

Ushering in GST

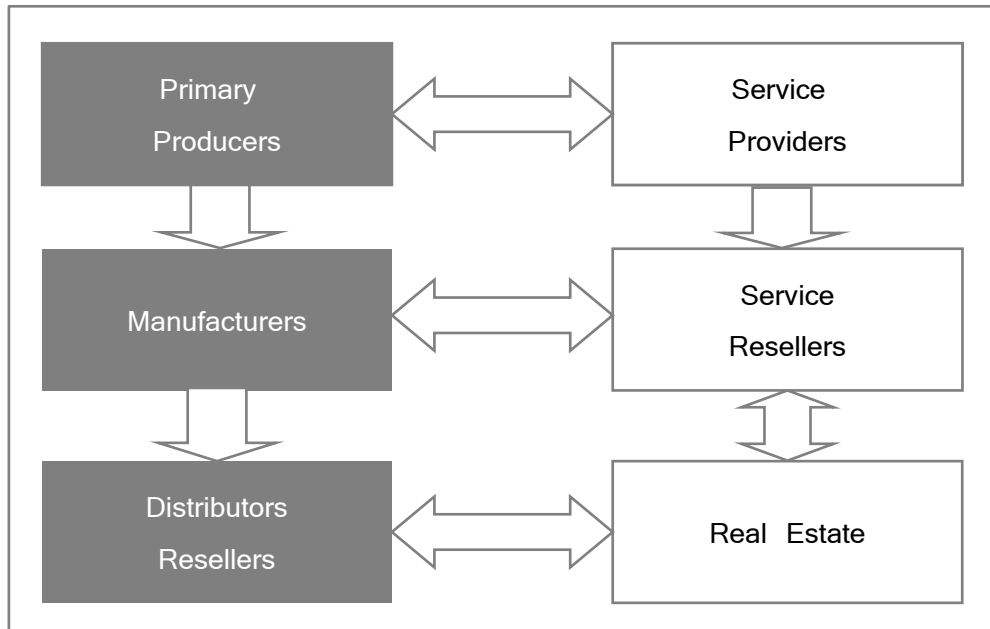
February 4, 2015



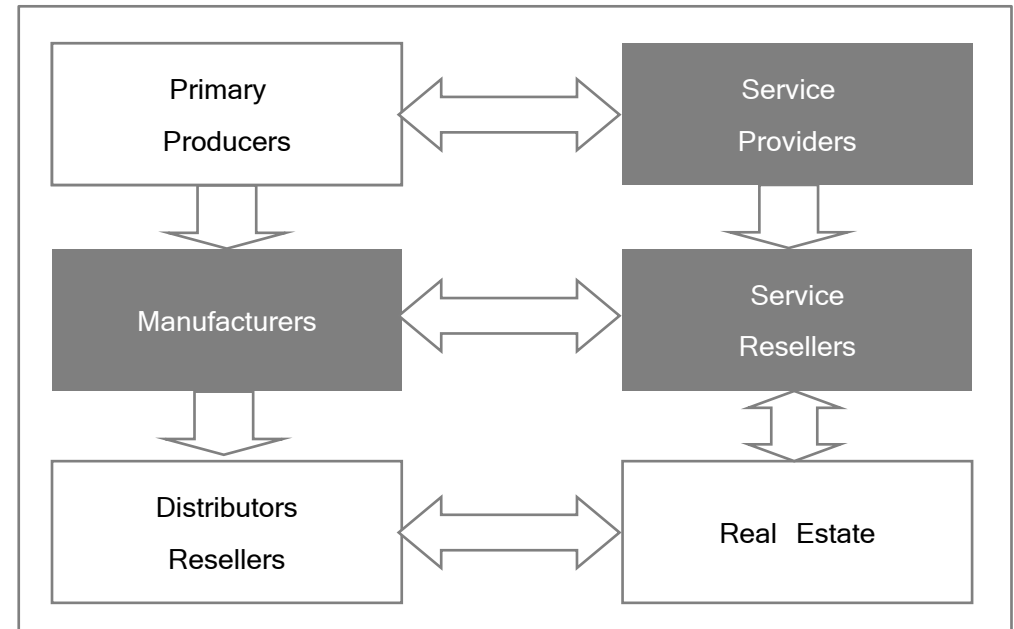
Building a better
working world

Current Patchwork of Indirect Taxes

State VAT



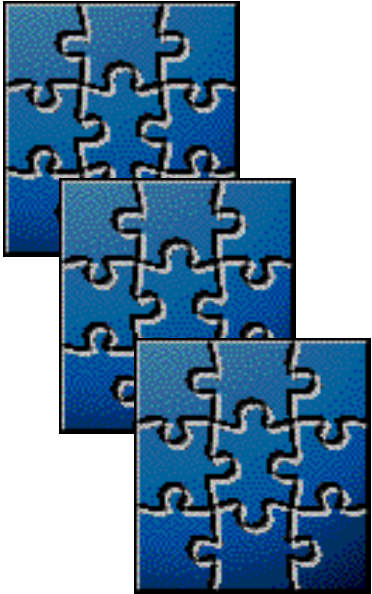
CENVAT/Service Tax



WHY GST?

- ▶ Less tax cascading
 - ▶ Increased investment
 - ▶ Improved competitive position of Indian producers
- ▶ Broader base, lower taxes
- ▶ Simpler and rational tax structure
- ▶ Improved administration (simplicity and lower cost of administration)
- ▶ Improved compliance

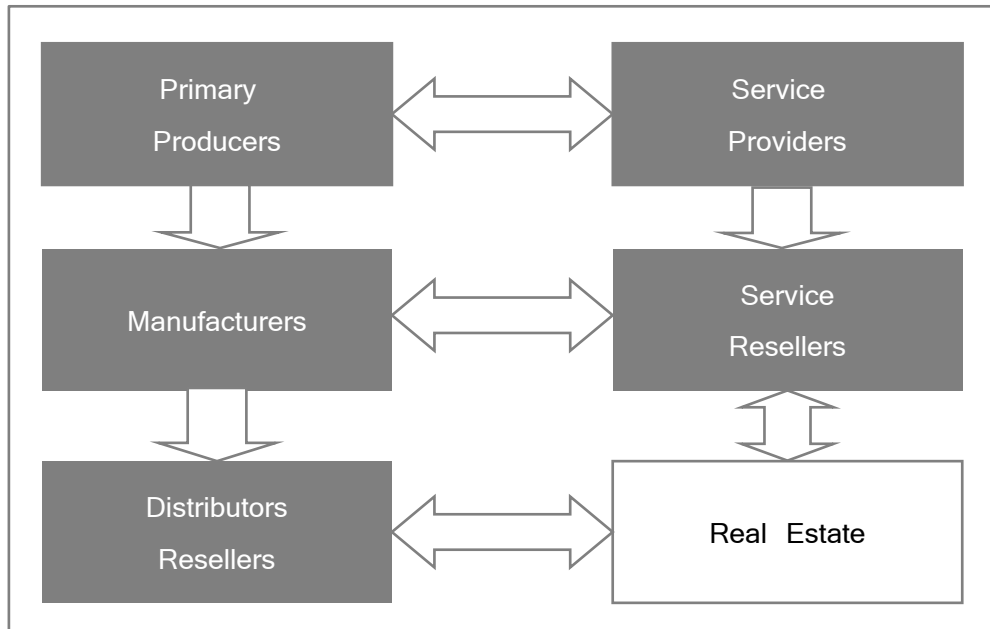
Issues under Debate



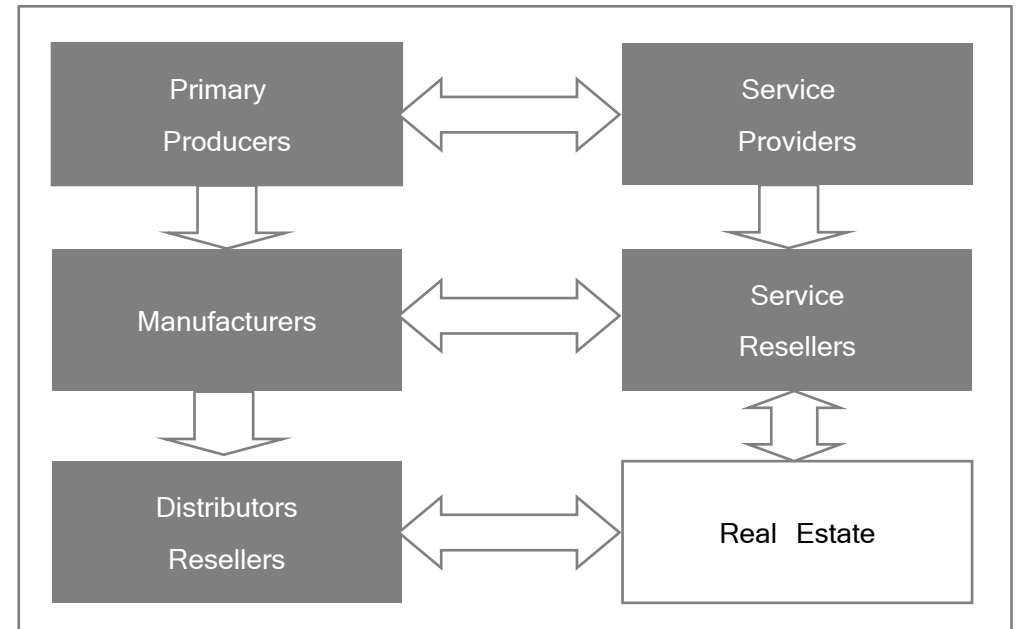
- ▶ Fiscal Autonomy Vs Harmonization
- ▶ Tax Rates
- ▶ Tax Base
- ▶ Taxes to be subsumed
- ▶ Compensation to States
- ▶ Consensus in GST Council
- ▶ Role of Dispute Settlement Authority

Proposed GST Framework

State GST (SGST)



Centre GST (CGST)



Empowering the Union and States to Levy the GST

- ▶ Dual GST: Both the Centre and States given concurrent powers to levy GST
- ▶ IGST: Centre given exclusive powers to levy GST on supplies in the course of inter-State trade and commerce and imports into India
- ▶ GST defined as any tax on supply of goods and services other than on alcohol for human consumption
- ▶ Effective date of these powers to be the date recommended by the GST Council
- ▶ Centre empowered to formulate rules for the Place of Supply

GST Council

- ▶ To be formed by the President within 60 days from the coming into force of the Constitutional Amendments
- ▶ **Consists of:**
 - ▶ The Union Minister of Finance (Chairperson)
 - ▶ The Union Minister of State for Revenue/Finance
 - ▶ The State Ministers (of Finance or any other Minister nominated)
- ▶ **GST Council to make recommendations on all aspects of GST:**
 - ▶ rates, rate bands, base, thresholds, taxes to be subsumed,
 - ▶ special provisions for Arunachal Pradesh, Assam, J&K, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura . Himachal Pradesh, and Uttarakhand
 - ▶ date for application of GST to petroleum products

GST Council

- ▶ Quorum for Council Meetings: 50% of the total members
- ▶ Required majority for Council decisions:
 - ▶ 75% of the weighted votes of the members present and voting
 - ▶ Weights: one-third for the Centre, and two-thirds for all States taken together
 - ▶ Effectively, decisions require agreement of the Centre + 63% of the States
- ▶ Council decisions are recommendations, which need to be ratified by Parliament and State Legislatures
- ▶ Council may decide modalities for dispute resolution

GST Base

- ▶ Consists of goods and services
- ▶ Goods defined in Article 366(12): "goods includes all materials, commodities, and articles"
- ▶ Services defined as "anything other than goods"
- ▶ No concept of deemed sales for GST (e.g., works contract, leasing, etc.)
- ▶ Debatable whether **land and real property** sales included in the definition of services
 - ▶ Agreements for purchase of real property prior to construction could be outside the scope of GST without the concept 'deemed sale'
 - ▶ Real property leases considered a service and thus subject to GST

Petroleum Products

- ▶ Petroleum products to be included in the GST base at a future date to be decided by the GST Council:
 - ▶ Petroleum Crude, High-speed Diesel, Petrol, Natural Gas, and Aviation Turbine Fuel
- ▶ Products exempted, not zero-rated
 - ▶ No credit to the petroleum producers and suppliers for GST on production and distribution inputs
- ▶ States empowered to levy sales tax (but not purchase tax) on the products, and the Centre empowered to levy the excise duty
 - ▶ No credit for the State sales tax and the Centre excise duty against the GST
 - ▶ State sales tax limited to intra-state sales only
- ▶ Cascading compounded if petroleum products taxable at multiple points in the supply chain without a credit system: e.g., tax on crude and then again on refined products

Electricity

- ▶ Electricity considered a good under international jurisprudence, thus included in the scope of GST
- ▶ However, State powers to levy a duty on electricity not subsumed under GST
 - ▶ No indication from the governments whether GST would still be extended to electricity
- ▶ Electricity transmission and distribution services not subject to electricity duty and remain within the scope of GST

Alcohol

- ▶ GST defined as any tax other than Alcoholic liquor for human consumption
 - ▶ Unusual way of excluding the products from the base
- ▶ Exclusion is meant to be interpreted as an exemption under GST
 - ▶ No GST on supplies of alcohol, and credit for GST on production and distribution inputs
- ▶ States empowered to levy sales tax on alcoholic liquor for human consumption, other than sales in the course of inter-state and international trade or commerce
- ▶ States also retain the right to levy excise duty on alcohol for human consumption
- ▶ Denatured alcohol included in the GST base
 - ▶ So are medicinal and toilet preparations (MTP). No separate excise duty provision for them

Tobacco

- ▶ Tobacco and tobacco products included in the GST base
- ▶ Centre empowered to levy supplementary excise duty on tobacco and tobacco products
 - ▶ No such power extended to the States

Central Sales Tax (CST)

- ▶ CST on inter-state sale of goods to be subsumed under the GST
- ▶ Imports and supplies of goods and services in the course of inter-state trade subject to the IGST (Article 269A)
 - ▶ IGST revenues to be apportioned between the Centre and States, based on the recommendations of the GST Council
- ▶ An additional tax of up to 1% to be levied by the Centre on inter-state supplies of goods. Revenues to be assigned to the origin states
 - ▶ Tax to be limited for two years or such longer period recommended by the GST Council
- ▶ Centre retains the power under Article 269 to levy tax on inter-state sale or consignment of goods not subject to GST (i.e., petroleum and alcohol)
 - ▶ The tax rate not limited to 1%. However, there is no indication that the Centre would exercise this power to tax petroleum or alcohol in excess of 1%.

Entertainment taxes

- ▶ Taxes to be subsumed under GST, except for:
 - ▶ “Taxes on entertainments and amusements to the extent levied and collected by a Panchayat or a Municipality or a Regional Council or a District Council”

Tax Rates

- ▶ GST rates to be decided by the GST Council
- ▶ Revenue Neutral Rates (RNR) estimated by NIPFP:
 - ▶ Three-rate structure (combined CGST+SGST):
 - ▶ 1% (or 2%?) for precious metals and articles,
 - ▶ 12% for basic necessities,
 - ▶ 27% Standard Rate for all other goods and services.
 - ▶ Extreme discomfort with these rates and their accuracy
- ▶ Options for a single moderate rate are under consideration

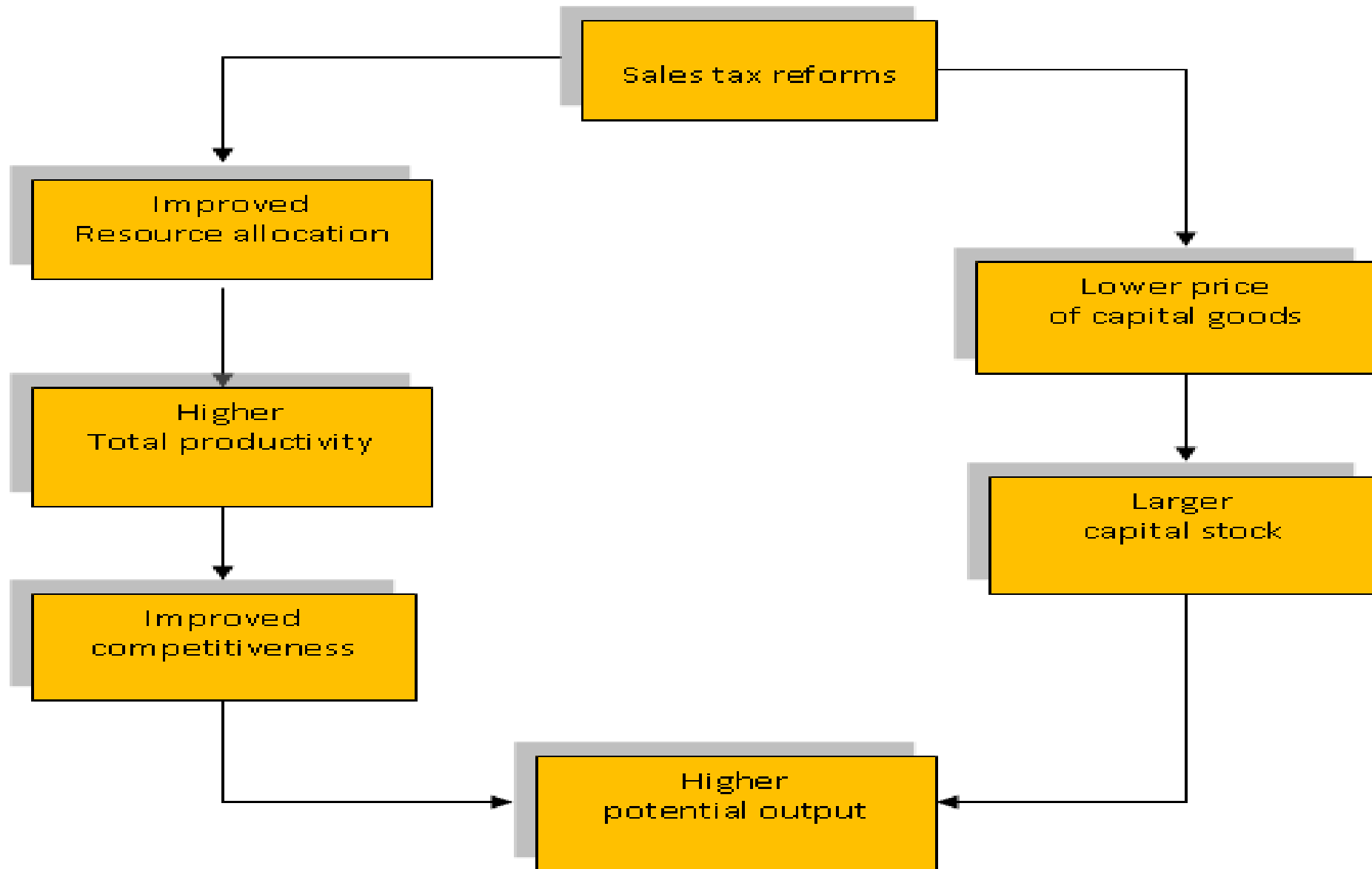
Revenue Compensation to States

- ▶ Centre agrees to provide compensation to States for any revenue loss from GST for up to five years
- ▶ Compensation to be 100% of the loss during the first three years, 75% in the fourth year, and 50% in the fifth year
- ▶ No clarity on the method for calculating revenue loss
 - ▶ States likely to insist on compensation up to old system revenues projected to future years on the basis of average/trend growth rate in the past 3/5 years
 - ▶ Centre may insist on broadening of the tax base and/or upward adjustment in tax rates to minimize compensation amount
- ▶ No incremental benefit of the 1% additional tax (CST) to the 'loser' states (those who receive compensation)
 - ▶ The additional tax is of benefit to only the 'gainer' states (those not eligible for compensation because the GST results in a revenue gain for them).
- ▶ Moral hazard of full compensation to States
 - ▶ No incentive for the States to improve and enhance revenue collection during the compensation regime

Key issues for businesses

- ▶ Rates and base
- ▶ Clarity on regulatory process
- ▶ Place of supply rules
- ▶ Whether excess input tax credit refund allowed
- ▶ Whether real property sales within GST scope
- ▶ Whether inputs to real property creditable
- ▶ Whether IGST will apply to consignment transfer
- ▶ When will GSTN be ready
- ▶ Transitional provisions
 - ▶ Carry forward of excess credit from current regime
 - ▶ Continuation of Centre and State incentives

GDP Flow Chart



GST – Impact on Business

GST will impact all aspects of a business:

- ▶ Cash flow
- ▶ Pricing
- ▶ Profits
- ▶ Capital expenditure
- ▶ Supply chain
- ▶ Domestic supply vs. Imports and Exports
- ▶ Transition
- ▶ Competition
- ▶ Compliance and systems

Cascading base

#	Description	Amount (Rs. Trillion)
A	<i>Current inputs</i>	
1	Petroleum sector	3.48
2	Electricity sector	1.29
3	Construction services	7.94
4	Total current inputs (1+2+3)	12.71
B	<i>Capital inputs</i>	
5	Petroleum sector	0.80
6	Electricity sector	1.13
7	Total Capex (5+6)	1.93
8	Total cascading base (4+7)	14.64

Indirect tax revenues – Centre & States

– Taxes to be subsumed within GST

#	Description	FY13 (Rs. Cr) Actual	FY14 (Rs. Cr) RE
1	Union Excise Duties (UED) + Service tax incl. POL revenues)	3,08,446	3,43,714
2	UED less POL revenues + Service tax	2,23,548	2,55,114
3	State revenues to be subsumed within GST (incl. POL and Alcohol)	4,46,566	4,92,260
4	State revenues to be subsumed within GST (excl. POL and Alcohol)	3,00,530	3,28,515
5	Centre + State revenues (incl. POL & Alcohol revenues)	7,55,012	8,35,974
6	Centre + State revenues (excl. POL & Alcohol revenues)	524,078	583,629
7	GDP at current market prices	1,01,13,281	1,13,55,073
8	Centre + State revenues/ GDP ratio (incl. POL & Alcohol revenues)	7.47%	7.36%
9	Centre + State revenues/ GDP ratio (excl. POL & Alcohol revenues)	5.18%	5.14%

Note: State taxes to be subsumed include State VAT, CST, Entry tax, Entertainment tax, Purchase tax
 Source: RBI study of State Finances, CSO, Union Budget documents

RNR estimation

- Alternate scenarios

#	Description	Unit	Amount
1	GDP at current market prices (FY13 approx.)	Rs. Trillion (Lakh crore)	100
2	Comprehensive GST base – PFCE + GFCE on goods and services (approx. in FY13)	Rs. Trillion	60
3	Centre and State indirect tax revenues / GDP ratio (incl taxes to be subsumed within GST and excl. taxes from Petroleum products and Alcohol)	%	5.18
Revenue Neutral Rate – alternative scenarios			
4	If base is Rs. 60 trillion (60% of GDP)	%	8.6
5	If base is Rs. 45 trillion (45% of GDP)	%	11.5
6	If base is Rs. 20 trillion (20% of GDP)	%	25.9

GST Base and Revenue Productivity

	Inception Tax Rate	C- efficiency	Revenue Productivity
Canada	7	0.68	0.5
Japan	3	0.64	0.5
New Zealand	12.5	0.98	0.73
Singapore	3	0.70	0.4

C-efficiency is a measure of tax base as a fraction of total consumption

Revenue productivity is tax revenues as a percent of GDP, per point of the standard VAT rate.

Modern VATs have broader tax base, and yield higher revenues.
New Zealand has the broadest base, the highest revenue productivity.

Impact on various sectors

▶ **Services sector**

- ▶ Increase in output tax rate
- ▶ Most impact: Telecommunications, Financial Services, Transportation

▶ **Petroleum sector**

- ▶ Blocked input taxes

▶ **Construction sector**

- ▶ No credit for GST on construction services to industrial and commercial users
- ▶ Most impact: Infrastructure, industrial and commercial property and structures

▶ **Alcohol sector**

- ▶ Blocked input taxes
- ▶ Non-transparency in tax

▶ **Electricity**

- ▶ Blocked input taxes

Way Forward

- ▶ Parliament to consider the Bill in the Budget Session (February/March 2015)
- ▶ Finance Minister does not consider it necessary to refer the Bill to the Parliamentary Standing Committee
 - ▶ However, opposition parties may insist on the referral
- ▶ Drafting of the GST law to commence in the new year, even though the law can be tabled only after ratification of the Constitution Bill
- ▶ Governments still planning for GST implementation on April 1, 2016. This timetable is challenging, but not impossible.

Thank you



Building a better
working world