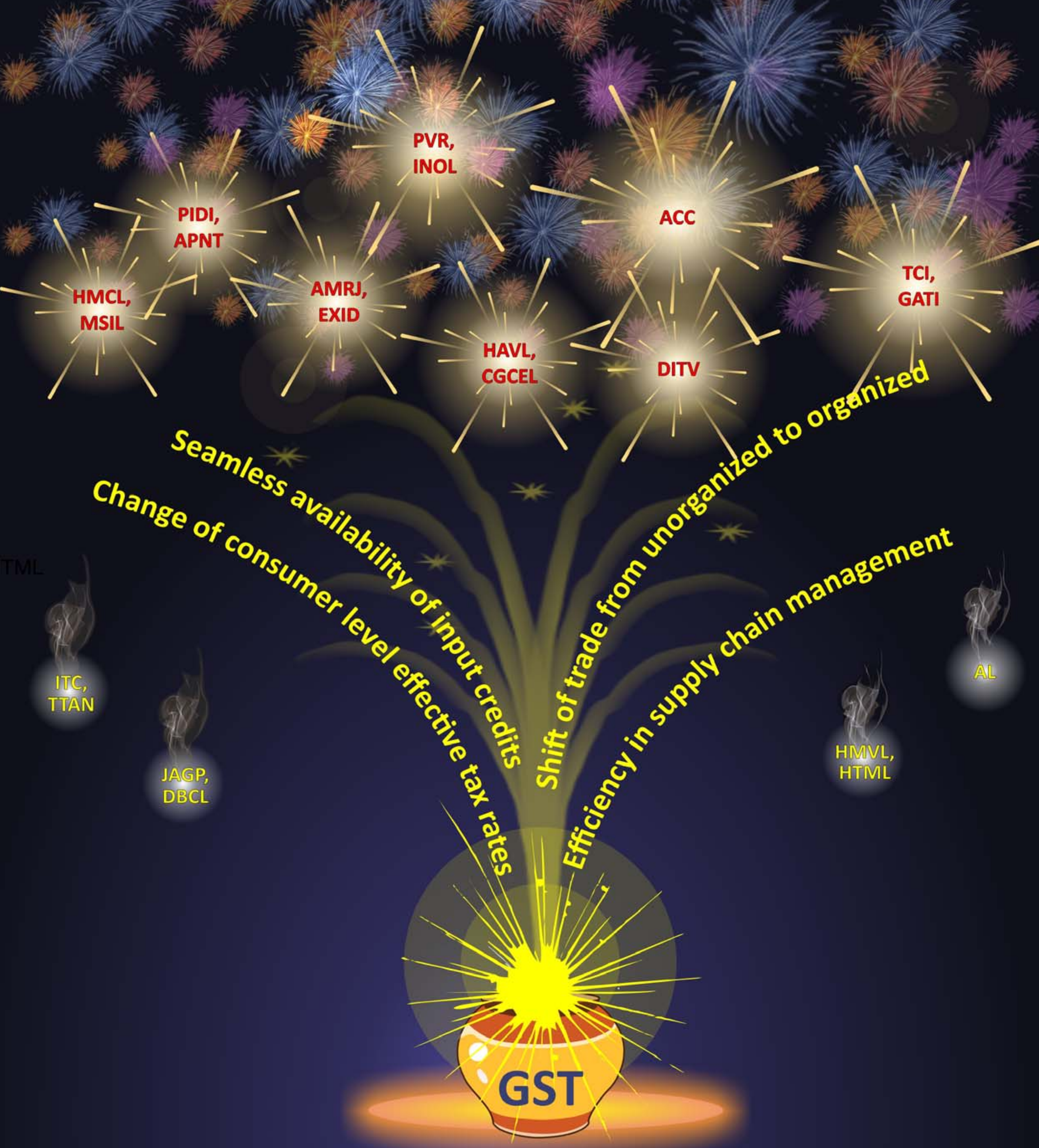
Motilal Oswal

Thematic | July 2016

# GST




# Ushering in a new era

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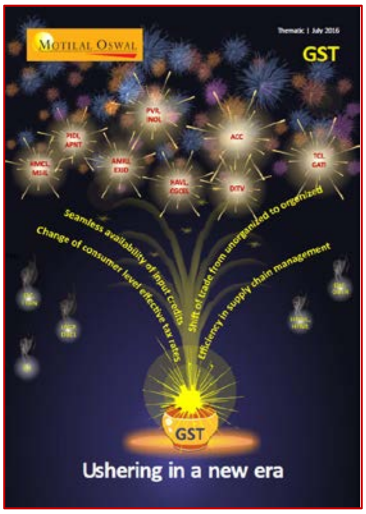


**GST**
**Ushering in a new era**

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# Ushering in a new era

## Sparkles and shimmers

- **India's biggest tax reform is at the cusp of its legislative birth. We believe implementation of the Goods and Services Tax (GST) would be a boon for India Inc. as a whole, since it (a) would simplify and rationalize taxes, (b) shift trade from the unorganized to the organized segment and (c) improve efficiency in the system.**
- **This is likely to benefit sectors like FMCG (ex-cigarette & jewelry), auto, cement, light electrical, multiplexes, retail and logistics. However, commercial vehicles, print media, cigarette and jewelry companies would be adversely impacted, in our view.**
- **On the macro front, we expect GST to have a neutral impact on government revenues initially (but should be accretive over time), while the reported CPI is likely to remain stable. However, consumers may feel the pinch due to rising taxation on services.**

### GST: India's biggest tax reform

- The indirect tax regime in India is set for a complete overhaul. We believe GST 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.

### India Inc. to be big beneficiary

- 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) re-jig in supply chain management.
- Sectors/companies likely to emerge as gainers: (a) Consumer – Pidilite; Asian Paints; Century Plyboards (b) Autos – Hero MotoCorp; Maruti Suzuki; Amara Raja Batteries; Exide Industries (c) Cement – ACC (d) Multiplexes – PVR; Inox (d) Light electrical – Havells; Crompton Consumer; Symphony; V-Guard (e) Media – Dish TV (f) Retail – Shoppers Stop, and (g) Logistics – TCI and Gati.
- Sectors/companies likely to lose: (a) FMCG – ITC; Titan (b) Media: Print companies – HMVL; DB Corp; Jagran Prakashan; HT Media (c) Automobiles – Ashok Leyland.

### Game changer for economy in longer run

- Approval of the GST constitution bill amendment will be the next trigger for the financial markets though its initial impact on economic activity will only be mildly positive. It is unlikely to impact inflation adversely, but could boost economic activity (subject to effective implementation). Over the longer term, it holds the potential to boost economic activity substantially, improve the government's revenue, and help achieve better transmission of prices.

### Revenue neutral initially, but accretive over time

- Assuming that GST rate aligns with the revenue neutral rate, as is intended, the effective tax rate will come down, which will broadly offset the increase in tax base (since exemption list will be pruned) and most of high-taxes items will be excluded from GST (at least initially). However, as GST will help reduce tax evasion, prune exemption list and improve compliance, the receipts will increase over time. We also believe that the fear among states to lose out on revenue is misplaced.

### Unlikely to raise CPI but could hurt Indian consumers

- As far as the impact of GST on inflation is concerned, a moderate GST rate 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 in the consumption basket than in CPI, Indian consumers are likely to feel the pinch of higher prices of services after GST is implemented.

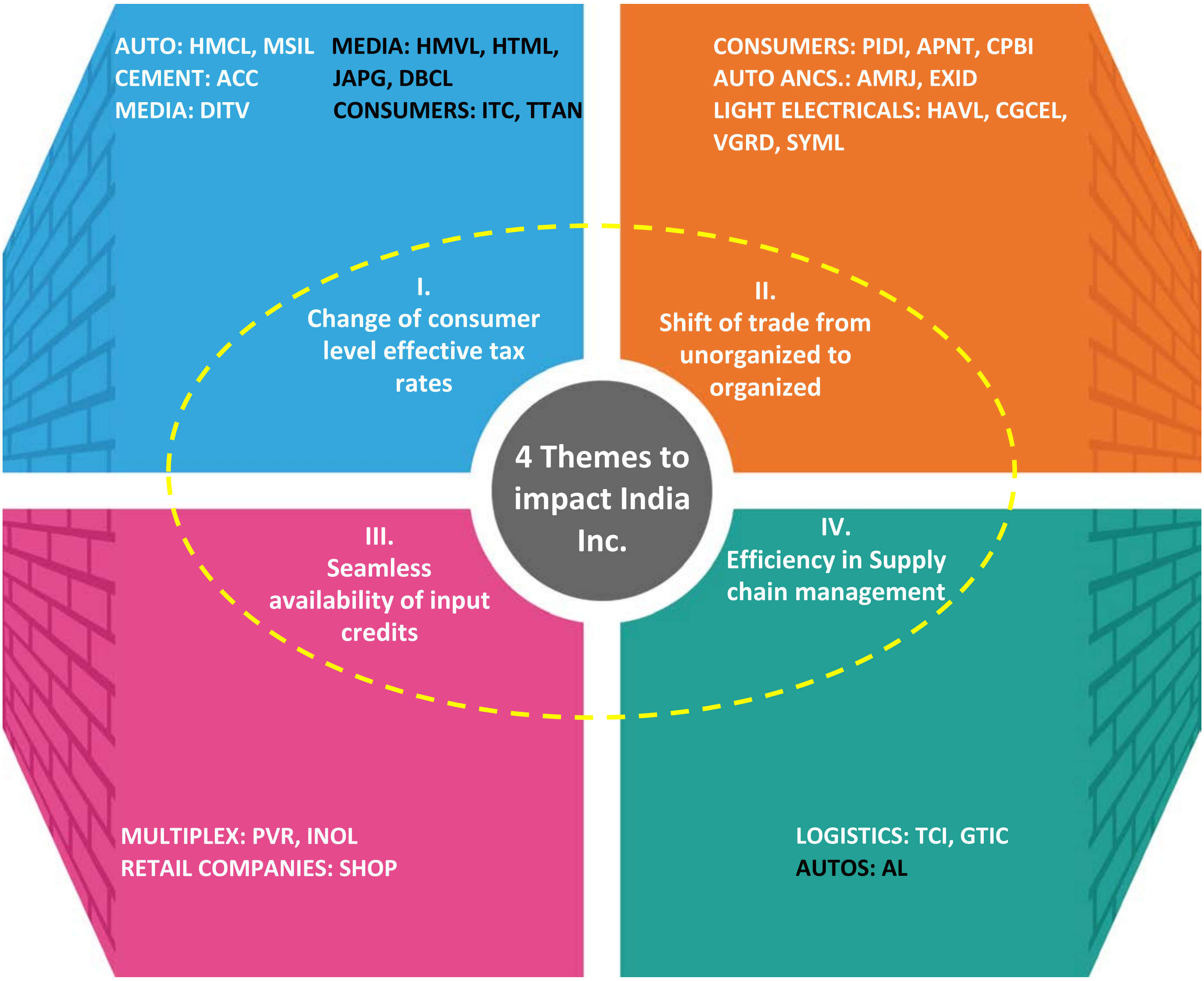
### Two key concerns

- Firstly, the 1% additional tax, if approved, may defeat the entire purpose of creating a unified market. Secondly, the exclusion of crude oil and petroleum products from GST in the initial period makes us skeptical of their inclusion later. This is because the central government’s support to compensate the state governments for revenue loss will expire after five years.

### Way forward and challenges ahead

- A rather long implementation schedule and challenges await us. For the corporate sector, GST would bring numerous complex changes, which could be disruptive at least for once.
- Grandfathering of existing location-wise benefits through different modes (such as (a) one-time settlement, or (b) interest-free loans of amount of tax collected) may adversely impact operating profits of some companies while increasing their other income.

## Four themes under GST with favorably/adversely impacted companies




**Note:** Companies in WHITE likely to be favorably impacted by GST, companies in BLACK likely to be negatively impacted Source: MOSL

## Impact on sectors

**As India Inc.'s tax regime transitions to GST, we are likely to see a varied impact on companies/sectors. Although it is difficult to quantify this impact, we have tried to identify sectors/companies under our coverage that could witness a Positive (represented by green color), Neutral (represented by blue color) and Negative (represented by red color) impact. We have shown the level of impact in various exhibits, where one, two and three circles represent a low, medium and high impact, respectively.**

**Exhibit 1: Sector-wise impact of GST**

| Sector | Change in Tax rate | Availability of Input credit | Unorganized to organized | Supply Chain Management | Overall |
|---|---|---|---|---|---|
| Auto - Batteries | 🟢 | 🔵 | 🟢🟢🟢 | 🔵 | 🟢🟢🟢 |
| Consumers - Retail | 🔵 | 🟢🟢🟢 | 🔵 | 🔵 | 🟢🟢🟢 |
| Logistics | 🔵 | 🔵 | 🟢🟢 | 🟢🟢 | 🟢🟢🟢 |
| Media - Multiplex | 🟢🟢🟢 | 🟢🟢🟢 | 🔵 | 🔵 | 🟢🟢🟢 |
| Auto - Two wheeler/ Four wheeler | 🟢🟢 | 🔵 | 🔵 | 🔵 | 🟢🟢 |
| Consumers: FMCG – Ex Alcohol and cigarette | 🟢 | 🔵 | 🟢 | 🟢 | 🟢🟢 |
| Capital Goods: Light Electrical | 🟢 | 🔵 | 🟢🟢 | 🟢 | 🟢🟢 |
| Media - Pay TV Distributor | 🟢 | 🟢 | 🔵 | 🔵 | 🟢🟢 |
| Cement | 🟢🟢 | 🔵 | 🔵 | 🟢 | 🟢🟢 |
| Metals | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 |
| Pharma | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| Capital Goods: Industrial | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| IT | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| Media - Pay TV Broadcasters | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| Textiles | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 |
| Telecom | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 |
| Auto - CV | 🔵 | 🔵 | 🔵 | 🔴🔴 | 🔴🔴 |
| Media - Print Media | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 |
| Consumers - Cigarette | 🔴🔴🔴 | 🔵 | 🔵 | 🟢 | 🔴🔴🔴 |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

**Our analysis (assuming a standard rate of GST of 18%) suggests that the autos, consumer, logistics, multiplex, light electrical, media and cement sectors are likely to be positively impacted, while the consumer (cigarette), print media and auto CV sectors may be adversely impacted.**

**Exhibit 2: Some key beneficiaries from GST**

| Stocks | Impact | Reasons |
|---|---|---|
| **AMRJ/ EXID** | ●●● | ■ Battery segment would benefit from reduction in cost disadvantage vis-à-vis unorganized players (45-50% of replacement market). Also, for the CV segment, where unorganized players are much more prevalent, fleet operators can claim offset for GST paid on batteries. |
| **APNT** | ●●● | ■ Under GST, the gross effective tax rate for Asian Paints will reduce from 26-28% currently to ~18%. We believe that the savings on tax outgo will either be retained and drive margin expansion or partially passed on to the consumer/trade to drive volume growth. There exists a sizable unorganized market (~35%) in the paints industry; we believe that the company would also benefit from gradual reduction in competition from unorganized players, with reduction of pricing gap. |
| **CPBI** | ●●● | ■ Century Ply currently pays average indirect tax rate of 26.5% (excise of 12% and average VAT of 14.5%) which will partly aid margin expansion and gain from shift of trade from the unorganized (65-70% of market) to the organized segment, given the reduced taxation difference. Considering the brand equity and quality of Century Ply, it should benefit from the shift in consumer preference towards to branded products. |
| **GTIC** | ●●● | ■ Its express logistics segment will witness higher volume growth; plans to enter into third-party warehouse management. |
| **HMCL** | ●●● | ■ GST will bring ~8% reduction in on-road prices for Entry level segment (HF Dawn/Deluxe) and Executive segment (Splendor/Passion). This would improve affordability and expand addressable market for this price-sensitive segment. |
| **INOL** | ●●● | ■ Inox will be a key beneficiary due to reduction of blended effective tax rate and will be able to retain part of it. Benefit of input credits on lease and maintenance of properties will be available which was not allowed under erstwhile regime. This in our view can expand EBITDA margin by ~200-300bps |
| **MSIL** | ●●● | ■ Entry level cars would see reduction in on-road prices by ~8%, driving demand for entry level segment. MSIL, which has over 80% of this segment, would be the biggest beneficiary. |
| **PIDI** | ●●● | ■ For Pidilite, gross effective tax rates are expected to reduce significantly to ~18% (v/s 26-28% under the current regime). Pidilite rarely initiates price cuts and we believe that the savings on tax would drive margin expansion. We note that the product segments this company caters to have significant presence of unorganized players. Post GST, it would also benefit from gradual reduction in competition from unorganized players due to reduction of pricing gap. |
| **PVR** | ●●● | ■ PVR will be a beneficiary on account of: (a) entertainment tax of 26.9% in FY16 on net box office collection (ticket sales constituted ~54% of FY16 revenue), (b) service tax of 15% on advertising revenue (~11% of FY16 revenue), and (c) blended VAT of 8% on F&B revenue (~25% of FY16 revenue). Service tax of ~INR760m paid on rent, maintenance and other expenses relating to properties was expensed out in FY16, as credit wasn't allowed. |
| **SHOP** | ●●● | ■ Implementation of GST could result in a two-fold benefit for Shoppers Stop: (a) availability of set off of input tax credit tax on rent (likely benefit of 150bp), and (b) single tax regime will bring majority of transactions of unorganized players under the tax net and thereby reduce the price gap in retail prices of various items, spurring organized players' growth. |
| **SYML** | ●●● | ■ Being a leader with 50% market share, it will be a key beneficiary of shift from unorganized to organized sector as unorganized sector is 80% of total air cooler market of ~5m units. Lower tax rate will result in volume growth and margins expanding, given the pricing power of the company |
| **TCI** | ●●● | ■ It will benefit from increased third-party logistics business (already catering to inbound auto logistics) and also will get higher volumes for its express logistics segment. |
| **ACC** | ●● | ■ While reduction of effective rates and supply chain costs will bring tangible benefits to the entire cement sector, we believe that it would be more positive for ACC, where earnings sensitivity will be higher, assuming homogenous benefits in taxation. |
| **CGCEL** | ●● | ■ CG CEL would benefit from the shift from the unorganized to the organized sector post GST. Fans which make up 45% of sales for CGCEL has 25% of sales from the unorganized sector while lighting which is the second largest category(30% of sales) has 40% sales from the unorganized sector. |
| **DITV** | ●● | ■ The benefits would be two-fold: (a) reduction in current effective indirect taxes from ~23% to 24%, part of which we believe the company will be able to retain, and (b) higher availability of input credits (of SAD) on set top boxes. |
| **HAVL** | ●● | ■ Likely to be a key beneficiary of GST on two counts: (a) lowering of tax rates (at consumer level) from 26-29% to 18% might lead to a combination of volume increase and margin expansion, and (b) increase in addressable market size, as most of the product segments (like fans, lighting, water heaters, air coolers, etc) in which the company operates has large unorganized markets, which will come under the tax net post GST and provide level playing field for all players. |
| **VGRD** | ●● | ■ Organized market on a blended basis accounts for ~60% of total addressable market size, which should see further increase due to the shift from unorganized to organized on account of strong brand and distribution of V Guard. |

Highly Negative: ●●●; Negative: ●●; Slightly Negative: ●; Neutral: ●; Slightly Positive: ●; Positive: ●●; Highly Positive: ●●●

**Exhibit 3: Some companies that may suffer an adverse impact**

| Stocks | Impact | Reasons |
|---|---|---|
| **ITC** | ●●● | ■ ITC pays blended weighted average VAT of ~24% while the blended central excise is levied at ~38.5% (paid on the basis of length of stick). The draft bill proposes inclusion of tobacco in GST and chargeable at ~40%, while the central excise on cigarettes may continue. This may lead to increase in the consumer level prices of the products and may have an adverse impact on volumes. |
| **HMVL/ HTML/ JAPG/ DBCL** | ●● | ■ Print companies are exempted from the levy of service tax on both ad and circulation revenues. If print ad/circulation income comes under the GST ambit, print companies will be adversely impacted. The impact will be marginally cushioned by input credits towards VAT charged on newsprint. Currently, print companies pay 4-5% as VAT on newsprint cost (~30% of revenue). We believe the ability of the print industry to pass on the tax burden to readers is limited in an era where print is increasingly becoming less competitive viz-a-viz digital media. |
| **TTAN** | ●● | ■ The RNR committee has recommended a GST rate of 2-6% for precious metals. Currently, jewelry attracts no excise duty and 1% VAT rate. If the committee's recommendations are accepted, Titan could be impacted. |
| **AL** | ●● | ■ The pruning of supply chain management and reduction of logistical bottlenecks may lead to a reduction in CV demand over the medium term. This may impact pure play CV players like Ashok Leyland. |

Highly Negative: ●●●; Negative: ●●; Slightly Negative: ●; Neutral: ●; Slightly Positive: ●; Positive: ●●; Highly Positive: ●●●


## GST: Complete overhaul of indirect tax system

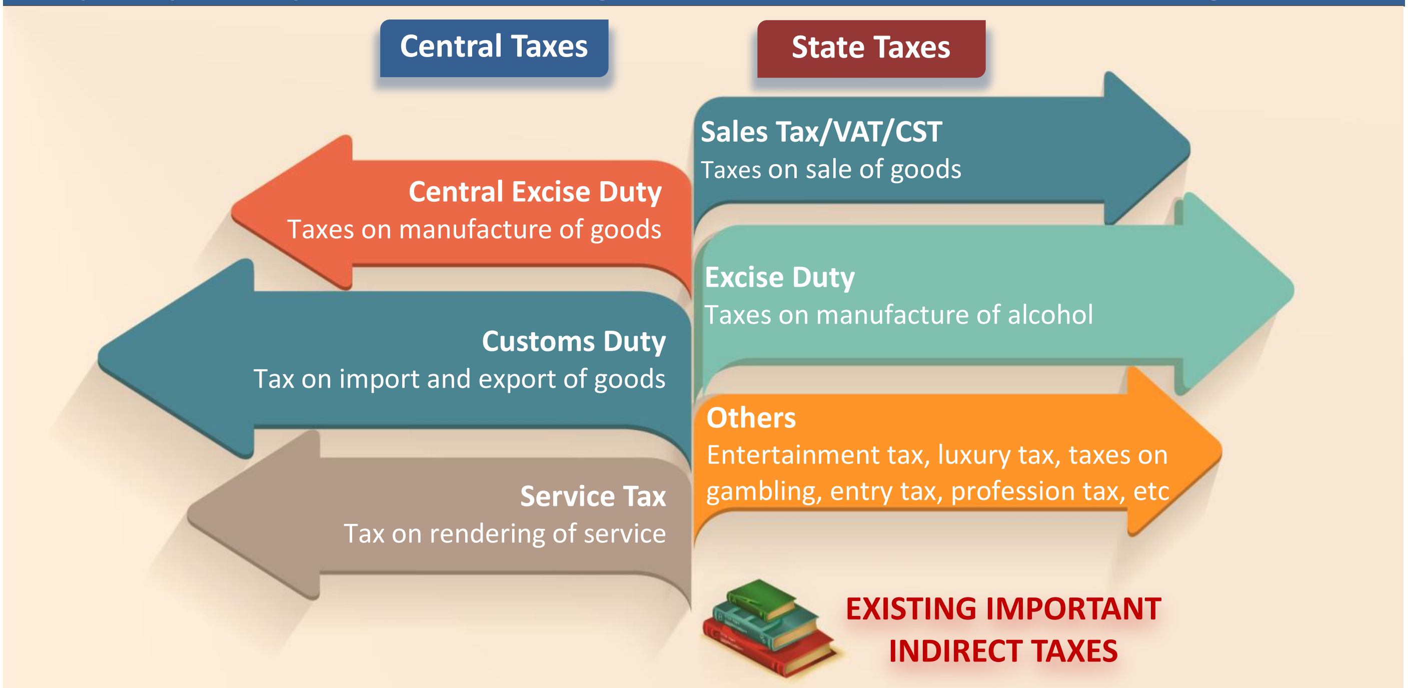
**Dawn of simpler, unified taxation regime**

- **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.**
- **The RNR Committee appointed by the government has suggested 15-15.5% RNR, with a high rate of 40% on demerit goods, low rate of 12% on essential goods, and a standard rate of 16.9-18.9% depending on the choice of exemptions and rates of tax on precious metals.**

### Current complex multiple taxation structure…

- India has a federal structure of government. The constitution of India provides autonomy to both the central and state governments to levy taxes on goods/services at different incidences in the value chain.
- The central government levies taxes on the manufacturing of goods (excise), rendering of services (service tax), and import of goods (customs duty).
- The state governments levy taxes on the sale of goods within their jurisdiction (VAT) and sale of goods when entities within their jurisdiction sell goods to entities outside (CST) in addition to multiple other levies like excise on alcohol, entertainment tax, luxury tax, stamp duty, octroi, etc.

**Multiple levy of tax by the central and state governments under the current indirect tax regime**

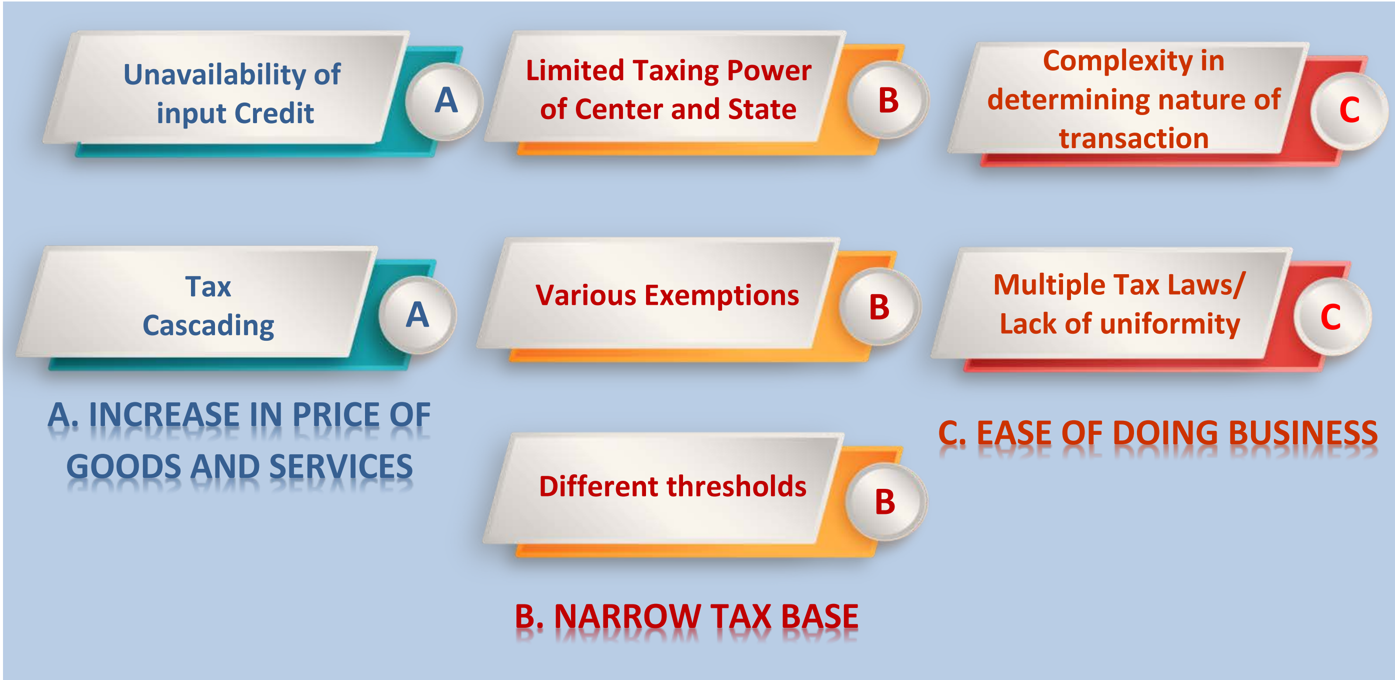



Source: MOSL

### ...leads to multiple shortcomings

- This multi-layered multiple taxation regime leads to (i) an increase in the prices of goods and services, (ii) narrowing of the tax base, and (iii) dampening of the ease of doing business.
- Further, the variations in thresholds for levy of different duties and disparities in tax rates applied to the same goods in different states and input and output goods within the same state lead to taxation disputes and pilferages in the value chain.

**Shortcomings in present indirect tax structure**

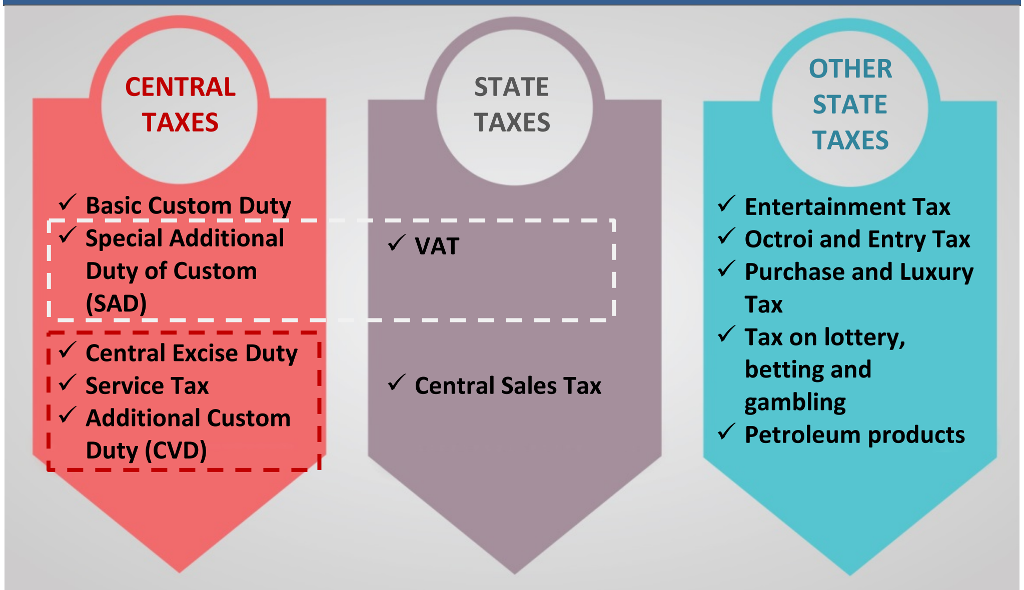



Source: MOSL

A. **Increase in prices of goods and services:** This is primarily on account of non-availability of input credit across the value chain and tax cascading.
   - **Unavailability of input credit:** Taxes paid under one statute are not allowed to be set off against taxes paid under other statute. Few examples:
     - Input credit is not allowed for CST paid on interstate movement of goods
     - Excise duty paid on manufacturing and service tax paid on rendering of service are not allowed to be set off against VAT paid on the sale of goods and vice-versa.
     - Taxes paid under one certain state level taxes cannot be used as an input for payment of other state taxes like entertainment tax, octroi, entry tax, etc.

CENVAT available only if tax paid under the same statute

**Limitations on utilization of input credit in current multilayered tax regime**



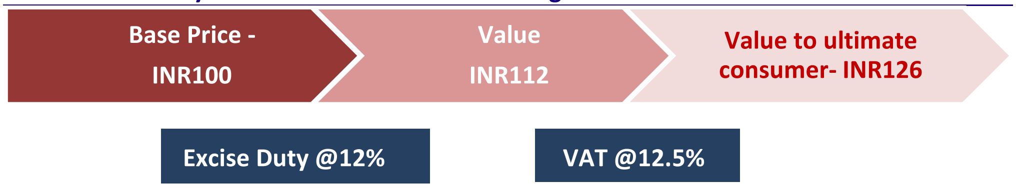

CENVAT credit available

Source: MOSL

- **Tax cascading:** Multilayered taxation structure leads to taxing the tax. For example, the central government levies excise duty on the basic value of goods. However, on the sale of the goods, VAT is levied by state governments on the value of the goods including excise.

Cascading effect, as VAT is charged on excise duty as well

**Exhibit 4: Multilayered taxation leads to cascading effect**




Source: MOSL

**B.** **Narrow base:** The current taxation base is narrow due to differential thresholds applicable under various tax laws and differences in the autonomy of the center and the state governments to levy indirect taxation. This gets further aggravated with the various area and product-based exemptions granted by both the central and the state governments.

- **Differential thresholds:** Currently, different levies have different thresholds for their applicability. For example: the threshold under excise is INR15m while the threshold under service tax is INR1m. This results in different tax bases across different duties, and hence, narrowing of the tax base.
- **Taxing power of center and states:** Currently, the center collects excise duty on the value of the product only till manufacturing (generally 2/3rd of the value), resulting in a loss of revenue for the center. State governments do not get any portion of service tax, which is collected only by the center, resulting in loss of revenue for the states.
- **Various exemptions:** Currently, ~300 goods/services are exempt by the center and ~100 goods are exempt by the state governments. The starting base for the excise/VAT is narrow and is being further eroded by a variety of area-specific

and conditional exemptions. Service tax is applicable on all services except those on the negative list and those specifically exempted by notifications.

C. **Dampening of 'ease of doing business':** The applicability of multiple tax laws, different rules and procedures, different rates/classification of same goods in different states, and complexity in determining the nature of transactions further hinder free flow of goods across the country and often lead to increased litigation issues.

- **Applicability of multiple tax laws, lack of uniformity in provisions and rates**: The plethora of indirect taxes applicable to businesses currently not only requires separate registration and assessment, but also subjects businesses to provisions and rates that vary from state to state.
- **Complexity in determining nature of transactions:** Under the current division of taxation powers by the Constitution, neither the center nor the states can seamlessly apply taxes to bundles (for example: services provided by restaurants). Further, with increase in the share of taxes on services, the state governments are keen to classify ambiguous transactions as sale of goods and levy taxes accordingly (for example: rendering of telecommunication services) which leads to double taxation.

## GST: The simplified indirect tax avatar

- GST is proposed to be a comprehensive destination-based indirect tax levy on the manufacture, sale and consumption of goods and services.
- Its main objective is to consolidate multiple indirect taxes into a simple tax, overcoming the limitations of the current indirect tax structure and creating efficiencies in administration.
- 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.

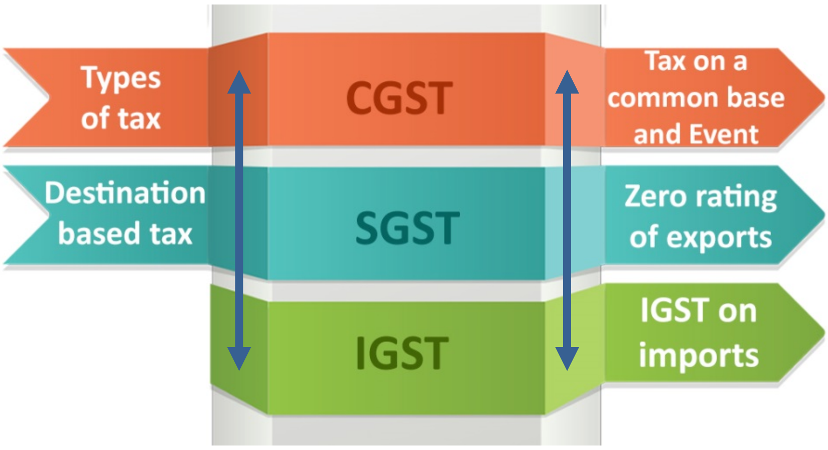
**Exhibit 5: Taxes to be subsumed under GST**

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

Source: Government, MOSL

- Under the new GST structure, both the center and the states would simultaneously levy GST across the value chain. 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. The Empowered Committee of State Finance Ministers had recommended withdrawal of area-based exemptions and their replacement with direct central/state government subsidies.

**Evolving model and features of GST**




Source: Government, MOSL

## RNR committee suggests a standard rate of 17-19% under GST

- The government appointed group on "Revenue Neutral Rate and Structure of Rates for the Goods and Services Tax" (Chairman: Arvind Subramanian; henceforth referred to as "RNR Committee") had suggested the following revenue neutral rate (RNR) and rate structure for GST after considering aspects of base and compliance efficiency under different approaches.

**Exhibit 6: The RNR committee placed its comfort on 15-15.5% RNR for GST**

| | RNR | Rate on precious metals | "Low" rate (goods) | "Standard" rate (goods & services) | "High/Demerit" rate or non-GST excise (Goods) |
|---|---|---|---|---|---|
| | | 6 | | 16.9 | |
| Preferred | 15 | 4 | 12 | 17.3 | 40 |
| | | 2 | | 17.7 | |
| | | 6 | | 18.0 | |
| Alternative | 15.5 | 4 | 12 | 18.4 | 40 |
| | | 2 | | 18.9 | |

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 (a) rationalize consumer-level taxes rates, (b) broaden the tax base, and (c) facilitate the ease of doing business. This will lead to multifarious benefits both for the government and the corporate sector.
- **Rationalizing the price of goods and services:** Under the current regime, the effective tax rates on goods are significantly higher than on 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.

### Exhibit 7: GST to rationalize tax in product prices

| Particulars | Column | Calculation | Amount | Amount | Particulars | Column | Calculation | Amount | Amount |
|---|---|---|---|---|---|---|---|---|---|
| **Input Manufacturer- Selling goods in same state** | | | | | | | | | |
| Cost | A | | 90 | | Cost | A | | 90 | |
| Margin | B | | 10 | | Margin | B | | 10 | |
| Value | C | **A+B** | | 100 | Value | C | **A+B** | | 100 |
| Excise @10% | D | **C*10%** | | 10 | CGST @ 10% | D | **C*10%** | | 10 |
| Vat @10% | E | **(C+D)*10%** | | 11 | SGST @10% | E | **C*10%** | | 10 |
| **Total** | F | C+D+E | | **121** | **Total** | F | C+D+E | | **120** |
| | | | | | | | | | |
| **Output manufacturer – Selling goods outside state** | | | | | | | | | |
| Cost | G | | 100 | | Cost | G | | 100 | |
| Margin | H | | 20 | | Margin | H | | 20 | |
| Value | I | **G+H** | | 120 | Value | I | **G+H** | | 120 |
| Excise @10% | J | **I*10%** | | 12 | ICGST @ 20% | J | **I*20%** | | 24 |
| Cenvat | K | **D** | -10 | | | | | | |
| Excise Paid | L | | 2 | | Input tax credit (CGST + SGST) | K | **C+D** | 20 | |
| CST @ 2% | M | **(I+J)*2%** | 6 | 2.64 | Total IGST Paid | L | **J-L** | 4 | |
| **Input tax Credit Available** | **N** | **M** | **-2.64** | | | | | | |
| VAT Refund claim | O | **-E+N** | -8.36 | | | | | | |
| Total VAT Paid | | | 0 | | | | | | |
| | | | | | | | | | |
| **Total** | P | I+J+M | | **134.6** | | P | | | **144** |
| | | | | | | | | | |
| Dealer | | | | | | | | | |
| Entry Tax | Q | **Assumed** | 3.60 | | Entry Tax | Q | | 0 | |
| Cost | R | **P+Q** | 138.24 | | Cost | R | **I** | 120 | |
| Margin | S | | 10 | | Margin | S | | 10 | |
| **Value** | T | **R+S** | | **148.24** | **Value** | T | **R+S** | | **130** |
| VAT @ 10% | U | **T*10%** | 14.824 | | CGST@10% | U | **T*10%** | 13.0 | |
| Total VAT Paid | V | **U** | 14.824 | | Input tax credit | V | **Utilized out of J** | -13.0 | |
| | | | | | Total CGST Paid | W | | 0.0 | |
| | | | | | | | | | |
| | | | | | SGST@10% | X | **T*10%** | 13.0 | |
| | | | | | Input tax credit | Y | **J-V** | 11.00 | |
| | | | | | Total SGST Paid | Z | | 2.00 | |
| Amount pd by customer | | **Q+S** | | 163.1 | Amount paid by customer | | **T+U+X** | 156.0 | |
| **Tax paid by customer** | | | | **30.4** | **Tax paid by customer** | | **U+Z** | **26.00** | |
| Tax paid to center | | **D+L** | | 12.0 | Tax paid to center | | **D+E+L-Y** | 13.0 | |
| Tax paid to state | | **N+R** | | 18.4 | Tax paid to state | | | 13.00 | |

*Assumption of tax rates: excise, VAT, CGST, SGST assumed at 10%

- **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 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.

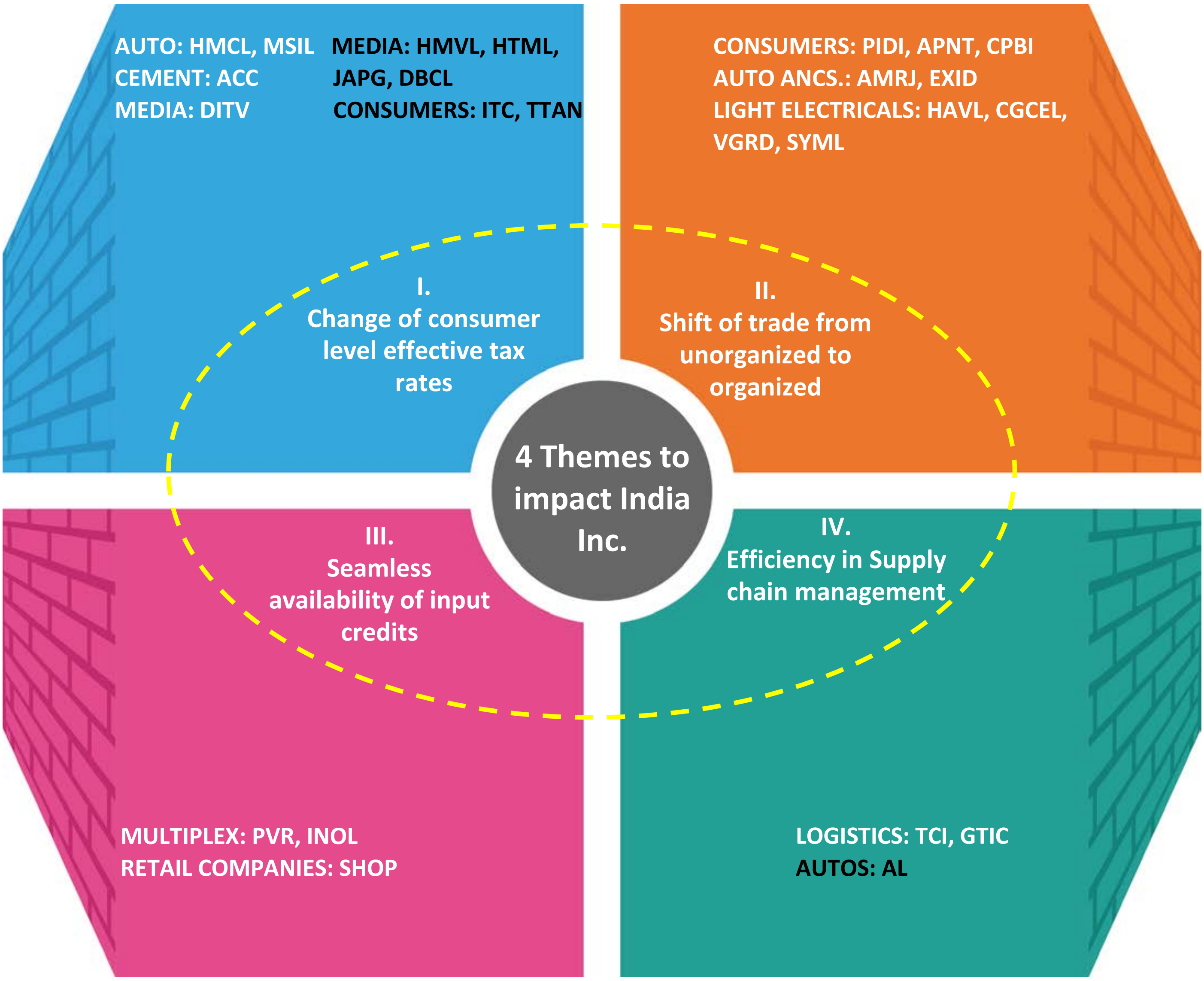
This is likely to bring multifarious benefits to both India Inc and the economy.

## 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.**
- **Sectors/companies likely to emerge as gainers**: (a) Consumer – Pidilite; Asian Paints; Century Plyboards (b) Autos – Hero MotoCorp; Maruti Suzuki; Amara Raja Batteries; Exide Industries (c) Cement – ACC (d) Multiplexes – PVR; Inox (d) Light electrical – Havells; Crompton Consumer; Symphony; V-Guard (e) Media – Dish TV (f) Retail – Shoppers Stop, and (g) Logistics – TCI and Gati.
- **Sectors/companies likely to lose**: (a) FMCG – ITC; Titan (b) Media: Print companies – HMVL; DB Corp; Jagran Prakashan; HT Media (c) Automobiles – Ashok Leyland.

**Four themes under GST with favorably/adversely impacted companies**




**Note:** Companies in WHITE likely to be favorably impacted by GST, companies in BLACK likely to be negatively impacted Source: MOSL

### Four key themes to have significant impact on India Inc

- Our analysis of GST suggests that four key themes emerge, which will have significant implications for India Inc:
  I. Change in consumer-level effective tax rates
  II. Shift of trade from unorganized to organized segment
  III. Efficiency in supply chain management
  IV. Decrease in cost due to seamless availability of input credits

**Themes under GST with favorably/adversely impacted companies**



- 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:
  (a) Applying uniform taxes across goods and services,
  (b) Reducing the current product-level exemptions (with center providing exemption to 300 products and states to ~100 products) to ~100 products
  (c) Removing the cascading impact of tax by subsuming the various tax levies into a single levy of GST, and
  (d) Applying uniform taxes on goods and services across the country

**Factors leading to change in effective tax rates**


Source: Government, MOSL

- GST is likely to bring a change in effective tax rates 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.
- If the recommendation of RNR committee is accepted, the standard rate of goods will be 17-19%. For the purpose of simplicity, we have used an average rate of 18% on standard goods for evaluating the benefits for various companies / sectors.
- **Key sectors to benefit**: Autos (Two Wheelers + Passenger Vehicles), Batteries, Consumer, Cement, Light Electricals, Pay TV Distributors, Multiplexes
- **Key sectors to be negatively impacted:** Print Media, Textiles, Cigarettes

**Exhibit 8: Sector-wise corporate tax rates**

| Sector | Excise | Service tax | VAT | CST | Other | Effective tax rate (Approx.) |
|---|---|---|---|---|---|---|
| **Auto** | | | | | | |
| Two wheeler/ Three Wheelers | 13.5%* | - | 12.5% | 2% | - | 30-31% |
| Four Wheeler | 13.5-29%* | - | 12.5% | 2% | - | 31-49% |
| CV | 13.5%* | - | 12.5% | 2% | - | 30-31% |
| Batteries | 12.50% | - | 12.5% | 2% | - | 29-30% |
| **Consumers** | | | | | - | |
| FMCG | | | | | | |
| Cigarettes | Depending on length | - | 24% | 2% | - | |
| Concessional goods | 0-6% | - | 4-12.5% | 2% | - | 6-22% |
| Others | 12.5% | - | 12.5% | 2% | - | 29-30% |
| **Cement** | @ 12% ad-valorem- + Rs6/bag specific - 30% abatement | | 12.5% | - | - | 22-24% |
| **Metals** | 12.5% | - | 4-5% | 2% | - | 19-21% |
| **Pharma** | 6% | - | 4-5% | 2% | - | 12-14% |
| **Capital Goods - Light electrical** | 12.5% | - | 12.5% | 2% | - | 29-30% |
| **Capital Goods - project** | 7.2% | 6% | 7.50% | - | - | 22% |
| **Information Technology** | - | 15% | - | - | - | 15% |

| Sector | Excise | Service tax | VAT | CST | Other | Effective tax rate (Approx.) |
|---|---|---|---|---|---|---|
| **Textiles** | 0-12.5% | - | 0-5% | 2% | - | 2-21% |
| **Telecom** | - | 15% | - | - | - | 15% |
| **Logistics** | - | 15% | - | - | - | 15% |
| **Media** | | | | - | | |
| Pay TV Broadcasters | - | 15% | - | - | - | 15% |
| Pay TV Distributor | - | 15% | - | - | 8-10% | 24-27% |
| Print Media | - | - | - | - | - | 0% |
| Multiplex | - | 15% | - | - | 24% | 42-43% |

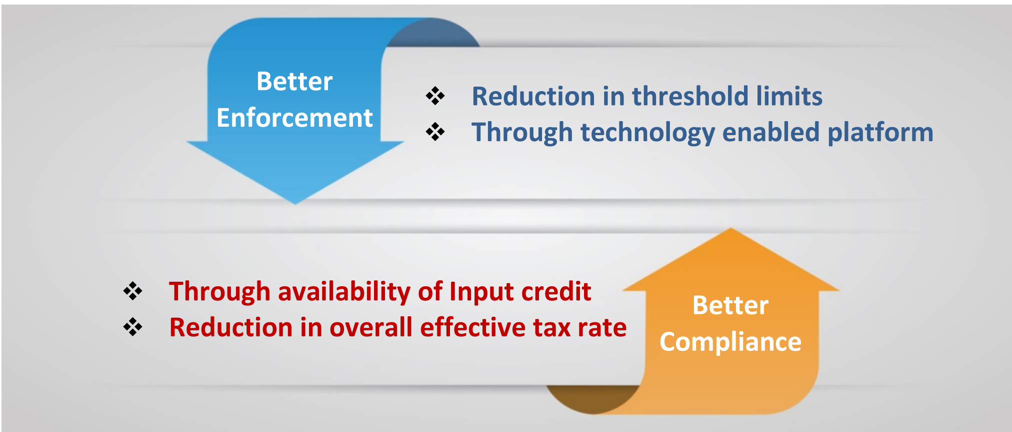
*Including NCCD

Source: MOSL

## 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 INR2.5m 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**



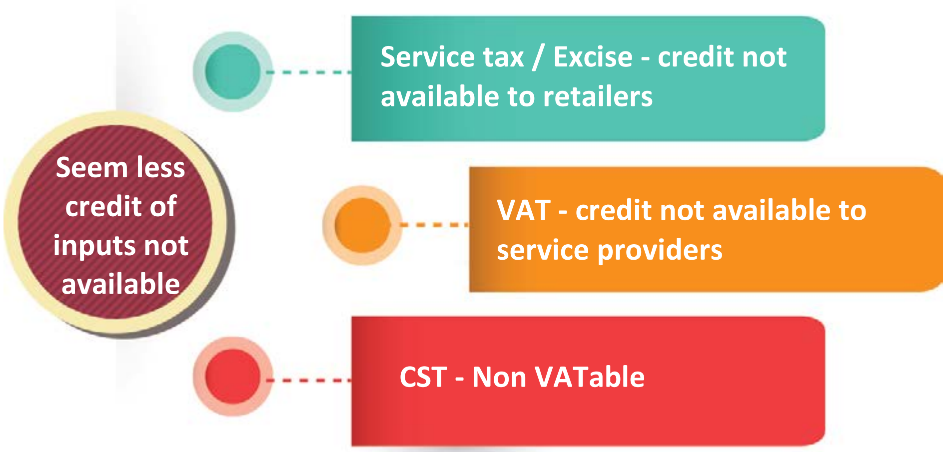

Source: MOSL

- **Key sectors to benefit:** Significant unorganized markets exist in the B2C sectors. Key beneficiaries: Auto Ancillaries (Batteries), Logistics, Capital Goods (Light Electrical), Consumer and Retail.

## 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**



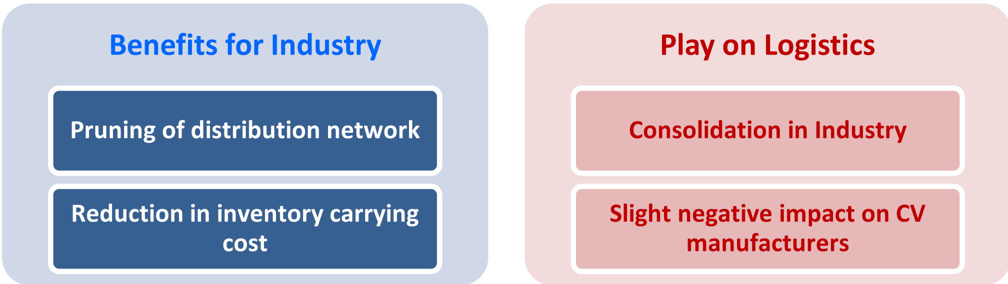

Source: Company, MOSL

- 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 9: 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

## Impact on sectors

**As India Inc transitions to GST, it is likely to witness varied impact on various sectors. While, it is difficult to quantify to impact of GST on various companies/ sector we have tried to identify Sector/ companies the companies in the MOSL coverage which are likely to be impacted materially. We have classified the impact as Positive (represented by green color), Neutral (represented by blue color), and Negative (represented by red color). We have shown the level of impact in various exhibits, where one, two and three circles represent a low, medium and high impact, respectively.**

**Exhibit 10: Sector-wise impact of GST**

| Sector | Change in Tax rate | Availability of Input credit | Unorganized to organized | Supply Chain Management | Overall |
|---|---|---|---|---|---|
| Auto - Batteries | 🟢 | 🔵 | 🟢🟢🟢 | 🔵 | 🟢🟢🟢 |
| Consumers - Retail | 🔵 | 🟢🟢🟢 | 🔵 | 🔵 | 🟢🟢🟢 |
| Logistics | 🔵 | 🔵 | 🟢🟢 | 🟢🟢 | 🟢🟢🟢 |
| Media - Multiplex | 🟢🟢🟢 | 🟢🟢🟢 | 🔵 | 🔵 | 🟢🟢🟢 |
| Auto - Two wheeler/ Four Wheeler | 🟢🟢 | 🔵 | 🔵 | 🔵 | 🟢🟢 |
| Consumers: FMCG – Ex Alcohol and cigarette | 🟢 | 🔵 | 🟢 | 🟢 | 🟢🟢 |
| Capital Goods: Light Electrical | 🟢 | 🔵 | 🟢🟢 | 🟢 | 🟢🟢 |
| Media - Pay TV Distributor | 🟢 | 🟢 | 🔵 | 🔵 | 🟢🟢 |
| Cement | 🟢🟢 | 🔵 | 🔵 | 🟢 | 🟢🟢 |
| Metals | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 |
| Pharma | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| Capital Goods: Industrial | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| IT | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| Media - Pay TV Broadcasters | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 |
| Textiles | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 |
| Telecom | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 |
| Auto - CV | 🔵 | 🔵 | 🔵 | 🔴🔴 | 🔴🔴 |
| Media - Print Media | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 |
| Consumers - Cigarette | 🔴🔴🔴 | 🔵 | 🔵 | 🟢 | 🔴🔴🔴 |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

**Our analysis (based on assumption the standard rate of GST at 18%) suggests that Autos, Consumers, Logistics, Multiplex, Light Electrical, Media, Cement sectors are likely to be positively impacted while Consumers – cigarette, Print media, Auto CVs sectors may be adversely impacted.**

# Autos

## Key implications for sector

- **~8% price reduction for customers:** For most segments, reduction in incidence of indirect taxes would be ~8% (of on-road price) at consumer level. This would drive demand expansion, especially in price-sensitive segments like two-wheelers and entry-level passenger vehicles (PVs).
- **Shift from unorganized to organized segment in batteries:** GST would reduce attractiveness of the unorganized segment (45-50% of replacement market). This would be primarily on account of (a) bridging the price differential between the organized (with ~8% decline in consumer-level price) and unorganized players (by bringing them under the tax net, leading to increase in their prices), and (b) ability of the commercial segment (CVs, taxis, etc) to avail input credit of GST on batteries (and offset it against their GST liabilities), leading to decline in net effective cost when buying from organized players.
- **Easing of logistical bottlenecks = freeing up of fleet capacity?** GST would ease bottlenecks in logistics, especially the time spent at check posts for administering local taxes. Subsuming local taxes in GST would ease the bottlenecks and increase on-road time for the fleet; this would be negative in the medium term, as increase in fleet productivity would dilute the need for fleet expansion and reduce CV growth. However, in the long term, it would reduce the replacement cycle and drive CV demand.
- **No major benefits on supply chain management:** Our discussions with industry participants highlight that as a general practice, Automobile companies dispatch goods directly from factories to dealers and do not route their sales through depots and C&F agents. Consequently, the benefits from distribution / supply chain management are expected to be minimal.

## Implications for companies

### Positive

- **Amara Raja/Exide:** The **b**atteries segment would benefit from shift in trade from unorganized to organized segment due to reduction in price gap vis-à-vis unorganized players (45-50% of the replacement market). Also, in the CV segment (where unorganized players are more prevalent), the fleet operator can claim offset for GST paid on batteries, thereby reducing the net effective cost while purchasing from organized players.
- **Hero MotoCorp:** ~8% reduction in on-road prices for entry (HF Dawn/Deluxe) and executive (Spelndor/Passion) categories would improve affordability and expand the addressable market for this price-sensitive segment.
- **Maruti Suzuki:** On-road prices of entry-level cars would reduce by ~8%, driving demand for the entry-level segment; MSIL, which has an over 80% share of the segment, would be the biggest beneficiary.

### Negative

- **Ashok Leyland:** The pruning of supply chain management and the reduction of logistical bottlenecks may lead to a reduction in CV demand over the medium term; this may adversely impact pure-play CV players like Ashok Leyland.

**Exhibit 11: Entry level OEMs and auto ancillary units catering to replacement markets to benefit**

| Company | Impact Due to: Change in Tax Rate | Impact Due to: Availability of addl. input credits | Impact Due to: Unorganized to organized | Impact Due to: Supply chain management | Impact Due to: Overall | Remarks |
|---|---|---|---|---|---|---|
| Amara Raja | 🟢 | 🔵 | 🟢🟢🟢 | 🔵 | 🟢🟢🟢 | ■ To benefit from the unorganized to organized segment shift, as pass-through of benefits of indirect tax savings will reduce the gap vis-à-vis unorganized. |
| Exide Industries | 🟢 | 🔵 | 🟢🟢🟢 | 🔵 | 🟢🟢🟢 | ■ To benefit from the unorganized to organized segment shift, as pass-through of benefits of indirect tax savings will reduce the gap vis-à-vis unorganized. |
| Hero MotoCorp | 🟢🟢🟢 | 🔵 | 🔵 | 🔵 | 🟢🟢🟢 | ■ HMCL's key segments – entry and 100cc executive motorcycles – are price sensitive and would see demand expansion. However, HMCL would witness increase in indirect taxes, as excise exemption at Haridwar plant would not be available from FY19. |
| Maruti Suzuki | 🟢🟢🟢 | 🔵 | 🔵 | 🔵 | 🟢🟢🟢 | ■ MSIL's entry-level car segment would benefit meaningfully, with ~9% price reduction at the customer level. |
| Bajaj Auto | 🟢 | 🔵 | 🔵 | 🔵 | 🟢 | ■ Bajaj would see benefit in the entry-level segment (~25%); premium segment would be relatively price insensitive. Exports, which contribute ~45%, would remain unaffected. |
| Bosch | 🔵 | 🔵 | 🟢 | 🔵 | 🟢 | ■ Pass-through of benefits to OEMs. Replacement market sales contribute ~20% and might benefit from shift from unorganized to organized segment. |
| TVS Motor | 🟢 | 🔵 | 🔵 | 🔵 | 🟢 | ■ TVSL's key segment of mopeds is price sensitive and would see demand expansion. |
| Bharat Forge | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Pass-through of benefits to OEMs. |
| Eicher Motors | 🟢 | 🔵 | 🔵 | 🔴 | 🔵 | ■ Both RE and CV segments are price insensitive; hence, no significant impact of change in tax rate. CV segment may see some adverse demand-side impact due to easing of logistics bottlenecks. |
| Mahindra | 🟢 | 🟢 | 🔵 | 🔵 | 🔵 | ■ We expect tractors to be charged at ~12% GST rate, which will be marginally positive. However, we expect the luxury car segment (to be taxed at 40% GST) to include PVs with >1.5ltr engines and thus the relative disadvantage would widen further. |
| Mahindra CIE | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Pass-through of benefits to OEMs. |
| Tata Motors | 🟢 | 🔵 | 🔵 | 🔴 | 🔵 | ■ Benefit of lower duties would be fully passed through, although demand isn't materially price sensitive. The CV segment may see some adverse demand-side impact due to easing of logistics bottlenecks. |
| Ashok Leyland | 🔵 | 🔵 | 🔵 | 🔴🔴 | 🔴🔴 | ■ Improved efficiency due to removal of logistics bottlenecks may adversely impact CV demand over the medium term. |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

**Exhibit 12: Customers could see up to 8% reduction in on-road price**

| | Rate (%) | Current | GST |
|---|---|---|---|
| **Ex-factory** | | **100** | **100** |
| Excise duty | 13.5* | 14 | 0 |
| CST | 2 | 2 | 0 |
| Logistics | 2 | 2 | 2 |
| Dealermargins | 5 | 6 | 6 |
| VAT | 12.5 | 15 | 0 |
| GST | 18 | 0 | 19 |
| **Ex-showroom** | | **139** | **127** |
| Road Tax/Registration | 8 | 11 | 10 |
| Insurance (of ex-showroom) | 3.5 | 5 | 4 |
| **On road** | | **155** | **142** |
| Indirect Taxes (% of ex-Factory) | | 31.2 | 19.4 |
| Indirect Taxes (% of on-road) | | 20.1 | 13.7 |

*including NCCD

Source: MOSL

# Consumer

## Key implications for sector

- **Change in effective tax rates to have mixed impact on Consumer companies:** At present, there is a wide divergence in the effective indirect tax rates of companies (ranging between 6% and 30%) due to product-specific and area-based exemptions/concessions. While we believe that the existing area-based exemptions will be grandfathered (and hence, may not have near-term impact), the pruning of product-based exemptions may have an adverse impact on some companies. On the other hand, the lowering of effective tax rates will have a positive bearing on demand/margins.
- **Bridging of pricing gap with unorganized players**: GST would reduce the attractiveness of the unorganized segment (particularly in the Paints, Adhesives and Plywood industries, where share of the unorganized segment is substantial, which would now be included in the tax net.
- **Consolidation of warehouse/logistics operations:** GST would ease logistical bottlenecks, especially the time spent at check posts for local taxes (drive operational efficiencies). The companies would also re-evaluate the consolidation of warehouses versus servicing under the current structure, which could gradually reduce supply chain management and inventory carrying cost.
- **Availability of input credit will aid margin expansion for retailers:** Retailers currently incur 10-15% of their operating expenditure toward rent and infrastructure service, on which service tax is levied. Given that retailers collect only VAT on the sale of goods at present, input credit of service tax is not available. Post GST, the availability of input credit on the services will additionally be available, which will aid margin expansion.
- **Tobacco and precious metals to be hit on expected significant increase in tax rates:** The RNR Committee's recommendation of levying 2-6% VAT on precious metals and GST on tobacco at a higher rate of 40% (+ continuing of central excise) may hurt the industry.
- **Alco-beverage operating margins may be hit by ~100bp on exclusion from GST:** Alcoholic beverages are likely be kept out of the GST ambit, which will be a negative for the industry and have an impact of ~100bp at the EBITDA level due to disallowance of input goods credit. However, industry associations are still lobbying for inclusion.

## Implications for companies

### Positive

- **Pidilite and Asian Paints**: Under GST, the gross effective tax rates for Pidilite and Asian Paints are expected to reduce significantly to ~18% (v/s the current 12.5% VAT and 12.5% excise). We believe that the savings on tax outgo would either be retained (drive margin expansion) or partially offered to the consumer/trade via offers to drive the incipient volume growth. Pidilite rarely initiates any price cuts and, hence, could be a greater beneficiary. Also, we note that there is a significant presence of unorganized players in the product segments to which these companies cater. Post GST, they would also benefit from gradual reduction in competition from unorganized players due to reduction in pricing gap between organized and unorganized players.

- **Shoppers Stop:** GST could result in a two-fold benefit for Shoppers Stop: (a) opportunity to set off input tax credit on rent (likely benefit of 150bp), and (b) reduction of price gap vis-à-vis unorganized players, as a single tax regime will bring most transactions of unorganized players under the tax net.
- **Century Ply:** The plywood industry is currently dominated by unorganized players, with 65-70% market share. Post GST, Century Ply will gain from shift of trade from the unorganized to the organized segment, given the reduced taxation difference (as unorganized segment will come under tax net). Considering the brand equity and quality of Century Ply, it should benefit from the shift in consumer preference towards to branded products.

## Negative

- **ITC:** ITC pays blended weighted average VAT of ~24% while the blended central excise (charged on length of sticks) is levied at ~40%. The RNR Committee proposes inclusion of tobacco in GST (at a rate of ~40%) and continuance of central excise on cigarettes; this may increase consumer-level prices of products and may hurt volumes.
- **TTAN**: The RNR Committee has recommended a GST rate of 2-6% for precious metals. Jewelry currently attracts 1% VAT and no excise duty. If the RNR Committee recommendations are accepted, TTAN could be impacted.

**Exhibit 13: Shift from unorganized to organized to benefit Consumer sector**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax rate | Addl. Input credits | Unorganized to organized | Supply chain management | Overall | |
| Asian Paints | 🟢🟢 | 🔵 | 🟢🟢🟢 | 🟢 | 🟢🟢🟢 | With unorganized companies coming under the tax net, the paints industry will witness a gradual shift toward organized players. |
| Century Ply | 🟢🟢 | 🔵 | 🟢🟢🟢 | 🟢 | 🟢🟢🟢 | Shift of trade from unorganized (~70% currently) to organized segment will benefit branded players like Century Ply. |
| Pidilite | 🟢🟢🟢 | 🔵 | 🟢🟢🟢 | 🟢 | 🟢🟢🟢 | Given Pidilite's pricing power, it can partially retain the benefit of lower tax rates, driving margin expansion. Also, shift from the unorganized to organized segment can bring additional volume growth. |
| SHOP | 🔵 | 🟢🟢🟢 | 🔵 | 🔵 | 🟢🟢🟢 | SHOP would benefit due to availability of input credits on service tax on rent and infrastructure. |
| BATA | 🔵 | 🔵 | 🟢 | 🔵 | 🟢 | The organized segment accounts for 30-35% of total footwear market in India, which is expected to gradually increase due to unorganized sector coming under tax ambit. |
| Colgate | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | Marginally benefits from lowering of current effective indirect taxes from 20-22% to 18% and pruning of supply chain under GST. |
| HUVR | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | Marginally benefits from lowering of current effective indirect taxes from 20-22% to 18% under GST and improved efficiency on supply chain management. |
| Britannia | 🔴 | 🔵 | 🔵 | 🟢 | 🔵 | Slight adverse impacted from increase in effective tax rates as the company's products today enjoy concessional rate of excise. Pruning of supply chain may yield some benefits. |

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax rate | Addl. Input credits | Unorganized to organized | Supply chain management | Overall | |
| Dabur | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Grandfathering of tax incentives in some of its plants may continue to benefit over the medium term but may have an adverse impact in the long term.<br>■ Increase in tax incidence in package juices will be a pass through, in our view. |
| GCPL | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ International business is half of sales and won't be affected.<br>■ Effective indirect tax incidence is higher than possible rate of 18% and thus a positive but the same will be passed on. |
| Jyothy Labs | 🔴 | 🔵 | 🔵 | 🟢 | 🔵 | ■ JYL could be impacted marginally, as its current blended VAT (9.5%, however JYL is paying lower VAT in fabric whitener segment) and excise duty (~4%, given location-based advantages) is lower than the proposed rate. |
| Page | 🔴 | 🟢 | 🔵 | 🟢 | 🔵 | ■ Marginally negative for Page, given that it currently pays lower taxes (5.5% VAT and nil excise, given the benefits to textiles industry). Availability of input credits and company's pricing power will partially negate the impact. |
| Emami | 🔴🔴 | 🔵 | 🔵 | 🟢 | 🔴 | ■ Current effective tax rates are lower at 7.5% due to product-level concessions. Increase in tax rates under GST may have an negative impact on volumes/margins. |
| JUBI | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 | ■ Effective tax rates are in range of 15-16%. Increase in tax rates is likely to adversely impact the company. |
| Marico | 🔴 | 🔵 | 🔵 | 🟢 | 🔴 | ■ Marico pays negligible/ miniscule excise and 6% VAT. If concessional rate of 12% on coconut oil get applied which may have some adverse impact on the company.<br>■ International business is 23% of sales and will not be impacted |
| TTAN | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 | ■ If RNR Committee recommendation of 2-6% tax is accepted, TTAN could be impacted, as this could impede sales from exchange of old gold jewelry. |
| ITC | 🔴🔴🔴 | 🔵 | 🔵 | 🟢 | 🔴🔴🔴 | ■ Rise in effective tax rates as proposed by RNR Committee will lead to higher consumer level prices and potentially impact volumes adversely. |

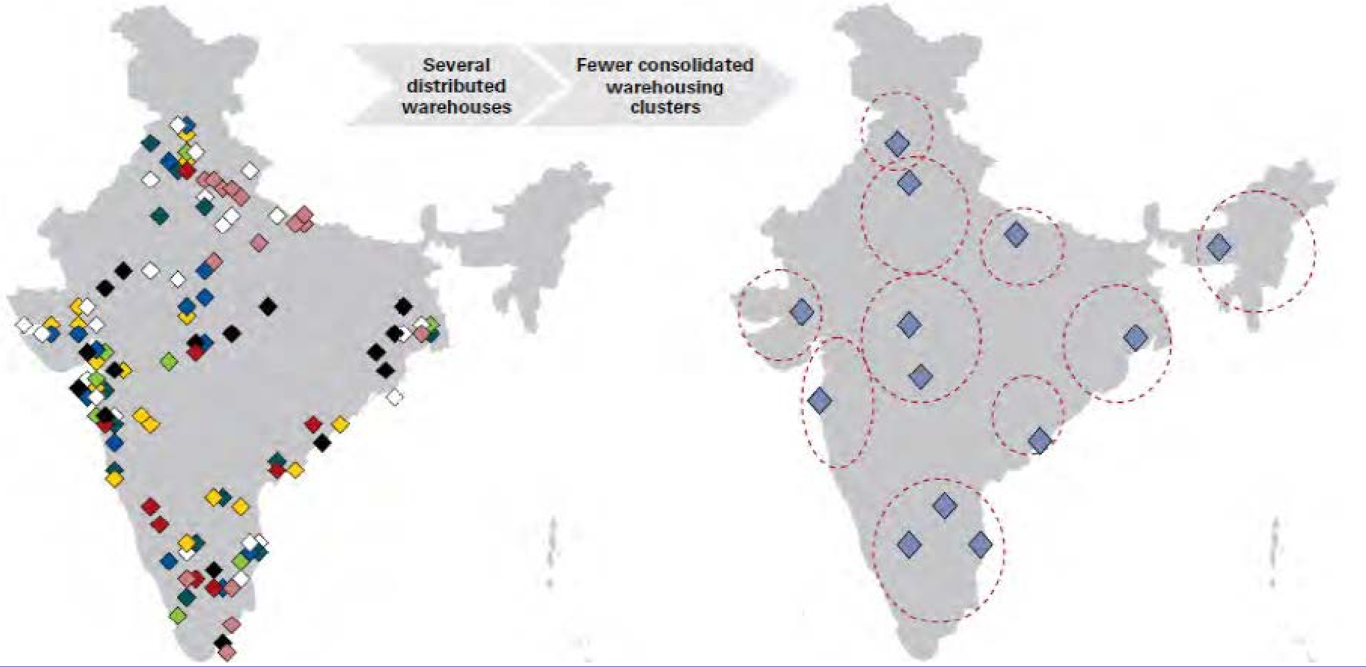
Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

## Logistics

### Key implications for sector

- **Promote hub-and-spoke model:** GST will create a single national market. We believe this would lead to a realignment of warehousing and supply chain requirements of companies. Instead of maintaining warehouses in each state to comply with each state's tax structure, companies would focus on creating regional hubs that cater to their regional markets.

**Exhibit 14: GST will promote the hub-and-spoke model, leading to higher outsourcing and thereby benefit logistics companies**




Source: KPMG, MOSL

- **Supply chain management to get a boost:** We believe that the expected shift to the hub-and-spoke model will increase the market opportunity for organized logistics players. Warehouse size will increase significantly and operations will be more automated, necessitating bringing in the organized logistics companies to manage the supply chain.
- **Expect reduction in transit time:** Inter-state checkpoints (where state authorities review and examine freight to apply appropriate duties) currently add to the transit time of goods through roads, increasing delays by 5-7 hours. According to World Bank, transit times can improve by 20-30% if delays due to roadblocks, tolls and other stoppages are halved. The reduction of checkpoints will directly improve transit times, thereby reducing the cost of logistics companies.
- **Organized sector to boost partially at the cost of unorganized:** The logistics sector is largely fragmented and comprises many unorganized players. Due to tax avoidance by unorganized players, there exists a cost gap between organized and unorganized players. We expect the cost competitiveness of

unorganized players to reduce post GST as they are brought under the tax base, thus shifting volumes to organized players.

- **Rising tax rates will have no material impact for the sector:** For the logistics sector, the effective tax rate will increase from 14.5% currently to 18% under GST. However, it will have no meaningful impact for the sector, as these services are generally on B2B transactions, where the taxes will be passed through and the recipient of service will be able to claim a set-off against taxes on output.

## Implications for companies

### Positive

- **TCI:** It is likely to be one of the key beneficiaries of the GST bill. Majority of TCI's revenue is derived by providing full truck-load (FTL) and less than truck load (LTL) road freight services via its TCI Freight division. While TCI Freight contributes the maximum revenue (37% of FY16 revenue), its EBITDA margins are the lowest (3-5%). By gradually eliminating unnecessary inter-state border checks, the GST bill is likely to lead to seamless truck movement. It is estimated that transit time and resultant costs could be reduced by 20%-30%. Further, through the creation of hub-and-spoke modeled warehousing chains, GST will eventually increase tonnage of trucks, thus ensuring cost efficiencies. TCI Supply Chain Solutions will further benefit from increased demand for warehousing solutions.
- **GATI:** The Company will be the other key beneficiary of GST. Through the creation of a national market and eventually hub-and-spoke modeled warehousing chains, GST will create a larger market for GATI's supply chain management solutions business. GST is also likely to lead to proliferation of e-commerce in India, creating immense revenue opportunities for GATI's e-commerce solutions.

**Exhibit 15: Consolidation of supply chain management to drive benefits for large logistics companies**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax Rate | Addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| Gati | 🔵 | 🔵 | 🟢🟢 | 🟢🟢 | 🟢🟢🟢 | Its express logistics segment will witness higher volume growth; plans to enter into third-party warehouse management. |
| TCI | 🔵 | 🔵 | 🟢🟢 | 🟢🟢🟢 | 🟢🟢🟢 | It will benefit from increased 3PL business (already catering to inbound auto logistics) and also will get higher volumes for its express logistics segment. |
| VRL | 🔵 | 🔵 | 🟢🟢 | 🟢 | 🟢🟢 | Benefit for its express logistics business. Potentially can enter into 3PL services. |
| Allcargo Logistics | 🔵 | 🔵 | 🔵 | 🟢 | 🟢 | Its contract logistics business could witness high growth, already doing some 3PL business |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

# Capital Goods

## Key implications for sector

- **Light Electricals sector to benefit more on reduction of tax rates**: Overall, GST should be positive for the sector, since it lowers the effective indirect taxes to ~18% from the current 29-30%. We believe GST will be more positive for the Light Electricals segment, where companies may benefit from volume growth and margin expansion. For industrial capital goods, we believe most of the benefits will be passed on to customers owing to the current weak demand scenario. Volume-based pickup in demand would depend on economic capex cycle recovery rather than pricing cuts.
- **Increase in addressable market a big opportunity for Light Electricals sector:** In Light Electricals (fans, motors, pumps, cables and lighting), there is significant presence of unorganized players. We believe GST will bring unorganized players under the tax net and, hence, provide a level playing field to companies like Havells, Symphony, Crompton Consumer and V-Guard.
- **Rejig of supply chain will also yield benefits:** The fast-moving electrical goods companies currently operate by opening depots / appointing C&F agents in every state for tax planning. Post GST, the distribution supply chain will be consolidated and lead to savings in distribution and inventory carrying cost.

## Implications for companies

### Positive

- **Havells/ V-Guard/Symphony/ Crompton consumer:** These are likely to be key beneficiaries of GST on two counts: (a) lowering of tax rates (at consumer level) from 26-29% to 18% may benefit them from a combination of volume increase and margin expansion, and (b) increase in addressable market size, as most product segments (like fans, lighting, water heaters and air coolers) in which these companies operate have large unorganized players, who will come under the tax net post GST and provide a level playing field for all players. Further, improved efficiencies in supply chain management will also aid margin expansion.

## Current tax rates for sector

- Capital Goods companies have a mix of product and project revenues. Currently, the effective tax rate for products is ~29% (12.5% excise, 2% CST in case of inter-state movement, and 12.5% VAT). In case of projects, which are treated as works contracts, 60% is assumed as products (attracts excise duty and VAT) and 40% as services (attracts service tax); the effective tax rate is ~22%.

**Exhibit 16: Light Electricals segment to benefit on shift from unorganized to organized**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax rate | Availability of addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| Symphony | 🟢🟢 | 🔵 | 🟢🟢🟢 | 🔵 | 🟢🟢🟢 | ■ Of the total air cooler market of ~5m units, the unorganized segment accounts for ~80% (4m). SYML has 50% market share in the organized segment. A shift from unorganized to organized segment will result in substantial gains for SYML. Further, lower effective tax rates would result in volume growth and margin expansion, given the company's pricing power. |
| Crompton Consumer | 🟢 | 🔵 | 🟢🟢 | 🟢 | 🟢🟢 | ■ Significant benefits will accrue due to (a) shift of trade in fans and lighting from unorganized to organized, (b) lowering of effective tax rates, which may be passed on but will drive volume growth, and (c) improved efficiency in supply chain management. |
| Havells | 🟢 | 🔵 | 🟢🟢 | 🟢 | 🟢🟢 | ■ Significant benefits will accrue due to (a) shift of trade in cables, fans, switchgear and lighting from unorganized to organized, (b) lowering of effective tax rates, which may be passed on but will drive volume growth, and (c) improved efficiency in supply chain management. |
| V Guard Industries | 🟢 | 🔴 | 🟢🟢 | 🟢 | 🟢🟢 | ■ On a blended basis, the organized market accounts for ~60% of the total addressable market, which should expand further due to the shift from unorganized to organized. |
| ABB India | 🟢 | 🔵 | 🟢 | 🔵 | 🟢 | ■ Benefit will arise from shift to organized players for motors, switchgear, pumps and inverters, where there is significant presence of unorganized players.<br>■ Benefit of lower duties would be fully passed through, and demand would be more volume driven. |
| Siemens India | 🟢 | 🔵 | 🟢 | 🔵 | 🟢 | ■ Siemens will benefit from shift of trade from unorganized to organized players in motors and switchgear. Benefit of lower duties would be fully passed through and growth would be more volume driven. |
| Voltas | | 🔵 | 🔵 | 🔵 | 🟢 | ■ ~50% of sales is from products and the balance from projects. Voltas will benefit from reduction in effective tax rates for consumers, which will boost volume growth. |
| Bharat Electronics | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ 40% of sales is from system integration, where service tax is applicable. Impact of taxes is passed through. See no significant impact of GST. |
| BHEL | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Power and industrial segments are demand driven and not price sensitive. Benefit of lower duties would be fully passed through, although demand isn't price sensitive. |
| Crompton Greaves | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Power and industrial segments are demand driven and not price sensitive. Benefit of lower duties would be fully passed through, although demand isn't price sensitive. |
| Cummins | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ ~40% of sales exempt from excise duty as export from SEZ. On the remaining, the regular duty rates are applicable. Do not see much impact of GST. |

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax rate | Availability of addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| L&T Core E&C segment) | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Complete projects business – so, service tax, excise duty and VAT are payable. Do not see much impact of GST. B2B business and any change in tax rate will be passed through. |
| Thermax | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ 60% of sales is from projects while 40% is from products. Benefits of lower tax rates will be passed though; so not much impact from GST. |
| Inox Wind | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 | ■ With GST, the relative advantage over competition on tax breaks at Himachal Pradesh plant may reduce. |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

# Cement

## Key implications for sector

- **Reduction of duties to increase savings by INR300-500/ton**: Reduction of indirect tax rates from the current 23-25% of gross realization [comprising excise duty (@ 12% ad-valorem + INR6/bag specific - 30% abatement) and sales tax (at 12.5%)] to 18% under GST will effectively lead to a benefit of INR300-500/ton. Given that EBITDA of Cement companies is currently in the INR500-800/ton range, upgrade potential would be significant, assuming no pass-through to customers. However, part of the benefit could be passed on to the customer; hence, upgrade in EBITDA/ton could be in the INR0-500 range.
- **Savings from rejig in supply chain management:** Cement sector's distribution channel currently operates through C&F agents and depots to (a) help establish reach, and (b) save on levy of CST during inter-state shipping of goods. Post GST, since CST will be subsumed, the entire distribution planning will be pruned and will be only be as per business requirements. This will result in some savings for companies in the form of lower distribution and inventory carrying costs.

## Implications for companies

### Positive

- **ACC/ JKLC/ Prism**: While the reduction of effective rates and supply chain costs will bring tangible benefits to the entire sector, we highlight that it would be more positive for ACC in large caps, and JKLC and Prism in midcaps, where the earnings sensitivity will be higher, assuming homogenous benefits in taxation.

**Exhibit 17: Proforma benefits of GST**

| Particulars | Amount |
|---|---|
| **Gross Realization(INR/ton)** | **6,020** |
| **Gross Realization(INR/bag)** | **301** |
| Less Sales Tax (@12.5%) | 38 |
| Less Excise Duty( @ 12.3% ad-valorem + Rs6/bag specific - 30% abatement) | 32 |
| Net Realization(INR/Bag) | 231 |
| Net Realization(INR/ton) | 4,629 |
| Gross Realization(INR/ton) | 6,020 |
| Less GST @18% | 1,083.6 |
| | 4,936.4 |
| Difference in net realization (INR/ton) pre and post GST | 307 |

Source: MOSL

**Exhibit 18: Reduction of taxes to be a big positive**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax rate | Addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| ACC | 🟢🟢 | 🔵 | 🔵 | 🟢 | 🟢🟢 | ■ Reduction in effective indirect tax will boost profitability for the sector even when part of it gets passed on to the consumers. Lower the profit base, higher the benefits – ACC among large caps; JKLC, Prism among midcaps. Minor supply chain benefits in terms of optimizing distribution channel. |
| JKLC | 🟢 | 🔵 | 🔵 | 🟢 | 🟢🟢 | |
| PRISM | 🟢 | 🔵 | 🔵 | 🟢 | 🟢🟢 | |
| ACEM | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| DBEL | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| ICEM | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| JKCE | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| ORCMNT | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| RAMCO | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| SRCMT | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |
| UTCEM | 🟢 | 🔵 | 🔵 | 🟢 | 🟢 | |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

## Multiplex

### Key implications for sector

- **Lowering of effective tax rate will aid margin expansion:** Multiplexes currently pay multiple indirect taxes: (a) entertainment tax of 24-26% on box office collection (55-60% of total revenue), (b) service tax of 15% on advertising revenue (~10% of revenue), and (c) VAT of ~8-10% on F&B revenue (20-25% of revenue). While the increase in VAT on F&B and service tax on advertising revenue will increase tax rates, it will be more than offset by significant decline in entertainment tax, considering the high proportion of ticket sales (box office collection) in total revenue. We believe that multiplexes have significant pricing power to retain the benefits, which will lead to margin expansion.
- **Availability of input credit to lower operating cost:** Multiplexes currently largely operate through leased premises and incur significant cost on rentals and infrastructure, on which they pay service tax. In the absence of any significant service tax / excise liability on output, the service tax paid on input is not available for set off, and hence, expenses as cost. Under GST, post the subsuming of all taxes, the credit of taxes on rentals and infrastructure services will be available even against box office collections and F&B revenue, which will lower the operational cost and drive margin expansion.

### Implications for companies

**Positive**

- **PVR:** Blended entertainment tax payable on net ticket sales is 26.9% in FY16 (ticket sales ~54% of revenue). VAT on F&B on blended basis stands at 8% (~25% of revenue). Service tax on advertising revenue stands at 15% (~11% of revenue). Close to INR760m of service tax paid (in FY16) on maintenance and other expenses of properties is expensed out currently since no credit is allowed against it. Considering that all the current indirect tax levies would be converged in GST, the credit of duties currently lost will be available. We believe that this should lead to a margin expansion of ~440bp (at 18% GST).
- **Inox Leisure:** Blended entertainment tax payable on net ticket sales is 23.8% (ticket sales ~65% of revenue). VAT on F&B on blended basis comes to 10% (~20% of revenue). Service tax on advertising revenue stands at 15%. Under GST, post all taxes converging into GST, the credit of taxes on rentals and infrastructure services will be available even against box office collections and F&B revenue—which will lower operational cost and drive margin expansion. We estimate that this should lead to a margin expansion of 200-300bp.

**Exhibit 19: Reduction of tax rates to boost earnings**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in tax rate | Addl. Input credits | Unorganized to organized | Supply chain management | Overall | |
| PVR | ●●● | ●●● | ● | ● | ●●● | Significant beneficiary on account of subsuming of entertainment tax and availability of input credit on services. |
| Inox Leisure | ●●● | ●●● | ● | ● | ●●● | |

Highly Negative: ●●●; Negative: ●●; Slightly Negative: ●; Neutral: ●; Slightly Positive: ●; Positive: ●●; Highly Positive: ●●●

# Media

## Key implications for sector

- **Change in effective tax rate positive for pay TV distributors, negative for broadcasters:** Effective indirect taxes for broadcasters, primarily comprising of service tax (at 15%), getting subsumed by a higher rate of GST (at ~18%) will adversely impact the sector. However, for pay TV distributors (DTH and cable companies), GST will lead to lowering of the effective tax rates, as alongside service tax, the state-levied entertainment tax (in the range of 8-10%) also gets subsumed.
- **Availability of additional input credit positive for pay TV distributors:** Under the current regime, distribution platforms pay basic customs duty + CVD + SAD on set-top-box imports; however, they receive input credit only to the extent of CVD. Under GST, SAD too would be available as credit that can be availed against GST.
- **Print sector currently exempted from indirect taxes may be subjected to tax under GST:** Print companies' revenues (advertisement and circulation) currently remain outside the tax ambit. Print companies also pay sales tax/VAT on the newsprint cost (~30% of revenue), the credit of which is not available; if print revenues are included in GST, the net impact would be negative—partially restricted by the corresponding input credits toward CST/VAT.

## Company-wise impact

### Positive

- **Dish TV:** Dish TV will benefit from GST on two counts (1) lowering of effective tax rates, as both service tax and entertainment tax (ET) get subsumed in GST, and (2) additional input tax credit on set top boxes. We believe Dish TV will be able to retain the reduction in tax rates, which will favorably impact margins. Amongst pay TV distributors, Dish TV should gain the most as (a) subscription income accounts for 90%+ of revenue, and (2) unlike the cable set-up, where the onus of ET collection/payment in most geographies lies with the LCOs (MSOs collect ET in select geographies), DTH companies collect/pay ET at a pan-India level.

### Marginally negative

- **Zee/Sun:** Broadcasters are likely to be negatively impacted, as service tax rates increase from 14.5% to 18%. We believe large broadcasters like Zee/Sun have enough pricing power to pass on the additional cost and will face limited adverse impact. However, smaller/niche broadcasters will be impacted.

### Negative

- **DB Corp/JAGP/HT Media/HMVL:** Print companies are exempted from the levy of service tax on both ad and circulation revenues. However, if print ad/circulation income comes under the tax ambit, print companies will be adversely impacted. The impact would be marginally cushioned by input credits toward VAT charged on newsprint. Currently, DB Corp/JAGP/HT Media/HMVL pay 4-5% as VAT on newsprint cost (~30% of revenue). Our industry interactions suggest that inclusion of ad/circulation revenue under the tax net remains a low-probability event. However, assuming such an event plays out, we believe the ability to pass on the tax burden to readers is limited in an era wherein print is increasingly becoming less competitive vis-a-vis digital media.

**Exhibit 20: Pay TV distributors to be the likely beneficiaries**

| Company Name | Impact Due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in tax rate | Availability of addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| Dish TV | 🟢🟢 | 🟢 | 🔵 | 🔵 | 🟢🟢 | ■ Net beneficiary of reduction in tax rates, which the company will be able to retain. |
| Den Networks | 🟢 | 🟢 | 🔵 | 🔵 | 🟢 | ■ Same as Dish TV. However, proportion of subscription revenue is lower than DTH and entertainment tax liability is borne by LCOs in certain areas. |
| Hathway | 🟢 | 🟢 | 🔵 | 🔵 | 🟢 | |
| Siti Cable | 🟢 | 🟢 | 🔵 | 🔵 | 🟢 | |
| SUN TV | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Dominant player in the South. Impact will be negligible as the increase in tax rate will be a pass through. |
| Zee Ent. | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ It is amongst the top 3 Hindi language broadcasters. Increase in tax rate will largely bea pass through. |
| DB Corp | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 | ■ Applicability of indirect taxation (currently exempted) will be negative. |
| HT Media | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 | |
| HMVL | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 | |
| Jagran Prakashan | 🔴🔴 | 🔵 | 🔵 | 🔵 | 🔴🔴 | |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

## Pharmaceuticals

### Key implications for the sector

- **Supply chain consolidation will help optimize cost:** Most pharma companies today operate through C&F and depot mechanism in most states. GST will enable pharma companies to rationalize their distribution networks through consolidation of depots/warehouses and better inventory management.
- **Increase in tax rates may have limited adverse impact:** The effective tax rate for pharma companies is currently 12-14% (primarily comprising 6% excise and 4-5% VAT and 2% CST). We believe that the levy of GST for most pharma products will be at concessional rates of ~12%. Pharma companies will have the pricing power to pass on the burden of additional taxes to consumers.
- **Removal of area-based exemptions may have adverse impact in long term:** Most pharma companies currently enjoy area-based exemptions on indirect taxation. While the existing area-based exemptions are likely to be grandfathered and may not have an impact in the near term, the future non-availability of such exemption may have a slight adverse impact on the sector.

**Exhibit 21: Supply chain benefits to accrue for companies with significant domestic presence**

| Company Name | Impact Due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in tax rate | Availability of addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| GLX | ● | ● | ● | ● | ● | No exports. However, increase in taxes will be passed through. |
| SANL | ● | ● | ● | ● | ● | Domestic business contributes 75% of sales. However, increase in taxes will be passed through. |
| ARBP | ● | ● | ● | ● | ● | India business at 14%, primarily API which gets taxed at higher rates. Benefits of lower taxation in the GST regime will be passed through. |
| CDH | ● | ● | ● | ● | ● | Domestic business contributes 35% of sales. Increase in tax rates will be passed through. |
| CIPLA | ● | ● | ● | ● | ● | 42% of sales from India. Increase in tax rates will be passed through. |
| DRRD | ● | ● | ● | ● | ● | Only 11-12% of sales are from India. |
| GNP | ● | ● | ● | ● | ● | Domestic business contributes 25% of sales. |
| LPC | ● | ● | ● | ● | ● | ~22% of sales from India. Increase in tax rates will be passed through. |
| SUNP | ● | ● | ● | ● | ● | Domestic business contributes 23% of sales. Increase in tax rates will be passed through. |

Highly Negative: ●●●; Negative: ●●; Slightly Negative: ●; Neutral: ●; Slightly Positive: ●; Positive: ●●; Highly Positive: ●●●

# Metals

## Key implications for sector

**Indirect tax burden to rise from ~16% to 18% (proposed), but net realization to be unchanged:** Metal companies have to pay an excise duty of ~12% and VAT of ~4%, which is proposed to rise to ~18% under GST. Although the tax burden is likely to rise, we do not expect any impact on net realization of companies. Demand for metal products to an extent is price inelastic (a 5% drop/rise in steel prices will not impact construction activity). Metal companies can easily pass on the impact of higher indirect taxes to consumers, in our view.

- **Savings on CST/entry tax/octroi on raw material on which input credit is currently not available:** Taxes such as CST/entry tax/octroi on raw materials add to a company's cost. Sourcing raw material from other states adds to cost, providing arbitrage benefit to companies that can source raw material from within the state (like Tata Steel getting iron ore for its Jharkhand plant from its mines in the state as against SAIL getting it from another state). Based on data available publically, in FY15, SAIL had to pay an entry tax of INR3.8b, representing ~1% of its net revenue. Under GST, SAIL will save cost on this front. Data on entry tax/octroi is not made available by other companies; hence, we are unable to ascertain the benefit to other metal companies.
- **Unorganized market coming under tax ambit, but this market is small:** The metal industry (particularly steel) also has to deal with tax evasion by the unorganized players, putting the organized players at a disadvantage (more so, as metal products are typically homogenous across suppliers). Unorganized players coming into the tax ambit will bridge this arbitrage. However, empirical evidence suggests that the unorganized market is not large and even if the tax bracket is expanded, the incremental benefit is insignificant.

**Exhibit 22: Availability of input credit to slightly benefit metal companies**

| | Impact Due to | | | | | |
|---|---|---|---|---|---|---|
| Company | Change in tax rate | Addl. input credits | Unorganized to organized | Supply chain management | Overall | Remarks |
| Tata Steel | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 | Increase in effective tax rate will be passed on to consumers as the demand is fairly price inelastic. Entry tax/CST on input raw material currently adds to production cost; will get a relief under GST. Supply chain rejig will bring some benefits for the sector while the impact of shift from unorganized to organized will be limited given that the overall unorganized market is small. |
| JSW Steel | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 | |
| SAIL | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 | |
| JSPL | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 | |
| Hindalco | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 | |
| NALCO | 🔵 | 🟢 | 🟢 | 🟢 | 🟢 | |
| NMDC | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | Currently no taxes on iron ore. Input raw material is a small part of total production cost. There are no supply chain issues in iron ore market. Hence, Neutral. |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

# Telecom

## Key implications of GST for the sector

- **Rising tax rates will be negative:** Increase in service tax from 15% to 18% would be mildly negative for the sector. In case of post-paid subscribers (~20% of revenue), the impact would be fully passed on to subscribers. For pre-paid subscribers, there could be a short-term disruption, with hit on the realized rate per minute in case the tax increase is not passed through due to competitive pressures. In case the price increase is passed through in two stages, there will be interim pressure on pricing and profitability. If fully passed through, there could be a short-term traffic volume impact on companies.
- **Additional input credit of SAD/VAT on infrastructure cost:** Telecom companies currently pay only service tax and are not able to attain the benefit of SAD/ VAT paid on entire infrastructure purchased. However, even in the current scenario, the license fee and spectrum charges are not subject to any tax levy and hence no significant benefit from this.

**Exhibit 23: Rising tax rate to marginally impact Telecom companies**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in Tax rate | Availment of addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| Bharti Infratel | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | Increase in tax rate will be a pass through given that the business is B2B and the customers will be able to claim a set off of input taxes against their output tax liability |
| Bharti Airtel | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 | Increase in service tax rate to be slightly negative |
| Idea Cellular | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 | Increase in service tax rate to be slightly negative |
| Reliance Communications | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 | Increase in service tax rate to be slightly negative |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

# Textiles

## Key implications for sector

- **Increase of output taxes may be not be materially negative:** For the textile sector, a significant proportion of sales is derived from exports, which will continue to be zero-rated. For domestic sales, there is lack of clarity on taxability under GST, considering textiles to be goods of basic necessity. However, if the output taxes are imposed on the sector, we believe that there will be an adverse impact on demand over the medium term.
- **Unorganized to organized shift may not have material impact on demand:** Though there is a big unorganized market, significant pricing difference between unorganized and organized players may not warrant a material shift to organized players under GST.

**Exhibit 24: Increase in tax rates may marginally impact domestic business**

| Company | Impact due to | | | | | Remarks |
|---|---|---|---|---|---|---|
| | Change in tax rate | Availment of addl. input credits | Unorganized to organized | Supply chain management | Overall | |
| Indo Count Industries | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | ■ Entire revenue from exports; hence, will have no impact. |
| Kitex Garments | 🔵 | 🔵 | 🔵 | 🔵 | 🔵 | |
| Arvind | 🔴 | 🔵 | 🔵 | 🔵 | 🔴 | ■ Arvind has a sizable (~85%) domestic business. We believe the increase in output taxes will adversely impact domestic demand. However the branded business has the pricing power to pass on the increase in tax rates |

Highly Negative: 🔴🔴🔴; Negative: 🔴🔴; Slightly Negative: 🔴; Neutral: 🔵; Slightly Positive: 🟢; Positive: 🟢🟢; Highly Positive: 🟢🟢🟢

## Banking and Financial Services

### Key implications for sector

- **Negligible impact due to rate increase:** Currently, fee-based income attracts service tax, whereas interest income is exempt. Under GST, the effective tax rate for fee-based services will increase to ~18% from the current 15%, resulting in a moderate increase in certain costs like loan processing charges, insurance premium, credit card charges, etc. Fee-based income was higher for private sector banks at 30% (median) of core income v/s 18% (median) for PSUs. We believe banks will pass on the higher taxes to consumers.
- **Input cost will increase marginally:** Input services will attract a GST rate of ~18%, higher than the current 15% rate, resulting in a higher cost for banks, as CENVAT credit is available only for 50% of the input service taxes paid and the rest is expensed. This will be partially offset by availability of proportional credit on purchase of goods, which is not available in the current regime.
- **Ease of doing business:** Since GST is a destination-based levy, companies would be required to take multiple registrations at all states where services are rendered. This will increase the administration and compliance for banks, which currently operate with a single central registration.

**Exhibit 25: Fee-based income of private sector banks higher**

| Bank | Fee as a % of core Income |
|---|---|
| **PSU Banks** | |
| SBI | 21 |
| PNB | 17 |
| Canara | 19 |
| BoB | 14 |
| BoI | 17 |
| UBoI | 15 |
| **Private Sector Banks** | |
| ICICI Bank | 30 |
| HDFC Bank | 23 |
| Axis Bank | 31 |
| Yes Bank | 35 |
| IndusInd Bank | 40 |

Source: MOSL

- **Impact on companies**: Increase in tax rates will be passed through. There will be no material impact on the BFSI sector.

# Information Technology

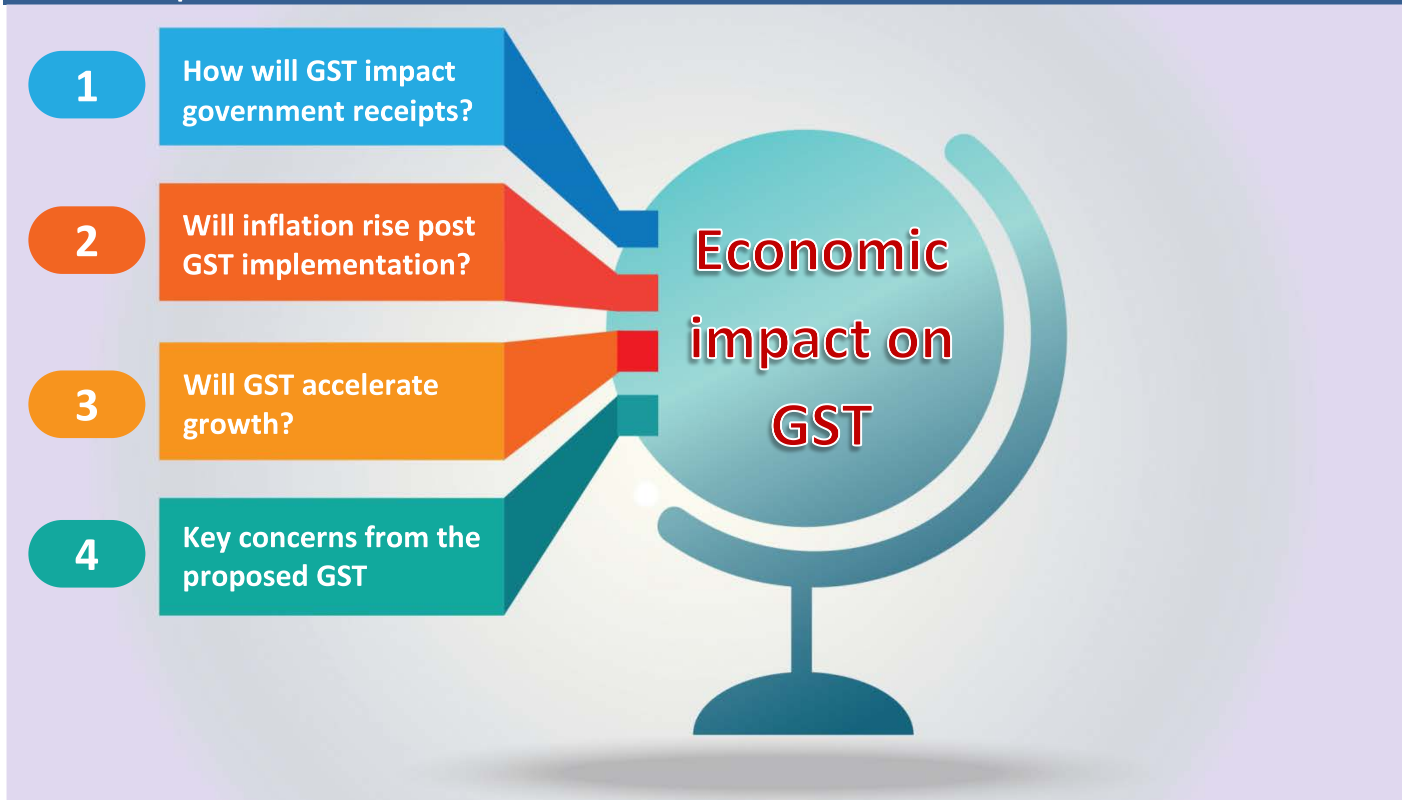
## No material implications for sector

- **No material impact from increase in effective indirect tax rates:** The Indian IT industry derives 74% of its revenue from exports, which are currently exempt from service tax and will continue under GST. For listed players, the proportion of domestic revenues is even lower. Tier-I vendors derive 2.3-6.5% of their total revenue from India, and a negligible proportion is contributed by hardware sales. On account of this, the impact of GST on listed Indian IT vendors would be meager in the overall scheme of operations.
- **Reduced litigation:** With the dawn of GST, litigation regarding classification of canned software as goods or service will end, as GST does not have a distinction between goods and services.
- **Ease of doing business:** GST, being a destination-based levy of tax, will require service providers to take multiple registrations at all locations, where services are rendered, against the current practice of single centralized registration.
- **Impact on companies**: Since significant proportion of exports is derived from exports it will not have a meaningful impact for any company.

## Economic impact of GST

- **Game changer in the longer run: Approval of the GST constitution bill amendment will be the next trigger for the financial markets though its initial impact on economic activity will only be mildly positive. It is unlikely to impact inflation adversely, but could boost economic activity (subject to effective implementation). Over the longer term, it holds the potential to boost economic activity substantially, improve the government's revenue, and help achieve better transmission of prices.**
- **Revenue neutral initially, but accretive over time: Assuming that GST rate aligns with the revenue neutral rate, as is intended, the effective tax rate will come down, which will broadly offset the increase in tax base (since exemption list will be pruned) and most of high-taxes items will be excluded from GST (at least initially). However, as GST will help reduce tax evasion, prune exemption list and improve compliance, the receipts will increase over time. We also believe that the fear among states to lose out on revenue is misplaced. .**
- **Unlikely to raise CPI but to hurt Indian consumers: As far as the impact of GST on inflation is concerned, a moderate GST rate 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 in the consumption basket than in CPI, Indian consumers are likely to feel the pinch of higher prices of services after GST is implemented.**
- **There are two key concerns in the proposed GST. Firstly, the 1% additional tax, if approved, may defeat the entire purpose of creating a unified market. Secondly, the exclusion of crude oil and petroleum products from GST in the initial period makes us skeptical of their inclusion later. This is because the central government's support to compensate the state governments for revenue loss will expire after five years.**

**Economic impact on GST**



## 1 How will GST impact government receipts?

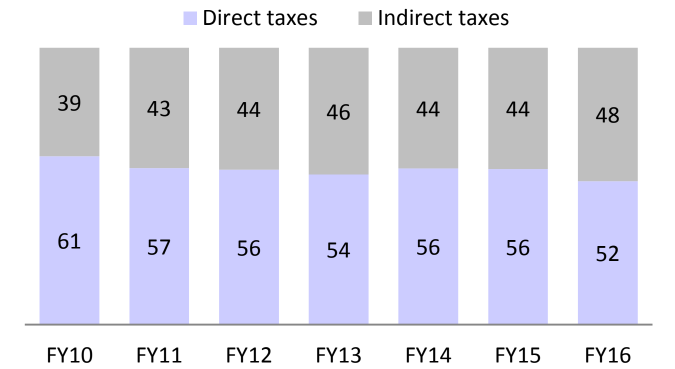
### Revenue neutral initially, but accretive over time

**Assuming that GST rate aligns with the revenue neutral rate, as is intended, the effective tax rate will come down, which will broadly offset the increase in tax base (since exemption list will be pruned) and most of high-taxes items will be excluded from GST (at least initially). However, as GST will help reduce tax evasion, prune exemption list and improve compliance, the receipts will increase over time. We also believe that the fear among states to lose out on revenue is misplaced**

India's tax-to-GDP ratio is one of the lowest among major emerging market economies. The tax elasticity has deteriorated considerably in the past few years. GST implementation is expected to increase overall tax collection by boosting economic allocation of various resources (helping to lift GDP growth) and reduce the incentive to evade taxes (helping to broaden the tax base).

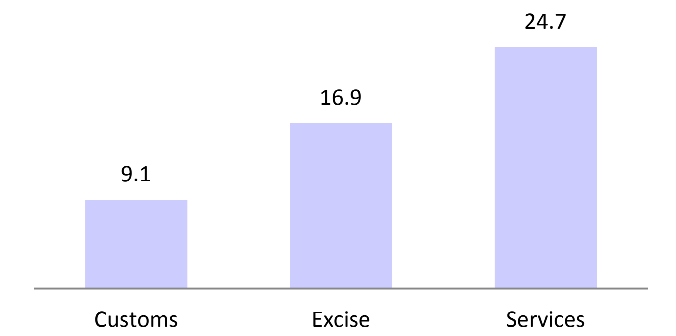
A look at the central government's tax collection shows that the share of indirect taxes has increased in the past few years, as economic slowdown has led to a deceleration in direct tax growth. *Exhibit 26* below shows that the share of direct taxes has fallen from ~60% of total tax collection in FY10 to 52% in FY16. One could argue that higher tax rate on fuel products in FY16 helped indirect taxes (or excise duties) to post one-off high growth; nevertheless, as the exhibit shows, indirect tax receipts have been increasing their share consistently, making indirect taxes more important for the central government.

**Exhibit 26: Share of indirect taxes has increased…**




Indirect taxes comprise customs, excise and service tax
Source: Budget documents, MOSL

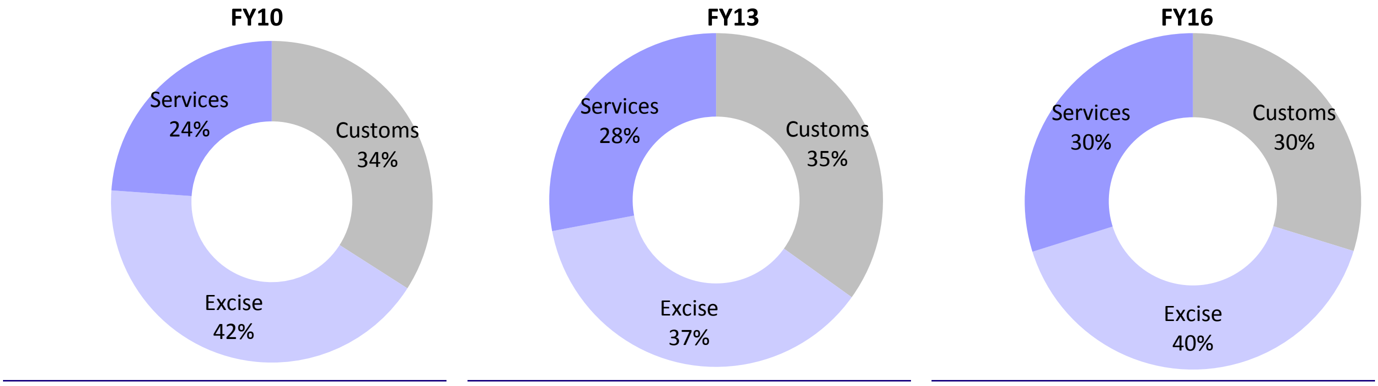
**Exhibit 27: …primarily supported by service tax collections**




Average growth in the past five years (FY12-FY16)
Source: Budget documents, MOSL

In exhibit 27, we look at the three components of indirect taxes – customs duty, union excise duty and service tax. Service tax collection has grown at the fastest pace in the past five years. This is what has helped service taxes to increase their share in total indirect tax collection for the central government – up from 24% in FY10 to 30% in FY16 *(Exhibit 28)*.

**Exhibit 28: Share of different taxes to total indirect tax collection of the central government**




Under GST, the most important thing to note is that the base will widen considerably. Currently, the central government has an extensive exemption list of 300 items as against 90 for most states. Together, this amounts to a loss of INR3.3t (or 2.7% of GDP). GST provides a historic opportunity to prune this exemption list.

With GST, many services that are currently tax exempt will come under the tax bracket. Pruning of the exemption list will help the government to recoup a substantial portion of the INR3.3t losses. Also, the major high tax items such as alcohol, tobacco and petroleum products will not be excluded from GST (at least initially), implying that the loss of revenue from GST implementation will be limited. Nevertheless, if the government sticks to its idea of implementing a revenue neutral GST rate, it implies that the effective tax rate will come down. However, with better tax compliance, reduced tax evasion and pruned exemption list, tax collection will increase over time.

## State governments' fear of losing tax receipts misplaced

Given all the benefits of GST, it is highly unlikely for governments to lose tax revenue. However, the focus of the state governments remains on insuring themselves against possible revenue loss – a myopic behavior, in our view. The central government has announced a number of other measures to provide comfort to state governments:

- Petroleum products are currently out of the GST ambit and will be included only at a later date (not decided yet).
- State excise duty on alcohol for human consumption and electricity duty on sale and consumption of electricity will not be subsumed under GST, to begin with.
- States may be allowed to levy excise duty or any other tax in addition to GST on tobacco and tobacco products.
- Under GST, unlike the current regime, states will receive a portion of total service tax collected by the center.
- Finally, even after all the factors stated above, if states incur revenue loss, the center has promised to compensate them for the first five years after GST implementation. (Till recently, the center's intent was to give compensation in a tapering manner – 100% for first three years, 75% in the fourth year and 50% in the fifth year. However, the states are demanding full compensation or 100% compensation for the first five years).

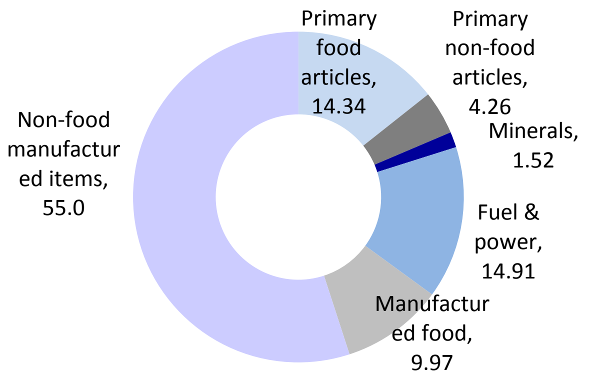
## 2 Will inflation rise post GST implementation?

**WPI to fall, while CPI is expected to remain largely unchanged…**

**As far as the impact of GST on inflation is concerned, a moderate GST rate 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 in the consumption basket than in CPI, Indian consumers are likely to feel the pinch of higher prices of services after GST is implemented.**

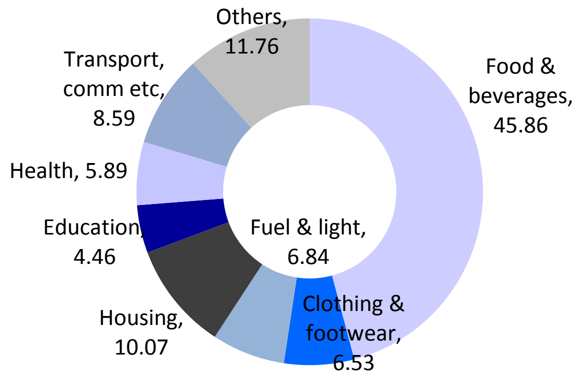
- GST will have differential impact on the wider spectrum of goods and services, as rates for many would change as a result of rationalization. In general, while primary agricultural goods are likely to stay exempted from GST (or taxed at lower rate), manufactured goods are likely to become cheaper, leading to a moderating impact on WPI *(Exhibit 29)*.
- As far as the impact on consumer price index (CPI) is concerned, it is unlikely to be affected much, since food constitutes for almost half of the basket, and other items such as real estate and fuel also hold high weightage. Thus, a large part of CPI will either be exempted or continue to attract the same tax structure as under the current regime *(Exhibit 30)*.

**Exhibit 29: WPI is dominated by manufactured items…**




Source: Office of Economic Adviser (OEA), MOSL

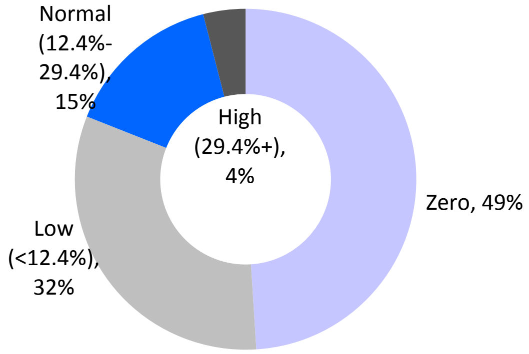
**Exhibit 30: …while food, fuel & rent have high weight in CPI**




Source: Central Statistics Office (CSO), MOSL

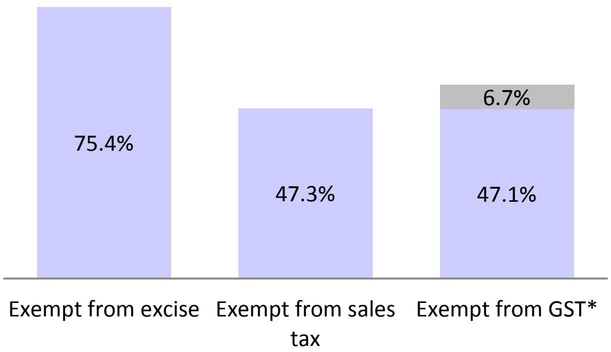
- A recent government study *(Exhibit 31)* says that about half of the CPI basket is not taxed, another one-third is actually taxed at a lower rate (less than 12.4%) and less than 20% is taxed at normal (12.4% to 29.4%) to high rate (above 29.4%).
- This is one of the key reasons why the average effective rate on consumption as measured by CPI is 10.4%. Excluding the items with high tax rates (such as alcohol, petrol, tobacco) and which will be outside the GST coverage, the effective tax rate drops to 7%.
- Further, under the current tax structure, almost 75% of CPI is exempt from excise, and 47% of the basket is exempt from sales tax (or VAT). The study says that ~54% of the CPI basket is likely to remain exempted from GST *(Exhibit 32)*.

**Exhibit 31: Less than 20% of CPI basket is taxed at normal to high rate…**




Source: Government, MOSL

**Exhibit 32: …and ~54% of the basket is likely to remain exempted from GST**

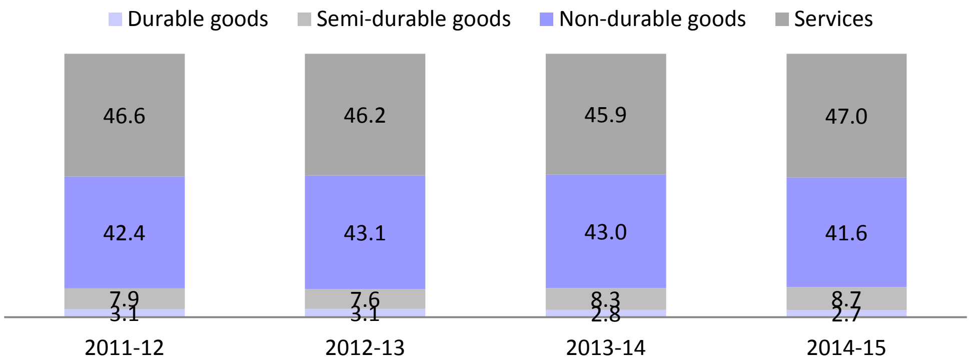



Source: Government, MOSL

## …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 *(Exhibit 33)*. 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 33: Services account for ~47% of Indian consumption basket**




Source: Government, MOSL

- Finally, we have looked at how inflation has behaved in some of the economies after GST adoption. While the analysis may not hold in strict sense because of the differential tax structure in the pre-GST regime and different domestic structure, it is important to note that three of the four economies studied here witnessed a fall in CPI-based inflation. Nevertheless, this conclusion must be considered with caution.

**Exhibit 34: Inflation increased in Australia (%)**

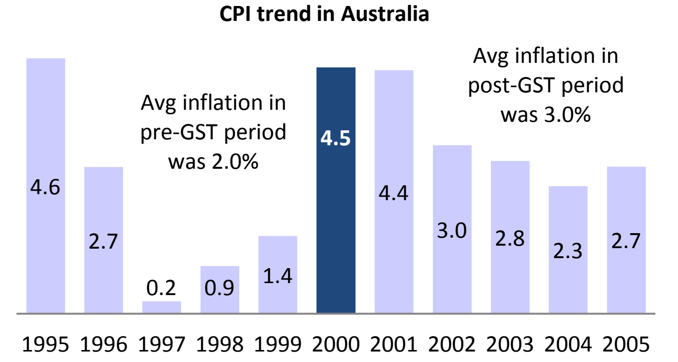



**Exhibit 35: In Canada, it decelerated (%)**

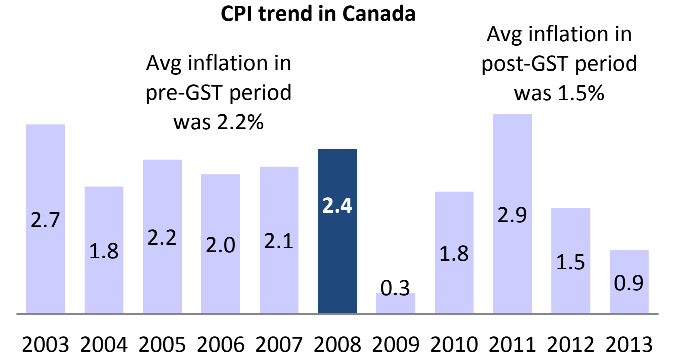



**Exhibit 36: Inflation eased in New Zealand (%)**

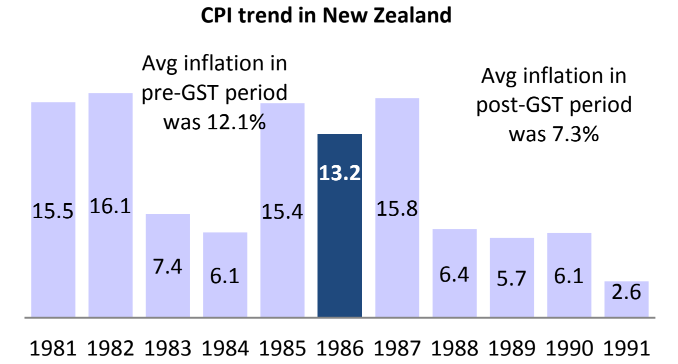
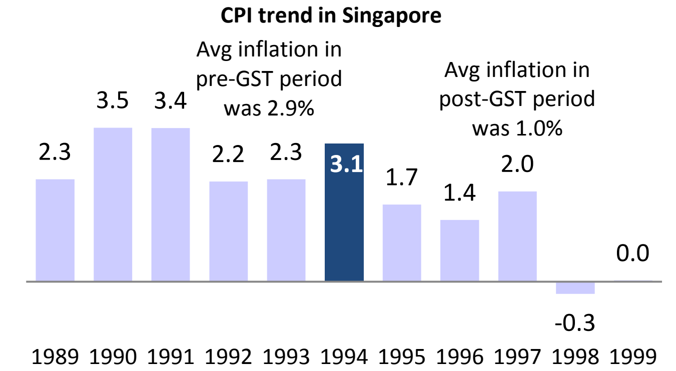



**Exhibit 37: In Singapore, it decelerated (%)**




**Highlighted bar represents the year of GST implementation**

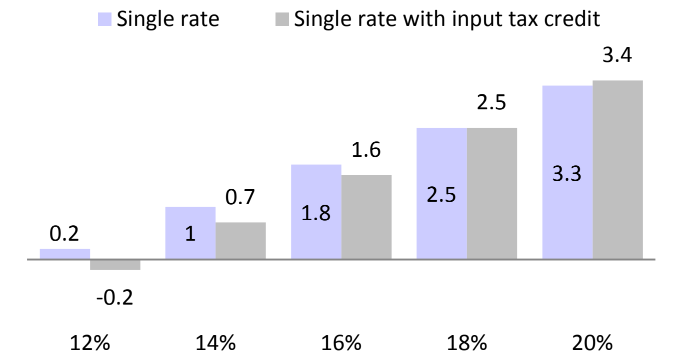
Source: IMF, MOSL

## CPI will be more sensitive to single rate than dual rate structure

As per the government study, a single rate GST will have a bigger impact on CPI *(Exhibit 38)*. Assuming the input-tax credit, CPI will increase by 1% if the single rate is 14%. A single rate of 18% will increase CPI by 2.5% (with or without input-tax credit).

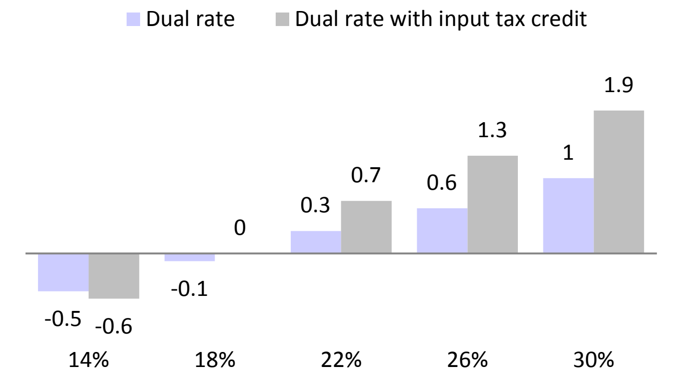
A dual rate structure with a lower rate of 12% and standard rate of 18%, implying a revenue neutral rate of 15-15.5%, will have lower adverse impact on CPI. If all producers react after adjusting for input tax credit, CPI will be unchanged *(Exhibit 39)*. Items such as healthcare (including medicines) and clothing will see higher inflation; however, others like cereals, fruits and oil & fats will see lower inflation.

**Exhibit 38: CPI will be more sensitive to single rate…**




Source: IMF, MOSL

**Exhibit 39: …while dual rate will have limited impact**




Source: IMF, MOSL

Overall, the impact of GST is likely to be muted on retail inflation, as a large portion of CPI will remain out of GST coverage.

## 3 Will GST accelerate growth?

### Seamless and effective implementation holds the key

**Approval of the GST constitution bill amendment will be the next trigger for financial markets though its initial impact on economic activity will only be mildly positive. Seamless and efficient implementation holds the key.**

- One of key reasons why GST is expected to boost economic activity is input tax credit, which is not available under current regime on many transactions. For example, capital equipment acquired for use in transportation, infrastructure, distribution, or construction sectors is currently outside the scope of excise duty; hence, no input tax credits are allowed for union excise duties.
- GST could provide for a more seamless and efficient crediting of taxes paid on capital goods, helping to reduce capital goods prices by 12-14%. Assuming a negative price elasticity of 0.5%, it implies an increase in demand for capital goods investment by 6-7%. Since machinery & equipment accounts for one-third of total investments, it implies an increase in investment by ~2%, which in turn could add 0.5 percentage points to GDP growth, assuming incremental capital-output ratio of 4.
- The oft quoted NCAER estimate of 0.9-1.7% acceleration in GDP growth is highlighted as a potential benefit of removal of cascading of exports. Nevertheless, one of the key assumptions was an exemption-free GST, which does not seem to be the case now, and thus, the benefit could be lower. As noted by the RNR Committee, the quantitative impact of the current regime of zero taxation of exports and that under proposed GST is unclear.

**Exhibit 40: GST may usher some accelerators as well as speed breakers to the growth process**

| GROWTH ENHANCING | GROWTH REDUCING |
|---|---|
| ❖ Removal of octroi/entry tax to ensure smoother transfers and ensure imports are not advantaged over domestic production<br>❖ Boost to exports by eliminating negative protectionism through CST, CVD and inter-state taxes<br>❖ Input tax credit to be extended for capital equipment acquired for use in transportation, infrastructure, distribution, or construction sectors<br>❖ Cost of capital goods may come down leading to higher investment and growth | ❖ If GST is not revenue neutral but revenue accretive for the government, it would lead to higher incidence of taxation on the private sector<br>❖ A higher tax burden on smaller players increases the compliance cost and may result in loss of activity for the informal sector<br>❖ Implementation of less than ideal GST model would erode the perceived gain from GST; specifically GST +/- rate structure can result in substantial cascading and sudden stop of input credit |

- A reflection on the major changes that may take place in the context of growth points to some likely gains as well as some speed breakers. While the growth acceleration would be a consequence of GST implementation, it is not germane to the process of tax changes.

- Overall, investment is discouraged to an extent under the current tax regime, since no input tax credit is provided for several transactions. This increases the cost of capital goods and thus, reduces investment. If tax credits are provided efficiently under GST, it may help investments, and thus, GDP growth.

## 4 Two key concerns from the proposed GST

**There are two key concerns in the proposed GST. Firstly, the 1% additional tax, if approved, may defeat the entire purpose of creating a unified market. Secondly, the exclusion of crude oil and petroleum products from GST in the initial period makes us skeptical of their inclusion later. This is because the central government's support to compensate the state governments for revenue loss will expire after five years.**

- **1% additional tax may defeat the objective of adopting GST:** *"Implementation of a comprehensive goods & services tax (GST) is expected, ceteris paribus, to provide gains in India's GDP somewhere within a range of 0.9 to 1.7 per cent"*, said a study done almost seven years ago by the National Council of Applied Economic Research (NCAER), which also figured in the Constitution Bill 2011. The Bill stated *"…by harmonizing the tax structure across states, this reform would also lead to the development of a common national market for goods & services…"* on its very first page. Nevertheless, the clause of an additional 1%, over and above GST, on inter-state supply (not sale) of goods for two years or more, defeats the entire purpose of creating a common national market. The committee headed by the Chief Economic Advisor (CEA) stated in its report *"…The proposed Constitutional Amendment bill provides for a 1 percent duty on inter-state sales for a limited period. We strongly recommend that this provision be deleted for the very reason that the CST militates against Make in India…"*.
- **If not now, including crude and petroleum products difficult at later stage also:** The center has assured the states that it will compensate them for revenue loss arising out of GST implementation for up to five years in a tapering manner (100% for the first three years, 75% in the fourth year and 50% in the fifth year). Therefore, there is no need to make exclusions. If states are wary of losing revenue, for instance, on petroleum products, the center will make good for them for up to five years. This is an incentive to widen GST coverage to the maximum extent possible. If petroleum products are excluded from GST initially, the probability of including them later is even lower because the insurance period of compensation from the center will expire after (at the most) five years. So, let's say, if states decide to allow the inclusion of petroleum products after three years, they will be eligible for compensation for a maximum of 75% of losses in the fourth year and 50% in the fifth year. In other words, the more the time taken, the lower is the probability of making up lost revenue on goods coming under the GST ambit. In its report, the committee states, *"The Committee cannot state this in any stronger terms: if the GST is to be a success—with an uninterrupted value chain that facilitates compliance and a buoyant source of revenue— these exemptions must be plugged. Using exemptions as selective industrial policy has led to generous un-selective policy, and proliferating exemptions. The road to exemptions hell is paved with the good initial intention of restricting exemptions to a few industries…"*

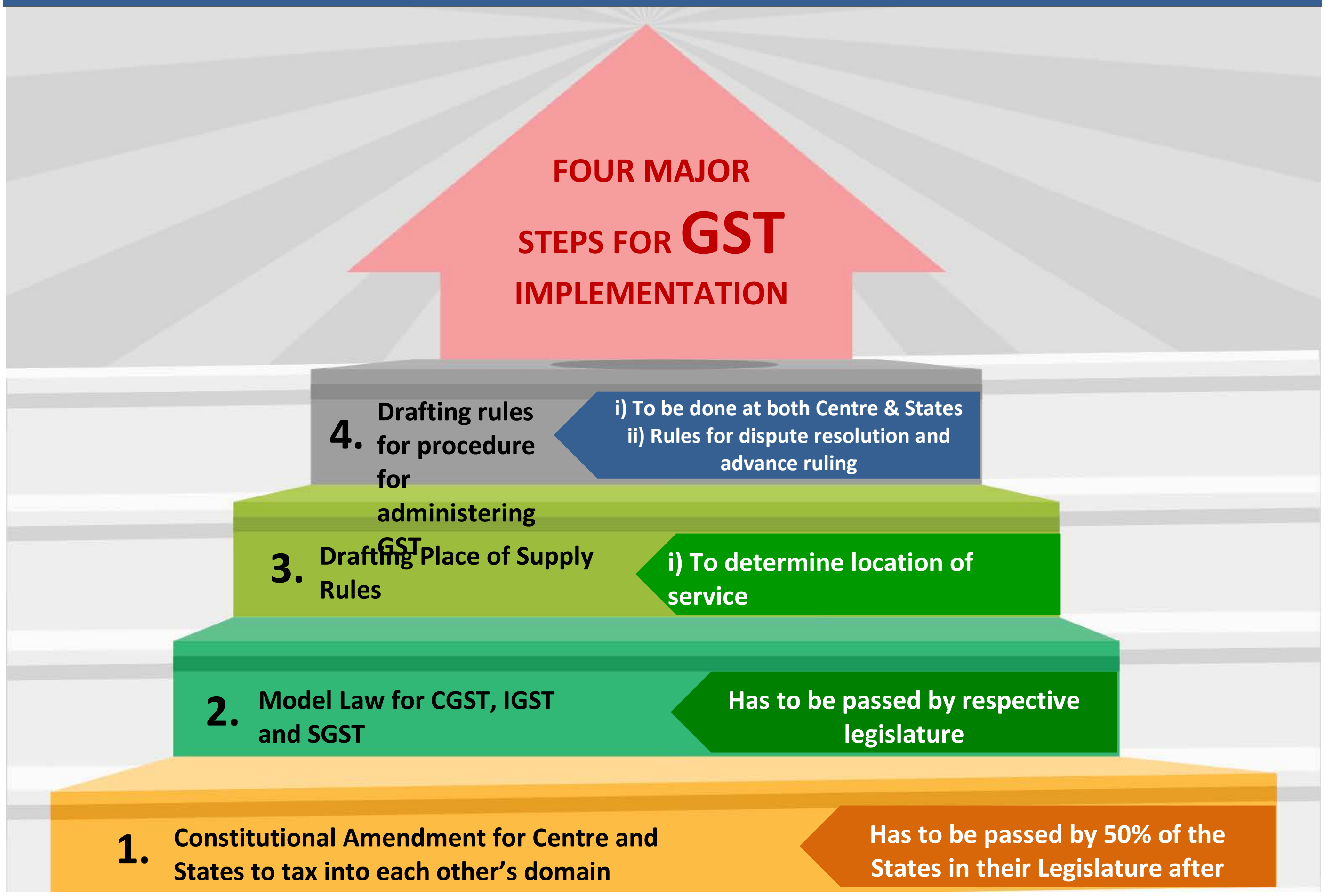
## Key challenges and way forward

### Implementation inevitable, but not imminent

- **The implementation of GST is likely to pose significant challenges. There could be a multi-year timeline for its final implementation. Not only is the legislative process at its early stage (constitutional amendment to be followed by at least half the states ratifying it to be followed by model CGST and SGST bills to be passed by respective legislatures), the subsequent process would also be elaborate.**
- **First, the proposed GST Council has to give final shape to the contentious design issues that are yet to be worked out. Second, the 'place of business' rules need to be defined tightly and satisfactorily; these would replace the current definition of taxability in the case of indirect taxes, both for goods and services. Finally, the background network and knowledge system involving both the payer and the payee would have to be built. All these would require an atmosphere of consensus building, which could be a little more time consuming than is currently being factored in.**
- **Grandfathering of existing location-wise benefits via different modes (such as (a) one-time settlement, or (b) interest-free loans of amount of tax collected) may adversely impact operating profits of some companies while increasing their other income.**

GST is still in its early stage of implementation and a fairly elaborate preparatory stage awaits us – both legislative and executive across states. While the implementation of GST is inevitable, it is not imminent.

**Four major steps for GST implementation**




Source: Government, MOSL

## GST Council: At the heart of GST implementation

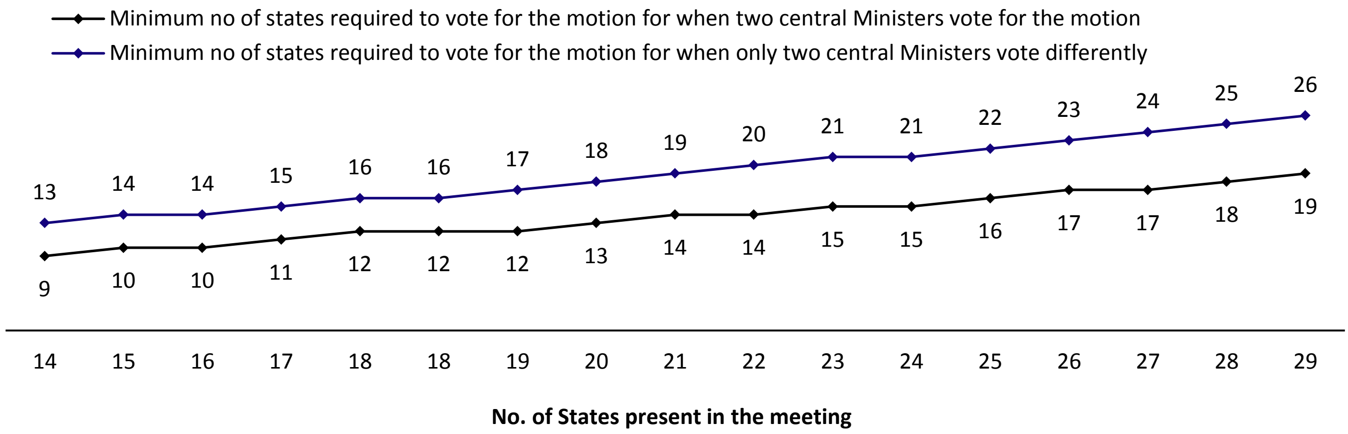
- The proposed GST Council is a decision making process that ensures near consensus for most aspects of GST, which at times may be highly contentious. The GST Council has its job – that involves critical architecture-related issues – cut out already.
- One of the key challenges of GST implementation would be drafting of places of supply rules, especially for the services sector. While GST has sorted out the issues relating to identification of manufacturing and services by clubbing the two, considerable work and agreement needs to be achieved for identification of origin and destination of services consumed. A careful drafting could avert a lot of litigation and transaction costs for corporate India in the future.
- Work on other issues relating to IT network design and implementation, staff training, dispute resolution, and transition issues are still ongoing.

**Exhibit 41: GST Council – composition and voting rights**

| No. of seats | Members | Vote share |
|---|---|---|
| | **Central Government** | |
| 1 | Union Finance Minister (Chairperson) | 33.33% |
| 1 | Union Minister of Charge of Revenue/Finance | |
| | **Minister in Charge of Finance/ Taxation or any other nominated Minister by each State Government** | |
| 1 | Andhra Pradesh | 66.67% |
| 1 | Arunachal Pradesh | |
| 1 | Assam | |
| 1 | Bihar | |
| 1 | Chhattisgarh | |
| 1 | Goa | |
| 1 | Gujarat | |
| 1 | Haryana | |
| 1 | Himachal Pradesh | |
| 1 | Jammu and Kashmir | |
| 1 | Jharkhand | |
| 1 | Karnataka | |
| 1 | Kerala | |
| 1 | Madhya Pradesh | |
| 1 | Maharashtra | |
| 1 | Manipur | |
| 1 | Meghalaya | |
| 1 | Mizoram | |
| 1 | Nagaland | |
| 1 | Odisha | |
| 1 | Punjab | |
| 1 | Rajasthan | |
| 1 | Sikkim | |
| 1 | Tamil Nadu | |
| 1 | Telangana | |
| 1 | Tripura | |
| 1 | Uttar Pradesh | |
| 1 | Uttarakhand | |
| 1 | West Bengal | |

Source: Government, MOSL

**Exhibit 42: GST Council – two-third majority of members present required**




Source: Government, MOSL

**Exhibit 43: GST Council has its job cut out**

| | |
|---|---|
| 1 | To select a Vice Chairperson of the Council for such period as they may decide |
| 2 | To develop procedure for the functioning of the Council |
| 3 | To decide on taxes to be subsumed |
| 4 | To decide on goods/services to be exempted |
| 5 | Model Goods and Services Tax Laws |
| 6 | Apportionment of IGST |
| 7 | Principles for 'place of supply' rules |
| 8 | Threshold limit of turnover for applicability of GST |
| 9 | Rates including floor rates with bands |
| 10 | Any special rates for specified period |
| 11 | Additional resources during natural calamity or disaster |
| 12 | Special provision for North-east and hilly states |
| 13 | Any other matter that the Council may decide |
| 14 | Date from which petroleum products would be brought under GST |
| 15 | To develop a harmonized market for goods and services |
| 16 | To recommend continuation of 1% additional tax on supply of goods beyond two years |

Source: Government, MOSL

**Exhibit 44: 'Place of business' rules – one of the hardest challenges**

| Some general challenges | Sector specific challenges |
|---|---|
| ■ Define location of a business separately for registered and unregistered business | ■ **Telecom:** Agreement for bandwidth/fibers laid across multiple states |
| ■ Claiming of credit by unregistered business | ■ Multi-location video conferencing |
| ■ Services related to immovable property | ■ Registration at multiple locations |
| ■ Bifurcating single invoice across multiple states for tax payment | ■ **Ecommerce:** How to decide taxability |
| ■ Allocation rules for services involving multiple states with a consolidated bill | ■ **Passenger transport:** Place of embarkation, return journey to be split |
| ■ Transfer credit availed by central office on common purchases (capital, audit, advertisement, etc.) to locations of other states | ■ **Stock broking:** Services to FIIs - an export of services |
| ■ Determining place of supply for works contract involving movable goods | ■ **Insurance companies:** Need registration at all states |

Source: Government, MOSL

### Grandfathering of current location-based exemptions

Currently, there are various area-based indirect tax exemptions provided by both the central and state governments. With the dawn of GST, area-based exemptions will need to be phased out, as they break the free flow of input credits in the value chain. Our discussions with various experts suggest that there are three possible options to mitigate this problem and honor the Doctrine of Promissory Estoppel:

1. **Refund of duty:** Under this scheme, the entity currently exempt from payment of duty under various schemes will be liable to pay duties as required under the normal course of business. The duty so additionally paid will be refunded by the state/central government after assessment. Some states (J&K, northern states) follow this mechanism and provide refunds. Our discussions with experts suggest that though this mechanism is the most preferred, corporates may not find this agreeable, as there could be various complexities in assessment and additional working capital could be blocked due to delay in receiving refunds.
2. **Upfront payment:** Under this mechanism, the government pays the present value of estimated duty concessions agreed to the corporates upfront. Going forward, the entities pay taxes in the normal course of business. However, this will entail significant amount of cash outflow from the state / central government upfront, and hence, may be difficult to adopt.
3. **Deferral of payment of taxes:** Under this scheme, the entities eligible for exemption levy taxation as in the normal course of trade. However, the duty so collected is retained, as an interest-free tax deferral for a specified period.

- We highlight that if option2 or 3 are followed, there could be a decline in the operating earnings (EBITDA), which may be counterbalanced by increase in non-operating income and decline in borrowing cost.

**Exhibit 45: Game changing aspects of GST and their impact on different agents**

| Changes that the GST would usher | Impact | | |
|---|---|---|---|
| | **Corporate** | **Govt. Revenue** | **Consumer price** |
| Availment of input tax credit for a wider range of taxes within CGST | Positive | Centre - Revenue Negative | Positive - price |
| Availment of input tax credit for a wider range of taxes within SGST | Positive | State - Negative | Positive - price |
| Dual power and administration | Both positive and negative - This simplifies from multiple laws for each tax, but then makes corporates subject to dual audit and demands | Positive - Can check pilferage better, may squabble over particular issue too | Neutral |
| Eliminate distinction between goods and services | Negative (huge increase in service tax to GST rates, but benefit in terms of lower litigation | Centre & States - hugely positive | Negative - rise in service charge |
| States to acquire power to tax service | Negative (dual compliance, audit); registration in all states for pan India services | States - hugely positive | Negative - rise in service charge |
| Place of supply rule | Negative - higher tax, production / relocation cost | Positive - higher revenue on end price | Positive - benefit of higher input tax credit may percolate, promotes consumption efficiency |
| Abolition of CST | Positive - apart from tax saving an enormous saving in compliance cost, faster movement of goods | Negative - for exporting state governments | Positive - lower price |
| Introduction of IGST | Mixed/Unknown | Positive - higher revenue | Negative - higher price |
| Exports to be exempt or zero rate as at present | Potentially positive if zero-rated instead of exempted | Negative - if zero-rated, as all input tax is to be refunded | Neutral for domestic consumers |
| Lower threshold limit of INR2.5m for GST | Negative - for smaller corporates, Neutral for bigger ones | Positive for center; marginally negative for states with lower existing threshold | Negative - higher price from higher taxation |
| Inter-state movement of goods currently exempt under Form F | Negative - to be taxable | Positive for govt. revenue | Negative - higher price from higher taxation |
| Tax on transfer of goods to branch or agents within state | Negative - to be taxable unless BIN no. same | Positive for govt. revenue | Negative - higher price from higher taxation |
| Non-creditable goods that exists at present | Unknown - may continue | Unknown - may continue | Unknown - may continue |
| Area/region based exemptions | Negative - likely to go | Positive - higher revenue | Negative - higher price from higher taxation |
| Stamp duty | Unknown - big relief to real estate if subsumed under GST | Unknown | Unknown |
| HSN based classification of commodities | Positive - uniform classification to simplify and lessen dispute | Positive- lower dispute and classification error | Neutral |
| GST registration no. (PAN based BIN) from currently varying practice of TIN (with or without PAN) | Positive - Easier compliance and credit claim | Positive - can effectively track compliance | Neutral |
| Extensive use of IT network | Positive - easier tax compliance and refund | Positive: Higher buoyancy, compliance, audit, lower transaction cost and inter-state/center disputes | Neutral |
| Sales vs. works contracts | Positive - easier to distinguish | Positive - less disputes and litigation | Positive - reduced tax burden may lower compliance |
| Only 3-4 rates (including zero rating) | Positive - simpler from the plethora of rates prevailing now but negative - for merit goods enjoying lower tax now | Positive - higher revenue and easier to administer | Positive - tax transparent to the consumer |

| Changes that the GST would usher | Impact | | |
|---|---|---|---|
| | Corporate | Govt. Revenue | Consumer price |
| Uniformity of rates across states | Positive - makes India a single market; promotes production efficiency | Positive - easier to administer; negative for states' autonomy to alter tax rates for exigencies | Positive - tax transparent to the consumer |
| Higher RNR (likely in 20-22%) | Negative - higher tax burden for the corporates | Positive- higher revenue potential | Negative - higher price from higher taxation |
| GST Council can alter rates if voted by 75% majority members | Positive - during downturns for reliefs, negative - during upcycle | Positive - gives a tool for counter-cyclical measures even within a rule-based taxation structure | Positive - provision for tax as shock absorber remains |
| End of price pyramiding | Negative - tax change would cease to be a ground for price change | Neutral | Positive - stable tax regime would ensure pricing stability |
| Removal of cascading | Positive - may discourage verticalization and encourage more efficient outsourcing | Negative - especially for states that enjoy benefit of cascading | Positive - lower price |

Source: Government, MOSL

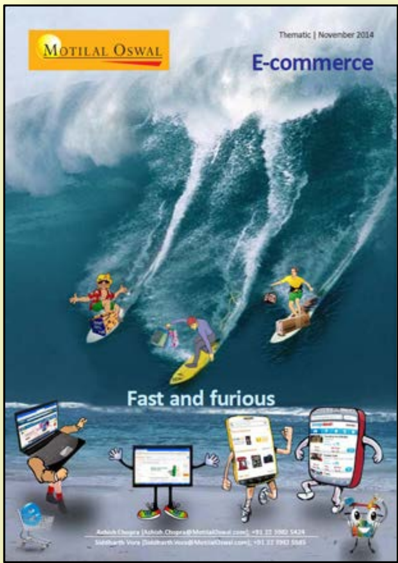
# THEMATIC GALLERY

## SECTOR RESEARCH

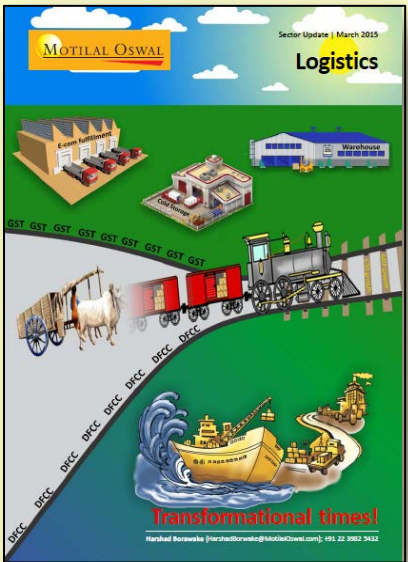



## SECTOR RESEARCH

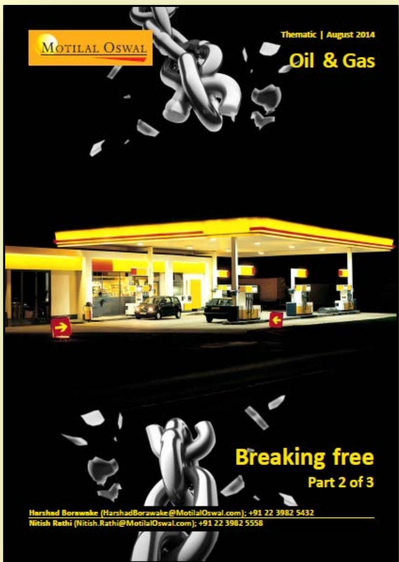





## SECTOR RESEARCH







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