

**AGENDA NOTE – 19<sup>th</sup> GST Council Meeting**

**Proposal for Increase in the Compensation Cess rate before the GST Council**

In pursuance of the recommendations of the GST Council in its 14<sup>th</sup> meeting held on 18.05.2017 and 19.05.2017, the Compensation Cess rates under section 8 (2) of the Goods and Services Tax (Compensation to States) Act, 2017, was notified vide notification No.1/2017-Compensation Cess (Rate), dated 28.06.2017 on intra-state or inter-state supply of the specified goods, including cigarettes.

2. In respect of tobacco and tobacco products, while deciding the Compensation Cess rates under the Goods and Services Tax (Compensation to States) Act, 2017, it was decided that in line with the weighted average VAT rate [28.7%], the GST rate on cigarettes may be kept at 28%. In addition, Compensation cess may be levied on cigarettes at rates equal to the specific excise duty rates [net of NCCD]. Further, with effect from 01.07.2017 the basic excise duty as well as the additional central excise duty [other than NCCD] was exempted on cigarettes.

3. In respect of cigarettes, the Fitment Committee had recommended GST rate of 28% and Compensation cess rates, which were 1.05 times the specific excise duty [net of NCCD]. However, with this method, the specific duty rate for cigarettes attracting the highest tax [i.e. cigarettes of length exceeding 75mm] exceeded the specific ceiling rate for the Compensation cess [Rs.4170 per thousand cigarettes] provided in the Schedule to the Compensation cess Act. That being so, it was decided to take 5% increase recommended by the Fitment Committee in *ad valorem* terms over and above specific excise duty [net of NCCD].

4. However, this method of calibrating the Compensation cess did not take into consideration the cascading of taxes [that is in earlier regime VAT being charged on value inclusive of the excise duty]. As a result, the total tax incidence on cigarettes in the GST regime has come down, as compared to the total tax in pre-GST regime.

5. To estimate the reduction in tax incidence in the GST regime, the total tax incidence with the present Compensation Cess rates and 28% GST [net of the applicable NCCD rates] is compared with the total tax incidence pre-GST with excise duty rates [net of the applicable NCCD] and VAT @ 30% [weighted average VAT rate for cigarettes being about 28.7%]. From this comparison, it is seen that the post-GST tax incidence on cigarettes of various slabs has reduced by about Rs.4.42 to Rs.12.23 per ten cigarettes [or Rs.0.44 to Rs.1.22 per cigarette]. As stated above, this reduction in total tax incidence in the GST regime vis-à-vis total tax incidence in earlier regime, is on account of methodology adopted not taking into consideration the cascading of taxes, [that is in earlier regime VAT being charged on value inclusive of the excise duty].

6. While any reduction in tax incidence on items of mass consumption would be welcome, the same would be unacceptable in case of demerit goods like cigarettes. Further, non-reduction of prices in cigarettes will lead to anti-profiteering investigation.

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7. That being so, it is proposed to amend the Compensation Cess rates on cigarettes by increasing the specific duty component in respect of all non-filter and filter cigarettes [except cigarettes of length exceeding 75mm] by the highest duty difference for a given slab. As for cigarettes of length exceeding 75mm, since the specific duty component is already at the Scheduled ceiling rate for the Compensation cess, the increase [equal to the highest of the difference in *ad valorem* terms, as per the ratio of the duty difference to the price including dealer's margin] may be made in the *ad valorem* component of Compensation cess where the applicable rate is only 5% as against the Scheduled ceiling rate of 290%.

8. Accordingly, the proposed increase in Compensation Cess of cigarettes is as under:

		<b>Compensation Cess Rates</b>		
		<b>From</b>	<b>Proposed Increase</b>	<b>To</b>
	<b>Non- filter</b>			
2402 20 10	Not exceeding 65 mm	5% + Rs.1591 per thousand	Rs.485 per thousand	5% + Rs. <b>2076</b> per thousand
2402 20 20	Exceeding 65 mm but not 70 mm	5% + Rs.2876 per thousand	Rs.792 per thousand	5% + Rs. <b>3668</b> per thousand
	<b>Filter</b>			
2402 20 30	Not exceeding 65 mm	5% + Rs.1591 per thousand	Rs.485 per thousand	5% + Rs. <b>2076</b> per thousand
2402 20 40	Exceeding 65 mm but not 70 mm	5% + Rs.2126 per thousand	Rs.621 per thousand	5% + Rs. <b>2747</b> per thousand
2402 20 50	Exceeding 70 mm but not 75 mm	5% + Rs.2876 per thousand	Rs.792 per thousand	5% + Rs. <b>3668</b> per thousand
2402 20 90	Others	5% + Rs.4170 per thousand	31%	<b>36%</b> + Rs.4170 per thousand

9. Considering that the Central Government has not levied any excise duty [except NCCD] over and above GST on cigarettes and that the objective of the Goods and Services Tax (Compensation to States) Act, 2017 is to provide for compensation to the States for the loss of revenue arising on account of implementation of the goods and services tax, the GST Council may recommend increase in the Compensation Cess rates as proposed in Para 8 above.

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