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India's GST Explained

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Summary

- On Wednesday, August 3, the upper house of India's parliament passed a nationwide Goods and Services Tax (GST) constitutional amendment which marks one of India's most significant economic reforms since Indian independence.

- The new tax regime will streamline a multitude of complex, often-overlapping state and national taxes, significantly increasing predictability and transparency for foreign investors, particularly those engaged in intrastate commerce.

Game-changing reform for the Indian economy and its businesses landscape

Wednesday's passage of the Goods and Services Tax (GST) constitutional amendment marks one of India's most significant economic reforms since independence and a capstone of Prime Minister Modi's economic reform agenda. By subsuming the multitude of indirect taxes levied by state and local governments into a single comprehensive tax, the GST creates a truly national market which will reduce red tape, making it easier for businesses to navigate interstate commerce. This reform is expected to add up to 2% to India's gross domestic product.

After more than 10 years of intense political deliberation, the bill passed in the lower house of Parliament in May 2015 under the ruling BJP party, but had stalled in the upper house due to opposition mainly from the Congress party. Three key amendments were added to the bill to enable its passage in the upper house. These include: dropping the additional tax of up to 1% on interstate trade; guaranteeing compensation to the states for loss of revenue during the first five years of implementation; and establishing a mechanism for resolving disputes.

The exact tax rate has not yet been determined, but is likely to be 17-18%. A new Council, composed of the Union Finance Minister, Union Minister of State for Revenue, and State Finance Ministers, will recommend rates, levy period of additional tax, principles of supply, and special provisions.

What's Next?

The passed bill with amendments will now go back to the lower house to be cleared. Parliament must pass legislation on the central GST bill as well as the integrated GST. All 29 states and two of the union territories will have to pass both these amendments and comprehensive state GST acts. The target date for implementation is April 2017, but will likely be extended due to expected political delays and deep debate on implementation guidelines. There exists a window of opportunity for the private sector to engage thoughtfully in dialogue on various sector priorities.

"Without GST, India won't harness its own 'common market.' We've been in BREXIT mode without knowing it."

– Indian business leader Anand Mahindra via Twitter

Foreign and domestic investors alike will see significant changes

E-commerce: A streamlined tax system across states will ease compliance and boost sales. However, e-commerce companies will be liable to collect taxes from suppliers on their platform, at the time of sale, which will increase their accounting burden and diminish working capital available to small sellers.

Capital Markets and Financial Services: Markets have already reacted favorably. The SENSEX and Nifty indexes are expected to hit record highs as implementation rolls out. Most banking and financial services in India are subject to a service tax of 14.5% which is likely to increase to 18-20% with GST, increasing the cost to consumers.

Manufacturing: Huge compliance cost reduction to companies doing business across multiple states. Manufactured goods are currently subject to excise duty, VAT, and a central sales tax, all of which will be subsumed under the GST. The indirect tax component will decrease from 27-30% to 17-18% with GST, making these goods more affordable for consumers.

Food Processing: Dramatic reduction in complexity to food & agriculture businesses with operations or shipping across multiple states in India (?). Companies that currently enjoy a tax exemption are unaffected, but those under a concessional tax bracket may face a higher tax burden.

Healthcare: GST will remove the inverted duty structure that adversely affects domestic manufacturers, reducing the cost of inputs and boosting investment. However, GST might override certain tax exemptions that reduce cost of services for consumers.

Energy: Expected impact is mixed. GST is likely to subsume multiple power sector taxes and thereby reduce the cost of greenfield projects as well as the per-unit retail tariff. However, the renewables sector may suffer if the myriad existing fiscal incentives for clean energy development are subsumed.

Retail: Many foreign single-brand retailers have been awaiting this reform to enter the Indian market given its immense boost to ease of assembly, packaging, and distribution across the country. From apparel to electronics, retail margins will benefit from GST, including rent offsets and streamlining operating structures.

ASG's India & South Asia Practice has extensive experience helping clients navigate markets across the region. For questions or to arrange a follow-up conversation please contact Ashlyn Anderson at 202-759-0753.