

## **Five years of GST: Kerala's experience and implications for fiscal federalism**

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The Goods and Services Tax (GST) regime has exhibited both strengths and weaknesses as it completed its fifth anniversary. It continues to make significant impact on India's fiscal federalism. With more than a dozen of taxes enjoyed by both Union government and States subsumed under GST, States have cooperated a lot in the implementation of GST. When Union Government compromised 35 per cent of its gross tax revenue, the States lost 44 per cent of their own tax revenue. Naturally the States need to get more share from GST, but that has not happened. More importantly along with the taxation powers the States have sacrificed some of their legislative powers also, but did not get enough gain from GST. This game change in States' taxes pattern and their legislative competency has affected their political courage, development activities and welfare programmes.

### **Fiscal growth: The story so far**

Despite political mistrust and disagreements between the Union government and the opposition party-ruled States, the GST Council managed the spirit of cooperative federalism in the initial stage. Even though, it is a fact that many States, including Kerala, are under severe fiscal constraints and are compelled to depend more on the Union government. When we look at the revenue performance of the States and Union government under GST regime for last five years, it is evident that most of the States have failed to achieve their desired goals. According to a recent study by the National Institute of Public Finance and Policy (NIPFP), the revenue attributable to the Union government appears to regularly be higher than the revenue from State GST, including IGST settlement. Comparing the growth in revenue collections before and after the GST is instructive when discussing revenue collection trends. It shows that the State's own tax revenue and revenues from taxes on goods

and services before the implementation of GST was higher than that in the years after. Additionally, there are significant regional differences in the average growth of State revenue from taxes on goods and services. The study makes two features clear. One, compared to the pre-GST era, certain States' average growth rates increased as a result of GST implementation, while others saw a fall. Two, the majority of the main States see nominal growth of less than 14 per cent, as guaranteed by the Union government.

Kerala's case is not much different. The State has not been able to achieve the desired growth even after five years. The optimum was 14% annual rise. Ever since the GST came into force, the growth in tax collections consistently remained below 10%. The compensation, therefore, increases. The State has received Rs. 26,501 crore from this account so far and came in the fifth position. Maharashtra, Karnataka, Gujarat and Tamil Nadu came in the first four positions, respectively. When we look at the GST revenue, in 2019-20 Kerala received Rs. 27,474 crore from SGST, share of IGST and compensation, which got decreased to Rs 18,595 crore in 2020-21 because of the COVID-19 pandemic and two consecutive floods. In the last financial year, it again picked up to Rs. 33,459 crore, but there is nothing to be proud of because out of this Rs 11,157 crore was received as compensation from Union government. However, the situation is changing gradually, compared to previous financial years, and the SGST revenue has shown positive growth in the first six months of the current fiscal. Till September 2022, Kerala has been able to collect Rs. 16,163 crore from SGST, even though the compensation has ended in June 2022. Although the data show a positive trend, it is a fact that along with other central policies GST would affect the State's finance in the current fiscal also. The State's Finance Minister K.N Balagopal has stated that the State stood to be deprived of around Rs 23,000 crore in 2022-23 compared to last financial year due to various factors, including the discontinuation of GST compensation.

On the other side, the revenue performance of Union government is impressive. It has managed to make reasonable growth in tax collection since last year. Even among the initial technical glitches and other confusions, the financial year 2018-19 witnessed healthy growth with Rs 11.7 lakh crore. In the backdrop of rate reduction without considering the 'Revenue Neutral Rate', the collection during financial year 2019-20 was below estimates and marginally grew at 4 per cent over previous financial year to reach Rs 12.2 lakh crore. While the early months of 2020-21 were heavily impacted by the pandemic, there was an improvement in the later months of the year and managed to reach Rs 11.32 crore, even

though it was lower than the previous year. There was a strong recovery in 2021-22, with total collections reaching Rs 14.76 lakh crore, which is 28% higher than the previous year and 23% more than 2019-20. This growth indicated that the economy is recovering from the impact of the pandemic. It is also the result of various policy and administrative measures that have been taken recently. The initiatives like enhancement of system capacity, nudging non-filers after last date of filing of returns, auto-population of returns, blocking of e-way bills and passing of input tax credit for non-filers, etc. have led to consistent improvement in the filing of returns over the last few months. Moreover, the Central enforcement agencies, along with the State counterparts have detected large number of tax evasion cases. Various rate rationalisation decisions taken by the last GST Council meetings to correct inverted duty structure have also contributed largely to this account. It is clear that this positive trend in the revenues will continue.

### **Federal conflict at GST council**

During the pandemic period, all the States have gone through severe fiscal stress. On the one hand, the economic slowdown due to the COVID-19 brought significant reduction in the States' tax revenues. On the other hand, the State governments were primarily positioned to deal with the health crisis raised by pandemic. Both have significantly increased their financial requirements. Federal disagreement over the Union government's slow payment of GST compensation to the States came to the fore in this circumstance of extreme urgency. States ruled by the opposition parties have accused the Union government of substantially hindering their efforts in fighting the health crisis and launching a post-pandemic economic recovery plan by failing to pay their dues. Instead, during the pandemic, the Union government advised the States to choose between two borrowing options to make up for the GST revenue shortfalls. This recommendation led to further protests from the States, which claimed that the Union government was pressuring them to take loans rather than providing its promised legislative commitment. Many States vehemently opposed this, finally the Union government has borrowed and released Rs 1.1 lakh crore in 2020-21 and Rs 1.59 lakh crore in 2021-22 as compensation to the States. This confusion created by Union Government during the time of extreme urgency has led to break the trust of States over GST Council. It is significant to note that apart from the opposition party-ruled States like Kerala, Rajasthan, Tamil Nadu, Chhattisgarh, West Bengal, Delhi and Punjab, there has been a growing support from at least few BJP-ruled States on many issues.

The demand of 12 more States for extension of compensation for ensuring a buoyant post-pandemic economic recovery has been denied by Union Government. In response to this, they said that no more compensation will be required by the States as the GST revenue collection for them have been very robust. It is significant to note that the GST Council has not even permitted to discuss this demand deliberately in its meetings. This attitude further led to lose of their trust on GST Council. The Hon'ble Union Finance Minister pointed out that Section 18 of the 101st Constitution Amendment Act, 2016, which says, Parliament shall, by law, on the recommendation of the GST Council, provide for compensation to the States for loss of revenue arising on account of implementation of the GST for a period of five years. It is clear that the timeframe for compensation to States has ended on 30th June 2022. However the 45th GST Council decided to extend the compensation cess collection till March 2026, exclusively to repay the back-to-back loans. Hence, the issue of GST compensation might snowball into another episode of federal conflict in the time to come.

### **Fallout of the supreme court judgement**

In the *Union of India vs Mohit Minerals Pvt. Ltd.* case, the three-judge bench of the Supreme Court comprising Justices D. Y. Chandrachud, Surya Kant and Vikram Nath deliberated at length on the larger issues of the constitutional framework of GST law and concepts such as cooperative federalism. In its judgment, the bench clearly pointed out that Union and State legislatures have "equal, simultaneous and unique powers" to make laws on GST, and the recommendations of the GST Council are not binding on them. It also stated that the constitutional role and functions of the GST Council must be understood in the context of the simultaneous legislative power conferred on Parliament and the state legislatures. In a multi-party federal system, it is possible that the party in power in the Centre may or may not be in power in other States. Even if the States have been given lesser power, they can still resist the mandates of the Union by using different forms of political contestations permitted by the Constitution. It is not imperative that one of the federal units must always possess a higher share of power over the other units, the court stated. The judgment provides an appropriate occasion for dialogue on several issues surrounding GST in the true spirit of cooperative federalism.

In its judgment, the Supreme Court has mentioned that the Centre yields more voting power in the GST Council, which is against the principals of cooperative federalism. In the present scenario, without the support of the Centre, the states can never muster three-fourth voting

strength in the Council. This point has not been discussed deliberately because there was a belief that all decisions will be taken based on consensus, and hence there is no need of voting in the Council. The GST Council successfully managed this believe till its 38th meeting where the voting was held for the first time since its inception. The Council has had 47 meetings so far and made more than 1500 decisions on various issues. With the exception of the rate set for lottery, all of these decisions were made in unanimity. However, the Council **voted for the first time to decide tax on lottery. The question was whether a uniform rate is needed for State-run lottery and private lottery?** Even though Kerala's demand did not get majority support, it received greater attention among the opposition party-ruled States and also in the national media.

### **Conclusion**

A conducive atmosphere for dialogue and discussion is necessary for the survival of cooperative federalism, especially in a country with such a diverse political landscape. Despite the pervasiveness of a sharp political division and partisan hostility, efforts must be made to reduce the disagreements and strife by forging a unifying stance on important governance issues. One such critical area that calls for a more deliberative and consensus-building environment is the GST reform, which was primarily made feasible through major federal bargains and discussions. This would help to strengthen fiscal federalism in particular. A more robust and transparent consultation approach between the Union government and the States, particularly on questions of resource distribution and decision-making, can advance the GST reform as we entered the significant milestone of five years of GST. As we move into the sixth year, many States are saying that the proactive outlook of the GST Council is decreasing gradually. Hence, it is imperative to re-evaluate the institutional framework and practices of the GST Council, especially in the light of the Supreme Court judgment, and explore how GST regime can be considered and modelled as a good example of cooperative federalism.

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