GST – Impact on Procurements for Manufacturers

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The Government of India along with the States have moved very fast in last couple of months to roll out GST law from 01.04.2017. Latest being forming of GST council, rules, FAQs etcetera could certainly make the GST introduction reality. The business community along with professionals have to analyse the GST impact on pricing policies, various business functions such as sales, procurement, cash flow, its internal control system and IT systems. In this article, we analyse the impact on procurements for manufacturers.

In most of the industries the materials cost would normally be substantial between 50-70%. Therefore, would influence management decisions such as product pricing, outsourcing, import vs domestic procurement, vendor selection etc. Some possible impacts of GST on procurement portion for a manufacturing industry are as under:

Impact on initial cash outflow

The expected standard GST rate of 18- 20% on goods and services would have an impact on initial cash outflow. The impact could be both positive and negative. The cash outflow could reduce in case of purchase of goods where presently around 28% (ED 12.5% + VAT 15%] is being paid. Further the CST 2% cascading and the credit restriction in some States for stock transfer would add to the tax cost presently. Stock transfer liable to GST being interstate or between different verticals within a State would add to the working capital requirement. This is only if purchases are from compliant vendors and credit was matched. In case of services cash flow would increase as presently 15% or abated values.

In cases like iron / steel goods, packing materials which presently enjoy the benefit of concessional rate of tax wherein overall tax rate is less than 20%, the cash outflow could increase. For example, packing carton boxes are liable for 6% ED and around 5.5% VAT in most states which accounts to not more than 12% tax. There could also be a scenario where presently goods completely exempted but would be taxable in GST regime leading to extra cash outflow. Proper planning for purchases is essential considering various factors. Few of them could be as follows:

a) Requirement of revision of EOQ levels based on cash flow impact and impact on sales if any. The dismantling of check posts would lead to reduction in the transit time.
b) Negotiation of price with vendors as there is a possibility of reduction in cost of production for manufacturing sector by 5-7% generally.
c) Revision in purchase / procurement budgets.
d) Considering the cash flow impact on working capital management.

Reduction in Cost of inputs

Nearly 60% to 70% of total production cost could compromise of material cost in most of the manufacturing industry. Generally, the manufacturers procure required inputs either from producers or dealers located within State or outside State. There could be reduction in cost of materials in GST due to following reasons:

a) No more Entry tax payments

In case of few states like Karnataka, Orissa, West Bengal, there is a levy of entry tax on specified goods entered into the state. In Karnataka, the entry tax rate is 2% on machineries and its parts. On petroleum products, the levy is 5% on purchase price. The entry tax paid is not eligible for input setoff as well. This levy is increasing the cost of materials procured. In GST regime, abolition of entry tax/ cotroi/ local body tax would result in decrease in cost of procurement.

b) Procurement from non-excise dealers

In case of goods procured from dealers other than first / second stage dealer, buyer can avail only VAT credit. Dealer would have procured goods from manufacturers / imported on payment of duties. If the dealers are not passing on the benefit of taxes paid, then the same would add to purchase cost. In GST, this scenario would not arise as dealers would be eligible take all credits and pass on the same to buyers.

c) Eligibility of credit on interstate purchases

Goods purchased from manufacturers or dealers from other states are liable to CST at the rate of 2% with C form or equal to local VAT rate without C form. In present IDT system, the CST paid is not eligible for credit. In GST, the supply of goods and or services in the course of interstate trade or commerce is liable for IGST. The amount paid by the purchaser towards IGST can be claimed as input credit. This would reduce the procurement cost for manufacturers.

Tax levy on purchases from unregistered dealers

On goods procured from unregistered persons, there is a need to pay VAT in all the states which would be eligible as credit provided the goods are used in relation to saleable goods.

In GST regime, it is not clear if this is going to be continued as number of unregistered dealers would get reduced substantially due to lower exemption limit. However, there could be a GST levy even on procurement of services on procurement of services from unregistered dealers. Therefore, planning should be made to avoid purchases from unregistered dealer which otherwise could increase the cost of compliance.

Procurements from composition dealers to be avoided

Under the present VAT regime, the tax paid on purchase of goods from composition dealers would not be eligible for input credit. Even in GST regime, the composition scheme would continue. The tax cannot be collected by the seller and therefore, there is no question of credit for the buyer of goods. However, due to ineligibility of credit on purchases, the cost of sales for composition dealer would increase. There is a need to reduce / completely avoid procuring goods from composition dealers in GST regime. However, this decision should be taken considering other factors such price of goods, necessity of goods etc.

Screening/ grading of suppliers

Presently, the credit of excise duty and VAT (though questioned in few states) paid on purchases would be eligible as credit if goods are received and put to use in business. Generally, it is not the responsibility of the buyers to ensure tax payment by the suppliers to the Government. To this understanding, there are exceptions in States like Delhi and Tamilnadu where the credit of VAT would not be eligible for the buyer of goods unless the taxes are paid by the seller to the Government. This very poor practice has now been extended to whole of India.

However, in GST regime, the credit would be eligible for buyers only if suppliers have paid their taxes properly and filed the return accurately and in time. The concept of matching credits has been introduced. Any default in tax payment by suppliers would make buyers ineligible for credits. Therefore, screening of suppliers would be critical. There would be a compliance grading. Therefore lower graded dealers / suppliers should be avoided. In present regime some States have a balck list of dealers. Dealers who do not issue proper invoices should also be avoided by the manufacturers.

Planning of purchases during transitional phase

In transitional phase, there would be a need for good planning to ensure that maximum credit benefit is availed. The important factors to be considered are as follows:

a. Timing of purchase – Manufacturers need to plan the time of purchase during transition phase considering the credit eligibility. For example, interstate purchases which suffer 2% CST could be delayed as CST is not eligible as credit. Similarly, entry tax impact could also be considered especially in case of machineries imported or procured from other states. Procurements after GST introduction would not be leviable to entry tax. Goods ineligible for credits under IDT and GST could be procured in GST regime with lesser tax.
b. Purchase from unorganized dealers – Purchases from unorganized dealers should be reduced. Dealers who are not regular in their tax payments, black listed dealers, dealers who do not issue proper invoices should be strictly avoided.
c. Vendors with multiple locations – It is necessary to ascertain if vendors could supply the goods from locations within the state instead of locations outside the state to avoid payment of CST which is ineligible. For this purpose, the transportation cost should also be factored in.
d. Contracts / agreements to be revised – All the contracts including purchase orders would have to undergo amendment to include GST clause.
e. Negotiation of price – Prices agreed as per the contracts should be renegotiated as the cost of manufacturing could reduce for the suppliers.

Conclusion

The points discussed above are only illustrative and list can go on when we analyse the impact in depth. An initial impact study is a tool which could help the business community and professionals to understand the impact of GST on various business functions. A stitch in time saves nine.

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