Can the Centre default on GST compensation to states?

States are agitated about the undue delay by the Centre in paying them the GST compensation, especially as they are starved of funding for fighting the Covid-19 pandemic. As per the GST Compensation Act, the Centre is mandated to compensate the states for loss of revenue on account of implementation of the GST for a period of five years. The compensation payments are to be funded by the Centre levying a cess on the GST on specified goods.

The Centre must dip into the consolidated fund to pay the states the compensation amount due to them. It may not have a legal obligation, but it does have a moral one.

Unsurprisingly, the funding problem has become more acute this year. Rough estimates point to states’ collections under the GST during the first quarter of this fiscal being lower by at least 40% as compared to the collections during the corresponding quarter of the last year. On the other hand, as per figures put out by the Controller General of Accounts, GST cess collections were Rs 14,483 crore in the first quarter of the current fiscal, compared to Rs 24,613 crore in the corresponding quarter of last fiscal—a shortfall of over 40%.

The issue of shortfall and delays in payment of compensation dominated the GST Council meeting held on June 12. All that the Centre and states could agree on was to call another meeting of the Council ‘shortly’ to exclusively discuss the compensation issue.

States, on the other hand, believe that they are entitled to the formula-based compensation regardless of the collections under the cess.

Second, states believed that the introduction of GST would put an end to the eggressive practice of the Centre levying cesses and surcharges, which are not shareable with them. That expectation has been belied. The Union Budget of 2018-19 increased rates of education and health cesses and imposed a social welfare surcharge on a number of imported goods. The Union Budget of 2019-20 raised the road cess on petrol and diesel by Rs 1 per litre. The Union Budget 2020-21 introduced a health cess on imported medical devices. The cess on petrol and diesel has been further increased to Rs 9 per litre during the current year. States feel, justifiably, that instead of levying cesses, the Centre should have increased the basic rates so that they too get a share of the additional collections.

Finally, states are anguished that even as the burden of fighting the pandemic has disproportionately fallen on their shoulders, the Centre has not been sufficiently sensitive to their deep fiscal woes. Furthermore, though Union excise duties and service tax were subsumed under the GST, the Centre is still left with buoyant sources of revenue like income tax, corporate tax, and customs duties which are outside the ambit of GST. Besides, the Centre has access to more non-tax revenues such as dividends from RBI and central PSUs.

That leaves the fact that the last option of the solicitor general is that the Centre is not legally obliged to pay the full compensation. The Centre may not have a legal obligation, but it certainly has a moral one. The states have been very accommodating right from the beginning in moving the GST process forward, and the Centre needs to reciprocate.