Impact of GST on Textile Industry

-By CA Madhukar.N.Hiregange & CA Mahadev.R

The Indian textiles and apparel industry contributes nearly 10% to manufacturing production, 2% to India's Gross Domestic Product (GDP) and constitutes 13% of country's export earnings. The industry, currently estimated at around $ 108 billion, is expected to reach $ 223 billion by 2021. Textile industry has been enjoying various tax exemptions, concessions under indirect taxes. Introduction of GST replacing the present indirect taxes could have considerable impact on textile industry. In this article, an effort has been made to shed some light on GST impact.

PRESENT INDIRECT TAXES APPLICABLE

Central Excise duty

Central excise duty was first introduced on woven garments in year 2001 which was subsequently extended to entire textile industry by 2003. The excise duty exemption option was also provided vide notification no.30/2004 with condition of non-availment of Cenvat credit. There was also an option to pay concessional rate of excise duty with Cenvat credit benefit. However, almost all assesses opted for exemption. In 2011, mandatory excise duty was reintroduced on branded garments with Cenvat credit benefit and abatement of 55% for duty payment. This mandatory levy was again removed in 2013 and optional scheme of paying duty with Cenvat credit benefit was continued.

In 2016, mandatory excise duty has been introduced again on branded readymade garments made up of textiles falling under central excise tariff heading 61, 62 and 63. The levy is attracted only when retail sale rice (RSP) is Rs.1000/- or more and levy is only on 60% value after standard abatement of 40%. For payment of duty, rate of 2% without Cenvat credit or 12.5% with Cenvat credit option is applicable. Non-branded goods continue with “Nil” levy without Cenvat credit benefit. Otherwise, option of paying 6% with Cenvat credit in case of garments / articles of cotton, not containing any other textile material is available. For garments of other composition, “Nil” rate without Cenvat credit or 12.5% with Cenvat credit is available.

Contract Manufacturing/ Job Work

In garment industry many times, brand name owners outsource the goods manufactured completely or on job work basis. There are special provisions that the central excise duty levy which in normal course should be with the job worker gets shifted to brand name owner.

Such brand name owner instead of job-worker needs to register and comply with excise provisions. Brand name owner alternatively could authorize his job-worker to obtain registration and pay the duty on goods.

VAT / Sales tax

Most of the states in India have exempted textiles and fabrics from levy of VAT / Sales tax. Garments including textiles are being subject to lower rate of VAT / Sales tax in many states. For example, in Karnataka state, readymade garments and other articles suffer lower rate of 5.5% tax. Textiles are exempted from VAT. For small players, the option of paying taxes at concessional rates is also provided under composition scheme in many states.

Entry tax

In case of many states, entry tax is levied on specified goods when goods enter local area. Even textiles such as cotton, woolen or silk or artificial silks are liable to entry tax in states like Karnataka at the rate of 1% which is adding to purchase cost.

GST RATE AND ITS IMPACT

Impact of GST on textile industry could be determined only after final rates are declared for the goods. Presently, most of the garment manufacturers opt for either complete excise duty exemption or payment at 2% duty without Cenvat credit benefit as most of the raw materials do not suffer excise duty, especially in case of cotton based sector. On branded garments, the effective excise duty rate would be 1.2% (if opted for 2% payment with abatement of 40%) or 7.5% (if opted for 12.5% payment with abatement of 40%). The sales tax would also be paid at lower rates or at concessional rates under composition schemes as applicable in different states. Exports have continued to be free from taxes all these years.

In GST regime, most of the indirect taxes such as central excise duty, service tax, VAT / Sales tax and entry tax would get subsumed. For textile and its products, the GST rate of 12% is expected. If it is so, then it could have a negative impact as the industry is as such price sensitive. Paying 12% GST would be costlier for assesses who presently paying 1.2 % excise duty + 5% to 6% of VAT which amounts to 6 to 7.2% tax. Even input tax credit on inputs and input services may not be sufficient to fill the gap as natural raw materials such as cotton may continue to get exemption in GST regime. It may be noted that other materials such as chemicals, dyes, accessories and packing materials which constitutes around 8% to 12% of total material cost could be liable for standard GST of 18% which is eligible as input tax credit when output GST is paid.

However, in case of manmade fibre segment, most assesses have been paying excise duty at regular rates along with VAT. Inputs such as polyster fibre, nylon and other petrochemicals suffer excise duty which can be claimed as Cenvat credit. This segment may get level playing field as GST rate of 12% could have positive impact on them who are already paying more than 12% tax. For this sector, seamless credit could also result in lower price of goods which could boost demand for non-cotton garments benefitting consumers by way of price reduction. It is expected that there can be a gradual shift in the domestic textile industry towards manmade fibre under GST regime due to tax advantage.

OPTION OF TAX PAYMENT JOB WORK IN GST

Even in GST regime, the principal would get the option of sending inputs or capital goods for job work (Section 55 of Model GST law). Raw materials sent to be received back within 1 year and capital goods to be received back within 3 years. If the goods are not received within this time limit, then supply of goods would be treated as supply for levy of GST. The processed goods could also be sent directly to customers of principal, provided job workers are registered or the details of job workers place are added as additional place of business in principal's registration certificate.

The principal manufacturers who have authorised the job workers to pay excise duty may be required to pay GST directly instead of authorising the job workers. However, when the goods are procured and supplied by job workers after processing, then the same would be treated as supply for levy of GST by job workers. Wherever the principal manufacturers are sending goods to job work units who are not required to be registered under GST regime, such units are to be added as additional place of business in principal's registration certificate.

It may be noted that the job work processing on goods sent by the principal would be treated as service for GST purpose. Job workers could choose GST exemption if the value of such services is not exceeding Rs.20 lakh per annum. However, such option may not be feasible as it would break the input tax credit chain. GST payment option could be a better choice as GST would provide seamless credit on goods and services. This would be beneficial even for the principal manufacturers. Therefore, the educating the job workers would be important.

There are a few transitional provisions which are applicable for the incomplete transactions and also requirement of declarations to ensure credit on the closing stock.

IMPACT ON EXPORT BENEFITS

Textile exports from India for FY 2015-16 stood at around US dollor 40 billion and Indian textile industry gets good amount of duty drawback on export of garments. Duty drawback rate varies from 7 % to 10% on FOB value of exports with cap limit varying from Rs.15 to Rs.620 when Cenvat credit benefits are not claimed. In GST regime, duty drawback may lose relevance as there would be seamless credit at each stage of value addition and better transparency. Even if duty drawback is continued to offset the impact of basic customs duty component, which is non-creditable tax, the drawback rate could be very less. This could impact largely, those assesses who are dependent on duty drawbacks for achieving good margin / profit.

Exports would be zero rated supplies under GST with benefit of credits on goods and services procured. The accumulated credits could be claimed as refund within 2 years from specified date. Due to better transparency, refunds could be faster in GST regime. Based on model GST law as updated in November 2016, 90% of the refund would be provisionally processed after filing of refund application subject to certain conditions. If this is really executed by the Government, then it could solve the cash flow problem for the industry.

CREDIT ON CAPITAL GOODS

The assesses who have plans for large investments in capital goods could plan for the same in GST regime which would enable them to take credit of taxes paid on capital goods procurement for utilisation against payment of output GST. Assesses who are engaged in export of goods could opt for Export Promotion Capital Goods (EPCG) scheme to procure the goods without payment of any duties. It is expected that the EPCG scheme wherein 6 times of duty saved amount to be exported within 6 years would continue in GST regime as this is provided under the Foreign Trade Policy under Ministry of Commerce.

PROCUREMENT PLANNING

Exemptions would be phased out in GST regime and there may not be any product specific or area specific advantage for textile industry which could create competitive environment. There is a need to plan for the procurement of inputs at better prices considering various factors such as quality, location of supplier, type of taxes charge etc. Taxes paid on interstate purchases would be eligible for credit in GST regime. Presently, CST paid on interstate purchases is not being allowed as credit for setoff against output VAT / sales tax.

The procurements from unorganised sectors or from suppliers who opts for composition scheme under GST could increase the cost of materials as such suppliers would not be eligible for any input tax credit. Therefore, the source of procurement would also play a vital role in GST regime.

IMPACT ON CASHFLOW

GST levy on supply

Unlike present indirect taxes, GST would be levied on supply of goods or services. Stock transfers between the different units of an entity would be subject to GST. However, transfers between units within same state may not be liable unless different GST registrations are obtained. This would have initial impact on cashflow. The goods receiving unit would be eligible for input tax credit of GST charged by goods sending unit. The level of stock to be maintained at warehouses, godowns, depots etc. to be decided considering this cash flow impact.

Return filing

All compliances including documentations would be automated in GST regime. Input credit eligibility would be subject to tax payment and return filing by supplier of inputs or services. Credits and liabilities would be matched online on monthly basis based on the various returns to be filed. As provided in GST return related reports released, there are 3 monthly regular returns to be filed in addition to one annual return followed by audit report. For distributing the credit of GST paid on common input services relating to units in multiple states, there is a separate return prescribed (ISD return). Increase in number of returns could increase compliance cost in form of addition time and staff recruitment.

GST implementation cost

Shift to GST regime from present indirect tax regime would have huge impact on the business. There is a need to analyse the impact on the entire business including main functions which would be helpful in preparedness for GST. ERP systems would need customisation for compliance under GST. Key personnel including the key vendors should be trained to understand the concept, impact and compliance requirement under GST. Textile industry needs to be ready for all this expenditure.

Conclusion

The impact of GST on textile industry would be substantial involving lot of transitional issues and industry needs to gear up for implementation of GST after understanding the impact. 1st June or 1st July 2017 looks to be a realistic date for implementation from recent political developments. Early preparation could provide lot of benefits including better transition planning. Professionals need to highlight the importance and assist the assesse in this regard. While analysing the impact, review of present law compliance could also provide scope for value addition assesses.

Please mail feedback / suggestions on madhukar@hiregange.com or mahadev@hiregange.com.

Appeared in KSCAA newsletter