Compensation cloud hangs over GST Council meeting next week

With the payout coming to an end on June 30, States are seeking at least 3 years' extension

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The GST Council, meeting scheduled to take place in Chandigarh, next week, is likely to thrash out the issue of compensation to States and Union Territories (UTs), which is coming to end on June 30.

Eluding consensus

While the Centre has maintained that it is committed to compensation to States / UTs for five years as per the Constitutional proviso, States are seeking extension for at least three more years beyond the June 30 deadline. This issue had surfaced in the last Council meeting held last year, too, but no consensus was arrived at. Subsequently, during the pre-Budget meeting and also during the last Council meeting in December, States raised the demand again.

As per Section 15 of the Constitution (61st) Act, 1998, Parliament shall, by law, on the recommendation of the GST Council, provide for compensation to States for loss of revenue arising on account of implementation of the goods and services tax for a period of five years from the date of its implementation. During the transition period, the States' revenue is protected at 4 per cent on average over the base year revenue of 2015-16.

Catch-22 situation

Officials admitted that the issue of compensation will be in focus in the next week's meeting. There are two options: either amend the law to extend the due date or consider special grants for some states which have reported lower growth in GST collection.

Jai Mohan, Senior Partner with NSRG & Associates, said, "The Centre is in a Catch-22 situation wherein it may be required to take a tough stance by turning down States' request which may have political consequences as well. If the Centre decides to take further loan to fund the deficit at a time when global recession is on the cards, it can have serious economic repercussions for the country as a whole.

The instance where the prevailing law is amended, rate rationalisation, modification of the compensation cess formula, setting up of an exemption list and securing a loan could be sources for the Centre to pay cess to the States. Such a move will not only stabilise a constitutional reform in India, which will be addressed in the next legislative session, it is also an ego battle between the Centre and the States; rather, this action will impose a higher burden on end customers — who have been the ultimate taxpayers," he said.

Exploring other options

Rajshree Sapra, Tax Partner with TVS, said given that the future cess collections will mostly be used for payment of compensation-related borrowing, there is going to be an involved discussion to find a solution. "This problem will need a more acute fix. Some States, while some may have grown at a better rate as compared to previous years," he said.

Sapra felt given that a large chunk of compensation cess collection will go towards payment of loans, the government may look at payment of additional funds. Since no new levies are proposed, given the inflationary conditions, other options need to be explored. There would also be a need to pay compensation differentially depending on various factors, including the growth of GST collections in the State. While the Centre and States may differ on compensation needs, the current growth rate of GST collections will help in dealing with the situation," he opined.