

Input tax credit to benefit goods, offset rise in tax on services

GST Council harmonises tax slabs to minimise the transitional impact

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Rates largely unchanged for manufacturing; in services, input tax credit to offset higher burden

GST has moved a step closer to reality with clarity on tax rates for most goods and services. Addressing the concerns raised by industry participants and associations, the GST Council has managed to minimise the transitional impact on most sectors.

For most manufacturing goods, the finalised GST rates are largely in line with the pre-GST effective tax incidences, so the taxation impact is largely neutral.

In sectors such as consumer durables, construction material and fast moving consumer goods (FMCG), the GST rates will be marginally different. However, for players having higher incidence of CST at present, the saving under the new tax regime will be to the tune of 2%. For segments under FMCG, the effective tax saving will differ across states due to a wide variation in value added tax (VAT) rates. The tax saving will be relatively higher in automobiles sector, specifically sports utility vehicles (SUVs), as the tax incidence will reduce from the current effective tax rate of 55.3% to 43% (28% GST + 15% cess). For all other segments of automobiles, tax incidence is marginally better compared with the previous effective rates.

The rates on many services are also largely in line with the current effective incidences, taking into account the pre-GST abatements, barring a few services.

Services such as telecom, financial service, and air travel for passengers in business class will now attract an additional burden of 3%, though the benefit of input tax credit due to amalgamation of taxes will dilute the impact. Air travel for passengers in business class, factoring 40% abatement, had an effective tax rate of 9%, which would be 12% post-GST. However, given input tax credit and the fact that business class air travellers are less price elastic, the higher tax incidence may not materially impact demand.

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.

In the initial discussions on GST, the Council had suggested only two tax brackets for services, viz. 12% and 18%. However, the finalised rate structure classifies services across 5%, 12%, 18% and 28%. CRISIL Research believes that, though the four tax rates for services has surprised industry participants, the finalised GST rates on many services were close to current effective incidences taking into account the pre GST abatements. Accordingly, services such as airlines (economy class travel), air-conditioned railway travel and restaurant services will have only marginal benefits. For instance, the air travel for passengers on an economy class, factoring 60% abatement, had an effective tax rate of 6%, which would be 5% post GST.

In case of hospitality industry, while the tax impact on major segments remains similar to pre GST taxes, hotels with room rent of above Rs 5,000 will face a burden due to additional tax impact as it has been classified at 28%.

As far as entertainment tax is concerned, though the finalised GST rate of 28% is lower than the pre-GST tax of more than 30% (tax varies widely across states), exclusion of entertainment tax imposed by local bodies under GST remains a worry for industry participants.

GST impact on goods and services

Impact on key services

Among key services, telecom, financial services, hotels, and air travel on business class will bear higher tax incidence. However, input tax credit will offset this burden somewhat.

Segment	Pre GST	Post GST	% change
Telecom	15%	18%	-3%
Financial Services	15%	18%	-3%
Transport of passenger by air in other economy class (business class)	9%	12%	-3%
Hotels for room rent above Rs 5,000	19.0%^	28%	-9%
Transport of passenger by rail	4.5%	5%	-1%
Transport of passenger by air in economy class	6%	5%	1%
Transport of passengers in radio taxi	6%	5%	1%
Transport of goods by rail	5%	5%	-1%
Entertainment	30%#	28%*	-2%

Note: #tax varies widely across states

*local body taxes are not subsumed under GST, can be charged over and above GST

^Maharashtra service tax of 9% (factoring 40% abatement) + luxury tax of 10%

Impact on major goods

A few segments of automobile and FMCG would witness positive impact due to lower tax incidence compared with 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

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