White Paper:

GST implications for FMCG Industry

14 April 2020

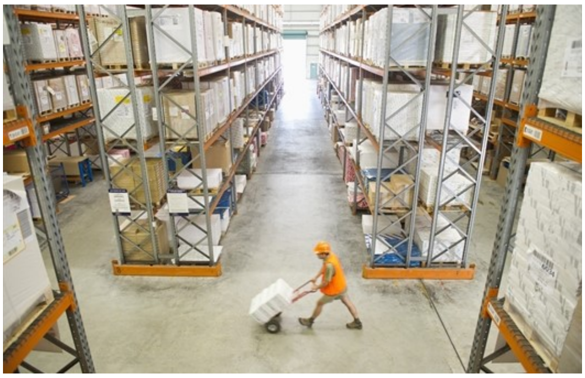
THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

1.0 Introduction

India is a country with a large population and is rapidly embracing consumerism or consumer culture where tastes and preferences are changing every day. This large consumer base coupled with the dynamic changes in tastes and preferences presents opportunities as well as challenges for the fast moving consumer goods industry (hereinafter abbreviated as "FMCG industry"). Also, in recent times, online shopping and the real estate developments in India such as the construction of shopping malls and hypermarkets, are opening up new distribution channels and expanding consumer reach for FMCG companies. FMCG has been one of the engines of growth in India and is poised to become the fourth largest sector in the Indian economy. Also, the FMCG industry is one of the most regulated industry and there are various regulations and food safety and product safety standards that are applicable to it.

Goods and Services Tax (GST) and various amendments that have been enacted from time to time have had an impact on FMCG industry. In this paper, RSM explores at a broad level, the impact that GST has had on the FMCG industry. In this paper, we have also looked at recent and proposed regulations such as e-invoicing and the new return filing system as that may also have impact on the way the FMCG industry operates.

One would appreciate that the FMCG industry has various complex and unique models and it is difficult to pinpoint one type of structure for the industry as a whole. For the simplicity of our readers, we have assumed a general model in which a FMCG business unit manufactures goods, distributes the same to their mother warehouses and from mother warehouses to state or regional warehouses and thereafter to their clearing and forwarding agents as well as their stockists having presence in different states and then supply to retailers, which ultimately supply to end customers.



Manufacturing and Distribution of Goods

The FMCG industry also comprises of various sub segments. While there are various sub categories and segments and the industry is so complex, in this note, we have considered the FMCG industry as comprising the following segments:

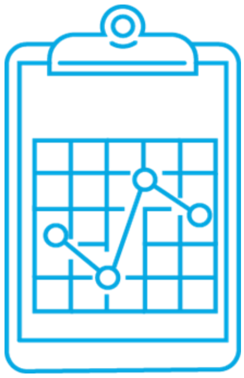
- **Foods and Beverages**: The food and beverage industry comprise groceries, fresh and frozen foods, packaged and semi packaged foods, aerated and non-aerated beverages. It is important to note that the alcoholic liquor for human consumption have been kept outside the purview of the Goods and Services Tax laws and so do not form part of the analysis of this note. Even the restaurants and eateries and outdoor catering have not been included in this analysis as there are very specific rules enacted for this segment which is not part of the scope of this study.

- **Personal and Household**: This includes items of durable as well as non-durable nature that are required for the personal and household use of persons. Even alcoholic preparations for toilet purposes are included in this category. Some broad product segments that are included in this category are toiletries, stationery, clothing, cleaning products, cosmetics, cleaning products, stationery, glassware etc.

- **Healthcare**: These include products in general healthcare for human as well as animal healthcare and products for occupational healthcare and safety in factories and hazardous premises.

It is a misnomer that the entire FMCG industry is business to consumer. While it is true that most of the products are intended for end consumption, but it would be wrong to say that the entire industry is a B2C industry. The industry is complex and has various value chain participants. It is this complexity of the industry itself along with the complex GST laws that makes for an interesting study.

2.0 Impact of Goods and Services Tax on FMCG Industry



Since FMCG products typically include repeat and daily usage items, any taxes on the same have repercussions not only for industry participants but also the massive consumer base at large. Under the prior indirect tax regime, this industry had faced a multiplicity of taxes such as excise duty, entry tax as well as different state VATs & in addition, CST on interstate transactions. There was cascading effect of taxes in the prior regime. Most importantly, the setoff of service tax was not available against VAT and CST and this used to be recorded as write offs or expenses in books. GST has resulted in reduction in costs which were to be previously expensed out in books such as the service tax on the outsourced services, as GST paid on input services is available for setoff against GST on supply of goods as well as supply of services. In this note we have analysed the GST impact on price, supply chain and other operational aspects.

2.1 Impact on Prices

In FMCG products, pricing is generally done on basis of Maximum Retail Price when goods are sold to the end consumer. As per Legal Metrology Act, the maximum retail price (MRP) includes all taxes and this ipso facto means that the MRP is inclusive of GST. Anti-profiteering regulations as per section 171 of the CGST Act, 2017 also warrant the attention of the reader. Section 171 of CGST Act, 2017, provides that any reduction in rate of tax on any supply of goods or services or the benefit of input tax credit shall be passed on to the recipient by way of commensurate reduction in prices. It is also believed that being a consumer facing industry, the FMCG sector is more vulnerable to risks that may arise due to profiteering. The entire value chain therefore has the responsibility of passing on the benefits of reduction in prices to their customer and ensure that they comply with the anti-profiteering guidelines. One of the most interesting questions that pops up is how suppliers should ensure compliance with anti-profiteering regulations and how anti-profiteering should be enacted. In our view, following are the key steps that businesses must follow and suggested guidelines that would help in establishing compliances with anti-profiteering:

1. **Maintenance of cost records:** It is important to maintain cost records and ensure that all costs are factored in when determining the costs of the products. It may also be advisable to consult industry peers on the manner in which they account for and record costs.

2. **Segregation of costs:** It is also advisable to bifurcate costs into product specific and general overheads. This will facilitate in deriving costs product or SKU wise if so desired by the anti-profiteering authorities.

3. **Impact Assessment of pre-GST and post-GST pricing:** Based on costs determined, analysis should be done of the costs and the applicable indirect tax rates in both the pre-GST and the post-GST regime and then the positive benefits arising either due to rate reductions in the GST regime or additional input tax credit available in GST regime should be quantified. In both the Pre- GST and GST regime, the Harmonised System of Nomenclature was in place. Thus, rate comparison on HSN basis should not be an arduous task. But in FMCG Industry, where there are a massive number of SKUs, assessing the classification as per HSN and the applicable rates may be an arduous task.

4. **Ascertaining the mechanism of transmitting gains due to GST implementation:** There are various mechanisms in which the gains from GST can be transmitted to down-stream value chain participants. These include quantity discounts, promotional schemes, striking down of MRPs etc.

As far as anti-profiteering is concerned, it is still not clear whether the same is to be adopted at a product level, at customer level or to the business entity as a whole. There have been various case laws enacted but each business needs to assess compliance with anti-profiteering in its own context.

As there are various products that form part of the FMCG kitty, it would not be possible for us to cover all products but given below are the different rate brackets and the products that fall within that rate:

Rate	Product Types Falling in Rate Bracket
NIL	Certain milk products such as lassi, curd, butter milk; cereals (other than those put up in unit container and bearing a registered brand name), salt, puja samagri, provisionally preserved vegetables and fruits which are not for immediate consumption, fresh almonds, sanitary napkins are few of the exempt products.
5%	Ultra High Temperature Milk, Certain frozen vegetables, Dried makhana, Cereals put up in unit container and bearing a registered brand name, Sweetmeats, Chalk (other than tailor's chalk), Pumice Stone, Certain fertilizers falling under HSN 2809, 3102, 3103, 3104, 3105, agarbatti, handmade safety matches, erasers, etc.
12%	Cheese, jams, marmalades, Namkeen and bhujia items put up in unit container and bearing registered brand name, soya milk drinks, Beverages containing milk, greaseproof paper, notebooks, calendars, umbrellas and sun umbrellas, geometry boxes etc.
18%	Certain sugar based confectionary items, cornflakes and prepared foods obtained from cereal flakes, hair oil, certain toiletries (such as toilet paper, toilet kits, disinfectants, soap, toothpaste etc.), glassware used for kitchen, LPG Stoves, scissors, shaving products (razors, razor blades, shavers and shaving cream), Preparations for oral of dental hygiene, Preparations containing Cocoa under HSN 1806, 2105 etc.
28%	All goods [including aerated waters], containing added sugar or other sweetening matter or flavored. Caffeinated beverages are taxable at 28% w.e.f 01st October 2019.

In the pre-GST era, there were several area-based exemptions. Many FMCG companies used to avail benefit of these schemes which typically gave tax holidays for 10 to 15 years. Under GST regime, to the extent of the unexpired period, states have enacted “Budgetary Support Scheme(s)” under which a certain percentage of the GST paid in cash is allowed as a refund. Refund under the Budgetary Support Scheme is computed on the basis of a percentage of the GST paid in cash. Since the GST is paid first and then refunds are obtained, there is not only a reduction in the cash flow in terms of lower refund but there is also a delay in obtaining the benefits. This may have the negative impact due to GST implementation.

Price is also influenced apart from anti-profiteering, HSN classification and area-based exemptions on various other cost drivers. GST with its ‘one nation one tax’ adage also encourages FMCG players to relook at their supply chain, which shall form part of the next area of study in this whitepaper.

2.2 Impact on Supply Chain

FMCG sector typically has long supply chains with several value chain participants and generally follow a multichannel strategy for distribution. Generally, all FMCG participants are now selling goods through physical as well as online channels. In the past, the structure of supply chain was highly influenced by area based exemptions, taxes on entry of goods and also on Central State Tax, which was applicable on inter-state movement of goods and generally became a cost as setoff of

Central Sales Tax was not available against State VATs and also against Excise Duty. Uniform taxes and elimination of Central Sales Tax (CST) for interstate movement of goods under GST era hold significance from supply chain perspective. Under GST, business units have incentives to consolidate their warehouses instead of maintaining one in each state to avoid CST. Efficient supply chains would in turn reduce logistics cost and bring down the costs of distribution.

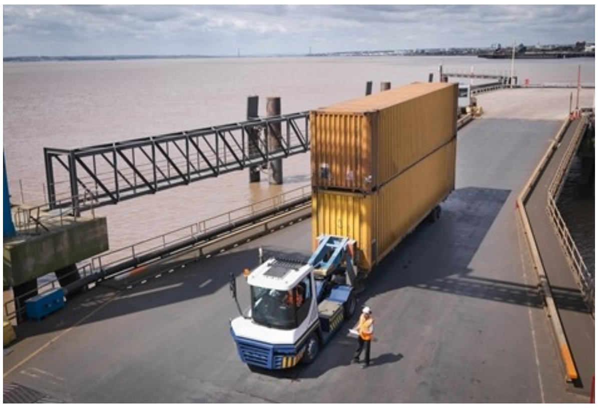
In GST era, the design of supply chain will be based on customer service and logistics cost and tax would not be a deciding factor in location and size of warehouse. Such efficient supply chain and warehousing would reduce logistics cost in the long run.

Further, in the past era, service tax generally was a cost for distributors or persons dealing in traded goods as they were required to do reversal of service tax in so far as the turnover comprises of traded goods. Now, with set-off of tax paid on input services available against the output taxes on all supplies, whether of goods or of services, many FMCG participants may look at outsourcing certain services to achieve specialization and focus on core productive tasks.

3.0 Impact on other operational aspects

There are many pressing issues arising out of GST implementation that have still not been clarified or settled by GST authorities. The implementation of GST has thrown various operational challenges for the FMCG sector. The following are the top three issues or areas that are of significance to the FMCG industries due to enactment of the GST regime.

3.1 E-way Bill Requirement for every movement



In GST, there is requirement to generate an E-way Bill for every movement of goods where the consignment value exceeds Rs. 50,000, whether for sale or for job work or exhibition. The requirement of E-way Bill is mandatory. In the FMCG industry where there are several movements in a day and different scenarios such as bill to/ ship to transactions, customer delivery, movements for exports etc. there is a need for understanding the need E-way bill requirements and ensuring compliance with all the necessary documentation.

3.2 Classification of Products and Changes in Rates

Typically many FMCG companies deal with a large number of SKUs that result in a need for proper mechanism for classification of the goods. There are many exemptions that are made available qua the end purpose of the products or based on conditions. For example, there are exemptions given for certain products only if they do not bear a registered brand name or if they are not put up in a unit container. Thus, the classification of products needs to be done carefully and also needs to be revalidated in the industry context. Maintenance of records related to exempt and taxable goods is also important for computing reversals of input tax credit under Rule 42 and Rule 43 of the CGST Rules, 2017. Since there are also frequent changes in GST rates, it is also recommended that FMCG companies should review the HSN masters and the product rates charged on regular basis. Time of supply provisions need to be adhered to in case of changes in product rates.

3.3 Promotional Schemes

The FMCG industry tends to participate in various promotional schemes. ‘Buy one – get one free’ is a very common scheme in the FMCG industry. As per section 17(5) of the CGST Act, input tax credit shall not be available for goods given as samples. Non availability of input tax credit may increase promotional expenses of FMCG companies, which leads to increase in overall prices of FMCG products. There have been various Circulars enacted on the GST treatment of promotional expenses and of goods given free of cost or distributed as free samples. Various legal and judicial pronouncements have also been enacted on this subject matter. It is advisable that the legal position based on circulars and judicial pronouncements is carefully examined by all FMCG companies, so they do not become liable for any statutory lapses.

4.0 Impact of recent and proposed amendments in GST compliances on FMCG sector

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As a part of the monthly compliance, given the recent announcements, it has become mandatory for all taxpayers to perform a reconciliation of input tax as per purchase register with the input tax as auto populated in Form GSTR – 2A. As per the amendments to the CGST Rules, the maximum credit to be availed in Form GSTR – 3B by registered taxpayer shall be restricted to 110% of the credit by their suppliers and appearing in Form GSTR – 2A. The balance credit can be availed as and when the invoice level details are reflected on the GSTN portal. This also implies that now reconciliation needs to be done on invoice level which may be an arduous task for the FMCG industry. The major issue that is to be faced by the FMCG industry is a need for tracking and maintaining records for the invoices and need for continuous and effective follow-up with the suppliers.

4.2 E-invoicing system is proposed to be implemented with effect from 1st October 2020. The new requirements of e-invoicing are designed to ensure interoperability of GST related documentation across several platforms. FMCG companies are now required to prepare an e-invoice for each and every supply and this imposes procedural burden on them. E-invoicing requirements and affixing of QR codes on B2C invoices is a requirement that is in addition to the E-way bill requirements.

4.3 The GST Council has sought to introduce the new returns, to be implemented from 1st October 2020. The return filers, who have just adjusted with the biggest change in indirect taxation, or maybe are still adjusting with the same, shall now have to make altogether new learning process to adapt with the new filing system. The upcoming system expects suppliers to upload their invoices on a continuous basis which may lead to complications especially for suppliers of goods. Also once the invoices are uploaded, the vendors have to continuously react to the mismatches communicated from their buyers. It is expected that the proposed return filing system would streamline the credit availment issues. However, it will increase the compliance burden, which companies should navigate with the help of GST consultant.

5.0 Conclusion

Thus, to summarise, implementation of GST has a mixed impact on FMCG industry. While removal of cascading effect under GST as compared to pre-GST regime is beneficial to all the FMCG companies, changes in GST rates is very fruitful for some companies but not all the companies in the FMCG industry. Further, another benefit accrues from the re-distribution strategy being adopted by various companies in the industry. It will take some time to reflect results because it involves multiple stakeholders and change in traditional approach. However, in the long run, it would definitely reduce costs and improve operational efficiency of FMCG companies, and ultimately, consumer would be benefited.

For further information please contact:

RSM Astute Consulting Pvt. Ltd.

13th Floor, Bakhtawar, 229, Nariman Point, Mumbai - 400021.

T: (91-22) 6108 5555 / 6121 4444

F: (91-22) 6108 5556 / 2287 5771

E: emails@rsmindia.in

W: www.rsmindia.in

Offices: Mumbai, New Delhi - NCR, Chennai, Kolkata, Bengaluru, Surat, Hyderabad, Ahmedabad, Pune, Gandhidham, and Jaipur.

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