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GST and its implication: Detailed perspective

Dr. Mahender Kumar
Associate Professor
Commerce Govt. College, Bhiwani

Abstract:

GST which is also known as goods and service tax is a new paradigm in the history of independent India. This is a tax which will be levied on the supply side of goods rather than the traditional view of manufacturing side of taxation. This paper tries to highlight the detail view of GST i.e. detailed introduction of GST, its advantages and its implication in large.

The aim of this paper is to make GST explainable and to make a concise and in depth view of GST and its impact on the Indian financial System.

Key words: GST, Impact and Incidence of tax, Tax base, Financial System.

Introduction:

Goods and service tax which is considered as one of the pioneer financial reforms after independence was first presented in the parliamentary session of 2005-2006 by the Vajpayee led government. Experts and analysts from Empowering committee headed by Asim das gupta brought forwarded strategies for its implementation and for studying its implications but due to lots of complications GST missed its deadline of rolling out in the year 2010.In 2011 the constitutional amendment bill was again brought into consideration but again due to lack of government coordination and the majority issues it couldn't be implemented.

But now with the passage of the Constitution Amendment Bill for Goods and Services Tax (GST) in the upper house of parliament on 3 August 2016, the Government of India seems all committed to replace the indirect taxes levied on goods and services by the Centre and States and implement GST by April 2017.
So after all this implementation and government process now the future of GST seems bright. The other section of this paper tries to explain goods and service tax and its advantages:

Goods and service tax:

The present structure of Indirect Taxes is very complex in India. There are so many types of taxes that are levied by the Central and State Governments on Goods & Services. Like Entertainment tax for watching a movie, Value added tax on purchasing goods and services. And there are Excise duties, Import duties, Luxury tax, Central Sales Tax, Service tax etc.

As of today some of these taxes are levied by the Central Government and some are by the State governments. So as to unified the tax structure GST came into existence.

As the name suggests, the GST will be levied both on Goods and Services. Any person, who is providing or supplying goods and services, is liable to charge GST.

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How is GST applied?

GST is a consumption based tax/levy. It is based on the "Destination principle." GST is applied on goods and services at the place where final/actual consumption happens.

GST is collected on value-added goods and services at each stage of sale or purchase in the supply chain. GST paid on the procurement of goods and services can be set off against that payable on the supply of goods or services. The manufacturer or wholesaler or retailer will pay the applicable GST rate but will claim back through tax credit mechanism.

But being the last person in the supply chain, the end consumer has to bear this tax and so, in many respects, GST is like a last-point retail tax. GST is going to be collected at point of Sale.

Figure 1. Mechanism of GST

Explanation of GST with the help of example:

Stage 1

Imagine a manufacturer of, say, shirts. He buys raw material or inputs — cloth, thread, buttons, tailoring equipment — worth Rs 100, a sum that includes a tax of Rs 10. With these raw materials, he manufactures a shirt.

In the process of creating the shirt, the manufacturer adds value to the materials he started out with. Let us take this value added by him to be Rs 30. The gross value of his good would, then, be Rs 100 + 30, or Rs 130.

At a tax rate of 10%, the tax on output (this shirt) will then be Rs 13. But under GST, he can set off this tax (Rs 13) against the tax he has already paid on raw material/inputs (Rs 10). Therefore, the effective GST incidence on the manufacturer is only Rs 3 (13 – 10).

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Stage 2

The next stage is that of the good passing from the manufacturer to the wholesaler. The wholesaler purchases it for Rs 130, and adds on value (which is basically his 'margin') of, say, Rs 20. The gross value of the good he sells would then be Rs 130 + 20 — or a total of Rs 150. A 10% tax on this amount will be Rs 15. But again, under GST, he can set off the tax on his output (Rs 15) against the tax on his purchased good from the manufacturer (Rs 13). Thus, the effective GST incidence on the wholesaler is only Rs 2 (15 – 13).

Stage 3

In the final stage, a retailer buys the shirt from the wholesaler. To his purchase price of Rs 150, he adds value, or margin, of, say, Rs 10. The gross value of what he sells, therefore, goes up to Rs 150 + 10, or Rs 160. The tax on this, at 10%, will be Rs 16. But by setting off this tax (Rs 16) against the tax on his purchase from the wholesaler (Rs 15), the retailer brings down the effective GST incidence on himself to Re 1 (16 –15).

Thus, the total GST on the entire value chain from the raw material/input suppliers (who can claim no tax credit since they haven't purchased anything themselves) through the manufacturer, wholesaler and retailer is, Rs 10 + 3 +2 + 1, or Rs 16.

In a full non-GST system, there is a cascading burden of "tax on tax", as there are no set-offs for taxes paid on inputs or on previous purchases.

Thus, if we consider the same example as above, the manufacturer buys raw materials/inputs at Rs 100 after paying tax of Rs 10. The gross value of the shirt (good) he manufacturers would be Rs 130, on which he pays a tax of Rs 13. But since there is no set-off against the Rs 10 he has already paid as tax on raw materials/inputs, the good is sold to the wholesaler at Rs 143 (130 + 13).

With the wholesaler adding value of Rs 20, the gross value of the good sold by him is, then, Rs 163. On this, the tax of Rs 16.30 (at 10%) takes the sale value of the good to Rs 179.30. The wholesaler,

again, cannot set off the tax on the sale of his good against the tax paid on his purchase from the manufacturer.

The retailer, thus, buys the good at Rs 179.30, and sells it at a gross value of Rs 208.23, which includes his value addition of Rs 10 and a tax of Rs 18.93 (at 10% of Rs 179.30). Again, there is no mechanism for setting off the tax on the retailer's sale against the tax paid on his previous purchase.

The total tax on the chain from the raw material/input suppliers to the final retailer in this full no- GST regime will, thus, work out to Rs 10 + 13 + 16.30 + 18.93 = Rs 58.23. For the final consumer, theprice of the good would then be Rs 150 + 58.23 = Rs 208.23.

Compare this Rs 208.23 — with a tax of Rs 58.23 — to the final price of Rs 166, which includes a total tax of Rs 16, under GST.

So with the help of this example mechanism of GST can be easily ascertained. Now the

other segment of the paper deals with Benefit and implication of GST

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Benefits of GST:

- Wider tax base, necessary for lowering the tax rates and eliminating classification disputes
- Elimination of multiplicity of taxes and their cascading effects
- Rationalization of tax structure and simplification of compliance procedures
- Harmonization of center and State tax administrations, which would reduce duplication and compliance costs.
- Automation of compliance procedures to reduce errors and increase efficiency

Implication of GST:

Distribution point of view:

- Changes in tax system could warrant changes in both procurement and distributionarrangements
- Current arrangements for distribution of finished goods may no longer be optimal with theremoval of the concept of excise duty on manufacturing
    - Current network structure and product flows may need review and possible alterationPricing

point of view:

- Tax savings resulting from the GST structure would require repricing of products
    - Margins or price mark-ups would also need to be re-examinedCash flow point of view:

- Removal of the concept of excise duty on manufacturing can result in improvement in cash flow and inventory costs as GST would now be paid at the time of sale/supply rather than at the time or removal of goods from the factory.

System changes and transaction management point of view:

- Potential changes to accounting and IT systems in areas of master data, supply chain transactions, system design
- Existing open transactions and balances as on the cut-off date need to be migrated out to ensure smooth transition to GST
- Changes to supply chain reports (e.g., purchase register, sales register, services register), other tax reports and forms (e.g., invoices, purchase orders) need review
- Appropriate measures such as training of employees, compliance under GST, customer education, and tracking of inventory credit are needed to ensure smooth transition to the GST regime

Taxation point of view:

- It's a major indirect tax reform in the country. The entire indirect tax code will be a new set. Any comparison with the present laws will be inappropriate. Lot of time will be devoted in understanding new concepts and procedures.

- Standard rate of 12% for CENVAT, 14.5% for Service tax, residuary rate of VAT at 12.5 % brings overall rate to 28%. But post GST, tax rate is likely to be between 18-20%, gain of 8- 10%. A detailed analysis is required to understand the impact of changes in tax rates.
- Currently, limited inter levy credits are allowed between excise duty and service tax. No cross credits are available across these taxes. When GST is introduced, it will facilitate seamless cross credit across the entire supply chain and across all states with a common taxbase.

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Conclusion:

In conclusion, GST which is likely to be inflationary would hit people in the lower income group hardest as they currently pay little or no income tax at all. However, a number of considerations suggest that the impact would be moderate. Sales tax and service tax component are already hidden in the prices of all commodities and basic items would be largely exempted from GST. Other necessities such as fuel and power, public transport and medical care are concerned, there is sufficient already. Government need to intervene to ensure that the poor is protecting from GST effect.

The implication of passing GST and the finalization of tax rate is also a cumbersome tax which will also create some implication in its implication as of now only few states have passed GST so the future is full of uncertainty but still there is a ray of home that it will create strong financial positivity as an when it will be fully implemented.

*Taxes to be subsumed and Journey of GST

GST would replace most indirect taxes currently in place such as:

Central Taxes	State Taxes
Central Excise Duty [including additional excise duties, excise duty under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955] Service tax Additional Customs Duty (CVD) Special Additional Duty of Customs(SAD) Central Sales Tax (levied by the Centreand collectedby the States) Central surcharges and cesses (relatingto supply of goods and services)	• Value Added Tax • Octroi and Entry Tax • Purchase Tax • Luxury Tax • Taxes on lottery, betting & gambling • State cesses and surcharges • Entertainment tax (other than the tax levied by the local bodies) • Central Sales Tax (levied by the Centre and collected by the States)

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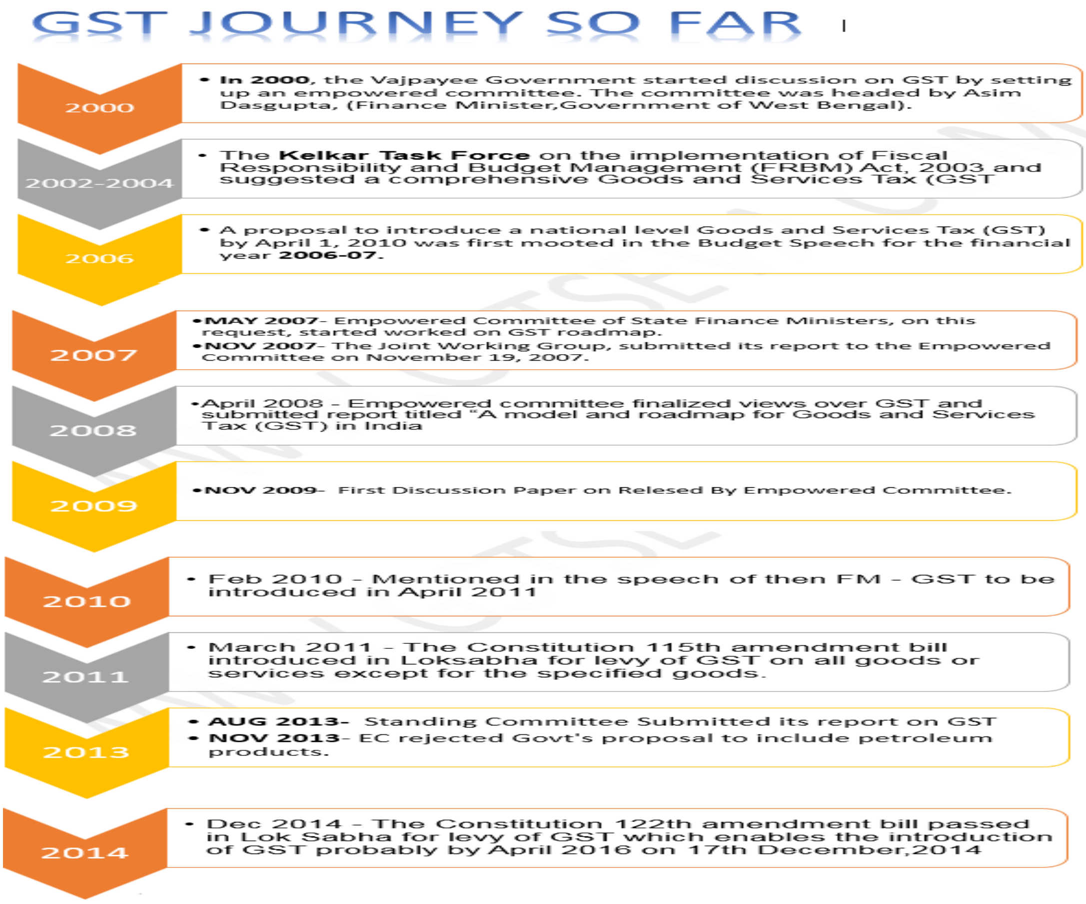

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