



STATE GOVERNMENT FINANCES - UPDATE JUNE 2020

Central tax devolution
to state governments
to be sharp 30% lower
than the budgeted level
of Rs. 7.8 trillion



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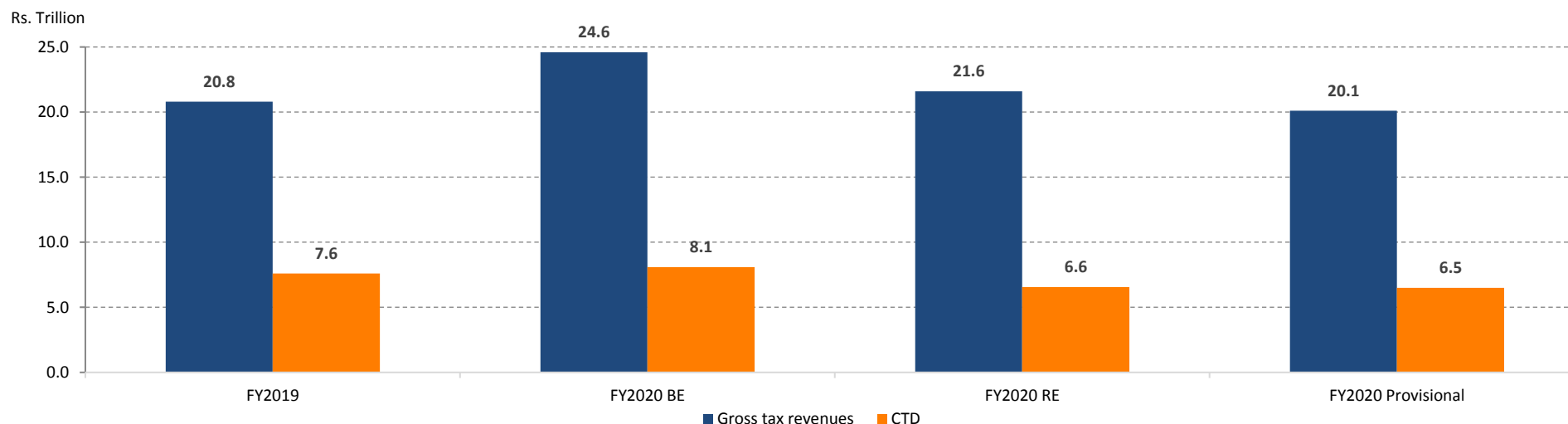
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The provisional data released by the Controller General of Accounts (CGA) has revealed that the Government of India's (GoI's) gross tax revenues contracted by 3.4% to Rs. 20.1 trillion in FY2020 from Rs. 20.8 trillion in FY2019 (refer Exhibit 1). Moreover, its gross tax revenues are a considerable Rs. 1.5 trillion lower than the level of Rs. 21.6 trillion forecasted in the revised estimates (RE) for FY2020; the extent of the shortfall is modestly higher than ICRA's estimate of Rs. 1.2-1.3 trillion.

With the Provisional data for FY2020 indicating that the gross tax revenues of the GoI were a sharp Rs. 1.5 trillion lower than the FY2020 RE, we estimate that the central tax devolution (CTD)¹ included by the GoI in its RE for FY2020 was around Rs. 537 billion higher-than-warranted, in line with our earlier forecast of Rs. 420-Rs. 550 billion. This amount would now be adjusted from the share in central taxes that would be devolved by the GoI to the state government in FY2021.

Exhibit 1: Trends in GoI's gross tax revenues and Central tax devolution



Source: Union Budget, CGA, ICRA research

¹ CTD is based on the recommendations of the successive Finance Commissions (FC) to the GoI regarding transferring a portion of its sharable taxes to the state governments. The Fourteenth FC had recommended that 42% of the sharable taxes of the GoI should be devolved to the states during its award period of FY2016-FY2020. We estimate that around 34%-37% of the GoI's gross tax collections (which includes various surcharges and cess that are not shareable with the state governments) were devolved to the states during FY2016-FY2019. However, in its Budget Estimates (BE) for FY2021, the GoI indicated that it would transfer Rs. 7.8 trillion as CTD, which is equivalent to a lower 32% of its estimate of gross tax revenues of Rs. 24.2 trillion for the current fiscal.

The provisional data published by the CGA for FY2020, indicates that the GoI transferred Rs. 6.5 trillion as CTD in FY2020, 14.5% lower than the Rs. 7.6 trillion devolved in FY2019. Moreover, this is Rs. 54 billion lower than the Rs. 6.6 trillion included in the revised estimates for FY2020. **Reducing this amount of Rs. 54 billion from our forecast of the FY2020 RE for CTD being Rs. 537 billion higher-than-warranted, the excess transfer of CTD to the state governments in FY2020 stood at around Rs. 484 billion, which would need to be adjusted in FY2021.**

Exhibit 2: ICRA's estimate of gross tax revenues and CTD for FY2021

Amount in Rs. Trillion	FY2021 BE	FY2021 Gross tax revenues of the GoI – ICRA estimates		
		20% lower than FY2021 BE	30% lower than FY2021 BE	40% lower than FY2021 BE
Gross tax revenues of the GoI	24.2	19.4	17.0	14.5
CTD of all states	7.8			
Estimated CTD in FY2021		6.8	5.9	5.1
Less excess CTD devolved in FY2020		0.5	0.5	0.5
Adjusted CTD estimated by ICRA		6.3	5.5	4.6

Source: CGA; ICRA research

In the ongoing fiscal, the tax collections of the GoI as well as of the state governments are expected to be considerably lower than the level forecast by them in their FY2021 budgets. This reflects the expected compression of consumption of several non-essential items during the period of the lockdown. Moreover, behavioural changes and economic uncertainty may delay the resumption of normal demand for discretionary goods and services even after the lockdown is lifted, which would continue to constrain tax collections.

In the Union Budget FY2021 presented on February 1, 2020, the GoI had indicated a 12.0% YoY growth in its gross tax revenues to Rs. 24.2 trillion. This growth assumption appeared challenging even prior to the escalation of the Covid-19 crisis, and now seems exceedingly unlikely. Significantly lower-than budgeted gross tax revenues in FY2021, would imply a sharp downward revision in the CTD for this year relative to the budgeted level of Rs. 7.8 trillion.

For estimating the CTD for FY2021, we have evaluated three scenarios, factoring in a shortfall of (a) 20% (b) 30% and (c) 40% relative to the budgeted level of the GoI's gross tax revenues of Rs. 24.2 trillion for FY2021. **Given the expected curtailment in non-discretionary consumption and impact of the pandemic on corporate profitability, job losses and income levels, our base case is that the GoI's gross tax revenues will be limited to Rs. 17.0 trillion, 30% lower than the FY2021 BE of Rs. 24.2 trillion (refer Exhibit 2). If the GoI transfers 35% of its gross tax revenues to the state governments in FY2021, in line with the past trend, ICRA estimates the aggregate CTD to all states would be Rs. 5.9 trillion for FY2021. Adjusting for the excess devolution of Rs. 0.5 trillion pertaining to FY2020 from the estimated CTD of Rs. 5.9 trillion, we estimate that the CTD of all states to be Rs. 5.5 trillion in FY2021, 30.5% lower than the CTD of Rs. 7.8 trillion included by the GoI in the budget estimates for FY2021, and a contraction of 16.2% relative to the amount transferred in FY2020.**

The BE of the GoI's gross tax revenues and the formula for CTD recommended by the FC, typically form the basis for the funds devolved each month during April-January of every fiscal year by the GoI as CTD to the states. Subsequently, based on the RE of the gross tax revenues included by it in the Union Budget (which is now typically presented on February 1 of the fiscal), the GoI adjusts the CTD that is released to the states for the months of February and March, to align it with the RE figure for both its gross tax revenues. If the actual gross tax collections of the GoI turn out to be different from the RE, the adjustment for the same is carried out in the subsequent fiscal year.

The Provisional data released by the CGA for April 2020 indicates that Rs. 460 billion was transferred to the states as CTD in that month, 7.1% lower than the amount of Rs. 495 billion transferred in April 2019, even though the FY2021 BE for CTD is 19.5% higher than the FY2020 RE for the same. ***This suggests that the GoI may have already started to adjust the monthly CTD in FY2021 for the excess amount devolved in FY2020, especially since its gross tax collections in April 2020 were a steep 44.3% lower than the level in April 2019.***



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