

IGST Settlement and Compensation Cess under GST :

Addressing the State Fiscal Stress

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Abstract

Despite being celebrated as one of the most important tax reforms in recent history, India's Goods and Services Tax (GST) has encountered numerous difficulties since going into effect. Undoubtedly, the reform has simplified indirect taxation and promoted a single market, but there are still some important problems that need to be addressed. This paper aims to comprehend the overall revenue performance of GST and looks at the two major issues that can help the States to deal with their fiscal stress such as; the distribution of huge unsettled amounts in IGST kitty without delay and the feasibility of continuing compensation cess at least for some more years even after the repayment of borrowings which is used for servicing the back-to-back loans taken during the COVID 19 period to compensate the revenue loss of the States. Continuance and sharing of compensation cess with states can help the States to handle with their fiscal stress.

Keywords: *GST, Revenue performance, IGST Settlement, Unsettled amount, Compensation Cess*

Introduction

German businessman Wilhelm von Siemens came up with the concept of the Value Added Tax (VAT)/Goods and Services Tax (GST) in the 1920s. It was implemented first in France in 1954, and then in several other nations, including Japan, South Korea, the United Kingdom, Australia, Canada, and others. There are more than 160 countries implemented VAT/GST (World Bank, 2015). GST is not the same in every country, even though it is intended to be a destination-based tax imposed on the consumption of goods and services. The GST was introduced in India as a follow-up to the VAT, which was first introduced in 2004. It was originally conceived as a single tax that subsumes all central and state indirect taxes in India. However, at the implementation level, we adopted a dual GST model followed by Canada, in which the structure of GST is given importance to preserving Centre-State fiscal relations.

Many believe that GST is one of the major policy successes of recent years, which stimulated the growth of the national market and provided a stable source of revenue to both Centre and States (Subrahmanian et.al, 2024). The introduction of GST is aimed to bring economic unification in India in the form of a 'One Nation, One Market, One Tax'. But during the implementation of this new tax system, 'One Tax' in the slogan is replaced with uniformity in tax rules and procedures such as centralization of tax administration, registration, tax payments, return filing, refund payments, etc. instead of uniform tax and tax rate. Also, the exclusion taxes on petroleum products, electricity, stamp duties on immovable properties, and excise duties on alcohol from the purview of GST leaves a gaping hole in the plan to implement a common indirect tax regime (Kumar, A, 2019; Mukherjee, S., 2019). Even after seven and a half years of implementation, GST is still a work in progress with continuous changes in rules, procedures, and rates. Till 31 December 2022, 718 notifications has been issued under Central Goods and Services Tax Act (excluding the notifications issued by various state governments and union territories) which make the assessment, levy, and administration of tax and its collection made cumbersome (Thekkekkara, J. and Kumary L, A., 2023). This itself proves the still existing confusion and unresolved issues which has been creating distorting implications in the efficiency of the GST system, rather than the advantages listed by the proponents such as the increase in the growth rate of the economy, tax collection, improved export, and the fiscal gains to the consumer States since it is a destination-based tax. Against this backdrop, this study attempts to comprehend the revenue performance and look into two issues of concern under Indian GST system such as; the

prevalence of huge unsettled amounts in Integrated Goods and Services Tax (IGST) kitty and the feasibility of continuing compensation cess at least for some more years even after the repayment of borrowings which is used for servicing the back-to-back loans taken during the COVID 19 period to compensate the revenue loss of the States.

Understanding the revenue performance

The revenue performance of GST is analyzed by looking at the performance of various components of GST such as Central Goods and Services Tax (CGST), States Goods and Services Tax (SGST), and Integrated Goods and Services (IGST). Table 1 gives us the details of the actual amount that the government has earned from the GST. The GST figure reported for 2023-24 is Rs 18.01 lakh crores, equivalent to 6.10 percent of GDP. This implies that the GST to GDP ratio could reach the pre-GST level of tax-GDP ratio of 6.13 percent (average annual share (2012-13 to 2016-17) of taxes subsumed in GST to GDP ratio calculated by Mukherjee, 2023) only in the fiscal year 2023-24. Even if the tax-GDP ratio is slightly improved and reaches the same level as the pre-GST period, tax buoyancy declined from 1.5 in 2021-22 to 1.4 in 2023-24, less than the buoyancy of 1.5 in 2016-17.

Table 1: GST Revenue Collection (in crores)								
Gross GST Revenue Collection								
Year	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25 (up to Oct-24)
CGST	118857.1	202433.7	227443.0	209916.0	269137.2	323923.1	375710.4	237372.7
SGST	171781.7	278805.9	309231.5	272827.8	344215.8	410251.2	471195.0	294365.1
IGST	387354.4	598736.8	586698.7	565719.4	762270.5	945220.5	1026789.9	654487.4
CESS	62614.3	97368.7	98748.6	88342.0	107667.2	128285.5	144553.8	88216.5
Total	740607.4	1177345.1	1222121.7	1136805.1	1483290.8	1807680.3	2018249.2	1274441.8
Net GST Revenue Collection (Gross Revenue - Refund)								
	2017-18*	2018-19*	2019-20*	2020-21	2021-22	2022-23	2023-24	2024-25 (up to Oct-24)
CGST	108301.1	184455.0	207243.1	191744.8	242767.2	294755.7	345404.6	217772.8
SGST	156939.1	254715.9	282512.7	250610.1	311117.5	374003.9	433654.1	270023.1
IGST	329398.9	509154.6	498917.6	485018.2	643208.7	795892.5	881348.6	554064.0
CESS	60167.1	93563.3	94889.2	84321.8	102713.0	123416.9	140671.6	85212.5
Total	654910.5	1041112.7	1080708.1	1011694.9	1299806.5	1588069.0	1801078.9	1127072.4
Growth (GST)			3.8	-6.4	28.5	22.2	13.4	
GDP (current)	17090042	18899668	20103593	19854096	23597399	26949646	29535667	15391471
Growth (GDP)		10.6	6.4	-1.2	18.9	14.2	9.6	
Net GST-GDP ratio (%)		5.5	5.4	5.1	5.5	5.9	6.1	
Tax buoyancy (%)			0.6	5.1	1.5	1.6	1.4	

*GST portal gives refund data from 2020-21 onwards only. We projected Net Revenue data for the years, 2017-18, 2018-19, and 2019-20 based on the average proportion of net revenue in gross revenue collection.

Source: GST Revenue - GST Portal, GDP – Niti Ayog

The difference in expected and actual revenue

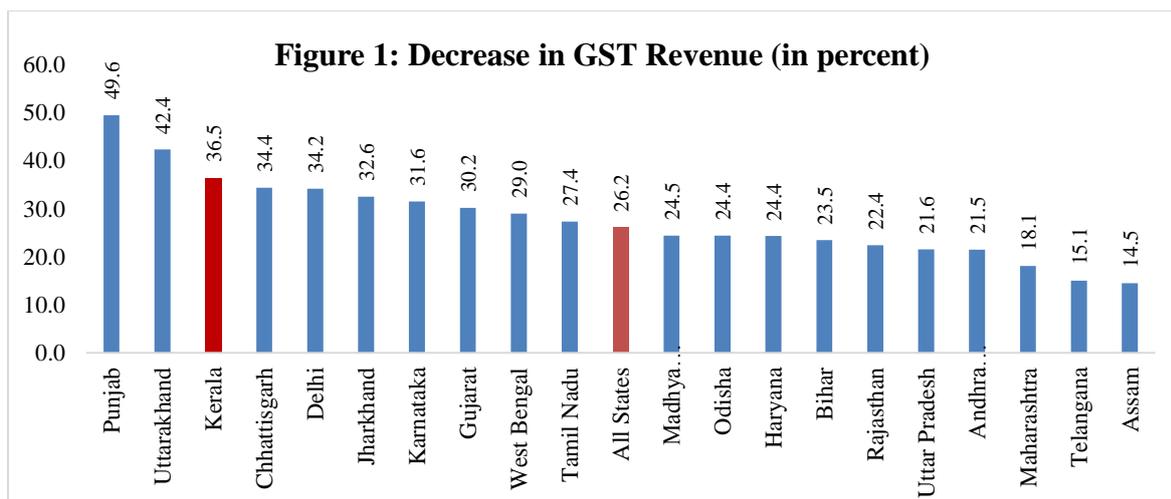
GST was introduced with the expectation that States could attain 14 percent revenue growth in five years, which is why the GST (Compensation to States) Act, 2017, was established to

protect states' revenue for the initial five years. In light of this, we have calculated the expected revenue assuming that revenue grows at an annual rate of 14 percent from the revenue collected in 2015-16 (CAG certified).

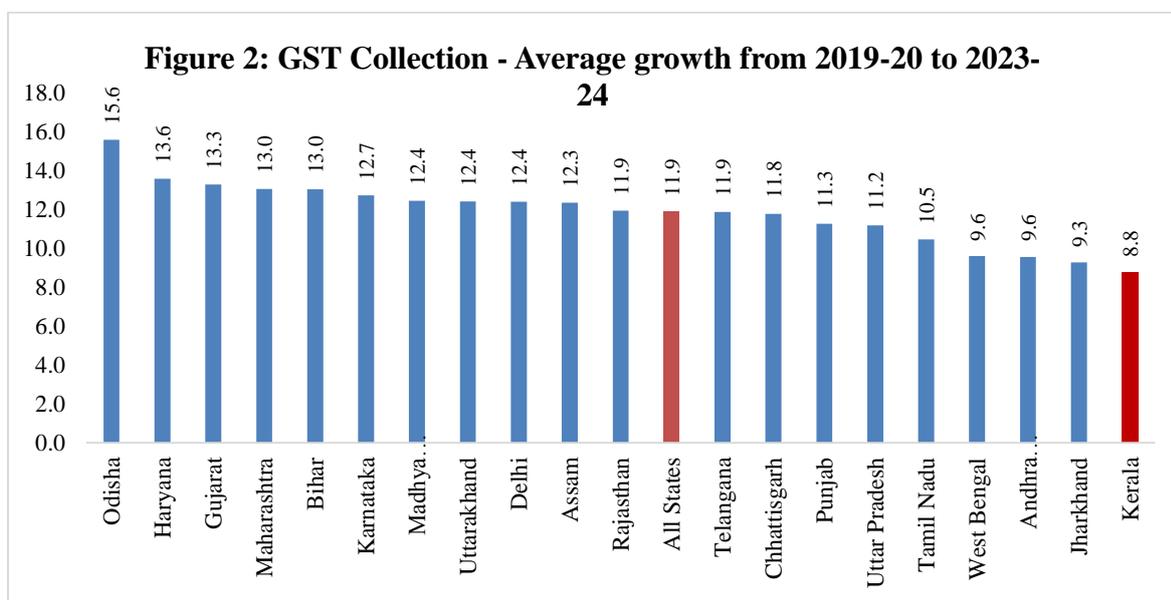
When we compare this expected revenue calculated with the actual GST collected (net of refund) in 2023-24, it is amply clear that the GST revenues are nowhere near the levels attained by the taxes subsumed under GST, even after seven years. The States too far away from the expected revenue are Punjab (49.6%), Uttarakhand (42.4%) and Kerala (36.5%). The revenue attainment of All states and union territories (UTs) is 26 percent below the expected (Figure 1). The 10 states remain above this percentage, showing how big the cost of the States to move to the much-discussed tax reform implemented after the culmination of a 14-year-long thought process that began in December 2002. Indeed, COVID hit the State's revenue mobilization hard during the years 2020-21 and 2021-22, it should be noted that the revenue performance did not improve during the later periods also. Many argue that tax rate cutting without serious examination of revenue implications is responsible for poor revenue performance and the current rates are not revenue neutral (RBI, 2019; Isaac, T, 2020; Mukherjee, S, 2021 & 2023; Joseph and Kumary L A, 2023; Subramanian, 2024).

Name of State/UT	Expected	Actual	Difference	Difference as % of Expected
Andhra Pradesh	39574.8	31056.0	8518.8	21.53
Assam	17074.2	14598.3	2475.9	14.50
Bihar	36001.2	27528.0	8473.2	23.54
Chhattisgarh	20986.5	13765.0	7221.4	34.41
Delhi	47878.2	31507.3	16370.9	34.19
Gujarat	82315.3	57434.6	24880.7	30.23
Haryana	43446.6	32867.0	10579.6	24.35
Jharkhand	18286.5	12327.0	5959.6	32.59
Karnataka	103104.3	70546.1	32558.2	31.58
Kerala	47984.4	30472.8	17511.6	36.49
Madhya Pradesh	43727.9	33030.7	10697.2	24.46
Maharashtra	172594.6	141317.1	31277.5	18.12
Odisha	31519.2	23823.1	7696.1	24.42
Punjab	41282.0	20825.8	20456.1	49.55
Rajasthan	48946.4	37965.8	10980.7	22.43
Tamil Nadu	84968.2	61708.3	23259.8	27.37
Telangana	45951.5	39032.9	6918.6	15.06
Uttar Pradesh	95241.7	74698.1	20543.6	21.57
Uttarakhand	14152.3	8155.2	5997.1	42.38
West Bengal	57330.5	40682.9	16647.6	29.04
All States	1133431.9	836682.0	296749.9	26.18

Source: Calculated based on the data availed from GST Portal



Source: Same as Table 2



Source: Based on the data availed from GST Portal

Figure 2 shows the average annual growth rate of GST collection in the States from 2019-20 to 2023-24. This indicates that the states' revenue growth performance is also poor compared to the expected growth rate of 14 percent. Odisha (15.6%) is the only State that could just pass this benchmark, followed by Haryana (13.6%). Kerala is the lowest performer with an average growth rate of 8.8 percent from 2019-20 to 2023-24. It is 12 percent for All states and UTs. The difference in expected and actual revenue in Kerala is Rs 17512 crore during the year 2022-23.

Undoubtedly, the central government has an upper hand in GST compared to the state governments since many taxes in which states had autonomy were subsumed in GST. States do not have the flexibility to raise taxes constitutionally without the consent of the GST council and Central government. The above analysis shows the GST experience of the State governments is not that good. Here arises the question of doubt whether a unified tax system is good for a diverse country like India, where the States vastly differ from each other in their sectoral composition and consumption pattern. For example; the proponents believe that this new taxation system would benefit the consumer States since it is a last-point, consumption-based tax. But the reality is entirely different. Maintaining the State's fiscal autonomy is crucial. The goal of the GST should be to strike the balance between fiscal autonomy and tax harmonization.

Two issues of concern under GST system

In this context, we can examine two important issues that need attention and urgent interventions on the part of the GST council to help the States from their fiscal stress, such as; the timely distribution of huge unsettled amounts in IGST kitty and the feasibility of continuing compensation cess at least for some more years even after the repayment of borrowings which can help the States to deal with their fiscal stress.

Unsettled amount

It is a fact that almost half of the total GST collection comprises with IGST. This IGST collection mainly takes place on account of interstate domestic trade and international trade. Domestic trade implies the interstate transactions between States ((1) business-to-business (B2B), (2) business-to-consumer (B2C) where the invoice value is more than 2.5 lakh, (3) business-to-consumer (B2C) where the invoice value is less than or equal to 2.5 lakh) and the international trade implies the imports (business-to-business (B2B)) (Mukherjee, S, 2019). This IGST collected from the States and Union Territories is to be settled between the Centre and the destination State/UT where the consumption of the goods/services happens. Here arises another set of problems; How did this settlement happen and how efficient is the present settlement process? finally, if the system is efficient, why huge unsettled amount remain in the IGST account? (Joseph and Kumary, 2023).

The data presented in Table 3 shows that the IGST amount shared between Centre and States is more or less similar and there is no such huge amount retained in the Centre's kitty. Also,

the States receive half of the total GST revenue collected each year. In response to the claim of Tamil Nadu that their Rs.1523.95 crores remain in the central government kitty (The Hindu, June 13, 2024), the Union Finance Ministry clarified that the Central government does not retain any GST that is due to any State government and also no amount is pending to be given to any State due to Integrated Goods and Services Tax (IGST) (The Hindu, June 15, 2024). But can we take it as completely true? Table 4 is from the answer to the Lok Sabha unstarred question No. 2373 to be answered on 18th December 2023, the IGST amount retained by the centre till November 23, 2023-24 is Rs.3,09,309 crores, which is against the initial agreement that the amount available in the IGST account will be distributed between the centre and the states at an equal proportion.

One major reason responsible for the accrual of this huge amount in IGST kitty is the unutilized ITC by the taxpayers. The system works in such a way that buyers claiming Input Tax Credit (ITC) for IGST in their returns identify the beneficiary State. Once the ITC is utilized, the State's portion is settled. ITC may not be utilized for reasons, such as the supply of exempt or non-GST goods; the blocked ITC as per law; or a lapsed period. In these scenarios, the beneficiary State cannot be determined, leading to a surplus in the IGST head (The Hindu, June 15, 2024). Here comes the question of efficiency and the need for a robust technological system. IT system is the backbone of the GST system in India and the efficiency of the system will ensure tax compliance and strengthen the tax administration.

Table 3: Net GST Revenue Collection and IGST Settlement (in crore)					
	2020-21	2021-22	2022-23	2023-24	2024-25 (up to Oct-24)
GST Revenue Collection (net)	1011694.9	1299806.5	1588069	1801078.9	1127072.4
CESS	84321.8	102713.0	123416.9	140671.6	85212.5
GST Revenue Collection (net) - CESS	927373.1	1197093.5	1464652.1	1660407.4	1041859.9
IGST Settlement (States)	217884	295497.8	358893.1	403027.9	260861.5
State's Revenue (SGST+IGST Settlement)	468494.1	606615.3	732897	836682	530884.6
Centre's Revenue* (CGST+IGST Settlement)	463586	593345	723270	815520	
Unsettled Amount	-4706.9	-2866.9	8485.1	8205.3	
Share in GST Revenue Collection (net) – CESS (%)					
State	50.5	50.7	50.0	50.4	51.0
Centre	50.0	49.6	49.4	49.1	
Unsettled amount	-0.5	-0.2	0.6	0.5	

Source: Calculated based on the data availed from the GST portal and *Receipt Budget.

Table 4: Details of IGST retained by the Centre (in Rs. Crore)					
FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24 (till Nov.23)
265518	283491	265601	348966	424180	309309

Source: Answer to the Lok Sabha unstarred question No. 2373 to be answered on 18th December 2023.

Due to the above-mentioned reasons, the IGST account remains with a huge unsettled amount, which aggravates the fiscal conditions of the States, especially those who are eligible for this settlement. At present, there is an enormous delay in settling the IGST amount due to the state concerned. The IGST settlement portion will be available to the states only after the dealers concerned file their monthly/quarterly returns. This has led to a huge unsettled amount in the IGST account. Neither it is available to the state nor the Centre. Whatever IGST is paid in the IGST account in the name of a state is settled only part by part on the submission of returns of the dealer concerned. This creates a heavy financial burden on the states. To address this issue, there is a need to provide for the transfer of SGST and CGST portion of the IGST settlement amount instantaneously to the respective accounts of the Centre and States when the Taxpayer of the state concerned pays the IGST. Also, it would be beneficial to understand the state's overall revenue profile if the State-wise IGST settlement on the CGST account is presented.

GST compensation cess

The GST (Compensation to States) Act, 2017 was established to assure revenue protection to the States for the first five years of the introduction of the GST, on account of any shortfall in the State's revenue from an annual growth rate of 14 percent of the taxes subsumed under GST in 2015-16. For this temporary arrangement to appease the dissatisfied States and pacify the political opposition, the Central government promised quarterly compensation till 30 June 2022, with the collection of a cess on luxury and demerit items, since 1 July 2017. The major issue with the Cess was that those States that collected Cess could not realize it by themselves. It was pooled and distributed according to the proportionate share of the revenue loss faced by the States.

The economic slowdown aggravated by COVID 19 adversely affected the GST collections and led to a shortfall in the Cess collection. Thus, the compensation payment to the States got delayed, which was against the stipulated norms, that compensation must be given out every two months after being provisionally estimated. During the COVID period, due to the fall in revenue of both Centre and State governments, the Central government made necessary

borrowings to compensate the States. This compensation promised and provided by the Central government helped the States to continue with the system of GST at least during the initial years by lessening the friction between the Centre and the States by providing some fiscal space to the governments.

Table 5: Compensation Cess collected from and shared with the States			
	Cess revenue (net)	Compensation to States	Difference
2017-18	60167.1	49622.0	10545.1
2018-19	93563.3	84619.4	8943.9
2019-20	94889.2	165568.0	-70678.8
2020-21	84321.8	168399.7	-84077.9
2021-22	102713.0	68939.0	33774.0
2022-23	123416.9	17973.0	105443.9
Total	559071.3	555121.1	3950.2
2023-24	140671.6	0	140671.6
2024-25 (up to Oct-24)	85212.5	0	85212.5
Total Cess Revenue Collected (up to Oct-24)	784955.5	0	229834.3

**In the GST portal, net cess revenue is available only from 2020-21 onwards. We projected net cess revenue data for the previous years based on the average proportion of net revenue in gross revenue collection.*

Source: Cess revenue data availed from the GST portal, Compensation to States – Annexure details-PIB, Accessed from; <https://static.pib.gov.in/WriteReadData/specificdocs/documents/2022/jul/doc202271971401.pdf>

Table 5 presents the details of the compensation cess collected from and shared with the States. The total cess revenue collected from the States till October 2024 was Rs.7.84 lakh crore and the compensation paid to the States till 2022-23 was Rs.5.55 lakh crore. This implies that even after the end of the GST compensation period, the GST compensation Cess collection was extended (till March 2026) against the original scheme, and the Rs.2.29 lakh crore collected additionally after the compensation period is being used for servicing the back-to-back loans taken during the COVID 19 period to compensate the revenue loss of the States.

The earlier section showed that most States are still suffering in collecting revenue at the proposed growth. The request raised by those States to extend the compensation period for another three years till 2024-25 wasn't accepted by the GST Council or the Central government. However, the government of India has been collecting the compensation cess and adjusting it to the loan amount that they have already taken for compensating the state's revenue loss during the COVID period. It is a fact that the GST compensation period cannot be continued forever, since it is more of a constitutional matter and has an effect on the fiscal space of the Central government to ensure a 14 percent growth for all the States over a longer

period. But the feasibility of continuing the Cess even after the repayment of borrowing for the compensation can be thought of. The possibility of transferring 50 percent of the cess collection to the states can be considered for the next fiscal.

Conclusion

The Goods and Services Tax (GST), implemented in India in 2017, is still a 'work in progress' concerning its fundamental structure and design. Though the current GST regime is an improvement on the earlier tax regime, it is still far from an ideal GST structure. The revenue performance of both the Centre and the States did not come up with the expectations due to various reasons that remain unresolved even after the seven and a half years of the implementation of the GST. The huge unsettled portion remaining in the IGST kitty should be cleared without further delay to the respective states. Also, it is important to consider the feasibility of continuing the GST compensation Cess even after the repayment of borrowing. Both these factors can relieve the States from their fiscal stress to a greater extent.

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