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TAXATION SYSTEM IN INDIA: GST AS NEW AVENUE TO STRENGTHEN TAX REVENUE

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Taxation System:

Taxation system is a backbone of any country's economy. To increase GDP, generate employment, build infrastructure etc. tax system plays a very important role. Every country generates revenue through different tax system. To understand the global scenario of tax system we need to see how different developed countries deploy their tax system.

Taxation system in India:

Taxes in India are levied by the Central Government and the state governments. Some minor taxes are also levied by the local authorities such as the Municipality and village panchayats. The authority to levy a tax is derived from the Constitution of India which allocates the power to levy various taxes between the Central and the State. An important restriction on this power is Article 265 of the Constitution which states that "No tax shall be levied or collected except by the authority of law". Therefore, each tax levied or collected has to be backed by an accompanying law, passed either by the Parliament or the State Legislature. The following diagram depicts the taxation system in India prior to GST.

Emergence of Goods and Service Tax in India.

The GST is expected to streamline the indirect tax regime. It contains all indirect taxes levied on goods, including central and state-level taxes. Billed as an improvement on the VAT system, a uniform GST is expected to create a seamless national market.

Through a tax credit mechanism, this tax is collected on value-added goods and services at each stage of sale or purchase in the supply chain, not only it will replace Central Indirect taxes but will replace state levied indirect taxes too. Experts say that GST is likely to improve tax collections and boost India's economic development by breaking tax barriers between States and integrating India through a uniform tax rate.

In India, a dual GST is being implemented wherein a central goods and services tax (CGST) and a state goods and services tax (SGST) is levied on the taxable value of a transaction. It collects tax on VAT method ie tax at every stage of value addition.

2017: on 1st July 2017 GST was introduced in the country.

The features of this Act are as follows:

- The Bill amends the Constitution to introduce the Goods and Services Tax (GST). Now, GST will subsume both the indirect taxes imposed by the Central Government – such as the Central Excise Duty, Central Sales Tax, Countervailing Duty and Service Tax. It will also subsume the state indirect taxes – such as the state Value Added Tax or VAT, Octroi and Entry Tax and Luxury Tax.
- The Centre and states will together implement the uniform GST which will be a "dual" GST – comprising of Central GST and State GST, which shall be legislated, levied and administered by the respective levels of government. The same taxable base will be subject to both GSTs. By subsuming various taxes and simplifying the complicated tax structure, it is expected to reduce compliance costs.
- It is already stated that a single system of tax administration will lead to simplification. Since collecting and verifying documents for claiming tax credits across states is an onerous task, only the Centre has the right as per the bill to levy and collect GST on supplies in the course of inter-state trade or commerce. The tax collected would be divided between the Centre and the States in a manner as decided by the Parliament, current laws, and the recommendations of the GST Council. In the 2011 bill introduced by the previous UPA government, the power to decide how to apportion the taxes between the Centre and State was with the Parliament – this power has been given in the 2014 law to the GST Council.

Goods and Service Tax: New Avenue to Strengthen Tax Revenue.

Taxation system plays a very important role in country's growth and prosperity. It enables government to build roads, bridges and connect villages to city. It helps in enhancing standard of education and provide equal chance for everyone to get educated. With such developmental projects only, the paid tax comes back to the tax payer. Therefore it is utmost important to have a strong taxation system which will enable the government to generate huge revenue. In India prior to Goods and Service taxes, Value Added Tax was the main source of generating revenue. In the following two tables how VAT and GST system works is explained.

Figure 1: System of Value Added Tax

Stage	Input Cost	Output Value	Value Addition	Tax Rate	Selling Price (Incl. Tax)	Tax Burden	Earnings
Manufacturer	0	100	100	10%	110	10	100
Whole seller	110	150	50	10%	165	15	40
Retailer	165	220	70	10%	242	22	55
Total Tax Collected						47	
Tax Percentage						19.42%	

- The manufacturer obtains input free-of-cost and adds a value of Rs. 100, with a tax rate assumed to be 10% - thus, the manufacturer sells the product to the wholesale person at Rs. 110, with a tax burden of Rs. 10.
- The wholesale person in turn obtains the product at Rs. 110 and the value of his output is Rs. 150 – thus resulting in net value addition of Rs. 50 (Value output at wholesale or Rs. 150 minus value output at manufacturer or Rs. 100). With a tax rate of 10% or Rs. 15 on the output value, the selling price is Rs. 165 (150 + 15).

Figure 2: System of Goods and Service Tax.

Stages	Input Cost	Output Value	Value Addition	GST Rate	GST	Input Tax Credit	Selling Price (incl. Tax)	Tax Burden
Manufacturer	0	100	100	10%	10	0	110	10
Whole Seller	110	150	50	10%	15	10	155	5
Retailer	155	220	70	10%	22	15	227	7
Total Tax Collected							492	22
Percentage of Tax							9.69%	

In Figure 2, nothing changes at the level of the manufacturer. However, at the wholesaler end, we find that tax is only paid for the value added (Rs. 50) and not for the output value (Rs. 150) – hence, the tax burden is only Rs. 5 and not Rs. 15 as in Figure 1. Similarly, at the retailer level, the tax is only on the value added at the retail level (Rs. 70) and not on the output value (Rs. 220) – a sum of Rs. 7. Hence, the total tax burden in this case is only Rs. 22 – a difference of Rs. 25 from Figure 1. It results in a reduction of the price of the product for the consumer by Rs. 15 from Figure 1 and a tax burden of less than 10%. Thus, we can see that the introduction of GST makes the product cheaper.

In practice, this system works through the concept called “input tax credits”. This means that when the wholesaler obtains the product from the manufacturer, he also obtains a receipt from the manufacturer or a certified legal document stating that the manufacturer has paid a tax of Rs 10 – therefore, when he has to pay the tax of Rs. 15 on the output value at his end – he shows this legal paper which subtracts Rs. 10 from his tax burden – reducing it to Rs. 5, which he pays as per Figure 2.

Similarly, the retailer obtains tax credit documents from the wholesaler specifying that the manufacturer and the wholesaler have paid their respective taxes – and so has to pay only Rs. 7. The cascading effect of taxes is thus avoided.

But some may ask – well, the taxes have actually reduced on the product – so why this is considered a big-ticket item or reform for governments? For mainly on reason - it is believed as well as observed that a reduction in these cascading taxes increases the incentive for more consumption, leading to higher revenues which compensate for the reduction in tax rates. Hence, nations promote GST. But that is not the lone reason to ask for GST in India. To understand this, we must realize how India's tax system works.

India has a federal system of governance, and the right to impose taxes is given both to central and state governments. Because of the right to impose taxes, both central and state governments also have the right to decide whether documents of manufacturers and/or wholesalers shall be accepted for tax credits or not while deciding on the retail price of the product. In many cases, state governments refuse to accept tax credits for taxes paid by manufacturers and/or wholesalers in other states.

In other cases, they refuse to accept tax credits for taxes paid by manufacturers or wholesalers to the Centre. In both situations, the consumer has to pay higher taxes, since tax is paid not on value added by the retailer, but on the final output value of the product at the retail end. In the example situation we gave, it would mean a tax of Rs. 22 at the retailer end instead of Rs. 7, entailing a higher burden of taxation on the consumer. Sometimes, some products are allowed tax credits but others are not allowed even when all other details are the same.

Because various state governments have their own rules and regulations with regard to accepting tax credits for taxes paid to other governments at different levels, manufacturers, wholesalers and retailers have to keep in touch with the latest rules and regulations formulated in this regard, and maintain a substantial set of machinery to keep up with these rules. This increases the transaction cost of bearing higher taxes – particularly for the manufacturers who want to earn higher profits through higher sales.

In addition, state governments too have to maintain a substantial administrative machinery to ensure that these rules are strictly enforced. All in all, this is a highly cumbersome process. And of course, there is the threat of tax authorities at the state level fleecing people at either of these ends – manufacturers, wholesalers or retailers.

GST simplifies the whole procedure and makes India a single unified market, thereby removing all these complications for people at all ends and making tax collection a much simpler process. It also makes it easier for the administration to certify that the taxes have been paid properly. And for the consumer, it ensures benefit through reduction in prices, incentivizing greater consumption. All in all, GST indeed helps everyone.

In addition, one must note that Figure 2 can be achieved for material products by VAT, but this leaves two loopholes: one, it allows states to decide VAT rates individually in their own territory; and two, it does not cover services which are taxed separately and differently across states. GST addresses this loophole as well and unifies India both in goods and services. In addition, currently different taxes are paid to different authorities at different levels, and it can't be ensured that the same person is paying taxes to all – ensuring tax compliance is a big headache. GST is expected to address this as well.

With regard to this particular bill introduced by the Modi government in Parliament, it is a constitutional amendment bill and has to be passed not only by 2/3rd majority of both houses of the Parliament (with at least half the house to be present and voting) but also by at least half the state legislatures in the country for it to be ratified by the President and become an Act.

Conclusion:

The principles of taxation advocate that either country must have strong tax base and have lesser rate of tax, or have higher rate of tax with fewer tax payers. In all developed coutries the simplified taxation system is being implementated the tax rates are lower and tax payers are many. It also creates a concensus to pay tax as the tax rate is low and compliance is compulsory. Since the tax rate is low more number of tax payers registers themselves and pay tax on annual bases, which helps the government to mobilise huge revenue eventhough the tax rates are low. GST in India is call as Good and Simple Tax as it subsumses all indirect taxes and provides a relief to both Government and the tax payers. The Government can collect tax with one single agency looking after the entire taxation system and the tax payer is suppose to submit qrtarly returns to only one tax collecting agency. Hence GST is a win win situation for both i.e. the tax payer and the Government. GST has put in place a very strong check and balance system which makes tax evasion almost impossible. Overall GST will prove to be the booster in fostering the growth of India and because of which India can become developed country.