Gold Market under GST Regime in India

Abstract

Goods and Services Tax (GST) is an indirect tax which was introduced in India on 1 July, 2017 and was applicable throughout India which replaced multiple cascading taxes levied by the central and state governments.The GST is governed by a GST Council and its Chairman is the Finance Minister of India.The tax rate under GST are set at 0%, 5%, 12%, 18% and 28% for various goods. Gold is a luxury product and price of gold has quadrupled in the last one decade. There are several opinions in respect of imposition GST burden. One opinion is that gold is not an essential commodity and it is not a commodity for the poor. So higher tax has no impact on the poor. Another opinion is that lacs of poor employee and small traders are engaged in this industry, so higher tax burden and tax compliance may leads to hamper their livelihood by losing their business. Government's view is that in the jewellery sector, cash transactions without paper dominates the formal transaction and there by the traders remained beyond the tax net, so there is need to bring them into the formal way through various compliance of the rules and regulations. In this backdrop the implications of GST on Gold in India is brought under consideration and an effort has been made to show the possible impact of GST on gold.

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Keywords: GST, Fiscal, Revenue, Gold & Jewllery, Transaction, Manufacture

Introduction

GST is categorized as indirect tax. This is the biggest fiscal reform since India's liberalisation in the early 1990s.It is a destination-based tax on the supply of goods and services. This means that each party throughout the supply chain – as long as their turnover is greater than Rs 2 cr. per annum-will be liable for GST when they buy a good or service. Once they have paid GST, providing they are buying the product from a GST-registered firm, they will receive an input tax credit to offset the tax against revenues from the sales of goods and services. One GST rate is applicable to each good or service across India. There are three different elements of the tax: 1. Central goods and services tax (CGST). This is the element of the GST which flows into central government's coffers. 2. State/Union Territory goods and services tax. This is known as SGST for 29 states and two Union Territories with legislatures and UTGST for Union Territories without legislature. This is the element of GST which is retained by the State or Union Territory. **3.** Integrated goods and services tax (IGST). This is levied on all imports into India and inter-state flows of goods and services. It has been drafted as separate legislation so the central government can monitor international trade flows and the movement of goods between states. The GST Council-the government body which sets GST rates on goods and services, drafts GST laws, and makes recommendations on goods and services that are exempt from GST-has settled so far on an eight-tier structure with rates of 0%, 0.25%, 3%, 5%, 12%, 18%, 28% and a more punitive rate of at least 43% to be levied on luxury and sin goods, namely tobacco, cigarettes, fizzy drinks, coal, and motor vehicles.

Gold and Gem Market in India

India's gold market is highly fragmented. It contributes around 7% to the GDP for the country and employs over 2.5 million people. Jewellery's retailing landscape is dominated by small businesses. Only 30% of total jewellery market are recognized in regional and national chains. The picture in jewellery manufacturing is more extreme, with 95% of the industry consisting of small-scale operations. For small jewellers and the unorganized sector, most of their sales happen through personal connections and cash transaction are not even recorded and it is done without bill. That way of doing business is under threat as the world's second-largest gold market in India. But this is changing. In recent years, large retailers and manufacturers have been gaining market share and gradually the country's gold market is becoming more organised and transparent. A contrarian theory on gold prevailed that gold is as the safest of safe heaven and even it is grounded by some sections of the invest community. It's price are determined by a mix of global factors and fundamentals. It gains its covetous status among the asset classes. The nation imports almost all the gold it consumes and demand last year was about 666 metric tons, according to the World Gold Council. That's more than the entire gold reserve of the European Central Bank. Prices of gold have been on the back foot for sometime but this should be seen as a passing phenomenon. Another factor that weighs in favour of gold is the asset mix of central banks across the world. For decades, central banks in both developed and emerging markets have been relying on buying gold or the benchmark 10-year US treasuries to build up reserves.

This market is guided by the World Gold council. World Gold Council is the market development organisation for the gold industry. The purpose of it to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market. Based in the UK, with operations in India, the Far East and the US, the World Gold Council is an association whose members comprise the world's leading gold mining companies. All copy right are reserved by them.

Review of literature:

Review of literature of a subject is helpful in understanding the conceptual framework and provides a detailed account of work which was done in the past on that particular subject.

Rai Govind Chandra has described that Indian Jewellery was very pivotal factor even prior to advent of the Greeks, and titled "Indian love for jewellery is proverbial".

In the opinion of **M. S. Shukla** much of the Indian jewellery has persisted to culture traditionally cherishing and adverting to its prized consummate forms and former masterpieces of design and technique.

In the article **Easther Bardhan** mentioned that the Gems and jewellery sector is facing several challenges and opportunities.

According to an article published in **Golden Times**, "Gold is the only thing that seeps into every strata and class of the Indian society, is equally sought by the well-heeled urban businessman and the poverty stricken rural labourer.

According to **Nirmal Bardia** convener, Jaipur Jewellery Association "Jaipur's Colour stone industry has a major contribution in the country's export of colored gems, hence we need shows to focus the developments in this area.

Nitish Deb concluded in his research that as far as the question of Uttar Pradesh economic and financial prospects are concerned Uttar Pradesh is not only a geographical unit but it also consists a vision, vast traditions and lifestyle.

As per a report published in **Marketing Master mind** "India possesses world's most competitive gems and jewellery market due to its low cost of production and availability of skilled labour.

According to a survey report published in **GJF News** "Mumbai's gold trade is fast losing out to Gujarat and Rajasthan..."

As per a report published in **Research and Markets** "Gems and jewellery have been used by the Indian Civilization since ages for both its aesthetic as well as investment purposes…"

In her research report **Gunjan Bihani** stated that "The appeal for jewellery is the highest among younger consumer sections.

Ashima Mahindra in her report stated that the gold market in Meerut is a good example of what impact the global economic slowdown is having on out local markets.

Aim of the Study

Since 1st July, 2017 nationwide Goods & Services Tax (GST) has been implemented in India. It is a biggest tax reform since liberisation in the early1990's. Consequently gold consumers face a slightly higher tax rate, although the whole industry have scope of adjustment. It was accounted that the gold supply chain will become more transparent and efficient, and this tax reform will boost economic growth. During last few months we see that the net impact on the gold industry have become positive and major companies have hauled the move. Although smaller traders are very panicked have lose their interest temporarily and to some extent. It is obvious that the gold supply chain should transparent and the interest of consumers should be protected. Prior to GST being implemented, the overall tax rate on gold jewellery stands at 12.2%. This is made up of 10% customs duty, 1% excise duty, and 1.2% VAT, but one GST replaces the excise duty and VAT components, but sits on top of the import duty. As it is very new measure as regards gold market, the net and overall effect of it is yet to be studied. Hence, this papers tries to find out the impact of GST on gold market in India.

GST for Gold

With a view to make the gold market transparent and efficient and bring the informal economy into formal way Goods Services Tax (GST) is implanted since 1St July, 2017. At GST regime which was rolled out from July 1, 2017, 3% tax is levied on gold by replacing more than a dozen domestic levies. In addition to the GST, gold will attract customs duty of 10% and a gold making charges of 5%. Customs duty of 10% was levied prior to the implementation of GST. However, the GST on gold making charges has been introduced at 5% recently. Moreover, under the purview of Prevention of Money Laundering Act PMLA provisions as a part of KYC requirement jewellers with a turnover of Rs. 2 crore per annum were mandated to collect PAN card for any purchase above Rs. 50,000. But with the notification of the Govt. in August, 2017 this has been revoked.

The provisions as narrated above may be analysed with the following table.

Sl. No.	Particulars	Before GST	After GST
A	Price of Gold	100	100
B	Custom Duty	10	10
C	A+B	110	110
D	Excise Duty- 1%	1.1	0
E	C+D	111.1	110
F	VAT- 1.2%	1.3	0
G	E+F	112.4	110
H	GST- 3%	0	3.3
I	G+H	112.4	113.3
J	Making Charge-12%(A+B)	13.2	13.2
K	I+J	125.6	126.5
L	GST-on Making Ch.-5%	0	0.7
M	Total Price of Jewellery (K+L)	125.6	127.2
N	Total Taxes and Duties (B+D+F+H+L)	12.4	14

In analyzing this we see that at pre-GST period, jewelers would pay 10% customs duty on gold and pay 1% excise plus 1.2% VAT over and above price of the gold. This effectively worked out to 12.4% including custom duty when buying jewellery and 11.32% when buying bars since bars do not attract excise duty. With the introduction of GST at 3% for gold and 12% for making charges and considering service tax 5% on making charge the effective rate comes to 14% including 10% customs duty. So, the effective price escalation on gold jewellery comes to 1.6%. It may be stated that at pre-GST period there was no any service tax on making charge. It is clear that gold is going to get slightly expensive for consumers in India.

Impact of GST

On Demand

As mentioned earlier, the slight increase in taxes is likely to impact demand initially, but we expect that pass down to retail consumers will not be much of an issue over a period of time. Jewellers have already stocked gold before the GST implementation as evident from the import data and therefore, it will be difficult to assess the impact on demand after the GST comes into force. India's gold imports in the first five months of 2017 have surged 144% year-on-year to 424.1 tons as per GFMS data. This means that imports will be much lower during the peak season during Qtr.4, as gold buying has been front-loaded in the first half of this year. Over the course of the year, as the industry and consumers adjust to the new environment and as further clarity emerges, we could see a revival in demand. We expect full year 2017 demand in India to be slightly higher than 2016, but still would be significantly lower compared to five-year averages.

On Jewellery Trade

GST is clearly going to benefit the organised trade more given that organised and branded retailers will find it easier to comply and implement the new rules. On the retail front, almost 30% of the jewellery sector is organised and these players could find it difficult to comply as effectively with the new rules. Secondly, for branded and organised jewellers who have integrated manufacturing, the additional 5% GST on making charges can be averted. Third, a structural shift towards organised trade is already under process and demonetisation and clampdown on cash transactions has hastened up that process. The government in the last budget imposed a limit of Rs 2 lakh on all cash transactions, and this will help organised retailers more as the unorganised players dealt more with cash. On the whole, there will be teething troubles initially for the industry to comply with the new set of rules but large organised and branded retailers will be at an advantage.

On sale of old jewellery

There was panic for the followers of the good old Indian habit of selling old gold jewellery for cash or for a modification. A fear that GST will bring lesser returns for old jewellery gripped customers and goldsmiths became apprehensive. Customers and jewellers were worried that a jeweller buying old jewellery from someone will charge 3% GST under reverse charge mechanism. So, if old jewellery worth Rs 1 lakh is sold, a GST of Rs 3,000 will be deducted which virtually means that customer gets less per gram of gold sold. But it is officially explained, that suppose somebody comes to a jeweller with old jewellery worth Rs 100. Then it is as good as buying gold. The jeweller buying the old jewellery will charge 3% GST on it. But at the time of purchase of jewellery in lieu not charge the 3% GST on sale. The 3 % can be claimed by the jeweller input tax credit. It has also been clarified that if the money from the sale of old jewellery is used to buy new jewellery, the tax paid on sale will be adjusted against GST on the purchase. If old jewellery is given to the jeweller only for some modification or remake then as per GST rules it will be considered as job works and 5% GST on making charge would be levied.

On Supply Chain

At this period GST will accelerate the pace of consolidation. Firms that at pre-GST period outsource manufacturing services from artisans and incur the 5% GST rate may look to develop in-house capabilities. Small jewellery shops which may have illegally benefited by not paying tax will lose that advantage, and large retailers can compete on a level playing field. Artisans – individuals or small collectives who hand-work intricate pieces of jewellery for larger manufacturers–fall outside the pre-GST rules. Under the new rules, however, artisans with a turnover north of Rs 2 crore per annum will need to become GST registered and need to file as many as 37 returns. On top of this, jewellery made by artisans subcontracting for larger manufacturers from another state would be treated as inter-state supply and subject to IGST, even if the artisans do not reach the turnover threshold of Rs 2crore per annum. Although supply chains are likely to become more efficient but there are some issues which may pose challenges to small-scale artisans and retailers with varying degrees of tax compliance there by struggle to adapt. In Qtr.-1 report to the market, Titan noted that "…we believe that the formalization of the economy bodes well for our jewellery division, Tanishq". The one story that we hear is that the business is becoming problematic for smaller jewellers," said Chirag Sheth, an analyst at London-based precious metals consultancy Metals Focus Ltd. "The bigger jewellers have deeper pockets, they have larger shops, better designs and better margins. It is very difficult for a smaller guy to compete."

On Maintenance of Stock

Under the pre-GST regime, for example, inter-state sales of jewellery attract an irrecoverable central government sales tax. To avoid this, firms have set-up warehouses in states where they conduct business so sales are booked intra-state, rather than inter-state. This is inefficient. Businesses often have multiple warehouses across India, with high logistical costs and they often hold excess levels of inventory. Under GST, while inter-state stock transfers will be taxable, the tax can be reclaimed once the goods are sold. If, for example, a large nationwide retailer had excess jewellery stock in one state and wanted to transfer it to a store in another state, it would pay IGST, which it can then off-set against sales revenue. Being able to reclaim the tax removes the incentive to maintain stock in multiple warehouses across India, and will allow retailers to become more efficient by consolidating warehouses and holding lower levels of inventory.

On In-House Production or Out Sourcing

If we analyse this provision deeply then we find that there are certain effect on this decision making process. There are two important GST rates which will affect the industry. The first is the 3% tax on gold products, such as jewellery. In addition, there is 5% tax on services that will apply to firms and individuals providing manufacturing services across the gold supply chain. This is a significant part of the industry. Taking these two rates into account, our analysis of the supply chain indicates the effective tax rate consumers face could increase to between 13.2% -14%. This range depends on whether the jewellery is manufactured in-house or is outsourced. Firms manufacturing jewellery in-house will have an advantage. This, however, overlooks the broader tax efficiencies GST will bring.

On Smuggling and Illegal Buying

A hike in taxes on gold that has jumped to 3 percent from 1.2 percent sales tax regime in India could stoke under-the-counter buying and drive up an appetite for precious metal smuggled into the country, where millions of people store big chunks of their wealth in bullion and jewellery.

Traders and buyers are apprehending that the move will likely force more transactions into the black market. Market experts had also expressed concerns that a higher tax rate on gold will only add to the already high proportion of cash transactions on the commodity, and will increase gold smuggling with most traders choosing to evade taxation altogether.

Three percent is too much. One will prefer to buy without receipts. The jeweller did not have any problem. Harshad Ajmera, the proprietor of JJ Gold House, a wholesaler in the eastern Indian city Kolkata is in the opinion that smaller shops could be more inclined to sell without receipts, potentially hitting sales at big jewellers that keep to the rules. For just to save 1%, some customers were earlier buying gold without receipts. With the 3% GST, now many more will be tempted to make unofficial purchases from small jewelers. The tax hike could also encourage more smuggling into the world's second-biggest gold consumer, which buys almost all its bullion abroad.

Aditya Pethe, a director at Waman Hari Pethe Jewellers in Mumbai is in the opinion that the GST rate has increased the incentive to bring in smuggled gold. The government should reduce import duty and make smuggling unviable. The country's legal imports typically stand at around 800 tons a year, with the metal used in everything from investment to religious donations and wedding gifts. Daman Prakash Rathod, director at wholesaler MNC Bullion in the southern city of Chennai is in the opinion that a lower import duty would increase legal imports and ultimately legal sales. Tax revenue would go up instead of going down.

On International Transaction

Gold exports may receive a boost. GST has been designed so it continues to support special economic zones (SEZs). Firms operating within SEZs are entitled to bring goods from the domestic tariff area (DTA) or from abroad without paying IGST. This will ensure working capital is not tied up for firms based in SEZs. A fast and efficient tax refund process–the government promises to rebate 90% of claims from firms in the DTA within 6-10 days–coupled with tax exemptions for SEZs and thereby encourage exports.

On Customers

Consumer demand faces a headwind from the higher rate of tax. This would have had a damaging effect on consumer demand in short run. Customers and jewellers may try to conduct recycling transactions under the counter, away from the prying eye of the tax man. However, GST can make the gold industry more transparent which, coupled with recent hallmarking legislation. Bureau of Indian Standards is pushing the industry towards mandatory hallmarking there by to ensure gold buyers be confident in the gold products they buy and ultimately suffering from the gross level of under-carating for them may be minimized.

Market's Reaction

Industry has reacted positively to the 3% GST rate. The 3% rate is viewed as being more manageable and will ensure greater compliance by small and independent retailers. Commenting on GST, the All India Gems and Jewellery Trade Federation (GJF) Chairman, Nitin Khandelwal said, "…we welcome the government's decision of 3% GST for gold. We are happy that the Centre has created a special category, which will help the industry." On the first day of stock market trading after the GST announcement, listed jewellers outperformed the broader equity market by an average of around 6%. Titan Co, PC Jeweller, Renaissance Jewellery, Tribhovandas, Bhimji Zaveri, Tara Jewels, Thanga Mayil Jewellery, Gitanjali Gems etc. all have welcomed the move.

Conclusion

It may be believed that GST may be disruptive in the short term as the industry has to adjust with the new tax regime. Manufacturers' and retailers' working capital could be tied up because of inter-state gold stock transfers. Small-scale artisans and retailers with varying degrees of tax compliance may struggle to adapt. Consumer demand faces a headwind from the higher rate of tax. But with the implementation, GST will eliminate double taxation and improve supply chains efficiency. GST can make the gold industry more transparent with the introduction of recent hallmarking legislation and thereby able to build the confidence of gold buyers. There is need to vigil very closely on unlawful trading. India's entire economy is on a rapid journey to becoming more organised and more transparent. Any tax efficiencies gained in the supply chain will be passed on to the consumer. One might be concerned firms could use input tax credits to fatten their margins. But anti-profiteering legislation will ensure this is policed, and that firms pass on the benefits to the end consumer. In view of this the measure may be welcome.

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