Frank Notes

Satish Chander

GST and Fertiliser Sector

The Goods and Service Tax (GST) is a long pending indirect tax reform which India has been waiting for quite some time. The intent of the government to put in place GST was announced in the Union Budget 2006-07. Since then there have been prolonged discussions between centre and state governments regarding the contours of its formulation and implementation. This comprehensive tax policy is expected to be one of the most important reforms in contributing to the Indian growth story.

GST is hoped to remove the cascading effect of various taxes and simplify the existing tax system. When introduced, GST will not only make the tax system simpler, but will also help in increased compliance, boost tax revenues, reduce the tax outflow in the hands of the consumers and make exports competitive. With a simpler tax administration, foreign investments are also expected to improve significantly. According to a report by the National Council of Applied Economic Research, GST is expected to increase economic growth by between 0.9 per cent and 1.7 per cent.

GST aims to get rid of the current patchwork of indirect taxes that are partial and suffer from infirmities such as multiplicity of taxes and also exemptions. It aims to replace the existing multiple structure of central and state taxes with a single unified tax rate across the country covering both goods and services. GST, being a destination based consumption tax based on VAT principle, would help in removing economic distortions and in development of common market in India. It implies value addition at each stage of production and supply chain with the set off benefits accruing from the producer's/service provider's point up to the retailer's level. The final consumer will thus bear only the GST charged at the last point of supply chain with set off benefits at all previous stages.

GST has been found an effective system worldwide and it is being used in more than 140 countries, with rates varying between 15% and 20%. It is fast becoming the preferred form of indirect tax in the Asia-Pacific region. It is interesting to note that there are 40 models of GST currently in force worldwide, each with its own peculiarities. Some countries have single rate of GST applicable to all products and some others have multiple rates with concessions to some products and exemptions to some other essential products and services.

It is heartening to note that the present Indian government is very keen to implement GST at the earliest. In May 2015, the lower house (Lok Sabha) of the parliament already passed the Constitution Amendment Bill for GST. It is now pending in the Upper House (Rajya Sabha). Meanwhile, steps for creating IT infrastructure and formulating GST laws are also being taken. The government has also initiated the process of industry consultation and is collecting the data regarding the impact of various tax structures on various industries.

Let us examine how GST will work and what are the advantages and some shortcomings of the GST mechanism for the fertiliser sector.

GST has special significance for the fertiliser sector which is currently allowed a number of tax concessions/exemptions both at input and output levels and there is also heavy subsidy on sale of fertilisers. The impact on fertiliser industry will depend on how these elements are treated under the proposed GST regime.

Anticipating the impact of proposed GST on fertiliser industry, the Fertiliser Association of India (FAI) had proactively flagged the issues impacting the fertiliser industry to the government as early as 2011. FAI has commissioned a study recently on likely impact of proposed GST on fertiliser industry by a professional tax consultant. Fertiliser industry through this study has already generated the type of information being currently collected by the Finance Ministry from other industries. Perusal of data & information and its analysis will help to formulate our suggestions to the government for implementation of GST. But few issues at macro level are very clear at this stage.

Fertiliser industry is going to be impacted adversely under proposed GST regime. Presently, fertiliser industry enjoys the support of Union and State Governments by way of tax concession / exemptions on inputs as well as on finished fertiliser products. This inter-alia includes concessional rate / exemption from excise and customs duties on inputs for manufacture of fertilisers, concessional rate of excise duty on finished fertilisers, concession / exemption from state VAT on fertilisers. Further, subsidy paid by Government on fertilisers is currently exempt from all taxes. The combined impact of these exemptions / concessions has been that the total incidence of tax on fertiliser products has been reduced significantly and is about 5-10% of the value of products. If these exemptions / concessions are withdrawn under GST and the rate of GST is kept, say, at a level of 18%, the incidence of tax on fertilisers will increase significantly. This in turn will either increase the retail prices of fertilisers or increase the fertiliser subsidy or both.

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Another likely issue is that the current incidence of tax on inputs is higher than the incidence of tax on finished fertilisers due to subsidy element, which is currently exempted, and taxing the subsidy in any case is not desirable even in future. Thus, it will result in accumulation of large amount of unutilised input tax credit blocking industry's funds with tax authorities on a regular basis.

Major portion of fertilisers are moved from one state to other on stock transfer basis based on the government directive under monthly supply plan. Thus, the point of taxation on stock transfer and effective mechanism for refund of tax credit also needs attention of the Government for the fertiliser sector. There would be need for regular monthly payments of unutilised input tax credit to address the issue of higher incidence of tax on inputs than the finished fertilisers.

Switch over to direct benefit transfer (DBT) of subsidy to farmers would mean sale of fertilisers at full price. For example, currently, there is a subsidy of almost 70% of cost of urea. This is not taxed at present. On introduction of DBT, the GST will also be levied on 70% subsidy which is currently exempted. This will increase the incidence of tax on the fertiliser products.

Further, at present, major inputs like natural gas and petroleum products for production of fertilisers are not proposed to be covered under GST. This means, levy of central and state taxes on these inputs will continue as per current practice and fertiliser manufacturers will not get input tax credit against tax paid on these inputs. This will result in cascading effect of tax on tax. This will also increase incidence of tax on final product and the cost of fertilisers to the farmers.

It is obvious from the above that fertiliser products are likely to suffer from higher incidence of taxes with implementation of GST. Therefore, it is strongly felt that there is a need for the government to pay special attention to fertiliser sector, keeping in view its direct linkage with farmers and agriculture. Any new tax regime should not directly or indirectly increase the cost of fertilisers to the farmers, especially when government continues to provide subsidy on fertiliser directly or indirectly. Prima facie, the government should thus; either allow zero or concessional rate of GST on fertilisers. FAI is in the process of firming up of its final recommendations to the government on this subject. ■

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