Electronic Gold Receipts (EGR) – GST issues and their resolution

C.S.Verma
Managing Director & Chief Executive Officer
FirstAdvantage Consulting Group Ltd.

Gold is recognised internationally as a quasi-currency, a precious metal and a safe-haven against economic and geopolitical turmoil. It usually displays a negative correlation with other asset classes like stocks and bonds, thereby performing the role of a portfolio diversifier.

As per World Gold Council (WGC) report the global supply for gold in 2024 has been 4,975 tonnes (3605 tonnes mined and 1,370 tonnes recycled). Out of the total global supply mentioned above, the global demand for gold in 2024 is: Jewellery 2004 tonnes, Technology & Industrial 326 tonnes, Bars & Coins 1180 tonnes, Central Banks 1044 tonnes and Over-the-Counter (OTC) & others at 421 tonnes.

Gold is deeply inter-woven into Indian socio-economic fabric, both as an ornament and as an asset class. There is an innate wisdom around owning this precious metal that has passed on from generation to generation, giving Indians a penchant for holding gold as an investment and a safe-haven.

India's gold market is one of the largest in the world, with annual consumption (imports) ranging from 700 to 900 tonnes. As per WGC, the India gold demand for 2024 report is 803 tonnes (Jewellery 563 tonnes + Bars & Coins tonnes 240 tonnes). If EGRs capture even 10% of the annual gold consumption in India, it could result in trading volumes of 70 to 90 tonnes per year, valued at approximately ₹90,000 crore (~$10 billion).

Further, according to the WGC, Indian households hold approximately 25,000 tonnes of gold, valued at over $2 trillion. Converting even a small fraction of this into EGRs can create a substantial market. As per the recent data, out of the total quantity of household gold jewellery, the gold pledged for loans is about 5,300 tonnes.

As per the WGC report (2024), the Indian old gold jewellery (scrap) recycling industry has grown from 75 tonnes in 2021 to 114 tonnes in 2024. The recycled gold is refined by the Indian refiners and add to the gold consumption requirement of India which has the potential for flowing into EGR.

The organized jewellery market has witnessed an 18-19% revenue CAGR in recent years, significantly outpacing the overall jewellery market's ~8% CAGR during FY 2019 - FY 2024. Leading organized players like Titan, Kalyan, and Senco have even achieved a collective revenue CAGR of 20% in this period.

All these factors point towards a latent potential for success of an organised platform and electronically tradeable instrument like EGR.

The Union Budget in 2021 catalysed setting up regulated gold exchanges in India. In line with the same, the Securities and Exchange Board of India (SEBI) stipulated the guidelines and framework for the EGR to be traded on regulated Exchanges as a separate segment.

Benefits of EGR to Indian economy

EGR has been notified as a "Security" under the Securities Contracts (Regulation) Act 1956. EGRs were conceptualised for exchange-grade gold to be deposited into approved vaults under depository supervision, converted into electronic units, which were to be traded on exchanges and subsequently held in demat accounts. This was aimed at creating a unitary instrument for organised investment and accumulation of gold as an asset class under the three-way organised assurance of Regulator, Exchange and Depository via authorised vault managers. This was aimed at enabling a vibrant electronic spot market for gold which is reliable, organised and convenient. The gold exchange, along with intermediaries like the vault manager and the clearing corporation, would facilitate the creation of EGR, its trading and redemption.

Thus, EGRs would improve transparency, pave way for uniform spot price discovery, quality assurance and greater integration with financial instruments and help actualise the vision behind monetization and financialization of gold in line with the Niti Aayog Report's recommendations for transforming India's gold markets. EGR could bring household gold stocks (arguably 25000 tons) back into circulation, increase recycling and reduce import dependence.

The young generation of professionals would find this an attractive proposition for investment rather than jewellery that involves loss of making charges. EGR come with multiple advantages of quality assurance, ease of electronic holding and freedom from counter-party risk.

However, EGR is first such Security that is converted from physical form and hence, lacks supporting GST framework which is inhibiting its success in meeting the Government vision and fulfilling its design purpose.

The EGR transaction process

EGR involves a transaction that converts an asset into a security. Current GST Act does not have direct provisions to cover tax implications for such a transaction which covers conversion and redemption from physical asset to security and vice-versa. The following GST issues and implications need to be resolved:

<u>GST Issues and their Resolution:</u>

1. **Deposit and Conversion of gold into EGR and subsequent trade**
   EGR is physically backed and can be interpreted as document of title backed by underlying gold. There is lack of clarity on Conversion of gold into EGR and subsequent first trade on being taken as 'supply' under GST (since title is given up by the depositor on first trade on exchange). Hence, the proposal is to

specifically exempt the conversion of gold into EGR from GST applicability. Notably, Government already notified exemption on transfer of capital asset being conversion of gold into EGR issued by designated Vault Manager, from scope of capital gains under Income tax. Similar exemption is sought under GST.

EGR being 'Securities', it is outside GST ambit. Since there is no relationship between initial Depositor and the ultimate buyer who redeems EGR into Gold, GST paid will be cost in hands of depositor (at 3%). Hence, there is no framework to discharge GST since EGR are traded on exchanges with no ability of seller to charge GST on conversion of EGR into gold.

2. **GST on subsequent trading in the form of EGRs on Regulated Exchange** Trading of EGRs is exempt from GST as a "Security" is exempt from GST]

3. **GST on final conversion of EGR into Gold**
   Final conversion of EGR into Gold should genuinely attract GST, since there is purchase of physical asset - gold.

Amendments proposed in GST for creation of EGR on gold that are revenue neutral

1. Generating EGR for Banks and Nominated Agencies importing Gold:
   Currently Banks and nominated agencies are not required to pay GST on import of Gold bars at custom port. They have to pay GST only after selling these imported gold bars. It is recommended that all banks and nominated agencies should be asked to convert gold Bars in to EGR so that same EGR can be traded on the exchange. Thus Following amendment in GST law is required:
   a) Gold Importing bank and nominated agencies should be asked to pay GST at port of import, if they do not give undertaking to convert imported Gold bars in to EGR. However, if they give undertaking to convert imported gold bars to EGR by transferring gold bars to the approved vaults, no GST should be levied at port of import.
2. EGR for Gold Refiners who import raw Gold Dore for refining and are using custom bonded warehouse arrangements:
   Currently Gold refiners having bonded warehouse facility are not required to pay GST until the Gold bars produced by them is sold. It is recommended that all Gold refiners having bonded warehouse should be asked to convert all Gold bars in to EGR so that same can be traded on the exchange. Thus, following amendment in GST law is required.:
   a) Gold Dore Importing Gold refiners who have bonded warehouse should be asked to pay GST at the time of removal of refined goods from bonded warehouse, if they do not convert Refined Gold bars in to EGR. However, if they convert Refined gold bars to EGR, no GST should be levied on removal of goods from bonded warehouse to approved vaults.
3. How to generate EGR for Refiners importing Gold Dore for manufacturing Gold Bars and not having bonded warehouse:
   Currently Gold refiners not having bonded warehouse facility are required to pay GST at port while importing gold dore. It is recommended that all Gold refiners not having bonded warehouse should be asked to give declaration at import port to GST that all Gold bars produced shall be converted in to EGR so that the same can be traded on the exchange. Thus, the following amendment in GST law is required:
   a) Gold dore Importing Gold refiners should be asked to pay GST at port of import, if they do not give undertaking to convert Refined Gold bars in to EGR. However, if they give undertaking to convert Refined gold bars to EGR by transferring refined gold bars to approved vaults, no GST should be levied at port of import.
4. How to generate EGR for Refiners buying scrap Gold/old gold & jewellery and converting to Gold bars:
   a) Currently GST exemption is given for purchase of scrap gold from individual to refiners. GST is required to be paid only on sale of Gold bars produced by the refiners. Thus, it is recommended that Gold refiners buying scrap gold/jewellery should be asked to convert all gold bars produced by them to EGR so that same can be traded on the exchange. No amendment in GST is required in this case.
5. How to redeem EGR: Any holder of EGR can visit intermediary for converting EGR to Gold by asking vault to transfer gold to holder of EGR. The intermediary shall raise an invoice in all cases in favour of EGR holder and shall also collect GST and deposit the same to the authorities. Thus, GST is collected when the Gold is physically delivered to the EGR holder willing to have physical gold. Thus following amendment is required in GST:
   a) When the securities are converted to commodity, it should remain within the ambit of supply and appropriate GST should be collected by the depositories for the same and paid to the revenue.

There is no revenue implication in the above proposed amendments. The changes suggested above can potentially bolster the EGR trade which has currently remained a non-starter, thereby fulfilling the Government's vision for an organised gold spot market in India.

Conclusion

It may be about time that India monetises domestic stocks of gold and enables this vibrant instrument as a unitary, electronic, organised and convenient tool and a vehicle for unlocking the potential of Indian economy by circulating the gold among investors and industry alike. A comprehensive approach towards GST enablers which is needed to support this vision behind EGR, is seen as the need of the hour.

In conclusion, the success of Electronic Gold Receipts (EGRs) would be a watershed moment in modernizing India's gold market, improving financial inclusion and contributing to growth of an organised eco-system around gold. With the help of technology and regulatory oversight, EGRs would create an effective platform for both investors as well as for the bullion industry.