Extending GST Compensation Cess

What is the issue?

The transition to GST is still in progress. Considering the uncertainty in revenue collections states demand that the compensation scheme that would end by June 2022 should continue for another 5 years.

What is GST compensation cess?

- Implementation of GST intended to eliminate cascading effect on domestic taxes and evolve a value-added tax on goods and services.
- The States agreed to forgo their revenue autonomy in favour of tax harmonisation.
- To compensate revenue loss incurred by states in implementing GST the Union government promised to pay compensation during the evolutionary phase of first 5 years.
- The shortfall in revenue that the States would have got from the taxes merged under GST would be compensated.
- The merged taxes in 2015-16 were taken as the base and a growth rate of 14% was applied every year.
- To finance the compensation requirements, a GST compensation cess was levied on notified goods such as tobacco products, automobiles, coal and solid fuels manufactured from lignite, pan masala and aerated waters.

What was the reason for mistrust?

- In the first two years the compensation to be paid was modest and the compensation cess collected was in excess.
- In 2018-19, the shortfall in the cess collections was met from the surpluses of the previous two years.
- However, in 2020-21, due to lockdown the loss of revenue to States was estimated at Rs. 3 lakh-crore of which Rs. 65,000 crore was expected to accrue from the compensation cess.
- Of Rs 2.35 lakh-crore, the Union government decided to pay Rs. 1.1 lakh-crore by borrowing from RBI under a special window
- The interest and repayment were to be paid from compensation cess to be collected in future.
- This plunged the Union-State relationship to a new low, creating humongous mistrust.

What are the Core issues?

- Although it was hoped that the tax structure would stabilise in the first five years, the reform is still in transition.
- **Return filing -** The technology platform could not be firmed up for a long time due to which the initially planned returns could not be filed.
- This led to large-scale misuse of input tax credit using fake invoices.
- The adverse impact on revenue collections due to this was compounded by the pandemic-induced lockdowns.

- **Revenue uncertainty for states –** GST is the only major source of revenue for the States.
- They wanted to mitigate revenue uncertainty to increase the spending commitments to protect the lives and livelihoods of people.
- They have no means to cushion this uncertainty
- Finance Commission which is supposed to take into account these uncertainties has already submitted its recommendations
- The next recommendations will be available only in 2026-27.
- This will have a adverse effect on public service delivery.
- **Structure of GST -** In addition to four main rates (5%, 12%, 18% and 28%) there are
    - special rates on metals, precious and semi-precious stones
    - Cess on 'demerit' and luxury items (15% to 96% of the tax rate).
- Multiple rates cause administrative and compliance problems create inverted duty structure and lead to classification disputes.
- This cannot be done without the cooperation of States. States would be unwilling to agree to rationalise rates unless the compensation payment for the revenue loss is continued.
- Restructuring is necessary to enhance the buoyancy of the tax

What needs to be done?

- Significant reforms in GST structure
- Reduction of items included in the exemption list of consumer price index to broaden the base of the tax.
- Bring petroleum products, real estate, alcohol for human consumption and electricity into the GST fold.
- Restructure the GST to unify the rates.
- 15th Finance Commission points that the compensation scheme applying 14% growth on the base year revenue was far too generous.
- Rate of growth of revenue for calculating compensation must be linked to the growth of GSDP in States to ensure the comfort of minimum certainty on the revenue.
- This will incentivise them to accomplish the reform in the true spirit of cooperative federalism.
- Extending the compensation payment for the loss of revenue for the next 5 years.

Reference

1. https://www.thehindu.com/todays-paper/tp-opinion/extending-gst-compensation-as-a-reform-catalyst/article38245410.ece

SHANKAR IAS PARLIAMENT
Information is Empowering