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GST COMPENSATION CESS

GST compensation cess would need to be re-purposed after March 2026; energy transition or bringing POL into GST could be considered as end-uses

SEPTEMBER 2024

Highlights

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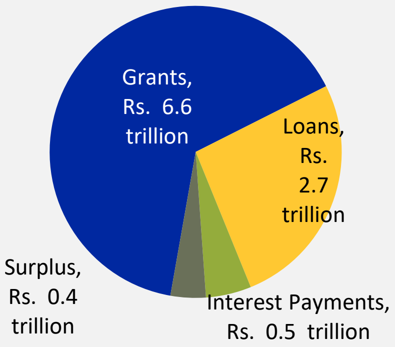
Exhibit: Composition of outflows from the GST Compensation Fund as per the GoI



Source: News reports; ICRA Research

The levy of the goods and services tax (GST) compensation cess had been extended until March 2026. If it is to be levied beyond this date, the purpose for that would need to be identified, as a cess can be imposed only for a specific purpose. One potential option is to revamp it into a "green cess", to channelise such collections to finance green infra projects and energy transition requirements, for achieving India's climate goals. Additionally, the petroleum, oils, and lubricants (POL) products can be brought under the GST regime and the cess proceeds can be used for compensating the state governments for losses, if any, due to this transition.

The GST compensation cess was initially imposed on specified items in July 2017, for a period of five years. Subsequently, its levy was extended until March 2026, to service the loans raised during the pandemic for providing GST compensation to the states. ICRA projects a surplus of ~Rs. 480 billion to remain after the repayment of back-to-back GST compensation loans by end-FY2026, slightly higher than the GoI's estimate of Rs. 0.4 trillion.

In its 54th meeting held in September 2024, the GST Council recommended forming a Group of Ministers (GoM) to study the future of the compensation cess beyond March 31, 2026, and determine how the surplus balance in the GST compensation fund will be used. If the cess is to be levied beyond March 2026, a specific purpose for that would need to be identified (as cess can be imposed only for a particular purpose and is outside the divisible pool) and a Constitutional amendment may also be needed.

One potential option is for the cess to be revamped into a "green cess", ensuring that such collections are used to finance green infra projects and energy transition requirements, for achieving India's climate goals.

Additionally, the POL products can be brought under the GST regime and the cess proceeds can be used for compensating the state governments for losses, if any, due to this transition. One rationale for including POL products in the ambit of GST, is to enable businesses to claim input tax credit on them, which would pare costs and enhance competitiveness. However, bringing POL products under the GST will reduce the fiscal autonomy of the states to modify sales tax rates at their discretion. Further, the variation in state sales tax rates on POL items would complicate the determination of compensation for revenue losses resulting from the inclusion of POL products under GST.

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Thank You!