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1. TAXATION AND GST BASICS

"In this world, nothing can be said to be certain, except death and taxes." –Benjamin Franklin

Benjamin Franklin was correct in his assessment of both death and taxes, but while taxes have been certain, they've been far from consistent.

Taxation refers to the act of laying a tax, or of imposing taxes, as on the subjects of a state, by government, or on the members of a corporation or company, by the proper authority; the raising of revenue; also, a system of raising revenue. (Source: ardictionary.com)

1.1. What is Tax

A tax (from the Latin taxo) is a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by a state or the functional equivalent of a state to fund various public expenditures. A failure to pay, or evasion of or resistance to taxation, is usually punishable by law. Taxes consist of direct or indirect taxes and may be paid in money.

The word tax is derived from the Latin word 'taxare' meaning to estimate. A tax is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is any contribution imposed by government whether under the name of toll, tribute, impost, duty, custom, excise, subsidy, aid, supply, or other name.

In modern taxation systems, governments levy taxes in money; but in-kind and corvée taxation are characteristic of traditional or pre-capitalist states and their functional equivalents. The method of taxation and the government expenditure of taxes raised are often highly debated in politics and economics.

Tax collection is performed by a government agency such as the Canada Revenue Agency, the Internal Revenue Service (IRS) in the United States, or Her Majesty's Revenue and Customs (HMRC) in the United Kingdom. When taxes are not fully paid, the state may impose civil penalties (such as fines or forfeiture) or criminal penalties (such as incarceration) on the non-paying entity or individual.

History of Taxation

The first known system of taxation was in Ancient Egypt around 3000–2800 BC in the first dynasty of the Old Kingdom. The earliest and most widespread form of taxation was the corvée and tithe. Tax called as corvée, was forced labour provided to the state by peasants. The Pharaoh would tour the kingdom, collecting taxes from the people.

In the Bible, it states "But when the crop comes in, gives a fifth of it to Pharaoh. The other four-fifths you may keep as seed for the fields and as food for yourselves and your households and your children". In the Persian Empire, a regulated and sustainable tax system was introduced in 500 BC and tailored to each Satrapy (the area ruled by a Satrap or provincial governor). It was the responsibility of the Satrap to collect the due amount and to send it to the treasury, after deducting his expenses (the expenses and the power of deciding precisely how and from whom to raise the money in the province, offer maximum opportunity for rich pickings).

Taxation in India

In India, the tradition of taxation has been in force from ancient times. It finds its references in many ancient books like 'Manu Smriti' and 'Arthasastra'. The Islamic rulers imposed jizya. It was abolished by Akbar. However, Aurangzeb, levied jizya on his mostly Hindu subjects in 1679.

The period of British rule in India witnessed some remarkable change in the whole taxation system of India. Although, it was highly in favour of the British government and its exchequer but it incorporated modern and scientific method of taxation tools and systems.

The history of Income-Tax in modern India dates back to 1860 when the first Income Tax Act was introduced by James Wilson who became (British) India's first finance member.

First Income Tax Act came in force on 24th July 1860 with the approval of The Governor General. It was a tax selectively imposed on the rich royalty and Britishers. For the first year of tax the government collects Rs 30 Lakhs. The act lapsed in 1865 and was reintroduced in 1867. There was need for more revenue to fight Anglo-Russian war. So Governor General Lord Dufferin introduced a comprehensive Income Tax Act in 1886. It was combination of Licence Tax and Income Tax. Taxes were collected in the same manner as land revenue.

In 1922, the country witnessed a paradigm shift in the overall Indian taxation system. Setting up of administrative system and taxation system was first done by the Britishers. The most comprehensive Income Tax Law was the Income Tax Act of 1922. 1919 Chelmsfod reforms made a distinction between the functions and resources of the state and the Central Govt. and Income Tax became a primary source of revenue for the central Government.

Based on the recommendations of Prof. Nicholas Kaldor, the Wealth Tax Act, 1957, the Expenditure Tax Act, 1957 and the Gift Tax Act, 1958 were introduced.

Income Tax Act, 1961 came into existence with effect from 01.04.1962, based on the recommendations of the Law Commission and the Enquiry Committee.

Broadly, there are two types of Taxes viz. Direct and Indirect taxes. Taxes in India are levied by the Central Government and the State Governments. Some minor taxes are also levied by the local authorities such as Municipality or Local Council. The authority to levy tax is derived from the Constitution of India which allocates the power to levy various taxes between Centre and State.

1.2. What is Direct and Indirect Tax

Direct and indirect taxes include all the different types of taxes levied by the government.

Direct Tax

A direct tax as the name suggests, are taxes that are directly paid to the government by the taxpayer. It is a tax applied on individuals and organizations directly by the government e.g. income tax, corporation tax, wealth tax etc.

Direct taxes include the taxes that cannot be transferred or shifted to another person. A direct tax is one imposed upon an individual person or property (i.e. real and personal property, wages, etc.)

as distinct from a tax imposed upon a transaction. Direct taxes are paid in entirety by a taxpayer directly to the government. Direct taxes are collected by the central government as well as state governments according to the type of tax levied.

Major types of direct tax include:

- ✓ Income Tax: Levied on and paid by the same person according to tax brackets as defined by the income tax department.
- ✓ Corporate Tax: Paid by companies and corporations on their profits.
- ✓ Wealth Tax: Levied on the value of property that a person holds.
- ✓ Estate Duty: Paid by an individual in case of inheritance.
- ✓ Gift Tax: An individual receiving the taxable gift pays tax to the government.
- ✓ Fringe Benefit Tax: Paid by an employer that provides fringe benefits to employees, and is collected by the state government.

Indirect Tax

Indirect tax is so called as it is paid indirectly by the final consumer of goods and services while paying for purchase of goods or for enjoying services.

Indirect taxes are taxes which can be shifted to another person. An example would be the Value Added Tax (VAT) that is included in the bill of goods and services that you procure. The initial tax is levied on the manufacturer, who then shifts this tax burden to the dealer and finally to the consumers by charging higher prices for the commodity by including taxes in the final price.

Since the cost of the tax does not vary according to income, indirect taxation includes Ad Valorem tax and Specific tax, of which Ad Valorem(VAT, GST) is proportional and Specific tax is fixed. However, indirect taxation can be viewed as having the effect of a regressive tax as it imposes a greater burden (relative to resources) on the poor than on the rich, as both rich and poor pay the same tax amount for consumption of a certain quantity of a specific good. The taxpayer who pays the tax does not bear the burden of tax; the burden is shifted to the ultimate consumers.

Some types of indirect taxes are:

- ✓ Excise Duty: Payable by the manufacturer who shifts the tax burden to retailers and wholesalers.
- ✓ Sales Tax: Paid by a shopkeeper or retailer, who then shifts the tax burden to customers by charging sales tax on goods and services.
- ✓ Custom Duty: Import duties levied on goods from outside the country, ultimately paid for by consumers and retailers.
- ✓ Entertainment Tax: Liability is on the cinema owners, who transfer the burden to cinemagoers.
- ✓ Service Tax: Charged on services rendered to consumers, such as food bill in a restaurant.

An indirect tax (such as sales tax, per unit tax, value added tax (VAT), or goods and services tax (GST)) is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). The intermediary later files a tax return and forwards the tax proceeds to government with the return.

An indirect tax may increase the price of a good to raise the price of the products for the consumers. Examples would be fuel, liquor, and cigarette taxes. An excise duty on motor cars is paid in the first instance by the manufacturer of the cars; ultimately, the manufacturer transfers the burden of this duty to the buyer of the car in the form of a higher price. Thus, an indirect tax is one that can be shifted or passed on. The degree to which the burden of a tax is shifted determines whether a tax is primarily direct or primarily indirect. This is a function of the relative elasticity of the supply and demand of the goods or services being taxed. Under this definition, even income taxes may be indirect.

Differences between Direct and Indirect Tax

There are different implications of direct and indirect taxes on the country. However, both types of taxes are important for the government as taxes include the major part of revenue for the government.

Key differences between Direct and Indirect Tax are:

- ✓ Direct tax is levied and paid for by individuals, Hindu undivided Families (HUF), firms, companies etc. whereas indirect tax is ultimately paid for by the end-consumer of goods and services.
- ✓ The burden of tax cannot be shifted in case of direct taxes while burden can be shifted for indirect taxes.
- ✓ Lack of administration in collection of direct taxes can make tax evasion possible, while indirect taxes cannot be evaded as the taxes are charged on goods and services.
- ✓ Direct tax can help in reducing inflation, whereas indirect tax may enhance inflation.
- ✓ Direct taxes have better allocative effects than indirect taxes as direct taxes put lesser burden over the collection of amount than indirect taxes, where collection is scattered across parties and consumers' preferences of goods is distorted from the price variations due to indirect taxes.
- ✓ Direct taxes help in reducing inequalities and are considered to be progressive while indirect taxes enhance inequalities and are considered to be regressive.
- ✓ Indirect taxes involve lesser administrative costs due to convenient and stable collections, while direct taxes have many exemptions and involve higher administrative costs.
- ✓ Indirect taxes are oriented more towards growth as they discourage consumption and help enhance savings. Direct taxes, on the other hand, reduce savings and discourage investments.
- ✓ Indirect taxes have a wider coverage as all members of the society are taxed through the sale of goods and services, while direct taxes are collected only from people in respective tax brackets.
- ✓ Additional indirect taxes levied on harmful commodities such as cigarettes, alcohol etc. dissuades over-consumption, thereby helping the country in a social context.

Direct and indirect taxes are defined according to the ability of the end taxpayer to shift the burden of taxes to someone else. A direct tax allow the government to collect taxes directly from consumers and is a progressive type of tax, which also allows for cooling down of inflationary pressure on the economy. Indirect taxes allow the government to expect stable and assured returns and bring into its fold almost every member of the society – something which the direct tax has been unable to do.

1.3. What is GST

GST or Goods and Services Tax, is a tax which combines various indirect taxes being charged by Central and State governments, which resulted in multiple receipts/payment/compliance being needed for multi-state business.

GST is a comprehensive indirect tax on manufacture, sale and consumption of goods and services throughout India (Except state of Jammu and Kashmir), to replace taxes levied by the central and state governments.

It is levied on both goods and services. The main aim of GST is to centralize taxation for businesses so as to relieve them of burden of compliance and better manage their cash and finances.

Important features of GST are

- ✓ GST is a value added tax, levied at all stages of the supply chain, right from manufacture to final consumption, where credit shall be allowed for taxes paid at previous steps as set-off
- ✓ GST would be applicable on the supply of goods or services, as against the present concept of tax on the manufacture and sale of goods or provision of services
- ✓ GST would be a destination based consumption tax ie, tax would accrue or deposited, to the taxing authority which has jurisdiction on place of consumption.
- ✓ GST would apply to both goods and services barring a few exceptions
- ✓ GST would be levied concurrently by both Centre and State. GST to be levied by the Centre on intra-State supply of goods and / or services would be called the Central GST (CGST) and that to be levied by the States would be called the State GST (SGST).
- ✓ However it is contemplated that the base and other essential design features would be common between CGST and SGST, across SGSTs for the individual States
- ✓ Inter-State supplies within India would attract an Integrated GST (aggregate of CGST and the SGST of the destination State).

1.4. GST History

Almost 150 countries have introduced GST in some form. While countries such as Singapore and New Zealand enforce tax, virtually everything at a single rate, Indonesia has five positive rates, a zero rate and over 30 categories of exemptions. In China, GST applies only to goods and the provision of repairs, replacement and processing services.

In India it started with introduction of Value Added Tax (VAT) at the Central and the State level. VAT has been considered to be a major step for the indirect tax reforms in India. Initially, GST was conceptualized as a national level goods and services tax, however, with the release of First Discussion Paper by the Empowered Committee of the State Finance Ministers on 10.11.2009, it has been made clear that there would be a "Dual GST" in India, taxation power will be with both - the Centre and the State, to levy the taxes on the Goods and Services.

Under the GST scheme, no distinction is made between goods and services for levying of tax. In other words, goods and services attract the same rate of tax. GST is a multi-tier tax where ultimate burden of tax fall on the consumer of goods/ services. It is called as value added tax because at every stage, tax is being paid on the value addition. Under the GST scheme, a person who was liable to pay tax on his output, whether for provision of service or sale of goods, is entitled to get input tax credit (ITC) on the tax paid on its inputs.

Indirect Tax Reform Timeline

- ✓ 1974 Report of LK Jha Committee suggested VAT
- ✓ 1986 Introduction of a restricted VAT called MODVAT
- ✓ 1991 Report of the Chelliah Committee recommends VAT/GST and recommendations accepted by Government
- ✓ 1994 Introduction of Service Tax
- ✓ 1999 Formation of Empowered Committee on State VAT
- ✓ 2000 Implementation of uniform floor Sales tax rates Abolition of tax related incentives granted by States
- ✓ 2003 VAT implemented in Haryana in April 2003
- ✓ 2004 Significant progress towards CENVAT
- ✓ 2005-06 VAT implemented in 26 more states
- ✓ 2007 First GST stuffy released By Mr. P. Shome in January
- ✓ 2007 F.M. Announces for GST in budget Speech
- ✓ 2007 CST phase out starts in April 2007
- ✓ 2007 Joint Working Group formed and report submitted
- ✓ 2008 EC finalises the view on GST structure in April 2008

GST Evolution

- ✓ In 2003, the Kelkar Task Force on indirect tax had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle.
- ✓ A proposal to introduce a National level Goods and Services Tax (GST) by April 1, 2010 was first mooted in the Budget Speech for the financial year 2006-07. Since the proposal involved reform/ restructuring of not only indirect taxes levied by the Centre but also the States, the responsibility of preparing a Design and Road Map for the implementation of GST was assigned to the Empowered Committee of State Finance Ministers (EC).
- ✓ Based on inputs from Govt of India and States, the EC released its First Discussion Paper on Goods and Services Tax in India in November, 2009.
- ✓ In order to take the GST related work further, a Joint Working Group consisting of officers from Central as well as State Government was constituted in September, 2009.
- ✓ In order to amend the Constitution to enable introduction of GST, the Constitution (115th Amendment) Bill was introduced in the Lok Sabha in March 2011. As per the prescribed procedure, the Bill was referred to the Standing Committee on Finance of the Parliament for examination and report.
- ✓ Meanwhile, in pursuance of the decision taken in a meeting between the Union Finance Minister and the Empowered Committee of State Finance Ministers on 8th November, 2012, a 'Committee on GST Design', consisting of the officials of the Government of India, State Governments and the Empowered Committee was constituted.
- ✓ This Committee did a detailed discussion on GST design including the Constitution (115th) Amendment Bill and submitted its report in January, 2013. Based on this Report, the EC recommended certain changes in the Constitution Amendment Bill in their meeting at Bhubaneswar in January 2013.

- The Empowered Committee in the Bhubaneswar meeting also decided to constitute three committees of officers to discuss and report on various aspects of GST as follows:-
  - Committee on Place of Supply Rules and Revenue Neutral Rates;
  - Committee on dual control, threshold and exemptions;
  - Committee on IGST and GST on imports.
- The Parliamentary Standing Committee submitted its Report in August, 2013 to the Lok Sabha. The recommendations of the Empowered Committee and the recommendations of the Parliamentary Standing Committee were examined in the Ministry in consultation with the Legislative Department. Most of the recommendations made by the Empowered Committee and the Parliamentary Standing Committee were accepted and the draft Amendment Bill was suitably revised.
- The final draft Constitutional Amendment Bill incorporating the above stated changes were sent to the Empowered Committee for consideration in September 2013.
- The EC once again made certain recommendations on the Bill after its meeting in Shillong in November 2013. Certain recommendations of the Empowered Committee were incorporated in the draft Constitution (115th Amendment) Bill. The revised draft was sent for consideration of the Empowered Committee in March, 2014.
- The 115th Constitutional (Amendment) Bill, 2011, for the introduction of GST introduced in the Lok Sabha in March 2011 lapsed with the dissolution of the 15th Lok Sabha.
- In June 2014, the draft Constitution Amendment Bill was sent to the Empowered Committee after approval of the new Government.
- Based on a broad consensus reached with the Empowered Committee on the contours of the Bill, the Cabinet on 17.12.2014 approved the proposal for introduction of a Bill in the Parliament for amending the Constitution of India to facilitate the introduction of Goods and Services Tax (GST) in the country. The Bill was introduced in the Lok Sabha on 19.12.2014, and was passed by the Lok Sabha on 06.05.2015. It was then referred to the Select Committee of Rajya Sabha, which submitted its report on 22.07.2015.
- GST Bill Passed in Rajya Sabha on 3rd August 2016 (03-08-2016)
- 29 March 2017 All 4 GST bills passed in Loksabha. The four bills passed by GST are Central GST (CGST), Integrated GST Bills (IGST), Union territory GST (UGST) and GST (Compensation to the State) Bill, 2017. There will be one tax for one commodity, ease of compliance for businesses, replacement of 17 indirect taxes, fall in logistics and inventory cost, etc. The Central GST (CGST) bill will merge all the indirect taxes like the service tax, excise duty, additional customs duty, special additional duty of customs, surcharges and cesses under one levy. The GST council has recommended a four-tier tax structure- 5, 12, 18, 28 percent.

1.5. GST Challenges

GST will be the biggest reform in Indian taxation since 1947, but there are many challenges for its successful implementation. These are as under

- Revenue Neutral Rate (RNR): In GST, the government revenue would not be the same as compared to the earlier taxation system. Hence, through RNR Government is to ensure that its revenue remains the same despite of giving tax credits.
- Threshold Limit in GST: Central Government must ensure that lowering of threshold limit should not be a "taxing" burden on small businessmen in the country hence, small business should be exempt from filing GST.

- ✓ Robust IT Network: Government had incorporated Goods and service tax network (GSTN), to develop and manage GST portal for registration, return filing, tax payments, IGST settlements etc. Thus there should be a robust IT backbone due to huge number of returns along with legal and financial compliance.
- ✓ Extensive Training to Tax Administration Staff: Tax administration staff at both Centre and state need to be trained properly in terms of concept, legislation and procedure.
- ✓ Numbers of enactments of laws - There will two types of GST laws, one at a centre level called 'Central GST (CGST)' and the other one at the state level - 'State GST (SGST)'. Further, there will be different tax rates for goods and services at the Central Level and State Level, and further division based on necessary and other property based on the need, location, geography and resources of each state. Thus huge number of laws and statutes.
- ✓ Additional Levy on GST: The Purpose of additional levy is to compensate states for loss of revenue while moving to GST. Finalizing the rate of levy is also a challenge to face.
- ✓ Clubbing Taxes: The biggest challenge of GST implementation is bringing all the indirect taxes under one roof, which is the biggest feature of GST. There has been opposition asking to including purchase tax by a few states. Other states are reluctant about alcohol, tobacco products coming under GST as major state revenue is derived from them.
- ✓ Tax Disputes Resolution: There has to be a uniform legal procedure for tax disputes and litigations to avoid any confusion.
- ✓ Defining Inter-State Transactions: With the transportation services available everywhere, the place of sale and consumption may not be the same. This makes it difficult to go forward with revenue allocation. Hence, it becomes important to define procedures to tackle such problems.
- ✓ Infrastructure for The Collection Process: Proper infrastructure has to be designed to track the movement of goods and services between states, collection and monitoring revenue, identify defaulters etc.
- ✓ Determining GST Rates: This is a major step in ensuring the success of GST. Arriving at rates which are conducive to both the government and public is will be a daunting task.
- ✓ The mechanism of imposing taxes, exemptions, abatements, other benefits are different in state and centre and is to be harmonized.
- ✓ Existing law has resulted in significant number of issues related to interpretation or various provisions and the category of the products and the nature of services, which needs to be addressed by GST.
- ✓ Administration mechanics of the centre and state and even in different states is different and needs to be made, uniform.

1.6. GST Benefits

The benefits of GST are manifolds and includes

- ✓ A simple GST tax structure brings greater compliance, thus increasing number of tax payers and more tax revenues of Government.
- ✓ GST will ensure competitive pricing. Tax paid by final consumer will come down in most cases. Lower prices will help in boosting consumption which is beneficial to companies.
- ✓ GST will increase exports. When the cost of production falls in the domestic market, Indian goods and services will be more price competitive in foreign markets

- ✓ The current state of Indian economy demands fiscal consolidation and reduction in Fiscal deficit. A report by CRISIL states that GST is best bet to achieve fiscal consolidation.
- ✓ Cascading effects elimination - At present, there are different state and centre level indirect tax levies which gives cascading effect and will be eliminated by GST.
- ✓ Revenue Growth - Introduction of GST will increase the tax base and also removes the multiple tax points which, will lead to higher revenue to both the states and the union.
- ✓ Transaction and costs reduction - A single registration and single compliance for both SGST and CGST provided by government with effective IT infrastructure, will lower transaction costs for businesses.
- ✓ Tax Multiplicity - GST will result in elimination of multiplicity of taxation. The reduction in the number of taxation applicable in a chain of transaction will help to clean up the current mess that is brought by existing indirect tax laws.
- ✓ Single Tax - Another feature that GST is 'one point single taxation'. This also gives a lot of comforts and confidence to businesses to focus on business rather than worrying about taxation. Businesses will also gains from their lower supply chain costs and pricing modalities. It will result in competitive prices to the consumers.
- ✓ Lowering tax burdens - Under GST, the cost of tax that consumers have to bear will be fixed, and GST would reduce the average tax burdens on the consumers.
- ✓ Corruption Reduction - It is one of the major problems in India. GST will be a step towards corruption free India with lessening of tax inspector raj.

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