Research Paper by Sub-Group-3 of Group I of Phase V, 2015

Following are the officers of sub-group-3 of the officers who attended MCTP training in Group I of Phase V conducted between 20th April to 1st May, 2015 at ISB, Hyderabad and at the Maxwell School of Citizenship and Public Affairs, Syracuse University, USA and Canada from 4th to 15th May, 2015. The sub-group was constituted under ADG, NACEN letter F.No. II(15)6/2015-NACEN dated: 20.05.2015:

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The group is assigned to present a Research Paper on 'Importance of implementation of GST reforms in India – Challenges for implementation in India – Lessons learnt in Canada for implementation in India' besides a Power Point presentation.

Introduction

1.1 The Indirect Taxation in India is proposed to undergo a radical change with introduction of Goods and Service Tax [GST] w.e.f. 01.04.2016.

About 140 other countries like Canada, Brazil, European Union, etc have switched over to GST in last two decades and have faced problem in its implementation, despite the fact that those countries had very few provinces. India has 29 states and 7 Union Territories with huge regional disparities, not only in economic terms, but socio-political and geographical terms also. Considering the fact that Centre-State relations have always been a matter of concern in the past, effective implementation of GST would be greatly dependent upon the coordination between Centre and the States.

It also requires robust and reliable GST network for seamless transfer of credit from originating state to destination state. Besides that, clear understanding of procedure and methodology of GST need to be informed to not only the trade and other stakeholders, including officers of State and Centre. Undoubtedly implementation is going to be a big challenge not only at the policy level, but also at the implementation level.

1.2 In 2004, Dr Kelkar task force recommended the need of Goods and Service Tax in India. Need for GST was felt in order to:

- Reduce barriers of Inter-state trade & create common nationwide market by elimination of multiple taxes;
- Redress the imbalance in taxation between manufacturing and service sector;
- Avoid Cascading effect and ensure transparency;
- Reduce the incidence of taxation by expanding the taxable base and
- Ensure that Investment choices should be influenced by economic considerations and not by tax rates or tax exemptions;

1.3 Introduction of GST would entail following benefits to Assessee- Reduction in multiplicity of taxes; Mitigation of cascading/ double taxation; More efficient neutralization of taxes especially for exports; Development of common national market and Simpler tax regime – by Fewer rates and exemptions and having Conceptual clarity (Goods vs. Services).

Besides this, the Exchequer/Govt. would benefit on account of the Simpler Tax system; Broadening of Tax base; Improved compliance & revenue collections and Efficient use of resources.

2. Indian Context:

2.1 The Empowered Committee has recommended that following Taxes should be, to begin with, subsumed under the Goods and Services Tax:

i. Into Central GST-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.

ii. Into State 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 and Entry tax not in lieu of Octroi.

2.2 **Features of Proposed GST:**

India is proposing to have Dual GST Model where the tax would have two components - a Central GST (CGST) and a State GST (SGST) to be levied and collected, concurrently, by the Centre and the States respectively. Besides this and Integrated GST on inter-State supplies of goods or services shall be levied and collected by the Centre. IGST will be applicable to the Import of goods and services; Inter-state stock transfers of goods and services and Export of goods and services – Zero rated.

It would be a destination based Taxation and will apply to all stages of the value chain. It will apply to all taxable supplies of goods or services (as against manufacture, sale or provision of service) made for a consideration except the Exempted goods or services, Goods or services outside the purview of GST and Transactions below threshold limits.

2.3 Road to GST- Milestones till date:

In Budget of 2006, FM announced the intent to introduce GST by 01.04.2010. In March 2013, GSTN Incorporated as Section 25 Company and on 19.12.14 the 122nd Constitutional Amendment bill was introduced in Parliament and the Lok Sabha passed it on 06.05.2015. **Bill has now been referred to a Select Committee of the Rajya Sabha.**

2.4 Key Features of 122nd Constitutional Amendment Bill:

I. Concurrent jurisdiction for levy of GST by the Centre and the States as proposed Article 246A;

II. Authority for Centre to levy & collection of IGST on supplies in the course of inter-State trade or commerce including imports as proposed Article 269A;

III. Authority for Centre to levy non-vatable Additional Tax @1% to be retained by originating State;

IV. GST has been defined as any tax on supply of goods or services or both other than on alcohol for human consumption under proposed Article 366(12A);

V. ‘Goods’ includes all materials, commodities & articles as per proposed Article 366 (12);

VI. ‘Services’ means anything other than goods as envisaged under proposed Article 366 (26A);

VII. Goods and Services Tax Council (GSTC), as proposed under Article 279A, shall be constituted by the President within 60 days from the coming into force of the Constitutional Amendments and shall Consists of Union FM & Union MOS (Rev), all State Ministers of Finance. Quorum shall be 50% of total members and decisions shall be made by majority of 75% of weighted votes of members present & voting which shall be 1/3rd weighted votes for Centre & 2/3rd for all States together. The Council shall make recommendations on Taxes, etc. to be subsumed in GST; Exemptions & thresholds; GST rates; Band of GST rates; Model GST Law & procedures; Special provisions for special category States; Date from which GST would be levied on petroleum products; Council to determine the procedure in performance of its functions. Council to decide modalities for dispute resolution arising out of its recommendations the changes in entries in List – I & II and also the Compensation for loss of revenue to States for five years

2.5 **Key Enablers for IGST would be:** Uniform e-Registration; Common e-Return for CGST, SGST & IGST; Common periodicity of Returns for a class of dealers; Uniform cut-off date for filing of Returns; System based validations/consistency checks on the ITC availed, tax refunds and Effective fund settlement mechanism between the Centre and the States

2.6 Way Forward for Introduction of GST: Constitutional amendment bill to be passed by 2/3rd majority in both Houses of Parliament and requires to be ratified by at least 50%of the State Legislatures whereafter it will have the assent by President of India. Thereafter, GSTC to be constituted to recommend GST Law and procedure and also GSTN (GST Network) a Section 25 Company formed to design automation of GST in line with TINXYS/NSDL

2.7 Salient features of the proposed model are:

- Consistent with the federal structure of the country, the GST will have two components: one levied by the Centre (hereinafter referred to as Central GST), and the other levied by the States (hereinafter referred to as State GST). This dual GST model would be implemented through multiple statutes (one for CGST and SGST statute for every State). However, the basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. would be uniform across these statutes as far as practicable.

- The Central GST and the State GST would be applicable to all transactions of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.

- The Central GST and State GST are to be paid to the accounts of the Centre and the States separately.

- 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.

- Cross utilisation of ITC between the Central GST and the State GST would, in general, not be allowed.

- 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.

- The administration of the Central GST would be with the Centre and for State GST with the States.

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

- Each taxpayer would be allotted a PAN-linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-based system for Income tax facilitating data exchange and taxpayer compliance. The exact design would be worked out in consultation with the Income-Tax Department.

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

2.8 Key Questions before introduction of GST- Challenges which are under discussion include

- the Extent of Dual Control;
- Rate structure (based on RNR);
- the Exempted Goods or Services;
- Exemption threshold;
- Composition threshold;
- Exclusion Vs. Zero rating of certain goods in GST regime;
- Role of Centre / States in inter-State Trade;
- Place of Supply Rules for Goods and Services;
- Account settlement between the Centre and the States under IGST model.
- Multiple registration within one State;
- Dispute settlement over taxable and enforcement jurisdiction and
- Audit, enforcement, recovery etc.

2.9 Challenges in Implementation in India

- Setting up of GST Network to act as a common platform and Clearing House
- Sharing of information on GSTN amongst Centre and 29 States and 7 Union Territories.
- New Uniform Dispute resolution mechanism.
- Settlement & Compounding provisions.
- Co-ordination between Central & State GST Administration- Rates, Zero rating, exemptions…
- Enforcement by Centre & State on same tax payer.
- Training and capacity building of all stake holders.

3.1 International Perspective in GST

Rates and Policy issues of VAT
Emerging Issues-Bit Coins/Coupons, B2C, Online Supply of Services, e-Commerce Transactions, Dispute Settlement between States, Exclusions and RNR.

3.2 International Best Tax Practices

- Single Tax agency for both direct and indirect taxes
- Certainty & Fairness of taxation- less frequent changes
- Use of IT- managed by professionals including Mobile based applications
- Time bound disposal of disputes
- Adequate availability of funds to improve efficiency & reduce Tax Gap
- Performance based pay

- Lateral entry of professional
- Insulation of officers from witch-hunt for bonafide acts
- Delegation of power at different levels
- Functional jurisdictions instead of territorial
- Apolitical approach at the top

4. Taxation Structure in Canada:

4.1 Before 1991, there were two types of General Sales Taxes in Canada: a Manufacturer's Sales Tax [also called Federal Sales Tax] imposed at the Federal level and Retail Sales Taxes imposed at the provincial levels. Although Federal Sales Tax contributed over 50% of total Federal Commodity Tax revenue from 1996 to 1982, it suffered from a number of serious economic deficiencies like it missed all stages beyond manufacturing and favoured imports over domestic production. GST was introduced on January 1, 1991 based on invoice credit method VAT and it replaced a hidden 13.5% Manufacturers' Sales Tax (MST).

4.2 GST also suffers from a number of structural flaws. Main issue concerns the presence of important exclusions which seriously undermine the efficiency, equity, ease of administration and revenue potential of the tax. Data show that non-export zero rating, exemptions and rebates as concessions entail very significant tax expenditure. In addition GST is very complex as it is supported by a voluminous body of law, jurisprudence, regulations and technical guidance. Although this complexity is not a typical of modern VATs and the GST litigation figures suggest that complexity is actually a problem in practice.

4.3 An ideal VAT should not distort the production decisions of the business and should minimise the distortions of consumption decisions. In practice, non-export zero rating of selected goods and services from VAT and non-standard rates are the primary source of distortion of consumption decisions. An ideal VAT, because it applies at a uniform rate to all goods and services, is regressive in the sense that VAT payments will constitute a larger proportion of expenditures by low-income households than those by middle income or high income households. Evidence suggests that the VAT, on its own, is very poor instrument to achieve equity objectives. Complexity of VAT is proportional to the level of compliance and administrative costs. In decreasing order of importance, design features that make the VAT harder to administer include VAT registration thresholds that are too low, multiple rates, non-export zero rating and exemptions.

4.4 Rumsey Rule states that when the demand for certain goods is unresponsive to price changes the goods bear higher tax rates than those borne by goods whose prices vary in relation to demand. Goods that are least responsive to price changes are usually necessities. Tax rates are inversely proportional to the absolute value of the price elasticity of demand.
Goods that are complimentary [or less substitutable] to leisure should be taxed more highly than others.

Differential Commodity tax rates increase compliance and restrictive costs, which can offset any efficiency gains from differential commodity tax rates. Intermediate goods should not be taxed.
One study using Canadian data analysed the impact on incidence of switching from retail sales tax to the harmonised sales tax. The authors concluded that 'overall, consumer prices in harmonising prices fell with the reform, although prices rose somewhat for the purchases of shelter, clothing and footwear, which tended to make reforms slightly regressive". The authors also made a

recommendation to use refundable Goods and Service Tax income tax credits to address distributional concerns for low-income individuals.

4.5 A uniform tax system would be much cheaper for taxpayers to comply with and much cheaper for the tax authorities to administer. In addition, simplicity would be expected to increase compliance as well as revenue collected per dollar of administrative costs. Such a system, however, could turn out to be quite regressive because necessities are taxed at the same rate as luxuries. However this did this regressivity may not be a huge problem when lifetime incidence and overall effects of the tax transfer system on income distribution are taken into account.

4.6 Real world general sales tax systems are non-uniform not because of optimal tax considerations but rather because of public policy preference. Examples of these preferences include exemptions and non-export zero rating. They're usually motivated by social objectives, including concerns about regressivity and income distribution. Surveys have supported uniformity in indirect taxation, noting however that the information needed to implement some elements of non-uniform taxation implied by optimal tax theory may be easier to obtain than was previously thought.

Unlike general sales taxes, excise taxes generally include those taxes that apply to specific goods only. Examples include alcoholic beverages, tobacco products and petroleum products-generally called 'sin taxes'. In theory, excise tax rates can be set to correct for externalities. In practice, however, by far the important reason for imposing excises is revenue generation. Excise tax rates are most commonly selected without proper regard to or even acknowledgement of externalities. Since the demand for excise goods especially alcohol, tobacco and fuels is relatively price inelastic because consumption either follows a habit or addiction or is a necessity. The less price inelastic the demand is, the less consumers will respond to the price change induced by the tax.

Uniform specific rates reduce absolute price differences between low price brands and high-priced brands. In contrast, ad valorem taxes increase absolute price differences. Externality correction favours specific over Ad valorem taxation. An inflationary environment favours ad valorem over specific taxation because the real value of the specific tax, as a percentage of the trade price, erodes over time.

4.7 VAT and retails sales taxes are commonly referred to as consumption taxes. Shift from Commodity Taxes to Consumption Taxes is necessary because some of the alternatives have features that resemble income tax, such as the fact that they are account based.

Retail sales tax applies to all sales to final consumers including those made directly from manufacturers and wholesalers. In practice, reasons which adversely affect the retail tax as a true consumption tax are-a certificate system is used to exempt business to business sales which opens system to abuse since certificates may be used by business to purchase dual [business and personal] use goods. Also these certificates are often limited in scope-while they allow exemptions from any business input purchases, capital equipment is often taxable. As a result, the cost base of many businesses includes some retail sales tax and hence cascading occurs. Retail sales tax does not feature a mechanism to relieve taxes on inputs exposed and is particularly penalising in industries that are export oriented. All consumer services should be taxable, but because many services can be used for a dual purpose without the supplier being able to establish what the principal purpose is, retail sales taxes exclude the majority of services from their base. The system is thus open to abuse because goods will be reclassified as services to avoid the tax.

4.8 Pierre-Pascal Gendron in world Journal of VAT/GST law in 2012 concluded that GST is not the best instrument and proposed elimination of some of the GST reliefs [non-export zero rating, exemptions and rebates].

4.9 In Canada [till August 2012] three VAT systems were in operation: the Federal GST; the HST in five states and the QST in the province of Québec till 31^{st} December 2012. GST was leviable in all 10 provinces @ 5%. HST [sometimes referred to as GST/HST] is a single VAT. The QST is actual VAT that applies in Quebec on the GST inclusive price of goods and services. GST/HST and QST apply to a broad range of goods and services and are imposed on consumption on a destination basis and relies on detailed place of supply rules for services to achieve that objective. Traditional retail sales tax [RST] is levied in three provinces and it generally applies to sale or lease of goods and a very limited range of services. RSTs are not harmonised in any way with the GST/HST or the QST.

Jurisdiction	Name of tax	Type	Rate (%)	Administration by	Comments
Canada	GST/HST	VAT	5/12, 13,15	Federal except in Quebec where it is provincial	GST rate [Federal] is 5% and is applied throughout the country; federal government also administers the tax in participating H ST provinces
Newfoundland and Labrador	HST	VAT	8	Federal	HST revenues collected in the HST provinces are distributed to the provinces based on estimated taxable consumption
Nova Scotia	HST	VAT	10	Federal	-do-
New Brunswick	HST	VAT	8	Federal	-do-
Prince Edward Island	PST	RST	10	Provincial	Applied to RSP including GST
Quebec	QST	VAT	9.5	Provincial	Applied to RSP including GST
Ontario	HST	VAT	13	Federal	As for Newfoundland and Labrador
Manitoba	PST	RST	7	Provincial	Applied to RSP **excluding** GST
Saskatchewan	PST	RST	5	Provincial	As for Manitoba
British Columbia	H ST	VAT	12	Federal	As for Newfoundland and Labrador

4.10 Sales taxes in Canada raised 7.3% of the GDP in 2007. This ratio for EU countries was 11.3%.

4.11 Some features of GST are in line with those of many VAT is in operation around the world: it includes some standard exemptions [public sector, non-profit and charitable activities; financial services]; reduced rates [new housing]; and zero rated supplies [basic groceries, agricultural and fishery products, prescription drugs and medical devices].

4.12 The GST/HST is a consumption VAT that seeks to achieve two goals simultaneously- raise revenues and deliver social benefits and incentives. Exclusions from GST base are called tax preferences to reflect the fact that they imply that preferential treatment is to be given to an individual, an organisation or an economic sector to accomplish a non-tax goal. Text preferences under GST come in three forms: exemptions, zero rating and rebates.

4.13 Generally, excise tax act imposes tax on the value of consideration of taxable supplies made in Canada. Exempt supply is defined in subsection 123(1) of the EPA to mean a supply included in schedule V of the ETA. These include supplies of real property, health care services, educational services, most child and personal care services, legal aid services, supplies made by registered charities and public institutions, certain supplies made by public sector bodies, most financial services and ferry, roads and bridge tolls.

The list reveals that exempt supply include goods and services that exhibit public goods or merit good characteristics like healthcare, education etc.

4.14 Zero rating provisions: In accordance with the destination principle, exports of goods and services from Canada, restrictions are zero rated since the territorial reach of the GST is limited by the fact that goods or services must be consumed in Canada to be taxable.

Other forms called non-export zero rating represent a tax preference. Concept of zero rated supply is defined in subsection 123(1) of the ETA to mean a supply included in schedule VI which encompass- prescription drugs and biologicals, medical and assistive devices, basic groceries, agriculture and fishing, exports, travel services, transportation services, supplies to international organisations, financial services rendered to non-residents and collection of customs duties by Canada Post.

4.15 Rebating provisions: GST/HST rebates are granted by two very different programs- New Housing Rebate and Public Service Bodies rebate. Commercial real property transactions are taxable. However residential Housing and residential rents are exempt. Residential housing sales are taxable but are subject to a partial GST/HST rebate for qualifying purchasers. The GST rebate works out to 36% of the GST on the first $3,50,000 of housing value and phases out upto $ 4,49,999. Municipalities, universities and public colleges, schools, hospitals, charities or public institutions are collectively referred to as Public Service Bodies. Entities that make exclusively exempt supplies do not register. Public Service Bodies rebate program returns a portion of all the GST paid on purchases to the entities. Non-registered Public Service Bodies can claim their share of GST/HST on purchases of inputs by filing an application for rebate. Rebates are provided precisely because most of the supplies from operators in those sectors are exempt. One of explanations for this system is that the federal government does not provide direct funding to such organisations.

4.16 Assessment and proposals for GST reforms in Canada:

i. GST/HST credit is a tax-free [under the income tax] quarterly payment to assist individuals and families with low or modest incomes in offsetting all or part of the GST they pay. Credit should be made more generous to offset the adverse distributional impacts of some of the proposals to eliminate a number of household related GST tax expenditures.

ii. Supplier's threshold [also known in many countries as the VAT registration threshold] stands at CAD 50,000 for PNC bodies and for all other persons at CAD 30,000. These thresholds are too low. In theory, the threshold should be set so that the last monetary unit of revenue equals the marginal cost of collecting VAT unit, considering all compliance and administrative costs. Proposal to increase the threshold while arguing for reduction in other exemptions appear to be contradictory. The justification for the two proposals are different though. It is argued that the threshold should be raised for administrative reasons [eg reallocate enforcement where revenue is found] while other exemptions should be reduced or eliminated for efficiency and revenue reasons. It is proposed that existing separate thresholds be combined into a single threshold set at minimum of CAD 100,000. Harmonising and raising the threshold will reduce the number of taxable persons that must actively interact with the Canada revenue agency.

iii. Many GST tax preferences should be eliminated and replaced by better targeted policies in order to tap the full revenue potential and desirable economic effects of the GST. The benefits will include reduction in various non-neutralities is and inequities, better targeting and value for money of socio-economic policies, and enhanced support for the slow but in exorable transition from an income tax based to a consumption-based in Canada. Such reforms would reduce the complexity of the GST and hence generate compliance and administrative cost savings. Author proposes to eliminate the following tax tax preferences

iv. Zero rating of basic groceries, prescription drugs, medical devices and agricultural and fish products and purchases.

v. Rebates for new housing and new residential rental property; and exemptions for water and garbage collection and municipal transit, childcare and personal services, Freddie road and bridge tolls.

vi. Make the GST/HST credit more generous to compensate for some of the impacts on low income households of the elimination of certain acts preferences.

vii. Set a single small suppliers threshold at CAD 100,000.

5. Recommendations to Meet Challenges in Implementation of GST in India

i. Draft simpler Statute, Rules & Procedures.

ii. Prepare for Robust GSTN and infrastructure to be managed by professionals.

iii. Putting in place platform for Coordination with States Agencies.

iv Efforts for Re-orientation of all Stake holders need to be made.

v. Intense Training of Staff & Stakeholders with provision for online training module.

vi. On Dispute Resolution
- Reducing the discretionary powers of officers
- Constitute Centralised Time-bound and speedy Dispute Redressal Mechanism
- Provision for Settlement & Compounding of less serious offences
- Penal interest and doing away with the concept of mens-rea.

vii. Threshold and Exemptions:
- A high threshold in beginning till the IT system is tested and it stabilises.
- Same threshold limit for Goods & Services.

- Fewer exemptions to avoid disputes.

viii. Use of International Best Practices need to be incorporated

ix. Certainty, Fairness and Transparency in tax system through use of IT

x. Regular feedback/ survey by independent agencies to make of the system more customer focussed.

6. **Conclusion**:

Proposed GST model is criticized for its inherent compromises, but it should be remembered that compromises are necessary in federal democracies. The countries which incorporated GST took time to stabilize the tax structure and in Indian context also only the time will be a witness to its success.

Experimentation does not mean it will result only in success or failure. There is no failure. It is either success or a lesson.

7. Bibliography:

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