The Impact of GST on the Manufacturing Sector in India

The manufacturing sector has been a major economic driver for many developing economies across the world, however, unlike most others, India's manufacturing performance has been lacklustre. Even though India enjoys a favourable demographic and geographic position, it has not been able to capitalise on this advantage. Manufacturing in India has been plagued by a complex tax structure, inadequate infrastructure and bureaucracy, halving its ability to perform well on a global scale. With only a 16% share in GDP, India's manufacturing sector has been close to stagnant for the last two decades. However, now manufacturing may be revived with the focused efforts of the new government. India, traditionally an agrarian economy, could even experience a paradigm shift from an agricultural economy to a manufacturing and service based economy.

The Indian government recognises the significance of the manufacturing sector in the country's economic development and is taking prudent steps to increase investments in the sector. Following India's desire to become a manufacturing hub, the government launched its much publicised "Make in India" initiative. A pet project of the Modi government, it proposes to provide domestic entrepreneurs and international players with various opportunities and transparency in the compliances required for investing and manufacturing in India.

The government also realises that becoming a manufacturing hub will need several strategic reforms to simplify manufacturing in India. One of the proposed reforms, in line with Make in India, is the implementation of the Goods and Services Tax (GST). The new GST regime will trigger a transformational shift from a complex multi-layered indirect taxation system to a unified indirect taxation system. GST will also propagate a positive change by ensuring cascading of taxes is reduced, thus leading to manufacturing synergy in India.

The new GST regime will be a modern tax reform which will usher in growth and opportunities for businesses in India. It will have a far-reaching impact on business avenues, compelling organisations to realign bottlenecks such as production cost, production time, supply chain, compliance, logistics, etc. with the changing indirect tax structure. Furthermore, all major business dynamics will have to be thoroughly analysed to assess the impact of GST on business.

Reduced cost of production

Manufacturing is a very competitive industry and reducing the cost of production while creating incremental value for customers remains a challenge for every business. The new GST regime will be greatly beneficial as a reduction in tax cascading may lead to a lower cost of production. Also, one of the major defects of the current indirect tax regime – the non-availability of tax credit of central/union taxes over state taxes and vice versa – could be eliminated by allowing unrestrictive tax credit under GST.

Hassle-free supply of goods

State-border checkpoints, which are tasked with material scrutiny and location-based tax compliance, negatively impact the overall production and logistics time and account for roughly 60% of a truck's transit time. These unproductive transit hours coupled with regulatory impediments reduce the efficiency of Indian manufacturers compared to their international counterparts. The new GST regime will unify the Indian market and assist the smooth flow of goods within the country. Although border checkpoints may not be done away with immediately, reduced compliance scrutiny at these checkpoints will reduce transport hassles.

Supply chain restructuring

Three specific aspects of GST – an additional 1% tax on supply of goods, the supply of goods and services to oneself, and input tax credit on inter-state sale – may propel the need for supply chain restructuring.

The additional 1% tax, envisaged as a replacement for Central Sales Tax, may not be available for credit, which will add to the cost burden in the price of products.

The terminology used in The Constitution (100th Amendment) Act, 2015 relates to "supply" and does not differentiate between "supply to oneself" and "supply from one person to another". The Select Committee has specifically stated that the additional tax should only be applicable in cases where there is a consideration i.e. supply to self should not be covered within its ambit. Clarity regarding "supply" is expected from the GST Act, which is yet to be proposed by the GST Council. If such a shift materialises, it will warrant a redrawing of warehouse strategy to optimise organisational profits.

Availability of input tax credit on inter-state sale of goods and services may lead to warehouse re-engineering which can remove an extra level of warehousing in the supply chain, thereby leading to greater cost benefits.

Increased compliance requirement

While the new GST regime may offer many benefits to businesses, it also has a flip side. Taking a cue from the OECD's guidelines for place of supply, which were released earlier this year, GST may lead to increased compliance requirements.

Area-based exemptions

As GST would lead to the entire country being considered a common and unified market, the current area-based exemptions would become irrelevant. As we do not have a finalised GST Act in hand, whether or not these area-based exemptions would be available is a matter of concern. If these exemptions are discontinued, those who enrolled due to this incentive would be at a loss.

GST rate

The GST regime may be perceived as a good indirect taxation system only if the tax rates proposed by the government do not exceed the revenue-neutral rate (RNR) expectation of the industry. If the GST rate is higher than expected (20–22%), it will negate every positive aspect of the new regime.

Although the proposed 100th Amendment Act is yet to pass through the Rajya Sabha (upper house of Parliament), the industry is eager with the expectation that GST may be applicable from 1 April 2016. Businesses are re-evaluating their strategies to align themselves with this change. On the other side, irrespective of the outcome of the GST Bill, every consumer, being on the receiving end of indirect taxes, is hoping the government proposes a lower RNR rate, which would help avoid inflationary pressure on product prices. In a nutshell, GST will have a far-reaching impact on the manufacturing sector as a whole once implemented in India.

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Contact

Mumbai
19, Adi Marzban Path
Ballard Estate, Fort
Mumbai 400 001
T: +91 22 6730 9000

New Delhi
B-376
Nirman Vihar
New Delhi 110 092
T: +91 11 2242 8454

Pune
VEN Business Centre
Baner–Pashan Link Road
Pune 411 021
T: +91 20 6720 3800

Chennai
Office No. 3, Crown Court
128 Cathedral Road
Chennai 600 086
T: +91 44 4208 0337

Hyderabad
6-3-249/3/1, SSK Building
Ranga Raju Lane
Road No. 1, Banjara Hills
Hyderabad 500 034
T: +91 40 2325 1800

Bengaluru
Office No. 312/313, Barton Centre
Mahatma Gandhi Road
Bengaluru 560 001
T: +91 80 4140 0131

Toronto
269 The East Mall
Toronto
ON M9B 3Z1
Canada
T: +1 647 707 5066

www.skpgroup.com

Connect with us

skpgrp.info@skpgroup.com

www.linkedin.com/company/skp-group

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