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GST Council walks a tightrope as it looks to jack up revenues

MOHAN LAVI

Ever since the Goods and Services Tax (GST) made its 'arangetram' in July 2017, a number of issues that have cropped up in its implementation have been resolved in some manner or the other. But one issue that has not been resolved is the compensation to the state governments. This is something that has been troubling the central government for the past four years.

In hindsight, maybe the 14% growth that was promised to the state governments was overly optimistic. Optimistic because in the first year of GST, everyone was trying to grapple with the law and a moody portal, the second year went in a lot of concessions being given and during the third year, the menace of fake invoices surfaced, forcing the GST Council to impose artificial restrictions on input tax credit. In the fourth year, Covid-19 took over.

The growth of 14% was promised for five years — this would end just before the 5th anniversary of GST in June 2022. On their part, the state governments have been putting in their requests not only for the payment of past dues but also for extension of the compensation cess for another five years. The Centre has an unenviable task before it due to the fact that its cash flow statement is going to be skewed with the outflows far exceeding the inflows. One also needs to keep in mind the fact that large amounts of Covid-19 relief measures are still being announced.

The GST Council is scheduled to meet in August 2021 to brainstorm on this issue. Pundits are using terms that are used mostly in corporate boardrooms — such as "out-of-the-box thinking". There are three options before the GST Council — replace the present compensation structure with a more prudent one, take measures to increase GST revenues drastically, and borrow more based on the strength of the balance-sheet of the government till the situation eases. We could have a fourth option as well which looks like a workable solution — a combination of the three options.

Solely relying on borrowing to fix the issue is a clear no-no. GST revenues are not the only issue that the government has, so borrowing only for this purpose will only fix a part of the problem leaving deficits in other areas. There can be no arguments against the fact that the present compensation structure needs to be changed. The 14% growth rate should probably be recalculated retrospectively and the revised compensation paid out over a period of, say, 10 years. State governments will object that 10 years will be too long but they should realise that Covid-19 has effectively taken away three years of normality. It is also important for states to realise that the compensation is not only a mathematical issue — it is also an economic one since the promise was made based on some parameters which changed the next day after the promise was made.

Projecting GST revenues

Expecting a meteoric rise in GST revenues will remain an expectation. An average of around Rs 100,000 crore is what could be expected over the next few years with a few spikes and falls from this number. The government has made it clear that the possibility of fuel coming under GST is ruled out for the next decade due to the good old reason which has now been discussed to death — the impact it will have on the revenues of state governments. The present tax structure for fuel borders on extortion. The central and state governments levy around 55% and 117% taxes respectively on fuel. Due to this, fuel with a base price of around Rs 36 will retail at around Rs 105. Even if fuel tax is at the highest rate of 28% and a compensation cess added to it, the tax rates may not come to the combined 172% it is today. Initially, it was thought that GST could be levied on Aviation Turbine Fuel (ATF) but this may also remain a thought, considering the present condition of the industry.

State governments will not permit alcohol to come under GST because they won't want to sacrifice their cash cow. Rolling out the e-invoicing scheme to everyone could see a small uptick in revenues since the menace of fake invoices will then be minimised. A Group of Ministers (GoM) is examining the feasibility of levying GST on products such as pan masala and gutka on the basis of the installed manufacturing capacity, rather than actual production/sales to check tax evasion. GST rates are in a sweet spot right now and can at best be tinkered with.

Yet another development that should concern the GST Council is the rising clout of regional powers that are not a part of the ruling party at the Centre. These members have been extremely vocal in the recent meetings of the GST Council. If a viable and amicable solution is not worked out for the compensation issue, some of these state governments may be tempted to levy some sort of local taxes to make up for what the Centre is not giving them.

Critics may object to this, stating that this goes against the spirit and structure of GST. Critics of these critics will respond that there are many other things that are against the spirit and structure of GST such as the artificial restrictions on availing input tax credit so one more will not matter much.

Whatever the GST Council has to do will have to be done between this year and the next. GST policies and decisions in 2023 will be largely influenced by the elections in 2024 and not by exigencies of the members of the Council. The next few years are going to be a tightrope walk for the GST Council as far as GST revenues are concerned. Everyone concerned will be hoping that the Persian adage "this too shall pass" comes true here.