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# Impact of GST on Automobile Dealers Industry



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The Indian auto industry is one of the largest in the world. The industry accounts for 7.1 per cent of the country's Gross Domestic Product (GDP). Almost 13% of the revenue from central excise is from this sector and claims a size of 4.3% of total exports from India. Despite its contribution to the economy and growth potential, this sector has been combating the hardship of high tax rates for substantially a long period of time now with central excise duty ranging between 12.5% to 30% coupled with introduction of multiple cesses at revenues whims and fancies, most recent being infrastructure cess.



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Apart from the high tax rates, industry has seen extensive litigations on VAT v/s Service Tax tussle, valuation issues in case of PDI charges, warranties, taxation on handling charges and many more. Thus, introduction of [GST](#) shall be a breather for this sector wherein taxes on vehicle are largely expected to be @ 18% in GST regime except for luxury cars where the rate may go upto 28% plus cesses. However, even this rate of taxation will be beneficial for this industry as full set-off of credits will be made available in the GST regime. This article focuses on the supply chain part of this industry i.e. the “Automobile Dealers”. Dealers play a very crucial role in the growth and prosperity of this industry and any adverse impact on dealerships shall have direct effect on the entire industry. Therefore, this article examines the intricacies of [GST on Automobile Dealers](#).

#### **Presently, dealers are paying following indirect taxes:**

- Service tax (ST) on services both as provider and also as receiver under reverse/ joint charge;
- Value added tax (VAT)/Central sales tax (CST) on Sale of Vehicle/ Spares/ Accessories;

In [GST regime](#), Automobile Dealers will be collecting and paying CGST and SGST (i.e. Central GST and State GST on intra-state sale of vehicles. Further, in case of inter-state sale of the vehicles, they will be collecting and paying IGST (i.e. Integrated GST, which is nothing but the summation of CGST + SGST). Impact of GST on various aspects is as examined below:

#### **1) Impact on Credits:**

Currently, automobile dealers are not able to avail CENVAT credit on the following indirect taxes paid by them:

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- CST Paid on purchase of vehicle, spares, consumables, accessories and assets;
- Excise Duty paid on purchase of vehicles, spares, consumables and accessories;
- NCCD, Auto Cess and Infrastructure Cess paid on purchase of vehicles;
- CVD paid on any imported Spares, accessories and consumables;
- SBC paid on input services;
- Reversal of proportionate CENVAT credit of service tax due to trading activity - Showroom Rent, Advertisement expenses etc.

In GST Regime, all the above duties/ taxes will get subsumed, therefore dealers should be able to avail the input tax credit of all its procurements of goods/ services except for few restrictions laid in the [Model GST Law](#).

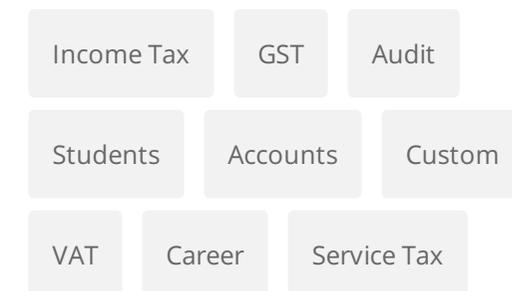
## 2) Impact on the procurement costs of vehicle:

Since, all of the above taxes gets subsumed in the GST, therefore the procurement cost to that extent will come down as explained below in a tabulation format:

### Procurement cost in the Current Regime:

Type of Vehicle	Vehicle Cost	Excise	CST	NCCD + Auto Cess	Infra Cess	Total Tax	Purchase Cost
Motor Cycles	50,000	12.50%	1.10%	2.00%	1%	8,300	58,300
Small Cars	4,00,000	12.50%	1.10%	2.00%	1%	66,400	4,66,400
Mid-size	7,50,000	24%	1.10%	2.00%	2.50%	2,22,000	9,72,000

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Luxury Cars	20,00,000	27%	1.10%	2.00%	4%	6,82,000	26,82,000
SUVs	16,00,000	30%	1.10%	2.00%	4%	5,93,600	21,93,600

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### Procurement cost in the GST Regime:

Type of Vehicle	Vehicle Cost	IGST	Cess	Total Tax	Purchase in GST	Cost Reduction in Purchase Cost
Motor Cycles	50,000	18%		9,000	50,000	<b>8,300</b>
Small Cars	4,00,000	18%		72,000	4,00,000	<b>66,400</b>
Mid-size Cars	7,50,000	18%	-	1,35,000	7,50,000	<b>2,22,000</b>
Luxury Cars	20,00,000	28%	2%	6,00,000	20,00,000	<b>6,82,000</b>
SUVs	16,00,000	28%	2%	4,80,000	16,00,000	<b>5,93,000</b>

- Since IGST and cesses shall be fully available as credit in the GST regime, therefore they will not form part of purchase cost and can be set-off from output GST payable on sale of the vehicle.
- Procurements are assumed to be in the course of Inter-state. GST rates have been assumed to be at such levels based on the various news

reports and the reports issued by various committees formed by the Ministry of Finance.

As noted above, reduction in procurement cost is substantial as cascading of taxes was just adding to the cost in this sector.

### 3) Impact on the Sale Price:

Since, the procurement cost reduces in GST and if the benefit of the same is fully passed on to the consumer, then it leads to reduction in sale price of the vehicles as tabulated below:

Type of Vehicle	Sale Price Current Regime			Sale Price in GST Regime		
	Sale Price	VAT @ 14.5%	Total SP	Sale Price	IGST @ 18% / 30% (2% cess)	Total SP
Motor Vehicle	61,215	8,876	<b>70,091</b>	52,500	9,450	<b>61,950</b>
Small Cars	4,89,720	71,009	<b>5,60,729</b>	4,20,000	75,600	<b>4,95,600</b>
Mid-size Cars	10,20,600	1,47,987	<b>11,68,587</b>	7,87,500	1,41,750	<b>9,29,250</b>
Luxury Cars	28,16,100	4,08,335	<b>32,24,435</b>	21,00,000	6,30,000	<b>27,30,000</b>
SUVs	23,03,280	3,33,976	<b>26,37,256</b>	16,80,000	5,04,000	<b>21,84,000</b>

Assuming that the sale price is at 5% mark-up above the purchase price. It is seen from the above calculation that overall reduction in the purchase cost of

the per vehicle ranges from 16% to 34% and if full benefit of such reduced prices is passed on to the end consumers then sale price of vehicles can come down in the GST regime which will boost this sectors growth and must have largely positive impact due to invasion of GST.

#### **4) Impact on Working Capital:**

Following aspects will impact the working capital of the automobile dealers in the GST regime:

**Vehicle Transfers:** transfer of vehicle/ spares to other premises will be liable for GST if the transfer is in the course of inter-state trade. Further, if there are separate dealerships of a dealer and separate GST registration number is obtained for each such dealership, then transfer of any goods/ services between such dealerships will also be liable for GST. This shall block the working capital as the taxes needs to be paid from own funds and collection of taxes will be at a later date only when such goods/ services are eventually sold.

**Free Service Coupon vouchers:** These coupons will be issued at the time of sale of the vehicle. As per the time of supply rule, GST on such coupons needs to be paid immediately on the date of issue of such vouchers. As per the policy of some manufacturers, the amounts in respect of such coupons will be redeemed to the dealers only once the customer brings the vehicle for repair to the workshop. Therefore, dealers would have to pay tax on such coupons immediately on its issue but the said taxes can be collected from the customers only when the vehicle comes for the repair leading to unnecessary blocking of funds in taxes.

**Vehicle Booking Advance:** It is quite common in this sector that the vehicles will be booked in advance on payment of certain amount as token. Currently, VAT is not being paid on such advances as the same is payable at the time of sale of such vehicle. However, this luxury of holding advances without payment of taxes is clipped in the GST regime and taxes need to be paid on receipt of the booking advances also. Therefore, dealers either have to pay taxes on the advances out of its pocket or collect taxes extra even on the token advances.

**Commission, warranties, incentives:** Currently, it is very difficult for dealers pay service tax on accrual basis on the following incomes and thereby as a system or practice many dealers are paying service tax on receipt basis:

**Commission from Bankers/ Insurers:** As details of the commission will be provided by bankers/ insurers at a later dates with constant changes involved. Therefore, generally dealers pay service tax on such receipts only upon receipt of commission;

**Income from manufacturer:** Various commissions, incentives, reimbursements, warranty receipts etc. are received from manufacturer.

Dealer dont pay taxes on these incomes on accrual basis as the same may or may not get approved by the manufacturer at a later date. Therefore, currently service tax is paid on receipt basis only when the amount is credited by the manufacturer and is reflected in the manufacturer's statement.

However, the luxury of paying taxes on receipt basis will not be accepted in the GST regime as everything will be system driven. Therefore, dealers will have to either get its system corrected with the bankers and manufacturers immediately to ensure smooth transition into the GST regime or else it would have to take the brunt of taxes on its own due to fault of its vendors.

### **5) Impact on Valuation:**

**Bundling of Car with accessories, warranty, handling charges:** Automobile dealers charge amounts for Sale of vehicle and also for various ancillary services such as insurance, extended warranty, accessories, logistics and handling, registration etc. It shall be imperative for the industry to understand whether the entire transaction shall be classified as separate supplies or whether it has to be classified as a 'composite supply' or as a 'mixed supply'. Valuation would depend upon the above classification. However, if the classification is not properly determined and if the same is not clearly carved out in the transaction/ agreement, then consequences of valuation issues could hit this industry with large scale litigation in the GST regime.

**Insurance, Registration etc. as reimbursements:** In the revised model GST Law, it is not stated whether GST is also required to be paid on the reimbursements. Automobile dealer collects various amounts from customers which are mere reimbursements and are paid back as it is to someone else. In other words, these amounts are collected merely as a pure agent such as:

- Insurance of the vehicle;
- Temporary/ Permanent Registration charges,
- High Security Number Plate Charges;
- Credit Card Swiping Charges etc.

Currently, Service Tax is not paid on such values, if collected as a pure agent. Ideally, these receipts must also be kept out of the GST net, or else it would create further valuation tussle in the GST regime.

**Road Tax/ Life Tax:** Currently, service tax or VAT is not paid on the Road Tax element. However, in the GST regime, value for the purpose of paying GST must also include Road Tax. Section 15 of the revised model law clearly states that no taxes shall be allowed as reduction from the value except CGST, SGST and IGST. Therefore, duplication of taxes to this extent shall continue, if not timely represented by the associations. Road tax rates are fairly high and it ranges between 2% to 15%. Such increased tax base would unnecessary increase cost for the consumers.

**Discounts:** Generally, dealers receive various discounts from its manufacturers based on targets, vehicles lifted, Special Customers, Year-End Discounts etc. It is pertinent to note that post supply discounts will not be allowed as deduction from the value if the same is not linked to any invoice. Therefore, discounts policy needs to be revisited and the same must be brought in line with the tax scheme to avoid taxes on high values.

**Related Party Transactions:** Transaction value can be rejected if the transaction is with any related party or if the same is with any of its other entity with separate GST No. Therefore, value in such cases needs to be calculated at

arms length to validate reasonableness and pricing in such cases has to be legally justifiable.

**Valuation of commissions etc:** Currently, in case of various commissions received from the manufacturers such as 'Extended warranty' or 'Road side assistance', Service Tax is being paid only on commission element. However, in GST regime, such tax treatment may not be acceptable and dealers will have to pay GST initially on the entire value of the warranty receipts and the amounts charged by the manufacturer can later be taken as a credit. Adoption of this would require tremendous efforts.

#### **6) Reduced current litigations:**

Currently, the sector is facing disputes on the following areas:

- **Valuation in Servicing of vehicle:** Complexity in bifurcation of the material and labour component in the servicing of vehicle has led to multiple disputes as both the service tax and sale tax authorities demand taxes on a higher component.
- **Handling Charges:** Whether it is liable for VAT or Service Tax has led to demand of taxes from both the authorities and thereby disputes.
- **Registration charges:** Disputes were noted on applicability of service tax on various charges that are merely collected as pure agent such as temporary permanent registration etc.
- **Incentives:** It has been a matter of dispute at a various judicial forums as to whether the incentives received by the automobile dealers from the manufacturer whether amounts to any 'Service' to be liable for service tax.

Such disputes would end in the GST regime as the tax base for both CGST and SGST shall be same.

## 7) Impact on Transitional Credits:

To transfer the existing credits in the GST regime, condition has been kept that such credit must have been admissible in the GST regime. Therefore, dealers should be able to transfer the following credits to the GST regime:

- **Credit of Service Tax:** The same must be properly reflected in the last service tax returns and documentation must be in place to establish the same. Further, service tax credit pertaining to cars, spares in stock can also be availed.
- **Excise Duty/ CVD:** Since, currently dealers are not availing the credit of excise duty & CVD. Therefore, they need to ascertain the value of stock as on the appointed day and based on the availability of the invoice, credit can be availed. Further, even if proper excise invoice is not available with the dealer still a percentage as prescribed can be taken as credit to transit its excise credit in the GST regime.
- **VAT/ SAD:** Similarly, if a dealer is not availing the credit of VAT/SAD currently due to restriction in the state VAT law, then credit can be availed based on the ascertainment of stock as on appointed day. However, if the credit of VAT is being currently availed then the same needs to be properly reflected in the last VAT return to transfer such credits to the GST regime.
- **Credit of CST:** The same cannot be availed based on the stock availability as on the appointed day.
- **Entry Tax:** Credit of same can be availed subject to possession of appropriate documents for the same in states where such set off is permissible.

## 8) Impact due to Anti-Profiteering Measures:

Since a dealer will be able to take the credit of goods lying in stock, the tax cost would decrease. This additional benefit accruing to a dealer is expected to be passed on to the end consumer by way of reduction in prices etc. A separate authority will be formed in the GST regime to monitor the non-compliance of the anti-profiteering matters which could have an adverse impact on the entire industry especially when the pricing is pre-decided by the manufacturer. Therefore, it is imperative for the dealer to establish passing of the GST benefit to its consumers. In these times of falling prices this may not be challenge though.

#### **9) Other Procedural requirements and its impact:**

- **Registration:** Dealers need to obtain separate registration for each state even if it pertains to the same dealership and covered under the same PAN. However, dealer can opt for multiple registrations within the state for various dealerships.
- **Returns:** Compliance burden will be very high in the GST regime as one has to file 37 Returns in one financial year for each registration apart from ISD returns, if any. Further, returns filed will be matched online with the support of the IT infrastructure with the returns of the vendors/ customers. In case taxes are not paid by the vendors or if the returns are not filed by the vendors, then the credit of such taxes is denied to the customers. Therefore, timely payment of taxes, filing of returns needs to be ensured in the GST regime.
- **Accounting:** Coordination/ communication, flow of documents from various branches to accounts department should be before 10th of the subsequent month. Therefore, accounting function needs to be more robust, live and automatic. As far as possible, a dealer must map its

accounting framework with other processes in an ERP environment and therefore finance & accounts department needs to be better structured to cope up with the needs of the GST regime.

- **IT Infrastructure:** In GST regime, businesses have to move from the manual environment to computerized environment. Only an efficient IT infrastructure and its best usage can help businesses meet the high compliance needs of the GST. If IT infrastructure is not optimally utilized, then it would be challenging for any business including real-estate sector to function efficiently in the GST regime. Further, in the computerized environment, physical interaction with the department officials would reduce substantially. ERP must be customized to make it capable to meet needs of the business as well as comply with GST.

### **Conclusion:**

The implementation of GST is possible from April 2017 or little later. Migrating to the new tax regime could have substantial impact on the business houses. There would be a positive impact for those who are vigilant. The negative impact of the GST can largely be averted if counter measures/ preparedness is in place. Businesses need to re-look and action must be taken on the following areas to reduce the adverse impact of GST:

- Contracts/ Agreements re-alignment to suit the needs of GST of breaking up into the multiple supplies, composite supplies or missing the supplies;
- Business re-structuring/ Transaction re-structuring needs to be assessed and implemented;
- Understanding the impact on various business departments including procurement, sales & Marketing, finance & Accounts, IT, Admin & HR etc. and re-structuring the same to suit the needs of the GST;

- Optimizing the transitional credits, future credits.
- Assessing the capacity building to meet the needs of the GST;
- Strategizing the right pricing to create right balance between margins and volumes;
- Ensure original entries are verified, keep evidences of tax payments etc;
- Representing through various bodies/ associations on various adverse provisions of the GST law;
- Conducting in-house training programs for learning & development of staff to ensure smooth implementation into the new regime.

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