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Excise on fertiliser makes no sense

Fertiliser makers can recover their excise payouts through the subsidy system, but that negates the purpose of imposing a levy.

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Marking a reversal of decades of policy, fertiliser is no longer exempt from excise duty (ED).

The Budget for 2011-12 has levied ED at 1 per cent on 130 items (including fertilisers), hitherto exempt from ED but attracting VAT. This is a precursor to GST, aimed at expanding tax coverage. However, these items will not be eligible for CENVAT credit.

In case a manufacturer wishes to avail CENVAT, he will have to pay ED at 5 per cent.

In a recent letter addressed by Revenue Secretary to his counterpart in the Department of Fertilisers (DoF), the former has opined that the impact of the 1 per cent levy is small, at Rs 2.65 to Rs 5.37 per bag of 50 kg and, therefore, unlikely to pose a heavy burden. This is a mistaken notion.

If 'food' can be exempt from excise duty, so can fertilisers. — Reuters

SERIOUS COST IMPACT

For those who avail of the 5 per cent ED option, the impact will be five times more and, therefore, cannot be dismissed as insignificant. Further, under the GST regime, CGST (to replace ED) would be 10 per cent, the rate at which all central levies will converge.

We are thus talking of an impact of Rs 27-Rs 54 per bag. On a total production of around 20 million tonnes, on urea alone, this works out to around Rs 1,100 crore per annum. It is, therefore, necessary to carefully analyse as to how this will be absorbed by the system.

Under the Fertiliser Control Order (FCO), GoI controls MRP (maximum retail price) of urea. This price is 'uniform' for all farmers. For DAP/complex fertilisers, producers are free to fix MRP; these fertilisers have been decontrolled in 1992 and the position continues till date.

How does Government fix MRP of urea? Over the last three and a half decades or so, it has set the selling price at a low level — unrelated to the cost of supply which is invariably higher on account of rising cost of feedstock and other inputs. The excess of cost of supply over the low MRP is reimbursed to manufacturers as subsidy. But, for this arrangement, which is unique to fertilisers, fertiliser production would have been unviable. The critical point is any factor that affects the cost of supplying urea is not considered relevant for fixing MRP. ED is one such factor. Hence, the Ministry of Agriculture (MoA) will not agree to revising the MRP to reflect the ED.

PRICING COMPULSIONS

The Government cannot afford to allow even a small increase in MRP. A hike of 10 per cent in MRP of urea in 2010 was effected after a long gap of eight years (last hike was in 2002).

Will it permit the duty effect, that may go up to 5 per cent now or 10 per cent next year, to be passed on to the farmer? While formulating their proposals, mandarins in MoF seem to have missed another key aspect of pricing urea under the FCO.

While MRP is meant to be 'uniform' for all farmers, on the ground there will be two sets of prices, depending on the applicable duty — 1 per cent or 5 per cent.

Manufacturers cannot increase MRP on their own. Any such attempt will amount to violation of FCO. Producers of DAP/complex fertilisers 'technically' can increase MRP. However, even here, the government can control 'informally', especially when the impact is significant.

SELF-DEFEATING MOVE

Producers could get higher ED-induced cost reimbursed through higher subsidy payments under NPS (new pricing scheme) for urea and NBS (nutrient-based scheme) for DAP/complex fertilisers. But this defies logic. If money collected from ED has to be returned, why levy it in the very first place?

The Government recognised this as far back as June 1980 when it abolished ED on all fertilisers. By the same logic, all finished fertiliser products were exempt from customs duty (CD).

Imported raw materials and intermediates used in producing fertilisers, namely, rock phosphate, sulphur and ammonia, were exempt from CD until 1998-99. The CD on imported phosphoric acid was removed in August 1992 when even fertiliser project imports were exempt from CD.

On other inputs — naphtha, fuel oil, LSHS, gas — used in the production of fertilisers, the government either charged 'nil' ED or a concessional rate as on naphtha.

In the 1997-98 Budget, ED on naphtha was eliminated. For fuel oil, the duty was lowered.

Hence, the government has consistently followed a policy of avoiding any 'artificial' increase in subsidy on fertilisers (first collect revenue by levying duty and then return by way of higher subsidy, MRP remaining unchanged). There is no reason to turn the clock back.

If 'food' can be exempt from ED/GST, there is no reason why fertiliser should also not be given the same treatment.

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