

## Mirae Flash: India GST bill passed

4 August 2016

# Goods and Services Tax



- *Productivity improvement over medium term through “one India” unified marketplace and simplification of current complex tax structure.*
- *Greater tax compliance to boost India’s growth.*
- *Consumer, logistics, autos and cement companies are key beneficiaries of GST.*
- *GST, along with other on-the-ground productivity improvements, instrumental to realizing India’s potential.*

India’s Upper House passed the long-awaited Goods and Services Tax (GST) Bill last night with a unanimous vote. We see this as a landmark reform to unify India’s 1.3 billion people into one single market. GST will replace at least 17 state and central taxes, simplifying the current arcane tax structure with hundreds of exemptions and cascading tax-on-tax. While there remains a number of legislative hoops to jump through, such as ratifying the legislation with at least half of India’s states, the most crucial and difficult hurdle has been cleared. GST implementation is expected to take place starting April 2017.

### Key benefits

“One India” – The most important benefit of GST is **productivity improvement in the medium term**. The current tax regime is such that input credit for state taxes paid in one state cannot be claimed in another state, thus encourages fragmentation of production and logistics along state lines. Successful implementation of GST will






take away the artificial tax advantage of goods produced within a state relative to those imported from other states. Firms will now be able to benefit more from economies of scale without being held back by sub-scale factories and warehouses. All in all, **GST will lead to market share gains for the organized sector with economies of scale**, while the small-scale unorganized tax-evading sector gets marginalized.

**Greater administrative efficiency** – Companies will be able to enjoy greater ease of tax administration as multiple taxes will be replaced by one. For example, tax forms / challans / annexures needed to be filed out would come down from 441 to 18 after GST implementation<sup>1</sup>.

**Greater tax compliance** – India loses a material amount of tax revenue because of the ~400 exemptions under the current tax regime between the state and federal level. A simpler taxation structure with less exemptions leads to greater tax compliance. According to the Finance Minister, **GST can boost economic growth by as much as 2 percentage points**.

## Sector implication

From a sector perspective, GST will generally be positive for consumer goods sectors from lower taxes. On the other hand, the services sector will be negatively impacted by higher tax burden. (Note that the final GST tax rate has yet to be decided. The committee under the Chief Economic Advisor recommends a standard rate of 17-18%. This is the assumed tax rate in our analyses.)

Sector	Impact from GST	+ / - / Neutral
FMCG	<ul style="list-style-type: none"> <li>Effective tax rate reduces by ~2-5%<sup>2</sup></li> <li>Better economies of scale through consolidation of manufacturing facilities and lower logistics cost</li> <li>Market share gain from unorganized sector</li> </ul>	
Autos	<ul style="list-style-type: none"> <li>~10-17% fall in vehicle prices<sup>2</sup></li> <li>Better economies of scale through consolidation of manufacturing facilities and lower logistics cost</li> </ul>	
Logistics	<ul style="list-style-type: none"> <li>Consolidation of warehouses and increased efficiencies of logistics chain.</li> </ul>	
Cement	<ul style="list-style-type: none"> <li>Lower tax incidence from ~27%<sup>3</sup></li> </ul>	
Exporters (Pharma / IT)	<ul style="list-style-type: none"> <li>Limited impact to these export-oriented sectors</li> </ul>	<b>Neutral</b>
Banks	<ul style="list-style-type: none"> <li>Limited impact – small tax increase on fee incomes</li> </ul>	<b>Neutral</b>
Telecom	<ul style="list-style-type: none"> <li>Moderate increase in tax incidence</li> </ul>	<b>Minor</b> 

Our Asia regional and India equity strategies (Mirae Asset Asia Sector Leader, Asia Great Consumer, and India Sector Leader) are positioned well in regards to the GST winners and losers discussed above.

India stands out in a world where demand growth is difficult to find. While the attractive demand-side story is well-known, India's Achilles' heel has always been supply-side bottlenecks due to various inefficiencies. The passage of the GST Bill is clearly an important milestone towards productivity improvement to realize India's potential. Together with other improvements we are witnessing on the ground, such as infrastructure rollout, financial inclusion, state electricity board reforms and bankruptcy code, India stands out as one of the best equity stories globally.

Source:

<sup>1</sup> Business Standard, March 8, 2016

<sup>2</sup> Nomura, July 20, 2016

<sup>3</sup> Citi, July 18, 2016

## Global Offices

### Mirae Asset Global Investments

East Tower 26F, Mirae Asset CENTER1 Bldg,  
67, Suha-dong, Jung-gu,  
Seoul, Korea (100-210)  
Tel.+82-2-3774-8200

### Mirae Asset Global Investments (HK)

Level 15, Three Pacific Place, 1 Queen's  
Road East, Hong Kong, HK  
Tel.+852-2295-1500

### Mirae Asset Global Investments (UK)

4-6 Royal Exchange Buildings,  
London, EC3V 3NL, United Kingdom  
Tel. +44-20-7715-9900

### Mirae Asset Global Investments (USA)

1350 Avenue of the Americas,  
33<sup>rd</sup> Floor, New York, NY, 10019, USA  
Tel. +1-212-205-8300

### Mirae Asset Global Investments (Taiwan)

6F, NO. 42, Sec.2 Zhongshan N. Rd.,  
Taipei City 10445, Taiwan (R.O.C)  
Tel. +886-2-7725-7555

### Mirae Asset Global Investments (India)

Unit No. 606, 6th Floor, Windsor Building  
Off. C.S.T Road, Vidyanageri Marg.  
Kalina, Sanatacruz (East), Mumbai  
400 098, India  
Tel. +91-22-6780-0300

### Mirae Asset Global Investments (Brazil)

Rua Olimpiadas, 194/200,  
12 Andar, CJ 121, Vila Olímpia  
São Paulo, CEP 04551-000, Brazil  
Tel: +55-11-2608-8500

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