

States may not get GST compensation in full, says Finance Ministry

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Centre for rate hike to make up for Rs 30K-cr revenue gap.

State governments are unlikely to get the full compensation promised for shortfall in goods and services tax (GST) collection as the finance ministry says the amount will be given only through money collected from the cess imposed for this purpose.

A key ministry official said states should agree to hike GST or cess rates in the Council meeting, the date for which is yet to be fixed.

Earlier, the impression was that whatever losses states bore would be fully compensated to them for five years from the date of GST rollout. The states might not get the full amount of their losses despite the recent Union Budget carving out a special dispensation from the surplus collected through the compensation cess in previous years.

With the GST revenues of many states facing contraction over the previous year and cess realisation lower than required, the shortfall could be around Rs 30,000 crore, even after taking into account the Budget proposal of a special dispensation.

After this year's provision of special dispensation, said officials, transfers to the compensation cess fund will, henceforth, be limited to collections through cess, which is levied on items such as aerated drinks, coal, paan masala, cigarettes and automobiles over the peak rate of 28 per cent.

Central Board of Indirect Taxes and Customs Member John Joseph, who was officiating as chairman at the time of Budget preparation, told Business Standard the compensation to states would be made only if available.

"The law is very clear. It says that for the purpose of paying compensation, compensation cess will be introduced. Compensation will be given from that. If that cess is not coming up to the required amount, the law does not say that you can take it from central GST...", he said.

States are free, he added, to increase the GST or cess rates to get full compensation.

Earlier, states were assured that their revenues would be protected to the extent of 14 per cent growth on the base year of 2015-16 for five years from the date of GST rollout, which was July 1, 2017.

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Clause 18 of the Constitution Amendment Act for GST stated “Parliament shall...on recommendation of the GST Council provide for compensation to the states for loss of revenue arising on account for implementation of the GST for a period of five years”.

Subsequently, the GST (Compensation to States) Act was passed, which states that compensation would be payable from the GST Compensation Fund.

Experts say the spirit of the law is that states will be fully compensated for revenue shortfall for a five-year period, assuming a 14 per cent growth rate, while the Centre was going by the letter. “Ideally, the Centre should not go back on its word given to states,” said an indirect tax expert, who did not wish to be named.

The Centre has estimated a compensation cess shortage of Rs 63,200 crore in financial year 2019-20 (FY20). In the first 10 months of FY20, GST collection grew 4.6 per cent. The central government will transfer a surplus from the previous two years of Rs 35,000 crore in two installments to the compensation fund. This still leaves a gap of around Rs 28,000 crore.

“It is decided to transfer to the GST Compensation Fund balances due out of collection of the years 2016-17 and 2017-18, in two installments. Hereinafter, transfers to the fund would be limited only to collection by way of GST compensation cess,” Union Finance Minister Nirmala Sitharaman had said in her Budget speech.

Joseph says, “If the compensation cess is not giving enough money, let them (states) increase the rate of cess or GST rates or add more items. The Centre never said that it will oppose the raising of rates.”

GST revenue of 23 states till end-December was Rs 15,100 crore lower than last year’s or a 3.9 per cent decline YoY. If revenue loss is assumed on the basis of 14 per cent growth, it would mean a shortfall of Rs 69,000 crore for these states till December. The loss would be much more, since 14 per cent growth for compensation in the GST laws is taken on the base year of FY16.

Compensation cess collection is Rs 7,000-8,000 crore a month, as against the compensation requirement of Rs 14,000-15,000 crore a month.

In the April-December period of FY20, Punjab’s and Andhra Pradesh’s GST collections fell by 16 per cent, that of Uttar Pradesh by 11 per cent, Kerala by 12 per cent, Gujarat by six per cent and Telangana by eight per cent. States have received compensation till September so far in FY20.

The Centre has pegged cess collection at Rs 98,000 crore in the Revised Estimate of FY20, which is Rs 10,000 crore lower than what was estimated at the beginning of the financial year.