International Journal of Multidisciplinary Approach and Studies
ISSN NO:: 2348 – 537X

Overview of Indirect Taxes and Goods and Services Tax in India

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INTRODUCTION:

Tax systems have gone through substantial changes throughout the world as countries strive to keep a competitive economy and meet the development needs. Similarly, the tax policy in India changed in response to the development strategies of the country. Initially, the tax policy was a result of the demands put on the government to save for and then invest on the economy. However, it put a lot of pressure on the country's citizens with little regard to who can actually pay or afford the tax. Now, as consumers are more aware and have more power to voice their opinions, tax reforms are made to keep consumers at the center. One such reform is the Goods and Services Tax (GST) being introduced by the central government. However, before we go on to understand what GST is it is best to understand the current Indian tax system and how GST will help the consumers and the government in keeping the economy competitive.

Current taxation system - Indirect Taxes

Indirect Tax can be definedin different ways. In vernacularterm, an indirect tax can be defined as the charge that is paid by one individual at first, but the burden of which will be passed over to some other individual. In other way, it is the amount collected by an intermediary (like a restaurant) from the person whoholds the actual economic burden of the tax (like customer). The intermediary files a tax return and eventually passes to the government.

TheIndian Indirect tax system is multi-layered and complex, withlevies both at the Nationaland State level. The Central government impose tax on goods atvarious levels like at the point of manufacture (Excise duty), import (Customs duty) etc. The states, on the other hand, levy tax on sale of goods within the boundaries of the state (Sales tax/Value Added Tax or VAT) as well as on the entry of goods into the state (Entry tax).The situation becomes complex for businesses to carry careful upfront analysis of the various tax costs involved in a transactionand at the same time ensure adequate backup documentation to support their tax positins and to constantly explore opportunities for tax optimization.
There are majorly five different types to indirect taxes.

Service Tax

Levied by the government, service tax is a tax on service providers on certain service transactions, but is actually borne by the customers. As described above, being an indirect tax, the service provider though pays the tax it recovers the paymentfrom the customer. This tax was earlier levied only on a specified list of services but its scope was increased in the 2012 budget wherein the services provided by air-conditioned restaurants and

accommodation provided by hotels etc. were also included in the list.The tax is charged to an individual service provider on cash basis, and to companies on accrual basis[2].
Generally,a uniform rate of 14%, from 01-04-2015, is charged by theService Provider from recipient except in cases where the liability is split between the provider of servicer and the recipient of service.For example, in restaurants, the tax is charged on only 40% of the bill as the Government assumes that the total bill consists of 40% service and 60% materials.Also, if the total turnover did not cross Rs. 1 million in the previous Financial Yearan exemption is provided.

Excise

In contrast with cusom duties, that is charged on goods from outside country, an excise or excise tax or excise duty is a type of tax charged on goods produced within the country.It is imposed on the manufacturer or producer,by the government,on the production of items. As the liability to pay is always on the manufacturer or producer of goods it is normally added to the cost of goods, and is collected by the manufacturer from the buyer of goods. However, the incidence of duty is deliberated to the clearance of goods from factory or approved warehouse implying that the duty is payable as the manufactured goods leave the Warehouse or the Factory.This tax is now known as the Central Value Added Tax (CENVAT).

Customs

Custom Duty is imposed under the Indian Customs Act formulated in 1962. The Act was introduced to allow the Central Government to collect the taxes for goods that are manufactured or produced outside the country. Custom Duties are usually levied with ad valorem rates with their base determined by the domestic value - the imported goods calculated at the official exchange rate. In a similar way, export duties are imposed on export values expressed in domestic currency. This tax was implemented to promote markets within the country.

VAT

Value-Added Tax collected on consumer spending by VAT-registered traders on their goods and services within a State. Usually, each such trader, in the supply chain, that is from manufacturer to retailer, charges VAT on his or her sales and is in turn entitled to deduct, from this amount, the VAT paid on his or her purchases.One way that this tax is different from others is that it is levied at multiple points and collected on the value added to the good at different stages of sale. It is therefore a method of taxing by stages.

Octroi/Entry tax

As goods enter a state, they are charged with some tax by the state. In other words, Entry tax/Octroi is levied by the State or Local authorities on the entry of goods within its jurisdiction, for reasons like consumption or sale on the purchase value of the goods. The value of the entry tax levied on different products can vary from state to state and act as a big amount of revenue generation for a few.

Other significant indirect taxes

- Stamp duty
- Profession tax

- STT
- Luxury tax
- Property tax
- Entertainment tax

HOW ARE IT CALCULATED/LEVIED

To have a deeper understanding on indirect tax, a small calculation is shown below:
Lets say that a wholesaler purchases 10 meters of cloth from the manufacturer at the rate ofRs. 90 per meter and sells to the retailer after adding value of Rs. 30 per meter. The retailer sells the cloth and makes a profit of Rs.60 per meter. In this scenario, calculating the total tax paid to the Government with VAT applied at the rate of 10% we get,
Wholesaler's Cost Price = Rs.10 × 90 = Rs.900
VAT = 10% of 900 = Rs. 90
Total = Rs.996
Value added by wholesaler = Rs. 10 × 30 =Rs.300
VAT = 10 % of 300 = Rs. 30
Retailer's cost = Rs.1326 (996+300+30)
Value added by retailer = Rs.10× 60 = Rs.600
VAT = 10 % of600 = Rs. 60
∴Net selling price = Rs. 1986(1326+600+60)
Total Tax paid = Rs. [90 + 30 + 60] = Rs.180

It is evident that the tax is levied at various stages. Moreover, this is a very simple scenario wherein only VAT is being calculated. In majority of the cases, other taxes like Entry tax et.al are levied by the state. Moreover, one can see that as VAT is applicable at each stage, tax is levied over tax. This is one of the biggest disadvantages of Indirect taxes that GST strives to remove.

GST

The acronym for "Goods and Services Tax", GSTis proposed to be anall encompassing tax levy on manufacture, sale as well as consumption of goods in addition toservices at the national level. It will replace all indirect taxes levied on goods and services by the Indian Central and State governments.

The Bill

Officially, The122nd GST Constitution Amendment Bill ('Bill') was introduced in the Lok Sabha on December 19, 2014 by Finance Minister Arun Jaitley. The bill was approved on May 6th 2015 and is a landmark achievement for the Government.The Bill seeks to introduce a goods and services tax (GST) which will subsumevarious Central indirect taxes, including the Central Excise Duty, Countervailing Duty, Service Tax, etc. It will also subsumethe value added tax (VAT), Octroi /entry tax, luxury tax, etc. levied by the State. The Bill also strives to establish a GST Council with the objective of optimising tax collection for goods and services by the Centre as well as the State. The Council will have the Union Finance Minister as Chairman, the Union Minister of State in charge of revenue or Finance, and the Minister in charge of Finance or Taxation, nominated by each State government.The GST Council will decide whichall taxes levied by the Centre, States will be a part of the GST; which goods and services will be subjected to GST; and the rates and the basis at which GST will be applied.Liquor or Alcohol for human consumption is exempted from or not included in the GST. Moreover, the GST Council will also decide when GST would be levied on the different categories of fuel, like crude oil and petrol.The Centre will levy an additional 1%tax on the supply of goods in the course of inter-State trade, which will go to the States for two years or till when the GST Council decides.Parliament can decide on compensating States for up to a five-year period if States incur losses by implementation of GST.[4]

Why GST

By removing the cascading effect of tax on tax,one of the biggestadvantage of GST would be a lower tax burden for businesses. In the current system, as mentioned above, a manufactured good first attracts excise duty and subsequently sales tax is imposed on it. The latter tax is hence imposed on the price of a good that is already inclusive of excise duty, making it a tax on tax. The GST will put an end to this for it will be one single tax that will be imposed only once on the price of a good. Moreover, the final consumer will bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.Under the GST structure, every company gets a deduction on the taxes already paid by its suppliers. That results in every buyer ensuring that his supplier has paid his part to claim his deductions.[5]

The GST concept has traversed a long road in accommodating States' concerns over erosion of fiscal autonomy and revenue loss. From what originally began as a single, harmonized levy, the present Bill proposes a three-layersystem of Central GST, State GST as well as an Integrated GST. Though the first two will be levied on the same set of goods and services, implying that the States get their part without any issues, the third, levied on inter-State transfers, will be collected by the Centre and will be shared with the States. The GST Council as mentioned above law will figure out the rates. The Bill should stick to its mandate of encompassing almost all Central and State leviesarriving at a simple rate structure — one thatgives boostto economic growth instead of focussing on just short-term revenues. The Bill also provides States with flexibility to raise taxes in order to deal with contingencies. This leaves little reason for States to complain, especially now that the 14th Finance Commission award is also taken into consideration.By creating a common market for seamless movement of goods and services,the Bill, will make India business friendly, moreso if it is accompanied by steps to simplify procedures and ensure contract enforcement.

There are, however, certain state specific issues. By becoming a comprehensive tax, many states fear that they will lose revenues once some of the major indirect tax levies get subsumed under GST.For instance, Maharashtra, earns more than 13,000 crore annually from octroior Entry tax. Gujarat, on the other hand, earns about 5,000 crore from the CST. Agrarian states such as Punjab and Haryana earn more than 2,000 crore from purchase tax. The Center is still working on provisions of compensation to such States if required. The compensation will come with a clause of five years.In the first three years, the Centre will reimburse a hundered percent of the revenue loss. In the fourth year, the Centre will reimburse seventy-five percent of the loss and in the fifht year, about fifty percent of the revenueloss due to GST. Moreover, as mentioned above, Sates will be allowed to collect an additional tax of 1% above the GST for goods that enter the state for a maximum period of two years. [6]

CONCLUSION

As evident above, GST offers multiple benefits over the current tax model in India. Though it has a long way to go in terms of getting approved, once implemented, it will surely be a relief for all businesses from the current complex system.

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