KERALA ECONOMY
2021, VOL. 2, NO.10-11-12. pp 4-13

ISSN : 2583-4436

Kerala's GST Revenue conundrum:

A preliminary exploration within the fiscal federal context

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The Problem

Recent empirical evidence from Indian states suggests that tax GSDP ratio, a common measure of tax effort, tends to move southwardly as the state's per capita GSDP crosses certain threshold level (Mohan and Shyjan 2021). Hence states with relatively higher level of per capita income like Kerala and also its neighboring state, Tamil Nadu, are confronted with the issue of low own tax revenue to GSDP, which in turn adversely affects the fiscal health of the state concerned. Goods and Services Tax (GST), made possible thanks to the sacrifice of fiscal autonomy by the states (Joseph and Ramalingam 2020) and implemented with great expectations, seems to have not made any major change. In fact, for Kerala there was a significant slip between the cup and the lip. The point needs further elaboration as the focus of this article Centres on this issue.

Here a comparative analysis of growth in revenue during the VAT period and the subsequent period is in order (see Table 1). The Table provides data on VAT/GST collection by the state of Kerala; the first six years pertains to the VAT period and the last four years wherein GST was in operation. The average growth rate recorded during the VAT period (2011-12 to 2016-17) was as high as 13% - only marginally lower than the threshold for getting entitled to GST compensation. However, as we move to the post GST period the observed growth rate was significantly lower compared to that of the VAT period. While we hasten to recognize the abnormal years during the post GST period, the growth rate (12.3%) even during the normal year (2018-19) was lower than that recorded during the VAT period. No wonder, Kerala turned out to be one of the states wherein the fiscal health is crucially dependent on GST compensation. In a context wherein, the compensation sky still remains cloudy, the fiscal uncertainty confronted by the state gets further heightened. In this context wherein the central concern of this paper is to undertake a preliminary exploration of the factors underlying Kerala's poor tax performance under GST within the fiscal federal context, given the inexorable link between Kerala's fiscal health and the fiscal decisions of the Centre.

Table 1: Trend in VAT and GST collection in Kerala

Year	VAT / GST collection (in crore)	Annual Growth rate (%)
2011-12	9803	
2012-13	12171	24.16
2013-14	13513	11.03
2014-15	14605	8.08
2015-16	16131	10.45
2016-17	18474	14.52
2017-18*	19020	3.0
2018-19	21366	12.3
2019-20	20316	-4.9
2020-21	20255	-0.3

Source: Commercial Taxes Dept/ SGST Dept, Govt of Kerala,
Compensation amount is not included in GST collection.
*In 207-18 data includes VAT and GST collection

It is well-known that GST was a half-baked cake hastily dished out to Indians and that considerable changes have taken place in GST through over 650 notifications. Frequent changes in GST law and procedures naturally created difficulties in the smooth functioning of the system. Technological glitches turned the situation from bad to worse. While many of these problems are told to be getting resolved, the fiscal federal relations show no indications of any significant improvement. Hence our focus on fiscal federal relations: but this is not to side-line the importance of other issues in understanding GST revenue collection.

Analytical background

It is a challenging task to design and implement Goods and Services Tax (GST) reforms in countries with federal constitutional structures (Due, 1990; Tait, 1988). The problems get compounded in developing country federations (Bird and Gendron, 2007; Gillis et al., 1990) and the case of India being no exception. Hence the introduction of the Goods and Services Tax (GST) in India has often been considered as a landmark reform in India's tax system since independence. There are many expected returns from GST even in a developing country (Rao R K, Mukherjee, S & Bagchi, A 2019). Yet, GST legislation in India had to wait for nearly 17 years of deliberations on account of a host of factors and the fear of loss of autonomy of the states wherein states account for around 60% of the combined government expenditure and collect only around 40% of the combined revenue (Isaac et al. 2019) being a prominent one. Govinda Rao stated "There is no unique GST and there are different models covering a variety of activities in different countries depending on what is politically acceptable" (Rao 2011).

Hence the new dual GST paradigm brought out through various institutional innovations, by harnessing the inbuilt scope for flexibility under GST (Bird and Gendron 2007) that led to the "Indianized" dual GST in July 2017 was destined to be cognizant of the imperative of addressing various complexities including the concerns of the states. Viewed thus, the fiscal health of the states is bound to be conditioned by the GST paradigm adopted by the country. GST is designed on the principle of destination- based consumption taxation, with seamless provision for input tax credit after subsuming VAT, Central Excise and various other indirect taxes of the Centre and states while ensuring revenue neutrality.

The revenue neutrality, ensuring equality between ex ante and ex post tax revenue, is a sine qu non for the acceptability of any tax reform. The estimated Revenue Neutral Rate (RNR) was 13.3 per cent for Centre (in two rate regimes with a lower rate of 6 per cent) and 14.8 per cent for states. (NIPFP, 2014). However, the report on RNR by Subramanian recommended an RNR of 15 to 15.5%. The Committee also observed that there should not be large shifts in the tax base in moving to the GST, implying that overall compensation may not be large. The Rate Fitment Committee appointed by GST Council recommended the rates under GST after taking into account the pre -GST period tax incidence (on account of Central Excise, Services tax and VAT (including cascading on account of these taxes) as well as the embedded taxes and the incidence of GST, Octroi, Entry tax etc. (Minutes of 14th GST Council, 18 -19 May 2017). Hence, in order to protect revenue neutrality, the Fitment Committee considered pre - GST tax incidence. In what follows we shall focus on two issues that are primarily in the domain of Centre state fiscal relations; tax sharing between Centre and States under GST and loss of revenue neutrality.

India's tax sharing in GST

GST in India is a tax on "supply" of goods or services as against the concept of tax on manufacture of goods or on sale of goods or on provision of services. GST is based on the principle of destination- based consumption taxation. It is a dual GST with the Centre and the States simultaneously levying it on a common base. By design GST revenue has got three components. The GST levied by the Centre is called as Central Good Services Tax (CGST) and that levied by the Stat is called State Goods and Services Tax (SGST). Union territories without legislature levy Union territory Goods and Services Tax (UTGST). An Integrated Goods Services Tax (IGST) is levied on inter-State supply (including stock transfers) of goods or services. Import of goods is treated as inter-State supplies and is subject to IGST in addition to the applicable customs duties. Import of services is also treated as inter-State supplies and is subject to IGST. The rates on each of these component is mutually agreed upon by the Centre and the States under the aegis of the GST Council. GST is applicable to all goods and services except alcohol for human consumption and petroleum products.

GST replaced the following taxes which were levied and collected by the Centre: a) Central Excise Duty, b) Duties of Excise (Medicinal and Toilet Preparations), c) Additional Duties of Excise (Goods of Special Importance), d) Additional Duties of Excise (Textiles and Textile Products), e) Additional Duties of Customs (commonly known as CVD), f) Special Additional Duty of Customs (SAD), g) Service Tax and h) Cesses and surcharges insofar as they relate to supply of goods or services.

State taxes which were subsumed in the GST are: a) State VAT, b) Central Sales Tax, c) Purchase Tax, d) Luxury Tax, e) Entry Tax of all forms; f) Entertainment Tax (except those levied by the local bodies), g) Taxes on advertisements, h) Taxes on lotteries, betting and gambling and i) State cesses and surcharges insofar as they relate to supply of goods.

Table 2 presents data on total GST collection in India and its three major components - CGST, SGST and IGST - since the introduction of GST in July 2017. Out of the four years for which data is presented, data for 2017-18 is only for eight months and that for the terminal year refers to the period of once in a century pandemic that caused unprecedented disruptions in the economy. Thus, there are only two years that could be considered a normal period. During this period, the total GST collection increased from Rs. 10.8 lakh crores in 2018-19 to Rs. 11.2 lakh crores in 2019-20 recording a growth rate of 3.7%. During the subsequent year, the total collection declined to Rs. 10. 5 lakh crore, with the recorded growth rate being -6.3 percent with GDP growth being -7.4 percent. However, the state's share in total GST (SGST and IGST share) increased by 19.8% during 2019-20 and that of the Centre recorded a much higher growth of 22.5%. As a result, as is evident from Table 2, while the share of the states in total GST increased only by 4.5% during the period under consideration (from 38.7% to 43.2%) that of the Centre increased by 6.5% (30.7% to 37.2%) indicating an unequal sharing of GST revenue between the Centre and the states.

In the GST collection, major share is accounted for by IGST, constituting around 55 per cent of collection except in 2019-20 (52 per cent) (see Table 2). An important point to note here is that half of the IGST collection comes from imports from other countries. When it comes to sharing of IGST, it remains as a black box and there is no clarity in the sharing of IGST from imports with states. The available data on imports on IGST gives only a consolidated picture. A clear understanding of the distribution of IGST on imports is yet to materialize with more data analytics.

The major issue, however, is with the sharing of IGST which is to be shared between the Centre and the states through the clearing house mechanism to be facilitated by the GSTN. The table indicates that notwithstanding a decline in the share of unshared IGST revenue from over 30% in 2017-18 to 19.6% in 2020-21 a substantial part of the IGST remains not shared. Here it is important to note that during the introduction of GST, it was envisaged that whatever amount available in the IGST account will be distributed as SGST and CGST. However, the available evidence tends to indicate that the actual experience belied our expectations costing dearly to the fund - starved states.

Table 2: GST collection in India during 2017-18 to 2020-21:
A disaggregated picture (Rs Crore)

Category	**2017-18**	**2018-19**	**2019-20**	**2020-21**
CGST	118900.7 (18.1)	202418.2 (18.7)	227444.5 (20.2)	209659.4 (20.0)
SGST	171850.2 (26.1)	278788 (25.8)	309233.1 (27.5)	272513.4 (26.0)
IGST including imports	366450.3 (55.8)	598746.4 (55.4)	586698.8 (52.2)	565514.8 (54.0)
Total GST	**657201.2**	**1079953**	**1123376**	**1047688**
States’ share in GST (Rs. Crore)	254453.2	418897.6	501742.7	452397.5
Centre’s share GST (Rs. Crore)	201503.6	342527.8	419954.1	389543.5
Share of States in GST (%)	38.72	38.79	44.66	43.18
Share of Centre in GST (%)	30.66	31.72	37.38	37.18

Balance in IGST account (%)	30.62	29.49	17.95	19.64

Note: states share of GST is the sum of SGST and states share in IGST settlement.
Source: Author’s calculation based on GSTN data

Reduction of GST rates and loss of revenue neutrality

Revenue Neutral Rate (RNR) under GST means the rates that protect the desired revenue after subsuming the existing taxes. The Rate Fitment Committee appointed by GST Council recommended the rates under GST after taking into account the pre GST period tax incidence (on account of Central Excise, Services tax and VAT (including cascading on account of these taxes) as well as the embedded taxes and the incidence of GST, Octroi, Entry tax etc.(Minutes of 14th GST Council, 18and 19, May, 2017).

GST rates were fixed based on the revenue neutrality principle. There are four tax rates namely 5%, 12%, 18% and 28% under GST. The tax rates for different goods and services are notified. Besides, some goods and services are under the list of exempted items (e.g. fresh vegetables, fresh fish, fresh meat, live animals, fresh milk, curd, lassi, butter milk etc). Rate for precious metals is an exception to four-tax slab-rule and the same has been fixed at 3%. In addition, unworked diamonds, precious stones, etc. attract a rate of 0.25%. A cess over the peak rate of 28% on certain specified luxury and demerit goods, like tobacco and tobacco products, pan masala, aerated waters, motor vehicles, is imposed to compensate States for a period of five years for any revenue loss on account of implementation of GST.

In response to the request from business community barely four months after the introduction of GST, the Central Government, based on the recommendation of GST Council, reduced the tax rates of around 200 items of goods from 28% to 18% (as per notification No.41/2017). This in turn reduced the tax collection of many states and turned out to be against the revenue neutrality concept that was adhered to the initial rate fixation by considering the revenue protection from subsumed revenue of states. As a result, at present only 32 commodities have 28% tax rate as compared to 229 commodities when GST was initiated.

Since Kerala is a consumer state with around 70 per cent of the goods being taxed at 14.5 per cent during the VAT period, a decline of tax rate to 9 per cent (SGST) has affected the revenue collection under GST. This decline in tax rate has affected the overall GST collection of States. Table 3 presents our estimates on the impact of rate changes on GST collection compared to the VAT period. Before GST, the majority of commodities attracted a tax rate of

12 per cent Excise duty and 14.5 per cent Value Added Tax including cascading of taxes. Under GST, for many of the commodities, the rates were fixed at 28 per cent by considering revenue neutrality. An analysis of rate reduction under GST compared to VAT period observed that there has been 40 per cent reduction in rate of tax and the corresponding reduction in tax revenue when compared to VAT even without considering the plausible increase of sales in Kerala.

It is evident from Table 3 that out of 19 commodities, 13 of them had 14.5 per cent tax during the pre-GST period, i.e., in 2015-16. During the pre-GST period, rate of majority of the commodities was under 14.5 per cent category of VAT. It was pointed in the GST Council meeting by the then Finance Minister of Kerala that 70 per cent of the VAT revenue emanated from goods that attracted the VAT rate of 14.5 per cent and that the same weight of the goods should have been there for 28 per cent tax slab under GST but this weight was only 20 per cent (Minutes of 14th GST Council, 18 and 19, May, 2017). It is clear that though revenue neutrality is considered during the finalization of GST rates, the concern of Government of Kerala was not addressed as only 21 per cent of the commodities came under the 28 per cent category. From Table 3 it is evident that the tax collection from 19 commodities during the pre-GST period amounted to Rs 9282.86 crore in Kerala. With the introduction of GST there has been a reduction of Rs 1242 Crore in the tax revenue and with further reduction in GST rates from 28% to 18% and 12% total loss from 19 commodities under consideration further increased to Rs 2034 Crore (Table 3). This decline has been beyond the control of the state of Kerala as the rate changes were based on the decision of the GST Council. This is a clear indication of the loss of revenue neutrality due to high-pitched rate reduction. Hence any inquiry into the reasons for the less than expected performance of the GST revenue for the state will lead to the door steps of loss of revenue neutrality, a basic precondition for the acceptability of any tax reform. No wonder the state of Kerala turned out to be one of the states where in fiscal health is contingent on the GST compensation.

It must be noted that the tax rate was reduced to 18 per cent or 12 per cent from 28 per cent, there has been no corresponding reduction in the price of those commodities. The intention of rate reduction was in anticipation of a corresponding reduction in the price of those commodities and thereby benefiting the consumers. But it has been found that while the prices are flexible upwards with increase in taxes, it is rigid downwards with reduction in taxes. Thus while the states, the Centre and the consumers have at large lost, the gain has been limited to those business aiming at profiteering. Hence a case could be made for reinstating the rates of those commodities which were under 28 per cent at the initial period of GST implementation. This will improve the revenue collection of states and ensure revenue neutrality leading to a reduction in the demand for GST compensation by the states.

Table 3: Comparison of VAT and GST rates and tax collection and the changes therein for selected commodities in Kerala (Rs crore)

Sl.No	**Item**	**VAT collection 2016-17**	**Rate of Tax under VAT (%)**	**SGST Rate of Tax as on 01/ 07/2017 (%)**	**New SGST Rate of Tax from 15/11/2017 (%)**	**Decline in tax collection as on 0/07/2017**	**Decline in tax collection as on 15/11/2017**
1	Motor vehicle	2638.33	14.5	14	14	91	91
2	Cement	1057.03	14.5	14	14	36	36
3	Tobacco products	879.13	14.5	14	14	30	30
4	Medicine	635.3	5	2.5	2.5	318	318
5	Gold*	629.65	5	1.5	1.5	101	101
6	White Goods	456.56	14.5	14	9	16	173
7	Iron & Steel	387.6	5	2.5	2.5	194	194
8	Electrical Goods	386.29	14.5	14	9	13	147
9	Paint	378.64	14.5	14	9	13	144
10	Tiles	337.43	14.5	14	9	12	128
11	Readymade garments	301.91	5	2.5/6	2.5/6	100	100
12	Electronic Goods	259.75	14.5	14	9	9	99
13	Rubber	202.02	5	2.5	2.5	101	101
14	Marble & Granites	159.62	14.5	14	9	6	61
15	Chicken	128.71	14.5	0	0	129	129
16	Hill Produce	124.78	5	2.5	2.5	62	62
17	Plywood	123.66	14.5	14	9	4	47
18	Timber	123.27	14.5	14	9	4	47
19	Glass	73.28	14.5	14	9	3	28
		9282.96				1242	2034

*compounding. Revenue loss for 40 per cent of turnover
Author's calculation based on the data of Commercial Taxes Dept/ SGST Dept, Govt of Kerala,.

Conclusion

The focus of this article has been to undertake a preliminary exploration on how to account for the sluggish performance of Kerala with respect to GST revenue since the introduction of GST as compared to the pre-GST period. The focus of enquiry has been with respect to the fiscal federal relations between the Centre and the states. It is observed that there is substantial share of GST collection remaining in the IGST account. During the introduction of GST, although it was envisaged that whatever amount available in the IGST account would be distributed as SGST and CGST. However, the practical experience has gone against the initial promises and huge amount is pending with IGST account wherein it is beneficial neither to the states nor to the Centre. This could be one of the reasons for the coincidence of higher GST collection and lower GST revenue realisation by the state governments. This is a clear indication of GSTN implementation flaws of GST especially in the IT-enabled platform.

From the analysis, it is observed that the revenue position of Kerala has not improved much during the GST period as compared to VAT period. The state has been, therefore, forced to survive with GST compensation from the Centre. This is against the initial objective of protecting revenue neutrality or more revenue generation to central and state governments. Revenue neutrality was ensured while fixing the rate of tax during the initial period of introduction of GST. But subsequent reduction in tax rate has led to the loss of revenue neutrality and substantial revenue loss for states like Kerala. Since the benefit of reduction in the tax rate has not been passed to the consumers by way of reduced prices, the only beneficiary of the rate reduction turned out to be the business by heightened pursuit of profiteering. Hence one of the major reasons for the decline in GST revenue in Kerala could the loss of revenue neutrality which in turn leading to increase in compensation requirement of state. Hence it is suggested to reinstate the rates of those commodities which were under 28 per cent at the initial period of GST implementation. This will improve the revenue collection of states and consequently the compensation requirement will reduce. Hence, until revenue neutrality is ensured, any attempt to do away with GST compensation cannot be justified.

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