

GOODS AND SERVICES TAX (COMPENSATION TO STATES) ACT, 2017

The Goods and Services Tax (Compensation to States) Act, 2017 (“**the GST Compensation Act**”) provides a mechanism to compensate the States on account of loss of revenue which may arise due to implementation of the Goods and Services Tax read together with the Constitutional (One Hundred and First Amendment) Act, 2016, for a period of 5 years.

This Act, *inter-alia* provides:

- (a) That the base year during the transition period shall be reckoned as the financial year 2015-16 for the purpose of calculating compensation amount payable to the States;
- (b) That the revenue proposed to be compensated would consist of revenues from all taxes that stands subsumed into the GST law, as audited by the Comptroller and Auditor General of India;
- (c) For reckoning the growth rate of revenue subsumed for a State at 14% per annum;
- (d) That the compensation will be released bi-monthly based on the provisional numbers furnished by the Central Accounting Authorities and the final adjustment to be done after the accounts are subjected to audit by CAG;
- (e) That the revenue foregone on account of grant of exemption in the special categories State (Article 279A), be counted for the purpose of determining revenue for the base year 2015-16;
- (f) That the revenue of States directly devolved to Mandi / Municipalities would be considered as revenue subsumed;
- (g) Levy of a cess over and above the GST on certain notified goods to compensate States for 5 years on account of revenue loss suffered by them;
- (h) That the proceeds of the cess will be utilised to compensate States that warrant payment of compensation;
- (i) That 50% of the amount remaining unutilised in the fund at the end of the fifth year will be transferred to the Centre and the balance 50% would be distributed amongst the State and Union Territories in the ratio of total revenues from SGST / UTGST of the fifth year;
- (j) That 50% of the amount remaining unutilised in the fund, at any point of time in any financial year during the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance 50% shall be distributed amongst the States in the ratio of their base year revenue.

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Relevant provisions of the GST Compensation Act warranting attention are reproduced below:

2. Definitions:

- (c) “cess” means the goods and services tax compensation cess levied under section 8;
- (g) “input tax” in relation to a taxable person, means:
- (i) the cess charged on any supply of goods or services or both to him;
 - (ii) the cess charged on import of goods, and includes the cess payable on reverse charge basis;
- (p) “taxable supply” means a supply of goods or services or both which is chargeable to the cess under this Act;

8. Levy and Collection of Cess

(1) There shall be levied a cess on such intra-State supplies of goods or services or both, as provided for in section 9 of the Central Goods and Services Tax Act, and such inter-State supplies of goods or services or both as provided for in section 5 of the Integrated Goods and Services Tax Act, and collected in such manner as may be prescribed, on the recommendations of the Council, for the purposes of providing compensation to the States for loss of revenue arising on account of implementation of the goods and services tax with effect from the date from which the provisions of the Central Goods and Services Tax Act is brought into force, for a period of five* years or for such period as may be prescribed on the recommendations of the Council :

Provided that no such cess shall be leviable on supplies made by a taxable person who has decided to opt for composition levy under section 10 of the Central Goods and Services Tax Act.

*This 5 years period has been further extended by Notification 1/2022-Compensation for a further period up to 31st March 2026 by introduction of Goods and Services Tax (Period of Levy and Collection of Cess) Rules, 2022.

(2) The cess shall be levied on such supplies of goods and services as are specified in column 2 of the Schedule, on the basis of value, quantity or on such basis at such rate not exceeding the rate set-forth in the corresponding entry in column 4 of the Schedule, as the Central Government may, on the recommendations of the Council, by notification in the Official Gazette, specify.

Provided that where the cess is chargeable on any supply of goods or services or both with reference to their value, for each such supply the value

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shall be determined under Section 15 of the Central Goods and Services Tax Act for intra-State and inter-State supplies of goods or services or both.

Provided further that the cess on goods imported into India shall be levied and collected in accordance with the provisions of Section 3 of the Customs Tariff Act, 1975(51 of 1975), at the point when duties of customs are levied on the said goods under Section 12 of the Customs Act, 1962 (52 of 1962), on a value determined under the Customs Tariff Act, 1975.

9. Returns, Payments and Refunds

(1) Every taxable person registered making a taxable supply of goods or services or both, shall –

- (a) Pay the amount of cess as payable under this Act in such manner;*
- (b) Furnish such returns in such forms, along with the returns to be filed under the Central Goods and Services Tax Act; and*
- (c) Apply for refunds of such cess paid in such form, as may be prescribed.*

(2) For all purposes of furnishing of returns and claiming refunds, except for the form to be filed, the provisions of the Central Goods and Services Tax Act and the rules made thereafter, shall, as far as may be, apply in relation to the levy and collection of the cess leviable under section 8 on all taxable supplies of goods or services or both, as they apply in relation to the levy and collection of Central Tax on such supplies under the said Act or the rules made thereunder.

10. Crediting proceeds of Cess to Fund

(1) The proceeds of the cess leviable under section 8 and such other amounts as may be recommended by the Council, shall be credited to a non-lapsable Fund known as the Goods and Services Tax Compensation Fund, which shall form part of the public account of India and shall be utilised for purposes specified in the said section.

(2) All amounts payable to the States under section 7 shall be paid out of the Fund.

(3) Fifty per cent. of the amount remaining unutilised in the Fund at the end of the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance fifty per cent. shall be distributed amongst the States in the ratio of their total revenues from the State tax or the Union territory goods and services tax, as the case may be, in the last year of the transition period.

¹[(3A) Notwithstanding anything contained in sub-section (3), fifty per cent. of such amount, as may be recommended by the Council, which remains unutilised in the Fund, at any point of time in any financial year during the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance fifty per cent. shall be distributed amongst the States in the ratio of their base year revenue determined in accordance with the provisions of section 5:

Provided that in case of shortfall in the amount collected in the Fund against the requirement of compensation to be released under section 7 for any two months' period, fifty per cent. of the same, but not exceeding the total amount transferred to the Centre and the States as recommended by the Council, shall be recovered from the Centre and the balance fifty per cent. from the States in the ratio of their base year revenue determined in accordance with the provisions of section 5.]

(4) The accounts relating to Fund shall be audited by the Comptroller and Auditor General of India or any person appointed by him at such intervals as may be specified by him and any expenditure in connection with such audit shall be payable by the Central Government to the Comptroller and Auditor-General of India.

(5) The accounts of the Fund, as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be laid before each House of Parliament

11. Other Provisions Relating to Cess

(1) The provisions of the Central Goods and Services Tax Act and the rules made thereunder, including those relating to assessment, input tax credit, non-levy, short-levy, interest, appeals, offences and penalties, shall, as far as may be, *mutatis mutandis* apply in relation to the levy and collection of the cess leviable under Section 8 on the intra-State supply of goods and services, as they apply in relation to the levy and collection of Central Tax on such intra-State supplies under the said Act or the rules made thereunder.

(2) The provisions of the Integrated Goods and Services Tax Act, and the rules made thereunder, including those relating to assessment, input tax credit, non-levy, short-levy, interest, appeals, offences and penalties, shall *mutatis mutandis* apply in relation to the levy and collection of the cess

¹ Inserted vide The Goods and Services Tax (Compensation to States) Amendment Bill, 2018 read with Notification No. 1/2019 – Goods and Services Tax Compensation dated 29.01.2019 - w.e.f. 01.02.2019.

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leviable under Section 8 on the inter-State supply of goods and services, as they apply in relation to the levy and collection of Integrated Goods Tax on such inter-State supplies under the said Act or the rules made thereunder.

Provided that the input tax credit in respect of cess on supply of goods and services leviable under Section 8, shall be utilised only towards payment of said cess on supply of goods and services leviable under the said Section.

Goods and Services Tax (Period of Levy and Collection of Cess) Rules, 2022²

Short title and commencement.-

1. (1) These rules may be called the Goods and Services Tax (Period of Levy and Collection of Cess) Rules, 2022.

(2) They shall come into force with effect from the 1st day of July, 2022.

Period for levy and collection of Cess.-

2. The period for levy and collection of cess under sub-section (1) of section 8 of the Goods and Services Tax (Compensation to States) Act, 2017 shall be up to the 31st March, 2026.

Salient features of the GST Compensation Act:

I. Levy of cess:

- GST Compensation Cess (under section 8 of the Act) will be levied on all intra-State and inter-State supplies of goods or services or both, including import of goods.
- The cess shall be levied on supplies based on value, quantity or such rate not exceeding the rate stipulated in Schedule of the GST Compensation Act. The extract of this Schedule is as under:

S. No.	Description of supply of goods or services	Tariff heading, Chapter, supply goods or services, as the case may be	item, sub- or of cess may be collected	The maximum rate at which goods and services tax of compensation may be collected
(1)	(2)	(3)	(4)	
1.	Pan Masala.	2106 90 20		135% ad valorem.

² Inserted vide Notf. No. 01/2022-Compensation Cess dt. 24.06.2022

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2.	<i>Tobacco and manufactured tobacco substitutes, including tobacco products.</i>	24	<i>Rs. 4170 per 1000 sticks or 290 % ad valorem or a combination thereof, but not exceeding Rs. 4170 per 1000 sticks plus 290 % ad valorem</i>
3.	<i>Coal, briquettes, ovoids and similar solid fuels manufactured from coal, lignite, whether or not agglomerated, excluding jet, peat (including peat litter), whether or not agglomerated.</i>	2701, 2702 or 2703	<i>Rs. 400 per tonne.</i>
4.	<i>Aerated waters.</i>	2202 10 10	<i>15% ad valorem.</i>
4A	<i>Motor vehicles for the transport of not more than 13 persons, including the driver.</i>	8702 10, 8702 20, 8702 30 or 8702 90	<i>25 % ad valorem.</i>
5.	<i>Motor cars and other motor vehicles principally designed for the transport of persons (other than motor vehicles for the transport of ten or more persons, including the driver), including station wagons and racing cars.</i>	8703	<i>25 % ad valorem.</i>
6.	<i>Any other supplies.</i>		<i>15 % ad valorem.</i>

- It may be noted that the actual rates of cess are provided vide Notification No.1/2017-Compensation Cess (Rate) dated 28.06.2017.

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- The Cess would not be leviable on supplies made by a person who has opted for Composition levy.
- Those supplies that are liable to tax with reference to their value (i.e., all supplies except coal, briquettes and similar solid fuels), are to be determined based on the valuation provisions under section 15 of the CGST Act.
- The cess levied under this Act would be payable over and above the CGST, SGST/UTGST and IGST tax leviable on. Cess would be levied on whole value exclusive of GST i.e., for Transaction value as per section 15 is Rs. 100 and GST Rate is 18% then Cess would be levied on Rs. 100 Calculation would be Rs. 100+18% GST+ % Compensation Cess (as specified).
- The cess on goods imported into India
 - shall be levied and collected as per section 3 of the Customs Tariff Act, 1975,
 - at the point when duties of customs are levied on the said goods under Section 12 of the Customs Act, 1962,
 - on a value determined under the Customs Tariff Act, 1975.
- **Dealer of second-hand goods:** The levy of Cess has been exempted on intra-State procurement of second-hand goods from an un-registered supplier when purchased by a registered person dealing in buying and selling of second hand goods and who pays the Cess on the margin basis of computation envisaged under rule 32(5) of the CGST Rules.
- **Old and used Motor Vehicles :** With effect from 13.10.2017, the Central Government reduced the rate of Cess to 65% which is otherwise payable on supply of motor vehicles which are purchased or leased before July 1, 2017 subject to the condition that such supplier has not availed input tax credit of Central Excise Duty or VAT or any other taxes paid thereon.

With effect from 25.01.2018, as a further relief measure, the Central Government has prescribed 'NIL' rate of Cess on supply of all old and used motor vehicles on which supplier has not availed CENVAT or VAT credit under the earlier regime or input tax credit in GST regime.

The scope and applicability of the notifications issued in respect of old and used motor vehicles (MV), can be better understood by a comparative analysis as summarised below:

Particulars	Notification No. 7/2017– Compensation Cess (Rate) dated 13.10.2017	Notification No. 1/2018 Compensation Cess (Rate) dated 25.01.2018
Scope	a. MV purchased and leased prior to July 1, 2017 which are	All old and used MVs Note: 1. Not applicable on

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	continued to be leased in GST regime b. MV purchased prior to July 1, 2017 and supplied in GST regime	lease transactions. 2. Can be purchased either before or after July 1, 2017
Rate of Cess	65% of Cess payable	NIL
Condition	Input tax credit (ITC) of Central Excise duty, VAT or any other taxes paid is not taken	ITC not taken in GST regime or CENVAT credit or VAT credit not availed in earlier regime

- **Refund of Cess upon Export:**

The exporter will be eligible to claim refund of Cess paid under the Act on export of goods on the similar lines as refund of IGST paid on exports. Further, Cess will not be charged on goods exported by an exporter under bond / LUT and refund of input tax credit of Cess relating to goods exported will be available on similar lines as refund of input taxes in relation to zero-rated supplies.

As per *Notification No. 3/2019 – Compensation Cess (Rate) dated 30.09.2019* for Tobacco and manufactured tobacco substitutes, no refund of unutilised input tax credit of compensation cess shall be allowed, where the credit has accumulated on account of rate of compensation cess on inputs being higher than the rate of compensation cess on the output supplies of such goods (other than nil rated or fully exempt supplies). Therefore, in case of inverted duty structure no refund is allowed.

- II. **Determination of Base Year Revenue:**

- The Compensation amount to be paid in any year during the transition period is to be computed taking the base year as 2015-16 only.
- The provisions of section 5(1) of the said Act lists the taxes imposed by State / Union that stand subsumed into the GST while the proviso to Section 5(1) lists out the taxes that shall not be included for calculation of base year revenue. The revenue collected by the States on account of the said taxed detailed in Section 5(1) of the Act alone would be considered for the determination of Base Year Revenue;
- The revenue collected would always be reckoned as 'net of refunds';
- The transition period will be the period of 5 years from the date when the respective SGST Acts commence.

- III. **Input Tax Credit and returns:**

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- Input tax credit on inward supplies liable to cess can be utilized only for payment of cess on outward supplies liable to cess under the Act.
- A taxable person effecting supplies chargeable to cess is required to file returns along with the returns prescribed under the CGST Act.

IV. General

- All provisions of the CGST Act and the IGST Act and the rules made thereunder, including input tax credit, assessment, appeals, offences, penalties, interest, non-levy and short levy will apply in relation to the levy and collection of cess on intra-State and inter-State supply, respectively.

***The Finance Act, 2023** sought to amend the Schedule to the Goods and Services Tax (Compensation to States) Act, 2017. The maximum rate at which GST Compensation Cess may be collected for items such as pan masala, tobacco and manufactured tobacco substitutes, including tobacco products have been revised and linked with retail sale price. Accordingly, a new explanation defining the scope of 'retail sale price' was proposed to be inserted therein.

Amendments to the Schedule to the GST (Compensation to States) Act, 2017 brought into force from 1st April, 2023

Amendments made in the Schedule to the Goods and Services Tax (Compensation to States) Act, 2017 by section 163 of the Finance Act, 2023 have been brought into force w.e.f. 01.04.2023 vide *Notification No. 01/2023-Compensation Cess dt. 31.03.2023*. The Schedule has been amended to revise the maximum rate at which GST Compensation Cess shall be collected for items such as pan masala, tobacco and manufactured tobacco substitutes, including tobacco products and to link the same with retail sale price. A new explanation defining the scope of 'retail sale price' has also been inserted therein.

Further, *Notification No. 01/2017-Compensation Cess (Rate) dt. 28.06.2017* which specifies the rate of GST Compensation Cess on goods has been amended vide *Notification No.2/ 2023-Compensation Cess (Rate) dt. 31.03.2023*.

