

CORPORATE RATINGS

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Revision in duty drawback rates for textile exporters: A much-awaited development

Effective December 19, 2018, Indian exporters are set to receive duty drawbacks at the revised rates notified by the Ministry of Finance, Government of India on December 6, 2018. The revision comes nearly a year after the last revision was implemented in October 2017, post transition to the Goods and Services Tax (GST) regime.

With exports accounting for more than one-third of the Indian textile market and the crucial role played by duty drawback in helping the Indian textile exporters maintain their global competitiveness, any revisions in this regard are closely watched. The revision was particularly awaited this time, considering the reduction in duty drawback rates for most textile product categories (with a few exceptions such as cotton yarn, bed/ toilet

/kitchen linen, carpets and curtains) announced last year under the GST regime, when compared with duty drawback rates for exporters claiming Cenvat in the pre-GST era (Columns C and D of Exhibit 1).

While the downward revision last year was implemented in expectation of full input credit availability under the GST regime in contrast to inefficiencies prevalent under the earlier regime, marginal adverse impact on profitability of some of the segments has been witnessed. The uneven flow of taxation through the textile value chain under the earlier tax regime, owing to dominance of unorganized players operating under composition scheme of taxation in some segments, used to result in a break in the input credit chain. Accordingly, most exporters used to claim duty drawback at higher rates without claiming Cenvat (Column B in Exhibit 1) in the pre-GST era. As a result, some exporters used to benefit from the higher duty drawback rates, considering the variations in input taxes blocked across the industry and the flat duty drawback rates, which used to support their profitability. With a shift to the GST regime, all players were required to claim duty drawback at the rates prescribed (Column D in Exhibit 1) after availing input credits.

Exhibit 1: Comparison of duty drawback rates under GST and earlier tax regime, for select products

Duty drawback rates	HS Code (A)	Earlier Regime		GST Regime (D)
		Without Cenvat (B)	With Cenvat (C)	
Apparels made of cotton	620101	7.7%	2.0%	0.9%
Apparels made of blended Fibers	620102	9.5%	2.5%	1.2%
Apparels made of man-made Fibers	620103	9.8%	2.5%	1.2%
Apparels made of silk	620104	7.6%	4.8%	0.4%
Apparels made of wool	620105	8.7%	3.5%	0.9%
Bed/Toilet/Kitchen Linen of Cotton	630201	7.5%	2.0%	2.0%
Curtains of blended fibres	630302	8.5%	2.2%	2.2%
Carpets (knotted) of man-made fibres	570104	8.9%	1.6%	1.7%

Source: Central Board of Excise and Customs, ICRA Research

Exhibit 2: Impact of recent duty drawback revision on India's top textile export categories

HS Code	Commodity	Share in India's exports		Duty Drawback Rates			Major products exported in the segment	Impact on major products exported
		FY18	H1FY19	Earlier (Oct'17 - Dec'18)	Now (From Dec-2018)	Change (bps)		
5205	Cotton Yarn	9%	11%	1-1.2%	1.3-1.7%	30-50	Single Cotton Yarn	Marginally +ve
6109	T-Shirts, vests etc.	7%	7%	2.0%	1.9%	(10)	Cotton T-shirts and Vests	Marginally -ve
6204	Women dresses/ jackets etc.	7%	6%	2-2.5%	2.1-2.4%	(10)-10	MMF, Cotton and Other Dresses	Neutral
5201	Cotton Fiber	5%	5%	0.2%	0.5%	35	Cotton - not carded or combed	Marginally +ve
6304	Furnishing Textiles	4%	5%	1.5-2%	1.5-2.6%	0-60	Cotton and other furnishing articles	Marginally +ve
6302	Home Textiles^	4%	4%	2.0%	2.6%	60	Cotton linen	Marginally +ve
6206	Women tops	4%	3%	2-2.5%	1.9-2.4%	(10)	MMF, Cotton and Other Tops	Marginally -ve
6211	Athleisure & other garments	4%	3%	2.5%	2.4-2.7%	(10)-20	Man-made Fiber Based	Neutral
6205	Men's Shirts	3%	3%	2.0%	1.9%	(10)	Shirts of cotton and others	Marginally -ve
5402	Synthetic Filament Yarn	3%	4%	1.7-2.3%	2.1-3.3%	40-100	Polyester Yarn	Marginally +ve to +ve
6203	Men's Other Apparels	3%	3%	2-2.5%	1.9-2.4%	(10)-10	Cotton/ MMF Trousers and Jackets	Neutral
5208	Cotton Woven Fabrics	3%	3%	1.6-2%	1.4-2.6%	(20)-60	Cotton Fabrics	Marginally +ve for a few
5407	Synthetic Woven Fabrics	2%	2%	1.8-2.0%	1.5-2.2%	(50)-40	Nylon, Polyester or Other Polyamides	Marginally -ve for a few
6111	Babies' Garments/ Accessories	2%	2%	1.9%	1.9%	-	Cotton Babies' Garments	Neutral
6305	Packing Sacks and Bags	2%	3%	1.5%	1.5%	-	Flexible Intermediate bulk containers	Neutral

^ India's top textile export categories

Note: Drawback rates and change mentioned are for the major exported product categories within the broader commodity segments

Source: Central Board of Indirect Taxes & Customs, ICRA research

The recent revision in duty drawback rates announced by the Government of India holds a mixed bag for the Indian textile exporters. As per ICRA's estimates, the impact is likely to be neutral to marginally positive for the top 15 product categories accounting for nearly two-thirds of India's total textile exports (Exhibit 2), while being marginally negative for a few. Besides, removal of drawback caps (absolute caps, per unit) in several product categories where the drawback rates are less than 2%, will also benefit the textile exporters.

Some prominent product categories which are expected to benefit marginally, to the extent of 30-60 bps, include cotton yarn, cotton fiber, cotton-based furnishing and home textiles. Unlike synthetic filament yarns where Indian exports are reasonable (~3-4% share in India's textile exports) and the increase announced is in the range of ~40-100 bps, higher increases in the range of 80-140 bps have been announced for synthetic spun yarn and related products, possibly with the objective of improving competitiveness of Indian manufacturers lacking scale vis-a-vis their International counterparts.

Maximum boost, ranging between 150-600 bps, has been implemented for niche segments such as wool/ silk-based products. Although these segments account for a miniscule portion of the total textile exports of the country, these are of strategic importance considering the dominance of Small and Medium Enterprises (SMEs) and handicrafts sector in these segments. Further, there have been some exceptions such as nylon filament yarn, which has been introduced in the list with a significant duty drawback rate (6.7%), which is expected to support profitability of players in this segment and strengthen India's exports in this category.

Notwithstanding the variations across categories, the recent revisions in duty drawback rates are expected to be marginally positive for the profitability and competitiveness of most segments of the Indian textile exporters. This is more so, given that export incentives (including Merchandise Exports from India Scheme (MEIS), Rebate of State Levies etc., besides duty drawbacks) are seen to have a meaningful contribution (upwards of 60% for the downstream segments such as home textiles and apparels) in the operating profits of textile exporters. Besides, given the modest net profitability of 2-4% for most product segments in the industry, the upward revision in export incentives by even 35-40 basis points (bps) on an average translates into a 10-15% improvement in net profits.

Having said that, ICRA maintains that the Indian textile industry continues to face concerns on continuance of these export subsidy schemes, after being challenged at the World Trade Organisation (WTO). Going forward, steps taken by the Government to address these concerns remain crucial for the profitability and competitiveness of the sector participants. In the meanwhile, recent revision in duty drawbacks provides visibility on their profitability in the near term.



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