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Goods and Services Tax: GST to have a positive impact on state government finances

MUMBAI: Implementation of goods and services tax (GST) will have a positive impact on state governments' finances in the medium to long term, according to a report by ratings firm India Ratings. Even in the short term, the impact on individual states varies across states, it said .

GST, a process towards standardisation of taxes across the country, is being criticised for its near term impact on inflation and to some extent impacting states' autonomy in deciding tax rates.

Nine state-level taxes included in GST are: state value added tax, central sales tax, purchase tax, luxury tax, entry tax (all forms), entertainment tax (except those levied by local bodies), taxes on advertisements, taxes on lotteries, betting and gambling and state cesses and surcharges insofar as they relate to the supply of goods or services. However, taxes on income, property and capital transactions, petroleum products, state excise and electricity duty are not part of GST and states would continue to levy and collect these in the same manner as earlier.

At an aggregate level, the state taxes that are subsumed in GST accounted for 55% of states' own tax revenue and grew at 14.0% during FY12-FY17, the report said. This will be the rate at which if state taxes that are subsumed in GST grow in FY18 over FY16, then centre will not be required to compensate states for any revenue loss. However, there are wide variations across states, with subsumed GST taxes growing at just 8.47% for Punjab during FY12-FY17 but 39.70% for Telangana.

GST revenues of all states combined will grow at a CAGR of 16.6% in FY18 over FY16, according to India Rating's calculations. However, since the picture at the individual state level differs, eight states namely Andhra Pradesh, Chhattisgarh, Gujarat, Himachal Pradesh, Madhya Pradesh, Odisha, Punjab and Tamil Nadu would need compensation from the central government for any revenue loss under baseline scenario. This would cost INR56 billion to the central government in FY18.

As post introduction of GST, input tax credit is available on both goods and services, Ind-Ra's calculation shows that the growth of GST component of states' own tax revenue for all states in such a case would drop to 15.5% in FY18 (base line scenario 16.6%) and three more states namely, Goa, Jammu and Kashmir and Jharkhand would require compensation from the central government. The total compensation amount therefore would increase to Rs 95 billion in FY18 (baseline scenario: Rs 56 billion). This is based on the assumption that in the final production of goods and services, service tax accounts for 10%.

Like the state VAT which was rolled out from April 2005 to January 2008, implementation of GST will also bring in some efficiency gains. If we combine the 5% efficiency gain with 10% input tax credit on services tax, then only five states namely Chhattisgarh, Gujarat, Odisha, Punjab and Tamil Nadu would need compensation from the central government and the total compensation amount would drop to Rs 37 billion in FY18.

To be able to absorb the positive impact of GST on state finances, states will have to keep a constant vigil on the buoyancy of taxes that are outside the purview of GST as also their own non-tax revenue, India Ratings said.

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