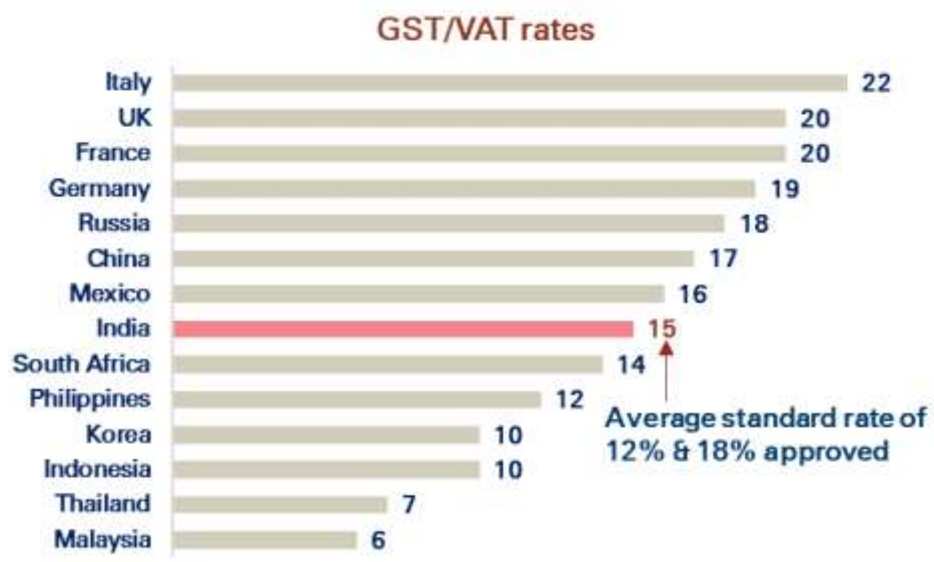
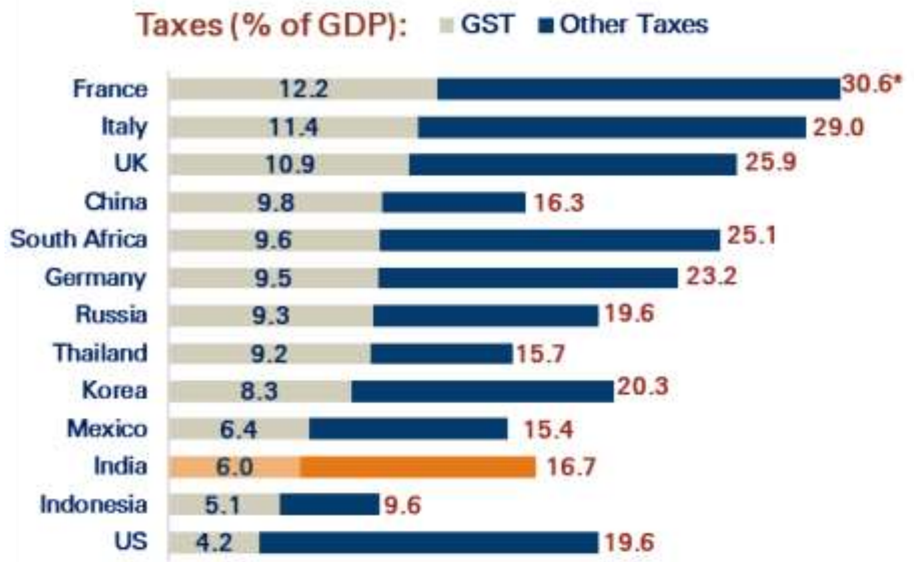
GST: Indian Journey and Way Forward

December 1, 2022

A simpler tax regime...





**Overall Tax/GDP ratio,*
Federal Taxes/GDP for India is~9% and is likely go up further as formalisation of economy happens

- Destination-based single tax on the supply of goods and services from the manufacturer to the consumer, levied on a national level
- European countries have higher indirect tax rates. Asian countries and US at the lower-end
- Evidence suggests that implementation of single tax regime (GST/VAT) results in higher revenue/GDP over time (RBI paper:)

Source: RBI, World Bank, GSTIN
*Goods and Services tax for FY20

….subsuming multiple taxes, and eliminating cascading effect

Central Taxes

- Central Excise Duty
- Additional duties of excise
- Excise duty levied under Medicinal & Toiletries preparation act
- Additional duties of customs
- Services Tax
- Surcharges & Cesses

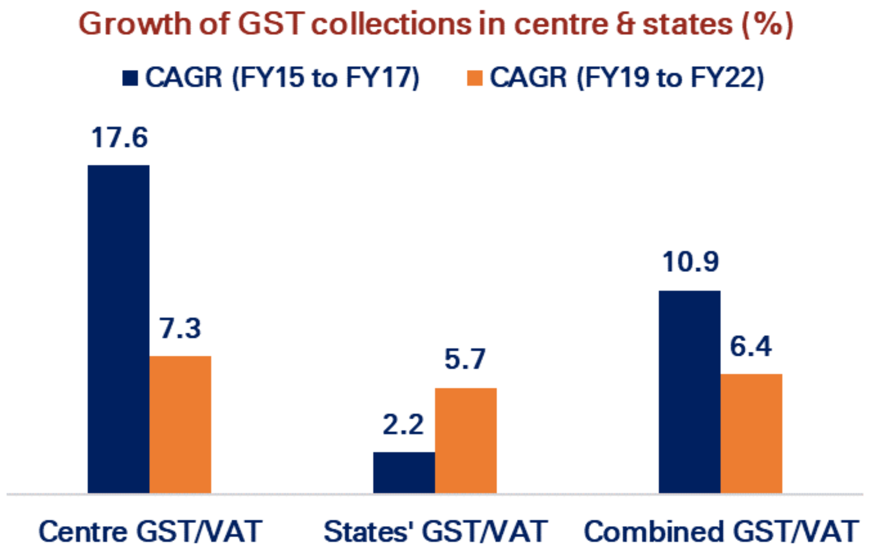
State Taxes

- State VAT/Sales Tax, Central Sales Tax
- Purchase Tax
- Entertainment Tax (other than those levied by local bodies)
- Luxury Tax
- Entry Tax (all forms)
- Taxes on lottery, betting and gambling
- Surcharges & Cesses

GST

Source: GST council

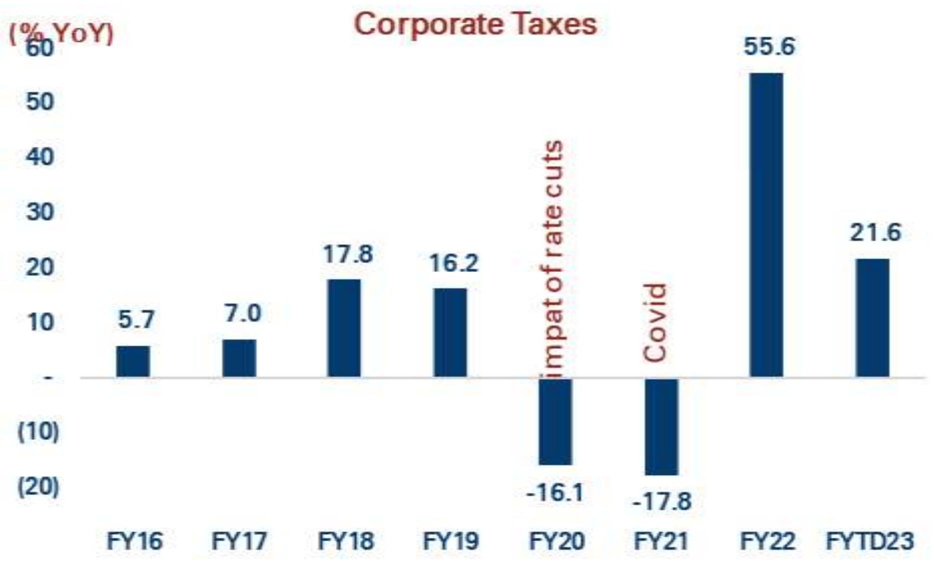
Evidence from India: Collections improved over the years…

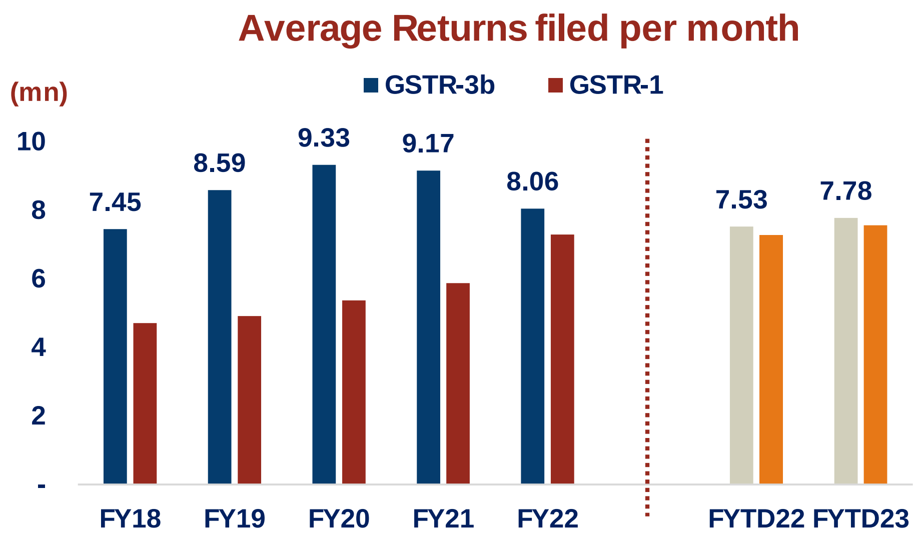


- GST revenues as % of GDP rising in India
  - Formalisation
  - Compliance
- Rub-off also visible now in corporate tax collections (22% YoY in H1 FY23)

Source: GSTIN, RBI

...helped by formalization and improved compliance

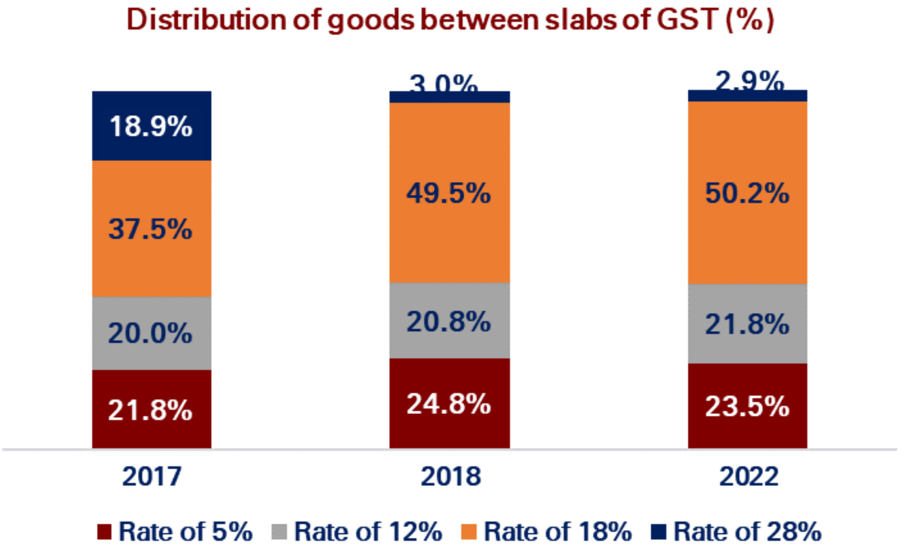


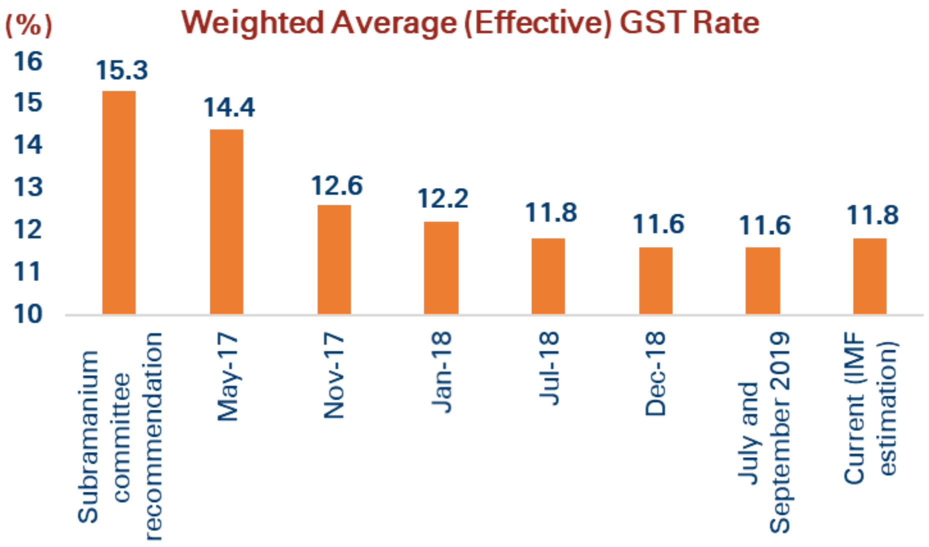


- Corporate taxes have been growing at 22% YoY in FYTD23, signaling economic recovery
- Compliance has also improved over time, with GSTR-3b filings crossing the 10mn mark in November 2020

Source: CGA, GSTIN, CEIC, ICICI Research

...Despite lower effective rates

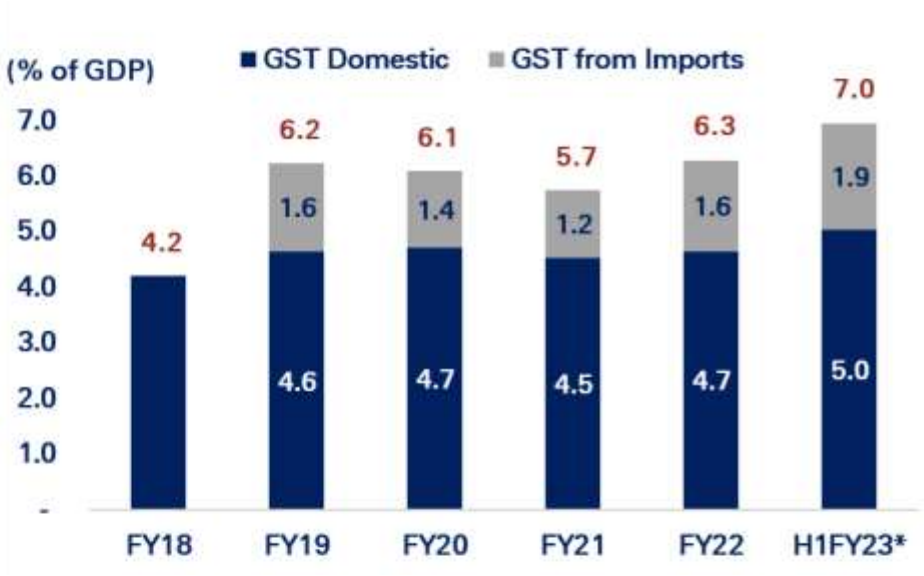


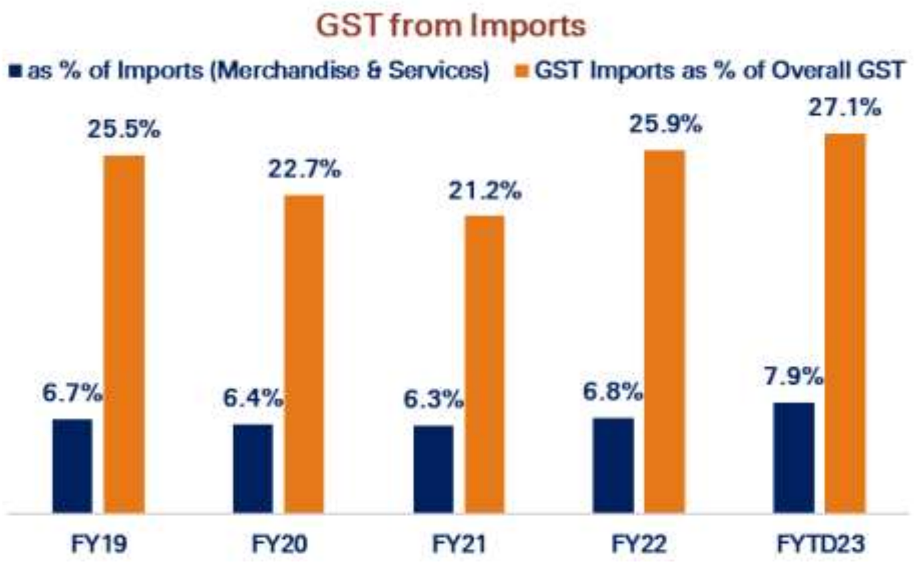


- The rates structure has undergone changes since implementation with more items being moved out of the highest tax slab
- Over 50% of the items are currently taxed at 18%, with less than 3% items at 28%
- The latest estimate puts weighted average tax rate at ~11.8%

RBI, GSTIN, IMF, ICICI Research

GST revenue mix: imports rising faster than domestic…

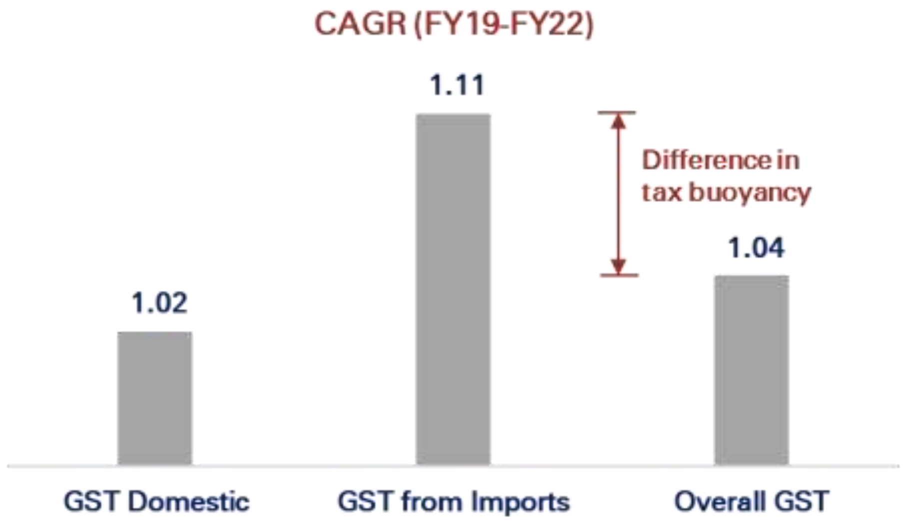


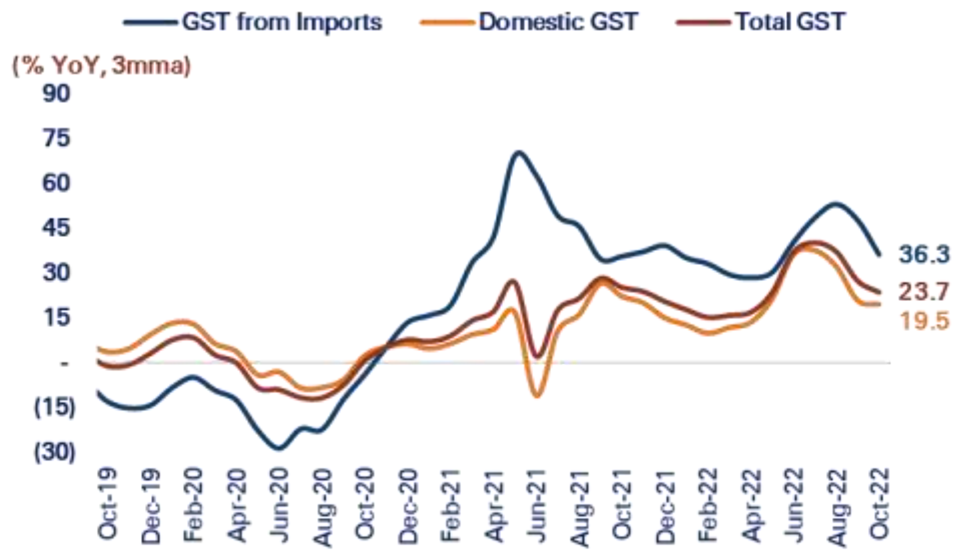


- GST collections from imports, as a percentage of GDP has grown to 1.9% by H1FY23
- Customs collections have risen by 11.5% CAGR over last five years. This year revenue from customs are lower by 7%
- Aggregate GST + Customs revenues increased by 24% this year and 8.7% over the last 5 years

Source: CEIC, GSTIN, ICICI Research

…But domestic collections also growing at ~20%

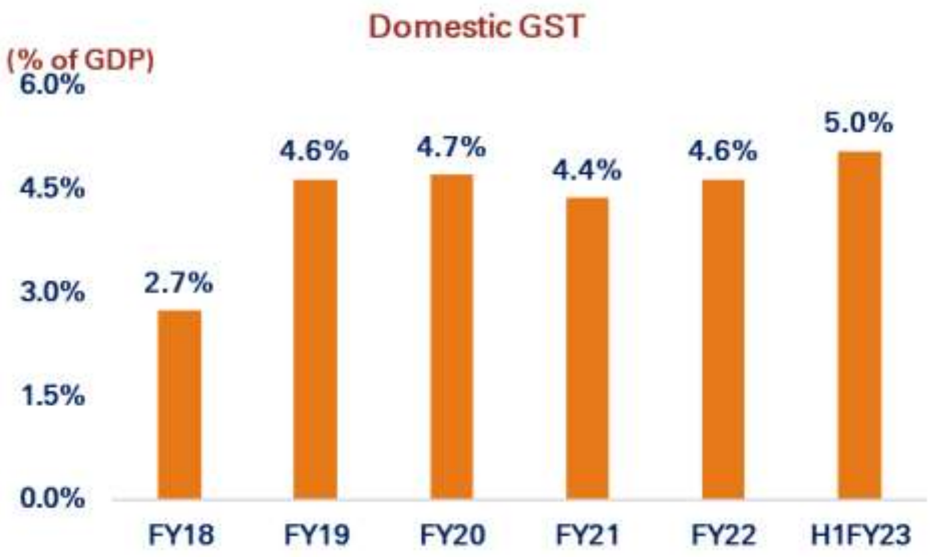




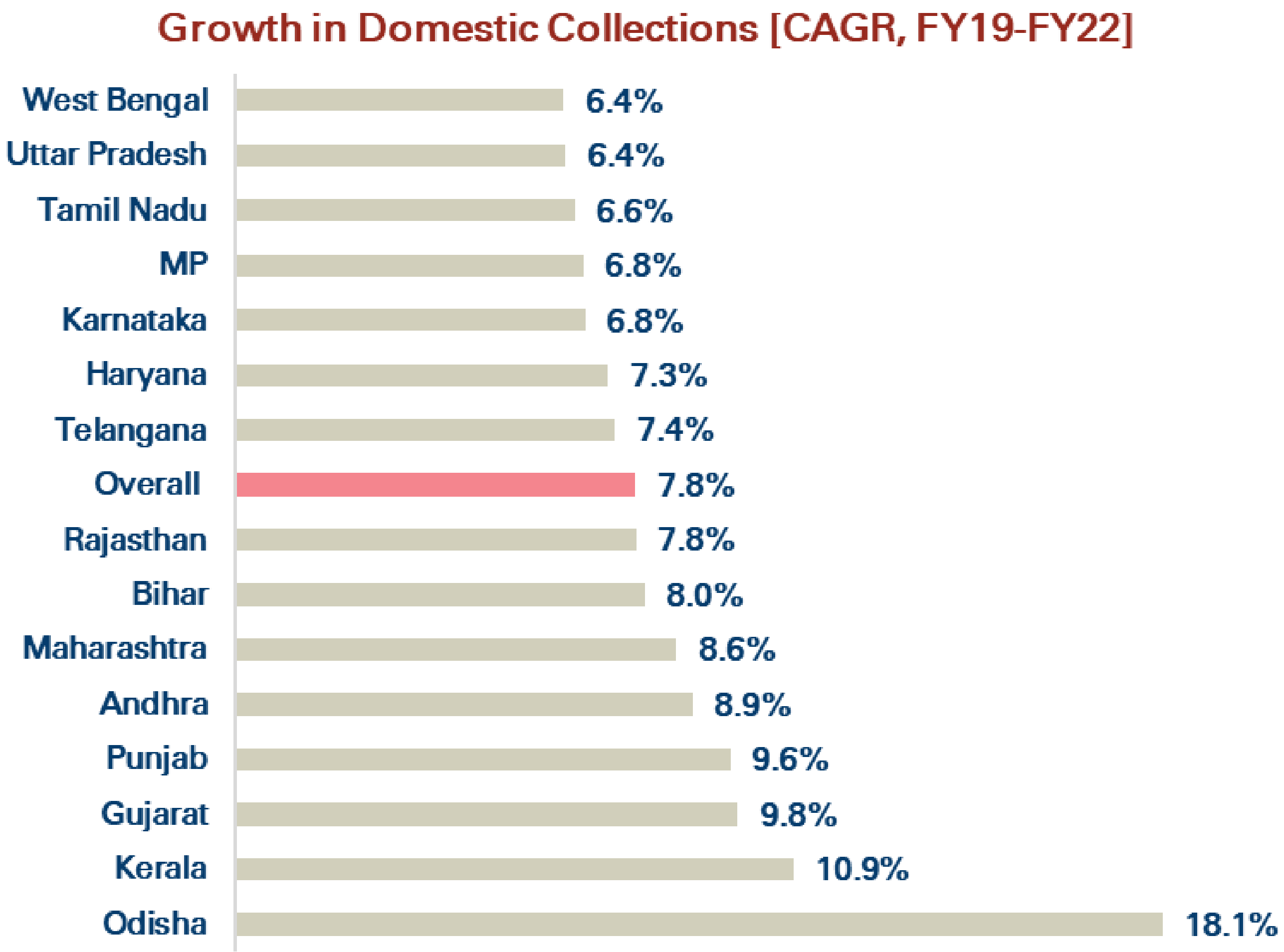
- GST from imports have grown at a higher rate as well compared to domestic collections, with a tax buoyancy rate of 1.11 compared to 1.02 for domestic collections
- What explains the domestic collections at around 20%
  - Formalisation and compliance
  - Inflation
  - Economic recovery

Source: GSTIN, CEIC, ICICI Research

Domestic Collections: How do states stack up?

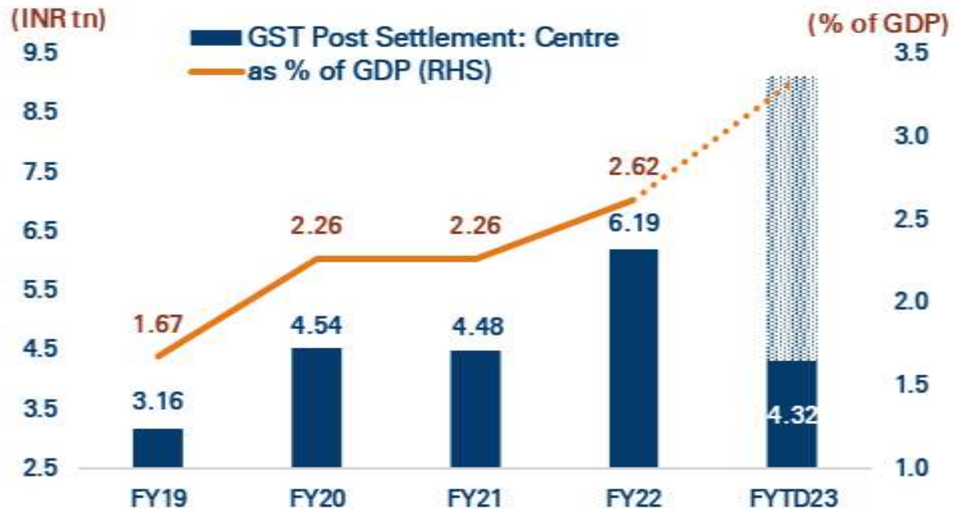


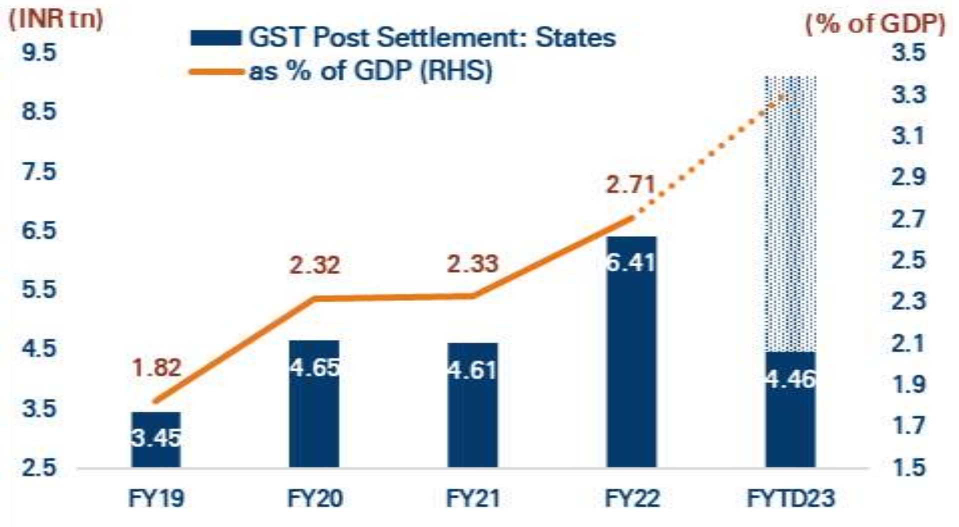
Collection buoyancy has varied across states with some states such as Odisha, Kerala growing at a faster pace than the national average, while others such as UP, WB & Tamil Nadu have seen lower pace than the national average



RBI, GSTIN, IMF, ICICI Research

Rising tide lifts all boats

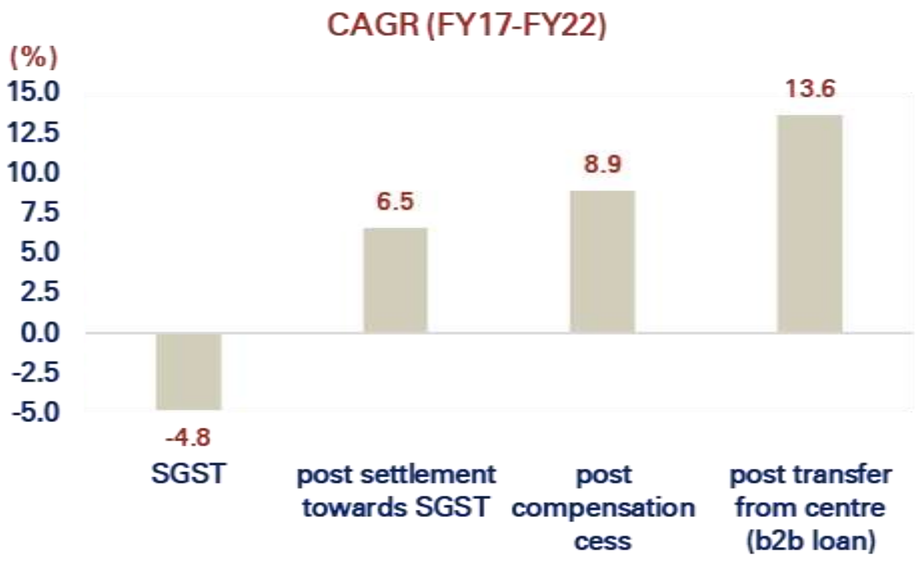


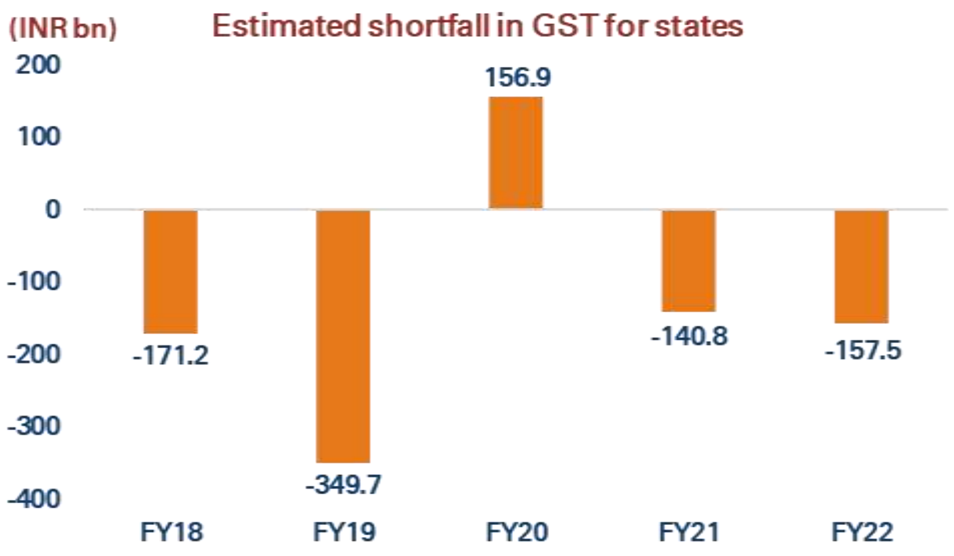


CGST vs SGST, post settlement and before the transfer of compensation cesses show a higher growth in SGST, with a near flat growth in FY21 due to the disruption caused by Covid

Source: MoF

States: 14% CAGR achieved through compensation from Centre

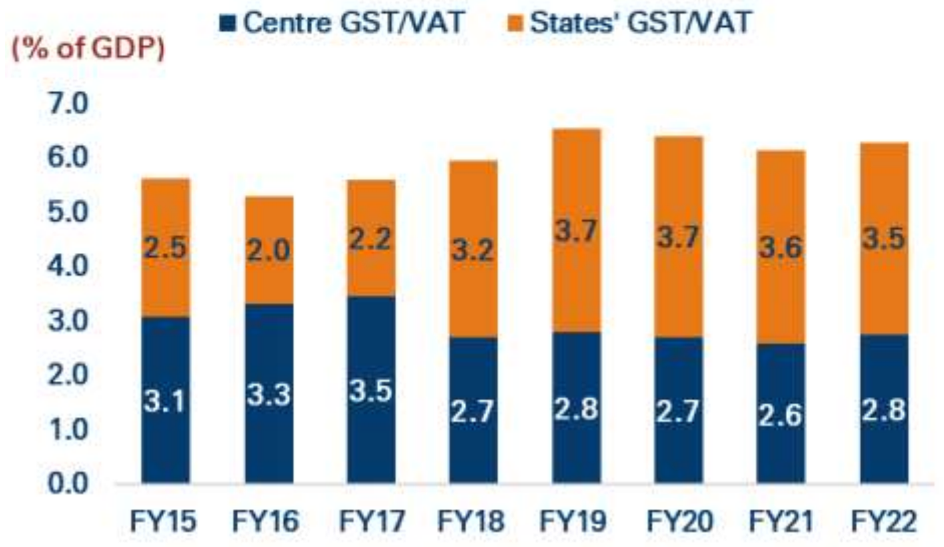


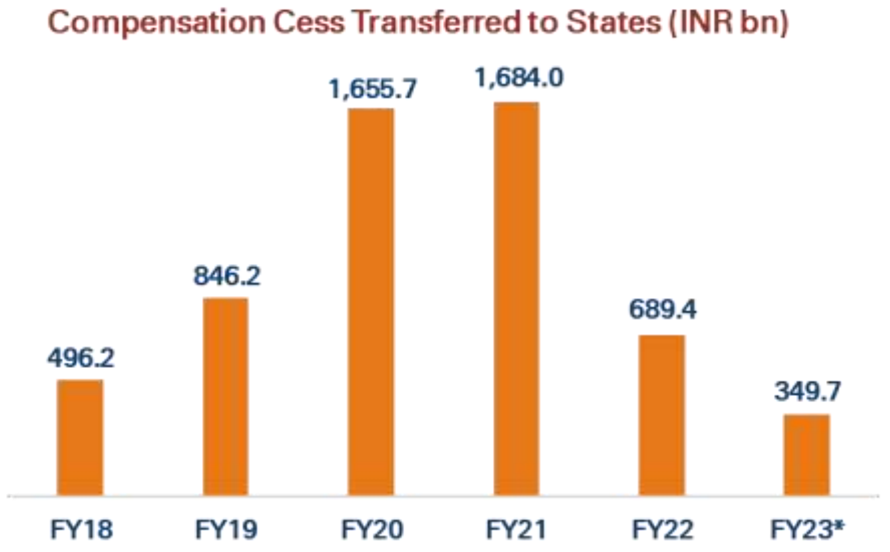


- Centre was constitutionally bound to ensure 14% revenue growth for states post the implementation via transfers to fund the gap, which they have been successful for most part

Source: GSTIN, ICICI Bank Research
Shortfall estimated using 14% CAGR over FY17 state taxes which were subsumed into GST

States are better-off compared with pre-GST regime

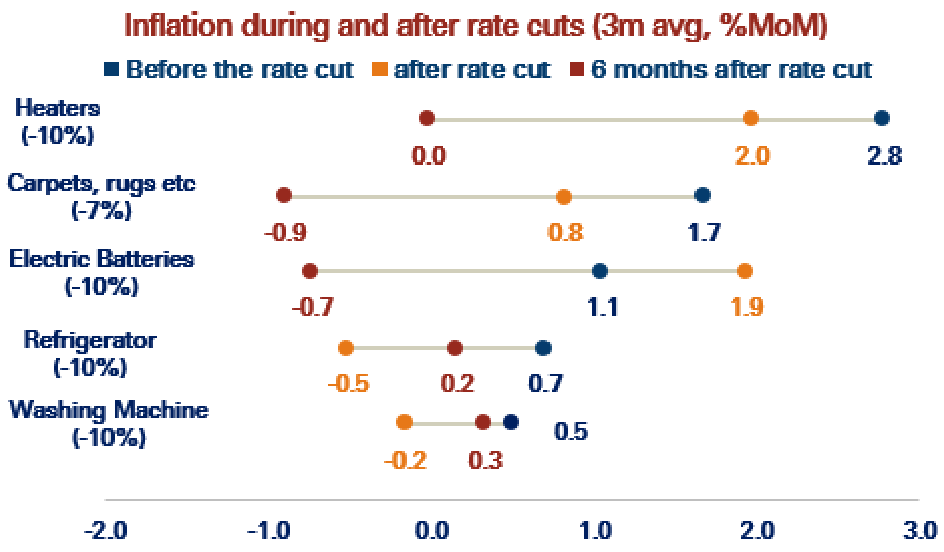




- Comparing earlier regime to GST, GST equivalent taxes increased from 2.5% in FY15 to 3.5% of GDP in FY22
- Centre has transferred INR 5.72tn to states as compensation cess during FY18-FY23, alongside b2b loan transfers of INR 1.1tn & INR 1.59tn in FY21 & FY22 to bridge the gap of 14% CAGR

Source: GSTIN, RBI, pib, ICICI Research

Consumers: Lower effective rates=Lower inflation

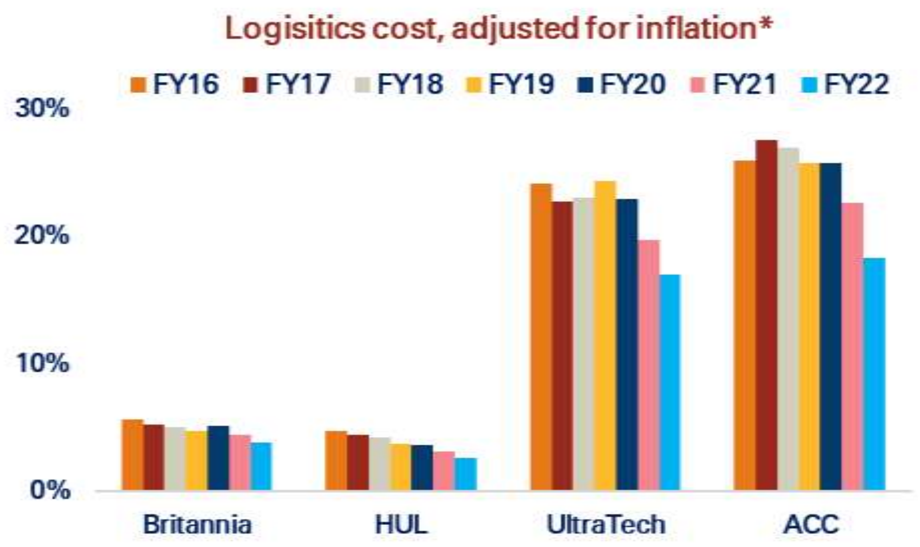


1% increase of effective rate of GST causes an increase of 0.4-0.5% increase in inflation

- Observation of the monthly inflation data for selected items shows that the sequential change in inflation shows a moderation after a reduction in slab
- The pace of sequential increase in inflation remains slower even after 6 months for the items observed

Source: MoSPI, GSTIN, ICICI Research

Economies of scale: How are they playing out



**Logistics cost as% of sales revenue, adjusted for inflation of diesel*

- The rate of increase of logistics cost/sales has decreased since the implementation of GST
- Additionally, 5-13% of sales revenue which was excise cost, has been removed since July 2018, eliminating the cascading effect of taxes

#ACC financials follow calendar year. Britannia, HUL & UltraTech FFY
Source: Company documents, MoSPI, ICICI Research

What is the way forward?

- Better compliance to drive collections upwards
- More formalization of the economy implies revenues to remain buoyant
- However, states will be looking for more revenues when compensation cess does not exist. Should we raise rates?
- To bring down inflation, lower effective tax rates would help rather than increase the same
- Lower the rates, more the compliance
- Ideally, we should bring more items into GST (digital transactions not included, gas, ATF)

Thank you