Effect of GST on financial markets

Akash Bharadwaj(ugc net)
MA economics (gold medalist)

Abstract – In this research paper we will focus on the effects of recently introduced GST on financial markets.

Introduction-The main function of GST is to transform India into a uniform market by breaking the current fiscal barrier between states. Thus the GST will facilitate a uniform tax levied on goods and services across the country.The goods and services tax is the biggest tax reform since 1947 and it has the potential to lead the economic integration of India.

It may sound a tad surprising that the GST is also likely to impact the capital markets. The normal query is how can a goods and services tax (GST) really impact capital markets. There could broadly be three kinds of shifts that are likely to happen in the capital markets in the post GST scenario. Firstly, there could be a greater preference for long term investing over short term investing and this will apply to equities and mutual funds. Secondly, there will be a preference for equity as an asset class over other classes of assets. This is likely to gradually manifest over the next few months and could impact financial planning metrics in a big way. Lastly, GST may see the rise of passive investment as a distinct asset strategy, the way it has emerged in the West. Let us look at each of these trends in greater detail..

1. Trend 1 - A case for long term investing over short term trading..

Remember, the equity market is made up of short term traders and long-term investors with both having a distinct role to play. While short term traders help in narrowing the spreads in the market and creating liquidity, it is the job of long term investors to help discover value. With GST being effective from July 01st, the effective rate of service tax at 15 % stands modified to 18 %. Remember, till June 30th, equity investors were paying service tax at the rate of 15 % (14 % service tax + 0.5 % Swachh Bharat Cess + 0.5 % Krishi Kalyan Cess). Effective 01st July, this activity will attract 18 % GST. Assuming that you pay 1 % in the cash market as round brokerage, your GST impact will be higher by 3 basis points. While this may not make a big difference for long term investors, it will definitely change the economics for short term traders. When you churn in and out of positions on a consistent basis, the additional 3 bps that you will be paying as GST will add up to quite a bit. This will create a preference for long term investing with less of churning.

Even in case of mutual funds, the Total Expense Ratio (TER) of an equity fund is estimated to go up by 5-6 basis points as a result of GST. Fund managers who churn less will be able to widen their performance over the more frequent churners as the impact of GST will gradually add up for them. GST will drive investors a little more towards serious long-term investing over short term trading.

2. Trend 2 - Equity will emerge as a smarter asset class to play growth

Over the last 3 years, we have seen tremendous fund flows into equity mutual fund through the SIP route underlying the rising retail interest in equities. With other asset classes giving tepid returns, investors are increasingly looking to equity to generate alpha. So, what will change after GST? Remember, GST is not just about rates but two additional important factors. For example, the global experience has been that GDP of countries implementing GST tend to see an accretion of up to 3 % in their overall GDP. On a GDP base of $2.5 trillion, that is likely to create an income effect of nearly $75 billion in the next couple of years. We can conservatively apply the Market Cap / GDP ratio and calculate how much of a wealth effect this will have. The moral of the story is that equities will be the best way to play this growth. Secondly, the implementation of GST will create a major structural difference to the distribution and logistics metrics of large companies. This will especially impact companies that operate in sectors like automobiles, two-wheelers, consumer durables and FMCG that operate national networks. With the doing away of state level taxes, the focus will shift to creating distribution and logistics networks based on business needs rather than based on state taxes. The impact of this shift on valuations of these companies will be massive and can be best captured by investing in the equity of these companies.

3. Trend 3 - Will GST lead to the rise of passive investing in India

That is a tough call, but not entirely off the mark. Passive investing is all about indexing your portfolio performance to an index like in the case of an index funds and equity ETFs. The additional 5-6 bps cost created by GST will make a further case for these passive funds. The shift may not happen immediately when alpha opportunities are still available aplenty. However, once the market gets more volatile and alpha opportunities less frequent, then passive investing may see a revival of interest.

An impact on equity investing is definitely on the cards in the post-GST scenario. The case for equities and the case for long term investing could actually get stronger due to GST. But GST may actually force money managers to tweak their strategy in the light of the emerging opportunities and also in the face of higher cost of transacting. This will apply to fund managers, PMS service providers and also to financial planners. It may be time for a strategy shift!

On July 1, 2018, it will be a year since the introduction of the Goods and Services Tax (GST). Heralded as India's greatest tax reform, GST aims to free Indians from multiple taxes, setting the base for a unified common market — One Nation, One Tax, One Market.

Under GST, every minute detail of every item sold is being digitally uploaded in a central tax database for over eight million Indian businesses.

If we average minimum 120 invoices per business, it still means a billion records every month. This is a mammoth task which has proved both challenging as well as rewarding.

As on April 2018, the GST collection crossed 1 trillion. Total assesses stood at 8.71 million and the total returns filed were around 6.04 million. Total GST compensation to the states for FY18 has been 478440 million.

That is a healthy benchmark to start the next year in. This is a win for India and now that the tax regime has stabilized, it's time to look ahead and continue the technology innovation and behavioral changes that further help in realizing the One Nation, One Tax dream.

Sectoral impact of GST

IT/ITes

Earlier, the IT industry was paying 15 percent service tax as opposed to 18 percent after the imposition of GST, leading to an immediate increase in the cost of implementation. But, it will definitely have a positive impact in the long-term.

Factors like no GST on exports, and removal of tax cascading will bring the cost down and an increase in the overall benefits of the IT sector.

Automobile

The GST has subsumed almost all the taxes — excise, VAT, sales tax, road tax, motor vehicle tax, registration duty. Overall, the GST impact on the automobile industry is less than the previous tax scheme due to the lowered tax scenario.

Logistics

After the GST rollout, India successfully jumped 19 positions (35th from 54th) in the Logistics Performance Index (LPI). The implementation of e-way bills was also a bold move.

After a wobbly start, the second innings of e-way bill system implementation has been successful. Physical check posts have been removed from the states, thereby reducing the transit time and increasing the revenue per vehicle.

BFSI

Though the tax increased from 15 percent to 18 percent, a major advantage of GST on financial services has a reduction in the number of indirect taxes.

It integrates different taxes and ensures that the tax burden is fairly divided between different entities involved in the system.

Inflation rate didn't rise: GST, it was widely feared, would cause inflation to rise, as with many countries that launched a single tax regime. That hasn't happened in India. The recent spike in consumer inflation has been due to high food and fuel prices, unrelated to GST. What helped? The much-criticised multi-slab structure. It ensured the levy was as close as possible to the existing rate, which meant the incidence of tax didn't rise. The second factor was the anti-profiteering authority. Though the body was set up after the GST rollout, the prospect of its establishment was enough to ensure businesses did not abuse the transition.

Single national market: Long queues of trucks at state borders disappeared as checkposts were dismantled, creating a seamless national market. These barriers had restricted movement of goods across the country, leading to huge delays and increasing transaction costs for the logistics sector, eventually translating into higher costs for consumers.

One tax nationally: A consumer in Kanyakumari now pays the same tax on an item as one in Jammu & Kashmir. GST has also allowed businesses to streamline distribution systems—production, supply chain, storage—to make them more efficient, having previously been forced to design them keeping state taxes in mind.

Formalisation kicks off, tax base begins to widen: One of the expected benefits was that GST would encourage formalisation of the economy. Evasion would stop making sense, thanks to transparent digital processes and incentive of input credit and invoice matching. With number of registrations crossing 10 million, it seems more businesses are signing up for GST. Rise in the Employees' Provident Fund Organisation subscriber base provides further evidence of the same. More people filing income tax returns could also have something to do with GST.

Everyone wins: As many as 17 taxes and multiple cesses were subsumed into GST, aligning India with global regimes. Central taxes such as excise duty, services tax, countervailing duty and state taxes — including value added tax, Oct roi and purchase tax — were all rolled into one. The new regime provided for free flow of tax credits and did away with cascading due to tax on tax, boosting company financials and resulting in reduced prices for consumers. It also ensured a single law for the whole country with uniform procedures and rules, which reduces compliance burden and business complexity. The government sacrificed revenues, but improved compliance should cover any gap.

WHAT HASN'T WORKED

Compliance has miles to go: The biggest dampener was the compliance process, as information technology glitches took more than the anticipated time to be resolved. The filing system that was put in place in the beginning was quickly abandoned as businesses struggled with compliance. A new return form is being crafted to help make the process much less painful for businesses and is likely to be available soon.

Cumbersome registration system: Multiple registration requirements have complicated things for industry, which was expecting simplicity. In many cases, registration is required in all states. Companies fear that multiple audits and assessments due to multiple registrations could make life more difficult for them going forward.

New cesses crop up: While GST scrapped a multiplicity of taxes and cesses, a new levy in the form of compensation cess was introduced for luxury and sin goods. This was later expanded to include automobiles. A new cess on sugar is also being examined.

Refunds problem for exports: The refund mechanism for exporters, including data matching law, besides procedures governing them, have irked the sector, particularly smaller entities that saw their working capital requirements rise. Though several efforts have been made to address the issue, it may require more intervention.

GST Council delivered: The GST Council, comprising central and state representatives, was the kind of federal arrangement that could have easily been bogged down by ego and politics. The Centre has a 33% vote while the states account for 66%, with any dispute needing 75% support to be resolved. It has never had to vote on any issues, with just one dissent recorded so far. There may have been bickering and differences of opinion, but matters were always thrashed out and a painstaking consensus achieved. The council has found solutions to most issues and these have not been shoddy compromises but sound decisions that have only improved the single tax. The council has provided a template for more such structures where the Centre and states could work together.

Next on the Agenda

There is consensus among experts and industry that GST has made vast progress from its early days of teething troubles. It has settled in as far as the consumer is concerned, but businesses want to see improvement. A simpler tax fi ling regime, fewer slabs and a broader tax base are some things the government needs to address in the year ahead

Expansion of tax base

There are many goods that are still outside the GST net, which comes in the way of seamless fl ow of input tax credit. Key items outside its ambit are electricity, alcohol, petroleum goods and real estate. Among fuels, it may be possible to bring natural gas and aviation fuel within GST. But it may not be easy to do that with diesel, petrol and kerosene as most states are opposed to such a move. Getting real estate under GST may also be diffi cult as it will require a constitutional amendment.

Tax slab rationalisation
There are as many as six slabs, excluding exempt goods. Though most goods fall in the 12%, 18% and 28% brackets, there is a case for merging slabs to reduce complexity and classifi cation disputes. The 12% and 18% bracket could be merged into one single slab in the 14-16% range.

Lower tax rate
There has been a substantial reduction in the number of products in the 28% bracket with goods moved to the 18% one. There is further scope for cutting the peak rate on all products other than 'sin' goods. Products such as cement, paint, air conditioners, washing machines, refrigerators etc should also see a reduction in the tax rate to 18% from 28%.

GST returns simplification
This is the biggest item on the agenda as far as businesses and compliance are concerned. The government has already taken an initiative in this direction with the proposed consolidation of all periodic returns into one. The committee set up for this task has been working on the new format and the IT-related changes required. A new and simplifi ed return fi ling process may become effective in the next six months.

Legislative changes
Over the past year, several issues that need to be fi xed through legislative changes have accumulated. Some of these relate to input tax credit, and the requirement of paying tax up front on various transactions such as deemed exports and subsequently claiming a refund. The government could introduce changes in the monsoon session to fi x these niggles.

More data analytics
The government has already started detailed analysis of a number of data sets to plug leakage. The format of the e-way bill has been designed to capture invoicerelated information so that the government can use data analytics to identify concern areas and plug revenue leakages. Businesses have already started receiving notices about discrepancies between amounts mentioned in different GST returns and those reported on the e-way bill portal. Income tax return forms released for this year have also sought specifi c information in relation to GST. The government can use the granular data to check tax evasion.

Anti-profi teering agency
The agency, which was constituted for a period of two years, has been functional for about six months and issued a few orders following investigations. The GST Council needs to decide whether to wind it up after two years or keep it going until the tax regime matures.

state and central indirect taxes, reduced cascading and credit blockages, created a common market and brought uniformity of indirect tax law and rates across the country, its biggest achievement has been obtaining a broad consensus among all the states and the Centre, which has strengthened the federal character of the Indian fiscal system.

During the year, multiple rates on goods and services have been evaluated and rationalised, given the possible leakage of revenue. The e-way bill system has been successfully implemented, difficult procedures of TCS and TDS (tax collected/deducted at source) have been kept in abeyance, and the anti-profiteering law has acted as a deterrent for most companies increasing their prices on account of GST.

While the government has worked to solve many issues, considerable intervention is still required to bring GST to its full efficiency. The proposal to have a single return will simplify compliance and do away with matching requirements.

Registrations need to be centralised for big service providers and, if that is not possible, assessments/ audits need to be centralised to avoid multiple interpretations of issues for the same entity. A lot has been achieved in this year of GST implementation and yet GST will continue to evolve as the law, procedures and rates are modified to suit the complex Indian market.

Summary-

Undoubtedly, GST has received positive as well as negative responses as befits its characterisation as a toddler. The various tax slabs should be merged so that complexity is reduced and financial markets gain momentum in the long run.The gst is undoubdetdly a welcome step in the economy of India to regularise the inconvenient and cumbersome tax system. However, further steps will bring out the true sense of One Nation One Tax.

REFERENCES-

1. Wikipedia.org.in
2. www.investopedia.com
3. Ibef.org
4. Your article library.com
5. Shodhganga inflibinet.ac.in
6. www.Financial express.com
7. Money control.com