CENTRE–STATE FINANCIAL RELATIONS VIS-À-VIS GST: RECONFIGURING INDIAN FISCAL FEDERALISM

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ABSTRACT

The introduction of the Goods and Services Tax (GST) through the Constitution (One Hundred and First Amendment) Act, 2016, reshaped the constitutional arrangements governing indirect taxation in India. The reform sought to reduce cascading taxes, simplify compliance and facilitate a common national market. Yet GST was not merely a tax-administration measure: it altered the practical setting in which the Union and the States exercise fiscal authority. This paper examines the constitutional design of Articles 246A, 269A and 279A, the role of the GST Council, the continuing importance of the Finance Commission and the experience of the compensation mechanism. It also considers the Supreme Court's decision in *Union of India v Mohit Minerals Pvt Ltd*, which clarified the legal status of GST Council recommendations and the relationship between cooperative decision-making and legislative competence. The paper argues that GST has not formally abolished State fiscal autonomy, but has narrowed independent State discretion in an important area of indirect taxation while making States more dependent on coordinated decisions, revenue settlement and wider fiscal transfers. The constitutional challenge is therefore to secure the benefits of harmonisation without allowing institutional cooperation to weaken democratic accountability or the practical capacity of States to discharge their responsibilities. The paper recommends transparent reasons for major Council recommendations, predictable procedures for fiscal shocks, better coordination between the GST Council and Finance Commission, and a time-bound intergovernmental dispute process.

Keywords: fiscal federalism; Centre–State financial relations; Goods and Services Tax; GST Council; State fiscal autonomy; Finance Commission; cooperative federalism; Mohit Minerals.

1. Introduction

India's constitutional system distributes public authority between the Union and the States. That division is often discussed through legislative lists, executive competence and judicial review, but federal government also depends on the distribution of financial resources. A government cannot meaningfully perform its constitutional responsibilities if it lacks adequate and reasonably predictable revenue. Fiscal arrangements are therefore not a technical adjunct to federalism; they are part of the practical conditions that make federal autonomy possible.

Fiscal federalism concerns the assignment of taxing powers, the allocation of expenditure responsibilities and the transfers used to address differences in revenue capacity. India's arrangements reflect the constitutional distribution of powers, the divisible pool of taxes, grants-in-aid, borrowing provisions and the work of the Finance Commission. They must also respond to significant differences among States in population, geography, industrial development, consumption patterns and the cost of public services. These differences make vertical and horizontal fiscal imbalance persistent features of the system.

The introduction of GST on 1 July 2017 marked a major change in this architecture. Before GST, the Union and States levied a range of indirect taxes under different constitutional and statutory powers. The division between taxes on goods and services, together with the multiplicity of levies and credit restrictions, could produce cascading effects, compliance burdens and disputes over the character or location of transactions. GST aimed to establish a more integrated value-added tax system, supported by input tax credit and a destination-based approach.

The constitutional reform required a new allocation of legislative competence. Article 246A provides a special basis for GST legislation; Article 269A addresses tax on inter-State supplies; and Article 279A creates the GST Council. These provisions establish an institutional model in which tax policy is shaped through continuing coordination between the Union and the States. The arrangement offers clear benefits, but it also creates a central question: whether the advantages of harmonisation are balanced by sufficient State influence, revenue predictability and accountability.

This paper approaches GST as a constitutional reorganisation of fiscal federalism rather than simply a change in tax administration. Its central argument is that the GST framework preserves

the formal legislative role of both levels of government, while changing the practical exercise of State fiscal discretion. The long-term legitimacy of this framework depends on transparent cooperation, reliable revenue arrangements and respect for the distinct constitutional responsibilities of the Union and the States.[1]

2. Research Problem, Questions and Objectives

The research problem concerns the relationship between a harmonised indirect-tax regime and the fiscal autonomy of States. GST depends on coordination because a fragmented approach can undermine the common market and complicate credit and settlement. At the same time, coordination can reduce the room available to individual States to adjust tax policy in response to local priorities. The issue is therefore not whether uniformity or autonomy is inherently preferable, but how the constitutional structure reconciles the two.

The paper addresses four questions. First, how does the Constitution distribute taxation and financial powers between the Union and the States? Secondly, how did the Constitution (One Hundred and First Amendment) Act, 2016 change that distribution? Thirdly, do the GST Council and the wider transfer system adequately protect State participation and revenue predictability? Fourthly, what reforms could strengthen cooperative fiscal federalism without treating State autonomy as subordinate to uniformity?

The principal objective is to evaluate the legal and institutional consequences of GST for Centre–State financial relations. The paper considers the constitutional basis of GST, the Council's role, the relationship between GST and the Finance Commission, the compensation experience and selected comparative lessons. Its contribution is analytical rather than econometric: it examines the structure of authority and the accountability of institutions, without claiming that legal materials alone prove a specific causal effect on revenue growth.

3. Methodology and Scope

The paper adopts a doctrinal and analytical method. Primary materials include the Constitution of India, the 101st Constitutional Amendment, GST legislation and relevant judicial decisions. Secondary materials include scholarship on fiscal federalism and public finance. Constitutional

[1]Constitution of India, arts 246A, 269A and 279A; Constitution (One Hundred and First Amendment) Act 2016.

provisions are read together rather than in isolation, particularly where the allocation of legislative power interacts with the institutional role of the GST Council.

The analysis is qualitative and institution-focused. It does not undertake detailed econometric modelling, State-by-State forecasting or a quantitative estimate of GST's effect on economic growth. Comparative references to Australia, Canada and Germany are used to identify institutional questions and possible lessons, not to suggest that their arrangements can be transplanted without regard to India's constitutional setting. The paper's conclusions should be read within these limits. Specific fiscal claims and comparative-law propositions should be supported by the relevant official reports or jurisdiction-specific literature before publication.[2]

4. Constitutional Foundations of Fiscal Federalism

4.1 Constitutional distribution of financial powers

The Constitution divides legislative authority between the Union and the States through Articles 245–255 and the Seventh Schedule. Financial relations are addressed in Articles 268–293, which provide for different forms of tax collection, assignment, distribution, grants and borrowing. Article 280 provides for the Finance Commission, an institution intended to make recommendations on specified aspects of the distribution of resources. The resulting framework recognises that fiscal capacity is central to the performance of public functions.

Indian federalism combines State governments with constitutionally assigned responsibilities and a Union possessing substantial legislative and financial powers. Residuary legislative authority is vested in Parliament under Article 248, subject to the specific constitutional arrangement for GST. The Constitution also contains mechanisms to transfer resources and respond to differences in State capacity. These provisions illustrate that Indian federalism is neither a system of entirely separate fiscal compartments nor a unitary arrangement in which States merely implement central policy.

4.2 Vertical and horizontal fiscal imbalance

Vertical fiscal imbalance occurs when the revenue resources available to a level of government do not match its expenditure responsibilities. Horizontal fiscal imbalance refers to differences

[2]See generally WE Oates, Fiscal Federalism (Harcourt Brace Jovanovich 1972); Robin Boadway and Anwar Shah, Fiscal Federalism: Principles and Practices of Multiorder Governance (Cambridge University Press 2009).

among States in their capacity to raise revenue and in the cost of providing public services. A State with a narrow tax base or high service-delivery costs may face a different fiscal position from a more urbanised or industrialised State. Equalisation and transfers help address these differences, although the design of such arrangements inevitably involves choices about fairness, incentives and accountability.

Fiscal autonomy should therefore be evaluated in practical terms. Formal authority to enact a tax law does not, by itself, ensure that a government can finance its responsibilities. Predictable transfers, transparent settlement arrangements and adequate information about future revenue are also important. Conversely, financial support does not necessarily destroy autonomy if States retain meaningful discretion over priorities and have a voice in the institutions that shape the rules.

4.3 Cooperative federalism as an institutional practice

Cooperative federalism describes a mode of governance in which different levels of government work through consultation and shared institutions while retaining their constitutional identities. It is not simply a demand that States agree with the Union. Genuine cooperation requires access to relevant information, opportunities to express dissent, reasoned consideration of competing interests and clarity about which institution is responsible for the final legal decision. Without these conditions, consultation risks becoming procedural rather than substantive.

GST makes this distinction especially important. A common tax system benefits from consistency in rates, definitions, credit and administration. Yet a State's ability to influence the system depends on the quality of Council deliberations and on whether recommendations are supported by adequate fiscal analysis. Cooperative federalism should consequently be assessed not only by the existence of a Council, but also by the transparency and practical fairness of its operation.

5. GST as a Constitutional Reconfiguration

5.1 The shift from fragmented taxation

Before GST, indirect taxation was spread across a number of Union and State levies. The division reflected constitutional distinctions between excise duties, services and the sale of

goods. As supply chains became more integrated and commercial transactions increasingly combined goods and services, this structure could lead to overlapping tax treatment, restrictions on credit and disputes about the appropriate taxing jurisdiction. GST sought to address these problems through a value-added framework in which input tax credit reduces the cascading effect of tax on tax.

The 101st Amendment was necessary because the earlier distribution of taxing powers could not simply be replaced by ordinary legislation. The Amendment introduced a special constitutional competence for GST, an arrangement for inter-State supplies and the GST Council. Parliament enacted central legislation, including the Central Goods and Services Tax Act, 2017 and the Integrated Goods and Services Tax Act, 2017, while State Legislatures enacted their respective GST laws. The result is a dual structure that combines common principles with separate Union and State tax components.[3]

5.2 Article 246A: special legislative competence

Article 246A confers power on Parliament and the Legislature of every State to make laws with respect to GST imposed by the Union or by that State, subject to the special rule for inter-State supplies. Parliament has exclusive power to legislate on GST where the supply occurs in the course of inter-State trade or commerce. This is a distinctive constitutional arrangement because it provides a specific source of competence rather than relying only on the traditional division between the Union, State and Concurrent Lists.

For intra-State supplies, the Union and the relevant State generally impose their respective components of GST. For inter-State supplies, the integrated mechanism is designed to support credit across State boundaries and to facilitate the allocation of revenue. Article 246A therefore represents shared legislative authority, but it does not mean that the Union and States are identical in every aspect of GST competence. The constitutional text itself distinguishes intra-State and inter-State supplies.

The federal importance of Article 246A lies in its combination of joint participation and differentiated authority. It enables a common system while preserving a legislative role for State institutions. The practical exercise of that role, however, is shaped by the need for

[3]Central Goods and Services Tax Act 2017; Integrated Goods and Services Tax Act 2017; Goods and Services Tax (Compensation to States) Act 2017.

coordinated policy and by the political and administrative weight of GST Council recommendations. The distinction between constitutional competence and practical discretion is central to any assessment of State autonomy.[4]

5.3 Article 269A: inter-State supplies and apportionment

Article 269A provides that GST on supplies in the course of inter-State trade or commerce is levied and collected by the Government of India and apportioned between the Union and the States in the manner provided by Parliament by law on the recommendations of the GST Council. It also authorises Parliament to formulate principles for determining the place of supply and whether a transaction constitutes inter-State trade or commerce. The provision is designed to manage transactions that cross State borders without recreating the fragmentation associated with the earlier system.

The destination-based principle generally associates tax revenue with the place where goods or services are consumed rather than where they originate. This can support a national market by reducing incentives to impose border-related tax barriers. It also makes accurate place-of-supply rules, timely settlement and transparent apportionment essential. If States cannot predict when or how revenue will be credited, the benefits of common taxation may be accompanied by budgetary uncertainty.

Article 269A also illustrates the interdependence of legislative design and administration. A constitutional rule may identify the authority responsible for levy and collection, but the effectiveness of the system depends on statutory detail, information-sharing and settlement practices. The fairness of the framework therefore requires attention not only to the formal distribution of powers but also to the processes through which revenue reaches the governments entitled to it.[5]

5.4 Article 279A and the GST Council

Article 279A establishes the GST Council as a constitutional forum comprising representatives of the Union and the States. It recommends matters including the taxes, cesses and surcharges that may be subsumed, goods and services that may be subject to or exempted from GST, model

[4]Constitution of India, art 246A; Constitution (One Hundred and First Amendment) Act 2016, s 2.
[5]Constitution of India, art 269A; Integrated Goods and Services Tax Act 2017.

laws, principles of levy, place-of-supply principles, threshold limits and rates. The Council is thus central to the coordination necessary for a harmonised indirect-tax system.

The Council's design gives States an institutional voice, but the existence of representation does not answer every question about influence. The voting structure, agenda-setting, access to fiscal information and practical ability to negotiate all affect the quality of participation. The system is most defensible where State representatives can assess the fiscal implications of proposals, alternatives are considered openly and the reasons for major recommendations are recorded.

Recommendations may have substantial practical influence even when they do not themselves become legislation. Common rates and procedures reduce transaction costs and support compliance across State borders. Yet that practical influence should not obscure the constitutional responsibility of legislatures. Institutional cooperation is sustainable when it persuades through evidence and deliberation rather than relying on an assumption that every recommendation must be accepted without independent scrutiny.[6]

6. Judicial Interpretation: Union of India v Mohit Minerals

The Supreme Court's decision in *Union of India v Mohit Minerals Pvt Ltd* is central to understanding the relationship between the GST Council and legislative competence. The case arose from the levy of integrated GST on ocean freight in the context of a composite import transaction. Beyond the immediate tax issue, the Court considered the constitutional status of Council recommendations and the relationship between Articles 246A and 279A.

The Court held that GST Council recommendations do not automatically bind Parliament and State Legislatures in the exercise of their legislative powers. The reasoning recognised that Article 246A grants legislative competence to the Union and States, while Article 279A establishes a body that makes recommendations. If recommendations automatically became legislation, the constitutional role of the legislatures would be materially displaced. The judgment therefore preserves a distinction between a recommendation, the legal act that gives

[6]Constitution of India, art 279A; GST Council, 'The GST Council', official website, https://gstcouncil.gov.in/gst-council-0 (accessed 26 October 2026).

it effect and the legislature's constitutional authority.[7]

This conclusion should not be read as making the GST Council merely symbolic. The Court recognised the importance of cooperative federalism and the Council's role in developing a harmonised national market. Recommendations can exert strong political, administrative and economic influence. A government may have compelling reasons to follow a recommendation even though it is not legally bound to do so in every context. The constitutional balance is consequently more nuanced than a choice between central control and complete State independence.

The judgment also supplies a useful standard for institutional practice. Recommendations should be supported by transparent reasons and accessible evidence; legislatures should be able to consider their constitutional and fiscal implications; and disagreement should lead to explanation and consultation rather than being treated as a rejection of federal cooperation. The decision protects legislative accountability, but the success of the wider GST framework continues to depend on mutual trust and predictable administration.

7. Fiscal Autonomy, Compensation and Institutional Risk

7.1 Fiscal autonomy as practical capacity

State fiscal autonomy has at least three dimensions: legal competence to raise revenue, practical capacity to secure adequate and predictable resources, and discretion to allocate those resources according to public priorities. GST affects these dimensions differently. The Constitution continues to recognise State legislative competence in relation to intra-State GST, but States have less independent discretion over many indirect-tax choices than they exercised under the pre-GST system. At the same time, common rules can reduce compliance costs and improve the functioning of inter-State trade.

The proper question is therefore whether the benefits of harmonisation are matched by adequate institutional voice and reliable resources. A State may formally retain authority yet face constraints if its revenue is volatile or if settlement delays make budgeting difficult. Equally, a coordinated system can support autonomy if States have meaningful influence over policy and

[7]Union of India v Mohit Minerals Pvt Ltd (2022) 4 SCC 481; see also Supreme Court judgment dated 19 May 2022, available at https://www.livelaw.in/pdf_upload/500-union-of-india-v-mohit-minerals-19-may-2022-419355.pdf (accessed 26 October 2026).

access to fair transfer mechanisms. The constitutional evaluation must consider both the legal allocation of power and the conditions under which that power can be exercised.

7.2 Compensation and the transition to GST

The Goods and Services Tax (Compensation to States) Act, 2017 created a statutory mechanism to compensate States for specified revenue losses during the transition to GST. The mechanism was linked to a defined transition period and an assumed annual revenue growth rate. The economic disruption associated with the COVID-19 pandemic placed the system under significant pressure and intensified disagreements over the timing, source and character of compensation payments.

The experience demonstrates the difference between a statutory guarantee for a defined period and a broader expectation that the Union will provide support in every future fiscal emergency. Those concepts should not be conflated. A durable federal tax arrangement needs clear rules about the duration of transitional guarantees, the treatment of exceptional shocks, the sharing of relevant information and the procedures for considering liquidity or stabilisation support. Where these rules are unclear, fiscal negotiation can become uncertain and politically contentious.

Compensation is also connected to the original bargain underlying GST. States accepted a common framework that replaced several of their earlier indirect-tax instruments. A transparent transition arrangement can help sustain confidence in that bargain, especially where States differ in consumption patterns and revenue capacity. Future reform should not assume that a temporary guarantee automatically continues after its statutory expiry; instead, it should develop an explicit and constitutionally sound approach to exceptional fiscal risk.[8]

7.3 The Finance Commission and the wider transfer system

The GST Council and the Finance Commission have different constitutional functions. The Council recommends GST policy and supports coordination in the operation of the tax. The Finance Commission, under Article 280, makes recommendations on specified aspects of tax devolution and grants-in-aid. The institutions are complementary: GST influences the

[8]Goods and Services Tax (Compensation to States) Act 2017, especially the provisions governing compensation and the transition period. The operation and current status of any particular payment arrangement should be verified against official records before publication.

composition and predictability of public revenue, while the Finance Commission addresses wider questions of fiscal capacity, equity and the distribution of resources.

A structured channel for exchanging fiscal data and scenario analysis could improve the coherence of the wider system. Such coordination could help assess the implications of revenue volatility, changes in consumption patterns and differences in expenditure needs. It should not merge the institutions' separate mandates or obscure accountability for their decisions. The objective should be a more informed fiscal framework in which tax policy and transfers are assessed as related but distinct parts of federal finance.

8. Comparative Federal Perspectives

Comparative federal systems can help identify questions that deserve attention in India, although institutional arrangements are shaped by each country's constitutional history. Canada's experience with federal and provincial consumption taxation illustrates the practical difficulties of coordinating a common tax framework while recognising the fiscal role of constituent units. The lesson for India is not to reproduce a particular model, but to consider how negotiated arrangements, transparent revenue allocation and differentiated regional interests can coexist with a functioning common market.

Australia provides a further point of comparison because national consumption taxation operates alongside questions concerning the distribution of revenue among constituent units. Its experience highlights that adopting a common tax does not eliminate debate over allocation principles. For India, this reinforces the importance of transparent criteria, reliable fiscal information and procedures through which States can understand and contest the consequences of distributional decisions.

Germany's federal arrangements demonstrate the significance of structured participation by constituent units in decisions with financial consequences. The broader institutional lesson is that cooperation is more sustainable when the role of regional governments is defined and the process for resolving disagreements is credible. These comparisons remain illustrative; any detailed claim about their legal operation should be supported by current primary materials and country-specific scholarship. Comparative analysis is most useful when it clarifies institutional

choices rather than treating foreign arrangements as ready-made solutions.[9]

9. Principal Findings

- GST has changed the practical operation of Indian fiscal federalism by replacing several separate indirect-tax arrangements with a constitutionally coordinated framework.
- Articles 246A, 269A and 279A establish a distinctive combination of shared legislative competence, inter-State tax apportionment and institutional consultation.
- GST has promoted harmonisation and market integration, while narrowing the independent policy space available to States in important areas of indirect taxation.
- *Mohit Minerals* confirms that GST Council recommendations do not automatically have binding legislative force, while leaving the Council central to practical cooperation.
- The compensation experience demonstrates the importance of clear transition rules and credible procedures for exceptional revenue shocks.
- The GST Council and Finance Commission are complementary institutions whose distinct mandates intersect in the wider system of fiscal federalism.

10. Reform Proposals

10.1 Publish reasons for major recommendations

The GST Council should, where practicable, publish concise explanatory statements accompanying major recommendations. These statements could identify the policy objective, principal alternatives considered, anticipated fiscal consequences and any important distributional effects among States. Such disclosure would help legislatures and the public understand the reasoning behind decisions and would improve the quality of scrutiny without turning the Council into a legislature.

[9]For comparative discussion, see Robin Boadway and Anwar Shah, Fiscal Federalism: Principles and Practices of Multiorder Governance (Cambridge University Press 2009); Anwar Shah (ed), The Practice of Fiscal Federalism: Comparative Perspectives (McGill-Queen's University Press 2007). Country-specific propositions should be supplemented with current primary sources.

10.2 Establish a fiscal-risk and information protocol

The Union and States should develop a standing protocol for identifying exceptional revenue shortfalls, sharing timely data and initiating consultation. The protocol should distinguish enforceable statutory entitlements from discretionary support and set out a transparent process for considering temporary liquidity or stabilisation assistance. It should also identify the information required to assess the scale and distribution of a fiscal shock.

10.3 Strengthen coordination with the Finance Commission

A formal mechanism for exchanging relevant fiscal data and scenario analysis could improve assessments of State revenue capacity, horizontal equity and transfer needs. Coordination should respect the distinct constitutional mandates of the GST Council and Finance Commission. Its purpose should be to make the overall fiscal framework more coherent, not to merge separate institutions or shift responsibility away from the bodies legally entrusted with particular functions.

10.4 Create a time-bound intergovernmental dispute process

Disputes involving GST administration, place of supply, settlement and implementation should have access to a clear sequence of technical consultation and time-bound mediation. The process should preserve access to constitutional courts and should not create an administrative barrier to legal remedies. Where appropriate, anonymised summaries of outcomes could help improve consistency and prevent recurring disputes.

10.5 Evaluate outcomes through multiple indicators

GST should not be assessed solely by reference to aggregate collections or the number of registered taxpayers. Relevant indicators include settlement timeliness, compliance costs, predictability of transfers, the quality of State participation, horizontal equity and the speed with which fiscal shocks are addressed. A balanced evaluation should distinguish improvements in tax administration from broader claims about federal fairness or State fiscal autonomy.

11. Conclusion

GST represents a major constitutional reorganisation of indirect taxation in India. Articles 246A, 269A and 279A replaced a rigid separation of many indirect-tax powers with a framework of shared legislative competence, inter-State apportionment and institutional coordination. The reform has supported tax harmonisation and the integration of the national market, but it has also changed the practical conditions under which States exercise fiscal discretion.

The constitutional position is not that GST has eliminated State autonomy, nor that the existence of the GST Council has resolved every tension in Centre–State relations. Rather, GST has made the exercise of fiscal power more interdependent. The decision in *Mohit Minerals* confirms that Council recommendations do not automatically displace the legislative authority of Parliament and State Legislatures. At the same time, the practical effectiveness of the system depends on sustained cooperation and the capacity of governments to rely on common rules.

The Finance Commission and the wider transfer system remain essential because a harmonised indirect tax cannot, by itself, correct differences in State revenue capacity or expenditure needs. The compensation experience further demonstrates the importance of clear rules for transition and exceptional fiscal stress. The long-term success of GST should therefore be measured not only by tax efficiency and market integration, but also by the transparency of shared decisions, the predictability of revenue arrangements and the ability of States to discharge their constitutional responsibilities.

The reform agenda is consequently institutional rather than merely technical. Reasoned recommendations, structured fiscal-risk procedures, coordination between the GST Council and Finance Commission, and credible dispute-resolution arrangements can strengthen confidence in the system. Cooperative fiscal federalism is most durable when it respects both the need for national coordination and the continuing constitutional role of States. GST's ultimate legitimacy will depend on maintaining that balance in practice.

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