Challenges Post GST Compensation Regime

This editorial is based on **'States GST challenge'** which was published in The Hindu Businessline on 30/05/2023. It talks about the challenges to states after the end of GST compensation regime.

For Prelims: GST, GST compensation cess, **Cooperative Federalism,** Centre-State Relations, GST Council

For Mains: Challenges to states post GST compensation end, Steps to Overcome these challenges.

The Goods and Services Tax (GST) brought about a significant transformation in India's taxation landscape. However, initially some manufacturing states had raised concerns about potential revenue implications. To address these apprehensions, the Centre assured states of protection against revenue losses through GST compensation cess for a five-year period after the implementation of GST.

Although the pandemic resulted in revenue dips for certain states, the Centre managed to clear outstanding dues through borrowings, demonstrating its commitment to supporting the states.

This compensation cess was extended till March 2026 for centre to recoup the amount disbursed to states through the union exchequer, however states will not get any share from the proceeds of extended levy.

What were the Apprehensions of States with GST Regime?

- **Concerns about Revenue Distribution:**
  - The "producing" states were apprehensive about losing out on revenue to the "consuming" states under the GST system.
  - Advanced states that produced more goods and sold them to less-developed states were worried about collecting comparatively less GST.
- **Loss of Power in Tax Rate Fixation:**
  - States opposed the GST because it proposed a **common tax rate for goods and services across the country.** This meant that states would lose the authority to set tax rates on various items, which undermined fiscal federalism and their autonomy.
- **Fear of Revenue Loss:**
  - **States were concerned about the potential loss of revenue** when transitioning from the previous tax regime to the GST system. As 17 existing indirect taxes were merged into one, it was **crucial to determine the "revenue-neutral" rate** to ensure that the same amount of revenue was collected as before.
  - **Incorrectly fixing the GST rate could lead to decreased revenue** collection, exacerbating fiscal challenges.

What is Goods and Services Tax (GST) ?

- The Goods and Services Tax (GST) is a **value-added tax** levied on most goods and services sold for domestic consumption. It is a **destination-based tax.**
- The GST became applicable from 2017 after the enactment of the **101st Constitution Amendment Act, 2016.**
- It is **paid by consumers,** but it is **remitted to the government by the businesses** selling the goods and services.
- **Centre and the States simultaneously levy tax** on a common base. GST levied by the **Centre is called Central GST (CGST)** and that levied by the States is called **State GST (SGST).**

How did States Come on Board with GST?

The states agreed to come on board when their concerns were addressed. There were several factors that influenced their decision:

- **Autonomy to Collect Revenue:**
    - One significant factor that persuaded states to agree to the GST was the provision allowing them to retain **control over revenue from alcohol and petroleum products.**
    - These items were **excluded from the GST framework,** enabling states to levy excise duty on alcohol and VAT on petroleum products.
    - This autonomy proved crucial during the pandemic when tax collections plummeted.
- **Revenue Compensation:**
    - To address the states' revenue concerns, the Union government assured them of **compensation for any revenue shortfall** below a growth rate of 14% (**based on the 2015-16 baseline**) for a period of **five years.**
    - A **compensation cess was introduced on luxury and sin goods to fund** this compensation.
- **Inclusion in the GST Council:**
    - The creation of the GST Council, comprising **representatives from each state and the Union government,** played a crucial role in garnering state support.
    - The GST Council became the decision-making body for all GST-related matters, with **voting provisions** in case of a lack of consensus.
    - The **Union government held one-third of the votes,** while the **states collectively held two-thirds.** This structure aimed to ensure a **cooperative and inclusive approach** to decision-making.

What Steps can States take After the End of GST Compensation?

The **absence of assured revenue protection means that states must explore alternative** avenues to enhance their fiscal capacity. This situation calls for proactive measures to maximize revenue collection while ensuring compliance.

To overcome the challenges posed by limited revenue-raising powers, states can employ the following strategies:

- **Utilize Tax Analytics:**
    - States should adopt tax analytics strategies and processes to gain insights from **comprehensive data analysis. By leveraging data collated from various sources,** states can make informed decisions based on accurate revenue projections.
- **Strengthen Compliance Monitoring:**
    - States should **reconcile information related to the movement of goods by cross-referencing e-way bill reports** with data from road transport departments.
    - This approach helps **detect potential discrepancies** and identify non-compliant taxpayers. However, reliance on such comparisons should be judicious, considering variations arising from different reporting requirements.
- **Tailored Measures for Non-Compliant Taxpayers:**
    - States should **profile taxpayers based on risk assessment** and previous compliance

history. By categorizing taxpayers and implementing specific policy measures for each group, **enforcement actions can be targeted effectively.** This approach is particularly crucial in tackling issues such as circular trading and fraudulent invoicing.

- **Focus on Service Industry:**
  - With the authority to **levy GST on services,** states **must assess the service industry within their jurisdiction.**
  - Building capacity and expertise in evaluating service-related transactions will **broaden the taxpayer base** and **enhance revenue collection.**
  - States should conduct GST audits and create awareness among taxpayers through trade facilitation kiosks and engagement programs.
- **Foster Cooperative Federalism:**
  - States should **collaborate with each other in the spirit of cooperative federalism.** By adhering to the principles of the GST laws and avoiding unnecessary territorial disputes, states can **create a business-friendly environment** and foster taxpayer confidence.
  - This approach will encourage compliance, boost revenue, and enhance economic growth.

Conclusion:

States must adapt to the **changing dynamics of revenue generation.** While the initial concerns were addressed by the Centre, states now face the challenge of independently raising revenue and widening the tax net.

By employing proactive measures such as leveraging tax analytics, strengthening compliance monitoring, focusing on the service industry, and fostering cooperative federalism, states can navigate these challenges successfully. It is imperative for states to create an environment that promotes ease of doing business and instills confidence in taxpayers, thereby **driving sustainable revenue growth and economic development.**

Drishti Mains Question:
GST compensation was a short-term measure to address the shortfall in states revenue. What can be the long-term solutions to it? Discuss.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q.1 Consider the following items: (2018)

1. Cereal grains hulled
2. Chicken eggs cooked
3. Fish processed and canned
4. Newspapers containing advertising material

Which of the above items is/are exempted under GST (Good and Services Tax)?

(a) 1 only
(b) 2 and 3 only
(c) 1, 2 and 4 only
(d) 1, 2, 3 and 4

Ans: (c)

Q.2 What is/are the most likely advantages of implementing ‘Goods and Services Tax (GST)’? (2017)

1. It will replace multiple taxes collected by multiple authorities and will thus create a single market in India.
2. It will drastically reduce the ‘Current Account Deficit’ of India and will enable it to increase its foreign exchange reserves.
3. It will enormously increase the growth and size of economy of India and will enable it to overtake China in the near future.

Select the correct answer using the code given below:

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (a)

Mains

Q:1 Explain the salient features of the Constitution (One Hundred and First Amendment) Act, 2016. Do you think it is efficacious enough “to remove cascading effect of taxes and provide for common national market for goods and services”? **(2017)**

Q:2 Explain the rationale behind the Goods and Services Tax (Compensation to States) Act of 2017. How has COVID-19 impacted the GST compensation fund and created new federal tensions? **(2020)**

Q:3 Enumerate the indirect taxes which have been subsumed in the Goods and Services Tax (GST) in India. Also, comment on the revenue implications of the GST introduced in India since July 2017. **(2019)**
