GST Compensation Extension

For Prelims: GST compensation cess regime, centrally-sponsored schemes,

For Mains: Revenue Shortfall and Economic Slowdown owing to Covid-19 pandemic, Cooperative federalism, fiscal federalism.

Why in News

Many states have demanded that the **GST compensation cess regime** be extended for another five years. Also, states have demanded that the share of the Union government in the **centrally-sponsored schemes** should be raised.

- These demands are made as **Covid-19 pandemic** has impacted their revenues.
- The provision for GST compensation is **going to end in June 2022.**

Key Points

- **About:**
  - **GST Taxation:** The GST became applicable from 1st July 2017 after the enactment of the **101st Constitution Amendment Act, 2016.**
    - With GST, a large number of central and state indirect taxes merged into a single tax.
  - **GST Compensation:** In theory the GST should generate as much revenue as the previous tax regime. However, the new tax regime is taxed on consumption and not manufacturing.
    - This means that tax won't be levied at the place of production which also means manufacturing states would lose out and hence several states strongly opposed the idea of GST.
    - It was to assuage these states that the idea of compensation was mooted.
    - The Centre promised compensation to the States for any shortfall in tax revenue due to GST implementation for a period of five years.
    - This promise convinced a large number of reluctant States to sign on to the new indirect tax regime.
- **Compensation Cess:**
  - States are guaranteed compensation for any revenue shortfall below 14% growth (base year 2015-16) for the first five years ending 2022.
    - **GST compensation is paid out of Compensation Cess** every two months by the Centre to states.
    - The compensation cess was specified by the **GST (Compensation to States) Act, 2017.**
    - All the taxpayers, except those who export specific notified goods and those who have opted for GST composition scheme, are liable to collect and remit the GST compensation cess to the central government.
  - **Compensation Cess Fund:** The GST Act states that the cess collected and the amount as may be recommended by the GST Council would be credited to the fund.

- **Concerns of States:**
  - **Revenue Shortfall:** The state's GST revenue gap in 2020-21 is expected to be about Rs. 3 lakh crore, while cess collections are only projected to reach Rs. 65,000 crore, leaving a shortfall of Rs. 2.35 lakh crore.
  - **Economic Slowdown:** At a time when growth is faltering, the delays in paying compensation to states as guaranteed by the GST Act will make it more difficult for them to meet their own finances.
  - **Decreasing Centre Devolution:** Most states are of the view that the Centre's share in centrally-sponsored schemes has gradually reduced and states' share has increased.
    - Due to this, their most significant demand is increasing share in centrally-sponsored schemes.

Goods and Services Tax

- GST was introduced through the **101st Constitution Amendment Act, 2016.**
- It is one of the **biggest indirect tax reforms** in the country.
  - It was introduced with the slogan of **'One Nation One Tax'.**
- The GST has subsumed indirect taxes like excise duty, Value Added Tax (VAT), service tax, luxury tax etc.
- It is essentially a **consumption tax** and is levied at the final consumption point.
- This has helped **mitigate the double taxation, cascading effect of taxes, multiplicity of taxes, classification issues** etc., and has led to a common national market.
- The GST that a merchant pays to procure goods or services (i.e. on inputs) can be set off later against the tax applicable on supply of final goods and services.
  - The set off tax is called **input tax credit.**
- The GST avoids the cascading effect or tax on tax which increases the tax burden on the end consumer.
- Tax Structure under GST:
  - Central GST to cover Excise duty, Service tax etc,
  - State GST to cover VAT, luxury tax etc.
  - Integrated GST (IGST) to cover **inter-state trade.**
    - IGST per se is not a tax but a system to coordinate state and union taxes.
  - It has a 4-tier tax structure for all goods and services under the slabs- **5%, 12%, 18% and 28%.**

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GST

What is it?

- GST aims to stitch together a common market by dismantling fiscal barriers between states
- It is a single national uniform tax levied across the country on all goods and services

Present Situation

- The Centre and states levy multiple taxes such as excise duty, octroi, central sales tax (CST), value-added tax (VAT) and entry tax, among others

Why amend the Constitution?

- Under current laws, only the Centre can impose taxes on services
- GST will empower states to collect service taxes

What about tax rates?

- There has been no agreement yet on tax rates for various goods and services
- States want the rate to provide relief to common citizens and small businessmen while preventing loss of revenue for states
- A panel headed by chief economic adviser Arvind Subramanian has recommended a revenue-neutral rate of 15% to 15.5%, with a standard rate of 18%
- The revenue-neutral rate is the rate at which there will be no revenue loss to the Centre and states under GST

Compensating states

- States want 100% compensation for the first five years, and want this specified in the main law through "fool proof" wording
- In the original Bill, the Centre had proposed 100% compensation for first three years, and 75% and 50% for the next two years, respectively
- The Centre has acceded to the states' demand and modified the Constitution Amendment Bill

What Happens After GST

1. GST will replace all local and central indirect taxes with a single tax.
2. States & the Centre will collect identical rates of taxes
3. E.g. If 18% is the GST rate, states and the Centre will get 9% each, called the SGST and CGST rates

Central Taxes

The Centre levies various taxes currently. GST will subsume all

- Countervailing Duty
- Additional Excise Duty
- Central Excise Duty
- Additional Customs Duty
- Cesses and Surcharges Services Tax
- Special Additional Customs Duty

50% Centre

State Taxes

Different states, different taxes. All these will be replaced by one indirect tax

- Vat/sales Tax
- Local Taxes
- Purchase Tax
- Levies
- Tax on Lottery and Betting
- Mandi Tax/Other State-Specific Local
- Entertainment Tax
- Tax on Inter-State Sales
- Luxury
- Octroi/ Entry Tax

50% State

- Rates may be specified in subordinate legislation–SGST law, CGST law by later this year.
- It backbone GST Network (GSTN) to be tested after rates are finalised; GSTN will enable real-time tax returns, registrations, input credit etc.

Inter-state movements

- The Centre would collect the Integrated Goods and Services Tax (IGST) on inter-state supplies
- IGST has been designed to ensure seamless flow of input tax credit from one state to another
- The IGST rate would roughly be equal to CGST plus SGST

What next

- More discussion on rates in the months ahead

Price impact

- The impact on prices is unknown
- Experts say GST will make most services costlier
- The 13th Finance Commission estimates prices of agricultural goods will increase by 0.61% to 1.18%, while prices of manufactured items will fall by 1.22% to 2.53%
- It will lower the overall tax inputs and make exports competitive

Timeline

2006-07: The govt moots a proposal for GST in the Budget; negotiations with states begin

2008: The govt. constitutes the empowered committee (EC) of state finance ministers

2009: The committee releases its first discussion paper

2011: The UPA govt. introduces the Constitution Amendment Bill for GST in Lok Sabha (LS)

Aug 2013: The Parliamentary Standing Committee submits its report; the govt incorporates recommendations of the committee in the Bill

Sep. 2013: Revised bill sent to the empowered committee

Dec 2014: The Constitution Amendment Bill introduced in the LS

May 2015: LS passes the Bill

August 2015: Congress insists on capping GST rate at 18%, and specifying the same in the Constitution Amendment Bill

July 2016: The Centre and states agree against capping GST rate in the Constitution Amendment Bill

Aug 2016: Rajya Sabha passes Constitution Amendment Bill Industry hails reforms, says will make doing business easier

Source: TH