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GST – impact on textiles & apparels

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Abstract
The Indian textile industry provides employment to a large number of skilled and unskilled workers in the country. It contributes about 10% of the total annual export, and this value is likely to increase under GST. GST would affect the cotton value chain of the textile industry including all garments for men and women like shirts, trousers, saree, apparels, shoes and any more clothing materials which is chosen by most small medium enterprises as it currently attracts zero central excise duty (under optional route) GST. It is expected that the tax rate under GST would be higher than the current tax rate for the textile industry. Natural fibers (cotton, wool) which are currently exempt from tax, would be taxed under GST. Despite this, the textile industry as a whole would benefit from the introduction of GST.

Keywords: textile, GST, industry etc

Introduction: GST – An Overview

The Goods and Service Tax ('GST'), considered India's biggest and most historic tax reform is just around the corner. To err is to perceive GST as just any other "Tax Reform". GST signifies "Change" that too a Game changer!!

With the Government leaving no stone unturned to usher in GST on 01 July 2017, GST roll-out is going to change market dynamics by creating an integrated marketplace. This new taxation regime would not only require organizations to capture appropriate data for computation and compliance, but also presents a unique opportunity for cost optimization and cash liberation. The hitherto shadow economy in business would be forced to join the mainstream and time of fake bills could end. Unless tax is paid no one can avail credit and claim refund on exports.

Downside of current tax structure

- Multiplicity of taxes - Multiple taxable events - Manufacture, Sales& Services
- Cascading effect- Restriction in credit availment
- Varied compliances under statutes
- Different Compliances under varied states
- Lack of automation in SME sector & Cash economy thriving in a big way

GST Regime Key Features

- One comprehensive levy on Goods & Services "One Nation One Tax"
- Shift to "Destination based Taxation" & Common - taxable event -"Supply"
- Increase in credit base –near seamless flow of eligible credits
- Improves business competencies with rewarding the honest and compliant.

Dual GST Structure

GST is levied by both the federal and state or provincial governments whereby a Central Goods and Services Tax (CGST) and a State Goods and Services Tax (SGST) will be levied on the taxable value of every transaction of supply of goods and services.

For within the state (Intra-State) supplies both CGST and SGST shall be levied with CGST Portion payable to Central Government and SGST Portion payable to respective state. For across the state (Inter-State) supplies IGST (CGST + SGST) shall be levied and collected by centre out of which the SGST Portion shall be transferred to respective consumer state

4 Tier Rate Structure

A four tier rate GST tax Structure of 5%, 12%, 18% and 28% with lower rates for essential items and the highest for luxury and de-merits goods that would also attract an additional cess, have been decided by the GST Council

- 5% - Essential Goods
- 12% - Standard slab rate
- 18% - Standard Slab rate
- 28% - De-merit and Luxury goods

Key industry features

Source: Textile Ministry, Make in India

- Textile Industry in India is one of key sector in Indian economy with a direct linkage to the overall growth of Indian and global economy. Textile plays a major role in the Indian economy India's textile market size (USD billion)
- It contributes 14 per cent to industrial production and 4 per cent to GDP.
- With over 45 million people, the industry is one of the largest source of employment generation in the country.

- The industry accounts for nearly 15 per cent of total exports.
- The Indian Textile industry is amongst very few industries that is vertically integrated from raw material to finished Products (From fibre to retail). With potential growth
- Opportunities in both the global and the domestic market it has leveraged its strong manufacturing position to achieve considerable expansion.
- The Textile and apparel industry can be broadly classified into two segments:
- Yarn & Fibre (Natural & Man-made)
- Processed Fabrics, Ready-made garments & Apparels

Current Tax Regime

Indirect taxes on textile sector is obfuscated and indifferent across its various sectors. Most of their products are either exempt or are taxed at a relatively lower rate and are extensively subsidized under different central and state regimes

The textile industry is taxed both under the central and state regime. The following are the indirect taxes applicable to the textile industry

- Central Excise Duty: The Central Government levies excise duty under the Central Excise Act, 1944. The tax is charged on the manufacture of goods and are meant for domestic consumption. Special excise duty and Additional duty of excise are also charged under the said act.
- The domestic textile industry has an optional route to pay zero excise duty across various stages of the value chain, provided they don’t claim the Input Tax Credit (ITC) at any stage. Cotton based industry are exempt from payment of excise and apparels have been attracting excise duty at effective rate of 1.2% (@ 2% with abatement @ 40%). Tax payable at the time of removal.
- Value Added Tax (VAT): State VAT is a form of sales tax levied by the state governments on intra-state sale of goods. VAT is applied by the State governments at each stage of sale, with a particular apparatus of credit for the input VAT paid.
- Currently in most of the states VAT on apparels is @ 4~5%. Fabric manufacturing in India is largely carried out through the SSI sector, where many of the companies operate under the composite scheme of taxation (applicable with turnover of up to Rs 1.5 crore). ITC cannot be claimed on purchases from suppliers under composite scheme. Tax payable at the time of sale.
- Central Sales Tax (CST): The Central sales Tax is a tax levied by the Union government but collected and retained by the state governments of the originating State on inter-state sale of goods. It is currently charged at the rate of 2% on the value of sale of goods. Tax payable at the time of sale.
- Entry Tax: Entry tax is an account based tax levied and collected by state governments on entry of goods into a local area for consumption, use or sale therein.
- Customs Duty: Custom duty in India is defined under the Customs Act, 1962 and enables the government to levy duty on exports and imports, prohibit export and import of goods, procedures for importing/exporting and offences, penalties etc. Under customs duty different taxes are levied like Basic customs Duty, Additional Customs Duty (CVD), Protecting duty, Anti-dumping duty and Safeguard duty. Custom duty on exports is normally nil rated except for raw cotton and cotton waste, imports are leviable to CVD and special CVD.
- Export Incentives: These are in form of drawback, rebate/ refund of taxes paid and several incentives in the form of scrips which could be sold.

Pertinent issue in current taxation

- Break in input tax credit chain: Most of industry, being an SSI, use composition scheme. Numerous transactions in the textiles industry flow from the unorganized to the organized sector and vice versa. Where Regular/Registered Taxpayer purchase goods from composition Taxpayers, they are not eligible for Input Tax Credit, thus breaking the Cenvat Credit chain. Input Tax credit paid on the previous transaction is included in the cost of the product making the product costly.
- Small Business Compliance Cost: Composition scheme Taxpayer is hesitant to join Credit chain as it increases the compliance cost of engaging professional to meet their Tax obligation.
- Job work under Central Excise: In terms of the Rule 4(1A) of Central excise rules, every person who gets the goods, falling under Chapter 61 or 62 or 63 of the First Schedule to the Tariff Act, produced or manufactured on his account on job work, shall pay the duty leviable on such goods. Therefore, it is the raw material supplier and not job worker who is liable to excise duty under current regime.
- Branded goods: Affixing of the brand name on goods amounts to manufacture under central excise and the person affixing brand name would be liable to pay the excise duty. If job worker affixes brand name on behalf of other job worker would be liable to excise, however if the brand owner if himself affixes the brand name then the brand owner can claim excise exemption.
- Differential treatment of Job Work under CENVAT and State VAT: For the purpose of CENVAT, job work units are treated like any other manufacturing unit with job workers paying CENVAT on processed fabrics and getting a credit of excise duty paid on their inputs i.e. grey fabrics. Unlike the CENVAT procedure, the State VAT treats job workers under the Works Contract category, where job worker pay tax on the total value of goods used in processing the fabric like dyes etc. including gross profit. This leads to a difference in tax base with the CENVAT tax base being more than the State VAT tax base.
- Inclusion of all other taxes into the GST: Supply chain of Textile Industry is loaded with input and output across state boundaries to reach the ultimate consumer. Octroi and Entry Tax are the bottlenecks, credit of which are not allowable, thus form the part of the cost. Subsume of octroi, entry tax etc. into GST will remove the cascading effect at the distribution stage.

GST on textile industry

GST on textile industry – An overview

- With the 101st constitutional amendment, Central Excise Act as well as provisions of VAT shall have their scope limited to the products like Petroleum & Tobacco. All other products, from the notified date would be liable for payment of GST.
- Under the GST regime, the concept of manufacture and levy of excise duty would be given a go bye. Tax would be levied on supply of goods/services whether by a manufacturer or by any other person.
- There would be following three Acts to administer and levy GST in India:- (i) The Central Goods and Services Tax Act. (ii) The State Goods and Services Tax Act. (iii) The Integrated Goods and Services Tax Act.
- Every manufacturer with an aggregate Turnover of more than Rs. 20 Lakhs is liable to registration under GST unlike excise duty where a manufacturer shall be liable for registration if the turnover exceeds Rs 90 Lakhs.
- Composition scheme available to persons whose aggregate turnover not exceeding Rs. 50 Lakhs,i.e. supply not greater than 50 lakhs. Further condition to adopt composition levy are no supply of services, no inter-state supply, no credit to be taken and no supply shall be made through an E- Commerce operator
- Supply of good shall be the taxable event and tax shall be payable at –

Table 1

S. No	Requirement	Time of supply or tax
A	Supply of goods	Earlier of the following:- 1. The date on which supplier issues an invoice with respect to supply or the last date on which he is required to issue invoice.
		2. The date on which supplier receives the payment with respect to supply.
B	RCM on receipt of Goods	Earlier of:
		▪ Date of receipt of goods or
		▪ Date of making payment or
		▪ Date immediately following 30 days from the date of issue of invoice
C	Any other	Due date for filing return Date of payment of tax

- Place of supply shall be location of goods at the time at which the movement of goods terminates for delivery to the recipient. The sum and substance of this is that the destination of goods is the place of supply.
- Import, export and supply to SEZ, EOU shall be considered as inter-state Supply
- Import of goods shall be taxed in GST and Tax paid (IGST) on imported goods shall be eligible for credit as input tax credit to the importer.
- Exports physical and supplies to SEZ will be treated as Zero Rated Supplies. No tax will be payable on export of goods. However, credit of input tax credit will be available and the same may be utilized by the exporter for other outward supplies. In the alternative, the exporter may claim refund of corresponding input tax credit. Export benefits like drawback, rebate/ refund would be available.
- As per the MGL, CGST can be used to set-off CGST & IGST, SGST for SGST & IGST and IGST for IGST, CGST & SGST respectively. Therefore, barring fungibility of CGST & SGST all other taxes are fungible.

Impact on textile industry

An important determinant of the tax incidence under GST will be the GST rate applicable to the textile segments. While the final GST rates are yet to be announced, even at the 12% lower rate recommended by the Dr. Arvind Subramanian Committee, the textile sector is likely to be negatively impacted. The cotton value chain is likely to be the worse affected as it is currently attracting zero central excise duty and tax in inputs may not be more than 2-4%.

- Revenue Neutral rate proposed to be higher under GST: Currently, the State VAT is ~4~5% on apparels and with ~1.2% effective central excise duty on branded garments with MRP of more than Rs 1000, the overall tax incidence on the finished goods, i.e. apparels is lower than 12%, which is the lowest rate being proposed in GST. This would be inspite of credit not being available for all tax/ duties paid in the past.
- Further the apparel retailers will not have sufficient input credits (such as service tax on rent of showrooms) to offset the increased tax liability if the GST is not levied on upstream sectors like yarn and fabrics and will be negative for retailers.
- Since there is a reduced tax advantage of cotton yarn vis a vis man-made yarn, there can be a gradual shift in the domestic textile industry towards manmade fibre. It may be noted that India currently operates with fibre mix of cotton: manmade of 60:40; as against global average of cotton: manmade of 40:60. Manmade inputs today suffer 12.5% + average 4/5 % VAT which is a cost. In GST available as credit.
- Fiscal barriers for inter-state movement to be removed: Reduce time of movement and logistic costs, stocking costs and carrying costs.
- Promote capital investment: With textile sector coming under GST, textile players which are oriented towards domestic markets will be able to set-off the GST paid on domestic capital goods (but not the import duty) as their sales will be subject to GST. Accordingly, this will reduce the cost of capital investments and hence will be positive for the players operating in domestic markets.
- Duty Drawback to lose relevance: With Input tax credit chain becoming more transparent and integrated, the tax credit for exporters will become easier and full credit of indirect taxes can be claimed; and the duty drawback

scheme, which aims to provide credit of indirect taxes could lose relevance under GST. However in the interim it would continue albeit at a lower rate.
- Increase in administrative cost for the textile industry as hitherto most of the activities were out of tax net.
- Improved compliances: An important effect of GST would be to improve compliance. The value chain under the GST will be fully traceable. As a result, ITC claims will have to be backed by full information chain of purchases & sales. Improved compliance will automatically lead to higher revenues for any given rate as long as that rate is not excessively high.

Conclusion

The expected rate of GST would be 12 %. Net of credit maybe still 6-9%. To some extent final cost would increase. However GST would help exporters. The cash dealing would significantly reduce. The unorganized industry would not be advantaged. The compliant would find their goods competitive and this protected sector would also join in contributing to tax in addition to employment etc which was there even today. Stocking pre GST would reduce in this industry. Smaller players whether in the textile processing, job workers, fabric manufacturers or garment units would have to bring in discipline in their recorded purchases and proper accounting which has not been strong in the past?

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