INSOLVENCY AND BANKRUPTCY CODE, 2016

The Code

An Act to consolidate and amend the laws relating to re-organization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India.

Background

At present, there are multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. The current legal and institutional framework does not aid lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system. Recognizing that reforms in the bankruptcy and insolvency regime are critical for improving the business environment and alleviating distressed credit markets, the Government introduced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (**BLRC**) under the Ministry of Finance. Trilegal worked with the BLRC to assist with the drafting of the bill.

After a public consultation process and recommendations from a joint committee of Parliament, both the houses of Parliament have now passed the Insolvency and Bankruptcy Code, 2016 (**Code**). While the legislation of the Code is a historical development for economic reforms in India, its effect will be seen in due course when the institutional infrastructure and implementing rules as envisaged under the Code are formed.

The Need

It is a law aimed at speedy winding up of insolvent companies, lowering NPAs, and redeploying capital productively. It is a significant reform — given the bad-loan crisis in banking, and cases of default such as Vijay Mallya’s.

India’s banking industry is in the throes of a crisis. Bad debts are piling up at banks. According to central bank data, stressed assets (which include gross bad loans, advances whose terms have been restructured and written-off accounts) rose to 14.5 percent of banking sector loans at the end of December 2015. That is almost Rs 10 trillion of loans that are stuck. Freeing up this money is crucial for the banking sector to go about its business.

There are, in fact, several laws that deal with insolvency for companies. However, it is this multiplicity of laws which creates a problem in the way of banks and causing them to fail to recover their loans. For example, DRTs are dealing with a backlog of Rs 4 trillion worth of cases. For the last three financial years, less than 20 percent of cases taken up by various channels such as DRTs, Lok Adalats and SARFAESI courts have been successfully resolved.

This law will help the lenders recover their money and keep the economy healthier

Sources :

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GST

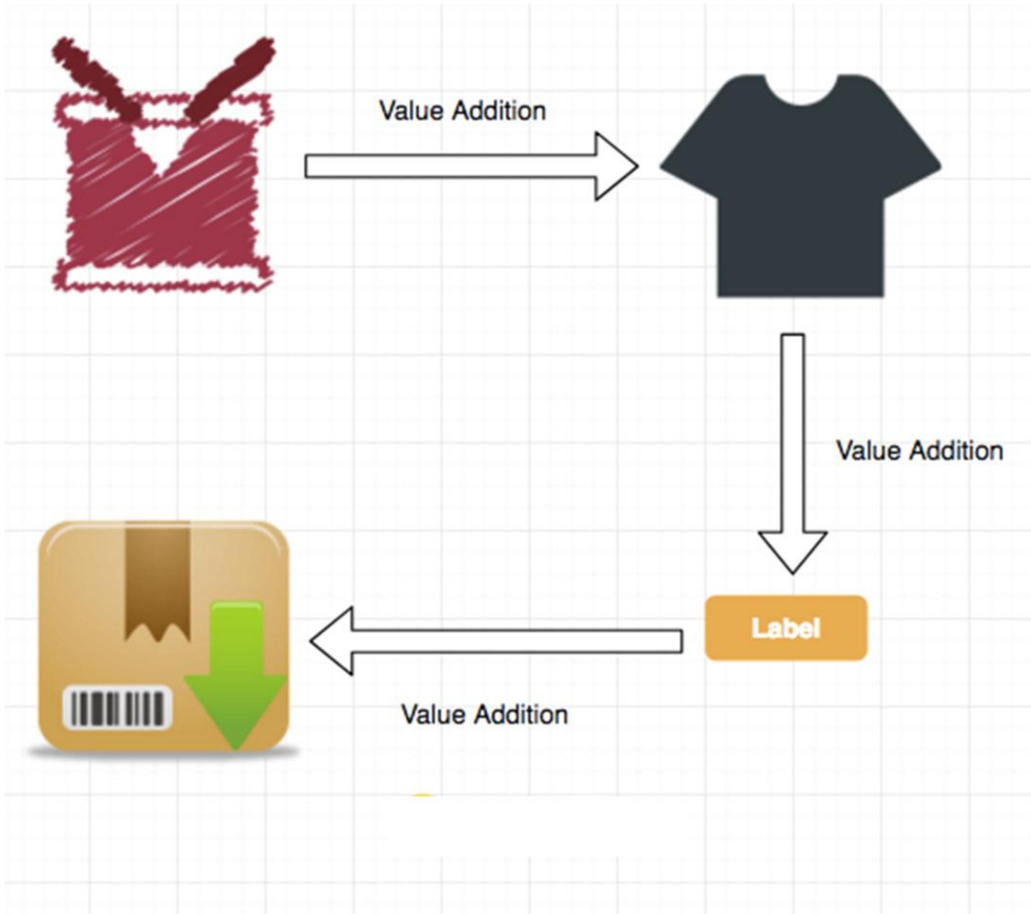
Goods & Services Tax is a **comprehensive**, **multi-stage**, **destination-based tax** that will be levied on every **value addition**.

To understand this, we need to understand the concepts under this definition. Let us start with the term 'Multi-stage'. Now, there are multiple steps an item goes through from manufacture or production to the final sale. Buying of raw materials is the first stage. The second stage is production or manufacture. Then, there is the warehousing of materials. Next, comes the sale of the product to the retailer. And in the final stage, the retailer sells you – the end consumer – the product, completing its life cycle.

So, if we had to look at a pictorial description of the various stages, it would look like:

Goods and Services Tax will be levied on each of these stages, which makes it a multi-stage tax. How? We will see that shortly, but before that, let us talk about 'Value Addition'.

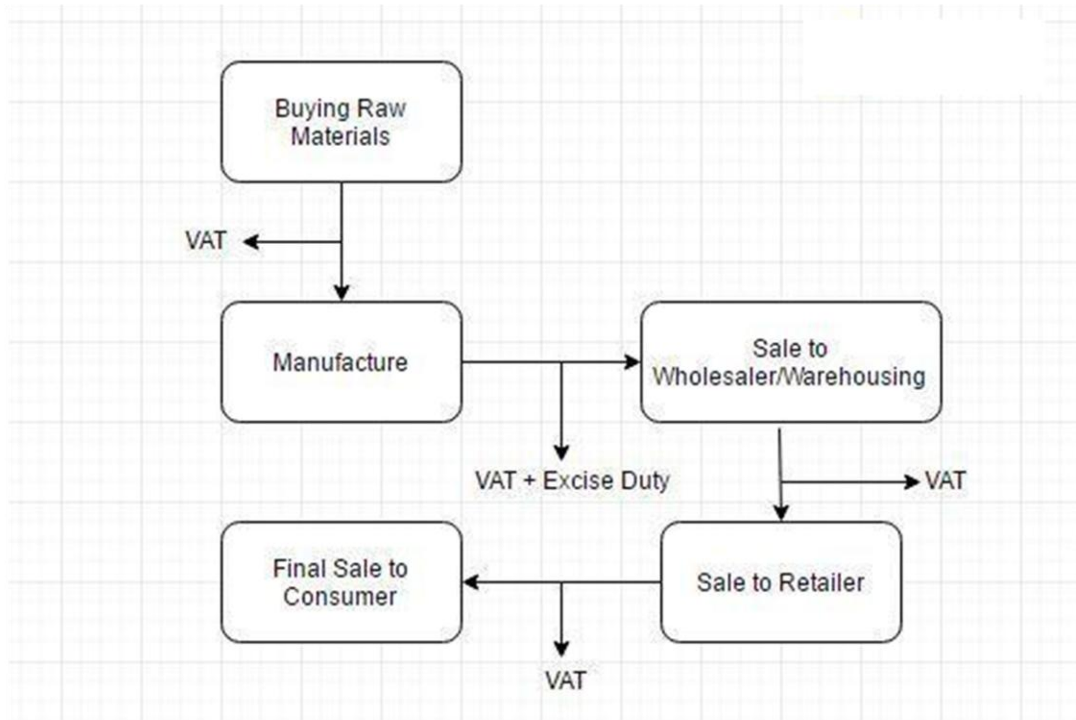
Let us assume that a manufacturer wants to make a shirt. For this he must buy yarn / cloth. This gets turned into a shirt after manufacture. So, the value of the yarn is increased when it gets woven into a shirt. Then, the manufacturer sells it to the warehousing agent who attaches labels and tags to each shirt. That is another addition of value after which the warehouse sells it to the retailer who packages each shirt separately and invests in marketing of the shirt thus increasing its value.



GST will be levied on these value additions – the monetary worth added at each stage to achieve the final sale to the end customer.

There is one more term we need to talk about in the definition – **Destination-Based**. Goods and Services Tax will be levied on all transactions happening during the entire manufacturing chain. Earlier, when a product was manufactured, the centre would levy an Excise Duty on the manufacture, and then the state will add a VAT when the item is sold to the next stage in the cycle. Then there would be a VAT at the next point of sale.

So, earlier the pattern of tax levy was like this:



Now, Goods and Services Tax will be levied at every point of sale. Assume that the entire manufacture process is happening in Rajasthan and the final point of sale is in Karnataka. Since Goods & Services Tax is levied at the point of consumption, so the state of Rajasthan will get revenue in the manufacturing and warehousing stages, but lose out on the revenue when the product moves out Rajasthan and reaches the end consumer in Karnataka. This means that Karnataka will earn that revenue on the final sale, because it is a destination-based tax and this revenue will be collected at the final point of sale / destination which is Karnataka.

Why Is Goods And Services Tax So Important?

So, now that we have defined GST, let us talk about why it will play such a significant role in transforming the current tax structure, and therefore, the economy.

Currently, the Indian tax structure is divided into two – Direct and Indirect Taxes. Direct Taxes are levies where the liability cannot be passed on to someone else. An example of this is Income Tax where you earn the income and you alone are liable to pay the tax on it.

In the case of Indirect Taxes, the liability of the tax can be passed on to someone else. This means that when the shopkeeper must pay VAT on his sale, he can pass on the liability to the customer. So, in effect, the customer pays the price of the item as well as the VAT on it so the shopkeeper can deposit the VAT to the government. This means that the customer must pay not just the price of the product, but he also pays the tax liability, and therefore, he has a higher outlay when he buys an item.

This happens because the shopkeeper has paid a tax when he bought the item from the wholesaler. To recover that amount, as well as to make up for the VAT he must pay to the government, he passes the liability to the customer who has to pay the additional amount. There is currently no other way for the shopkeeper to recover whatever he pays from his own pocket during transactions and therefore, he has no choice but to pass on the liability to the customer.

Goods and Services Tax will address this issue after it is implemented. It has a system of Input Tax Credit which will allow sellers to claim the tax already paid, so that the final liability on the end consumer is decreased.

How Does GST Work?

When Goods and Services Tax is implemented, there will be 3 kinds of applicable Goods and Services Taxes:

CGST: where the revenue will be collected by the central government
SGST: where the revenue will be collected by the state governments for intra-state sales
IGST: where the revenue will be collected by the central government for inter-state sales

In most cases, the tax structure under the new regime will be as follows:

Transaction	**New Regime**	**Old Regime**	**Comments**
Sale within the state	CGST + SGST	VAT + Central Excise/Service tax	Revenue will now be shared between the Centre and the State
Sale to another State	IGST	Central Sales Tax + Excise/Service Tax	There will only be one type of tax (central) now in case of inter-state sales.

Example

A dealer in Maharashtra sold goods to a consumer in Maharashtra worth Rs. 10,000. The Goods and Services Tax rate is 18 percent comprising CGST rate of 9 percent and SGST rate of 9 percent. In such cases the dealer collects Rs. 1800 and of this amount, Rs. 900 will go to the central government and Rs. 900 will go to the Maharashtra government.

Now, let us assume the dealer in Maharashtra had sold goods to a dealer in Gujarat worth Rs. 10,000. The GST rate is 18 percent comprising of CGST rate of 9 percent and SGST rate of 9 percent. In such case the dealer has to charge Rs. 1800 as IGST. This IGST will go to the Centre. There will no longer be any need to pay CGST and SGST.

How Will GST Help India And Common Man?

The basis of Goods and Services Tax is the seamless flow of Input Tax Credit (ITC) along the entire value addition chain. At every step of the manufacturing process, businesses will have the option to claim the tax already paid in the previous transaction. Understanding this process is crucial for businesses. A detailed explanation here.

To understand this, let us first understand what is Input Tax Credit. It is the credit an individual receives for the tax paid on the inputs used in manufacturing the product. So, if there is a 10 percent tax that the individual must submit to the government, he can subtract the amount he has paid in taxes at the time of purchase and submit the balance amount to the government.

Let us understand this with a hypothetical numerical example.
Say a shirt manufacturer pays Rs. 100 to buy raw materials. If the rate of taxes is set at 10 percent and there is no profit or loss involved, then he has to pay Rs. 10 as tax. So, the final cost of the shirt now becomes Rs (100+10=) 110.

At the next stage, the wholesaler buys the shirt from the manufacturer at Rs. 110, and adds labels to it. When he is adding labels, he is adding value. Therefore, his cost increases by say Rs. 40. On top of this, he has to pay a 10 percent tax, and the final cost therefore becomes Rs. (110+40=) 150 + 10 percent tax, i.e., Rs 15 = Rs. 165.

Now, the retailer pays Rs. 165 to buy the shirt from the wholesaler because the tax liability had passed on to him. He has to package the shirt, and when he does that, he is adding value again. This time, let's say his value add is Rs. 30. Now when he sells the shirt, he adds this value (plus the VAT he has to pay the government) to the final cost. So, the cost of the shirt becomes Rs. 214.5 Let us see a breakup for this:

Cost = Rs. 165 + Value add = Rs. 30 + 10 percent tax = Rs. 195 + Rs. 19.5 = Rs. 214.5

So, the customer pays Rs. 214.5 for a shirt the cost price of which was basically only Rs. 170 (Rs 110 + Rs. 40 + Rs. 30). Along the way the tax liability was passed on at every stage of transaction and the final liability comes to rest with the customer. This is called the **Cascading**

Effect of Taxes where a tax is paid on tax and the value of the item keeps increasing every time this happens.

Action	Cost	10 percent Tax	Total
Buys Raw Material @ 100	100	10	110
Manufactures @ 40	150	15	165
Adds value @ 30	195	19.5	214.5
Total	170	44.5	214.5

In the case of Goods and Services Tax, there is a way to claim credit for tax paid in acquiring input. What happens in this case is, the individual who has paid a tax already can claim credit for this tax when he submits his taxes.

In our example, when the wholesaler buys from the manufacturer, he pays a 10 percent tax on his cost price because the liability has been passed on to him. Then he adds value of Rs. 40 on his cost price of Rs. 100 and this brings up his cost to Rs. 140. Now he has to pay 10 percent of this price to the government as tax. But he has already paid one tax to the manufacturer. So, this time what he does is, instead of paying Rs (10 percent of 140=) 14 to the government as tax, he subtracts the amount he has paid already. So, he deducts the Rs. 10 he paid on his purchase from his new liability of Rs. 14, and pays only Rs. 4 to the government. So, the Rs. 10 becomes his input credit.

When he pays Rs. 4 to the government, he can pass on its liability to the retailer. So, the retailer pays Rs. (140+14=) 154 to him to buy the shirt. At the next stage, the retailer adds value of Rs. 30 to his cost price and has to pay a 10 percent tax on it to the government. When he adds value, his price becomes Rs. 170. Now, if he had to pay 10 percent tax on it, he would pass on the liability to the customer. But he already has input credit because he has paid Rs.14 to the wholesaler as the latter's tax. So, now he reduces Rs. 14 from his tax liability of Rs. (10 percent of 170=) 17 and has to pay only Rs. 3 to the government. And therefore, he can now sell the shirt for Rs. (140+30+17) 187 to the customer.

Action	Cost	10 percent Tax	Actual Liability	Total
Buys Raw Material	100	10	10	110
Manufactures @ 40	140	14	4	154
Adds Value @ 30	170	17	3	187
Total	170		17	187

In the end, every time an individual was able to claim input tax credit, the sale price for him reduced and the cost price for the person buying his product reduced because of a lower tax liability. The final value of the shirt also therefore reduced from Rs. 214.5 to Rs. 187, thus reducing the tax burden on the final customer.

So essentially, Goods & Services Tax is going to have a two-pronged benefit. One, it will reduce the cascading effect of taxes, and second, by allowing input tax credit, it will reduce the burden of taxes and, hopefully, prices.

Source : https://cleartax.in/s/gst-law-goods-and-services-tax