Implementation of VAT and its impact on State’s Revenue

VAT Implementation:

Pursuant to the decision taken by the Empowered Committee of State Finance Ministers and based on national consensus, Value Added Tax (VAT) was introduced in Orissa w.e.f. 1.4.2005 by replacing the erstwhile Sales Tax Act. The VAT scheme immediately expanded the tax base after its inception due to the fact that it eliminates cascading i.e. tax on tax because of set off tax paid on inputs and capital good. Reduction in cost of domestic product because of inbuilt system of input tax credit makes domestic products competitiveness, helps growth of industries, increases marketability of products having perspective impact on employment generation. Now, the VAT system has been stabilized further in the sphere of almost all economic activities in the State. The State has achieved a healthy growth rate of tax revenue collection at 22.12% during 2005-06, 21.57% during 2006-07 and 13.19 % during 2007-08 (upto Feb-2008). The State has not claimed any compensation from the Centre during 2005-06, 2006-07 and 2007-08.

Status of VAT Collection:

The collection under the VAT Act during 2007-08 stands at Rs.2908.26 crore (upto Feb-2008) as against Rs. 3089.09 crore during the year 2006-07. The comparative position of tax collection since 01.04.2006 upto 31.03.2008 under VAT regime is given below:

<table>
<thead>
<tr>
<th>Month</th>
<th>Collection during 2005-06 (under VAT regime)</th>
<th>Collection during 2006-07 (under VAT regime)</th>
<th>Percentage (%) of Growth Col.5/ Col.3</th>
<th>Collection during 2007-08 (under VAT regime)</th>
<th>Percentage (%) of Growth Col.5/ Col.3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross Collection</td>
<td>Progressive Collection</td>
<td>Gross Collection</td>
<td>Progressive Collection</td>
<td>Col.5/ Col.3</td>
</tr>
<tr>
<td>April</td>
<td>78.23</td>
<td>78.23</td>
<td>88.28</td>
<td>88.28</td>
<td>12.85</td>
</tr>
<tr>
<td>May</td>
<td>91.23</td>
<td>169.46</td>
<td>218.87</td>
<td>307.15</td>
<td>81.26</td>
</tr>
<tr>
<td>June</td>
<td>269.58</td>
<td>439.04</td>
<td>252.92</td>
<td>560.06</td>
<td>27.57</td>
</tr>
<tr>
<td>July</td>
<td>196.66</td>
<td>635.70</td>
<td>252.98</td>
<td>813.05</td>
<td>27.90</td>
</tr>
<tr>
<td>August</td>
<td>192.28</td>
<td>827.98</td>
<td>239.70</td>
<td>1052.80</td>
<td>27.15</td>
</tr>
<tr>
<td>September</td>
<td>196.54</td>
<td>1024.52</td>
<td>232.59</td>
<td>1285.39</td>
<td>25.46</td>
</tr>
<tr>
<td>October</td>
<td>197.67</td>
<td>1222.19</td>
<td>233.68</td>
<td>1519.07</td>
<td>24.29</td>
</tr>
<tr>
<td>November</td>
<td>201.09</td>
<td>1423.28</td>
<td>229.72</td>
<td>1748.79</td>
<td>22.87</td>
</tr>
<tr>
<td>December</td>
<td>204.88</td>
<td>1628.16</td>
<td>248.30</td>
<td>1997.09</td>
<td>22.66</td>
</tr>
<tr>
<td>January</td>
<td>232.46</td>
<td>1860.62</td>
<td>272.92</td>
<td>2270.02</td>
<td>22.00</td>
</tr>
<tr>
<td>February</td>
<td>247.19</td>
<td>2107.81</td>
<td>298.39</td>
<td>2568.41</td>
<td>21.85</td>
</tr>
<tr>
<td>March</td>
<td>433.97</td>
<td>2541.78</td>
<td>520.74</td>
<td>3089.09</td>
<td>21.57</td>
</tr>
<tr>
<td>Total</td>
<td>2541.78</td>
<td>166</td>
<td>3089.09</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
CST Collection:
The collection under the CST Act during 2007-08 (upto Feb-2008) stands at Rs. 481.09 Crore as against Rs. 722.48 Crore during the year 2006-07 recording a growth rate of -18.65% (upto Feb-2008). Rate of CST was reduced from 4% to 3% w.e.f 1.4.07 as a part of CST phasing out. Consequently there has been a decline in collection on CST. As Government of India assured for full compensation of CST loss, claim of Rs. 202.56 Crore has been made upto Dec, 2007. Government of India has already released Rs. 131.56 Crore upto October, 2007.

The total collection under all Acts (VAT, CST, Entry Tax, Profession Tax, Entertainment Tax, Luxury Tax) during 2007-08 (upto Feb-2008) is Rs. 4001.91 Crore as against Rs. 4458.88 Crore during the year 2006-07 recording a growth rate of 8.07% (upto Feb-2008).

Registration of the Dealers:
The total number of dealers as on 1.04.07 was 106680 (TIN-81061+SRIN 25619). During the period from April to December 07, 6608 TIN dealers and 1246 SRIN dealers have been registered and during the same period, Registration Certificates of 580 TIN dealers and 259 SRIN dealers have been cancelled. Hence, the balance number of the dealers as on 1st January 08 is 113695 (TIN 87089+SRIN26606).
A ROAD MAP TO GOODS AND SERVICES TAX (GST) IN INDIA

1. Introduction

Introduction of the Value Added Tax (VAT) at the Central and the State level has been considered to be a major step- an important breakthrough- in the sphere of indirect tax reforms in India. If the CEN VAT and VAT are a major improvement over the pre-existing Central excise Duty at the national level and the sales tax system at the State Level respectively then the Goods and Services Tax (GST) will indeed be a further significant improvement – the next logical step – towards a comprehensive indirect tax reforms in the country encompassing both commodity and services tax under a full fledged destination based VAT regime. The central focus of the transition to GST is to introduce an efficient, effective and tax payer-friendly system of taxation of goods and services in the country, in line with international best practices as well as the special characteristics of the Indian economy. Keeping this objective in view, an announcement was made by the Union Finance Minister in the context of Budget 2007-08 to the effect that GST would be introduced w.e.f. 1st April, 2010.

2. Concept of GST

GST is a comprehensive value added tax on goods and services. It is collected on value added at each stage of sale and purchase in the supply chain without state boundaries. In GST structure, different stages of production and distribution are interpreted as a mere tax pass-through, and the incidence of tax is essentially borne by the final consumer within a taxing jurisdiction.

If GST in its real form is implemented in the Indian context, it would integrate all taxes currently levied in India by Central and State Governments on goods and services like excise duty, service tax, entry tax or octroi, state excise, countervailing custom duty, telecom license fee, luxury tax, tax on consumption/sale of electricity, entertainment tax etc.

3. Why GST is a preferred tax structure?

- G.S.T. is quite a simple tax structure because under GST just one or two rates are charged on all goods and services and it is a uniform single tax across the entire supply chain.
• GST increases tax revenue due to wider base & better compliance. GST allow full credit for all input taxes across supply chain and across states within a tax jurisdiction.
• GST structure promotes exports on account of its zero rating and refund of tax paid on inputs used in export production and services exports.
• It reduces distribution cost as there is no tax barrier in GST for inter-State movement of goods, which encourages state wise branches and depots involving additional supply chain cost.
• GST is unbiased tax as it is neutral to business processes, business models, organization structure, product substitutes and geographic locations.

4. GST : The Global Scenario –

More than 140 countries have introduced GST/National VAT in some form. While country, such as Singapore virtually taxes everything at a single rate, some countries have more than one rate (a zero rate, certain exemptions and higher and lower rates). In some countries, it is recoverable only on goods used in the production process and specified services. The standard GST rates in most of the countries ranges between 15% to 20%. In Scandinavian countries (North Europe) where social security coverage is higher, it ranges between 22 to 25%.

In India, the standard rate of excise duty is 16% on manufacturer’s sale price. In addition, there is a state VAT at 4% and 12.5%. Therefore, the aggregate peak rate of taxes works out to 22% on retail sales price or at consumption level with standard rate of excise duty. At a lower end with 4% VAT it works out to 13.5%. It is therefore, feasible to fix tax neutral GST rate of 20% (less, if existing duty exemptions are reduced).

5. Justification of GST in Indian Context

Despite the success with VAT, there are still certain shortcomings in the structure of VAT both at the Central and the State level. The deficiency in CENVAT of the Government of India lies in non-inclusion of several Central taxes in the overall framework of CENVAT, such as, additional customs duty, surcharges, etc; and thus keeping the benefits of comprehensive input tax and service tax set-off out reach for manufactures / dealers. Moreover, no step has yet been taken to capture the value-added chain in the distribution trade below the manufacturing level in the existing scheme of CENVAT, resulting in a significant loss of opportunity of revenue gain for the Centre.
introduction of GST at the Central level will not only include comprehensively more indirect Central taxes and integrate goods and service taxes for the purpose of set-off relief, but may also lead to revenue gain for the Centre through widening of the dealer base by capturing value addition in the distributive trade.

In the existing State-level VAT structure, there are, even now, several taxes which are in the nature of indirect tax on goods such as, luxury tax, entertainment tax, etc. and yet not subsumed in the VAT for set-off relief. Moreover, in the present State-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under State VAT, and contributing to that extent a cascading effect on account of CENVAT element. This CENVAT load needs to be removed. Furthermore, any commodity, in general, is produced on the basis of physical inputs as well as services, and there should be integration of VAT on goods with tax on services at the State level as well. This is the essence of GST, which will be a further improvement on goods-based VAT in the State. However, for this GST to be introduced at the State-level, 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 necessary for giving this power also to the States. The GST at the State-level is, therefore, justified for (a) comprehensive set-off relief (involving goods as well as services) for trade, industry and agriculture, (b) removal of cascading effect of CENVAT load and (c) additional power of taxation of services of the States.

The GST at the Central and State-level will thus give more relief to trade, industry and agriculture through a more comprehensive and wider coverage of input tax and service tax set-off relief, further removal of cascading effects and more powers of taxation to the Central and the States. If this GST is properly formulated with appropriate calculation of rates, then there may eventually be revenue gains for both the Central and the States. If the potentiality of these revenue gains is significant, there may also be a likelihood of reduction of the overall incidence of taxes from the existing level, and yet retaining the revenue gains. This possibility of reduction of this overall incidence of taxes may mean a gain to trade, industry and consumers. In other words, there is a possibility of a collective gain for the Centre, the States, trade, industry, agriculture and also the common consumers.
6. **Goods & Services Tax Model For India**

It is important to take note of the significant administrative issues involved in designing an effective GST model in a federal system with the objective of having a harmonious market. Together with this, there is a need for preserving the sovereign powers of Central and State Governments in their taxation matters. To fulfill these objectives there is a need is to propose a model that would be easily implementable, while being generally acceptable to all the stake holders.

**6.1. Salient features of the GST Model being worked out by the Empowered Committee**

Keeping in view the report of the Joint Working Group on Goods and Services Tax and the views received from the States a dual GST with defined functions and responsibilities of the Centre and the States is recommended. Salient features of the proposed model are as follows.

(i) The GST shall have two components : one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States and Union Territories (UTs) (hereinafter referred to as State GST). Rates for Central GST and State GST should be prescribed separately, reflecting revenue considerations and acceptability.

(ii) The Central GST and the State GST should be applicable to all transactions of goods and services. HSN classification for goods should be used both for the Central GST and the State GST. A classification for services should be evolved by examining international practices, keeping, at the same time, in view the particular characteristics of India's services sector.

(iii) The Central GST and the State GST should be credited to the accounts of the Centre and states separately.

(iv) Since the Central GST and State GST are to be treated separately, taxes paid against the Central GST shall be allowed to be taken as input tax credit (ITC) for the Central GST and could be utilized only against the payment of Central GST. The same principle will be applicable for the State GST.

(v) Cross utilization of ITC between the Central GST and the State GST should not be allowed.

(vi) Ideally the problem related to credit accumulation on account of refund of GST, in the particular cases where input tax exceeds output tax, should be avoided both by the Centre and the States.
(vii) Procedures for collection of both the Central GST and State GST should be uniform.

(viii) Under the proposed model, the productive / distribution chain for goods with regard to manufactures having gross turnover of more than Rs. 1.5 crores would belong to both the Centre and the State. However, keeping in view the prevailing tax payer bases and the availability of the administrative machinery with the Centre and States, the remaining tax payers for goods will be assigned exclusively to the States for the purposes of registration, collection, ITC matters etc for both the Central GST and the State GST.

(ix) The present thresholds prescribed in the state VAT Acts below which VAT is not applicable (which varies from state to state), may also be adopted under the GST.

(x) The taxpayer would need to submit one periodical return (i.e, the same document), with one copy given to the Central GST authority, the other to the State GST authority concerned.

(xi) Each taxpayer should be allotted a PAN based taxpayer identification number, with two additional digits to distinguish between states, and another digit to distinguish between the Central GST and the State GST, i.e. a total of 13 digits. This would bring the GST PAN based system in line with the prevailing PAN based system for Income tax, Excise duty and Service tax, facilitating data exchange and tax payer compliance.

(xii) Keeping in mind the need of tax payers convenience, functions such as assessment, enforcement, scrutiny and audit should be undertaken by the authority which is collecting tax, with information sharing between the Centre and the States.

(xiii) Composition /Compounding Schemes for the purpose of GST should be designed keeping in view the present threshold limits followed by different states under VAT.

6.2. Central and State Taxes to be subsumed under GST

The 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.

(i) Taxes or levies to be subsumed should be primarily in the nature of indirect taxes, either on the supply of goods or on the supply of services.
(ii) Taxes or levies to be subsumed should be part of the transaction chain which commences with import/ manufacture / production of goods or provision of services at one end and the consumption of goods and services at the other.

(iii) The subsumation should result in free flow of tax credit at intra and inter State levels.

(iv) The fees that are not specifically related to supply of goods & services should not be subsumed under GST.

(v) Revenue fairness for both the Union and the states individually would need to be attempted.

(a) On application of the principle, it is recommended that the following Central Taxes should be subsumed under the Goods and Services Tax:

(i) Central Excise Duty
(ii) Additional Excise Duties
(iii) Service tax
(iv) Additional custom duty, commonly known as countervailing duty (CVD)
(v) Surcharges
(vi) Ideally, Cesses should also be merged with the GST. However, keeping in view the specific needs of the concerned Ministries, it was decided that for the time being these levies may not be included in the GST.

(b) Following State taxes and levies should be subsumed under GST.

(i) VAT / Sales tax
(ii) Entertainment tax (unless it is levied for the local bodies)
(iii) Luxury tax
(iv) Taxes on lottery, betting and gambling.
(v) State Cesses and Surcharges in so far as they relate to supply of goods and services.
(vi) Entry tax not in lieu of octroi.

State Taxes proposed to be kept outside the preview of GST

Some of the States are levying purchase tax, octroi or entry tax in lieu of octroi. Ideally all these should also be subsumed under GST. However, keeping in view the specific
requirements of the concerned States and the interest of the local bodies, it was decided that for the time being these taxes may not be included in the GST.

**Tax on items containing Alcohol** : Considering the requirements of several States, alcoholic beverages may not be brought under the GST.

**Tax on Tobacco products** : Tobacco products should be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST without ITC.

**Tax on Petroleum Products** : In view of the requirements of the States as well as the Centre, out of the basket of petroleum products, Crude, Motor Spirit (including ATF) and HSD may be kept outside GST, as is the prevailing practice in India.

**Taxation of Services** : With regard to taxation of services, it is proposed that the States should be given the power to levy taxes on all services. Regarding the collection of services taxes, the States may collect taxes on services of intra-state nature both for Central GST and State GST. Similarly the Centre may collect tax for services of interstate nature both for Central GST and State GST. An arrangement to transfer the Central portion of GST on inter-state services to the Centre, and the State portion of the GST on the inter-state services collected by the Centre to the States, may be worked out based on the destination principle.

### 6.3 Number of Tax Rates

Considering the economic reality of the country and the fact that certain categories of goods and services may need to be taxed at a rate lower than the standard rate, it is recommended that there should be standard and a lower rate. A significant lower rate could be assigned for precious metals, jewellery, stones and diamonds.

**Rates of Central GST and State GST** : Rates of Central-GST and State-GST: The required rate of tax has to be worked out in accordance with the tax base. The calculations would have to be done separately for the Centre and the States on the basis of a transparent methodology jointly worked out by the Centre and the States.

**Zero Rating of Exports** : Export should be zero-rated. Similar benefits may be given to SEZs. However, such benefits should only be allowed to the processing zones of the Special Economic Zones (SEZ). No benefit to the sales made from a SEZ to Domestic Tariff Area (DTA) should be allowed.

### 6.4 Inter-State Transaction of Goods

The following mechanism has been proposed to be put in place to deal with inter-state transactions of goods, based on the existing vast banking network that widely utilizes information technology (IT) :
(a) The seller in the exporting State (say State A) collects GST for inter-State GST transaction from the importer i.e. the purchasing dealer in the importing State (say State B). This GST is collected at the applicable rates for both the Central and the State GST.

(b) The seller makes a monthly deposit of the GST collected for inter-state transaction in a designated bank to the credit of the respective State Government, i.e. State B in present case. The seller would provide details of all transactions, including details of purchasing dealers, to the bank.

(c) This information would be available also to the State B Government automatically though a GST portal where the bank of State A uploads the information.

(d) The purchasing dealer in State B claims ITC on the basis of a digitally signed (by the bank of State A) invoice /challan when the files his tax return. The State B grants ITC on the basis of the credit received by it from the bank.

(e) The Central and state authorities can access information regarding all inter-state dealers/ transactions and tax payment from the GST portal.

(f) If the State B purchaser is a non-dealer, then the money deposited in the State B Government account will remain with that Government since ITC will not be claimed by the purchaser.

   The advantages of this system are : (1) there is no paper declaration forms; (2) cross checking by the administration is not required; (3) there is a safe transaction with little possibility of revenue loss for the importing or exporting states; (4) fund transfers from one Government to another is not required; and (5) revenue of the importing State is not subject to control of the exporting State.

6.5 Tax Exemptions

Various tax exemptions have been granted both by the Centre and States to achieve objectives of promoting a particular sector, or to reduce tax burden on a particular segment of society in the interest of fairness or to promote a particular economic activity etc. Tax exemptions have the effect of narrowing the tax base and increasing the administrative and compliance cost of GST. Therefore, it is felt that exemptions should be minimized. Direct and transparent subsidies, instead of tax exemptions, are more efficient way to achieve the targeted objective. It is recommended that apart from a dual rate GST structure at the Central and the State levels, there should be a common exemption list. Further, specific provisions to
provide limited flexibility to the States within a set of prescribed criteria may need to be incorporated, as in the prevailing VAT structure, in order to accommodate exemption of goods of local importance. Similar limited flexibility would need to be provided to the Centre to address exceptional situations such as natural disasters.

6.6 Special Industrial Area Scheme

All states have discontinued their incentive schemes for industries with effect from January 1, 2000. However, incentives granted earlier have continued. Similarly, the Central Government need to discontinue the practice of area/industry based tax incentives. After the introduction of GST, the exemption schemes should be converted, if at all needed, into cash refund schemes after collection of tax. The burden of incentives must fall only on the particular State or the Centre granting the incentives, while the GST scheme should remain unaffected.

6.7 Advance Ruling

Advance ruling and dispute resolution authorities should be set up by the Centre and States to ensure uniformity and fairness in decision-making.

6.8 Joint Authority and Legislation

The authority to amend the common exempted list and the common composition scheme should rest with a joint authority of Central and State Governments to ensure that no single State or Central Government amends either of these unilaterally.

6.9 IT Infrastructure

The success of the GST largely depends upon IT infrastructure available for collection, compilation and exchange of data at the shortest possible time. IT infrastructure with national coverage and extensive reach is critical for the successful implementation of GST. For this, an initiative at the Central Government level needs to be taken in order to put in place a strong IT infrastructure.

7. Roadmap

A roadmap detailing the preparation until the introduction of GST is presented in Table given below.