

Impact of GST on Procurements

GST is not just a tax reform but it is a business reform. It shall change the way in which business processes are performed and the way in which the business transactions are undertaken. Although, GST will bring with it, both positive and negative aspects. However, the organizations that will plan its business processes better in a manner to best suit the needs of the GST regime, then such organization will have competitive edge over others. Therefore, it is of due importance that business house proactively re-structure its business processes and optimize its tax position to reduce the negative impact of the changing tax environment.

Procurements department plays a key role in any business set-up as they directly deal with the cost element. Apart from focusing on volumes and margin of sales, businesses also very keenly track the cost of procurements and efforts are always made to control the costs/ overheads. Various key aspects that a business needs to take care in the GST from procurements point of view are as under.

Mapping current procurements:

The first stage of planning the procurements is to know the current purchases, it shall be important for the businesses to map their entire procurements in a manner to understand them better. Procurements can be mapped based on the various criteria's as required by the management. For instance, all purchases can be grouped in various baskets based on the tax components levied on such procurements. Many a times, procurements are being made to optimize the current taxes.

In case currently procurements are being made from a particular vendors only to suit the needs of the present tax regime, then such procurements needs to be re-looked. Indicative cases, where procurements are currently made to optimize the present taxes are as under:

- Currently, purchasing from the dealers registered under excise as the excise benefit will be passed on;
- Currently, purchases being made from CST vendors as local VAT is not eligible as credit;
- Purchases being made locally only to avail local VAT credit.

It is pertinent to note that above purchases were being made in the current regime to take the benefit of the present taxes. However, such benefits will not be available in the GST regime, therefore in all cases where currently procurement policy is driven by the tax implications, then all such procurements needs to be re-looked into for the other competitive sources.

Purchase price/ cost

It shall be very important for the businesses to strategies its procurement pricing and procurement cost based on the impact of GST. Below table determines the impact of procurement cost/ price on the purchases based on the various illustrative situations as under:

Particulars	Impact on purchase price/ cost
There will be free flow of credits in the GST regime. Cascading of the taxes will reduce substantially in the GST regime. For instance, CST element is cost in the current regime. Such costs will be trimmed in the GST regime	Reduction in the purchase cost
Passing of the GST benefit by the suppliers by reducing the price of the goods/ services - Anti-profiteering restriction in the law	Reduction in the purchase cost
Sourcing from inter-state competitive vendors due to erosion of local depots in a bid to identify better procurement pricing	Increase in freight costs
Purchases from composite dealers	Increase in cost of tax
Non-passing of the GST benefit by the vendor - Initial short term inflationary effect on the pricing of the goods	Increase in costs
Currently, reversal of VAT credits in case of stock transfers to other states	Reduction in the purchase cost
GST credit not available for set-off due to restriction of the input tax credit	High increase in purchase costs

Purchase planning

Purchase planning is an important activity in every organization to understand and properly plan the needs of the production / provision of final products /services. It helps to decide what to buy, when and from what sources. Most organizations spend around 20-60% of their money on the materials, supplies, capital equipment, technology, and services that are necessary to keep the

enterprise running. Organizations need to transform their operations by aligning resources and technology and taxes thereon to enable organization to make the most cost effective purchases possible. Various elements of the purchase planning that needs to be looked into from GST point of view are as under:

a) Change in EOQ levels, lead times, carrying costs etc.

EOQ is the order quantity that minimizes the total holding costs and ordering costs. Under GST regime entire nation will become a one common market and in case the geographical location of the procurement undergoes a change then a corresponding change in the EOQ levels, lead times and the carrying costs must be planned and accordingly the promised delivery times to the customers must be changed.

b) Revision in purchase budgets

The amount stated in the purchase budget is the amount needed to ensure that there is sufficient inventory in hand to meet customer orders. Organizations should compare the current purchase budget with proposed budget taking the GST rate and eligibility of credits etc. into consideration, revise the budgets. If the prices are going go high in GST regime, then increasing the purchase budget in terms of value can be looked into. On the other hand, if the GST impact is positive side on purchase cost, then decrease the purchase budget amounts accordingly.

c) Revision in product costing

Product cost refers to the costs used to create a product. These costs include direct labor, direct materials, consumable production supplies, and factory overhead including taxes. Since the objective of GST is to give seamless credit throughout supply chain, then the above procurement costs may get reduced ranging from 2%-5%. By considering the above reduction in procurement cost organizations should revise the product costing to get better competitive price in the market to edge over others.

d) Changing the purchase forecasts based on impact of GST on sale of a product or on the industry

Organizations should consider the changing of the purchase forecasts based on impact of GST on sale of a product or on the industry in the following manner:

- If the prices of the products increases in the GST regime, the purchases should accordingly forecasted and procured in advance so that consistent survival in the market is possible.
- How the entire industry in which organization is carrying its operations is impacted due to GST and accordingly change the purchase forecasts.

e) Timing of purchases to be re-visited especially during transitional phase

The most important thing that the organizations can do during the transitional phase is timing of purchases. If the rate of GST is going to be high in GST regime when compared to present indirect tax regime then purchase can be pre-poned otherwise it can be postponed/ deferred. Further, this decision can be taken based on the credits eligibility of the purchases made in the current regime vis-vis GST regime. Impact analysis of delay in purchases vis-a-vis consequences for the same must also be looked into.

f) Procuring with a type of GST i.e. CGST/IGST to avoid accumulation of one type of credit

Though the seamless flow of credit is the objective of the GST, however cross sectional utilisation of SGST credit between two states would not be available in the GST regime. Therefore, if the SGST credits of one state is not available to be utilised against the SGST credit of another state, then organizations need to plan their procurements in such a way that any one type of credit must not get accumulated leading to insufficient credits and cash payment is required to discharge that GST liability. Similar position may remain w.r.t cross utilization of CGST and IGST credits of one state with that of another state, however clarity is awaited on the same.

g) Reduction in Purchases from CST vendors or other sources where credit not available

Under GST regime transitional credit is available only when such credit is eligible in present regime and also GST regime as well. Since, CST credit is not eligible credit under present CST law, therefore the same is not eligible to be transferred into the GST regime. Hence, in such situations instead of procuring under CST, organizations may consider to reduce the purchases in the existing regime to the extent which will not affect the current sales.

h) Procurement from un-registered vendor

Procurement from unregistered vendors can have implications in the form of reverse charge liability which could have direct impact on the working capital. Therefore, businesses may have to avoid procurements from unregistered dealers especially in a scenario where the credit is not available.

i) Advance payment to vendors

Policy with respect advance payment to vendors have to be looked into. Currently, excise duty and VAT/CST are not applicable on advances instead the tax is payable only

when the goods are removed from the factory gate or when the sale takes place. However, GST needs to be paid on the advance element also upon the receipt of any advances. Therefore, traders and manufacturers need to adapt themselves to this change and tax needs to be collected even on the advances such that it does not impact the working capital. Failure in collection of tax on advances directly leads to payment of taxes out of own funds thereby blocking the working capital in taxes.

j) Transactional restructuring:

Procurement transaction must be structured in a manner to save taxes, avoid blockage of credits and lead to speedy avilment and utilization of credits. Various areas of transactional restructuring could be as under:

- ✓ Contracts re-alignment (tax clause);
- ✓ Mixed supply v/s Composite supply;
- ✓ Bill to v/s ship to location;
- ✓ Centralized PO v/s decentralized PO;
- ✓ Master PO v/s individual PO's for Just In Time purchases.

Managing procurement vendors

As prices are expected to come down in GST regime, every customer would like to procure goods/services at a cheaper price. In this aspect, Purchase department of an organization has to be more proactive to manage their procurements/ suppliers better and to crack a better deal from their vendors. GST is nothing but an opportunity for the purchase department to enhance their vendors list and negotiate, this aspect is being discussed below in detail as under:

a) Vendor masters updation, Tax master updation

Once GST is implemented, the first and foremost important task is to update the vendor masters and tax masters with the additional information based on the structural changes and the tax changes performed by each businesses in the GST regime.

b) Vendor Performance/ compliance

It is very important that every supplier has to comply with GST, as the concept of compliance rating in the GST regime will be playing a crucial role. It not only defines the compliance status of the business but also has an impact on the business, either positive or negative. Suppose if compliance rating is low on scale either because of delay in payment of taxes or invoices etc, then the customer would think twice before transacting a business with such vendors.

c) Matching concept for Input Tax credits

An important aspect in GST is that tax credit to the purchaser is linked with that of tax payment of such taxes by the vendor. Unless, the vendor pays the taxes on supply of the goods/ services, the customer will not be entitled to take credit of such supplies. If supplier has not remitted taxes, then GST becomes cost to buyer and in turn, price of his supply would substantially goes up which would affect the market.

Further, if there is any delay on account of vendor in remitting taxes, then the buyer can take credit of taxes only after discharge of taxes by supplier. Till then, buyer has to wait for the payment by supplier. This becomes a big challenge to the business to follow up with the supplier for taking credits.

Therefore, procurement department needs to assess their current vendors and the un-organised/ non-compliance oriented vendors must be trimmed down.

d) Identifying multiple new vendors

As GST is a united indirect tax and since it will change the entire dynamics of the businesses, therefore prices of almost all the businesses will undergo a change. Therefore, it gives an opportunity to the businesses consider entire nation as a common market and enhance the geographical purchase horizon and get the quotes multiple new vendors. Therefore, against the current practice of obtaining 3 or 4 quotations, business can identify multiple new vendors and get revised quotations from the existing vendors to obtain for a better and cheaper price at same quality in the GST regime.

e) Conducting vendor education programmes for un-organized vendors

Since GST involves compliance from both the supplier and the buyer, procurements from un-organized vendors is a bit challenge to the business as the credits may be lost. In such cases, vendor education programmes needs to be conducted for un-organized vendors to bring awareness about GST. Such programmes shall ultimately fetch results for the customers in the long run.

f) Pricing of procurements from related parties

Although, transaction value with the related party vendors will be acceptable in the GST regime. However, department officers have been given adequate powers to reject the transaction value if there is an iota of doubt on the truth or accuracy of the value adopted or if the value is not kept at the arms length. Therefore, each supplier has to review the current pricing of transactions with the related parties and make suitable changes, if any

to comply with GST. Otherwise, GST officers may litigate into the valuation in respect of the related party transactions.

g) Obtaining information from vendors

A simple information form must be issued to the vendors asking for filling and submitting information that needs to be updated in the vendor masters. An illustrative list of various information that needs to be immediately collected from the vendors is as under:

- ✓ Name of the Vendor;
- ✓ PAN of the Business;
- ✓ Provisional GSTIN No. in each supplying state;
- ✓ Details of Goods supplied & HSN Code;
- ✓ Software used by your organization for accounting purpose;
- ✓ Vendor IT readiness and support required if any;
- ✓ Understanding of the GST law – trainings
- ✓ Date of last reconciliation? Any open issue?
- ✓ Restriction on issuing of PO if above information not provided.

Documentation

- a) As one of the criteria for allowing the credit under GST would be proper documentation on the basis of which credit is availed under earlier law. Ensuring that all the details of goods lying in the stock are collated in a master data with the documentary proofs capturing the details such as quantity, value at which such goods are procured, location at which such goods are stored and the amount of credit that is availed on such goods with the document based on which such credit is availed.
- b) Ensuring this exercise before stepping into GST regime will safeguard the credits that are getting transformed from current regime to the GST regime.
- c) The goods lying with the job worker/ other locations are having utmost importance under GST regime. Ensure that proper documentation with all the details of quantity, value etc. is kept readily available of the goods lying with the job worker so that the credits availed on such inputs are properly transformed to GST regime.
- d) System must be properly planned in such a way that proper invoices are obtained wherever necessary during the transitional phase so as to enable the entity in safeguarding the credits.

- e) It is pertinent to note that the credits that are lying in the closing balance in the periodical returns filed will only be allowed to be taken as credit in the GST regime. Ensuring that proper reconciliations between books, returns and computations are accomplished to make sure no credits are missed out.
- f) It is the foremost exercise that need to be in operative for smooth transition of credits into GST regime.

Conclusion:

These are not the exhaustive list of areas or actions that a procurement department has to look into or perform in the verge of implementation of GST. There can be many more business specific or transaction specific impact that one has to be aware of and act. Therefore, it is imperative for the procurement department to proactively understand the impact of GST on their business and act immediately to curb the negative impact and multiply the positive impact to ensure smooth transition into the new world of taxation.

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