Implications of GST on Clean Energy

At the stroke of midnight on July 1st 2017, India paved way for what is being called the biggest tax reform in the country, the Goods and Services Tax (GST) replacing a slew of indirect taxes with a unified one. The historic connotation of the timing was recreated to position GST as the panacea for economic growth, the most progressive move for India since the Independence; however, all its benefits are yet to be scrutinized and analyzed.

Consumption or sale of electricity, including from renewable energy, has been kept outside the ambit of GST but various taxes are levied on procurement of goods and services. The taxes paid against such procurements become a cost – which translate into higher pricing of the end product. The Government has always strived to promote renewable energy in India and accordingly, various exemptions had been provided to the sector. However, now, within the GST regime the renewable energy sources have been brought under various tax brackets.

GST and it’s components

GST is a uniform indirect[[1]](#footnote-1) tax levied on goods and services across the country; as an umbrella tax, it will replace central taxes like central excise, service tax, additional duties of excise & customs, special additional duty of customs, besides cesses and surcharges, on supply of goods and services.

Even though the principle of GST is to introduce a single uniform tax rate for all goods and services, the Indian government has introduced four[[2]](#footnote-2) slabs of tax structure for different goods and services. GST Council[[3]](#footnote-3)finalized a four-tier GST tax structure of 5%, 12%, 18% and 28%, with lower rates for essential items and the highest for luxury and de-merits goods that would also attract an additional cess.

In a federal system like India where the Centre and the States have powers to levy and collect taxes through appropriate legislation, dual GST has been introduced. The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services and Integrated GST (IGST) - which will be levied by Central Government on inter-State supply of goods and services The GST levy will potentially impact both manufacturing and services sector for the entire value chain of operations – procurement, manufacturing, and distribution, warehousing, sales, and pricing.

*In the earlier system, tax was levied at each stage separately by the Union government and the States at varying rates, on the full value of the goods. Under the GST system, tax will be levied only on the value added at each stage. It is a single tax (collected at multiple points) with a full set-off for taxes paid earlier in the value chain. Thus, the final consumer will bear only the GST charged by the last dealer in the supply chain with set-off benefits at all the previous stages.*

GST and the RE Sector

Despite India’s plan to push 175GW of renewable power by 2022, GST for solar and wind energy are put in a higher tax bracket than before. The GST was expected to bring about reduced tax exemptions and considering that the renewable energy sector did benefit from various exemptions and concessional duty earlier, an impact on the ‘delivered cost of renewable energy’ under the GST regime is very likely.

* While the solar sector enjoyed tax exemption in most states until recently, under the GST regime, taxes will be levied at 5%.
* The wind energy sector also faces a marginally negative impact, as the rates for its components such as the electricity generator, rotor, wind turbine controller increases to 5% from the earlier 3-4%.
* As all engineering services come under the 18% bracket, the wind equipment manufacturers with a task of setting up projects for developers, which being a service, will attract 18% GST, up from 12 % tax on engineering services earlier.
* Biomass, earlier slated to be under the 12% slab has been brought under the 5% too
* Interestingly, along with wind and solar, coal has also been brought under the 5% bracket. A substantial drop from the earlier 11.69%.
* The coal cess currently contributing to the National Clean Energy & Environment Fund (NCEEF) with a mandate to finance and promote clean energy initiatives is a carbon tax that will now be redirected to be used to compensate states for the loss of revenue due to the GST regime.

While the final impact of GST on individual grid connected projects may not be much, the impact on the overall sector needs to be assessed a little more in detail in view of the reduced coal prices, decreased NCEEF and costlier support equipment like batteries.

Industry Opinion

The GST rates are bound to translate into an increase in the cost of production, at ***3.5-4.5% for solar*** and ***4% for wind***, according to industry experts. Leading upto the launch in July, the earlier GST Council reports had slated for the renewable energy sector to be taxed under the 18% slab – which had induced some fear in the industry, however, the recent revision to 5% is more acceptable for the sector. With the dynamic and flourishing nature of the solar industry, the experts are of the opinion that increase in project costs could rectify itself in a few months’ time. However, with the possibility of electricity generated from coal dropping – the situation needs to be analyzed closely.

While the Energy Minister is of the opinion that a lower GST rate of 5% on coal would help DISCOMS provide power at affordable rates, clubbing coal into the same bracket as renewables is a major setback to the years of efforts of the Government to achieve grid parity promoting renewable energy in the country.

When the GST was announced the differential taxing of various components of a solar or wind projects has raised a red flag in the sector, with the experts being cautious about the implications of the ambiguity of the GST reforms – which taxes solar projects at 5% but GST rate varies from 18% for capital goods such as inverters and module mounting structures to 28% for cables and batteries. This issue was raised by the renewable energy developers to the Ministry of New and Renewable Energy which eventually clarified that components such as cables and batteries used for solar projects will be taxed at 5%.

Key Takeaways

1. A major concern for the sector is the ***lack of clarity on the ambiguity of the GST rates***. Taking solar as an example, while taxes are levied at 5% for solar projects, many other remaining components have been identified under the 18% or 28% tax slab – for very small installations of 100 kW in residential sector, solar inverters used will invite 18% GST. However, the MNRE offered some clarity in this issue by stating that the components used for solar projects will all be charged at 5% - the only catch is that project developer will have to pay 28% and will be able to claim the refund provided he has the receipt while filing his taxes. The operational clarity is yet to come.
2. While the renewable energy industry seems fairly optimistic with the 5% tax bracket, the bigger concern here is the undoing of the all the efforts to bring renewables at a grid parity to coal. The ***60% decline in taxation on coal*** is likely to make thermal power cheaper by as much as Rs 0.15; this could unravel the advances made to push renewables to the mainstream, despite the record low rates seen, an increase in tariff could translate to Rs 2.44/kWh to Rs 2.56/kWh – which would increase the financial burden of the utilities. The overall tax depreciation of the coal industry has a high probability of ensuring that the utilities in the future opt for coal based power, which with the drop in price would be cheaper than the solar or wind based electricity.

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| --- | --- |
| Source of RE | Tax rate under GST |
| Solar PV – Grid | 5% |
| Solar – Off Grid | 5% |
| Wind Energy Projects | 5% |
| Biomass Projects | 5% |
| Waste to Energy Projects | 5% |

**The tables below depict lack of clarity for the renewables sector with the GST tax rates**

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| --- | --- |
| Components of RE projects | Tax rate under GST |
| Solar Batteries | 18-28% |
| Solar Mounting Structure | 18% |
| Cables | 18% |
| Services | 18% |
| *Developers can claim a refund later where they will be charged 5%* | |

* *A 60% decline in the tax on coal, bringing it into the same bracket as solar, wind i.e.5% undermines the continued efforts to bring renewables on par with coal based power*
* Consequences of simultaneously taxing renewables and reducing tax on coal paints a regressive picture for a nation committed to increase its renewable energy capacity to 175GW by 2022

Road ahead

The GST reform in the country was a long time in the making, but even as it was rolled out recently there are many teething issues which need to be addressed to ease the way. Clarity and a vision of the larger picture needs to be comprehended.

* Lowering the taxes on coal put renewables at a direct disadvantage, especially since India has been consciously and loudly making its transition to a low carbon economy. India with its ambitious plans of 175 GW of renewable energy by 2022 seems to have created hurdles for itself. The repercussion of taxing renewable goods and services whilst bringing down the tax levied on coal will have a regressive effect on the progress made in the renewables sector. The most obvious question that arises here is if the government has conducted the studies and calculations to understand the consequences of this move for the power sector in the country.
* The redirection of the funds collected under the NCEEF is another contentious issue; questions regarding the legitimacy of such a move needs to be raised, the rationality of utilizing funds set up for a completely different purpose being superseded by the GST law needs to be clarified.

While Solar was never taxed before, the 5% GST rate will put the domestic sector at a disadvantage; already the domestic solar modules were slightly more expensive than the imported ones. The Government needs to reassure the domestic sector which already faces tough competition from the lesser costing Chinese solar models, with a well thought out action plan to put them at an advantage.

India’s firm pledge towards renewable energy, building a low carbon economy will face some a bumpy path ahead. The gravitas of decreasing the tax on coal showcases the lax in commitment of the country which has an ambitious target to have almost 50% of renewables to be a part of the energy mix in 5 years. Synchronization between India’s ambitions and targets with the tax reforms are a must for them to translate to reality. While the sector awaits clarity, if these issues are not ironed out, far from being a panacea for economic growth, the GST could end up reversing some of the landmark achievements of India’s renewable energy sector.

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1. Indirect taxes are levied on consumption while direct taxes are levied on income [↑](#footnote-ref-1)
2. As India observes substantial income inequality different items used by different segments of society have been taxed differently. [↑](#footnote-ref-2)
3. Comprising the Union Finance Minister (Chairman of the Council), the Minister of State (Revenue) and the State Finance/Taxation Ministers to make recommendations to the Union and the States [↑](#footnote-ref-3)