International Journal of Applied Home Science
Volume 5 (4), April (2018) : 898-905
Received : 01.03.2018; Revised : 08.03.2018; Accepted : 20.03.2018

REVIEW PAPER
ISSN : 2394-1413

GST effect on textile and apparel industry of India- An overview

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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 replaced a number of central and state taxes. Taxation of textile sector is opaque and non-neutral across its various segments. Textile production will become more competitive; better technology, improved productivity, more balanced fibre mix, more innovative products and more competitive exports may overtake any adverse effect of GST, which should also be neutralized through a recasting of the subsidy regime. Efficient formulation of GST will lead to resource and revenue gain for both Centre and States majorly through widening of tax base and improvement in tax compliance.

Key Words : GST, Textile, Apparel industry, Impact

INTRODUCTION

The Goods and Service Tax (‘GST’), considered India’s biggest and most historic tax reform is just around the corner. 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.Goods and Services tax (GST) constitutes the last mile of a long journey of reforms of indirect taxes in India. GST replaced a number of central and state taxes. The important taxes that may be subsumed in GST are 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.

Taxation of textile sector is opaque and non-neutral across 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

Cite this Article: Srivastava, Meenu (2018). GST effect on textile and apparel industry of India- An overview. *Internat. J. Appl. Home Sci.,* **5** (4) : 898-905.

are supported through payments of un-rebated taxes (duty drawback) on textile inputs and other subsidies.

GST :

The One Hundred and Twenty Second Amendment Bill of the Constitution of India, formally referred to as The Constitution (One Hundred and First Amendment) Act, 2016, introduced a national Goods and Services Tax in India from 1 July 2017. The GST law is likely to change the whole scenario of current indirect tax system. It is considered as biggest tax reform since 1947.Here is a brief chronology outlining the major milestones on the proposal for introduction of GST in India:

– In 2000, Vajpayee government started discussion on GST by setting up an expert panel headed by Asim Dasgupta, former West Bengal finance Minister.

– In 2003, the Kelkar Task Force on indirect tax had suggested to have a comprehensive indirect tax reform through GST.

– In 2006, UPA finance minister P Chidambaram proposes GST in his Union budget. The empowered committee of state finance ministers was assigned the responsibility to chalk out a road map for its implementation.

– In 2008, Empowered committee submits a report ‘A model and roadmap for GST in India’.

– Based on inputs from the Centre and states, the empowered committee released its first discussion paper on GST in November, 2009.

– In order to amend the Constitution to enable introduction of GST, the Constitution (115th Amendment) Bill was introduced in the Lok Sabha in March 2011.

As per the prescribed procedure, the Bill was referred to the Standing Committee on Finance of Parliament for examination and report.

– The Parliamentary Standing Committee submitted its report in August, 2013, to the Lok Sabha. Most of the recommendations made by the Empowered Committee and the Parliamentary Standing Committee were accepted and the draft Amendment Bill was suitably revised.

– In June 2014, the draft Constitutional Amendment Bill was sent to the Empowered Committee after approval of the new government.

– In 2015, Jaitley in his budget speech sets GST rollout deadline on April1, 2016. Lok Sabha approves the bill on may,6. The congress demands capping GST rate at 18%. The NDA government fails to get it passed in Rajya Sabha.

– In 2016, center and states agree on constitution amendment bill without a cap on the rates. The bill is approved by the RS on august 2016. The amended bill is passed in the LS on august 8.

– The GST council headed by the Union Finance is formed. The council decided on four-slab rate GST structure of 5%, 12%, 18% and 28%. The ‘sin’ or ‘demerit’ products such as tobacco items, aerated drinks and luxury cars, would come under the highest tax slab and may attract a cess, which would raise the tax burden to 40%.

– In 2017, the date for the implementation of the new tax structure is shifted July 1, 2017, as the center and states took time to finalize the draft bills- CGST, IGST, SGST and U-GST.

Taxes comes under GST :

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 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.

Reviews :

Das and Gupta (2004), remarked that the tax compliance can be improved by implementing simple reforms in personnel policy in Indian income tax and concluded that the GST will lead to higher tax compliance and lower tax evasion by Indians.

Poonam (2017) in her study on "Goods and Services Tax in India: An Introductory Study' concluded that GST would be a really necessary step in the field of indirect taxation. Paper has tried to relinquish information concerning GST system. She additionally quoted that consumer's tax burden can just about scale back to 25% to 30%. Indian manufactured products would become a lot more competitive in the domestic and international markets. This taxation system would instantly encourage economic growth. GST with its transparent mode will prove easier to administer.

Mahender (2017) studied "GST Effect on Manufacturing Industry – India" and concluded that manufacturing industry is playing a significant role in Indian business scenario hence manufacturing sector is economic growth of nation. The author further states that textile and garment industry maybe negatively impacted with the introduction of GST. Media companies (DTH) may also have negative scenario.

NishithaGuptha (2014) in her study stated that implementation of GST in the Indian framework will lead to commercial benefits which were untouched by the VAT system and would essentially lead to economic development.

Lourdunathan and Xavier (2017) in their study concluded that GST will bring One Nation and One Tax market. Efficient formulation of GST will lead to resource and revenue gain for both Centre and States majorly through widening of tax base and improvement in tax compliance.

Benefits of GST :

To business and industry:

– **Easy compliance:** A robust and comprehensive IT system is the foundation of the GST regime in India. Therefore, all tax payer services such as registrations, returns, payments, etc. would be available to the taxpayers online, which would make compliance easy and transparent.

– **Uniformity of tax rates and structures**: GST ensure that indirect tax rates and structures are common across the country, thereby increasing certainty and ease of doing business. In other words, GST would make doing business in the country tax neutral, irrespective of the choice of place of doing business.

– **Removal of cascading**: A system of seamless tax-credits throughout the value-chain, and across boundaries of States, would ensure that there is minimal cascading of taxes. This would reduce hidden costs of doing business.

– **Improved competitiveness:** Reduction in transaction costs of doing business would eventually lead to an improved competitiveness for the trade and industry.

***To Central and State Governments**:*

– **Simple and easy to administer:** Multiple indirect taxes at the Central and State levels are being replaced by GST. Backed with a robust end-to-end IT system, GST would be simpler and easier to administer than all other indirect taxes of the Centre and State levied so far.

– **Better controls on leakage:** GST result in better tax compliance due to a robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an inbuilt mechanism in the design of GST that would incentivize tax compliance by traders.

– **Higher revenue efficiency:** GST is expected to decrease the cost of collection of tax revenues of the Government, and will therefore, lead to higher revenue efficiency.

To consumers :

– **Single and transparent tax proportionate to the value of goods and services:** Due to multiple indirect taxes being levied by the Centre and State, with incomplete or no input tax credits available at progressive stages of value addition, the cost of most goods and services in the country today are laden with many hidden taxes. Under GST, there would be only one tax from the manufacturer to the consumer, leading to transparency of taxes paid to the final consumer.

– **Relief in overall tax burden:** Because of efficiency gains and prevention of leakages, the overall tax burden on most commodities will come down, which will benefit consumers.

GST on Textile Industry :

There are 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 operate.

An important determinant of the tax incidence under GST will be the GST rate applicable to the textile segments. The cotton value chain is likely to be the worst 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 in spite of credit not being available for all tax/ duties paid in the past.

- Further the apparel retailers do 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 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.

- **Promote capital investment:** With textile sector coming under GST, textile players which are oriented towards domestic markets are able to set-off the GST paid on domestic capital goods (but not the import duty) as their sales is subject to GST. Accordingly, this 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 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 is to improve compliance. The value chain under the GST is fully traceable. As a result, ITC claims have to be backed by full information chain of purchases and sales. Improved compliance are automatically lead to higher revenues for any given rate as long as that rate is not excessively high.

- **Shift towards organized sector:** A substantial segment of the Indian textile industry operates under the unorganized sector. It creates a gap in the input tax credit system. If the registered taxpayers buy inputs from the unorganized sector, they can not avail input tax credit facility. GST on textile brings a significant change in the input tax credit system and it creates an important balance between organized and unorganized sectors of the industry. In fact, GST helps the entire textile industry in shifting towards an organized sector.

- **Input Tax Credit for Capital Goods:** Presently, Indian textile manufacturers need to pay heavy excise duty while importing capital goods. This excise duty is costly as input tax credit facility is not available under current tax laws. But with GST's launch, the excise duty will have input tax credit facility and it will decrease the total import cost for capital goods.

- **Textile industry will be more competitive:** GST will restructure the input tax credit claiming process. It will make the entire textile industry more aggressive in the export market. In addition to this, input tax credit will be a significant step for promoting the export of textile products. It will also encourage the manufacturers to adopt cutting-edge production system to develop existing products.

- **GST encourage the farmers:** Cotton yarn and fabrics will come under 5% GST tax slab and it will inspire the farmers to grow ample amount of cotton more than before. The farmers will get the accurate price for their hard work. It is expected that GST on textile will create development in the entire value chain.
- **Readymade garments will be costlier:** GST on readymade garments will create a huge difference in the current consumption. The tax slab will be 12% under GST while the present slab is 4-5% VAT and 2% excise. This higher tax slab will definitely increase the price of readymade garments for the consumers.

Specific Effects of GST on Textile :

The main effects of GST on textile producers and consumers can be divided into two parts: (a) the main effect arising from a likely increase in the effective rate of tax under GST as compared to the present domestic indirect taxes and (b) other subsidiary but positive effects. The first effect is being entitled as the rate revenue effect.

– **Fibre-neutrality Effect** Depending on how the GST is structured, it will treat all fibres in the same way whether cotton based or based on man-made fibres. Important substitution effects that will be induced in a fibre-neutral fiscal regime as compared to the present one, which gives relatively favorable treatment to certain segments like Khadi and handloom and cotton textiles. There will thus be adjustments within the textile sector even if the overall textile sector demand does not get affected by the transition to GST rate, as discussed below.

– **Handloom** industry currently produces both low as well as high value added products. The uniform GST rate is likely to be significantly higher than the current effective tax rate of the Handloom industry. Therefore, producers of low value-add handloom products can be expected to upgrade to the power loom sector, resulting in increased productivity, quality and returns on investment. This can be classified as a **process efficiency** effect.

– The **cotton textile** industry presently has a lower effective tax rate as compared to the synthetic textile industry. The uniform GST rate is therefore likely to lead to higher increase in prices of cotton textiles as compared to synthetic textiles. As a result, cotton textile manufacturers can be expected to increase blending of synthetic fibres with cotton fibres. This can be classified as the **fibre-neutrality** effect. This will also lead to a **product diversification effect** where more blends and mixes of types of fibres can be encouraged.

– **Transparency Effect** In the present system, many textiles outputs are exempt and taxes paid on inputs are blocked. These are rebated, especially in the case of exports, through a variety of export promotion schemes and only partially through the tax system. Furthermore, when the inputs are non-textile inputs, the blocked input taxes are not collected from the textile dealers. Instead, these may be shown as paid by dealers of the concerned input, whether goods or services, although the tax will be loaded on the price of the textile product and paid by the textile consumer. In GST all input taxes will be rebated whether meant for exports or domestic use through the tax system. In the GST system, these taxes will be collected from the consumers of the textile products and shown as paid by the textile dealers. This will make the system of taxes as well as subsidies more transparent.

– **Export Zero Rating Effect** Under GST, exports will be fully and automatically zero-rated. This will cover all domestic taxation of inputs used for products that are exported. This will reduce the scope of duty drawback scheme considerably as all input taxes paid in regard to domestic indirect taxes, namely, central excise duties, service tax, state sales tax, inter-state sales tax, and entry tax which would have been merged in GST, will be rebated. Only customs duties paid on imported inputs used for textile exports may not be covered under GST although countervailing duty should be covered. The money that will be released from duty drawback scheme should then be used for supporting the sector.

– **Common Market Effect** With the abolition of the inter-state sales tax (central sales tax) and entry tax, the Indian market will become a genuine all-India market without fiscal barriers. Textile industry, where considerable transmission of both inputs and outputs takes place across states, will be one of the main beneficiaries.

– **Investment Promoting Effect** With taxes paid on purchases of machinery and equipment also being fully rebated, investors will be induced to modernize textile production by induction of modern machinery and equipment. This may be further facilitated by redesigning the Technology Upgradation Funds Scheme (TUFS).

Conclusion :

GST fundamentally change the way the textile sector is presently taxed in India. The main implications of GST compared to the present domestic indirect tax regime in the context of Textiles are as follows:

– CGST and SGST rates are likely to be higher than the corresponding textile sector RNRs; as a result, the central and state government will get higher revenues than at present; and textile prices would go up (Rate-Revenue Augmentation Effect);

– GST is likely to have a fibre-neutral rate structure unless differentiation is introduced by explicit choice (Fibre Neutrality Effect);

– Textile outputs will be taxed if domestically consumed and input taxes paid will be rebated making the tax-regime transparent (Transparency Effect);

– Exports will be zero-rated and all input taxes paid will be rebated by the tax authorities making duty drawback kind of schemes redundant (Export Zero-rating Effect);

– Fiscal barriers to inter-state movement of textile inputs and outputs like the CST and the entry tax will be eliminated (Common Market Effect);

– Taxes on capital and machinery will be fully rebated (Investment Promoting Effect); and

– For the industry, compliance costs will be lower (Compliance Promoting Effect).

Thus, GST will result in transparency; shifting of tax burden on to the final consumer; full rebating of tax paid on inputs and capital used for the production of textiles; and a fibre neutral tax regime. Depending on the GST rates that are finally determined, it may result in a higher tax burden on textiles. But the resultant impact on demand may be small. On the other hand, textile production will become more competitive; better technology, improved productivity, more balanced fibre mix, more innovative products and more competitive exports may overtake any adverse effect of GST, which should also be neutralized through a recasting of the subsidy regime.

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