GST Compensation: Centre to Borrow on Behalf of States

Why in News

Recently, the **Centre has decided to borrow an estimated revenue shortfall of Rs. 1.1 lakh crore as loans to States** to meet the **Goods and Services Tax (GST)** shortfall.

Key Points

- **Borrowing:**
    - The borrowing **will not have any impact on the** fiscal deficit **of the Government of India** as the Centre is acting as mediator only. The Centre is borrowing the loan and passing that on to the states.
    - The **amounts will be reflected as the capital receipts of the state governments** and as part of financing of its respective fiscal deficits.
- **Background:**
    - The **economic slowdown had reduced both GST and** cess **collections** in FY 2019-20, resulting in a 40% gap (shortfall) between the compensation paid and cess collected.
    - 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.**
    - The Centre **distinguished the GST shortfall into two types:**
        - Due to GST implementation itself.
        - Caused by the impact of **Covid-19**.
    - The Finance Minister termed the fall of GST revenue due to Covid-19 as an **act of God.** However, the **GST Compensation Act, 2017** did not foresee an act of God.
        - The GST Compensation Act, 2017 **guaranteed states that they would be compensated for any loss of revenue in the first five years of GST implementation,** until 2022, using a **cess levied on sin and luxury goods.**
    - The Centre has been at loggerheads with many states over the compensation issue due to GST shortfall. In August 2020 at **GST Council** meet, the **Centre had proposed two options to states to meet the shortfall:**
        - A special window could be provided, in consultation with the **Reserve Bank of India (RBI)**, so that the states can get Rs. 97,000 crore at a reasonable rate of interest, the amount can be repaid after five years (of GST implementation) ending 2022 from cess collection.
        - Another option is that this entire gap of Rs. 2.35 lakh crore can be met by the borrowing by the states in consultation with RBI.
    - However, many states were against these two options and were planning to move the Supreme Court over the issue.
- **Benefits:**
    - The borrowing by the Centre would **avoid differential rates of interest** that individual

states may be charged for their respective **State Development Loans (SDLs)** and would be an **administratively easier arrangement.**
    - The **country's general government debt,** which includes both the Centre's and States' borrowings **will not increase due to this step.**
    - The States that get the benefit from the Special Window are likely to borrow a considerably lesser amount from the additional borrowing facility of 2% of Gross State Domestic Product under **Atma Nirbhar Package.**
        - The borrowing limits of state governments was increased from 3% to 5% of GSDP for the year 2020-21 under **Atma Nirbhar Package.**

Goods and Services Tax

- GST was introduced through the **101st Constitution Amendment Act, 2016.**
- It is an **indirect tax** levied on the supply of final goods and services. 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.
- It is **levied only on the value addition** and is collected on goods and services at each point of sale in the supply line.
- 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** 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%.**

Source: TH