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GST & its Probable Impact on the FMCG Industry in India

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ABSTRACT

Goods and Services Tax (GST) will be a game changing reform for Indian economy by developing a common Indian market and reducing the cascading effect of tax on the cost of goods and services. GST is a consumption based tax levied on sale, manufacturing and consumption on goods & services at a national level. Many taxes such as central excise duty, service tax, central surcharge and cess etc. levied by Central Government and VAT / sales tax, entertainment tax, octroi & entry tax, purchase tax, luxury tax, taxes on lottery etc. levied by State Governments have been subsumed under GST.

The fast moving consumer goods (FMCG) sector of India comprises more than 50 percent of the food and beverage industry and another 30 percent from personal and household care, thereby spanning the entire rural and urban parts of the country (Subramanian, 2015). Under the proposed GST regime, it is expected that it would result in a simpler tax regime, especially for industries like FMCG. Presently the peak tax costs for industry players amount to approximately 27% (i.e. Excise Duty of 12.5% and VAT ranging from 12% to 15%). Under the GST regime, it is proposed that the revenue neutral rate would be in the range of 16% to 19%, thereby resulting in significant benefit for the sector.

Key Words: GST, FMCG, Tax.

Introduction: The Goods and Services Tax (GST), the biggest reform in India's indirect tax structure since the economy began to be opened up 25 years ago, at last looks set to become reality. The Constitution (122nd) Amendment Bill finally got the nod of Rajya Sabha. Government successfully stitching together a political consensus on the GST Bill, to pave the way for much-awaited roll out of the landmark tax reform that will create a common market of 1.25 billion people. GST will be a game changing reform for Indian economy by developing a common Indian market and reducing the cascading effect of tax on the cost of goods and services. It will impact the Tax Structure, Tax Incidence, Tax Computation, Tax Payment, Compliance, Credit Utilization and Reporting leading to a complete overhaul of the current indirect tax system. Law, provide for compensation100% to States for any loss of revenues arising on account of GST, for a period which may extend to five years, based on the recommendations of the GST Council Here, every tax payer will be issued a 15 digit common identification number which will be called as "Goods & Service Tax Identification Number" (GSTIN) a PAN based number.

GST is a consumption based tax levied on sale, manufacturing and consumption of goods & services at a national level. Many taxes has been subsumed under GST which are as under

Central Indirect Taxes & Levies	• Central Excise Duty • Additional Excise Duties • Excise Duty levied under the Medicinal Preparations (Excise Duties) Act, 1955 • Service Tax • Additional Customs Duty (CVD) • Special Additional Duty of Customs • Central Surcharge and Cess
State Indirect Taxes & Levies	• VAT / Sales Tax • Entertainment Tax (other than the tax levied by local bodies) • Central Sales Tax • Octroi & Entry Tax • Purchase Tax • Luxury Tax • Taxes on Lottery Betting and Gambling • State Cesses and Surcharges

Items not covered under (as in Proposed Draft) GST:
Alcohol, tobacco, petroleum product etc. are not covered under GST.

Objectives of the Paper

This paper deals how proposed Goods and Services Tax will affect the economy of India. The paper has the following objectives:

1. To understand how GST will operate in various cases.
2. To understand how it will become boon or bane for Indian Economy.
3. To study the proposed impact of GST on the FMCG Industry in India.

Research Methodology:

The main objective of the study is to compare the current and proposed tax system in India by studying the applicability of GST in various cases. The secondary data has been used for this study.

Dual GST model:

The Dual GST model and the taxes levied on each kind of transaction and procedure of set off of GST can be understood with the help of illustration given below:

The GST can be of three type viz. (i) SGST – 'State GST' collected by the State Government, (ii) CGST – 'Central GST' collected by the Central Government and (iii) IGST – 'Integrated GST' collected by the Central Government.

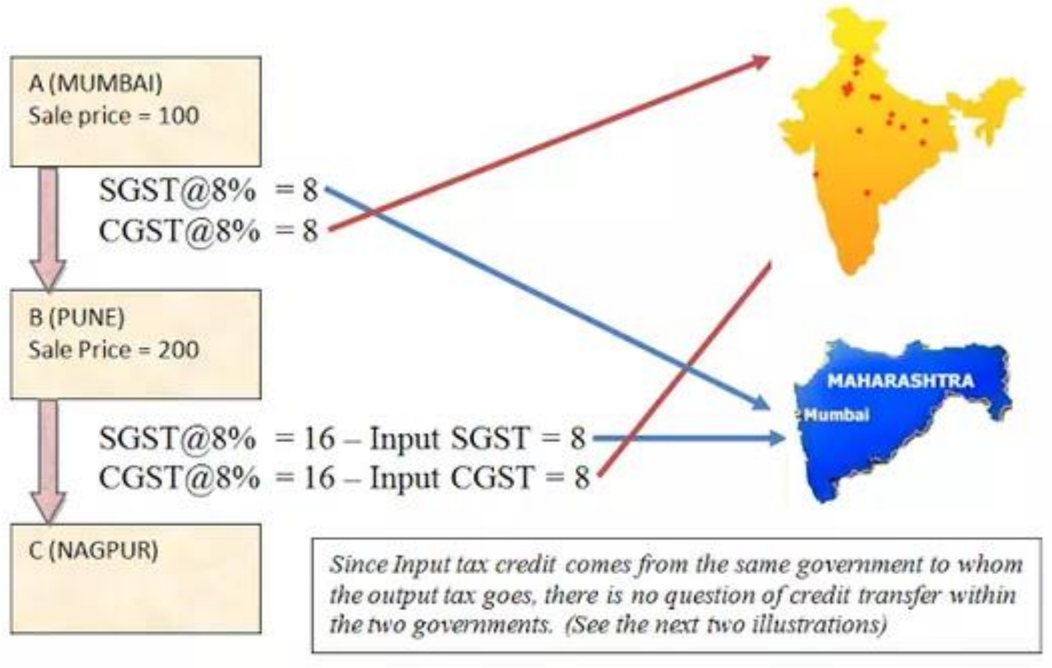
How GST operates?

Let us understand how GST will operate under the new system. Three cases have been taken to clarify how GST will operate under the proposed system-

Case 1: ***Sale in one state, resale in the same state***

In the Figure 1 **(Asawa, 2016)**, goods are moving from Mumbai to Pune. Since, it is a sale within a state, CGST and SGST will be levied. The collection goes to both the Central Government and the State Government as described in the diagram. Then the goods are resold from Pune to Nagpur. This is again a sale within a state, so CGST and SGST, both will be levied. Sale price is increased so tax liability will also increase. In the case of resale, the credit of input CGST and input SGST (Rs. 8) is claimed as shown; and the remaining taxes go to the respective governments.

Figure 1: Applicability of GST in case of sale in one state followed by resale in the same state



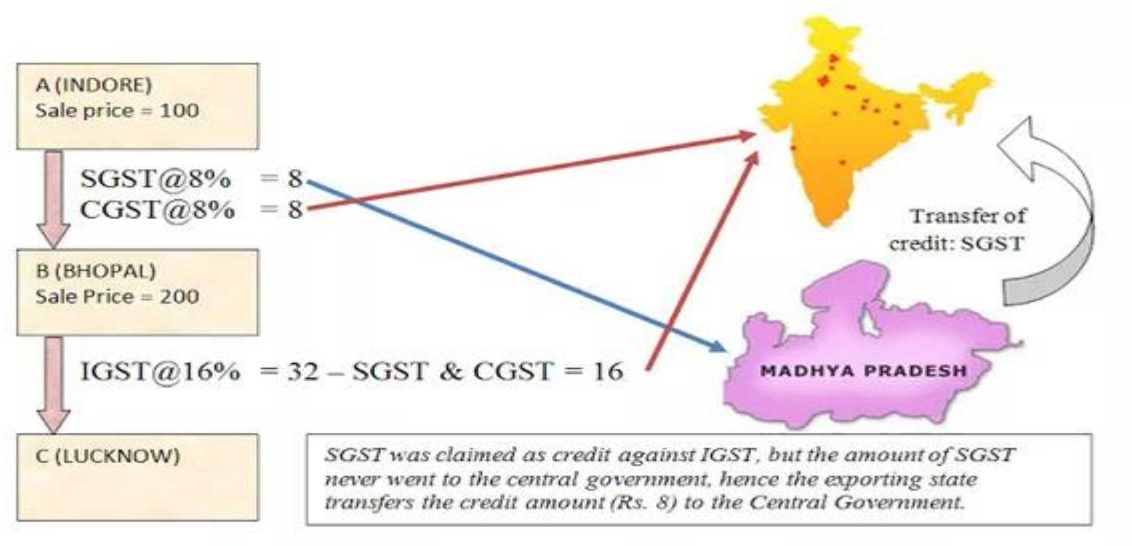
Note. Adapted from *"What is the difference between the current taxation and the new Goods and Service Tax (GST) in India: What is the impact"*, by P. Asawa, 2016.

Case 2: ***Sale in one state, resale in another state***

In Figure 2 **(Asawa, 2016)**, goods are moving from Indore to Bhopal. Since, it is a sale within a state, CGST and SGST, both will be levied. The collection goes to both, the Central Government and the State Government as pointed out in the diagram. Later, the goods are resold from Bhopal to Lucknow (outside the state). Therefore, IGST will be levied. Whole IGST goes to the central government.

Against IGST, both the input taxes are taken as credit. But we see that SGST never went to the central government, still the credit is claimed. This is the crux of GST. Since this amounts to a loss to the Central Government, the respective State Government will compensate the central government by transferring the credit to the Central Government.

Figure 2: Applicability of GST in case of sale in one state followed by resale in another state

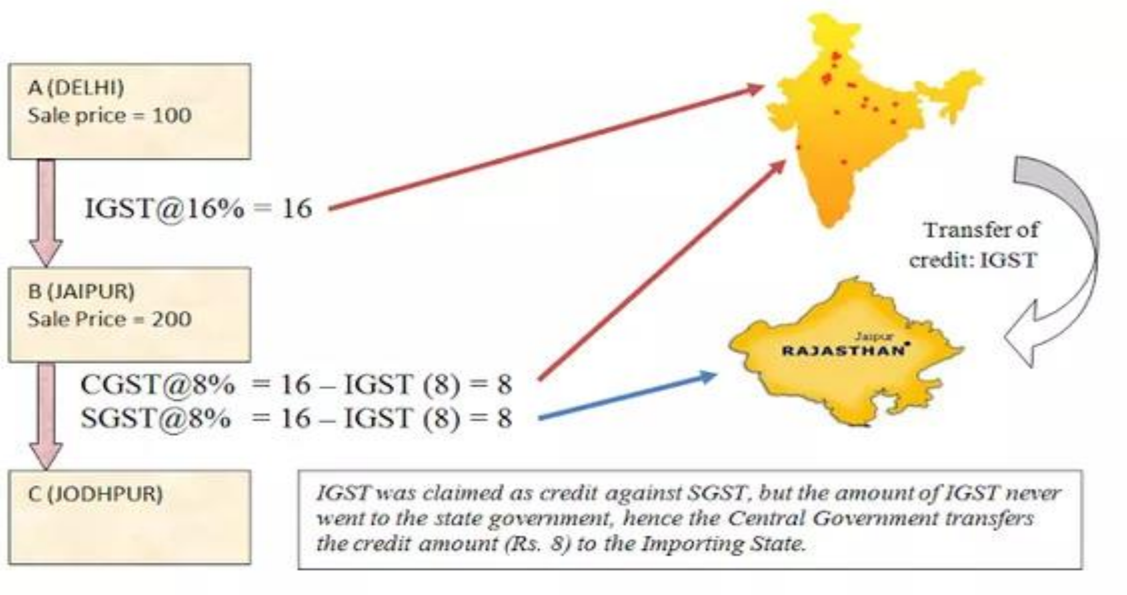


Note. Adapted from *"What is the difference between the current taxation and the new Goods and Service Tax (GST) in India: What is the impact"*, by P. Asawa, 2016.

Case 3: ***Sale outside the state, resale in that state***

In Figure 3 **(Asawa, 2016)**, goods are moving from Delhi to Jaipur. Since it is an interstate sale, IGST will be levied. The whole collection will go to the Central Government. Later the goods are resold from Jaipur to Jodhpur (within the state). Therefore, CGST and SGST will be levied.
Against CGST and SGST, 50% of the IGST that is Rs. 8 is taken as a credit. But one can see that IGST never went to the respective State Government, still the credit is claimed against SGST. Since this amounts to a loss to the State Government, the Central government will compensate the State Government by transferring the credit to the State Government.

Figure 3: Applicability of GST in case of sale outside the state followed by resale in that state



Note. Adapted from *"What is the difference between the current taxation and the new Goods and Service Tax (GST) in India: What is the impact"*, by P. Asawa, 2016.

Table 1: COMPARISION OF CURRENT AND PROPOSED SYSTEM AT A GLANCE

• (Existing System – Sale With In State)

Particular	Input Manufacturer	Output Manufacturer	Dealer	Total Revenue Tax
Cost Of Material	-	100	121	-
Cost Material Assuming Profit @10%	100	110	133.10	
Excise @10%	10	11.00-10.00=1.00 (110*10%-Input)	-	11.00(Centre Government) (10.00+1.00)
VAT @10%	11(110*10%)	12.10-11.00=1.10 (121*10%-Input)	13.31-12.10=1.21 (133.10*10%-Input)	13.31(State Government)
Total	121.00	133.10	146.41	

- (After GST -Sale With In State)

Particular	Input Manufacturer	Output Manufacturer	Dealer	Total Revenue Tax
Cost Of Material	-	100	110	-
Cost Material Assuming Profit @10%	100	110	121	-
CGST@10%	10.00	11.00-10.00=1.00	12.10-11.00=1.10	12.10 (Central Government) (10.00+1.00+1.10)
SGST @10%	10	11.00-10.00=1.00	12.10-11.00=1.10	12.10 (State Government)
TOTAL	120.00	132.00	145.20	-

- (Existing System-Inter State Sale)

Particular	Input Manufacturer	Output Manufacturer (State X)	Dealer (State Y)	Total Revenue Tax
Cost Of Material	-	100.00	123.42	-
Cost Material Assuming Profit @10%	100	110	135.80	-
Exicse@10%	10.00	11.00-10.00=1.00	-	11.00(Central Government) (10.00+1.00)
VAT @10%/CST@2%	11.00	2.42-2.42=0	13.58	13.58 State 'X' 8.58 State 'Y'
Total	121	123.42	149.38	

• (After GST-Inter State Sale)

Particular	Input Manufacturer	Output Manufacturer (State X)	Dealer (State Y)	Total Revenue Tax
Cost Of Material	-	100	110.00	-
Cost Material Assuming Profit @10%	100	110	121.00	-
CGST@10%/IGST @20%	10	22.00-20.00=2.00	12.10-12.10	Central Government (10.00+2+10-9.9)=12.10 (CGST + Paid In Cash +Tfd By State X-Tfd To State Y)
SGST@10%	10	-	12.10-9.9=2.2	State' X' (10-10=0) State 'Y' (9.9+2.2)=12.10 Tfd By Central Govt.+ Balance Liability)
TOTAL	120.00	132	145.20	

Source: VAT Monthly Magazine, 2016

How GST is boon for Indian Economy:

- Introduction of a GST is very much essential in the emerging environment of the Indian economy.
- There is no doubt that, in production and distribution of goods & services are increasingly used or consumed. Separate taxes for goods and services, which is the present taxation system, requires division of transaction values into value of goods and services for taxation, leading to greater complications, administration, including compliances costs. In the GST system, when all the taxes are integrated, it would make possible the taxation burden to be split equitably between manufacturing and services.
- GST will be levied only at the final destination of consumption based on VAT principle and not at various points (from manufacturing to retail outlets). This will help in removing economic distortions and bring about development of a common national market.
- It will also help to build a transparent and corruption-free tax administration. Presently, a tax is levied on when a finished product moves out from a factory, which is paid by the manufacturer, and it is again levied at the retail outlet when sold.
- According to experts, by implementing the GST, India will gain $15 billion a year. This is because; it will promote more exports, create more employment opportunities and boost growth. It will divide the burden of tax between manufacturing and services (Ghosh, 2015).

- Improvement in International investor's confidence as there will be single tax in all over of the country in place of multiple taxes.

How GST is bane for Indian Economy:

- Doesn't include petroleum and alcohol products. Heavy loss to the exchequer.
- It requires strong IT (Information Technology) infrastructure at grass-root levels. India essentially lacks this. This factor is going to be the bottleneck, if not addressed well in advance.
- Very high rates 5%, 12%, 18%, 28% compared to current 12.5 % VAT.
- Tax-sharing between States and the Centre is another bottleneck. Nice to see that there is a consensus now.
- Majority of dealers are not covered with the Central Excise but are only paying VAT in the states. Now all the VAT dealers will be required to pay "Central Goods and Service Tax".

Impact of GST on FMCG:

The fast moving consumer good (FMCG) sector of India comprises more than 50 percent of the food and beverage industry and another 30 percent from personal and household care, thereby spanning the entire rural and urban parts of the country. Reports suggest the sector contributes a significant USD 6.5 billion in direct and indirect taxes (Subramanian, 2015). The current Indirect Tax regime in India provides for a complex tax environment due to multiplicity of taxes, tax cascading and elaborate compliance obligations.

In the ensuing paragraphs, we have sought to identify the key issues arising from the Model GST Law as may be relevant for the FMCG Industry.

1. **Input Tax Credit**
   Reconciliation of inward and outward supplies, if there is a mismatch between the details of outward supplies uploaded on the GST Network by the vendors and the inward supplies uploaded by the recipient. Such mismatch will be communicated to the recipient. If the mismatch is not rectified by the vendor in the month of communication, the recipient will be liable to pay the differential GST along with interest, in the subsequent month. This provision places the liability for non-compliance on the recipients, i.e. the FMCG companies, as against their vendors. Placing the responsibility on FMCG companies for non-compliance by vendors and stockists will cause undue hardship to these companies.
2. **Area based exemptions under the Excise legislation and State Industrial Policy**
   The First Discussion Paper on GST had stated that area-based exemptions under the Excise legislation and incentives under the State Industrial policies should be converted to a tax refund mechanism. However, the transition provisions prescribed under the Model GST Law do not provide for the treatment of the said exemptions/ Incentives. Further, the valuation provisions envisage that subsidies should be included in the transaction value. This would impact the benefits available to the industry.
3. **Transition provisions for traded goods**
   The transition provisions provide that the credit balance which was admissible under the present regime would be carried forward under GST. In case of stocks of imported finished goods, Countervailing Duty is not admissible under the present regime, and in case of goods procured from contract manufacturers, Excise Duty credit is also not available.

Accordingly, based on these provisions, under the GST regime, such stocks would suffer double taxation.

4. **Power to challenge the transaction value**
   The Model GST Law provides that if there is a reason to doubt the accuracy of the transaction value declared by the supplier, then the authorities can determine the transaction value as per the GST Valuation Rules. Such an unfettered power to question the transaction value can lead to litigation.
5. **Taxability of Free Supplies**
   Supply of goods between persons without consideration is deemed to be a 'supply'. Accordingly, stock transfer of promotion materials/ free samples will be subject to GST. Subsequent supply of the said promotion materials to stockists/end customers will also attract GST. The valuation of such samples/ materials will be as per the GST Valuation Rules, i.e. the transaction value of goods of like kind and quality or the cost of sales. Under the present regime, free supplies are not subject to VAT. Hence, promotion expenses of FMCG companies will increase under the GST regime.
6. **In case of warehouse across the states**
   Many of the FMCG companies set up units which offered tax benefits. They set up warehouses across the states in a bid to have a more tax efficient system. The very fact that they do not have to pay CST led them to carry out stock transfers to the warehouses. With the GST roll out the CST will be subsumed into GST and will have far reaching implications.
7. **In the current scenario the traders are not entitled for any credit other than state VAT**
   In the countries where GST or similar tax structure is prevalent the retailers avail of tax credits when they create infrastructure. This is likely to change for the FMCG industry with the GST implementation. Since the GST encompasses the goods and services under one fold, there will not be any distinction between manufacturers, traders and service providers with regard to taxation.
8. **Impact on working capital**
   The impact on the working capital is likely to be significant for the FMCG industry. This is because of the time gap expected between the payment of GST and recovery of the tax credit. A sizeable chunk of money is expected to be blocked between the two transactions. Stock transfers do not attract tax and the VAT is paid when the sales take place. However, with the GST in place it will be payable on the stock transfer as it is a destination based tax. The realization of the tax credit will only happen when the goods are actually sold which may take a long time. A serious rethink is required on the warehousing strategy.

In a major incentive to India Inc, the Central Government has decided to continue with area-based excise duty exemptions provided to the North-East and hilly States when the Goods and Services Tax (GST) regime kicks in from April 1, 2017. However, these will be provided as refunds, not as exemptions. The Finance Minister, Mr.Arun Jaitley after the second meeting of the GST Council said that it was agreed that there would be levy of tax on all exempted entities under GST. The Centre or the State that gets the tax will then reimburse it to the exempted entity. There are certain condition prescribed in proposed GST law in section 145 such as goods must be for taxable supplies, invoice should be within 12 months from appointed day, eligible credit computed as per

GAAP, excess claim can be recovered as arrear of tax, etc. As far as concerned with input tax credit in proposed GST bill, GSTR1 can include missing invoice up to 17th of respective month which are not included by supplier and auto generated invoice GSTR 2 on basis of GSTR1 filled by other supplier can be add , reject , modify details upto 17th of respective month/quarter (Gupta, 2016).

However, in case of warehouse across the states, inter-state transactions to become tax neutral under GST inter-state sales transactions between two dealers would be cost equivalent compared with stock transfers / branch transfers. According to the proposed model, Centre would levy IGST, which would be CGST plus SGST on all interstate transactions of taxable goods and services. The inter-state seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. Similarly the importing dealer will claim credit of IGST while discharging his output tax liability in his own State. This will result in inter-state sales transaction becoming tax neutral when compared to intra-state sales. India would become one single common market no longer divided by state borders (Paradkar & Kadakia, 2011).

Conclusion:

In short, under the proposed GST regime, various Indirect Taxes would be subsumed (except for few taxes such as Stamp Duty) and hence it is expected that it would result in a simpler tax regime, especially for industries like FMCG. Apart from simplification of tax compliances, the rate of tax will also have a significant impact on the FMCG sector. Presently the peak tax costs for industry players amount to approximately 27% (i.e. Excise Duty of 12.5% and VAT ranging from 12% to 15%). Under the GST regime, it is proposed that the revenue neutral rate would be in the range of 5% to 28%, thereby resulting in significant benefit for the sector. So, GST would have an impact on the pricing, working capital, contracts with vendors and customers, ERP systems, processes, internal control and accounting. Another important impact of GST on FMCG companies would be the opportunity to review the supply chain and move to a supply chain based on business parameters. Hence, GST would impact every aspect of the business.

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