Annapoorna and GST | The Weird Follies of an Imperfect Indirect Tax Regime

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India's first Goods and Services Tax (GST) regime with the aim of unifying and simplifying the nation's complex indirect tax structure was introduced by the Modi government in July 2017.

While in principle it would progressively streamline indirect taxes over time, the GST system also presented significant challenges for various sectors, including the restaurant industry.

> A recent incident in Tamil Nadu has exposed the oft-pointed disparity in the taxation of raw and processed food products which adversely impacts restaurants, influencing pricing, operations, and subsequently, consumer behaviour.

Indeed, a matter involving buns and cream and a famous Coimbatore restaurant chain has left the Tamil Nadu BJP with egg on its face. More about that here.

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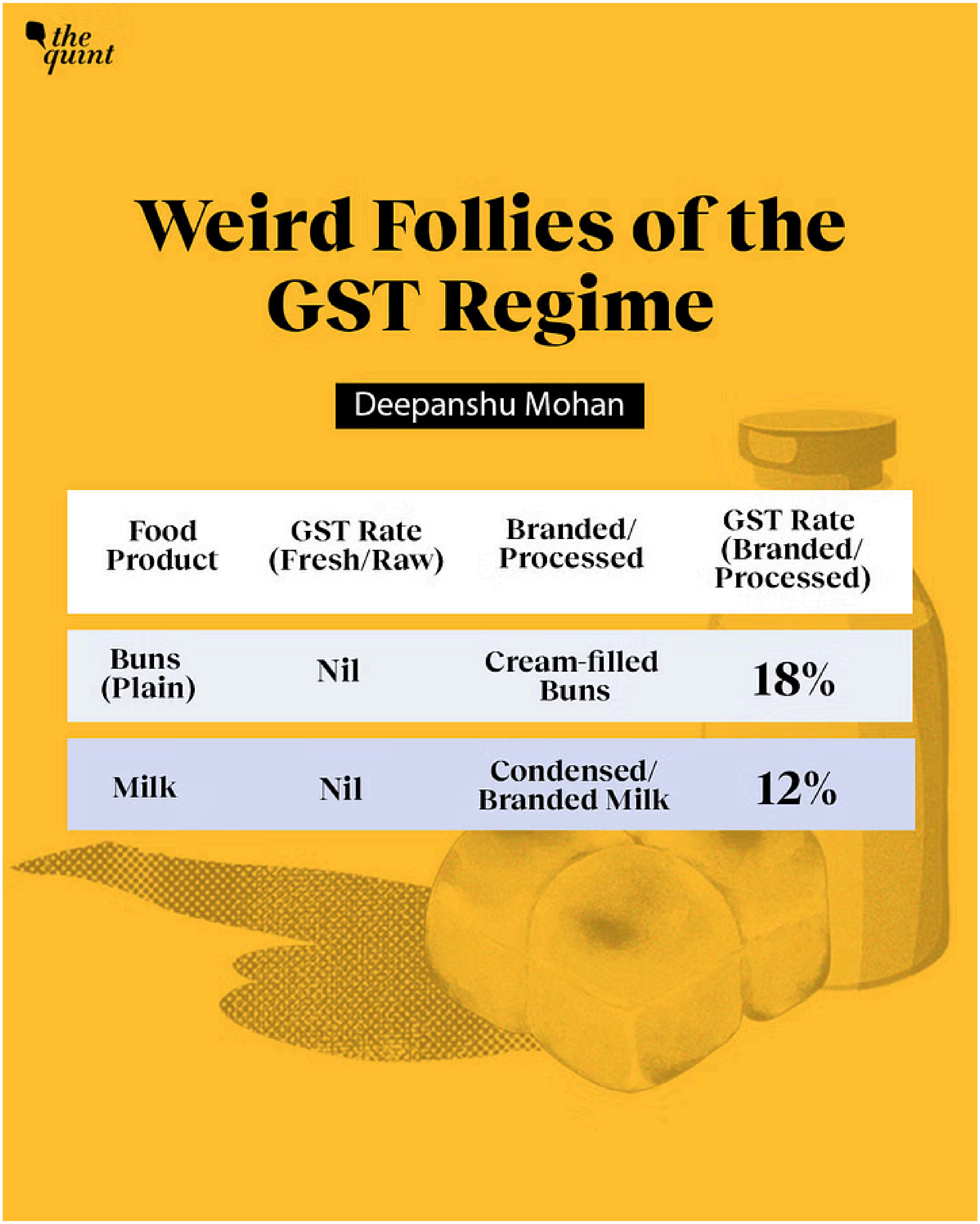
The GST regime in India operates on multiple tax slabs, primarily five percent, 12 percent, 18 percent, and 28 percent, with different food products falling under these categories.

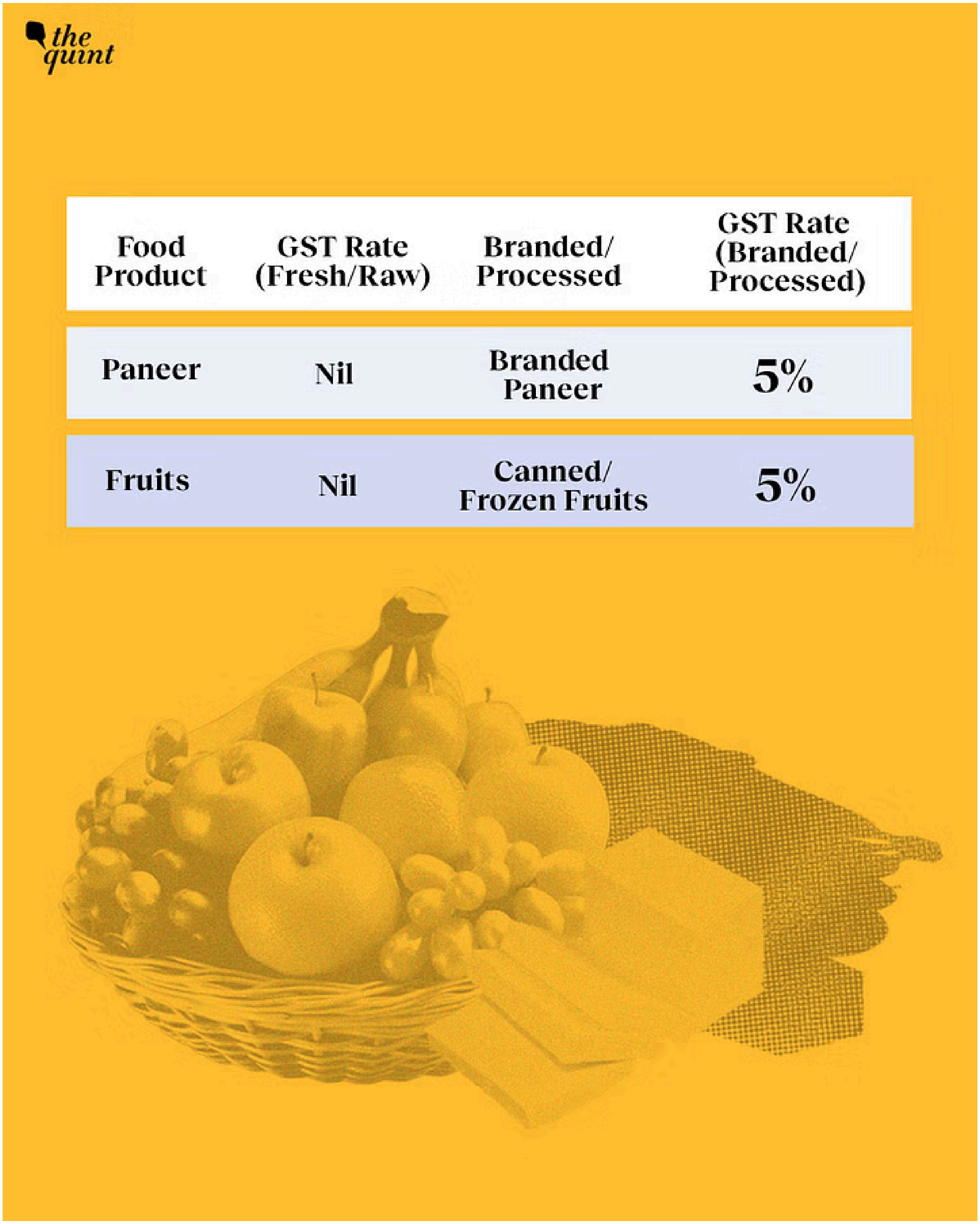


Food Product	GST Rate (Fresh/Raw)	Branded/ Processed	GST Rate (Branded/ Processed)
Buns (Plain)	Nil	Cream-filled Buns	18%
Milk	Nil	Condensed/ Branded Milk	12%

The disparity in the taxation of raw and processed food products.

(Photo: The Quint)

Basic raw ingredients like fresh vegetables, grains, and milk are either exempt or taxed minimally at five percent, while processed food products such as pre-packaged meals, sauces, and condiments attract much higher rates, ranging from 12 percent to 28 percent.



Food Product	GST Rate (Fresh/Raw)	Branded/ Processed	GST Rate (Branded/ Processed)
Paneer	Nil	Branded Paneer	5%
Fruits	Nil	Canned/ Frozen Fruits	5%

The disparity in the taxation of raw and processed food products.

(Photo: The Quint)

For restaurants, GST is levied at two standard rates:

Five percent for restaurants that do not claim input tax credit (ITC)

18 percent for restaurants that claim ITC

While this simplifies the taxation structure for restaurants, the aforementioned variation in GST rates creates complexities.

Food Product	GST Rate (Fresh/Raw)	Branded/ Processed	GST Rate (Branded/ Processed)
Rice	Nil	Pre-cooked/ Packaged Rice	5%
Atta, Maida, Besan	Nil	Branded Packaged Flour	5%
Natural Honey	Nil	Branded Honey	5%

The disparity in the taxation of raw and processed food products.

(Photo: The Quint)

Restaurants rely heavily on a mix of raw ingredients and processed or semi-processed food products to manage kitchen efficiency and provide a wide array of dishes.

> But this disparity in taxation creates a pricing imbalance for restaurants. Establishments that rely on processed or pre-prepared ingredients for quicker service and consistency face higher costs due to the increased GST on such products.

This raises overall operating expenses, which are often passed on to consumers through higher menu prices. Furthermore, this price escalation can hurt smaller, quick-service restaurants or chains. These higher costs can erode profit margins or necessitate frequent price increases, ultimately affecting customer retention.

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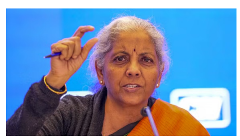

Restaurants, especially those in fast food and quick-service categories, depend on processed ingredients to maintain speed, standardisation, and convenience. The GST disparity between raw and processed ingredients complicates supply chain management.

> The higher tax on processed foods means that restaurant chains must balance their procurement strategies carefully, often weighing the benefits of using pre-prepared ingredients against the increased cost burden.

For example, a fast-food chain serving pizza might opt for pre-packaged sauces and toppings to maintain uniform taste across outlets. However, the high GST on these processed goods adds to their operating costs.

In contrast, a fine-dining restaurant that uses fresh ingredients sourced locally may benefit from lower tax rates but might also face more complex inventory management and preparation processes.

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The impact of these GST disparities is felt more acutely by restaurants in urban areas compared to those in smaller cities or rural areas as they depend more on processed and semi-processed food products due to the high demand for quick service and convenience.

In contrast, restaurants in Tier-II and Tier-III cities may have more access to fresh, locally sourced raw ingredients, which are either tax-exempt or attract minimal GST. This reduces their cost burden and allows them to price their menu items more competitively compared to their urban counterparts.

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To mitigate these challenges, the following reforms could be considered:

1. **Reducing GST on Essential Processed Foods**: Lowering the tax rates on minimally processed and essential food products commonly used by restaurants
2. **Simplification of ITC Utilisation**: Streamlining the ITC system for restaurants could help them maximise the benefits of GST credit, especially when they procure a mix of tax-free raw ingredients and higher-taxed processed products
3. **Encouraging Locally Sourced Ingredients**: Incentives for restaurants that source locally grown, fresh ingredients could promote the use of raw materials with lower GST rates, helping reduce operational costs while supporting local farmers

Reforms in the GST structure, particularly for processed food products, could help create a more level playing field for restaurants, improve operational efficiency, and ensure that dining out remains an affordable option for consumers across the country.

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