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GST Rate tax neutral for the tractor industry

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GST expected to be implemented from July 1, 2017

Current tax incidence for the industry remains at levels of 12-13%

GST Rate likely to be neutral for tractor industry

The Constitution (One hundred and Twenty-Second Amendment) Bill, 2014 related to the proposed Goods & Services Tax (GST) was cleared by the Rajya Sabha in August, 2016 and is expected to be implemented from July 1, 2017. The GST, which is heralded as the single largest tax reform, aims to simplify the tax structure. The implementation of GST is expected to have implications for the corporate sector as a result of tax rate differentials from the existing system; additionally the simplified tax structure was also likely to lead to supply chain efficiencies for the corporates.

With a view of improving the levels of agri-mechanization in the country, the central government had exempted tractors from excise duty in the Union Budget for 2004-05, that continues till date. While tractors are exempt from Excise Duty, tractor OEMs inputs continue to attract taxes, which is absorbed by the OEMs in the absence of an option to set off the input taxes (as a result of excise exemption on final product). The total tax incidence for the industry in the existing taxation structure amounts to around 12-13%; thus, with the GST council indicating a GST rate of 12% for the industry, the tax incidence for the industry is expected to remain at similar levels. Therefore, GST implementation is likely to be overall neutral for the tractor industry.

Tax Structure Explained

The tractor OEMs currently incur taxes of around 12-13% on most input components (Excise & VAT) such as engine, transmission, driveline, wheel rims, sheet metal fabrication, seats etc. Since the component costs inclusive of all taxes currently amount to about to ~65-70% of the dealer price, the effective tax incidence on account of inputs works out to ~8%. With CENVAT credit unavailable, the OEMs absorb these taxes as input cost. The tax incidence on inputs combined with VAT on final product takes the total tax incidence for the industry to levels of around 12%-13%. With the GST rate for input components increasing to 28% from the earlier taxation structure, the total tax incidence on inputs is estimated to increase. However, since the proposed GST regime works on a value-added principle and a manufacturer can claim refund for taxes paid on all inputs, the fixation of a GST rate of 12% on tractors would allow the OEMs to take credit of the cumulative input duties and taxes (post the increase in GST).

Although input prices would increase, availability of input credit would help offset the impact

Thus, the total tax incidence of the industry would remain at broadly similar levels and its implementation is neutral for cost structure of the tractor OEMs.

Table: Tax Structure

	Pre GST	Post GST
Inputs		
Central Excise Duty	Ranges from 0 to 12.5% (Estimated blended average of 8-8.5%)	
VAT (State wise)	4-5%	Increased to 28% for most components
CST	2%	
Total	12-13%	
Final Product		
Central Excise Duty	0% (Exempt)	
VAT (State wise)	5-5.5%	
CST	2%	12%
Total	~4.5-5% (Input VAT credit available on same state sales)	

Source: ICRA Research

Sample Calculation

A sample calculation of the current cost structure in the industry and the resulting tax incidence is shown in the table below. As is apparent from the table, even post the incorporation of a GST rate of 12% (and increased GST at 28% for input components), the tractor price, OEM margin and total tax incidence for the industry would remain at levels similar to the current tax structure. However, in a case wherein tractors would have been exempted, it could have been negative for the industry, due to increase in GST rates for input components, as the OEMs would not have been able to take input tax credit, thereby leading to a decline in their margins. A point to be noted here is that manufacturers would have to claim a refund from the government, since the input tax credit would exceed the effective tax on tractors. Thus, the working capital requirements of the tractor OEMs would increase, depending on the time period taken for the refund to be received from the government (clarity regarding the same still awaited).

Assumptions for sample calculation:

- Dealer Margin of 6%
- OEM Conversion Margin (% difference between factory cost and dealer price) of 30%
- Input cost assumed to be 70% of factory cost
- Tax incidence on input in current scenario includes excise, VAT, CST) – effective rate of 12.5%; increased to 28% post GST

Exemption under GST would have been a negative for OEMs

Consolidation of warehousing facilities and depots could help OEMs rationalize inventory holdings

Table: Sample Cost Break up Calculations

	Pre GST		Post GST
			Rate – 12%
Final Retail Price	100.00	Input Cost (excl duties) (similar to (i))	55.90
Dealer Price (Excluding 5% VAT)	95.24	GST (Input) @ 28%	15.65
Factory Cost	89.85	Factory Cost (adding (ii))	98.51
Input Cost	62.89	Dealer Price (adding dealer margin)	103.9
Input Cost (excluding excise, VAT, CST) – (i)	55.90	GST (output) @12%*	10.59
Total Taxes	11.75	Input Tax Credit	15.65
Tax incidence	13.31%	Final Retail Price	98.84
Conversion Margin (ii)	26.95	Total Taxes	10.59
		Tax incidence	12.00%

Source: ICRA Research; * GST on output to be calculated on dealer price after excluding GST (Input), as Input tax credit is available for the latter

Supply Chain alignment to drive operational efficiencies

In the tractor industry, almost all the OEMs follow a model of having stock depots in various states. Since there are multiple check posts for goods transportation between states, maintenance of stock depots has become a necessity for various OEMs. In addition to inventory management, the maintenance of stock depots reduces taxation costs arising from movements of goods across states (central sales tax and other entry taxes for intra-state transport of goods).

Along with simplification of tax structure, GST is expected to facilitate smooth transportation of goods within the country, which would help ensure better movement of goods within the country. As a result, logistics costs are expected to decrease post implementation of GST; additionally, a consolidation of warehousing facilities and depots would aid reduction in operational costs and help OEMs rationalize inventory holdings. Although the impact of these operational efficiencies is difficult to quantify as yet, the ability of OEMs to align their supply chains to maximize benefits could be instrumental in helping them improve their profitability and competitiveness.

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