India Insights

The Indian economy newsletter

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contents

Tune in

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Decoded: Impact of GST on various sectors

The much awaited indirect tax reform of our country in the form of Goods and Services Tax (GST) is now clearly on its way to be introduced in India, very soon. With the passage of the Constitution Amendment Bill in the recently concluded monsoon session of the Parliament, and the Honourable President's assent, GST has now officially entered the framework by way of the Constitution (One Hundred and First Amendment) Act, 2016 (the Act).[1] The Act is not just a tax rate change, but is perceived to be a 'business transformation exercise', having far reaching implications on various areas of business – both from a fiscal as well as from a non-fiscal perspective. It is also likely to have potential gains for the industry, consumers, government and the overall economy of the country. Therefore, it has never before been so important to analyse and understand the current impact. This article attempts to analyse key implications of GST on various sectors.

The government has released the model GST law which reflects the basic framework of GST and also gives an opportunity to provide necessary comments/feedback/ suggestions, which would be included in the final GST law.[2] The recommendation or point of view on various sectors, as mentioned below are in reference to the provisions in the model law and are aimed at identifying the applicability of such provisions for each of the discussed sectors.

IT/ITES

While the taxability of services in India began in 1994, it was only in 2008 that the Information Technology/Information Technology enabled Services (IT/ITeS) sector was made taxable under the Service Tax law.[3] Having said that, services have always been treated with discriminative advantage vis-à-vis goods by the Indian indirect tax laws. From the rate of tax to compliance obligations, the service sector has enjoyed the benefit of relaxed policy conditions, be it from having an option to register one centralised office despite having offices in various states, filing of half yearly returns, or claiming the refund of unutilised credits through one office, etc. With GST subsuming as many as 17 indirect taxes, it intends to provide a common treatment for taxation of goods and services, therefore reducing the extant discrimination between businesses dealing in goods and services, it is the need of the hour for the service industry, particularly the IT/ ITeS sector, to rise and adapt to the rigors of taxation that GST intends to bring in.

Currently, service tax is levied at 15 per cent (including cess), whereas the GST rate is likely to be higher (around 18 to 22 per cent).[4] This could significantly raise the cash payout towards such taxes, and also increase the amount of input tax credits in the hands of service exporters.

1. GST bill gets nod from President Pranab Mukherjee; The Economic Times; 8 September 2016;, The Constitution (One Hundred and First Amendment) Act, 2016; Ministry of Law and Justice; 8 September 2016

2. Model GST Law; Empowered Committee of State Finance Minister June 2016; Ministry of Finance; June 2016

3. Information Technology Software Services; CBEC; 10 May 2008

4. GST: tax rate likely to be higher than 18%; The Hindu; on 5 August 2016, GST Bill: Congress' obsession with 18% rate is illogical; 20% is the number; Firstpost; 5 August 2016

At present, even if a service exporter is operating from different locations across Indian states, under the service tax laws, centralised registration at one place is allowed. This enables the exporter to consolidate input tax credits of all locations at the centralised office and file a single refund claim. However, under dual GST – which consists of Central GST (CGST) and State GST (SGST), multistate offices will need to be registered separately, therefore, compliances and claims of refunds will need to be filed separately in each state. If the centralised office of the service exporter requires its other offices to provide ancillary or support services, stock transfer of services within the legal entity could be critical, as the same may become taxable under GST.

While the tax cost is likely to reduce as credit of taxes paid on goods and services can be cross utilised, cash outflow is expected to be significantly higher. Procurement decisions may need to be deliberated and analysed, to avoid accumulation of credit in one state without corresponding tax liability and cash payout in another state without any credit. Blockage of funds in refund claims is also likely to go up. Continuance of duty free imports, which is presently available to software technology parks/export oriented units is not yet clear and may impact cash flow and working capital, if the duty-free benefit is taken away. Decisions around structuring contracts/agreements, to have effective credit accumulation across multiple operating states, may need to be done. Compliance cost is also likely to rise significantly because of the requirement of adhering to state-wise compliances, going forward.

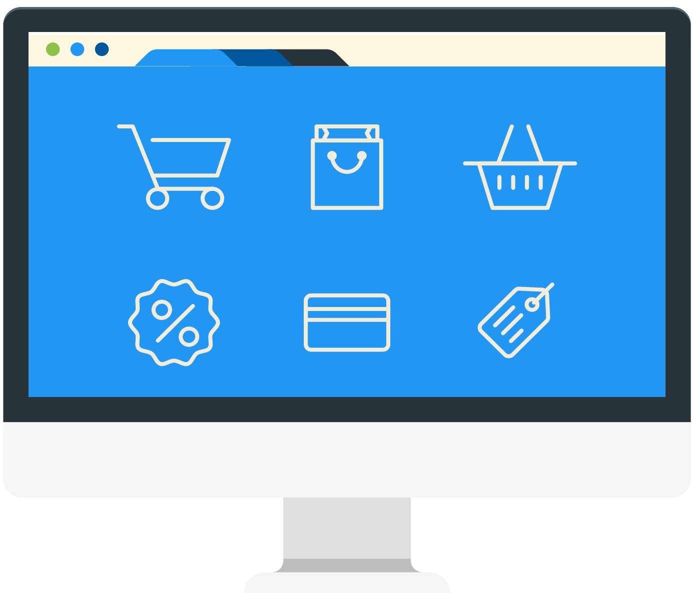
E-commerce

The e-commerce sector has witnessed unprecedented growth in India in the last couple of years, so have the disputes with various tax authorities. From uncertainty of tax, to increased compliance, to double taxation, the e-commerce industry is saddled with many vexed issues. The crux of the issue lies in the fact that the Indian taxation laws have not been able to evolve at the rate and pace that is commensurate with the growth of this industry.

Uncertainty of tax can be attributed to the fact that provision of services in India attracts service tax collected by the central government, whereas sale of goods attracts Value Added Tax (VAT) which is collected by state governments. Currently, majority of e-commerce players follow the 'marketplace model' where they provide a platform for sellers and buyers to connect and contract a sale or purchase of goods. Companies collect a service fee or commission from the supplier for effecting the sale/purchase on which, generally, service tax is paid. Since the e-commerce market place itself does not sell any products, no VAT is paid by such companies, but is the liability of the supplier/seller of goods. This has landed e-commerce players in a huge legal wrangle with the state VAT authorities, which has sought to portray the e-commerce market place as an 'agent' for the supplier who is treated as a dealer in goods, and has accordingly been demanding VAT in many cases.

Since VAT/CST is an 'origin-based' tax today, interstate sales are taxed in the state from where the movement of goods commences, and the consuming state (where the end consumer is located) does not get any revenue from such transaction. However, consumer states have also sought to levy taxes by way of VAT or entry taxes, citing that the sale transaction concludes upon delivery of goods in their states, which would inevitably lead to double taxation.

The e-commerce industry is hoping for GST to be a panacea for all their vexing issues. Besides bringing certainty to taxation, GST is also expected to address the problem of double taxation. As GST is a destination-based consumption tax, revenue is likely to go to the state where goods are finally consumed. Collection, allocation and distribution of taxes between states could be taken care by GSTN and ecommerce players need not be saddled with double taxation. However, based on the model GST law, the compliance burden is likely to significantly increase for e-commerce companies, as they have been made liable to deduct tax at source and are required to remit the tax on behalf of the suppliers, and have been representing this matter very strongly with policy makers.



Automobile sector

Presently, the automotive sector operates under a complex indirect tax environment due to multiplicity of taxes, elaborate compliance obligations and cascading tax effect. The sector has been saddled with multiple taxes such as central excise duty, national calamity contingent duty, automobile cess and VAT, which can cumulatively exceed 23 to 24 per cent. Also, certain taxes and cess levied on input services are not creditable, which has further pushed up the cost of automobiles. GST, even with standard rate of 18 to 20 per cent, coupled with the liberal credit regime, may reduce the cost of automobiles. With GST subsuming many central, state and local taxes, the overall compliance burden is expected to decrease, bringing in a lot more efficiency in operations.

Currently, most of automobile manufacturing facilities are located across a few states in India, and most of these automobiles are sold to cross border dealers in states in which they are manufactured. In doing so, 2 per cent central sales tax is charged on the value of the automobile and excise duty thereon, and the same is not creditable to the purchasing dealer. However, under the GST scheme, IGST charged on interstate supplies would be fully creditable. From the indirect tax perspective, the whole country will be treated as a single market and is anticipated to add to operational efficiencies.

However, exemption and incentives currently offered by states in which manufacturing facilities are established may not be continued under the GST regime, which may have to be factored in while determining the prices of the products.

Overall, the auto industry may gain from the implementation of GST, since it is expected to reduce logistics costs by removing trade hurdles, cascading effect of taxes, reduced tax rates, paving way for more competition in the sector.

Real estate and construction sector

Taxes in the real estate sector encompass levy on land, under-construction contracts and on fully constructed/ immovable properties. Traditionally, stamp duty, which is a subject matter of the state, is levied on land and immovable property transactions and has been kept outside the purview of GST. Under the model GST law, service is defined to mean 'anything other than goods'. Accordingly, to remove any ambiguity, the government should clarify and specifically exclude land from the definition of service to remain consistent with existing levy of stamp duty.[1]

Further, construction contracts are marred by complexity of dual levy - VAT at state level and service tax at central level, and embroiled in disputes due to ambiguity in the statutes. The biggest relief under GST to the real estate sector comes in the form of doing away with levy of multiple taxes and overlapping of taxes. The model GST law specifies that work contracts would be taxed as supply of 'service'. This is certainly a welcome move, as it not only provides certainty to taxability of construction contracts, but also resolves the issue. Also, there may not be any necessity of segregating goods from services for tax purposes, which would certainly go a long way in achieving the government's ambitious initiative of improving ease of doing business.

Given the understanding that the standard rate of tax would be made applicable even to iron and steel products, which constitute significant portion of construction cost, construction cost may increase to this extent. However, with the credits available on interstate purchases and liberal credit mechanism prescribed, the builders/ developers could pass on the benefits of reduced prices to the customers in a market which is likely to grow as businesses and consumers start benefiting from GST.

(With inputs from Kalyan Kumar K, Associate Director, Indirect Tax, KPMG in India)

1. Model GST Law; Empowered Committee of State Finance Minister June 2016; Ministry of Finance; June 2016

Partner speak

"Malcom Gladwell says transformation isn't about improving, it is about re-thinking. This has never been so applicable for global businesses before. After industrial and web revolution, businesses need to adapt to digital revolution. This does not mean changing processes or operating model only. Current business environment is changing the internal and external ecosystem across industries – customers, regulators, competition, alliances – everything is taking a new shape and form. Businesses are moving from vertical & horizontal growth to amoeba growth dimensions. Therefore, in order to remain relevant, businesses require a complete overhaul in a synchronised manner and not just drive incremental improvement initiatives. This places business transformation critically as one of the top agenda items on the board for many leading companies today"

Romal Shetty
Chief Operating Officer - Advisory
and Head of Telecom,
KPMG in india

Insights

Romal Shetty

Chief Operating Officer - Advisory
and Head of Telecom,
KPMG in india

De-coding the new 'buzz' word transformation – What is all it about?

Today, businesses across the globe are changing at an unprecedented pace. Technological innovations, evolving customer profile, changing regulatory environment and economic complexities are key drivers for transformation. In order to remain relevant and be future ready, businesses need to invest in transformation across the ecosystem – organisation, technology, operations and data. This transformation is not dominated by any one element of the ecosystem but driven by a complete overhaul of the operating model.

Simply put, business transformation refers to a change in strategy and operating model of an organisation that is driven by multiple internal and external factors, simultaneously.

Let us take an example – a sportswear company, a decade ago, could have propelled based on a 'product only' strategy of selling shoes and fitness wear through branded stores. However, to stay relevant in current times, these companies have ventured into smart shoes with in-built pedometer and application-based virtual workouts. Not just this, they are continuously devising new means and ways of improving their online sales channels, brand loyalty measures, customised offers, fitness tips, omni-channel experience, near real-time demand forecasting and inventory management. Additionally these companies are training its staff in new technologies and have combined IT and products function for innovation, etc. As a result of the above, a traditional sportswear company has transformed into a fitness lifestyle provider. While the core product still remains the same, the whole ecosystem needs to be adapted to new ways.

A successful business transformation is likely to lead to new business opportunities, new revenue streams and healthier financial performance. It could enable companies to step into white spaces and build an effective and agile organisation to deal with challenges of constant changes, short lived innovation and newer ecosystems.

What is the adoption level and drivers of business transformation across organisations?

Business transformation is prevalent across organisations. According to KPMG International's Global Transformation Study 2016 held across 16 countries, 96 per cent of organisations are involved in some or the other form of transformation and half of them have completed at least one transformation in the last two years. The story is same for Indian companies, where 90 per cent indicated that they completed some form of business transformation.[1]

Some of the top drivers for such massive drive for business transformation are:

Customer driven – whereby businesses shift their operating model to meet customer demands of an anytime, anywhere service, with greater transparency, along with self-service and control over their purchase transactions.

Market driven – where governments allow new sectors, encourage start-ups, and boost globalisation to change the competitive landscape for organisations.

Technology driven - whereby disruptive innovations can change the shape and form of products and services sold or completely change the way a company internally operates. About one-third of respondents in the survey indicated that they were about to start some form of a technology transformation programme.

How do we tangibly measure the success of business transformation?

There is no one Key Performance Indicator (KPI) to measure performance of transformation initiatives. Rather, it can be measured through a performance index made up of multiple financial, operational and people related metrics. It is important to lay a balanced scorecard lens over transformation projects for holistic evaluations and assessment of overall business value generated.

For example, any major transformation project can have Key Performance Indicators (KPIs) linked on following four dimensions:

- Project and business case-oriented –benefits vs. cost, budgeted vs. actual time line
- Market facing improvements – higher wallet share, revenue growth, Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) growth, higher Customer Satisfaction Survey (CSAT) score, improved brand index, and others
- Enhanced savings in terms of leaner processes, organisational structure, higher automation and built-in preventive controls
- Degree of adoption of new operating model – Human Capital Happiness Index.

1. KPMG Global Transformation Study 2016; KPMG International; May 2016

Which are the key sectors where business transformation will be more dominant in coming years?

Based on current market dynamics, all key sectors may need to undergo transformation in what they have to offer or the way they operate. The pace and form of transformation may differ from sector to sector, depending on their ecosystem. However, in the near future, sectors that can be watched out for transformation include retail, financial services, telecom, education and manufacturing (specifically with respect to supply chain management).

Briefly elaborate some of the emerging transformation trends in India?

Indian companies are equally active in the transformation journey as their global counterparts. Majority of them have started or completed various transformation initiatives in last two years as per KPMG International's Transformation Study 2016. With elements like GST, Digital India, Start up boom and changing consumer profile, India companies are at tipping point of transformation. In order to convert this challenge into an opportunity, they need to carefully invest and execute transformation initiatives effectively.

(With inputs from Deepti Sagar, Partner, Management Consulting, KPMG in India)

What can be KPMG's role in business transformation? How can we help?

We, as KPMG, can help organisations with their varied business transformation needs – strategy, funding, business case, operations, accounting, tax, regulatory and so on. Specifically with respect to tax, this is an added advantage we have vis-a-vis other boutique firms as we are able to combine tax know-how in context of overall business environment with greater efficiency. Business transformation touches all the areas and we are better positioned to provide enhanced value in this domain.

Opinion

Rohan Lobo

Partner
Management Consulting
KPMG in india

Role of digital in business transformation

Companies are clamouring to become more 'digital' and 'transform their businesses'. But what does digital really mean? To some it is a new business or revenue model. To others, it is utilising the power of technology to transform business processes and enhance productivity. To others still, digital is utilising the power of ubiquitous connectivity to transform customer engagement. The lack of a common understanding is typical of conversations amongst management and leadership.

To us, digital is less an end but a means to an end. It deals more with the 'how' rather than the 'what'. Digital is how businesses create more value by:

- Transforming the way they address a market or build a new market and / or
- Engaging with customers and / or
- Dealing with their processes to support productivity and / or
- Establishing risk and governance mechanisms for managing operations and change.

Digitisation has played a major role in transforming industries in India. A growing number of Indian companies have already reaped handsome rewards from it. The digital revolution has spurned one of the India's largest traditional sweets and snacks manufacturer to look beyond the traditional brick and mortar stores. It has embraced an online presence that permits it to reinforce the core principles of the brand and extend its outreach through the new medium.

Health care industry now allows health workers to connect with specialists using mobile phones and it includes remote ICU monitoring, electronic health records and a mobile telemedicine unit. Prescriptions can now be signed and transmitted electronically directly from a doctor (mobile device if out of office) to a patient's registered chemist.

Transforming a market place for one's business involves a re-thinking of business value chain. This includes evaluating how market forces in multiple sectors converge to create untapped value-pools in areas of operation.

For instance, the evolution of Internet of Things (IoT) is transforming motor – insurance while providing a new revenue stream to telecom providers who sell telematics products, subscriptions to run IoT applications and access to platform technology to drive such applications. Banking sector is not far behind. In order to cater to the millennial generation they have developed a full-fledged integrated technology platform using the combined power of analytics, cloud technologies, social media and mobility. Since the day of its launch, Indian banks have witnessed a high level of retail engagement. The new technology has better potential to interact with new customers when compared to the bank's staff.

Transformation also means being acutely aware of how customers interact with the business and what trends in the market place define value to customers. For instance, a leading Mobile Virtual Network Operator (MVNO) using United Kingdom's O2 network managed to find the perfect balance of cost reduction and customer delight. It does not have a call center – all queries are answered online by its own members. The company's entire business model rests on its community – members not only help new customers, they recruit new ones to the network, and come up with strategies to grow the business.

Leadership plays an important role in a transformation – especially through demonstrated executive ownership, accountability, de-bottlenecking and support. A good example is how some of the public sector undertakings, have significantly leveraged their digital presence through a successful social media presence, interactive websites and digital newsletters.

An agile mind-set supported by insightful data that focuses on value addition and relevance to changing trends addresses the 'how' of digital. This brings people from multiple functions and disparate technology together to address inputs from the customer on value drivers. One of the leading telecom company, through its open network initiative, has provided its customers a unique view into the network coverage and signal strength across India, opening up a new avenue for customer feedback on service quality. Exposing the limitations of the network takes courage and it is this courage that enables an organisation to address opportunities and build solutions that supports the entrepreneurial culture required to compete in the digital-world.

The Indian government is leaving no stone unturned when comes to digitisation. It plans to transfer all company and individual documents into a "digital godown" which not only is highly secure but will also help in smart retrieval when required. Their motto is to of minimise government and maximise governance. Digitisation is the future India is looking forward to.

Market trends

Gaurav Moda

Partner
Management Consulting
KPMG in india

Looking beyond today

Organisations across the globe today have recognised the need to transform their businesses and operating models to keep pace with evolving customer needs and behaviours, regulations, disruptive technologies and globalisation. Business transformation has traditionally been an area of focus for companies preparing to operate at the 'next level', due to a marked change either in their top line (step growth) or in their bottom line (turnaround). However, transformation is fast capturing the attention of companies at various stages of their business lifecycle, across sectors and across the globe. More and more companies are seriously considering some sort of transformation initiatives, either functional or overall business transformation.

However, there is also a growing awareness among business leaders that transformation is not a one-time activity, and therefore requires creation of institutional mechanisms that make the businesses agile and adaptive to continuous change. Transformation, therefore, is evolving from a single - step change to a process of continuous improvement. It can be seen as a series of incremental steps, which enable rapid adjustments and course corrections, as well as a faster market response.

While the concept of transformation resonates well with several industries, in India, in particular mature sectors like financial services, manufacturing and public sector appear to be ripe for transformation projects due to increasing focus on cost cutting measures and expansion plans. India is also home to a large number of family owned or family run businesses which are now looking to move to the next level, with the next generation at the helm. Such companies are increasingly taking up formal business transformation initiatives, especially those focussed around HR/people transformation, governance and processes.

While organisations are increasingly undertaking transformation initiatives, they also need to consider some typical pitfalls that could derail the transformation agenda. To begin with, organisations should ensure a balanced focus on both business model as well as operating model changes; it has been observed that organisations often underestimate the importance of the required operating model changes. Additionally, organisational culture and resistance to change often becomes a barrier to the successful execution of transformation. Finally, it is imperative to ensure that transformation plans get translated into effective implementation on ground. In addition to managing these typical pitfalls, customer centricity and a focus on continuous improvement can help companies realise elevated gains out of their transformation endeavors.

KPMG in the NEWS

Venture capital funds for defence - Business Standard[1]

"The Defence sector occupies a huge space in India's long-term strategic planning and the government is leaving no stone unturned for indigenisation of the industry. For the sector to thrive in any economy, MSMEs should produce high yielding products. Indian defence MSMEs, however, have long been stifled due to many reasons such as dearth of funds, infrastructure deficit and absence of high-end technology. The need of the hour is for the government to take initiatives for bridging the ever widening gap between MSMEs and the global defence market."

Gaurav Mehndiratta
Partner, Tax,
KPMG in India

Diversity can ignite business ideas - Hindustan Times[2]

"A people-centric approach within the company helps build a motivated and positive workforce in the same way that customer-centricity facilitates external business expansion. KPMG International's Global CEO Outlook Survey 2016 suggests that talent management is one of the top priorities for Indian CEOs."

Vishalli Dongrie
Partner and Head,
People and Change Advisory
KPMG in India

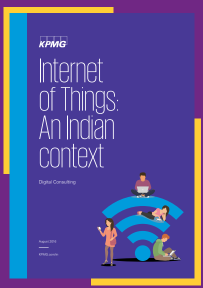
Turn things around - Business Standard[3]

"Today, several organisations are involved in transformation in some form or the other – either enterprise-wide or function-specific. KPMG International's Global CEO Survey 2016 illustrates the concerns and focus of CEOs with regard to making transformation a reality. Among them are 125 Indian CEOs heading companies across sectors. The survey suggests many CEOs are looking at multiple manifestations of transformation with an aim to streamline the processes, eliminate red tape and undertake overall restructuring with an objective to effectively respond to dynamic market needs."

Romal Shetty
Chief Operating Officer - Advisory and Head of Telecom
KPMG in India

1. Venture Capital Funds For Defence; Business Standard; 8 September, 2016
2. Diversity can ignite business ideas; Hindustan Times; 23 August, 2016
3. Turn things around; Business Standard; 15 august 2016

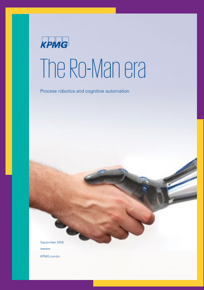
Featured publications



Internet of Things: An Indian context

Digital technology is re-shaping the Indian manufacturing industry. This process is further accelerated by emerging technologies such as Internet of Things (IoT). The paper attempts to cover the rapid evolvement of traditional manufacturing enterprises in India and their IoT readiness.

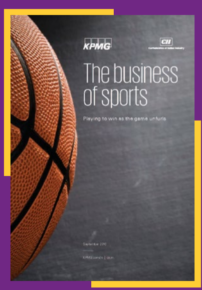
Click here for the report



The Ro-Man era

The entry of process robotics and cognitive automation in the Indian context is expected to transform operating models. Organisations need to understand this paradigm of change, factors influencing the transformative choices and the effect of automation on the ecosystem. Our publication, The Ro-Man era helps to understand and demarcate the roles where robots can be deployed and provides a quick dipstick to ascertain automation readiness.

Click here for the report



The business of sports

The KPMG-CII whitepaper on 'The business of sports' attempts to highlight the common grounds between all stakeholders to enhance the development of sports in India and create a road map for a potentially successful collaboration between business and sports.

Click here for the report

Indian healthcare start-ups

Start-ups need to identify consumer-focused solutions, sought after by investors globally. Their focus has to be on extensive innovation, differentiated products offering and sustainable business models. Recognising the need and the role of start-ups in the Indian healthcare sector, this publication by KPMG in India and FICCI, investigates the challenges they face and puts forth suitable measures to boost fund flow. The report highlights various opportunities for both start-ups and investors, wherein they can complement each other to create a flourishing healthcare start-up ecosystem in India.

Click here for the report

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