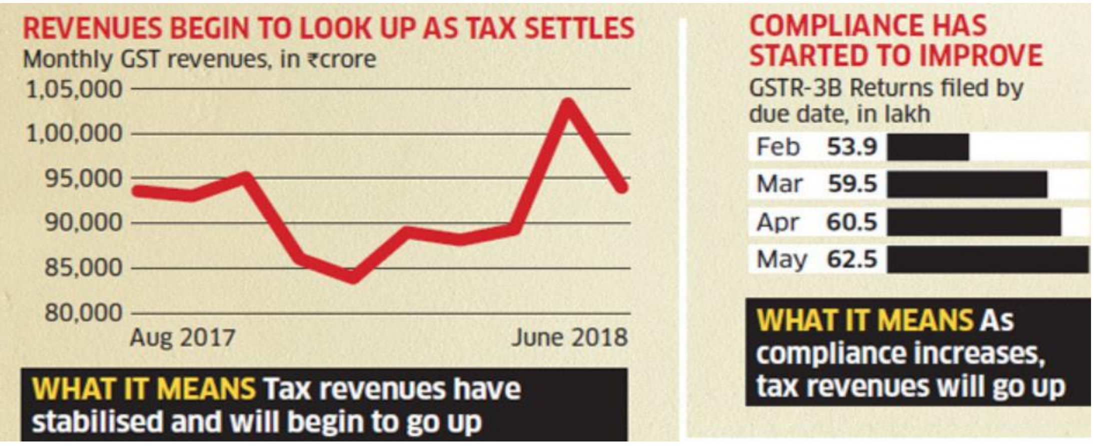
GST to Transform India

India's Prime Minister, Narendra Modi introduced India's biggest tax reform, GST on July 1st, 2017. GST subsumed the existing multiple tax rates on goods and services across the country into a single tax system. In one year, GST has seen a shift towards formalisation of the Indian economy with 11.2 million businesses registered (up 40%), widening of the tax base, monthly revenue of Rs. 896 billion (AU$ 17.9 billion) till March'18, improvement in compliance and a free flow of tax credits resulting in reduced prices for consumers.

Until now, India has been a low tax revenue economy, as a large portion of income is generated by small and medium sized companies who are often provided with tax exemptions. Furthermore, a large part of the economy belongs to the informal sector, and as such pay little to no tax. Unsurprisingly, India's tax to GDP ratio in fiscal year 2018 stood at 11.6%. This is low compared to global standards. To put this into perspective, in 2016-17, Australia's tax to GDP ratio stood at 21.6%. The launch of GST has seen a rise in tax collections to Rs. 956 bn (AU$ 19.1 bn) in June 2018 and 68.4 million people filing income tax returns.



Source: One year of GST: The successes, failures and what's next on the agenda, June 29, 2018 Economic Times

The introduction of GST has been driven by technology and brings along several anti-evasion measures that make it very difficult to circumnavigate. Two examples include:

- ***Invoice matching*** is a measure where the purchaser of goods will receive tax credit only when details of Inward supply match the details of outward supply entered by the supplier. Reverse charge, a mechanism through which large registered firms have to pay tax for purchases from small unregistered firms. Thus, aiming to address evasion methods and boost GST collections.
- ***The E-way bill*** introduced on 1st April 2018 is an electronic generation of a bill when goods shipped across the country are above the value of Rs. 50,000 (AU$ 987) including local transportation above 50 kms. This bill must be generated before the goods are shipped and contain details of the goods, their consignor, recipient and transporter. Thus, the e-way bill is expected to become a tax deterrent for tax evaders that look to keep transactions completely off their books or under report their turnover.

GST is implemented with the ideology 'One Country, One Tax'. It is expected to remove cascading that happens due to double taxation, bring uniform procedures and rules for the whole country which reduces the compliance burden and reduces logistical speed breakers. In the Pre-GST era, a typical truck in India used to spend 20% of its time in interstate check points varying from state to state. This cost the Indian economy around US$ 45 billion (4.3% of GDP). However, with the introduction of e-way bill removing with interstate clearances, the yearly logistics costs are expected to reduce by 20% and reduce delivery time. This is expected to boost company financials and result in reducing prices for consumers and thus boost consumption in the Indian economy. It will help reduce fiscal deficit of India. The Indian Government seeks to improve its GST collection in financial year 2019 up to Rs. 1.03tn (AU$ 260 bn).

The introduction of GST in a large economy like India with 29 different states and 7 union territories and multiple laws is arguably one of the most complex tax reforms undertaken anywhere in the world. Thus, a reform of this magnitude came with its shares of implementation challenges (IT outages, complex return filing and refund procedures, system issues and complex rules for transitioning of credit). Another burden was that every business had to file three returns every month mandatorily as well as an annual return. A lot of businesses found it difficult to comply and it subsequently increased their operations costs. However, this was later brought down to one return per month. These teething issues are inevitable given the scale of implementation of the tax and are being rectified by the Government constantly. The Indian government is also taking measures to expand the GST tax base, rationalise the GST tax slabs (5 different tax rates), legislative changes to ensure availability of tax credit and data analytics to fix the tax leakages. It has received positive appreciation from other economies. GST in India is still in its growth phase and the tax system in India is on par with countries having a good indirect tax structure.

In the Indian economy, the informal or unorganised sector accounts for nearly 50% of GDP. These companies mainly flourish due to tax evasion and non-compliance with regulatory norms that allows them to offer products at comparatively lower prices. In the GST-era, it will be a struggle for such companies to survive as they will be faced with taxes and a sharp spike in compliance cost, lowering margins. Hence, there is an anticipated shift of business from the small, unorganised sector to organised sector in India. Thus, Indian listed companies are the likely beneficiaries and are attracting significant investment from global investors. The extent of the shift per sector and companies that are likely to benefit are shown below.

THE ANTICIPATED SHIFT

Sectors with presence of significant unorganized segment.

Sector	Unorganized segment (in %)	Key companies in organized segment
Apparel industry	70	Aditya Birla Fashion and Retail, Page Industries
Batteries-after market	40	Exide Industries, Amara Raja Batteries
Dairy industry	78	Parag Milk Foods, Prabhat Dairy, Heritage Foods
Jewellery	75	Titan Co., Tribhovandas Bhimji Zaveri, Kalyan Jewellers
Plywood and laminates	70 and 55	Greenply Industries, Century Plyboards, Greenlam Industries
Fans	25	Crompton Greaves Consumer, Bajaj Electricals, Havells
Lighting	35	Philips India, Crompton Greaves Consumer, Bajaj Electricals, Havells, Surya Roshni
Pumps	30	Kirloskar Brothers, CRI Pumps, Shakti Pumps (India)
Faucets/sanitaryware	55-60/35-40	HSIL, Cera Sanitaryware
Diagnostic industry	85	Dr Lal Pathlabs, Thyrocare, Metropolis, Super Religare Laboratories
Packaging industry	45	Uflex, Essel Propack, Huhtamaki PPL, Jindal Poly Films
Plastic products	40	Supreme Industries, Finolex Industries, Jain Irrigation Systems
Air coolers	75-80	Symphony, Bajaj Electricals, Voltas
Dyes and pigments	50	Sudarshan Chemicals, Atul, Bodal Chemicals, Clariant Chemicals
Footwear	50-55	Bata India, Relaxo Footwear, Liberty Shoes, Mirza International
Textiles (ex-apparel)	>90	Welspun India, Raymond, Bombay Dyeing
Retail	>90	Shoppers Stop, Future Retail, Trent

Source: Edelweiss research

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