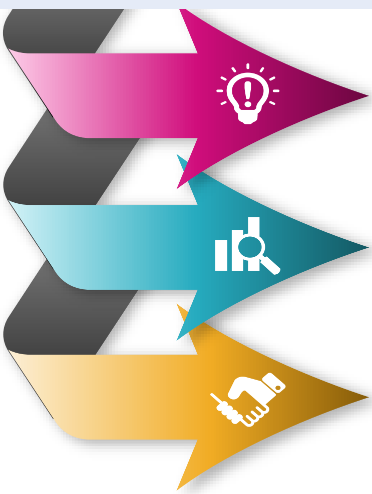
GST, A Boon or Bane?

GST in a nutshell

- GST is a comprehensive tax on goods or services as enacted by the Indian Parliament in August, 2016. It will be applicable on transaction value and subsume all other indirect taxes
- GST is a consumption-based tax; payable in the state where goods or services are consumed
- This tax reform may bring about improvement in government financials by expanding the tax net to more companies across India; create a seamless markets across states; boost consumption; and enable a higher ease of doing business
- However apprehensions remain on the inflationary impact of the reform; increased compliance costs; robustness of the GST IT architecture; treatment of stocks which remain within the value chain as of 30th July, 2017; and possible litigation due to classification issues and the anti-profiteering clause in the GST Act

Why GST?

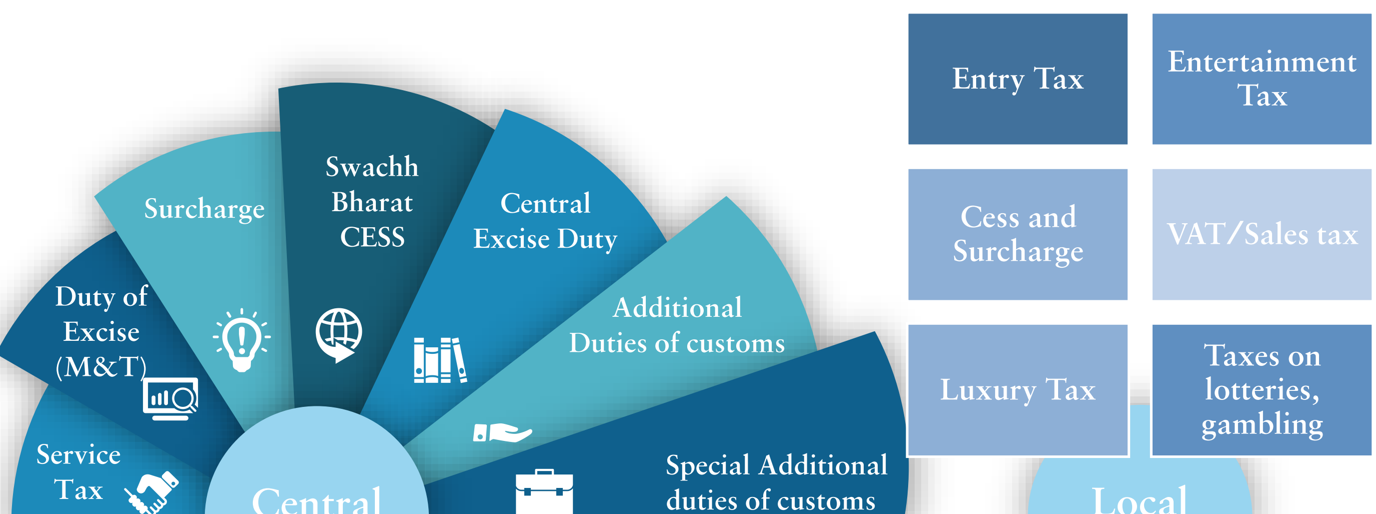


The current indirect tax system has lot of cascading impacts with multiple taxes at the state and central level, having a huge impact across the value chain

The valuation of taxes is complex as there are multiple acts governing them and this in turn reduces the ease of doing business

In the current indirect tax system, India works like a fragmented market across different states and Union territories

GST is a single tax that subsumes all other indirect taxes in India



GST, A game-changer?

Widening of indirect tax net across various sectors of the economy

Possibly higher ease of doing business

Seamless market across 29 states and 7 union territories

Input credit as a part of GST gives fillip to manufacturing and the governments 'Make in India' initiatives

Possible boost to macro environment with higher tax collection and lower fiscal deficit

Possible boost to investment

Possible increase in consumption as some goods may have lower overall taxation

Lower logistics cost due to reduction in cascading effect of multiple taxes

Bring unorganised players under the tax net

New and more effective supply chain models may emerge

Time to market can reduce as interstate operability is expected to ease

Control on leakages

Stakeholder analysis

GOI

01

- The indirect tax reform, is expected to increase net tax collection by plugging leakages; better monitoring; and implementation of end to end system
- The system has inbuilt incentives to report and comply with the system
- The increase in indirect tax collection may reduce India's fiscal deficit and result in better government financials and improved overall macroeconomic scenario
- Systematic reporting of indirect taxation will also provide the foundation for plugging direct tax leakages

Why the rollout of GST may increase tax collection?

- In the present context, when a trader purchases goods from a manufacturer, he has to pay excise duty and VAT. But when he resells those goods to his customer, he can only charge VAT. As a result of this, excise duty gets added to his input cost. To prevent this, many traders evade indirect taxes
- With the GST rollout, the trader will be eligible for full credit of indirect taxes paid at the input stage. This in turn lower any incentive to evade taxes and therefore GST rollout is expected to boost indirect tax collection

Stakeholder analysis (contd..)

Corporates

02

- The GST rollout is expected to positively impact large and mid-size Indian corporates as the reform is expected to boost consumption; create a seamless single market across states and enable higher ease of doing business
- However the extent of impact would vary across different sectors
- SMEs will be impacted with higher compliance costs; infrastructure setup costs and operational challenges such as having to register themselves across different states for GST compliance

Sector/Industry	New Tax Rates	Impact	Comments
Construction & Infrastructure	18%	Neutral	Despite higher tax rate the sector is likely to benefit from input tax credit; current inventory management is a concern
Cement, Building materials & paint	18%-28%	Neutral	▪ Overall tax in cement sector may decline; decline in logistic cost will also help the sector ▪ Input tax credit will be helpful for building material industry ▪ GST rates for paints are higher than current indirect taxes
Steel	18%	Neutral	Largely similar to the prevailing effective rate
Capital Goods	18%	Positive	Fall in rates from 25% to 18% is positive for the sector; however the real impact is a function of raw material cost and the tax bracket specific companies fall in
Fertilizer & Pesticides	5%-18%	Neutral	▪ The current effective tax rate stands at 6%; as per latest announcement the new rates is expected to have no major impact ▪ GST rate on pesticides announced at 18%
Automobiles & Auto Ancillaries	18%-43%	Neutral	Passenger vehicle segment will see reduction in overall taxation; Hybrid vehicles are set to become expensive with an additional CESS of 15%; two-wheelers will be marginally impacted with GST rate in range of 28%-31% from current tax rate of 30.2%; GST rate for commercial vehicles will be marginally lower at 28% compared to 30.2% in current system; GST on tractor at 12% while on tractor-parts at 18%
Healthcare/Pharma	5% -18%	Neutral	Taxation rate doesn't change much; however input tax credit may lead to rationalization of supply chain in the sector
IT Services	18%	Positive	Under GST, both the IT service providers and their clients will be eligible to claim full credit of GST; this is expected to eliminate the cascading effects of the present tax structure
Financial Services	18%	Negative	Higher taxes compared to the current regime will make transactions costly; insurance premiums are set to rise
Consumer Discretionary	28%	Negative	White good products like television, air conditioner, refrigerator and washing machine are set to be expensive as current tax was in range of 23-28%; however in few cities where additional octroi of 5% was charged there will be a marginal reduction in price
Consumer Staples	5%-28%	Positive	Lower taxes compared to current regime except packaged chicken, edible oil, butter; may lead to increase demand
Hospitality & Aviation Services	5%-28%	Neutral	▪ The impact depends on the location where the hotel service is available, currently different regions have different structure; dining out in five star hotels is set to become more expensive ▪ Business class travel is expected to become more expensive with higher tax rate

Stakeholder analysis (contd..)

Consumers

03

- Consumers may benefit from the GST regime on goods with the new GST rates. However higher rates on services may have inflationary impact on consumers
- The anti-profiteering clause in the GST may be favorable to consumers, as the entire tax benefit may be possibly passed on
- Impact of higher service tax is expected to pinch the pocket; spends on services like app-cabs, restaurant dining, hotel, movies, aviation services and financial services will directly take a hit
- Inflation may reduce in medium to long-term as things stabilize and tax benefits are passed to consumers

Impact on financial markets

- As the GST is a watershed reform in India, its successful implementation is expected to be a game-changer for the economy in the long run
- The inflationary impact of GST is expected to be mixed. In the short run, inflation could rise due to higher cost of services, while in the longer run reductions in the cascading effect of taxes, avoidance of double taxation, and lower logistics costs may help lower inflation
- The GST rollout is expected to have a positive impact on India's GDP in the medium term with improvements in the ease of doing business, growth in investments and higher exports. Higher tax collections may positively impact India's fiscal health
- Transaction cost may increase marginally with higher service tax

Impact on mutual fund industry

AMC's

- Marginal increase in total expense charged to the investor as the GST rate of 18% is higher than the earlier 15% service tax rate
- Increased compliance cost

DISTRIBUTOR's

- All MF distributors have to obtain GSTN registration number as most of them provide inter-state services
- GST rate of 18% applicable on commissions earned from MF sales
- Increased compliance cost

All information as on 30th, June, 2017