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GST hike on tobacco products may bring double whammy; tobacco farming gives livelihood to crores of people

Rajat Mohan | Updated: Aug 27, 2020

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With dwindling GST collections due to pandemic induced lockdown and sluggish recovery in demand, GST Council in its 41st meeting is likely to deliberate on various proposals to raise funds for the states facing revenue shortages and claiming compensation as promised at the time of introduction of GST. Several states such as Delhi, Bihar, Punjab, etc. have requested the GST Council to consider mobilizing funds by levying maximum possible cess on sin goods such as cigarettes, pan masala, and aerated drinks. Once again, while considering such an ad-hoc increase in tax rates, facing the heat at the forefront would be tobacco products.

While there is no doubt that tobacco products do not merit any concessional tax rate, any ad-hoc increase in GST rates or compensation cess on selective tobacco products such as cigarettes is likely to produce negative results for the industry as well as the economy. As a matter of fact, empirical data suggest that an increase in National Calamity Contingent Duty (“NCCD”) negatively impacted overall sales of legally traded cigarettes and therefore lead to negative growth in revenue collections.

It is essential to understand that tobacco at its core is agricultural produce which is cultivated in more than 13 states and is a source of livelihood for 47.5 million people1 in India. Therefore, apart from being a major revenue contributor for the Government, the cultivation of tobacco is a major source of farm income in India. As per the data publicly available, tobacco farmers have been consistently highlighting for successive years that the yield of Flue-Cured Virginia (“FCV”) tobacco has declined despite there being no decrease in consumption of tobacco in India. To illustrate, the total yield of FCV in India during the year 2013-14 was 325 million kgs which stood reduced to 210 million kgs in the year 2019-20.

One of the major reasons for such decrease in the production of FCV is the reduced demand of the produce by the manufacturers on account of a year on year increase in taxes, which has impacted the demand of legally produced and tax paid tobacco products. It is pertinent to note that with every increase in tax rates, legally produced tobacco product become more expensive, making smuggled and illegally traded tobacco products more lucrative for the intermediaries as well as the end consumers.

As per studies, nearly 25% of the total cigarette industry in India comprises of internationally smuggled or locally manufactured tax-evaded cigarettes and the said trade become more lucrative with every such ad-hoc increase in tax/cess rates. Currently, the tax evasion makes smuggled cigarettes 40% cheaper than legally produced cigarettes in India thereby adversely impacting their demand and ultimately affecting the Indian cultivator/ farmer. It is pertinent to note that due to such regressive taxation regime coupled with all-time low demand due to Covid-19, the Tobacco Board of India (“TBI”) recently decided to reduce the crop size of tobacco in the State of Andhra Pradesh by 15% for the current season i.e. 155 million kilograms less than the last season.

The reduction in crop size will translate into wastage of the excess crop produced valued at more than 200 crores only in the State of Andhra Pradesh itself. It is also important to note that as on 11.05.2020, the cultivated FCV worth Rs. 4400 crores are awaiting the auction process by TBI3 causing grave hardships for the tobacco farmers. Most importantly, such a reduction in the demand for home-grown tobacco does not proportionately correspond with a reduction in the consumption of tobacco products. In fact, the data suggest that tobacco use amongst Indians have grown over the same time period.

Therefore, while the state tax policy for tobacco should disincentivized its consumption, such policy must, however, keep in mind that distorted and unplanned tax regimes have always lead to increase in use and consumption of illicitly smuggled tobacco in

India which is cheaper for end consumers and on which no taxes are collected by the Government. Additionally, such products are manufactured using tobacco not originating in India, aggravating the distress of Indian tobacco farmers. Further, such illegally smuggled products also do not follow any regulations made by the Government with respect to mandatory labelling requirements concerning the harmful effects of consumption of tobacco.

Given the above, it is imperative that rather than simply proposing to increase the tax on tobacco products every time revenue shortfall is faced, the Central and State Government adopt well-defined tax policies (including rate rationalization) which disincentivizes smuggling of tobacco products from outside India, widens the tax net, create tax buoyancy, promotes local farmers and provides the government with a credible data on the total sales of tobacco product and the smoking population.

Accordingly, it is expected that GST Council in its 41st meeting, will not only consider the demands from states such as Delhi and Punjab for generating additional revenues for payment of compensation cess but will also carefully balance the needs of the tobacco-growing states such as Andhra Pradesh and Karnataka where the livelihood of millions of people directly or indirectly involved in tobacco farming is at stake as well as the overall tobacco policy of the nation to ensure that further incentives are not created for the illicit smuggling of tobacco products into India.

Source: *https://www.financialexpress.com/economy/gst-hike-on-tobacco-products-may-bring-double-whammy-tobacco-farming-gives-livelihood-to-crores-of-poeple/2066968/*