

A case for including Petrol and Diesel under GST?

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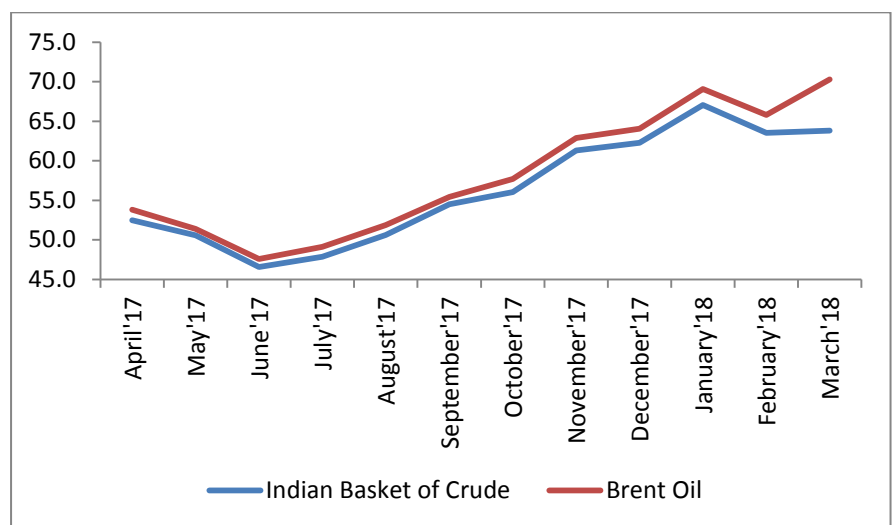
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Overview

Prices of petrol and diesel have risen sharply in the past one year and reached a 5 year high with the price of diesel being ₹64.82 per litre and petrol price rising to ₹73.95 per litre in Delhi.

Petrol, diesel, ATF, natural gas and crude oil have are out of the GST ambit ever since the new tax regime was rolled out on a nationwide basis. Presently only LPG, kerosene and naphtha are subject to a GST rate. Bringing fuel products under the ambit of GST has been deliberated for long however the state and centre have not been able to build a consensus on revenue sharing. With the present increased witnessed in prices of diesel and petrol, the debate has re-commenced in the light of the potential impact on inflation.

Chart 1: Prices of Crude oil (\$/bbl)



Source: Bloomberg, PPAC

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Prices of crude oil have risen during FY18 recovering from its fall during the previous fiscals. The rise in prices is due to production cuts by both OPEC and Non-OPEC countries caused supply disruption along with unrest in some Middle Eastern countries. The increase in demand of oil due to the recovery of European economies has also contributed to the rise in prices. Brent has increased by 30.6% whereas Indian basket of crude has increased by 21.5% during FY18.

Chart 2: Daily prices of Petrol and Diesel in Delhi (₹/litres)

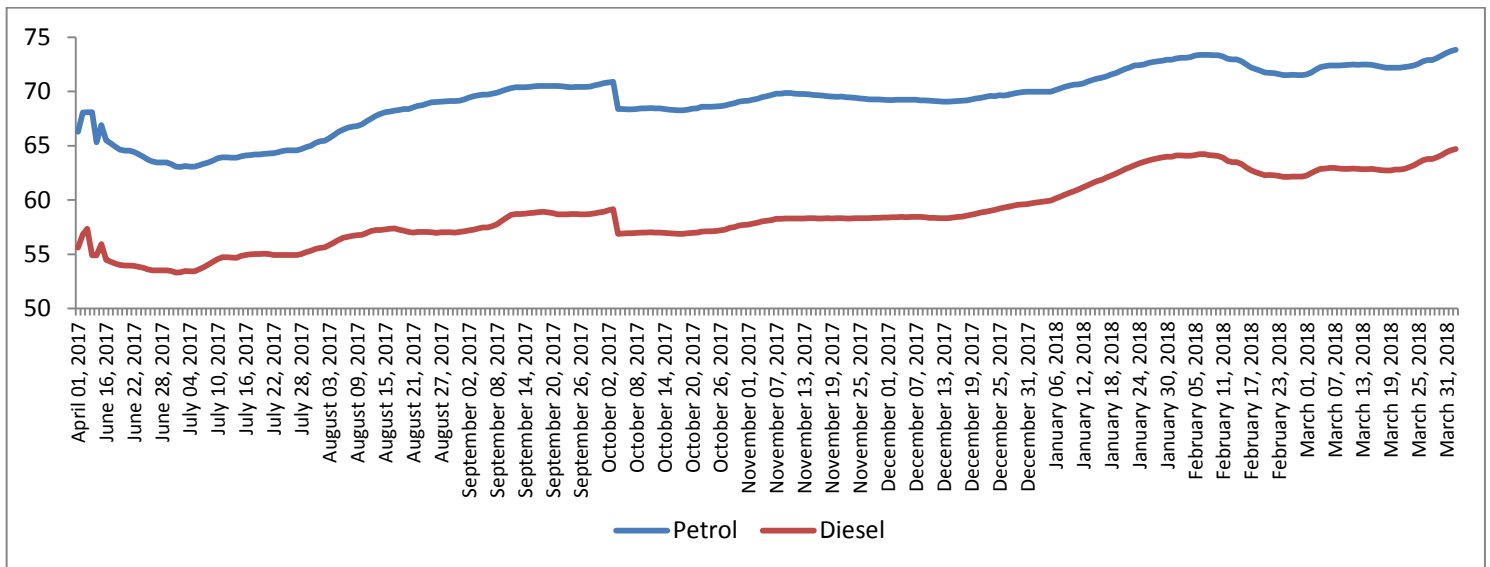


Table 1: Price build-up for petrol and diesel in Delhi (₹/litre) as on 04.04.2018

	Petrol	Diesel
Price Charged to Dealers (excluding Excise Duty and VAT)	35.15	37.42
Excise Duty (collected by the Central Govt.)	19.48	15.33
Dealer Commission	3.60	2.52
VAT (includes VAT on dealer commission) (collected by the State)	15.72	9.55
Retail Selling Price	73.95	64.82

Source: Indian Oil/PPAC

Currently the government (centre plus states) is collecting around 100% taxes (Excise Duty and VAT) on the base price of petrol, which is much higher than the peak GST rate.

During FY14 when the price of petrol charged to the dealers was ₹47.18 (higher than the price being charged now) and with the exchange rate was ₹62/USD (lower than the current rate of ₹65.05/USD), the government’s effective tax rate was 43% taxes with the retail price being almost the same as today at ₹73.20. The price of crude oil during FY14 was \$107/bbl, as compared with the price of crude oil being \$70/bbl during March 2018. Therefore, the government’s tax collections have benefited significantly on this score.

In the case of diesel, the government currently collects an effective rate of 66% taxes (Excise Duty and VAT) on the base price of diesel. During FY14 when the price of diesel charged to the dealers was ₹52.68 (higher than the price being charged now) and diesel price was subsidised (₹8.37/litre), the government collected 22.5% taxes on the base price with the retail price being ₹55.48, lower than the current price the consumer is paying currently.

It has been observed that the collection by the government of excise duty and VAT has increased over the years as the incidence of taxes too has increased commensurately. The lower price of global crude did not lead to commensurate decline in retail prices as tax rates were increased progressively.

Government Budget impact

The government is impacted by fuel prices in two ways.

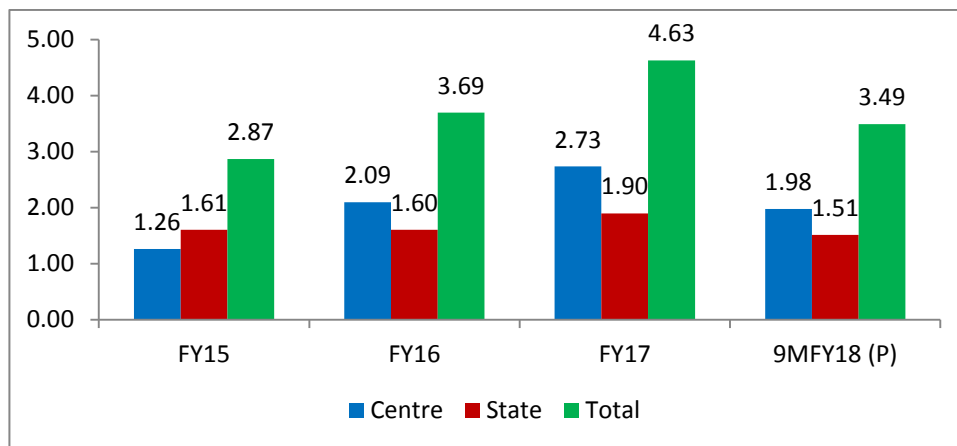
- First, the government (both centre and states) earns substantial revenue from petro-products through taxation. As they have been kept out of GST, states are also able to levy variable taxes as a result of which prices vary across states.
- Second, the government also provides a subsidy for fuel products in order to buffer against prices.

Revenue collections

Chart 3 below provides information on the tax revenue earned by the government on crude oil and petroleum products in the last 4 years. As can be seen during FY17 ₹4.63 lakh crore was collected by the government through various taxes and levies with the centre accounting for 62% of the total. For the centre during FY17, 89% of the total came from excise duties and the balance from crude oil cess and customs. For the state during FY17, 88% of the total came from state VAT levied on POL products and the balance from royalties, crude oil cess, octroi and duties. Maharashtra contributes 14% (highest) towards the state wise collection of sales tax/ VAT on POL products.

During 9MFY18, even with the incidence of GST falling on LPG, kerosene and naphtha, 81% of the total tax collections for the centre came from excise duties and 7% from IGST and CGST whereas for the State 87% was contributed by the VAT levies and 3% was from SGST/UTGST. Presently it appears that the government would rather not lower the tax rates and include the rest POL products under the GST ambit as it would impact revenue collections.

Chart 3: Tax collections on Petro-products (in ₹ lakh crores)



Source: PPAC

Subsidy

The fuel subsidy during FY15 was ₹60,269 crore and included that towards diesel which was de-regulated on 18th October, 2014. The revised estimates for FY18 are ₹24,460 crore and the fuel subsidy for the year FY19 are ₹24,933 crore. Efforts have been made to lower the fuel subsidy by restricting the products that are to be subsidized as well as target them more effectively. Table 2 shows how these numbers have moved in the last 3 years.

Table 2: Petroleum subsidy provided by the government (in ₹. crore)

	FY15 (A)	FY16 (A)	FY17 (A)	FY18 (RE)	FY19 (BE)
Fuel Subsidy	60,269	29,999	27,539	24,460	24,933

Source: Ministry of Finance

Inflationary impact

Petrol has a weight of 1.60% and High Speed Diesel (HSD) has a weight of 3.09% in the WPI and in terms of the CPI, petrol has a weight of 2.18% and diesel has a weight of 0.14%.

A 10% increase in the fuel prices will lead to a direct increase of around 0.5% in WPI and around 0.25% in CPI. There would be other indirect impact in terms of higher prices of transport, power etc. which could be around 50% of the direct impact.

CARE Ratings Views and Opinion

The inclusion of petrol and diesel under the GST ambit has been long deliberated. Over the past few years when crude oil prices had dropped globally, government had increased the excise duty on petroleum products, which had increased the revenue receipts of the government coffers. With the sharp recovery of crude oil prices globally and with the increase in the prices of the auto fuels, inclusion of petrol and diesel under GST will help in rationalising the prices of these auto fuels.

Table 3: Scenario testing: Retail Price of petrol and diesel under different tax rates

Effective tax rate	90%	80%	60%	53%
	Petrol	Petrol	Diesel	Diesel
Price Charged to Dealers (excluding Excise Duty and VAT)	35.15	35.15	37.42	37.42
CGST	15.82	14.06	11.11	9.88
Dealer Commission	3.60	3.60	2.52	2.52
SGST/UTGST	15.82	14.06	11.11	9.88
Retail Selling Price	70.39	66.87	62.16	59.70
Change from the current RSP	-4.8%	-9.6%	-4.0%	-7.9%

Source: CARE Ratings

Here it is assumed that instead of an effective tax rate of 100% on petrol and 66%\$ on diesel, GST of 90% and 80% are applied on petrol and 60% and 53% on diesel. This is 10% and 20% reduction in effective tax rates of 100% and 66% respectively for petrol and diesel. It is also assumed to be equally distributed across the centre and states.

Assuming the price charged to the dealers, the exchange rate and dealer commission to be constant, there would be a decline in the retail prices by approximately 5-10% in petrol and 4-8% in diesel based on these two scenarios.

Concluding remarks

1. There could be a strong case for bringing petrol and diesel under GST.
2. The present effective tax rates are significantly higher than that of the highest GST slab.
3. By increasing the rates when crude oil price came down, the government was able to garner additional revenue.
4. With crude oil price increasing, the choice is between lowering the tax rate or increasing subsidy.

- Using a combination of the two, and lowering the price of petrol and diesel at the retail level will help to bring down both WPI and CPI inflation. Otherwise, the inflationary impact would be quite significant on both cores and weigh down on the concerns of monetary policy.

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