THE SEVERE CONSEQUENCES OF HIGH CIGARETTE TAXATION IN INDIA

Second Edition
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Preface

In view of the overwhelming response to the First Edition of *The Severe Consequences of High Cigarette Taxation in India*, The Tobacco Institute of India is pleased to publish a Second Edition.

The Second Edition of this Handbook includes more recent data and updated information on Cigarette Taxation in India. The Handbook attempts to provide an insight into the high and discriminatory nature of Tobacco Taxation in India and its serious consequences on the domestic legal cigarette industry, tax revenues and tobacco farmers in the country.

We are confident that this Handbook will serve as an effective reference document and facilitate a more equitable tobacco taxation regime in India.
Tobacco Taxation in India is High & Discriminatory towards Cigarettes

- Tobacco consumption pattern in India is unique with legal cigarettes comprising a mere 10% of overall tobacco consumption and the balance 90% constituted by other tobacco products such as bidis, chewing tobacco, khaini, etc., and by illegal cigarettes.

- Despite its small share of tobacco consumption, the Government collects 86% of tobacco related revenue from Legal Cigarettes alone.

- The reason for this distorted pattern of collections is that Cigarettes are subjected to high and discriminatory rates of taxation compared with other tobacco products.

- As per data available up to 2016-17, on a per kg basis of tobacco consumption, taxes on cigarettes are 55 times higher than other tobacco products.

- The discriminatory tax treatment of cigarettes continues even under the present Goods and Services Tax (GST) regime which is in effect from July 2017.

Source: Ministry of Finance (GoI); Tobacco Board & Industry estimates  *Includes Illegal Cigarettes
Legal Cigarette Industry is Penalized by Excessive Taxation

- The Legal Cigarette Industry is facing a huge challenge of massive volume losses due to the unprecedented duty increases since 2011-12.

- The tax burden on cigarettes has trebled in the last six years.

- The increases in duty rates since 2012-13 have resulted in persistent drop in Cigarette shipment from the factories over the last six years.

- Legal Cigarette Shipments from Factories have dropped by a massive 25% to 83 billion sticks in 2017-18 from the level of 110 billion sticks in 2011-12.
The Severe Consequences of High Cigarette Taxation in India

Steep Hike in GST Compensation Cess has Increased the Tax Burden on Cigarettes

- The Goods and Services Tax (GST) was implemented in the country with effect from 1st July 2017 replacing more than a dozen Central and State levies like excise duty, service tax and local sales tax or VAT etc.

- The highest GST rate of 28% is now being levied on Cigarettes in addition to the GST Compensation Cess and the National Calamity Contingency Duty (NCCD).

- The GST Council effected a steep increase in the GST compensation cess rates across various length-based segments of Cigarettes on 17th July 2017.

- The revised cigarette tax rates translate to a weighted average increase of about 13% over the rates prevailing immediately prior to the imposition of GST.

- The tax incidence on cigarettes post the increase in GST Compensation Cess rates is not in keeping with the fundamental GST principle of Revenue Neutrality.

- Incidence of taxes on cigarettes after accounting for the GST Compensation Cess increase has trebled in the last 6 years.
The Severe Consequences of High Cigarette Taxation in India

Cigarette Taxes in India are Amongst the Highest in the World

- According to WHO data, Cigarette taxes in India, as a percentage of per capita GDP, are excessively high.

- Cigarette taxes in India are almost 12 times higher than in the USA; 9 times higher than Japan; almost 6 times more than China; 5 times higher than Germany; 3 times more than in Australia, UK & Malaysia and 2 times higher than Pakistan and Thailand.

![Bar Chart]


- Since 2011-12 whilst inflation as measured by the Consumer Price Index (CPI), has increased by 49%, taxes on cigarettes have trebled during this period.

- Growth in cigarette taxation is well ahead of inflation making cigarettes beyond the reach of most tobacco consumers.
Cigarettes are Least Affordable in India

- According to the ‘WHO Report on the Global Tobacco Epidemic, 2017’ affordability of cigarettes in India is very low compared to other countries.

![Affordability chart](chart.png)

Higher percentage indicates lower affordability of Cigarettes

Source: WHO Report on Global Tobacco Epidemic, 2017

- The low affordability of cigarettes explains the low per capita cigarette consumption in India.

- The reason for this disparity in per capita consumption and the low affordability of cigarettes in India is the continuous tax increases on cigarettes that have been much ahead of inflation in the country.

![Per Capita Consumption chart](chart.png)

Inequitable tobacco taxation policy in India has led to shrinkage of the legal cigarette industry and encouraged consumers to shift to low price, low revenue yielding tobacco products and to illegal cigarettes.

Over the last three decades, while overall tobacco consumption has increased by 33%, the legal cigarette share of total consumption in India has declined from 21% in 1981-82 to 10% in 2016-17.

With the resultant Revenue sub-optimization and increase in overall tobacco consumption the objectives of both revenue enhancement and tobacco control are defeated.

While the legal cigarette industry in India is in the organized sector, has statutory oversight and is completely compliant with all regulations, the bulk of tobacco consumed in the country is largely produced in the unorganized sector which escapes compliance and enforcement.

This large unorganized sector, estimated at 68% of overall tobacco consumption, pays little tax either due to tax exemption or evasion.

**Source:** USDA, FAO and Tobacco Board

*Includes illegal cigarettes*
High Cigarette Taxes are Fueling Unabated Growth in Illegal Cigarette Trade

- High and consistently escalating taxes on Cigarettes provide a profitable arbitrage opportunity for tax evasion.

- Illegal cigarettes are growing rapidly and currently account for 1/4 th of the total Industry.

- According to Euromonitor International, illegal cigarettes in India have more than doubled from 12.5 billion sticks in 2005 to 25.7 billion sticks in 2017, making India the 4th largest illegal cigarette market in the world.

- Based on current tax rates on cigarettes, it is estimated that the Government loses more than Rs.13,000 crores of revenue per annum on account of the illegal cigarette trade.

- Due to the particularly steep tax increases since 2012-13, there has been a 31% increase in illegal cigarette trade with its resulting impact on the Legal Cigarette Industry which has shrunk by as much as 25%.

- The steep increase in tax under GST has opened the floodgates for contraband at both the premium as well as the value end of the market. The 19% weighted average tax increase for duty-paid King-size cigarettes has served to facilitate considerably higher sales of smuggled international brands of King-size cigarettes at prices that are substantially lower than the cost of duty-paid cigarettes.
The Severe Consequences of High Cigarette Taxation in India

**The Times of India**
22nd August, 2018

**SMUGGLING ACROSS INDO-MYANMAR BORDER**

Five held with foreign cigarettes,

Duplicate cigarette factory busted,
goods worth Rs 100 crore seized

**Ahmedabad DRI seizes smuggled cigarettes worth Rs 1.44 crore**

**The Navhind Times**

Foreign cigarettes worth Rs 17 cr seized

**The Hindu**

Four held for smuggling foreign cigarettes

**Business Standard**

DRI seizes Rs 1.5 cr worth of cigarettes smuggled from UAE

Press

Kolkata

Rs 1.5 cr worth of cigarettes smuggled from UAE
## Recent Seizures of Smuggled Cigarettes by Enforcement Agencies

<table>
<thead>
<tr>
<th>Date</th>
<th>Place</th>
<th>Seizure Value (Rs. Lakhs)</th>
<th>Enforcement Agency</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 6, 2019</td>
<td>Guwahati</td>
<td>Not Available</td>
<td>Police</td>
</tr>
<tr>
<td>February 25, 2019</td>
<td>Lucknow</td>
<td>15</td>
<td>Customs</td>
</tr>
<tr>
<td>February 20, 2019</td>
<td>Mangaluru</td>
<td>1.44</td>
<td>Customs</td>
</tr>
<tr>
<td>February 18, 2019</td>
<td>Lucknow</td>
<td>20</td>
<td>Customs</td>
</tr>
<tr>
<td>February 14, 2019</td>
<td>Kanpur</td>
<td>50</td>
<td>Customs</td>
</tr>
<tr>
<td>February 7, 2019</td>
<td>Mumbai</td>
<td>1700</td>
<td>Directorate of Revenue Intelligence (DRI)</td>
</tr>
<tr>
<td>February 4, 2019</td>
<td>Kochi</td>
<td>Not Available</td>
<td>Air Intelligence Unit</td>
</tr>
<tr>
<td>February 4, 2019</td>
<td>New Delhi</td>
<td>Not Available</td>
<td>Customs</td>
</tr>
<tr>
<td>January 21, 2019</td>
<td>Guwahati</td>
<td>18</td>
<td>Police</td>
</tr>
<tr>
<td>January 20, 2019</td>
<td>New Delhi</td>
<td>8</td>
<td>Police</td>
</tr>
<tr>
<td>January 14, 2019</td>
<td>Ghaziabad</td>
<td>1100</td>
<td>Police</td>
</tr>
<tr>
<td>December 31, 2018</td>
<td>Patna</td>
<td>119</td>
<td>DRI</td>
</tr>
<tr>
<td>December 16, 2018</td>
<td>Vijayawada</td>
<td>15</td>
<td>Police</td>
</tr>
<tr>
<td>December 16, 2018</td>
<td>Palghar, Maharashtra</td>
<td>330</td>
<td>Police</td>
</tr>
<tr>
<td>December 12, 2018</td>
<td>Chennai</td>
<td>0.74</td>
<td>Customs</td>
</tr>
<tr>
<td>December 8, 2018</td>
<td>Chennai</td>
<td>0.36</td>
<td>Air Intelligence Unit</td>
</tr>
<tr>
<td>December 5, 2018</td>
<td>Dibrugarh, Assam</td>
<td>76</td>
<td>DRI</td>
</tr>
<tr>
<td>December 4, 2018</td>
<td>Chennai</td>
<td>1.5</td>
<td>Police</td>
</tr>
<tr>
<td>November 29, 2018</td>
<td>Guwahati</td>
<td>398</td>
<td>DRI</td>
</tr>
<tr>
<td>November 5, 2018</td>
<td>Trichy Airport</td>
<td>10</td>
<td>Air Intelligence Unit</td>
</tr>
<tr>
<td>November 2, 2018</td>
<td>Guwahati</td>
<td>559</td>
<td>DRI</td>
</tr>
<tr>
<td>October 19, 2018</td>
<td>Vasco, Goa</td>
<td>200</td>
<td>DRI</td>
</tr>
</tbody>
</table>

*Source: Press Reports*
Shrinking Legal Cigarette Volume is Threatening Tobacco Farmers’ Livelihood

- The huge drop in Legal Cigarette volumes and the consequent reduction in the demand of Flue Cured Virginia (FCV) tobacco in cigarette manufacture have reduced earnings of Tobacco farmers in Andhra Pradesh, Karnataka and Telangana.

- Since 2013-14, the earnings of FCV tobacco farmers have shrunk cumulatively by more than Rs. 4,000 crores due to drop in offtake of tobacco for the manufacture of domestic legal cigarettes.

- The reduction in domestic demand is transferring to the burgeoning smuggled cigarette market which does not use tobaccos grown in India.

- The reduction in offtake severely affects tobacco farmers as they are left with no choice but to grow less remunerative alternative crops.

- The Indian Tobacco farmers will only be able to recoup their lost earnings as and when the legal cigarette volumes witness any recovery.
Equitable Taxation Will Help Widen the Tobacco Tax Base

- Equitable tax policy and improved compliance would bring a much larger proportion of the unorganized tobacco sector, which is either lowly taxed or escapes taxation, into the tax net and widen the tobacco tax base.

- While GST is expected to help in bringing a large part of the unorganized sector into the tax net, a huge disparity in rates of tax still exists between cigarettes and other tobacco products.

<table>
<thead>
<tr>
<th>Product</th>
<th>GST Rate</th>
<th>NCCD (Rs. per thousand sticks)</th>
<th>GST Compensation Cess</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Specific (Rs. per thousand sticks)</td>
</tr>
<tr>
<td>Bidi (Machine made)</td>
<td>28%</td>
<td>2</td>
<td>NIL</td>
</tr>
<tr>
<td>Cigarette (up to 65 mm)</td>
<td>28%</td>
<td>90</td>
<td>2076</td>
</tr>
</tbody>
</table>

- The wide gap in tax incidence between cigarettes and other tobacco products should be reduced gradually and all tobacco products including Bidis taxed in a comparable manner.

- Consumer shift to more revenue-efficient tobacco products like cigarettes would also maximize the economic value per unit of consumption and benefit revenue collections. Each percentage increase in cigarette share of tobacco consumption can fetch the Government an additional Rs.3,000 crores per annum as revenue.

- Equitable tax policy would also help the transition from low quality, unhygienic tobacco products with no regulatory oversight to products manufactured in factories under strict quality supervision and with statutory compliance.
Moderate Cigarette Taxation Aids Revenue Collection

- Moderation and stability in rates is an effective means of increasing tax revenue and is a well-established principle of fiscal policy that also helps in widening the tax base.

- Revenue growth from Cigarettes has been the maximum with moderate excise duty rate increase of 5.7% CAGR during the period of 2003-04 to 2006-07 as is evident from the chart.

- GST has ushered in transformational change in the Indian economy.

- In order to address the initial anomaly in GST rates, the GST Council has announced rate corrections for several categories of goods since July 2017.

- Government should adopt a similar approach in the case of duty-paid cigarettes as well.

A balanced, practical and non-discriminatory tobacco taxation policy combined with strict measures for curbing illicit trade and tax evasion are required to resolve the crisis of tobacco farmers and mitigate the immense hardship of the legal cigarette industry, within the overall tobacco control objectives.
The Tobacco Institute of India

The Tobacco Institute of India (TII) is a representative body of farmers, manufacturers, exporters and ancillaries of the cigarette segment of the tobacco industry in India, whose members account for more than 98% of the country’s domestic sales of duty paid cigarettes. The Institute is recognized as a repository of reliable information on the industry and is privileged to be consulted by Government, Parliamentary Committees, Chambers of Commerce/Trade Associations and Media for information and policy recommendations on Tobacco issues.

As an organization, TII has always supported evidence-based, equitable, reasonable and implementable regulation and recognises the need to create greater awareness regarding tobacco consumption in India.
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