



Influence of 'GST' on the fast moving consumer goods

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Abstract

The fast-moving consumer goods (FMCG) sector is an important contributor to India's GDP. Fast moving consumer goods (FMCGs) constitute a large part of consumers' budget in all countries. Indirect Taxes would be subsumed (except for few taxes such as Stamp Duty) and hence it is expected that it would result in a simpler tax regime especially for industries like FMCG. Apart from simplification of tax compliances, the rate of tax will also have a significant impact on the FMCG sector. GST would have an impact on the pricing, working capital, contracts with vendors and customers, ERP systems, processes, internal control and accounting. Another important impact of GST on FMCG companies would be the opportunity to review the supply chain and move to a supply chain based on business parameters. Hence, GST may bring certain changes in every aspect of the business. The article uses an exploratory research technique based on past literature from respective journals, reports, newspapers and magazines covering wide collection of academic literature on Goods and Service Tax. According to the objectives of the study, the research design is of descriptive in nature. Available secondary data was extensively used for the study. The objectives of the paper are, focused on about Goods and Service Tax and its impact on the FMCG. And also examine Key Takeaways of the Model GST. With the implementation of Goods and Service Tax, FMCG sector would really change. GST will alter the present system of production-based taxation to a consumption-based one. FMCG sector is the major taxation contributor both direct and indirect in the economy. The multiplicity of the taxation influences the company's decision on manufacturing location and distribution of Goods.

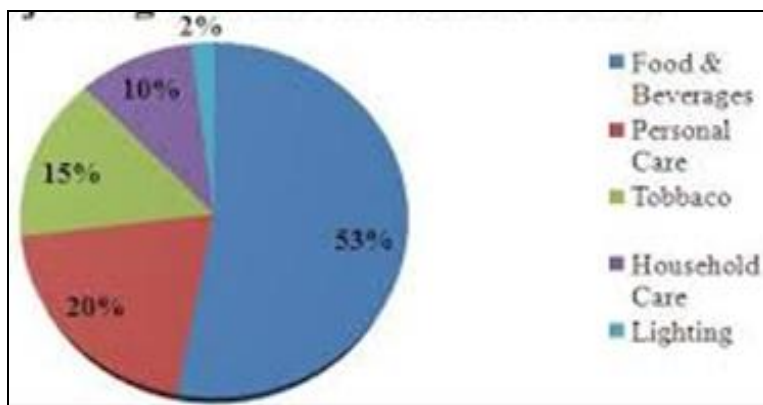
Keywords: FMCG, GST on FMCG, FMCG Growth Prospect, Indian FMCG industry, input tax credit and taxability and valuation of stock transfers

Introduction

The current Indirect Tax regime in India offers for a complex tax environment due to multiplicity of taxes, tax cascading and elaborate compliance obligations.

Under the proposed GST regime, various Indirect Taxes would be subsumed (except for few taxes such as Stamp Duty) and hence it is expected that it would result in a simpler tax regime especially for industries like FMCG. Apart from

simplification of tax compliances, the rate of tax will also have a significant impact on the FMCG sector. Presently the peak tax costs for industry players amount to approximately 27% (i.e. Excise Duty of 12.5 % and VAT ranging from 12% to 15 %). Under the GST regime, it is proposed that the revenue neutral rate would be in the range of 17% to 19%, thereby resulting in significant benefit for the sector.



Source: <https://www.google.co.in/search?q=Images+or+graph+on+gst&tbm=isch&imgil=nh-p1RKa5bfB5M%253A%253BdsDPb7Fop8-uLM%2>

Fig 1: Major Segments of the FMCG Sector

There has been significant progress on the GST front recently.

With the release of the draft Model GST Law on 14 June

2016, a major milestone has been achieved and we have certainly moved a step closer to GST. India finally seems to be on the cusp of implementing this much awaited Tax Regime. In the light of the above developments, industry would now need to analyse the provisions of the draft law in detail and its impact on their business. This is essential to ensure that, timely representations are made to the Government as well as to identify key implementation requirements as part of the preparations for transition from the existing indirect tax regime to GST regime.

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

FMCG Sector in Indian market –Overview

With a population of over one billion, India is one of the largest economies in the world in terms of purchasing power and increasing consumer spending, next to China. The Indian FMCG industry, with an estimated market size of ~2.0 trillion, accounts for the fourth largest sector in India.

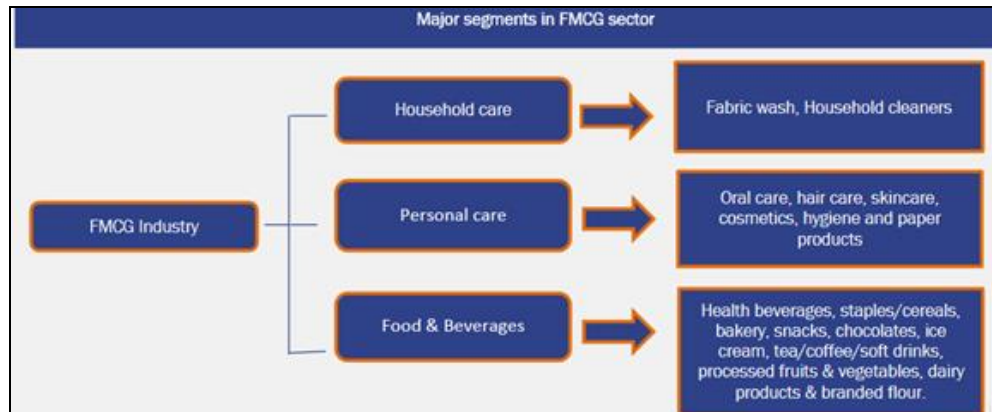


Fig 2

In the last decade, the FMCG sector has grown at an average of 11% a year; in the last five years, annual growth accelerated at compounded rate of 17.3%.The sector is characterized by strong presence of global businesses, intense competition between organized and unorganized players, well established distribution network and low operational cost. Availability of key raw materials, cheaper labor costs and presence across the entire value chain gives India a competitive advantage. During 2012, the country witnessed

high inflation, muted salary hikes and slowing economic growth, which affected the FMCG sector with companies posting deceleration in volume growth in their quarterly results. However, the trend seen in 2012 is likely to accelerate in 2013 as growth will come from rural dwellers that are expected to see a rise in their disposable incomes.

Fast Facts: Indian FMCG Industry

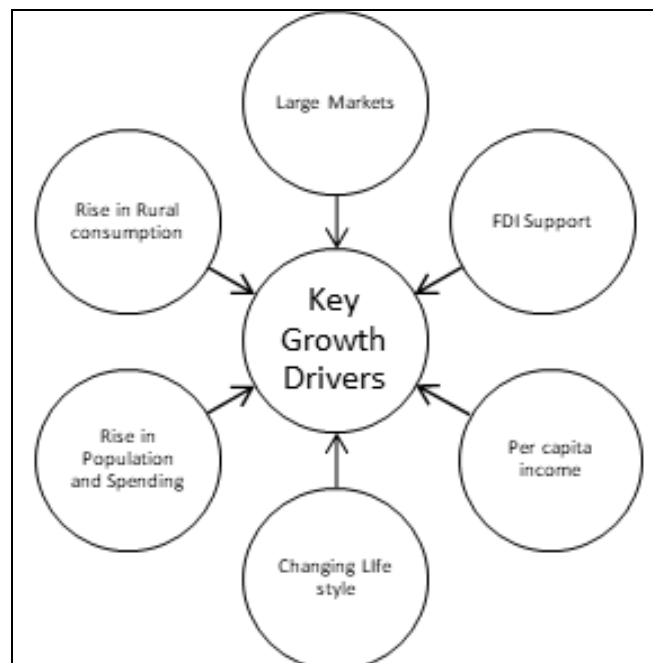


Fig 3

- The Indian FMCG industry represents nearly 2.5% of the country's GDP.
- The industry has tripled in size in past 10 years and has grown at ~17% CAGR in the last 5 years driven by rising income levels, increasing urbanization, strong rural demand and favorable demographic trends.
- The sector accounted for 1.9% of the nation's total FDI inflows in April 2000-September 2012. Cumulative FDI inflows into India from April 2000 to April 2013 in the food processing sector stood at 9,000.3 crores, accounting for 0.96% of overall FDI inflows while the soaps, cosmetics and toiletries, accounting for 0.32% of overall FDI at 3,115.5 crores.
- India's labor cost is amongst the lowest in the world, after China & Indonesia, giving it a competitive advantage over other countries.
- Unilever Places \$5.4 billion bid for a 23% stake in Hindustan Unilever which is the largest Asia Pacific cross border inbound merger and acquisition (M&A) deal so far in FY'14 and is the fifth largest India inbound M&A transaction on record till date.
- Excise duty on cigarette has been increased in the Union Budget for 2013-14, which would hit major industrial conglomerates like ITC, VST Industries in the short term.

Review of literature

Empowered Committee of **Finance Ministers (2009)** introduced their First Discussion Paper on Goods and Services Tax in India which analyzed the structure and loopholes if any in GST.

Vasanthagopal (2011) in the article GST in India: A Big Leap in the Indirect Taxation System discussed the impact of GST on various sectors of the economy. The article further stated that GST is a big leap and a new impetus to India's economic change.

Seventy Third Report of **Standing Committee on Finance (2012-2013)**. The Constitution (One Hundred Fifteenth Amendment) Bill, 2011

Bird (2012) summarizes in the article The GST/HST: Creating an integrated Sales Tax in a Federal Country the impact of GST will be on Canada.

Garg (2014) in the article named Basic Concepts and Features of Good and Services Tax in India analyzed the impact and GST on Indian Tax scenario and concluded that it will strengthen out free market economy.

Objectives of the study

The paper uses an exploratory research technique based on past literature from respective journals, reports, newspapers and magazines covering wide collection of academic literature on Goods and Service Tax. According to the objectives of the study, the research design is of descriptive in nature. Available secondary data was extensively used for the study. The objectives of the paper are:

1. To study about Goods and Service Tax.
2. To review its impact on the FMCG.
3. To examine Key Takeaways of the Model GST.

Key aspects of GST

1. Input tax credit

Scope

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. Further, the definitions of inputs and input services also provide for exclusions.

Therefore, it appears that even under GST, restrictions on Input Tax Credit will continue. Further, a nexus of goods and services received is also required to be established with outward supplies. Hence, the industry needs to represent for a broad based credit mechanism.

Reconciliation of inward and outward supplies

If there is a mismatch between the details of outward supplies uploaded on the GST network by the vendors and the inward supplies uploaded by the recipient, such mismatch will be communicated to the recipient.

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

1. Area based exemptions under the Excise legislation and State Industrial Policy

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

Further, the valuation provisions envisage that, subsidies should be included in the transaction value. This would impact the benefits available to the industry.

2. 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.

3. 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. Schedule-1 of the Model GST Law deems any supply between two persons without consideration as a 'supply'. It is expected that there would be State wise registrations for CGST, SGST and IGST. It seems that each registration in a State would be treated as different persons, though presently there is no enabling provision in the Model law to treat each

registration as a separate person.

4. 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 stockiest/end customers will also attract GST. The valuation of such samples/ materials will be as per the GST Valuation Rules, i.e. the transaction value of goods of like kind and quality or the cost of sales. Under the present regime, free supplies are not subject to VAT. Hence, promotion expenses of FMCG companies will increase under the GST regime.

5. 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.

Major takeaway features

1. The FMCG Industry should file representations to the Government on the key issues arising out of the Model GST Law, as discussed above.
2. Some important action points arising from the Model GST laws are as under:
 - Analyze the impact of GST on business operations such as extent of costs savings in procurements, review procurement contracts, impact on free supplies, discount schemes, impact on product pricing, and the overall financial impact of GST.
 - Review impact of place of supply provisions on procurement and distribution, and ascertain the extent of credit utilization and blockage, if any.
 - Review the procurement and distribution model and evaluate options to move to an efficient supply chain.
 - Changes in the mechanism of utilization of Input Tax Credit will require effective vendor management. Businesses will need to ensure that their vendors are compliant, by applying appropriate commercial safeguards such as release of payment only after the vendor has uploaded the invoice on the GSTN, or the possibility of vendor consolidations.
 - Review arrangements with group of companies and the impact on valuation for inter-group transactions.
 - Review the impact of GST on business processes and ERP systems, and prepare a high level transition plan.
 - Ensure that Input Tax Credits are duly reported on a regular basis in the relevant returns so as to eliminate loss of credit on transition to GST.

Conclusion

GST will alter the present system of production-based taxation to a consumption-based one. With the implementation of Goods and Service Tax, FMCG sector would really change.

FMCG sector consist 50% Food and Beverage sector and 30% is Household and Personal care. FMCG sector is the major taxation contributor both direct and indirect in the economy. The multiplicity of the taxation influences the company's decision on manufacturing location and distribution of Goods. FMCG companies set their manufacturing units and warehouses where they can avail tax benefits. To transfer the stock from the warehouses among the states they have to pay taxes. So, GST would surely impact on FMCG sector as taxes affect the cost to the company.

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