

TAXATIONEXT

(By S. Jaikumar, Advocate, Swamy Associates)

Prologue: To me GST is the soul of the expected Indian Tax Revolution! ETA of GST was April 2010! But the flight is delayed and now the ETA is October 2010! It may be further delayed, maybe to April 2011 or even later! But I am sure, being the dream of an aspiring nation to become the 2020 superstar, GST, the Messiah, shall certainly arrive! This sequel on GST is written in parts, trying to document the genesis and its evolution! This trilogy is on the First Paper of the Empowered Committee released on 10.11.2009.

GST – THE NECESSITY

"Necessity is the mother of invention"

- **Plato, Greek Philosopher, 427 – 347 B.C**

Goods and Services are the two terminal points in any trade and commerce. Though they run parallel and are mutually exclusive, many a times, they blend at a point where they are thoroughly fused together! For example, if activities like teaching are pure services where there would be no involvement of goods at all would be one terminal point, the sale of commodities which are pure goods and where there would be no provision of services, would be the other terminal point. But in cases like construction of a building etc, there will be both, such as services (construction) as well as goods (cement, steel, etc). In such cases, the goods as well as the services would have a meeting point, so intertwined, where the services as well as the goods component cannot be distinguished or bifurcated. At present, having Excise/Customs duties for the commodities and Service tax for the services, the Government has formulated separate mechanisms to deal them separately. It would be relatively easy to tax the terminal points like the pure goods under Excise and pure services under Service tax. But levying tax on the sectors like ready-made garments etc, where both the goods and services are equally and inseparably present, taxing them has always been Herculean task!

VAT IN INDIA

The foundation stone to the GST was laid by the then Finance minister Mr. V.P. Singh, whereby, he introduced the first comprehensive and milestone set – off scheme under the Central Excise law, called MODVAT (Modified Value Added Tax) scheme in the year 1986. This MODVAT scheme neutralized the cascading effect of tax – on – tax by giving the credit of the excise duty paid on the inputs to be set- off against the duty payable on such final products.

This MODVAT scheme, which was introduced to the inputs, raw materials and consumables which were used directly or indirectly used in the manufacture of the final products, was extended to the capital goods in the year 1994. With few restrictions like 50% availment in the first year and the balance in any subsequent years and no depreciation claim on the credit amount, this was the next beneficial extension of the MODVAT scheme.

The year 1994 also saw a radical change in the indirect tax domain with the introduction of an indirect tax on services called the "Service Tax" through the Finance Act, 1994. Though introduced to three services like Telephones, Non-Life Insurances and Stock broking in the year 1994, this tax has multiplied like virus and today has near to 200 services in the net. With the tax rate @ 5%, the service tax lived its initial years without the benefit of the set – off schemes. Further, the Central Board of Excise and Customs (CBEC) had also issued certain clarifications in certain services, whereby, it had been clarified that there was no need to pay any service tax by the sub – contractors of the main service providers, if the main service provider is paying the service tax. Hence, both the moderate rate of tax as well as the non – requirement for the sub- contractors to pay any tax, did not either hurt the service tax assesses to cry for any credit scheme nor the Government to think of such a scheme for service tax. Subsequently, with the increase in the service tax rate from 5% to 8% and then to 10%, the service industry started feeling the pinch. Thus, in the year 2002, the Government introduced a "limited edition" of service tax credit and extended it in the year 2003 to all taxable services.

The year 2004 has to be hailed as another significant year in Indirect tax administration as this year saw the introduction of "cross-sectoral" credit through the Cenvat Credit Rules, 2004 (CCR). The scheme rechristened as CENVAT credit is a milestone, whereby, the credit of the excise duty/countervailing duty paid on the inputs/capital goods and the service tax paid on the input services were allowed to be used for the payment of excise duty payable on the final products manufactured as well as for the service tax payable on the output services provided.

Year 2005 saw the Value added Tax (VAT) being introduced in many States in India, whereby, the set-off scheme was introduced in the State administered indirect tax – Sales Tax! Now with the sound and solid groundwork, India is all set to launch the GST – the TAXATIONEXT!

GST – ECO SYSTEM!

To me, there are four direct players in this GST game, namely, the Central Government, the State Government, the Trade and last but not the least, the Consultants. Now we shall see the benefits to all of them, sequentially.

Firstly, the Central Government. Today, the Centre levies indirect taxes on goods and services, namely the Central Excise duties on manufacture of goods, the Service tax on provision services and the Customs duties on import of goods. In the goods sector, the Centre is now empowered to levy taxes only upto the stage of manufacture. Today, the Centre is not able to levy a tax on the trading of the goods as the Centre is not empowered to tax the SALE of goods but only empowered to tax "MANUFACTURE" as per Entry 84 of the Union List. In other words, the huge value addition in the value chain of the commodities, from the stage of manufacture till the stage of retail trade, is out of the levy of Central Excise. Only the States are today empowered to tax the goods on their SALE upto the retail trade. By this GST, the Centre would be empowered to tax the commodities till the retail point and increase its tax base multifold. An illustration below, keeping a notional GST rate of 10%, would make the proposition lucid and clear.

Stage of Supply chain	Purchase value of input	Value addition.	Value of supply made to next stage	Rate of GST	GST on output	Input tax credit	Net GST
Manufacturer	100	30	130	10%	13	10	3
Wholesaler	130	20	150	10%	15	13	2
Retailer	150	10	160	10%	16	15	1
						Total	6

In the above table, at present, the Centre is collecting Central Excise duty only upto the stage of the manufacture, which is 3. Now with the GST in place, the Centre would be empowered to tax till the retail point, thereby increasing its tax collection to 6! This whopping increase in tax collection would be the incentive for the Centre to pursue GST!

Secondly the State Governments! Today, as per Entry 54, the State List is confined to taxing SALE of goods and as on date, the States are not empowered to tax the Services, which is emerging as the biggest tax grosser in the last decade. Every State knows that Service sector is going to be the hero of indirect taxes in future. This GST would enable the States to tax the Services, which is the greatest incentive for the States! Further, as on date, as per Article 286 of the Constitution, the States are not allowed to tax imports. This GST would enable the States to levy tax on the import of goods too! This double bonanza of taxing the services as well as taxing the imports would be a great incentive for the States to pursue GST!

Thirdly our R.K.Lakshmanji's common man! With the Centre and State hitting the bull's eye, the benefit for the trade is the much – sought – after - relief from the cascading effect! With the CENVAT scheme and the State VAT scheme had already offloaded the cascading effects in their respective taxes, the cascading effect remains today, mainly in two areas namely, in the CST as well as the VAT payable on the manufacture! Today, with no set- off available, CST is forming part of the cost. With the introduction of GST, Government has promised to withdraw CST completely, thereby, granting a Relief No.1! Second major relief is, today, VAT is paid on the value of the manufactured goods including the excise duty component, but after the advent of VAT, the VAT would be payable only on the value of the manufactured goods and not on the value including the excise duty! Thirdly, the Central Excise duty is today forming part of the price in the value chain beyond the point of manufacture or beyond the registered dealer point. The GST would take this duty component right through the value chain, thereby, maintaining a better tax ecology!

Last but not the least is about my own brethren, the Consultants! Though Central Excise Act is from 1944 still we are litigating on the question as to what is "manufacture" in the corridors of every other tax court. Same way, the Finance Act for Service tax which came into force from 1994, has already rolled out the 1,11,11,111,111th notice and still growing! GST is going to be a potential stew, which I am sure, would feed me and my fraternity for eternity and hence GST would be our Almighty!

TODAY IN INDIRECT TAXES...

In Excise Act, though the mother of "manufacture", because of its inclusive definition has created light years of litigation. The "deemed" concepts of manufacture and marketability has literally "doomed" the assesses because of its interpretational warfare! The issues over the cobweb valuation match our Mother Universe in both size as well as uncertainty! Though the uniform rates have controlled the classification disputes, the countless notifications still remain to be Lord Hanuman's tail!

In Service Tax, the issues are even murkier! Being the tax team's fastest growing grosser of revenue as well as generating astronomical number of issues relating to applicability (owing to lousy inclusive definitions), classification, valuation, this tax is, today, the "crowning glory" of Indian Indirect taxes!!!

The VAT has been plagued by the different definitions and rates in different States, the Border Controls and the deviation of practices! Similarly, the origin based tax, no set – off, stock transfer distortions, complex law on transit sales, check post controls and the conflict with VAT has created a cancer in CST, making the life of the trade miserable!

SALE vs SERVICE

The epic tussle between SALE vs SERVICES would match that of Coke – Pepsi war! As discussed *supra*, in transactions involving both the components of sale of goods as well as provision of services (eg. Tyre Retreading), the question to classify the transaction as "goods" or as "services" has always been an intrigue. The dispute as to whether to classify as "goods" and tax a transaction as "SALE" or to treat the same as "SERVICE" and tax the same as service would arise in many situations (eg. Software). In this connection, reference is drawn to the landmark decision of the Apex Court in the case of **Tata Consultancy Services v. State of Andhra Pradesh - 2004 (178) E.L.T. 22 (S.C).**

Likewise, "Works Contracts" is another imbroglio! In the celebrated judgement in the case of **BHARAT SANCHAR NIGAM LTD Vs UNION OF INDIA-2006 (2) S.T.R. 161 (S.C.,** the Hon'ble Apex Court held that, though there may be a overlapping of levy of Sales tax as well as service tax in a single transaction, there cannot be a overlapping of the value of such taxable events.

With the tax eco system completely ruined by extreme famine and ruthless floods and when the cup was overflowing with woes and despair, the GOOD NEWS came!!! - **MEET YOU IN PART II.**