

Demerit Goods under GST

September 3, 2020

Demerit or sin goods are, as the name suggests, in economics, demerit goods are **“goods or services whose consumption is considered unhealthy, degrading, or otherwise socially undesirable due to the perceived negative effects on consumers themselves”**. Luxury goods are goods for which **demand increases more than proportionately as income rises, and is a contrast to a “necessity good”**, for which demand increases proportionately less than income. Luxury goods are often synonymous with superior goods and veblen goods.

Demerit Goods Under GST

Demerit goods are usually over-consumed if left to market forces. Examples of demerit goods include tobacco, alcoholic beverages, recreational drugs, gambling, junk food and prostitution. Because of the nature of these goods, **governments often levy taxes on these goods (specifically, sin taxes), in some cases regulating or banning consumption or advertisement of these goods.** The GST Council has bracketed four items into this category – **high end cars, pan masala, aerated drinks and tobacco products.** Consuming pan masala and tobacco products have serious negative health implications, aerated drinks have low nutritional value and high end cars guzzle fuel and cause environmental harm.

The GST council had agreed to cap the cess on various so-called demerit (or sin and luxury) goods in the legislation. The cess on colas and cars was capped at 15%, which means that the total tax incidence on sweetened drinks and cars cannot be more than 43% (tax rate of 28%+cess of 15%). **These cess rates are an enabling provision and the actual tax incidence could be lower, depending on the decision of the GST council.** The capping of cess is done at a higher rate only to give the GST Council more headroom in the future if there was a need to

increase those.

The cap for pan masala is 135%. On tobacco and cigarettes, the cap is 290%, or Rs 4,170 per 1,000 cigarette sticks. **The cess would be applicable for five years, the period for which the Centre has committed to compensating states for potential revenue losses. This period could be extended by the GST Council.**

A merit good or service is something that **adds to the welfare and well-being of society when it is produced and consumed.** An example of a pharma company producing a vaccine to inoculate children against Hepatitis B. That will clearly mean better health for citizens and a more productive workforce. This is a clear example of a merit good, the production of which the Government will want to encourage.