GST: A Major Tax Reform Impacting Indian Businesses

*A. K. Mittal **

Introduction

The Goods and Services Tax, one of the biggest reforms in India's indirect tax structure, is likely to revolutionise the Indian economy in an unprecedented manner. As envisaged, GST will propel GDP growth to newer heights, lower income disparity and simplify decision making of businesses. The GST rollout will be a milestone for the nation as its implementation will have a far-reaching impact on the Indian economy.

Understanding GST

GST is a value-added tax levied at all points in the supply chain with credit allowed for any tax paid on input acquired for use in making the supply. It would apply to both goods and services in a comprehensive manner, with exemptions restricted to a minimum.

In keeping with the federal structure of India, it is proposed that GST will be levied concurrently by the Centre (CGST) and the states (SGST). It is expected that the base and other essential design features would be common between CGST and SGST across SGSTs for individual states. Both CGST and SGST would be levied on the basis of the destination principle. Thus, exports would be zero-rated, and imports would attract tax in the same manner as domestic goods and services. Inter-state supplies within India would attract an Integrated GST (aggregate of CGST and the SGST of the destination State).

Benefits of GST

GST has been envisaged as an efficient tax system, neutral in its application and distributionally attractive. The advantages of GST are:

- Wider tax base, necessary for lowering tax rates and eliminating classification disputes
- Elimination of multiplicity of taxes and their cascading effects
- Rationalization of tax structure and simplification of compliance procedures
- Harmonization of center and state tax administrations, which would reduce

* *Professor, GJIMT, Mohali*

duplication and compliance costs

- Automation of compliance procedures to reduce errors and increase efficiency

Destination principle

The GST structure would follow the destination principle. Accordingly, imports would be subject to GST, while exports would be zero-rated. In the case of inter-state transactions within India, State tax would apply in the state of destination as opposed to that of origin.

Taxes to be subsumed

GST would replace most indirect taxes currently in place such as:

Central Taxes	State Taxes
Central Excise Duty [including additional excise duties, excise duty under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955] Service tax Additional Customs Duty (CVD) Special Additional Duty of Customs (SAD) Central Sales Tax (levied by the Centre and collected by the States) Central surcharges and cesses (relating to supply of goods and services)	Value-added tax Octroi and Entry tax Purchase tax Luxury tax Taxes on lottery, betting and gambling State cesses and surcharges Entertainment tax (other than the tax levied by the local bodies) Central Sales tax (levied by the Centre and collected by states)

It will substantially lower the indirect tax incidence over a period of time, which will reduce the costs of manufactured goods. For instance, in the automobile sector, India currently operates at an indirect tax incidence of 32-40% based on class of the cars, whereas China operates at 17% and the global average GST is 16%.

Due to higher indirect tax incidence, our manufactured goods are more expensive. Lowering of indirect taxes will boost domestic consumption of goods by 7 to 10 times as it will bring in disproportionate price elasticity effects which will drive India's economic growth in the next decade. There will be huge benefits of moving to a system that taxes goods and services at the last stage or at the stage of consumption. For the corporates, it simplifies decision-making as companies can now focus on business efficiency rather than tax benefits.

GST removes multiplicity of taxes across states and will create a single national taxation system and a single common market. Also, they will sell goods closer to the markets, by creating fewer modern and at scale warehouses and an efficient inbound and outbound supply chain from these warehouses. As the above transformation happens, logistics sector will have to play a big role to ensure the full benefits of GST flow through the economy.

While India is one of lowest transportation cost markets, it's also one of the most inefficient logistics markets (at 14% of the GDP). The missing piece in the above two seemingly opposite assertions is "inventory".

In the US in 1970's inventory was 55% of logistics spend base, when the logistics spend was 16% of GDP. The spend has now reduced to 7-8% of GDP with inventory cost at only 10% of this spend base. Currently, Indian inventory spend (losses, obsolescence, wastage) can be up to 50-60% of the overall logistics spend. If it were to get to the US level of logistics efficiency, significant amount of capital can be unlocked through inventory.

For a 2-3 trillion dollar economy, this could mean a potential of $200 billion wasteful inventory spend being available to deploy in productive value creation and further propelling economy's growth.

The Indian logistics sector

The Indian logistics sector can fulfil India's GST dream by adopting three bold measures which will have a revolutionary impact on the overall economy.

First, it should enable shorter and predictable transportation lead times. In developed markets, trucks cover 600-800km per day, whereas Indian trucks cover only 250-300km per day due to many factors. India can improve truck efficiency and achieve 800-1000km per day of transit through check post time reduction, better truck technology, road infrastructure upgradation and unique driver management techniques, which can lead to significantly shorter lead times and thus massive reduction in safety stocks. Innovative technology can be further used to make transit times more and more predictable and accurate as has been shown by technologies used in cab app companies.

Second, logistics sector should adopt zero warehousing as the best warehousing strategy. Indian companies have to rethink and be bold about their plant and warehousing footprint. India is large geography, but very well connected and most locations can be reached with 3-5 days of transit with efficient logistics systems. Most successful global players believe in plant fulfilment to provide best logistics efficiencies. Indian companies have to think hard about the need of regional warehousing and gradually eliminate the same. If not fully eliminate, they should build large 1-2 warehouses to reduce storage space and thus inventory in the system.

Last, it should build transparency and visibility of inventory through extensive use of technology. Currently, the US spends 50% of its total logistics spend (which as highlighted above is 6-8% of GDP) on technology. From 70s to now, the US has gradually replaced inventory spend with technology spend, making logistics more reliable and efficient. Through e-commerce and start up ecosystem, India has got to the technology bandwagon. It now has to be used extensively to enable end to end visibility through the supply chains, promoting efficiency by reducing inventory and need of multiple warehousing.

GST reform, along with innovation in logistics sector can be a game changer for Indian economy. It will be a constitutive shift which will propel our economic growth and benefit not only businesses, but also the Indian society in entirety.

GST would bring in significant change in doing business in India. Advocacy for best practices, gearing up for changes in processes, training teams and developing IT systems for being GST compliant are the key areas to be assessed.

The Government is committed to introduce GST by April 2017. Tax payers need to be GST compliant to be able to test system changes in time. Depending on the operating geographies, size and sector, the changes would be substantial and may require proactive planning with a time-bound action plan.

In order to prepare for the implementation of GST, companies need to understand GST policy development and its implications for scenario planning and transition roadmap preparation.

Impact of GST on Business

The key imperatives for companies are:

Understand key areas of impact in their business.

Prepare different scenarios for the design and application of GST.

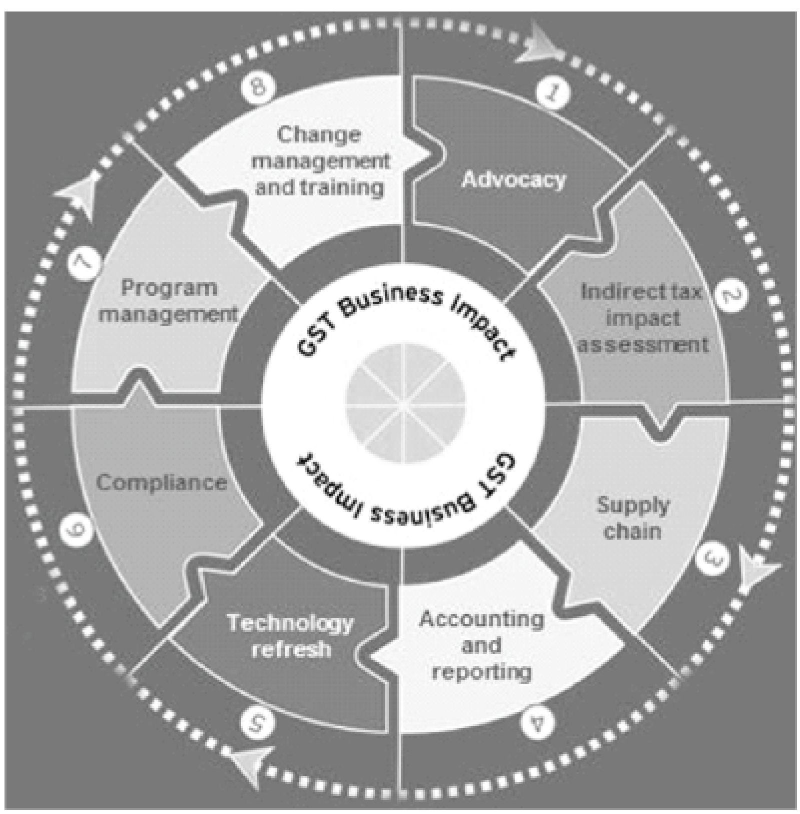
Continually track policy development regarding GST and update prepared scenarios.

Identify any areas of adverse impact and prepare contingency measures.

Identify issues and concerns requiring representation to authorities and develop a strategy for effective advocacy.

Salient Features of GST

The power to make laws in respect of supplies in the course of inter-state trade or commerce will be vested only in the Union Government.



Sourcing	Inter-state procurement could prove viable May open opportunities to consolidate suppliers/vendors Additional duty/CVD and Special Additional duty components of customs duty to be replaced
Distribution	Changes in tax system could warrant changes in both procurement and distribution arrangements Current arrangements for distribution of finished goods may no longer be optimal with the removal of the concept of excise duty on manufacturing Current network structure and product flows may need review and possible alteration
Pricing and profitability	Tax savings resulting from the GST structure would require repricing of products Margins or price mark-ups would also need to be re-examined
Cash flow	Removal of the concept of excise duty on manufacturing could result in improvement in cash flow and inventory costs as GST would now be paid at the time of sale/supply rather than at the time or removal of goods from the factory.
System changes and transaction management	Potential changes to accounting and IT systems in areas of master data, supply chain transactions, system design Existing open transactions and balances as on the cut-off date need to be migrated out to ensure smooth transition to GST Changes to supply chain reports (e.g., purchase register, sales register, services register), other tax reports and forms (e.g., invoices, purchase orders) need review Appropriate measures such as training of employees, compliance under GST, customer education, and tracking of inventory credit are needed to ensure smooth transition to the GST regime

States will have the right to levy GST on intra-state transactions, including on services.

The Centre will levy IGST on inter-state supply of goods and services. Import of goods will be subject to basic customs duty and IGST.

GST is defined as any tax on supply of goods and services other than on alcohol for human consumption.

Central taxes such as Central Excise duty, Additional Excise duty, Service tax, Additional Custom duty and Special Additional duty as well as state-level taxes such as VAT or sales tax, Central Sales tax, Entertainment tax, Entry tax, Purchase tax, Luxury tax and Octroi will subsume in GST.

Petroleum and petroleum products, i.e., crude, high speed diesel, motor spirit, aviation turbine fuel and natural gas, shall be subject to GST - date to be notified by the GST Council.

Provision will be made for removing imposition of entry tax /Octroi across India.

Entertainment tax,, imposed by states on movie, theatre, etc., will be subsumed in GST, but taxes on entertainment at panchayat, municipality or district level will continue.

GST may be levied on the sale of newspapers and advertisements. This would mean substantial incremental revenues for the Government.

Stamp duties, typically imposed on legal agreements by states, will continue to be levied.

Administration of GST

Administration of GST will be the responsibility of the GST Council, which will be the apex policy making body for GST. Members of GST Council comprise Central and State ministers in charge of the finance portfolio.