Likely impact of GST on Automobile Industry in India

India is on the verge of a giant leap from the current indirect tax regime to the new indirect tax regime, namely Goods and Services Tax ('GST'), scheduled to come into effect from 1st July, 2017. GST is a new chapter in Indian economy, possibly the biggest or one of the biggest and most significant tax reforms India has witnessed ever since the independence. The entire structure of taxation on goods as well as services is being realigned into a single destination based value added tax as against the current origin based set up of multiple taxes with limited credit for the tax suffered on earlier transactions in the chain. Therefore, GST is going to impact everyone in the economy - each sector across the business world - manufacturing, trading, construction, exports, banking & finance, insurance, professionals, all sorts of services etc., the governments at all levels, even the judiciary and hence ultimately the Common Man who pays for the goods and services. The impact would depend on effect of changes on one's business as also on one's ability to analyse the impact of changes not only on own business but also that in procurement and distribution chain to optimize the benefit under the new regime. The changes may have positive or negative implications for a given business entity or segment of an industry or given industry as a whole. Automobile industry is one of the largest in the world, growing and dynamic sectors in the Indian economy, having complex operations from tax angle and subjected to fairly high rates of taxation under the current provisions and would obviously have wide implications, both positive and negative, on change over to GST. The annual production of industry was 23.96 million vehicles in FY (fiscal year) 2015–16, following a growth of 2.57 per cent over the last year. The automobile industry accounts for 7.1 per cent of the country's gross domestic product (GDP). The Two Wheelers segment, with 81 per cent market share, is the leader of the Indian Automobile market, owing to a growing middle class and a young population. Moreover, the growing interest of companies in exploring the rural markets further aided the growth of the sector. The overall Passenger Vehicle (PV) segment has 13 per cent market share. India is also a prominent auto exporter and has strong export growth expectations for the near future. In FY 2014–15, automobile exports grew by 15 per cent over the last year. In addition, several initiatives by the Government of India and the major automobile players in the Indian market are expected to make India a leader in the Two Wheeler (2W) and Four Wheeler (4W) market in the world by 2020

The automobile industry broadly comprises of the following:

- Automobile Manufacturers (OEMs), who manufacture Motor Vehicles – broadly divided into four segments viz. passenger cars including utility vehicles, commercial vehicles – for goods & passenger application, two wheelers and three wheelers, each having different business processes, tax structure and therefore issues related to taxation.

- Auto Ancillaries supplying components to the OEMs
- Dealers of OEMs

GST would impact each of the above constituents of the auto industry. This article intends to highlight the key GST impact areas mainly from the OEM perspective. As stated, OEM constituent has segments and each segment – notably passenger cars, has further sub- segments, each having different features and hence different tax implications. However, in this article we have dealt with implications from the point of view of OEM as single sector and wherever the implication is significant and related to one of the segments / sub-segments, made reference to the same. Moreover, since we are trying to cover all the implications or impact areas for the sector in this single article, number of them have been summarized though quite a few of these issues can be subject matter of detailed discussion. Also, we have concentrated mainly on Motor Vehicles and not so much on spare parts and service activities of OEMs.

1. Quantum of tax burden on the end customer:

The impact areas are as follows:

a) Currently, the Motor Vehicles are subject to multiple indirect taxes viz. Central Excise Duty, Automobile Cess, Infrastructure Cess, National Calamity Contingent Duty (NCCD) as applicable depending on tariff classification, Central Sales Tax (CST) on inter-state sales, and State level taxes notably Value Added Tax (VAT) and other taxes like Entry Tax, Local Body Tax, Octroi etc. varying from State to State, which all get passed on to the end customer. There is tax cascading also in as much as CST & VAT are payable on the value inclusive of Central Excise duty & other central levies and VAT is payable on CST. CST impact of 2% & cascading effect thereon is particularly relevant for cars & two wheelers which are sold directly from OEM factory to dealers, most of which are inter-state sales. At present, depending upon the type of vehicle, the indirect tax burden in the hands of ultimate customer could generally vary somewhere between 28% and 56% of the price. Under GST, all these duties, taxes and cesses would be subsumed and cascading effect avoided. The expected combined rate of tax under GST for Motor Vehicles is 28% or 28% plus cess at the rate ranging from 1% to 15% depending on type of vehicle except the electric cars which will attract 12% tax.

b) The outbound supply chain is restricted between manufacturer and dealer and there are no other intermediaries, except for sales of spare parts, which means limited amount of margins in the distribution chain as compared to number of other trades with longer chain in distribution. Under GST, price to end customer would be subjected to full tax incidence as against Central Excise Duty currently applicable only on manufacturer's price and not the trading margins. Though moderately, this would broaden base for tax levy in GST and hence would have adverse cost implication for end customer.

c) The OEM factories typically supplying given model of vehicle to dealers spread across the country, either directly or through depots, involves good amount of expenditure on outbound logistics. Under the current regime, no Central Excise Duty and CST are liable on transportation cost for vehicles directly sold from OEM factory to dealers whereas under GST such transportation cost would suffer tax at the same rate as applicable for the Motor Vehicle. This would have adverse cost implication for cars and two wheelers where the distribution model of direct sales to dealers is a common practice.

d) A chart showing expected combined rate of tax under GST including the Cess where applicable vis - a - vis rate of tax burden currently on end customer for different types of Motor Vehicles is appended. As stated in (b) and (c) above, in GST the rate would apply on a wider base value. If we see the rates under GST, the tax rate on high end passenger cars viz. large cars and sports utility / utility vehicles with specified higher features (both attract very high rate in the current regime), would significantly reduce. However, these high end cars are sold in relatively much less numbers. In case of small cars which account for bulk of domestic car sales as also for the commercial vehicles and two/ three wheelers, the change is marginal when we also consider the increase in base value for tax computation.

Post GST Change In percentage of tax applicable on various Motor Vehicles

Sr. No.	Type of Vehicle	HSN Code	Pre GST duties & taxes			Post GST	Post GST Likely Difference in tax
			Central Excise incl. Cesses	VAT & CST* (Approx.)	Total	(CGST + SGST incl. cesses)	
			%	%	%	%	%
1	Passenger Cars including UVs:	8703					
(a)	Small Car - Petrol		14.63	18.07	32.70	29	-3.70
	length < 4000mm engine cc < 1200						
(b)	Small Car - Diesel		16.13	18.31	34.44	31	-3.44
	length < 4000mm engine cc < 1500						

(c)	Mid - segment car		29.13	20.37	49.50	43	-6.50
	length > 4000mm engine cc < 1500						
(d)	Large Car		32.13	20.83	52.96	43	-9.96
	length > 4000mm engine cc > 1500						
(e)	Sports Utility Vehicle/ Utility vehicle		35.13	21.30	56.43	43	-13.43
	length > 4000mm engine cc > 1500						
	ground clearance > 170 mm						
(f)	Hybrid Car - Mid segment & large		13.63	17.91	31.54	43	11.46
	engine cc < 1500 & engine cc > 1500						
(g)	Electric Car ***		7.13	8.70	15.83	12	-3.83
2	Fully Built Commercial Vehicles						
(a)	(Goods truck, bus > 13 persons) Diesel	8704 & 8702	12.63	15.20	27.83	28	0.17

(b)	Special Purpose vehicles	8705	12.63	15.20	27.83	28	0.17
3	Chassis - diesel - for Goods truck	8706	13.13	15.27	28.40	28	-0.40
	-for bus > 13 persons		14.13	15.40	29.53	28	-1.53
4	Two Wheelers - Petrol	8711					
	Motor cycles - engine capacity > 350 cc		13.63	17.91	31.54	31	-0.54
	Other Motor cycles, scooters, mopeds		13.63	17.91	31.54	28	-3.54
5	Three wheelers (other than electric)	8703 & 8704	12.63	17.75	30.38	28	-2.38

*** Varies state to state & depends on distribution model. Cars and 2/3 wheelers are generally sold from OEM factory to dealers directly and then by the dealers locally. Sales from OEM factory to dealers are mostly inter-state. Hence, effect of CST @2% & VAT @13.5% both considered, including cascading effect. Commercial vehicles generally sold from depots. Effect of VAT @13.5% only considered on value inclusive of Excise Duty. Some other local taxes may also apply. Hence, overall % indicated is approximate %.**

**** Dealer margin is not subjected to Central Excise Duty and CST. Similarly, in case of cars and 2/3 wheelers generally sold directly from OEM factory to dealer, the transportation charges are not subjected to Central Excise Duty. These two elements would be subjected to GST which factor needs to be considered while making comparison.**

***** Some exemptions under VAT in some of the states. VAT rate considered in working at 6%. Actual impact will depend on VAT rate in respective State.**

e) The concessional rate for Hybrid cars is withdrawn in GST and they would be subjected to tax @43%, a major set- back to the upcoming segment. As for electric cars, the impact would depend on different VAT rates currently applicable in respective States.

f) Post sale services like insurance, AMC, servicing, repairs etc. may cost more to the customers with increase in rate of tax on services. As regards repairs, there is some ambiguity as to their treatment as supply of goods or as supply of services whether to be treated as composite supply with significant 10% difference in rates applicable on components and service.

g) State Level Vehicle Tax / Road Tax is not subsumed in GST and it will continue to be a cost to the customer. If taxes on acquisition of vehicle reduce, some States may be tempted to hike the Vehicle Tax. The Automobile Industry had strongly recommended that the Vehicle Tax be subsumed in GST which is not acceded to by the Government. (SIAM recommendations on GST).

h) Car / vehicle leasing is expected to cost more to the customer with lease taxed at the same rate of central (& State) tax as applicable for sale of car / vehicle and further there being no transitional provision for credit of taxes already paid in respect of cars/ vehicles under on – going leases as also with no abatement for amount representing as interest in transactions for financial leasing including hire purchase, currently available under service tax.

2. Impact on cost of production and distribution:

Under the present tax structure, the OEMs are eligible for input tax credit of Central Excise Duty and VAT on their procurement of inputs and capital goods as well as for input tax credit of service tax on most of the services they avail. Their transactions are with registered entities and credit chain is well established to capture and avail of the input tax credits eligible. However, in the current structure there are inherent limitations on credit eligibility whereas under GST, input tax credit would be fully allowed barring a few exceptions, thereby cost incidence of tax paid at earlier stage in the supply chain would be totally avoided. This would lead to tax neutrality in both inward and outward transactions and business decisions can be made based purely on operating efficiency rather than on tax considerations. All this in effect would reduce the cost of procurement & production as well as cost of distribution which would be the biggest benefit to industry in GST. The main potential areas for saving / additional benefit under GST are as follows:

a) Saving of 2% CST on inter- state procurement.

b) Saving in VAT surrender where the sales to customers in other States are routed through depots - commercial vehicles as well as on transfers of semi-finished goods to other factories – 4% or even more of corresponding purchases within State.

c) Saving in octroi/ LBT/ Entry Taxes without credit on procurement.

d) Input tax credit on outward transportation – net benefit where the vehicles are sold through depot – commercial vehicles.

e) Vendor price reductions for corresponding benefits in supply chain as also towards excise duty on any transactions in the supply chain with entities not registered. Tax cascading effects in supply chain which can involve 3/4 levels will be avoided and which can also be built in negotiations

f) Wider input tax credit availability e.g. warranty parts, services related to trading activities, items like furniture, office equipment etc. currently out of credit chain.

g) Rationalization of procurement decisions due to flexibility arising out of tax neutrality e.g. decisions on job work, location of vendor no bar, level of assembly – all decisions can be made based on operating efficiency alone.

h) Rationalization of vendor base.

i) Tax neutrality will support procurement of higher level assemblies and consequently more outsourcing if economical.

j) Realignment of production processes even if the units are in two different States e.g. centralized production of certain components and its supply to other units if operationally more efficient.

k) Eventually, vendors will also rationalize their processes and locations to optimize costs.

l) Realignment of distribution chain e.g. with no specific tax benefit to anyone in effecting sales through depots, depot operations can be restricted only based on business needs e.g. proximity to customer and possibilities of more direct sales from factory can be explored. The concepts like regional depots at central places to cater to dealers in more than one State due to tax neutrality and have the benefit of existence of depot at lower cost, bulk transportation by railway or even waterways up to certain central place for further distribution there from without tax implication etc. can be put through.

m) Saving in current cost of non-abatement of Excise Duty on post- sale incentives,

However, the requirement for working capital on inventory at all stages – in factory, at depots, in transit, at dealerships will go up with blocking of more funds in taxes in the absence of transactions at concessional rate like C Form, F Form transactions currently possible.

While the scope for input tax credit is widened, compliance effort for the same would considerably go up with credit matching concept and new issues on reconciliation will arise.

3. Impact on the State Incentive Subsidies on current Investments / Area based Central Excise exemption in Uttarakhand

Most of large OEMs have made huge investments in particular States providing special incentives and are currently availing various package scheme incentives from the respective State governments. These schemes provide for payment of incentive based on the output State VAT/CST paid on the sales made from that State net of input tax credit availed in the particular State. In some cases the refund is provided for the State taxes paid on the gross basis. Further in some States there is upfront exemption from payment of sales tax.

With the advent of GST Regime the entire taxation concept for goods would be moving from origin based taxation to destination based consumption tax. Hence an OEM which is having a plant in a State and is making interstate sale from that plant, under GST Regime it would pay IGST which would accrue to the receiving State. Under the current regime the OEM would have paid CST which was collected by the originating State. Therefore, in GST Regime the concerned State

Government would not be willing to give the subsidy in respect of the IGST paid on the interstate sale and also in respect of the CGST component collected in respect of the local sales.

The OEMs have already started representing this issue with the respective State Governments with suggestions as would protect the quantum of incentives.

This could be a major impact area for the companies who have made investment on the assumption that they would get a particular level of incentive/subsidy and a matter of concern till the issue is satisfactorily resolved with concerned State Government.

A number of OEMs were attracted to Uttarakhand, substantially keeping in mind the exemption from Central Excise Duty under the area based central excise exemption scheme. Since the concept of exemption is not in tune with the concept of free credit flow in GST, the scheme of benefit to units in the area would need total revision. There is no clarity in public domain on how the Central Government proposes to go about. While some of the OEMs have completed the period of exemption benefit, few companies are still within the benefit period and decision by the Central Government would be crucial for them. Besides, for these OEMs the decisions like product pricing under GST, vendor pricing etc. would be crucial but very complex.

4. Input Tax Credit on GST Transition Stock:

This may not normally be a major issue for OEMs at their factories since purchases are from registered entities and credits will be carried forward on the basis of returns. However, during transition, ensuring that credit is timely availed for all receipts will be challenge due to large volumes and diverse locations, though well set processes exist. The depots, predominantly in commercial vehicles, will have Excise Invoices as they receive vehicles from OEM factories. Problem would be restricted to any vehicles transferred from other depots without Excise Invoice but the depot registrations and provision introduced for Credit Transfer Document will help in most such cases.

As far as dealers are concerned, in Cars and two wheelers, where there are direct sales to dealers, the dealers will have Excise invoices. As for sales from depots, ,commonly done in commercial vehicles, depot registrations have been taken by OEMs so that the dealers have excise invoices and problem is restricted to old stock prior to such arrangement. The provision introduced for Credit Transfer Document will help here also in most cases.

The ‘eligible duties’ on which credit is available to traders on transition do not include Infra-structure cess applicable on Cars. To that extent, credit will not be available to the dealers on the transition stock and the same would be a cost.

5. Finance, Accounting, Costing, Legal Compliance, Tax Administration, IT, Training etc.

The areas of implication which could be favourable or adverse as well as the areas which would need lot of effort are:

(a) Overall reduction in cost but working capital requirement likely to go up. Continuation of quantum of Government incentives can be a concern for some OEMs.

(b) Current VAT accumulation problem at manufacturing locations (due to transfers to depots/ CST sales at 2%) will not be there but the problem may shift to depots and need close monitoring.

(c) Easier compliance in some matters e.g. no Section4A / Rule 10A valuation, no GAQ computation on stock transfers, lesser classification issues, no Forms collection, no issue of pre-determined sale etc.

(d) Big challenge of setting up new internal processes, accounting and IT system to comply with GST provisions in particular with new concepts like tax on advances received (a common practice in automobiles), credit matching, taxability of internal services, new valuation provisions, extension of related person concept & coverage of employees therein, ITC at depots, concept of composite supply and in particular its implications in services etc., some of which are very difficult to implement in OEMs who have complex operations and organization. Carried forward issues under old laws like assessments, litigations etc. will simultaneously continue.

(e) Study of cost implication at Vendor end and re-negotiate the prices. Similarly, study of the cost implications at dealer end and dealer incentive schemes and re- work compensation and incentive schemes. Dealer incentives will have to be passed on with invoice reference.

(f) Re- working of product and services pricing.

(g) Extensive training – internal as well as external to Vendors and Dealers as they become partners in credit chain and any tax optimization efforts.

(h) Absence of LTU & Centralized Service Tax registration under GST – major tax administration concern for several companies operating under the same. Internal monitoring processes will change.

(i) Tax function at States / depots / branches will have to be strengthened due to State level compliances and changes will be required in internal monitoring processes.

(j) Compliance of anti-profiteering provisions.

(k) Raising of self- invoicing on all purchases from unregistered persons. Plain reading and absence of clarification results in all imports also requiring self- invoicing - compliance efforts.

6. GST on Petroleum Products – a lost opportunity:

The diesel, petrol and CNG are and can reasonably be expected to continue for next few years at least to be the main fuel for Motor Vehicles on Indian roads. They constitute largest part of the cost of running a Motor Vehicle. As such, any policies concerning them have bearing on automobile industry. Diesel and petrol are heavily taxed by both the Centre and the States. Their inclusion in GST and the consequent benefits to Petroleum companies could rationalize their prices and also made extension of full GST principles to transport sector possible. This could possibly have helped Automobile sector in terms of demand for Motor Vehicles. However, with the decision to defer GST implementation for petroleum products for the time being, the automobile industry has lost the opportunity till the policy decision is made to include petroleum products under GST.

7. Long Term impact on its own products?

The tax neutrality because of GST would remove one barrier viz. tax cost in free movement of goods within country. Government is seriously pursuing the initiatives to reduce the road transportation time through improvement of road infrastructure as well as through various measures to reduce time involved in any procedural issues in transit. One such initiative being implemented along with GST is E way bill. Over long term, all these initiatives, if not GST alone, can change distribution practices in the country, and consequently the goods transportation practices e.g. shift towards heavier vehicles for long distance transportation, which may have implication on demands across segments of goods vehicles.

Overall Conclusion:

The impacts on OEMs will be both positive and negative and great effort will be required to move over to GST regime. GST will have positive impact on profitability due to reduction in tax costs consequent upon free availability of credit for taxes on earlier transactions in the supply chain as well as due to enhanced efficiency and possibility to have re-look at all processes as a result of tax neutrality. The Automobile industry has fair amount of competence and experience to deal with such issues. The quantum of Government incentives may be a concern for some OEMs till the issue is settled. The GST rates are also by and large in line with the industry expectations, except the rate on hybrid cars. Working capital requirements may go up with more blockage of funds in tax component, will need monitoring and could certainly involve more cost. Overall tax compliance effort will drastically go up in the initial two years or so and dealing in the new set up and several new concepts & issues will be a critical challenge till the processes fully settle down. Assessment of impact areas within organization as well as at vendor and dealer end and reworking the prices is another massive exercise. The automobile industry can be expected to pass on overall likely gain to customers on account of severe competition and the statutory requirement but it would vary from model to model and considering all the complexities. it may be difficult to predict at this stage what per cent age of reduction will take place in prices to customers. On the whole despite the challenges in implementation, the industry has always welcome and supported the concept of value added taxation around which the GST is built.

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Acknowledgements

We thank Study Group on Indirect Taxes Pune for drafting this article and Study Group on Indirect Taxes Chennai for reviewing the same. For any queries, you may connect with CA. Dilip Satbhai at dvsatbhai@yahoo.com .

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