Centre, states again spar over compensation for central sales tax losses

A fresh row has broken out between states and the centre over the compensation to the states for phasing out the central sales tax that could jeopardize the ongoing deliberations on the proposedgoods and services tax (GST).

In a strongly worded letter to Union Finance MinisterPranab Mukherjee, the empowered committee of state finance ministers has said the Centre's dithering on compensation could have adverse consequences on the process of tax reforms.

The letter, written by committee chairman and Bihar's deputy chief minister Sushil Modi, is in response to a communique from finance secretary R S Gujral that said the issue of CST compensation should be considered as "finally settled".

"I am afraid that this unilateral decision of the government, without even giving an opportunity to the states to put forward their point of view, is likely to adversely affect the process of tax reform in the country including the introduction of GST," Modi said in the letter reviewed by ET.

The committee's posturing marks an escalation in the long-running tussle between the Centre and oppositionruled states over the issue of CST compensation. States are demanding the compensation as they fear the GST will significantly dilute their revenues.

The GST has missed several deadlines for implementation because of the resistance from states. While the states accuse the Centre of shortchanging them, the Centre feels letdown because of the states' delay in arriving at a deal on GST.

The Centre and states had agreed to reduce the central sales tax, levied on inter-state goods sales, by 1% every year beginning 2007 and eliminate it by April 2010 when the unified GST was to be rolled-out. But the reduction in CST had to be stalled after 2009 because of the delay in implementing GST.

The compensation package for Rs 19,000 crore of estimated revenue loss included transfer of power to states to levy service tax on some services, removal of additional excise duty on tobacco products and textiles, value-added tax on imports, budgetary support and increase in floor rate of VAT.

While some elements of the package were implemented, some remained as negotiations on GST floundered. The Centre has already removed additional excise duty from tobacco, provided for budgetary support and transferred revenues from 33 existing services to states.

However, it is yet to bring the 44 new services under tax net or impose VAT on imports. States, on the other hand, also did not adhere to the provisions of the agreed package. Only a few of them raised the floor rate of VAT or imposed the tax on textiles.

In his letter, Modi has pointed out that the Centre and states had worked out a revised compensation package in 2008, guidelines for which were issued subsequently.

"The revised guidelines did not envisage any further non-monetary steps by states such as increasing VAT rate to 5% from 4%, or imposing tax on textile and sugar," Modi said in the letter. He also said the Centre did not raise the tax rate on declared goods in 2010-11 and that it could not penalise states for its own inaction.

Experts say it is imperative that the Centre and states bridge the trust deficit so that GST can be rolled-out quickly.

"The manner in which compensation would be given under GST, if any, should also be clearly laid down and agreed so that these disputes do not arise later," said Pratik Jain, partner, indirect and regulatory service at KPMG.

(Economic Times)