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Abstract

A comprehensive multistage Value Added Tax (VAT) system, viz., Goods and Services Tax (GST), is introduced in India since 1 July 2017. GST encompasses various taxes from Union and State indirect tax bases and it is a dual VAT system with concurrent taxation power to Union and State governments. It was envisaged that removal cascading of taxes and enshrining destination based consumption tax system under GST will encourage investment and improve ease-of-doing business in India. Though it is not right time to comment on success or failure of Indian GST system unless the tax system stabilizes, so far revenue mobilization from GST is not encouraging. The shortfall in GST collection has been acknowledged in the 'Medium Term Fiscal Policy cum Fiscal Policy Strategy Statement' of the Union Budget 2019-20. The genesis of revenue shortfall may be design and structural in nature and/or compliance and tax administration related. However, the uncertainty surrounding GST revenue collection is an issue which needs an in-depth assessment for fiscal management of Union and State governments. The impact of revenue uncertainty will not be restricted to Union finances alone; it will spill over to state finances through inter-governmental fiscal transfers. Therefore, depending on seriousness of the uncertainties associated with GST revenue collection, devising an inter-governmental fiscal transfer framework may be a challenging task for the Fifteenth Finance Commission. Given the information available in the public domain, this paper attempts to explore possible causes of revenue shortfall and assess possible impacts of revenue shortfall on Union and State finances.

Key Words: Revenue Uncertainty, Inter-Governmental Fiscal Transfers, Goods and Services Tax (GST), State Finances, India.

1. Introduction

A comprehensive multistage Value Added Tax (VAT) system, viz., Goods and Services Tax (GST), is introduced in India since 1 July 2017. The GST encompasses various indirect taxes from Union and State indirect tax bases. In a federal system, harmonization of the tax base is expected to reduce vertical fiscal imbalance (Rao, 2007). The shift from origin based to destination based tax system is also expected to reduce horizontal imbalance among Indian States. It is expected that states having larger consumption base will gain from GST as compared to states having larger production base. Reductions in vertical as well as horizontal imbalances are expected to reduce dependence on inter-governmental fiscal transfer system as the only instrument to achieve fiscal equity in Indian federalism. The consolidation of various taxes on goods as well as services under the GST system was long overdue in India. Recommendations of various tax reforms committees, constituted since Independence, helped in removing cascading of taxes as well as enshrining destination principle in consumption taxes. Implementation of recommendations of the tax reform committees in different points of time helped in sequencing tax reforms which ultimately culminated to introduction of GST (Mukherjee and Rao, 2019). Indian GST is a dual VAT system with concurrent taxation power bestowed on Union and State governments. In the GST regime every transaction (or value addition) attracts Central GST (CGST) as well as State GST (SGST). Inter-state transactions (including branch/ consignment transfers) and imports (in addition to Basic Customs Duty) attract Integrated GST (IGST). IGST rate comprises of prevailing CGST and SGST rates and due input tax credit (ITC) is allowed against IGST or CGST-cum-SGST liability arising in the downstream of the value chain. The continuation of ITC chain across tax jurisdictions is expected to reduce cascading of taxes, improve tax compliance (by capturing paper trails of transactions) and reduce transaction costs associated with inter-state transactions. Different provisions under the GST system, e.g., Reverse Charge Mechanism (RCM), are expected to encourage formalization of the economy and therefore efficiency gains.

Harmonization of tax rules, regulations, rates, processes and procedures across States is expected to improve ease-of-doing business in India. The removal of cascading of taxes and transaction costs associated with inter-state transactions is expected to encourage investment and therefore economic growth. However, the success of any tax reforms depends on successful implementations of the reforms and ease-of-tax compliance.

Unless the GST system stabilizes, it would be difficult to comment on success of the system in terms of revenue mobilization. However, GST collection is falling short of targets set in Union Budgets. The shortfall in GST collection has been acknowledged in the 'Medium Term Fiscal Policy cum Fiscal Policy Strategy Statement' of the Union Budget 2019-20. The genesis of the revenue shortfall may be GST design and structural in nature and/or compliance and tax administration related. However, the uncertainty surrounding GST revenue collection is an issue which needs an in-depth assessment for fiscal management of the Union and State governments. The impact of revenue uncertainty will not be restricted to Union finances alone; it will spill over to state finances through inter-governmental fiscal transfers. Therefore, depending on seriousness of the uncertainties associated with GST revenue collection, devising an inter-governmental fiscal transfer framework may be a challenging task for the Fifteenth Finance Commission (FFC).

The impact of GST revenue shortfall on state finances will be restricted to only central grants-in-aid transfers during GST compensation period (1 July 2017 to 30 June 2022). In this period States' revenue on account of State GST (SGST) will be protected. States will continue receiving compensation in case there is any shortfall in SGST collection from the projected revenue, at 14 percent. Therefore, still June 2022 of the FFC's award period (2020-21 to 2024-25) there will be no impact from GST on State finances on account of own tax revenue mobilization. However, if the GST revenue shortfall continues, eventually central transfers to States may fall which may impact State finances. Therefore, it will be a challenging task for the FFC to devise a fiscal transfer framework for the period aftermath of GST compensation period. It is desirable for the FFC to explore uncertainties related to revenue mobilization on account of GST and devise a fiscal transfer framework keeping in mind the revenue uncertainties.

Given the information available in the public domain, this paper attempts to explore possible causes of revenue shortfall from GST and assess possible impacts of revenue shortfall on Union and State finances.

In the next section, we discuss the problems associated with estimation of revenue under protection under the GST system for Union and State Governments. In section 3, we discuss possible causes of GST revenue shortfall. Impacts of GST revenue shortfall on Union Government's revenue are discussed in section 4. We explore impacts of GST revenue shortfall on central transfers in section 5. The importance of fiscal transfers in State finances is discussed in section 6. In section 7, we discuss trends in State GST collection and we draw our conclusions in section 8.

2. Problems associated with Estimation of Revenue under Protection from GST

It is difficult to compare GST revenue collection with earlier system of taxation due to several reasons. First of all, given the disaggregated data available either in the Budget Documents or Finance Accounts of State Governments, for pre-GST regime it is not possible to separate revenue on account of sales tax or VAT, CST and entry tax into two baskets – a) items which are under GST and b) out-of-GST items (mainly petrol, diesel, aviation turbine fuel, crude petroleum oil, natural gas and alcoholic beverages for human consumption). Difficulty in separating revenue collection into two baskets and when revenue collection from majority of out-of-GST items depends on volatility of international crude oil prices and foreign exchange rate, it is difficult to estimate the size of revenue of states that needs to be protected under GST. Secondly, GST subsumes various taxes and cesses which were earlier used to be collected by local governments/ authorities (e.g., local body tax, Octroi) and other institutions (e.g., water cess by State Pollution Control Boards) and they need not be necessarily reflected in the State Budget documents. According to the Goods and Services (Compensation to States) Act of 2017, revenues on account of these taxes and cesses are considered to be protected and due GST compensation will be released to States. In the absence of information on state-wise revenue collection from these taxes and cesses, it will be difficult to estimate the revenue under protection for States. Thirdly, information on State-wise SGST collection, disbursement of IGST settlement and GST compensation are not available in the public domain; therefore from the existing database it is not possible to estimate state-wise revenue under protection under GST. Aggregate shortfall in the GST collection may be lower but distribution of the shortfall across states will differ. States experiencing higher than 14 percent growth rate in SGST collection are not expected to compensate states having lower than 14 percent growth rate. Therefore, it is not possible to estimate likely size of the GST compensation package required to protect revenues of the States.

2.1 Expected Revenue from GST

In the absence of any recent estimate of revenue under consideration from GST and respective shares of Centre and States in total GST collection, we use the estimates provided in the 'Report on the Revenue Neutral Rate and Structure of Rates for the Goods and

Services Tax (GST)' by the then Chief-Economic Advisor for 2013-14 (Government of India 2015a). We use simple method of revenue projection based on annual growth rate of Gross Value Added (GVA) at Basic Prices (see Table 1). Here our basic assumption is that tax buoyancy is unitary and it is constant over time. Table 1 shows that expected revenue from GST is likely to be Rs. 1,499,451 Crore for 2018-19. Therefore, monthly revenue from GST is expected to be Rs. 124,954 Crore during 2018-19. However, monthly average GST collection till December 2018 is Rs. 97,355 Crore and therefore gap in monthly GST collection is expected to be Rs. 27,600 Crore. This shows that there is considerable shortfall in GST revenue collection and it demands an in-depth analysis to identify reasons for such shortfall.

Table 1: Revenue Expectation from GST

Year	GVA at basic prices (Current Prices, 2011-12 Series) (Rs. Crore)	Annual Growth Rate of GVA (%)	Revenue under GST - CEA Report (Rs. Crore)*		
			Centre	States	Total
2011-12	8,106,946				
2012-13	9,202,692	13.52			
2013-14	10,363,153	12.61	327,728	535,722	863,450
2014-15	11,504,279	11.01	363,815	594,712	958,528
2015-16	12,574,499	9.30	397,660	650,037	1,047,698
2016-17	13,935,917	10.83	440,714	741,042	1,181,757
2017-18	15,482,715	11.10	489,631	844,788	1,334,419
2018-19	16,961,365	9.55	536,392	963,059	1,499,451

Notes: *Both for Centre and States' revenue under GST is estimated (beyond 2013-14) based on annual nominal GDP growth rate. For States, beyond 2015-16 revenue under GST is estimated based on nominal annual growth rate of 14 percent.

Source: Estimates are based on Government of India (2015a) and EPWRF India Time Series Database.

3. Causes of GST Revenue Shortfall

Revenue shortfall under GST is not conducive for fiscal sustainability. GST revenue shortfall may arise due to problems associated with a) design and structural issues related to GST, b) policies and practices of GST administration and c) tax compliance. In addition, under the 'inflation targeting regime' adopted by the Reserve Bank of India (RBI) since February 2015, achieving 14 percent nominal growth rate in GST revenue requires at least 10-11 percent real growth rate of GDP, if we assume tax buoyancy is one. However, the prevailing growth rate in GDP is lower than 10 percent.

3.1 GST Revenue Shortfalls: Design and Structural Issues

For a federal country like India, designing a destination based VAT system with dual control was a challenge. As compared to Central Sales Tax (CST) regime, inter-state trade (including branch/ consignment transfers) attracts Integrated GST (IGST). In the GST regime, inter-state purchasers need to block considerable cash flow as IGST payment (or Credit), as IGST rate (comprising CGST and SGST) is higher than the earlier CST rate (2%). Depending on gestation period in the value chain, duration of blocking cash flow as

IGST will vary across sectors. The blocked IGST credit could only be realized when IGST or CGST-cum-SGST liability arises in the downstream of the value chain. Moreover, in the GST regime branch/ consignment transfers also attract IGST. In the CST system there was no CST liability on consignment/ branch transfers, and therefore it blocks working capital of businesses operating in multiple jurisdictions. The rate of tax on holding inventory might have gone up under the GST regime. Inventory has a significant impact on revenue collections in the economy, as tax departments in value added tax regimes collect taxes not just on final consumption, but in the interim on stocks held as well. Dramatic fall in inventory has happened in India since the beginning of financial year 2016-17. The difference in average quarterly stock between 2014-16 to 2016-18 is Rs. 39,865 Crore or 1.57 percent of GDP (Rao and Mukherjee, 2019). The fall in inventory level will result in level (scale) correction in GST revenue collection. Perhaps this aspect of revenue shortfall was not perceived by the policy makers earlier.

3.1.1 GST Rate Structure and Revenue Neutrality

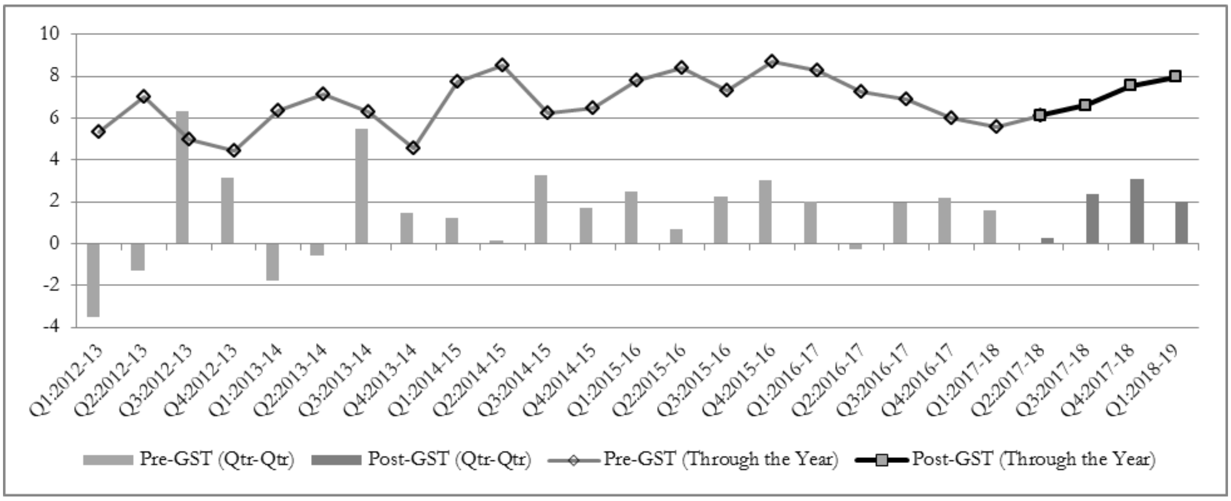
In the GST system, item-wise GST rates are set for commodities based on prevailing statutory tax rates of Central and State taxes without giving due consideration on revenue neutrality aspect of the GST. Since GST removes cascading of taxes, it is expected that tax collection on account of cascading part of taxes will reduce and therefore a higher tax rate is required in the less cascading regime to achieve revenue neutrality. Any tax reform results in efficiency gains in terms of attracting investment and re-defined inter-sector linkages. However, to reap the benefits of efficiency gains of the GST system, stabilization of the new tax system is required. In the absence of access to information on tax-rate wise tax base and tax collection for pre- and post-GST regimes, it is difficult to understand the revenue neutrality of the present GST regime. However, given the shortfall of GST collection and continuous reduction GST rates, it will be right time for the GST Council to initiate reviewing the revenue neutrality aspect of the GST.

Multiple rate structure of GST may have helped to moderate the GST incidence across different segments of the society but it is prone to classification disputes. Moreover, frequent reductions of GST rates may have improved tax compliance, but revenue implications of such moves cannot be ignored. In addition, frequent changes in the compliance requirements and processes and procedures may delay the stabilization of the GST system.

3.2 GST and Economic Growth

Year-to-Year growth rate of Gross Value Added (GVA) at basic prices (2011-12 series, at constant prices) shows that growth rate was falling since Q4 of 2015-16 and it was 5.6 percent at Q1 of 2017-18 (Figure 1). The growth rate of GVA has gone up from 5.6% in Q1 of 2017-18 to 8% in Q1 of 2018-19. However, average growth rate during 2017-18 (6.4%) was lower than that achieved in 2015-16 (8.1%) and 2016-17 (7.1%). In drawing conclusions about the impact of GST on GVA from these numbers, it should be borne in mind that seven months prior to the introduction of GST, the economy received a shock in the form of withdrawal of high denomination notes. This shock is seen to have reduced the growth rate of the economy at least in the two quarters prior to the date of introduction of GST, resulting in a lower base and possibly a higher rate of growth in the period since. It can however be stated that with the introduction of GST, the rate of growth of the economy has not recorded a sharp decline. In fact, it perhaps continued its recovery from the shock of withdrawal of high value currency notes.

Figure 1: Growth Rate of GVA at Basic Prices (2011-12 Series, Constant Prices)



Source: EPWRF India Time Series Database

3.3 Policies and Practices of GST Administration

There are several provisions of GST which are yet to be adopted in practice, e.g., reverse charge mechanism (RCM). In RCM system, businesses purchasing from unregistered entities and/or composition dealers have to deposit due taxes on inputs that they purchase and the corresponding input tax credit (ITC) they can claim when their tax liabilities under GST (either IGST or CGST-cum-SGST) arises. The proposed system is supposed to force informal businesses to take GST registration and get integrated with larger value chains. Adoption of RCM has been postponed till 30 September 2019. The decision may have helped in improving tax compliance but revenue implications of the decision cannot be ignored. There is need for benefit-cost-analysis of postponement of any provision of the GST.

In the 32nd meeting of the GST Council (held on 10 January 2019), it is decided to extend annual turnover limit for GST registration under composition scheme from Rs. 1 crore to Rs. 1.5 crore and allowed annual return submission, instead of quarterly return submission. However, they will continue to pay taxes on quarterly basis. The tax rate for manufacturers under the composition scheme has been reduced from 2 percent to 1 percent. The annual turnover limit for composition scheme for services / mixed supplier is extended upto Rs. 50 lakh with composition rate of 6 percent. GST threshold has been extended from current Rs. 20 lakh to Rs. 40 lakh (for small states from Rs. 10 lakh to Rs. 20 lakh and given an option to opt for raising threshold to Rs. 40 lakh). Revenue implications of these decisions cannot be notional or negligible and therefore GST revenue collection is expected to bear the burden of these policy decisions. Moreover, this will impact union finances in terms of higher compensation payment obligation in case states' GST collection falls.

Similarly, revenue impact of introduction of e-way bill on movements of goods is not clear though it has put considerable compliance burden on businesses.

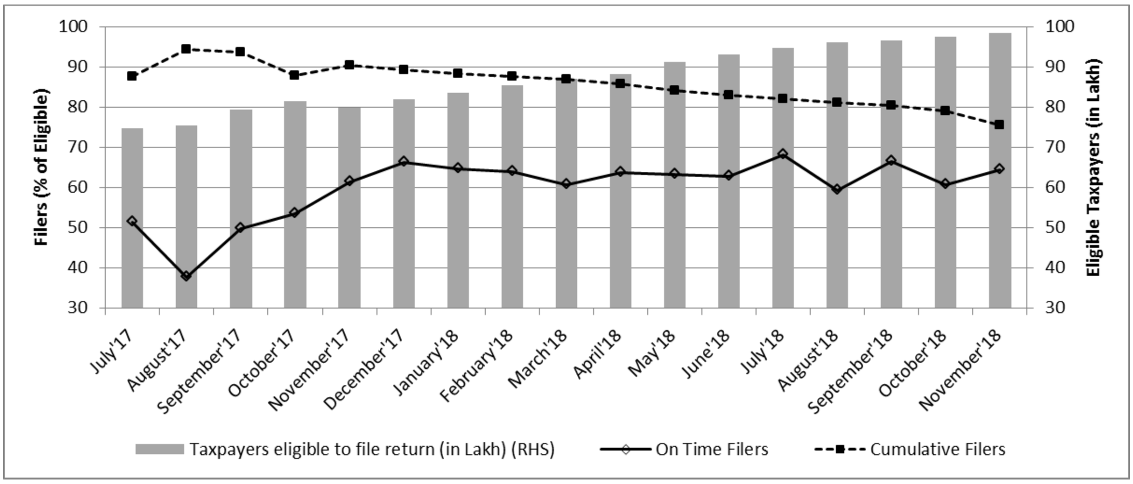
3.4 Tax Compliance

> "The tax administration of GST is now based on self-declared Tax Return, in which the assesse decides on his own how much tax liability he has and claims input tax credit as per his own calculations. Since implementation of some of the main features of GST such as, matching of returns, e-way bill as well as reverse charge mechanism have been postponed the tax compliance may not be up to the mark".[1]

Filing of tax return under GST is yet to be stabilized. Still a considerable section of the taxpayers are facing problems to file return on-time. Though filing of past returns with late fee is acceptable in the GST regime, on-time filing of return is desirable to achieve stability in the tax compliance regime. There is considerable difference between on-time and cumulative returns submitted for a particular month. Both on-time and cumulative GSTR-3B filed till 27 December 2018 is shown in Figure 2 and it shows that on average only 60 percent of eligible taxpayers are submitting returns on-time. The reason for shortfall in on-time return submission needs to be assessed to achieve better compliance. Unless GST return submission (GSTR-3B) is stabilized, monthly revenue collection under GST cannot be stabilized. In other words, monthly revenue collection of GST is dynamic depending on past returns submitted by taxpayers. Along with GSTR-3B, taxpayers are also expected to file GSTR-1, which establishes tax liability of tax payers based on their sales. GSTR-1 is informative in nature and actual tax payment is made through GSTR-3B. There is no information available in the public domain on the compliance of GSTR-1 filing by taxpayers. Therefore, stability in GSTR-3B submission by encouraging on time submission of returns is desirable to achieve stability in monthly revenue collection under GST. It is to be mentioned here that non-filers (of GSTR-3B) are not necessarily tax evaders, but they may need assistance (time) in filing due returns. Perhaps frequent changes in the compliance requirements are not conducive to achieve stability in the GST regime.

[1] http://pib.nic.in/newsite/PrintRelease.aspx?relid=173899 (last accessed on 19 February 2019).

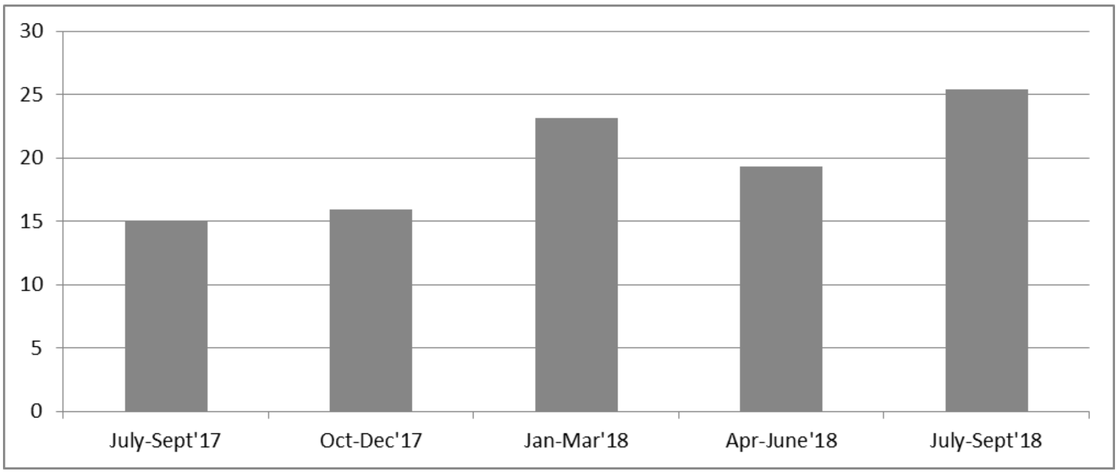
Figure 2: On-time and Cumulative Filing of GSTR-3B (as on 27 December 2018)



Source: Compiled from 'Lok Sabha Unstarred Question No. 4063, dated 4 January 2019' and Press Releases of the GST Council.

As compared to regular taxpayers, composition taxpayers are also required to file quarterly returns. Figure 3 shows that one-fourth of composition taxpayers did not file tax returns till 27 December 2018. Figure 2 and 3 together show that problems associated with filing of tax returns are common across all taxpayers and it may not be dependent on frequency of return submission obligation alone. Perhaps strengthening taxpayers' services in terms of assistance to file returns may help in achieving stability in the tax compliance regime.[2]

Figure 3: Percentage of Composition Taxpayers who have not filed return on time (%)



Source: Lok Sabha Unstarred Question No. 4063, dated 4 January 2019.

In the 31st meeting (held on 22 December 2018), the GST Council has waived late fees payable for delayed filing of returns in Form GSTR-3B and Form GSTR-4 for the months/quarters from July 2017 to September 2018 in case the same are furnished between 22 December 2018 to 31 March 2019. Further the due date for filing of 'annual

[2] GST Rate Reductions happen in meeting held in August, September, October, November 2017 and July 2018

returns' has been extended upto 30 June 2019. Available evidence shows that the number of late filers per month has reduced over time whereas the amount they were paying in the form of late fee has increased. The average late fee per return submission has increased from Rs. 100 in September 2017 to over Rs. 800 in February 2018 (Rao and Mukherjee, 2019). This does suggest that while compliance is picking up – the percentage of returns which are filed late has declined from over 56.4 percent in August 2017 to a little over 11 percent in November 2018. However, the complete waiver of late fee may cause moral hazard problem for those who have filed return earlier for the period July 2017 to September 2018 with payment of late fee. Moreover, such decisions may encourage some taxpayers to wait for late fee waiver, instead of filing return on-time or with late fee. It is also announced that a new simplified return filing system shall be rolled out on trial basis from 1 April 2019. Introduction of a new system of return filing will impose additional cost of tax compliance in terms of procurement of new software and training of personnel to comply with new system. This move will further delay in stabilization of GST return submission system.[3]

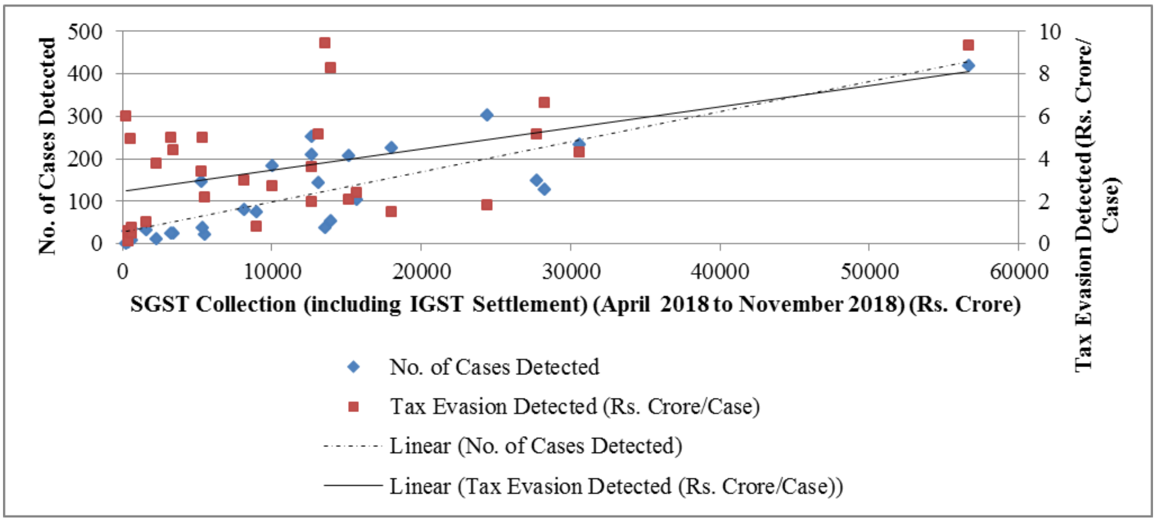
3.4.1 Tax Evasion

Claiming ITC against fake invoices is the most common method of tax evasion. Till December 2018 of 2018-19, there are 499 identified cases of claiming ITC against fake invoices which involve tax evasion of Rs. 3894.94 crore.[4] Regular taxpayers are required to file invoice-wise monthly sales through Form GSTR-1. There was also discussion on matching of invoices (between sellers and purchasers) to identify any possible instances of fraud of claiming ITC against false invoices. However, the system of invoice-matching is yet to be rolled out. Introduction of invoice-matching may reduce tax evasion on account of fraudulent ITC claims based on false invoices, but it may not be an effective instrument to curb tax evasion on account of under-invoicing. Under-invoicing is result of collusive tax evasion mechanism where sellers and purchasers collude and mutually agree to under-report value of the transaction. Identification of tax evasion on account under-invoicing requires in-depth data mining and data analytics. Although the system of self-populating of purchases through GSTR-2 may help tax administrations to curb tax evasion on account of false ITC claims but not collusive tax evasion practices. There are many platforms available where taxpayers could verify their ITC claims prior to filing tax return and therefore possibility of collusion (submission of pre-matched data) increases. During April to October of 2018-19, 6585 cases of GST evasion for an amount of Rs. 38,895.97 Crore have been detected by the field offices of the Central Board of Indirect Taxes and Customs (CBIC). Till October 2018, an amount of Rs. 9480.09 Crore has been recovered from such tax evaders.[5] For States, during April to November of 2018-19, 3196 cases of GST evasions involving an amount of Rs. 12766.85 Core have been identified. States having larger SGST collection (including IGST settlement) have detected larger number of cases of tax evasion and the amount of tax evasion per detected case is also high (Figure 4). During April to November 2018, an amount of Rs. 7909.96 crore has been recovered by state tax administrations from 2634 cases of evasions.[6] The performance in

[3] Source: Lok Sabha Unstarred Question No.4040, To Be Answered On Friday, January 4, 2019
[4] Source: Lok Sabha Unstarred Question No. 4063, dated 4 January 2019.
[5] Source: Lok Sabha Unstarred Question No. 2902, dated 28 December 2018.
[6] Source: Lok Sabha Unstarred Question No. 733, dated 14 December 2018.

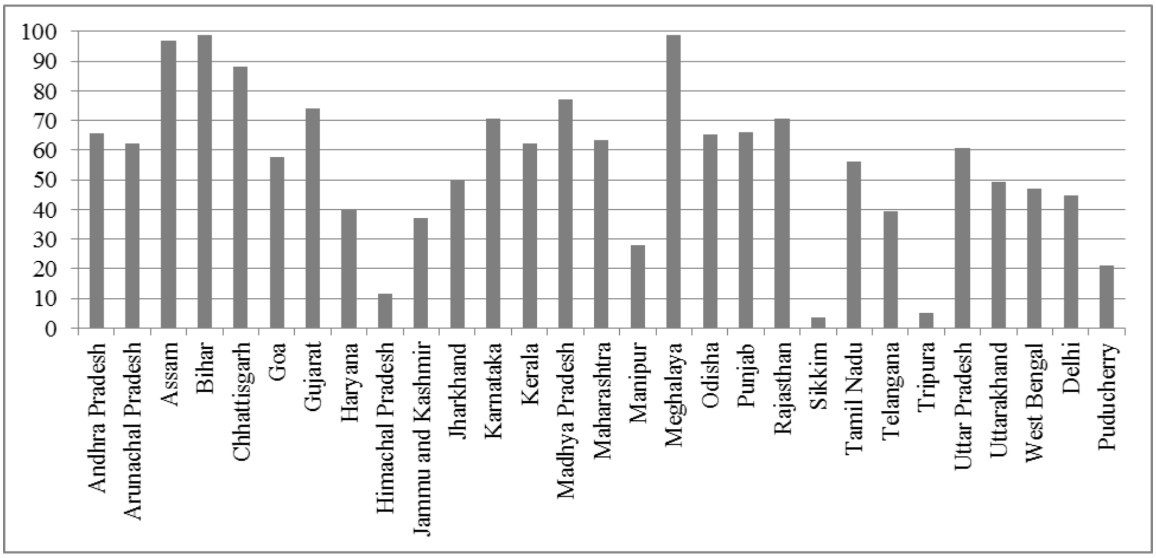
recovery varies across States and also there is an increasing trend between recovery performance (amount recovered as percentage of detected amount of tax evasion) and tax collection under SGST (Figure 5). Tax evasion could be one of the reasons for shortfall in GST revenue collection.

Figure 4: Incidence of GST Evasions at the State Level



Source: Source: Lok Sabha Unstarred Question No. 733, dated 14 December 2018.

Figure 5: State-wise Performance in Recovery of Evaded GST*



Note: *-Recovery Performance is measured by the amount recovered as percentage of detected amount of tax evasion
Source: Computed

To combat tax evasion, E-way bill is introduced to capture information on movements of goods. However, effective enforcement of e-way bill system demands on intensive monitoring and therefore possibility of revenue leakages cannot be ruled out. Evidence shows that till November 2018, 1100 cases of e-way bill frauds have been identified which involve an amount of Rs. 27.64 crore.[7]

> "To improve revenue collection, the steps which are being taken include introduction of e-way bill, simplification of measures for filing tax returns, steps to capture invoice details of transactions so that the same could be matched with credit taken and verification of transition credit availed by tax payers".[8]

Effective tax compliance relies on fine balance between 'trust' and 'power' between taxpayers and tax administrators. So far tax compliance under the GST system is relying on voluntary compliance and enforcement functions like audit/ scrutiny assessment yet to be initiated. The trust between taxpayers and tax administrators is important for better compliance for any successful tax reforms. However, given revenue shortfall under the GST system and evidences of tax evasion, tax administrators may be compelled to adopt 'power' based approaches in tax compliance. Though tax enforcement may help in increasing deterrence, it will reduce trust in tax administration. Increasing tax effort through strengthening tax administration could be one of the alternatives which may help in arresting GST revenue shortfall in the long run.

4. Possible Impacts of GST Revenue Shortfall on Union Government's Revenue

For Union Government, GST subsumes Union Excise Duty, Service Tax and some parts of Customs Duty. From Customs Duty, Additional Duty on Customs (or Countervailing Duty, CVD) and Special CV Duty (or SAD) are subsumed under Integrated GST (IGST) system. All imports attract Basic Customs Duty (BCD), IGST and other duties and cesses specific to goods. Goods which are not included under the GST system continue to attract Union Excise Duty and Customs Duty. In the GST regime, Union Government shares tax base associated with Union Excise Duty, Service Tax and parts of Customs Duty (which is subsumed under IGST) with State Governments. In returns, Union Government gets taxation power to tax the tax base of State Governments which is subsumed under GST (comprising of Sales Tax/ VAT, Central Sales Tax, Entry Tax, Luxury Tax, Entertainment Tax, Taxes on Lottery, Betting and Gambling, Purchase Tax etc.).[9] On the consolidated tax base of GST, subsuming taxes from Union and State indirect tax baskets, Union and State Governments levy respective shares of GST. In other words, GST is a dual VAT system where every transaction/ value addition in goods as well as services attracts Central GST (CGST) as well as State GST (SGST). Two parallel channels of taxation (CGST and SGST) and input tax credit system function without any overlapping, except in the case of Integrated GST (IGST). Inter-state transactions (including consignment/ branch transfers) and imports attract IGST and IGST liability can be adjusted with available ITC on account of IGST, CGST

[7] Source: Lok Sabha Unstarred Question No. 1893, dated 21 December 2018.

[8] Source: Lok Sabha Unstarred Question No. 1916, to be answered on Friday, 21 December 2018.

[9] Out-of-GST items attract State taxes like sales tax, Central and Sales Tax and State specific cesses and surcharges.

and SGST. GST is introduced under dual tax administration system where CGST and IGST are administered by the Union Government and SGST is administered by the States.[10] IGST collected from Business-to-Business (B2B) transactions are input tax credit in transition and it will be claimed whenever other GST liability (IGST or CGST and SGST) arises in the downstream of value chain. IGST collected from Business-to-Consumer (B2C) transactions or any other transactions where ITC against IGST is not admissible becomes tax proceeds and it will be shared with States. Therefore, entire IGST collection is not available for disposal for the Union Government as tax proceeds. Since, Union government administer the collection of IGST, responsibility of payment of due ITC against IGST lies with the Union government. Initially IGST settlement between Union and State governments was on ad hoc basis (50:50 as CGST rate is equal to SGST rate). Regular settlements, based on actual state-specific ITC claims against IGST payment, are initiated recently.

GST Compensation Cess (GSTCC) is levied on some commodities (e.g., tobacco and tobacco products, aerated water, motor vehicles) to generate GST Compensation Fund to provide compensation to states for revenue loss on account of GST during first five years of GST implementation (1 July 2017 to 30 June 2022). The revenue loss of a particular state will be estimated based on the difference between projected revenue of a year and actual GST collection. The revenue projection will be based on 14 percent annual growth rate of net revenue (net of refunds) collected by the state from taxes subsumed under GST (excluding out-of-GST items) in the base year 2015-16. Due ITC against GST Compensation Cess is allowed and it is adjustable against GSTCC liability arising in the downstream of value chain.

Prior to GST, Union government used to collect various cesses and surcharges from commodities and services and the proceeds from these cesses and surcharges were kept out of the divisible pool of taxes. GST subsumes all cesses and surcharges of union and state governments on items which are under the GST system. States' revenue under protection in GST includes revenue on account of their cesses and surcharges. It was also expected that Union government will keep adequate provision in the GST Compensation cess to compensate revenue loss on account of Union cesses and surcharges, unless the corresponding revenue is already taken into account in setting GST rates. It is also not clear whether GSTCC will continue post GST compensation period and if so, what will be the revenue sharing mechanism with States. It will be also desirable to expand the scope and coverage of GSTCC by including a few more environmentally harmful commodities to initiate the next level of environmental fiscal reforms in India.

Table 2 shows that gross tax collection till December 2018 from taxes subsumed under GST (including taxes on out-of-GST items) is 65.4 percent of the revised estimate of 2018-19. Tax collection on account of these taxes falls short of 9 percent as compared to corresponding period of the previous year (i.e., 2017-18) (COPPY). However, 2017-18 was the first year of introduction of GST and it was expected to have considerable revenue implications on account of transitional credit. Till December 2018, CGST collection has

[10] However, to reduce compliance burden on taxpayers some basic functions of tax administration like registration, acceptance of returns and tax payments are centralized under the GST Network (GSTN). Moreover, depending on annual turnover taxpayers are distributed between Central and State tax administrations for audit/ scrutiny assessment.

reached 67.5 percent of the 2018-19 RE. It may be too optimistic to expect that in CGST collection in another two months (January to February) could help to meet the revised target set for 2018-19. Average monthly CGST collection (after IGST settlement) during March to December 2018 was Rs. 34,033 crore (including IGST settlement, both ad hoc and regular).[11] A simple projection, assuming average monthly collection will continue for the rest of the financial year of 2018-19, shows that CGST collection will be Rs. 408,401 Crore for 2018-19 (till 31 March 2019). It will fall short of RE of 2018-19 by Rs. 95,499 Crore or 19 percent of RE of 2018-19. Tax collection from Customs Duty and Union Excise Duty has also fallen short of tax collection from the COPPY. Gross Tax Collection (GTR) has reached 63.4 percent till December 2018 as compared to 69.6 percent in the COPPY.

Table 2: Union Government's Gross Tax Collection from Commodities and Services* (Rs. Crore)

Tax Heads	**2015-16@**	**2016-17@**	**2017-18@**	**2018-19 (RE)@**	**2018-19 (upto December 2018)#**		**2017-18 (upto December 2017)#**		**2019-20 (BE)@**
					Rs. Crore	as % of 2018-19 (RE)	Rs. Crore	as % of 2017-18 (AC)	
Customs	210,338	225,370	129,030	130,038	97,047	74.6	110,152	85.4	145,388
Union Excise Duties	287,149	380,495	258,636	259,612	156,354	60.2	183,044	70.8	259,600
Service Tax	211,414	254,499	81,228	9,283	5,767	62.1	79,930	98.4	-
Central Goods and Services Tax (CGST)	-	-	203,261	503,900	340,370	67.5	109,639	53.9	610,000
Integrated Goods and Services Tax (IGST)	-	-	176,688	50,000	12,643	25.3	155,486	88.0	50,000
Goods and Services Tax Compensation Cess	-	-	62,612	90,000	70,298	78.1	38,806	62.0	101,200
Total	**708,901**	**860,365**	**911,455**	**1,042,833**	**682,479**	**65.4**	**677,057**	**74.3**	**1,166,188**
As % of Gross Tax Revenue (GTR)	48.7	50.1	47.5	46.4	47.9		50.7		45.7
Gross Tax Revenue (GTR)	**1,455,891**	**1,715,968**	**1,919,184**	**2,248,175**	**1,424,451**	**63.4**	**1,336,566**	**69.6**	**2,552,131**

Notes: *- includes States'/ UTs' Share
Sources: @-Compiled from Union Budget Documents (Annual Financial Statements) & #-Monthly Accounts of Controller General of Accounts (CGA).

[11] This is based on Form GSTR-3B submitted during April 2018 to January 2019. It is compiled from monthly press releases of the GST Council.

Table 3 shows that Gross Tax Collection from taxes subsumed under GST for 2018-19 RE falls short of budget estimate of 2018-19 and actual tax collection of 2016-17. The shortfall in major indirect tax collection compels the government to set the budget estimate of 2019-20 at a level (as percentage of GVA at basic prices) equivalent to 2016-17. Revised target of 2018-19 sets the performance in indirect tax collection better than 2017-18. However, actual revenue collection may depict different picture from the revised estimate. A moderate improvement in tax collection from other taxes (mostly from direct taxes) by 0.37 percent of GVA has created fiscal space to make up the loss in tax collection from taxes discussed in Table 3 (0.29 % of GVA), as a result marginal improvement in GTR observed in 2017-18. However, possibility of similar revenue substitution may not exist in 2018-19, as collection of Corporate and Personal Income Tax together has reached only 61.4 percent of 2018-19RE till December 2018, as compared to 65.1 percent of actual collection reached during the same period of 2017-18.

Table 3: Union Government's Gross Tax Collection from Commodities and Services (as % of GVA at Basic Prices, 2011-12 Series, at Current Prices)

Tax Head	2015-16	2016-17	2017-18	2018-19 (BE)	2018-19 (RE)	2019-20 (BE)
Customs	1.67	1.62	0.83	0.66	0.77	0.77
Union Excise Duties	2.28	2.73	1.67	1.53	1.53	1.37
Service Tax	1.68	1.83	0.52	-	0.05	-
Central Goods and Services Tax (CGST)	-	-	1.31	3.56	2.97	3.23
Integrated Goods and Services Tax (IGST)	-	-	1.14	0.29	0.29	0.26
Goods and Services Tax Compensation Cess	-	-	0.40	0.53	0.53	0.54
Total	**5.64**	**6.17**	**5.89**	**6.58**	**6.15**	**6.17**
Tax Collection from Other Taxes	**5.94**	**6.14**	**6.51**	**6.81**	**7.11**	**7.33**
Gross Tax Revenue (GTR)	11.58	12.31	12.40	13.39	13.25	13.49
GVA at Basic Prices (2011-12 Series, At Cr. Prices, Rs. Crore)	12,574,499	13,935,917	15,482,715	16,961,365	16,961,365	18,911,922*

Notes: *-Estimated assuming 11.5 percent growth rate with reference to 2018-19.
Source: Union Budget Documents (Annual Financial Statements) & EPWRF India Time Series database.

Stabilization of the GST system is important to mitigate uncertainties and fiscal sustainability of Union and State Finances. This aspect has been acknowledged by the Union

Government in the *Medium Term Fiscal Policy cum Fiscal Policy Strategy Statement* of the Union Budget 2019-20.

> "The full benefits of GST reforms should start accruing from FY 2020-21 and completely stabilise thereafter to ensure sustainable fiscal path. But certain risk factors would also need to be acknowledged."

Shortfall in GST collection will not only impact Union Finances alone but also spill over to State finance through inter-governmental fiscal transfer system. In the next section we will discuss the process of transmission and possible intensity of the impact.

5. Possible Impacts of GST Revenue Shortfall on Central Transfers

Tax collection on account of Customs Duty, Union Excise Duty, Service Tax and CGST will be part of divisible pool of taxes. A part of IGST collection, which is not the credit-in-transition, will also be a part of divisible pool of taxes. Therefore, entire IGST collection will not be available for the Union Government and also not constitute divisible pool of taxes. It is difficult to comprehend what percentage of unsettled IGST will fall under the divisible pool of taxes. In the revised estimate of 2018-19, an amount of Rs. 50,000 crore has been accounted under IGST, whereas till December 2018 balance IGST available, collection over the ad hoc and regular settlements to States and Union government, is Rs. 12,643 Crore. It will be optimistic to expect that revised target for IGST would be met from another two months' (January and February 2019) collection of IGST. At the best it would reach Rs. 16,857 Crore, if the present trends in collection and settlement continue for IGST. So, there will be a shortfall in IGST collection of Rs. 33,143 Crore from the revised estimate of 2018-19 (i.e., Rs. 50,000 Crore). Unless the GST system stabilizes, it would be difficult to understand the pattern of ITC utilization against IGST for B2B transactions. It is also difficult to understand what percentage of balance IGST will fall under the divisible pool of taxes (Rao, 2018). In 2017-18, gross collection of IGST was Rs. 387,356 Crore and net collection was Rs. 168,623 Crore (over refund and settlement).[12] However, an amount of Rs. 176,688 Crore has been shown under 'divisible pool' against IGST in the actual figures for 2017-18 in the Union Budget 2019-20 (Table 2). The IGST settlement during 2017-18 was Rs. 205,938 Crore.

Proceeds of GST Compensation Cess (GSTCC) will be used to provide GST revenue compensation to states for any GST revenue shortfall from the projected GST collection. According to the Goods and Services (Compensation to States) Act of 2017 (u/s 10), the proceeds of GSTCC will be transferred to Public Account of India and will be utilized to provide compensation to states. The Act also mentions that after the transition period, half of the unutilized amount GST Compensation Fund will be transferred to Consolidated Fund of India as the share of Centre and the remaining half will be distributed among the States/ UTs in the ratio of their total revenues from the State tax or the Union territory goods and services tax, as the case may be. Till December 2018, GSTCC collection is Rs.

[12] Source: http://pib.nic.in/PressReleseDetail.aspx?PRID=1541584 (last accessed on 19 February 2019).

70,298 Crore[13] and compensation released till October–November 2018 to states is Rs. 48,202 Crore.[14] The balance amount available with GSTCC Fund is Rs. 22,096 Crore. However, in the Union Budget 2019-20, the entire collection of GSTCC in 2018-19 is shown as 'divisible pool of taxes'. Similarly in 2017-18, an amount of Rs. 62,612 crore has been shown as GSTCC collection against actual figures for 2017-18 in the Union Budget 2019-20, whereas gross GSTCC collection was Rs. 62,614 Crore.[15] At the best Union Government may assign the balance amount of GSTCC collection, over the compensation released to States, as 'divisible pool of taxes'. Therefore, if the current trends in monthly average GSTCC collection (i.e., Rs. 7,811 Crore) and monthly average GST compensation payment to States (i.e., Rs. 6,025 Crore) continue, there will be balance of Rs. 21,432 Crore in GSTCC account over the GST compensation released to States. So there will be shortfall of Rs. 68,568 Crore from the revised estimate of GSTCC for 2018-19 (i.e., Rs. 90,000 Crore).

All together it is expected that there will be GST revenue shortfall of Rs. 197,210 Crore (Rs. 95,499 Crore on account of CGST, Rs. 33,143 Crore on account of IGST, and Rs. 68,568 Crore on account of GSTCC) in 2018-19 for Union Government. Therefore, shortfall would be 8.77 percent of the revised estimate of Gross Tax Revenue collection for 2018-19.

Table 4 shows that in the revised estimate of 2018-19, tax collection from 'commodities and services' is expected to grow by 14.4 percent with reference to actual collection in 2017-18. Achieving targeted growth rate in GST collection may be difficult, given the prevailing shortfall in revenue collection. Revenue shortfall in GST collection is expected to impact Gross Tax Revenue collection in 2018-19. It is unlikely that taxes from other sources (mainly from Corporate and Personal Income Tax) could compensate the revenue loss. Therefore, ultimate size of revenue shortfall will be contingent upon possible improvement in tax collection from other sources and possibility of compliance improvement in the GST system. Any shortfall in revenue collection of the Union Government will impact state finances in terms of lower tax devolution and grants-in-aid transfers.

[13] Source: http://www.cga.nic.in/MonthlyReport/Published/12/2018-2019.aspx (last accessed on 25 February 2019)
[14] Source: Rajya Sabha Question No 174 Answered On 05.02.2019
[15] Source: http://pib.nic.in/PressReleseDetail.aspx?PRID=1541584 (last accessed on 19 February 2019).

Table 4: Annual Growth Rate of Union Taxes (%)

	2015-16	2016-17	2017-18	2018-19 (BE)	2018-19 (RE)	2019-20 (BE)
Taxes on Income and Expenditure	**6.7**	**14.6**	**17.8**	**15.0**	**20.1**	**15.0**
Corporation Tax	*5.7*	*7.0*	*17.8*	*8.7*	*17.5*	*13.3*
Taxes on Income Other Than Corporation Tax	*8.5*	*21.5*	*19.8*	*26.9*	*26.9*	*17.2*
Taxes on Property and Capital Transactions	-0.6	8.9	30.1	-7.9	-7.9	16.4
Taxes on Commodities and Services	**30.0**	**21.4**	**6.0**	**22.4**	**14.4**	**11.8**
Central GST (CGST)				197.1	147.9	21.1
UTGST, IGST & GSTCC				-40.8	-40.8	8.1
Customs, UED, Service Tax	*30.3*	*21.4*	*-45.5*	*-20.6*	*-14.9*	*1.5*
Taxes of Union Territories without Legislature	21.1	6.9	-25.6	-12.1	-8.9	11.0
Gross Tax Revenue (GTR)	**16.9**	**17.9**	**11.8**	**18.3**	**17.1**	**13.5**
State's share excluded from the Consolidated Fund	49.8	20.1	10.7	17.1	13.1	10.9
Tax Revenue of the Central Government	4.7	16.7	12.5	19.0	19.3	14.9

Source: Annual Financial Statements, Union Budget.

Table 5 shows that Customs Duty, Union Excise Duty and Service Tax used to contribute 45 percent of total tax devolution to states during 2014-17. In the GST regime, the share from these taxes is expected to fall and the fall was expected to be compensated by the shares of CGST and IGST. However, in the face of revenue shortfall from CGST, it is unlikely that indirect taxes will regain the share in tax devolution very soon. Compositional changes in the tax devolution may not be an issue as long as total tax devolution remains buoyant. However, in the face of revenue short fall, retaining growth rate in tax devolution will be another area of concern. In 2017-18 growth rate in tax devolution went down to 11.5 percent from 20 percent in 2016-17. It is expected that in 2018-19, growth rate may fall further. Substantial rise in growth rate in tax devolution in 2015-16 is mainly due to rising share of states in divisible pool of taxes from 32 percent to 42 percent as recommended by the Fourteenth Finance Commission. Till December 2018, tax devolution to states constitutes 64 percent of revised estimate of total tax devolution of 2018-19; it was in the same percentage of actual tax devolution in 2017-18 during the same period.

Table 5: Tax Devolution to States (Rs. Crore)

Description	2014-15@	2015-16@	2016-17@	2017-18#	2018-19 (RE) #	2019-20 (BE) #
States' Share in Central Taxes (A)	337,835	506,175	607,861	677,900	761,454	844,605
States' Share in Central Taxes on account of Customs Duties, Union Excise Duties and Service Tax (B)	137,318	240,131	281,644	129,017	88,629	85,653
(B) as % of (A)	40.6	47.4	46.3	19.0	11.6	10.1
States' Share in Central Goods and Services Tax (CGST) ('C)				84,816	211,137	255,620
States' Share Integrated GST (IGST) (D)*				67,998	-	
Transfer on Account of (B), ('C) & (D)	**137,318**	**240,131**	**281,644**	**281,831**	**299,766**	**341,272**
(B+D+E) as % of (A)	40.6	47.4	46.3	41.6	39.4	40.4
States' Share in Other Taxes (E)	200,517	266,044	326,217	396,068	461,688	503,333
('E) as % of (A)	59.4	52.6	53.7	58.4	60.6	59.6
Annual Growth Rate of (A)	6.15	49.83	20.09	11.52	12.33	10.92

Note: *-There is no Tax Devolution assigned against IGST for 2018-19 (RE) and 2019-20 (BE)

Sources: @-Finance Accounts of State Governments and # - Union Budget Documents

The share of tax devolution and grants-in-aid to states in Gross Tax Revenue (GTR) is expected to fall from 58 percent in 2017-18 to 55.4 percent in 2018-19 RE (excluding 'loans and advances to state governments'). The fall in central transfers will be sharper on account of non-tax devolution transfers, if the revenue shortfall continues on account of indirect taxes. Table 6 also shows that states' share in central taxes constitutes much lesser than 42 percent of divisible pool of taxes (as recommended by the Fourteenth Finance Commission). It implies that at least 7 percent (in 2017-18) to 9 percent (2019-20) of GTR accounts for cost of collection of taxes and revenues on account of cesses and surcharges (Table 6).

Table 6: Centre's Grants-in-Aid Distribution to States (As % of Gross Tax Revenue)

	2015-16	2016-17	2017-18	2018-19 (BE)	2018-19 (RE)	2019-20 (BE)
States' Share in Central Taxes (A)	34.77	35.43	35.07	34.70	33.87	33.09
Centrally Sponsored Schemes (B)	13.99	14.06	14.87	13.45	13.56	12.84
Finance Commission Grants ('C)	5.81	5.57	4.81	0.85	4.72	5.17
Other Grants/ Loans / Transfers (D)	3.66	3.18	4.20	5.81	4.31	5.69
Loans and Advances to State Governments (E)	0.86	1.04	0.91	0.89	1.07	0.78
Total (B+C+D)	23.47	22.81	23.88	20.12	22.59	23.69
Total (A+B+C+D)	58.23	58.25	58.95	54.81	56.46	56.79

Source: Annual Financial Statements and Budget at a Glance of Union Budget

6. Importance of Fiscal Transfers in State Finances

Aftermath of Fourteenth Finance Commission award and re-structuring of Centrally Sponsored Schemes (CSS), we have two financial year audited account statements of state finances. Table 7 shows that for general category states, on average tax devolution and grants-in-aid together contribute more than two-fifth of revenue receipts and revenue expenditure. General categories states receive three-fourth of own (tax and non-tax) revenue receipts as transfers from centre. The dependence on central transfers is much higher for special category states, given their limited capacity to generate own resources. This shows that any shortfall in GST collection is expected to spillover to state finances and the impact will differ across states depending on their capacity to generate own resources.

Table 7: Importance of Central Transfers in State Finances

	General Category States		Special Category States]	
	2015-16	2016-17	2015-16	2016-17
States' Share in Central Taxes				
- as % of Revenue Receipts	26.4	28.5	27.5	29.1
- as % of Own Tax & Non-Tax Revenue	40.5	49.1	66.5	71.8
- as % of Revenue Expenditure	26.2	27.7	28.7	30.3
Grants from Central Government				
- as % of Revenue Receipts	15.6	15.3	31.2	30.5
- as % of Own Tax & Non-Tax Revenue	24.0	26.3	75.7	75.3
- as % of Revenue Expenditure	15.5	14.9	32.7	31.7
Central Transfers				
- as % of Revenue Receipts	42.0	43.8	58.7	59.5
- as % of Own Tax & Non-Tax Revenue	64.5	75.4	142.1	147.1
- as % of Revenue Expenditure	41.6	42.6	61.5	62.0

Source: Compiled from Finance Accounts of State Governments

7. GST Collection of the States

An attempt is made to estimate monthly average revenue that is required to be protected under GST for the states. Table 8 shows that monthly average GST revenue of States during July 2017- March 2018 (9 months) of 2017-18 was Rs. 37,553 crore (including IGST settlement and GST compensation received) and during April 2018 to January 2019 of 2018-19 (10 months) it was Rs. 48,542 Crore (excluding GST compensation for December 2018 to January 2019). The growth rate in monthly revenue is 29 percent. The reason for such a high growth rate is that the figures also include IGST settlement amount. A part of IGST settlement amount would be claimed as ITC against SGST and therefore it will not constitute state's revenue. In the absence of data on state-wise SGST collection, amount received on account of IGST settlement and GST compensation, it would be difficult to estimate state-wise revenue under protection. The needs for revenue compensation will differ across states and unless state-wise revenue under protection is available in the public domain it would be difficult to comprehend on revenue impacts of GST in State Finances. However, Table 8 shows that average monthly requirement of GST compensation has gone up in 2018-19 by Rs. 672 crore - from Rs. 5,353 Crore in 2017-18 to Rs. 6,025 crore in 2018-19 (till November 2018 GST compensation has been released to States).

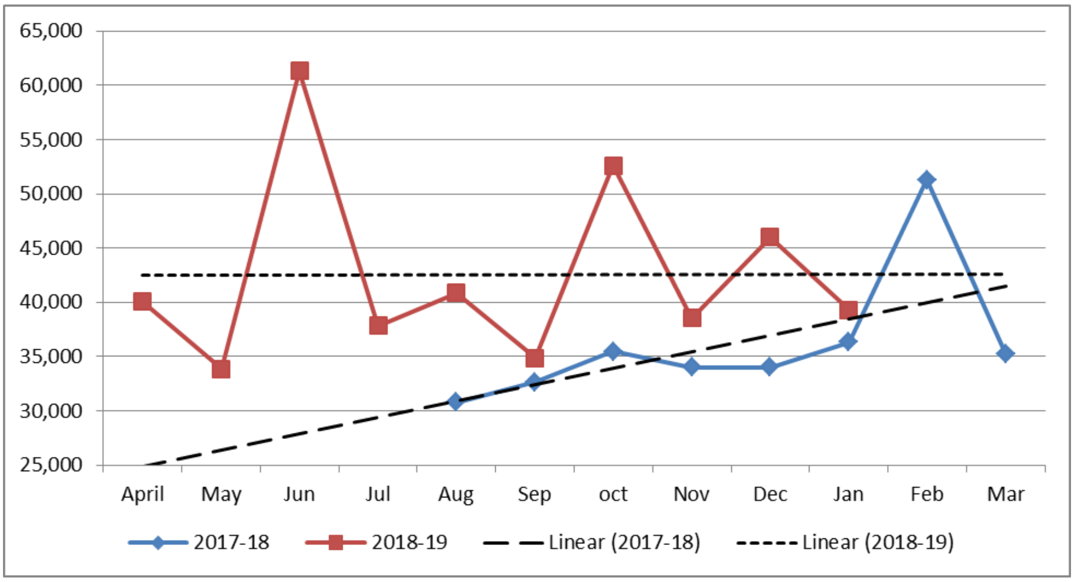
Table 8: Collection of SGST and GST Compensation Received

Period	2017-18				2018-19		
	SGST Collection (including IGST Settlement)	GST Compensation Received	Total		SGST Collection (including IGST Settlement)	GST Compensation Received	Total
July-August	30,805	10,805	41,610	April-May	73,896	3,899	77,795
Sept-Oct	68,121	13,694	81,815	June-July	99,144	14,930	114,074
Nov-Dec	68,008	3,898	71,906	Aug-Sept	75,710	11,922	87,632
Jan-Feb	87,585	13,085	100,670	Arrears for April-Sept		1,758	1,758
March	35,282	6,696	41,978	Oct-Nov	91,173	15,693	106,866
				Dec-Jan	85,249	N.A.	85,249
Total	**289,801**	**48,178**	**337,979**	**Total**	**425,172**	**48,202**	**473,374**
Monthly	**32,200**	**5,353**	**37,553**	**Monthly**	**42,517**	**6,025**	**48,542**

Note: N.A. – Not Available
Source: Rajya Sabha Question No 174 Answered On 05.02.2019

Figure 6 shows that volatility in monthly SGST collection (including IGST settlement) has gone up in 2018-19 as compared to 2017-18. The volatility in SGST collection is not attributable to release of IGST settlement, as IGST settlements are released on monthly basis. Though average monthly revenue collection during 2018-19 (Rs.42,517 Crore) has gone up from 2017-18 (Rs. 36,224 Crore), there was an increasing trend in SGST collection during 2017-18 whereas we have not found any trend in SGST collection during 2018-19.

Figure 6: Monthly SGST Collection (including IGST Settlement)

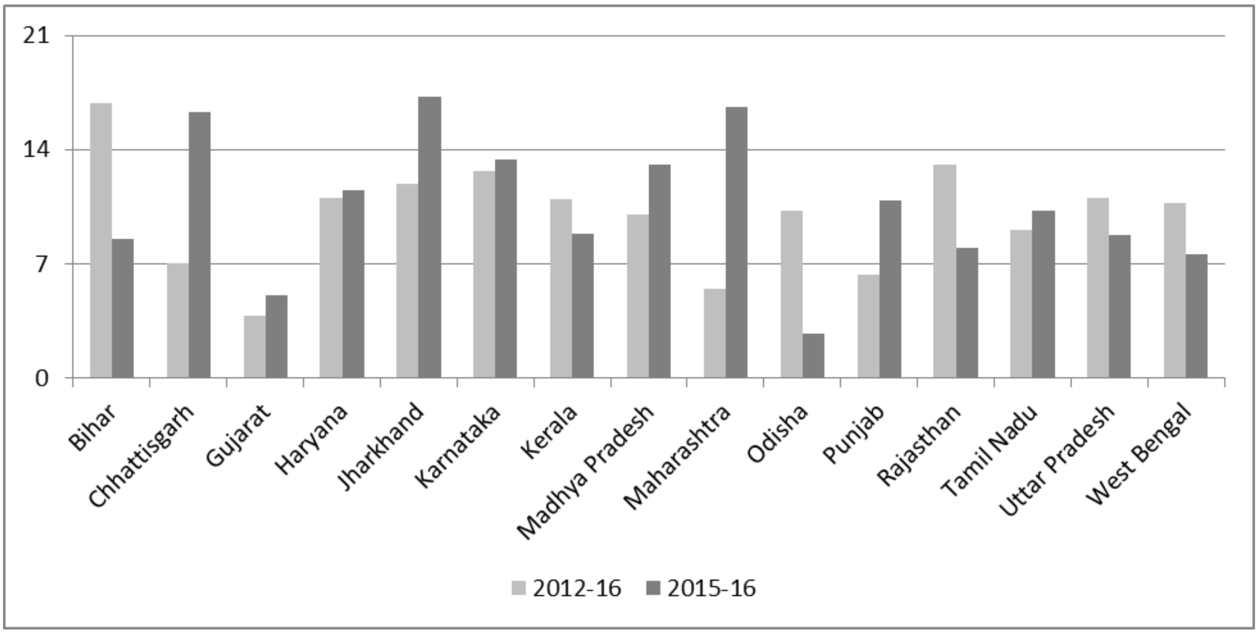


Source: Compiled from Rajya Sabha Question No 174 Answered on 05.02.2019

Under the *Goods and Services Tax (Compensation to States) Act, 2017*, Union Government has assured the states to provide compensation for the first five years of implementation of GST for revenue loss on account of introduction of GST. The compensation mechanism helped states to minimize their revenue uncertainties on account of Own Tax Revenue. Revenue uncertainties associated with any tax reform is the major cause for concern and therefore acceptance of states' demand for GST compensation through an Act by the Union Government helped to reach a consensus for rolling out GST. In a low inflation regime, especially when Reserve Bank of India (RBI) has adopted a inflation targeting framework from February 2015, assuring 14 percent growth in tax collection demands nominal GDP growth by at least 10 to 11 percent.[16] However, projected GDP growth rate of 2018-19 (9.55%) is lower than that of 2017-18 (11.10%). This is expected to result in over estimation of the revenue of states that needs to be protected/ compensated. However, the benefits of 14 percent assured growth in revenue collection under GST will differ across states. States like Gujarat and Punjab have had low rates of growth and the assurance of 14 percent would imply augmentation of revenue while states like Bihar might not get the same deal (Figure 7). Revenue implications of GST differ across States, where some states have achieved overwhelming growth in SGST revenue (e.g., Maharashtra) and some states are reeling under revenue loss (e.g., Odisha, Kerala) (Rao and Mukherjee, 2019).

[16] If we assume tax buoyancy under GST is 1.

Figure 7: Average Annual Growth Rate in Comprehensive VAT/ Sales Tax Collection for Major States*



Note: *-includes Sales Tax/ VAT, Entry Tax and Central Sales Tax (CST)
Source: Computed from Finance Accounts of respective State Governments

8. Conclusions

The GST regime is evolving in many different ways – it is evolving in structure as well as in the associated compliance and administrative regimes. The evolution is desirable and helpful in as much as it addresses the concerns faced by the taxpayers. However, the evolution also implies a long transition before the regime achieves stability, which in turn introduces an element of uncertainty into the regime. The positive gains from GST would be associated partly with the structure of the new regime and partly with stability in the regime. In other words, the timeline for the economy to experience the gains from GST might be extended beyond the initial years.

What is however very interesting is that the graduated transition to the "ideal" GST regime seems to have resulted in the Indian economy bypassing some of the anticipated shocks in the form of increase in inflation or a reduction in growth rate. In addition to internal factors (e.g., stress in the Indian Banking System), external factors (e.g., increase in international price of crude oil) could also contribute to a delay in the speed with which the economy can extract gains from the GST regime. Any analysis of the impact of GST should therefore be suitably nuanced to take these factors into account.

The conclusions of the paper are as follows:

a) Upto June 2022, revenues of states under GST are protected. So far there will be no impact on State Finances on account of Own Tax Revenue collection. However, if the GST revenue shortfall continues, Union Government will face fiscal stress and it will spillover to state finances in terms of lower tax devolution and grants-in-aid transfers.

b) The estimated shortfall in GST collection is Rs. 197,210 crore or 8.77 percent of Gross Tax revenue in 2018-19. If the share of states in central transfers (on account of tax devolution and grants-in-aids) remains unchanged at 55.4 percent of GTR, the expected fall in central transfers would be Rs. 109,254 Crore in 2018-19. If states do not increase their revenue mobilization, they may require containing their expenditures to meet the FRBM targets. There may be demands from States to give relief from the FRBM targets, so that they could continue with present level of expenditures. It may build up public debt and may cause stress on state finances in future.

c) What will be the impact on State Finance after GST Compensation Period is over
    a. An extension of the GST compensation period beyond the first five years of implementation of GST: There is considerable demand from a group of states to extend the GST compensation period beyond June 2022, possibly upto 2025.[17] Many states have submitted memorandum to the Finance Commission for consideration of extension of GST Compensation Period beyond 2022.[18]
    b. If GST Compensation Period is not extended, States will ask GST Council to allow them to set their SGST rates according to their revenue needs. If States are allowed to deviate from the harmonized GST rate structure, it may lead to GST rate wars among states. Alternatively, GST Council may set floor rates along with bands within which states could set their SGST rates.[19] However, it will be politically difficult for a state to set GST rates higher than the rate prevailing in the neighboring states. The higher rate may lead to trade diversions to low rate jurisdictions and therefore revenue loss for the high rate state.
        i. However, in absence of GST compensation, there will be no binding force to keep harmonized tax system intact.
    c. So far the response of the GST Council on account of GST is to reduce tax rates by taking out some commodities from high tax rate to low tax rate. Revenue implications of such moves need to be studied.

d) Possibility of moderating the impact of revenue shortfall under GST may be explored by the Union as well as State Governments by increasing collection of other tax and non-tax revenues. However, lower nominal growth rate of gross value addition may be a constraint in improving tax collection.

e) In face of revenue uncertainty / shortfall, containing expenditures is another dimension which may be explored.
    a. Revenue expenditure of the Union Government as percentage of GVA has fallen from 16 percent in 2011-12 to 14 percent in 2015-16 and it remains stable since then. However, revenue expenditure as percentage of GVA is

[17] https://www.businesstoday.in/opinion/perspective/why-govt-may-extend-gst-compensation-period-for-states/story/303900.html

[18] https://www.livemint.com/Politics/Iq0tB2Nsd1jBbg4VGJm4GO/Govt-may-continue-GST-compensations-till-2025.html

[19] The Rajya Sabha Select Committee suggested that GST rates will be levied with floor rates and with bands, where a band is defined as “Range of GST rates over the floor rate within which Central Goods and Service Tax (CGST) or State Goods and Services Tax (SGST) may be levied on any specified goods or services or any specified class of goods or services by the Central or a particular State Government as the case may be” (Government of India, 2015b).

higher than total revenue receipts which resulted in revenue deficit. On average, revenue deficit was 3.4 percent of GVA during 2011-12 to 2016-17. It is to be noted that a significant part of revenue expenditure arises on account of interest payment obligations of the union government. On average interest payment constitutes 3.7 percent of GVA and 24.5 percent of total revenue expenditure during 2011-17. Grants-in-aids are transfers to States and UTs and once we exclude interest payment and grants-in-aid from total revenue expenditure of the union government, revenue deficit turns into revenue surplus. Since, revenue expenditure (excluding interest payment and grants-in-aid) remains stable since 2014-15 (at 8 percent of GVA) and grants-in-aids transfers are expected to fall during 14th Finance Commission award period (2015-16 to 2019-20) and due to consolidation of Centrally Sponsored Schemes, it is important for the Union Government to look for opportunities to reduce interest payment obligation by re-negotiating interest rates on past loans. Capital expenditure as percentage of GVA remains stable at 2 percent and any cut in capital expenditure may hamper investment in infrastructure and therefore future economic growth.

b. For states salaries, subsidies and pensions accounts for 38 percent of revenue receipts, 61 percent of own (tax and non-tax) revenue, 37 percent of revenue expenditure and 82 percent of Central transfers. Therefore, it will be important to contain expenditures on account of these heads and give more importance to delivery of public goods and services. However, many states have taken different path against fiscal consolidation by announcing income support to farmers and farm loan waivers, which will impact state finances in the coming days.

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