



*Let noble thoughts come to us from all sides*

*Rig Veda*

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**Chief Editor's Office :** Room No. 660, Soochna Bhawan, CGO Complex, Lodi Road New Delhi 110 003 Ph: 24362971. Yojana (English): Room No. 647, Soochna Bhawan, C.G.O. Complex, Lodi Road, New Delhi - 110 003. **Business Manager (Hqs.) :** Ph :24367260, 24365609, 24365610

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No. of Pages 64

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## TEX REFORM-INTERGRAL TO DEVELOPMENT

Taxes – the word conjures up an image of a person rushing to pay his income tax before the last date. Or, an income tax raid on a businessman where wealth and money is unearthed. However scary the term may sound but it is a fact that Taxes are essential for development of any economy. It is these very taxes which the citizens of a country pay that go towards development activities like building roads and bridges, constructing dams, maintaining the railways network, offering health care services, etc.

The rajas and maharajs of yore also collected taxes. The more enlightened ones like Ashoka and Akbar evolved a systematic taxation policy and also tax collection policy so as to earn revenue to run the kingdom without creating much hardship for the common man. Some kings had an arbitrary tax collection system which they used to maintain their lavish lifestyles and wage wars. Today, in the modern economies, taxes are regulated by various rules and regulations and are monitored by the people's representatives.

Indian tax system is the most complicated one in the world with the Centre, the States and the local bodies having powers to levy variety of taxes to earn revenue. Various kinds of taxes are collected at different levels like the direct taxes which affect the common man directly like the income tax and wealth tax, indirect taxes which the common man pays for goods and services availed of like VAT and service tax, corporate tax, etc. Every budget sees expectations on tax reforms by both the common man and the corporates. The common man wants the income tax slab raised, while the corporates want tax relief in various sectors. Government handles these requests according to the economic necessity. Over the years India has experienced unprecedented rates of economic growth. This growth required reforms in the taxation system to make it simpler and attractive for the foreign as well as domestic investors. In an effort to keep in line with the changes in global economy, Indian taxation system has undergone remarkable reforms during the last decade with rationalization and simplification of tax laws.

The Goods and Services Tax which was passed recently is one of the most historic tax reforms in Indian taxation history. It seeks to streamline the taxation system so that there is only a single tax paid for supply of goods and services. The bill will replace nearly 15 state and federal taxes which is in line with the Government's focus on cooperative federalism. With 16 States ratifying the GST bill so far, minimum requirement of 50 percent states ratifying the bill has been completed. The Government is all set to usher in a new era on 1st April, 2017 with the roll out of the Goods and Services Tax (GST) in the country. It is expected that this landmark reform will go a long way in facilitating ease of doing business and enabling India to compete with world trade.

While the GST is a major step towards simplifying tax system in India, the complexity of the system so far has resulted in evasion of taxes and creation of blackmoney in the country. The amount of this black money is so huge that it is said to run almost like a parallel economy in the country. The Government has adopted a multipronged strategy to unearth and control black money which includes policy-level initiatives, more effective enforcement action on the ground, putting in place robust legislative and administrative frameworks, systems and processes with due focus on use of information technology. Voluntary disclosure of income Schemes (VDIS), Constitution of the Special Investigation Team (SIT) on Black Money, Enactment of a comprehensive new law - The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 to specifically deal with the issue of black money stashed abroad, Introduction of the Benami Transactions (Prohibition) Amendment Bill, are some of the recent major initiatives of the Government in this regard.

Indian taxation system has come a long way from closed, complicated one to open, simple and futuristic. And the current Government is committed to take it further to make India one of the most favorable investment and manufacturing destinations in the world.



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YE-17/2/2016

# Tax Reforms: Past, Present and Future

**TN Ashok**



*GST is .... a giant leap for the country in tax reforms to inspire confidence of manufacturers and investors to push the economy forward and one can hope for a further slew of reforms in the 2016-17 budgets to propel GDP growth further. While the government might take time on DTC or Corporate India's bucket list, it is apparent that it will stay focused on the main objective of making tax laws simple to make life easier for the individuals as also business besides bringing in larger populations into the tax net and making every Indian conscious of his social obligation toward paying taxes, making the country more tax compliant*

**T**

ax reforms are an integral part of the development process of any country. Even developed countries such as the United Kingdom and the United States, which are often the role models for developing countries such as India, too undertook reforms in the last few years.

Take the United Kingdom. The Conservative Liberal Democrat coalition government undertook reforms between 2010 and 2015. In the reforms initiated in 2013, two million people were virtually removed from paying income tax altogether when the Chancellor of the Exchequer presented the budget. The raft of reforms brought about a rise in the personal allowance, which meant that no one paid any tax until he or she earned more than £9,440. The threshold for the higher rate of tax - above which people pay tax at 40 per cent - dropped from £34,370 to £32,010, excluding the personal allowance.

At the same time the top rate of income tax fell in 2013-14 from 50 per cent to 45 per cent for those whose taxable income exceeded £150,000.

Take a country like the United States. A symbol of free trade and an advanced economy, it is a country that needs tax reforms very badly.

Realising this, two legislators are trying to deliver a broad tax reform. Max Baucus, the Democrat who heads the Senate's tax-writing committee, and Dave Camp, his Republican counterpart in the House of Representatives, have been at the exercise for the last three years; they have been talking to people and floating ideas. Though any full plan is yet to fructify, their principles are sound: lower tax rates for both corporations and individuals, paid for by limiting or scrapping tax breaks.

Though they belong to different parties, both Baucus and Camp have felt that ideally, no tax break should be spared, even the popular ones for charity, housing, health insurance and research and development. Though desirable, they impose a cost, in the form of higher taxes, on other desirable things. As an Economist article points out, the political reality is that, some of these tax breaks will survive, just as there is no hope for a carbon tax, one of the more sensible ways to raise money.

Yet Camp and Baucus found enough common ground to build a more efficient tax system. They differ on the crucial question of whether tax reform should raise more revenue. While Camp, being a Republican, felt NO, Baucus, like the rest of his

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The author was Economics Editor and Chief of Bureau (Economic) of PTI specialising in infrastructure/finance/commerce sectors and environment. He has covered the historic Earth Summit in 1992 at Rio De Janeiro as also the 1st inaugural WTO Ministerial Summit at Singapore in 1996. He provides strategic advice on public affairs/ media to leading MNCs and Indian transnationals.

Democrats led by the President Barack says YES.

So, India is no exception to tax reforms. Ever since economic reforms were unveiled in the early 90s, tax reforms too became a crying need. After much deliberation, the then government felt that any taxation system should be reasonable, fair and non-discriminatory so that, both the individual tax payer under the direct taxes category and the corporates and industry accounting for bulk of the indirect taxes, became not only tax compliant, but feel the social and civic obligation to pay taxes which are the core for any government to undertake development projects.

So, tax reforms have been one dynamic process through successive governments until 2016. The principles have largely remained the same , a transparent, just, equitable and fair taxation system that was easy to administer. Consistently, the governments of the day have been rationalising the direct tax structure in such a way that the individual tax payer benefitted the most.

Year after year, though marginally, the ceiling on entry level taxation was lifted and the taxation slabs have now been neatly and simply structured into three slabs. 10 per cent, 20 per cent and 30 per cent flat for incomes ranging between Rs 2.50 lakhs to Rs 5 lakhs to Rs 10 lakhs respectively. That is, those earning less than Rs 2.50 lakhs paid no tax, between Rs 2.50 to Rs 5 lakhs paid at 10 per cent and Rs 5 lakhs to Rs 10 lakhs at 20 per cent and those above Rs 10 lakhs paid a flat 30 per cent tax on their incomes.

The corporate taxes too have been rationalised. Besides a plethora of excise and customs levies have been made easier. In all these, the main aim has been to encourage people to become tax compliant and bring in a larger population into the tax net. While the tax to GDP ratio may be progressive, the tax to demographic population is abysmal, it is said that hardly 2 per cent of the population pays

tax. And this population is concentrated in the urban agglomerate.

Even as the government brings more and more reforms to bring more and more people into the net and raise the tax collection buoyancy, the single most critical tax reform that stands out is the **Goods and Services Tax (GST)**. Virtually codifying all taxes into one so that manufacturers did not face the burden of multiple taxation in the country and movement of goods becomes easier.

Let's see why the GST is a historic piece of legislation, given the twists and turns and uncertainties it faced before it was finally adopted by both Houses of Parliament. The GST is expected to make consumer the "king". The Constitution (122nd Amendment) Bill was first passed

**...tax reforms have been one dynamic process through successive governments until 2016. The principles have largely remained the same , a transparent, just, equitable and fair taxation system that was easy to administer. Consistently, the governments of the day have been rationalising the direct tax structure in such a way that the individual tax payer benefitted.**

by the Lok Sabha in May 2015, then taken up again by the Lower House to approve the changes made in it by the Rajya Sabha. Finally, both houses accorded approval and it has got the Presidential assent as well. The government had moved six official amendments, including scrapping of 1 per cent additional tax, to the bill which was approved by the Upper House.

The GST is expected to be a legislative measure that will help transform the economy ushering in transparency and most of all, bringing the concept of "One Country One Tax" into fruition. The tax rate

under the GST regime will be kept at "minimum workable rate" so that no state government ends up annoying its people with a higher tax rate. The final rate is to be decided by the GST Council. The bill will now have to be ratified by at least 16 of the 29 state assemblies, which the Prime Minister hoped would be done at the earliest.

The GST forges a single economic zone for the country from a thicket of overlapping federal and state taxes. The **New York Times** described the legislation as the biggest tax reform since 1991 when India opened its markets first. Potentially one of the most dynamic economies in the developing world, India is hampered by a bewildering array of state-by-state tax codes that discourage doing business across state borders.

The GST is widely viewed as a breakthrough that will allow the authorities to confront the problem, eventually creating a more unified economy that will allow businesses to expand nationwide far more easily, the NY Times observed. "This is long overdue but hugely consequential for the ease of doing business, and for demonstrating to the outside world that India is dragging its economy into the 21st century," Milan Vaishnav, a senior associate in the South Asia program at the Carnegie Endowment for International Peace is quoted as saying.

The GST replaces 15 existing state and federal taxes and could help India increase its economic growth by 0.5 and two percentage points. The GST is in keeping with the present governments' line of thinking of having cooperative federalism wherein the Centre and the States work together for the nation's benefit and where the states also get their due share. The government had revised the tax revenue sharing formula to devolve more to the states to bring them in line with the Centre's line of thinking of marching hand in hand.

It all began in 1991 when government embraced market reform

policies devolving more power to the states, including more taxes to them. Successive governments had felt the need for a tax overhaul as it became increasingly clear that overlapping tax codes blocked growth.

Benefits of GST will be indeed slow to come, probably by 2019. It is also likely that the GST could eventually lead to an inflationary bump as the government's Chief Economic Advisor Arvind Subramanian points out. The GST is a single uniform tax pan India that will be "fiendishly, mind-bogglingly complex to administer," Subramanian is quoted as saying.

In the longer run, the GST is expected to attract foreign investment reducing the cost of capital goods; raise manufacturing and exports, increase tax collections and most importantly create jobs, the need of the hour.

The GST is being hailed as the mother of all economic reforms in India. Business leaders and Corporate India claims that the change would have a profound effect on their daily lives. It is expected that GST will put an end to "Tax Terrorism" because industry says that under the plethora of taxes in States and the Centre, it is currently "harassed and victimized" by multiple tax authorities. "Most of the time, we are busy in complying with those taxation formalities, collecting taxes, depositing taxes, submission of forms, our money stuck in the system, and other issues," a spokesman of the industry is quoted as saying.

The vexatious issue between the Centre and States on GST has been tax rates. States want high rates to maximize their revenue and the Centre pushes for lower rates to prevent inflation from spiking. India's economy is now growing at a robust 7.6 per cent enjoying the lowest inflation rate in decades. Job growth is still not there and the corporate sector is still starved of funds leading to a lull in the manufacturing sector. Much of the growth momentum is being pushed by the services sector including the

IT and IT enabled services netting in valuable foreign exchange which now stands at over US\$ 370 billion.

Tax reforms don't end with GST. We still have another major legislation to push through, the **Direct Tax Code** (DTC) that will simplify the direct taxes structure further benefitting a large number of the population. The Finance Ministry has indicated in 2016-17 budget that the direct tax code was being scrapped. But the standing committee on Finance of Parliament has told the Finance Minister that DTC provisions need to be brought forth as the next major step towards reforming the tax reforms.

What does DTC entail? As envisaged by the government, it seeks to replace the **Indian Income Tax Act of 1961** by amending all laws relating to direct taxes, namely income tax, dividend distribution tax, fringe benefit tax and wealth-tax with a view to establishing an economically

**In the longer run, the GST is expected to attract foreign investment reducing the cost of capital goods; raise manufacturing and exports, increase tax collections and most importantly create jobs, the need of the hour.**

efficient, effective and equitable direct tax system that can facilitate voluntary compliance and help increase the tax-GDP ratio.

Another objective is to reduce the scope for disputes and minimize litigation. It seeks to provide stability in the tax regime as it is based on accepted principles of taxation and best international practices. It will eventually pave the way for a single unified taxpayer reporting system. The Highlights of the Direct Taxes Code: proposed measure has 319 sections and 22 schedules against 298 sections and 14 schedules in the existing IT Act, Once enacted, DTC will replace

archaic (older and no longer useful) Income Tax Act. However, many provisions in the Income Tax Act will be a part of DTC as well. Mutual Funds/ULIP will be dropped from 80C deductions : Income from equity-oriented mutual funds or ULIP shall be subject to tax @ 5 per cent, Fringe benefits tax will be charged to the employee rather than the employer. Political contribution of up to 5 per cent of the gross total income will be eligible for deduction.

The DTC seeks to have a Single Code for direct taxes: All the direct taxes are sought to be brought under a single Code and unify compliance procedures, eventually paving the way for a single unified taxpayer reporting system. The use of simple language in the DTC seeks to achieve voluntary tax compliance from the people so the that tax laws have clarity. The Scope for litigation wherever possible is being reduced, avoiding ambiguity so as to avoid rival interpretations. The statute has been developed in a manner capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments.

As most taxpayers are in the small and marginal category, the tax law is what is reflected in the Form. So tax laws are being logically reproduced in a Form. The DTC seeks to provide stability where all rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the Code itself, thereby obviating the need for an annual Finance Bill. The changes in the rates, if any, will be done through appropriate amendments to the Schedule brought before Parliament in the form of an Amendment Bill.

Since a lot of thought has gone into the DTC, it cannot be wished away. While nomenclatures could change, call DTC by another name, but certainly most of the provisions are going to be retained for the benefit of the tax payer.

The Corporate sector has a huge bucket list for further tax reforms.

Abolition of the Minimum Alternate Tax (MAT), burying the ghost of retrospective tax (the Vodafone/IT department crisis in realising arrears of tax), phasing out tax holidays could reduce investments in SEZs, and restoration of capital gains tax treatment for buy-back of shares.

GST is, thus, a giant leap for the country in tax reforms to inspire confidence of manufacturers and investors to push the economy forward and one can hope for a further slew of reforms in the 2016-17 budgets to propel GDP growth further. While the government might take time on DTC or Corporate India's bucket list, it is apparent that it will stay focused on the main objective of making tax laws simple to make life easier for the individuals as also business besides bringing in larger populations into the tax net and making every Indian conscious of his social obligation toward paying taxes, making the country more tax compliant.

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#### HIMANSH, India's Remote, High-Altitude Station

As part of the Indian government's initiatives to better study and quantify the Himalayan glacier responses towards the climate change, National Centre for Antarctic and Ocean Research (NCAOR), Goa, under the Ministry of Earth Sciences has established a high altitude research station in Himalaya called HIMANSH (meaning, a slice of ice), situated above 13,500 ft (more than 4000 m) at a remote region in Spiti, Himachal Pradesh.

The station houses many instruments to quantify the glacier melting and its relation to changing climate. Some of the instruments that are available at this research facility include Automatic Weather Stations for weather monitoring, water level recorder for quantifying the glacier melt, ground penetrating radar to know the thickness of glaciers, geodetic GPS systems to study the glacier movements, snow fork for studying snow thickness, steam drill, snow corer, temperature profilers, as well as various glaciological tools. Also, this will be used by the researchers as a base for undertaking surveys using Terrestrial Laser Scanners (TLS) and Unmanned Aerial Vehicles (UAV) that would digitize the glacier motion and snow cover variations with exceptional precision. Himansh will provide the much needed fillip to the scientific research on Himalayan glaciers and its hydrological contribution.

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I would like to thank AAI for their invaluable guidance throughout my journey. I would like the opportunity to thank the whole teachers for establishing an institution of their own to guide the aspirants. I hope AAI will produce good civil servants in future too.

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Ashish Dahiya

I want to thank God my family friends and family guidance provided by AAI Institute that made me the best. Recently I received very valuable night to improve my GS module writing and essay from you sir and those were very good as compare to others whom started from the scratch but achieved in 2015. The Sir's extream and history classes were indispensible for my preparation which lead to my selected success especially in this exam. Thank you Sir.

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# India's Tax System: Increasing Progressivity

**Malini Chakravarty**



***It is hoped that introduction of GST would help to simplify and rationalise the tax system and increase compliance. At the same time, it is also important that the government take some steps to increase direct taxes that would help increase progressivity of India's tax structure***

# W

e all pay taxes to the government in some form or the other in our daily lives. These taxes we pay play an important role in financing different functions that the government performs. There are many responsibilities that the government is required to fulfil. These include ensuring the rule of law; providing public goods and services; building physical and social infrastructure; investing in education of the population; alleviating poverty, etc. Clearly, the government needs to mobilise a significant amount of financial resources in order to fulfil its many commitments. The government mobilises financial resources for funding its different activities mainly through taxes, user fees/ service charges and borrowings. The sources of funds which neither create liabilities nor reduce assets are called **Revenue Receipts**. Other sources of funds such as borrowings which create liabilities or those that reduce assets (e.g. disinvestment) are called **Capital Receipts**. Thus, taxes and user fees/service charges are some examples of revenue receipts of the government while borrowings are capital receipts.

## Tax Revenue and Non-Tax Revenue

Government's revenue receipts can be further divided into two categories:

tax revenue and non-tax revenue. **Tax Revenue:** Tax revenue refers to the money collected by the government through payments imposed by law. **Non-Tax Revenue:** Non-Tax Revenue refers to revenue of the government raised through instruments other than taxes such as fees/user charges, dividends and profit of public sector enterprises, interest receipt, penalty or fine, etc. For most countries across the world, tax revenue forms a significant proportion of government revenues.

## Direct and Indirect Taxes

Taxes can be broadly classified into two kinds: Direct Taxes and Indirect Taxes. **Direct Taxes:** Those taxes for which, the burden of the tax falls on the entity that is being taxed are known as direct taxes. In other words, an entity that directly pays this kind of a tax to the government bears the burden of that particular tax and cannot shift the tax burden. Direct taxes are levied on incomes, property and wealth. **Indirect taxes**, on the other hand, are those taxes for which the tax-burden can be shifted or passed on to other persons later through business transactions of goods/ services. These taxes are indirect because the agent who bears the burden of the tax is not the one on whom it is normally levied. Indirect taxes include Customs Duties, Excise Duties, Service Tax, and Sales Tax/ Value Added Tax (VAT).

The author is presently working with Centre for Budget and Governance Accountability (CBGA). Her research interests include issues related to macroeconomics, public finance, international trade and social protection.

## Taxes: Different Types

There exist a number of taxes, both direct as well as indirect, that are levied on incomes of various kinds, production and sale of goods and services within the economy and others that are levied on cross-border movement of goods. Examples of some of the different types of taxes that exist in India is given in the box.

### Division of Taxation Powers between Centre and States

The Constitution of India clearly demarcates the taxation powers at different levels of governance. Thus, the power to levy taxes and duties has been divided among the governments at the three tiers i.e. Central Government, State Governments, and Local Bodies.

The power to levy taxes on corporations and personal income (except for tax on agricultural income, which the State Governments can levy) lies mostly with the Central government.

In the arena of indirect taxes, the Central government has the authority to impose a broad spectrum of excise duties on production or manufacture and service tax on services provided, while States are assigned the power to levy tax on the sale of goods and some other taxes. Some of the indirect taxes that the Centre levies are Customs Duties, Central Excise, Sales Tax and Service Tax.

State Governments have been vested with the power to levy: Sales Tax, Stamp Duty (a duty on transfer of property), State Excise (a duty on manufacture of alcohol), Land Revenue (a levy on land used for agricultural/non-agricultural purposes), Duty on Entertainment and Tax on Professions. The system of Sales Tax levied by State governments has been replaced with Value Added Tax (VAT) since 2005 when all States moved to the VAT system.

Local Bodies have been empowered to levy tax on properties (buildings, etc.), Octroi (a tax on entry of goods

Direct Taxes	Indirect Taxes
<ul style="list-style-type: none"> <li><b>Corporation Tax:</b> This tax is levied on the incomes of registered companies/corporations in the country (whether national or multinational/foreign). National companies in India are taxed on the basis of their aggregate income, irrespective of its source and origin. Whereas foreign companies are taxed only on income that arises from operations carried out in India. <b>Taxes on Personal Income:</b> This is a tax on the income of individuals, firms, etc. other than Companies, under the Income Tax Act, 1961.</li> <li>Direct taxes also include other Taxes such as the '<b>Securities Transaction Tax</b>', which is levied on transaction in listed securities undertaken on stock exchanges and in units of mutual funds.</li> <li><b>Capital Gains Tax:</b> Profits generated from the sale of a <i>capital asset</i> (physical and financial), such as, any kind of property held by an assessee, paintings, jewellery and ornaments, business stocks, mutual funds, etc., are taxable as capital gains, either short-term or long-term. The capital gain or net profit which is taxable is basically the difference between the price at which the asset is sold and the price at which it was purchased. The tax is applicable in the year in which the sale of the capital asset takes place.</li> <li><b>Wealth Tax:</b> This is a tax levied on the specified assets of certain persons including individuals and companies, under the Wealth Tax Act, 1957. Wealth tax is not levied on <i>productive assets</i>. Therefore, investments in shares, debentures, UTI mutual funds etc. are not subjected to wealth tax. Wealth tax was, however, abolished in 2015-16 and replaced by an additional surcharge to be paid by the super-rich.</li> <li><b>Property Tax:</b> As per the Income Tax Act of India, incomes from properties are regarded as one of the heads of income. Therefore, tax is levied on the income from property. These usually include buildings, flats, shops and land etc.</li> </ul>	<ul style="list-style-type: none"> <li><b>Excise Duties:</b> It is a type of tax levied on those goods, which are manufactured in the country and are meant for domestic consumption.</li> <li><b>Sales Tax:</b> It is generally charged at the point of purchase or exchange of certain taxable goods, charged as a percentage of the total value of the product.</li> <li><b>Value Added Tax (VAT):</b> VAT, is a multistage tax, levied only on the 'value added' at each stage of a supply chain and not on the entire value of sales; in VAT, taxpayers receive credit for tax already paid on the inputs in earlier stages of the supply chain.</li> <li><b>Service Tax:</b> It is a tax levied on services provided by an entity and the responsibility of payment of the tax lies on the service provider.</li> <li><b>Customs Duties:</b> It is a type of tax levied on goods imported into the country as well as on goods exported from the country.</li> </ul>

for use/consumption within areas of the Local Bodies), Tax on Markets and Tax/User Charges for utilities such as water supply, drainage, etc. In the last few years, Octroi has been abolished in a number of Local Bodies.

### Distribution of Revenue collected in the Central Tax System

For various reasons, imbalances arise between the taxation powers and expenditure responsibilities of the Centre and the States respectively.

In order to address this, a Finance Commission is set up once every five years to recommend sharing of financial resources between the Centre and the States, a significant part of which pertains to the sharing of revenue collected in the Central government tax system. At present, revenue collected from all Central taxes, barring those collected from Cesses, Surcharges and taxes of Union Territories, and an amount equivalent to the cost of collection of central taxes – is taken as the shareable / divisible pool of Central tax revenue. The 14<sup>th</sup> Finance Commission (beginning April 1, 2015), has recommended devolution of 42 per cent of the shareable / divisible pool of Central tax revenue to States every year and the Centre is to retain the remaining amount for the Union Budget.

### Tax-GDP Ratio and Progressivity of Taxes in India:

A country's tax-GDP ratio is an important indicator that helps to understand how much tax revenue is being collected by the government as compared to the overall size of the economy. A higher tax-GDP ratio gives more room in a government's budget so that it can spend more without borrowing. However, despite many years of high growth, India's tax-GDP ratio continues to remain low, so much so that it has the lowest tax-GDP ratio among the BRICS countries. There is therefore, an urgent need to raise this ratio.

Another aspect of India's structure is the lack of progressivity in it. Taxes that impose a proportionately greater burden (in relation to their consumption or income) on the lower income groups than on the upper income groups are described as being **regressive taxes**. Indirect taxes, therefore, are generally considered to be regressive since the rich and the poor are subject to the same tax rate for similar goods they consume. Direct taxes, on the other hand, are considered to be **progressive** since they are linked to the tax-payee's ability to pay and the average tax rate increases as the taxable income of the

**India's Tax- GDP Ratio (Centre and States combined) (in per cent)**

Year	Total Tax-GDP Ratio	Direct Tax-GDP Ratio	Indirect Tax-GDP Ratio
2001-02	13.39	3.11	10.28
2002-03	14.08	3.45	10.63
2003-04	14.59	3.86	10.73
2004-05	15.25	4.23	11.02
2005-06	15.91	4.54	11.37
2006-07	17.15	5.39	11.77
2007-08	17.45	6.39	11.06
2008-09	16.26	5.83	10.43
2009-10	15.5	5.8	9.6
2010-11	16.3	5.8	10.50
2011-12	16.3	5.6	10.7
2012-13	16.9	5.6	11.3
2013-14(RE)	17.1	5.7	11.4
2014-15 (BE)	17.4	5.8	11.6

*Note: RE – Revised Estimate, BE – Budget Estimate;*

*Source: Indian Public Finance Statistics 2014-15, Min. of Finance, Govt. of India.*

tax payer increases. In India, more than 60 per cent of total tax collected (Centre and States) is accounted for by indirect taxes, implying that the tax structure is extremely regressive.

### Reforms in Taxes:

Over the years, a number of tax reforms, especially in the indirect tax system, have been initiated by the government to make India more tax-friendly as well as make the tax system less complicated. One major tax reform being pursued currently refers to the Goods and Services Tax (GST). Although, the sales tax was replaced by the VAT in all States by 2005, at present, a number of other indirect taxes are levied in addition to the VAT. This leads to the problem of cascading effect of taxes, whereby an item is taxed several times from the production to the final retail sales stage. That, in turn, has the effect of raising the tax component of products and results in higher tax-induced prices. Further, multiple taxes imposed by different States and the Central Government give enormous scope for tax evasion.

The GST is to put an end to the complex web of multifarious indirect taxes that exist at present and replace

them with one indirect tax: the GST. It is similar to a VAT and hence, is expected to reduce the problem of cascading effect of taxes. It is to be levied on most goods and services barring items such as petroleum, tobacco, alcohol, etc. The GST, though a single tax, would comprise two components: a central GST and a State GST. As per the Committee headed by A. Subramanian, the number of rates is likely to be limited to: i) a standard rate to be levied on majority of goods and services, ii) a lower rate on merit goods and essential items, and iii) a higher rate on non-merit goods like luxury goods. With the GST, the demarcation of taxation powers between the Centre and the States would get diluted considerably as both the Centre and States can impose indirect taxes on production as well as sale of goods and services.

It is hoped that introduction of GST would help to simplify and rationalise the tax system and increase compliance. At the same time, it is also important that the government take some steps to increase direct taxes that would help increase progressivity of India's tax structure. □

(E-mail: malini@cbgaindia.org)

## DO YOU KNOW?

### Project SAKSHAM

'Project SAKSHAM' is a New Indirect Tax Network of the Central Board of Excise and Customs (CBEC) pertaining to systems integration. It was approved by the Cabinet Committee on Economic Affairs. The project is expected to help in the implementation of Goods and Services Tax (GST), extension of the Indian Customs Single Window Interface for Facilitating Trade (SWIFT) and will also facilitate taxpayer-friendly initiatives under Digital India and Ease of Doing Business of Central Board of Excise and Customs.

The aim of the project is to ensure readiness of CBEC's IT systems by April, 1, 2017, when GST is to be introduced. The challenge is to upgrade the IT systems and making sure that the existing Tax-payer services keep running without glitches since the number of Taxpayers/ Importers/Exporters/Dealers under various indirect tax laws administered by CBEC at present is about 36 lakhs, which is likely to grow more than 65 lakhs once the GST is introduced. This will obviously lead to document load on CBEC's current IT system, which was set up in 2008, unable to tackle the increased load under GST without an immediate upgrade of its IT Infrastructure.

CBEC's IT systems need to be integrated with the Goods & Services Tax Network (GSTN) for processing of registration, payment and returns data sent by GSTN systems to CBE. They must also act as a front-end for other modules like Audit, Appeal and Investigation. This IT infrastructure is also urgently required to carry out the CBEC's e-Services in Customs, Central Excise & Service Tax, and also in implementation of tax-payer service like scanned document upload facility, extension of Indian Customs Single Window Interface for Facilitating Trade (SWIFT) initiative and integration with Government initiatives such as E-Nivesh, E-Taal and E-Sign.

CBEC has also implemented the Indian Customs Single Window Interface for Facilitating Trade (SWIFT) and is collaborating with other partner agencies involved in Customs clearance to make this process simpler and faster. The Customs EDI system which is currently operational at about 140 locations in India has to be extended to many more locations with improved response time and better service delivery. Taxpayers have to be given a facility for Upload of Digitally Signed Scanned Documents in order to reduce the physical interface with tax authorities and to increase the speed of clearance.

The total cost involved in the project is Rs.2256 crore, which will be incurred over a period of seven years. □

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YE-175/2016

# Indirect Tax Reforms : Facilitative Tax Regime

*Najib Shah*



***Following the policy of “RAPID” (Revenue, Accountability, Probity, Information, Digitisation), CBEC has taken a lot of initiatives for improving the ecosystem for doing business in India by relaxing the procedures and addressing the concerns of manufacturers/importers/exporters, which would go some distance in fostering a non-adversarial and facilitative tax regime***

**T**

ax – Direct and Indirect Tax play a very important role in nation building. In the scheme of Indirect taxes, the Central Board of Excise and Customs (CBEC), a statutory body constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) has been tasked with the formulation and implementation of policy concerning the levy and collection of customs, central excise and service tax. The Government has, while appreciating the significant role of revenue collection in the growth and development of the country, also stressed that tax policy should be aimed towards creating a competitive, predictable, and clean tax policy environment which is non-adversarial in its approach. Following the policy of “RAPID” (Revenue, Accountability, Probity, Information, Digitisation), CBEC has taken a lot of initiatives for improving the ecosystem for doing business in India by relaxing the procedures and addressing the concerns of manufacturers/importers/exporters, which would go some distance in fostering a non-adversarial and facilitative tax regime.

Indirect Tax collections have shown a turnaround during 2015-16. With growth in indirect tax collections, the Indirect Tax to GDP ratio for 2015-16 is about 5.2 per cent, as compared to 4.4 per cent for 2014-15. Estimated

Indirect Tax to GDP ratio for 2016-17 is 5.20 per cent. In 2015-16, CBEC achieved a figure of 7.09 lakh crore, representing a growth of 31 per cent and has been tasked to collect Rs. 7.78 lakh crore in the current fiscal.

Some of the path-breaking initiatives undertaken by CBEC in the last two and a half years are:

**i) Make in India:**

To provide a level playing field to domestic private sector in defence manufacturing, customs and central excise duty exemptions to defence supplies and central excise duty exemptions to defence PSUs and Ordnance Factory Boards have been withdrawn.

**ii) Preparatory steps towards implementation of GST:**

- a) Excise duty of 1 per cent (without input tax credit) imposed on jewellery.
- b) To reduce multiplicity of taxes, 13 cesses levied by other Ministries and administered by Department of Revenue are being abolished. Education Cess and Secondary and Higher Education Cess on excisable goods & taxable services abolished.
- c) Service Tax imposed on all services provided by the Government or local authority to

a business entity, except services that are specifically exempted or covered by any other entry in the Negative List.

### iii) Ease of Doing Business

- (a) To address issues relating to Customs Clearance and Infrastructure, impacting clearance of Exim goods, Customs Clearance Facilitation Committee (CCFC) have been set up at every major Customs seaport and airport.
- (b) Central Board of Excise and Customs, has launched Customs SWIFT (Single Window Interface for Facilitating Trade) clearances from 01.04.2016 onwards. This allows traders the facility to lodge their clearance documents electronically at a single point only with the Customs. Required permissions, if any, from other regulatory agencies are obtained online by Customs, and clearances are effected based on the same without the trader having to approach each agency individually. This project has been launched in India from 1st April, 2016 and has significantly resulted in reduction in time of clearances. So far, since 1st of April 2016, around one million import documents (Bills of Entry) have been processed successfully on single window platform.
- (c) To increase the coverage of digitally signed documents and subsequent phasing out of physical/manual submission of documents, CBEC has enabled that all importers, exporters, shipping lines and air lines shall file customs documents under digital signature with effect from 01.01.2016.
- (d) Deferred duty payment for select categories of importers and exporters: This provision will enable release of cargo without payment of duty, which shall enable speedier clearance and improved liquidity in hands of the businesses.
- (e) 24X 7 customs clearance facilities extended to 19 sea ports and 17 Air Cargo complexes.
- (f) Procedure for handling related party transactions by Special Valuation Branches and those involving special relationships has been completely revamped.
- (g) E-payment of central excise and service tax refunds and rebates through RTEGS/NEFT implemented.
- (h) Number of central excise returns filed by manufacturers reduced from 27 to 13.
- Central Board of Excise and Customs, has launched Customs SWIFT (Single Window Interface for Facilitating Trade) clearances from 01.04.2016 onwards. This allows traders the facility to lodge their clearance documents electronically at a single point only with the Customs. Required permissions, if any, from other regulatory agencies are obtained online by Customs, and clearances are effected based on the same without the trader having to approach each agency individually. This project has been launched in India from 1st April, 2016**
- (i) CENVAT Credit Rules amended to improve credit flows and reduce litigation.
- (j) Facility of direct dispatch of goods by registered dealer from seller to customer's premises provided. Similar facility allowed in respect of job-workers.
- (k) Time limit for taking CENVAT Credit of duty/tax paid on inputs and input services increased from six months to one year.
- (l) Circular issued to simplify procedure to deal with Audit objections raised by CAG. The Circular provides that demand notice in cases of agreement on audit objections should be issued and decided expeditiously. However, where revenue does not agree with the objections, no demand notice would be issued. This is an effort to make the indirect tax administration assessee friendly and non-adversarial by bringing the audit objections to closure in an expeditious and fairer manner.
- (m) 80 per cent of the refund amount granted within 5 days for service exporters.
- iv) Dispute Resolution and Litigation Management:**
- (a) Penalty provisions in Customs, Central Excise and Service Tax rationalised to encourage compliance and early dispute resolution.
- (b) Withdrawal of all cases in High Court and CESTAT where there is a precedent Supreme Court decision and against which, no review is contemplated by the department.
- (c) The threshold limit below which appeals are not to be filed by the department in CESTAT (Tribunal) and High Courts has been raised to Rs 10 lakhs and Rs 15 lakhs respectively. 2051 cases in High Court and 5261 cases in CESTAT have been identified for such withdrawal.
- (d) Prosecution proceedings in cases older than fifteen years involving duty of less than Rs 5 lakh have been identified for withdrawal.
- (e) Pre show cause notice consultation has been made mandatory at the level of Principal Commissioner/ Commissioner in all the cases where duty involved is above Rs 50 lakhs.

It would also not be out of place to mention that CBEC has, for the second year running, conducted a

tax payer's experience survey in association with FICCI and KPMG. Several initiatives including the ones outlined above have revealed that 72 per cent of the respondents have felt a perceptible change in policies of the Tax Department by way of becoming liberal and friendly to the tax payer. The number of reforms with regard to clearance procedures pertaining to import and export of goods have had a positive impact on time and cost. The impact is visible in the improved scorecard of India in Logistics Performance Index (LPI), a survey done by World Bank Group on trade logistics. India has moved up 19 positions (from 54 to 35) in LPI rank and Indian Customs has moved up by 27 positions (from 65 to 38) in 2016 report as compared to 2014 report.

## **Goods and Services Tax**

The phenomenon of GST has gripped the imagination of the economists, industry and the government. In fact, it is the hottest selling topic and a keen source of discussion at many domestic and international forums. The genesis of the introduction of GST in the country was laid down in the Budget Speech of 2006. Thereafter, there has been a constant endeavor for the introduction of the GST in the country whose culmination has been the 122nd Constitution Amendment Bill.

**Why GST:** Presently, the Central Government levies tax on manufacture (Central Excise duty), provision of services (Service Tax), interstate sale of goods (levied by the Centre but collected and appropriated by the States) and states levy tax on retail sales (VAT), entry of goods in the State (Entry Tax), Luxury Tax, Purchase Tax, etc. It is clearly discernible that this fractured mandate of taxation between the Central and State Governments leaves a lot of gaps in the supply chain. There is cascading of taxes as taxes levied by Central Government are not available to set off against the taxes being levied by the State governments. Further, the variety of VAT tax laws in the country

with disparate tax rates and dissimilar tax practices divides the country into separate economic spheres. Creation of tariff and non-tariff barriers such as Octroi, entry Tax, Check posts etc. hinder the free flow of trade throughout the country. Besides that, the large number of taxes created high compliance cost for the taxpayers in the form of number of returns, payments etc. In fact, it is said that our tax laws have created a situation where business decisions are based on tax considerations rather than logical economical factors. All these issues created a need for one tax that will be able to mitigate number of these problems to a large extent.

**it is said that our tax laws have created a situation where business decisions are based on tax considerations rather than logical economical factors. All these issues created a need for one tax that will be able to mitigate number of these problems to a large extent.**

All the taxes mentioned earlier are proposed to be subsumed in a single tax called the Goods and Services Tax (GST) which will be levied on supply of goods or services or both at each stage of supply chain starting from manufacture or import and till the last retail level. GST is proposed to be a dual levy where the Central Government will levy and collect Central GST (CGST) and the State will levy and collect State GST (SGST). The Centre will also levy and collect Integrated GST (IGST) for inter-state supply of goods and services.

### **Advantages of GST:**

#### **A) Advantage to the Government:**

- Will help to create a unified common national market for India, giving a boost to Foreign investment and "Make in India" campaign.

- Will prevent cascading of taxes as Input Tax Credit will be available across goods and services at every stage of supply.
- Harmonization of laws, procedures and rates of tax.
- Will improve environment of compliance as all returns to be filed online, input credits to be verified online, encouraging more paper trail of transactions.
- Uniform SGST and IGST rates will reduce the incentive for evasion by eliminating rate arbitrage between neighboring States and that between intra and inter-state sales.
- Electronic matching of input tax credits all-across India thus making the process more transparent and discourage mere 'invoice shopping'.
- Common procedures for registration of taxpayers, refund of taxes, uniform formats of tax return, common tax base, common system of classification of goods and services will lend greater certainty to the taxation system.
- Greater use of IT will reduce human interface between the taxpayer and the tax administration, which will go a long way in reducing corruption.
- Will provide a more transparent basis for applying the WTO's National Treatment Principle on import of goods by charging additional duty of customs (CVD) as equivalent to IGST.
- It will boost export and manufacturing activity, generate more employment and thus increase GDP with gainful employment leading to substantive economic growth.
- Ultimately, it will help in poverty eradication by generating more employment and more financial resources.

**B) Advantages to Trade and Industry:**

- Simpler tax regime with fewer exemptions.
- Reductions in the multiplicity of taxes that are at present, governing our indirect tax system leading to simplification and uniformity.
- Will prevent cascading of taxes as Input Tax Credit will be available across goods and services at every stage of supply.
- Reduction in compliance costs - No multiple record keeping for a variety of taxes - so lesser

investment of resources and manpower in maintaining records.

- More efficient neutralization of taxes especially for exports thereby making our products more competitive in the international market and give boost to Indian exports.
- Simplified and automated procedures for various processes such as registration, returns, refunds, tax payments, etc.
- All interaction to be through the common GSTN portal- so

less public interface between the taxpayer and the tax administration.

- Timelines to be provided for important activities like obtaining registration, refunds, etc.
- Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption, which in turn means more production thereby helping in the growth of the industries. This will create India as a "Manufacturing hub"

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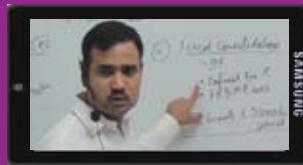
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# Ushering in a New Era of Tax Reforms

**D S Malik**



*...this overall gamut of large scale tax reforms both in case of Direct and Indirect taxes will go a long way in making India one of the fastest growing emerging economy in the world with a tax friendly base*

**T**

he present Government from its very inception has shown its commitment to tackle the menace of black money. The very first decision of the present Government after taking over in May 2014 was to set-up a Special Investigation Team (SIT) headed by the Hon'ble Mr. Justice M.B. Shah, former Judge of the Supreme Court as Chairman and Hon'ble Mr. Justice Arijit Pasayat, former Judge as Vice Chairman. The constitution of Special Investigating Team (SIT) was approved by the Union Cabinet in its First Meeting to implement the decision of the Hon'ble Supreme Court on large amounts of money stashed abroad by evading taxes or generated through unlawful activities.

The SIT has since then given its various reports to unearth black money and undisclosed assets beside suggesting/recommending various other measures to that effect. Many SIT recommendations have been already accepted by the Government such as mandatory quoting of PAN for cash transactions etc.

Another major step undertaken by the present Government to unearth black money from domestic market was the Income Declaration Scheme (IDS)-2016 which was a huge success. This Scheme was the latest initiative of the Government of India to tackle the

menace of domestic black money. It was announced by the Union Finance Minister in his Budget Speech of 2016. Accordingly, the Government had formally launched the Income Declaration Scheme (IDS) 2016 from 1<sup>st</sup> June, 2016 which was kept open for four months i.e. till 30<sup>th</sup> September, 2016. It provided an opportunity to persons who had not paid full taxes in the past to come forward and declare their domestic undisclosed income and assets. Declarations could have been made online as well in printed copies of the prescribed form up to the midnight on 30th September, 2016.

Under IDS-2016, 64275 declarations were filed upto the midnight of 30<sup>th</sup> September, 2016 with an aggregate of Rs.65,250 crore worth of hitherto undeclared incomes in the form of cash and other assets being declared. With the final stock taking of declarations being filed in physical printed forms all over the country, this number is likely to be further revised upwards.

The response to the Scheme was much higher than the expectations of the tax experts and others. Under IDS-2016, the declarer had to pay 45 per cent tax on the declarations made which include a penalty of 15 per cent.

Before that, the Government had brought a Scheme i.e. Undisclosed Foreign Income and Assets and

Imposition of Tax Act, 2015 to unearth the black stashed outside the country. The Act provided for one time compliance window to declare assets held abroad and pay due taxes and penalty on the value of assets declared. The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 came into force with effect from 1st July, 2015.

A total of 644 declarations were made under the compliance window provided in the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. The amount involved in these 644 declarations was 4,164 crores. The declarants were liable to pay tax at the rate of 30 per cent and a like amount of 30 per cent by way of penalty on the value of assets declared, by 31st December, 2015. The amount received by way of tax and penalty upto 31st December, 2015 is Rs 2,428.4 crore. The shortfall was primarily on account of certain declarations, in respect of which, there was prior information under the provisions of Double Taxation Avoidance Agreements (DTAAs)/Tax Information Exchange Agreements (TIEAs) or receipt of payment after 31st December, 2015. Other major steps taken by the Government to tackle black money include making tax crimes predicate offence under PMLA; amendment of FEMA to provide for confiscation of domestic assets in place of foreign assets; enactment of Black Money Law and Amendment to Benami Act among others.

Besides above, various international treaties were signed for exchange of information about tax evasion and undisclosed assets including signing of FATCA with USA; amendment of Mauritius Treaty; Initiative for signing of Automatic Exchange of Information Treaty with all major countries including Switzerland, initiatives under BEPS (Based Erosion and Profit Sharing) such as country by country reporting, PoEM (Place of Effective Management) etc.

An assessment of Rs.8000 crore in HSBC cases as well as filing of 164



*Income Tax: Direct Tax for the Common Man*

prosecution complaints in 175 HSBC cases; detection of Rs.5, 000 crores of undisclosed deposits in foreign accounts made out of ICIJ cases, 55 prosecution cases filed in those cases; big investigation in Panama cases has led to 250 references being made to other countries asking for details about tax evaders and bank accounts among others. The quantum jump in the searches and survey has resulted

**The effort of the Government is to widen the tax base by including maximum people who are liable to pay the taxes under its tax net and make the people tax compliant by making payment of due taxes in time. This will not only increase the revenue collections of the Government, but would also help in bringing down the tax rates to a reasonable level.**

in seizure of Rs.1986 crores as well as undisclosed income of Rs.56, 378 crore in the last two and half years. The upgradation of IT capabilities has led to non-intrusive methods of detection of tax evasion. Rs.16, 000 crores received as tax out of one such system of Non-filers of Monitoring System (NMS). 3626 cases of prosecution and compounding in the last two and half

years which is more than double as compared to previous two years.

Other major tax initiatives in case of Direct Taxes undertaken by the Government include reversal of retrospective tax laws, increase in the threshold limit for filing appeals by the Income Tax Department and making the tax laws simpler and transparent so that more and more people become tax compliant. The efforts of the Government is to widen the tax base by including maximum people who are liable to pay the taxes under its tax net and make the people tax compliant by making payment of due taxes in time. This will not only increase the revenue collections of the Government, but would also help in bringing down the tax rates to a reasonable level. The Government focuses to provide maximum tax based services online so that there is minimum human interaction i.e., Minimum Government, Maximum Governance. This will bring down not only corruption, but would also bring more transparency and efficiency in the tax system. Accordingly, to prevent undue harassment, the Income Tax Department is also focusing on electronic based communication with the tax payers at large. Providing a fair environment to not only corporate but individual taxpayers seems to be the key focus of the Government. The

Prime Minister in various PRAGATI Meetings had also asked the tax officials to take care of pending grievances and resolve them at the earliest.

Similarly, in a bid to settle pending tax disputes with companies, the Union Budget 2016-17 also announced a one-time settlement window for resolution of tax disputes. Terming litigation as a “scourge” for a tax friendly regime which also creates an environment of distrust, the Finance Minister in the Budget had announced a Dispute Resolution Scheme (DRS).

A taxpayer who has an appeal pending as of today before the Commissioner (Appeals) can settle his case by paying the disputed tax and interest up to the date of assessment, the Finance Minister had announced. The Scheme, which is currently open, allows for no penalty in respect of Income-tax cases with disputed tax up to Rs 10 lakh will be levied. A penalty of up to 25 per cent of the minimum imposable penalty on cases with disputed tax exceeding Rs 10 lakh will be imposed for both direct and indirect tax cases. Any pending appeal against a penalty order can also be settled by paying 25 per cent of the minimum of the impossible penalty.

Domestic and foreign investors are also gaining comfort from the Government's attempt to have transparent tax policies and its efforts to reach out and discuss all policy changes.

A case in point, for instance, was the plugging of the tax loophole with Mauritius. India and Mauritius amended the double Tax Avoidance Agreement in May this year, which allowed India to levy capital gains tax from the sale of shares of an Indian company from April 1, 2017 onwards. Soon after the announcement, the Finance Ministry swung into action and met with foreign institutional investors as well as domestic companies to clarify their doubts.

It also announced its intent to plug similar tax loopholes with other countries such as Singapore and the

grandfathering period till April next year gave investors the opportunity to transition smoothly into the new tax environment.

Another area of tax reforms includes the field of Corporate Tax. India, companies are also looking forward to Budget 2017-18 when the Finance Minister is expected to throw more light on his roadmap to lower corporate taxes.

In Budget 2015-16, the Finance Minister had announced a plan to lower the corporate tax rate from the existing

**The GST, which is seen as the most ambitious and most significant tax reform in the history of indirect tax laws, would subsume not only the Union Levies including the Central Excise Duty, Service Tax etc, but also the State Level levies such as Value Added Tax, Octroi, Entry Tax, Purchase Tax and Entertainment Tax among others. It is the culmination of efforts of over 13 years by the successive Central and State Governments to reach the present level.**

30 per cent to 25 per cent over a four year period, which would be in line with the rates of other Asian countries and enhance India's competitiveness as an investment destination. This would, in turn, be done with an elimination of incentives to companies.

As far as tax reforms in the field of Indirect Taxes are concerned, the historical tax reform being undertaken by the present Government as a challenge is the Goods and Services Tax (GST), which is at present under the process of implementation. The Government has decided to implement this law with effect from 1<sup>st</sup> April, 2017. The Economic Survey 2015-16 had termed GST as a reforms measure “perhaps unprecedented in the modern global tax history.” In fact, this is the result of the present

Government's strenuous efforts to carry every political party on board and get the 122nd Constitution Amendment Bill passed by both the Houses of Parliament unanimously in the first week of August this year during the last Monsoon Session. This Constitution Amendment Bill was stuck for the last more than ten years I.e. since 2006, in the Parliament for one reason or the other.

The GST, which is seen as the most ambitious and most significant tax reform in the history of indirect tax laws, would subsume not only the Union Levies including the Central Excise Duty, Service Tax etc, but also the State Level levies such as Value Added Tax, Octroi, Entry Tax, Purchase Tax and Entertainment Tax among others. It is the culmination of efforts of over 13 years by the successive Central and State Governments to reach the present level.

The Union Finance Minister who chairs the GST Council that includes State Finance Ministers as its members, has set a target date of 22<sup>nd</sup> November 2016 to finalise all the modalities of the tax, including the model legislation and the crucial rates for the tax.

In the last two meetings held on 22<sup>nd</sup>, 23<sup>rd</sup> and 30<sup>th</sup> September, 2016, the GST Council has already decided on issues including the threshold for businesses on which GST would be levied, the Draft Business Rules, the future of Area Based Exemptions as well as control over small businesses among others.

Businesses with an annual turnover of up to Rs 10 lakh in North Eastern States and upto Rs 20 lakh in other States will be exempted from GST. On the issue of administrative control, States will have the sole control over manufacturing businesses with an annual turnover of up to Rs.1.5 crore. For those above the threshold, there will be an element of dual control and either the State or Centre will have control over the businesses based on the risk assessment.

Some analysts have however, pointed out certain concerns with

regard to the implementation of GST from April next year. One such concern is that certain number of items are exempt from the tax, e.g., petroleum and petroleum products and electricity will not be under GST. States and the Centre will continue to levy taxes on them.

However, a pragmatic approach will allow the Centre and States to reach a consensus on issues easily, and allow for the timely roll-out of GST.

Notwithstanding these concerns, the Centre is hopeful that the model Bills for Central GST, State GST and Integrated GST will be finalized by next month i.e. November, 2016 and can be passed by the Parliament and respective State Assemblies during their respective Winter Sessions before the end of December, 2016.

Simultaneously, the work on IT infrastructure for GST – GST Network (GSTN) that will provide a common system to States, Centre and taxpayers,

is almost complete. Working of GST Network will be tested in January and February next year.

The GST Law is being keenly awaited by domestic and foreign investors as well as global rating agencies have, as it would promote Ease of Doing Business and cut down on internal tariff barriers put-up by each State Government. The Government expects that it would give a boost to the country's ranking in the Ease of Doing Business Report, where it is currently placed at 130 out of 189 countries. The Prime Minister hopes to bring India amongst the top 50 countries on the rankings.

The International Monetary Fund (IMF) in its recent World Economic Outlook had said that the advent of GST would boost India's medium term growth prospects. Noting that it is positive for trade and investment, the IMF report said, "This tax reform and the elimination of poorly targeted subsidies

are needed to widen the revenue base and expand the fiscal envelope to support investment in infrastructure, education and healthcare."

The Union Finance Minister said during his recent visit to Washington in October 2016 that structural reforms like GST can only add to India's growth prospects. The IMF and the World Bank have pegged India's growth rate to 7.6 per cent in the next two years.

As per various estimates, GST will boost revenue collections by plugging leakages and evasion and will have the potential to boost the country's gross domestic product by as much as 2 per cent.

Thus, this overall gamut of large scale tax reforms both in case of Direct and Indirect taxes will go a long way in making India one of the fastest growing emerging economy in the world with a tax friendly base. □

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# Road Map for Taxation



*Be it the announcement of a road map for phasing out deductions under the Income-tax; indicating that the rate of corporate tax will be reduced from 30 per cent to 25 per cent over the next four years along with corresponding phase-out of exemptions and deductions to simplify the tax laws, making them clearer and more transparent; or the policies encouraging entrepreneurship through incentives for start-ups, an array of reforms are what now India is being credited for*

# A

fter having faced criticism globally over uncertain tax policies, India in the past 2 years has been on a tax overhaul which has shored up the government's reform credentials.

Be it the announcement of a road map for phasing out deductions under the Income-tax; indicating that the rate of corporate tax will be reduced from 30 per cent to 25 per cent over the next four years along with corresponding phase-out of exemptions and deductions to simplify the tax laws, making them clearer and more transparent; or the policies encouraging entrepreneurship through incentives for start-ups, an array of reforms are what now India is being credited for.

With the recent success of the Income Declaration Scheme for unearthing domestic black money, India with these reforms is also increasing its revenues and is also getting acclaimed globally.

The Finance Minister, in his budget speech, proposed a limited period compliance window for domestic taxpayers to declare their undisclosed income whether in the form of investment in assets in India or otherwise, and clear up their past tax transgressions by paying a total of 45 per cent of the undisclosed income.

The Scheme was effective from 1 June 2016 for a period of 4 months (i.e. till 30 September 2016) and saw an overwhelming response with Indians declaring over Rs 65,000 crore of unaccounted income. Any disclosure made under the Scheme was immuned from high taxes and penalty with no scrutiny or inquiry shall be undertaken in respect of such declarations.

To encourage entrepreneurship through incentives for start-ups, the government had announced that income of such start-ups subject to specified conditions would not be chargeable to income-tax and that they could receive capital at a value which may not be equivalent to the fair market value.

Additionally, the government also decided to abolish Wealth -tax, which was introduced in 1957 and was levied @1 per cent on Individuals, HUF's and Companies if the Net Wealth of such person/entity exceeds Rs. 30 lakhs.

To reduce litigations, the government went for Direct Tax Dispute Resolution Scheme, providing an opportunity to taxpayers to settle their past cases by making payment of the prescribed tax, interest or penalty in respect of any tax arrear or specified tax. The key objective of the Scheme is to reduce the pending direct tax litigation, involving various corporate and personal tax cases or disputes which can be settled in one go.

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The author is currently Special Correspondent with CNBC TV18, has been a business journalist since last more than eight years working with Hindustan Times, Financial Express and The Pioneer. She specializes in writing on economic, socio-economic and politico-economic issues ranging from taxes, international trade relations, infrastructure, social schemes and many more.

Besides, another scheme for APA or Advance Pricing Agreements was introduced in the Income-tax Act in 2012 and the Rollback provisions were introduced in 2014. The scheme is seen as one of the most robust endeavors to provide certainty to taxpayers in the domain of transfer pricing by specifying the methods of pricing and determining the arm's length price of international transactions in advance for a maximum period of five future years. Further, the taxpayer has the option to roll-back the APA for four preceding years. More than 700 applications (both unilateral and bilateral) have been filed in just four years.

North Block, which has not been seen in such a revolutionary mode ever before, took another decision to build upon and overcome various legacy issues.

A series of recommendations of the first report of the Tax Administration Reform committee (TARC) relating to dispute management were also being taken forward.

The CBDT has issued specific guidance notes, circulars and instructions for uniformity in approach on interpretation of taxation provisions from time to time. This process is being further strengthened with the issue of Circulars on the recommendations of the High level Committee set up by the Finance Minister to identify issues requiring clarification. CBDT has also clarified various provisions of the Income-tax Act for reducing litigation and easing burden of compliance.

Amendments/ clarifications have been issued for e.g. in respect of indirect transfer, foreign tax credit rules. This has not just reduced litigation by the department, but has also increased the limits of disputed tax, thereby bringing more and much needed clarity.

Meanwhile, a major transition seen in the last few years is the fact that PM himself is issuing instruction to Income-tax officers - an attempt towards a non-adversarial tax regime, to correct the image of the department.



*Taxing Wealth*

The Central Board of Direct Taxes (CBDT) has issued a consolidated instruction to its officers on November 7, 2014 to achieve a non-adversarial tax regime. The CBDT has directed its officers of the Income-tax Department to adhere to the specified guidelines issued time to time. Besides, various procedural reforms also took place to bring in greater ease in doing business.

This is being done by department using 'Sevottam' platform that connects all income tax offices in the country to address the queries and grievances in real time, or making PAN and TAN application process faster and paperless.

To ease the burden of taxpayers like you and me, the Income Tax Department introduced usage of either digital signature or Electronic Verification Code (EVC) to file a paperless income tax return in India. The EVC can be generated by using Aadhaar Number, Net Banking, ATM or registered e-mail and mobile number of a taxpayer. In order to include more taxpayers under the EVC process, the Central Board of Direct Taxes (CBDT) has recently issued a notification to include two additional modes of generating the EVC. Now, taxpayers can also use their Bank account or Demat account details

to generate the EVC for electronic verification and filing of their paperless Income Tax Return.

It has also cut down on the face to face meeting with the tax officers to reduce complaints of harassment by bringing in e-hearing for paperless assessments.

This concept uses email-based communication for paperless scrutiny proceedings on a pilot basis and it is now being carried in various divisions.

Additionally, the CBDT has recently notified the procedures and the standards to be followed to ensure secured transmission of electronic communication.

The Ministry of Finance, Government of India, had announced, through a Press Release issued on 10 December 2015, a new facility for pre-filling of the withholding tax [called Tax Deducted at Source (TDS)] schedule while submitting online rectification request on the e-filing portal of Income-tax department.

With such series of work, the transition, transformation and up gradation in direct taxes is still going on to get India at par with best global practices and biggies. □

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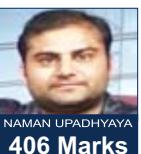
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# Black Money Menace: Government on War-footing

*Dilasha Seth*



***The Indian government has significantly stepped up efforts to unearth black money from the system, which is only set to expand going forward with the help of technology such as Project Insight. While the efforts using technology are in the right direction, the focus must be on discouraging cash transactions and encouraging card payment in the economy. This will be the key to curb black money circulation***

**E**ven at two hours to midnight on September 30th, people were seen streaming into various tax offices across the country while many others were glued to their computer screens to declare all the unaccounted wealth and assets they owned and come clean. They were amongst the 64275 individuals who availed the ‘one-time opportunity’ offered by the government and made black money disclosures under the four-month window that opened on June 1. The midnight hustle guaranteed the declarants a comfortable sleep in future amid government’s war-like approach to fight the black money menace. The declarants will escape prosecution under the Income Tax Act, Wealth Act and Benami Act. Although the government will get close to Rs 30,000 crore in taxes by September next year from the Income Declaration Scheme (IDS), which is 45 per cent of the Rs 65250 crore worth of declarations that came in, it may well be just a tip of the iceberg. Incidentally, the Prime Minister has taken up the task of unearthing black money on a mission mode. It could be made out from his statement last month warning evaders of ‘tough decisions after September 30.’

Of the over 120 crore population in the country, less than 5 per cent or 5.43 crore individuals pay taxes. Honest taxpayers face a steep tax burden on account of non-compliance by a significant chunk of individuals who do not declare income. Although, it is difficult to ascertain the quantum of black money flow in the economy, various estimates and reports peg it at anywhere between 20 per cent and 70 per cent of the size of India’s 2 trillion-dollar economy. According to the Swiss government, till the end of 2010, there were deposits worth Rs 9500 crore in all Swiss banks by Indian citizens. Of about Rs 8 lakh crore worth direct tax revenue, the collections are significantly skewed in favour of corporation tax, which had a 60 per cent share and personal income tax a 40 per cent share. This highlights the potential of widening of the tax base. Of the 25 crore PAN card holders in the economy, only 5.43 crore pay taxes. Government’s toughened stance against black money, in line with its electoral promise is set to make the going difficult for tax evaders within the economy and those with unaccounted wealth stashed overseas.

The government is working on a multi-pronged strategy to tackle the black money menace. Besides IDS, a slew of other measures includes

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Foreign Assets Disclosure window, constitution of Special Investigative Team (SIT) for black money, reworking bilateral tax treaties, making PAN card mandatory for transactions over Rs 2 lakh, Project Insight and signing information exchange treaties with various countries. The introduction of one of the biggest taxation reforms—goods and services tax (GST)—from next financial year will also make it tough to evade indirect taxes, which is likely to improve the overall compliance rate. The GST will subsume various indirect levies of Centre and states like Service Tax, Excise Duty, Octroi, Value Added tax, among others and create an input tax credit chain for refunds.

### **Non-Intrusive Target Evaders**

According to the Ministry of Finance, Rs 16,000 crore have been collected by using non-intrusive measures using third party information and quoting of PAN on account of upgraded IT database.

At present, about 92 per cent of the tax department's revenue comes from tax deducted at source (TDS), advance tax and self-assessment tax, while the remaining 8 per cent comes after scrutiny. This looks set to change.

Stepping up tech support to nab evaders, the big ticket 'Project Insight' with the help of L&T Infotech will allow the government to collate all information available with the Income Tax Department from various sources and systematically profile people using permanent account number (PAN) details. Through profiling, all transactions by a person including purchase of immovable property, jewellery and vehicles will be available with the tax department in a systematized manner, making identification of tax evaders simpler. The project is also expected to rank tax evaders based on the amount of tax that could be recovered, so that the authorities could go after the highest value targets first. Several government departments like Central Board of Direct Taxes, Intelligence Bureau and others are working closely on the project.



*Unearthing Black Money*

The government has also made it mandatory to furnish PAN for all transactions over Rs 2 lakh through all payment modes from January 1, 2016. It has also revised monetary limits for furnishing of PAN for gold jewellery to above Rs.2 lakh from the earlier limit of Rs 5 lakh. All fixed deposits with post offices, cooperative banks, Nidhis, Non-Banking Finance Companies will also need PAN.

**A quantum jump in the searches and survey has resulted in the seizure of Rs 1,986 crore as well as undisclosed income of Rs 56,378 crore in the last two and half years. Most seizures by the income tax department were in the medical and education sector.**

Currently, seven third-party sources have to mandatorily report transactions and file an Annual Information Return (AIR). These include banks that accept cash deposit of Rs 10 lakh or more in a year from any person; bank or a company issuing credit cards where payment against bills exceeds Rs 2 lakh in a year for any person; mutual funds collecting Rs 2 lakh or more for sale of units by any person; company receiving Rs 5 lakh or more against issue of shares, bonds/debentures and registrar/sub-registrars in respect of sale/purchase of immovable property exceeding Rs

30 lakh and the RBI for issue of bonds exceeding Rs 5 lakh.

### **I-T Lens Widens**

A quantum jump in the searches and survey has resulted in the seizure of Rs 1,986 crore as well as undisclosed income of Rs 56,378 crore in the last two and half years. Most seizures by the income tax department were in the medical and education sector.

In what underlines the department effectiveness in using third party information, the CBDT issued 7 lakh letters to individuals to come clean under IDS. This was based on information of 90 lakh pieces of information of transactions without PAN.

It has scrutinized the Annual Information Returns (AIR) for high value transactions which have divulged cash deposits of over Rs 10 lakh in a savings bank account, sale/purchase of immovable property valued at Rs 30 lakh or more, and many of these transactions do not have PAN.

The Prime Minister, in his address to tax officers a few months ago, had pointed out that if 42,000 officials of CBDT are engaged for ensuring direct tax revenue, then the tax net should increase further.

The Central Board of Direct Taxes (CBDT) has also instructed officers to scrutinize production details and tax returns filed by the companies

engaged in mining activities and take appropriate action in case of discrepancy found.

In case of indirect taxes, the enhanced enforcement measures have helped unearth tax evasion of Rs 50,000 crore of indirect taxes and undisclosed income of Rs 21,000 crore.

### **SIT for Capping Cash Transactions:**

The special investigative team on black money constituted in 2014 and chaired by former Supreme Court Judge MB Shah has called for a complete ban on cash transactions over Rs 3 lakh to curtail black money circulation in the economy and a limit of Rs 15 lakh on cash holdings in its recent report. The suggestions if accepted, made after examining provisions in various countries, may make transacting or holding cash over the said amount illegal and punishable under law.

It was felt that the limit of cash transaction could only succeed if there was a limitation on cash holding. It suggested that if any person of industry required holding more cash, they may obtain necessary permission from the Commissioner of Income tax of the area.

The SIT has suggested that an Act be framed to declare such transactions as illegal and punishable under law. It is being deliberated by the Ministry of Finance.

The panel has asked the Reserve Bank of India (RBI) to develop an institutional mechanism, in consultation with the revenue department, to share export-import and foreign exchange (forex) transaction information with investigative agencies, to curb illicit financial flows out of the country. It called for a mechanism to allow sharing of information of RBI databases with enforcement authorities – the Department of Revenue Intelligence (DRI) and Enforcement Directorate (ED) - for verification.

It has also asked the Directorate of Revenue Intelligence (DRI) to take

action against those companies which had claimed duty drawback without bringing earnings from exports to India. In such cases, the country loses on two counts — first by not getting export proceeds and then by wrongful claim of duty drawback.

### **Unaccounted Money Stashed Abroad:**

The information exchange pacts with other countries will make it further challenging to stash black money in overseas accounts. The Indo-US Foreign Account Tax Compliance Act (FATCA), which came into effect last year is aimed to ensure that tax is paid on income generated from wealth abroad. India has already started receiving under Automatic Exchange of Information (AEOI) under FATCA. The government will start receiving

**The government is on a spree to revise the double taxation avoidance agreement with these countries and gain taxation rights over capital gains, which currently rests with these low or no tax jurisdictions. India has revised DTAA with Mauritius and Cyprus and is close to amending the pact with Singapore.**

information from other countries under AEOI route from 2017 onwards.

Although, it will provide information prospectively from the time of coming into effect, it may help the tax department to detect audit trail for an entity's past transactions.

The government has filed 164 prosecution cases of the 175 cases of black money stashed overseas in a HSBC bank's accounts worth Rs 8,000 crore. Based on investigation by International Consortium of Investigative Journalists (ICIJ), undisclosed deposits in foreign accounts worth Rs 5000 crore have been detected by the government and 55 prosecution cases have been filed.

Similarly, investigation in the Panama Papers has led to 250 references being made to other countries asking for details about tax evaders, bank accounts, etc.

In the compliance window in 2015 for undisclosed assets stashed abroad, the government received disclosures worth Rs 4147 crore, and the 60 per cent tax translated to Rs 2428 crore in revenue.

The Panama Papers leak revealing over 11 million documents figured names of at least 500 Indians who flouted rules and regulations. These documents pertain to 214,000 offshore entities and span almost 40 years. The papers originated from Mossack Fonseca, a Panama-based law firm with offices in more than 35 countries.

In the light of the Panama leak, the SIT has suggested amendment of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 where an assessee must inform the concerned jurisdictional commissioner of Income Tax Department of the state before investing any amount or purchasing any property overseas, even if the permission of the Reserve Bank of India was not required.

### **Revising DTAs:**

Tax evaders have often exploited loopholes in the existing tax treaties with low or zero tax jurisdictions like Mauritius, Singapore and Cyprus, ensuring complete tax avoidance. This ensures that unaccounted money kept overseas is routed back to India disguised as foreign capital. While Double Taxation Avoidance Agreements (DTAA) are aimed to ensure that taxpayers do face the burden of double taxation in both countries, evaders have managed to avoid taxes in both countries. The government is on a spree to revise the Double Taxation Avoidance Agreement with these countries and gain taxation rights over capital gains, which currently rests with these low or no tax jurisdictions. India has revised

DTAA with Mauritius and Cyprus and is close to amending the pact with Singapore.

Mauritius and Singapore are the top two FDI sources in India, making up for about half of total direct investments into the country. Total FDI from Mauritius over the last decade and a half stands at US\$95.9bn, while that from Singapore is about US\$45.8bn. Cyprus is eighth on the list with investments worth US\$8.5bn.

Ahead of General Anti Avoidance Rule (GAAR) being rolled out from April 1, 2017, these low tax jurisdictional economies have, in fact voluntarily come forward to revise treaties to plug these loopholes. GAAR is a set of rules designed to give Indian authorities the right to scrutinize and tax transactions which they believe are structured solely to avoid taxes.

India amended the DTAA with Mauritius in April, allowing New Delhi to impose capital gains tax on shares. Companies routing funds into India through Mauritius from the next fiscal will have to pay short-term capital gains tax at 50 per cent prevailing rate during a two-year transition period beginning April 2017. The short term capital gains tax rate is 15 per cent at the moment. The full rate will be imposed from 2019 onwards. The concessional rate of 50 per cent would be subject to fulfilment of conditions in newly-inserted Limitation of Benefit (LOB) which is an expenditure of at least Rs 27 lakh in Mauritius in the previous fiscal. The Singapore treaty amendments are being negotiated by the two sides. It will automatically be amended from April 1, 2017 as it is under the same protocol as Mauritius.

India has Double Tax Avoidance Agreements with 82 nations, including all popular tax haven countries. Of these, India has expanded agreements with 30 countries which requires mutual effort to collect taxes on behalf of each other.

Cyprus has also agreed to give India taxation rights over shares in return for removal from the blacklist. Companies based in Europe and the US routed investments into India, deriving complete tax avoidance as the tax treaty provided for zero capital gains tax and a low withholding tax rate of 10 per cent on interest payments made to entities based in Cyprus. India has agreed to take Cyprus off the blacklist. Cyprus was declared a non-cooperative jurisdiction by India in 2013 over not sharing information related to Indian account holders. It was the first tax jurisdiction to be labeled that by India, leading to a 30 per cent withholding tax on all payments made to Cyprus and greater scrutiny of Indian entities receiving funds from there requiring additional disclosures, including the source of the money. Indian entities with investments from Cyprus also have to forego deductions on account of expenditure and allowances.

**With all major economies of the world uniting against the cause of eradication of black money, seen from Base Erosion and Profit Sharing (BEPS) agreement and multilateral information exchange pacts, it will become very difficult to carry out tax evasion. The free exchange of information between countries will now provide more leads to tax officers to pin down offenders.**

#### **Benami Transactions Act:**

The Benami Transactions (Prohibition) Amendment Act approved by the Parliament in August saw widening of definition and increase in penalty and punishment for those who hold assets in the name of other person or in fictitious name to avoid taxation. The legislation is intended to effectively prohibit benami transactions and thereby prevent circumvention of law through unfair practices. The definition of a

benami transaction has been widened to include a transaction made in a fictitious name; where the owner is not aware of or denies knowledge of the ownership of the property; or the person providing the consideration for the property is not traceable.

Investment in property or real estate is used commonly to park unaccounted money. A significant number of transactions in real estate are not reported or are under-reported.

The Bill has made the penalty and prosecution provisions more stringent. The penalty under the amended Act will be rigorous imprisonment of one year up to seven years, and a fine which may extend to 25 per cent of the fair market value of the benami property as against imprisonment up to three years or fine or both in the current legislation.

The penalty for providing false information will be rigorous imprisonment of six months up to five years, and a fine which may extend to 10 per cent of the fair market value of the benami property.

#### **Way Forward:**

With all major economies of the world uniting against the cause of eradication of black money, seen from Base Erosion and Profit Sharing (BEPS) agreement and multilateral information exchange pacts, it will become very difficult to carry out tax evasion. The free exchange of information between countries will now provide more leads to tax officers to pin down offenders. The Indian government has significantly stepped up efforts to unearth black money from the system, which is only set to expand going forward with the help of technology such as Project Insight. While the efforts using technology are in the right direction, the focus must be on discouraging cash transactions and encouraging card payment in the economy. This will be the key to curb black money circulation. □

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YE-177/2016

# GST: Game Changer for Indian Economy?

*Ranjeet Mehta*



***The GST subsumes India's messy plethora of indirect taxes, duties, surcharges and cesses into a single tax. It is expected to ease a cumbersome tax system, help goods move seamlessly across state borders, curb tax evasion, improve compliance, raise revenues, spur growth, stimulate investment and make investing and doing business in India easier***

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t the outset, the Government of India must be complimented on the tremendous efforts being made on the GST front. The passage of the Constitutional Amendment Bill as well as release of the Model GST laws indicates the determination of the Government to implement GST at the earliest. One of the thrust policy initiatives of the government is the Make in India project that would enable India to become a manufacturing hub as it will create employment / job opportunities for the burgeoning youth of the country. In order to make India a manufacturing hub, it is imperative that the foreign investors/companies find it conducive to do business here. One of the major impediments to a smooth business, especially in the manufacturing sector, is the uncertain and unpredictable indirect tax regime.

The current multi-staged tax structure has charges from the State and Union governments separately, leading to cascading effect of taxes. There are taxes at different rates and at multiple points. The Centre has taxes like Income Tax, Service Tax, Central Sales Tax, Excise Duty and Security Transaction Tax while at the State

level it includes VAT or Sales Tax, Octroi, State Excise, Property Tax, Entry Tax and Agriculture Tax. These taxes lead to increased tax burden on the Indian products affecting the prices and sales in the domestic as well as international markets.

To address this, the Constitution Amendment Bill for Goods and Services Tax (GST) has been approved by the President of India post its passage in the Parliament (Rajya Sabha on 3 August 2016 and Lok Sabha on 8 August 2016) and ratification by more than 50 per cent of state legislatures. The Government of India is committed to replace all the indirect taxes levied on goods and services by the Centre and States and implement GST by April 2017.

To have achieved this, in a large and complex federal system of multiparty democracy, with a Centre, 29 States and 2 Union Territories of widely divergent interests via a constitutional amendment requiring broad political consensus, affecting potentially 7.5 million tax entities, and marshalling the latest technology to use and improve tax implementation capability, is perhaps breathtakingly unprecedented in modern global tax history.

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Sometimes, we are insufficiently appreciative of how much the country has achieved in coming to this point with the GST. Credit should go to all stakeholders at the Centre and the States for having worked towards the GST. The time is ripe to collectively seize this historic opportunity because the GST will decisively alter the Indian economy for the better.

GST is also the most significant tax reform since independence for India which is now Asia's third largest economy. The GST subsumes India's messy plethora of indirect taxes, duties, surcharges and cesses into a single tax. It is expected to ease a cumbersome tax system, help goods move seamlessly across state borders, curb tax evasion, improve compliance, raise revenues, spur growth, stimulate investment and make investing and doing business in India easier.

With GST, it is anticipated that the tax base will be comprehensive as virtually all goods and services will be taxable with minimum exemptions. GST will be a game changing reform for the Indian economy by creating a common Indian market and reducing the cascading effect of tax on the cost of goods and services. It will impact the tax structure, tax incidence, tax computation, tax payment, compliance, credit utilization and reporting, leading to a complete overhaul of the current indirect tax system.

GST will have a far-reaching impact on almost all the aspects of the business operations in the country, for instance, pricing of products and services, supply chain optimization, IT, accounting, and tax compliance systems. That is the reason why GST Bill has been described as a reform measure of unparalleled importance in independent India.

Currently, tax rates differ from state to state. GST will bring uniformity, reduce the cascading effect of these taxes by giving input tax credit,



*GST: Facilitating inter-state trade in goods*

will have a comprehensive tax base with minimum exemptions — will help industry, which will be able to reap benefits of common procedures and claim credit for taxes paid. This is expected to reduce the cost for consumers. GST will increase India's GDP by around 2 per cent as per the Finance Ministry.

the poorest States — for example, Uttar Pradesh, Bihar, and Madhya Pradesh — who happen to be large consumers will increase substantially.

- The Indian GST will be a leap forward in creating a much cleaner dual VAT which would minimise the disadvantages of completely independent and completely centralised systems. A common base and common rates (across goods and services) and very similar rates (across States and between Centre and States) will facilitate administration and improve compliance while also rendering manageable the collection of taxes on inter-State sales. At the same time, the exceptions — in the form of permissible additional excise taxes on special goods (petroleum and tobacco for the Centre, petroleum and alcohol for the States) — will provide the requisite fiscal autonomy to the States. Indeed, even if they are brought within the scope of the GST, the States will retain autonomy in being able to levy top-up taxes on these goods.

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#### **Major Benefits of GST:**

- The GST will decisively take the Indian economy to the next level for the better. As the Prime Minister outlined in an interview, the GST will increase the resources available for poverty alleviation and development of the country. This will happen indirectly as the tax base becomes more buoyant and as the overall resources of the Central and State governments increase. But it will also happen directly because the resources of
- The GST will facilitate 'Make in India' by bringing India on a single tax platform. The current tax structure is fragmenting Indian markets along State lines. These distortions are caused by three features of the current system: the

Central Sales Tax (CST) on inter-State sales of goods; numerous intra-State taxes; and the extensive nature of countervailing duty exemptions that favours imports over domestic production. In one fell dive, the GST would rectify all these distortions: the CST would be eliminated; most of the other taxes would be subsumed into the GST; and because the GST would be applied on imports, the negative protection favouring imports and disfavouring domestic manufacturing would be eliminated.

- Another significant benefit is, the GST would improve tax governance in two ways. The first relates to the self-policing incentive inherent to a value-added tax. To claim input tax credit, each dealer has an incentive to request documentation from the dealer behind him in the value-added/tax chain. Provided the chain is not broken through wide-ranging exemptions, especially on intermediate goods, this self-policing feature can work very powerfully in the GST. The second relates to the dual monitoring structure of the GST — one by the States and one by the Centre. Critics and taxpayers have viewed the dual structure with some anxiety, fearing two sources of interface with the tax department and hence two potential sources of harassment. But dual monitoring should also be viewed as creating desirable tax competition and cooperation between State and Central authorities. Even if one set of tax authorities overlooks and/or fails to detect evasion, there is the possibility that the other overseeing authority may not.
- The scenario of multiple taxes and its cascading effect which is a burden on common man has been addressed by GST. The framework of proposal has dual GST which means it will

have a federal structure. GST will basically have three kinds of taxes namely Central, State and one called integrated GST that will help to tackle inter-state transactions. Under the current GST tax reform, all forms of supply of goods and services like transfer, sale, barter, exchange and rental will have a CGST and SGST.

- Amalgamating several Central and State taxes into a single tax would help mitigate the

**The proposed GST regime law aims to simplify and harmonize the indirect tax regime in the country. GST shall be levied on both goods and services which would subsume most of the indirect tax laws (except few taxes such as stamp duty) and hence is touted as a major tax reform. Transfer of (completed) properties may continue to be outside the purview of GST and be liable only to applicable stamp duties.**

double taxation, leading to a common national market. From the consumer's point of view, the advantage would be in terms of a reduction in the overall tax burden on goods, which is currently estimated at 25 per cent to 30 per cent.

- Reduction in Prices: Manufacturers or traders would not have to include taxes as a part of their cost of production, which would lead to reduction in prices.
- Lower compliance and procedural cost: There would be reduction in the load to maintain compliance. Also keeping record of CGST, SGST and IGST separately would not be required.
- GST's successful implementation would give a strong signal to the foreign investors about India's

ability to support ease of doing business.

- GST will reduce tax burden on producers and foster growth through more production. This double taxation prevents manufacturers from producing to their optimum capacity and retards growth. GST would take care of this problem by providing tax credit to the manufacturer.

- Various tax barriers such as check posts and toll plazas lead to a lot of wastage for perishable items being transported, a loss that translates into major costs through higher need of buffer stocks and warehousing costs as well. A single taxation system could eliminate this roadblock for them.

- A single taxation on producers would also translate into a lower final selling price for the consumer, therefore less burden on the common man. Also, there will be more transparency in the system as the customers would know exactly how much taxes they are being charged and on what base.

- GST provides credits for the taxes paid by producers earlier in the goods/services chain. This would encourage these producers to buy raw material from different registered dealers and would bring in more and more vendors and suppliers under the purview of taxation. GST also removes the custom duties applicable on exports. Our competitiveness in foreign markets would increase on account of lower cost of transaction.

## Sectorial Impact

### Real Estate Sector:

The real estate sector has strong economic multiplier effects through backward and forward linkages. Construction is the second largest employment generator in the country

after agriculture and accounts for a significant proportion of the GDP. According to the Economic Survey 2015-16, the real estate sector constituted 7.4 per cent of India's GDP in 2013-14. Under the current indirect tax regime, the real estate industry has been embroiled in disputes due to ambiguity in provisions as well as multiple taxation.

Under the current law in force, various types of different taxes are involved, starting from construction of property to sale of the same to end customer:

- Service tax.
- Value Added Tax (VAT).
- Stamp duty.
- Building Cess on construction, etc.
- Further, there are various other taxes which are embedded in the cost of procurements (such as excise duty, CST etc)

Hence, sale of under construction property attracts multiple taxes/duties under the current regime, leading to cascading of taxes and higher tax cost burden on house purchasers.

The proposed GST regime law aims to simplify and harmonize the indirect tax regime in the country. GST shall be levied on both goods and services which would subsume most of the indirect tax laws (except few taxes such as stamp duty) and hence is touted as a major tax reform. Transfer of (completed) properties may continue to be outside the purview of GST and be liable only to applicable stamp duties.

The GST is likely to result in transparency in the real estate sector, which will significantly reduce tax evasion through more efficient transaction-tracking methods, and improved enforcement and compliance. Since GST may be levied on a single value, the current issue of levying tax on tax (VAT on central excise duty) is likely to be removed.

At present, developers pay various non-creditable taxes on supplies. GST may replace these multiple taxes with a single tax; credit on supplies may also be available, thus reducing costs for all players. However, if real estate output is exempted, then input GST credit could be a substantial cost for the sector, resulting in blockage of credit and higher costs to end consumers.

### Health Care Sector

One of the major concerns of this industry is the current inverted duty structure that adversely affects domestic manufacturers, cost of inputs being higher than output. This discourages investment in this industry. GST may either remove the inverted duty structure or allow refund of accumulated credit. This would be

**...as GST is a destination-based tax, it might be a challenge to determine the destination of certain services (at present, services are taxed at the place of rendering the service). This may lead to a difficulty in determining state GST, central GST or inter-state GST on B2B and B2C transactions.**

a boon for this industry and can act as its growth catalyst.

The current cascading tax structure on import duty makes it expensive for the industry to import machinery. GST is likely to reduce this cost. Further, GST is expected to have a positive effect on the pharmaceutical sector. It will help the industry by simplifying the tax structure, since eight different taxes are levied in the pharmaceutical industry at the moment. A consolidation of all these into one tax would ease doing business, as well as mitigate the cascading effects of multiple taxes applied on one product.

Apart from this, GST will also result in operational efficiency by streamlining the supply chain which

can alone add 2 per cent to India's pharmaceutical market size. Because GST will help pharmaceutical companies rationalize their supply chain, they will have to review their distribution networks and strategy.

Additionally, GST implementation will also envisage a seamless flow of tax credit, account for improvement in overall compliance and is also expected to create a level-playing field for pharmaceutical companies in India.

A big advantage for companies will be the reduction in transaction costs with the discontinuance of Central Sales Tax (CST). GST is expected to bring down the manufacturing cost and even a 2 per cent reduction in production or distribution cost is believed to add over 20 per cent to profits. If the rate of GST is below the current total tax rate, it will eventually help consumers by making healthcare and medicines more affordable which already is a big goal for the Indian Government.

This sector enjoys several tax exemptions and benefits. It is still not clear whether these benefits will continue under GST. Health insurance and diagnostic centres, which are mainly service-oriented, may fall under higher tax rates, thereby making such services more expensive for consumers.

### Banking and Financial Services Sector:

In India, most of the banking and financial services are exposed to service tax, at the rate of 14.5 per cent, while GST is expected to be 18 per cent to 20 per cent. Thus, services are likely to get costlier. GST may make things cumbersome as financial service providers may be required to adhere to compliances across multiple states instead of the current single, centralised registration compliances

Also, as GST is a destination-based tax, it might be a challenge to determine the destination of certain services (at present, services are

taxed at the place of rendering the service). This may lead to a difficulty in determining state GST, central GST or inter-state GST on B2B and B2C transactions.

Interest on loans, trading in securities, foreign currency and retail services are also expected to fall within the ambit of GST. Recommendations by the banking industry suggest that such services and income should not come under GST. It is still to be seen whether these recommendations will be accepted.

Overall, it appears that imposing GST on banking and financial services may become a challenge and India, if successful, will chart a new course, which could well become a model for the rest of the world.

### Travel, Tourism and Hospitality:

India's travel, tourism and hospitality industries have multiple taxes, levied by both the Centre and the States. It is expected that under GST, supplies of hotels and restaurants will be subjected to a single tax.

At present, no credit is available on input services related to renovation or construction of hotels and resorts. This is expected to change under GST. R&D cess, payable on franchise fees and technical know-how, is likely to be subsumed under GST, thus simplifying compliance procedures and reducing multiple taxes. However, it is unclear whether various benefits available under the existing Foreign Trade Policy will continue under GST. If such benefits are provided, input credit may not be available, resulting in higher costs. On the whole, GST is likely to eliminate multiplicity of taxes and lack of credits. However, it may also lead to increase in tax rates.

### Education Sector:

The education sector currently enjoys various tax exemptions and benefits; services provided by schools and colleges are either not taxed or are covered in the negative list. The situation is likely to continue even

after the implementation of GST. In case it doesn't, the sector may be able to avail of input credit or CENVAT credit on the duty paid on purchase of inputs and services. These are likely to bring down the final cost for the industry.

### Impact on Common Man

As the GST reaches its final stages, the historic legislation promises to unify the tax system for the nation and increase the GDP by 2 per cent. So, while services could get more expensive, it's a mixed bag for consumers for goods.

**As the GST reaches its final stages, the historic legislation promises to unify the tax system for the nation and increase the GDP by 2 per cent. So, while services could get more expensive, it's a mixed bag for consumers for goods.**

Goods today are typically taxed at 12.5 per cent (excise duty) plus 5-15 per cent (VAT) which is invariably passed on to the end customer. If the standard rate of GST is capped at 18 per cent, there exists a scenario where prices of goods can significantly reduce for the customer. This is because procurement costs will also go down for a business and some of the profit can be passed on to the end of the chain. The corollary to this is the Consumer Price Index where 55 per cent items are tax-exempt, 32 per cent are at a low rate and only 12 per cent are at a standard rate.

This means that some essential items in a household (textiles, books, cooking oil, etc) are actually subject to about 5-8 per cent tax because of exemptions. If the rate hits 18 per cent, then these goods go up in pricing, wobbling the entire structure. In the service industry, the typical tax output will go up from 15 per cent to 18 per cent.

Eating out under GST regime could be cheaper, as right now you

pay service tax and vat both. Under the GST regime, it would be a single tax. As the states are expected also to decide service tax rates, your phone bill could see escalation of taxes. Accordingly, services consumed by a common man such as telecom, rail, transportation, banking, air travel, etc may become expensive. Whereas small cars, FMCG products, etc may become cheaper.

Television could get cheaper, as part of the Make in India initiative, the GST is expected to be lower. So at present for Rs 20,000 LED TV you pay around 24.5 per cent tax, shelling out Rs 24,900 eventually. Under GST if it is around let say 18 per cent, it will cost Rs 23,600, thereby bringing the cost down for the consumer.

Buying bags, shoes, electronics goods online will be getting more expensive as the e-commerce industry comes into a tax net and will have to pay tax deducted at source for every purchase from its sellers. So e-commerce companies which will see shrinking of profit margins and increase tax compliance net could slash discounts and freebies that they offer.

It can be concluded that the real success of GST lies on the impact on the common Indian consumer. The essence of GST is that all goods and services be taxed at moderate rate. "One Nation, One Tax" proves to be a game changer in a positive way and proves to be beneficial not only to the common man, but to the country as a whole. As and when a new law is imposed, it surely leaves its impact especially on the common man. Same applies in case of GST wherein the common man being the final consumer of goods shall be directly affected after introduction of GST. We hope GST leaves a positive impact and helps to boost up the Indian economy and convert India into a unified national market with simplified tax regime. A rising Indian economy will anyways help in the financial growth of the common man! □

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# GST and the Constitutional Conundrum

*Jayanta Roy Chowdhury*



***What the future holds for India's taxation laws is something which the Indian polity would determine in its own unique manner. However for the present, the churn which has produced GST will for many years to come well define India's federal relations***

**T**

he much awaited Goods & Services Tax, intended to transform India into a single marketplace as similar taxes have transformed Canada and the European Union, may have one unintended consequence : turning India's constitution from being described as 'Federal with a Unitary Bias' to a 'Constitution for the Union with a Federal Bias'.

Ahead of the passage of the GST, protesting against the vexatious system of multiple taxation at various stages in different states, some ingenious businessmen came up with the slogan of "One nation, One Tax." The process of unifying the country's market started with VAT in the beginning of this century. However, states remained staunchly independent in their taxation policy, in some cases led by their own fiscal imperatives and this created a situation where VAT was often supplemented by a variety of taxes, leading to India being described as one of the highest taxed nations.

The slogan was, of course, a reaction to the absence of a seamless scheme of taxation which smoothens the course of commerce and not a reflection of the process of constitution making in the aftermath of independence and partition. India's decision to be a federation with a Unitary bias was

coloured by its own experiences during partition, when sedetious tendencies threatened to render apart the nascent state still in its infancy.

Many who were involved in the proceedings of the Constituent Assembly as well as independent observers have often opined that the Assembly was possibly obsessively focused on the need for ensuring the unity and integrity of the new nation. In fact, in one lengthy debate, Syamanadan Sahaya, MP from Bihar argued "In the matter of financial adjustments between Provinces and the Centre, I think that the Provinces have not been treated as well as they should be. In fact, I have a feeling that in this matter, the Provinces are worse off than in the days of the 1935 Act. The responsibilities of the Provinces, their commitments and their sphere for introducing ameliorative measures for the people are greater than even those of the Centre and as such, they should have been given sufficient scope in the field of taxation."

However, the fear of excessive federalism was cogently argued as being against the spirit of One India and the framework which thus came out tended to focus legislative and taxation powers with the centre rather than with the states. Indeed, Pt Hridaynath Kunzru, MP from the United Provinces placed the Unitary debate in focus

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in the same debate arguing : “The financial and administrative stability of the provinces depends to no small extent on the position of the Centre. It would be short-sighted of the provinces to demand a larger share from the Centre, regardless of the effect that their claims would have on the position of the Central Government.”

In the early years, with most states run by Congress Ministries in sync with the Union Government led by Pandit Jawaharlal Nehru never sought to question this arrangement. From the 1960s, when alternate Governments emerged in states, there have been challenges which sought greater powers for the federal units.

States currently have the right to tax a wide range of goods and professions through a variety of taxes, levies and charges, which states have over time very cleverly enlarged taking advantage of loose drafting of legislations. Bengal for instance, levies a charge on coal sold outside its borders. Other states had introduced an entry tax for goods coming from across its borders. These to any consumer or business are indeed anachronisms.

However, this ability of raising higher taxes gave states which were efficient, the ability to raise larger resources to address problems unique to them or in some cases to squander larger resources. The State of Tamil Nadu, which opposed many clauses in the GST had a point when it said that it had implemented wide ranging social sector reforms on the back of cash generated from its taxation programme.

It is true that the Southern states have done remarkably well in their social parameters – its health and education parameters have helped catapult it way ahead of its rivals and are comparable to that of OECD countries. In the words of economist Jean Dreze “Kerala and Tamil Nadu routinely come at — or near — the top in rankings of summary development indexes, they also surpass other States in terms of the speed of improvement.”

Even more than the states, it would be municipal bodies which could

levy many taxes independently and earn handsomely, for instance, the Mumbai Corporations huge income from Octroi duty which will be financially challenged with the roll out of the GST, their power to tax would be virtually decimated. Recognising this, the Ministry of Urban Development has asked for a 25 to 30 per cent share for all urban local bodies in the state’s share of the nation-wide goods and services tax.

**The combination of these two Acts – the GST Constitution Amendment and the FRBM Act - in turn, turns the states' Chief Ministers and Cabinets into political executives charged with implementation of programmes within their respective provinces, but without the right to consider how to raise funds for such programmes or even to scale up their programmes without the connivance of the central government.**

While GST is expected to be divided between the Centre and states based on a mutually acceptable formula, the Ministry has argued that urban local bodies will have to deal with a huge fiscal gap once local body tax, octroi and other entry taxes are scrapped to make way for the new taxation system.

Besides this, legally speaking, the GST Amendment Act effectively transfers the power of taxation over large swathes of possible taxation to an unelected body. Effectively, the GST Council, set up by the Act, takes on the power of deciding tax rates



*GST: Affecting Federalism*

from both the Union Parliament and state legislatures and these have to be implemented across the country. Without going into the issue of weightage of voting powers within the GST Council, the fact remains that this Council will now be the Supreme legislative body in determining tax rates on all goods and services through the length and breadth of the country and not the directly or indirectly elected Members of Parliament and State legislature. In essence, this will be like an educated super-body elected by Electors.

Not only this, the snuffing out of a variety of taxes which the state levied by subsuming them in the GST and the early bias which the Constitution imbibed by granting the Union taxation powers over income and over residual matters, means the state executive and legislature will have little say over what taxes can be raised in their respective states.

A Fiscal Responsibility and Budget Management Act also caps the amount of money which a state may raise through bonds or market loans. While the measure was indeed necessary given the propensity of Indian states to rush into indebtedness which would have put even Greece to shame, the measure does stop a potential Dr B C Roy or a Sir Visvesveraya or a Partap Singh Kairon from turning to debt as an instrument to address their state's extraordinary needs for development funds.

The combination of these two Acts – the GST Constitution Amendment and the FRBM Act - in turn, turns

the states' Chief Ministers and Cabinets into political executives charged with implementation of programmes within their respective provinces, but without the right to consider how to raise funds for such programmes or even to scale up their programmes without the connivance of the Central Government.

The power to tax is the crux of the argument of "sovereignty", succinctly made during the American War of Independence which the Continental states waged. The Finance Minister, a polished constitution lawyer himself very deftly and aptly handled the objections raised to the move by stating that : "For some of those who felt that this was surrendering their sovereignty, this was, in fact, pooling in of sovereignty of the states at the Centre."

However, it would do well to remember that the world has not yet totally embraced GST as a panacea for its fiscal ills. In fact, the United States itself has, as yet, not agreed to usher in any form of GST. Possibly because of the federal nature of its constitution. In fact, the plethora of taxes levied by US federal authorities, States and other municipal governments are often bewildering for a newcomer. Especially since direct taxes fall in the purview of the states in that country, unlike in India, where it is levied by the Central Government and then shared with states according to a set formula.

State and local taxable income is determined under state law, though often based on federal taxable income calculations. Yet, in some cases, this is not so, with states devising alternative measures of calculating taxable income, or even alternative taxes. Confusing as this may be, the total measure of taxation on individuals still work out to 24.8 per cent of GDP, compared to India's 16.6 per cent.

In fact, in Canada where the GST was introduced in the last century, the provinces have the power over direct taxes, while the federal Government has the power to tax indirect taxes, which is why the change over to GST did not entail any impact on state powers.

It is yet to be seen how the Indian polity will respond to the challenge to the eventual implementation of the Goods and Services tax. It could well accept the taxation powers which have now evolved or chafe at the bit and seek a change from the new status quo.

In case, states eventually decide to seek a fiscal arrangement which is less straight-jacketed they could then either chose the Australian model, where 75 per cent of all taxes are raised by the federal or commonwealth government and distributed through a very sophisticated mechanism akin to that established by India's Finance Commissions or opt for the Canadian model, with India's states swapping the power to levy indirect taxes with the Centre and instead taking over the power to tax direct incomes or to devise a new system altogether.

What the future holds for India's taxation laws is something which the Indian polity would determine in its own unique manner. However for the present, the churn which has produced GST will for many years to come well define India's federal relations. □

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# Goods and Services Tax: The International Experience

**Pravakar Sahoo  
Ashwani Bishnoi**



***For the first time, all political parties came together and passed the GST Bill unanimously. This is not only a mature act but truly an achievement for the government. The GST is called the world's most complex tax reform, where 7.5 million businesses can register, make payments, and file returns on a GST portal. It is really a big relief for business, as even today, because of layers of taxes and exemptions, the cost of tax compliance in India is too high. In sum, it is a much needed landmark reform***

**T**

he most awaited economic reforms in India, for a simplified and uniform tax rate, were passed in the Parliament of India on 3 August 2016. The biggest tax reform in independent India, and also the biggest economic reform since the structural reforms in 1991, has now been passed in both Houses of Parliament after 11 years of political logjam, debate, and discussion.

The Goods and Services Tax (GST), which subsumes 15 central and state taxes on goods and services, will create one single indirect tax rate across states, and make India a truly unified market. Come April 2017, there will be no state boundaries in taxation terms. This landmark achievement, which will be a game-changer in coming years, is by far the biggest milestone of the government in terms of economic reforms, but the GST rate still needs to be fixed, and operational issues sorted out.

The existing system of the central value added tax (CENVAT) and state VAT suffers from the cascading effect. As the two are not inter-linked, the system leads to high tax on consumers, different input tax credit from the centre and states, and differential state VAT rates. One of the most difficult challenges for investors and industry

in India is its complicated tax system with multiple rates at both the centre and states. Compliance with taxation norms requires enormous time and money, and simplification has been one of the most demanded reforms from industry and investors over the past decade. Integrating taxes on goods and services will reduce the cost of compliance and also give full tax credit for inputs at one go.

The present VAT system, at both central and state levels, has certain shortcomings. At the central level, only taxes paid on raw materials is given as input credit, but not taxes paid for post-manufacturing expenses. Service tax is imposed on limited products; therefore, it is difficult to give credit of services tax consumed in the process of manufacturing these products. The comprehensive GST will tax both goods and services, and is, therefore, essential to reduce the cascading effect.

The present state VAT suffers from limitations like charging VAT on excise duty already paid to the centre, levying various other indirect taxes like luxury tax, entertainment tax, etc., and not having the provision of taking input credit on the central sales tax (CST). Therefore, a compressive GST is necessary to align rules for taking and utilising credits for CGST and SGST. Overall, both assesee and

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the government exchequer will benefit from a simpler tax system, mitigation of cascading effect, development of common markets, broadening tax base, and reduction in compliance cost.

The proposed dual GST, with a central and state GST, will replace this system. The CST will be replaced by an Integrated Goods and Services Tax (IGST), to be levied on inter-state supplies of goods or services in India and collected by the Centre. The IGST will apply to import of goods and services and inter-state stock transfers of goods and services. As the proposed GST is a destination-based tax, the tax burden will shift from the state of origin to the state of consumption, and result in less revenue for manufacturing and developed states. Though the GST would compensate states for any revenue loss for the first five years, it is not good news for developed states, which have invested in infrastructure and other utilities to attract investment and industries for growth. Therefore, consumption or destination states (like Odisha, Uttar Pradesh, Bihar, and Kerala) stand to gain, while origin states (like Tamil Nadu, Gujarat, and Maharashtra) stand to lose. Overall, one single indirect tax rate all over India will create a common market and lead to a less effective tax burden on final consumers.

The GST will not apply to a few lucrative sectors (such as alcoholic products for human consumption, electricity, real estate, and petroleum products); states will apply differential tax rates on these sectors. However, petroleum products, the prices of which have wide implications on the general prices of other products, will be brought under the GST once the GST Council notifies the date.

A uniform, pan-India GST will facilitate seamless input tax credit, eliminate the tax-cascading effect, and enable the free flow of goods and services across states. This will help manufacturing firms achieve economies of scale across the supply chain and source raw material and sell

their products without any additional tax burden with proper input tax credit. This will result in scale economies in production. Ultimately, transaction cost would be lower, and consumers would benefit.

The existing differential tax structure across states creates distortionary incentives for different players. For production and logistics, investors prefer locations that offer the least tax rate and administration. Now, this tax incentive-influenced skewed production structure will go, which is good for 'Make in India'. Therefore, simplifying the tax system through the GST would be a game changer, though other important reforms, like land acquisition and flexible labour laws, will remain to be made.

### International Experience

The international experience shows that the success of a GST depends mostly on the model and effective implementation. Over time, many countries have fine-tuned their framework to reap the benefits of GST in terms of growth, revenues, and price stability. So far, the experience in countries like Australia, Canada, and New Zealand is better fiscal finance and price stability in the short- to medium-term. Of course, in case the GST rate is high, there is always the fear of price hike immediately after GST implementation in the short run.

Many services (such as education, health, and commercial and business services) are not taxed now or taxed at a low rate. As the proposed GST rate is 18–22 per cent, implementation of GST may lead to inflation in the short term. International experience shows that inflation went up in the short term as a lot of new services and goods taxed under GST which were not taxed earlier. GST framework will make it very difficult for non-GST paying or businesses not paying taxes as the entire value chain starting from manufacture to retail would transparently captured by an integrated IT infrastructure. Therefore, on one hand there is possibility of reduction

of tax burden due to mitigation of cascading effect and increase in tax revenue to the government owing to increase in base whereas on, other hand, there is possibility of spike in prices.

There are around 160 countries in the world that have implemented VAT/ GST. There are seven countries in ASEAN, 19 in Asia, 53 in Europe, seven in Oceania, 44 in Africa, 11 in South America and 19 in Caribbean, central and North America. Clearly, Europe has the highest number of countries which have implemented VAT or GST. France was one of the first countries to implement GST in 1954, followed by Germany in 1968 and the United Kingdom in 1973<sup>1</sup>. Typically, GST is a unified tax system in most of the countries but Canada and Brazil have dual GST like India proposed GST. Standard rate of VAT/GST in most of the countries ranges between 16–20 per cent similar to India's proposed GST rate of between 18 to 22 per cent.

If we look at some of the major countries like Australia, Canada, New Zealand, Singapore, Japan, Korea United Kingdom etc (Table-1), we find that they have done fairly well in most of the macroeconomic indicators. The type of GST framework varies from country to country. For example, Australia adopted the least neutral, New Zealand most neutral while Canada's GST was intermediate. Most of these countries in Table-1 experienced a temporary spike in their price levels immediately after the GST implementation. However, price levels stabilised and then declined after few years and in the medium term. As reported in Table-1, the inflation rate in most of the countries have stabilised at lower rate after the implementation of VAT/GST. Other macro indicators like GDP growth rate, fiscal balance, current account balance, Tax-GDP ratio have improved in most of the countries, particularly in case of Canada, Australia, New Zealand, Korea, Singapore and United Kingdom. Therefore, a simple and unified tax system like GST has made

these economies more competitive, helps improve exports, generate more revenues to the exchequer and stabilise prices. However, the performance of the economy in general and major macro indicators as mentioned in Table-1 varies in great deal across countries due to the level of development of these countries and also effective implementation of proper GST model. Moreover, performance of these macro variables like growth, fiscal balance, current account balance, etc are not dependent only on the taxation structure but many other structural, policy and endowment factors.

Following the success of many countries adopting GST framework, Malaysia is among the recent countries in Asia to introduce GST and China is working towards a uniform system of taxes. Malaysia introduced the GST of 6 per cent only from 1<sup>st</sup> April 2015. In the south Asian region most of the countries including Bangladesh, Sri Lanka, Pakistan and Nepal had VAT in place from the 1990s latest by early 2000s. Most African countries also had VAT in place before India did with the exception of a few like Burundi, Congo, Gambia and Mozambique and Seychelles, who have done so during the last 7–8 years.

Similar to the Indian context, it is only Canada that has the concept of dual GST. While there was a strong opposition to the introduction of GST in Canada by various political factions, Canada went ahead and implemented it despite the opposition. In fact, the government of Canada has been pragmatic and consistently worked towards reduced GST rate post-implementation. In Canada, the GST replaced the Manufacturer's Sales Tax and came into force in 1991. The tax did not apply to products such as groceries, residential rent, and medical services, and services such as financial services. The macro economic performance in terms of growth, government finance, tax revenues and price stability have improved in case of Canada during post-GST period (Fig-1). Similarly,

Australia which implemented GST in 2000 has experienced positive outcomes particularly in case of tax revenues and current account balance (see Fig-2). Another country that has been successful in implementing GST is New Zealand which introduced GST in 1986. Unlike most countries, there are few exemptions: for example, all types of food are taxed at the same rate. In the European Union, the GST, better known as the Value Added Tax, are known as 'output VAT' (VAT on its output supplies) and 'input VAT' (VAT that is paid by a business to another business on the supplies it receives). A business is usually able to recover the tax it paid either by setting it against the output VAT if it is in excess by claiming a repayment from the government.

However many countries have had to increase rates very soon after introduction. This is highly relevant in the India context where once revenue-neutral rate was discussed at 27 per cent and now realistically being talked about at 16–18 per cent. It is imperative that a reasonable rate structure is adopted to ensure the success of GST.

### International ExperienceL lessons

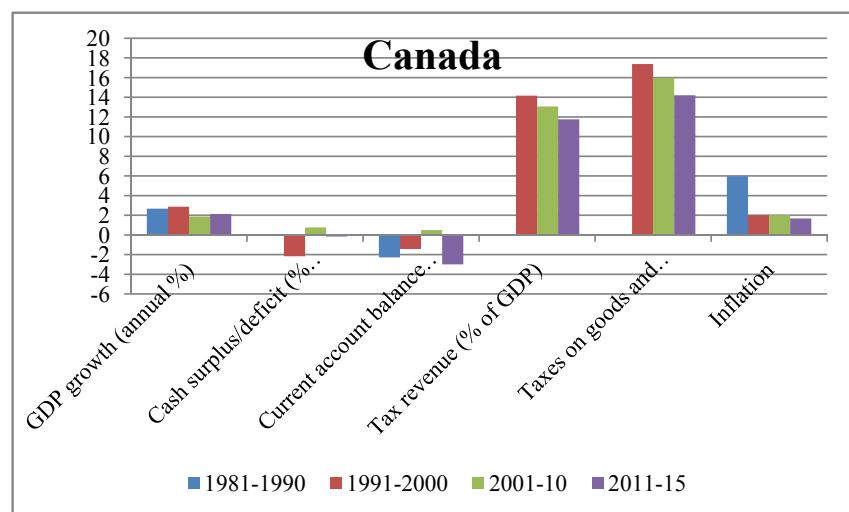
A main challenge encountered by most of the GST countries was

that GST would be inflationary in nature especially if the effective tax rate is higher than what prevailed before. For instance, Singapore saw a spike in inflation in 1994 when it introduced the GST. That makes it all the more important for administrators to keep tabs on how prices move after imposition of the tax. Malaysia, to an extent, was able to mitigate this risk as price control on account of the GST was administered by the Ministry of Domestic Trade and Consumer Affairs.

Another key lesson from Malaysia is that businesses need to start early with the implementation process to be GST-ready. The Malaysian Government received strong resentment even after providing 1.5 one and half years for GST preparedness. Given the complex GST model proposed in India and the need for a businesses to undergo a transformation to adapt to the GST regime, it would be quite challenging for the Indian government to tackle the task of requiring businesses to implement GST in less than 9 months, with 1 April 2017 as the potential date.

Further, the international experience is that, for long, GST has been essentially a central tax and the levy by two different levels of

**Figure-1: GST and Macroeconomic Performance in Canada**



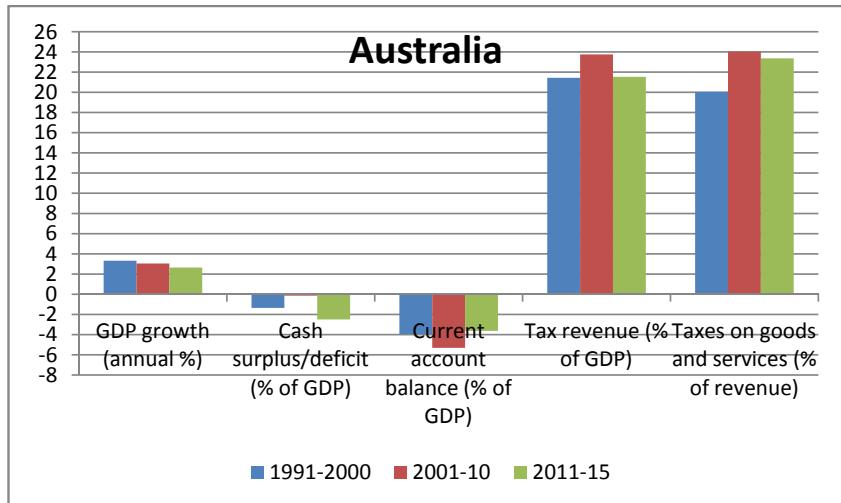
Source: World Development Indicators, World Bank.

**Table-1: Economic Performance of GST Implementing Countries**

Country	Year of introduction	GDP Growth (per cent)						Fiscal Balance (per cent of GDP)					
		1961–70	1971–80	1981–1990	1991–2000	2001–10	2011–15	1961–70	1971–80	1981–1990	1991–2000	2001–10	2011–14
Australia	2000	5.09	3.02	3.42	3.32	3.05	2.64	-	0.11	0.04	-1.36	-0.14	-2.50
Brazil	1964	6.19	8.51	1.77	2.60	3.73	1.02	-	-	-3.39	-2.26	-2.37	-2.13
Canada	1991	5.21	4.06	2.67	2.87	1.87	2.13	-	-	-	-2.17	0.77	-0.16
France	1954	5.57	3.64	2.49	2.10	1.22	0.85	-	1.16	-1.05	-4.50	-4.94	-4.21
Japan	1989	9.30	4.50	4.64	1.14	0.80	0.62	-	-3.32	-3.31	-	-4.01	-7.72
Korea, Rep.	1977	8.71	9.05	9.74	6.63	4.44	2.96	-	-	1.53	1.90	1.49	1.69
Mexico	1980	6.81	6.71	1.88	3.64	1.82	2.84	-	-	-2.55	-0.45	-	-
New Zealand	1986	-	1.26	1.91	3.06	2.55	2.71	-	0.49	-2.47	-	1.41	-2.16
Singapore	1994	9.35	9.09	7.79	7.19	5.91	3.96	-	-	10.51	14.95	5.75	8.92
United Kingdom	1973	3.06	2.14	2.95	2.44	1.62	2.10	-	-1.24	-0.70	-3.62	-4.90	-6.44
		Current Account Balance (per cent of GDP)						Tax to GDP (per cent)					
Year of introduction		1961–70	1971–80	1981–1990	1991–2000	2001–10	2011–15	1961–70	1971–80	1981–1990	1991–2000	2001–10	2011–14
Australia	2000	-	-	-5.56	-3.95	-5.32	-3.64	-	19.40	22.27	21.43	23.75	21.53
Brazil	1964	-	-4.40	-1.55	-1.93	-0.68	-3.32	-	-	12.01	11.31	15.39	14.50
Canada	1991	-1.91	-2.87	-2.28	-1.43	0.49	-3.00	-	-	-	14.16	13.07	11.75
France	1954	-	0.23	-0.58	1.26	0.11	-0.84	-	18.45	19.32	20.45	22.12	22.74
Japan	1989	-	-	-	2.39	3.44	1.64	-	10.27	11.84	12.27	9.84	10.24
Korea, Rep.	1977	-	-3.80	-0.74	0.60	1.64	5.12	-	-	13.35	13.08	14.23	14.44
Mexico	1980	-	-4.69	-0.79	-3.28	-1.30	-1.93	-	-	11.78	9.53	-	-
New Zealand	1986	-	-	-	-3.30	-4.32	-3.17	-	27.86	30.42	-	29.74	27.34
Singapore	1994	-	-11.41	0.34	13.99	19.71	19.21	-	-	14.54	15.45	12.80	13.58
United Kingdom	1973	1.51	-0.30	-0.77	-1.33	-2.32	-3.99	-	23.02	24.26	25.33	26.33	25.52
		Taxes on Goods and Services (per cent of revenue)						Inflation (Growth in CPI)					
Year of introduction		1961–70	1971–80	1981–1990	1991–2000	2001–10	2011–14	1961–70	1971–80	1981–1990	1991–2000	2001–10	2011–15
Australia	2000	-	21.10	23.12	20.04	24.03	23.37	2.47	10.45	8.13	2.22	3.01	2.30
Brazil	1964	-	-	24.17	25.09	31.02	25.99	-	-	-	-	6.69	6.72
Canada	1991	-	-	-	17.38	15.97	14.21	2.94	8.06	5.97	2.00	2.02	1.68
France	1954	-	34.47	29.67	26.37	23.59	21.57	4.22	9.67	6.37	1.72	1.71	1.10
Japan	1989	-	22.22	19.38	13.87	31.78	37.04	5.80	9.10	2.06	0.84	-0.26	0.72
Korea, Rep.	1977	-	-	34.72	32.33	28.01	24.88	-	16.48	6.39	5.10	3.19	1.90
Mexico	1980	-	-	56.05	55.03	-	-	2.87	16.80	69.08	18.69	4.68	3.61
New Zealand	1986	-	18.94	21.06	-	26.27	26.29	4.02	12.52	10.76	1.83	2.57	1.57
Singapore	1994	-	-	16.00	17.07	22.83	24.49	1.19	6.72	2.28	1.73	1.62	2.53
United Kingdom	1973	-	26.23	29.99	32.80	31.32	32.98	-	-	-	2.69	2.10	2.27

Source: *World Development Indicators, World Bank*

**Figure-2: Figure-1: GST and Macroeconomic Performance in Canada**



Source: *World Development Indicators, World Bank.*

government was considered infeasible or undesirable due to high collection costs, compliance costs and possible distortions arising from tax disharmony and the possible limitations on the central government's powers to undertake effective macroeconomic and redistribution policies (Bird and Gendron 2007)<sup>2</sup>. Technical objections to the levy of sub-national GST were also raised on account of cross-border trade. Therefore, most federal countries have the VAT at the federal level though some of them share the revenues with sub-national governments. The earliest sub-national VAT was introduced in Brazil on an origin basis. The European Union (EU) implemented the VAT on the basis of the destination principle, but the issue of cross-border trade continues to be a subject of discussion (Keen 2009; Cnossen 2010)<sup>3</sup>. The Canadian experience with dual VAT by harmonising the tax bases and to some extent rates has shown that the system is eminently workable.

The international experience with GST suggests that it is necessary to keep the exemptions to the minimum, but resisting the pressures from various political groups to accord exemptions in one pretext or other is not going to be easy. However, it is possible to prune the list collectively by all the states concerned in a reform exercise

like this. Keeping the exemption list long will not enhance states' fiscal autonomy, makes the tax base narrower and in any case will not ensure comprehensive crediting of input taxes.

Among different countries, New Zealand has the least number of exemptions and the most comprehensive coverage of GST, but it may not be possible to follow that in a country like India. At the same time, it is important to resist the political pressures to accord exemptions to fulfil ostensible objectives of equity, administrative ease, regional development, employment creation through small-scale industry development and many more.

From the lessons learnt, there is no denying that acceptance of GST by general public, businesses and firms would not be an easy task, with advance planning and extending adequate time to industry, continued dialogues between businesses and administrators, engaging with industry on the implementation planning, a reasonable tax rate, timely release of the legislative documents, has proven to aid in smooth GST implementation in many countries. Of course, GST is proven to be an efficient tax collection system despite teething problems in the initial implementation period.

### Operational Issues:

As the main hurdle of constitutional amendment is over, the operational issues of effective implementation are likely to be taken care of soon, as the Finance Minister has promised to implement the GST from 1 April 2017. And many issues need sorting out. The GST is a landmark reform bill. However, given that India's tax system is complex, the implementation of the GST is fraught with challenges. The two main challenges that the government would need to overcome is the setting of the revenue-neutral rate (RNR) and the threshold limit in the GST. It would be mandatory to ensure that through the RNR the revenues of the government remain the same despite of giving tax credits. Similarly, fixing an appropriate threshold limit would be a challenge especially to ensure that there is 'no taxing' burden on small businessmen in the country.

There are few other challenges that make introduction of GST by 1 April 2017 a daunting target. These include rolling out the required IT platform for implementing GST and sorting out the administrative arrangements for a very complex GST system consisting of state GSTs, central GST, and an integrated GST for inter-state movement of goods and services. Tax litigation policies and procedures have to be unified and an effective litigation system has to be evolved before implementation of GST on a national level. Having a robust IT network is another major challenge for the implementation GST. Government has already incorporated Goods and Service tax network (GSTN). GSTN has to develop GST portal which would ensure technology support for registration, return filing, tax payments, IGST settlements, etc. A robust IT backbone would be essential. Improvement in banking system, providing extensive training to tax administration staff, finalisation of the GST rate, safeguarding the interests of less developed states with lower revenue potential, protecting and balancing the present and future

revenues of the centre and states are a few of the other key challenges.

The successful implementation of GST requires fixing the appropriate GST rate, which is the RNR, and requires an efficient IT infrastructure and capacity building of the entire tax administration. There have been many recommendations for fixing the revenue-neutral GST rate at between 11 per cent and 12 per cent. But the report of the Committee on RNR and Structure of Rates for General Sales Tax (2015) headed by Dr. Arvind Subramanian (Chief Economic Adviser to the Government of India) recommended that the RNR should be between 15 per cent and 15.5 per cent, with a standard GST rate of 17–18 per cent.

Second, the government needs to go all out for a successful ‘Digital India’ programme, as the GST will require a state-of-the-art IT infrastructure all over India for effective implementation. Ensuring high-speed IT connectivity across states with huge geographical disparity in such a short time is going to be challenging. Moreover, the entire tax administration needs capacity building to handle the GST.

The proposal to give states the freedom to impose the state GST within a band will dilute the purpose of unified GST. Therefore, the GST Council, the proposed highest decision taking body, made up of voting representatives from the states and the centre, should stick to one GST rate for every state. There are also issues of balance of power in favour of the Centre in most powerful GST council with one-third share in voting rights.

For the first time, all political parties came together and passed the GST Bill unanimously. This is not only a mature act but truly an achievement for the government. The GST is called the world’s most complex tax reform, where 7.5 million businesses can register, make payments, and file returns on a GST portal. It is really a big relief for business, as even today, because of layers of taxes and exemptions, the cost of tax compliance in India is too high. In sum, it is a much needed landmark reform.

But, although the merit of the GST is evident and indisputable, the devil lies in the details, as they say, and only time will tell if it is a success.

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# GST: One Nation, One Tax



**This tax, because of its transparent character, would be easier to administer. Also remember, implementation of GST will help in improving India's ranking in ease of doing business which, in turn, will help foreign investors to bring more and more money into the country**

**I** am sure that the enactment of the GST, will bring about the best as far as the economic management of this country is concerned, in a federal form. It will empower the States. It will increase the revenue of the States as also of the Central Government. It will try to dissuade and discourage, and bring down levels of evasion. It would ensure that there is no tax on tax. So the cascading effect of taxes in the value of goods itself, will no longer be there and that would even make some of the products cost less. It would, certainly, give a boost, as far as the economy is concerned, which is required at this very critical stage."

Excerpts from the speech of the Union Finance Minister while moving the Constitution Amendment Bill (related with the Goods & Services Tax) for consideration and passage in Rajya Sabha on August 3, 2016

With this speech, the Finance Minister managed to end the long wait for the introduction of one of the most ambitious tax reforms of independent India, the Goods & Services Tax or GST. Since, the 122<sup>nd</sup> Constitution Amendment Bill has become a law (101<sup>st</sup> Amendment) enabling the Centre and the States to levy GST concurrently, India is all set to usher the Financial Year 2017-18 with a new tax regime i.e. GST. Accordingly, India

will join the select club of nations such as Canada, Australia, Singapore and Malaysia having GST as the indirect tax system.

Now, in order to introduce GST from April 1 next year, the Government has set the process in motion. First, the Goods & Service Council, the apex body of Centre and the States, has not just been set up, but already taken key decisions in its initial meetings. Second, GST Network for providing all kinds of information technology support for GST is fully functional. Third, model GSR law is in public domain which will finally be converted into supportive legislations. And, fourth, the Government aims to finalise rates, exemption, threshold limit and key rules for GST by November 22, 2016.

## What is GST?

GST is a simplified tax structure applied on both goods and services. It is a value-added tax levied at all points in the supply chain with credit allowed for any tax paid on input acquired for use in making the supply. It would be applicable on supply of goods or services as against the prevailing system of tax on the manufacture of goods or on sale of goods or on provision of services. It would be a destination based tax as against the existing system of origin based tax.

In order to maintain the federal structure, the nation is going to have

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dual GST, Central GST (CGST) and the State GST (SGST). This means that there will be common tax base for both the Centre and the States. There will also be Integrated GST (IGST). It would be levied on inter-State supply of goods or services. This would be collected by the Centre so that the credit chain is not disrupted. Import of goods or services would be treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties. Rates for all the three would be decided by the GST council.

### **Why GST?**

India has a multiplicity of taxes as the Constitution prescribes different power for the Centre and the States to make legislations for levying taxes on goods and services at various levels. For example, the Central Government is authorized to make legislation as well as rules to impose tax on the manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.) while the States have the powers to levy tax on the trading of goods. The Centre has two distinctive powers: first, it has power to levy tax on the Inter-State sales of goods (however, the tax is collected and retained by the States) and second, only the Centre can impose tax on services i.e. Service Tax.

Such a system makes the entire indirect tax system a complex one. Not only this, this has many disadvantages. For example, a business man has to maintain too many records for tax compliance. This increases the cost of running business, while, at the same time goes against the basic principle of ease of doing business. Similarly, multiplicity of taxes results in tax on tax which makes a good costlier for the consumer. As GST will have just one tax, which means compliance would be easier and cheaper and thus help in ease of doing business. Similarly, since GST is to be levied at all stages right from manufacture up to final consumption with credit of taxes paid at previous stages available as setoff, this will remove the anomaly of tax

on tax. It is believed that the new tax regime would result in significant reduction in overall tax burden (which is currently anything between 25-30 per cent) on goods, thus, making them cheaper for the consumers.

### **GSTN**

In order to provide IT infrastructure and services for implementation of the GST, the Government set up Goods and Services Tax Network (GSTN). It is a Section 25 company which means it will not work for profit. It is a Non-Government and private limited company. The Central Government holds 24.5 per cent equity in GSTN while all States, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5 per cent. Remaining equity is with non-Government financial institutions. The company has been mandated to:

**...multiplicity of taxes results in tax on tax which makes a good costlier for the consumer. As GST will have just one tax, which means compliance would be easier and cheaper and thus help in ease of doing business.**

- Provide common and shared IT infrastructure and services to the Central and State Governments, Tax Payers and other stakeholders.
- Partner with other agencies for creating an efficient and user-friendly GST Eco-system.
- Encourage and collaborate with GST Suvidha Providers (GSPs) to roll out GST Applications for providing simplified services to the stakeholders.
- Carry out research, study best practises and provide Training and Consultancy to the Tax authorities and other stakeholders.
- Provide efficient Back-end Services to the Tax Departments of the Central and State Governments on request.

- Develop Tax Payer Profiling Utility (TPU) for Central and State Tax Administration.
- Assist Tax authorities in improving Tax compliance and transparency of Tax Administration system.
- Deliver any other services of relevance to the Central and State Governments and other stakeholders on request.

### **GST Council**

After the 101<sup>st</sup> Constitutional Amendment, the first big development was setting up of the GST Council. This council is an apex body comprising of Centre and the States for GST. It has been empowered not just to finalise nitty-gritty of GST, but also to resolve disputes. The Council is headed by the Union Finance Minister while the Union Minister of State for Finance (In-charge of revenue) and the Minister In-charge of finance or taxation or any other Minister nominated by each State Government will be members. Effectively, the council will have two members including the Chairman from the Centre and one member each from 29 States and the 2 Union Territories (with legislature) taking the total strength to 33. The Union Revenue Secretary will be Ex-officio Secretary to the GST Council while the Chairperson, Central Board of Excise and Customs (CBEC) will be a permanent invitee (non-voting) to all proceedings of the Council.

The Council will make recommendations to the Union and the States on important issues related to GST, like the goods and services that may be subjected or exempted from GST, model GST Laws, principles that govern Place of Supply, threshold limits, GST rates including the floor rates with bands, special rates for raising additional resources during natural calamities/disasters, special provisions for certain States, etc.

Every decision of the Council will be taken at a meeting, by a majority of not less than three-fourths of the weighted votes of the members present and voting. Now, the voting college has

**Table 1**

**Goods and Services Tax – Basic Issues**

*Taxes/duties to be subsumed*

From Centre:

- Central Excise Duty
- Duties of Excise (Medicinal and Toilet Preparations)
- Additional Duties of Excise (Goods of Special Importance)
- Additional Duties of Excise (Textiles and Textile Products)
- Additional Duties of Customs (commonly known as CVD)
- Special Additional Duty of Customs (SAD)
- Service Tax
- Cesses and surcharges as far as they relate to supply of goods or services

From State:

- State VAT
- Central Sales Tax
- Purchase Tax
- Luxury Tax
- Entry Tax (All forms)
- Entertainment Tax (except those levied by the local bodies)
- Taxes on advertisements
- Taxes on lotteries, betting and gambling
- State cesses and surcharges insofar as far as they relate to supply of goods or services

*Commodities not included in GST at all:*

- Alcohol for human consumption
- Electricity
- Real Estate.

*Commodities to be included in GST but at a later date:*

- Petroleum crude
- Motor spirit (petrol)
- High speed diesel
- Natural Gas
- Aviation Turbine Fuel
- Existing system of VAT and Sales Tax will continue for these products.

*How tobacco to be treated under GST:*

- GST to be levied on tobacco and tobacco products. In addition, the Centre would have the power to levy Central Excise duty on these products.

*Compensation to the States for revenue loss, if any, after introduction of GST*

- States to get full compensation for revenue loss, if any, for first five years.

*How import to be treated:*

- Imports of Goods and Services will be treated as inter-state supplies and IGST will be levied on import of goods and services into the country.

*How exports to be treated:*

- Exports will be treated as zero rated supplies.

*List of goods and services to be exempted:*

- Effort is to keep the list of exemptions smaller. GST council will decide about goods and services to be exempted.

*What next before the introduction of GST:*

- Centre to enact two legislations, one related with CGST and another related with SST. States and Union Territories with legislature to enact a law related with SGST. These are ordinary laws and can be enacted by simple majority in Parliament/State Legislatures.

been structured in such a way so the neither the Centre nor all States together can apply veto. The vote of the Central Government will have a weightage of one-third of the total votes cast, and the votes of all the State Governments (including the Union Territories with legislatures) taken together shall have a weightage of two-thirds of the total votes cast. Any decision will require at least three-fourth of total votes.

**Key Decisions by GST council**

The council, in its first two meetings, took some major decisions:

**Threshold Limit**—For GST, the exemption threshold is fixed at Rs.20 lakh. However, this will be Rs 10 lakhs for businesses in the 7 North Eastern States (Assam, Meghalaya, Manipur, Nagaland, Mizoram, Arunachal Pradesh and Sikkim) and 3 Hill States (Jammu & Kashmir, Uttarakhand and Himachal Pradesh). It means that those traders with a turnover of below Rs.20 lakh annually in general States will be exempted from getting registered under GST while for North East States and Hill States, those with less than 10 lakh annual turnover will be out of GST. Experts justify these threshold limits by saying that many small scale traders and service providers would be saved from undertaking GST compliances and it also reduces a substantial burden for tax authorities to assess small time dealers.

**Cross Empowerment** — It has been decided to adopt the middle path in terms of sharing of administrative powers between the Centre and the States. It was agreed upon that States will get exclusive control over all dealers up to an annual turnover of Rs1.5 crore. For traders with revenue above Rs. 1.5 crore, there will be an element of dual control and cross empowerment of officials of the Centre and the States based on formulation of risk assessment. It has also been decided that the Centre will get control over all the existing 11 lakh service tax-registered dealers irrespective of their revenue levels.

**Composition Scheme** — A consensus has been reached on the

shape of compounding or composition scheme. It was decided that traders with gross turnover up to Rs 50 lakhs will pay 1-2 per cent tax. Such a scheme aims to facilitate small traders. Under the scheme, a taxpayer shall pay tax as a percentage of his turnover during the year without the benefit of input tax credit (ITC). The floor rate of tax for Central Goods & Services Tax (CGST) and State Goods & Services Tax (SGST) will not be less than 1 per cent. A tax payer opting for composition levy will not collect any tax from his customers. Tax payers making inter-state supplies or paying tax on reverse charge basis will not be eligible for composition scheme.

**Area Based Exemption** – At present, hill states such as Jammu & Kashmir, Himachal Pradesh and Uttarakhand besides 7 North Eastern States get area based exemptions. Such exemptions from taxes provided for companies to set up plants is difficult. Now it has been decided to continue with area-based excise duty exemptions based on GST regime kicks in from next year. However, these will be provided as refunds, not as exemptions. It was agreed that there would be levy of tax on all exempted entities under GST. The Centre or the State that gets the tax will then reimburse it to the exempted entity. The States will now decide on

the specific industrial exemptions they wish to continue. The exact details on whether all the exemptions will be grandfathered or refunded will be worked out.

### GST Rates

The Empowered Committee of the Finance Minister suggested two guiding principles for finalising GST rates and now these have become guiding for the GST council too. First of the guiding principle says that the rate of taxation as it is leviable today with the implementation of the GST will gradually come down from its present level so that it is more citizen friendly. The second principle prescribes that the taxation should be adequate enough to maintain the present levels of revenue to make sure that the Central and State Governments are able to discharge their duties and obligations with the fullest amount that they collect. It is believed that the GST council will follow these two principles before arriving on the final rates. It is also expected that there will be four rates:

- Merit Rate - Essential Goods or Services;
- Standard Rate - Goods or Services in General;
- Special Rate - Precious metals
- Nil Rate - Exempted Goods or Services.

It must be highlighted here that GST will bring benefit not just for the Industry/business or trading community, but also for the masses. If the new system is going to reduce multiplicity of taxes, to mitigate cascading/double taxation, bringing more efficient neutralization of taxes especially for exports and developing the common nation market, then it is going to be a simpler tax system for the consumer where he can expect reduction in prices of goods & services due to elimination of cascading of taxes, uniform prices throughout the country, transparency in the taxation system and increase in employment opportunities. Introduction of GST would make our products competitive in the domestic and international markets. Studies show that this would instantly add up to 2 per cent in GDP. There may also be revenue gain for the Centre and the States due to widening of the tax base, increase in trade volumes and improved tax compliance. This tax, because of its transparent character, would be easier to administer. Also remember, implementation of GST will help in improving India's ranking in ease of doing business which, in turn, will help foreign investors to bring more and more money in to the country.

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## NORTH EAST DIARY

### NORTH-EAST STATES AS 'PRIORITY STATES' FOR PMUY

**M**inistry of Petroleum and Natural Gas will extend the benefits under Pradhan Mantri Ujjwala Yojana to the people of all Hilly States including North-East States by treating them as 'Priority States' and release LPG connections to the eligible beneficiaries. This measure will help to tackle the difficulties faced by poor people in accessing LPG for cooking purposes, residing in the States of Jammu and Kashmir, Himachal Pradesh, Uttarakhand, Sikkim, Assam, Nagaland, Manipur, Mizoram, Arunachal Pradesh, Meghalaya and Tripura. Pradhan Mantri Ujjwala Yojana is being implemented with an objective to provide deposit free LPG connections to BPL households as a clean fuel solution. So far, more than 50 lakh connections have been released to the beneficiaries.

1 lakh LPG connections will be released in the next 15 days. The Central Government has released 2 lakh connections during the last 2 years in J&K vis a vis 5 Lakh connections released during the previous 8 years in J&K by the previous governments. There are 4 LPG bottling plants in the state and another LPG plant at Kargil will be put up and also to increase the capacity of Leh LPG plant.

PMUY scheme provides assistance of Rs. 1600/- to the woman beneficiary, comprising security deposit of Domestic cylinder & pressure regulator; Suraksha hose; Domestic gas consumer card and installation charges.

### SECOND LINE BETWEEN NEW BONGAIGAON AND KAMAKHYA IN ASSAM

**T**he Cabinet Committee on Economic Affairs has given its approval for construction of second line between New Bongaigaon and Kamakhya of Northeast Frontier Railway in Assam. The estimated cost for this line is Rs.2,232.32 crore and an expected completion cost of Rs.2,586.85 crore. The 176 km long railway line is expected to be completed in five years during 12th and 13th Plan period.



# Goods and Services Tax

**GST - scripting the economic destiny of the Nation !**



## BENEFITS OF GST

- Growth in GDP.
- Employment generation.
- Boosting investment.
- Low compliance cost.
- One Common Market.
- Brings down logistics and inventory costs.
- Replacing multiplicity of taxes.
- Boosting revenue through low evasion & input tax credit.

GST - a single tax on supply of goods & services right from manufacturer/supplier to the consumer.



A nation is made, when taxes are paid

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## PM on GST

- Goods and Services Tax (GST) is a “Great Step by Team India,” a “Great Step Towards Transformation,” and a “Great Step Towards Transparency.”
- Passage of the Bill is a victory not for any political party, but for Indian democracy.
- The consensus over GST is proving that Rashtraneeti is above Rajneeti (national issues are above politics) in India.
- GST is one more pearl in the necklace of Ek Bharat – much on the lines of the Railways, the All India Services, and visions such as Bharat Net and Sagarmala.
- With GST, we intend to bring uniformity in taxation. The consumer would be supreme in the new dispensation.
- The judicious use of man, money, machine, material and minutes (time) is an important principle of sound economic policy, and GST would aid in achieving this.
- GST would help bring in real time data, as its strength was in technology. Most of the things that can impact consumer inflation have been kept out of the ambit of GST. GST would help reduce corruption in collection, as well as the cost of collection.
- Small businesses will also gain tremendously from GST, and will feel more secure with GST.
- This reform will promote Make in India, help exports and thus boost employment while providing enhanced revenue.
- GST is a system that benefits all Indians and promotes a vibrant and unified national market.
- GST will also be the best example of cooperative federalism, will take India to new heights of progress.

## FM on roll out of the Goods and Service Tax

- The Government is working on a target date of 1st April, 2017 for the roll out of the Goods and Services Tax (GST) in the country.
- Post GST the system will be more efficient, more compliant and the avoidance will become more difficult. There will be no cascading effect of tax on tax. There are many items which will either have lower rate of tax or no tax at all
- There will be one tax for one nation. There will be seamless transfer of goods and services through the country.
- The whole country will become one integrated market. Simplification will be easier. It will also lead to lesser leakages and evasions and therefore the tax base will naturally expand. This will benefit both states and the Central Government.
- This is a historical reform in the taxation of our country being carried out by our Parliament. This is a major reform, which will in the long run, go in the interest of the country.

### FROM OUR READERS ...

I would like to assert that the issues on Women Empowerment and Energy were really commendable. I wish to thank the entire team for the appreciable efforts they put in. The articles were thought provoking and enlightening and a mirror for the people. They would certainly help to shape our opinions in the right manner and direction. I would request to publish some issues on Terrorism, or National sanctuaries etc.

Saundarya Sinha

Multifaceted approach along with national and global importance on each different subject makes the articles of yojana very valuable.

Archie Roy

### Response from Yojana Team

We are really grateful to our readers who take time out to send in encouraging words and valuable suggestions. It makes our work seem worthwhile.

We do try to incorporate your suggestions in our journal whenever possible. We will definitely consider them while planning our issues.

Please do write in with your feedback on our issues. It will help us in planning our issues.

Thanks once again

# GST: Rejuvenating the Manufacturing Sector

*Amiya Kumar Mohapatra*



***Indian manufacturing sector is primarily resource-driven than technology-driven and therefore the input cost and subsequent taxes on it, make the sector more challenging. Manufacturing sector can be strengthened through fiscal interventions like tax concession, tax reduction on the manufacturing process, especially on import of technology and research and development. Besides, subsidies and other fiscal interventions on inputs cost, import of technology and plant equipments will change the investment climate and eco-system and able to boost the manufacturing sector. Policy paradigm is the need of the hour and the initiatives taken by the present government is forward-looking especially on the tax-front***

**I**ndia is projected to be the ‘Youngest Nation’ in the world by 2020, and the average age of our population will be around 29 years. Besides, by that time, we will have surplus youth of 47 million whereas the world will be facing a shortage of youth of 56 million to take the development agenda further. Therefore, the richness of demographic dividend needs to be properly utilized to accelerate our development process and to achieve higher GDP. The benefits of the demographic dividend can be realized only by making these youth productive in terms of health, education and skill development. To attain this, Indian manufacturing sector has great potential to absorb these youth and provide them the right forum to make them skillful. Even though, service sector contributes highest to GDP and sustained till date, making the country a ‘Knowledge Economy’, but long-term growth of any nation depends a lot upon the contribution of manufacturing sector, to make the growth self-sustaining. India’s manufacturing sector’s contribution is approximately around 16 per cent to GDP over a period of time, even being a valued sector, in terms of its contribution to GDP, employment,

skill development etc. Therefore, it is necessary to focus on its growth perspective.

## National Manufacturing Policy and Make in India

Any paradigm shift in policy that has benefited the masses socially and economically, has always got the top priority in India’s developmental agenda. To break the vicious circle and Stagnation of manufacturing sector, Government of India has formulated ‘National Manufacturing Policy’ to promote this sector and has taken various initiatives to trigger growth of manufacturing sector to its potential and set a target of achieving 25 per cent of GDP by 2025.

Indian manufacturing sector has great potential to create 90 million jobs and is able to produce USD 1 trillion and can contribute approximately 25-30 per cent to GDP by 2025 (McKinsey Report, 2012). To achieve the same, ‘National Investment and Manufacturing Zone’ (NIMZ) has been created to boost the sector. It is based on infrastructure-building approach through which, the congenial infrastructure support is provided to bring much-needed improvement in the manufacturing sector. NIMZ planned to have single

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window to provide solutions and approvals to the sectors and contribute in ease of doing regulations and laws, leverage on incentives etc.

Unveiling of ‘Make in India’ initiative brought unprecedented changes in the investment landscape of India. Multi National Companies (MNC) are invited and encouraged to contribute in manufacturing to boost manufacturing sector in India. Government of India has created necessary avenues for making ‘Make in India’ successful and ‘Skill India’ to unleash the true potential of manufacturing sector.

### Tax Reforms and Manufacturing Sector

In a rapidly changing environment, understanding and assessment of public policy and subsequent developmental intervention is very essential to look for a better tomorrow. Public policy and its implications have tremendous impacts on our economic growth and social development. These policies need to be redefined and reformulated in order to customize them according to the current need of the economy. To match with the pressing needs, government has initiated a series of tax reforms like tax concessions, tax reduction, tax holidays, simplifying tax formalities and ease of legal frameworks to facilitate faster economic development.

Tax reforms can be considered as efficient, when they result in enhancing the tax revenue with positive spill-over effects in terms of accelerating production, increasing employment and enhancing skills for job creation. The aim of tax reform is to bring certainty in taxes, augment tax buoyancy with positive long-term economic effects. Reforms must address twin objectives namely, ‘*feasibility in implementation and sustainable in revenue generation*’. Considering the above fact, tax reform (both direct and indirect taxes) is essential to bring much-needed revolution in fiscal-setting in fostering growth of Indian economy. To rejuvenate the

manufacturing sector, tax incentives need to be provided to the manufacturing units in general and sector-specific in particular, keeping in mind to achieve the set target 25 per cent of GDP by manufacturing sector.

### Tax Reforms and Incentives

- Indirect tax reform was already initiated by the present government by formulating unified tax systems through “*Goods and Services Tax*”(GST). Introduction of GST is considered as the ground-breaking reforms in Indian fiscal system as well as in Indian federal finance in the indirect tax regime.
- Bundling of plethora of Indirect taxes of Centre and states into a single tax code will bring down the cost and price especially in the manufacturing sector. Incidence and impact of multiplicity of indirect taxes and their cascading effects on input cost remains the biggest challenge for Indian manufacturing sector. However, tax code gets rationalized and become efficient owing to implementation of GST.
- Differential and multiplicity of tax codes across the states of India make inter-state trade less competitive and more challenging. But due to introduction of GST- a unified and uniform indirect tax code, the cascading effects of indirect taxes got nullified and cost of a product become simplified benefiting both producer and consumer. GST will break the inter-state barriers across the states and will develop a common national market making the manufacturing sector more competitive in India and world as well.
- Due to implementation of GST, the cost of production is expected to reduce by 15-25 per cent on indirect tax components. This will help in curbing inflationary situation and will improve profitability in the manufacturing sector.
- Along with GST, government has taken initiatives to create a litigation-free, investors-friendly environment to make India a hub of global manufacturing.
- In the recent budget, government made a provision for startups that the profits for three out of the first 5 years would be eligible for 100 per cent deduction. This is applicable to those who set up their startups in between April 2016 to March 2019.
- New manufacturing companies incorporated on and after 1<sup>st</sup> March 2016, are given an option to be taxed 25 per cent along with required Surcharges and Cess subject to other applicable conditions, which is lower than the previous year.
- To promote small sectors, government has reduced the corporate tax rate for relatively small enterprises i.e. companies with turnover not exceeding Rs. 5 crores.
- To reduce cost and improve competitiveness among domestic manufacturing industries, government has reduced custom



and excise duties rates on certain inputs to 'Make in India' scheme attractive.

- To make 'Make in India' a success, government has been reinstating the exemption of MAT for non-resident investors, those are manufacturing goods in SEZs. This will give big boost to 'Make in India' campaign by triggering the growth of manufacturing sector.
- Government has also allowed manufacturer to import of capital goods at zero customs duty to promote electronic sector under the Zero duty Export Promotion Capital Goods Scheme (EPCG).

### Conclusion:

The praxis of policy should be designed after understanding the need of the economy, in the context of socio-economic environment and

public needs. Indian manufacturing sector is primarily resource-driven than technology-driven and therefore, the input cost and subsequent taxes on it, make the sector more challenging. Manufacturing sector can be strengthened through fiscal interventions like tax concession, tax reduction on the manufacturing process, especially on import of technology and research and development. Besides, subsidies and other fiscal interventions on inputs cost, import of technology and plant equipments will change the investment climate and eco-system and able to boost the manufacturing sector. Policy paradigm is the need of the hour and the initiatives taken by the present government are forward-looking especially on the tax-front. The success of the various initiatives undertaken by government depends upon the outcome (contribution to GDP and employment) and their

effectiveness rely on how does the government monitor and implement various schemes and programs meant for the overall development of the nation and manufacturing sector in particular. Implementation of GST would go a long way in promoting 'Make in India' and will give much relief to the manufacturing sector and country by getting rid of cascading effects of sales taxes, VAT etc.

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Richard Bach

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## FAQs on GST

Following are the answers to the various frequently asked questions relating to GST:

### Question: What is GST? How does it work?

**Answer:** GST is one indirect tax for the whole nation, which will make India one unified common market.

GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

### Question: What are the benefits of GST?

**Answer:** The benefits of GST can be summarized as under:

#### ● For Business and Industry:

- ❖ Easy compliance: A robust and comprehensive IT system would be the foundation of the GST regime in India. Therefore, all tax payer services such as registrations, returns, payments, etc. would be available to the taxpayers online, which would make compliance easy and transparent.
- ❖ Uniformity of tax rates and structures: GST will ensure that indirect tax rates and structures are common across the country, thereby increasing certainty and ease of doing business. In other words, GST would make doing business in the country tax neutral, irrespective of the choice of place of doing business.
- ❖ Removal of cascading: A system of seamless tax-credits throughout the value-chain, and across boundaries of States, would ensure that there is minimal cascading of taxes. This would reduce hidden costs of doing business.
- ❖ Improved competitiveness: Reduction in transaction costs of doing business would eventually lead to an improved competitiveness for the trade and industry.
- ❖ Gain to manufacturers and exporters: The subsuming of major Central and State taxes in GST, complete and comprehensive set-off of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports. The uniformity in tax rates and procedures across the country will also go a long way in reducing the compliance cost.

#### ● For Central and State Governments:

- ❖ Simple and easy to administer: Multiple indirect taxes at the Central and State levels are being replaced by GST. Backed with a robust end-to-end IT system, GST would be simpler and easier to administer than all other indirect taxes of the Centre and State levied so far.
- ❖ Better controls on leakage: GST will result in better tax compliance due to a robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an in-built mechanism in the design of GST that would incentivize tax compliance by traders.
- ❖ Higher revenue efficiency: GST is expected to decrease the cost of collection of tax revenues of the Government, and will therefore, lead to higher revenue efficiency.

#### ● For the consumer:

- ❖ Single and transparent tax proportionate to the value of goods and services: Due to multiple indirect taxes being levied by the Centre and State, with incomplete or no input tax credits available at progressive stages of value addition, the cost of most goods and services in the country today are laden with many hidden taxes. Under GST, there would be only one tax from the manufacturer to the consumer, leading to transparency of taxes paid to the final consumer.
- ❖ Relief in overall tax burden: Because of efficiency gains and prevention of leakages, the overall tax burden on most commodities will come down, which will benefit consumers.