TRANSPORTATION & LOGISTICS

Goods and Services Tax

Ready. Steady. Go?

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As the Indian transportation and logistics industry looks forward to the next level of growth, efficiency and sophistication, it gradually leaves behind the traditional issues pivoted around inefficiencies and regulatory challenges. However, amidst the current signs of global economic nervousness, the pressure to reduce the cost of doing business is occupying increasing bandwidth in the boardrooms of India Inc.

It is in this context, that regulatory reforms proposed in the form of Goods and Services Tax (GST) are much needed now than perhaps ever before. Not surprisingly, during our multiple deliberations with leading industry representatives, we too found the wider industry getting increasingly anxious about ‘when will GST actually be introduced?’, ‘can robust plans be made in advance catering to the post-GST business scenario?’, ‘what could be the key tax and business implications?’, and many more such critical concerns. Indeed, the fact that no industry can afford to ignore such matters speaks volumes about GST’s potential to launch the much awaited fiscal renaissance.

This paper analyzes several aspects of the proposed reform. Given that, multiple rounds of discussions have already been going on between the Government and industry representatives and that much has been deliberated upon the technicalities of GST, this paper focusses on implications, both from fiscal and business perspective as well as areas requiring the attention of the government.

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With a potential to additionally contribute over one percent\(^1\) to India’s Gross Domestic Product (GDP), the proposed Goods and Services Tax is eagerly being looked forward to. Not only will this reform usher in perhaps a never-seen-before opportunity to revisit, rationalize and re-engineer transportation and logistics networks in India, but will also unleash a new era of developing logistics infrastructure and taking investments to the next level. Given that the inefficient shape of longer supply chains with warehouses in almost every state is fiscally preferred in the existing regime, it is now time to overhaul and compress the entire logistics setup.

Further, the international experiences of GST, which over 140 markets have introduced in some or the other variants, the delay in implementation in the Indian context seems to become all the more a cause of concern. The below framework summarizes the milestones in the evolution of GST, since the time it was proposed by the Union Government in 2006-07.

### Evolution trajectory of Goods and Services Tax

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Interestingly, driven by GST’s capability to create one unified market across India, the recent months have witnessed heightened traction in terms of exclusive political discussions to achieve consensus on various issues between the Centre and the States. Consensus will be critical before the framework can be finalized, which will be the stepping stone for the roll out of GST across the country.

While decisions have been tentatively taken for dual GST, separate regime for inter-state transactions, tax on inter-state stock transfers, taxes to be subsumed of taxes and exclusion of products, and credit fungibility across goods and services, etc., the issues such as constitutional amendments, Central Sales Tax (CST) compensation package, rate band/uniform rate for states etc. are still under discussions.

Various initiatives have been taken to finalise the framework and achieve consensus on different aspects of GST:

- The Constitutional Amendment bill was introduced in the 2011 Budget session. The Bill has been referred to the Standing Committee and public debate has been initiated.
- National Securities Depository Limited (NSDL) has been appointed as the technology partner and a pilot IT project has been rolled out in 11 States.
- Recently, the State Finance ministers had visited various European countries to study the working of the comprehensive European Union Value Added Tax (EU VAT).

The tentative decisions on the proposed framework, emerging from White papers/Discussion papers, can be summarized as follows:

- Introduction of Dual GST enabling the Centre and States to simultaneously tax transactions.
- Separate Central regime for inter-State transactions, namely Inter-State GST.

- Taxation of inter-State stock transfers of goods.
- Proposed rate of 16 percent for services and 12 to 20 percent for goods.
- Rationalization of the indirect tax structure by subsuming the key (but not all) taxes.
- Availability of credits across goods and services.
- Alcohol, Petroleum products and Natural Gas to be kept out of the GST net.
IMPACT OF GST ON TRANSPORTATION AND LOGISTICS INDUSTRY

The Transportation & Logistics of goods, on account of its current ‘tax centric’ approach, is likely to witness the impact of GST in various aspects.

Change in business strategies for logistics and warehousing service providers

Currently, the decision to base inventory and distribution models are based on levy of Central Sales Tax and varied state-Value Added Tax (VAT) rates and provisions. Tax optimization and administration is often considered over the operational and logistics efficiency. However, under the GST regime the tax will be levied on stock transfers and full credit will be available on inter-state transactions. This will free the decisions on warehousing and distribution from tax considerations and decisions will be based purely upon operational and logistics efficiency.

This will lead to change in dimensions for logistics requirements of the clients forcing logistics service providers to rethink their business operations including creating new warehousing and logistics locations and expanding / closing existing warehouses at certain locations.

In fact, networks and infrastructure associated with warehousing and logistics hubs are expected to be most impacted in the entire supply chain. Network and infrastructure related businesses would get drastically realigned, ensuring proximity to manufacturing locations or consumption markets and ultimately resulting into several hub-and-spoke models.

From the infrastructure perspective, the scenario would consist of lesser number of warehouses but with larger sizes, amounting to consolidation of currently widely spread warehouses almost one in each state. This would translate into expansion of some of the existing warehouses, development of new ones and indeed shutting down of several existing setups.

In addition, locations of strategic significance for warehousing and logistics networks would eventually also turn out to be critical transportation hubs.

Such impacts would command fulfillment of certain pre-requisites pivoted around infrastructure including land availability, road/rail/multimodal connectivity, power, etc. This would in turn require all stakeholders – Logistics Service Providers (LSPs), end users, industry associations and the government – to plan in advance so that foreseeable issues could be addressed in time and would help evolve a more agile, efficient, flexible and futuristic supply chain.

LSPs and their end users both would need to re-engineer their supply chains, focusing on optimal locations for warehouses and logistics centres. Some of the target regions would include Chennai-Bangalore belt in the South, Nagpur region in the Central part and Mumbai-Gujarat-Rajasthan-National Capital Region (NCR) corridor in the North-West, driven by the high potential for upcoming manufacturing activities and the planned Delhi-Mumbai Industrial Corridor (DMIC).

RECOMMENDATIONS

In order to assist industry players to optimally develop and successfully implement revamped supply chains, government may commission an exhaustive study to identify tactical locations for logistics-cum-transportation hubs, multimodal opportunities, crucial haulage corridors and related infrastructure requirements. Findings of such a study would help the Government to be ready with the infrastructure requirement once GST is introduced and would also alleviate the concerns and nervousness that industry players currently witness regarding the expected benefits and unforeseen challenges GST may bring up.
Cash Impact Planning

Currently, abatements are available to transport service providers under the Service Tax law. These are not likely to continue in the GST regime. Also, the liability to pay tax may shift from the recipient of service to provider of transport service requiring it to pay full taxes on accrual basis. On account of this, a major impact will be seen on the cash flow for transport service providers who generally operate on marginal profit basis.

Businesses need to quantify the cash impact and realign their working capital strategies to reduce / mitigate the cash flow impact.

Petroleum Products – Impact of exclusion from GST

The most important benefit under the GST regime would be availability of credits across goods and services on all purchases and inputs used in the course of business with denial of input tax credits in very exceptional circumstances only. This will help achieve the goal of introduction of a truly consumption tax, reduction in the operating costs for businesses and rationalization of the cost of goods and services.

It is proposed that petroleum products will be out of the GST net. This will have severe implications on the Transportation sector, where motor spirits constitutes the largest cost component for the business (almost 55-60 percent 2). On the other hand, GST at the full rate will be payable on the transport charges. Exclusion of petroleum products from the GST net will break the chain of credits thus adding to the costs.

RECOMMENDATIONS

An alternative model for taxing transport service providers will have to be evolved to mitigate the cash flow implications on the transport service providers.

Petroleum products should form part of the GST regime albeit with a higher rate of tax. Input tax credit should be fully allowed to transportation service providers.

2. Crisil report on Domestic Freight Transportation 2010
Place of Supply, Tax Administration and Input Tax Credits

The most important change will be the transition from the present central tax regime (service tax) to the dual GST regime requiring payment of taxes simultaneously to the Centre and States and compliances across the country. The Place of Supply rules will govern the State where the tax will be payable on any transaction of Transportation & Logistics.

In the case of warehousing, the Place of Supply can be defined as the place where the warehouse is situated. On the other hand, for transportation contracts, taxes may be levied by each State through which the goods move, perhaps based on the distance traversed in each State or alternatively in the State from where the journey of transport commences. The latter that is, the State from where the journey of transport commences, would be an ideal basis for taxation. Though being a simplistic model, the same would pose challenges to the transportation service providers such as registration and compliances requirements across all the locations from where the goods are loaded and dispatched.

Also, another challenge envisaged is the ability of the transportation service providers to capture credits in respect of the expenses incurred enroute. Transportation service providers may incur expenses in different States during the journey from one location to another and it will be essential to avail input tax credits on such costs. In the event, appropriate rules are not framed under the GST law for claim of these credits, the transportation sector will have to be ready to absorb the impact on account of these tax costs.

RECOMMENDATIONS

It will be essential to evolve a mechanism for centralized registration and compliances, the absence of which will add to the administrative costs of the service providers. Scrutiny of records, etc. by multiple States will complicate tax compliance. On the other hand, States may find it difficult to track and tax the transactions taking place in their respective territory.

Similarly, only centralized registration will enable transportation service providers to claim and utilize credits on expenses incurred enroute. In the absence of such mechanism, there could arise situations requiring claim of refunds from different States.
Though GST discussion currently does not address this particular area, appropriate administrative mechanism will have to be established to provide for taxation of services provided to or from such locations.
Rapid emergence of organized service providers

With the clear availability of credits, GST will score over the existing regime especially in the Transportation & Logistics industry, where a tendency is seen to engage with the unorganized players for tax considerations. The GST regime will usher in the emergence of the organized service providers since taxes will no longer be added costs for the businesses.

Given the highly fragmented nature of the Indian transportation and logistics industry (the leading 10 listed players command less than 5 percent of the overall market), implementation of GST is expected to unleash plethora of opportunities for organized players.

Further, the players in the unorganized sectors too would be expected to improve their service levels if they intend to successfully grow in the likely ‘shape up’ or ‘shape out’ competitive landscape. The post-GST regime is in fact likely to offer many more unseen opportunities for unorganized players to tie up/collaborate with established players. This may ultimately result in a win-win scenario for both the collaborating parties and the industry at large.

All industry stakeholders – LSPs, both organized and unorganized, and end users of logistics services – ought to set up dedicated teams to understand and implement the best possible strategy to leverage the benefits of increased penetration of organized services. Key constituents of such a strategy may include plans to raise funds, classify strategic locations for warehousing, optimize transportation options and identify a potential partner for supply chain collaboration.

Taxability on the basis of ‘Negative List of Services’

GST is likely to bring in taxation of services on the basis of ‘Negative List’ (no tax will be levied on services in ‘Negative List’, whereas all others will be taxed). Taxability on the basis of ‘Negative List of Services’ will bring within the tax fold the services in relation to export of goods, which are exempted as of now. Examples of these could be handling of export cargo or ocean freight. There could be some such unintended levies resulting in increase in cost of business especially export of goods.

RECOMMENDATIONS

Appropriate rules will be required to zero rate services in relation to export of goods.

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CONCLUSION

As India prepares for a transition to the next level of logistics growth trajectory, regulatory policies need to evolve well ahead of the introduction. Further, on account of the delay in implementation of GST, it is critical to gauge the advantages the industry at large and the various stakeholders specifically are currently losing out. It is in this context that this paper analyzes the key fiscal as well as business implications of the proposed GST.

The below table summarizes the key business implications that may accrue to the wider industry owing to increased organization in post-GST scenario:

Critical business implications in light of expected increase in organized business

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td>Supply chain re-engineering</td>
<td>Many service providers and end users would revamp their supply chains, realigning the locations of warehouses, corridors used and transportation options exercised, thus generating tremendous business opportunities for Fourth-party Logistics (4PL) firms specializing in supply chain re-engineering as well as for providers of network optimization tools such as Transportation Management Systems (TMS).</td>
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<tr>
<td>Transportation</td>
<td>Re-organized countrywide networks would decrease cost of primary freight since warehousing locations are likely to be placed closer to manufacturing/import/export locations. In contrast, this would increase secondary freight due to fewer warehouses.</td>
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<tr>
<td>Outsourcing</td>
<td>The expected improvement in service levels and more competitive pricing due to increased penetration of organized players may pull end users/manufacturers to re-think their conventional inhibitions towards outsourcing.</td>
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<tr>
<td>Consolidation</td>
<td>Increased availability of efficient and organized players may spur a wave of consolidation activities, including inbound and domestic transactions. Increasing business collaborations among new entrants and fresh unorganized-turned-organized players may be visible. This may catalyze collaborative usage of supply chain assets, thus driving efficiency for all stakeholders.</td>
</tr>
</tbody>
</table>
| Service levels       | • The general service levels may witness an upswing. Especially, hi-end Value Added Services (VAS) such as world class track and trace, kitting, picking and packing may witness increased application.
• Increased demand/supply of day/time-definite services is also likely due to increased customer expectations and better organized supply chains. |
| Automation           | Efficient handling of larger volumes per warehouse (owing to new/consolidated warehousing) would command increased reliance on automation/technology applications such as Put-to-Light, Pick-to-Light, Enterprise Resource Planning (ERP) and Warehouse Management System (WMS). |
| Skill set upgradation | With increasing share of organized logistics setups, the need for technically qualified and optimally skilled workforce across the supply chain is likely to become more glaring. Hence, to cater to this increasingly indispensable need, supply of skilled workforce may improve. |

Undeniably, GST will be pivotal in rationalizing the indirect tax procedures. While it is imperative for policymakers to further accelerate the deliberations ensuring early implementation, other stakeholders such as service providers, users and industry bodies too need to collaboratively prepare their road map in advance – the sooner, the better!
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At CII Institute of Logistics we create a platform for the Industry to gain more insights into the emerging trends, industry specific problems of national importance and global best practices in logistics & supply chain management. We enable the industry to cut down the transaction cost, increase efficiency, and enhance profitability and enable to sensitize and bring solutions to macro level issues.

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CII Institute of Logistics to become an International Centre of Excellence in Logistics and SCM and to facilitate Indian industry to be referred in Global Business for its Best Practices in SCM and Logistics.

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CII Institute of Logistics to be a platform to create and share intellectual capital for reducing transaction cost and improving competitiveness, in the process nurture the skills of Logisticians and ensure adoption of Best Practices in Logistics and SCM through online and offline activities.

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- Education
- Training
- Advisory
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ABBREVIATIONS

CII
Confederation of Indian Industries

4PL
Fourth-Party Logistics

CST
Central Sales Tax

DMIC
Delhi-Mumbai Industrial Corridor

ECSFM
Empowered Committee of State Finance Ministers

ERP
Enterprise Resource Planning

EUVAT
European Union Value Added Tax

GDP
Gross Domestic Product

GST
Goods and Services Tax

LSP
Logistic Service Provider

NCR
National Capital Region

NSDL
National Securities Depository Limited

TMS
Transportation Management Systems

VAS
Value Added Services

VAT
Value Added Tax

WMS
Warehouse Management System
ACKNOWLEDGEMENT

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