Source : www.thehindu.com Date : 2023-01-30

REVISIT THE TAX TREATMENT OF TOBACCO PRODUCTS

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

January 30, 2023 12:08 am | Updated 02:11 am IST

‘It is cause for concern that while most countries regularly increase taxes on tobacco products to make them less affordable, India has not done so’ | Photo Credit: Getty Images/iStockphoto

Adam Smith, in his famous work The Wealth of Nations, argued that commodities such as sugar, rum and tobacco, though not necessary for life, are widely consumed, and thus good candidates for taxation. Research in India and around the world supports the use of taxes to regulate tobacco consumption. However, in India, tobacco taxes have not increased significantly since the implementation of the Goods and Services Taxation (GST) over five years ago, making these products increasingly affordable, as recent studies show.

In 2017, the economic burden and health-care expenses due to tobacco use and second-hand smoke exposure amounted to 2,340 billion, or 1.4% of GDP while India’s average annual tobacco tax revenue stands at only 537.5 billion. Despite the government’s goal of making India a $5 trillion economy, the increasing affordability of tobacco poses a threat to this vision and could harm GDP growth. Tobacco use is also the cause for nearly 3,500 deaths in India every day, which impacts human capital and GDP growth in a negative way.

The current GST system for tobacco taxation in India has features that are hindering efforts in regulating consumption. One issue is the overuse of ad valorem taxes, which are not effective in reducing consumption. Many countries use a specific or mixed tax system for harmful products. The GST system in India relies more on ad valorem taxes than the pre-GST system, which primarily used specific excise taxes. Many countries with a GST or value-added tax (VAT) also apply an excise tax on tobacco products. In India, the share of central excise duty in total tobacco taxes decreased substantially from pre-GST to post-GST for cigarettes (54% to 8%), bidis (17% to 1%), and smokeless tobacco (59% to 11%). A large part of the compensation cess as well as the National Calamity Contingent Duty, or NCCD (it is levied as a duty of excise on certain manufactured goods specified under the Seventh Schedule of the Finance Act, 2001) currently applied on tobacco products is specific. If specific taxes are not revised regularly to adjust for the inflation, they lose their value. Inflation indexing should be made mandatory for any specific tax rates applied on tobacco products.

There is a large discrepancy in taxation between tobacco products. Despite cigarettes accounting for only 15% of tobacco users, they generate 80% or more of tobacco taxes. Bidis and smokeless tobacco have low taxes, encouraging consumption. Taxes should be made more consistent across all tobacco products, as none is more or less harmful than the others. The main principle behind tobacco taxation should be in protecting public health. Notably, bidis are the only tobacco products without a compensation cess under GST, despite being just as harmful as cigarettes. This lack of a cess on bidis has no public health rationale. The current six-tiered tax structure for cigarettes is complex and creates opportunities for cigarette companies to avoid taxes legally by manipulating cigarette lengths and filters for similarly named brands. Instead, the tiered system should be eliminated or reduced to two tiers, which can then be phased out over time to have a single tier.

The GST rates on certain smokeless tobacco ingredients such as tobacco leaves, tendu leaves, betel leaves, areca nuts, etc. have either zero or 5%-18% GST. It is important that all products that are exclusively used for tobacco making are brought under the uniform 28% GST slab. This will generate the right public health message — that all tobacco products are bad and their consumption needs to be discouraged.

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Smokeless tobacco products in India are taxed ineffectively due to their small retail pack size (often 1/2 gram or less) which keeps the price low. To standardise and increase the retail price, mandatory standardised packing should be implemented for smokeless tobacco pouches (at least 50 g-100 g). This will also make it easier to implement graphic health warnings on the packaging.

GST currently exempts small businesses with less than 40 lakh annual turnover. Many smokeless tobacco and bidi manufacturers operate in the informal sector, which reduces the tax base on these products. While these exemptions are intended to protect small businesses, the public health rationale requires that they not be extended to businesses that produce or distribute tobacco products. Therefore, conditions should be imposed on these exemptions so that tobacco businesses do not benefit from them.

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Before GST, taxing tobacco was a way for State governments to increase revenue and regulate consumption. For example, Rajasthan had a 65% VAT on tobacco products. After GST, States can no longer raise taxes on tobacco, which hinders their ability to increase revenue and regulate consumption. While a uniform tax across the country is good, not increasing it at the national level at regular intervals harms public health.

It is cause for concern that while most countries regularly increase taxes on tobacco products to make them less affordable, India has not increased taxes on any tobacco products in over five years. This may undo much of the progress seen in a 17% reduction in tobacco use from 2009-10 to 2016-17. Both the GST Council and the Union Budget should take the opportunity to significantly increase taxes on all tobacco products, including bidis, cigarettes, and smokeless tobacco, through hikes in excise duties or compensation cess.

Rijo M. John is a health economist and adjunct professor at the Rajagiri College of Social Sciences, Kochi, Kerala

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BACK TO TOP

END