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GST System in India – A Look through the Lens of Fiscal Autonomy and Federalism

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ABSTRACT

This paper combines two important and non-separable fields of discourse: political science and taxation. This paper attempts to examine the GST Council and the overall GST system, introduce them, and analyze them from the viewpoint of fiscal autonomy of the states and federalism. There have been allegations that the GST system is against the federal structure and that it largely undermines the fiscal autonomy of the states. This paper will analyze the system keeping in mind the various allegations and discuss the various issues with the system. This paper also attempts to advocate against the current hatred towards the system and suggests some reforms to tackle the current issues and improve the system. The GST system was a much-needed and ambitious reform, which was the need of the hour, and the hostility and discontent of the states due to them losing their uncanny and uncontrolled fiscal power that they had in the erstwhile system, is precisely what this paper advocates against. This paper tries to bring out how instead of hampering the federal structure, the GST system has provided a platform for the center and the states to come together, thereby strengthening cooperative federalism.

KEYWORDS: GST Council, Cooperative Federalism, Fiscal Autonomy, GST, Goods and Service Tax

INTRODUCTION

This paper is an attempt to combine two very important and non-separable fields of discourse, political science and taxation. This paper is an attempt to look at the GST Council and the overall GST system, introduce them and analyze them from the viewpoint of fiscal autonomy of the states and the federalism. There has been allegations on the GST system to be against the federal structure and that it largely undermines the fiscal autonomy of the states. This paper will analyze the system keeping in mind the various allegations and discuss about the various issues with the system. This paper also attempts to advocate against the current hatred towards the system and suggests some reforms to tackle the current issues and make the improve the system. The GST system was a much needed and an ambitious reform, which was the need of the hour, and the hostility and discontent of the states' due to them losing their uncanny and uncontrolled fiscal power that they had in the erstwhile system, is precisely what this paper advocate against. This paper tries to bring out how instead of hampering the federal structure, the GST system has provided a platform for the center and the states to come together, thereby strengthening the cooperative federalism.

BRIEF BACKGROUND

In India, prior to the GST regime that came into force in July 2017, there was a complex and corrupt system of multiple indirect taxes like VAT, excise duty, service tax etc, out which some were to be collected by the state government and some by the central government. This whole system was very confusing and very cumbersome. Now post July 2017, when the GST system was implemented, the old cumbersome indirect tax regime was replaced by GST tax slabs system which was much more simplified and streamlined as compared to the erstwhile system. Even though the system was far better than before, it wasn't very simple and hassle free even after there being a clear division between the State and the Central and how each would collect the tax, due to the multiple slab system and it not being very comprehensive. These problems were discovered later in run and should be addressed to maximize the fruitfulness of GST.

The sheer importance of this topic can be inferred from the fact that almost all the citizens have either come across or paid this indirect tax called GST. The current GST system in India divides the GST into 3 major parts – State GST (SGST), Central GST (CGST) and IGST. The 3 major GST (or components of the GST system in India) is further divided into 4 slabs – 5%, 12%, 18% and 28%. Now, there has been a lot of confusion with regards to the products and which category of the 4 slabs they would fall in.

This is one dilemma, that has daunted not only the producers and manufacturers, but also the policy formulators because in my opinion, there is no clear distinction for division of the various products into various slabs as such and if only there exists a distinction, it would be too thin of a line of distinction to remove the dilemma.

GST SYSTEM

As mentioned in the earlier section of this paper, prior to the GST system being introduced, there was a system of multiple indirect taxes and the whole process was very much corrupt and cumbersome. The evidence for the same could be taken from the report of the Task Force on GST which mentioned that the Indian taxation system led to misallocation of resources and was hampering the development of the overall country.¹ Not only this, but the earlier system also had a lot of loopholes which were exploited by the clever and corrupt businessmen to evade taxes. Many also complained that there was a cascading effect of tax. All this and the cries of numerous people along with the task force recommendation, led to GST being introduced in 2017.

The GST system in India, is a kind of destination based value-added tax system which is levied throughout the Indian State on the manufacture, sale and consumption of goods and services (as the name suggests., Goods and Services Tax). Now one might ask as to what is a value-tax system? To put it in simple layman terms, this tax is levied and collected at every stage, a value addition takes place in the manufacturing and sale of goods and services.²

The Indian GST system is very much similar to the Canadian GST model and the inspiration for the former was taken from the latter due to certain reasons one of which is the similarity of the overall system of the country i.e., both India and Canada follow a 'Federal System'. Both India and Canada have a similar Dual GST system.³

The Indian GST system comprises of the following components – CGST (levied by the Center), SGST (levied by the state)/ UGST (levied by the Union Territory) and IGST (levied by the Center on inter-state transactions of goods and services). The current GST system can be said to be a clear tax system as there is one tax for both goods and services. The current system also eliminated the cascading effect and minimizes the evasion by making the system more water-tight in comparison to the earlier times.⁴

There are 5 major tax slabs under the GST regime in India –

- i. 0% or tax free – All the essential goods and services are included in the tax free i.e., 0% slab. These include fruits, vegetables, milk, medical services, education services etc.
- ii. 5% tax, 12% tax, 18% tax
- iii. 28% tax – Luxury goods, cars, construction materials like paint, cement, tobacco products and more.

The main ideology behind these slabs is to keep the essential items and food products in the lower tax slabs and the luxury goods and harmful products towards the higher end of this tax slab spectrum. One exception to this is the gold which has a separate category of 3% and rough, precious and semi-precious stones at 0.25%.⁵

The decision of the division of slabs mentioned above and the overall policy formulation with regards to the GST is done by the GST council of India. The GST council of India was formed on 15th September 2016 and the provisions for the same was inserted in the Indian Constitution under S.279A via the 122nd amendment. The president is empowered to appoint the members of the GST Council which is chaired by the Union Finance Minister. The major function of the council apart the ones mentioned above, is to make recommendations with regards to the tax rates, exemptions etc. The decisions in the GST council are taken after a valid meeting and a majority vote for the said decision. However, interestingly, till date, majority of the decisions taken by the council have been consensus based and they have exercised their voting rights to take decision only once. The voting rights with the center rests at 33% and the state representatives at 66% collectively.⁶

This GST system has simplified and made it very convenient for the users to comply and pay and for the administration to administer the tax. A few very important aspects of a good tax system is that it should have minimum compliance costs, should be tax-payer friendly and that it should not be too complicated and complex for both the compliance and for administration. The earlier system, drastically lacked in all the aforementioned aspects and the new system i.e., the GST system kind of ticks all the right boxes towards being a good tax system which is taxpayer friendly, easier to comply and administer and has reduced compliance costs.

One excellent example of the current system being tax-payer friendly and easy to comply with is the composition scheme. This scheme was specifically designed keeping the small businesses in mind who cannot afford the cost of complying with the regular GST scheme. Under this scheme, the paperwork and compliances along with the tax-rate are significantly reduced to cater to these small businesses and enable them to easily comply and pay the tax. One small tradeoff, however, is that those who choose to pay tax under the composition scheme will not be able to claim Input Tax Credit and avail the benefit for the same.

¹ M V Maruthi, 'A Comprehensive Analysis of the Goods and Service Tax (GST) in India' (2020) 4 International Review of Business and Economics 62.

² Dr. Baneswar Kapasi, 'Indian GST and Canadian GST – A Comparative Study' (2017) 7 International Journal of Research in Management, Economics and Commerce 246.

³ Manisha Patawari and Dr. Sanjay Prakash Srivastava, 'Comparative Analysis of GST in India and Canada' (2021) 9 IJCRT g546.

⁴ M V Maruthi (n1).

⁵ 'GST Rate Slabs Simplified' (Kotak) < <https://www.kotak.com/en/stories-in-focus/taxes/gst-rate-slabs.html#:~:text=The%20GST%20council%20has%20fitted,%25%20and%2028%25%20under%20GST.> > accessed on 14th April 2024.

⁶ Manisha Patawari and Dr. Sanjay Prakash Srivastava, 'Comparative Analysis of GST in India and Canada' (2021) 9 IJCRT g546.

It is interesting to know that since the time of its inception, as per the needs and as per the recommendations from the GST council, various reforms and amendments are taking place almost every year to further refine the GST system and, in an attempt, to tackle the issues and loopholes that come up. One example of a reform which recently made this system just a little bit more tax-payer friendly and easier to comply with is that it removed the mandate of GST registration for traders and businesses who deal with goods and services which are not taxed under the GST system (to put it simply, goods and services which fall under the 0% tax slab. Thus, it could be inferred that the GST system had a lot of positives about it. Also just like any other discourse, not all is positive about the GST. One very big question raised on the GST regime is regarding the GST Council and its impact on the fiscal autonomy of the states. Let us now have a look at what the GST council is and how it works in order to be able to analyze the impact it might have, whether positive or negative or doesn't affect at all, the fiscal autonomy of the states.

GST COUNCIL AND STATES' AUTONOMY – AN IN-DEPTH LOOK

As per Article 279A(1) of the amended Constitution, the President must create the GST Council within a period of 60 days from the date of the enforcement of the aforementioned article. Enacted on September 12, 2016, the provision followed its notification two days earlier on September 10, 2016. The GST Council serves as a collaborative entity involving both the central and state governments. Its membership includes the Union Finance Minister as the Chairperson, the Union Minister of State for Revenue or Finance, and the Finance or Taxation Ministers (or their representatives) from each state. Article 279A(4) specifies the Council's role in advising the Union and state governments on various GST-related matters. These responsibilities include identifying taxable and exempt goods and services, drafting model GST laws, determining principles for the Place of Supply, setting threshold limits, and recommending GST rates, including minimum rates and rate bands. The Council also suggests special rates to raise resources for emergencies like natural disasters and offers guidance on state-specific provisions when necessary.⁷

One big blow to the states' fiscal autonomy, is allegedly given by the 'voting system' and the 'decision making system' of the GST Council. The GST Council has a 'Weighted Voting System' in place wherein 1/3rd of the total votes rests with the Central Government and the rest 2/3rd rests with the states collectively. However the catch here is that for a successful resolution, it has to attract 3/4th of the votes in its favour. This effectively gives the Central Government to stall the decision as per its whims and centralizes the power a little.⁸

This power imbalance between the centre and the states, with the latter holding lesser power in the GST Council, which a key body for GST, raises important questions and concerns regarding the federalism and states fiscal autonomy, when it comes to GST. The states' power to independently plan its fiscal policies without any interference or influence from the centre has been heavily curtailed under the current GST system, as alleged and can be inferred from the structure and the process followed by the GST Council. This allegation and criticism is raised because in the erstwhile VAT system, the states had considerably more autonomy in planning their tax policies and deciding their own tax rates. Different states had different tax rates, as per their need. This was very much in line with the 'Federal Structure' which allegedly been encroached upon and hampered. The erstwhile system, did give the state's more autonomy but on the flip side, as mentioned earlier, made it very difficult and troublesome for the businesses to conveniently do business.

Now, one landmark case, that acted as a propellant in keeping this discourse of 'GST Council and Federalism' alive, is the Mohit Minerals Case.⁹ In this case, they basically analysed the relevant constitutional provisions leading to the formation of the GST Council and reiterated the thing written on the paper, i.e., the recommendations of the GST Council are not binding on Union or the States. Even though this was not the main issue being dealt with in the case and was a secondary finding and ruling of the court, this ruling became the most discussed one and the controversial one and the case became a landmark and famous case only because of this finding.¹⁰

It is often argued that the ruling of the Mohit Minerals case was misinterpreted by majority of the people. They took it as a fatal blow on the very existence of the GST Council and its power. Since the court held it to be recommendatory and not binding, the states or the union government could on paper easily refuse to implement the recommendations given forth by the council. However, in reality this has not been the case. In my opinion, the GST Council is a classic example of cooperative federalism, where the centre and states come together to the table, to discuss the various recommendations and objections one might have to the recommendations, to reach a final conclusion which even though is a mere recommendation, the states and union implement them to their benefit. The 54 meetings of the council which have been held so far and their recommendations have proven to be beneficial and useful.¹¹

⁷ D Ananda, "Goods and Service Tax and its implications for fiscal federalism in India" (2024) 6(2) IJPSG, 95-100.

⁸ S. Bhattacharjee and P. Sakar, 'Voting in the Goods and Service Tax Council of India' MPRA. <https://mpra.ub.uni-muenchen.de/86355/1/MPRA_paper_86355.pdf> accessed on 25th November 2024.

⁹ Union of India v. Mohit Minerals, Civil Appeal Nos. 1390 and 1394 of 2022, Supreme Court.

¹⁰ Srinivas Kotni, "Supreme Court's judgment on GST Council: Does it promote or hinder cooperative federalism?" The Leaflet. <<https://theleaflet.in/explainer/supreme-courts-judgment-on-gst-council-does-it-promote-or-hinder-cooperative-federalism>> accessed on 25th November 2024.

¹¹ GST Council. <[https://gstcouncil.gov.in/gst-council-0#:~:text=As%20per%20Article%20279A\(4,limits%2C%20GST%20rates%20including%20the.](https://gstcouncil.gov.in/gst-council-0#:~:text=As%20per%20Article%20279A(4,limits%2C%20GST%20rates%20including%20the.)> accessed on 25th November 2024.

This in my opinion, does not go against the concept of federalism. Even though, the states have lost some autonomy to levy the tax rates as per their own whims, they still haven't lost their fiscal autonomy completely, as even the states have an important say, rather they are an integral part of the GST Council decision making process, as mentioned above. This collective decision process of the Center and the States, only adds to my case that GST Council in reality doesn't hamper the states' fiscal autonomy, rather it promotes cooperative federalism and decision making.

To further supplement my argument, let us look at the concept of veto power with the center and the states in the GST Council. No doubt that the center can veto whenever they want and affect the decision making process of the states. However on the flip side of the coin, even the states have the veto power, and the centre cannot get away with its fancies whenever they wish to do so, because the same could be vetoed by the states' collectively as a whole. Thus, both the centre and state exercising veto powers on each other, has put in place a mechanism to keep a check on the whims and fancies of either stakeholders and prevents one from acting in a way that is detrimental too and against the benefit of the other.¹² Thus one must not forget that where 1/3rd power is with the 'Centre' alone, 2/3rd rests with the states collectively and the states can collectively act to keep a check on the centre. I feel that, this goes miles in promoting cooperation not only amongst the states but also amongst state and center, thereby fostering the values of cooperative federalism.

OVERALL GST SYSTEM AND FEDERALISM

One of the biggest critique of the GST System being introduced and which is valid till very recent, is the fiscal and financial losses being faced by the states, as compared to the erstwhile system, where they had much more autonomy and earnings in concern. The implementers of the GST had already thought of the same, and the states were promised compensation for their losses for certain initial period. 'GST Compensation Cess' was introduced for the same. The states, which were major players in manufacturing, were the actively criticizing the GST system, because of the effects it might have on development of the industries in those states, as the GST is a tax on sale of goods and services, hence is a destination based tax, with the destination being the place where such sale of goods and services occur.¹³

The impact of COVID-19 compounded the problem, directly affecting revenue-generating streams once lockdowns came into effect in late March 2020. The GST was a consumption-based tax and the central government had initially also assured of compensating states for loss of revenue on account of GST, for a period of five years. However, the Union Finance Minister Nirmala Sitharaman, in August 2020 announced their inability to meet the compensation payment requirements, taking the defence of 'Act Of God'. What is shocking is that the compensation to the states have been pending since April 2020.

To further enlighten the distressing situation of the GST Compensation and the financial losses to the states, during 2020 the compensation requirement estimate was around Rs 3 Lakh Crores whereas the estimated collection was projected to be around Rs 65,000 Crores. Thus, there was an immediate shortfall of Rs 2.35 Lakh Crores.¹⁴

The GST Council and the overall GST System in India, is no doubt a very ambitious and a great move towards a simplified and more centralized indirect tax system as compared to the erstwhile regime of multiple indirect taxes. It goes without saying that in an attempt to centralize and simplify the indirect tax system, some amount of autonomy have to be sacrificed, which essentially is the price one has to pay for ease of doing business and simplification. Post the GST, even though the overall tax collection has improved considerably and the center alongwith a few states are enjoying the fruits of the GST System, all these benefits is at a cost of the autonomy of certain states, specially the states who were leaders in the manufacturing industries. These states have not only lost fiscal autonomy, thereby impacting the 'Federal Structure' enshrined in our constitution, but have also been suffering considerable losses, whereas at the same time certain states are better off than before. It seems as if GST has redistributed the profits, taking it from the well to do states in the erstwhile system, and given it to the center and other not so well to do states.

No doubt that the GST Council and the GST System has given some blow to the fiscal autonomy and federal structure that existed between the centre and the states prior to this system, and this becomes all the more evident when you dissect the system and look at it in bits and pieces. However, that is not the right approach. One should take a holistic view and understanding of the system, and how the whole GST system works and impacts as a whole. When you look at the system in this sense and consider the real practices, the situation is not that bad, as it may seem to be. The state may have lost the uncanny power it had in the erstwhile system, however, it still has the option to raise its issues in the GST Council meetings and get the required help and assistance.

This process is available on the paper, however in reality it is a difficult and cumbersome process. Due to its central nature of the GST system and the structure of the GST Council, it becomes very hard to cater to the needs of each and every state, as the tax rates are centrally fixed with a share of the collection going to the concerned state. Furthermore, individual states do not have the requisite power to object to a decision that might affect it negatively. Such objection can only be made by states collectively as a whole. Thus the concerned state will have to approach other states and try and convince them to help it out by objecting to a particular proposal. Even this is not without problems because what might be problematic for one might be beneficial for the other. This is a very big disadvantage of the overall GST system, that has robbed the states away of their precious and much needed autonomy, which they ought to have got in order to fully reap the benefits of the marvellous and ambitious system.

¹² Article 279A of the Constitution of India.

¹³ D Ananda, "Goods and Service Tax and its implications for fiscal federalism in India" (2024) 6(2) IJPSG, 95-100.

¹⁴ Aanchal Magazine, 'Explained: The Issues in GST Compensation,' Indian Express. <

<https://indianexpress.com/article/explained/gst-council-compensation-states-centreexplained-issues-in-gst-compensation-6574139/> > accessed on 25th November 2024.

SUGGESTIONS

To effectively address the challenges posed by India's Goods and Services Tax (GST) regime, it would be pertinent to find a middle ground wherein the central government sacrifices a. it of its power and grants some autonomy within the framework of the GST System, so as to make it more states friendly. This should be done keeping in mind that it does not affect or hampers the benefits of the a simplified and unified tax system. Rather it should leverage the simplicity and benefits of the unified system to help the system become a bit more decentralized. One of the suggestions to improve the system could be to reevaluate the decision-making processes within the GST Council to increase the role and power of states and revising the compensation mechanism to make it more robust and adaptable to economic fluctuations.

Another very big contributing factor to the tension between the Centre and States with respect to the GST System, is the distrust between the two parties. Trust between the central government and the states is vital, particularly during periods of economic uncertainty. States require clear and prompt assurance that their fiscal concerns will be handled equitably. To this end, mechanisms for resolving disputes under the GST framework must be strengthened. Such measures would not only reduce tensions but also foster a cooperative and constructive relationship between various levels of government. Reforms could also focus on ensuring that states have the flexibility to adapt tax policies to their unique economic conditions without undermining the integrity of the unified tax system.

CONCLUSION

All in all, to conclude, India has come a far way from where we were earlier and have succeeded in developing a good GST system in some aspects as per our country's need which works excellently for the country and a few states. But our system is not perfect, and has some glaring loopholes, especially when it comes to the discourse of states' fiscal autonomy and federal relations being hampered by the current system. The system no doubt has hampered the autonomy a bit and has tweaked the federal structure, making a move towards cooperative federalism when considered as a whole. However, these issues could be improved in ways which I have tried to suggest in the previous section of this paper.

To conclude we have a long way to go but certain reforms in the current system, that makes the system a little more geared towards the states, will go miles in making the journey much more pleasant and hassle-free, which is very essential as the country and the GST Council has other issues that needs to be dealt with to cater to the needs of the country, rather than the states and centers fighting amongst themselves within the council. It is a step towards 'cooperative federalism' and it should be received with a positive spirit, with an attitude to collectively work out the differences and blockages that might arise in this journey. There has been much criticism for the system, but with cooperation and a positive attitude, all the loopholes in the current system can be worked out, ultimately the states and the country as a whole.

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