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Do states have space to lower VAT on petrol?

With rise in international oil prices in the last year retail price of petrol has moved up ever since the government linked the base price to global trends i.e. April onwards. The central government has provided relief in terms of excise duty cut first in Nov'21 and more recently in May'22. The message passed on to the states is that they too must try and lower their taxes to lower price of fuel products. However, the challenge for any government (centre or states) is that if taxes are reduced there would be a tendency for their tax collections to get affected. It is a zero sum game.

When the centre lowers the excise duty there is an automatic transmission to the base price on which the VAT is imposed and the revenue can get affected in parallel. The countervailing force is that as the base price increases with international price of crude going up there is a natural upside to the VAT revenue. The net effect is what matters.

The analysis below looks at the retail price of petrol in different states assuming that the basic price to the dealers plus excise charged by the centre and dealer commission is the same. The VAT rates are then superimposed on the base price of petrol for two points of time- November 4th and June 1st. The VAT rates as of April 1st have been used for all states as provided by PPAC. Some states have lowered their VAT rates subsequently, which is not considered here. The purpose is to analyze the fiscal space that is available to states to lower VAT rates on petrol given that the base price has changed with the centre lowering the excise duty by Rs 8 in May while the crude oil price rise has caused the cost for OMCs to increase.

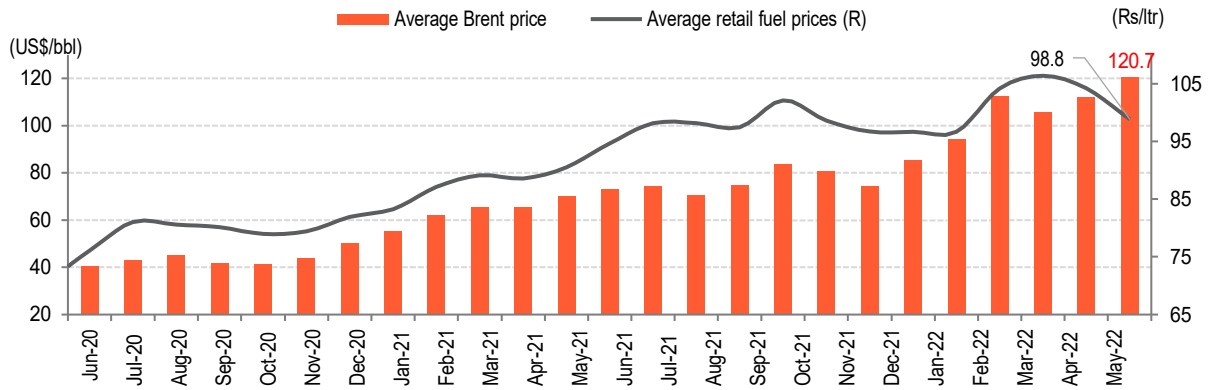
The base price for petrol was Rs 79.98/litre in November and after lowering of excise by Rs 8 in May, brought the base price to Rs 81.01, which is higher. This is so because in this period the crude oil price had gone up thus enhancing the cost to the OMC by Rs 9.10/litre (the dealer commission has come down marginally).

Some results

It has been observed that 16 States have made gain between 20-30 paise/litre due to the increase in oil prices combined with cut in excise duty of the centre, while for another 12 States, the gain has been between 10-20 paise/litre. Therefore it may be concluded that States have limited fiscal space to further cut VAT rates, in consonance with the current excise duty cut if they have to ensure that their revenue does not decrease.

Backdrop: International crude prices have risen considerably from its low of US\$ 19/bbl seen in Apr'20 during Covid-19 times. Now it is trading at +US\$ 120/bbl. The volatility in international oil prices was also seen in domestic retail prices of petrol and diesel. Domestic retail prices of petrol and diesel started increasing in tune with global oil prices. Petrol prices have risen from Rs 73/lt to Rs 113/lt between Apr'20 to Apr'22 and diesel prices from Rs 65/lt to Rs 100/lt. It is important to understand how the mechanism of pass through of international prices to domestic retail prices work.

Fig 1. Movement of international crude and domestic retail prices:



Source: CEIC, Bank of Baroda Research, Till 14 Jun 2022

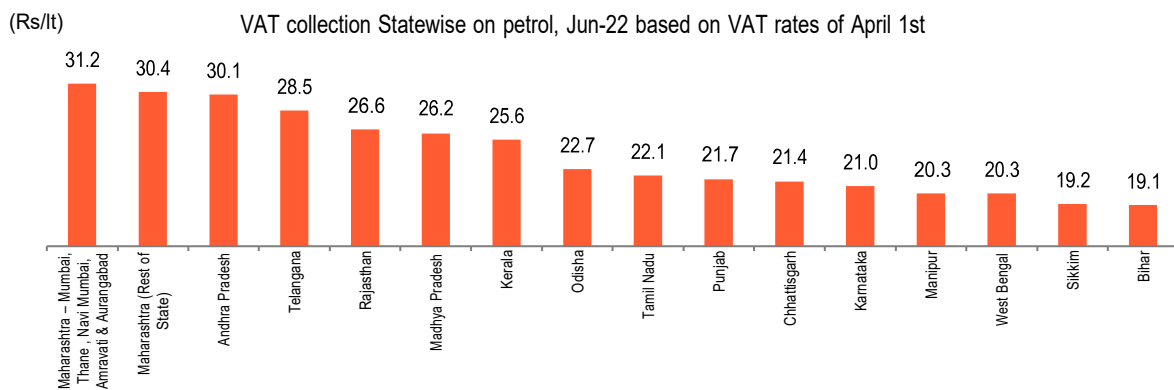
When retail price of petrol rose to Rs 109.7 as on 1 Nov 2022, government gave relief to the consumers by reducing petrol duty on petrol from Rs 32.9/lt to Rs 27.9/lt. VAT also was reduced simultaneously as the base price came down. For Delhi for instance with the OMCs holding on to their price and the centre lowering excise duty, the VAT on petrol came down to Rs 15.5 from Rs 23.99 level in Nov’21.

Recently, in May’22, government has again cut the excise duty on petrol and diesel by Rs 8/lt (from Rs 27.9/lt to Rs 19.9/lt) and Rs 6/lt (from Rs 21.8/lt to Rs 15.8/lt), respectively. This has led to a call to states to reduce VAT in response to the current excise duty cut by the centre.

The VAT story across states

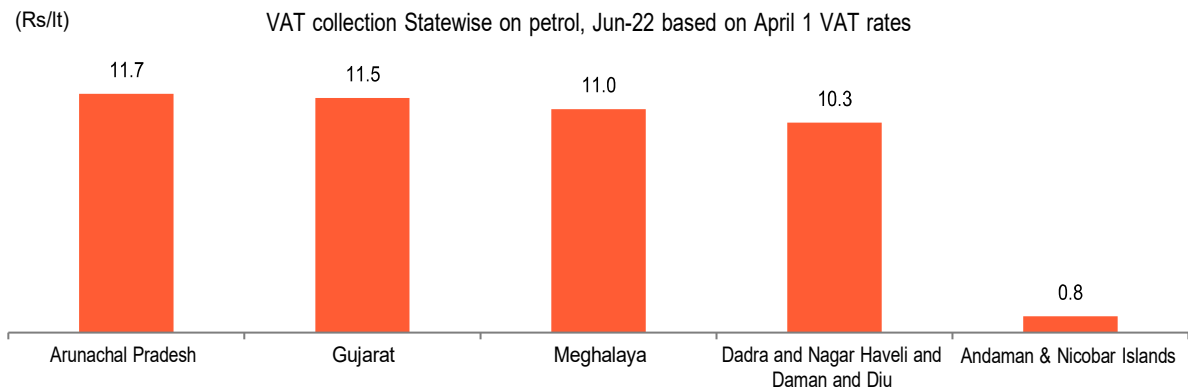
Considering the VAT rates which are available as of Apr’22, it can be observed that Maharashtra, Andhra Pradesh, Telangana, Rajasthan and Madhya Pradesh has the highest collection in terms of VAT on petrol. Andaman and Nicobar, Dadra, Nagar, Haveli, Daman & Diu, Arunachal Pradesh, Gujarat and Meghalaya are the ones where the collection of VAT amount is the lowest.

Fig 2. Top 15 States in terms of collection of VAT:



Source: PPAC, IOCL, Bank of Baroda Research

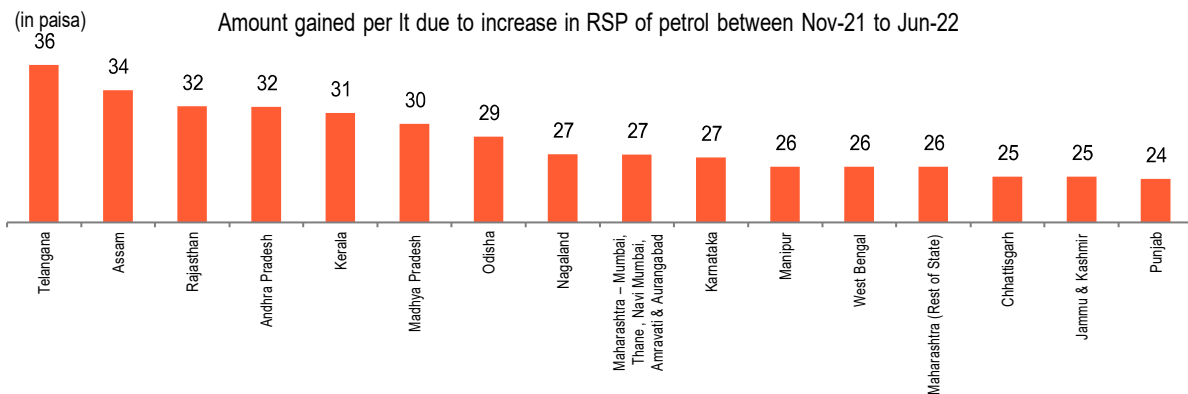
Fig 3. Bottom 5 States in terms of collection of VAT:



Source: PPAC, IOCL, Bank of Baroda Research

The chart below illustrates the space that is available for States to reduce VAT in response to the current excise duty cut by the centre and the rise in international oil price. It must be remembered that the OMCs have not increased their price even though crude oil price has now gone past the \$ 120/barrel level.

Fig 4. Net increase in price of petrol for various states (Paise/litre)



Source: PPAC, IOCL, Bank of Baroda Research

As can be seen, states have limited scope to lower the VAT on petrol without affecting their tax revenue. In FY21 for instance states earned Rs 2.21 lakh crore on duties on petroleum products while the centre earned Rs 4.20 lakh crore. In the first nine months of FY22, the states earned Rs 2.07 lakh crore while for the centre it was Rs 3.10 lakh crore. The centre's collections were lower post the reduction in duty in November. In these 9 months, VAT/sales tax were Rs 1.89 lakh crore and the highest collections were in Maharashtra (Rs 24,886 crore), Uttar Pradesh (Rs 18,998 crore), Gujarat (Rs 15,600 crore), Tamil Nadu (Rs 15,291 crore) and Karnataka (Rs 14,182 crore).

Appendix: State-wise VAT rates

States	VAT rates on Petrol as on 1 Apr 2022
Andaman & Nicobar Islands	1.0%
Andhra Pradesh	31% VAT + Rs.4/litre VAT+Rs.1/litre Road Development Cess and Vat thereon
Arunachal Pradesh	14.5%
Assam	32.66% or Rs.22.63 per litre whichever is higher , Rebate of Rs.5 per Litre & Additional rebate of Rs. 5.3 per litre
Bihar	23.58% or Rs 16.65/Litre whichever is higher (30% Surcharge on VAT as irrecoverable tax)
Chandigarh	Rs.10/KL cess +15.24% or Rs.12.42/Litre whichever is higher
Chhattisgarh	24% VAT + Rs.2/litre VAT
Delhi	19.40% VAT
Goa	20% VAT + 0.5% Green cess
Gujarat	13.7% VAT+ 4% Cess on Town Rate & VAT
Haryana	18.20% or Rs.14.50/litre whichever is higher as VAT+5% additional tax on VAT
Himachal Pradesh	17.5% or Rs 13.50/Litre- whichever is higher
Jammu & Kashmir	24% MST+ Rs.2/Litre employment cess, Rebate of Rs.4.50/Litre
Jharkhand	22% on the sale price or Rs. 17.00 per litre , which ever is higher + Cess of Rs 1.00 per Ltr
Karnataka	25.92% sales tax
Kerala	30.08% sales tax+ Rs.1/litre additional sales tax + 1% cess
Madhya Pradesh	29 % VAT + Rs.2.5/litre VAT+1%Cess
Maharashtra – Mumbai, Thane , Navi Mumbai, Amravati & Aurangabad	26% VAT+ Rs.10.12/Litre additional tax
Maharashtra (Rest of State)	25% VAT+ Rs.10.12/Litre additional tax
Manipur	25% VAT
Meghalaya	13.5% or Rs 11.00/Litre- whichever is higher (Rs.0.10/Litre pollution surcharge)
Mizoram	16.36% VAT
Odisha	28% VAT
Puducherry	14.55% VAT
Punjab	Rs.2050/KL (cess)+ Rs.0.10 per Litre (Urban Transport Fund) + 0.25 per Litre (Special Infrastructure Development Fee)+13.77% VAT plus 10% additional tax or Rs.12.50/Litre whichever is higher
Rajasthan	31.04% VAT+Rs 1500/KL road development cess
Sikkim	20% VAT+ Rs.3000/KL cess
Tamil Nadu	13% + Rs.11.52 per litre
Telangana	35.20% VAT
Uttar Pradesh	19.36% or Rs 14.85/Litre whichever is higher
Uttarakhand	16.97% or Rs 13.14 Per Ltr whichever is greater
West Bengal	25% or Rs.13.12/litre whichever is higher as sales tax+ Rs.1000/KL cess – Rs 1000/KL sales tax rebate (20% Additional tax on VAT as irrecoverable tax)

Source: PPAC, IOCL, Bank of Baroda Research, Note: Major States in terms of VAT collection have been highlighted, VAT rates of Maharashtra, Rajasthan and Kerala have been revised which is not incorporated in the table

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