Goods and Services Tax: A Paradigm Shift in the Indian Indirect Tax Regime

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The focus of the paper is on the process of introducing the Goods and Services Tax (GST), bringing out the perspectives of different stakeholders, its comparison to various advanced countries who have already adapted it, various sectors and the contentious issues. The GST IS expected to accommodate a variety of taxes and add simplicity to the indirect tax regime. The Empowered Committee (EC) was mandated in 2007, to bring about consensus among the States to move towards GST. The important stakeholders in the process were the Government of India (GoI), Individual States, Industry and the committees commissioned by the Government of India or Empowered Committee. However, the EC faced challenges since there were issues of control between the Centre and States, expected loss of revenue by some States, extent of uniformity across various commodities and their tax rates, input credit mechanism and dispute settlement. The deadline date for the introduction of GST kept getting postponed due to the slow resolution of the over challenging issues. With all demand being met and the Government having majority in the Lower House of the Parliament, it was tabled in the Parliament as the 122nd Constitutional Amendment Bill (CAB) in December 2014. But with the political hindrances in the Rajya Sabha kept delaying the bill's passage of becoming a constitutional amendment. With various negotiations and roadblocks, the bill was finally cleared on August 3, 2016. With clearance of bill what was left behind was implementation challenges and its various impacts on various businesses in the country.

Key Words: *GST, Indirect Tax, VAT, CST,.*

INTRODUCTION

The Old Era- Indirect Taxes

India has a federal structure of government. The constitution of India provides autonomy to both the central and state governments to levy taxes on goods/services at different incidences in the value chain. The central government levies taxes on the manufacturing of goods (excise), rendering of services (service tax), and import of goods (customs duty). The state governments levy taxes on the sale of goods within their jurisdiction(VAT) and sale of goods when entities within their jurisdiction sell goods to entities outside (CST) in addition to multiple other levies like excise on alcohol, entertainment tax, luxury tax, stamp duty, octroi, etc.

The Current structure leads to multiple shortcomings

(a) This multi-layered multiple taxation regime leads to (i) an increase in the prices of goods and services, (ii) narrowing of the tax base, and (iii) dampening of the ease of doing business.

(b) Further, the variations in thresholds for levy of different duties and disparities intax rates applied to the same goods in different states and input and output goods within the same state lead to taxation disputes and pilferages in the value chain.

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A. Increase in prices of goods and services

This is primarily on account of nonavailability of input credit across the value chain and tax cascading.

- **Unavailability of input credit**: Taxes paid under one statute are not allowed to be set off against taxes paid under other statute. Few examples:
  - Input credit is not allowed for CST paid on interstate movement of goods
  - Excise duty paid on manufacturing and service tax paid on rendering of service are not allowed to be set off against VAT paid on the sale of goods and vice-versa.
  - Taxes paid under one certain state level taxes cannot be used as an input for payment of other state taxes like entertainment tax, octroi, entry tax, etc.
- **Tax cascading**: Multilayered taxation structure leads to taxing the tax. For example, the central government levies excise duty on the basic value of goods. However, on the sale of the goods, VAT is levied by state governments on the value of the goods including excise.

B. Narrow base

The current taxation base is narrow due to differential thresholds applicable under various tax laws and differences in the autonomy of the center and the state governments to levy indirect taxation. This gets further aggravated with the various area and product-based exemptions granted by both the central and the state governments.

- **Differential thresholds**: Currently, different levies have different thresholds for their applicability. For example: the threshold under excise is INR15m while the threshold under service tax is INR1m. This results in different tax bases across different duties, and hence, narrowing of the tax base.
- **Taxing power of center and states**: Currently, the center collects excise duty on the value of the product only till manufacturing (generally 2/3rd of the value), resulting in a loss of revenue for the center. State governments do not get any portion of service tax, which is collected only by the center, resulting in loss of revenue for the states.
- **Various exemptions**: Currently, ~300 goods/ services are exempt by the center and ~100 goods are exempt by the state governments. The starting base for the excise/VAT is narrow and is being further eroded by a variety of area-specific and conditional exemptions. Service tax is applicable on all services except those on the negative list and those specifically exempted by notifications.

C. Dampening of 'ease of doing business'

The applicability of multiple tax laws, different rules and procedures, different rates/ classification of same goods in different states, and complexity in determining the nature of transactions further hinder free flow of goods across the country and often lead to increased litigation issues.

- **Applicability of multiple tax laws, lack of uniformity in provisions and rates**: The plethora of indirect taxes applicable to businesses currently not only requires separate registration and assessment, but also subjects businesses to provisions and rates that vary from state to state.
- **Complexity in determining nature of transactions:** Under the current division of taxation powers by the Constitution, neither the center nor the states canseamlessly apply taxes to bundles (for example: services provided by restaurants). Further, with increase in the share of taxes on services, the state governments are keen to classify ambiguous transactions as sale of goods and levy taxes accordingly (for example:

rendering of telecommunication services) which leads to double taxation.

Entering the New Era with GST

The indirect tax regime in India is set for a complete overhaul. GST would simplify and rationalize taxes, shift trade from the unorganized to the organized segment and improve efficiency in the system. The real value of GST would be in the area of tax governance, where a system plagued with a plethora of discretionary, ad-hoc taxes would move toward a ruled-based, transparent and stable tax regime. This would make the tax system fairer by ensuring 'neutrality' across players, products or services, locations or business cycles.

GST is proposed to be a comprehensive destination-based indirect tax levy on the manufacture, sale and consumption of goods and services. Its main objective is to consolidate multiple indirect taxes into a simple tax, overcoming the limitations of the current indirect tax structure and creating efficiencies in administration. GST will facilitate a seamless flow of input credit across the entire supply chain. Introduction of GST will rationalize the tax content in product price, enhance the ability of business entities to compete globally, and possibly trickle down to benefit the ultimate consumer. Better compliance should address instances of tax evasion by expanding the base.

Under the new GST structure, both the center and the states would simultaneously levy GST across the value chain. The center would levy and collect central goods and services tax (CGST), and the states would levy and collect state goods and services tax (SGST) on all transactions within the state.

In case of inter-state sale of goods and import of goods in the country, IGST would be applicable. IGST again would have two components – CGST and SGST. SGST would go to the state where the ultimate consumption of goods takes place. The GST framework does not allow for any specific region-wise exemptions (available for backward areas) or other exemptions; else, these would result in breaking the value chain. The Empowered Committee of State Finance Ministers had recommended withdrawal of area-based exemptions and their replacement with direct central/state government subsidies

RNR Committee Suggests a Standard Rate of 17-19% Under GST

The government appointed group on "Revenue Neutral Rate and Structure of rates for the Goods and Services Tax" (Chairman: Arvind Subramanian; henceforth referred to as "RNR Committee") had suggested the following revenue neutral rate (RNR) and rate structure for GST after considering aspects of base and compliance efficiency under different approaches.

TABLE 1
The RNR Committee placed its comfort on 15-15% RNR for GST

	RNR	Rate on precious metals	Low rate goods	Standard rate goods and services	Demerit goods
Preferred	15	6 4 2 6	12	16.9	40
				17.3	
				17.7 18.0	
Alternative	15.5	4 2	12	18.4 18.9	40

Source: Government of India, RNR Committee Report

GST - The Game Changer

GST takes over the short comings:

- By accommodating all the other indirect taxes and applying homogenous tax rates on goods and services, GST will
  - (a) rationalize consumer-level taxes rates,
  - (b) broaden the tax base, and
  - (c) facilitate the ease of doing business.

This will lead to multifarious benefits both for the government and the corporate sector.

(A) Rationalizing the price of goods and services: Under the current regime, the effective tax rates on goods are significantly higher than on services. GST aims to tax goods and services at a common rate, thereby rationalizing the effective tax rates for goods and services. Further, tax cascading and availability of seamless input credits across the value chain would help lower prices.

(B) Broadening the tax base: GST aims at broadening the tax base by (a) lowering the threshold limit for applicability of indirect tax, (b) permitting the center to levy taxes on sale of goods and the states to levy taxes on rendering of services, and (c) rationalizing the various exemptions available under the current regime.

a) **Differential thresholds**: With the introduction of GST, the threshold for all indirect taxes would be INR1m, which is significantly lower than the current threshold of INR15m for excise and in line with the current threshold ofINR1m for service tax.

b) **Taxing power of the center and the states**: With the introduction of GST, the center would be able to tax the entire value of goods, not just the value till the point of manufacture. The states would get a proportional share of the tax on all services provided in the country.

c) **Various exemptions:** With the introduction of GST, the list of product-wise exemptions is expected to be trimmed to ~100 goods/services (from the current ~300 goods by the center and ~100 by the state governments).Further, it is proposed that various area-based exemptions would be available

(C) Ease of doing business: GST aims to simplify the taxation regime by subsuming most indirect taxes. Further, the following anomalies in the current tax regime would get addressed:

a) **Determining the nature of transactions**: With the introduction of GST, there would be no difference between sale of goods and services for the purpose of taxation. This would lead to reduction in litigation issues and also facilitate taxation of bundled services.

b) **Uniformity in provisions and rates**: With the introduction of GST, there would be a single rate of tax for goods and services as well as uniform provisions/rules for all states and the center. This would facilitate free movement of goods and services across the country and also lead to greater compliance.

GST Benefits Visible in Many Different Shades

If we analyze the amended bill four key themes emerge which might have a significant impact on India Inc.:

(a) change in effective tax rates for various products and services,

(b) availability of seamless input credit across the value chain,

(c) shift of trade from currently unorganized segments to organized segments, and

(d) re-jig in supply chain management.

(A) Change in Effective Tax Rates for Various Products and Services

There exists wide variability in the current effective indirect tax levies across sectors, primarily on account of (a) different classification of goods and services, (b) exemptions/ concessions available to various goods/services under different statutes, and (c) cascading impact of taxation, which brings inefficiencies in the system.

GST is expected to simplify the tax structure and change the effective tax rates on various sectors by:

(a) Applying uniform taxes across goods and services,

(b) Reducing the current product-level exemptions (with center providing exemption to 300 products and states to ~100 products) to ~100 products

(c) Removing the cascading impact of tax by subsuming the various tax levies into a single levy of GST, and

(d) Applying uniform taxes on goods and services across the country.

TABLE 2

Sector	*Excise*	*Service tax*	*VAT*	*CST*	*Other*	*Effective tax rate*
Auto						
Two wheeler/ three wheeler	13.5	–	12.5%	2%	–	30–31%
Four wheeler	13.5–29%	–	12.5%	2%	–	31–49%
CV	13.5%	–	12.5%	2%	–	30–31%
Batteries	12.5%	–	12.5%	2%	–	29–30%
Consumer		–			–	
FMCG		–			–	
Cigarettes	Depending on length	–	24%	2%	–	
Concessional goods	0–6%	–	4–12%	2%	–	6–22%
Others	12.5%	–	12.5%	2%	–	29–30%
Cement	@12%ad–valorem+Rs6/ bag specific– 30% abatement	–	12.5%		–	22–24%
Metals	12.5%	–	4–5%	2%	–	19–21%
Pharma	6%	–	4–5%	2%	–	12–14%
Capital goods–light electrical	12.5%	–	12.5%	2%	–	29–30%
Capital goods–project	7.2%	6%	7.5%	–	–	22%
Information technology	–	15%		–	–	15%
Textiles	0–12.5%		0–5%	2%	–	2–21%
Telecom	–	15%				15%
Logistics	–	15%				15%
Media	–					
Paytv broadcaster	–	15%				15%
Paytv distributor	–	15%				15%
Print media	–					
Multiplex	–	15%			24%	42–43%

GST is likely to bring a change in effective tax rates for most sectors. However, this would have a material implication only for those companies (a) that have the pricing power to retain the decrease or do not have the pricing power to pass on the increase in effective tax rates, or (b) where increase / decrease in consumer pricing would impact volume growth, and hence, corporate earnings.

(B) Shift of Trade from Unorganized to Organized

India has significant presence of the unorganized sector. A National Commission for Enterprises in Unorganized Sector (NCEUS) report estimates that in 2005, out of the 485m persons employed in India, 86% or 395m worked in the unorganized sector, generating 50.6% of the country's GDP. GST implementation is expected to narrow the large indirect tax differential between the organized and unorganized players. This would be achieved by ensuring better compliance and enforcement by (a) reducing the threshold limit for exemption from indirect taxes (to INR2.5m under GST from the current INR15m under excise), (b) tracking the flow of GST credit in the entire value chain using technology platforms, (c) ensuring availability of seamless input credit, and (d) reducing the overall effective tax rates.

(C) Seamless Availability of Input Credits

Under the current regime, the taxes levied by different levels of government /different states are not allowed to be set off against each other. For example:

a. Excise duty paid to the central government for manufacture of goods is not allowed to be set off against state VAT payable on sale of goods and vice versa.

b. In the service industry, companies have to incur service tax liability on sales. However, they also spend sizeable portions on capex on which they are charged VAT. Current regulations do not allow service tax to be set off against VAT and vice versa.

c. State VAT paid on inputs in one state is not available for set off if the output is sold in another state. However, on payment of CST on declared goods, a dealer can claim refund of VAT paid to the originating state in case of inter-state sale.

d. Central sales tax of 2% is a non-VA Table tax, and hence, increases the cost of goods.

e. Companies trading goods (retailers), which pay VAT, are not allowed to claim credit for the service tax paid on different items since they have no central tax against which this can be set off.

Unavailability of input credit makes the current system complex and inefficient,resulting in increased cost for businesses. This is likely to get addressed under GST when the plethora of multiple taxes is subsumed under a single tax

(D) Efficiency in supply chain management

Currently, decision making in supply chain management is based not only on business requirements but also on tax planning. The current legal framework exempts CST if interstate movement of goods is for stock transfer and not for sale. Consequently, in several sectors, companies open various depots and appoint C&F agents to avail this exemption and incur additional costs. Under GST, since CST is subsumed, supply chain management would become a pure play of business requirements. In several sectors, we expect consolidation of the current supply chain, leading to reduction in operational cost on the one hand and lower inventory carrying cost on the other. Logistics would emerge as a big sector, with consolidation in the industry. Implementation of GST may also be slightly negative for CV manufacturers, as this would help ease bottlenecks in logistics, especially time spent at check posts for local taxes. This would increase the on-road time for the fleet and enhance fleet productivity, diluting the need for fleet expansion and reducing CV growth over the medium term.

Economic Impact of GST

Approval of the GST constitution bill amendment has been the trigger for the financial markets though its initial impact on economic activity has only be mildly positive. But over the longer run it holds the potential to boost economic activity substantially, improve the government's revenue, and help achieve better transmission of prices.

Assuming that GST rate aligns with the revenue neutral rate, as is intended, the effective tax rate will come down, which will broadly offset the increase in tax base (since exemption list will be pruned) and most of high-taxes items will be excluded from GST (at least initially). However, as GST will help reduce tax evasion, prune exemption list and improve compliance, the receipts will increase over time

As far as the impact of GST on inflation is concerned, a moderate GST rate will help reduce wholesale price index (WPI), while the impact on consumer price index (CPI) will be limited. However, since services constitute a larger share in the consumption basket than in CPI, Indian consumers are likely to feel the pinch of higher prices of services after GST is implemented.

The only concern here is the exclusion of crude oil and petroleum products from GST in the initial period makes us skeptical of their inclusion later. This is because the central government's support to compensate the state governments for revenue loss will expire after five years.

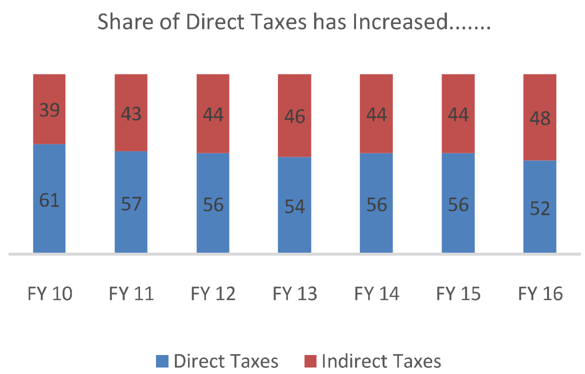
How will GST Impact Government Receipts?

Assuming that GST rate aligns with the revenue neutral rate, as is intended, the effective tax rate will come down, which will broadly offset the increase in tax base (since exemption list will be pruned) and most of high-taxes items will be excluded from GST (at least initially). However, as GST will help reduce tax evasion, prune exemption list and improve compliance, the receipts will increase over time. We also believe that the fear among states to lose out on revenue is misplaced.

India's tax-to-GDP ratio is one of the lowest among major emerging market economies. The tax elasticity has deteriorated considerably in the past few years. GST implementation is expected to increase overall tax collection by boosting economic allocation of various resources (helping to lift GDP growth) and reduce the incentive to evade taxes (helping to broaden the tax base).

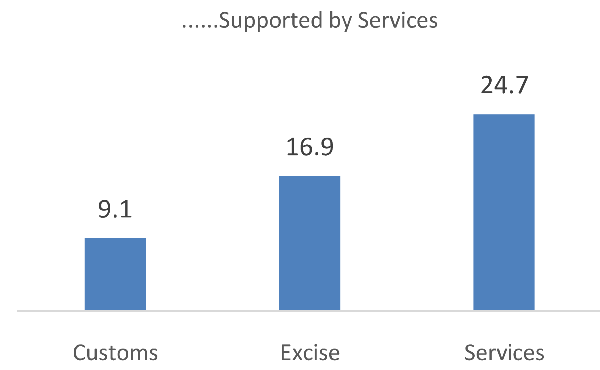
A look at the central government's tax collection shows that the share of indirect taxes has increased in the past few years, as economic slowdown has led to a deceleration in direct tax growth. H Exhibit below shows that the share of direct taxes has fallen from ~60% of total tax collection in FY10 to 52% in FY16. One could argue that higher tax rate on fuel products in FY16 helped indirect taxes (or excise duties) to post one-off high growth; nevertheless, as the exhibit shows, indirect tax receipts have been increasing their share consistently, making indirect taxes more important for the central government.

In exhibit below, we look at the three components of indirect taxes – customs duty, union excise duty and service tax. Service tax collection has grown at the fastest pace in the past five years. This is what has helped service taxes to increase their share in total indirect tax collection for the central government – up from 24% in FY10 to 30% in FY16.



Note: Indirect Taxes include customs, excise and services

Source: Budget Documents, Ministry of Finance



Note: Average growth rate in last 5 years

Source: Budget Documents, Ministry of Finance

TABLE 3

	FY 10	FY 13	FY 16
Services	24%	28%	30%
Customs	34%	35%	30%
Excise	42%	37%	40%

Source: Budget Documents, Ministry of Finance

Under GST, the most important thing to note is that the base will widen considerably. Currently, the central government has an extensive exemption list of 300 items as against 90 for most states. Together, this amounts to a loss of INR3.3t (or 2.7% of GDP). GST provides a historic opportunity to prune this exemption list. With GST, many services that are currently tax exempt will come under the tax bracket. Pruning of the exemption list will help the government to recoup a substantial portion of the INR3.3t losses. Also, the major high tax items such as alcohol, tobacco and petroleum products will not be excluded from GST (at least initially), implying that the loss of revenue from GST implementation will be limited. Nevertheless, if the government sticks to its idea of implementing a revenue neutral GST rate, it implies that the effective tax rate will come down. However, with better tax compliance, reduced tax evasion and pruned exemption list, tax collection will increase over time.

State Governments' Fear of Losing Tax Receipts Misplaced

Given all the benefits of GST, it is highly unlikely for governments to lose tax revenue. However, the focus of the state governments remains on insuring themselves against possible revenue loss – a myopic behavior, in our view. The central government has announced a number of other measures to provide comfort to state governments:

- Petroleum products are currently out of the GST ambit and will be included only at a later date (not decided yet).
- State excise duty on alcohol for human consumption and electricity duty on sale and consumption of electricity will not be subsumed under GST, to begin with.
- States may be allowed to levy excise duty or any other tax in addition to GST on tobacco and tobacco products.
- Under GST, unlike the current regime, states will receive a portion of total service tax collected by the center.
- Finally, even after all the factors stated above, if states incur revenue loss, the center has promised to compensate them for the first five years after GST implementation. (Till recently,

the center's intent was to give compensation in a tapering manner – 100% for first three years, 75% in the fourth year and 50% in the fifth year. However, the states are demanding full compensation or 100%compensation for the first five years).

Will Inflation Rise Post GST Implementation?

As far as the impact of GST on inflation is concerned, a moderate GST rate will help reduce wholesale price index (WPI), while the impact on consumer price index (CPI) will be limited. However, since services constitute a larger share in the consumption basket than in CPI, Indian consumers are likely to feel the pinch of higher prices of services after GST is implemented. GST will have differential impact on the wider spectrum of goods and services, as rates for many would change as a result of rationalization. In general, while primary agricultural goods are likely to stay exempted from GST (or taxed at lower rate), manufactured goods are likely to become cheaper, leading to a moderating impact on WPI

As far as the impact on consumer price index (CPI) is concerned, it is unlikely to be affected much, since food constitutes for almost half of the basket, and other items such as real estate and fuel also hold high weightage. Thus, a large part of CPI will either be exempted or continue to attract the same tax structure as under the current regime.

A recent government study says that about half of the CPI basket is not taxed, another one-third is actually taxed at a lower rate (less than 12.4%) and less than 20% is taxed at normal (12.4% to 29.4%) to high rate (above 29.4%). This is one of the key reasons why the average effective rate on consumption as measured by CPI is 10.4%. Excluding the items with high tax rates (such as alcohol, petrol, tobacco) and which will be outside the GST coverage, the effective tax rate drops to 7%. Further, under the current tax structure, almost 75% of CPI is exempt from excise, and 47% of the basket is exempt from sales tax (or VAT). The study says that ~54% of the CPI basket is likely to remain exempted from GST.

Importantly though, while services comprise a very small share in CPI, they account for almost 50% of the total consumption basket in the economy. Thus, while the impact of GST may not be visible in the official inflation measures, it will certainly pinch Indian consumers, as the share of services has been rising.

Finally, we have looked at how inflation has behaved in some of the economies after GST adoption. While the analysis may not hold in strict sense because of the differential tax structure in the pre-GST regime and different domestic structure, it is important to note that three of the four economies studied here witnessed a fall in CPI-based inflation. Nevertheless, this conclusion must be considered with caution.

Will GST Accelerate Growth?

One of key reasons why GST is expected to boost economic activity is input tax credit, which is not available under current regime on many transactions. For example, capital equipment acquired for use in transportation, infrastructure, distribution, or construction sectors is currently outside the scope of excise duty; hence, no input tax credits are allowed for union excise duties.

GST could provide for a more seamless and efficient crediting of taxes paid on capital goods, helping to reduce capital goods prices by 12-14%. Assuming a negative price elasticity of 0.5%, it implies an increase in demand for capital goods investment by 6-7%. Since machinery & equipment accounts for one-third of total investments, it implies an increase in investment by ~2%, which in turn could add 0.5 percentage points to GDP growth, assuming incremental capital output ratio of 4.

The often quoted NCAER estimate of 0.9-1.7% acceleration in GDP growth is highlighted as a potential benefit of removal of cascading of exports. Nevertheless, one of the key assumptions was an exemption-free GST, which does not seem to be the case now, and thus, the benefit could be lower. As noted by the RNR Committee, the quantitative impact of the current regime of zero taxation of exports and that under proposed GST is unclear.

A reflection on the major changes that may take place in the context of growth points to some likely gains as well as some speed breakers. While the growth acceleration would be a consequence of GST implementation, it is not germane to the process of tax changes.

Overall, investment is discouraged to an extent under the current tax regime, since no input tax credit is provided for several transactions. This increases the cost of capital goods and thus, reduces investment. If tax credits are provided efficiently under GST, it may help investments, and thus, GDP growth.

Key Challenges and Way Forward

The implementation of GST is likely to pose significant challenges. There could be a multi-year timeline for its final implementation. Not only is the legislative process at its early stage (constitutional amendment to be followed by at least half the states ratifying it to be followed by model CGST and SGST bills to be passed by respective legislatures), the subsequent process would also be elaborate. GST is still in its early stage of implementation and a fairly elaborate preparatory stage awaits us – both legislative and executive across states. While the implementation of GST is inevitable, it is not imminent.

GST Council: at the Heart of GST Implementation

The proposed GST Council is a decision making process that ensures near consensus for most aspects of GST, which at times may be highly contentious. The GST Council has its job– that involves critical architecture-related issues– cut out already. One of the key challenges of GST implementation would be drafting of places of supply rules, especially for the services sector. While GST has sorted out the issues relating to identification of manufacturing and services by clubbing the two, considerable work and agreement needs to be achieved for identification of origin and destination of services consumed. A careful drafting could avert a lot of litigation and transaction costs for corporate India in the future. Work on other issues relating to IT network design and implementation, staff training, dispute resolution, and transition issues are still ongoing.

GST Council Job Cut of

1. To select a Vice Chairperson of the Council for such period as they may decide
2. To develop procedure for the functioning of the Council
3. To decide on taxes to be subsumed
4. To decide on goods/services to be exempted
5. Model Goods and Services Tax Laws
6. Apportionment of IGST
7. Principles for ‘place of supply’ rules
8. Threshold limit of turnover for applicability of GST
9. Rates including floor rates with bands
10. Any special rates for specified period
11. Additional resources during natural calamity or disaster
12. Special provision for North-east and hilly states
13. Any other matter that the Council may decide
14. Date from which petroleum products would be brought under GST

TABLE 4

Some general challenges	*Sector specific challenges*
Define location of a business separately for registered and unregistered business	Telecom: Agreement for bandwidth/fibers laid across multiple states
Claiming of credit by unregistered business	Multi-location video conferencing
Services related to immovable property	Registration at multiple locations
Bifurcating single invoice across multiple states for tax payment	Ecommerce: How to decide taxability
Allocation rules for services involving multiple states with a consolidated bill	Passenger transport: Place of embarkation, return journey to be split
Transfer credit availed by central office on common purchases (capital, audit, advertisement, etc.) to locations of other states	Stock broking: Services to FIIs - an export of services
Determining place of supply for works contract involving movable goods	Insurance companies: Need registration at all states

15. To develop a harmonized market for goods and services
16. To recommend continuation of 1% additional tax on supply of goods beyond two years

"Place of Business" rules-one of the hardest challenges

Grandfathering of current location-based exemptions

Currently, there are various area-based indirect tax exemptions provided by both the central and state governments. With the dawn of GST, area-based exemptions will need to be phased out, as they break the free flow of input credits in the value chain. Our discussions with various experts suggest that there are three possible options to mitigate this problem and honor the Doctrine of Promissory Estoppel:

1. **Refund of duty**: Under this scheme, the entity currently exempt from payment of duty under various schemes will be liable to pay duties as required under the normal course of business. The duty so additionally paid will be refunded by the state/central government after assessment. Some states (J&K, northern states) follow this mechanism and provide refunds. Our discussions with experts suggest that though this mechanism is the most preferred, corporates may not find this agreeable, as there could be various complexities in assessment and additional working capital could be blocked due to delay in receiving refunds.
2. **Upfront payment:** Under this mechanism, the government pays the present value of estimated duty concessions agreed to the corporates upfront. Going forward, the entities pay taxes in the normal course of business. However, this will entail significant amount of cash outflow from the state / central government upfront, and hence, may be difficult to adopt.
3. **Deferral of payment of taxes**: Under this scheme, the entities eligible for exemption levy taxation as in the normal course of trade. However, the duty so collected is retained, as an interest-free tax deferral for a specified period.

CONCLUSION

GST will 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. The transparent and complete chain of set-offs which will result in widening of tax base and better tax compliance may also lead to lowering of tax burden on an average dealer in industry, trade and agriculture. The subsuming of major Central and State taxes in GST, complete and comprehensive set-off of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This is likely to increase the competitiveness of Indian goods and services in the international market and to boost Indian exports.

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