GST:
Changing The Operating Paradigm Of Business

The onset of the GST will mark a most fundamental change in India's business operating environment. An altogether new operating paradigm for industry, GST will impact at the core how business conducts itself – from warehousing to operations to retail. CFO focus will be invested in change management within the firm and strong education and engagement with vendor bases. With the broad contours of the GST largely in place, IMA's India CFO Forum brainstormed, at its 21st Annual CFO Roundtable in Mussoorie in February, and at core CFO discussions in key chapter cities, the areas of focus for organisational readiness. This issue's cover story concentrates then on the core focus areas of operationalising GST, arguably among the greater transformation exercises that Indian industry has undertaken in recent memory.

At its very core, GST will shift taxation from origin- to consumption-based. Various indirect taxes will be subsumed, hopefully eliminating the cascading effect for the most part. The GST Council has fixed four tax rates: 5 per cent, 12 per cent, 18 per cent and 28 per cent. (Luxury goods, which fall in the highest slab currently, will be subject to an additional cess, equivalent to the difference between the current and the highest GST rate, so as to offset any loss to the exchequer.) Thresholds and bands for different classes of goods and services are yet to be confirmed, which continues to cause uncertainty, but the wider structure is clear enough for operating decisions to be taken and 1-2 clear scenarios to be planned for.

Engagement with FinMin and the GST Council: Still key

A set of detailed rules will set the framework for enforcing the GST. Ideally, these guidelines should be based on adequate consultation with all stakeholders, including industry. Till recently, a lack of adequate transparency obscured insight into how the rules are being formulated. Illustratively, there is little clarity on the determination of the point and place of supply. This is particularly problematic for e-Commerce companies, but across the board, firms will now have to capture customer data with far greater detail and accuracy than before. Issues like these will demand the most active collaboration and sharing of perspectives within industry rather than a silo-based approach, to pool both ideas and crucially, issues to raise with the government and the GST Council. Members of IMA's CFO Forum who have opted for this approach in advocacy have found the Council and Finance Ministry both open and keen to understand challenges and issues. Recommendations, for example, in pharma, in the area of free promotional samples or taxation of essential medicines have been well received.

In some companies, VAT authorities have conducted seminars, and have demonstrated a keen understanding of the subject. Moreover, organisations are finding

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that senior tax officers at the Centre are forthcoming in sharing views and engaging with industry to build a wider understanding of the GST.

MOVING TO A GST-COMPLIANT ORGANISATION

CORE TEAMS: CROSS-FUNCTIONAL AND DEDICATED

The CFO community is adopting various avenues to drive a successful transition to the GST. At M&M, a strategic council (responsible for advocacy and organisational matters), and an operating council (handling implementation issues) are charged with the responsibility to manage several important focus areas, including registration requirements, transitional issues, IT readiness, new business models, and organisational alignment and training. At Dr Reddy's, the transition to the GST is being driven by a small 'core' team, and a larger cross-functional team drawn from functions such as indirect tax, supply chain, and IT. As a first step, the company has conducted an impact analysis, revealing several areas of concern that it is now concentrating on.

Crucially, every CFO is clear on involving the wider organisation and on ensuring that GST implementation is viewed not just as an F&A initiative, but a business one.

REGISTERING FOR THE GST

The shift to the GST will mean new registration requirements. Services companies, in particular, are setting in place processes to ascertain critical data, such as the place and point of sale. Large manufacturing firms with a footprint across states will see a possible consolidation of manufacturing related registrations, but services firms, on the other hand, must register for service provision in each state of provision. The more forward thinking – and process-mature – firms are considering registering in each state irrespective of whether it currently offers services there to avoid registration-related delays from impacting service delivery.

> In order to transition successfully to the GST, M&M has created strategic and operating councils, one handling advocacy/ organisational matters, the other implementation issues

ON TRANSITION...

Any exercise, when it commences, will face issues in transition. A major area of worry in the law as it stands is in the treatment of paid taxes, such as excise and sales tax, on the date the GST comes into force. The government has committed to setting a mechanism enabling input tax credit on such tax payments. However, this may be easier said than done, especially in manufacturing operations, where multiple layers of vendors interact with the organisation.

At the other end, there is uncertainty about how, and to what extent, organisations will receive input tax credit on unsold inventories at the time of transition. It is in any event unlikely that duty paid on unsold goods that are held at stockyards will be eligible for input tax credit. If left unresolved, such legacy issues could lead to a surge in assessment cases and litigation. Crucially, it may encourage customers to defer purchases and orders. Companies may well decide to under-stock until the issue is settled. While it is imperative for the government to frame clear guidelines, organisations must, in the meantime, set up dedicated 'legacy teams' that tackle transition issues.

SUPPLY CHAIN AND VENDOR MANAGEMENT: BEYOND CRUCIAL

The ability to claim input tax credits in a GST regime will depend greatly on the quality, accuracy, and completeness of the data filed by a firm's vendors. This makes it imperative to familiarise vendors with the GST, and to ensure that they have the right systems and processes in place. Little underscores the practical necessity of this process more than the fact that the GST regulation proposes a timeframe of only two months for any rectification of input/output tax credits.

Even as GST will be beneficial to individual organisations as well as vendors, the full potential is only possible to achieve if vendor training and the creation of transparent systems encompassing both stakeholders are prioritised.

From the IT systems standpoint, companies will need to handhold vendors to get their systems geared up for the GST to drive the full upside of the new tax regime. Across IMA's CFO Forum, discussions are underway with ERP partners such as SAP and Oracle to create small instances of the software, which could be installed at the vendor site for the seamless flow of information. Further, big ERP companies can also help vendors in rural areas set up offline models that work in areas with limited connectivity.

Each element of vendor tax structures now need to be revisited, and forward thinking CFOs as in IMA's CFO programme are already studying micro – and yet key – avenues to maximise spend effectiveness. Illustratively, most companies do not worry about incidental taxes in areas such as travel, hotels, etc. When compounded, however, such expenses can add up to as much as 4-5 per cent of company revenue. Educating vendors may lead to potential savings in these areas over the long run.

Best practices:

TVS Motor focuses equally on internal training programmes – which 400-500 managers have already completed – as it does on training its large external stakeholder base of ~4,000 dealers and 400-500 vendors. Plainly, this is harder to do with smaller vendors – given their higher churn rates, each new employee needs to be trained afresh – but TVS is planning a module-based training programme to tackle the issue.

At Titan, the onset of GST will require its watch- and jewellery-related vendors to substantially improve their record-keeping practices. In turn, this will allow the company to track transactions more effectively. Crucially, the individual workers ('karigars') in its jewellery unit will also have to maintain proper accounts. This will be easier to do in Titan's own karigar centres and parks – which are supervised by its employees – than with external karigars. In this regard, the company is, therefore, looking to possible bring all such workers under a single roof, and therefore maintaining records on their behalf.

GST will benefit organisations and vendors alike, but realising its full potential is possible only by prioritising vendor training and the creation of transparent systems

Aditya Birla Fashion Retail is encouraging its vendors to change their invoice-accounting practices. Specifically, it is asking them to split each purchase invoice into individual components, allowing them to claim credits on each. The company has organised several workshops to train its supply chain of about 600-700 vendors – 70 per cent of which are medium- or small-scale, and several proprietor-driven. Firms are also considering similar two-stage payment mechanisms that will split up the invoice into two stages, paying the basic value of the goods upfront and the tax only post-reconciliation. In this case, reconciliation itself becomes key and process capacity will need to be accelerated across the board.

Dr Reddy's is focused on improving the vendor invoice reconciliation process in order to ensure it is able to fully avail of the ITC on the onset of GST. The company is also viewing the transition as an opportunity to review and clean its vendor master – a massive task, given that it comprises 40,000-50,000 suppliers (though the company transacts with 5,000-6,000 of them any point of time).

In addition, it has undertaken an 'ABC' analysis of its active vendors: category A vendors are those who are expected to fully comply with the GST; category B are those who require some persuasion; and category C are those who will have to be pushed hard. Dr Reddy's has started engaging with the high-risk category C first – and has set in place a Standard Operating Protocol (SOP). Surprisingly, many of the company's

Companies like TVS Motor, Titan, Aditya Birla Fashion Retail and Dr Reddy's are actively working with vendors and dealers to ensure a smooth transition

SME vendors are not too far behind – they are familiar with the new law and already use robust IT platforms. Recognising the importance of an 'outside in' view, Dr Reddy's has engaged an external consultant to identify potential sources of savings in procurement – though the reluctance of vendors to share their cost sheets is a deterrent.

READYING THE IT BACKBONE

IT preparedness – of organisations as well as the tax authorities – is key to the GST's effective implementation. For companies, it is vital to continuously engage with the entire ecosystem, and align processes and systems in a manner that ensures compliance and minimises leakage. Moreover, building internal technology platforms that 'speak' to those of vendors is critical to availing input tax credits.

That said, potential changes to accounting and IT systems in the areas of master data, supply chain transactions, and system design will pose huge challenges. The migration

> **Robust IT preparedness will mean ensuring compliance and minimising leakage while building technology platforms that 'speak' to vendors' systems**

of existing transactions to the new system will come with its own set of issues. Companies must leverage the IT capabilities of the big ERP players to help small vendors be part of the new tax regime. Getting budget approvals for new servers and applications, changing the mindset of senior management, and driving process overhaul will all be important focus areas for CFOs on this score.

Illustratively, to ensure IT readiness, M&M is working with technology majors to develop customised GST-compliant platforms that integrate tax functionalities with business processes. In addition, to further ease its transition to the GST, M&M is developing an in-house technology solution, whose testing process is likely to be completed by end-December 2016. In all of this, since the GST rules will evolve over the next year or so, it is crucial to build flexible IT systems that can adapt to any changes in the tax regime.

CREATING NEW BUSINESS MODELS

GST will trigger a fundamental transformation in business models across the manufacturing sector. Efficiency gains, for instance, may be maximised by moving to a 'hub and spoke' model. Crucially, too, locational decisions will no longer be based on tax breaks and incentives, but on business logic. Moreover, a single, nationwide tax will encourage leaner supply chains. Further, GST will encourage 'pull-based' business models, in which goods are moved less frequently. This is because, while excise tax is imposed at the factory gate, GST is levied each time a good is sold: a warehouse bills a dealer, who in turn bills the customer, and each transaction will face a GST liability. Finally, while working capital need may rise in the near term due to supply-chain disruptions, in the medium- to long-term, firms will need to rethink their business to optimise working capital. In doing so, they should also focus on finding ways to share gains with vendors, driving their internal efficiencies as well. Moreover, companies should pass on gains to customers, generating additional demand in the process.

ORGANISATIONAL ALIGNMENT AND TRAINING

Redesigning business structures to enable compliance with the new tax must be a key priority, especially for larger organisations. Often, companies operate with separate, specialised teams for different taxes such as excise, sales and VAT. The onset of the GST will necessitate creating a single team dedicated to ensuring compliance with the law. Also, having regional teams, if not state-level ones, with the competencies required to tackle region-specific issues, will help. India's largest companies are considering the creation of regional competency centres, which are, in turn, they supported by state-level, subordinate teams.

Involving the wider organisation

Although Finance will have to be the main 'coordinator' or 'facilitator' in executing the GST, the process cannot be solely Finance-led. Rather, it will require the involvement of the entire organisation. In line with the maxim of change starting at the top, a fundamental driver of GST's eventual positive impact on organisations will lie in the CFO's ability to make senior management to accept and support the changes on account of the implementation of the new tax regime.

At a functional level, not only will the core business, but also all sub functions such as Logistics, Legal and HR need to be aligned for the smooth rollout of GST. Illustratively, HR and Legal should work together to be prepared to deal with emergent situations that may require retrenching or recruiting people or reviewing contracts with vendors or customers. CFOs are driving awareness of the impact of GST implementation internally and building a rigorous impact analyses to identify the specific changes needed in both operations and IT systems. Ultimately, involving everyone across the organisation in the process can help mitigate the risk to business continuity.

At Titan, while the indirect-tax team leads the initiative, each function has its own GST team. Aditya Birla has a steering committee, comprising the top leadership, which is supported by teams that handle specific areas, such as IT, vendor management, front-end distributor management, internal accounting, and process and system changes. It has also set up a committee to resolve

The Services Sector: Breaking New Ground

The services sector will potentially undergo the most significant transition and organisations will have to be prepared on multiple planes for a GST India. At one level, services – unlike goods – are not clearly defined within the Act, which makes it difficult to determine the tax slab for any given service. Equally, it is uncertain who will administer service tax at the state level, although on current indications, the onus could end up resting on the state VAT authorities. Ultimately, how well the GST is enforced on services firms will depend crucially on the quality and depth of training provided to the existing VAT, excise, sales, and service tax cadres, who will all be absorbed in the GST administration. Equally, the ability of Finance and tax offices within services firms to deal with multiple tax jurisdictions will also need to be enhanced.

The complex prerequisite of separate registrations in each state under the GST regime will make compliance more cumbersome than it is currently. This would mean decentralisation of reconciliations and assessments, which will increase the burden. The CFO Forum has been of the view that companies should be allowed to continue with the central registration procedure for the first two years till their operations stabilise and submissions to both the Council and the Ministry of Finance have been made.

Crucially, services firms will prima facie face a higher tax rate of 18 per cent (compared to 15 per cent today) and will have to find ways to offset this higher outgo by identifying specific areas wherein they will be able to avail input tax credits. The ability to pass on this cost to consumers/customers will be a factor of latent demand in the market and its capacity to absorb the same. If passed on, inflation will be a necessary fallout, at least in the short term.

Specific elements of the model law on services will need close understanding in any event – for example, GST will require 'no-consideration' services to be valued at fair value – the current practice is zero valuation – and companies will need to revisit their arrangements for services such as gifts. As another illustration, under the current tax laws, there are specified services for which the recipient as against the supplier is liable to pay taxes. However, under the GST law there is a lack of clarity on such reverse charges in terms of what services (and products) are covered and how the process will work.

legacy issues, such as ensuring that tax collection dues from the current VAT regime are completed. TVS Motor has established cross-functional teams, which include both younger and senior managers, to steer the GST execution process.

Finance will have to be the main 'facilitator' in executing the GST, but the process cannot be solely Finance-led, requiring the entire organisation, including Logistics, Legal and HR, to be involved

STRATEGIC OPERATIONS:

Location-related decisions

Under the GST, manufacturing businesses will need to closely re-assess existing operational structures. Many, for example, will gain from centralising their warehousing, and by bringing their warehouses closer to the point of consumption. TVS Motor, for one, is considering reducing the number of warehouses it has, from one in each state currently, to just a handful of strategic locations. Titan also plans to bring down its total, from over 20 to a much smaller number. For its jewellery businesses, in particular, all options are on the table - it may, for example, even transport directly from factories to stores, thus avoiding a potential tax liability on stock transfers.

The impact on pricing

GST will cause many companies to

reassess their pricing strategies. On the one hand, some firms may need to contend with a whole gamut of tax rates for their various products and services, but on the other, they might reap various benefits under the new framework. Aditya Birla, for instance, employs construction services and furniture providers while setting up its retail outlets. Since these vendors will become eligible to claim input credit, it will bring down the capex involved in setting up new stores. Clearly, though, maximising such gains will depend on how a company negotiates with its vendors and channel partners.

OPEN ISSUES: THE NEED FOR CLARITY

Clearly, no change as dramatic and landmark as this – which, in the long run, is, as endorsed by every CFO IMA engaged with on the subject, going to be beneficial (including a clear advantage to the organised sector over the unorganised) – some open, and potentially contentious issues remain.

Who will be the administrator?

For one, there is no agreement on whether it is the states or the Centre that will run tax assessments. Industry, plainly, would prefer a centralised system, because the states may have varying interpretations of the law, but it is possible that VAT offices may be charged with this responsibility across states.

Input costs of energy: Out of the ambit

There is still a lack of clarity on input costs and the exclusion of five items – crude oil, natural gas, aviation fuel, diesel and petrol – from the GST ambit will lead to some complexity, for the sector itself, but also for everyone else who uses energy as an input.

Open issues that still demand clarity include the treatment of energy as an input cost, an anti-profiteering clause, and the question of who will administer the new tax

The anti-profiteering clause: Still cause for concern

In principle, the anti-profiteering clause is clear – companies must pass on any pecuniary benefit attributable to the GST to their customers. However, how this will be implemented is not certain – though the GST Council is expected to come up with a set of practical rules. The CFO Forum's suggested option is for the government to fix industry-specific 'safe harbours' – the minimum percentage of the GST-related gain that should be passed on to customers. In this regard, companies could take a cue from transfer pricing practices – and conduct a segmental exercise to compute margins and tax liability, and the benefit that is passed on to consumers. However, given the complexity of business models, it will be difficult to precisely quantify the gains that are attributable solely to the GST. Higher documentation requirements for companies – in terms of recording all price changes, and the reasons thereof – will be an added requirement.

Crucially, the anti-profiteering provision is applicable on vendors, too, and requires them to pass on any GST-derived cost saving to their customer, the company. Recognising this, Mylan Labs has started to re-negotiate its vendor agreements in order to insert relevant clauses. Meanwhile, with regard to its sales to the government, Mylan Labs has added a clause in its tenders – and this has been accepted by the government – that any change in tax liability under the GST will be over and above the current quote. Effectively, the company is now bidding for government tenders at the net selling price.

In the absence of detailed rules and a clear understanding of the dynamics of each sector, this clause remains an important open issue. This will limit the ability to change prices in response to changing tax rates – and it is certainly questionable whether a free-market economy should even have such price-control mechanisms. Its enforcement could be problematic and lead potentially to even greater paperwork, including the need to carefully document all price changes, and the reasons thereof. On this score, several multi-brand companies – including automobile manufacturers – do

Unless detailed rules are framed, the anti-profiteering clause will limit firms' ability to change prices in response to changing tax rates

not necessarily change the price of each brand every time the excise rates change. At times, depending on varying purchasing power, they also price differently in each state. Under the new rule, though, firms will have to find ways to justify such differential pricing, which complicates matters, too, for e-Commerce companies, who often grant heavy discounts.

The impact on cash flows: Potentially negative

In many cases, the GST will raise working capital and cash flow requirements. For instance, it will be levied on stock transfers, and this will block working capital. The tax will also be imposed on imported inputs, which currently do not face a tax liability, and tax credit under the GST will be available only after a lag.

Specific issues like the allocation of R&D expenses, the processing of refunds, credits on advertising spends, and registration for IT services exporters, also need attention

Processing of refunds: Unnecessary hold up?

The government has proposed that 90 per cent of the refund due in the case of inverted duty structures and exports will be processed within a month, subject to the company providing adequate documentation. The balance 10 per cent will be refunded provided field officers deem it appropriate. Given that company and vendor-level data will anyway be already available in the GSTN, this requirement for extra documentation could be reconsidered.

Input tax credit on advertising spends: Some dissonance

Correctly apportioning the credit for service tax paid on advertising spends will be a major challenge, especially because sales take place in different geographies, while service tax on the advertising spend is paid at a single location. Organisations will be eligible for credit only in one location, even though the expenditure was incurred across geographies. Thus, the company may not be able to avail of the entire input tax credit.

IT services exports: A potential case for centralised registration

Depending on the place of supply, services companies will need to register in multiple locations – an issue that has been highlighted before the GST Council. For IT services, the matter is further complicated by the fact the services are often delivered remotely. Exports, in particular, face another challenge: Inputs such as software and data communication links are often imported from overseas vendors, and are contracted centrally at headquarters. These inputs are then distributed across production lines in different locations. The parts produced in different states are aggregated centrally, and then exported. This means that each production centre will have to transfer credits to the head office. A solution might lie in the fact that the government does not earn any revenue in such instances and since under the GST, exports are zero-rated, a centralised registration at the HQ location for IT service exporters could be considered.

R&D expenses: Still open for decision

Specific issues such as the allocation of R&D expenses will also need to be considered. Centralised R&D centres where cross-charges for R&D services are not applicable will now have to be reconsidered, as those services will be construed as supply. Complicating matters further, it is difficult to find appropriate comparables for specific R&D activities – and the GST Council has not yet defined the relevant valuation rules. This is further complicated for export oriented firms where R&D expenditure has thus far not been allocated to operations in SEZ units. Under the GST, the company will have to bill such expenses to each SEZ unit, which in turn will reduce the amount of exempt income from that unit. ■

This article is based on brainstorming by IMA's India CFO Forum at its 21st Annual CFO Roundtable and at CFO Forum discussions hosted in Bangalore, Hyderabad and Mumbai in 2017.