh for SGST (lower for some underdeveloped States), Rs 1.5 crore for CGST for goods and a lesser amount (not indicated) for services.
- The GST rate structure is also not clear. In the Discussion Paper by the Empowered Committee, two rates have been mentioned – a lower rate for essential items and a standard rate for other goods and services. But the rates have not specifically been mentioned. There is mention of rates, which are only proposed, but not confirmed in a speech by Finance Minster. There is a fear among a number of States that the proposed rate structure might erode their constitutional power to levy taxes. The rates also remained a sensitive issue at the time of the introduction of the Modified Value Added Tax or MODVAT in 1986 with more than 20 rates. Severe compliance problems have been realized, as there was lack of clarity regarding the payment of input tax credits to manufacturers. Regarding the proposed GST rate, the Centre is in favor of a single rate and a wider tax base. In fact, a single rate would be optimal in case of GST. However, States fear there would be loss of revenue if the rate were too low to realize potential benefits of GST.
- While the design of the CGST is more or less clear, there is a concern regarding the optimal design of SGST. There is a need of harmonization across the Union Territories and States.
- The institutional reform is an important issue. One potential problem is taxing the telecommunication sector. In the telecommunication sector:

- Services are generated somewhere,
- It has been purchased elsewhere,
- It is consumed in another location, and
- The payment for the services takes place in a different place.

If such services are intermediary in nature then there would not be any problem since in the next stage the tax credit mechanism would operate. However, if such services are for final purposes, then there should be some clear policy guidelines so that no State suffers in terms of revenue loss. For the successful operation of the IGST method, a lot of efficiency is also required in the computerization system.

Annexure

Part 1: Examining VAT

(This can be further illustrated by incorporating more producers, say D and E, taking some arbitrary value addition by D and E and comparing the tax burden in case of VAT as well as in the absence of VAT). Table I compares the 'tax burdens' of Sales Tax vis-à-vis VAT.

Table I: Value Added Tax (Amount in Rs.)

Producer/ Manufac-turer	Cost of Input	Output Value	Value Addition	Tax Rate	Selling Price Including Tax Rate	Tax Burden
Producer A	-	100	_	10%	110	10
Producer B	110	150	50(150-100)	10%	155 (150+10% on 50)	5
Producer C	155	200	50(200-150)	10%	205 (200+10% on 50)	5

[**Note:** VAT is calculated using the 'Subtraction Method.' In this method, VAT payable by a registered dealer (who might be a supplier of raw materials, manufacturer, wholesaler or retailer), is calculated as VAT=Tax Rate (Sales Value of Output-Input Value) or, VAT=Tax Rate (Value Addition by final dealer). For example, VAT payable by producer C = 10% (200-150) = Rs.5. The value of outputs of each producer has been tallied independent of taxes in order to calculate VAT, in order to avoid confusion].

If the Tax Credit Method is applied, VAT = Output Tax-Input Tax. For example, the sales value of producer C is Rs.200. Apply the tax rate 10% on this to get output tax of C, which is Rs.20. The purchase value or input cost of C is Rs.150. Apply 10% tax rate on this to get Rs.15. This Rs. 15 is producer C's Input Tax Credit. Now producer C should pay VAT = Output Tax-Input Tax (Input Tax Credit) = Rs.20-Rs.15 = Rs.5.[1]

[1] The Input Tax Credit is defined as- Input tax credit is the portion of input tax of a registered dealer which is refundable (or set off) from the total tax liability corresponding to the sale of goods. Hence, government refund all input purchases of a registered dealer on claim.

Part 2: How would GST work?

Let us illustrate with the following hypothetical example (with a manufacturer, one wholesaler and one retailer) how GST will work.

Let us suppose that GST rate is 10%, with the manufacturer making value addition of Rs.30 on his purchases worth Rs.100 of input of goods and services used in the manufacturing process.

At 10 % GST, the ***Input Tax Credit (ITC)*** would be Rs.10 (i.e. tax on purchase value on Input).Similarly; GST on output would be Rs.13 (tax on the value of output).[See the following Table]

The manufacturer will then pay net GST of Rs. 3 after subtracting Rs. 10 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 13.

The manufacturer sells the goods to the wholesaler. When the wholesaler sells the same goods after making value addition of (say), Rs.20, he pays net GST of only Rs. 2, after ***setting-off***[2] of Input Tax Credit of Rs. 13 from the gross GST of Rs. 15 to the manufacturer.

Similarly, when a retailer sells the same goods after a value addition of (say) Rs. 10, he pays net GST of only Re.1, after setting-off Rs.15 from his gross GST of Rs. 16 paid to wholesaler.

Thus, the manufacturer, wholesaler and retailer have to pay only Rs. 6 (= Rs. 3+Rs. 2+Re. 1) as GST on the value addition along the entire value chain from the producer to the retailer, after setting-off GST paid at the earlier stages. The overall burden of GST on the goods is thus much less. This is shown in the table below. The same illustration will hold in the case of final service provider as well.

[2] By 'set-off' it means that at each stage, sellers pay the ***Net GST*** after deducting the tax burden on the value of input they purchased from the tax burden of the value of output they produce. Each seller pays a GST after 'setting off' their Input tax Credit. Hence, a seller maintains two separate invoices/ accounts. In one invoice, she maintains the total taxable amount of the value of inputs she has purchased, and in the other invoice, she maintains the total taxable amount of the value of output she produces. The taxable amount of her input value would be reimbursed to him on claim(called input tax credit).

Table II: Illustration of how GST would Work							
Stage of supply chain	Purchase value of input	Value addition	Value at which supply of goods and services made to next stage	Rate of GST	GST on output	Input Tax credit	Net GST= GST on output- Input tax credit
Manufacturer	100	30	130	10%	13	10	13-10=3
Wholesaler	130	20	150	10%	15	13	15-13=2
Retailer	150	10	160	10%	16	15	16-15=1

Source: 'First Discussion Paper On Goods and Services Tax In India' by The Empowered Committee Of State Finance Ministers, New Delhi November 10, 2009,p-33.

Therefore, GST would be beneficial for –

1. **Consumers:** The final burden of tax would be much less
2. **Government:**
   - Reduction of taxes that create unnecessary cascading effects (like Central Sales Tax or CST, CENVAT and other service taxes).
   - Reduction of Tax compliance efforts and administrative costs.
   - Wider tax base as states would be entitled to levy tax on services and inclusion of more taxes
   - Tax evasion would be reduced as a result of the reduction in the tax burden
3. **Business:** Easier Compliances

Part 3: An Illustration on CGST and SGST

Suppose that the rate of CGST is 10 % and that of SGST is 10 %. When a wholesale dealer of steel in Uttar Pradesh supplies steel bars and rods to a construction company which is also located within the same State for, say Rs. 100, the dealer would charge CGST of Rs. 10 and SGST of Rs. 10 in addition to the basic price of the goods.

He would be required to deposit the CGST component into a Central Government account while the SGST portion into the account of the concerned State Government (In this example it is Uttar Pradesh). Of course, he need not actually pay Rs. 20 (Rs. 10 + Rs. 10) in cash as he would be entitled to ***set-off*** this liability against the CGST or SGST paid on his purchases (i.e. inputs used by him). Actually, his output tax would be Rs.20. Now suppose the value of input purchased by him is, say Rs.60.Then the Input Tax Credit would be Rs. 6 for CGST and Rs. 6 for SGST. Then the dealer is supposed to pay a net GST of Rs.4 (Rs.10-Rs.6) as CGST and Rs.4 as SGST. But for paying CGST he would be allowed to use only the credit of CGST paid on his purchases while for SGST he can utilize the credit of SGST alone. In other words, CGST credit cannot, in general, be used for payment of SGST. Nor can SGST credit be used for payment of CGST.

Part 4: Options for taxing Goods and Services across States under GST

Option-1: The seller in the Origin State (say, West Bengal) collects the tax revenue[3] (i.e. SGST) and remits the tax to the Origin State government. The Origin State Government then transfers this remittance to the Destination State (say, Kerala). However, this would have required:

- Massive co-ordination between the States.
- In-depth controls on movement of goods in terms of check posts, road permits, etc in order to verify whether the goods have really moved out of the State.

Option-2: The seller in the Origin State collects the tax revenue (i.e. SGST) and remits the tax directly to the Destination State government. But for this, the following would be required:

- The Selling dealer has to be registered in various Destination States in order to remit the tax to the respective State governments. But this would be very cumbersome in terms of administration since each seller has to be registered to each State.
- A number of troubles would accrue to the trade and commerce in terms of compliance.

[3] The seller can pass the tax to the buyer of the Destination State including the tax element in the price of the final product. When the buyer pays to the seller, the seller would give the tax (SGST) to the State in which he/she belongs (which is the Origin State).

Option-3: The seller in the Origin State collects the tax revenue (i.e. SGST) and remits the tax to the Origin State government. The Central government would be a clearing agent and transfers the tax collected (in respect of Inter-State transactions) to the Destination State. This option would have the following advantages:

- Simpler Compliance.
- This method would ensure more transparency regarding the movement of tax revenue to the Destination State, since the revenue would move via Centre.
- Less grievance of States since Centre would be involved in such transactions.

The Empowered Committee of State Finance Ministers suggested *Option-3.*

Let us discuss how the IGST would operate through the following examples.

The operation of IGST: An Illustration

Let us assume that-

The Central GST or CGST=8%

The State GST or SGST=9%

Then Integrated GST or IGST=17% (Since, IGST=SGST+CGST)

Let us also assume that –

The Seller: Dealer X

- The Buyer: Dealer Y (also a registered Dealer)

The Origin State: State A (i.e. the State in which Dealer X, the seller belongs)

The Destination State: State B (The State in which the buyer Dealer Y belongs)

Let us suppose that Dealer X in State A purchases goods worth Rs. 100 locally (i.e. from a buyer who belongs also in State A) and sells the goods to the Dealer Y in State B at Rs. 120.

The following would be applicable for Dealer X:

Dealer X:

Credits available on local purchases of Rs. 100/-

CGST: 8

SGST: 9

Tax Payable on interstate sales of Rs. 120/-

Total Tax Payable: Rs. 20.4 (17% on Rs. 120/-)

i.e. Dealer X would maintain two invoices. In one invoice, he would include the relevant Input tax Credits on her purchase of inputs (I.e. CGST Rs.8 and SGST Rs.9) which she would get from Center and State A on claim. On the other hand, she needs to remit a total tax (Rs.20.4) to State government A. The Centre would collect this tax from State A and would transfer to State B.

Since the Dealer X (or the seller X) is entitled to claim her input tax credits, actually she needs to pay a Net Tax=Rs.20.4-Rs.8 (CGST)-Rs.9 (SGST) =Rs.20.4-Rs.17=Rs.3.4.

The following table would clear the above transactions more comprehensively-

Table III: Computation of Net Tax Payable by Seller X			
Total Tax Payable		20.4	
Less: Credit of			
CGST	8.0		Credit of Rs. 8/- pertaining to centre utilized.
SGST	9.0	17.0	
Net Tax Payable by Dealer X		3.4	Net Tax paid to the Centre

Total Tax payable to the Centre by the Dealer X is Rs. 20.4. However, she will exploit the credit of CGST (pertaining to Centre) of Rs. 8/- and SGST (pertaining to State A) of 9/- and pay net tax of Rs. 3.4 to the Centre.

Then State A will transfer the credit of SGST (i.e. Rs. 9/-) to the Centre. By doing this, it has been ensured that the entire tax revenue of Rs. 20.4 [Rs.8 retained by the Centre itself (CGST) +Rs.9 transferred by State A to the Centre+Rs.3.4 (net tax) paid by Dealer X which goes to the Centre] has been transferred to the Centre. Hence

State A has not retained any revenue in respect of this inter-State sale at all.

In the earlier example, we have illustrated the procedure of tax collection under an ***inter-State transaction (i.e. transaction across two different States)***.

Let us try to understand the process of tax collections in case of a transaction ***within a same State*** (intra-State Transaction).

Now let us assume that Dealer Y in State B sells these goods to another dealer at the same State (State B) at Rs. 150.[Note: Dealer Y purchases at Rs.120 from another State(which is State A) and sells at Rs.150 within the same State in which Dealer Y belongs(State B). Since Dealer Y purchase at Rs.120 from another State, which is a Inter-State transaction, IGST would be applicable on her purchase. But since she sells in same State, which is an intra-State transaction, CGST and SGST would be applicable on her sell.)

The following is applicable for Dealer B:

Credits available on inter-State purchases of Rs. 120/-

Input Tax Credit or ITC: Rs. 20.4 [This is the Input Tax Credit which Dealer B is entitled to get on claiming from the Central government. Applying the IGST (since Dealer Y purchases her inputs from another State, hence IGST should be applicable on her purchase) .This is calculated as-17% of Rs.120]

Tax Payable on intra-State sales of Rs. 150/-

CGST: Rs. 12.0 (8% on Rs. 150/-)

SGST: Rs. 13.5 (9% of Rs. 150/-)

State B should receive revenue of Rs. 13.5 in respect of this sale.

[Note: Net tax payable by Dealer Y= (CGST+SGST)-ITC (This ITC is calculated by applying IGST on her inter-State purchase) .Since, Dealer Y purchases goods at Rs. 120, she can claim Input Tax Credit (ITC) of Rs.20.4. On the other hand, since she sells the products at Rs.150 to a buyer who belongs to the same State, the tax payable on this is Rs.12 (CGST)+ Rs.13.5(SGST). Therefore, the Net Tax payable by Dealer Y is = (12.0+13.5)-20.4=5.1]

Now, Dealer Y can pay this IGST in the following ways-

Option-I: Set off the ITC first completely against the tax payable for CGST and balance against tax payable for SGST

Now, what is meant by setting off her ITC (the IGST on her purchase in this context) completely against the tax payable for CGST and balance against tax payable for SGST?

It is the following steps:

- Subtract the portion of ITC(In this example, the Input Tax Credit or ITC is Rs.20.4) from total CGST payable(which is Rs.12.0)
- Balance (subtract) the remaining portion of ITC (Rs.20.4 –Rs.12.0) for SGST payable.

The following table shows this in a comprehensive manner-

Option-I: Set off the Input Tax Credit (ITC) first completely against the tax payable for CGST and balance against tax payable for SGST

Table IV: Payment of Tax by Dealer Y (Option I)				
CGST Payable	12.00		SGST Payable	13.5
Less: ITC Credit	12.00		Less: ITC Credit (Rs. 20.40 Less Rs. 12)	8.4
Net CGST Payable	–		Net SGST Payable	5.1

In this case, State B will get SGST revenue of Rs. 5.1 from the dealer Y (which is the net SGST payable to State B by Dealer Y).

Moreover, Centre will pay the credit of ITC utilized in payment of SGST i.e. Rs. 8.4. Hence, in total State B will receive total SGST of Rs. 13.5.

Option-II: Set off the ITC first completely against the tax payable for SGST and balance for tax payable for CGST.

In this option, the net tax can be paid via the following steps:

- Subtract the portion of ITC from total SGST payable (which is Rs.13.5)
- Balance (subtract) the remaining portion of ITC (Rs.20.4 – Rs.13.5=Rs.6.9) for CGST payable

Table V: Payment of Tax by Dealer Y (Option II)				
CGST Payable	12.00		SGST Pay-able	13.5
Less: ITC Credit (Rs. 20.40 Less Rs. 13.50)	6.9			
Net CGST Payable	5.10			

In this case, Centre will pay Rs.13.5 to State as SGST. Moreover, Centre will collect Rs. 5.10 from Dealer Y as net CGST after balancing for the ITC of Rs.6.9.

Option-III: Set off certain amount say Rs. 10 against CGST and Rs. 10.4 against SGST

Table VI: Payment of Tax by Dealer Y (Option III)				
CGST Payable	12.00		SGST Payable	13.50
Less: ITC Credit	10.00		Less: ITC Credit	10.40
Net CGST Payable	2.00		Net SGST Payable	3.10

In this case, State B will get SGST revenue of Rs. 3.1 from the dealer X and Centre will pay the credit of ITC utilized in payment of SGST i.e. Rs. 10.4. Hence, in total State B will receive total SGST of Rs. 13.5. Dealer Y would pay net CGST of Rs.2.00 to the Centre.[Note: In this case, Dealer Y can divide her ITC also in a manner so that IGST Credit for Centre might be Rs.10.40 and for State Rs.10.00, or in any other manner].

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About CBGA

Centre for Budget and Governance Accountability (CBGA) promotes transparent, accountable and participatory governance, and a people-centred perspective in the policies shaping up the government's budgets. CBGA's research on public policies and budgets, over the last eight years, has focused on the priorities underlying budgets, quality of government interventions in the social sector, responsiveness of budgets to disadvantaged sections of population and structural issues in India's fiscal federalism. Research on these issues has laid the foundation for CBGA's efforts pertaining to training and capacity building on budgets (mainly with the civil society organisations in the country) and policy advocacy with important stakeholders. Please visit the website www.cbgaindia.org to know more about the organisation.

About Christian Aid

Christian Aid is a British and Irish charity working to tackle the causes of poverty and injustice in some of the world's poorest countries. It supports local communities to find their own solutions to the problems they face. It is unequivocal about working where the need is greatest, regardless of race or creed. Christian Aid believes that Poverty is an outrage against humanity. It robs people of dignity, freedom and hope, of power over their own lives. Christian Aid has a vision – an end to poverty – and it believe that vision can become a reality. Christian Aid's essential purpose therefore is to expose the scandal of poverty, to help in practical ways to root it out from the world and to challenge and change the systems that favor the rich and powerful over the poor and marginalized.

How has VAT been implemented in India?
What are the prominent features of GST?
What is Central GST and State GST?
What are the unresolved issue of GST?

These are just some of the questions to which you will find helpful answers in this easy-to-use primer.

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