



INTEGRATED GOODS AND SERVICES TAX (IGST)

—CA. Upender Gupta*

Abstract The new regime of Goods and Services Tax as proposed to be brought in by inserting Art. 269A into the Constitution aims to simplify the process of paying indirect taxes, thereby boosting the economy. The article discusses the taxation models adopted worldwide like Origin-based Taxation, Deferred Payment and Reverse Charge, Dual VAT with deferred payment, Compensating VAT, Viable Integrated VAT, Prepaid VAT or the Split Payment Method and goes on to explain why the IGST model is best suited to Indian conditions. The advantages offered by this model for both the tax payers and the tax administrators have been highlighted along with certain essential requirements in the administrative set-up for the model's effects to be fully felt. The author finally argues that the IGST model has the potential to drastically reduce procedural barriers and create a common market, allowing the economy to flourish.

I. IGST MODEL OF TAXATION

Goods and Services Tax, colloquially known as GST has been hailed as the single biggest reform that the indirect tax landscape of India will witness since independence. It has been proclaimed as a game changer, a reform that will act as a catalyst for the growth of Indian economy and put it on a higher trajectory. This reform proposes to do away with a large number of taxes levied on different economic activities by the Central and State Governments. Presently the Central Government levies tax on manufacture (Central Excise duty), provision of services (Service Tax), inter-state sale of goods (Central Sales Tax levied by the Centre but collected and appropriated by the States) and the States levy tax on retail sales (VAT), entry of goods in the State (Entry Tax), Luxury Tax, Purchase Tax, etc. All these taxes are proposed to be subsumed in a single tax called

* Commissioner (GST), CBEC, Ministry of Finance, GOI.

the Goods and Services Tax (GST) which will be levied on supply of goods or services or both at each stage of the supply chain starting from manufacture or import till the last retail level. GST is proposed to be a dual levy where the Central Government will levy and collect Central GST (hereinafter “CGST”) and the State will levy and collect State GST (hereinafter “SGST”) on intra-State supply of goods or services. The Centre will also levy and collect Integrated GST (hereinafter “IGST”) on inter-State supply of goods or services. There is also a proposal to levy non-VAT-able Additional Tax not exceeding 1% on inter-State supply of goods. This tax would be levied and collected by the Centre and assigned to the originating State.

Before the IGST Model and its features are discussed, it is pertinent to understand how inter-state trade or commerce is regulated in the present indirect tax system. It is important to note that presently the Central Sales Tax Act, 1956 regulates the inter-state trade or commerce (hereinafter “CST”) the authority for which is constitutionally derived from Article 269 of the Constitution.¹ Article 269 reads as follows:

Article 269:

- (1) Taxes on the sale or purchase of goods and taxes on the consignment of goods shall be levied and collected by the Government of India but shall be assigned and shall be deemed to have been assigned to the States on or after the 1st day of April, 1996 in the manner provided in clause (2).

Explanation.—For the purposes of this clause,—

- (a) the expression “taxes on the sale or purchase of goods” shall mean taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce;
 - (b) the expression “taxes on the consignment of goods” shall mean taxes on the consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce.
- (2) The net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Union territories, shall not form part of the Consolidated Fund of India, but shall be assigned to the States within which that tax is leviable in that year, and shall be distributed among those States in accordance with such principles of distribution as may be formulated by Parliament by law.

¹ INDIA CONST. Article 269.

- (3) Parliament may by law formulate principles for determining when a sale or purchase of, or consignment of, goods takes place in the course of inter-State trade or commerce.

CST, which has been in force for a number of decades in India, is now disclaimed as being the single greatest obstacle to the growth of inter-state trade in the country. CST can be said to be a major reason for India still being a political union rather than an economic union. Not only is it non-VAT-able [i.e. credit of CST is not available as Input Tax Credit (hereinafter referred to as “ITC”) for payment of other taxes], but the fact that it is administered through forms and archaic procedures, and regulated through check posts and *nakas*, has made it a big deadwood for the capacity and capability of India’s competitiveness in the international market. Another negative feature of CST is the opportunity it provides for ‘arbitrage’ because of the huge difference between tax rates under VAT and CST being levied on intra-State sales and inter-State sales respectively. In the proposed scenario, the IGST Model has emerged as a beacon of light in the field of darkness encompassing the sub-national VAT and has the capacity to positively influence the dynamics of inter-State trade in a manner unfathomable earlier.

To explain, if GST can be viewed as a body, its heart would definitely be the taxation of inter-State supplies. Worldwide, wherever the GST, commonly known as ‘VAT’, has been introduced, countries with federal set-ups having sub-national entities have been using different models to deal with the intricacies of trade taking place across sub-national entities. A large number of models are already in vogue for handling supplies, which take place in the course of inter-sub-national trade or commerce. Some of the key models being presently used by various tax administrations across the world are as follows:

- (i) Origin-based taxation: In this model, tax is paid at the point of origin with no further credit. This model fails to meet the requirements of a common single market and leads to large number of refund claims.
- (ii) Deferred Payment and Reverse Charge: In this model, sales to registered buyers outside the State are zero-rated and tax is paid by the recipient on reverse charge basis at the entry point. The model is used in the EU and leads to considerable leakages (carousel frauds). The model requires massive exchange of information between the taxpayers located in the originating and destination locations.
- (iii) Dual VAT with deferred payment: Here a single tax administration (normally central) collects the central as well as state tax. The remaining attributes are more or less same as in the previous model. The system is the most popular globally and is applicable in Canada, Australia, Germany and many other federations. The system works well when tax is collected

by the central government, which has the power to enforce it both at the point of origin as well as destination.

- (iv) **Compensating VAT (C-VAT):** This model allows taxation of all inter-State sales as a federal levy at a specific rate. If the states have variable rates, the C-VAT rate could be taken as the lowest, average or the highest of the applicable rates. C-VAT paid on inter-state sales is available as ITC from the federal taxes only, or refunded when the proof of their subsequent taxation in the destination state is produced. This model works well only when the state rate is relatively much lower, thereby permitting its credit entirely from the federal tax from the possible value addition at the next stage. Thus, if the federal rate is 18% and the state rate is 5% it is possible to impose CVAT at the rate of 5% and allow its credit from 18% tax rates applicable at next stage if the value addition is up to 20% at the next stage.
- (v) **Viable Integrated VAT (VIVAT):** In this model all Business to Business sales (B2B sales), whether intra-State or inter-State are subjected to a specific rate. Since tax paid on B2B sale is mostly eligible as ITC, it helps in maintaining the tax chain, which is settled through a clearing house mechanism. However the method suffers from the disadvantage of treating intra-State and inter-State sales differently. Moreover, it requires knowing the status of the buyer at the time of sale. It also suffers from the disadvantage of the possibility of revenue reaching the wrong State as inter-State B2C (Business to Customer) revenue is retained at origin.
- (vi) **Prepaid VAT (P-VAT):** Under this model, the buyer has to deposit the tax directly with the destination state and send the proof of payment to the seller. The liability of the seller is deemed to have been discharged on furnishing the proof of tax payment by the buyer. If the seller does not show the proof of payment of tax to the Destination State, he has to personally discharge the liability. This method allows immediate ITC as soon as the payment of tax is made and does not leave the buyer at the mercy of the supplier discharging the liability.
- (vii) **Split Payment Method (SPM):** In this model, the buyer pays the tax to a blocked bank account with the tax authorities' bank, which can only be used by the seller for discharging his tax liability. The chain of payments is thus completed while at the same time final payment by the ultimate seller ensures that the payment is credited in the destination state. In other words, the tax account is kept segregated at all stages and thus the amount of tax is available for reaching the destination state quite easily.

A question may be posed as to why India chose to develop a new model of taxation despite the existence of numerous other pre-existing models. To understand this, it is important to know the various parameters on the basis of which

a sub-national VAT system needs to be evaluated. The following factors are the major touchstones of judging a good sub national VAT system:

- (i) State autonomy in tax-setting: The system should help preserve tax-setting power for sub-national governments. This is of great importance in India as State governments are permitted to have the power of actual tax collection in their respective jurisdictions.
- (ii) Destination principle: The revenue on the final consumption should belong to the Destination State. Moreover the revenue should be available to the Destination State as soon as the taxable event is completed and taxes are paid by the supplier.
- (iii) Compliance symmetry: The business transactions within the State and across different States should be treated identically.
- (iv) Proper tax incentive to the administration collecting the tax: The implementation of the proposed model should not require additional manpower. Additionally, it should not make an administration responsible for the collection of tax when the benefit thereof would actually accrue to some other State.
- (v) Avoid predatory competition amongst States: While maintaining the State's autonomy, the system should not permit the States to do mutual harm by exporting taxes to the Destination State or engage in tax wars to stake claim on the tax base of other States.
- (vi) Preserve the ITC chain: It should be ensured that the ITC chain not break as the breakage will compromise the twin objectives of establishing a single common market and removing cascading.
- (vii) Minimise cost of compliance for taxpayers: The purpose of GST and its consequent impact on GDP growth will be compromised if the system adds significantly to the cost of compliance.

It is important to note that the models under use globally suffer from the following drawbacks:

- (i) Lacks compliance symmetry i.e. different treatment to B2B and B2C sales – models are only designed to handle B2B sales;
- (ii) B2C sales are taxed in originating State thereby violating destination principle;
- (iii) Leads to increase in compliance costs which in turn –
 - a) results in blockage of funds;
 - b) refunds of State VAT portion in exporting State and that of federal taxes in importing;

- c) delays in availability of ITC to buyers;
- d) results in lack of incentives to States for tax collection; and
- e) fails to check tax evasion as taxes are mostly paid on reverse charge basis and not by the supplier at the time of sales.

Thus it may not be incorrect to say that the models discussed above have certain imperfections that make them unworkable in a federal set-up like India, especially since India is going to have Dual GST model. Therefore, the IGST model was adopted to fit into the Indian economic and political matrix. The IGST model is an ode to Indian ingenuity and innovativeness as it tries to overcome the pitfalls associated with the various models discussed above and tries to achieve the objectives of harmonised sub-national VAT. For understanding IGST Model, it is important to look at the constitutional framework for taxation of inter-State supplies which is provided in the proposed Article 269A of the Constitution (122nd) Amendment Bill.² The relevant provision is as follows:

Proposed Article 269A:

- (1) Goods and services tax on supplies in the course of inter-State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Explanation— For the purposes of this clause, supply of goods, or of services, or both in the course of import into the territory of India shall be deemed to be supply of goods, or of services, or both in the course of inter-State trade or commerce.

- (2) Parliament may, by law, formulate the principles for determining the place of supply, and when a supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

It is discernible from a plain reading of the proposed Article that:

- (i) IGST would be levied on the supply of goods and/or services that take place in the course of inter-State trade or commerce;
- (ii) It would be levied and collected by the Central Government;
- (iii) The collected IGST would be apportioned between the Union and the States in the manner as may be provided by the Parliament by law on the recommendations of the Goods and Services Tax Council;
- (iv) Imports would also be subjected to IGST; and

² The Constitution (122nd) Amendment Bill, 2014, Article 269A.

- (v) Parliament would lay down the principles for determining the Place of Supply Rules (hereinafter referred to as “POSR”) that would determine the character of supply i.e. whether inter-State or intra-State.

Some of the features of this Model are considered to have the potential to revolutionise the inter-State trade or commerce. These are:

- (i) IGST would be leviable on any supply of goods and/or services that would take place in the course of inter-State trade or commerce;
- (ii) There is no difference in the treatment of Business to Business (B2B) supplies or Business to Consumer (B2C) supplies;
- (iii) It would be a stand-alone tax that would be paid by the supplier in the exporting State. The supplier can utilise the ITC of CGST as well as that of SGST paid by him at the time of intra-State procurement and that of IGST paid by him at the time of inter-State procurement for discharging the liability of IGST;
- (iv) The purchaser in the importing State would be able to take full ITC of IGST paid by the supplier in the exporting State;
- (v) The purchaser can utilise the said ITC for discharging his tax liabilities on account of IGST, CGST and SGST associated with his supplies whether inter-State or intra-State;
- (vi) The IGST would be permitted to be utilised for payment of IGST, CGST and SGST in that order;
- (vii) The exporting State would transfer the amount of SGST utilised by the supplier for payment of IGST to the Central Government;
- (viii) The Central Government would transfer the amount of IGST utilised for payment of SGST to the concerned importing State;
- (ix) The Central Government would also transfer the SGST portion of IGST paid by the taxpayer in the exporting State on B2C inter-State supplies to the importing State.
- (x) The transfer of funds would be carried out by the Central Government on the basis of information contained in the periodical returns submitted by the taxpayers;
- (xi) Central Government would act as a clearing house for transfer of funds between the exporting State and Centre on the one hand and between the Centre and importing State on the other hand.

The essential requirements for the successful working of the proposed IGST Model cannot be overemphasised, particularly when the ITC of taxes paid in one State are allowed to be utilised by the taxpayer located in other State(s).

The model would work with inbuilt system-based validations and checks on all aspects of availment and utilisation of ITC as well as that of tax payments. There are certain other requirements for successful working of the model that are as follows:

- (i) Uniform e-registration of taxpayers;
- (ii) Common e-return for all types of taxes namely CGST, SGST & IGST;
- (iii) Common periodicity of returns for a class of taxpayers if not for all;
- (iv) Uniform cut-off dates for filing of e-returns;
- (v) Mandatory reporting of supply and purchase invoice details prior to or along with filing of e-returns;
- (vi) System based verification of returns;
- (vii) Well laid down Place of Supply Rules for determining the nature of supply.

The IGST Model scores over the presently used models elsewhere in the world in many ways. This model appears to be a win-win situation for the taxpayers as well as for the tax authorities. Some of the advantages of this model are as listed below:

- (i) For Taxpayers:
 - a) Maintenance of uninterrupted ITC chain on inter-State supplies for taxpayers located across States;
 - b) No refund claim for suppliers in exporting State, as entire ITC is allowed to be used while paying the tax;
 - c) No substantial blockage of funds for the inter- State supplier or recipient;
 - d) No cascading as full ITC of IGST paid by supplier is allowed to the recipient in the Destination State;
 - e) Suppliers are required to pay taxes in the State where they are located and they are not required to obtain registration in Destination State only for payment of taxes;
 - f) Tax reaches the Destination State through clearing house mechanism based on the information contained in the periodical returns submitted by the taxpayers;
 - g) Model handles Business to Business as well as Business to Consumer supplies.

(ii) For Tax Administrations:

- a) Upfront tax payments by suppliers in the exporting State;
- b) No refund claims on account of inter-State supplies;
- c) Proper tax incentive to the administration for collecting the tax;
- d) Avoids predatory competition amongst States;
- e) Tax gets transferred to Importing State in accordance with the Destination principle;
- f) Self-monitoring model as taxes are paid upfront and full ITC is allowed to taxpayers located across the States;
- g) Results in improved compliance levels;
- h) Effective fund settlement mechanism between the Centre & States.

Overall it can be said that the introduction of GST in the country would open up new vistas in the field of indirect taxation in the country. It would be the first time when both the governments, that is, Central and State, would have taxation powers over the entire supply chain- thereby ending the fractured mandate of taxation that has been the bane of indirect taxation for so long. Additionally, GST would create a common national market by freeing the inter-State trade from the chains of forms and anachronistic procedures and more importantly from cascading of taxes that has been contributing towards increasing the cost of carrying out business without any resultant benefits. The choice of IGST Model for dealing with inter-State supplies points towards one objective- the creation of a common national market and unleashing the chained energy of the Indian manufacturing capacity. It is said that India has the potential to be the leading economy of the world and the advent of GST can play a crucial role in this regard.

Disclaimer- The views expressed in this article are solely the author's and are not representative of the Government's stand.