

GOODS AND SERVICES TAX: A GAME CHANGER¹

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With the passage of the Constitution (“One Hundred and First”) Act, 2016, India is now one step closer to adopting a goods and services tax (“G.S.T.”) as its new indirect tax structure. Although this is only the first step in the legislative process of transition of the indirect taxes in India to the G.S.T. regime, it is a major leap towards the final implementation of G.S.T. in India.

G.S.T. has been defined as “any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption.” In essence, G.S.T. is a comprehensive single tax that is levied on the supply of goods and services in the country. It is a value added tax that is levied throughout the supply chain with permissible credits for tax paid on inputs acquired.

Once implemented, G.S.T. is expected to provide relief to businesses by adopting a more comprehensive and wider coverage of input tax set-off and service tax set-off. Additionally, G.S.T. will subsume a majority of the central and state levies within its fold, eventually phasing out the different taxes and levies and bringing them under the umbrella of G.S.T. The existing indirect tax laws have not been able to completely remove the cascading burden of taxes already paid at earlier stages. In addition to this, there are several levies by the central government and the states on the manufacture and sale of goods and the provision of services for which no set-off for input tax credit is available. G.S.T. is expected to mitigate these indirect tax inefficiencies currently prevalent under the existing framework.

G.S.T. is not merely a tax change, but is also expected to have a multifaceted impact on business. Given its omnipresence in almost every business transaction, any change in the indirect tax regime will impact almost every level of the value chain. The implementation of G.S.T. is expected to create a paradigm shift in the Indian economy at both the micro level and the macro level. At a macro level, G.S.T. will promote transparency, cost-effectiveness, and lead to a shift from unorganized to organized trade in India. At a micro level, G.S.T. will, *inter alia*, impact an organization’s supply chain, procurement, logistics, finance, taxation, and pricing policies. The basic premise behind G.S.T. is to create a single, cooperative, and undivided Indian market, thereby making the economy stronger and more powerful.

BRASS TACKS

As mentioned above, G.S.T. will subsume central and state levies within its fold. To this end, G.S.T. will have three charging components: central G.S.T. (“C.G.S.T.”) and state G.S.T. (“S.G.S.T.”), levied together on intrastate supplies of goods and services, and integrated G.S.T. (“I.G.S.T.”) on interstate supplies of goods and

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services. The rates would be prescribed keeping in mind revenue consideration and acceptability. While the G.S.T. model will be implemented through multiple statutes, the basic features of indirect tax law, including, *inter alia*, charge ability, the definition of taxable events and taxable persons, the measure of levy, and the basis of classification, would remain uniform across these statutes.

C.G.S.T. and S.G.S.T. will be applicable to all transactions of goods and services made for consideration except those specifically exempted or outside the purview of G.S.T. (e.g., “alcoholic liquor for human consumption and petroleum products”) and transactions which are below a prescribed threshold.

Every person who is engaged in an interstate transaction will have to be registered under G.S.T., irrespective of the turnover limits. Interstate transactions shall be subject to I.G.S.T., which shall be collected by the central government. The input tax paid, which may include I.G.S.T., C.G.S.T., and S.G.S.T., on goods or services acquired by a person can be utilized against the payment of I.G.S.T., C.G.S.T., and S.G.S.T., in that order. Thus, the biggest transition which G.S.T. seeks to bring is the free set-off provision and utilization of inputs available.

G.S.T. RATE STRUCTURE

With the government’s intention to enforce G.S.T. from April 1, 2017, the rate of tax is likely to be decided in the upcoming winter session of the Parliament. The G.S.T. rate is to be recommended by the G.S.T. Council depending on various factors, such as economic conditions, revenue buoyancy, and revenue neutral state. The G.S.T. Council is also empowered to propose a “floor rate with band” to provide flexibility to states to levy tax at rates higher than the floor rate, but within the band.

COMPENSATION TO STATES

Setting aside value added tax and merging it with G.S.T. may reduce the revenue generated by states. To provide some relief, for the first five years of G.S.T.’s implementation, the central government will compensate the loss of revenue (if any) which the states may incur due to such implementation.

IMPACT ON BUSINESS

In general, G.S.T. is expected to provide a welcome relief to businesses by providing a wider coverage of input tax set-off by subsuming several central and state levies. Further, by providing a continuous chain of set-off from the manufacturer to the retailer, the tax burden of goods and services on the end-consumer is expected to reduce. This reduced tax burden will also reduce the price of exports, thereby increasing the competitiveness of Indian goods and services in international markets.

Below are some impacts that organizations will need to consider under the proposed G.S.T. regime.

Finance and Working Capital

Organizations may need to rework their budgets and working capital expectations

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based on the G.S.T. tax rate applicable to them in order to appropriately meet working capital requirements.

Increased Compliance

With state-wide registration required wherever an organization has an establishment, along with increased filings on a monthly basis, it is expected that compliance requirements will increase under the G.S.T. regime.

Supply Chain Management

Most goods have a multi-layered value chain structure with several layers between the manufacturer and the ultimate customers. Typically the value chain would comprise of Manufacturer → Warehouse → Wholesaler → Retailer → Customer. In this value chain, historically, warehousing was a layer largely meant to facilitate interstate branch transfers to avoid the incidence of central sales tax.

Under the G.S.T. regime, seamless input tax credit will be available on interstate transactions, thereby dispensing with the requirement of maintaining warehouses in every state. Multi-state organizations would now have the option to replace many of their small warehouses in multiple states with larger and strategically located mother warehouses in selected states. This is expected to reduce distribution costs, which can be expected to be passed on to the end consumer.

Information Technology

One of the most crucial areas in the transition process will be the technology and enterprise resource planning (“E.R.P.”) alignment from the current regime to the G.S.T. regime. Accounting software will need to be aligned to the provisions of the G.S.T. law. Computer systems will have to be updated to include the new tax codes. In addition to this, new modules will need to be developed to enable generation of G.S.T.-compliant output reports and invoices.

Business Realignment

Under the G.S.T. regime, the prices of goods and services are expected to change. As mentioned above, there will be a tax credit at each level in the supply chain. Businesses may need to realign their current business models under the G.S.T. regime in order to stay competitive in the market. To this end, procurement, logistics, distribution, and pricing policies may need to be revisited. Further, businesses may also re-negotiate contracts with vendors, and, *inter alia*, decide the extent to which G.S.T. levies are to be absorbed or passed on to the consumer.

POTENTIAL HURDLES

Like all significant changes in law, G.S.T. is expected to have its set of teething issues during the transition process before the benefits, to their fullest extent, can be enjoyed by industry and consumers.

Technology Infrastructure

At present, the technology infrastructure prevalent across states operate on different platforms and differ in technical complexity. G.S.T. will require a single seamless integrated platform that can efficiently manage the requirements of tax payers

across 29 states and seven union territories. The government will have to ensure that this infrastructure is in place before G.S.T. goes live.

Non-G.S.T. Items

At present, alcoholic liquor for human consumption and petroleum products are excluded from the G.S.T. basket. The government will have to be careful that frequent changes are not made to the G.S.T. basket, so as to ensure that G.S.T. will remain the tax of convenience it is desired to be rather than becoming a tax of validation.

Administrative Realignment

The G.S.T. regime contemplates the integration of and information-sharing between the C.G.S.T. and the S.G.S.T. arms. If history is any yardstick, implementation of systems which could enable harmonization and seamless flow of data between inter-governmental bodies could be both time-consuming and arduous.

Division of Tax Collections Between States

The G.S.T. regime will result in states losing their individual identities, as they will only partake in a share of the total levies collected. In order for G.S.T. to succeed, it is essential that a just and equitable formula be sought for distribution of the receipts between the states and the central government.

Different Taxing Powers

The key taxing powers are not merged under the G.S.T. regime and therefore continue to remain either with the central or state government. As a consequence, the non-G.S.T. central and state levies will continue as they are.

CONCLUSION

While the government's initiative to make G.S.T. a reality has been received with overwhelming support and favor, the roadmap to its success is not straightforward and cannot be taken for granted.

In general, G.S.T. is expected to be a boon for commerce and industry due to the expected cost reductions and lower tax rates. The ripple effect of these benefits is also expected to reach the end consumer. Further, G.S.T. will also provide an opportunity to less developed states to compete in the national market on an equal footing, thereby boosting their individual economies and the Indian economy at large. Lastly, the uniform tax rate will also improve the ease of doing business in India, which has been the mantra of the Indian prime minister.

That said, the G.S.T. regime may not be tax-favorable for all industries. For example, the cost of insurance products is expected to rise, which, if passed on to the end consumer, will negatively impact insurance penetration in the country. Further, with the dual charging components, the compliance burden on businesses is expected to increase.

Despite the setbacks, industry is optimistic that G.S.T. will live up to the expectations. The National Council of Applied Economic Research projects that the introduction of G.S.T. would lead to a G.D.P. growth in the range of 0.9% to 1.7%,



and export growth between 3.2% and 6.3%.² Thus, G.S.T. will not just restructure indirect taxation in India, but will seminally influence the way businesses function.

While the government has its work cut out to ensure that G.S.T. is the game changer it is touted to be, its successful implementation could be a major step towards making India the economic powerhouse it is destined to become.

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² Report of the Select Committee on the Constitution 122nd Amendment Bill, 2014, dated July 22, 2015.

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