Goods and Services Tax: How will it impact Foreign Direct Investments strategy in India?

Pratima Singh

MBA-International Business

Email: pratimasingh309@gmail.com

Abstract

India's inward investment regime went through a series of changes since economic reforms were ushered in 1990s. The expectation of the policy makers was that an investor-friendly regime will boost the foreign investments in India. The introduction of Goods and Services Tax (GST) is one of the biggest structural reforms in India which will boost foreign investor's confidence for making investments in India. This paper aims to decipher how GST will work in favour of making the Make in India initiative a success and at the same time provide a level playing field for foreign investors.

This paper will help in analyzing the impact of GST on attracting FDI in India and how it will help in making India's initiative related to FDI a success.

The paper will be based on secondary data with relevance to the current economic scenario.

Keywords: Goods and Services Tax, Foreign Direct Investment, Economic Growth, Economic Reforms.

1. Introduction

Goods and Services Tax is one indirect tax for whole nation, which will make India one unified common market- *One Nation; One Tax; One Market*. GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage.

The implementation of GST is expected to bring in the much-needed boost to the nation's economy. It is believed that the implementation of new tax structure will attract more FDI and increased tax compliance, which in turn would increase corporate transparency. "For India to grow faster, *FDI is important… For that purpose, Indian economy should be integrated as truly one single economy and … rationalization of tax, the GST, as the government is seeking, is very important reform. I hope it can be successful,"* said Takehiko Nakao, President of Asian Development Bank (ADB).

GST implementation is a breakthrough tax-reform with respect to Foreign Direct Investments in India. Increased tax compliance will ensure reduced litigations and increased investor confidence. In a slow global economy, GST will provide the required boost to international trade and FDI, which will aid in the economic growth of the country.
GST is a destination based tax, which will make the business easier for multinationals in India. The country will finally become one common market, with uniform pricing across states, and optimal allocation of resources, making our goods more competitive. Stable, transparent and predictable tax regime will encourage local and foreign investment in India creating significant job opportunities.

This paper tries to analyze how GST will improve the business scenario in India in terms of ease of doing business, tax compliance, corporate transparency and growth in trade.

2. Methodology

This research will be based on secondary data with relevance to the current trends and reforms happening in Indian economy. It is based on secondary data because while analyzing Goods and Services Tax with respect to FDI, the factors involved are of macroeconomic nature. The required data have been collected from various sources. Some of the sources are as follows:

- World Investment Reports
- Asian Development Bank's Report
- Publications from Ministry of Commerce, Govt. of India
- Reviews from the research already undertaken on issues related to FDI and GST
- Websites of World Bank, IMF, WTO, RBI, UNCTAD, ASSOCHAM
- Reports from Department of Industrial Policy and Promotion (DIPP)

3. Findings and Discussions

Incomplete utilization of FDI is due to lack of structural reforms, incoherent institutional policies and regulatory conditions. Now, since GST is on the way for implementation it is going to boost the confidence of foreign investors in the economy. The GST opens up more opportunities for doing business in India, as the business-operation environment will be enhanced in the following aspects:

- Removing cascading tax effect
- Higher threshold for registration
- Online procedure for GST
- Lesser compliances
- Increased efficiency in logistics
- Regulating the unorganized sector

3.1 Ease of Doing Business in India

- **Reducing tax burden**

GST is a clear system of input tax credits throughout the value chain. The GST has been developed as a set of much clearer tax rules on goods and services with uniformity and tax rates and structures across the whole of India. All procedures can be carried out online by taxpayers, making compliance easy and involving minimal bureaucratic intervention.

With tax uncertainties, foreign investors who were reluctant to invest in India will now gain confidence to invest as the taxation system will become more certain with the implementation of GST.

- **Impact on Business**

Sourcing	Manufactures get the option of consolidating supplies from vendors
Distribution	GST will allow optimization of warehouses which will enhance the "Make in India" initiative as foreign investors will find it easier to set up the warehouses for their business in India
Pricing & Profitability	GST would require re-pricing of products.
Cash-flow	Removal of excise duty on manufacturing will improve cash flows as GST would now be paid on supply or sale of good
Transaction Management	Appropriate measure related to tax reports, IT systems in online transactions needs to be reviewed

3.2 Impact on Trade strategy related to FDI

- GST will require lesser number of paper-work and documents work at intermediary level which will reduce red-tapism and corruption which will bring in more corporate transparency in terms of foreign investments made in India.
- It will increase the rating of India in Ease of Doing Business.
- With increase in exports of India, the manufacturing sector will get a boost and infrastructure will flourish.
- Make in India will get a boost with high profits arising out of the manufacturing sector which is brick and mortar of the economy.
- It will bring transparency in businesses and will monitor tax evasion in trade practices with certainty in taxation.

3.3 Exports to Increase

With uniform taxation and cost efficiencies owing to reduced time and costs in transportation, the Made in India products will become competitive in the global market. There is a tendency of manufacturers to locate manufacturing facilities as well as warehouses in states or locations that offer better tax structures regardless of their suitability in terms of other resources.

Efficient allocation of productive resources and providing full tax offsets, as envisaged under the GST, is therefore expected to result in gains for exporters.

The new GST allows greater flexibility in manufacturing as the tax barrier on inter-state transactions has been removed. Moreover, the GST will not be levied on export of goods and services.

3.4 Survey

According to a survey conducted by *Feedback Business Consulting Services* across 67 Indian companies, majority believed that the GST implementation would be constructive for the Indian economy.

Around 72 percentage respondents reverted that they believed investments would increase across different sectors and a significant portion of that would be in the form of FDI, especially in the automotive and heavy engineering sector.

4. Conclusions

GST will convert a diversified tax regime into one uniform tax rate making India a single market place. This would facilitate seamless transportation of goods across borders with a significantly lower transit time, thereby stepping up demand for logistics services. The GST Bill will also lead to higher vehicle capacity utilization resulting in increased efficiencies at every node of the logistics.

A major change involving GST implementation is its compliance, which will necessitate robust systems and tracking of information. Since the entire process of tax has been revamped, the process of accounting and auditing will also undergo a change. Much of this change will occur on the systems that organisations use for compliance.

5. Road Ahead

India is a federal nation with 29 states and seven union territories and implementing GST where every State will have its own legislation; it is going to be a tedious and challenging undertaking to implement GST with the exact intent with which it is being made.

With GST reform, India is on the right track towards unifying its internal market, further improving the ease of doing business, brightening the prospects of the country becoming a manufacturing base, while creating new business opportunities for Indian, as well as overseas, companies.

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