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The Role of GST in Shaping Cooperative Fiscal Federalism between Centre and States

Arja. Nageswara Rao,
Lecturer in Political Science
Government Degree College, Puttur, Tirupati District
Email: nageswara.anrao944@gmail.com

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1.Introduction

The introduction of the Goods and Services Tax (GST) in 2017 brought about a major transformation in India's taxation system. It replaced numerous indirect taxes such as VAT, Service Tax, and Excise Duty that were previously levied by the Central and State governments. Through this measure, the GST aimed to create a common market across the country, guided by the concept of "One Nation, One Tax." This means that goods and services are now taxed more uniformly throughout India, thereby reducing confusion and facilitating trade between states.

The GST is not merely a new taxation system; it also stands as a significant example of cooperative fiscal federalism. Within India's federal structure, both the Central and State governments possess their own distinct powers to enact laws and collect taxes. Prior to the GST, these powers were clearly demarcated, with each tier of government levying its own specific taxes. However, the GST brought both levels of government together on a common platform to share the authority to tax goods and services.

To make these possible, amendments were made to the Constitution, and a new body known as the GST Council was established. This Council comprises representatives from both the Central and State governments. They work collaboratively to determine the tax rates, rules, and policies related to the GST. This mechanism ensures that decisions are not made unilaterally by the Centre, but rather through dialogue and consensus reached with the States. Thus, GST has transformed not only the tax collection mechanism but also the framework of mutual cooperation between the Central and State governments. It has strengthened coordination between them and established a system wherein both share the responsibility for managing the country's indirect taxation. Consequently, by restructuring the constitutional and fiscal relations between the Centre and the States, GST stands as a practical illustration of cooperative fiscal federalism in action.

2.The Relationship between Indian Federalism and the Goods and Services Tax (GST)

The relationship between the Indian federal system and the Goods and Services Tax (GST) represents a historic shift from fiscal federalism to cooperative federalism. It signifies a concept of "pooled sovereignty," wherein both the Centre and the States have voluntarily ceded their exclusive powers to create a unified national market.

2.1. Constitutional Changes

Prior to the GST, the Constitution clearly demarcated taxation powers: the Centre levied taxes on services and the manufacturing sector (Excise), while the States levied taxes on the sale of goods (VAT/Sales Tax).

Article 246A: Introduced through the 101st Constitutional Amendment Act (2016), this article serves as the cornerstone of this relationship. It grants concurrent power to both the Parliament and the State Legislatures to enact laws regarding the GST.

Merger of Taxes: In exchange for a share in the common pool of taxes, the States surrendered various local taxes (such as Entry Tax, Luxury Tax, and Octroi).

2.2. The GST Council: The Federal Focal Point

The GST Council (Article 279A) is the first constitutional body established in India with the mandate to facilitate joint decision-making between the Centre and the States.

Composition: It comprises the Union Finance Minister (as Chairperson) and the Finance Ministers of all the States.

Voting Structure: A three-fourths majority is required to make decisions.

The Centre holds one-third of the voting power.

The States collectively hold two-thirds of the voting power.

Significance: Due to this structure, neither the Centre nor a few individual States can take unilateral decisions; consequently, they are compelled to adopt a consensus-based approach.

2.3. Impact on Fiscal Autonomy

In this relationship, there is often a tension between efficiency and autonomy:

Loss of Sovereignty: States have lost the independent authority to alter tax rates on many goods and services to suit their specific local political or economic requirements.

Dependence on the Centre: While the "destination-based" nature of GST has benefited consumer States such as Bihar or Odisha manufacturing States initially feared a potential loss of revenue. This led to the enactment of the GST Compensation Act (which guarantees revenue growth for the first five years).

Cooperative vs. Competitive Federalism: Although the Council fosters cooperation, delays in compensation payouts and disputes over tax rate slabs frequently test the "bargaining" nature of Indian federalism.

3.The Role of the GST Council

According to Article 279A of the Indian Constitution, the GST Council takes decisions on GST-related matters through voting:

- The Central Government holds one-third (33%) of the total votes.
- All State Governments, collectively, hold two-thirds (66%) of the votes.
- A 75% majority is required for any decision to be passed.

Due to this provision, the Centre effectively possesses veto power. Even if all the states are in agreement, they cannot pass any decision without the support of the Centre. The Union Finance Minister presides over this Council, further reflecting the Centre's pivotal role.

Article 279A (11) empowers the GST Council to establish a mechanism for resolving disputes among the following entities: Between the Centre and one or more States; Between the Centre and one or more States on one side and one or more other States on the other; or between the States themselves.

Given that the Centre already exerts a strong influence in the voting process, this raises concerns that the Council's decisions in disputes involving the Centre might appear biased.

Although the objective of GST is to eliminate the cascading effect of taxes and clearly demarcate taxation powers between the Centre and the States, the structure of the Council suggests a high degree of central control over indirect taxation. This could potentially diminish the fiscal autonomy of the states, create potential conflicts between the CGST and SGST Acts, and raise questions regarding the spirit of federalism.

4.What is Cooperative Federalism?

The term 'federalism' is derived from the Latin word foedus, which means 'treaty' or 'agreement.' It is a system wherein power is shared between the central government and state governments, as safeguarded by the Constitution.

Key Concepts

Power Sharing: Neither the Centre nor the States can unilaterally alter the rules. Both possess their own distinct spheres of authority.

Cooperation over Competition: Unlike older systems where governments competed with one another, cooperative federalism focuses on the Centre, States, and local bodies working together to achieve goals aimed at public welfare.

5.The Indian Context

India employs a unique and flexible form of federalism. According to Dr. B.R. Ambedkar, the Indian Constitution is not as rigid as the American model.

"Depending on the needs of the nation at any given time, India can function either as a federal system or as a unitary (centralized) system."

Although countries such as the United States, Canada, and Australia initially began with competitive systems, they much like India have evolved toward this modern, cooperative approach.

6.The concept of federalism is fundamentally based on three major factors

Federalism is based on cooperation between different levels of government rather than a strict division of powers. This idea rests on three main factors. First, during national emergencies like war, national interest becomes more important than the usual division of powers. Second, advances in technology and communication make coordination between governments easier. Third, the rise of welfare states requires large financial resources for services like health and education, which states cannot manage alone without support from the Centre.

The Indian Constitution encourages such cooperation. It allows Parliament to make laws on State matters if two or more States request it. It also provides for financial relations, grants under Article 282, and administrative coordination through All India Services. These features make India's federal system flexible rather than rigid.

The Supreme Court has held that federalism is part of the basic structure of the Constitution. However, Indian federalism does not mean a weak Centre. The system works because the Centre has certain special powers, such as those under Article 246A for GST. In West Bengal v. Union of India case, the Court noted that India does not follow a traditional model of federalism but has developed its own unique version.

The framers of the Indian Constitution departed from a rigid model of federalism, opting instead for a pragmatic system tailored to India's specific needs, traditions, and aspirations thereby rendering it unique. Although the Constitution establishes a strong central authority, this does not negate its federal character; consequently, India is often described as a quasi-federal nation.

In the case of State of Karnataka vs. Union of India, the Supreme Court observed that the Constitution blends federal features with strong unitary elements. It further affirmed that federalism is not merely an administrative arrangement but constitutes a fundamental constitutional principle. The Constitution empowers Parliament to enact laws on State subjects at the request of the States, regulates fiscal relations between the Centre and the States (including grants provided under Article 282), and fosters administrative

cooperation through the All India Services thereby infusing flexibility and cooperation into the federal framework.

Parliament validated a State tax that had previously been struck down by the Court. In recent times, the GST Council stands as a prime example of cooperative federalism, wherein the Centre and the States jointly make decisions regarding matters of indirect taxation.

The Supreme Court has also held that federalism constitutes an integral part of the basic structure of the Constitution. However, federalism in India does not imply an absence of central authority; rather, specific powers such as those under Article 246A pertaining to GST enable this system to function effectively. Therefore, the rationale behind the Constitution (One Hundred and First Amendment) Act, 2016, can be understood through the concept of a cooperative and flexible federalism characterized by necessary features of centralization.

The Goods and Services Tax (GST) regime does not violate India's federal structure. It is constitutionally enshrined in Articles 246A, 269A, and 279A, which carefully distribute powers between the Centre and the States.

Article 246A grants concurrent legislative power to both levels of government to enact laws regarding GST. Clause (1) operates subject to Clause (2); through a non-obstante clause, it clarifies how this power is to be exercised without one authority overriding the other. This reflects a constructive sharing of power in consonance with federal principles.

Article 269A pertains to GST on inter-state trade and commerce. It ensures that tax revenue adheres to the destination-based principle meaning the revenue accrues to the State where the goods or services are ultimately consumed. To ensure this distribution, the Integrated GST (IGST) mechanism facilitates a systematic settlement of accounts between the Centre and the States.

Article 279A establishes the GST Council, comprising the Union Finance Minister and the Finance/Revenue Ministers of the States. This Council functions as a recommendatory body designed to foster cooperation; procedural irregularities do not render its decisions invalid.

Thus, the GST regime does not undermine cooperative federalism; rather, it further strengthens it. According to estimates by various experts, the GST is expected to economically improve resource allocation, facilitate hassle-free tax credits, boost GDP growth, and enhance government revenue.

Exports play a crucial role in strengthening the economy under the GST regime. Since exports are zero-rated, goods and services meant for international markets carry

little to no tax burden. This lowers production costs and improves the global competitiveness of Indian products, linking international trade closely with India's economic performance under GST.

A well-designed GST system has the potential to increase GDP significantly. Introduced through the Constitution (101st Amendment) Act, 2016, GST is one of the most important indirect tax reforms in India, affecting everyone from consumers to large businesses.

However, the success of GST depends on effective implementation. Proper administration can promote economic growth, while poor execution may create challenges for taxpayers and authorities. Careful consideration of exemptions and past concerns such as the withdrawn proposal for an additional 1% tax on inter-state trade shows the need for a balanced approach.

7.Conclusion

For Indian federalism, GST acts like a double-edged sword. It has demonstrated a spirit of cooperation by aiding in the economic integration of the nation and eliminating the cascading effect of taxes. At the same time, safeguarding the fiscal autonomy of the States remains a significant challenge. To realize true cooperative federalism under GST, it is imperative that the Centre remains sensitive to the fiscal requirements of the States, thereby ensuring that shared taxation powers do not morph into excessive central control.

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