

The Goods and Services Tax

The commonly known term, GST, stands for Goods and Services Tax. It more specifically comprises of Central Goods and Service Tax (CGST), Integrated Goods and Service Tax (IGST) and State Goods and Service Tax (SGST). The GST regime of taxation was introduced all over India by a constitutional amendment in 2016 and the enactments of the Central Goods and Services Act, 2017 and the Integrated Goods and Services Act, 2017 by the Parliament and a corresponding act by the states, for example, the Gujarat Goods and Services Act, 2017. The GST regime of taxation replaced several of the prevailing taxes and reformed the basis for the levy and collection of taxes. The GST is a very significant change for the economy, business and law. It was in the making for decades. It could not have been brought in without amending the constitution. In this chapter, we will first trace the evolution of the principles of taxation, leading up to GST and then apprise the salient features of the GST regime of taxation.

Constitution and Taxation

Taxation has been there for very long. A ruler could sustain only by imposing taxes on the subjects. Thus, very early the law got formulated that the ruler has the right to tax. The right to rule and the right to collect tax were two sides of the same coin. The sovereign (ruler) had the right to tax, and the reverse, the one who had the right to tax was the sovereign. As a result, it has been a cardinal principle of taxation that there can be no tax without the authority of the law. Centuries back, as agriculture was the main activity, land revenue was the main source of tax for the ruler. During the British period, as the economy diversified with the industrial revolution, other heads for taxation emerged. Among the indirect taxes, this included sales tax on the sale of goods; excise duty on the manufacture of goods; and customs duty on the import of goods. The basis for taxation was simple. Take the case of sale of goods. The rate of sales tax for different kind of goods was provided. Every trader making a sale was to charge the stated rate on the sale consideration and deposit the amount with the government. Similarly, the rate of excise duty was provided by the government. Every manufacturer putting the goods in circulation was to charge the rate on the value sale and deposit it with the government.

After Independence, the Constitution of India made elaborate provisions on taxation. Article 265 of the Constitution provides: 'No tax shall be levied or collected except by the authority of law.' Consistent with this, the Constitution of India makes elaborate provisions on the rights of the Union and the states to impose taxes. The Constitution of India separates the legislative functions of the Union and the states. It contains three lists, the Union List, the State List and the Concurrent List. The Union alone can legislate on the entries in the Union List. The states alone can legislate on the entries in the State List. However, both, the Union and the states can legislate on the entries in the Concurrent List. Some of the important sources of indirect taxes

in the Union List were custom duty, excise duty and inter-state sale of goods. The important sources in the state list were sale of goods within the state.

The Union and states made laws to levy and collect the taxes in their domain. There is always a play of strategy between the state and the tax payer. The tax payer looks to minimise paying the taxes. The strategy of the tax payer can range from outright tax evasion to find creative designs to minimise the tax. But the state is continually looking to protect and enhance its resources. The state attempts to counter every strategy of the tax payer by counter strategies. It codifies these in the tax laws. It is no surprise that the tax laws become very complex and intricate. But there is more to it. The indirect taxes affect the seller or the manufacture of that class of goods, a higher tax rate increases the price and lowers the demand. Second, as the burden of the tax is passed on to the final consumer, higher taxes lead to disaffection among the subjects. A wrong taxation regime can impede the economy. The state is forever watchful of this and fine tuning the taxation rates and regime of taxation. Through this play, the tax laws developed over the decades. As the economy developed, the following two significant aspects emerged.

Service Tax

From 1990s, services developed as an economic activity. The Constitution of India had not contemplated it and provided on it. However, the residual power of taxation was vested in the Union. The Parliament, in the Finance Act, 1994, introduced service tax on three services. Thereafter, each year, the Parliament expanded the list of services. The Central Government made rules detailing out the services and the procedure for the application and collection of taxes. In two decades, a complex structure for the levy and collection of service tax got created.

Value addition and taxation

The second aspect was, as manufacturing and services developed, gaps in the prevailing basis for taxation emerged. The academic fields of economics and taxation analysed the developing nature of the economic activities and developed a better understanding of the field. Historically, wherever there was a transaction or economic activity, the state was drawn towards it to tax. It appeared that surpluses were being generated and the state could tap a small proportion out of it. The basis for taxation could only be a part of the value of the transaction. With the diversification of the economy, it emerged that the transaction value was not an indicator of the magnitude of the economic activity. Take the case where a trader buys a unit of goods for Rs 80,000 and sells it for Rs 82,000. With the rate of sales tax for the goods at 10%, the trader is charged Rs 8000 in taxes while buying the goods and charges Rs. 8200 while selling the goods. But the economic activity at his end was only Rs 2000, the difference in the price at which he bought the goods and sold it. This was the value addition done by the trader and should be the basis for taxation. This was recognised and sales tax regime was changed to by the states to be

charged on VAT (value added tax) basis. For example, Gujarat enacted the Gujarat Valued Added Tax Act, 2003. The trader got a credit for the input tax.

Similarly, take the case of a manufacturer who buys metal sheets and manufactures pipes and sells them. The manufacturer buys Rs. 10 lakhs worth of metal sheets and pays, at the rate of 10% excise duty, Rs. 1 lakh in excise duty. The manufacturer makes pipes out of the sheets and sells them for Rs. 11 lakhs and charges Rs. 1.1 lakh in excise duty. But the economic activity at his end was in converting the metal sheets into pipes whose value was the difference in the selling and buying prices, that is, Rs. 1 lakh. This was the value addition and should be the basis for the levy of excise duty. This was recognised in MODVAT (modified value added tax) basis for the levy of the tax. The manufacturer got a credit for the input tax.

Once it is recognised that the value added should be the basis for the levy of the indirect taxes, logically, an integration of all the indirect taxes should be done. To illustrate, X manufactures plastic buckets from plastic granules. He buys granules for Rs. 10,000. The seller charges him another Rs. 1,000 as sales tax and pays it to the government. X avails commission agent for Rs. 1,000 for procuring the granules. On this, the service provider charges him Rs. 100 in service tax and deposits it with the government. X buys floor cleaning detergent for cleaning the floor of the workshop. This costs X Rs. 200. The seller charges him Rs. 20 as sales tax. The manufacturer sells the finished goods corresponding to the granules for Rs. 15,000 and collects taxes on it and pays to the government. Applying the value added basis for taxation, a rebate should be given for the taxes already paid, which come to a total of Rs. 1,120. Effectively, the tax would then be on the actual value created by X. We took up only a few inputs to illustrate the point. In reality, a manufacturing entity will be using several raw materials, goods and services. All taxes towards goods and services could be taken into account for working out the rebate. We can extend the arrangement to a person providing a service or trading. A service provider would pay input tax on goods bought and services availed, for which he should get credit.

Thus, the idea emerged that there should be an integration of the indirect taxes and it should be levied on the basis of the value added by an entity. For the idea to be put into practice, like for any other idea, several administrative arrangements would need to be put in place. For example, X buys goods of value Rs. 10,000 from Y. X is charged an additional Rs. 1,000 in tax. X sells the goods for Rs. 11,000 and collects Rs. 1,100 in tax. X should be required to pay only the difference in the tax, i.e., Rs. 100, to the government. However, for this, he must establish to the satisfaction of the tax collection agency, that a tax of Rs. 1,000 has already been paid to the government. This will be possible only if the tax collection agency requires every entity to register with it and maintains detailed accounts of all receipts of taxes. The law would need to ensure that every transaction is done with the supporting documentation, furnishing the details of the transaction and of the taxes paid on it. Thus, technically, there could be a single indirect tax based on the principle of value addition. The transition was made by several other countries. But it required a massive information network at all India level.

The second, and equally important constraint in securing a new basis for taxation was the federal arrangement on taxation in the Constitution of India. The significant heads of indirect taxes with the Union were excise duty and service tax and the states had the sales tax. To a proposal of the Union for unifying the taxes, the states must agree and come forward. The states, whose revenue would diminish in the arrangement, would be unwilling to the change. A political consensus must emerge among the Union and the states to make the change. This took more than a decade to secure.

Introduction of the GST Regime

Following a convergence, the Constitution of India was amended in 2016 and a 'goods and services' tax introduced. Article 246A was inserted which read:

246A. Special provision with respect to goods and services tax. —(1) Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of every State, have power to make laws with respect to goods and services tax imposed by the Union or by such State.

(2) Parliament has exclusive power to make laws with respect to goods and services tax where the supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

Thus, the Parliament alone became competent to make laws on inter-state supply of goods and services. There was no change here as the centre alone was levying service tax and tax on inter-state sale of goods. Significantly, both the Parliament and State legislatures got the power to make laws on intra-state supply of goods and services. Article 366 of the constitution which defines all the key terms, was inserted with a definition of 'goods and services tax'. The definition read:

366(12A) "goods and services tax" means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption.

Goods in the article was already defined as: '(12) "goods" includes all materials, commodities, and articles. A definition of 'services' was inserted as: '(26A) "Services" means anything other than goods.' The constitution was also amended to work out the sharing of the revenue between the Union and the states. The constitutional amendment created the basis for the Parliament and the state legislatures to legislate on goods and services tax. The Parliament enacted legislations including, the Central Goods and Services Tax, 2017 and the Integrated Goods and Services Tax, 2017. The first act applied to the supply of goods and services intra-state and the second one, inter-state. The state legislatures enacted legislation levying state GST. For example, Gujarat enacted the Gujarat Goods and Services Act, 2017. With the enactments, and formulation of rules under them, the new GST regime of taxation came into operation. The salient features of the GST regime are summarised below.

Introduction of GST

Goods and Service Tax (GST) became effective from 1 July 2017. It replaced several taxes related to goods and services. Except the Basic Customs Duty, most of the indirect taxes were subsumed in the GST regime. Levies of the Central Government subsumed under the GST regime include excise duty; additional duties of customs; special additional duties of customs; service tax; central sales tax; and cesses and surcharges. Levies of the State Government subsumed under the GST regime include tax on sale of goods; purchase tax; luxury tax; entry tax; entertainment tax; and state cesses.

GST Rate of taxation

The GST makes the following classes of goods and services and prescribes the rate for the application of GST:

1. No tax (including exports). This category includes, for example, supply of milk and supply of educational services.
2. Essential Goods and services: Rate 5%. This category includes for example, spices and air transportation by economy class.
3. Products or services with basic necessities: Rate 12%. This category includes for example, umbrellas and transportation of passengers by business class or first class.
4. Revenue Neutral Rate: Rate 18%. This category includes for example toothpaste and supply of Food/drinks in restaurant having facility of air-conditioning.

Demerit Goods: 28%. This category includes Acs and fridges and five-star hotel with room rent more than Rs. 7500 per day.

Taxable Event

Transactions happen seamlessly between the parties. At one stage in the transaction, the tax should get levied. This is called the taxable event. In the case of GST, the taxable event is the 'supply' of goods or services. Section 7 of the Central Goods and Services Tax Act, 2017 defines 'supply'. An edited version of the section reads:

7. (1) For the purposes of this Act, the expression "supply" includes—

- (a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;
- (b) import of services for a consideration whether or not in the course or furtherance of business; and
- (c) the activities specified in Schedule I, made or agreed to be made without a consideration;

(2) Notwithstanding anything contained in sub-section (1), —

.....

- (a) activities or transactions specified in Schedule III; or
- (b) such activities or transactions undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities, as may be notified by the Government on the recommendations of the Council, shall be treated neither as a supply of goods nor a supply of services.

Thus, first, supply involves the movement of the goods or services. It must happen under a contract where the seller or the service provider is supplying in the ordinary course of business or to further its business. An exception is made for import of services. If a service is imported under a contract, even if it is not in the course of ordinary business of the supplier, it becomes a supply of the service. The activities in schedule 1 are taken to be supplies, even if these are without any consideration. This includes:

1. Permanent transfer of business assets.
2. Supply of goods and services between related persons towards furtherance of business.
3. Supply of goods by a principal to his agent for the agent to supply it further on behalf of the principal.
4. Supply of goods by an agent to his principal where the agent has received the goods from another party on behalf of the principal.
5. Import of services from a related party or another business entity of the person in the course or furtherance of business.

Section 7(2) excludes certain activities from being 'supply'. The prominent entries in the schedule include:

1. Services by an employee to his employer in the course of his employment.
2. Services by any court or Tribunal.
3. Services of funeral, burial crematorium or mortuary.

4. Sale of land and building.
5. Actionable claims, other than lottery, betting and gambling.
6. Functions performed by MPs, MLAs and constitutional authorities.

The Central Goods and Services Tax Act, 2017 defines goods as:

Section 2(52) “goods” means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply.

Thus, under GST, goods are every kind of movable property other than money and securities. Intangible Properties can be goods. While actionable claims are goods, only lottery, betting or gambling have been specifically included under GST. All other actionable claims are outside the scope of GST. For example, transfer of unsecured debt to a third party would not be covered under the GST.

The Central Goods and Services Tax Act, 2017 defines ‘services’ as:

2(102) “services” means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged.

Explanation. —For the removal of doubts, it is hereby clarified that the expression “services” includes facilitating or arranging transactions in securities;

The definition of services is broad. Following this definition, sale of land and building is a service. Similarly, services provided by an employee to the employer is a service. However, as we have seen above, the scope of ‘supply’, by the Schedule 3, has excluded these from the application of GST.

Composite Supply and Mixed Supply

A contract may supply two or more goods together; two or more services together; or two or more goods and services. In such cases, if the supply is naturally bundled, it is defined by the Act as composite supply. In this case, the rate of GST will be the rate of the goods or service that is pre-dominant in the supply. An example of this is an airline which provides complimentary food in air travel. In this case, air travel and food are naturally bundled. If the supplies, however, are not naturally bundled together, but are only supplied together, such a

supply is called a mixed supply. In this case, the rate of GST will be the rate of goods or service that has the highest rate of tax. An example of this is a gift box containing sweets, biscuits, dry fruits and aerated drinks. All the items are capable of being sold individually. As the aerated drinks have the highest GST rate, the entire box will be taxed at this rate.

Time of Supply of Goods

The GST gets levied on 'supply' of goods. Section 12 of the Central Goods and Services Act, 2017 specifies the time when the 'supply' is taken to be made. It states the time of supply to be earlier of the date of issue of invoice or the due date when the invoice was required to be issued, and date of receipt of payment. Section 31 requires the supplier, where the supply involves movement of goods, to issue a tax invoice before or at the time of removal of the goods for the supply. If the supply does not involve movement of the goods, the supplier has to issue the tax invoice before or at the delivery of the goods to the recipient. The date of payment is the earlier of when the supplier records in the books and the actual receipt in the bank account.

Time of Supply of Service

The Act and the rules frames under it prescribe a period for issue of tax invoice. Section 13 of the Central Goods and Services Act, 2017 specifies the time of supply of service, with reference to the prescribed period for issuance of the tax invoice. The time of supply is the earlier of the followings:

1. If invoice is issued within the prescribed period, the earlier of the date of invoice or the date of receipt of payment.
2. If invoice is not issued within the prescribed period, the earlier of the date of provision of service or the date of receipt of payment.
3. If the above two do not apply, the date of receipt of service shown in the books of the recipient.

Valuation of Supply Under GST

Section 15 of the Central Goods and Services Act, 2017 provides on the value of supply that is to be taxed. Where the supplier and the recipient are unrelated persons, the value is to be an addition of, the transaction value; all taxes, duties, fees and charges other than GST; incidental expenses incurred before or at the time of supply; interest, late fee or penalty for delayed payment; and subsidy directly linked to supply, except government subsidy. From the aggregate amount, a discount given before or at the time of supply is to be subtracted. In the cases where

the consideration is not wholly in money or supply is to not to an unrelated person, the value is the Open Market Value of the supply.

Intra-state and Inter-state Supplies

The GST is a dual structured tax. It is charged by both, the Central Government and the State Governments. The place of supply determines the kind of GST that applies to the transaction. If the location of the supplier and the place of supply are in two different states, it becomes a case of an inter-state supply of goods or services. In this case, the charge is done under the central act, the Integrated Goods and Services Tax Act, 2017. The tax is called IGST.

If the location of the supplier and the place of supply are in the same state, it is a case of an intra-state supply of goods and services. In this case, both, the Central Goods and Services Act, 2017 and the enactment of the State legislature on GST (for example, the Gujarat Goods and Services Act, 2017) apply. The first act levies the Central Goods and Services Tax (CGST) and the second, the State Goods and Services Tax (SGST). Import of goods or services is deemed to be inter-state supplies.

Place of Supply of Goods

The location of the supplier and the place where the goods are supplied become relevant concern for determining whether the supply is inter-state or intra-state. This in turn will determine the taxation. The way of settling the location of the supplier is not prescribed. Ordinarily, it refers to the site or premises, in control of the supplier, from where the goods are ready to be supplied. The place of supply has been defined in the Integrated Goods and Services Tax Act; 2017. It contemplates the following situations.

1. Where the supply involves movement of goods, the place where the movement for delivery of the goods terminates.
2. Where the supply involves movement of goods to be delivered to a recipient, on the instructions of a third party, the place where the principal place of business of the third person is located. This cover the cases where the recipient is receiving the goods as an agent of the third party.
3. Where supply does not involve movement of goods, the place of supply is the place where the goods are located at the time of delivery.
4. Where the supply of goods is by installing or assembling them at site, the place of supply is the site where the goods are installed or assembled.

5. Where goods are supplied on board a conveyance, the place of supply is the location at which the goods are taken on board.

Location of Supplier of Service

The CGST Act defines the location of supplier of services. It reads:

Section 2(71) “location of the supplier of services” means, —

- (a) where a supply is made from a place of business for which the registration has been obtained, the location of such place of business;
- (b) where a supply is made from a place other than the place of business for which registration has been obtained (a fixed establishment elsewhere), the location of such fixed establishment;
- (c) where a supply is made from more than one establishment, whether the place supply and the Place of supply in case of services of business or fixed establishment, the location of the establishment most directly concerned with the provisions of the supply; and
- (d) in absence of such places, the location of the usual place of residence of the supplier;

Place of Supply of Service

Section 12 of the Integrated Goods and services Act, 2017 provides on the place of supply of service. A summary is as follows.

1. If the services directly relate to immovable property, for example, architects, engineers or estate agent, the location of the immovable property.
2. For restaurant, catering, personal grooming, fitness, beauty treatment, health services, the place where the services are performed.
3. For training and performance appraisal services, if the recipient of services is a registered recipient, the place of supply is the location of the recipient. If the recipient is not a registered, the place of supply is the place where the services are actually performed.
4. For services of admission to a venue, for example, a sporting event or an amusement park, the place of supply is the location of the venue.
5. For services of organizing an event, if the recipient of services is a registered recipient, the place of supply is the location of the recipient. If the recipient is not a registered, the place of supply is the location of the venue.
6. For services of transportation of goods, if the recipient of services is a registered recipient, the place of supply is the location of the recipient. If the recipient is not a registered recipient, the place of supply is the location where the goods are handed over for transport.

7. For services related to transportation of passengers, if the recipient of services is a registered recipient, the place of supply is the location of the recipient. If the recipient is not registered, the place of supply is the location of embarkation.
8. For services on board a conveyance, the place of supply is the first scheduled point of departure.
9. For telecommunication services which involve installation of a device at a site, the place of supply is the location of such installation.
10. For post-paid telecommunication services with respect to portable devices, the place of supply is the billing address of the customer.
11. For pre-paid telecommunication services with respect to portable devices, the place of supply is the location of the intermediary who facilitates the supply or where the payment is received.
12. For banking and financial services, the place of supply is the address of the recipient in the records of the supplier. If the address is not available, the place of supply is the location of the supplier.
13. For insurance services, if the recipient of services is a registered recipient, the place of supply is the location of the recipient. If the recipient is not registered, the place of supply is the address of the recipient in the records of the supplier.
- 14) For services which do not fall in any of the above categories, the place of supply is the location of the recipient, if the recipient is registered. If the recipient is not registered, it is the address of the recipient in the records of the supplier. Even further, If the address of the recipient is not available, the place of supply is the location of the supplier.

Input Tax Credit

The GST works on the value added basis. In this, the tax payer get a credit for GST paid on the input goods and services. These are to be deducted from the GST which gets levied on the supply of goods and services. The GST tax regime provides the order in which the input tax credit can be utilised. It is as follows:

1. Input tax credit of IGST shall be utilized first against the IGST payable, then against CGST / SGST.
2. Input tax credit of CGST shall be first utilized against CGST payable and remaining if any, against IGST payable.

3. Input tax credit of SGST shall be first utilized against SGST payable and remaining if any, against IGST payable.

Further, the input tax credit of IGST should be entirely exhausted first and only then the credit of CGST and SGST can be utilized to set-off the tax liability.

