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An Impact of good & Service Tax on Indian textile industry

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Abstract— Goods and Services tax (GST) constitutes the last mile of a long journey of reforms of indirect taxes in India. GST will replace a number of central and state taxes. The important taxes that may be subsumed in GST are cenvat and service tax at the central level and State VAT/sales tax, central sales tax, and entry tax at the state level along with a number of additional or special duties and cesses and surcharges. The final design of the GST and the related constitutional amendment are yet to be finalized. However, the impact of GST on the textile sector will be quite significant. GST will fundamentally change the way the textile sector is presently taxed in India. Taxation of textile sector is presently opaque and non-neutral across its various segments. This study examines the implications of GST for the Indian textile industry. It estimates the revenue neutral rates for the relevant textile segments under the GST and highlights the implications of GST for the growth, employment and export potential of the industry. It also highlights changes required in the subsidy and support policies of the government as and when the GST regime replaces the current regime of indirect taxes.

Index Terms— Goods & service tax, textile industry, Excise duty

1 Introduction

Goods and Services tax (GST) is one hundred and first amendment of the constitution of India. Taxation of textile sector is not transparent in its various segments. Many textile outputs are either exempt under the central and state tax regimes or are subjected to relatively low tax rates. Most of the indirect taxes fall on inputs, both goods and services, and therefore remain hidden. On the whole, the textile sector is lightly taxed and extensively subsidized. Textile exports are supported through payments of un-rebated taxes on textile inputs and other subsidies. So the current impact of GST on textile industry is negative, considering the fact that it is the second largest textile industry in the world after China. Apart from providing one of the basic necessities of life i.e. cloth. The textile industry contributes about 14% to the country's industrial output. After agriculture this industry provides employment to maximum number of people in India employing 35 million people. Besides, another 46 million people are engaged in allied activities.

Textile Industry contributes around 4% of GDP, 9% of excise collections, 18% of employment in industrial sector, and has 16 % share in the country's export. India is the largest exporter of yarn in the international market and has a share of 25% in world cotton yarn export market. India contributes for 12% of the world's production of textile fibers and yarn.

Classification of Indian Textile Industry

The textile industry can be broadly classified into two categories, the organized mill sector and the unorganized decentralized sector. The organized sector of the textile industry represents the mills. It could be a spinning mill or a composite mill. Composite mill is one where the spinning, weaving and processing facilities are carried out under one roof. The decentralized sector is engaged mainly in the weaving activity, which makes it heavily dependent on the organized sector for their yarn requirements. This decentralized sector is comprised of the three major segments that is power loom, handloom and hosiery. In addition to the above, there are readymade garments, khadi as well as carpet manufacturing units in the decentralized sector. Thus textile industry classification is as follows:-

1. Organized sector

A) Spinning mills or composite mills

2. Unorganized decentralized sector

A) Power loom segment

B) Handloom segment

c) Hosiery segment

D) Khadi& Carpet manufacturing segment

Organized mills

The organized mill sector contributes around 10% of the fabric production in the country. Mills which comprise both spinning and weaving are called composite mills.

Power loom

This sector comes under unorganized sector and contributes 55 % of the total cloth production of the country. It is capital intensive and is decentralized. Indian power loom fabric is competing successfully in global market. The Power loom sector has been contributing about 55% to total production of entire textile industry over last decade, at approximately 16,000 sq. meters per year.

Handloom sector

This sector is the largest economic activity after agriculture and provides direct and indirect employment to more than 45 lakh weavers. It contributes nearly 23 % of total cloth production. Indian handloom is a part of heritage. India's genius is known to the world through its handspun cloth.

Silk, Jute, Cotton and Khadi are the major areas in Handloom sector.

Garments& Hosiery

Indian apparel industry has a great potential and is a major foreign exchange earner. Indian apparels are high in fashion and hence are in great demand abroad. There are around 30,000 manufacturing units in the country, but these are small and fragmented. They employ around 3 million people and earn Rs. 18,000 crores by exports.

Literature review

In the year 2000, for the first time the idea of initiating the GST was made by the then BJP Government under the leadership of AtalBehari Vajpayee. An empowered committee was also formed for that, headed by AsimDasgupta (the then Finance Minister of the West Bengal Government). The committee was formed to design the model of the GST and at the same time inspect the preparation of the IT department for its rollout. In 2011, the previous United Progressive Alliance (UPA) Government also introduced a Constitution Amendment Bill to facilitate the introduction of the GST in the LokSabha but it was rejected by many States. Now in year 2016 this bill got green signal under the umbrella of Modi government.

The GST is basically an indirect tax that brings most of the taxes imposed on most goods and services, on manufacture, sale and consumption of goods and services, under a single domain at the national level. In the present system, taxes are levied separately on goods and services. The GST is a consolidated tax based on a uniform rate of tax fixed for both goods and services and it is payable at the final point of consumption. At each stage of sale or purchase in the supply chain, this tax is collected on value-added goods and services, through a tax credit mechanism.

The model of GST and the rate

A dual GST system is planned to be implemented in India as proposed by the Empowered Committee under which the GST will be divided into two parts:

Central Goods and Services Tax (CGST)

State Goods and Services Tax (SGST)

The Goods and Services Tax (GST) is said to replace all indirect taxes levied on goods and services by the Government, both Central and States. The GST will consolidate all State economies. It will be one of the biggest taxation reforms to take place in India. The GST will make a significant breakthrough paving way for an all-inclusive indirect tax reform in the country.

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Research Methodology

The study contains exploratory research design and Data collection is done by secondary sources including newspaper, journals and various government websites.

Findings& Discussion

Major changes in tax rates specific to textile inputs/outputs:

1. Excise duty on fabrics made from cotton alone increased from 5% to 6%
2. Excise duty on synthetic textile inputs such as polyester and viscose also increased to 12%
3. Abatement applicable to branded ready-made garments increased from 55% to 70% of the Retail Sale Price.

The overall impact of GST on the textile industry and consumers will depend on how the available policy options are exercised in implementing GST in relation to textiles. There is three segments that would be in a relatively disadvantageous position are:

1. Khadi and Handlooms
2. Cotton textiles
3. Carpet weaving.

The main policy options, which may be considered for specific segments or all segments of textiles, are as follows:

A) Zero rating-Zero rating involves an effective mechanism for refunds and even advanced tax jurisdictions find it difficult to implement it. It should be recognized that zero rating will not cover producers below threshold levels. On the other hand, it may lead to rush for registration with the central and state governments to claim the refunds. It may also open up an avenue for claims that may be fraudulent.

B) Exemption-Exemption The second option is exemption for selected segments. Exemption does not mean no incidence of tax since it results in blocked input taxes. It may result in higher tax incidence due to blocked input taxes and tax cascading. The tax impact of exemption becomes dependent on the nature of supply chain. For example, vertical integration may reduce the magnitude of block input taxes. This option is also not recommended as it distorts resource allocation choices. It shifts tax burden from consumption to production. Exemption to fabrics leads to pressure from industry for exemption from production inputs as well. This leads to complexities in the administration of tax. In general, selective exemptions detract from the supply chain neutrality as well as fiber neutrality in the textile sector. Under the GST scheme, area-based exemptions will be discontinued.

C) Lower rate of tax -Lower rate of tax The next option is to subject the textile segments to the lower rate of tax, which may be possible in a dual rate regime. This is an advisable option if the government chooses to have a lower GST rate along with a standard rate. It is also suggest that all textile fabric categories (e.g., khadi, cotton, synthetic, and ready-made garments) should be in the same category to avoid classification disputes and maintain fibre neutrality. However, the scope of lower tax rate needs to be determined. There will be issues if inputs are taxable at higher rate and outputs are taxable at the lower rate. It gives rise to issues relating to refunds and requires monitoring of refunds.

D) Standard rate of tax with appropriate subsidies-Standard rate of tax with appropriate subsidies another option is to apply the standard rate of tax with appropriate subsidies. If the country goes for a single rate regime, this option may be recommended in preference to zero-rating and exemption even if there is a net positive effect on prices. However, the price effect of GST will depend on the actual level of the standard GST rate. A GST regime with a standard rate results in a clean tax system. It achieves production efficiency, which is the key concern as opposed to the regressively of the tax system. It can be accompanied by an appropriate subsidy regime to support weakest segments of the textile industry. In the case of textiles, additional resources will be released to finance such subsidies as many of the existing support schemes will not be required once zero-rating of exports becomes integral to the tax system as under GST.

Policy Options for Specific Textile Segments

Khadi and Handlooms -The handloom industry plays an important role in the country's economy, being one of the largest economic activities and providing direct employment to over 65 lakh people engaged in weaving and allied activities. The sector is a substantial contributor to the overall fabric production in India. The fabric production from handloom sector was 6.9 billion square meters in the year 2011-12, forming 11% of the country's total fabric production. Majority of this production is consumed in the domestic market and a minor percentage of overall production gets exported. Handloom products have always faced competition from power loom sector, where the cost of production is much lower. Slowly handloom industry has moved towards production of more value added products, where the price of the product is judged more by its aesthetic and heritage value. Silk Saree from Varanasi, scarf from Barabanki, home furnishing from Bijnore, shawls from Kullu, ikat sari from Sonepur and Bargarh, cotton saree from Chanderi are few such examples of value added handloom products.

Handloom products are value added products and do not perceive any considerable market shrinkage of handloom product. Zero rating can be one option to avoid increase of tax burden on handloom products. Zero rating is possible only if all input taxes are refunded. But it will be quite difficult to manage its administrative process. The zero rating policy option has been tried earlier by different jurisdictions, who have found it difficult to administer and monitor input tax refunds. The other option is to subject it to the standard GST rate while facilitating the handloom weaving process through different interventions, which will help in decreasing the cost of production or increasing the value of product.

Suggestions

Some of the possible suggestions are mentioned below:-

1. Raw material bank: Yarn constitutes more than 60% of the overall cost of handloom products. Typically major yarn spinners are not located within or near the handloom clusters and they do not sell yarn directly to the weaver/master weaver/cooperatives. There are a number of agents involved in the process of delivering the yarn from mill to weaver, which increases the price of yarn and sometimes creates artificial shortage of raw material availability, which in turn increases the price of yarn. Development of raw material (yarn) bank at a cluster level will not only ensure continuous supply of raw material but will also help in reducing the price of yarn.

2. Supply of handloom parts at subsidized rate: Many times handloom weavers can't change the defective handloom parts due to its high price. This reduces the efficiency level of the handloom weavers and also deteriorates the quality of the products. Supply of handloom parts at subsidized rate will help handloom weavers to improve their efficiency, which will help in reduction of cost of production. Also, an improvement in quality will enable the handloom weavers to charge a premium for their product.

3. Improved Dyeing facility: Color fastness is the most common quality problem with handloom products. Many consumers hesitate to purchase handloom products due to this problem. Usage of age old dyeing facility is the reason behind such quality problem. Installation of better dyeing technology at cluster level will help in solving this quality issue, which will help in increasing the demand of handloom products and its price as well.

4. Product & design development: Supporting handloom weavers in product and design development will help them in reducing the cost of manufacturing and developing higher value added products, which can be sold with higher premium. This facility can be provided to handloom weavers through training or opening facility Centre at the cluster level. It is important to mention here that Ministry of Textiles is implementing many such interventions through different schemes. The scale and cover-

age of those interventions might be expanded to improve its effect on overall handloom industry.

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