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Denying the GST compensation to the States – Flouting the Cooperative Federalism

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ABSTRACT

GST which was termed as the radical indirect reform regime which came into force on the mid night of 1st July 2017 was termed as the ideal example of cooperative federalism. GST was an attempt to bring about uniformity in indirect taxation in India which suffered from the multi layered imposing structure and cascading effects. The change was not easy as there was no concurrent power of taxation under the constitution. So after the101th constitution amendment in 2016, GST was implemented to form ''one Nation, one Tax'' to make India internationally more competent and to enhance the intra national trade and commerce to develop the GDP of the country. The drastic changes in taxation regime could be successfully implemented only with the corporation of the States. The states were worried about there revenue loss while changing over from an origin-based tax structure to a destination-based taxation. The Centre promised the states to compensate initially for 5 years to cope up with new system. But now at amidst the pandemic of Covid 19 both the Centre and State is suffering a huge economic loss. The financial crisis of the states is augmented by the Centre's decision to stop the payment of the GST compensation which was due to the States. This has certainly and truly effected the Centre -State relations and the ''federalism'' the one among the basic feature of Indian Constitution. Turning back at the States at times when they need the most may disrupt the working of GST, the indirect tax regime which was already struggling to exist.

Keyword: *Indirect tax, Centre –Sstate financial relation, GST, revenue loss, compensation to the states, cooperative federalism.*

I. INTRODUCTION

Federal form of government implies that the governing powers will be shared between the different levels of government. In India the legislative, administrative and financial powers were typically shared according to the Constitution of India. This federal feature we adopted or followed from Govt of India Acts 1919 and 1935 which was most apt for India, a diverse country in terms of tradition, culture, religion, race, language, etc. Governing from the centre

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may not be able to do justice to all local needs and necessities.

Imbibing the Gandhian philosophy of treating the villages as units of polity, the panchayats was already in operation. But because of the financial dependency they could not deal the entire matters perfectly. It was realised that in an era of globalisation decentralisation is the principal countervailing trend which can ensure that the growth process is pro-poor, pro-women, pro-nature and pro-jobs.[2] It was commonly agreed that only decentralisation can ensure the voices and concerns of the poorest of the poor. In India in 1990's by 73rd and 74th Amendments to the constitution direct local democracy became a reality. The principle of 'Cooperative Federalism' gained more and more importance in this context. Governance based on harmonious understanding between the three tiers of governance – Centre, State and local government was thus became a guiding feature of Indian federalism.

II. Fiscal federalism

Fiscal federalism deals with financial arrangements and their working in a federal polity.[3]Fiscal federalism is part of broader public finance discipline. The term was introduced by the German-born American economist Richard Musgrave in 1959.[4] Fiscal Federalism means the division of responsibilities regarding public expenditure and taxation between the different levels of the government. The constitution has given power to the three levels of Government to levy and collect the taxes through an elaborate systematized scheme. Part XII of constitution is entirely devoted to the financial relations between the centre and the states. By Article 245 the legislative power is divided between the centre and the states. Article 246 with list I, II and III given in the seventh schedule of constitution of India prescribes the subject matter in which the centre and state can legislate. The taxing power which includes levy, collection and appropriation is shared between the centre and the states in these ways in the constitution

1. Taxes levied by the Centre and allow the State to collect it and retain it.
2. Taxes levied and collected by the union and assigns the entire proceeds to the States.
3. The Centre will transfer the power to levy, collect and to utilize the revenue so collected to the States.

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[2] Decentralisation in India Challenges & Opportunities, United Nations Development Programme 55, Lodi Estate New Delhi - 110 003 India,

[3] M M Sury, GST and Fiscal Federalism in India, 229,(1st Eddition) 2018

[4] Naim Kapucu, Fiscal Federalism, https://www.britannica.com/topic/fiscal-federalism

4. Taxes levied and collected by the Centre and apportioned between the Union and the States
5. Taxes exclusively for the Centre.

   By this arrangement the Centre and the states accrues revenue required for meeting their responsibilities.

Fiscal relations in India between the union and state governments have endured significant changes in recent years.

(i) Replacement of the Planning Commission by NITI Aayog in January 2015

(ii) 14th Finance Commission headed by Prof. Y V Reddy recommended the more transfer of revenue to the states i.e the share of states in the net proceeds of the shareable Central taxes should be 42% against 32% recommended by 13th Finance commission.

(iii) the 101th Constitutional amendment in 2016 to introduce the Goods and Services Tax (GST) and the establishment of the GST Council for the central and state governments to deliberate and jointly take decisions.[5]

(iv) The concurrent powers were granted to the Union and the States to impose goods and service tax by Article 246A, which never find place in Indian constitutional history.

(v) By abolishing the entry taxes which has to be paid while the goods entering each state, India has turned to one market with same rate of tax in all the states.

III. Reforms in Indirect Tax System in India and Evolution of GST

Of the two types of taxes direct and indirect, the indirect tax plays a prominent role in raising the major part of the revenue needed for the governments functioning. It was only in 1970' s the direct tax become the major revenue earner. Even then the indirect taxes assume the major contributor position. The indirect tax structure which we followed from the British reign was multi layered, burdened with cascading effects and the rate war existed between the States. Efforts were made to simplify the taxation system since independence starting from the Taxation Enquiry Commission with Dr.John Mathai as its chairman in 1953. These efforts continued with the Indirect Taxation Enquiry Committee in 1976 under Shri L K Jha which recommended, converting specific rates into ad valorem rates, rate consolidation and input tax credit mechanism of value added tax at manufacturing level (MANVAT). In 1986, the recommendation of the Jha Committee on moving on to value added tax in manufacturing was

[5] Pinaki Chakraborty,Fiscal Federalism in India Who Should do What? 05 APR 2019, https://www.theindiaforum.in/article/fiscal-federalism-india

partially implemented through modified value added tax (MODVAT).[6]Then after the adoption of new economic policy in 1991 the Chellaih committee submitted its reform reports in 3 volumes and much of its recommendations were implemented. the MODVAT was modified into CENVAT by merging the rates into three. Later in 1994 the service tax was introduced on three services namely general insurance, telecommunication and stock broking. By 2012 the number of services were increased and a negative list was introduced excluding this every service were brought under the purview of service tax.

By the continuous efforts which initiated in 1995 end with the replacement of Sales Tax Acts with VAT in all states by 2005. Even then India remained incompetent to an extend in the international trade and with barrios in intra state trade and commerce. So, the importance of implementing GST which was introduced in 1954 in France and was adopted by more than 160 countries were high lighted my many economists. The Kelkar Task Force on Fiscal Responsibility and Budget Management (FRBM) recommended in 2005 introduction of a comprehensive tax on all goods and service replacing Central level VAT and State level VATs except the customs duty.[7] In the budget speech of 2005-2006 the union Finance minster announced the implementation of GST by 2010. By tireless efforts and by an Amendment to the constitution GST was enforced on July 1 st of 2017 by subsuming the following taxes:

At the central level

a. Central Excise Duty,

b. Additional Excise Duty,

c. Service Tax,

d. Additional Customs Duty commonly known as Countervailing Duty, and

e. Special Additional Duty of Customs.

At the State level, the following taxes are being subsumed:

a. Subsuming of State Value Added Tax/Sales Tax,

b. Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States),

c. Octroi and Entry tax,

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[6] GOODS AND SERVICE TAX (GST) CONCEPT & STATUS, Central Board Of Indirect Taxes And Customs (CBIC) Department Of Revenue Ministry Of Finance Government Of India As On 01 St August, 2019Fiscal%20Federalism/GST-Concept%20and%20Status01072019n.pdf

[7] Id

d. Purchase Tax,

e. Luxury tax, and

f. Taxes on lottery, betting and gambling.[8]

India has adopted a Dual GST model, i.e the GST would be administered by both the Central and the State Governments. The GST to be levied by the Centre on intra-state supply of goods and/or services is Central GST (CGST) and that by the States is State GST (SGST).

On inter-state supply of goods and services, Integrated GST (IGST) will be collected by Centre. IGST will also apply on imports.[9] The GST was implemented through four legislations, CGST, SGSCT, IGSCT and The Goods and Services Tax (Compensation to States) Act, 2017. All states enacted the State GST for their own states and the other three were enacted by the Union Parliament.

IV. Compensation to the states for the revenue loss due to GST

GST is a consumption based/Destination based tax i.e. the tax should be received by the state in which the goods or services are consumed and not by the state in which such goods are manufactured which became a matter of concern for the manufacturing states. The states were also worried in compromising with their financial autonomy. They were concerned about the revenue loss that may occur due to the abolition of entry fee and were not in a position to estimate the share of service tax that may accrue to them. The Centre got the consensus of the state for the amendment of the constitution and implementation of the GST by promising the states to compensate the loss that may occur to the States for 5years. For this The Goods And Services Tax (Compensation To States) Act, 2017 was enacted which extend to whole of India including Jammu and Kashmir.

V. History of compensation to the states in India

The first instance of compensation as part of agreement between the centre and the state in post-independence period was in 1956. This was when the sales tax on textiles, tobacco, and sugar was replaced by additional duties of excise.[10] The agreement provided that the share accruing to each state shall not in any case be less than revenue realised from the levy of sales tax on these goods for the financial year 1956-56 in that state. The decision was implemented

[8] Goods and Services Tax One Country One Tax One Market https://dor.gov.in/sites/default/files/GST_FAQ.pdf
[9] GST: The illustrative guide to how transactions will take place after tax reform, May 20, 2017, https://www.moneycontrol.com/news/business/economy
[10] M M Sury, GST and Fiscal Federalism in India, 289, (1st Eddition) 2018, New century Publications, New Delhi

through the Additional Duties of Excise Goods of Special importance) Act,1957.[11]

In 1983 Kamlapati Tripathi committee recommended the extension of additional excise duties to some more products and accordingly the sales tax on vanaspati, drugs and medicines, cement, paper and paper board and petroleum products were to be replaced by additional excise duties.[12] Many of the states believed that this would erode their revenue position. In spite of elaborate formulae for protecting the financial interests of the states put forward by Kalapati Tripathi committee lack of confidence in the Centre by some of the states disallowed the implementation of the scheme. Thus, an important tax reform could not achieve its aim due to the friction between the Centre and the States.

Coming to Compensation due to GST implementation The Goods and Services Tax (Compensation to States) Act, GST guarantees all states an annual growth rate of 14 percent in their revenue during the period July 2017-June 2022. If a state's GST revenue cannot attain 14 percent, such 'loss of revenue' will be compensated by the Centre. To collect this amount the Centre levied a GST compensation cess on certain luxury and sin goods such as cigarettes and tobacco products, pan masala, caffeinated beverages, coal, and certain passenger vehicles.[13] The Act requires the Centre to credit this cess revenue into a separate Compensation Fund and all compensation grants to states are required to be paid out of the money available in this Fund.[14]

The Act describes in 14 sections scheme of compensation. Section 3 he estimated growth rate of the sates during the transition period is fixed as 14. For calculating the compensation amount the 'base year' was decided as 2015-2016 financial year. An elaborate scheme was drawn out as to avoid any ambiguities in future including the power to remove the difficulties arising in the implementation.

VI. The Pandemic Covid 19 And Due GST Compensation.

While the GST was going through the initial stages and while struggling for successful operation unexpectedly a pandemic broke out which was spread by corona virus and it affected entire world. The world resorted to complete lock down. In India the lock down was implemented in 5 phases from 25th March to 30th June 2020 which very drastically affected the economic condition of the country. The Centre as well as State revenue was

[11] Id
[12] Id
[13] Suyash Tiwari, The issue of the GST compensation to states,August 26, 2020 05:39 PM, https://www.cnbctv18.com/economy/explained-the-issue-of-the-gst-compensation-to-states-6741931.htm
[14] Id

badly affected where the responsibilities of the Government's augmented considerably. They have to spent a huge amount on medical service, for providing ration, for preventive measures an many more.

At the contrary the GDP growth rate for 2015-16 and 2016-17, was far short by 10.5% and 11.8%, respectively. Since then, things have become much worse with a growth of 4.2% in 2019-'20 and a significant GDP contraction expected in this financial year due to Covid-19.[15]

The economic conditions of the States worsened with the denial of GST compensation on name of 'Act of God' by the union minster. The reality is that even before the Pandemic the GST compensation was due to the states. In 2019-20, the delay in payment was observed due to insufficient funds with the Centre for providing compensation to states.[16]Already 1.65 lakh crores were pending union government instead of paying the compensation in the 41st meeting of the Goods and Services Tax (GST) Council, states were offered with two options to resolve the contentious issue of compensation shortfall which was estimated as Rs 2.35 lakh crore.

The first option for states is a special window to be provided, in consultation with the RBI, for borrowing the projected GST shortfall of Rs 97,000 crore and an amount that can be repaid after five years of GST implementation ending 2022 from the compensation cess fund.

The second option is to borrow the entire projected shortfall of Rs 2.35 lakh crore — both on account of faltering GST collections and the expected shortfall due to the pandemic — under a special borrowing window facilitated by the RBI.[17]

The states are not happy with it especially the non- NDA governed states had noted their protest and certainly it is not fair for a union Government to turn back from their promises. This will adversely affect the fiscal systems of the country and many finance ministers of the state had registered their dissent.

Kerala finance minister Thomas Isaac, have suggested that the GST council itself should be allowed to borrow and the money repaid from the compensation cess. He has paused that cut in compensation and bringing in a distinction between GST and Covid-related revenue loss is unconstitutional. He has said that the states' FRBM limit should be raised by at least 1.5

[15] Shoaib Daniyal, With the Centre refusing to pay compensation to states, is GST nearing an end?,August 29 2020, https://scroll.in/article/971657/with-the-centre-refusing-to-pay-compensation-to-states-is-gst-nearing-an-end

[16] Id at Suyash Thiwari.

[17] Aanchal Magazine ,Compensation shortfall: GST dues stuck, states told to borrow via RBI, August 28, 2020 https://indianexpress.com/article/business/economy/nirmala-sitharaman-gst-payment-states-rbi-6572835/

percentage points if the entire Rs 2.35 lakh crore has to be borrowed.[18]

VII. Conclusion and suggestion

A responsible Centre can never claim the ‘’Act of God’’ as an excuse from reverting back from their agreements and promises which may disrupt the smooth relation between the Centre and the states. It’s purely a betrayal and will lead to the collapse of the indirect tax system of the country and the GST which was implemented by them may demand a restructuring.

The Centre Government have to take steps so as to avoid friction in the centre state relations. They have to take precautions that GST highlighted as an example of cooperative federalism itself may not disrupt the cooperative federalism.

The legality of the council borrowing money buy centre is unclear since it isn’t a sovereign entity. And also, its not correct on the part of the state to combine the GST loss and the loss of revenue due to the covid.

Union and state should go hand in hand in this most crucial condition caused by covid 19. This hard phase has to be overcome by the cooperative actions. The other countries in the world had already adopted measures to reduce the difficulties of the assesses. Some countries may even have extended the time to December 2021 for the back payments. The centre should take a favourable view in the GST compensation in order to protect the basic federal feature of the country. The Centre must extend the GST compensation for two more years than the agreed 5 years for the success of the GST -the Indirect Tax Reform.

Even if the lock down is lifted and the economic activities have started India is expecting a long and protracted economic slowdown. Another matter has to be realized while going through this crisis brought about by the Covid- 19 is that we cannot highly depend upon the taxes for the revenue. The government have to find out new means for exercising the responsibilities. We have to cope up with the new normal because yet no vaccines are invented or no one knows whether we can return to the old normal ever.

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[18] Id at Aanchal Magazine.