

# **G**rand implementation **S**tructural impact **T**axation uniformity

**Taxation impact on major manufacturing sectors  
largely neutral**

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## GST to create business efficiency in the medium term

Under the Goods and Services Tax (GST), emphasis on value addition; amalgamation of a large number of central and state taxes into a single tax; and set-off allowance of prior-stage taxes will mitigate the ill effects of cascading. This will also allow free flow of tax credit in intra and inter-state transactions, leading to a more efficient and leaner tax structure.

CRISIL Research believes that the reform will improve tax efficiency on account of three major changes over the existing system:

- The limitation in central value added tax (CENVAT), pre GST, lied in non-inclusion of several central taxes such as additional customs duty and surcharges. At the state level, there were several taxes, such as luxury tax and entertainment tax, which were not subsumed in the VAT. Pre GST, state VAT was also applied on the value of goods including CENVAT, leading to a cascading effect to the tune of CENVAT load.
- Pre GST, service tax was not allowed for set-off against VAT
- Pre GST, CST was levied on inter-state transfer of goods but did not carry any set-off relief.

CRISIL Research believes that industry stabilisation, under the new tax regime, will take a couple of quarters. However, the benefits of GST on business practices and company strategies will be seen only in the medium term (1-3 years). The extent of business efficiency is estimated to be higher in goods as compared to services. At present, supply chains across major manufacturing industries are strategised based on tax arbitrage aspect. Seamless tax treatment under GST will eliminate the need of multiple warehouses across states. Furthermore, companies will modify their supply chains based on the assessment of tax saving, inventory carrying cost and response time to meet market demand.

For major sectors, the tax rates announced by GST council are mostly in line with the present effective tax incidences. In sectors such as consumer durables, construction material and FMCG, GST rates have marginal difference. However, for players having higher incidence of CST at present, the saving under the new tax regime will be to the tune of 2%. Specifically for the segments under FMCG, effective tax saving will differ across states due to a wide variation in VAT rates on FMCG items.

On the other hand, tax saving will be relatively higher in automobiles sector, specifically sports utility vehicles (SUVs) as the tax incidence will reduce from current effective tax rate of over 50% to 43% (28% GST + 15% cess). For all other segments, tax incidence is marginally better compared to the previous effective rates.

- **Improved demand in select sectors:** GST legislation emphasises anti-profiteering measure for companies. Accordingly, any reduction in the rate of tax on supply of goods or services or the benefit of input tax credit needs to be passed on to the recipient by way of commensurate reduction in prices. Demand improvement is likely in sectors where such tax reduction will be significant. However, these segments may witness an improvement in demand provided companies pass on the tax savings to consumers.

- **Manufacturing companies to benefit:** While the new regime, in the medium term, will have a structural impact on the supply chains of goods as well as services, the extent of efficiency is estimated to be higher in supply chain of goods. Seamless transport of goods is also estimated to benefit companies/ industries which have pan- India logistic network, wherein supply clusters are concentrated around specific geographies and demand regions are spread across different states.
- **Structural changes in supply chains:** Many businesses have already been revisiting their supply chain decisions. Other players may do so post stabilisation of GST implementation. This may give a major impetus to the logistic industry at pan India level. Many companies are expected to migrate from a current strategy of 'multiple warehousing' to the 'hub and spoke' model as tax treatment across India will be same. From now on, most business decisions will be focused on supply chain efficiency and not on state-wise tax arbitrage. This in turn, may lead to a major business opportunity for organised warehousing players operating large sized warehouses in key geographies.

At present, most warehousing clusters are situated near major demand regions such as NCR, MMR, Kolkata, Bengaluru and Chennai. While these clusters will continue to remain major warehousing hubs, the sector may also witness emergence of other warehousing hubs which will prove effective for pan India logistic players. For example, Nagpur-considered geographical centre of the country- has been witnessing traction for the last few years. Many FMCG and e-commerce companies have already announced their plans to set-up warehousing facilities around the city.

- **Increasing share of organised players:** Input tax credit, being the crux of GST mechanism, will ensure wider coverage of tax payers in the supply chain. As supply from registered taxpayers only will be allowed for input tax credit, businesses and stakeholders will insist on registration of their suppliers and traders- leading to increase in the share of organised participants. Furthermore, suppliers failing to comply with the timelines of GST returns will have an impact on their compliance rating.

## GST impact

This section highlights the impact of GST on major industries as well as on key stakeholders.

### Impact on major industries

CRISIL Research has highlighted industry-specific impact based on the current tax slab, announced GST rate and likely shift in business practices in the medium term. Among these major sectors, few segments of automobile and FMCG would witness positive impact due to lower tax incidence compared to the total tax paid pre GST.

- Automobiles

Segment	Excise	CST	VAT*	Infrastructure Cess	Luxury Cess	Total pre GST rate	GST	Cess	Effective GST	Change
Two/ three wheelers	12.5%	2.0%	13.5%			30.2%	28.0%	0.0%	28.0%	2.2%
Small Cars (length < 4m)	12.5%	2.0%	13.5%	1.0%		30.2%	28.0%	1.0%	29.0%	1.2%
Mid Segment Cars	24.0%	2.0%	13.5%	4.0%		47.3%	28.0%	15.0%	43.0%	4.3%
Large Cars (engine > 1500 cc)	27.0%	2.0%	13.5%	4.0%	1.0%	49.0%	28.0%	15.0%	43.0%	6.0%
Sports Utility Vehicles	30.0%	2.0%	13.5%	4.0%	1.0%	55.3%	28.0%	15.0%	43.0%	12.3%
Commercial vehicles	12.5%	2.0%	13.5%			30.2%	28.0%	0.0%	28.0%	2.2%

Note: \* VAT rates vary across states; luxury cess of 1% is tax collected at source for cars whose ex-showroom prices are more than Rs 1 million

- Consumer durables

Segment	Excise	VAT*	Total pre GST rate	Effective GST	Change
White goods	12.5%	13.5%	27.7%	28.0%	-0.3%

Note: \* VAT rates vary across states

- Construction material

Segment	Excise	VAT*	Total pre GST rate	Effective GST	Change
Cement	12.5%	13.5%	27.7%	28.0%	-0.3%
Steel	12.5%	5.0%	18.1%	18.0%	0.1%

Note: \* VAT rates vary across states

- **FMCG**

Segment	Excise	VAT*	Total pre GST rate	Effective GST	Change
Soap	12.5%	13.5%	27.7%	18.0%	9.7%
Shampoos	12.5%	13.5%	27.7%	28.0%	-0.3%
Pastries and cakes^	6.0%	6.0%	12.4%	18.0%	-5.6%
Waffles and wafers coated with chocolate^	12.5%	6.0%	19.3%	28.0%	-8.7%
Milk	0.0%	0.0%	0.0%	0.0%	0.0%
Ghee	0.0%	13.5%	13.5%	12.0%	1.5%
Butter	0.0%	13.5%	13.5%	12.0%	1.5%
Hair Oil	12.5%	13.5%	27.7%	18.0%	9.7%

Note: \* VAT rates vary across States; ^ Wide difference in State VAT rates

## Impact on key stakeholders

- This section includes specific cases where GST impact will be significant.

Stakeholder	GST impact
<ul style="list-style-type: none"> <li>• All tax payers</li> </ul>	<ul style="list-style-type: none"> <li>• With need for registration and filing of returns in multiple states, compliance costs are likely to go up. Overall tax compliance, too, is expected to go up. This will also impact some of the smaller entities in SME-dominated sectors. Over the longer term, this is likely to lead in consolidation and gain in market share for the organised sector</li> </ul>
<ul style="list-style-type: none"> <li>• Impact on manufacturing states</li> </ul>	<ul style="list-style-type: none"> <li>• The destination-based taxation structure of GST implies that states with manufacturing bases will potentially lose revenue which will be compensated by the central government – about Rs. 500 billion in the first year. The key states that will require compensation are Gujarat, Maharashtra, Uttar Pradesh, Tamil Nadu and Haryana. Proceeds from the additional cess on sin goods/ luxury items will constitute the pool from which the states would be compensated for any revenue loss.</li> </ul>
<ul style="list-style-type: none"> <li>• Existing companies which have signed MoUs with states for tax subsidies</li> </ul>	<ul style="list-style-type: none"> <li>• Several states have, in the past, offered tax incentives to companies for setting up manufacturing units. Dilution of the power of states to levy independent taxes/offer exemptions under GST regime, will impact existing projects too. State governments and impacted companies will need to find out solutions. However, at present there is lack of clarity on this issue.</li> </ul>
<ul style="list-style-type: none"> <li>• Revenue authorities</li> </ul>	<ul style="list-style-type: none"> <li>• Tax monitoring will become easier on account of the robust GST network platform where all returns can be accessed instantly and in a user-friendly manner. This will help revenue officials monitor the sequence of supply of goods and services as well as flow of input tax credit</li> </ul>
<ul style="list-style-type: none"> <li>• Financial institutes</li> </ul>	<ul style="list-style-type: none"> <li>• GST will increase working capital requirements across major manufacturing sectors on account of tax liability on inter-state 'stock transfer'. Accordingly, businesses will not be able to claim their tax credits until the shipped goods are sold. To reiterate, stock-transfers in the current regime does not attract any tax even during an inter-state transfer.</li> </ul>

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