

Centre State Relations in India

Prof. Uday Shankar

Rajiv Gandhi School of Intellectual Property Law

Indian Institute of Technology, Kharagpur

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

Lecture 25: Goods and Services Tax & Goods and Services Tax Council

Greetings to all of you. So we have started discussing on financial relation and in that financial relation today we shall be discussing an important development which took place in this country and which has introduced a newer tax system on an indirect tax subject matter, i.e., goods and services tax. This tax system has in a way introduced a newer kind of experiment on Centre State relationship.

So we will discuss what is the connect between GST system and Centre State relation then we will look into that how GST system has come, what is the backgrounder and what has been the arrangement of taxing power prior to GST coming into effect, what kind of change GST has brought in. We will confine only to the discussion on Centre State relation, how this GST Council is functioning, what is the mandate and then what is the role of this GST Council in strengthening federal structuring be it cooperative federal model or collaborative federal model. Then how the entire discussion on GST connects with fiscal federalism which is the subject matter and then what Supreme Court has said on GST. So we need to understand that when it comes to tax levying power, when it comes to power to generate revenue, the framers made it very clear that the power shall lie either with the Centre or with the State. Therefore, framers avoided enlisting any subject matter related to tax in the Concurrent List. So that there shall be exclusivity either the Centre shall levy the tax or the State shall levy the tax and then depending upon the constitutional arrangement whatever Centre levying tax the proceeds of it can be shared

with the State or it can be retained with the Centre. So that was the original arrangement when you look at the constitutional scheme.

So implementation of GST has really played a very vital role in transforming Centre State relation on the matter of finances because prior to it as I said there had been a kind of exclusivity. For example, Union had the power to tax on manufacturing of goods which was known as excise and then provision of services, i.e., service tax which was there with the Centre and States were given an exclusive power to tax on sale of goods. Sale and purchase was the exclusive power of the State which was known as VAT. So excise duty was the responsibility Centre, VAT was the responsibility of the State and that is how they are trying to generate revenue in their respective domains. So GST has altered that financial relationship and has introduced a concurrent jurisdiction on the matter of indirect tax and that jurisdiction has been entrusted to both the Centre and the State.

So what you find that post-GST now what was earlier an exclusive domain of the Centre and the exclusive domain of the State on a tax levying power, it has become a sort of connected one where both the Centre and the State have got a shared responsibility on levying of the tax through this GST model. So this traditional fiscal understanding, fiscal relationship, fiscal arrangement has been introduced in a newer form under the Centre and State relation. So, what is goods and service tax and how it has transformed the relationship let us look at it. So 101st Constitutional Amendment Act introduced a new system in India wherein on the matter of indirect tax it was considered to be a kind of one unit, entire country was considered to be one unit and it was suggested in the year 2000 by Kelkar Task Force on Indirect Taxes that in order to avoid a different layering of the tax structure in this country which is affecting the industrial growth, affecting the investment in this country let there be a kind of inform structure across the country.

Apart from this Kelkar Task Force there are two more Committees which suggested for it one First Discussion Paper on Goods and Services Tax which was released by the Empowered Committee of State Finance Ministers in 2009 and then the Task Force on Goods and Services Tax also submitted a report on goods and service tax which was released by 13th Finance Commission in 2009. So what you find is that with GST different taxes have now been

subsumed like Central Excise Duty, Service Tax, Surcharges, Cesses, VAT, Sale Tax, Luxury Tax are now part of GST. As I said prior to GST exclusive power was given to the Centre to make a law on levying taxes which was there under Article 246. So for example, Custom Duty, Central Excise Duty, Service Tax was there with the Union List that is what was the provisioning. Accordingly, a similar situation was there with the State also, where exclusive power was there with the State to tax on sale and purchase (Entry 54), excise duty on alcoholic liquors, opium and narcotics (Entry 51), taxes on luxuries, entertainments, amusements, betting and gambling (Entry 62), octroi or entry tax (Entry 52) and electricity tax ((Entry 53) was there with the State government and on a direct taxes, income tax is there with the Union.

So what GST regime has brought it, what transformation it has brought it? GST regime has introduced a unified taxing structure for the country. It said that any tax on supply of goods or services or both except on the exemptions which are there for the supply of alcoholic liquor for human consumption. So that is still outside the domain of GST. And Article 246A has been introduced through 101st constitutional amendment which provided for a special provision for goods and service tax. This arrangement was needed in order to come up with a kind of newer formula on the legislative relation. Prior to this, the formula was exclusivity with the Union and with the States in their respective domains.

Now because new formula has brought in a concurrent jurisdiction on the tax Article 246A has come into picture come into play. And then what Article 246A says? It says “*notwithstanding the provisions of Article 246 and 254*” meaning thereby it gives in a way overriding power to the Union on the matter of GST. So whatever arrangement we have discussed while discussing legislative relation on Article 246 here on a financial relation GST brings in a newer kind of arrangements. State legislatures power to impose tax is further restricted when you look at Article 246A(2). So what Article 246A(2) has done is that Parliament has got an exclusive power to make laws with respect to GST where the supply of goods or of services or both takes place in the course of inter-State trade of commerce where there is a transaction happening between more than one States.

Article 269A says that GST on supplies in the course of inter-State trade or commerce shall be levied and collected by the Union and the collection of the GST be apportioned between the

Union and the States in the manner as may be provided by Parliament on the recommendation of GST Council. So, a new constitutional body came into existence that is known as Goods and Service Tax Council (GST Council) which we will be discussing after a while. So what it suggested is that that let Parliament come up with the law to formulate the principles for determining the place of supply, when a supply of goods take place or of services and board takes place in the course of inter-State trade or commerce. So when you look at it the major change which has been brought in the in a GST regime is that earlier the taxes were largely driven by the arrangement on manufacturing. Now with GST it has been done on the factor of sale or consumption which has its own impact.

Now what broadly GST has introduced? GST has introduced on indirect tax matter one nation one tax. Now for the entire country you have one tax, where different slabs are there depending upon the goods. Prior to this, one goods were getting subjected to different tax slabs one by the Centre other by the State and which was in a way unnecessarily discouraging the industry, creating a sort of bottlenecks for the industry to grow. So now you have uniformity in tax market. So what you find is that GST has in a way an attempt to create a common national market in this country where it is been suggested that trade shall be without any barrier, movement of goods shall be without any barrier, movement of guaranteeing of services should be without any barrier.

So, common national market has been realized with the enactment of GST. Then it has also minimized the cascading effect as I said that earlier what was happening is that two layers of government levying taxes and directly or indirectly affecting adversely the industry or the economic growth, now that has been addressed through this GST. Then with discarding the exclusivity on the tax levying power, GST introduces concurrent power upon both the Union and the State and now you have unification through integrated GST and GST Council. So that is what they decide for the entire country. So this is the GST regime where you find that you have Central Goods and Services Tax Act, then 2017 Integrated Goods and Services Tax Act, 2017 and then State has enacted a law on their respective State Goods and Services Tax Act

So now you have a concurrent model where you find for intra-State, Central GST and State GST and then inter-State you have integrated GST structure. GST Council is a new constitutional

body which has been introduced with an idea to recommend on the rate slabs, what all goods are to be brought in within the ambit what all services are to be brought within the ambit of GST. This GST Council is a political body and a multi-member body where representation of the States and the Centre is there. So Article 279A establishes GST Council and what are who are the members it says that Finance Minister of the Union shall be the Chairman of the Council and Minister of the State (Revenue) shall be the member and members are Finance Minister of every State they are the members of this Council and then what is the quorum one half of the total members of the Council shall constitute the quorum at its meeting and the Council shall determine that what shall be the procedure for the functioning of the Council. So in a way independence has been given to this constitutional body to decide the procedure that how the meetings are to be conducted, how the proceedings shall be carried forward.

What is the function of GST Council? You look at it you find that taxes, cesses and surcharges levied by the Centre, the States and the local bodies it now it is been subsumed under GST. So it is the Council which recommends that what shall be the slab for taxing and which goods shall fall under which slab and rate, the goods and services that may be subjected to or exempted from the GST. So that is also the Council decides that what goods are to be brought within the ambit, what goods are to be exempted for example alcoholic liquor for human consumption is excluded. Then it is also suggested that Council shall come up with the model GST laws because every State has to make a law. So it is desirable that there shall be a model law so that every State introduces law in their respective States based on that model law. Then principles of levy, apportionment of integrated GST and the principles that govern the place of supply that how do you understand that that goods and services are supplied at a particular location so that that becomes clear that who shall pay the tax and how the collection shall happen and the threshold limit of turnover below with the goods and services may be exempted from GST that is what it further says.

What shall be the rates of tax shall also be the responsibility of GST Council. Any special rate or rates for a specified period to raise additional resources during natural calamity or disaster is again the responsibility of the GST Council. Special provisions are been made for north Eastern States, Jammu and Kashmir, Himachal Pradesh and Uttarakhand considering the geographical positioning of these States. It has been suggested that the States may require some kind of

incentivization in order to attract industry and therefore, it is suggested that let them be benefited for certain period on the matter of GST. So the Council has been given a wide power one may say that what was earlier being deliberated on the floor of the House on the matter of tax now that is been shifted to the GST Council in a unified forum. So you can very well visualize that what kind of effort must have gone in making the GST Council a reality because different political priorities different kind of preferences of the States and the Centre. Now with GST coming into a existence the Centre and the States they have addressed their differences and they have agreed to come on the one platform and they have decided to they have decided to come up with one kind of unified structure which would be beneficial for economic growth of the country.

So, GST for that matter or GST Council for that matter is a phenomenal development and contribution to the fiscal federalism in this country. What a guiding principles for this GST Council one is that it shall be kind of harmonized structure as I said that it is generally been decided that which categories of goods shall be taxed under what category. Then development of a harmonized national market for goods and services, centrally controlled at kind of tax regime and concurrent a space for tax for States this is what is the guiding principle for the GST Council. The constitutional amendment also talks about the weightage of vote in the GST Council it says that every decision of GST Council shall be taken by majority of not less than three fourth of the weighted votes of members present and voting and the vote of the Central government is one third of the total votes and the votes of all State governments taken together shall have the weightage of two thirds of the total vote. So, you can very well visualize that somewhere the arrangement has been done where prominence has been given to the Central government possibly in order to cater the national interest one may argue that that is the reason why this kind of arrangement has been suggested under Article 279A because one third is there so, in a way there is a veto available with the Union government. So, if even if the States come together collectively there is a possibility that Union government may block that kind of proposal from the State government. But then when it comes to the functioning of GST Council, I believe what is to be kept in mind is not that kind of conflict, not that kind of confrontation because the GST Council has come into existence by addressing those conflict and confrontation for a larger goal of making India common national market, unified common market. Therefore, the functioning of Council shall get driven by the idea of dialogue discussion and collaboration and

not with confrontation or conflict. Then you find that there is a case of excessive legislation under Article 246A where GST legislation also made the provisions on incidental matters of investigation, arrest, penalty, interest and punishment because when you look at the language of Article 246A it says “*laws relating to goods and service tax and matters incidental thereto*”. So, question is that whether Article 246A also covers these issues of investigation, arrest, and penalty or not. The matter is pending before the Supreme Court in Aditya Gupta v. Union of India and before the Delhi High Court in Dhruv Krishan Maggu v. Union of India.

Now, GST as I said is based on the idea of cooperative federalism because earlier what was the kind of domain of the Union and the State, now with this new kind of an arrangement in place is suggested or it is to be always understood that both the Centre and the State they come together and agree to share their taxing powers. The idea is to come together and not to compete on this issues of who shall be levying lesser tax or higher tax. Let the tax slap be the same in throughout the country on the indirect matter and the competition shall be on providing a better infrastructure so that so that industry gets attracted in one or the other States. Both the Union and the States they have got a voting right in the GST Council which again manifest that there is a talk on cooperation which is required on the matter of taxes. So, now the GST Council plays a very significant role in facilitating a kind of collective decision making on the matter of levying tax on goods and services. Though GST Council also suggest for a kind of dispute resolution mechanism between the Union and the State whenever some problem comes and then it is the Council which is supposed to address that concern of different States by following the principle of cooperative approach and a kind of balance view between the Centre’s take and the States view point. GST is also an example of collaborative federalism, why collaborative because the States have surrendered their legislative power on the matter of tax to a body with the GST Council because they are they are deciding collectively.

So, GST Council is a kind of testament of a collaborative federalism where they have voluntarily decided to give up their jurisdiction, give up their power in order to ensure that on the matter of indirect taxation let there be no fragmentation happening in India because otherwise when prior to GST it was appearing that that one State was competing with another State on the matter of imposing taxes and which in a way was adversely impacting the growth of industry and the movement of goods and services. So, GST Council has got a mandate to discharge the

responsibility in a collaborative way with a with an idea to promote harmony and with a kind of fulfilment of the goal based on mutual interest and because of that only it seems that it was decided that for the first 5 years after GST came into existence that there shall be compensation to some of the States who may lose out or who might have lost in because of this new tax regime coming into effect. So, that 5 year compensation scheme was been introduced which got over last year. State governments are demanding that let the period get extended to another 5 year because of the pandemic which struck in 2020. Though the Centre is not agreeing to, the Centre is saying that instead of extending it for 5 year let the State go for borrowing for fulfilling the financial requirements. So, GST Council is a platform which works on negotiation which all works on coordination in order to address the differences between the Union and the States. So, both the Union and the States they rely on each other for the effective functioning of GST Council. On a fiscal federalism GST has as I said brought in a new kind of experiment by bringing uniform tax system across the country. Then it also talks about equitable revenue sharing as I said that compensation mechanism was introduced for the first 5 year.

So, these are kind of changes which have been done in fiscal federalism. Though in recent times, we have seen that some of the States have objected to this very point that Centre has not been disbursing the required amount as it is claimed by the State under this compensation scheme. The Centre has been asserting that it has fulfilled the mandate as recommended by the GST Council. So, time is to be seen that how this collaborative model works for the larger benefit of the economy of this country. GST matter has gone to the court for example, in this Union of India v. VKC Footsteps India Pvt. Ltd., it was suggested that when it comes to GST Council (Article 279A) discharge of the function of GST is to be guided by the harmonized structure which is crucial to the cooperative federalism and court has said that there is nothing called supremacy of the Union over the State on the matter on the functioning of GST Council. It is the cooperation which shall be really looking into the fact. It says that the entire idea is to see that how competing parties they come together and how they solve it, how they really work in the interest of the people, in the interest of economy and in the interest of industry. This is another phenomenal judgment which has been given and which has created a sort of you may say disturbances on the functioning of GST Council or how the entire things may be unfolded in future on the matter of the functioning of GST Council or legitimacy of function GST Council.

Union of India v. Mohit Minerals which was decided in the 2022 where the court has said that when it comes to bindingness of the decision of GST Council, the decision does not bind the Legislature it has just got a recommended to power and because it has got a recommended to power the State Legislature or Parliament may decide contrary to what has been agreed upon in the GST Council. That's what becomes now a crucial one, imagine that GST Council decides something and that decision has not been taken based on anonymity there is a division of votes and then one or the other State going back to the Legislature and passing a law contrary to what GST Council decides then the entire design of GST Council will collapse and the idea of unified tax structuring on indirect matter will completely go away. So, therefore, it is suggested that though the GST Council is a recommended body but then when the legislature takes it up be it Parliament or State Legislature, there has to be a very strong and cogent reason for Differing with the GST Council. Unless and until that is there on a mere political wish or will, deviations from the recommendation should not be encouraged. So, though it has to do with the sovereignty of the Legislature, the power which is entrusted by the Constitution, but then when it comes to conflict between Article 246 and Article 246A or Article 279A what is to be seen is that that there is a larger goal let down under the Constitution. The larger goal is to make India as a unified market, unified market for both goods and services, unified market for both movements of goods and services. I would say also of people because when you look at Article 19 where there is a right given to every citizen to go and settle to earn livelihood in any part of the country. So, a well ingrained mandate is there under the Indian Constitution to create India into a common market and going by that whenever such kind of conflict comes in between Article 279A and the legislative authority every attempt should be made to go for an harmonious conciliation instead of resolving it by looking at a kind of hierarchical structure on power making. So, this is what is important to look at impact on GST on Centre State relation has been there. One as I said there has been centralization of tax regime now it is unified tax structure where there is one tax lab on a particular set of goods for the entire country.

Obviously, State legislative power has been eroded when you look at the weightage of voting given in the GST Council. Then horizontal effect on federalism is also there because when it comes to distribution of revenues it is been suggested that the States which are having more population they may be eligible for better revenue sharing. So, these are the concerns then again

conflict should not become a kind of main feature of GST Council as it has been seen in recent time where some of the States have protested on non-release of the compensation amount. So, this is something which needs to be addressed in order to see the success of GST model and the fulfillment of constitutional goal of common market which is which is categorically given under the Indian Constitution. These are the references for this module. Thank you.