Breaking down GST: slabs, payments, dispute

The Centre and the states are in a tussle over delayed compensation payments under GST. What led to this, how much is due, and what is being done about it?

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THE GOODS and Services Tax (GST), rolled out in July 2017, marked a major shift from the traditional production-linked tax to a consumption-based tax. The new regime subsumed state levies such as VAT, sales tax, octroi, entry tax, together with central levies such as excise and service tax. States gave up some of their taxation rights in lieu of the Centre passing on their revenue share under GST and also compensating them for potential revenue losses in the first five years.

The tussle between the Centre and the states, which has escalated in recent weeks, involves the passing on of this share, and the payments under the compensation cess head.

What does GST include?
GST includes a tax levied by the Centre on the intra-state supply of goods and/or services called Central GST (CGST), and a corresponding tax levied by states/UTs called the State GST (SGST/UTGST) on these goods and services. CGST and SGST are levied simultaneously on every purchase of goods and services, except exempted ones. The consumer pays an overall rate under one of the major tax slabs—5%, 12%, 18% and 28%—out of which half accrues to the Centre and half to the state where consumption happens.

Integrated GST (IGST) is the GST levied on inter-state transactions and exports/imports of goods and services. IGST is a combination of SGST and CGST and is first levied and administered by the Centre, which then distributes it between the consuming state and itself. In addition, a compensation cess—ranging from 1-200%—is levied on sin and luxury goods like cigarettes, pan masala and certain categories of automobiles, over and above the topmost slab of 28%.

How does all this work?
Take spoons and forks, for which the GST is 12%. A consumer will pay 12% on the price of the spoons and forks if she buys from a manufacturer in the same state (intra-state transaction). Then, 6% will be the Centre’s share as CGST and 6% the state’s share as SGST.

For a wholesale (B2B) transaction, the GST allows the seller to claim input tax credit (ITC) by setting off the tax liability against the tax already paid. For example, a manufacturer in Andhra Pradesh sells spoons and forks to a shop in Andhra Pradesh (intra-state transaction). The shop-owner pays 12% to the manufacturer. When a customer buys these from his shop, she pays 12% GST on the full price. The shop-owner then takes ITC for the 12% he has already paid and deposits 12% GST with the authorities, removing the cascading effect of taxation.

In the whole transaction, GST of 12% is in effect applied only once after ascertaining ITC. However, if the spoons and forks are manufactured in Andhra Pradesh and sold to a shop-owner in Maharashtra, the inter-state transaction attracts 12% IGST (6% CGST, 6% SGST). The IGST is levied and collected by the Centre, and the division with the consuming state happens later.

Now, if a consumer buys from the shop in Maharashtra, she pays 12% GST (6% CGST, 6% Maharashtra GST). The shop-owner has already paid IGST on the input. Since GST is a destination-based tax, the state share in IGST from the transaction should accrue to the consumption state, Maharashtra, and not the exporting state, Andhra Pradesh. Therefore, the shop-owner can make use of the IGST as a credit to pay for the CGST and Maharashtra GST.

The final apportionment of the IGST thus happens between the consuming state (Maharashtra) and the Centre, after setting off the credit from the IGST payment made earlier in the exporting state.

How are states compensated?
As per the GST (Compensation to States) Act, 2017, states are guaranteed compensation for revenue loss on account of implementation of GST for a transition period of five years (2017-2022). The compensation is calculated based on the difference between the current state’s GST revenue and the protected revenue after estimating an annualised 14% growth rate from the base-year of 2015-16.

The high rate of 14%, which has got compound since 2015-16, has been seen as deleterious from economic realities. While hearing the first few meetings of the GST Council, then Finance Minister Arun Jaitley had proposed a revenue growth rate of 10.6% (the average all-India growth rate in the three years preceding 2015-16). Council meeting records show the suggestion of 14% revenue growth was accepted “in the spirit of compromise.”

How did compensation become an issue?
Compensation payments to states started getting delayed since October last year as GST revenues started to slow down. The Covid-19 pandemic has widened the gap, with GST revenues declining 41% in the April-June quarter.

While the 14% growth rate in tax revenue has been compounded over the base year 2015-16, collections have remained around the same level for two years. As a result, the states’ monthly protected revenue, which was Rs 49,020 crore for 2018-19 and Rs 55,862 crore for 2019-20, has risen to Rs 63,706 crore in 2020-21. In the ongoing financial year, the GST revenue for July has been Rs 40,256 crore, while monthly protected revenue is Rs 63,706 crore, leaving a gap of Rs 23,450 crore (taking into account settlement of IGST). For April-July, only Rs 21,140 crore has been collected as compensation cess, including Rs 7,265 crore in July.

The Centre on July 27 released Rs 13,806 crore to the states for March 2020, wrapping up the full payout for FY20 at Rs 165 lakh crore. Compensation remains pending for the four months of this financial year (April to July).

How is the dispute now placed?
Fresh tensions have resulted after senior Finance Ministry officials are learnt to have reported the Centre’s inability to compensate states in the near future, which was followed by the Attorney General of India’s legal opinion that the Centre does not have an obligation to pay for a revenue shortfall. The AG is learnt to have suggested that the GST Council can recommend to the Centre that it allow the states “to borrow on the strength of the future receipts from the compensation fund” and that the Centre will have to take the “final decision in the matter.”

States such as Punjab, Kerala, Bihar are not in favour of being asked to borrow to bridge the revenue gap, that will be then repaid from the compensation cess fund. They are of the view that receipts in the compensation fund are likely to be too low to meet the revenue shortfall, let alone being used for repaying states for borrowing. They have suggested raising tax rates or cess rates, or bringing in more items under the 28% slab and the compensation cess. The rest of the revenue gap, Punjab has suggested, can be bridged through market borrowing by the Centre that can then compensate the states.

On August 1, Finance Minister Nirmala Sitharaman said the Attorney General’s view on GST compensation was sought after consultation with the states and a meeting of the GST Council would be held now to discuss the legal opinion. A GST Council meeting on compensation was slated to be held in July but was not. It is expected to be held shortly.