
CENTER-STATE FINANCIAL RELATION UNDER THE GST REGIME: A CRITICAL STUDY

Bhaba Bhaya Hara Ratha, School of Law, CHRIST (Deemed to be University), Bengaluru

ABSTRACT

The Indian constitution is considered to be quasi-federal in nature as it has more unitary features. However, it has a clear distribution of legislative, administrative, and financial power between the center and the states, and through this distribution of power, it seeks to promote the concept of cooperative federalism. The introduction of the GST through the 101st amendment act, of 2016 was made on the lines of cooperative federalism to improve the center-state financial relationship. The GST was brought into the picture to overcome the problem of double taxation and to avoid the complexity of taxation that was levied by different states under different state tax codes. The introduction of GST can be seen as a major breakthrough that aims at making India a unified market with the objective of a one nation one tax system.

However, in recent times it has been observed that the new GST regime has adversely affected the center-state relationship. It has led the states to lose their financial autonomy and has also made the states more dependent on the center due to the compensation mechanism that was developed through this amendment. The paper focuses mainly on the dynamic relationship between the state and the center which is the basis of the federal structure of India, the issues and challenges before the GST regime, and provides solutions to overcome the challenges to make GST effective in the long run.

Keywords: Quasi-federal structure, Cooperative federalism, Center-state relationship, GST (goods and service tax), One-nation One tax.

INTRODUCTION

The constitution of India provides for a federal government with a clear demarcation of power and authority between the two levels of the government i.e., the central government and the state government. According to Granville Austin, the Constitution of India was perhaps the first Constituent body to embrace from the start what A.H Birch and others have called "Cooperative federalism".¹ The adaptation of the idea of cooperative federalism in India is crucial as India is comprised of different states having different cultural political and economic diversity. Cooperative Federalism is a concept that strengthens the relationship between the center and the states as well as between the states and local governments in India. The principle of cooperative federalism directs all governing entities to step up and work together to address shared social, political, economic, and civic issues. By allocating crucial powers and responsibilities to the Center and states, the framers of the Indian Constitution aimed to promote a coordinated approach to governing. A stable connection between the federal government and the states is desired under the theory of cooperative federalism.

The administration of any country with multiple levels of government must be in a way that promotes coordination among themselves for better governance of the country. The Indian constitution in Part-IX specifically enumerates the separation of legislative, administrative, and executive powers of the government. In addition to that, Under the 7th Schedule of the Indian Constitution, all the powers are divided between central and state lists, while a concurrent list gives some residual powers to the Centre.

The GST regime which was introduced through the 101st amendment act, 2016 was enacted on the lines of cooperative federalism in which both the central government and the state government have jointly ceded their taxing authority to create a single tax system and realize the dream of an economically united India.² The constitution of India has also been amended accordingly. Moreover, the central and state government under the new GST regime were required to act as per the recommendation of the GST Council. However, it can be acknowledged that the process of transition in the new indirect taxes regime could result in revenue shortfalls for the states and so it was unanimously decided that the losses incurred by

¹ The State of Rajasthan v. UOI, 1977 AIR 1361

² GST: COOPERATIVE FEDERALISM (July 12, 2019), iasscore, <https://iasscore.in/topical-analysis/gst-cooperative-federalism>

the states will be compensated from a pooled GST compensation fund for first five years, the period that ended in June 2022.³

CONCEPTUAL FRAMEWORK

The constitution of India gives power to both the central and state government to levy taxes with respect to the items mentioned in the central list (List-I) and the state list (list-II) respectively under schedule 7 of the constitution and enact laws with respect to the same. The power to impose taxes and duties is given to the Centre under Entry 82 to Entry 92C and Entry 97 of the Union List (List I). The States have similar powers under Entry 45 to Entry 63 of the State list (List II). Before the implementation of the Goods and Service Tax, the system of taxing goods and services was plagued by issues such as the multiplicity of state and central taxes on goods and services, which had a cascading effect on taxes and there was no clarity regarding the distinction between goods and services which made the levying of separate taxes untenable. To overcome all these issues, goods and service tax was introduced.⁴

The 122nd Constitutional Amendment Bill, 2014, also known as the GST (Goods and Services Tax) Bill, altered the Constitution and granted the Parliament and state legislatures concurrent authority to enact legislation governing the taxability of goods and services. It was introduced in the Lok Sabha in 2015 and then put to the test in the Rajya Sabha's monsoon session in 2016. It was then presented before the state legislatures becoming one of the most notable and anticipated tax reform plans since 1991. The bill attempts to remove the shortcomings of the Tax regime in India by eliminating the cascading of taxes, increasing compliance, and reducing economic distortions due to inter-state tax variations.⁵ In August 2016, the Bill was passed in both the House of Legislature with 18 States ratifying the Bill and President Pranab Mukherjee giving his assent and enacted as the 101st Constitutional Amendment Act, 2016. The Goods and Service Tax Act, 2017 was enacted by the Indian Parliament in the year 2016 and is enforced in the entire country, except for the State of Jammu and Kashmir. Under the ambit of the GST Act, 2017, the Indian Parliament has also enacted four separate Acts to regulate the

³Ambar Kumar Ghosh, Five years of GST: Implications for India's fiscal federalism, Observer Research Foundation (July 18, 2022) <https://www.orfonline.org/expert-speak/five-years-of-gst/>

⁴ Jaya Pandey, Fiscal Federalism in India an Insight into The Concept and Structure of Sales Taxation, Legal Services India, <https://www.legalserviceindia.com/articles/fiscal.htm>

⁵ Ministry: Finance, The constitution (122nd Amendment) (GST) Bill, 2014, PRS Legislative Research, <https://prsindia.org/billtrack/the-constitution-122nd-amendment-gst-bill-2014>

application of taxes, the levy of taxes, and the distribution of the revenue collected from these taxes. The four Acts are as follows:

- a) The Integrated Goods and Services Tax Act, 2017
- b) The Central Goods and Services Tax Act, 2017
- c) The Goods and Services Tax Act of each respective State. For example, Maharashtra Goods and Services Tax Act, 2017;
- d) The Union Territory Goods and Services Tax Act, 2017.⁶

The Goods and Services Tax (GST) is a comprehensive indirect tax levied on the manufacture and sale of goods and consumption of services throughout India.⁷ In India, a dual system of GST is followed which means that both the central and the state governments have the power to levy GST. In other words, with respect to the inter-state supply of goods and services, the central government has the exclusive power to levy tax i.e., IGST, and with respect to Intra-state sales of goods and services both the central and state government has the power to levy taxes i.e., SGST and CGST respectively. This dual system of GST was adopted keeping in mind the federal structure of India.

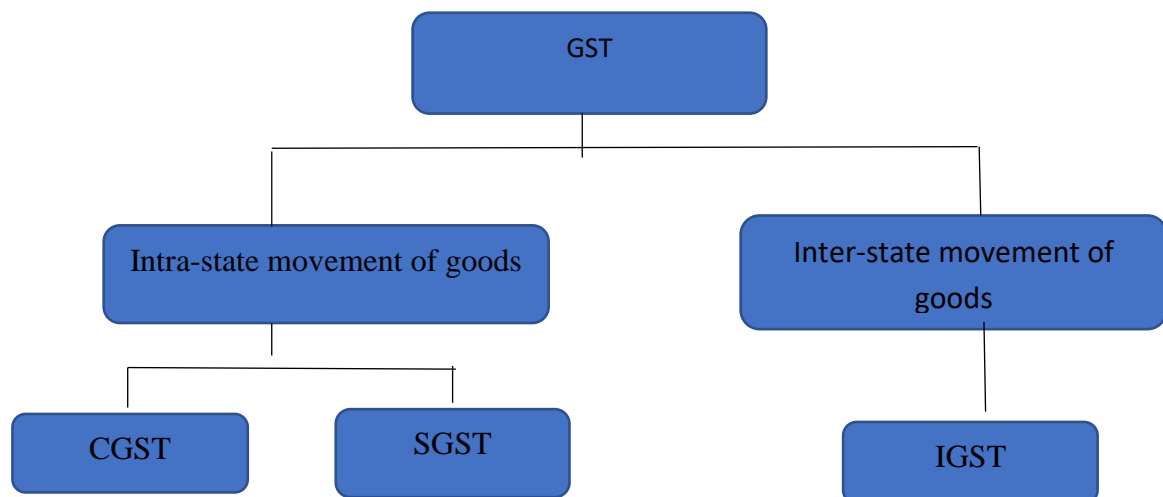


Figure 1: The division of GST with respect to Inter-state and Intra-state movement of goods⁸

⁶ Mihir Shyam Asolekar, The Dynamics of Centre-state Relationship under GST Regime: A Case Study on One-Nation One-Tax in India, 4 INT’L J.L. MGMT & HUMAN. 1833 (2021).

⁷ Taxation in India: overview of Indian Tax system, Invest India, <https://www.investindia.gov.in/taxation>

⁸ What is SGST, CGST, IGST and UTGST?, Cleartax, (Oct 10, 2022), <https://cleartax.in/s/what-is-sgst-cgst-igst>

The Goods and Service Tax has also subsumed all the varied taxes levied by the Centre and the State governments into one single tax called the GST. The various Taxes that were subsumed after the passing of the GST are as follows:

- I. **TAXES SUBSUMED UNDER CGST:** Excise Duty, Medical Excise, CVD (countervailing duty), Service Tax, CESSSES, SAD (special additional duty), Surcharges
- II. **TAXES SUBSUMED UNDER SGST:** VAT / Sales Tax, Entry Tax / Contract / LBT, Purchase Tax, Luxury Tax, Entertainment Tax, State cesses & Surcharges, Taxes on Lottery, batting, and Gambling.

Transaction	New Regime	Old Regime	Distribution of revenue
Intra-state sale	CGST+SGST	VAT + Central Excise + Service Tax	Both the center as well as the state shall share the revenue equally
Inter-state sale	IGST	Central sales Tax+ Excise/Service Tax	The center shall impose the taxes in case of inter-state sales and shall divide and distribute the share of taxes based on the destination of goods.

Table 1: The components of the Indian GST system related to the intra-State and inter-State transactions as practiced in India.⁹

AMENDMENTS

Several articles of the Indian constitution were amended and new articles were inserted in order

⁹ Goods and Service Tax GST (India) What is GST? Indirect Tax Law Explained (Jan 11, 2022), Clear Tax; <https://cleartax.in/s/gst-law-goods-and-services-tax>

to implement the GST. These are as follows:

Article 246A: This article provides special provisions for GST. According to article 246A (1), both the parliament and state legislature have the power to make laws with respect to taxation on goods and services whereas according to Article 246A (2), the central government has exclusive power to make laws with respect to taxation of inter-state movement of goods and services

Article 269A: It deals with the Levy and Collection of GST for Inter-State Supply. This article gives the Parliament the exclusive power to make laws with respect to inter-state supplies, and the manner of distribution of revenue from such supplies between the Centre and the State and It also allows the GST Council to frame rules in this regard.¹⁰

Article 279A: This article provides for the establishment of the GST Council. The GST Council is an apex member committee to modify, reconcile, or procure any law or regulation based on the context of Goods and Services Tax in India and it also recommends rates of tax, period of levying of additional tax, principles of supply, and special provisions to certain states.¹¹

Article 286: This article deals with restrictions on Tax Imposition. This was an existing article that restricted states from passing any law that allowed them to collect tax on the sale or purchase of goods either outside the state or in the case of import transactions and it was further amended to restrict the passing of any laws in case of services too. Further, the term ‘supply’ replaces ‘sale or purchase’.¹²

Article 366: It was amended to include certain important definitions with respect to the new provision of GST. It included the following definitions:

- Goods and Services Tax means the tax on the supply of goods, services, or both.¹³
- The term “Services” was defined under article 366 (26A). It refers to anything other than goods.

¹⁰ Amendment of Indian Constitution for GST (Jan 12, 2022), cleartax, <https://cleartax.in/s/constitution-amendment-gst>

¹¹ Amendment of Indian Constitution for GST (Jan 12, 2022), cleartax, <https://cleartax.in/s/constitution-amendment-gst>

¹² Amendment of Indian Constitution for GST (Jan 12, 2022), cleartax, <https://cleartax.in/s/constitution-amendment-gst>

¹³ Amendment of Indian Constitution for GST (Jan 12, 2022), cleartax, <https://cleartax.in/s/constitution-amendment-gst>

- The term “State” was defined under article 366 (26B). It includes Union Territory with the legislature.

CHALLENGES AND ISSUES

Although the GST was enacted on the lines of cooperative federalism and to improve the financial cooperation between the center and the states but in practice, it affects the fiscal relationship between the center and the states. There are many challenges and issues in the GST regime which can be dealt with as follows:

1. Financial autonomy of states

The Financial autonomy of the states has been compromised with the introduction of the GST in 2017 as a result state governments lost their independent taxation powers. Liquor and fuel are the only two significant avenues left for states to generate their own tax revenues, without having to seek approval from the Union government, since they are outside the GST regime¹⁴.

2. Dependency of states on center

The states have often claimed that the central collected funds that are transferred to the states are inadequate. Moreover, the states have complained that the resources allocated to them are inadequate to enable the state in discharging their responsibilities and resulting in the widening of the gap between their own resources and needs. This has increased the dependency of the state on the center.¹⁵

3. Parliament’s dominance over states

The insertion of certain articles through the 101st amendment act gives the upper hand to the central government and can prove to be a major roadblock in the future for the federal structure of India. Article 246A of the Constitution empowers the Parliament and State Legislatures to enact legislation on GST charged by the Union and States. However, Article 246A (2) of the constitution gives exclusive power to the Parliament to make laws with respect to the Inter-state movement of goods and services.

4. GST Council

¹⁴ GST and Fiscal Federalism, Drishti IAS (May 21, 2022), <https://www.drishtias.com/daily-updates/daily-news-editorials/gst-and-fiscal-federalism>

¹⁵ Rinki Dahiya and Priya Dahiya, Understanding the Changing Notions of Centre State Financial Relations Under GST Regime, XIX BIPA, Jan-June, 2022.

As per Article 279A (4), the Council will make recommendations to the Union and the States on important issues related to GST, like the goods and services that may be subjected or exempted from GST, model GST Laws, principles that govern Place of Supply, etc.¹⁶ The main problem regarding the GST council is the share of votes between the center. All decisions of the council shall be made by a three-fourth majority of the Votes Cast: the center has one-third of the Votes Cast, and the States together shall have two-thirds of the Votes Cast¹⁷. This indirectly gives the union government veto power over a state's financial policies.¹⁸

5. Compensation mechanism

After the implementation of GST, the richer states have lost much of their revenues. The main reason behind this is the collection of tax at the point of sale and not at the point of manufacturing. That means, if a manufacturing unit in Karnataka is selling its product in Andhra Pradesh, then the government of Andhra Pradesh can collect the tax and not the state of Karnataka.

To make up for this loss, the central government decided to compensate the loss incurred by the states for the first five years i.e., 2017-2022¹⁹. However, many states have claimed that they are not being compensated as timely as promised by the central government. Moreover, during the Covid-19 pandemic, the Union government violated the compensation guarantees to the States under the GST regime and this has impacted their economy, and to uplift, this economic slowdown the states have requested to extend the deadline of the compensation period which expires in June 2022 but the center has not yet extended the deadline.²⁰

RECENT JUDICIAL DEVELOPMENT: Union of India V Mohit Minerals Pvt. Ltd²¹

This recent supreme court judgment on the GST council has exposed the defect in the GST framework and has highlighted the need to change the GST framework in order to promote cooperative federalism. In this case, the taxpayers challenged the levy of IGST by the union government; The petitioners in the instant case filed a writ petition in the Gujrat high court

¹⁶ <https://gstcouncil.gov.in/gst-council>

¹⁷ GST: COOPERATIVE FEDERALISM (July 12, 2019), iasscore, <https://iasscore.in/topical-analysis/gst-cooperative-federalism>

¹⁸ Rinki Dahiya and Priya Dahiya, Understanding the Changing Notions of Centre State Financial Relations Under GST Regime, XIX BIPA, Jan-June, 2022.

¹⁹ Miss Rajni, GST: Issue & impact between Centre & State, 11 IJSER. 1071(Jun-2020)

²⁰ GST and Fiscal Federalism, Drishti IAS (May 21, 2022), <https://www.drishtiias.com/daily-updates/daily-news-editorials/gst-and-fiscal-federalism>

²¹ Civil Appeal No. 1390 of 2022

challenging the two notifications issued by the union government on the taxation of ocean freight and the levying of GST by the union government on the ground that they have already paid custom duty for imports and the levying of IGST on the freight element for transportation would amount to double taxation. The center in this case contended that GST was levied on the recommendations of the GST council, which is of binding nature.

The major question that revolved around this case was whether the recommendation of the GST council is binding on the union and states.

The Gujrat high court in the instant case ruled that the recommendation of the GST council are only of persuasive value and they are not binding in nature. However, the union government challenged this decision of the Gujrat high court before the apex court.

The supreme court held that the GST council recommendation does not have binding power as it is a recommendatory body that is established for aiding the government in enacting legislation on GST.²² The reasoning given by the supreme court was that article 246A which deals with the power of the union and states to make laws with respect to GST does not contain the force that would convert the recommendation of the GST council into legislation. The court also highlighted the importance of the term “simultaneous power” which is used to define the concurrent power exercised by the legislature and the states under Article 246A and differentiated it from the concurrent power under article 246 which is subject to repugnancy under article 254. The court stated that the role of the GST Council has to be understood as a constitutional and recommendatory body in the context of the simultaneous legislative power conferred on the parliament and the state legislatures by virtue of article 246A.

ANALYSIS

The introduction of GST can be considered the largest-ever Tax reform in India. It replaced the VAT regime that was prevalent in India. Its main aim was to integrate the nation's tax regime and to make a system of one nation one Tax. The state and the union government mutually agreed to give up their right to Tax for the public good. It was enacted keeping in view the federal structure of the Indian constitution and to promote cooperative federalism in

²² SBS AND COMPANY LLP, Analysis on Supreme Court Judgment in Mohit Minerals- Striking Down the Levy on Ocean Freight (June 9, 2022),<https://www.sbsandco.com/blog/analysis-on-supreme-court-judgment-in-mohit-minerals-striking-down-the-levy-on-ocean-freight>

the true sense. GST replaced many taxes which were levied by the union and the state government separately. The introduction of GST solved the problem of multiple taxation and tax cascading. many amendments were also made to the constitution to effectively implement the new GST regime.

The structure of taxation under the GST can be summarized as follows;

The CGST and SGST, which is levied by both central and central government on the intra-state movement of goods and services.

The IGST, which is levied solely by the union government on the inter-state movement of goods and services

However, as GST is a developing taxation system it has many loopholes and drawbacks. it will not be wrong to say that practically the GST regime is a little biased and gives an upper hand to the central government. Since the introduction of GST, the states have lost their autonomy in matters of taxation. GST is a destination-based tax and it is seen that the manufacturing states have to incur losses due to the new regime. Although the union government assured the states to compensate for the losses incurred by the states many states complained that they are not being adequately compensated. To make the GST regime effective in the long run and keeping in mind the diversity of India the GST regime needs to be revisited and certain amendments are needed to be made to cater to the needs of the states.

CONCLUSION AND SUGGESTIONS

The financial relationship between the center and the state is a very sensitive subject. The introduction of GST is a substantial addition to India's taxation structure, and it has a considerable impact on the financial relationship between the center and the states. To successfully implement the GST, the constitution was amended, new articles were inserted and numerous taxes were subsumed into the GST to make the Indian taxation system a one-nation, one-tax system. It is a system that tries to improve cooperation between the center and the state and promote cooperative federalism. However, it has to be carefully dealt with as any inconsistency in jurisdiction or distribution of power will give rise to conflict between the states and the center.

on July 2022 the GST completed 5 years since its introduction in India. In these 5 years, many problems were identified in the GST system from time to time. In my opinion, to make GST effective in the long run the center should aim to be more accommodating toward states' concerns. More financial autonomy should be given to the states to reduce the dependency of the states on the center. Moreover, the compensation mechanism should be effectively implemented in regular intervals to adequately compensate for the losses incurred by the states due to the GST regime. Also keeping in mind, the recent judgment of the supreme court in *Union of India V Mohit Minerals Pvt. Ltd* adequate reforms should be made to the GST council in order to make it a recommendatory forum for both the states and the center and suggest measures that will cater to the needs of both the center and the states.

REFERENCES

ONLINE RESOURCES

1. <https://www.orfonline.org/expert-speak/five-years-of-gst/>
2. <https://www.legalserviceindia.com/articles/fiscal.htm>
3. <https://prsindia.org/billtrack/the-constitution-122nd-amendment-gst-bill-2014>
4. <https://www.investindia.gov.in/taxation>
5. <https://cleartax.in/s/what-is-sgst-cgst-igst>
6. <https://cleartax.in/s/gst-law-goods-and-services-tax>
7. <https://cleartax.in/s/constitution-amendment-gst>
8. <https://www.drishtias.com/daily-updates/daily-news-editorials/gst-and-fiscal-federalism>
9. <https://gstcouncil.gov.in/gst-council>
10. <https://iasscore.in/topical-analysis/gst-cooperative-federalism>
11. <https://www.sbsandco.com/blog/analysis-on-supreme-court-judgment-in-mohit-minerals-striking-down-the-levy-on-ocean-freight>

CASES

1. Union of India V Mohit Minerals Pvt. Ltd
2. The State of Rajasthan v. UOI

BOOKS

1. P.M Bakshi, The Constitution of India
2. J.N Pandey, The Constitutional Law of India
3. M.P Jain, Indian Constitutional Law

JOURNAL ARTICLES

1. Mihir Shyam Asolekar, The Dynamics of Centre-state Relationship under GST Regime: A Case Study on One-Nation One-Tax in India, 4 INT'L J.L. MGMT & HUMAN. 1833 (2021).
2. Miss Rajni, GST: Issue & impact between Centre & State, 11 IJSER. 1071(Jun-2020)
3. Rinki Dahiya and Priya Dahiya, Understanding the changing Notions of Centre-state Financial Relations Under GST Regime, XIX BIPA, Jan-June, 2022