

Centre State Relations in India

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Week 06: Financial Relations: Allocation of Taxing Power; Distribution of Revenue, Goods and Services Tax, GST Council

Lecture 24: Legislative Power relating to tax laws

Greetings to all of you. So, we have discussed legislative relations, administrative relations. Now let us take up the third important aspect of Centre State relation, i.e., financial relation. So, we start a new module on financial relation and to begin with we will start looking at the historical background on tax relating provisions, what was there prior to the commencement of the Constitution and how it has been incorporated in the Constitution. So, this is what we will discuss, we will discuss the legislative power to impose tax, we will discuss the historical background, we will discuss what was the arrangement of taxing power under the Government of India Act 1935 and then what is the larger principle of fiscal federalism in India and how the current Constitution of 1950 deals with taxing power. Now, when you look at the financial relation, financial relation is always a very important subject matter because it does not only talk about the mechanism to fulfill the responsibilities, it also in a way avoids a conflict on the matter of revenue generation and that is why it is suggested that financial relation plays a crucial role because it strengthens the federal structuring, it clearly makes the government responsible for fulfilling the responsibility based on the resources what they would be able to generate.

So, efficient functioning of the government entirely depends on or squarely dependent upon the capability of the State to generate revenue, generate resources and that is why you find a relationship between resource and revenue, resource and responsibility when you look at the arrangement done under the Indian Constitution or for that matter resource and responsibility arrangement done in any federal Constitution where you find that responsibilities are entrusted and

at the same time the Constitution also suggests the ways to generate revenue so that the responsibility can be effectively and efficiently taken up. So, for this purpose what is suggested is that there has to be a distribution of taxation power between the Centre and the State because the idea of taxation comes from imposing a kind of obligation on every individual to contribute towards public good. So that whatever is the public good, whatever is to be stated to be a public good everyone has got a contribution and everyone has got a kind of claimable interest though not directly but indirectly on such public good. So that is what is the idea of imposing tax by the sovereign on individuals or on companies that is what you call it as mechanism of direct tax or indirect tax.

Direct tax on company or individual and indirect tax on goods and services which we will be discussing in detail while taking up GST. So in federation what you find is that, that both the functions and the taxing powers between the Centre and the State governments are clearly spelled out so that there should not be any conflict and it is important that financial relationship between the Centre and the State should be done in such a way so that the federal polity, the federal relationship, the federal structure gets governed in a very smoother way. There should not be any unnecessarily kind of hassles on the issues of revenue division on the issue of revenue generation. So when you look at the historical background what you find is that, that to impose tax has always been considered to be an authority of sovereign. Now in India the tax related legislative framework came when Britishers came in India and they provided for having a central fiscal authority in the under the Charter Act of 1833 which invested this financial and legislative power solely on the Governor General of Bengal and Governor General of Bengal was later on re-designated as Governor General of India.

So, entire administrative arrangement was centralized under the Charter Act of 1833 but later on as the governance has moved ahead under the British rule Government of India Act was enacted in the year 1919 where the Central Legislative retained the power to legislate for the entire country relating to any subject whereas Provinces got power by way of delegation. So 1919 Act was an experiment done on a unitary arrangement and where the main power was there with the Central Legislature and the sources of revenue under the 1919 arrangement was divided between the Centre and the Provinces. Then in India a newer experiment was done under Government of India Act 1935 wherein federal structure was introduced for the first time where different autonomy was

given a very defined autonomy was given to the Federal government and the State governments or the Provincial government under the Government of India Act 1935 and it has been provided that revenues and finances of Provincial government shall be distinct from that of the Federal government. So, one may say that foundation was laid down for a clear division on fiscal matter between the Centre and the State under Government of India Act 1935. Government of India Act 1935 provides for collection and retention of levies by the Federal government and spelled out details of the distribution of financial resources and grants-in-aids to Provinces clearly been provided under 1935 Act. A detailed provisions was done in Part VIII of the Government of India Act 1935 where it dealt with the finances, property and suits which was further divided into Chapter I and Chapter II you would find that something similar has also been done under the Constitution of India 1950. So taxing power division has been done under the 1935 Act where federal legislative list has been made and provincial legislative list has been made where it has been suggested that taxes on customs, capital of companies, tax on railway and air, railway fares, freight and stamp duties all the subject matter shall be exclusively with the Federal Legislature. They shall be given the power to levy tax to impose tax whereas, Provinces are been asked to levy tax on land revenues, agricultural income, betting and gambling. So this is kind of illustrative provisions which are provided there under the Government of India Act 1935 and what you find is that as far as the federal tax is concerned Government of India Act divided revenue sources into three categories. One category was where the revenue was to be entirely kept with the Federal government then second category was where it was exclusively to be there with the Provincial government and the third was where taxes levied by the Federal government but shared with the Provinces or assigned to them second one was collected and retained by the Provinces.

So these are the arrangements which are done. One important thing you would observe is that that no provisioning has been done on the matter of taxes on the concurrent list or on the shared list between the Centre and the States. This when you look at the Constitution of 1950 you find that 1950 Constitution somewhere carried forward the arrangement which was there under 1935 Act. Though it is a matter of fact that the federal set up given under 1935 Act was never been implemented in its fullest sense because of non-cooperation from the Congress Party but at the same time the framers of the Constitution thought of continuing with this administrative arrangement and administrative machinery for a new India for new country. So Constitution of

India provided for a dedicated provision for Finance, Distribution of Revenue between the Union and the States. One very remarkable aspect of designing fiscal federalism under the Indian Constitution is that it was decided not to provide for any entry on the matter of tax in the Concurrent List and you can very well visualize the visionary approach of the makers of the Constitution that they thought that if you have a tax related provisions in the Concurrent List then it would unnecessarily lead to a conflict between the Center and the State. Instead of that, let the tax be levied by the Center and then proceeds can be divided between the Center and the States or proceeds can be handed over to the States.

Instead of that they have gone for this arrangement and not decided to provide for a subject matter related to entry in the Concurrent List. Another important provision under the Indian Constitution is which says that no tax shall be levied without the authority of law. So Article 265 is very clear which says that there has to be a backing of the law statutory law which shall justify, sanction, approve the levy of tax in India. If there is no statutory backing then imposition of such tax shall be unconstitutional and to whatever money is being collected through the tax shall be required to be returned to the taxpayer. It is important to learn and understand that whatever rules we have read while reading the legislative relation, rules of interpretation be it pith and substance, colorable legislation and liberal reading of the Entry all those rules are mutatis mutandis applicable also for interpretation of tax entries.

So be it the rule related to liberal interpretation of the Entry, be it the rule of harmonious construction of the Entries or reading of incidental or ancillary matter while interpreting the legal provision, same interpretation rules shall be made applicable with regard to tax entries. This is the principles in fiscal relation. It is said that States have been assigned taxes of a local nature, for example, agricultural income is been assigned prior to GST sales tax was assigned to State government. Centre's power to levy taxes have been there on the subject matter where tax base is prevalent is existing in more than one State or Centre's power to levy tax on a uniform basis throughout the country and not vary from State to State that is what has been broader principle of keeping the tax levy in power with the Centre or the State. Taxes which can be collected conveniently by the Center rather than the State is also kept in mind that which is Centre can collect and then as I said proceeds can be shared with the State.

Then Centre alone is allowed to regulate the money supply, contract foreign loans, charge income tax on non-agricultural income and on services or collect import or export duties. Obviously, we will be discussing separately the matter of borrowing in a separate module. Then further it says that for reasons of redistribution and stabilization of economy, all broad based and redistribution of taxes, money supply function and borrowing powers are there with the Centre. This has been done primarily for a very specific reason that it is the responsibility of the Centre to see that economic planning of the country is done in a stabilized way and there should not be any kind of financial stress on the country because of over borrowing by the States. Therefore a kind of centralized monitoring system has been envisaged under the Constitution. So that Central government controls the situation, looks into the specific requirements and intervene. For that there is a law made which talks about fiscal management on the matter of larger fiscal policies which will be discussing when we will be talking about the borrowings, grants and grants in aids. It has been also said that the most expenditure functions are assigned to the States due to their comparative advantage in providing the public services.

One can very well visualize that this has been done for a very simple reason that the relationship between the State government and the people is very close and therefore it is easier for the State government to fulfill the responsibility entrusted under the Constitution and that is why it says that most expenditure functions are assigned to the States because the States are situated closer to the people and the State can effectively look into the matter of effective allocation of resources in turn to see that expenditure is improving upon going in the right direction and State is monitoring the same. So that is a very thoughtful provision under the Indian Constitution. When you look at the arrangement done on a taxing power scheme there is an elaborative provision under the Constitution on tax related power where separate taxing power is given to the Centre and the States and then Centre has got a power to transfer funds to the State under the Constitution. So this is what is the broader arrangement done where Part XII of the Constitution with deals with Finance, Property, Contract and Suits. Chapter I deal with Finance, Chapter II deals with borrowing.

We will discuss these two separately in detail. When you look at Chapter I you find that Distribution of Revenues between the Union and the States that is discussed and then Miscellaneous Provisions with regard to grant in aid and is discussed under Article 282. Borrowing deals with Article 292 when we discuss about the limitations on borrowings of the States, what

kind of monitoring mechanism the Centre enjoys on the subject matter of borrowings. So you find that legislative division of power which is there in the Constitution as I said that separate legislative entries are there on the matter of tax for example in Union List you have Entry 82 to Entry 92B which talks about tax related entries then in the State List you have Entry 45 to Entry 63 which is again related to tax where subject matters are indicated on which state can levy tax in pursuant to Article 246 of the Constitution. And as I have highlighted that there is no subject matter on which both the Centre and the States are empowered to levy tax.

So no concurrent power of taxation is given in the Constitution that I believe a very distinct feature of the Indian Constitution and it certainly is a very visionary, futuristic in order to avoid any kind of conflict on the matter of revenue generation on resource generation between the Centre and the States. Whatever is not been provided under the specific entries it is been stated that tax levying power can be read also as a residuary power under Entry 97 of List I. So if a specific entries are missing from the Union List or the State List then it is not to be read that those powers are not there with the with either government. It has to be read within under the residuary power Entry 97 List I in pursuant with Article 246 of the Constitution. Then it says that collection accrues to the Union in the Consolidated Fund of India and whatever collection is accrued to the State it goes to The Consolidated Fund of State. As I said that one of the principle is that under Article 265 categorically says that no tax in India can be imposed without any authority of law so there is a clear reference that there has to be a statutory law tax cannot be levied merely based on the executive instructions or administrative policies there has to be a clear law made on tax related subject matter.

So the power under Article 265 is sovereign power and the legislative power that is what the Supreme Court says and not only the levy but also the collection of a tax must be under the authority of law that is what the court clarifies. So the tax proposed to be levied or collected must be within the legislative competence of the Legislature imposing the tax. What is to be examined that on the subject matter on which the tax is imposed whether that subject matter falls within the relevant Entry of List I or List II because as I said it has to be with authority of law so one thing to be check is that the competence of the Legislature to impose tax as per the constitutional scheme or not. It also says that no tax to be imposed beyond the tax entries which are given. So legislative entries are very clearly defined entries when you look at the List I or List II you find that legislative

entries are separate and tax related entries are separate. For example you find that Entry 1 to Entry 81 in List I it deals with legislative entries on which the Parliament can legislate whereas you find that Entries 82 to 92A deals with tax related entries on which Parliament can levy tax. For example it says that Entry 22 in List I deal with railways while Entry 89 of List I deal with terminal taxes on goods or passengers carried by railways. So there is a distinction it is not that by reference of railway one should read that tax related power is also included under Entry 22 that kind of reading should not be there. Tax cannot therefore be levied outside the specific tax entries that is a very clear position that's what the Court has said in this famous case of *Synthetics & Chemicals Ltd. v. State of Uttar Pradesh* that a tax can be avoid only under a tax entry and not under a non-tax entry that is something which is not permitted under the constitutional scheme.

Entries 1 to 44 with regard to the State list talks about the general legislative matter whereas Entries 45 to 63 deals with taxation related matter. For example Entry 18 is related to land and then Entry 45 relates to land revenue. So only because land as a subject is given in Entry 18 one should not read that revenue related matter is also to be read within Entry 18 of the Constitution. This is a very famous case we have discussed this on earlier occasion also, *R.M.D. Chamarbaugwalla v. Union of India* which categorically said that whether a resolution passed under Article 252 by the Mysore Legislature has relinquished all its legislative power concerning imposition of tax and price competition after delegating to the Parliament the power to make laws concerning control and regulation of price competition. The Court says that bidding and gambling is there under Entry 34 and taxes are there in Entry 62 and these are two separate subject matters and therefore when control of price competition was surrendered to Parliament by the resolution power to tax was not surrendered. So one should not infer unless and until there has been a kind of explicit resolution on the subject matter related to tax.

So these are the references of this module. Thank you very much.