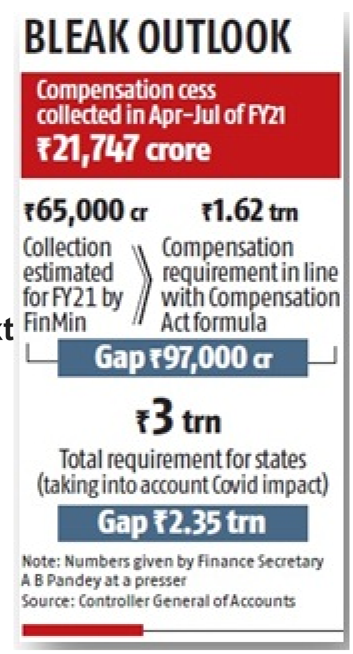
COVID-19 and the GST Compensation Brawl

Syllabus: Prelims GS Paper I : Current Events of National and International Importance.

Mains GS Paper III : Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.



Context

Recently, the 41st GST Council meeting held to discuss on compensating states for revenue shortfall. The Centre offered two options to states to compensate them amid inadequate cess collections under the goods and services tax (GST) regime. One was an offer of a special window to states, in consultation with the Reserve Bank of India, to the tune of ~95,000 crore at a reasonable interest rate. The other was for states to borrow ~2.35 trillion from the market, with the RBI as a facilitator.

Background

The COVID-19 outbreak and nationwide lockdown made a severe dent on the revenue collections of states pushing them to look at possible revenue earning measures including phased opening of liquor vends and pan and gutka shops in the first phase of relaxations for restarting economic activity post lockdown.

According to the sources in the state government departments - GST collections, one of the prime sources of revenue for the states, was seriously compromised in the month of April with several state governments reporting serious fall in the collections that were as high as 80-90 per cent in some cases.

Government is yet to estimate a complete and perfect detail of data in respect of GST collections for the quarter ending on June – 2020 as the delay is caused due to deferment of filing of GSTR 3B returns by the Government. This was done as Government wanted to ease compliance burden on taxpayers during lockdown. However in the following paragraphs, we have tried to give a rough idea of GST collection (Union Government Data) for the quarter ending on June – 2020.

The worst hit seems to be states such as Delhi, West Bengal, Assam, Andhra Pradesh that have reported fall in April GST collections to the tune of 90 per cent. In case of Delhi, officials have indicated that they have collected just ₹ 300 crore in April against normal monthly collection of Rs 3,000 crore. Similarly, Assam seems to have collected just about ₹ 200 crore as GST in April against close to ₹ 1,000 crore at this point of the year.

West Bengal is also facing serious fall in tax collections as lockdown has completely stopped service sector activity while manufacturing also remains suspended. GST collections have been badly hit in hilly states that depend largely on tourism and hospitality for revenue.

GST revenue collection in June stood at Rs 90,917 crore, up from Rs 62,009 crore mopped up in May and Rs 32,294 crore in April. The goods and services tax (GST) mop up was 9 per cent lower on a year-on-year basis in June, while it was 62 per cent down in May and fell 28 per cent in April.GST collections for the first quarter (April-June) of this financial year has been impacted due to COVID-19, firstly due to the economic impact of the pandemic and secondly due to the relaxations given by the government in filing of returns and payment of taxes due to the pandemic. However, figures of past three months show recovery in GST revenues," the finance ministry said.

States like Punjab, Chhattisgarh, Madhya Pradesh, Bihar, Assam, Andhra Pradesh, Telangana, Karnataka witnessed growth in collection in June over last year. North Eastern states like Sikkim, Manipur, Mizoram, Tripura, Nagaland, Arunachal Pradesh, too witnessed Increase in revenue during the month. The gross GST revenue collected in the month of June, this year stood at Rs 90,917 crore of which Central GST is Rs 18,980 crore, State GST is Rs 23,970 crore, Integrated GST is Rs 40,302 crore (including Rs 15,709 crore collected on import of goods) and Cess is Rs 7,665 crore.

In the light of above, the central government is mulling over to provide a GST relief package to the worst-hit sectors like restaurants, aviation, hospitality and realty sectors that help to mitigate the impact of COVID outbreak. The package may consist of a six-month suspension of GST payments for those sectors who suffered the most due to this pandemic, according to Ministry of Finance sources.

Another proposal considered by the government is to adopt a cash-based system for levying the tax in lieu of the current system based on invoices. A cash-based system implies that businesses would pay GST to the government when they received the cash in hand not when the invoice is raised.

GST Proceeds : Distribution to States

Under article 18 of the Constitution Amendment Act 2016, Parliament may, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for such period which may extend to five years. On the lines of above article , the Centre on Monday (27/07/2020) released Rs 13,806 crore to the states for March 2020, wrapping up the full payout for FY20 at Rs 1.65 lakh crore, compensation payments for this financial year since April remain pending. It has been indicated by the Union Ministry of Finance that it may not be able to pay further outstanding amount to states in near future. However, the states have regarded this meagre amount of compensation as a sort of “brazen betrayal of federal trust”

Compensation turns Sensation

The problem of compensation to states did not erupt suddenly (on account of **COVID – 19** or CAA protests or riots) but the same started finding its place since last October when the payments to states got delayed as GST revenues realised lower than expected. The COVID – 19 pandemic has deepened the economic slowdown and impacted revenues, with GST collections recording a 41% decline in the April – June Quarter. As the amount to be paid to states started rising with a compounded 14% rate even as compensation collections remained around the same level for two consecutive years, the high 14% rate has been viewed as delinked from economic realities. For instance, in the ongoing financial year, the SGST (state GST) revenue for June has been Rs 23,970 crore, while monthly protected revenue is Rs 63,706 crore, leaving a gap of Rs 39,736 crore (not taking into account settlement of IGST, the tax levied on all inter-state supplies of goods and services). Only ₹ 14,675 crore has been collected as compensation cess in April-June, including ₹7,665 crore in June.

The Centre has cleared compensation dues for FY20 of ₹1.65 lakh crore, while the collection under the compensation cess fund was only ₹95,444 crore, implying the payments were over 70% higher than the collection.

The gap was partly bridged by money from the compensation fund that had remained unutilised in the first two years of GST, along with ₹33,412 crore that was ploughed back from Consolidated Fund of India to the compensation fund. (This was after the settlement of IGST dues had showed an excess apportionment by the Centre in FY18, due to the ad-hoc method of IGST settlement being followed in the first few months after the GST rollout in July 2017.)

Now, compensation payments to states are pending since April.

States’ view on Compensation Gap

Market borrowing has been discussed in the GST Council as one of the possible solutions, although the legality of the Council in borrowing will need to be explored. There is also an emerging view among states in favour of hiking the GST rates or restructuring the GST slabs. The states, however, agree that tinkering with the rate structure needs to be done only after the effects of the pandemic-induced slowdown wear off.

There are differing views among states on the Council itself resorting to market borrowing. While Kerala backs such a move and Bihar opposes it, all states are unanimous on sticking to the 14% assured rate for compensation. Some states are also of the view that the compensation period should be extended beyond the stated period of five years. Hiking the cess rate or lowering of the guaranteed compensation rate have featured in the discussions of GST Council meetings, but states are not in favour of either option. In their paper, Kelkar and Rao have said the Centre should promptly respond to the demand from states to pay them overdue compensation cess by borrowing from the market.

Last but not the least : CRISIL's view

Indian economy is headed for a five per cent contraction in the current financial year 2020-21, thanks to Covid-19 pandemic, according to CRISIL.

The rating agency had predicted 1.8 per cent growth in its April estimate. India is headed for a contraction for the first time in over four decades, on account of Covid-19 uncertainty and impact from over a 50-day lockdown. CRISIL's GDP forecast is in line with the ones made by leading brokerages like Goldman Sachs which predicted the amount of 5 per cent contraction for the Indian economy this year. At its last monetary policy meet ended May 22, the Reserve Bank of India, too, painted a negative growth picture for the fiscal.

"CRISIL forecasts India's GDP growth to fall off a cliff and contract 5 per cent in fiscal 2021. Earlier, on April 28, we had slashed our prediction to 1.8 per cent growth from 3.5 per cent growth. Things have only gone downhill since. While we expect non-agricultural GDP to contract 6 per cent, agriculture could cushion the blow by growing at 2.5 per cent," it said in a report titled India GDP growth outlook for FY21.

CRISIL said about 10 per cent of gross domestic product (GDP) in real terms could be permanently lost, adding going back to the growth rates seen before the pandemic is unlikely in the next three fiscals.

In the first quarter, the rating agency sees 25 per cent contraction from the impact of over 50-day lockdown, which brought a significant part of the economy to a halt. On March 25, India imposed the world's strictest stay-at-home orders to contain the virus. Now, the country is trying to open up its economy even as the Covid-19 cases continue to rise.

"The first quarter of this fiscal will be the worst affected. June is unlikely to see major relaxations as the Covid-19 affliction curve is yet to flatten in India. Not only will the first quarter be a washout for the non-agricultural economy, services such as education, and travel and tourism among others could continue to see a big hit in the quarters to come. Jobs and incomes will see extended losses as these sectors are large employers," CRISIL said.

CRISIL said the government's economic package of Rs 20.9 lakh crore to support the economy is not substantial, adding it focusses majorly on reforms, most of which will have payoffs only over the medium-term.

Now , let us see what happens next as states have asked to give them 7 working days to think about the options given in the latest GST Council meeting.

Under the lens:

Objective :

According to CRISIL, the only sector which has given Indian economy reason to smile even after the Lockdown period and COVID crisis is

(a) IT Sector
(b) Banking Sector
(c) Agriculture Sector
(d) Pharmaceutical Sector

Conventional :

What are the states' apprehensions regarding the hiking of the cess rate or lowering of the guaranteed compensation rate ? What in your opinion would be the best way out to bridge the compensation gap ?