



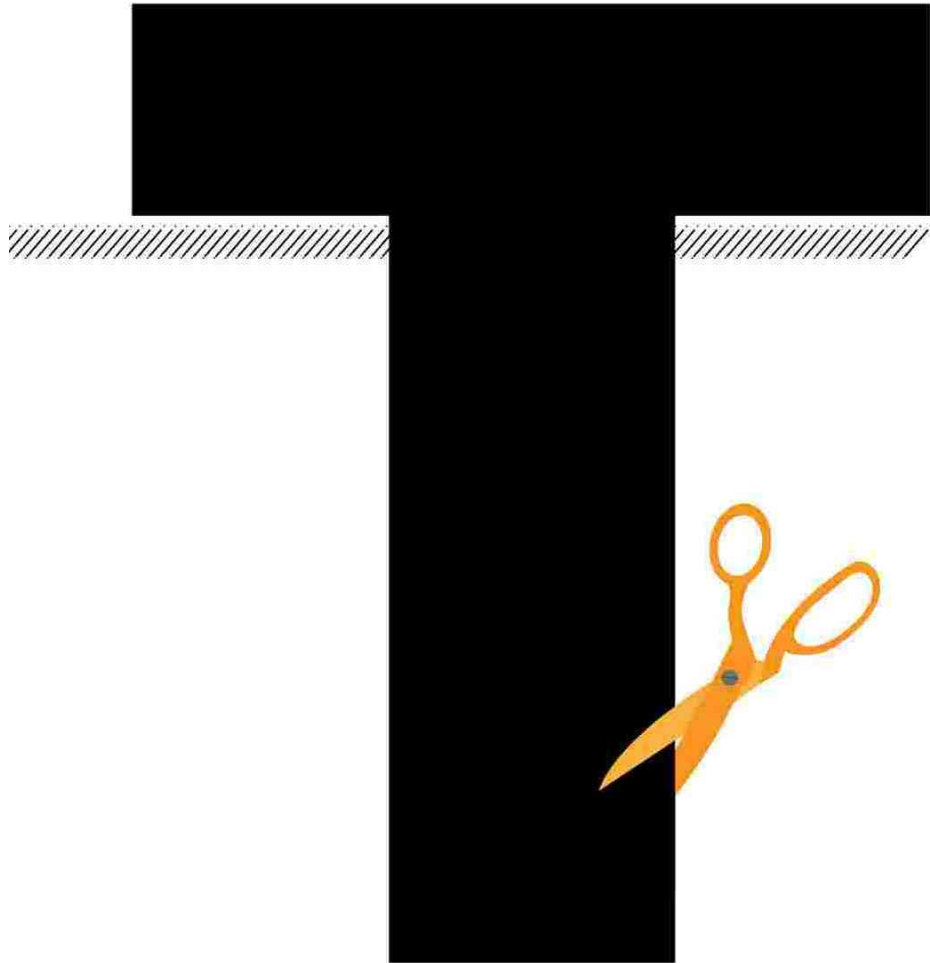
# The Great GST Divide

**Economy - GST**

WHY THE GST COUNCIL HAS  
BECOME A BATTLEGROUND  
FOR A TURF WAR BETWEEN  
CENTRE AND STATES

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ILLUSTRATION RAJ VERMA



**Economy – GST**

**amil Nadu** Finance Minister P. Thiaga Rajan's speech at the 43rd meeting of the GST Council on May 28 could not have been music to Centre's ears. Referring to delay in payment of GST compensation to states, unilateral decisions such as imposition of cesses (whose proceeds go to only the Centre) and the overall distrust between central and state governments, the former Wall Street veteran said "rancour in the relationship" has set in. Finance ministers of Kerala, Punjab and Maharashtra pitched in and questioned Centre's plan to raise more debt in FY22 to compensate states for revenue loss due to GST implementation despite expectations of revenue buoyancy. The "rancour" even prevented an agreement on an issue as important as taxing Covid-19 vaccines. The matter had to be referred to a group of ministers (GoM).

Is the council, which has held 44 meetings since 2016 and has a record of ensuring that all its decisions except one have been unanimous, losing its federal character amid the financial stress being faced by both Centre and states due to the Covid-19 outbreak? The biggest source of discontent among states, after all, has been pending compensation for FY21. The central government had promised to make good any loss suffered by states due to implementation of GST. Several states say they have been paid much less than what was their due.

Five years after giving up their freedom to tax goods and services in favour of the GST Council, states are coming around to a view that they have been short-changed

and their voices muzzled. GST Council decisions require a three-fourth majority. Centre has a one-third vote and states the remaining two-third. The former also has a veto on decisions.

**States Rise Up**

The build-up to the 43rd GST Council meeting on May 28 was ominous. It all began with a letter by West Bengal Chief Minister Mamata Banerjee to Prime Minister Narendra Modi demanding reduction of GST on Covid-19 vaccines. In response, Finance Minister Nirmala Sitharaman took to social media to explain in a series of tweets the technical problems in exempting vaccines from GST. Three days later, on May 12, West Bengal Finance Minister Amit Mitra wrote to Sitharaman raising the issue of pending GST compensation to states and urging her to call a meeting of the GST Council as it had not met since October last year.

Four days before the meeting, Punjab Finance Minister Manpreet Singh Badal wrote to Sitharaman terming the agenda of the GST Council "mundane" and not addressing any of the "substantive issues." He raised the issue of pending compensation for FY21 and reduction of GST on Covid essentials. Two days before the meeting, finance ministers of non-BJP ruled states deliberated upon issues to be raised in the GST Council. Though their biggest concern was pending compensation for FY21, the issue of reduction in GST on Covid vaccines and essentials such as PPE kits, sanitisers, ventilators and medical oxygen was also taken up. The stage was set for a showdown.

**Compensation Conundrum**

The biggest reason states agreed to give up their autonomy to tax goods and services was an assurance by the central government that it would compensate them for any revenue loss from subsuming of indirect taxes such as sales

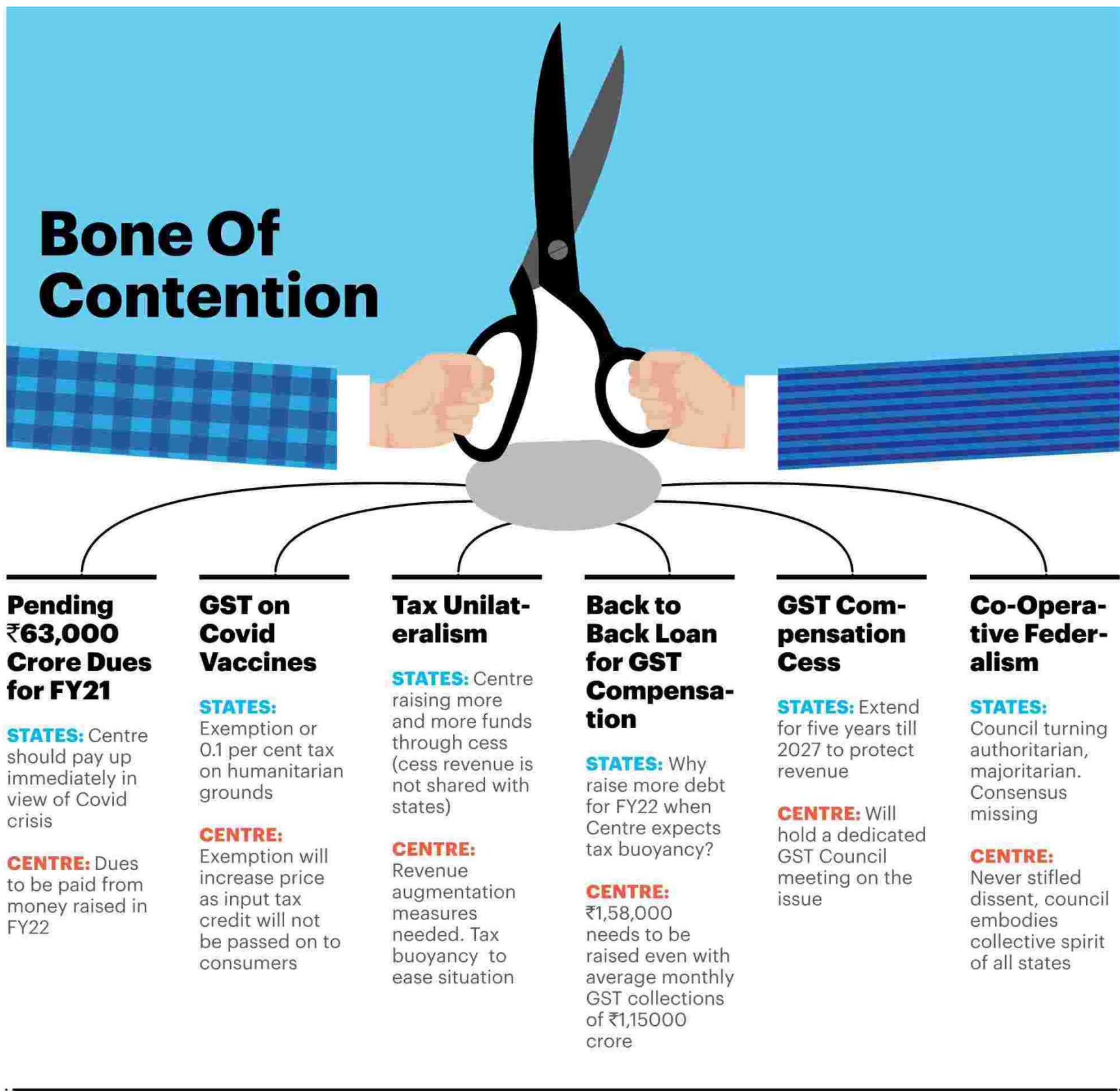
tax/VAT into GST. The GST (Compensation to States) Act, enacted in 2017, guarantees states 14 per cent annual growth in GST revenue over base year FY16 for five years between July 2017 and June 2022. While this worked well till FY19, problems cropped up in FY20 when Centre started finding it tough to pay states as economic slowdown affected its revenues. The Covid-19 outbreak aggravated the problem by putting huge pressure on both Centre and states. As per the Ministry of Finance data, states are yet to be paid ₹63,000 crore GST compensation for FY21 despite disbursement of

₹1,10,000 crore loans raised by Centre to meet states' GST shortfall. As per the finance ministry, ₹70,000 crore had been released as of March 31 this year, over and above the funds raised through loans. An additional ₹14,000 crore had been paid as part of the Integrated Goods and Services Tax settlement.

**9****PER CENT**

Share of cess in  
central revenue,  
up from 6.9%  
in FY15





**Pending ₹63,000 Crore Dues for FY21**  
**STATES:** Centre should pay up immediately in view of Covid crisis  
**CENTRE:** Dues to be paid from money raised in FY22

**GST on Covid Vaccines**  
**STATES:** Exemption or 0.1 per cent tax on humanitarian grounds  
**CENTRE:** Exemption will increase price as input tax credit will not be passed on to consumers

**Tax Unilateralism**  
**STATES:** Centre raising more and more funds through cess (cess revenue is not shared with states)  
**CENTRE:** Revenue augmentation measures needed. Tax buoyancy to ease situation

**Back to Back Loan for GST Compensation**  
**STATES:** Why raise more debt for FY22 when Centre expects tax buoyancy?  
**CENTRE:** ₹1,58,000 needs to be raised even with average monthly GST collections of ₹1,15,000 crore

**GST Compensation Cess**  
**STATES:** Extend for five years till 2027 to protect revenue  
**CENTRE:** Will hold a dedicated GST Council meeting on the issue

**Co-Operative Federalism**  
**STATES:** Council turning authoritarian, majoritarian. Consensus missing  
**CENTRE:** Never stifled dissent, council embodies collective spirit of all states

**Centre Fails to Pay Dues to States**



in ₹ crore; Source: Finance Ministry

The GST compensation cess statement for FY21 reveals that against the pending amount of ₹63,000 crore, the closing balance is ₹3,940 crore. This is the lowest since the launch of GST. This came as a surprise to state finance ministers. Even before the pandemic, India's Gross Domestic Product growth had slumped to 4.2 per cent in FY20 from 6.1 per cent in FY19. The closing balance was as high as ₹55,737 crore in FY20. This diminishing pool and lack of clarity on payment of FY21 dues was one of the main triggers for what happened in the GST Council meeting. The

clarity that state governments wanted remained elusive.

**States' Shortfall**

As against Centre's accounts stating a closing balance of ₹3,940 crore, just the state of Punjab is owed a lot more than that. Punjab Finance Minister Manpreet Singh Badal told *BT* that after all adjustments, the Centre owed his state ₹5,000 crore. "It is a huge amount for the state. The Congress party raised the issue in the GST Council," he says.



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“Kerala needs to be paid more than ₹4,000 crore on this account. The amount is much bigger for several other states,” says Kerala Finance Minister K.N. Balagopalan. Chhattisgarh Finance Minister T.S. Singh Deo says states are not even getting the protected revenue. “In lieu of the right to taxation that state governments have surrendered, they are bound to be paid an assured increase of 14 per cent in GST revenue over the base year. From that point of view, we lost ₹1,300 crore in the previous financial year.”

Maharashtra Chief Minister Uddhav Thackeray raised the issue during a meeting with the prime minister on June 8. “Maharashtra was expected to get approximately ₹46,000 crore as GST compensation but has received only ₹22,000 crore,” state Finance Minister Ajit Pawar, who

PHOTOGRAPH BY BANDEEP SINGH



**“When we decided that a GoM would decide on waiver of tax for Covid treatment items, is that an amicable way of arriving at a solution or do you think this is adversarial?”**

**Nirmala Sitharaman**, Finance Minister

accompanied Thackeray, told mediapersons after the meeting.

This does not mean that all states have been denied their dues. “There is no pendency. We have received ₹7,229 crore as GST compensation and ₹6,009 crore as part of the debt raised to meet the deficit,” says Uttar Pradesh Finance Minister Suresh Khanna.

While the GST Council deliberated on debt to be raised to meet the FY22 shortfall, the Centre did not seem to have a clear plan on previous financial year’s dues, a key demand of states. It is pinning hope on expected buoyancy in GST revenues in the current financial year to pay its dues for FY21, a delay that the states are finding unappetising. “On compensation for the current financial year, we have proposed to the council that if we take the same methodology and formulae that we adopted the last time, the gap is around ₹1,58,000 crore. Unlike last year, the economy has not suffered as much this year. So, last year, deficit was more than the back-

to-back borrowing that took place. This year, even if we are able to collect average monthly GST revenue of ₹1,10,000, our deficit will be ₹1,50,000 crore while we will be doing a back-to-back borrowing of ₹1,58,000 crore,” Revenue Secretary Tarun Bajaj said after the meeting. This means states can be compensated by ₹8,000-10,000 crore for previous year’s shortfall. “If we are able to collect an average monthly GST revenue of ₹1,15,000 crore for the 12-month period, the deficit comes to ₹1,25,000 crore, and if we borrow ₹1,58,000 crore, this will compensate for another ₹33,000 crore,” he added. States, however, are not convinced, as even this amount is way short of the ₹63,000 crore that they are owed. The only commitment they have got from the Union finance minister is that there will be further deliberations and a dedicated meeting on extending the compensation cess period beyond June next year.

**₹158k**  
**CRORE**

**Amount Centre  
will borrow to pay  
states in FY22**

**The Cess Question**

The finance minister denies that the GST



Council is losing the essence of co-operative federalism. “When finance ministers of states, some of them who are chief ministers, meet, there will be discussions, there will be rebuttals, arguments, but that’s what the forum is meant for. Is that immediately tussle or dent in federalism?” she said in an exclusive interaction with *BT*. However, Chhattisgarh Finance Minister Deo says the moment the Centre fails to pay committed revenue to states, the concept of federal unanimity comes under question. “If central compensation is delayed for whatever reasons, the very basis of GST and the council is compromised. Also, it does not serve the interests of states, particularly the manufacturing states, to forgo their rights to taxation. It is the consuming states that are benefiting at the expense of the producing states,” he adds.

P. Thiaga Rajan is more direct and blames Centre’s “less than compassionate position” towards states. “The reluctance of the Union to settle the dues in a timely manner has introduced justifiable rancour in the relationship,” he said in his speech at the council meeting.

Experts say this was expected. “Over the last two years, the level of co-operation visible after GST rollout has been missing. This was bound to happen as the law evolves,” says Rajat Bose, Partner at law firm Shardul Amarchand Mangaldas. Bose says states, which had a key role in the beginning, are realising that issues specific to their needs have to be addressed. “Once regional issues come in, it is difficult to arrive at a consensus, like it happened in case of Kerala lottery or gaming industry in Maharashtra,” he says.

Ranjeet Mahtani, Partner, Dhruva Advisers LLP, says Centre will have to play the role of a referee. “In the context of the federal character of the council, the decisions have to be with consensus. Till 2019, the decisions were with consensus. The central government has to take a statesman-like position and become a referee in effect so that the federal character remains intact,” he says. He, however, maintains that on matters of state revenue, ideals like federal unity take a backseat. “The binding glue on which states came together for GST was compensation for revenue losses on account of subsuming of state taxes. When the five-year



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PHOTOGRAPH BY MANESH AGNIHOTRI

period is over, resources for running government machinery will become a major issue.”

**Tiff Over Cess**

States are also becoming vocal on tax unilateralism – raising revenue via cess – by the central government, leading to shrinking of the divisible pool. Cess revenue is not shared with states. Kerala and Tamil Nadu finance ministers raised the issue in the GST Council. “Close to 18 per cent of central government revenue is being raised from cess and not distributed (among states). Total control of finances is with the central government. It needs to be discussed and reviewed,” said Balagopalan. “As Centre gets more financial control, state finances suffer. For India to prosper, a harmonious Centre-state relationship is a must.” Rajan said increase in states’ devolution from the divisible pool of taxes to 42 per cent has largely been offset by increase in collection from cesses to ₹2.55 lakh crore in FY20, 80 per cent more than ₹1.4 lakh crore in FY14. According to Budget documents, share of cesses in gross tax revenue has grown from 6.9 per cent in FY15 to almost 9 per

cent in FY20 after peaking at 10 per cent in FY17. This does not include GST compensation cess. Rajan said the gradual shift of petrol and diesel taxation from excise to cesses has led to revenue loss for states. “A shift of over ₹50,000 crore relative to FY14 ratios of excise and cess, away from the pool of divisible taxes, has led to reduction of ₹20,000 crore (41 per cent of ₹50,000 crore) in states’ payment as share from the divisible pool,” he said.

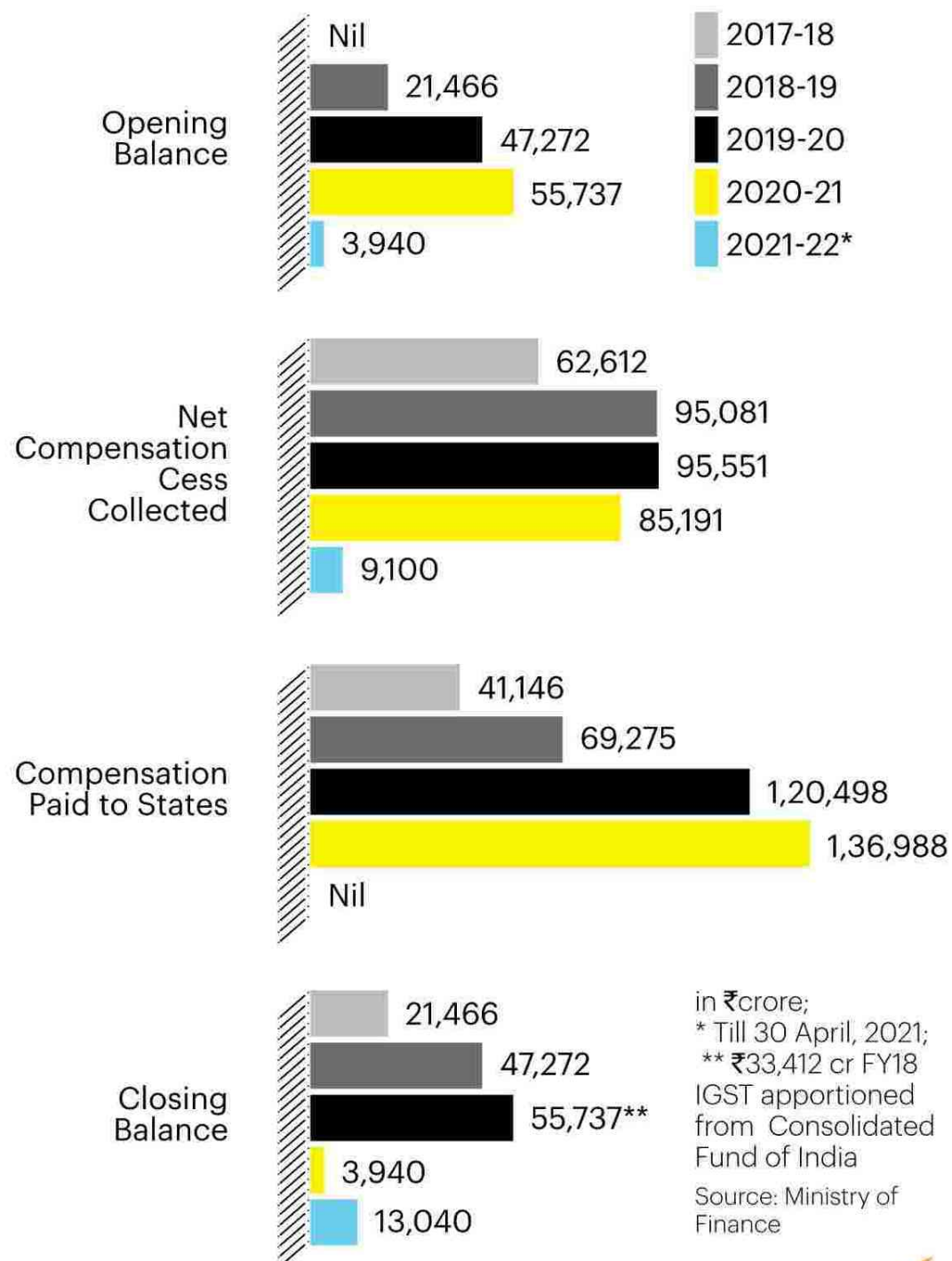
**Political Divide**

Another disturbing trend is vertical split on party lines on key issues. Take the proposal for curtailing GST on Covid vaccines and equipment. “Both Gujarat and Odisha were in favour of zero tax on the vaccine along with states like West Bengal, Kerala, Maharashtra, Chhattisgarh, Tamil Nadu and Rajasthan. But if the matter was put to vote, Gujarat would have sided with Centre due to political alignment. The proposal would not have passed muster,” said a source present in the meeting.

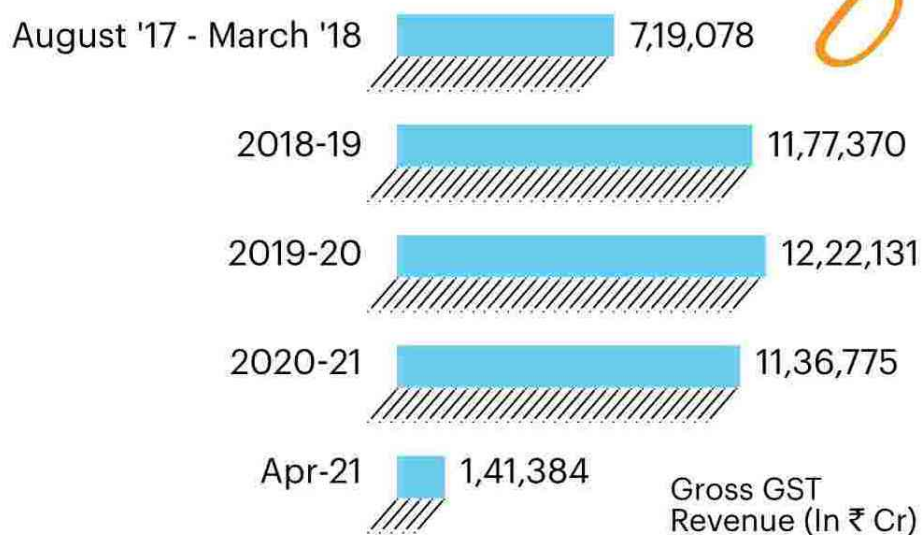
The finance minister has already told the West Bengal Chief Minister that reduction in GST on vaccines will increase prices as manufacturers will not be able to offset taxes with taxes paid on inputs. She also says there is no political divide in the GST Council. “When we decided that a GoM would decide on waiver of tax for Covid treatment items, is that an amicable way of arriving at a solution or do you think this is adversarial? So, avoid this assumption that it (GST Council) is a place for quarrel, fight and



## Record Low Cess Closing Balance for FY21 Shows Stress on Finances...



## ...As GST Revenue Falls



bickering. I must say to the credit of every member of the GST Council that they are being absolutely statesman-like like in their behaviour," she said.

The GoM finally recommended status quo. The council met again on June 12 to discuss the recommendations of the GoM and decided to keep GST on Covid vaccines unchanged. A few days prior to this, the prime minister had announced a new policy according to which Centre would procure 75 per cent of the vaccines and supply to states free of cost. After the meeting, Sitharaman said in the press conference that since the Centre would procure the vaccines, there won't be any tax burden on any state.

Still, consensus proved to be short-lived. In an ugly turn of events, West Bengal Finance Minister Amit Mitra, in a tweet, blamed the Centre for muzzling his voice. Mitra, who wanted to register his dissent on the vaccine issue, said, "Since my voice ignored, I have recorded my dissent by letter. Unprecedented. Slow death of the only body of cooperative federalism." In a letter to the finance minister, he pointed out that he repeatedly tried to voice his objections but his voice was muzzled and the secretary cut off the virtual link."

After this, Minister of State (Finance) Anurag Thakur took to Twitter claiming that Mitra remained silent when the Union finance minister asked for comments from the members. "The finance minister has never stifled dissent in the GST Council. It is unbecoming of a senior member of the council to suggest that this has happened. The GST Council embodies the collective spirit of all states towards debate in a healthy manner," he said.

While GST on vaccine remained unchanged, the council waived tax on black fungus medicine, and reduced tax on Remdesivir, along with a slew of other Covid equipment. These were demands of some states, though it will take more than this to bring peace at the GST Council.**BT**