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INTERNATIONAL JOURNAL  
FOR LEGAL RESEARCH & ANALYSIS

# **IMPACT OF GST ON THE CENTER STATE RELATIONS IN INDIA**

Authored By- Chirag Patel R S

## **ABSTRACT:**

The GST Act was enacted to bring a simpler, transparent taxation system to the country. It aimed to bring a unified taxation system throughout the country. It has brought in several changes in the taxation system as well as the federal structure of the country. This involved the taxation of goods and services in an integrated manner and due to which the separate tax laws for the center and state has been blurred. The Constitution previously had not provided for any concurrent taxation powers to the Centre as well as the States. This required the Constitution to be amended for conferring simultaneous power on Parliament as well as the State Legislatures, including every Union Territory with Legislature to make laws for levying goods and services tax on every transaction of supply of goods or services or both.

This paper will study the changes in the center state relations due to the enactment of GST and how the present division of revenues takes place between the center and the state. The paper addresses certain constitutional hurdles due to the enactment of GST and suggests certain measures which can help in removing the present difficulties faced by the country in the process of uniform taxation.

# **CONTENT ANALYSIS:**

## **I. INTRODUCTION**

The federal structure is one of the basic features of the Indian Constitution. The states have financial autonomy over certain subjects. The constitution bifurcates the powers and duties between the center and state. The GST law which was enacted has impacted the center state relations. The first part of the research paper deals with a brief introduction to GST, the concept of federalism, and the purpose of the interstate council. The paper later proceeds with the impact on center-state relations. The paper concludes with the researcher trying to give certain suggestions to maintain the center-state harmony.

### **A. GST**

GST (Goods and Services Tax) is an indirect tax that has replaced several other indirect taxes in India. It was enacted on March 29, 2017, in Parliament as part of the Indian government's execution of the One Hundred and First Amendment to the Constitution of India, however, it took effect on July 1, 2017. GST is designed to be a dual-levy taxation system, with both the federal and state governments imposing and collecting taxes. Central GST (CGST) and Integrated GST (IGST) would be managed by the Centre, while the States (SGST) will manage State GST. This will contribute to the country's economic unification, stability, and transparency. The use of a single tax base would also aid in the avoidance of double taxation. For tax collection, there are five different tax slabs: 0%, 5%, 12%, 18%, and 28%. However, certain items are free from GST, such as petroleum goods, alcoholic beverages, and electricity. Rough, precious, and semi-precious stones are charged a special fee of 0.25 percent on gold and 3 percent on silver. Furthermore, a 22 percent cess or additional charges on top of the 28 percent A few things, such as aerated drinks, expensive autos, and tobacco products, are subject to GST. Pre-GST, most commodities had a statutory tax rate of about 26.5 percent; post-GST, most items are likely to have a tax rate of around 18 percent. Various indirect taxes are grouped under the GST umbrella. Furthermore, the use of information technology via the Goods and Service Tax Network (GSTN) would make things more transparent and easier.

The purpose of GST in India is to:

- i. Remove the tax cascading effect

- ii. Implement a simpler indirect taxation system
- iii. Increase the size of the tax base
- iv. Put in place an equitable levy
- v. Make things more transparent
- vi. Obtain consistent tax rates across the nation
- vii. Develop cooperative federalism.
- viii. Transition to a tax system based on a digital basis.
- ix. Boost income for the federal and state governments
- x. Put better mechanisms in place for the nation

## **B. Federalism**

In *S. R. Bommai v Union of India*, several judges have characterized Indian Federalism in diverse ways. SAWANT, J., has observed, “Democracy and Federalism are an essential part of our Constitution and are parts of its basic structure.” JEEVAN REDDY, J. observed “The fact under the scheme of our Constitution, greater power is conferred upon the Centre visà-vis the State do not mean that State is mere appendages of the Centre. Within the sphere allotted to them, States are supreme. The Centre cannot tamper with its powers. More particularly, the courts should not adopt an approach, an interpretation, which has the effect of or tends to have the effect of whittling down the power reserved to the states.”

A Federal-State derives its existence and every power- executive, legislation, or judicial- whether it belongs to the federation, or the component State, - is subordinate to and controlled by the Constitution. A constitutional division of power between the center and the component territorial units is a crucial point in most definitions of federalism the center and the component territorial units is a crucial point in the most definition of federalism and in our graphic model of a federal system and under the VII Schedule and part Vth, VIth of Constitution of India, power is distributed between center and state. <sup>1</sup>

The GST Act has affected the federal structure by replacing VAT. Certain powers of revenue which were vested with the state are now transferred to the center. This will be a catalyst for the conflict between the center and states. Thus, the role to prevent the conflict, the interstate council has been

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<sup>1</sup>Tripathi, Anurag, *Federal Structure of Indian Constitution*, 2010

established.

### **C. Inter-State Council**

The Constitution of India establishes a policy that sets out the territories of the Union and the countries that it can use in its assigned territories. In line with this, the Constitution establishes a comprehensive system of devolution of power between the Union and the States in the areas of law, administration, and financial authority. The issue of legislative power is divided into three Lists in the Seventh Schedule to the Constitution: Union of Trade Unions (Table I), List of Provinces (Table II), and Related Program (Table III). Parliament has been given the remaining powers to legislate. The Union Government has taken steps to address disputes over the transfer of power between the Institute from time to time.

In 1988, the Union Government established the Commission, led by Justice R.S. Sarkaria, to evaluate the effectiveness of existing Union-State programs. The establishment of the Eternal Council of Provinces as a separate national forum for discussion, with the mandate clearly defined in Article 263 of the Constitution of India, was one of the key recommendations of the Sarkaria Commission. The Inter-State-Council was established under Article 263 of the Constitution of India by order of the President dated 28/5/2009, in response to this recommendation. Composition of Council as follows:

- Prime Minister Chairman
- Chief Ministers of all States Members
- Chief Ministers of Union Territories having a Legislative Assembly and Administrators of UTs not having a Legislative Assembly and Governors of States under President's Rule (Governor's Rule in the case of J&K) Members
- Six Ministers of Cabinet rank in the Union Council of Ministers to be nominated by the Prime Minister Members
- Four Ministers of Cabinet rank as Permanent invitees Members

The Inter-State Council is a consultative body mandated to investigate and discuss matters of mutual interest between the Union and the Provinces or between the provinces, making recommendations, especially on better policy and co-ordination of these matters, and alternatives. news. General Interests Areas to which the Chairperson may refer. The Council also considers any

additional national interest issues that the Chairperson may raise in the Council.<sup>2</sup>

## **II. Impact On Centre-State Relations**

### **A. The Vat And Gst**

VAT and GST are synonymous in most nations throughout the globe, but not in India for several reasons. In India, the Value Added Tax (VAT) was introduced to replace the Sales Tax. VAT was a consumption tax levied on goods when the value was added at each level of the supply chain, and it was eventually paid by the end consumer, like Sales Tax. However, unlike Sales Tax, which is only charged on the final sale of goods, it is. VAT is a tax that is likely to be paid on an organization's value-added at each step of providing services or manufacturing products. VAT is the most varied and transparent indirect tax, with the ability to enhance tax collection by broadening the tax base and deterring tax fraud built-in. The notion of Input Tax Credit/Rebate is used to offer a set off for previously paid taxes under VAT. The Value Added Tax (VAT) was India's first major indirect tax reform, and it was made possible by the Indian tax regime's constitutional requirements. Although VAT was a much-needed change in the Indian tax system, it resulted in a complicated tax structure that helped India achieve better transparency and a partial decrease in tax evasion. Each state had its VAT rates, as well as a slew of other municipal taxes such as Entry Tax and Octroi. Due to constitutional stipulations, each state had autonomy under the State List, through which VAT was implemented, and each state had the right to collect and charge VAT on assorted items at rates specified by the state.<sup>3</sup>

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<sup>2</sup>Pandey Sumedha, *Changing Paradigm of Centre State Financial Relations in India with Special Reference to GST Good and Services Tax*, 2021

<sup>3</sup> Ms. Joyline Clara, *A Comparative Study of GST And VAT Tax Systems*, IOSR Journal of Business and Management

## **B. The constitutional Changes Relating To Center-State Relations.**

The most significant changes by the 101st Amendment of the Constitution are as follows:

- a) In article 246, a new article has been added which enables to make tax provisions by both Union and State concerning the GST scheme. It allows both to levy taxes on goods and services. It further specifies that Union has exclusive power to make laws (Tax provisions) concerning the inter-state supply of GST.
- b) Article 268A of the Constitution was omitted. One must remember that it was added only to allow the Union to tax services but as GST includes both goods and services, no special provision for taxing services was required.
- c) A new article 269A has been inserted which provides for goods service tax on supply of inter-state trade/commerce. The tax shall be levied only by Union Government and shall be distributed/shared between center and state. This sharing shall be decided by the Goods and Service Tax Council. But as the levying and collecting authority is Union Government and the decision need to be approved by the Parliament.
- d) Article 270 was also amended to provide for the distribution of revenue collected under GST between the Union and States. Finance Commission becomes relevant because this division is especially important for the fiscal autonomy of states which receive a fixed proportion of GST collections as provided by the finance committee and approved by the Parliament.
- e) Article 271 of the Constitution was also amended. Surcharges could not have been added to GST because of article 246A. As the power of the Centre was limited to levy surcharge on Goods and Services article 271 was amended. Now, Union Government can levy a surcharge on any good or service.<sup>4</sup>

For any amendment of the Constitution, earlier only 2/3rd majority of Parliament was made mandatory. In the case of GST, all states were also a part, and their interests were also involved in this amendment of the Constitution. Hence, a special provision was made which requires the ratification of the bill by the legislatures of at least half of the States in addition to the method of voting mentioned above for amendment of the Constitution. This amendment is especially important because any time in the future if any modification is to be done in GST Council, the bill

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<sup>4</sup>Amendment of constitution for GST available at <https://cleartax.in/s/constitution-amendment-gst>

(Constitutional Amendment) will require the ratification by legislatures of at least half of the States. So, the GST Council created under Article 279A became a constitutional body.

### **C. The Dual Gst Model And Federalism**

India adopted a dual GST approach, in which taxes are imposed simultaneously by the center and the states, or on a single basis that encompasses both goods and services, throughout the country in the following manner: All sales within a single state's jurisdiction are taxed by the Centre and the States on the same basis and at the same rates, which is known as the GST rate. Even though it is split into two equal portions, the Centre's share is known as CGST, and the State's share is known as SGST. The Centre solely taxes all states at the full GST rate, regardless of where they are located. This tax is known as the IGST. In the event of cross-state sales of goods and services, the Input Tax Credit on purchases may be deducted from taxes paid on sales, regardless of source. Only those Union Territories that do not have a legislature will be referred to as UGST. The IGST concept is a fantastic illustration of Centre-State Co-operative Federalism in India. The Centre will impose a full IGST (full GST), which, as previously said, is equivalent to CGST Plus SGST. After adjusting Input Tax Credit applicable under IGST, CGST, or SGST on his purchases, Inter-State shipments will pay IGST solely on additional value (value addition). The state that provides the products will transmit the SGST credit utilized in the payment of IGST to the Centre, and the state that receives the supply (the ultimate destination of the commodity) would be entitled to collect the credit from the Centre when discharging his output tax duty. The tax is transferred from the states where the items are sold to the supplier state once the center has claimed it. The most significant benefit of this type of IGST model is that it is self-monitoring, even though all relevant transaction information would be submitted to a central agency that would function as a clearinghouse, transferring funds from the supplier state to the buyer state after verifying claims and informing both state governments.<sup>5</sup> This IGST model of tax solves various kinds of disputes that may arise, but certain grey areas need to be cleared in cases where the inputs are taken from various suppliers who are not registered. But this impacts consumers and businesses and not the relationships of States.<sup>6</sup>

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<sup>5</sup>Gupta, CA. Upender. "INTEGRATED GOODS AND SERVICES TAX (IGST)." National Law School of India Review, vol. 28, no. 2, 2016, pp. 134-42,

<sup>6</sup>Jain, Shreya (2016), "The Goods and Services (GST) Regime through the lens of Fiscal Federalism in India", Indian Law Institute, Law Review,

## **D. Gst Compensation To States**

GST scheme of taxation has altered the mechanism of VAT as GST is charged at the time of supply and it depends on the destination of consumption e.g. If any good is manufactured in U.P. (State A) but consumed in Karnataka (State B), the tax will be collected in Karnataka (State B) thus the revenue generated through GST is credited in the account of the state where consumption takes place and not where the production has taken place (State U.P.). This is a simple example for commodities like biscuits, and toffees but there could be complex situations where inputs are sent to other states and then after value addition may be sold in any of the states. Due to this nature of the tax, many states (manufacturing States like Gujarat, Haryana, Karnataka, Maharashtra, Tamil Nadu, and Andhra Pradesh) felt that they would have serious revenue losses. Central government after analyzing the problem of fear among States passed a Transitory Act for five years on 12th April 2017 by the Ministry of Law and Justice by the name of 'The Goods and Service Tax (Compensation to States) Act 2017', to provide for the loss of revenue arising out on account of implementation of Goods and Service Tax in pursuance of the provisions of the Constitution (One hundred and first amendment) Act 2016 which shall extend to the whole of India and shall come into force on such date as the central government may by notification announce in the gazette. The Act was created as mentioned above to compensate States in case of any loss in revenue. The compensation is offered for five years from the date of GST implementation. The calculation of revenue loss in any fiscal year shall be based on the revenue of the fiscal year 2015-16 which shall be treated as the base year. Revenue growth of 14% shall be added to the revenue of the base year for calculating the revenue loss. One must remember that revenue of any state for 2015-16 (base year) shall be estimated by adding revenue from Central Sales Tax, State VAT, Local body Tax, Octroi, Entry Tax as well as revenue from Advertisement Tax, Luxury Tax, etc. but will not include the revenue of such goods which have not been included in GST such as petroleum products. Most importantly it was made clear that the calculation of compensation is done on a provisional basis and released at the end of every 2 months. But the compensation will not only be on a provisional basis, but this was also to give relief to States for regular expenditure. A yearly calculation of the overall revenue will be done which shall also be audited by CAG of India. A compensation Cess Fund has been created which will be called a GST Compensation Cess. GST compensation cess applies to certain notified goods which will be in addition to GST. GST cess is also applicable on

imports.<sup>7</sup>

### **E. Centripetal Bias**

Because of improved efficiency and resource distribution at multiple places, all conventional and non-traditional economic scholars feel that a federal system is significantly superior to a centralized one. But what are the income and function split between national and subnational governments? There is no definitive solution to this question. There is an inherent centripetal tendency in all federal countries, according to empirical evidence. Although no studies on the cost, efficiency or welfare benefits of decentralization in India have been conducted, no one can refute India's centripetal bias, which is based on the Indian Constitution itself. All finance commission reports (which oversee correcting horizontal and vertical imbalances as well as other improvements in the fiscal system) plainly show that the states have been given more responsibilities than income. Most experts point out that states' income only covers 30 to 35 percent of their spending requirements, forcing them to rely on central fund transfers and subsidies to even meet their revenue expenditure demands, jeopardizing the states' fiscal autonomy.<sup>8</sup>

The implementation of GST was envisioned to grant more funds to states as earlier devolutions although had increased as most central transfers were principally based and thus automatic but did not have a significant impact on states' funds. It was assumed that one nation one tax would help in reducing competitive federalism which has resulted in the loss of 2.8% of revenue as a percentage of GDP (Report of NIPFP) through various concessions and tax exemptions by states as well as evasion of tax leading to higher incomes of the state.

### **F. Items Barring Center-State Relations Under Gst Model**

Ever wondered why we get liquor in places like Goa or Puducherry for a lesser price compared to your state or why people find it more cost-friendly for their vehicle registration from another state instead of their own. It is because some goods and services are having a bar on Center-State relations and are having respective tax models for their states.

Likewise, some goods do not attract GST as they are on the verge of control either by respective state governments or under the central government, respectively.

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<sup>7</sup>Pandey Sumedha, *Changing Paradigm of Centre State Financial Relations in India with Special Reference to GST Good and Services Tax*, 2021

<sup>8</sup> "GST and Autonomy of States." *Economic and Political Weekly*, vol. 45, no. 4, 2010, pp. 5–6.

The items like Alcohol used for human consumption, Natural gas, Petrol, its products, electricity, etc.

## **Overshadow Effect On GST In India**

Now alcohol, petrol, and diesel are not yet included in the GST because state finance ministers have demanded it from the union's finance minister, claiming that the high tax they earn comes from alcohol, petrol, and diesel. So, including it on the GST list would have a significant impact on their tax revenue.

In addition, the cost of fuel in the province near the ports is comparable to the cost of fuel in other parts of the country. Additional transportation costs and national government service tax are included in this. These transportation costs and state government services will have to be taxed on the shoulders of the central government if they are listed in the GST but have not been included.

Also, because alcohol generates more revenue for provincial governments, it is excluded. Some states, such as Tamil Nadu, Karnataka, Uttar Pradesh, and others, have not taxed them under the GST scheme because they are their main source of revenue.

### **List of Entries in Schedule III of the CGST Act**

Schedule III of the CGST Act covers duties or functions that may not be classified as delivery of goods or the provision of services. There are now eight items in Schedule III of the CGST Act, which are listed in the same order as the GST Act and include additional information:

- Employee Services under Employment Agreement
- Services by Court or Tribunal
- MP or Person in a constitutional post or government post
- Services about a deceased or Funeral and related services
- Sale of land and/or completed building
- Actionable Claims except for Betting, Gambling, Lottery, etc.
- High Sea Sale or Sale from and to Non-taxable territories or Third-country export
- Merchant Trade supply

Even though GST covers several things, there are still some exceptions. The GST Act negative list is particularly important because it contains activities that are not under GST. It is important to have a complete understanding of these items to avoid charging the wrong GST for this purchase. It is also important to understand what items are released in GST.



## Conclusion And Suggestions

The researcher has attempted to study in detail the provisions of the GST, and how it has impacted the revenue system of the country. It has specially focussed on the impact on the central state relations of the fiscal relations, compensation, etc. It has also analyzed the constitutional amendments and the hurdles to the constitutional spirit due to the enactment of GST.

Implementation of GST has not been exceptionally smooth despite a long negotiation history. In the last three years 40 GST council meetings have been held, eighteen before GST implementation and more than twenty-two after the implementation of GST. In the meetings post-implementation, there have been various changes in procedures, regulations, tax rates, fines, and refunds. The changing and chopping of rates and regulations have created more problems than it has solved. For example, between July 2018 and August 2019, the gap in compliance with filing GSTR-3B has almost doubled. This gap in compliance has been created because the reconciliation of information is not timely. It also delays refund under input tax credit because of which compliance falls further which results in the lower collection. This may be one of the causes why the funds collected in 2018–19 are lesser in comparison to tax collections of 2017–18. Moreover, the delays also create volatility in fund collection. It so happens that in some months, GST collections drop to 80,000 crores while in some others it increases to 1,08,000 crores creating problems of governance for states. A stable, transparent GST system is basic for effective governance. Although there can be a shortfall in the collection of GST, in exceptional circumstances such as COVID-19 when the economy was locked down completely for 40 days. There can be no explanation for declining GST collections in 2018–19 and 2019–20 as compared to 2017–18. The decrease also provides valuable information i.e., GST which is a destination-based tax, and replaced VAT which was a production-based tax has not affected different states differently as the decline in GST fund collections is almost similar in all states.<sup>9</sup>

Some suggestions to improve the center state relations concerning GST are:

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<sup>9</sup>Pandey Sumedha, *Changing Paradigm of Centre State Financial Relations in India with Special Reference to GST Good and Services Tax*, 2021

- It is true that there would be issues political, social as well as economic where the Centre and states or states and states might have differences of opinions, debates, or disputes but if they can be contained/negotiated purposefully then naturally the optimal result could be achieved.
- Tax effort has been poor because otherwise, the tax revenue could not have declined as the tax base grew. So, one needs to analyze the reasons why tax effort has slackened? The most important reason could be 1) noncompliance 2) policy uncertainty and poor administration.
- The government and GST Council should sit together to decide the exemption limit thresholds (which are different) tax slabs, penalty and fines, and all other issues. Any change if required shall be done only at the beginning of the fiscal year and not in between.
- It is especially important to change the tax slab or charge then all beneficiaries shall be granted benefit and any fine up to that point of time shall be withdrawn at once. Any dispute shall be settled within three months which would enhance compliance and discourage policy uncertainty.

