GOODS & SERVICES TAX CASES

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Works contract

- Assessee claimed to have executed works contract in nature of supplying and fixing of wooden counters to bank, etc., and it claimed deduction under section 3F of U.P. Trade Tax Act in respect of raw materials purchased for manufacturing wooden structure on ground that said material had been purchased within State of U.P. Tribunal rejected assessee's claim. It was held that if entire work was being executed at site by assessee, namely, preparation of counters, and thereafter fixing same at site in a continuous process then only it was entitled to claim deduction. Further, deduction under section 3F(2)(*b*)(*iii*) was admissible only in case if assessee was able to prove that goods had been purchased within State of U.P. and tax had been paid. Since Tribunal had not examined case in light of aforesaid observations, matter was to be remanded back to it for disposal afresh (All.) **408**

Classification of goods

- Where Tribunal held that spray oil sold by assessee was a pesticide or fungicide and not a petroleum product as assumed by Assessing Officer, it was held that application by spraying itself would not make product in question fungicide or pesticide; therefore, assessee was to be ordered to produce samples with containers which were sold in sealed bottles with manufacturer's name to enable Assessing Officer to identify product (Ker.) **411**

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GOODS AND SERVICES TAX IN INDIA

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The Goods and Services Tax (GST) is a comprehensive Value Added Tax (VAT) on the supply of goods or services. On most of the goods and services, the rate of tax remains the same but as per the necessity of the nation, some goods or services can be declared as 'exempted' or 'zero rated'. What is dual GST, what are its benefits and how does it work, are some of the issues which have been deliberated upon in this article. By way of conclusion, the author's opine that the introduction of GST at the State level, the additional burden of CENVAT and services tax would be comprehensively removed, and a continuous chain of set-off from the original producer's point and service provider's point up to the retailer's level would be established which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax.

Introduction

1. If the Value Added Tax (VAT) is considered to be a major improvement over the pre-existing Central Excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will be a further significant breakthrough - the next logical step - towards a comprehensive indirect tax reform in the country.

Keeping this overall objective in view, an announcement was made by Shri P. Chidambaram, the then Union Finance Minister in the Central Budget (2007-08) to the effect that GST would be introduced from April 1, 2010 and that the Empowered Committee of State Finance Ministers, on his request, would work with the Central Government to prepare a roadmap for introduction of GST in India.

GST is a comprehensive VAT on the supply of goods or services. France was the first country to introduce this tax system in 1954 devised by a public servant. In India, due to non-consensus between the Central and State Governments, the proposal is to introduce a dual GST regime, *i.e.*, Central and State GST.

Meaning of

2. GST is a tax on goods and services, which is leviable at each point of sale or provision of service, in which at the time of sale of goods or providing the services the seller or service provider can claim the input credit of tax which he has paid while purchasing the goods or procuring the service.

On most of the goods and services the rate of tax remains the same but as per the necessity of the nation some goods or services can be declared as 'exempted' or 'zero-rated'. The whole system is developed in such a way that it avoids the cascading effect and the final consumer bears the burden of all the taxes.

The sellers or service providers collect the tax from their customer, who may or may not be the ultimate customer, and before depositing the same to the exchequer, they deduct the tax they have already paid.

Dual GST

3. Many countries in the world have a single unified GST system, *i.e.*, a single tax applicable throughout the country. However, in federal countries like Brazil and Canada, a dual GST system is prevalent whereby GST is levied by both the federal and State or provincial Governments. In India, a dual GST is proposed whereby a Central Goods and Services Tax (CGST) and a State Goods and Services Tax (SGST) will be levied on the taxable value of every transaction of supply of goods and services.

Impact on Prices of Goods and Services

4. The GST is expected to foster increased efficiencies in the economic system thereby lowering the cost of supply of goods and services. Further, in the Indian context, there is an expectation that the aggregate incidence of the dual GST will be lower than the present incidence of the multiple indirect taxes in force. Consequently, the implementation of the GST is expected to bring about, if not in the near term but in the medium to long term, a reduction in the prices of goods and services. The expectation is that the dealers would start passing on the benefit of the reduced tax incidence to the customers by way of reduced prices. As regards services, it could be that their short-term prices would go up given the expectation of an increase in the tax rate from the present 10 per cent to approximately 14 per cent to 16 per cent.

Benefits of Dual GST

5. The dual GST is expected to be a simple and transparent tax with one or two CGST and SGST rates. The dual GST is expected to result in :—

- reduction in the number of taxes at the Central and State level
- decrease in effective tax rate for many goods
- removal of the current cascading effect of taxes
- reduction in transaction costs of the taxpayers through simplified tax compliance
- increased tax collections due to wider tax base and better compliance.

Applicability of both CGST and the SGST on all transactions

6. A transaction of 'supply of goods' will attract both the CGST and SGST as applicable on goods. Similarly, a 'supply of service' will attract both the CGST and SGST as applicable on services.

How does it work ?

7. 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.

The illustration shown below indicates, in terms of a hypothetical example with a manufacturer, one wholesaler and one retailer, as to how GST will work. Let us suppose that rate of GST is 10 per cent 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 & services made to next stage*	*Rate of GST*	*GST on Output*	*Input Tax credit*	*Net GST = GST on output - Input Tax credit*
Manufac-turer	100	30	130	10%	13	10	13-10 = 3
Whole-saler	130	20	150	10%	15	13	15-13 = 2
Retailer	150	10	160	10%	16	15	16-15 = 1

The GST can be divided into following sections to understand it better :—

(*a*) *Charging Tax* - The dealers registered under GST (manufacturers, wholesalers and retailers and service providers) are required to charge GST at the specified rate of tax on goods and services that they supply to customers. The GST payable is included in the price paid by the recipient of the goods and services. The supplier must deposit this amount of GST with the Government.

(*b*) *Getting Credit of GST* - If the recipient of goods or services is a registered dealer (manufacturers, wholesalers and retailers and service providers), he will normally be able to claim a credit for the amount of GST he has paid, provided he holds a proper tax invoice. This 'input tax credit' is set-off against any GST (output), which the dealer charges on goods and services, which he supplies to his customers.

(*c*) *Ultimate burden of tax on last customer* - The net effect is that dealers charge GST but do not keep it, and pay GST but get a credit for it. This means that they act essentially as collecting agents for the Government. The ultimate burden of the tax falls on the last and final consumer of the goods and services, as this person gets no credit for the GST paid by him to his sellers or service providers.

(*d*) *Registration* - Dealers will have to register for GST. These dealers will include the suppliers, manufacturers, service providers, wholesalers and retailers. If a dealer is not registered, he normally cannot charge GST and cannot claim credit for the GST he pays and further cannot issue a tax invoice.

(*e*) *Tax Period* - The tax period will have to be decided by the respective law and normally it is monthly and/or quarterly. On a particular tax period, which is applicable to the dealer concerned, the dealer has to deposit the tax if his output credit is more than the input credit after considering the opening balance, if any, of the input credit.

(*f*) *Exempted goods and services* - Certain goods and services may be declared as exempted goods and services and in that case the input credit cannot be claimed on the GST paid for purchasing the raw material in this respect or GST paid on services used for providing such goods and services.

(*g*) *Zero-rated goods and services* - Generally, export of goods and services are zero-rated and in that case the GST paid by the exporters of these goods and services is refunded. This is the basic difference between zero-rated goods and services and exempted goods and services.

(*h*) *Tax invoice* - Tax invoice is the basic and important document in the GST and a dealer registered under GST can issue a tax invoice and on the basis of this invoice, the credit (Input) can be claimed. Normally, a tax invoice, must bear the name of supplying dealer, his tax identification Nos., address and tax invoice Nos. coupled with the name and address of the purchasing dealer, his tax identification Nos., address and description of goods sold or service provided.

(*i*) *Carry forward of Input Tax Credits (ITC) and CENVAT Credit (CC) balances* - Going by the precedence at the time of VAT implementation, it is believed that the accumulated ITC and CC will both be allowed to be carried forward under the GST regime, albeit upon fulfilment of prescribed conditions, if any.

(*j*) *Refund of unutilised CC on inputs and input services* - It is envisaged that under the proposed Dual GST model there would be refund of unutilized accumulated CCs at the end of each fiscal year and that refunds would not be restricted only to those relating to exports.

(*k*) *Cross-utilization of credits between goods and services* - Under the GST regime, the incidence of tax will be on supplies, be it supplies of goods or services. The taxes will be levied in parallel by the Centre and the States who will levy the CGST and SGST, respectively, on each supply of goods/services. Accordingly, the cross-utilization of credits for goods and services would be allowed subject to the fact that cross-utilization of credits between the CGST and SGST would not be permissible.

Systems of GST

8. Internationally, there are *three* systems in vogue :—

(*a*) Invoice system

(*b*) Payment system

(*c*) Hybrid system

(*a*) *Invoice system* - In the invoice system, the GST (Input) is claimed on the basis of invoice and it is claimed when the invoice is received, it is immaterial whether payment is made or not. Further, the GST (Output) is accounted for when invoice is raised. Here also the time of receipt of payment is immaterial.

One may treat it as mercantile system of accounting. In India the present system of sales tax on goods is an invoice system of VAT and here it is immaterial whether the taxpayer is following the cash basis of accounting or mercantile basis of accounting.

The advantage of invoice system is that the input credit can be claimed without making the payment. The disadvantage of the invoice system is that the GST has to be paid without receiving the payment.

(*b*) *Payment System* - In the payment system of GST, the GST (Input) is claimed when the payment for purchases is made and the GST (Output) is accounted for when the payment is made.

In this system, it is immaterial whether the assessee is maintaining the accounts on cash basis or not.

The advantage of cash invoice system is that the tax (output) need not be deposited until the payment for the goods and/or services is received. The disadvantage of the payment system is that the GST (input) cannot be claimed without making the payment.

The taxes on services in India are based on this payment system since service tax is payable on receipt basis and further Cenvat credit is only allowable when payment of the service is made.

In some countries, this system is also adopted for small traders to keep them away from the complexities of the invoice system, which is purely a mercantile system.

(c) *Hybrid system* - In hybrid system the GST (Input) is claimed on the basis of invoice and GST (Output) is accounted for on the basis of payment, if allowed by the law. In some countries, the dealers have to put their option for this system or for a reversal of this system before adopting the same.

These three systems can be summarised as under :—

Description	*Input Credit*	*Output Credit*
Invoice system	On receipt of	On issue of invoice
Payment system	On making the payment	On receiving the payment
Hybrid system	At the option of dealer to be declared in advance	At the option of dealer to be declared in advance

It always depends on the law of the country, which decides the system of GST to be followed by the dealers.

Conclusion

9. There was a burden of 'tax on tax' in the pre-existing Central Excise duty of the Government of India and sales tax system of the State Governments. The introduction of Central VAT (CENVAT) has removed the cascading burden of 'tax on tax' to a good extent by providing a mechanism off 'set off' for tax paid on inputs and services up to the stage of production, and has been an improvement over the pre-existing Central Excise duty. Similarly, the introduction of VAT in the States has removed the cascading effect by giving set-off for tax paid on inputs as well as tax paid on previous purchases and has again been an improvement over the previous sales tax regime.

But both the CENVAT and the State VAT have certain incompletenesses. The incompleteness in CENVAT is that it has yet not been extended to include chain of value addition in the distributive trade below the stage of production. It has also not included several Central taxes, such as additional excise duties, additional customs duty, surcharges, etc., in the overall framework of CENVAT, and, thus, kept the benefits of comprehensive input tax and service tax set-off out of the reach of manufacturers/ dealers. The introduction of GST will not only include comprehensively more indirect Central taxes and integrate goods and services taxes for set-off relief, but also capture certain value addition in the distributive trade.

Similarly, in the present State-level VAT scheme, CENVAT load on the goods has not yet been removed and the cascading effect of that part of tax burden has remained unrelieved. Moreover, there are several taxes in the States, such as, luxury tax, entertainment tax, etc., which have still not been subsumed in the VAT. Further, there has also not been any integration of VAT on goods with tax on services at the State level with removal of cascading effect of service tax. In addition, although the burden of Central Sales Tax (CST) on inter-State movement of goods has been lessened with reduction of CST rate from 4 per cent to 2 per cent, this burden has not been fully phased out. With the introduction of GST at the State level, the additional burden of CENVAT and services tax would be comprehensively removed, and a continuous chain of set-off from the original producer's point and service provider's point up to the retailer's level would be established which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax. This is the essence of GST. Also, major Central and State taxes will get subsumed into GST which will reduce the multiplicity of taxes, and, thus, bring down the compliance cost. With GST, the burden of CST will also be phased out.

Thus, GST is not simply VAT *plus* service tax, but a major improvement over the previous system of VAT and disjointed services tax - a justified step forward.

19-GST