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EXCESSIVE OBSESSION WITH GST COMPENSATION CESS! THE RS 1.4 LAKH CROR E GAIN THAT THEY (☺) DIDN'T SEE... STATES REMAIN NET GAINERS EVEN POST DISCONTINUATION OF COMPENSATION CESS

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The recent GST rate rationalization marks an important milestone in the evolution of India's indirect tax framework. The former CEA et al. in a recent article in Business Standard *(Business Standard, July 17:GST re-labelling misleads and obscures)* have argued that following the discontinuation of the GST compensation cess, states would face revenue losses under the revised arrangement. However, such an analysis is half baked as it provides only one side of the story. When we look at a complete analysis, states emerge as net beneficiaries of the GST reform undertaken in September 2025 once the overall fiscal impact is carefully decoded.

Primarily, the **authors** in the aforesaid article have argued that the compensation cess levied on products such as tobacco, which was earlier transferred entirely to the states, has now been reclassified as an Additional Excise Duty (AED) and sub-sumed within the Basic Excise Duty (BED). Since BED forms part of the divisible pool and is shared between the Centre and states according to the Finance Commission's devolution formula, it is argued that states would lose the exclusive benefit they previously enjoyed from the compensation cess.

Our estimates indicate that after accounting for GST collections together with States' share in Basic Excise Duty, States are expected to be net gainers by approximately ₹1.43 lakh crore in FY27 compared with FY26. Under the revised frame-work, with the Compensation Cess discontinued and Additional Excise Duty introduced, States' combined share from GST and Basic Excise Duty is projected to increase to nearly ₹19.1 lakh crore in FY27 from Rs 17.7 lakh crore in FY26. There has been an increase in the overall share of the pie whose benefits will accrue to the states.

With the introduction of AED in Basic Excise Duty (BED) , in FY27, we have created a hypothetical scenario in which by assuming 20% growth over FY26 BED numbers, and assuming that this entire amount is AED , it is estimated at Rs 35,874 crore. While, under the old arrangement in FY26, this AED would have been given as compensation cess, and hence states receive 100% of it (i.e., Rs 35,874 crore). However, in the new arrangement, states receive 41% of AED which is Rs 14,708 crore. **This leads to a hypothetical loss of ~Rs 21,000 crore in FY27. This amount is miniscule when divided among all 28 states.**

Additionally, the impact of the revised tax structure from 28% to 40% on certain commodities such as pan and tobacco indicate that for an intra-State supply with a taxable value of ₹100, States earlier received ₹19.74 under the 28% GST regime Following the increase in GST on specified demerit goods from 28% to 40%, the States' share rises to ₹28.20. **Thus, the revised structure results in an additional ₹8.46 accruing to States compared with ₹3.54 for the Centre, clearly indicating that the benefits of higher taxation accrue to States as well.**

The Compensation Cess was never intended to constitute a permanent source of revenue for States. It was introduced under the GST (Compensation to States) Act, 2017 as a transitional arrangement pursuant to the constitutional guarantee under which assured States compensation for any revenue loss arising from the implementation of GST. According to GST Council data on taxes subsumed under GST, **States recorded an average annual growth of only around 8% in revenues from the taxes subsumed under GST during the pre-GST period, whereas SGST revenues have grown by nearly 13% on average during the post-GST period. Even after the withdrawal of the Compensation Cess, States' GST revenues are projected to grow by around 7% in FY27 over FY26, indicating that States continue to experience healthy revenue growth even without compensation support.** The Compensation Cess has fulfilled its intended role as a temporary transition mechanism.

Another misnomer that needs to be corrected is that cess was never revenue of the Centre because its proceeds ultimately went to the States. That is not quite correct. The cess was levied by the Union Government and appeared as a Union tax receipt subsequently transferred to GST Compensation Fund in the Public Account of India, which finally went to states as grants.

Going forward, we expect a rebound in the GST collections and yearly growth in the range of 8-9% and the moderation in collection is due to rate rationalization, which is on expected lines.

GST GROWTH WILL REBOUND IN FY27

- With the GST Rate rationalization in Sep 2025, the overall GST revenues (including the compensation cess) has declined to 5.6% for FY26, compared to 9.4% in FY25. Further, in Q1FY27, the YoY growth stands at 1.5% only with compensation cess of last year and 8.4% without including cess. Going forward, we expect a rebound in the GST collections and yearly growth in the range of 8-9% and the moderation in collection is due to rate rationalization, which is on expected lines.
- Post the discontinuation of compensation cess, it is being argued by some researchers that the States' share in overall GST has reduced and states are now facing losses in the range of Rs 15,000 to Rs 20,000 crore annually. We believe **that this argument is completely fallacious and in truth the States may be receiving ~Rs 1.43 lakh crore (table in the next page) more in FY27 as compared to FY26.**

GST Revenue over the years								
FY	Rs Lakh Crore						% YoY	
	CGST	IGST	SGST	GST	Compensation CESS	Overall GST	GST	Overall GST
	1	2	3	4=1+2+3	5	6=4+5	7	8
FY18	1.19	1.72	3.87	6.78	0.63	7.41	-	
FY19	2.02	2.79	5.99	10.80	0.97	11.77	59.3%	59.0%
FY20	2.27	3.09	5.87	11.23	0.99	12.22	4.0%	3.8%
FY21	2.10	2.73	5.66	10.48	0.88	11.37	-6.7%	-7.0%
FY22	2.69	3.44	7.62	13.76	1.08	14.83	31.2%	30.5%
FY23	3.24	4.10	9.45	16.79	1.28	18.08	22.1%	21.9%
FY24	3.76	4.71	10.27	18.74	1.45	20.18	11.6%	11.6%
FY25	4.14	5.16	11.25	20.56	1.53	22.09	9.7%	9.4%
FY26	4.44	5.51	12.31	22.27	1.05	23.32	8.3%	5.6%
FY27 P	5.08	6.06	14.13	25.27	0.00	25.27	13.5%	8.4%
Memo: Quarterly Progress								
Q1 FY26	1.2	1.5	3.2	5.8	0.40	6.22	12.4%	11.8%
Q1 FY27	1.27	1.52	3.53	6.32	0.00	6.32	8.4%	1.5%

STATES' SHARE IN OVERALL GST

- The GST Compensation Cess officially expired on 01 Feb 2026, ending its transitional purpose of bridging state revenue shortfalls. However, the Government has introduced additional excise duty (AED) through the Central Excise (Amendment) Act 2025, on "sin" goods like tobacco and pan masala, which has moved to 40% of GST from 28%.
- To know the impact of states revenue, we have calculated states' revenue share in GST as well as Basic excise duty (BED) pre and post implementation of the changes which were introduced in Feb/Mar'26.
- As per the old arrangement (with compensation cess) in FY26, states reced the full cess amount, along with FC devolution of 41% share in central taxes. So, the States' share was: **SGST + 41% of CGST and IGST plus the GST Compensation Cess.**
- However, in FY27, with the new arrangement (additional excise duty introduced) which is now included under Basic excise duty and devolved to the states as per the FC formula of 41%.
- The total GST collection for FY26 was Rs 23 lakh crore (including GST compensation cess) while the Basic Excise Duty (BED) was ~ Rs 45780 crore. States' share would thus be SGST + 41% of CGST and IGST and also 41% of Basic Excise duty. Thus, states' total share in GST and excise duty is ~ Rs 17.7 lakh crore.
- Under the new arrangement in FY27, **the states' share in GST (with 41% of BED) is projected to be ~ Rs 19.1 lakh crore. Thus, states' total gain becomes Rs 1.43 lakh crore.** Thus, the argument that states are in loss is completely flawed, rather GST rationalization has increased the pie and states are a beneficiary of this larger pie.

Old Arrangement (FY26) in Rs crore	
GST Compensation Cess	
1. GST Collection (CGST+IGST +SGST+ GST Compensation cess)	2331820
1.1 CGST	444310
1.2 IGST	551302
1.3 SGST	1231485
1.4 GST Compensation Cess	104723
2. States' share (SGST + 40% of CSGT +IGST+ Cess)	1744409
3. Basic Excise Duty (BED)	45780
4. States Total share of GST + 41%*BED	1763179
New Arrangement FY27 in Rs crore	
AED is part of BED	
5. GST Collection (CGST+IGST +SGST) P	2526795
5.1 CGST	507653
5.2 IGST	606359
5.3 SGST	1412783
6 States' share (SGST + 40% of CSGT +IGST)	1869528
7. Basic Excise Duty (AED included)	90810
8. States' share in BED	37232
9. States Total share of GST + 41%*BED	1906760
10. NET GAIN (9-4)	**143581**

Source: SBI Research; P: FY27 GST collection with break-up are SBI projections

A NOTE ON ADDITIONAL EXCISE DUTY (AED) & ITS CALCULATION

- With the introduction of AED in Basic Excise Duty (BED) , in FY27 the budget number exhibited a growth of 98% to Rs 90,810 crore from 45,780 crore in FY26. Though, AED is included in BED but the amount has not been disclosed separately by the Government but it was clearly mentioned that BED is presently leviable on specified petroleum products and tobacco and tobacco products in terms of entry no. 84 of List I of Seventh Schedule to the Constitution.
- The problem is that: the compensation cess goes to 100% to states while AED (as part of BED) will go to as per FC devolution formula (i.e., 41%). This indicate less revenue to the states. But how much is this? For this we need to find out the amount of AED?
- We have created a hypothetical scenario in which by assuming 20% growth over FY26 BED numbers, the FY27 calculated Excise duty only amount would be Rs 54,936 crore. Deducting this amount from overall BED (i.e., Rs 90,810 crore) leads to AED which is Rs 35,874 crore.
- While, under the old arrangement in FY26, this AED would have been given as compensation cess, and hence states receive 100% of it (i.e., Rs 35,874 crore). However, in the new arrangement, states receive 41% of AED which is Rs 14,708 crore. This ushers to a hypothetical loss of ~Rs 21,000 crore in FY27. This amount is miniscule when divided among all 28 states and trifling as compared to the ~Rs 1.43 lakh crore more that states are expected to receive in FY27 because of the larger pie.

A NOTE ON COMPENSATION CESS

- In public discourse, there is a common misconception that GST compensation cess was never revenue of the Centre because its proceeds ultimately went to the States. That is not quite correct. The cess was levied by the Union Government and appeared as a Union tax receipt. In the accounting sense, it was first collected and recorded by the Centre and was subsequently transferred to GST Compensation Fund in the Public Account of India, which finally went to states as grants.
- It may be noted that compensation cess of Rs 88,000 crore in FY26 is now been budgeted at nil in FY27. At the same time, the Budget estimates has raised the tax burden on tobacco via the Central Excise (Amendment) Act, 2025, which has discontinued the GST compensation cess and introduced a higher, fixed-per-stick excise duty, which is levied on top of a 40% flat GST.

Hypothetical Calculation of AED (Rs crore)

	FY24	FY25	FY26	FY27
6.01 Basic Excise duties	32047	39180	45780	90810
% YoY	-	22.3%	16.8%	98.4%
Of which,				
Excise Duties	Assuming 20% growth in FY27 over FY26			54936
and hence, AED				35874
Old arrangement: AED as part of compensation cess, states receive (100%)				35874
New arrangement: States receive 41% of AED				14708
New-Old				**-21166**

Source: Receipt Budget; SBI Estimation

- Thus the States will now get SGST share under GST and 41% of CGST under the collections Basic Excise Duties. For example: **consider an intra-State supply with a taxable value of Rs 100. At the old rate of 28%, states used to get Rs 19.74 and Centre Rs 8.26. (Rs 14 from SGST and Rs 5.74 from the FC devolution formula at 41%). In the current scenario, the increase from 28% to 40% GST lead to Rs 28.2 share for the states and Rs 11.8 for the Centre. (Rs 20 SGST + Rs 8.2 from CGST transfer to states). So the new arrangement has effectively led to an increase of Rs 3.54 for Centre and Rs 8.46 for the states.**
- **Given this, the loss due to excise (Estimated at ~ Rs 21000 crore) will further be minimized and become negligible.**

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