

REPORT

# **GST COMPENSATION IN INDIA**

**State Level Experience and the Way Forward**



An Autonomous Institution of Government of Kerala  
Sreekariam, Thiruvananthapuram-695017

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## **State Level Experience and the Way Forward**

September 2021



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## 1. Introduction

The introduction of GST in India has often been touted as the most profound reform in indirect taxation since independence. This could be accomplished because, during the decade-long negotiations the States surrendered many of their constitutionally guaranteed indirect taxes. The States, which together account for around 70 percent of the combined expenditure of Centre and States, have been persuaded to forgo a substantial part of their tax revenue with a constitutional guarantee of 14 percent growth in their GST revenue. Thus viewed, had there been no assurance of GST compensation, the long-cherished 'One Nation One Tax' regime would have remained as a distant dream. By July 2022, the originally set compensation period of five years is set to end.

This report highlights the various sources of revenue that were foregone by the States towards realizing the GST, analyses the States' experience under GST and makes the case for continuing the compensation. It also recommends ways to finance the GST compensation in the years to come.

### 1.1 Tax revenue surrendered

The outcome of the GST is that the tax revenue is shared equally between Centre and States. Given the equality in the distribution of outcomes, the question arises whether the cost of establishing GST has also been equally shared. The cost is viewed in terms of the pre-GST revenue surrendered by States and the Centre. A clear answer to the question is available from the Government of India appointed committee (2015) to "Study the Revenue Neutral Rate and

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The establishment of GST in India was possible only because the states surrendered many of their constitutionally inherited indirect taxes in exchange for GST Compensation that guaranteed 14% growth in their GST revenue.

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Our estimates show that while the states surrendered 51.8% of their total tax revenue the centre surrendered only 28.8% of their gross tax revenue in order to materialise GST.

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Structure of Rates for the GST" headed by Dr. Arvind Subramanian. The committee has shown that the revenue forgone by the Centre has been Rs. 3.28 lakh crore while it was higher for the States (Rs. 3.69 lakh crore). Our estimate revealed that this amounted to the surrender of 51.8 percent of the States' total tax revenue and 28.8 percent of the center's gross tax revenue. While in absolute terms the difference is not substantial, in relative terms the States surrendered almost twice that of the Centre.

The relinquishing of over 50 percent of their tax revenue, implied a surrender of much of their fiscal autonomy and reducing States to subordinate position. The GST compensation is the constitutionally paid price for the higher surrender that the States have made.

## **1.2 Compromised revenue neutral rate**

A pre-condition for establishing GST has been to arrive at the Revenue Neutral tax Rate (RNR) such that the potential revenue loss to the center and the States is minimized. A Tax Force headed by Arvind Modi in 2009 recommended CGST rate at 5 percent and SGST rate at 7 percent. The Arvind Subramanian committee recommended 8 percent and 9 percent respectively for the Centre and States for protecting revenue allocation. Thus, it is evident that for minimizing the revenue loss, the tax rate should be higher in the case of States as compared to the Centre. However, with the expectation of the constitutionally guaranteed GST compensation, the States agreed to reduce the tax rate such that SGST is imposed at the same rate as CGST.

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GST as of now is shared equally between the Centre and States, although two expert committees recommended for higher share for the States, indicating the States' compromise.  
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### 1.3 Forgone tax base

To a greater extent tax revenue is dependent on the tax base. During the pre-GST period, the tax revenue for the Centre from the industrial output (excise duty) has been limited only to the point of manufacturing indicating a very narrow tax base. On the other hand, the States were entitled to a much wider tax base as they could levy tax on the entire supply chain up to the final consumption point. More importantly, the - post-manufacturing stages in the value chain accounted for about 50 percent of the value addition on which only States could levy tax. With the introduction of GST, the Centre expanded the tax base at the cost of the States and States have forgone substantial revenue for building one country one tax system. Here again, it is important to note that other than GST compensation there have been hardly any other provisions in the GST Act to pay for sharing the tax base.

### 1.4 Forfeited cascading revenue

While cascading of tax is generally considered inimical to economic efficiency, it used to serve as an additional source of revenue mobilization by the States during the pre-GST period. Thus viewed, cascading has been a boon to the States and bane to the economy. While the Centre has also been able to mobilize additional resources on account of tax cascading, given their higher tax base the benefits used to be proportionately higher for the States. It is evident that States lost more as compared to the Centre with the GST implementation. However, it is with the expectation of GST compensation that the States have forgone this additional source of revenue.

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With the introduction of GST, since the Centre expanded the tax base at the cost of the States, substantial revenue was forgone by the states for building one country one tax system.

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While addressing the issue of cascading under GST, the States lost more as compared to Centre.

## 1.5 Conceded tax rate

Apart from the tax base, the tax revenue is governed by the tax rate. During the pre-GST period, most of the goods attracted a tax rate of 14.5 percent by the States. With the introduction of GST, the 14.5 percent category good has been brought under the 12 percent or 18 percent category wherein the States' share being only 6 percent or 9 percent respectively. Only a few goods were brought under the category of 28 percent where the share of the States is 14 percent. For instance, in July 2017, more than 200 goods were under the 28 percent category but from October 2017 onwards the rate of the majority of these commodities was reduced to 18 percent. Thus viewed, States lost 8.5 per cent as goods were brought to 6 per cent and 5.5 per cent in case of 9 per cent. This loss has also been expected to be covered under the GST Compensation.

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Instead of the 14.5 % on much of the taxable goods during the pre-GST period, with GST, the States lost 8.5 per cent for those goods brought to 6 per cent and 5.5 per cent in case of 9 per cent.  
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In the interest of sustaining cooperative federalism the GST compensation can't be confined to a limited period of five years. As long as there is GST there shall be GST compensation.  
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On the whole, it is high time to recognize that the GST compensation Act is premised on the explicit recognition of the unconditional surrender that the States together have made towards evolving one common market with one tax regime - a key ingredient in making Indian economy a globally competitive economy. Hence there is reason to believe that in the absence of GST compensation, GST would not have been born. This being the case, one fails to understand the reason as to how the GST could continue without GST compensation even after five years. Hence in the interest of sustaining cooperative federalism, the GST compensation can't be confined to a limited period of five years. As long as there is GST there shall be GST compensation for the State for adjusting revenue loss.

## 2. GST compensation: Empirical evidence

As per the GST (Compensation to the States) Act 2017, the actual revenue collected by a State in any financial year during the transition period (since 1-7-2017) shall be-

- a) The actual revenue from State tax collected by the State (SGST), net of refunds given by the said State under Chapter XI (Refunds) and Chapter XX (Transitional Provisions) of the State Goods and Services Tax Act 2017.
- b) The integrated goods and services tax apportioned to that State (IGST settlement) as per the Integrated Goods and Services Tax Act 2017, and;
- c) Any collection of taxes on account of the taxes levied by the respective State under various Acts which are subsumed in goods and services tax, net of refund of such taxes (Pre-GST subsumed Tax arrears)

The total GST compensation payable in any financial year shall be the difference between the projected revenue (as per section 6 of the Act) for any financial year and the actual revenue collected by a State mentioned above (as per section 7 of the Act) (*For the salient features of the of GST (Compensation to States) Act, 2017 refer Annexure*).

The State, as per the Goods and Services (Compensation to States) Act, 2017, will get compensation for the loss on account of the introduction of GST for five years from the date of implementation, i.e., July 2017 to July 2022. For the purpose of compensation, net collection of taxes subsumed under GST in the year 2015-16 has been taken as the base year and 14 percent is assumed as

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the annual growth rate to determine the protected revenue in a year after the introduction of GST. The growth rate is applied to the base year collection to calculate the protected revenue. The actual collection is deducted from the protected revenue (projected revenue) and the balance is given as compensation on a bi-monthly basis. The union government created a GST compensation fund which is financed through the GST Compensation Cess (GSTCC) on select commodities.

**Compensation Amount =**

Protected Revenue<sup>1</sup> - Actual Revenue of the State

**Protected Revenue in year n =**

Revenue from the subsumed taxes in 2015-16 \* [ 1+ 0.14]<sup>n</sup>

For the purpose of analysis, the revenue shortfall is calculated without considering the collection of arrear taxes in respect of various Acts which are subsumed under GST as the data of all the States are not available.

The revenue shortfall (which is protected revenue minus actual collection) for 31 States and Union Territories are reported in Table 1.<sup>2</sup> The trends indicate an increase in revenue shortfall right from its implementation and the COVID-19 pandemic further accentuated it in 2020-21.

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<sup>1</sup> The term protected Revenue is termed as projected Revenue in the GST (Compensation) to States Act 2017

<sup>2</sup> GST collection data is taken from GST portal (<https://www.gst.gov.in/download/gststatistics>) and protected revenue is computed using the information from Year-wise Pre-GST regime revenue from taxes subsumed in GST document, obtained from GST portal.

Based on the average annual growth rates of States in the last 4 years, a conservative estimate on GST revenue is projected for 2021-22 and the revenue shortfall jumps to approximately Rs 4 lakh crore. A more realistic estimate is obtained by applying the growth rate of 2018-19 over 2017-18. This yields a revenue shortfall of Rs 3.6 lakh crore.

The revenue shortfall as a percent of the protected revenue was 28 percent in 2017-18 which reduced to 16.8 percent in 2019-20 (Table 2). Further, it increased significantly to 31.6 percent in 2020-21 largely due to COVID-19 and our calculation indicates it to be between 30.7 percent (conservative projection) or 21.3 percent (realistic projection) in 2021-22.

In the case of Kerala, in 2017-18, the revenue shortfall was 17.3 percent. It increased to 26.2 percent, 32.8 percent, 45.4 percent, and 51.7 percent respectively during 2018-19, 2019-20, 2020-21, and 2021-22. It is observed that the fall in revenue was severe in Kerala. This needs to be seen in the context of Kerala being a consumer state, heavily dependent on IGST settlement. Any inquiry into the IGST shortfall at this juncture is made almost impossible because the needed data for analysis is yet to be disclosed.

As per the GST (Compensation to States) Act 2017, the compensation is to be paid from the GST Cess to be collected from selected goods as per the said Act.

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In the case of Kerala, the revenue shortfall was 17.3 % in 2017-18. It increased to 26.2 %, 32.8 %, 45.4 % respectively during 2018-19, 2019-20, 2020-21. It is projected to be 51.7 % in 2021-22.

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Any analysis about the GST Cess collection is impossible because of the required disaggregated data regarding GST Cess collection by the centre is yet to be published.

Since there is a growing gap between compensation due to the States and compensation cess collected, the question is to what extent the compensation cess as it exists today has been adequate to meet the required revenue. Any analysis in this direction is almost impossible because the required disaggregated data regarding GST cess collection by the Centre is yet to be published.

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The analysis of the compensation released shows that Central Government has paid all the compensation that was due to 18 major States for the period from 2017-18 to 2019-20. However, the GST compensation is pending only for the year 2020-21 for all the States except Haryana, Odisha, and Karnataka in Table 3). For Kerala Rs. 2776 crore due in 2020-21.

**Table 1: Revenue Shortfall (Rs. in crore)**

State	2017-18	2018-19	2019-20	2020-21	2021-22*	2021-22**
Jammu and Kashmir	-2494	-2698	-3485	-4739	-5659	-5043
Himachal Pradesh	-2135	-2541	-2655	-3695	-4314	-4203
Punjab	-6849	-10222	-11744	-16623	-20349	-20195
Uttarakhand	-2667	-3277	-3584	-5308	-5507	-5826
Haryana	-4519	-5998	-6869	-11256	-13361	-11962
Delhi	-4894	-8148	-9155	-17349	-22873	-23940
Rajasthan	-6332	-4869	-7361	-13027	-16475	-13697
Uttar Pradesh	-6925	-8282	-9984	-22994	-29777	-26040
Bihar	-7892	-5458	-6015	-9329	-9925	-6342
Sikkim	-78	4	57	-60	-49	38
Arunachal Pradesh	-13	179	360	347	642	964
Nagaland	-90	48	170	146	312	466
Manipur	-54	124	253	165	293	473
Mizoram	-29	144	205	162	284	502
Tripura	-446	-319	-338	-536	-606	-481
Meghalaya	-479	-241	-191	-454	-503	-360
Assam	-2002	-1440	-1588	-3486	-4058	-2707
West Bengal	-6169	-5671	-7060	-14438	-18704	-16838
Jharkhand	-2638	-2339	-2674	-4959	-5951	-4888
Odisha	-5247	-5782	-5654	-8507	-9918	-9483
Chhattisgarh	-2728	-3877	-4801	-6803	-8256	-7580
Madhya Pradesh	-6792	-5746	-7123	-12214	-14759	-12070
Gujarat	-7022	-10722	-14016	-24897	-32366	-30791
Maharashtra	-9721	-13636	-19224	-45627	-62023	-58358
Karnataka	-13227	-16533	-18871	-31388	-39403	-37760
Goa	-900	-1029	-1291	-2445	-3091	-2899
Kerala	-3789	-6536	-9021	-14719	-19073	-18189
Tamil Nadu	-7746	-7205	-10166	-22319	-30296	-28821
Puducherry	-641	-881	-1108	-1441	-1745	-1700
Telangana	-3168	-2453	-3796	-8716	-11549	-9622
Andhra Pradesh	-3338	-1994	-3651	-8865	-11542	-8854
<b>Total</b>	<b>-121024</b>	<b>-137398</b>	<b>-170380</b>	<b>-315374</b>	<b>-400601</b>	<b>-366206</b>

**Source: GST Portal****Note:***(1) Revenue shortfall is calculated as the difference between GST collected and projected revenue.**(2)\* indicates projected revenue shortfall. For this projection GST collection for 2021-22 is done using the annual average growth rate of the last four years. This represents the conservative scenario.**(3)\*\* indicates that the growth rate of 2018-19 over 2017-18 is applied to project the GST revenue collection for 2021-22. This represents the realistic scenario.*

**Table 2: Revenue Shortfall (Per centage of Protected Revenue)**

State	2017-18	2018-19	2019-20	2020-21	2021-22*	2021-22**
Jammu and Kashmir	-40.3	-38.2	-43.3	-51.6	-54.1	-48.2
Himachal Pradesh	-45.2	-47.2	-43.3	-52.8	-54.1	-52.7
Punjab	-36.4	-47.7	-48	-59.7	-64.1	-63.6
Uttarakhand	-41.4	-44.6	-42.8	-55.6	-50.6	-53.5
Haryana	-22.8	-26.6	-26.7	-38.4	-40	-35.8
Delhi	-22.4	-32.8	-32.3	-53.7	-62.1	-65
Rajasthan	-28.4	-19.2	-25.4	-39.4	-43.7	-36.4
Uttar Pradesh	-16	-16.7	-17.7	-35.8	-40.6	-35.5
Bihar	-48.1	-29.2	-28.2	-38.4	-35.8	-22.9
Sikkim	-24.5	1	13.8	-12.7	-9	7
Arunachal Pradesh	-4	47.3	83.1	70.5	114.2	171.5
Nagaland	-27	12.8	39.3	29.7	55.5	82.8
Manipur	-12	24.1	43.1	24.7	38.4	62.1
Mizoram	-11.8	51.4	64.4	44.4	68.4	121.1
Tripura	-43.5	-27.3	-25.4	-35.3	-35	-27.8
Meghalaya	-57.9	-25.5	-17.8	-37.1	-36	-25.8
Assam	-25.7	-16.2	-15.7	-30.3	-30.9	-20.6
West Bengal	-23.6	-19	-20.8	-37.3	-42.4	-38.2
Jharkhand	-31.7	-24.6	-24.7	-40.2	-42.3	-34.7
Odisha	-36.5	-35.3	-30.3	-40	-40.9	-39.1
Chhattisgarh	-28.5	-35.6	-38.6	-48	-51.1	-46.9
Madhya Pradesh	-34.1	-25.3	-27.5	-41.4	-43.9	-35.9
Gujarat	-18.7	-25.1	-28.8	-44.8	-51.1	-48.6
Maharashtra	-12.4	-15.2	-18.8	-39.2	-46.7	-43.9
Karnataka	-28.2	-30.9	-30.9	-45.1	-49.7	-47.6
Goa	-31.7	-31.9	-35	-58.2	-64.5	-60.6
Kerala	-17.3	-26.2	-31.8	-45.4	-51.7	-49.3
Tamil Nadu	-20	-16.3	-20.2	-38.9	-46.3	-44.1
Puducherry	-45	-54.3	-59.9	-68.3	-72.6	-70.7
Telangana	-15.1	-10.3	-14	-28.1	-32.7	-27.2
Andhra Pradesh	-18.5	-9.7	-15.6	-33.2	-37.9	-29.1
<b>Average</b>	<b>-28</b>	<b>-19.2</b>	<b>-16.8</b>	<b>-31.6</b>	<b>-30.7</b>	<b>-21.3</b>

**Source: GST Portal**

**Table 3. Compensation received by the States (Rs. In crore)**

States	2017-18	2018-19	2019-20	2020-21
Andhra Pradesh	382.0		1840.8	2306.6
Bihar	3041.0	2571.0	3525.0	7397.5
Chhattisgarh	1483.0	2261.0	3081.4	3756.6
Gujarat	3687.0	6419.0	10646.5	17969.3
Haryana	1199.0	2820.0	5453.4	13543.6
Jharkhand	1539.9	1029.0	1532.7	1393.7
Karnataka	6246.0	10754.0	14496.9	35223.1
Kerala	1772.0	2884.0	5575.0	11942.0
Madhya Pradesh	2511.0	2866.0	4530.8	8691.5
Maharashtra	1488.0	8330.0	15018.1	26954.0
Odisha	2079.8	3390.0	3928.8	8814.7
Punjab	4037.0	7129.0	8805.0	15496.0
Rajasthan	2653.1	2176.0	4439.5	9048.8
Tamil Nadu	682.0	3151.0	8922.0	14639.0
Telangana	253.5	500.0	2263.2	2827.3
Uttar Pradesh	2124.0	308.0	5179.5	9628.2
West Bengal	1608.0	1977.0	4358.7	9266.1
<b>Total</b>	<b>36786.3</b>	<b>58565.0</b>	<b>103597.5</b>	<b>198898.0</b>

**Source:** Various state budgets, <https://www.gst.gov.in/> and <https://pib.gov.in/PressReleasePage.aspx?PRID=1701719>

### 3. GST compensation beyond 2022

The GST compensation period will end up in July 2022. The empirical evidence tends to suggest that the huge surrender that the States have made for realizing the 'one nation one tax' system is manifested in the revenue shortfall of the States making the case for GST compensation shall continue so long as there is GST gets reinforced. Further with the COVID-19 pandemic and the economic prospectus as discussed below reinforces our case for continuing GST compensation. - which has been endorsed by States governments. The background for such demand including but not limited to:

#### 3.1 States showing no signs of economic rebounding to pre-pandemic levels

The devastating COVID-19 outbreak seems to leave a lasting impact on the economy due to extreme social and economic strain. Apart from the human toll in the second wave, the economy is confronted with an unprecedented rise in the unemployment of millions of people and a contraction in earnings. Youth, women, workers with relatively lower educational attainment, and the informally employed have generally been hit hardest. Employment has declined to a greater extent in those sectors with larger concentrations of younger or lower-skilled workers. The IMF estimate suggests that close to 95 million more people are estimated to have fallen below the threshold of extreme poverty globally in 2020 compared with pre-pandemic projections. The World Economic Outlook (2021) predicts that lockdowns and containment measures may be needed more frequently in 2021 and 2022 than in advanced

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economies, the likelihood of medium-term scarring effects on the potential output would be higher in developing countries than advanced countries.

The post-pandemic GDP projections of India till 2026 released in April 2021 with pre-pandemic projections released by the IMF in October 2019. The projection(s) shows that recovery of the economy to pre-pandemic levels is far from sight (see Figure 1). It is also worth noting that these projections have not factored in the second wave which is much more deadly and harmful for the economy. The absolute GDP or growth in India is not converging to pre-pandemic estimates even by 2025. Although growth is likely to recover in 2022, it would still take five years to reach a level that was predicted before the pandemic.

### **3.2 Increased expenditure burden of States in the wake of pandemic**

The COVID-19 crisis led to massive erosion of government revenue on the one hand and increased expenditure burden on the other. The State Governments across the country have responded with measures to save lives and livelihoods in the form of increased social security measures for the vulnerable sections of the people and various stimulus packages. Loss of employment, livelihoods, and incidence of poverty levels have increased the burden on the state exchequer in form of an increased

- a) need for providing food subsidies and
- b) demand for programmes to support livelihoods and employment, especially for educated youths.
- c) demand for pandemic/disaster-resilient social Sector i.e., health and education sector.

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These projections hold true for all the states and are particularly relevant for states which have been severely hit by the pandemic and pandemic-induced restrictions.

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The increased expenditure burden is likely to continue for the Governments as the economy shows no signs of recovery in the immediate future.

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There is no clear evidence of Government expenditure coming back to pre-pandemic forecasts even in 2026.

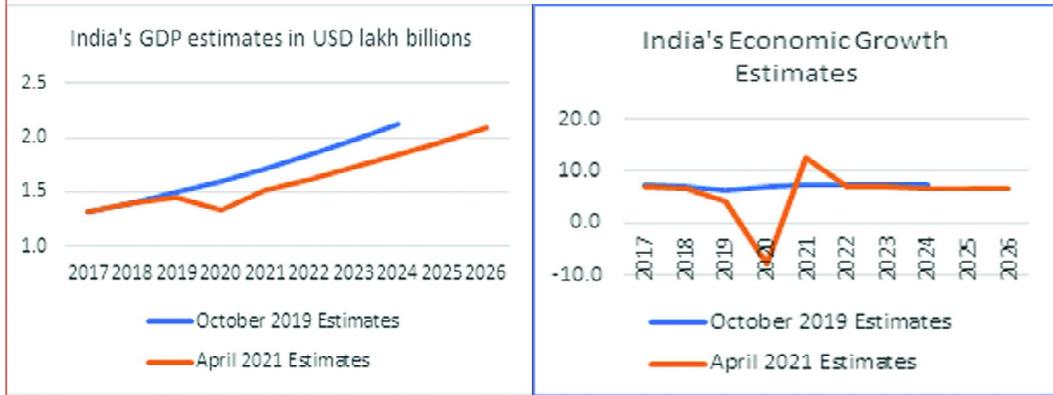
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- i. *Health sector*: Pandemic has indicated the need for well organised and resilient health sector where the public sector will play a significant role. This will require States spend much more than what it is currently doing. In the absence of any central support for this sector States' expenditure responsibility rise catastrophically.
- ii. *Education Sector*: Pandemic has stopped schooling for close to two academic years for most kids in India except for a very privileged minority. For education sector that is resilient to pandemics requires boosting the IT infrastructure of the schooling system. This will require States to spend much more than it is currently doing.

The increased expenditure burden is likely to continue for the governments as the economy shows no signs of recovery in the immediate future. The IMF's revised estimates after the COVID-19 pandemic indicate the difference in expenditure burden (see Figure 2). There is no clear evidence of government expenditure coming back to pre-pandemic forecasts even in 2026. The crude measure shows their government expenditure would increase at least one percent of GDP. This could vary across States in India owing to the state's responsiveness to the crisis.

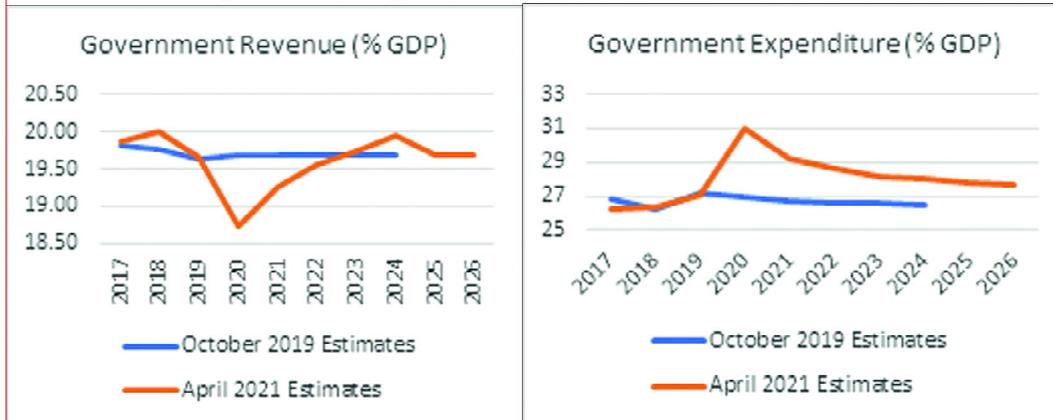
Given the limited revenue-enhancing powers of the Indian States, the state governments would confront huge fiscal stress without the extended support from the union government.

**Figure 1: Different estimates on Indias GDP and its growth**



Source: The World Economic Outlook Database, IMF

**Figure 2: Pre and post pandemic comparisons of government revenue and expenditure**



Source: The World Economic Outlook Database, IMF

## 4. Extending GST compensation beyond 2022 and constitutional amendment

Clause 18 of the Constitution (One Hundred and First Amendment) Act, 2016 limits the parliament not go beyond five years for compensating the States as follows:

“A draft amendment clause may be suggested as follows: *“Parliament shall, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for a period as decided by the Council”*”

*“Parliament shall, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for a period of five year”*

Considering the pandemic situation and the revenue position of almost all the States, the GST Council may recommend extending the GST compensation w.e.f July 1, 2022. The Council may recommend the Union government to propose to initiate a constitutional Amendment in clause 18 of the Constitution (One Hundred and First Amendment) Act, 2016. A draft amendment clause may be suggested as follows:

*“Parliament shall, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for a period as decided by the Council”*

## 5. Financing GST compensation

Since the economic activity has been severely disrupted due to COVID-19, States are not in a position to narrow down the revenue gap. As already noted, this calls for an increase in the GST compensation period. Now the question is how to finance the compensation.

The existing financing mechanism for compensation is a special compensation cess, levied over and above the GST on sin/luxury goods. When the Union Government faces a situation in which there is a higher demand from the States, and the actual cess collection is too low, they have resorted to borrowing. The Union Government meets the shortfall in the compensation cess through borrowing under the special window.

This section provides possible strategies that the Union Government could adopt, based on the recommendations of the GST Council, to continue the Compensation after 2022.

**Following are the possible options available to the GST Council for financing the State revenue shortage:**

### 5.1 Increase in rates and coverage of cess

The current rates prescribed for the listed sin/luxury goods ranges between 1percent (Petrol, liquefied petroleum gas (LPG) or compressed natural gas (CNG) driven motor vehicles of engine capacity not exceeding 1200cc and of length not exceeding 4000mm) and 204percent (Pan masala (gutkha) containing tobacco). It is neither feasible nor advisable

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It is desirable to search for avenues other than cess to finance GST compensation.

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to make a significant change in the existing rates in this pandemic period. However, it is reasonable to change the rate of some of the luxury items based on the purchasing pattern. For example, a 25 percent cess can be charged for motor vehicles of engine capacity exceeding 1500 cc other than motor vehicles specified against entry at S. No 52B. Similarly, a 30percent cess can be levied for SUV-type motor vehicles of engine capacity over 1500cc. Currently, there are twenty-three items on the cess list. In addition, more luxury and environmentally hazardous items could be included.

## 5.2 Special rate as per Article 279 A(4)(f)

As per the Article 279 A (4)(f) of the 101 Constitution Amendment Act 2016, the Goods and Services Tax Council shall make recommendations to the Union and the States on "*any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster*". A special rate evoking this provision may be recommended by the GST Council.

## 5.3 Increase the tax rates of GST

During the four years of GST, the Council had reduced tax rates twice for around 200 goods ie., goods covered in the 28 percent brackets to 18 percent, from 18 percent brackets to 12 percent, and from 12 percent to 5 percent. As a result, the 15 percent RNR has been slashed to 11.5 percent. This has naturally reduced the revenue collection. In the above context following changes are suggested.

— // —  
There is scope for increasing the rate of cess and its coverage.  
— // —

— // —  
Considering the pandemic situation, a special rate as per Article 279 A (4)(f) could be considered for raising additional revenue.  
— // —

**Table 4.** Existing and proposed hike in GST rates for different slabs

Existing Rates (%)			Proposed Rates (%)		
IGST	CGST	SGST	IGST	CGST	SGST
0.25	0.125	0.125	0.50	0.25	0.255
3	1.5	1.5	4	2	25
5	2.5	2.5	6	3	35
12	6	6	14	7	75
18	9	9	20	10	105
28	14	14	30	15	15

- a. The proposed rate increase is beneficial to both the Center and the States. The increases in the Central GST will indirectly increase the tax devolution to the States.
- b. After increasing the rates as mentioned above, the fitment committee may re-schedule goods/services in the appropriate rate brackets without affecting the potential revenue from such goods/services.
- c. The rate increase coupled with the effective national wide enforcements functions by center and States will naturally increase the revenue. This will reduce the shortfall in revenue considerably and reduces the burden of the Union Government to compensate the revenue gap of the States.

————— // —————  
There is also scope for marginal increase in GST rates across different slabs.  
————— // —————

#### **5.4 Regular revision of projected revenue growth rate**

The present projected revenue growth of 14 percent can be continued for the next five years considering the shock of pandemic and revenue loss to the States. Subsequently, based on the actual collection pattern, the projected growth rate can be revisited and revised every two years.

————— // —————  
Growth rate for deciding compensation shall be flexible instead of being fixed.  
————— // —————

## 5.5 Borrowing for the States

The Centre in consensus with the States decided to borrow from the market for paying GST compensation to States during 2020-21 and the funds are passed on to the state governments as back-to-back loans, in lieu of the GST compensation cess disbursement. This special window borrowing by the Union Government has removed the differential rates of interest that the States would have been charged if they hit the market through the issuance of State Development Loans (SDLs). In the books of accounts of the Centre, the borrowings will not reflect on the Centre's fiscal deficit and whereas in the State's accounts, it will be treated as capital receipts as part of the financing of their respective fiscal deficits.

“  
The system of Centre borrowing and transferring to the State Governments as back-to-back loans, in lieu of the GST compensation can be continued.  
”

The Centre is playing the role of intermediary to ensure that the general government (Union + States) borrowing costs don't rise. The debt servicing of this borrowing will be met out of the future cess amount collected from the GST cess of goods notified under the GST compensation to States Act 2017. Hence the States don't have to bear any cost of the debt. All States/Union Territories have agreed to use this option of borrowing proposed by the Centre to bridge part of their GST revenue shortfall. In this context, the GST Council in its 42nd meeting decided to continue cess collection beyond July 2022 to repay the loan taken to meet the compensation gap.

On the contrary, if state governments are involved in the borrowing process to meet the compensation cess shortfall in the short run, the servicing cost will increase significantly. As most States have already crossed the borrowing limit during the period 2016-20 as recommended by the 14th Finance Commission (25 percent) and FRBM Review Committee (20

percent) (Refer Table 5) the system of Centre borrowing and transferring to the state governments as back-to-back loans, in lieu of the GST compensation can be continued.

**Table 5: Debt position of Indian states during the GST compensation period (Average)**

State	Debt to GSDP Ratio	State	Interest Payment to GSDP Ratio
Nagaland	41.85	Punjab	3.17
Punjab	41.04	Nagaland	2.75
Manipur	37.32	West Bengal	2.74
Himachal Pradesh	36.47	Himachal Pradesh	2.68
West Bengal	35.77	Rajasthan	2.37
Mizoram	35.24	Kerala	2.17
Rajasthan	34.34	Manipur	2.13
Uttar Pradesh	33.8	Arunachal Pradesh	2.11
Arunachal Pradesh	33.54	Uttar Pradesh	2.05
Meghalaya	31.93	Tripura	2.03
Bihar	31.88	Meghalaya	1.98
Tripura	30.91	Haryana	1.92
Kerala	30.73	Bihar	1.88
Andhra Pradesh	29.73	Uttarakhand	1.83
Jharkhand	28.5	Goa	1.82
Goa	27.5	Andhra Pradesh	1.78
Haryana	26.4	Tamil Nadu	1.76
Uttarakhand	24.53	Mizoram	1.7
Madhya Pradesh	24.22	Jharkhand	1.66
Odisha	23.27	Madhya Pradesh	1.53
Telangana	23.11	Telangana	1.47
Tamil Nadu	22.28	Sikkim	1.45
Sikkim	21.52	Gujarat	1.38
Chhattisgarh	20.94	Maharashtra	1.3
Gujarat	19.14	Chhattisgarh	1.23
Karnataka	19.05	Assam	1.2
Assam	18.55	Odisha	1.16
Maharashtra	17.72	Karnataka	1.12

**Source:** Finance Accounts and Budget Documents of the respective States. The actual values during the period are considered for compilation.

Centre should not  
hesitate even to resort  
to deficit financing to  
meet its obligation to  
States

## 5.6 Deficit financing

The need for compensating the States for the loss of their revenue on account of GST is evident both analytically and empirically. Considering the imperative of the provision for compensation for the States, the Centre should not hesitate even to resort to deficit financing to meet its obligation to States for sustaining the one nation one tax regime and upholding the spirit of cooperative federalism.

## **Annexure**

### **Salient features of GST (Compensation to States) Act, 2017**

The Goods and Services Tax (Compensation to States) Act, 2017 and The Goods and Services Tax (Compensation to States) Amendment Act, 2018 are meant to provide compensation to the States for the loss of revenue arising on account of implementation of the goods and services tax in pursuance of the Clause 18 of the Constitution (One Hundred and First Amendment) Act, 2016. Clause 18 stipulates that " Parliament shall, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for a period of five year"

#### **I. Relevant Definitions (Section 2)**

- a) Cess [Section 2(1)(c)] means the goods and services tax compensation cess levied under section 8.
- b) Compensation [Section 2(1)(d)] means an amount, in the form of goods and services tax compensation, as determined under section 7.
- c) Fund [Section 2(1) (f)] means the Goods and Services Tax Compensation Fund referred to in section 10.
- d) Projected growth rate [Section 2(1) (k)] means the rate of growth projected for the transition period as per section 3.
- e) Transition date [Section 2(1) (q)] shall mean, in respect of any State, the date on which the State Goods and Services Tax Act of the concerned State comes into force.
- f) Transition period [Section 2(1) (r)] means a period of five years from the transition date.

#### **II. Projected Growth Rate (Section 3)**

The projected nominal growth rate of revenue subsumed for a State during the transition period shall be fourteen per cent per annum.

#### **III. Base Year (Section 4)**

For the purpose of calculating the compensation amount payable in any financial year during the transition period, the financial year ending 31st March, 2016, shall be taken as the base year.

#### **IV. Base year Revenue Calculation (Section 5)**

1. The base year revenue for a State shall be the sum of the revenue collected by the State and the local bodies during the base year, on account of the taxes levied by the respective State or Union and net of refunds, with respect to the taxes (listed below) , imposed by the respective State or Union, which are subsumed into goods and services tax prior to the commencement of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016.

They are

- a) The value added tax, sales tax, purchase tax, tax collected on works contract, or any other tax levied by the concerned State
- b) The central sales tax
- c) The entry tax, Octroi, local body tax or any other tax levied by the concerned State
- d) The taxes on luxuries, including taxes on entertainments, amusements, betting and gambling or any other tax levied by the concerned State
- e) The taxes on advertisement or any other tax levied by the concerned State
- f) The duties of excise on medicinal and toilet preparations levied by the Union but collected and retained by the concerned State Government
- g) Any cess or surcharge or fee leviable by the State Government for the above mentioned taxes

The following taxes shall not be included in the calculation of the base year revenue net of refunds for that State

- a) Any taxes levied on the sale or purchase of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption;
- b) Tax levied under the Central Sales Tax Act, 1956 on the sale or purchase of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption
- c) Any cess imposed by the State Government on the sale or purchase of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption

- d) The entertainment tax levied by the State but collected by local bodies, under any Act
2. In respect of the State of Jammu and Kashmir, the base year revenue shall include the amount of tax collected on sale of services by the said State Government during the base year.
  3. In respect of the States mentioned in the article 279A of the Constitution (Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand), the amount of revenue foregone on account of exemptions or remission given by the said State Governments to promote industrial investment in the State, with respect to such specific taxes referred above shall be included in the total base year revenue of the State.
  4. The Acts of the Central Government and State Governments under which the specific taxes are being subsumed into the goods and services is notified.[For State-wise list of Acts subsumed under GST please refer Notification No.1/2018 (Goods and Services Tax Compensation) of Department of Revenue, Ministry of Finance, (GSR.1116(E)] [For Kerala refer Appendix]
  5. The base year revenue shall be calculated on the basis of the figures of revenue collected and net of refunds given in that year, as audited by the Comptroller and Auditor-General of India.
  6. In respect of any State, if any parts of revenues mentioned here are not credited in the Consolidated Fund of the respective State, the same shall be included in the total base year revenue of the State, subject to such conditions as may be prescribed.

#### **V. Projected Revenue for any year (Section 6)**

The projected revenue for any year in a State shall be calculated by applying the projected growth rate over the base year revenue of that State.

Year	Equation	Projected Revenue (Percentage)
2015-16	100	100
2016-17	$100 (1+14/100)^1$	114.00
2017-18	$100 (1+14/100)^2$	129.96
2018-19	$100 (1+14/100)^3$	148.15
2019-20	$100 (1+14/100)^4$	168.89
2020-21	$100 (1+14/100)^5$	192.54
2021-22	$100 (1+14/100)^6$	219.50

## VI. Calculation and Release of Compensation (Section 7)

1. The compensation under this Act shall be payable to any State during the transition period.
2. The compensation payable to a State shall be provisionally calculated and released at the end of every two months period, and shall be finally calculated for every financial year after the receipt of final revenue figures, as audited by the Comptroller and Auditor-General of India. In case any excess amount has been released as compensation to a State in any financial year during the transition period, as per the audited figures of revenue collected, the excess amount so released shall be adjusted against the compensation amount payable to such State in the subsequent financial year.
3. The total compensation payable for any financial year during the transition period to any State shall be calculated in the following manner
  - a) The projected revenue for any financial year during the transition period, which could have accrued to a State in the absence of the goods and services tax, shall be calculated as per section 6
  - b) The actual revenue collected by a State in any financial year during the transition period shall be-
    - i. The actual revenue from State tax collected by the State, net of refunds given by the said State under Chapters XI (Refunds) and XX (Transitional Provisions) of the State Goods and Services Tax Act
    - ii. The integrated goods and services tax apportioned to that State;
    - iii. Any collection of taxes on account of the taxes levied by the

respective State under various Acts which are subsumed in goods and services tax, net of refund of such taxes as certified by the Comptroller and Auditor-General of India.

- c) The total compensation payable in any financial year shall be the difference between the projected revenue for any financial year and the actual revenue collected by a State.
4. The loss of revenue at the end of every two months period in any year for a State during the transition period shall be calculated, at the end of the said period, in the following manner
- a. The projected revenue that could have been earned by the State in absence of the goods and services tax till the end of the relevant two months period of the respective financial year shall be calculated on a pro-rata basis as a percentage of the total projected revenue for any financial year during the transition period, calculated in accordance with section 6. For example if the projected revenue for any year calculated in accordance with section 6 is one hundred rupees, for calculating the projected revenue that could be earned till the end of the period of ten months for the purpose of this sub-section shall be  $100 \times (5/6) = \text{Rs.}83.33$ ;
  - b. The actual revenue collected by a State till the end of relevant two months period in any financial year during the transition period shall be-
    - i. The actual revenue from State tax collected by the State, net of refunds given by the State under Chapters XI (refund) and XX (Transitional provisions) of the State Goods and Services Tax Act
    - ii. The integrated goods and services tax apportioned to that State, as certified by the Principal Chief Controller of Accounts of the Central Board of Excise and Customs
    - iii. Any collection of taxes levied by the said State under various Acts which are subsumed in goods and services tax, net of refund of such taxes
  - c. The provisional compensation payable to any State at the end of the relevant two months period in any financial year shall be the difference between the

projected revenue till the end of the relevant period in accordance with para (a) and the actual revenue collected by a State in the said period as referred to in para (b), reduced by the provisional compensation paid to a State till the end of the previous two months period in the said financial year during the transition period

5. In case of any difference between the final compensation amount payable to a State calculated in accordance with Para 3 upon receipt of the audited revenue figures from the Comptroller and Auditor-General of India, and the total provisional compensation amount released to a State in the said financial year in accordance with Para 4, the same shall be adjusted against release of compensation to the State in the subsequent financial year.
6. Where no compensation is due to be released in any financial year, and in case any excess amount has been released to a State in the previous year, this amount shall be refunded by the State to the Central Government and such amount shall be credited to the Fund in such manner as may be prescribed.

## **VII. Levy and Collection of Cess (Section 8)**

1. There shall be levied a cess on such intra-State supplies of goods or services or both, as provided for in the Central Goods and Services Tax Act, and such inter- State supplies of goods or services or both as provided in the Integrated Goods and Services Tax Act, and collected in such manner as may be prescribed, on the recommendations of the Council, for the purposes of providing compensation to the States for loss of revenue arising on account of implementation of the goods and services tax with effect from the date from which the provisions of the Central Goods and Services Tax Act is brought into force, for a period of five years or for such period as may be prescribed on the recommendations of the Council. No such cess shall be leviable on supplies made by a taxable person who has decided to opt for composition levy as per the Central Goods and Services Tax Act.
2. The cess shall be levied on such supplies of goods and services as are specified in Schedule of this Act, on the basis of value, quantity or on such basis at such rate as the Central Government may, on the recommendations of the Council, by notification in the Official Gazette, specify. Where the cess is chargeable

on any supply of goods or services or both with reference to their value, for each such supply the value shall be determined under section 15 of the Central Goods and Services Tax Act for all intra-State and inter-State supplies of goods or services or both. Further the cess on goods imported into India shall be levied and collected in accordance with the provisions of section 3 of the Customs Tariff Act, 1975, at the point when duties of customs are levied on the said goods under section 12 of the Customs Act, 1962, on a value determined under the Customs Tariff Act, 1975.

#### **VIII. Returns, payments and refunds (Section 9)**

1. Every taxable person, making a taxable supply of goods or services or both, shall -
  - a. Pay the amount of cess as payable under this Act in such manner;
  - b. Furnish such returns in such forms, along with the returns to be filed under the Central Goods and Services Tax Act; and
  - c. Apply for refunds of such cess paid in such form as the case may be.
2. For all purposes of furnishing of returns and claiming refunds, except for the form to be filed, the provisions of the Central Goods and Services Tax Act and the rules made thereunder, shall, as far as may be, apply in relation to the levy and collection of the cess leviable under section 8 on all taxable supplies of goods or services or both, as they apply in relation to the levy and collection of central tax on such supplies under the said Act or the rules made thereunder.

#### **IX. Crediting proceeds of Cess to Fund (Section 10)**

1. The proceeds of the cess leviable under section 8 and such other amounts as may be recommended by the Council, shall be credited to a non-lapsable Fund known as the Goods and Services Tax Compensation Fund, which shall form part of the public account of India and shall be utilised for purposes specified in the said section.
2. All amounts payable to the States under section 7 shall be paid out of the Fund.
3. Fifty per cent of the amount remaining unutilized in the Fund at the end of the transition period shall be transferred to the Consolidated Fund of India

as the share of Centre, and the balance fifty per cent shall be distributed amongst the States in the ratio of their total revenues from the State tax or the Union territory goods and services tax, as the case may be, in the last year of the transition period.

4. Notwithstanding anything contained in the para 3 above, fifty per cent of such amount, as may be recommended by the Council, which remains unutilised in the Fund, at any point of time in any financial year during the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance fifty per cent shall be distributed amongst the States in the ratio of their base year revenue determined in accordance with the provisions of section 5. Provided that in case of shortfall in the amount collected in the Fund against the requirement of compensation to be released under section 7 for any two months' period, fifty per cent of the same, but not exceeding the total amount transferred to the Centre and the States as recommended by the Council, shall be recovered from the Centre and the balance fifty per cent from the States in the ratio of their base year revenue determined in accordance with the provisions of section 5.
5. The accounts relating to Fund shall be audited by the Comptroller and Auditor- General of India or any person appointed by him at such intervals as may be specified by him and any expenditure in connection with such audit shall be payable by the Central Government to the Comptroller and Auditor-General of India.
6. The accounts of the Fund, as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be laid before each House of Parliament.

#### **X. Other Provisions relating to Cess (Section 11)**

1. The provisions of the Central Goods and Services Tax Act, and the rules made there under, including those relating to assessment, input tax credit, non-levy, short-levy, interest, appeals, offences and penalties, shall, as far as may be, mutatis mutandis, apply, in relation to the levy and collection of the cess leviable under section 8 on the intra-State supply of goods and services, as they apply in relation to the levy and collection of central tax on such intra-State supplies under the said Act or the rules made thereunder

2. The provisions of the Integrated Goods and Services Tax Act, and the rules made thereunder, including those relating to assessment, input tax credit, non-levy, short-levy, interest, appeals, offences and penalties, shall, mutatis mutandis, apply in relation to the levy and collection of the cess leviable under section 8 on the inter-State supply of goods and services, as they apply in relation to the levy and collection of integrated tax on such inter-State supplies under the said Act or the rules made thereunder. Provided that the input tax credit in respect of cess on supply of goods and services leviable under section 8, shall be utilised only towards payment of said cess on supply of goods and services leviable under the said section.

#### **XI. Power to make Rules (Section 12)**

1. The Central Government shall, on the recommendations of the Council, by notification in the Official Gazette, make rules for carrying out the provisions of this Act.
2. In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters
  - a) The conditions which were included in the total base year revenue of the States, referred to in article 279A(4)(g) of the Constitution, section 5(3) of this Act
  - b) The conditions subject to which any part of revenues not credited in the Consolidated Fund of the respective State shall be included in the total base year revenue of the State, section 5(6) of this Act.
  - c) The manner of refund of compensation by the States to the Central Government under section 7(6) of this Act
  - d) The manner of levy and collection of cess and the period of its imposition under section 8(1) of this Act.
  - e) The manner and forms for payment of cess, furnishing of returns and refund of cess under section 9(1) of this Act.
  - f) Any other matter which is to be, or may be, prescribed, or in respect of which provision is to be made, by rules.

## **XII. Laying of Rules before Parliament (Section 13)**

Every rule made under this Act by the Central Government shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

## **XIII. Power to remove difficulties (Section 14)**

2. If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, on the recommendations of the Council, by order published in the Official Gazette, make such provisions, not inconsistent with the provisions of this Act, as appear to it to be necessary or expedient for removing the difficulty. Provided that no order shall be made under this section after the expiry of three years from the commencement of this Act.
3. Every order made under this section shall, as soon as may be after it is made, be laid before each House of Parliament.

## **XIV. The Schedule under this Act (list only)**

1. Pan Masala
2. Tobacco
3. Coal
4. Aerated Waters
- 4A. Motor vehicles for the transport of not more than thirteen persons including the driver [inserted as per The GST (Compensation to States) Amendment Act 2017]
5. Motor Cars and other motor vehicles principally designed for the transport of persons (other than motor vehicles for the transport of ten or more persons, including the driver), including station wagons and racing cars.
6. Any other supplies

Goods	GST Compensation Cess (Rate)
Unmanufactured tobacco (with lime tube) – featuring a brand name	65%
Unmanufactured tobacco (without lime tube) – with a brand name	71%
Branded tobacco refuse	61%
Cheroots and Cigar	21% or 4170 per thousand, whichever higher
Cigarillos	21% or Rs. 4170 per thousand, whichever is higher
Cigarettes containing tobacco excluding filter cigarettes, of length not more than 65mm	5% + 2076 per thousand
Cigarettes containing tobacco apart from filter cigarettes, of length more than 65mm and up to 75mm	5% + 3668 per thousand
Cigarettes of tobacco substitutes	Rs.4006 per thousand
Branded 'hookah' or 'gudaku' tobacco	72%
Chewing tobacco (without lime tube)	160%
Chewing tobacco (with lime tube)	142%
Pan masala (gutkha) containing tobacco	204%
All goods, excluding pan masala containing tobacco 'gutkha', with the brand name	96%
All goods, excluding pan masala containing tobacco 'gutkha', not bearing a brand name	89%
Coal, ovoids, briquettes, and similar solid fuels manufactured from lignite, coal, whether or not agglomerated, excluding jet, peat (including peat litter), whether or not agglomerated	400 per tonne
Aerated waters	12%
Motor vehicles for the transport of not more than 13 persons, including the driver	15%
Motor vehicles, excluding ambulances, three-wheelers and vehicles of engine capacity not exceeding 1200cc and of length not exceeding 4000 mm, with both spark-ignition internal combustion reciprocating piston engine and electric motor as motors for propulsion or with with both compression-ignition internal combustion piston engine [diesel-or semi diesel] and electric motor as motors for propulsion	15%
Petrol, liquefied petroleum gas (LPG) or compressed natural gas (CNG) driven motor vehicles of engine capacity not exceeding 1200cc and of length not exceeding 4000mm.	1%
Diesel driven motor vehicles of engine capacity not exceeding 1500cc and of length not exceeding 4000mm.	3%
Motor vehicles of engine capacity not exceeding 1500 cc	17%
Motor vehicles of engine capacity exceeding 1500 cc other than motor vehicles specified against entry at S. No 52B	20%
Motor vehicles of engine capacity over 1500cc, popularly known as Sports Utility Vehicles (SUVs) including utility vehicles.	22%





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