GST: A Reality

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All set for July rollout


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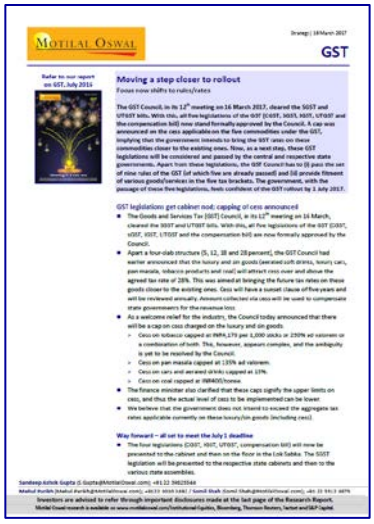
GST Council finalizes tax rates

Paves the way for July rollout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GST

Moving a step closer to rollout

Focus now shifts to rules/rates

Beginning of a new era

One tax benefits max

After a long wait, in one of its biggest indirect tax reforms, India finally implemented GST with effect from July 1, 2017. Like all big transformations, we believe GST will create disruption in the near term. However, in the long term, it is expected to (a) simplify and rationalize taxes, (b) shift trade from the unorganized to the organized segment, and (c) improve efficiency in the system. On the macro front, we believe this will be revenue accretive for the government, with the tax base expanding though tax rates on various products remain close to the current effective tax rates. While reported CPI is likely to remain stable, consumers might feel the pinch due to higher taxation on services. We believe big disruptions like GST also create opportunities in equity markets.

India's biggest tax reform a reality now

- The indirect tax regime in India is being completely overhauled with the migration to GST with effect from July 1, 2017. We believe this would simplify and rationalize taxes, shift trade from the unorganized to the organized segment, and improve efficiency in the system.
- The real value of GST would be in the area of tax governance, where a system plagued with a plethora of discretionary, ad-hoc taxes would move toward a ruled-based, transparent and stable tax regime. This would make the tax system fairer by ensuring 'neutrality' across players, products or services, locations or business cycles.

Near-term pain for long-term gain

- Our channel checks suggest that while the larger corporates are well prepared for the change, SMEs and other trade participants are still grappling to understand its impacts and procedures. This is likely to create trade disruption in the economy in the near term.
- However, in the long term, this is likely to simplify taxation and provide ease of doing business in India. We believe that four key themes would emerge, which might have a significant impact on India Inc: (a) change in effective tax rates for various products and services, (b) availability of seamless input credit across the value chain, (c) shift of trade from currently unorganized segments to organized segments, and (d) rejig in supply chain management.

Revenue accretive for government; reported inflation unlikely to rise

- The GST rates for most products have been retained in the bands closest to the respective current effective rates and the tax on services has been hiked only slightly. Yet, we believe government revenues would increase over the medium term, with expansion in the tax base (since the exemption list will be pruned and threshold for levying tax reduced) and reduction in tax evasion.
- Over time, we expect the government to look at rationalizing taxes to further encourage the shift towards the organized segment.

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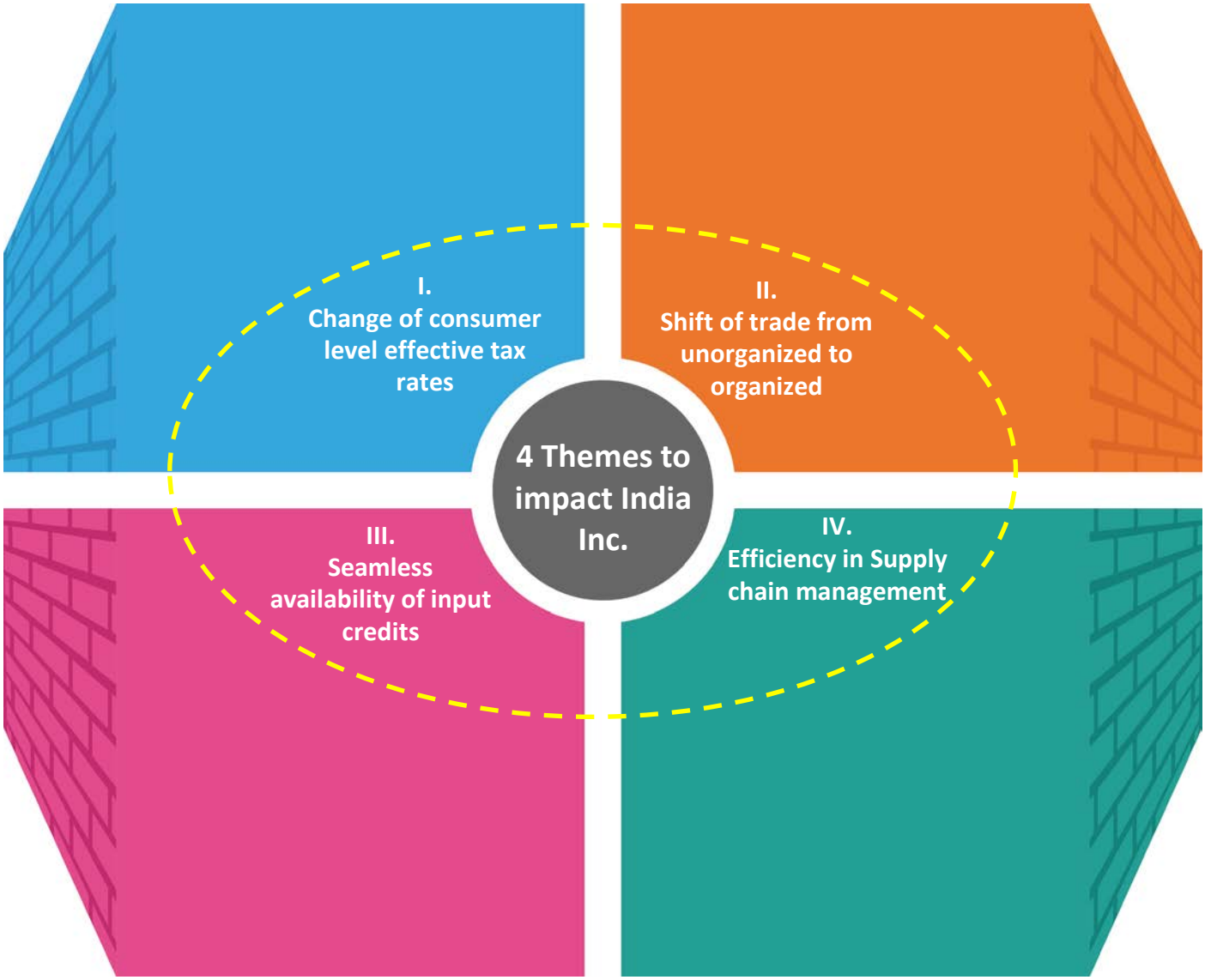
- As far as the impact of GST on inflation is concerned, the GST rates will help reduce wholesale price index (WPI), while the impact on consumer price index (CPI) will be limited. However, since services constitute a larger share of the consumption basket than in CPI, Indian consumers are likely to feel the pinch of higher prices of services.

India Inc to be big beneficiary

- Our analysis highlights that sectors/companies likely to emerge as gainers are: (a) Consumer – Pidilite, Asian Paints, Century Plyboards; (b) Autos – Hero MotoCorp, Amara Raja Batteries, Exide Industries; (c) Multiplexes – PVR, Inox; (d) Media – Dish TV; (e) Retail – Shoppers Stop; and (f) Logistics – TCI, Gati.
- Sectors/companies likely to be adversely impacted: (a) Media: Print companies – HMVL, DB Corp, Jagran Prakashan, HT Media; (b) Autos – Ashok Leyland.

Four themes under GST



Source: MOSL

GST: Complete overhaul of indirect tax system

Dawn of simpler, unified taxation regime

- **GST will be a destination-based tax on a comprehensive base of goods and services across the value chain. It aims to address the complexities in the current multiple taxation regime.**
- **It will subsume the plethora of indirect taxes levied by various levels of government and help to (a) lower the tax incidence on organized manufacturing, (b) expand the narrow tax base, and (c) provide ease of doing business.**

- Considering the federal structure of government, it will have two components – CGST and SGST. While CGST will be levied and collected by the central government, SGST will be levied and collected by the state government in whose jurisdiction the goods / services are consumed.
- GST will facilitate a seamless flow of input credit across the entire supply chain. Introduction of GST will rationalize the tax content in product price, enhance the ability of business entities to compete globally, and possibly trickle down to benefit the ultimate consumer. Better compliance should address instances of tax evasion by expanding the base.

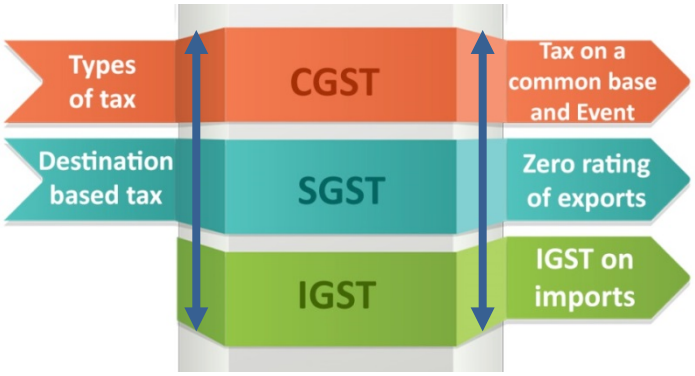
Exhibit 1: Taxes to be subsumed under GST

	Center	States
Taxes to be subsumed under GST that finds a mention in the Constitutional Amendment Bill	■ Central Excise Duty (CENVAT) ■ Additional Excise Duties ■ Service Tax ■ Additional Custom Duty in the nature of countervailing duty ■ Special Additional Duty of Customs ■ Surcharges and cesses that relate to supply of goods and services	■ Sales Tax (VAT) ■ Central Sales Tax (levied by Centre) ■ Entertainment Tax (unless levied by local bodies) ■ Purchase Tax ■ Octroi and Entry Tax in lieu of octroi ■ Luxury Tax ■ State Surcharges and cesses that relate to supply of goods and services ■ Taxes on lottery, betting and gambling
A few other taxes that may be subsumed	■ Cesses on rubber, tea, coffee, etc. ■ Surcharges (National Calamity, Education Cess, etc.)	■ State Excise Duty (except liquor)
Taxes to be subsumed under GST in due course by GST Council	■ Petrol and Petroleum Products	■ Petrol and Petroleum Products
Taxes that would be definitely kept out of GST	■ Basic Customs Duty, Anti-dumping Duty, ■ Export Duty	■ Alcoholic liquor for human consumption
Taxes that are unlikely to be subsumed in GST	■ Excise Duty on tobacco products ■ Specific Cess ■ Specific Central Cess like education and oil cess	■ Property Tax ■ Tax on consumption of electricity ■ Stamp Duty

Source: Government, MOSL

- Under the new GST structure the center would levy and collect central goods and services tax (CGST), and the states would levy and collect state goods and services tax (SGST) on all transactions within the state.
- In case of inter-state sale of goods and import of goods in the country, IGST would be applicable. IGST again would have two components – CGST and SGST. SGST would go to the state where the ultimate consumption of goods takes place. The GST framework does not allow for any specific region-wise exemptions (available for backward areas) or other exemptions; else, these would result in breaking the value chain.

Evolving model and features of GST



Source: Government, MOSL

GST: Addresses shortcomings in the current structure

By subsuming most of the indirect taxes and applying homogenous tax rates on goods and services, GST will:

- **Rationalizing the price of goods and services:** GST aims to tax goods and services at a common rate, thereby rationalizing the effective tax rates for goods and services. Further, tax cascading and availability of seamless input credits across the value chain would help lower prices.
- **Broadening the tax base:** GST aims at broadening the tax base by (a) lowering the threshold limit for applicability of indirect tax, (b) permitting the center to levy taxes on sale of goods and the states to levy taxes on rendering of services, and (c) rationalizing the various exemptions available under the current regime.
  a) **Differential thresholds:** With the introduction of GST, the threshold for all indirect taxes would be INR1m, which is significantly lower than the current threshold of INR15m for excise and in line with the current threshold of INR1m for service tax.
  b) **Taxing power of the center and the states:** With the introduction of GST, the center would be able to tax the entire value of goods, not just the value till the point of manufacture. The states would get a proportional share of the tax on all services provided in the country.
  c) **Various exemptions:** With the introduction of GST, the list of product-wise exemptions is expected to be trimmed to ~100 goods/services (from the current ~300 goods by the center and ~100 by the state governments). Further, it is proposed that various area-based exemptions would be available.
- **Ease of doing business:** GST aims to simplify the taxation regime by subsuming most indirect taxes. Further, the following anomalies in the current tax regime would get addressed:
  a) **Determining the nature of transactions:** With the introduction of GST, there would be no difference between sale of goods and services for the purpose of taxation. This would lead to reduction in litigation issues and also facilitate taxation of bundled services.
  b) **Uniformity in provisions and rates**: With the introduction of GST, there would be a single rate of tax for a particular goods and services as well as uniform provisions/rules for all states and the center. This would facilitate free movement of goods and services across the country and also lead to greater compliance.

GST benefits visible in many different shades

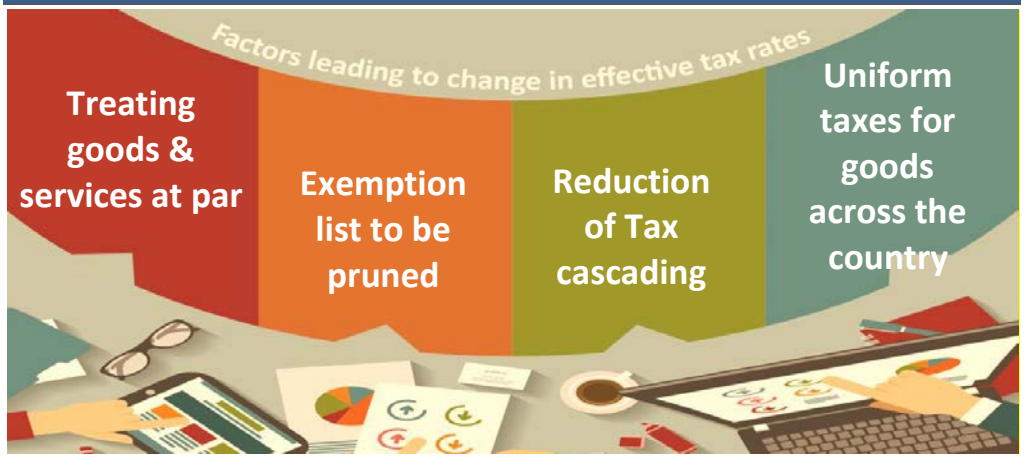
Four key themes emerging

- **Four key themes emerge, which will have an impact on India Inc: (a) change in consumer-level effective tax rates, (b) shift of trade from unorganized to organized segment, (c) seamless availability of input credits, and (d) improved efficiencies in supply chain management.**

THEME #1 Change of consumer level effective tax rates

- There exists wide variability in the current effective indirect tax levies across sectors, primarily on account of (a) different classification of goods and services, (b) exemptions/concessions available to various goods/services under different statutes, and (c) cascading impact of taxation, which brings inefficiencies in the system.
- GST is expected to simplify the tax structure and change the effective tax rates on various sectors by:

Factors leading to change in effective tax rates



Source: Government, MOSL

- GST is likely to keep effective tax rates intact for most sectors. However, this would have a material implication only for those companies (a) that have the pricing power to retain the decrease or do not have the pricing power to pass on the increase in effective tax rates, or (b) where increase / decrease in consumer pricing would impact volume growth, and hence, corporate earnings.

Exhibit 2: Rate structure under GST

Category	GST Rate	Goods / services
Exempted/zero rated	0	Essential food and services
Special category for Gold	3	Gold
Lower rate	5	Commodities, essentials
Standard rate 1	12	General use Goods
Standard rate 2	18	Services, certain consumer durables/ staples, metals
Higher rate	28	Autos, consumer discritionary, personal products
Sin/demerit goods	28 + cess	Aerated drinks, tobacco products, pan masala, luxury cars

Source: GST council, MOSL

Exhibit 3: Impact of GST on sectors

Sector	Current Effective tax rate	GST rate	Remarks
Consumers			
Paints	25-26%	28%	❖ Neutral: Companies will be able to pass price increase to consumers
Toothpaste	25-26%	18%	❖ Positive: Reduction in duty rates may be passed on to generate volume benefits or may be partially retained to improve margins
Adhesive	22-23%	18%	❖ Positive: Reduction in duty rates may be passed on to generate volume benefits or may be partially retained to improve margins
Soaps	25-26%	18%	❖ Positive: Reduction in duty rates may be passed on to generate volume benefits or may be partially retained to improve margins
Biscuits	5-17%	18%	❖ Neutral: Duty incidence is broadly maintained
Cigarettes	28% + excise depending on length	28% + cess (as per length + ad valorem)	❖ Neutral: Tax incidence is broadly maintained at current level and hence no major impact
Auto			
2 Wheelers	30-31%	28%	❖ Marginally positive: Entry-level two-wheelers can derive some volume benefit on reduction in tax rate by 2-3%
Motorcycles (engine>350cc)	30-31%	31%	❖ Neutral
3 Wheelers	30-31%	28%	❖ Neutral: Companies will have to pass on benefit to consumers
4 Wheelers	31-49%		❖ Neutral: Tax rates are broadly same as current rates. Change in tax rates whatever applicable will be passed on
Small Cars (length < 4 m ; Petrol<1200 cc)		29%	
Small Cars (length < 4 m ; Diesel < 1500 cc)		31%	
Mid Segment Cars (engine < 1500 cc)		43%	
Large Cars (engine > 1500 cc)		43%	
Sports Utility Vehicles (length > 4m ; engine		43%	
1500 cc; ground clearance > 170 mm)		43%	
Mid Segment Hybrid Cars (engine < 1500 cc)		43%	
Hybrid motor vehicles > 1500 cc		43%	
Hydrogen vehicles based on fuel cell tech > 4m		43%	
CV	30-31%	28%	❖ Neutral: Companies will have to pass on benefit to consumers
Auto Anc			
Batteries	29-30%	28%	❖ Slightly positive: Companies may retain a portion of reduced tax rates, which may improve margins
Tyres	24-28%	28%	❖ Neutral: Tax incidence is broadly maintained at current level and hence no major impact
Cement	22-24%	28%	❖ Neutral: Increase in tax rates will be pass-through and is unlikely to impact volumes
Metals	19-21%	18%	❖ Neutral: Reduction in duty rates will be passed on to consumers
Pharma	4-14%	5-12%	❖ Neutral: Duty incidence is broadly maintained for pharmaceutical products
Capital Goods – Light electrical and aircon	22-26%	28%	❖ Neutral: Marginal increase in tax rates is likely to be passed to consumers
Capital Goods – Project	22%	18%	❖ Neutral: Decrease in tax rates will be passed on to customers
Information Technology	15%	18%	❖ Neutral: Increase in rate will be offset by availability of input tax credit
Telecom	15%	18%	❖ Neutral: Competitive intensity remains high, leaving little

Sector	Current Effective tax rate	GST rate	Remarks
			chance to pass on duty hike to consumers ❖ But input tax credit of ~150bp from VAT could reduce the impact
Multiplex			❖
Ticketing	25%-27%	28%	❖ Limited benefit from availability of input tax credit offset by increase in duty for F&B
F&B	10.50%	20-21%	
Pay TV Distributor	21%	18%	❖ Positive
Print media	0%	5%	❖ Slightly Negative: 5% increase in tax rate on 2/3 of revenue, cushioned by input tax available on ½ of costs
Home Building			
Tiles / Sanitary ware	25-28%	28%	❖ Neutral: Will slightly increase product price differential between unorganized and organized players, boosting competitiveness of unorganized players
Ply wood	24-25%	28%	❖ Neutral: Will slightly increase product price differential between unorganized and organized players, boosting competitiveness of unorganized players
Gems and Jewellery	2%	3%	❖ Hike likely to be passed on
Ready Made garments- Above 1000	6-8%	12%	❖ Neutral as increase will be cushioned by input tax credit
Ready Made garments – Below 1000	5-7%	5%	❖ Neutral
Textiles - Natural	0%	5%	❖ Companies will be able to pass on the increase
Textiles – Man Made	12.50%	18%	❖ Increase will be passed on

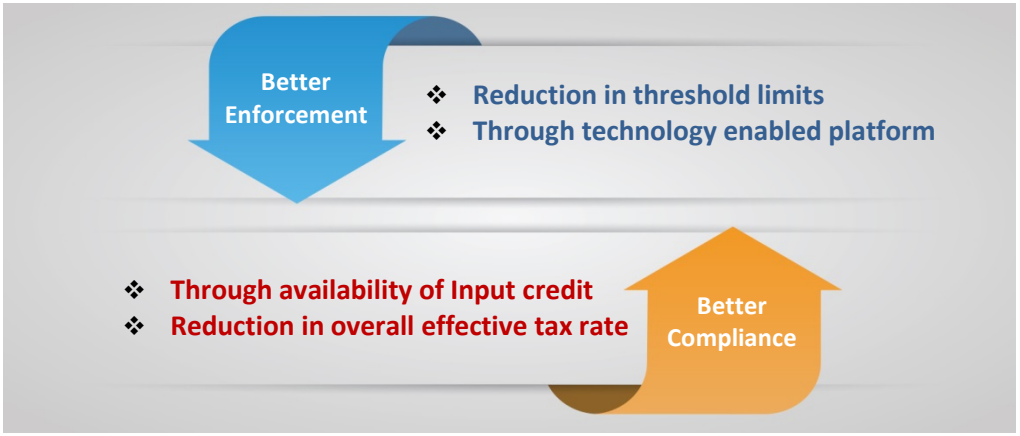
Source: MOSL

- **Key sectors to benefit**: Autos (Two Wheelers) , Batteries, Consumer, Pay TV Distributors, Multiplexes
- **Key sectors to be negatively impacted:** Print Media

THEME #2 Shift of trade from unorganized to organized

- India has significant presence of the unorganized sector. A National Commission for Enterprises in Unorganized Sector (NCEUS) report estimates that in 2005, out of the 485m persons employed in India, 86% or 395m worked in the unorganized sector, generating 50.6% of the country's GDP.
- GST implementation is expected to narrow the large indirect tax differential between the organized and unorganized players.
- This would be achieved by ensuring better compliance and enforcement by (a) reducing the threshold limit for exemption from indirect taxes (to INR2m under GST from the current INR15m under excise), (b) tracking the flow of GST credit in the entire value chain using technology platforms, (c) ensuring availability of seamless input credit, and (d) reducing the overall effective tax rates.

Measures that will lead to shift of trade from unorganized to organized



Source: MOSL

- We believe this will present opportunities to take advantage of the shift in favor of organized names. However, our discussions with experts and sector participants highlight that the shift will be prompt for some sectors, gradual for others and challenging for a few.
- To play this theme, one has to carefully consider (a) probability/timing of the shift and (b) market share expansion potential, with narrowing price differential between organized and unorganized players.

- **Potential beneficiaries:** Significant unorganized markets exist in the following sectors: Logistics, Home building, Capital Goods (Light Electrical), Consumer and Retail.

Exhibit 4: Significant market share of unorganized players across sectors

Sector	Total Market size	Organized		Unorganized		Top organized listed players
	INR b	INR b	%	INR b	%	
Home building						
Paints	406	264	65%	142	35%	Asian Paints, Berger Paints, Kensai Nerolac
Adhesive	60	42	70%	18	30%	Pidilite, Jyoti resins & adhesives
Plywood	250	88	35%	163	65%	Century plyboards, Greenply industries
Tiles	260	129	49%	131	51%	Kajaria ceramics, Somany ceramics
Luxury/ Sin Goods						
Jewellery	3,000	750	25%	2,250	75%	Titan, Tribhovandas bhimji zaveri, PC Jewellers
Alcohol	410	205	50%	205	50%	United spirits, United breweries, Radico Khaitan
Cigarettes	1,750	1,488	85%	263	15%	ITC, VST industries, Godfrey phillips
Watches	89	45	50%	45	50%	Titan
FMCG						
Biscuits	186	121	65%	65	35%	Britannia, ITC
Hair Oil	80	40	50%	40	50%	Marico, Bajaj Corp, Dabur
Beverages	524	262	50%	262	50%	Dabur, ITC, Manpasand beverages
Dairy	5,371	1,077	20%	4,295	80%	Parag milk, Prabhat Dairy, Heritage foods
Detergents	200	160	80%	40	20%	Hindustan Unilever, P&G, Jyoti laboratories
Tea And Coffee	100	50	50%	50	50%	Hindustan Unilever, Tata global beverages, Nestle

Sector	Total Market size	Organized		Unorganized		Top organized listed players
	INR b	INR b	%	INR b	%	
Consumers - others						
Footwear	336	134	40%	202	60%	Bata, Relaxo footwear
Garments - Innerwear	200	104	52%	96	48%	Page industries, Rupa industries
Apparel	3,550	960	27%	2,590	73%	Arvind, ABFRL
Plastic	900	540	60%	360	40%	Supreme industries, Sintex industries, Jain irrigation
Luggage	40	13	33%	27	67%	VIP industries, Safari industries
Light Electricals						
Fans	60	45	75%	15	25%	Crompton greaves consumer, Havells, Bajaj electricals
Pumps	92	64	70%	28	30%	Kirloskar brothers, KSB pumps, Crompton greaves consumer
Air Coolers	27	5	20%	22	80%	Symphony, Havells, Voltas
Domestic Switchgear	20	19	95%	1	5%	Havells, ABB, Siemens
Industrial Switchgear	38	29	75%	10	25%	Havells, Schneider electric, Siemens
Modular Switches	20	12	60%	8	40%	Havells
Domestic Wires And cables	80	64	80%	16	20%	Finolex cables, Havells, KEI industries
Industrial Cables	120	72	60%	48	40%	KEI industries, Finolex cables
Electrical Lighting	122	73	60%	49	40%	Crompton greaves consumer, Bajaj Electricals, Havells
Healthcare						
Diagnostic	435	65	15%	370	85%	Dr. Lal Pathlabs, Thyrocare technologies
Hospitals	4010	401	10%	3609	90%	Apollo hospitals, Fortis healthcare, Narayana Hrudayalaya
Logistics						
Logistics - Road	6,800	340	5%	6,460	95%	TCI, VRL, GATI
Auto						
Batteries	230	150	65%	80	35%	Exide, Amara Raja
Tyre	500	400	80%	100	20%	MRF, Apollo, CEAT, JK Tyre
Metals	4600	4140	90%	460	10%	Tata Steel, JSW Steel, SAIL

Source: MOSL

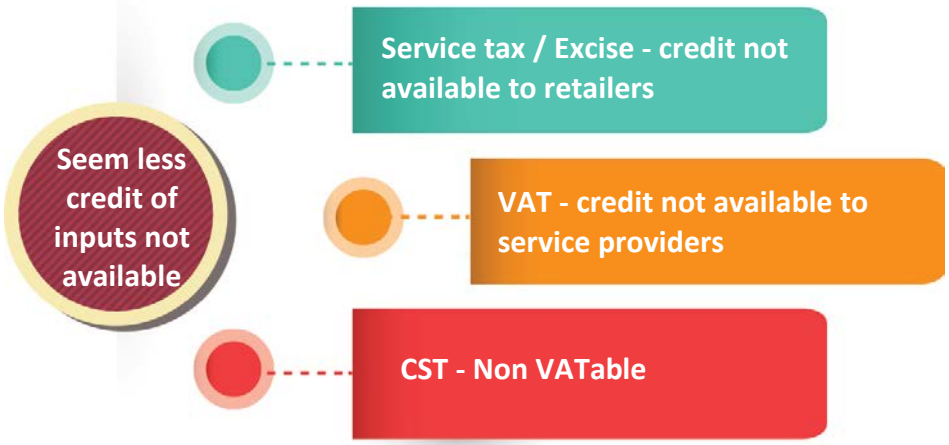
THEME #3 Seamless availability of input credits

- Under the current regime, the taxes levied by different levels of government / different states are not allowed to be set off against each other. For example:
  a. Excise duty paid to the central government for manufacture of goods is not allowed to be set off against state VAT payable on sale of goods and vice versa.
  b. In the service industry, companies have to incur service tax liability on sales. However, they also spend sizeable portions on capex on which they are charged VAT. Current regulations do not allow service tax to be set off against VAT and vice versa.

c. State VAT paid on inputs in one state is not available for set off if the output is sold in another state. However, on payment of CST on declared goods, a dealer can claim refund of VAT paid to the originating state in case of inter-state sale.
d. Central sales tax of 2% is a non-VATable tax, and hence, increases the cost of goods.
e. Companies trading goods (retailers), which pay VAT, are not allowed to claim credit for the service tax paid on different items since they have no central tax against which this can be set off.

- Unavailability of input credit makes the current system complex and inefficient, resulting in increased cost for businesses. This is likely to get addressed under GST when the plethora of multiple taxes is subsumed under a single tax.

Seamless credit of inputs not available currently



Source: Company, MOSL

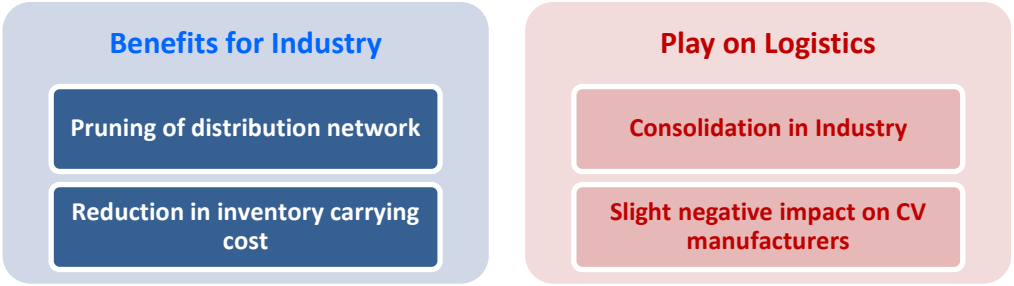
- This would particularly benefit retailers, multiplexes that operate through leased stores and pay significant indirect taxes (service tax) on lease rentals. The GST regime would allow these indirect taxes to be set off.

THEME #4 Efficiency in supply chain management

- Currently, decision making in supply chain management is based not only on business requirements but also on tax planning. The current legal framework exempts CST if interstate movement of goods is for stock transfer and not for sale.
- Consequently, in several sectors, companies open various depots and appoint C&F agents to avail this exemption and incur additional costs.
- Under GST, since CST is subsumed, supply chain management would become a pure play of business requirements. In several sectors, we expect consolidation of the current supply chain, leading to reduction in operational cost on the one hand and lower inventory carrying cost on the other.

- Logistics would emerge as a big sector, with consolidation in the industry.
- Implementation of GST may also be slightly negative for CV manufacturers, as this would help ease bottlenecks in logistics, especially time spent at check posts for local taxes. This would increase the on-road time for the fleet and enhance fleet productivity, diluting the need for fleet expansion and reducing CV growth over the medium term.

Exhibit 5: Supply chain consolidation to yield material benefits



Source: Company, MOSL

- **Key sectors to benefit:** Logistics, FMCG, Metals and Light Electricals
- **Key sectors to be negatively impacted:** Automobiles – CV Manufacturers

Economic impact of GST

Revenue accretive over the medium term

With the increase in the tax base, GST is likely to be revenue accretive for the government over the medium term. It is unlikely to impact reported inflation adversely, but consumers are likely to feel the pinch since 47% of the consumption basket comprises of services, on which the effective tax rate would be 3% higher in the GST regime.

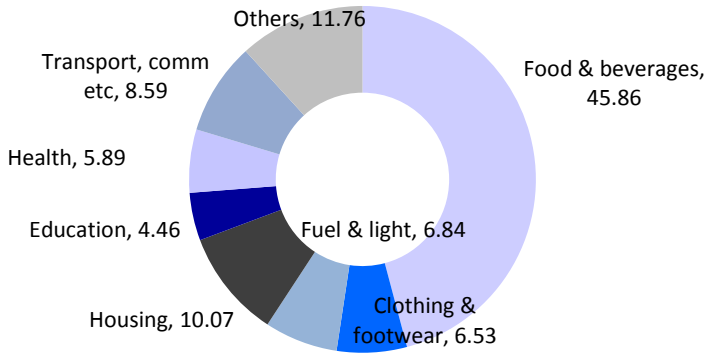
How will GST impact government receipts?

- While fixing the GST rates, the government had attempted to contain inflation by keeping the rates on various products close to the prevailing rates. However, for services, the GST rate is slightly higher.
- GST intends to increase the tax base by (a) lowering the threshold limit for applicability of indirect tax, (b) permitting the center to levy taxes on sale of goods and the states to levy taxes on rendering of services, and (c) rationalizing the various exemptions available.
- With widening of the tax base, we believe government revenues would increase over the medium term. Over time, we expect the government to rationalize tax rates to further encourage the shift towards the formal economy.

CPI expected to remain largely unchanged

- As far as the impact on consumer price index (CPI) is concerned, it is unlikely to be affected much, since food constitutes almost half the basket and other items such as fuel also hold high weightage. A large part of CPI will either be exempted or continue to attract similar tax rates.

Exhibit 6: Food, fuel & rent have high weight in CPI

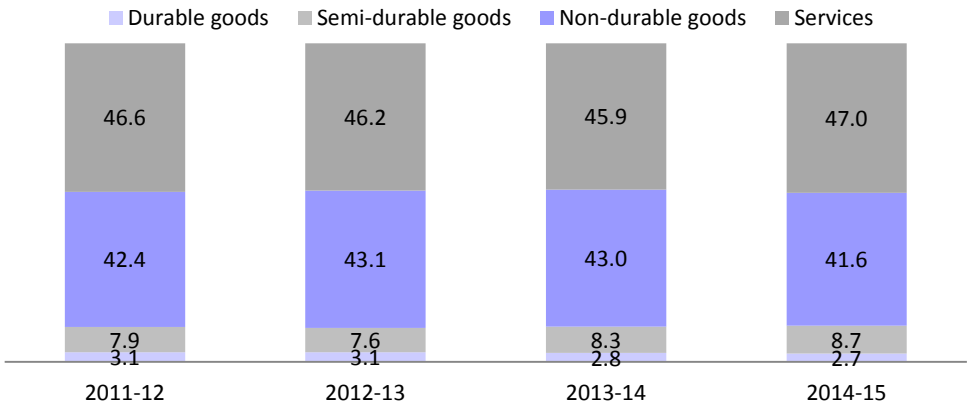


Source: Government, MOSL

However, consumers are likely to feel the pinch

- Importantly though, while services comprise a very small share in CPI, they account for almost 50% of the total consumption basket in the economy. Thus, while the impact of GST may not be visible in the official inflation measures, it will certainly pinch Indian consumers, as the share of services has been rising.

Exhibit 7: Services account for ~47% of Indian consumption basket



Source: Government, MOSL

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