

GST - Compensation woes - Council needs to consult Finance Commission for way out!

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41st meeting of the GST Council is crucial as it can make or mar future of goods and service tax (GST). The reported agenda for meeting is Attorney General's (AG's) opinion on the Centre's obligation to compensate States for GST revenue shortfall during the worsening Covid-19 times.

AG's opinion is likely to result in discussion on means on raising resources to compensate States for the shortfall. There is a merit in the idea of widening cess base as well as cess rate for sin goods. The resulting increase in accruals to GST-CF) would help bridge the shortfalls in the Fund.

It is here pertinent to quote opinion of Voluntary health Association of India (VHAI). In a recent letter to Finance Minister Nirmala Sitharaman, VHAI has shown how existing total tax burden on all tobacco products in India is **"far lower"** than 75% of retail prices recommended by World Health Organisation (WHO).

VHAI has urged GSTC to levy compensation cess on bidis, apart from specifying rise in different imposts on other tobacco products.

VHAI's calculations show that implementation of its recommendations can help the Government raise an additional tax revenue of Rs 49,740 crore from all tobacco products.

We would urge GSTC to exercise caution in levying compensation cess on perceived luxury products and other non-sin products. Time is also not appropriate to tinker with tariff rates on other products. At present, all businesses are gasping for certainty in economic environment. It is unwise to flog an exhausted horse.

As put by Managing Director, Volkswagen Group's Indian companies G.S. Boparai,

"You need to have a road map and policy certainty, which runs from less than three years to a decade. You can't tweak policy in every budget. Our plans get disrupted".

In an interview with a pink daily, Mr. Boparai added: ***"It is not easy to operate, and it is not easy to run business"*** in India.

The Council should thus bat for total phase-out of lockdown restrictions to let the horse stand on its own legs. That is the key to increasing tax and non-tax revenue, apart from improving accruals to GST-CF.

News reports say that AG has opined that the Centre is not obligated to pay for the revenue shortfall. The Centre can allow states ***"to borrow on the strength of future receipts from the compensation fund"***, with the central government taking the ***"final decision in the matter"***.

This goes against the constitutional obligation of the Centre to compensate the States for any shortfall in state GST receipts

This technique would be an off-budget debt initiative. It would be akin to fertilizer companies taking short-term loans from the banks against delayed subsidy receipts under a special banking arrangement.

We hope no one is nurturing the weird idea of GSTC itself resorting to market borrowings to cover up shortfall in GST-CF. It is constitutional body without assets. Both the Centre and the States, on the other hand, have assets and are thus capable of raising debt with or without giving guarantees to bond subscribers. Mopping up fresh debt from capital markets for financing general expenditure of the Governments is stretching the idea of living beyond one's means.

The resort to market borrowings to merely cover up shortfall in tax receipts should thus be the last option. This is because the general Government debt is already much higher than the prudent level.

GSTC owes an explanation as to whether and why it preferred AG to 15th Finance Commission (15thFC) for consultation. Both are constitutional entities. The 15thFC is better qualified to give a roadmap for not only GST compensation but also rebooting GST reforms. The redesign of GST framework is required to cope with the long-term impact of Covid pandemic and associated lockdowns on the economy.

It is still not late to once again revise terms of reference of 15thFC for seeking its specific recommendation on whether GST compensation should be extended beyond five years ending June 2022. The extension should be continued till States attain threshold level of 14% growth in State GST, a level at which compensation is not required.

GST compensation is the cost of Centre-pushed reform and it has to be thus borne by it. All said and done, GST is the Centre's baby and must be nurtured into a healthy child with a bright future.

The 15thFC should also be asked to recommend non-disruptive avenues to raising resources for GST Compensation Fund (GST-CF).

It is open to debate whether AG is apt entity to consult on an issue that impacts Centre-State financial relationship. After all, AG represents the Centre's interests just as Advocate General (AGN) protects the interests of the concerned State. The country needs a balanced opinion that serves the interest of cooperative federalism.

If consulting Government's top-notch law officers is deemed as search-light for GST compensation, then GSTC should form a committee of AG and AGNs for seeking interpretation of the constitutional and statutory provisions of compensation issue.

Yet another option is to make presidential reference to the Supreme Court for interpretation of constitutional and statutory provisions on GST-CF.

According to the Constitution (One Hundred and First Amendment) Act, 2016,

"Parliament may, be 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 a period of five years."

Parliament later enacted the Goods and Services Tax (Compensation to States) Act, which was notified on 12th April 2017. It is unfortunate that the Centre deliberately left vague this compensation issue in this enactment. This was in spite of well-articulated plea by certain State FMs in initial meetings of GSTC for clear-cut legal clarity.

In the 7th meeting of GSTC held during December 2016, Tamil Nadu FM, for instance, observed that cess should not become a cross around the council's neck and suggested to have a formulation that if cess was found to be inadequate, the Council shall arrive at ways to meet the shortfall.

GSTC Chairperson, Mr. Jaitley had then assured state FMs that

"there was constitutional commitment for the Central Government to provide hundred per cent compensation and how it would be done was for the Council to decide."

Before proceeding further in this editorial, we must put in a caveat. As agenda for 41st meeting is not officially released, we have to rely on reported information leaked to few scribes. In fact, any analysis of prospects of GST, once branded as good and simple tax, has to be transitory for want of official information.

The Council has not yet made public agenda and minutes of last two meetings held on 14th March 2020 (before imposition of lockdown) and 40th meeting held on 12th June 2020. The Council should realize that holding back vital information encourages avoidable liaison between government functionaries and businessmen.

We urge the Council to make public within fortnight the agenda and minutes of any meeting to improve ease of doing business and thus add to clarity in revenue generation. If GSTC is a deemed legislative body as once perceived by late Arun Jaitley ji, then it should keep in mind the

swiftness with Parliament upload verbatim record of debates.

We don't know whether GSTC discussed threadbare the impact of economic slowdown, which skyrocketed after the imposition lockdown on 24th March 2020. It is important to distinguish between natural disaster (Covid-19 infection) and manmade disaster (lockdown). The latter was contrived to fight this novel influenza virus.

How much GST shortfall is due to Covid and how much it is due to lockdown is impossible to quantify. Here, we should also factor in the impact of demonetisation on GST, which is considered a man-made disaster by critics.

The broad principles of compensation to States for shortfall below the threshold revenue growth were decided in September 2016, whereas demonetisation was announced on 8th November 2016.

West Bengal Finance Minister Amit Mitra then foresaw the grave risk that demonetisation posed to GST through economic slowdown. The Centre should thus accept its role in stunting the growth of economy and GST.

The distinction between man-made and natural disasters is important as the Centre should not distance itself from its obligation to timely compensate the States for the shortfall in state GST revenue.

It is here pertinent to note that the Centre defaulted in its statutory obligation to make compensation payments to States on bimonthly basis much before Covid came calling.