A Study on Perspective Impact of GST on FMCG Sector in India

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Abstract

The fast moving consumer goods (FMCG) segment is the fourth largest sector in the Indian economy. The market size of FMCG in India is estimated to grow from US$ 30 billion in 2011 to US$ 74 billion in 2018. Growing awareness, easier access, and changing lifestyles have been the key growth drivers for the sector.

The sector is likely to see a significant impact once the Goods and Services Tax (GST) Bill is passed as the companies set up warehouses across the states in a bid to have a more tax efficient system. Even from the fast-moving consumer goods (FMCG) industry, the sheer efficiency of goods and services tax (GST), if the design is such that the credits do not stick to the business and are passed on in the value chain, there will be benefits even from an efficiency perspective for a FMCG industry. The second fact is the fact that FMCG industry today has a network design which is also entirely driven by the concept of stock transfers and then sale through depots.

As GST is replacing various indirect taxes used to be levied by central and state government, it has an impact on all most all the sectors of Indian economy. FMCG is one such sector directly having its impact on large public. It is very important to study the possible positive and negative impact of GST implementation on FMCG sector.

Hence, the study covers possible impact of GST in FMCG sector. It also explains the perspective positives and negatives of GST implementation to FMCG sector. The study further covers the effectiveness of GST in FMCG sector in the countries already implemented it.

Key Words

E GST, FMCG, Cenvat Credit, SGST & CGST.

1. Introduction

The FMCG sector contributes a significant USD 6.5 billion in direct and indirect taxes. The fast moving consumer good (FMCG) sector of India comprises more than 50 percent of the food and beverage industry and another 30 percent from personal and household care, thereby spanning the entire rural and urban parts of the country. Reports suggest the sector contributes a significant USD 6.5 billion in direct and indirect taxes. Hence, the sector is likely to see a significant impact once the Goods and Services Tax (GST) Bill is passed as the companies set up warehouses across the states in a bid to have a more tax efficient system. Even from the fast-moving consumer goods (FMCG) industry, the sheer efficiency of goods and services tax (GST), if the design is such that the credits do not stick to the business and are passed on in the value chain, there will be benefits even from an efficiency perspective for a FMCG industry. The second fact is the fact that FMCG industry today has a network design which is also entirely driven by the concept of stock transfers and then sale through depots.

Multiple warehouses will not consolidate nearly because there is a tax change, because the 2 percent origin tax of central sales tax (CST) will go away assuming 1 percent origin tax does not exist in the design of GST. Then there could also be an opportunity to see whether they can consolidate warehouses, but still keeping in mind, the speed to market. So, those are two things that I directly see as a benefit from the FMCG.

In FMCG industry, there are several procurements which are done from fiscal units which are in places like Himachal and Uttaranchal where there is a complete excise benefit. What will be the treatment of those units tomorrow? Will they move on to a refund mechanism and hence what could be the trapped cash flow, working capital requirements and so on and so forth, net of the input credit that may potentially lie? Second is, today in the value added tax (VAT) regime, many of the processed foods which are in the FMCG regime are in the lower tax bracket of 4-5 percent as an example. Tomorrow, the question is whether we will go for a two rate structure or a single rate structure, in my personal view, practically and politically, it appears it will be a two rate structure.

2. Research Design

2.1 Significance of the Study

As GST is replacing various indirect taxes used to be levied by central and state government, it has an impact on all most all the sectors of Indian economy. FMCG is one such sector directly having its impact on large public. It is very important to study the possible positive and negative impact of GST implementation on FMCG sector.

2.2 Objectives

1. To describe the concept of GST
2. To examine the perspective impact of GST in FMCG Sector
3. To analyze the experience of other GST implemented countries
4. To examine the issues associated with GST

2.3 Scope of the Study

The study covers possible impact of GST in FMCG sector. It also explains the perspective positives and negatives of GST implementation to FMCG sector. The study further covers the effectiveness of GST in FMCG sector in the countries already implemented it.

2.4 Type of Research

The study is descriptive in nature as it describes the various attributes of GST and its impact on Indian economy in general and on FMCG sector specifically.

2.5 Method of Data Collection

The study involves secondary data collected from blogs, articles published by experts, experts opinions collected from various media and information collected from government of India's official websites.

3. Concept of GST

3.1 What is GST?

GST stands for "Goods and Services Tax", and is proposed to be a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. It will replace all indirect taxes levied on goods and services by the Indian Central and State governments.

3.2 The Need for GST

Suppose Mr. A sells goods to Mr. B and charges sales tax; then Mr. B re-sells those goods to Mr. C after charging sales tax. While Mr. B was computing his sales tax liability, he also included the sales tax paid on previous purchase, which is how it becomes a tax on tax.

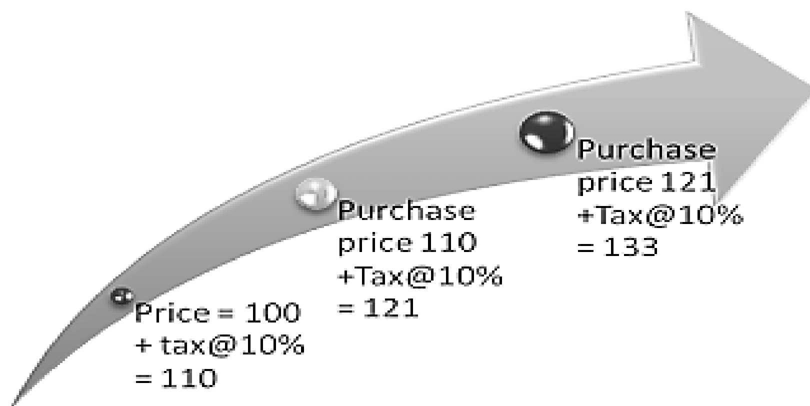

Figure: 1 Tax on Tax

This was the case with the sales tax few years ago. At that time, VAT was introduced whereby every next stage person gets credit of the tax paid at earlier stage. This means that when Mr. B pays tax of Rs. 21, he deducts Rs. 10 paid earlier.

We begin by stating the dual GST model and the taxes levied on each kind of transaction. See these abbreviations before we understand them-

1. SGST – State GST, collected by the State Govt.
2. CGST – Central GST, collected by the Central Govt.
3. IGST – Integrated GST, collected by the Central Govt.

Now look at the chart that follows:

Transaction	New System	Old System	Comments
Sale within the state	SGST and CGST	VAT & Excise/ST*	Under the new system, a transaction of sale within the state shall have two taxes, SGST - which goes to the State, and CGST which goes to the Centre
Sale outside the state	IGST	CST & Excise / ST*	Under the new system, a transaction of sale from one state to another shall have only one type of tax, the IGST-which goes to the Centre

Figure: 2 Comparison of old and new Taxation

3.3 Significance of GST

GST is clearly a long term strategy; it would lead to a higher output, more employment opportunities, and economic inclusion. Initially however, it is likely cause high inflation rates, administrative costs, and face stiff oppositions from states due to loss of autonomy.

In GST, The consumer pays the final tax but an efficient input tax credit system ensures that there is no cascading of taxes. GST is levied only on the value-added at every stage of production.

Example:

Let's say GST is kept at 15% then for Company XYZ Pvt.Ltd, following scene would arise.

XYZ PVT. LTD.			
Material Cost	**Manufacturing**	**Profit**	**Final Cost**
Rs.1,15,000/-	Rs. 20,000/-	Rs. 30,000	1,15,000 + 20,000 + 30,000 = Rs. 1,65,000
Tax@15% = 15,000	No Tax	No Tax	Tax@15% = Rs. 24,750/-
From Rs. 24,750/- tax of Rs. 15,000/- is already paid hence Remaining tax is Rs. 9,750			

Figure: 3 Example

Hence Double taxation was avoided for XYZ Pvt. Ltd.

3.4 GST Rate

13th finance commission recommended a rate of 12%. State says they will not settle for anything below 15%. However government would settle between 14%-16%. According to Government there would be two Slabs, one a lower rate slab for essential items and another effective rate for most items. Some goods will be exempted and a lower rate by 1% for precious metals such as gold, platinum, silver.

3.5 Challenges After GST is Passed

1. Service sector may oppose because they have to register in every state with central and state government. So every business at all India level will have around 60 registrations while they are having just one today. Moreover their rates will also go up.
2. Retail business may oppose because their taxes will go up and they will also have to deal with Central Government now in addition to States.
3. GSTN may not work optimally for quite sometimes.
4. Dual control can increase harassment to businesses.

4. Global Perspective of GST

Experience of Other Countries on GST

The VAT/GST tax system is better than other models because it reduces hidden taxes. The system is non-regressive and fair to the final consumer. Any negative effect on low-income people due to the flat tax rate can be compensated by the government through various measures as VAT/GST provides the government with a steady flow of revenue.

Already adopted in more than 150 countries, it has been tested and proven to work well with the public and the government.

To illustrate this point, it's best to look at examples in the countries that have adopted GST. Take for example, Australia where GST was introduced in 2000. When GST was implemented, there was corresponding reductions in personal income taxes, state banking taxes, federal wholesales tax and some fuel taxes, leading State Treasurer Peter Costello to claim that people were effectively paying no extra tax.

Likewise, Curtin University of Technology, Perth in 2000 made statements that the real estate market would be impacted with an eight percent increase in the cost of homes with the introduction of the GST.

This proved to be false as the real estate market boomed between 2002 and 2004 and demand saw a dramatic increase. This is an example of negative perception of GST which in reality is merely assumptions that are far from the truth.

In Canada, the GST replaced the Manufacturer's Sales Tax and came into force in 1991. The tax did not apply to products such as groceries, residential rent, and medical services, and services such as financial services.

New Zealand introduced GST in 1986 and unlike most countries, there are few exemptions: for example, all types of food are taxed at the same rate. However, there are a few exceptions including rents collected on residential rental properties, donations, precious metals and financial services. The laws in New Zealand ensured that prices on headlines must be GST inclusive, except when businesses claim to be mainly wholesale client-based.

In the European Union, the GST, better known as the Value Added Tax, are known as 'output VAT' (VAT on its output supplies) and 'input VAT' (VAT that is paid by a business to another business on the supplies it receives). A business is usually able to recover the tax it paid either by setting it against the output VAT or, if in excess by claiming a repayment from the government.

Malaysia is thinking of introducing the GST soon as a better and more effective tax to replace the Sales Tax and Service Tax. Since it is already well received and implemented in more than 150 countries, there is no doubt that it should come to Malaysia, the system will prove to be effective and efficient.

4.1 Key Issues Arising from GST

1. Input Tax Credit

The definition of capital goods has been drafted on the same lines as in the existing CENVAT Credit Rules. Accordingly, Input Tax Credit will be allowed only of those goods falling within specified Chapters of the Model GST Law. Therefore, it appears that even under GST, restrictions on Input Tax Credit will continue. If there is a mismatch between the details of outward supplies uploaded on the GST Network

by the vendors and the inward supplies uploaded by the recipient, such mismatch will be communicated to the recipient.

If the mismatch is not rectified by the vendor in the month of communication, the recipient will be liable to pay the differential GST along with interest, in the subsequent month. This provision places the liability for non-compliance on the recipients, i.e. the FMCG companies, as against their vendors.

2. Area Based Exemptions Under the Excise Legislation and State Industrial Policy

The First Discussion Paper on GST had stated that area-based exemptions under the Excise legislation and incentives under the State Industrial policies should be converted to a tax refund mechanism. However, the transition provisions prescribed under the Model GST Law do not provide for the treatment of the said exemptions/ Incentives.

3. Transition Provisions for Traded Goods

The transition provisions provide that the credit balance which was admissible under the present regime would be carried forward under GST.

In case of stocks of imported finished goods, Countervailing Duty is not admissible under the present regime, and in case of goods procured from contract manufacturers, Excise Duty credit is also not available. Accordingly, based on these provisions, under the GST regime, such stocks would suffer double taxation.

4. Taxability and Valuation of Stock Transfers

The charging section of the IGST Act provides for the levy of IGST on the supply of goods made in the course of inter-state trade or commerce. Further, as per the Model GST Law, the term ‘supply’ includes transactions between a principal and an agent.

However, the GST Valuation Rules provides that if the transaction value is not available, then the transaction value of goods of like kind and quality should be considered. Hence, for stock transfers, where a supply for a consideration of goods of like kind and quality is available, such transaction value is to be adopted, and if there is no such supply, then the cost of sales would have to be adopted.

There should be a consistent basis for the valuation of stock transfers.

5. Taxability of Free Supplies

Supply of goods between persons without consideration is deemed to be a ‘supply’. Accordingly, stock transfer of promotion materials/ free samples will be subject to GST. Subsequent supply of the said promotion materials to stockists/end customers will also attract GST. Under the present regime, free supplies are not subject to VAT. Hence, promotion expenses of FMCG companies will increase under the GST regime.

6. Discounts

Discounts/ incentives provided after the supply of goods will be excluded from the transaction value, provided the same is known at or before the time of supply of goods, and is linked to the invoices for the supply of goods. Further, discounts at the time of supply are excluded from the transaction value, only if it is in the course of normal trade practice and is disclosed on the invoice.
Discounts provided under secondary market schemes will therefore not be eligible for an exclusion from the turnover.

7. Place of Supply of Services

The definition of location of supplier *inter alia* provides that the establishment most directly concerned with the supply shall be considered to determine the place of supply.
FMCG companies invariably receive services which are provided from multiple locations and received at multiple locations. There are also situations where it is not possible to determine the location of receipt of a service, for example, broadcasting, advertising, etc. In such situations, the Place of Supply provisions are unclear on which establishment would be regarded as the service provider/ receiver, in order to determine whether the supply is an intra-State or inter-State supply.
This needs to be clarified, as it is critical to availment and utilization of Input Tax Credit by the FMCG companies.

8. Input Service Distributor

The Model GST Law provides for the distribution of IGST/ CGST/ SGST. This is a welcome measure.

The distribution of SGST as IGST needs to be clarified as the GST framework does not contemplate utilization of SGST of one state against SGST of another state.

9. **Point of Taxation**

The point of taxation for supply of goods or services, among other criteria, includes the date on which the recipient shows receipt in his books of accounts. It would be a challenge to track this date on an ongoing basis.

Further, the Model GST law provides for reverse charge, among other criteria, the date of receipt of goods or services or the date of receipt of invoice as the point of taxation, whichever is earlier. It would be cumbersome to track these two dates.

The point of taxation in general needs to be restricted to date of invoice or date of payment, whichever is earlier.

10. **Power to Challenge the Transaction Value**

The Model GST Law provides that if there is a reason to doubt the accuracy of the transaction value declared by the supplier, then the authorities can determine the transaction value as per the GST Valuation Rules. Such an unfettered power to question the transaction value can lead to litigation.

11. **Waybills and Check-Post Related Compliances**

There is no clarity as to whether the present system of waybills and check-posts would continue. The Model GST Law grants power to the Government to prescribe documents for consignment of goods exceeding INR 50,000 in value. In the light of these provisions, it is important that the FMCG Industry represent for the removal of waybills and check-posts related compliances, with the objective of optimization of delivery schedules, lowering operational costs of and consequently enabling competitive pricing.

5. Perspective Impact of GST on FMCG Sector

5.1 Positives

EY expert decodes Reports suggest the FMCG sector contributes a significant USD 6.5 billion in direct and indirect taxes. The fast moving consumer good (FMCG) sector of India comprises more than

50 percent of the food and beverage industry and another 30 percent from personal and household care, thereby spanning the entire rural and urban parts of the country. Reports suggest the sector contributes a significant USD 6.5 billion in direct and indirect taxes. Hence, the sector is likely to see a significant impact once the Goods and Services Tax (GST) Bill is passed as the companies set up warehouses across the states in a bid to have a more tax efficient system.

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5.2 Negatives

In FMCG industry, there are several procurements which are done from fiscal units which are in places like Himachal and Uttaranchal where there is a complete excise benefit. What will be the treatment of those units tomorrow? Will they move on to a refund mechanism and hence what could be the trapped cash flow, working capital requirements and so on and so forth, net of the input credit that may potentially lie? Second is, today in the value added tax (VAT) regime, many of the processed foods which are in the FMCG regime are in the lower tax bracket of 4-5 percent as an example. Tomorrow, the question may arise, whether we will go for a two rate structure or a single rate structure, in my personal view, practically and politically, it appears to be a two rate structure. Then even in such a situation, the lower rate is 12. So, optically, from a fiscal regime manufacturer of no excise, a lower rate of 4-5 percent to a rate of 12. What really happens? Is that something which is going to bring down the prices or

what happens to the prices is a question that needs to be looked at by each of those FMCG manufacturers.

Conclusion

GST transition is not just a transition of tax; it impacts every aspect of the business operations and therefore it requires a 'whole of business' approach to ensure a smooth transition.
So, from a point of view of efficiency on the cascading side, it definitely. If the law pans out the way it is, with the way it is expected to. There will be those efficiencies which will come on the input side, from a point of view of removal of cascading. How much of that removal of efficiency cascading and hence efficiency is offset by rates is something that will have to be seen because if the rates are also in the lower rate of say 12 percent basket, it could be possible that the efficiencies will flow through the value chain. Some of them are at the higher rate of 18 percent, then that is where the problems are. And also on the input side, for a processed food, there are raw materials which are non-processed, agri-produced raw material which today, may be exempt. What happens to them tomorrow? Will they continue to remain exempt. All these will be needed to be factored to really come to an understanding as to what happens to a particular product whether the price falls, remains constant or marginally goes up.

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