

Fiscal and Cooperative Federalism Under The Indian Constitution.

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Abstract

With the advent of Goods and Services Tax in July 2017, which was a much awaited step of the government. The sudden acceptance and approval in the parliament was a debatable issue back then. The advent of GST and the method of imposition was one of the issues that the public at large faced. Having said the, erasing double taxation was one of the key takeaways of GST. However, amidst the pros and cons of Goods and Services a major impact that was observed was on the financial autonomy of the States. This directly impacted the key fiscal relations between the State and Centre. The author has divided this article in three parts. Part I, gives an introduction of the concept of a Fiscal Federalism vis-à-vis the related provisions enshrined in the Indian Constitution. Part II, draws a picture about the taxation regime prior to the imposition of GST and Part III concludes with the impact of GST on the financial autonomy of the States.

Key Words: Goods and Services Tax, GST, Federalism, Fiscal Relations, Centre-State Relations, Fiscal Federalism,

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I INTRODUCTION

The governance of a state requires decentralisation with respect to certain functions, in order to ensure a harmonious relationship between the Union and the States. This is enhanced by the federal structure wherein powers and functions are divided between the Union and the respective States. While countries like the United States of America and Australia practice federalism strictly, the same is not the case with India, which has often been referred to as a quasi-federal system of governance owing to the fact that it has a unitary Centre but at the same time, certain essential functions and autonomies have also been delegated to its States.

A federal state is a political contrivance intended to reconcile national unity and power with the maintenance of state rights. The method through which federalism attempts to reconcile the apparently inconsistent claims of national sovereignty and of state sovereignty involves the formation of a constitution under which the ordinary powers of sovereignty are divided between the central government and the separate states or provinces.² This division powers me, however, vary under every different federal constitution but largely the general and core principle on which it should rest remains the same. The sentiment, which forms a necessary condition for the formation of a federal state, is that the people of the proposed state should wish to form for many

² A. V. DICEY AN INTRODUCTION TO THE STUDY OF THE LAW OF THE CONSTITUTION 142-143 (10th Edition 2008).

purposes a single nation, yet should not wish to surrender the individual existence of each man's state.³ The sentiment which creates a federal state is the prevalence throughout the citizens of more or less allied countries of two feelings which are to a certain extent inconsistent- the desire for national unity and the determination to maintain the independence of each man's separate State.⁴

India does not strictly function on the lines of what constitutes a purely federal state. According to Dr. Ambedkar⁵,

"The Indian Constitution is a Federal Constitution inasmuch as it establishes what may be called a Dual Polity which will consist of the Union at the Centre and the States at the periphery each endowed with sovereign powers to be exercised in the field assigned to them respectively by the Constitution. Yet it avoids the tight mould of federalism in which the American Constitution was caught, and could be both unitary as well as federal according to the requirement of time and circumstances."

The Drafting Committees of the Constituent Assembly hence chose 'Union' rather than 'federation' in order to indicate two things,

³ *Id.*

⁴ *Id.*

⁵ CAD VII, I, 33-34.

- (a) that the Indian Union is not the result of an agreement by the states, and
- (b) the component states; have no freedom to secede from it.

Though the country and the people may be divided into different States for convenience of administration, the country is one integral whole, its people a single people living under a single imperium derived from a single source.⁶

The nature of the Indian Constitution is distinct as although it consists of essential features of a federation, it differs from the typical federal systems of the world in various aspects. The essential characteristics of a federal Constitution are present in the Indian Constitution.⁷ However, it is often pointed out that the Constitution does not embody the federal principle, as in certain contingencies the Centre can encroach upon the subjects reserved for the States. The power of intervention given to the Centre, it is argued, is thus against the federal system, for it places the States on a lower pedestal. The Indian Constitution contains certain provision such as Article 3, Article 31(3), Article 155, Article 163, Article 249, Article 256, Article 257, Article 288(2), Article 352, Article 353, Article 354, Article 356, Article 357, Article 358, Article 360, Article 365, Article 386(3), Article 359 which give way for a deviation from the strict application of the federal principle. It is on the basis of these Articles that critics argue that

⁶ *Hinsa Virodhak Sangh v. Mirzapur Moti Juresh Jamat*, (2008) 5 SCC 33 : AIR 2008 SC 1892.

⁷ *State of W.B. v. U.O.I.*, A.I.R. 1963 SC 1241.

the fundamental postulate of a federal polity that, the Central and State Governments functioning under it are coordinating authorities, wherein each is independent within its own sphere. It is so greatly modified in the relationship between the Union and the States that the Indian Constitution is not entitled to be called a federal Constitution.

It is true that even though there is a distribution of powers between the Union and the States as under a federal system, the distribution has a strong Central bias and the powers of the States are hedged in with various restrictions which impede their sovereignty even within the sphere limited to them by the distribution of powers basically provided by the Constitution.⁸ However, the relationship between the Indian Union and States does display aspects of cooperative federalism and fiscal federalism. Cooperative federalism, according to Birch, is distinguished by, the practice of administrative cooperation between general and regional governments upon payments from the general governments, and the fact that the general governments, by the use of conditional grants, frequently promote developments in matters which are constitutionally assigned to the regions.⁹

FISCAL FEDERALISM IN INDIA

8 K. C. WHEARE, MODERN CONSTITUTION

9 A. H. BIRCH, FEDERALISM, FINANCE, AND SOCIAL LEGISLATION IN CANADA, AUSTRALIA, AND THE UNITED STATES (1955).

Fiscal federalism helps governmental organisation to realise cost efficiency by economies of scale in providing public services which correspond most closely to the preferences of the people.¹⁰ From the point of view of the economy, it creates a unified common market which promotes greater economic activity. The problems arise from the extent of decentralisation and its relation to the level of development, heterogeneity of the population, harmonization of their preference patterns, allocation of functions and financial sources to different levels of government, arbitration of vertical and horizontal imbalances and the institutional mechanism to conduct inter-governmental relations.¹¹ Federal finance calls adequacy and elasticity with respect to resources. This implies that there exist sufficient resources for discharging constitutional responsibilities, and elasticity implies the expansion of resources in response to the growing needs of the government.¹² The practical effect of the division of tax powers has been to deny both these characteristics in the case of States. A vertical imbalance between the Centre and the States is built into the Constitution by the provisions relating to the powers of taxation. This imbalance has arisen not with the aim of making the Centre stronger, but out of the aim to build a common economic space in the country and an apprehension that with more powers the States may put up walls within this space.¹³ The level of development may vary from State to State owing to factors like endowment of

¹⁰ B.P.R. VITHAL, M.L. SASTRY FISCAL FEDERALISM IN INDIA(2001).

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

natural resources, and standards of public services due to their historical backgrounds and other factors, which eventually lead to the creation of horizontal imbalances between the States.

A successful federation calls for the possession of adequate financial resources with the Union as well as the States so as to enable them to discharge their respective responsibilities under the Constitution. To achieve this object, our Constitution has made elaborate provisions, mainly following the lines of the Government of India Act, 1935, relating to the distribution of the taxes as well as non-tax revenues and the power of borrowing, supplemented by provisions for grants-in-aid by the Union to the States. The object of this division is an equitable distribution of the financial resources between the two units of the federation instead of dividing the resources into two watertight compartments, as under the usual federal system.¹⁴ The Supreme Court has given a fitting interpretation to this arrangement in the case of *Coffee Board v. C.T.O.*¹⁵,

“Realising the limitations on the financial resources of the States and the growing needs of the community in a welfare State, the Constitution has made specific provisions empowering Parliament to set aside a portion of its revenues for the benefit of the States, not in stated proportions but according to their needs. The resources of the Union

¹⁴ DURGA DAS BASU INTRODUCTION TO THE CONSTITUTION OF INDIA 369 (22nd ed.).

¹⁵ AIR 1971 SC 870

Government are not meant exclusively for the benefit of the Union activities. The Union and States together form one organic whole for the purposes of utilisation of the resources of territories of India as a whole.”

Article 246 and the Seventh Schedule of the Indian Constitution envisage the scheme for distribution powers and allotment of subjects in the following manner:

(i) Union List (List I): It vests the Union with all functions of national importance such as defence, external affairs, communications, constitution, organization of the Supreme Court and the High courts, elections etc.

(ii) State List (List II): It vests the States with a number of important functions touching on the life and welfare of the people such as public order, police, local government, public health, agriculture, water land etc.

(iii) Concurrent List (List III): It includes administration of justice (excluding Supreme Court and High Courts), economic and social planning, trade and commerce, etc. It is of interest to note that higher education; forests and population control were all added to this list in 1977 during the emergency when it was felt that the states were not doing justice to these subjects of national importance.

Number of Items in each list?

The Union and State lists include the powers of taxation as well. The enumeration of taxation powers placed in the Union List includes: tax on income other than agricultural income, excise duties, customs and corporate tax. Service tax had been included in view of diminishing importance of customs. The State List contains land revenue, excise on alcoholic liquor, tax on agricultural income, estate duty, tax on sale or purchase of goods, tax on vehicles, tax on professions, luxuries, entertainment, stamp duties etc. The Concurrent List does not include any taxation powers. There have been two important points of debate:

- (i) That there is a mismatch between the functions allocated to the centre and to the states, their powers of taxation, and
- (ii) That the more buoyant tax areas have been assigned to the centre. But, it has also been pointed out that “the Constitution recognizes that the division of resources and functions between the Union and the states was such that there would be imbalance between them” and that “the Finance Commission periodically corrects the imbalance bringing about an alignment between them”¹⁶

The Constitution of India makes a distinction between the legislative power to levy a tax and the power to appropriate the proceeds of a tax so levied and hence, the powers of a Legislature

¹⁶ *Supra*, at note 9.

in these two respects are not identical.¹⁷ Thus, for instance, while the State Legislature has the power to levy an estate duty in respect of agricultural lands under entry 48 of List II, the power to levy an estate duty in respect of non- agricultural land belongs to Parliament under Entry 87 of List I. Similarly, it is the State Legislature which is competent to levy a tax on agricultural income under Entry 46 of List II, while the Parliament has the power to levy income-tax on all incomes other than agricultural under Entry 82 of List I. Constitutional provisions for distribution of revenues between the union and the states in India are as follows:

Article 268¹⁸ provides for duties levied by the Union but collected and appropriated by the States. The revenue from stamp duties on bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, etc. and excise duties on medicinal, toilet preparations containing alcohol or opium of Indian hemp or other narcotic drugs is collected and appropriated by the States. Though all of these items are included in the Union List and the Union government can levy taxes on them, yet all these duties are collected by the States and form part of the revenue of the State who collects them.

¹⁷ *Supra*, at note 13.

¹⁸ CONSTITUTION OF INDIA, art. 268.

Article 268 (A)¹⁹ provides for taxes on services which shall be levied by the Union and such tax can be collected and appropriated by the Union and the States.

Article 269²⁰ provides for taxes levied and collected by the Union but assigned to the States. This category contains items of revenue which fall under the exclusive jurisdiction of the State like land revenue, stamp duty (except on documents included in the Union List), succession duty and estate duty, taxes on goods and passengers carried by road or inland waters, consumption or sale of electricity, tolls, taxes on employment, duties on alcoholic liquors for human consumption, opium, India hemp and other narcotic drugs, taxes on the entry of goods into local area, taxes on luxuries, entertainments, amusements, betting and gambling, etc.

Article 270²¹ provides for taxes levied and collected by the Union and distributed between the Union and the States. It includes all taxes and duties referred to in the Union List, except the duties and taxes referred to in Articles 268 and 269, respectively, surcharge on taxes and duties referred to in Article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India. The basis of distribution in this case is decided by the Parliament by law.

19 CONSTITUTION OF INDIA, art. 268(A).

20 CONSTITUTION OF INDIA, art. 269.

21 CONSTITUTION OF INDIA, art. 270.

Article 271²² provides for levy of surcharge on certain duties and taxes for purposes of the Union. Notwithstanding anything in Articles 269 and 270, the Parliament may at any time increase any of the duties or taxes referred in those articles by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part the Consolidated Fund of India.

Article 272²³ provides for taxes which are levied and collected by the Union and may be distributed between the Union and the States. Article 275²⁴ deals with grants from the Union to certain States.

The Finance Commission plays a vital role in the financial relations between the Union and States. The Constitution of India empowers the President to establish a Finance Commission under Article 280 after every five years and such a commission shall be entrusted with the responsibility to make recommendations to him about the distribution of net proceeds of taxes between the Centre and the States. The Commission is also required to suggest the principles on which grant-in-aid of the revenues should to be given to the state governments out of Consolidated Fund of India.²⁵ It is also required to give its view on any matter which may be referred to it by the President in the interest of sound finances. Over the years, the Central Government has been

22 CONSTITUTION OF INDIA, art. 271.

23 CONSTITUTION OF INDIA, art. 272.

24 CONSTITUTION OF INDIA, art. 275.

25C. RANGARAJAN AND D. K. SRIVASTAVA FEDERALISM AND FISCAL TRANSFERS IN INDIA (2011).

accepting the recommendations made by the Finance Commissions.

The Commission has touched even such subjects as debt burdens of the states, returns of public section undertakings, etc. However, the role of Finance Commission has considerably been sidelined due to the increasing role of Planning Commission through which more funds are transferred to the States than through the Finance Commission. Further, it is the Planning Commission which determines the discretionary grants and not the Finance Commission.(Reference?)

In so far as the allocations made by the Finance Commissions are concerned, it has been claimed that these were made, often, on the considerations of ensuring equity with pursuing redistributive principles. It does appear that the transfer scheme, after taking into account pre-devolution and post-devolution financial position of the states, has helped the relatively poorer states²⁶. In the approach to horizontal devolution, each of the previous Finance Commissions has come up with its own formula, with changes in criteria adopted and with the assignment of weights to different criteria for determining the share of individual states in the total share of Central resources. However, this approach has led to a criticism that the “gap filling approach” of the successive Finance Commissions, had encouraged fiscal imprudence of some of the states. The relative importance to be attached to equity in distribution and efficiency in utilization of resources in

²⁶ Srinivasan Committee, 2002. ?

determining the respective shares of various states in federal transfers has become a critical factor. Resolving the tension between equity and efficiency remains a fundamental challenge in public policy²⁷. The choice of criteria and the weights assigned by each Commission for the distribution of income tax and union excise duties had regularly provoked not only reaction from the state governments but also invoked critical comments from academics and public finance experts.

TAXATION REGIME PRIOR TO GST

The indirect taxation structure in India comprised of a host of laws and regulations. Tax is levied upon different activities including manufacturing, sale, trading, services, and imports. In the constitutional scheme, taxation powers on goods was with Central Government but it was limited up to the stage of manufacture and production while States have powers to tax sale and purchase of goods. Centre had powers to tax services and States also had powers to tax certain services specified in clause (29A) of Article 366 of the Constitution. This sort of division of taxing powers created a grey zone which led to legal disputes. Determination of what constitutes a goods or service is difficult because in modern complex system of production, a product is normally a mixture of goods and services.²⁸

²⁷ Bagchi Committee, 2001.

²⁸ Goods and Services Tax Concept and Status, Central Board of Indirect Taxes and Customs, Department of Revenue, Ministry of Finance, Government of India, July

Service Tax was levied and collected by the service provider on certain services but borne by the service receiver. With effect from 2012, all services became taxable except for those mentioned under the 'Negative List'. Central Excise duty was levied on goods manufactured in India and was administered by the Central Government. Value Added Tax, earlier known as Sales Tax, was a multistage tax introduced in 2005 and was levied at each stage of the value addition, with a provision to allow Input Tax Credit on tax paid at an earlier stage, which can be appropriated on the VAT liability on subsequent sale. The major reason for bringing VAT was to remove the cascading effect of taxes caused due to making visible the chain of transactions. The other indirect taxes include Octroi, Entertainment Tax, Purchase Tax, Central Sales Tax, etc. Octroi is the local tax charged by the State Government when the product enters into the State territory. Entertainment tax is charged by the local and regional governments on the services which are designed to provide the consumer with leisure activities. Purchase Tax is levied by the food grains producing states on the sale of food grains. Central Sales tax is the tax which is levied on interstate sale of goods.

After the independence, excise duty was levied by the Central Government on a few commodities which were in the nature of raw materials and intermediate inputs. Consumer goods largely

1, 2019, available at http://gstcouncil.gov.in/sites/default/files/01082018_GST_Concept_Status.pdf

(Formating?) remained outside the purview of taxation. The Taxation Enquiry Commission established under Dr. John Mathai in 1953, recommended that sales tax should be used specifically by the States as a source of revenue with Union governments' intervention allowed generally only in case of inter-State sales. It also recommended levy of a tax on inter-State sales subject to a ceiling of 1%, which the States would administer and also retain the revenue.²⁹

This was followed by the Constitution (Sixth Amendment) Act, 1956, by virtue of which the power to levy tax on sale and purchase of goods in the course of inter-State trade and commerce was assigned to the Union Government. By mid-1970s, central excise duty was extended to most manufactured goods. Central excise duty was levied on unit, called specific duty, and on value, called ad valorem duty. A drawback of this system was the fact that the number of rates were too many with no offsetting of taxes paid on inputs thus causing significant cascading and classification disputes.

The Indirect Taxation Enquiry Committee constituted in 1976 under Shri L K Jha recommended, inter alia, converting specific rates into ad valorem rates, rate consolidation and input tax credit mechanism of value added tax at manufacturing level.³⁰ In 1986, the recommendation of the Jha Committee on moving on to value

²⁹ *Id.*

³⁰ http://shodhganga.inflibnet.ac.in/bitstream/10603/52848/16/16_chapter%206.pdf

added tax in manufacturing was partially implemented with the introduction of modified value added tax (MODVAT). In principle, duty was payable on value addition but in the beginning it was limited to select inputs and manufactured goods only with one-to-one correlation between input and manufactured goods for eligibility to take input tax credit.³¹

The next wave of reform in indirect tax sphere came with the New Economic Policy of 1991. The Tax Reforms Committee under the chairmanship of Prof. Raja J Chelliah was appointed in 1991 and it recommended broadening of the tax base by taxing services and pruning exemptions, consolidation and lowering of rates, extension of MODVAT on all inputs including capital goods. It suggested that reform of tax structure must have to be accompanied by a reform of tax administration, if complete benefits were to be derived from the tax reforms.³² Most of these recommendations were implemented.

In 1999-2000, tax rates were merged in three rates, with additional rates on a few luxury goods. In 2000-01, three rates were merged into one rate called Central Value Added Tax (CENVAT). A few commodities were subjected to special excise duty.³³

A new set of reforms in indirect taxation were recommended in 1994 by the National Institute of Public Finance and Policy under

³¹ *Supra*, note 1.

³² *Id.*

³³ *Id.*

the leadership of Dr. Amaresh Bagchi in a report, titled "Reform of Domestic Trade Taxes in India". The replacement of Sales Tax with Value Added Tax through moving towards a multitier mechanism of taxation, allowing input tax credits for all inputs, including on machinery and equipment, harmonization and rationalization of tax rates across States with two or three rates within specified bands, pruning of exemptions and concessions except for a basic threshold limit and items like unprocessed food; zero rating of exports, inter-State sales and consignment transfers to registered dealers; taxing inter-State sales to non-registered persons as local sales; modernization of tax administration, computerization of operations and simplification of forms and procedures, were some of the key recommendations.³⁴

A standing Committee of State Finance Ministers was constituted, as a result of meeting of the Union Finance Ministers and Chief Ministers in November, 1999, to deliberate on the design of VAT which was later made the Empowered Committee of State Finance Ministers (EC). Haryana was the first State to implement VAT, in 2003. In 2005, VAT was implemented in most of the states.³⁵

The introduction of CENVAT removed to a great extent cascading burden by expanding the coverage of credit for all inputs, including capital goods. CENVAT scheme later also allowed credit of services and the basket of inputs, capital goods and input

³⁴ *Supra*, note 1.

³⁵ *Id.*

services could be used for payment of both central excise duty and service tax. Similarly, the introduction of VAT in the States has removed the cascading effect by giving set-off for tax paid on inputs as well as tax paid on previous purchases and has again been an improvement over the previous sales tax regime.³⁶

However, certain fallacies were noted in both CENVAT the State VAT. The CENVAT had yet not been extended to include chain of value addition in the distributive trade below the stage of production. Similarly, as far as State-level VAT was concerned, CENVAT load on the goods had not yet been removed and the cascading effect of that part of tax burden had remained unrelieved. Further, there had also not been any integration of VAT on goods with tax on services at the State level with removal of cascading effect of service tax.³⁷

Central Sales Tax was another source of distortion in terms of its cascading nature. It was also against one of the basic principles of consumption taxes that tax should accrue to the jurisdiction where consumption takes place. Despite remarkable harmonization in VAT regimes under the auspices of the EC, the national market was fragmented with too many obstacles in free movement of goods necessitated by procedural requirement under VAT and CST.³⁸

³⁶ *Id.*

³⁷ *Supra*, note 1.

³⁸ *Id.*

IMPACT OF GST ON FINANCIAL AUTONOMY OF STATES

Financial autonomy to any level of government is necessary in order to enable it to determine the taxation structure to best suit the revenue needs of the State. However, it is also equally important to ensure at the same time that such powers do not lead to inter-jurisdictional differences in policies and procedures which then cause economic distortions, create negative externalities, or impose higher compliance and enforcement burden.

India follows a dual GST regime wherein all transactions of goods and services mainly attract two levies, namely, Central GST, which is levied and collected by the Centre, and the State GST, which is levied and collected by the State. The inter-state supply of goods and services is regulated through the Integrated GST which is levied by the Central Government. Under IGST, the seller pays tax on the net value addition after adjusting available credit of IGST, CGST, and SGST on the purchases. The credit of the SGST used in the payment of IGST is transferred to the Centre by the exporting State. The importing dealer will claim credit of IGST while discharging his output tax liability in his/ her own State. The Centre then transfers the credit of IGST used in the payment of SGST to the importing State.³⁹

³⁹ GST Impact on the Indian Economy, Anjali Agarwal, New Century Publications

GST has been seen as major reform in the indirect taxation regime of India. It has subsumed numerous indirect taxes which were being levied by the Centre and the States. They are as follows,

Central Level

1. Central Excise Duty
2. Service Tax
3. Countervailing Duty(levied on imports in lieu of excise duty)
4. Special Additional Customs Duty(levied on imports in lieu of VAT)
5. Central Sales Tax
6. Excise Duty levied on Medicinal and Toilet Preparations
7. Surcharges and Cesses

State Level

1. VAT/ Sales Tax
2. Entertainment Tax
3. Luxury Tax
4. Taxes on lotteries, betting, and gambling
5. Entry Tax not in lieu of octroi
6. Cesses and surcharges

In most states, the majority of the tax revenue was flowing from indirect taxes that have now been subsumed under the GST which has uniform rates fixed by the GST Council. The Centre has a veto over the Council's decisions. Where a state could previously

impose special cesses and levies to boost its income for social and other spending, it is now at the mercy of the GST Council (and thereby the Centre).⁴⁰ States in the country have had two main concerns regarding GST. The first concern is the loss of revenue. The States which are producing goods or services fear that they will lose substantial revenue owing to the fact that GST is a destination based consumption tax. The second concern is the loss of autonomy like constitution of GST Council, dispute settlement authority, compensation mechanism and dual control.⁴¹

However, it should also be noted that both the Centre and States have concurrent powers to tax the supply of goods and services. The taxation powers of the States have now been extended to services which comprise a large share of the GDP and the sector is also considered as the fastest growing sector in the economy. Similarly, the taxing powers of the Centre have been extended to the retail stage and to this extent there will be an expansion in its taxing powers, which will be limited to around 12% of the GDP. ? (Referemce?) Since the expansion in the power of the States is significantly larger than the Centre, GST will alter the balance of power in favour of the States thereby reducing the vertical imbalance.⁴² States will have a much broader tax base under the GST regime. In the present scenario, the Federal Government is empowered to tax services and goods up to the production stage

⁴⁰ GST: THREAT TO INDIAN FEDERALISM? [online] Av. At: <http://blog.mylaw.net/gst-threat-indias-fiscal-federalism/> - Format

⁴¹ GST Impact on the Indian Economy, Anjali Agarwal, New Century Publications

⁴² GST: Concept and Roadmap, Atul Kumar Gupta, Lexis Nexis p 526-527.

while the State governments are empowered for levying sales tax on the goods sold in its territory. All the imported goods are also charged with custom duty by the Federal Government while States charge Sales Tax on them. With GST, States will be able to tax not only the goods but the services and imports as well. The broader tax base will be a major advantage for the States.⁴³

In the past under the sales tax regime in the states, the flexibility to use the tax system as a tool for achieving various social and economic objectives has generated economic distortions. Further, if the States are allowed the autonomy to increase the rates by setting SGST rates as the floor rates, then they would have a tendency to opt for this laidback option rather than improve their enforcement mechanism.⁴⁴ This increase in tax rates might create an incentive to evade the tax, as a result of which, the industries in competing states will become uncompetitive.

The exercise of concurrent jurisdiction by the Central and State Governments over the entire value chain and over all the taxpayers on the basis of common tax base for goods and services will increase the revenue for the States. The Thirteenth Finance Commission had considered the issue pertaining to loss of revenue and autonomy of States in a GST framework. It had opined that the concern of constriction of fiscal autonomy and sovereignty should be viewed from the perspective that while the State

⁴³ GST: Concept and Roadmap, Atul Kumar Gupta, Lexis Nexis p 528.

⁴⁴ *Id.*

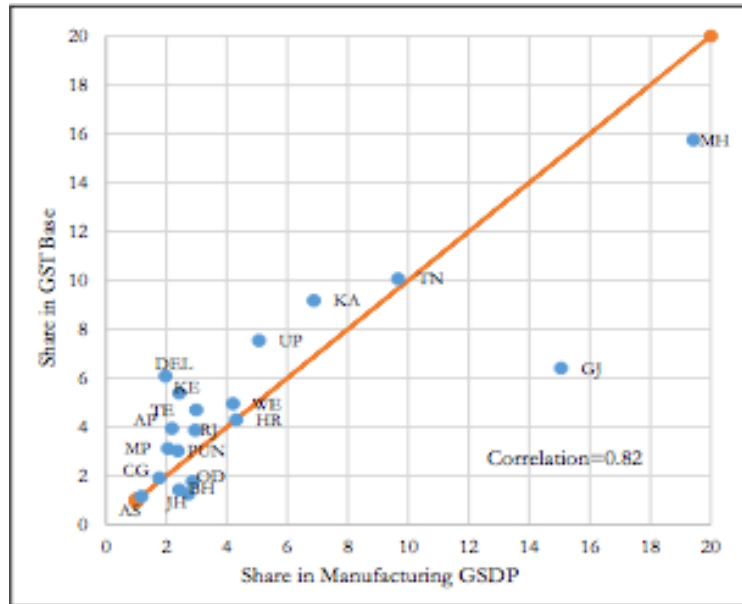
Governments will not be able to deviate from the nationally agreed model for GST, such constraints will apply to the Central government as well. The States have a certain fiscal margin available to them as they can impose an additional levy (additional tax) on Inter-state sale (specifically for the Origin State).⁴⁵ The Commission also noted that the tax base of the State Governments will significantly increase with the inclusion of the tax on Services as well as the tax on manufacture. The tax base of the Central Government, on the other hand, will increase only to the extent of tax on sales. Thus, it cannot be said that the vertical imbalance will increase in favour of the Central Government. It noted how GST will improve cooperative federalism amongst all the stakeholders.⁴⁶

The Economic Survey which comprises of the government's annual report of the state of the economy, was released in January, 2018 and has argued that the fears of the manufacturing states about losing out on revenue are unfounded. It has done this by running a correlation between each state's share in the potential Goods and Services Tax base and its gross domestic product i.e. the total value of the goods and services it produces. It concluded that since "each state's share in the GST base is almost perfectly correlated [coefficient of 0.95] with its share in overall GSDP",

⁴⁵ Supra, note 42, at p 334-335.

⁴⁶ Supra, note 42, at p 334-335.

hence, “the biggest tax bases still seem to be in the biggest producing states”.



Source : Survey calculations based on GST data and CSO.

Fig 1. Share in GST Base and Manufacturing GDSP

The distribution of the GST base among the states is closely linked to the size of their economies allaying fears of major producing states that the shift to the new system would undermine their tax collections.⁴⁷ The Survey includes two important findings - that, the biggest tax bases still seem to be in the biggest producing states, and that the GST tax base is balanced in terms of correlation to manufacturing and services. The Survey uses GST

⁴⁷ A New, Exciting Bird’s-Eye View of the Indian Economy Through the GST, Economic Survey 2017-18, Volume 1, Ministry of Finance, available at http://mofapp.nic.in:8080/economicsurvey/pdf/032-042_Chapter_02_ENGLISH_Vol_01_2017-18.pdf

data to list for the first time ever in India state-wise distribution of international exports of goods and services. Based on this data the Survey confirms that a “state’s GSDP per capita is highly correlated with its export share in GSDP”.⁴⁸

However, simultaneously, the survey also provided data that seems to give weightage to the fears of the producing states. The report explained this away by arguing that the Goods and Services Tax base of Maharashtra and Gujarat might be lower than their share in manufacturing but that is balanced out by their “significant presence in services”. This, however, does not really counter the argument that the new tax penalises manufacturing states. In the future, if a state were to leave out services and only concentrate on manufacturing then this would cause it to lose out on its rightful share of tax, as per the Economic Survey’s analysis.⁴⁹ Further, drawing a correlation between the potential GST share of a state and its GDSP does not address the issue of the States losing out on revenue. A high correlation could still theoretically result in a scenario where a state’s revenue under the Goods and Services Tax is lower than it was under the previous tax regime.⁵⁰

1. FEW REFERENCES MISSING

2. INTRODUCTION TOO LONG

3. ENTIRE PAPER SUMS UP IN MERELY 2 ISSUES.

⁴⁸ Id.

⁴⁹ Economic Survey Argues That GST Will Actually be Good for Indian Federalism, The Scroll, available at <https://scroll.in/article/866939/the-economic-survey-argues-that-gst-will-actually-be-good-for-indian-federalism-really>

⁵⁰ Id.