

## How does GST work?

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### What is GST?

**GST** stands for Goods and Service Tax. It is not simply VAT plus service tax, but a major improvement over the previous system of VAT and disjointed services tax. GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point upto the retailer's level. It is essentially a tax only on value addition at each stage, and a supplier at each stage is permitted to set-off, through a tax credit mechanism, the GST paid on the purchase of goods and services as available for set-off on the GST to be paid on the supply of goods and services. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

### How does it work?

The illustration shown below indicates, in terms of a hypothetical example with a manufacturer, one wholesaler and one retailer, how GST will work. Let us suppose that GST rate is 10%, with the manufacturer making value addition of Rs.30 on his purchases worth Rs.100 of input of goods and services used in the manufacturing process. The manufacturer will then pay net GST of Rs. 3 after setting-off Rs. 10 as GST paid on his inputs (i.e. Input Tax Credit) from gross GST of Rs. 13. The manufacturer sells the goods to the wholesaler. When the wholesaler sells the same goods after making value addition of (say), Rs. 20, he pays net GST of only Rs. 2, after setting-off of Input Tax Credit of Rs. 13 from the gross GST of Rs. 15 to the manufacturer. Similarly, when a retailer sells the same goods after a value addition of (say) Rs. 10, he pays net GST of only Re.1, after setting-off Rs.15 from his gross GST of Rs. 16 paid to wholesaler. Thus, the manufacturer, wholesaler and retailer have to pay only Rs. 6 (= Rs. 3+Rs. 2+Re. 1) as GST on the value addition along the entire value chain from the producer to the retailer, after setting-off GST paid at the earlier stages. The overall burden of GST on the goods is thus much less. This is shown in the table below. The same illustration will hold in the case of final service provider as well.

Table

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

### **Which central taxes are proposed to be subsumed under GST?**

The following Central Taxes should be, to begin with, subsumed under the Goods and Services Tax:

- ++ Central Excise Duty
- ++ Additional Excise Duties
- ++ The Excise Duty levied under the Medicinal and Toiletries Preparation Act
- ++ Service Tax
- ++ Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- ++ Special Additional Duty of Customs ++ 4% (SAD)
- ++ Surcharges, and
- ++ Cesses.

### **Which state taxes are proposed to be subsumed under GST?**

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

- ++ VAT / Sales tax
- ++ Entertainment tax (unless it is levied by the local bodies).
- ++ Luxury tax
- ++ Taxes on lottery, betting and gambling.
- ++ State Cesses and Surcharges in so far as they relate to supply of goods and services.
- ++ Entry tax not in lieu of Octroi.

### **What is the taxable event?**

Taxable event for the GST is at the point of sale of goods and services only by the Centre.

### **What is the fate of Central Sales Tax?**

CST will be abolished in the GST regime.

### **Would there be purchase tax?**

It is not clear as of now. In case Purchase Tax has to be subsumed then adequate and continuing compensation has to be provided to such States. This issue is being discussed in consultation with the Government of India.

### **How to utilize the input tax credit (ITC)?**

Since the Central GST and State GST are to be treated separately, in general, 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.

#### **Will cross utilization of credits between goods and services be allowed under GST regime?**

Cross utilization of credit of CGST between goods and services would be allowed. Similarly, the facility of cross utilization of credit will be available in case of SGST. However, the cross utilization of CGST and SGST would generally not be allowed except in the case of inter-State supply of goods and services under the IGST model which is explained in answer to the next question.

#### **How is the location of the supplier and the recipient relevant?**

The location of the supplier and the recipient within the country is immaterial for the purpose of CGST. SGST would be chargeable only when the supplier and the recipient are both located within the State.

#### **How would a particular transaction of goods and services be taxed simultaneously under Central GST (CGST) and State GST (SGST)?**

The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services. Further, both would be levied on the same price or value unlike State VAT which is levied on the value of the goods inclusive of CENVAT.

#### **Illustration:**

Suppose hypothetically that the rate of CGST is 10% and that of SGST is 10%. When a wholesale dealer of steel in Uttar Pradesh supplies steel bars and rods to a construction company which is also located within the same State for, say Rs. 100, the dealer would charge CGST of Rs. 10 and SGST of Rs. 10 in addition to the basic price of the goods. He would be required to deposit the CGST component into a Central Government account while the SGST portion into the account of the concerned State Government. Of course, he need not actually pay Rs. 20 (Rs. 10 + Rs. 10 ) in cash as he would be entitled to set-off this liability against the CGST or SGST paid on his purchases (say, inputs).

#### **How will be Inter-State Transactions of Goods and Services be taxed under GST in terms of Integrated GST ( IGST) method?**

The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases.

#### **How will GST benefit the small entrepreneurs and small traders?**

The present threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. The existing threshold of goods under State VAT is Rs. 5 lakhs for a majority of bigger States and a lower threshold for North Eastern States and Special Category States . A uniform State GST threshold across States is desirable and, therefore, the Empowered Committee has recommended that a threshold of gross annual turnover of Rs. 10 lakh both for goods and services for all the States and Union Territories . The threshold for Central GST for goods may be kept at Rs.1.5 crore and the threshold for services should also be appropriately high.

#### **How will GST benefit the exporters?**

The subsuming of major Central and State taxes in GST, complete and comprehensive setoff of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports.

#### **How will imports be taxed under GST?**

With constitutional amendments, both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import on goods and services.

#### **Will there be any concept of manufacture?**

The concept of manufacture may simply vanish.

### **Are the procedures common for the state and central GST?**

To the extent feasible, uniform procedure for collection of both Central GST and State GST would be prescribed in the respective legislation for Central GST and State GST.

### **How to submit the periodical returns?**

The taxpayer would need to submit periodical returns to both the Central GST authority and to the concerned State GST authorities.

### **What are the advantages of GST?**

- ++ elimination of multiple taxes
- ++ elimination of cascading effect
- ++ it will redistribute the burden of taxation equitably between manufacturing and services.
- ++ speeds up economic union of India ;
- ++ better compliance and revenue buoyancy;
- ++ tax incidence for consumers may fall;
- ++ lower transaction cost for final consumers;
- ++ it acquires a very simple and transparent character;
- ++ uniformity in tax regime
- ++ efficiency in tax administration;
- ++ increased tax collections due to wide coverage of goods and services
- ++ the increasing proximity of our tax system to the global tax system.
- ++ it may boost our economy and enable us to compete at the global front.
- ++ It will certainly reduce the tax burden for consumers;
- ++ it will reduce prices of manufacturing goods, attract higher investment
- ++ creates employment due to its rationalisation and simplification of taxes
- ++ it will lower the tax rate by broadening the tax base
- ++ it will foster a common market across the country
- ++ it will promote exports
- ++ it will spur growth

**(The author is working with the Department and the views expressed are strictly personal)**