Automobile Sector or the Automobile Industry (auto sector / auto industry in short) is one of the largest, growing and dynamic sectors in the Indian economy. To emphasise its significance in the Indian economy, during 2015-16 for which data is available, the auto sector accounted for 7.1% of country’s GDP and provided employment (direct and indirect) to 29 Million people. Most major global automobile manufacturers now have their manufacturing facilities in India. The auto sector, including the vehicle manufacturing activity, is spread over a number of States in India making it a very crucial contributor to exchequer in almost all the States.

The auto sector comprises of Automobile Manufacturers (OEMs) who manufacture Motor Vehicles, Auto Ancillaries supplying components to the OEMs, the Dealers of OEMs and providers of associated services for vehicles. This article intends to focus on the GST implications from the OEM perspective. The Automobile manufacturing broadly has for segments – passenger cars including utility vehicles, commercial vehicles – for goods & passenger application, three wheelers (again for goods & passenger application) and two wheelers. Just to give an idea about the numbers, the Gross Turnover of the Automobile Manufacturers in India during FY 2015-16 in terms of US Dollars was 63,866 Million which increased to 67,724 Million in FY 2016-17. While the data on Gross Turnover for FY 2017-18 is not available, during FY 2017-18, the industry produced 29.07 Million vehicles, higher than any of the earlier years. This makes it one of the largest players in the world in each of the segments. The auto sector also has strong presence in exports and 4.04 Million vehicles were exported from India in 2017-18. In terms of number of vehicles, two wheelers are by far the most popular form of vehicles sold in India, accounting for 81% of Domestic Sales and 80% of the vehicles produced in FY2017-18. (Source siamindia.com Statistics)

Auto sector’s operations are somewhat complex from tax angle. Under the pre-GST provisions, the sector on the whole had complicated tax structure in terms of multiple taxes with diverse provisions, multiplicity of classifications & rates, cascading effects, issues on set off of taxes suffered at earlier stage, valuation issues etc., besides being subjected to fairly high rate of taxation, generally varying somewhere between 28% and 56% of price. The sector has always welcome and supported the concept of value added taxation around which GST is built, despite challenges in implementing such a major change, in anticipation of having simple & rational tax structure under GST and also rational rates of taxation on its products. On review of actual year one working under GST, the impacts thereof on OEMs are seen as both positive and negative, though the extent of such impact would vary between the segments referred to above depending on their existing business processes and tax structure & issues. The GST implications from OEM perspective and expectations from GST, both positive and negative, and some of the pending issues that need attention are dealt with below under different
headings / areas of possible impact and in doing so, the changes brought about through the subsequent Notifications have also been considered.

1. Tax on the end customer:

(a) Subsuming number of taxes into two taxes – CGST & SGST, with uniformity of legal provisions across States, common tax base for both taxes avoiding cascading of tax on tax, as well as doing away with valuation methods like Rule 10A and MRP based valuation for spare parts, are major positives. On the negative side, State level Vehicle Tax/ Road Tax is not subsumed in GST despite strong recommendation from auto industry and will continue to be extra cost to the end customer. Moreover, this tax would remain in State domain and States may be tempted to hike the same for revenue considerations.

(b) The multiplicities of classifications and the possibility of consequent disputes is reduced. However, due to cess levy & flexibility available to the Government in fixation of its rates, multiple rates still prevail which need to be restricted to minimum, ideally to two rates (other than concessional rates specifically provided).

(c) Under the earlier tax regime, Central Excise Duty and CST were not payable on transportation cost of vehicles directly sold from OEM factory to dealer, which was a common distribution practice for cars and two wheelers. Due to concept of composite supply, post GST, such transportation cost (which is a sizable amount) suffers tax at same rate as applicable for the vehicle. Similarly, under GST, the final price to the customer is subjected to full tax incidence against Central Excise Duty which was not applicable on trading margins. These two changes have the effect of broadening the tax base.

(d) High rate of tax on Passenger Cars, other than those which merit classification as small car, has been one of the grievances of the auto sector. In the tax rates initially notified under GST, taking cognizance of this, the rate of tax on high end Passenger Cars and Utility Vehicles was significantly lower compared to existing rates and some benefit was also offered in rate of tax on mid-size cars compared to earlier rates. However, by Notification No. 5/2017 – Compensation Cess (Rate) dated 11.09.2017, the Cess on these Cars was increased, substantially nullifying the above benefit. A table showing combined rate of revised tax under GST vis-à-vis pre-GST rate on major categories of vehicles is attached as Annexure A. The GST rates would apply on a wider base value, as mentioned in (c) above. It will be seen that the change in rates is marginal if we consider the increase in base value. Thus, the issue of higher rates of tax on cars remains mostly unaddressed.

(e) The concessional rate of tax for Hybrid Cars (other than those meeting small car criteria) in earlier tax regime has been withdrawn in GST and they are subjected to tax @43%, which is a major set- back to the upcoming segment.

(f) As regards post sale repairs and servicing, there is ambiguity on its tax treatment due to composite supply concept. Government needs to confirm its acceptance on the current industry practice of treating spare parts / material used as supply of goods and labour as supply of service rather than treating the activity as composite supply which would be very subjective and dispute prone.

(g) Though this is not auto sector specific, limiting the value and rate of tax applicable on supplies of old and used vehicles is a welcome step as the same would restrict the double
tax incidence on same goods (Reference Notification No. 8/2018 – Central Tax (Rate), Notification No.9/2018 – Integrated Tax (Rate) and Notification No. 1/2018 – Compensation Cess (Rate), all dated 25.01.2018).

2. Impact on cost of production and distribution:

(a) Major positive is reduction in costs (though some of these benefits have to be passed on to customers in terms of anti-profiteering provisions), mainly on account of the following:

1. Saving of 2% CST on inter-state procurement.
2. Saving on VAT surrender where sales to customers in other states are routed through depots – mainly commercial vehicles - as well as on transfers of semi-finished goods to other factories in different states – 4% or even more of corresponding purchases within State.
3. Saving in octroi/LBT/Entry Taxes without credit on procurement.
4. Input Tax Credit on outward transportation – net benefit for commercial vehicles sold through depots.
5. Vendor price reductions for corresponding benefits in supply chain.
6. Wider Input Tax Credit availability e.g. warranty parts, services related to trading activities, items like furniture earlier out of credit chain.
7. Saving in cost of non-abatement of Central Excise Duty on post sale incentives.
8. Realignment of distribution chain e.g. number of depots restricted as depot in a State can now cater to customers in neighbouring states without extra tax implication.
9. Benefits in transportation cost due to reduction in transportation time with abolition of check posts.

(b) Further potential of saving in course of time due to tax neutrality such as through rationalization of procurement decisions on job work, level of assemblies & outsourcing, selection of vendors with location no bar, realignment of production processes even where units are in different States, eventual rationalization at vendor end as well – as all these decisions can be made purely based on operating efficiency alone.

(c) While the scope of Input Tax Credit is widened, a major negative is considerably increased compliance effort with credit matching concept and reconciliation issues. Moreover, the issue of concern is that while matching of credit with the tax actually paid is being insisted, since no formal mechanism has yet been provided by the Government for matching and confirmation of credit, the credit availed remains provisional. This issue may continue for some more time till GSTN return processes are revamped. With huge amounts at stake and with large vendor base, the auto sector is really apprehensive of this situation as even if few vendors are eventually found errant, cost implications can be very high. Keeping in view the difficulties, the Government really needs to relook at its stand on this matching obligation on recipient at least for the initial period of one to one and half years or so till the GSTN processes on return matching are revamped and stabilized.

(d) Another major negative is that in the absence of transactions at concessional rate like C Form or F Form transactions as permitted under the pre-GST laws, the requirement for working capital on inventory at all stages – in factory, at depots, in
transit, at dealerships has gone up with blocking more funds in taxes. Credit accumulation issues at depot locations is another problem.

(e) In auto sector, it has been common practice for OEMs to provide dies, mould etc. as well as part of the material required by vendor (who procures rest of the material on his own account and as such does not qualify to be job worker) for supply of components to the OEM. There is ambiguity on how such items should be valued while they are sent to the vendor as well as while the vendor supplies the components and different practices are being followed with provisions interpreted differently. Since huge values and large number of transactions are involved, to avoid litigations at later date, Government needs to come out with an amendment / Notification clarifying that the value of such supplies should be reckoned as NIL, keeping in consideration the principle of value added taxation and the fact that these are only intermediary transactions and the value of such dies, moulds etc. and material is already considered in vehicle pricing and eventually subjected to tax.

(f) The issue of place of supply in case of tooling cost recovery where component supplier and the customer are in different state is also a bone of contention. Section 10 (1) (c ) of IGST Act provides that where the supply does not involve movement of goods, whether by the supplier or the recipient, the place of supply shall be the location of such goods at the time of the delivery to the recipient. Hence, if the supplier of component develops tool in a state and the customer is located in another State, it is required to charge CGST: SGST which would not be available as credits to the customer located in different state resulting in increased cost.

(g) In case of international tooling transaction also, the cost is recovered from the foreign customer but in the absence of movement of tool from India to outside India, it fails to satisfy the condition of export of goods. The supplier has to charge GST resulting in increased cost and affecting international competitiveness of Indian automobile sector.

(h) The Input Tax Credit on supplies procured to provide fringe benefits to employees in terms of employment agreement/ conditions, is generally disallowed in GST also as under the earlier tax regime. While there is no justification for the disallowance itself in the system of value added taxation, the peculiar valuation provisions also require tax to be paid on such fringe benefits on their open market value. This is creating ambiguity and different practices are being followed. Even the Government responses are somewhat conflicting. Since auto sector employs large number of employees and it has been a trade practice of providing them with several fringe benefits, it is concerned about the issue. It is quite likely that the Government will not deviate from its policy of not allowing Input Tax Credit on supplies meant for providing benefits to employees. But to avoid ambiguities in this area, Government needs to notify that the value of any supplies to employees in terms of employment agreement / conditions will be taken as Nil as no Input tax Credit is allowed on the corresponding supplies used for the same.

(i) In order to receive supplies from vendors in other states just in time as per production requirements, one of the practices followed is vendor despatching the same little ahead of delivery schedules and the supplies being held at transporter warehouse at OEM location and supplied as per OEM requirement. With E way bill procedures, there is apprehension that under such arrangement view may be taken that these are local supplies requiring vendor to take registration at transporter warehouses, treat supplies as internal transfers, take credit and pay tax as local
supplies on actual supply to OEM from the warehouse. This will complicate the existing practice.

(j) Variation in the price of components is a common practice in the industry. The effect of such price variation has to be given by issuance of credit note/debit note. In view of the requirement to mention the reference of original invoice on the credit note/debit note, the component supplier is required to issue

3. Impact on the State Incentives / Subsidies and on Area based Central Excise exemption:

(a) The State Governments have either not come out with policy on how they would deal with the issue in changed tax structure under GST or have restricted the quantum of benefit to SGST, thereby denying benefit on inter State supplies. This is a major negative implication for companies who made major investments in specific states keeping in mind a particular level of incentive / subsidy they would get. State Governments need to address this issue and protect the quantum of incentives.

(b) Number of OEMs and their ancillary vendors were attracted to Uttarakhand, mainly in view of the Central Excise Duty exemption scheme. While some of them have completed the period of exemption benefit before introduction of GST, some were / are still within benefit period. The exemption which in effect entailed benefit equal to 100% of Excise Duty on value addition stands withdrawn with introduction of GST. The compensation provided by the Central Government in lieu thereof in the form of budgetary support broadly works out to amount equal to sum total of 58% of CGST paid through debit in cash ledger and 29% of IGST paid through debit in cash ledger ( in both cases after utilization of Input Tax Credit of Central Tax and Integrated Tax) – again a negative impact for auto sector.

4. Compliance effort:

(a) The auto sector has revamped its internal tax function in line with requirements under the GST regime and put in extensive efforts in setting up new internal processes, new accounting and IT system to comply with GST requirement after study of GST law and in particular some new concepts therein. Extensive effort has also been put up in re-working of product pricing and cost implications at vendor end as well as on training – both internal as well as for vendors and dealers.

(b) Easier compliances in some matters like uniform legal provisions across states, lesser classification issues, no forms collection, no GAQ computation on stock transfers, no Section 4A / Rule 10A valuation, no issue of pre-determined sale etc. reduce the compliance effort.

(c) However, the experience is that the overall compliance effort has increased due to requirement of matching input tax credit to tax payment by vendor as well as due to requirement of paying full tax and availing credit at corresponding location on all internal transfers of goods or services and need to strengthen the tax function at locations like depots, branches etc. to take care of this aspect. Compliance of anti-profiteering provisions is another new area for compliance.

(d) In auto sector, it is common practice to collect payments against supplies in advance and considering the operating complications, compliance of requirement
to treat point of receipt of advance as time of supply involved lot of efforts. Vide Notification No. 66/2017 – Central Tax dated 15.11.2017 the said requirement with regard to advances received has been dispensed with for goods which is a positive development for auto sector.

(e) On the procurement side, the retrospective price amendments are frequent. The practice during the pre-GST period was to issue combined debit / credit note for the same i.e. one document covering number of earlier supplies. Requirement of one debit note / credit note per corresponding original invoice results in sizable increase in administrative effort in accounting for such transactions.

(f) Number of companies in auto sector had taken registration under LTU and Centralized Service Tax Registration mainly to facilitate centralized administration. Absence of such arrangements has led to completely decentralized tax administration at registrations in respective States, under different authorities, Central or State, with possibility of different views being taken by the authorities on the same issues. This is a matter of concern for auto sector as most companies have registrations in several States.

**Overall Conclusion:**

After almost one year of working, the implications of GST on auto sector have been both positive and negative (leaving aside the teething problems), as discussed earlier. Besides, as stated earlier, they vary from segment to segment and even within sub-segments. A comparison of performance of Auto Industry during FY 2017-18 in terms of numbers vis-a-vis FY2016-17 is given in Table attached as Annexure B. While it shows good overall growth in numbers under the selected criteria, one has to understand that such changes are reflection of a number of more important factors such as economic conditions, changes in market conditions, differences in conditions & specific issues in years being compared and taxation is just one of the factors having bearing. Besides the comparison is in numbers and the overall respectable growth number is reached through relatively better performance in two wheeler and three wheeler segments. However, based on these figures, within limitations of what has been mentioned of such comparisons, one can conclude that the overall impact of GST on auto sector in it’s very first year has not been negative and the sector despite the initial issues has migrated to the new tax system with the extensive efforts put in for the same. There have been negative implications and areas of concerns on which auto sector has been representing to the Government and positive response thereon will help growth of the sector and strengthen its position and contribution to the economy.

xxx

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- Indirect Taxes Committee
### Annexure A

**POST GST CHANGE IN PER CENTAGE OF TAX APPLICABLE ON MAJOR CATEGORIES OF MOTOR VEHICLES**

| Sr. No. | Type of Vehicle                        | HSN Code | Pre GST duties & taxes | Post GST | Post GST  
|---------|----------------------------------------|----------|------------------------|----------|-------------
|         |                                        |          | Central Excise incl. Cesses | VAT & CST* incl. Cesses | Total incl. cesses | in tax % | $$ |
|         |                                        |          | %                      | %        | %           | %        | $$ |

1. **Passenger Cars including UVs:**
   - Small Car - Petrol (length < 4000mm engine cc < 1200)
     - HSN Code 8703
     - Pre GST duties & taxes: 14.63% Central Excise, 18.07% VAT & CST
     - Post GST: 29% Total
     - Change in percentage of tax applicable: -3.70%

2. **Fully Built Commercial Vehicles**
   - (a) Goods truck, bus > 13 persons Diesel
     - HSN Code 8702
     - Pre GST duties & taxes: 12.63% Central Excise, 15.20% VAT & CST
     - Post GST: 28% Total
     - Change in percentage of tax applicable: 0.17%

3. **Chassis - diesel - for Goods truck**
   - (c) Special Purpose vehicles
     - HSN Code 8705
     - Pre GST duties & taxes: 12.63% Central Excise, 15.20% VAT & CST
     - Post GST: 28% Total
     - Change in percentage of tax applicable: 0.17%

4. **Two Wheelers - Petrol**
   - Motor cycles - engine capacity > 350 cc
     - HSN Code 8711
     - Pre GST duties & taxes: 13.63% Central Excise, 17.91% VAT & CST
     - Post GST: 31% Total
     - Change in percentage of tax applicable: -0.54%

5. **Three wheelers (other than electric)**
   - HSN Code 8703 & 8704
     - Pre GST duties & taxes: 12.63% Central Excise, 17.75% VAT & CST
     - Post GST: 28% Total
     - Change in percentage of tax applicable: -2.38%

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* Varied from state to state & also depended on distribution model. Some local taxes also applied.

$$ Dealer margin was 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 were not subjected to Central Excise Duty. These two elements are also subjected to GST which will reduce / nullify the apparent benefit in rate of tax.
### Annexure 'B'

#### Performance of Automobile Industry during FY 2017-18 vis-à-vis FY 2016-17 - Number of vehicles

<table>
<thead>
<tr>
<th>Category</th>
<th>Production Trends</th>
<th>Domestic Sales Trends</th>
<th>Export Trends</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2016-17</td>
<td>2017-18</td>
<td>Change %</td>
</tr>
<tr>
<td>Passenger Vehicles</td>
<td>38,01,670</td>
<td>40,10,373 (+) 5.49</td>
<td>30,47,582</td>
</tr>
<tr>
<td>Commercial Vehicles</td>
<td>8,10,253</td>
<td>8,94,551 (+) 10.40</td>
<td>7,14,082</td>
</tr>
<tr>
<td>Three Wheelers</td>
<td>7,83,721</td>
<td>10,21,911 (+) 30.39</td>
<td>5,11,879</td>
</tr>
<tr>
<td>Two Wheelers</td>
<td>1,99,33,739</td>
<td>2,31,47,057 (+) 16.12</td>
<td>1,75,89,738</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td>2,53,29,383</td>
<td>2,90,73,892 (+) 14.78</td>
<td>2,18,62,128</td>
</tr>
</tbody>
</table>

Source: siamindia.com  Statistics - Performance of Auto Industry during 2017-18