NITMA

Note on Goods and Service Tax (GST)

The Ministry of Textiles had commissioned a study on GST to M/s Ernst & Young and Wazir Advisors. The same was circulated to members for views and comments. Based on the discussions with industry, Federation of Indian Chambers of Commerce & Industry (FICCI) has prepared a draft Paper on GST for Textiles Industry which was circulated to all members on 12th May 2014 and the same is attached for information of members .

It is submitted for information of Executive Committee that this point was discussed in the CITI Committee also held on 30th April, 2014 and the minutes of the meeting was received by NITMA on 15th May, 2014. It was decided that CITI would support the introduction of GST for the textile industry provided the whole industry is covered without any exemption and the lowest rate of GST is applied to the Sector. It was also decided to recommend to the Government that an option of paying 50% of the applicable duty without claiming any credit for duty paid in the previous stages should also be provided. It was also decided that CITI should prepare a note on implementation of GST and circulate to the Committee for obtaining views of the Industry and submit the same to Government after incorporation of the suggestions received from industry.

The Committee may like to take note and discuss.

FICCI'S DRAFT REPORT ON GST FOR INDIAN TEXTILES INDUSTRY

Indian Textiles Sector- Deserves Special Treatment under the GST

Indian Textiles Industry

- The size of India's textile and apparel industry is estimated at $94 billion in 2012. Out of this domestic industry is of $63 billion and exports worth $31 billion. India has an overwhelming presence in textiles from fibre to garments stage and the sector's importance in the economy can be seen from its contribution in GDP, industrial production, export earnings and employment. The sector contributes about 14% to country's industrial production, 4% to the GDP, 11% to country's export earnings and employs 45 million people in various activities.

- The sector is heterogeneous, very fragmented and in general has low technology base. The industry provides a basic necessity to the masses with large scale employment potential. In addition, a large part of the production is carried out in the unorganised and SME sector. Majority of weaving, knitting, processing and garmenting sector is in the unorganized sector. Following is the structure of Indian textiles industry:

    - Spinning sector is relatively in the organized sector.
    - Mill sector is in the organized sector engaged in spinning and weaving
    - Unorganized sector is divided into:
    - ✓ Power loom (Weaving)
    - ✓ Handlooms (Weaving)
    - ✓ Hosiery (Knitting/Garmenting)

- In some segments unorganised sector accounts for 80% of the production in that sector. Besides, there are segments of hand weavers, processors etc and these small players remain most vulnerable to the uncertainties of trade and economic environment.

- Powerlooms and hosiery segments together contribute 83.35% of the total cloth production.

Table: Composition of cloth production Segment

	Contribution to total Cloth Production (%)
Mill	**3.83**
Handlooms	**11.42**
Powerloom	**61.94**
Hosiery	**21.41**
Others (Khadi, Wool & Silk)	**1.40**

- The garment sector is decentralized, with substantial part of production being sub-contracted to small fabricators and contract manufacturers. It is estimated that there are over 75,000 garment units in India, but most of them are small in size and undertake work as contract manufacturers for large exporting firms.

- Some of the other challenges facing the industry which makes it vulnerable are given below:

  - ✓ Highly fragmented weaving, processing and garmenting segments.
  - ✓ Cloth production dominated by decentralised powerloom sector which uses obsolete technology.
  - ✓ Low productivity of the handloom sector which employs 43.32 lakh handloom weavers on 27.83 lakh handloom household units contributing only about 11% of total cloth production.
  - ✓ Very low technology in weaving.
  - ✓ Inflexibility in labour laws because of which manufacturing units are not able to execute large seasonal orders.

- A large amount of the textile sector is not under the tax net currently as many sector specific exemptions are being given due to employment and other perspectives.

- In the above context, FICCI is suggesting special treatment to be meted out to this sector under the GST.

NITMA

General Suggestions with regard to GST

- **Pan India GST for Textiles is important**: There may be the case that the Centre and the States proceed with implementing the GST irrespective of the fact that some States may opt not to come on board at the time of its introduction. Further, it is understood that States may also be given the option to opt out of the GST at a point of time subsequent to their introducing the GST. This would not be in the interest of textiles sector where most of the raw materials and intermediates move from one State to another State where production takes place. If any State is not part of this regime, even if initially, it will be an inefficient option for industry like textiles. So as a pre-condition, all States need to be part of the GST regime.

- **Uniform Rate for Goods & Services:** FICCI has sought uniform rate of GST on both goods and services. This is important because in certain sectors there are interpretative disputes on what are 'goods' and 'services'. For instance, in case of textiles, there could be dispute over activities like dyeing whether it is to be considered as manufacturing or service activity.

- **Merit Rate for Textiles**: As we understand, three rates are being proposed under the GST namely Merit Rate, Standard rate and the nil rate of duty. Given the nature of the sector as explained above and vulnerability of the large number of segments in textiles, FICCI suggests that the sector should be kept in the lowest/merit rate of GST. Currently, parts of the industry are VAT exempt and a large part of the industry is kept out of excise duty. Any sudden increase in rates would destabilize the complete industry as has been the case in the past.

- **No Break in Value Chain**: There should not be any break in the textiles value chain in the industry and any relief should be provided in terms of refund without denying any credit on input tax to the next level. Any break in the value chain, would defeat the whole purpose of GST.

- **Subsume All Indirect Taxes:** There is no clear indication that all the existing indirect taxes will be subsumed in the Central GST and State GST. Certain taxes, apart from the one already expected to be subsumed, that industry feels should be subsumed under GST with a clarity that credit of the same will be allowed are as follows:

    - Stamp Duty
    - Professional tax
    - Octroi
    - Water Cess & Other Cesses
    - SAD
    - NCCD
    - Service tax on Royalty
    - Electricity Duty

- **Threshold for Exemption:** A large segment of textile trade and industry comprising of micro, small and medium scale enterprises will require time to transition to the GST. Suitable threshold limits and composition schemes should be incorporated in the statutes to provide relief to the MSME sector. FICCI recommends that a uniform threshold limit (both for services and manufacturing) be set and further that this limit for registration under both the CGST and the SGST be set at a gross turnover of approximately Rs. 50 lakhs p.a. Thereafter, a composition Scheme could be introduced for annual gross turnover between Rs. 50 lakhs and Rs. 1 crore.

- **Grandfathering Exemptions:** Exemptions from indirect taxes like Central Excise and VAT have been extended to various segments of textiles industry under various schemes of the Central and the State Governments. These schemes serve the twin objectives of development of industrially backward areas as well as encouragement to industries that are considered to be critical for the economic development of the country. Such schemes have been very common in textiles. States like Tamil Nadu, Karnataka, Andhra Pradesh, Rajasthan and Punjab have given exemptions under their textiles policy from VAT/CST/SGST. Similarly, stamp duty exemptions have been provided under the textiles policy by States like Tamil Nadu, Maharashtra, Karnataka, Andhra Pradesh and Rajasthan. This is in addition to many other incentives under textiles policy and schemes of the Centre. Based on the nature of exemptions and the time period for which such exemptions have been granted, industry has made significant investments across the country. Accordingly, it is for consideration whether these exemption schemes should be grandfathered to continue up to their legislated lives. This could be done by granting exemption from the GST, where the current exemption is for both Central Excise and VAT, or by granting exemption from the CGST, in cases where the existing exemption is from Central Excise, and exemption from the SGST, if the existing exemption is from VAT.

- **Cash Refund instead of Exemptions:** More importantly, in order to ensure that there is no break in the GST chain, conversion of the exemption schemes to cash refund schemes must be carried out so as to ensure that the grandfathering of these benefits do not impact the GST value added chain. FICCI, therefore, recommends that all existing exemption schemes provided to textiles sector be converted into cash refund schemes for the remaining duration of their validity or for the remaining portion of the underlying investment value.

- **Uniform Exemptions under Central and State GST**- It is necessary to bring uniformity in the list of goods which are exempted and in the list of merit goods under both Central Excise and State VAT in order to ensure smooth transition. These lists need to be aligned across all States before the introduction of the GST, so that the rate changes are uniform at the time of transition. FICCI strongly recommends therefore that these lists be standardized across the CGST and the SGST prior to their coming into force.

- **Unrestricted Input Tax Credits:** Tax on all legitimate business expenses (both on products & Services), should be considered for credit under the GST. Full neutralization of input taxes must be guaranteed in order to remove tax cascading. The efficiency of neutralization would, to a large extent, ensure the success of this fiscal policy imperative. Accordingly, the common list of exempt goods and services should be kept to a minimum and wherever required or desirable, goods and services should be "zero" rated. This will ensure that the tax chain is not broken and that all input taxes are recouped. Consequently, input tax credit of GST on goods and services must be allowed to all tax-payers without any restrictions like nexus of inputs to output or disallowances on account of stock-transfers.

- **Compensate for the Additional Support Under Drawback:** Industry is apprehensive that currently, under the drawback whatever little support is available to the industry besides the credit of duty on inputs, will no longer be available which will impact the export competitiveness. In such a scenario, Government needs to come out with more export promotion schemes to compensate for the loss of support under the GST for exports. In current tax structure, exporter gets 8% duty drawback against the tax burden of approx. 2% i.e. exporter gets incentive of 6%, which will affect the exports adversely.

- **Uniformity in Applicability of GST Administration**: For GST to be successful, uniformity of tax base across India needs to be emphasized. Freedom to each State to legislate, levy and administer State GST, gives rise to the possibility of each State adopting different standard, as far as taxes to be subsumed in State GST. Even today many States have levied Entry Tax despite clear understanding that State VAT would subsume it. Once the GST framework is agreed upon, no State should be allowed to deviate from it.

- **Treatment of Fuels under the GST:** Fuels (Lignite/Pet Coke/Furnace Oil/Coal etc) are important without which the manufacturing process cannot be completed. Currently, the treatment of input tax credit on fuel is different in different States. The Credit on fuel is being allowed under CENVAT. Its credit under SGST needs to be provided.

Suggestions Related to Specific Segments of Textiles Industry

- **Actual Incidence and the Merit Rate:** As many segments of textiles especially the cotton based, enjoys exemption at various levels the proposed GST rate should not be higher than the merit rate. Even this rate as we understand from the E&Y AND Wazir's draft report would be much higher than the actual incidence of tax on the sector currently. In order to enable proper integration and transition from VAT/Excise regime to GST, the sector needs to be subject to merit rate and not any other rate. Also, while fixing the merit rate the actual incidence of tax on textiles sector which is currently on an average 9.3% should be kept in mind. Otherwise the large unorganised segment in fabric and garments would be further incentivized to expand more in the parallel sector which would act as a big deterrent for the country to capture significant share of global market.

- **Zero Taxed Exports:** As taxes on fuel, diesel, electricity, Octroi etc will not be adjustable, therefore apart from GST refund, provision for such items that are not included needs to be made via duty drawback or other subsidies for exports. However, if the current export incentive schemes are getting challenged under the WTO then it would be advisable to have subsidy for the whole industry and not just for exports.

- **Introduce Alternate Subsidy Schemes before GST:** As a pre-condition, and in lieu of the above concern, Government needs to put in place alternate subsidy schemes before bringing in GST.

- **Subsidy for Weak Links in Value Chain:** Segments like handloom, powerloom, hosiery, processing which are primarily unorganized and are the weak links of the textile value chain, should be given exemptions or subsidies to ensure they are not unduly burdened by the introduction of GST.

- **Remove Differentiation between Cotton and Man-Made Textiles:** Currently, cotton and man-made based textiles have different incidence of tax. This disparity should be removed under the GST. This should also be taken into account while calculating current incidence of taxes on both the segments. In case averaging is done for any segment, instead of simple average modal/median principle of averaging should be done so that majority of the industry is not hit.

- **Nomenclature for Man-Made Textiles:** The draft report needs to replace 'synthetic' with 'man-made' as man-made include viscose also.

- **Treatment of Synthetic Fibres:** As synthetic fibers are considered petrochemical products, it needs to be emphasized that these products should not be differentiated under GST. If it is considered as petrochemical product, then the credit of input tax need to be made available under GST.

- **Hosiery sector:** From the current scheme of thought on GST design, it seems that impact on hosiery sector is going to be significant. In the hosiery industry, 70% of the raw material used consists of cotton, which has zero tax in the current tax structure. Hence, the net tax levy on the hosiery industry is not more than 7%; so the current tax incidence should be kept in mid while fixing the merit rate under GST. And since majority of the industry is unorganized, it will further dis-incentivise the players to come in the organized sector if the incidence is going to be higher. So for such common man products and necessities, there has to be the lowest rate of tax.

- **Clarification on Work Contracts:** Under GST, clarity is required for taxation, valuation, jurisdiction of works contracts and labor contracts. At times, industry engages contractor/ job workers to perform certain part of its manufacturing process. It provides semi-finished products to the contractors to carry out a part of the manufacturing process without involvement of any material by the contractor, excepting the consumables.

The activity undertaken by the job worker does not attract any WCT (Work Contract Tax) at present (as no material is involved) and also since the activity of the job worker amounts to manufacture within the Central Excise Act, it is not covered within the scope of the taxable service. The treatment of this particular activity under the GST needs to be clarified as per the current norm.

Suggestions related to Administrative and Procedural Issues

- **Refund on Exports:** Further GST refund on exports, needs to be as smooth as drawback. Currently, drawback comes directly to bank account, whereas in case of Excise/VAT the procedure is long drawn and cumbersome. There should be an interest clause for any delay in refunds.

- **Automatic Refund Mechanism:** Obtaining refunds in the existing VAT regime is a long drawn process and assessees have to follow cumbersome procedures and frequently engage in litigation with the Commercial Tax Department/Central Government Tax administration. In order to avoid such cash lock up under GST, an automatic refund system should be put in place for input taxes related to all "zero" rated goods and services. Further, it is recommended that all unutilized input tax credits at the end of the fiscal year should be either refunded in cash or be allowed to be carried forward to the next financial year, at the option of the assessee. This is in line with global best practices.

- **Clarity with regard to Stock transfer, discounts etc:** Unambiguous provisions should be laid down in GST with respect to the following:

    - So that Stock transfer, branch transfer & depot transfers are not charged to tax (Sales Tax) on removal from factory.
    - Tax treatment to be clearly defined in case of opening stock lying at Depot and C&F agents on which excise duty has already been paid but VAT is not paid
    - Treatment of discounts, sales commission, incentives which are not given through the invoices but passed on subsequently through Credit Notes.

- **Single Assessment Agency:** Since the tax base for CGST & SGST is uniform, to avoid duplication of Assessment, the Assessment of both CGST and SGST should be done by one agency only. Multiple assessments may lead to frequent re-opening of the cases based on different interpretation under two different GSTs. Hence, assessment by single agency needs to be there.

- **Single Point for Registration:** Single point GST registration system is required. The company should be able to make the net payment of CGST and SGST after adjusting the total CGST and SGST input credit available against total CGST and SGST output liability at consolidated level. In effect, the facility of gross liabilities, set off, eliminations etc should be made available to be updated on the web portal.

Cross utilization of tax credit between the Central GST and State GST should be allowed. Inter-state settlements, if any, can be facilitated by CGST Authorities. The excess credit should be made available for refund on quarterly basis.

- **Consolidation of Returns:** There should be a facility to file consolidated monthly returns for the company having operations in more than one State by giving State wise details in the return rather than having State wise filing. Currently, for the assesses having multi-location units in different States, it is not possible to use the excess credit of one unit against the duty or VAT liability of the manufacturing units in the other States. The credit of VAT, Service Tax and Excise shall be fungible across the manufacturing units of the same assesses.

- **Single Window for Compliances**: There should be a single window system for regulatory compliance and Assessment for both CGST and SGST.

- **Distribution of Service Tax Credit by Head Office:** Currently, in the event of Head Office availing services, it distributes the Service Tax credits to different units located at different places in its capacity as a service distributor. Since Service tax is currently a Central tax, there is no dispute in such distribution. With the services being assigned to States for SGST, the distribution of Service Tax credit by Head Office to Units in different States may pose problem.

- Currently, the credit of excise duty & VAT is on the basis of receipt of goods whereas that of Service Tax is on payment to the service provider. Basis of availment of credit relating to Inputs and services should be based on the recognition of expenses.

REFERENCES:

- *FICCI Paper on "Towards the GST: An Approach Paper"- April 2013*

- *Strategic Plan 2012-17, Ministry of Textiles, February 2014*

- *E&Y and Wazir Advisor's Draft Report on Implication of the GST on Indian Textiles Sector*