

CHALLENGES TO INDIAN FEDERALISM IN SPECIAL REFERENCE TO GOODS AND SERVICES TAX

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ABSTRACT

The essence of Indian federal arrangement lies in the fact that, the State governments are not subsidiaries of the Central Government. The Central and State governments have been made autonomous as both of them draw their authority from the Indian Constitution. Our Constitution elaborately discusses the details the power sharing arrangement between the Union and the States across Article 245 to 300 in Part XI and XII. While Part XI (Articles 245-263) states the legislative and administrative relations, Part XII (Articles 246-300) deals with the financial relations.

KEYWORDS: Federal Arrangement, Centre-state Relations, Federalism, Territorial Pockets, Foreign Affairs.

Introduction

A Federation simply means two sets of Governments. It is a system of governance wherein there is a territorial division of power between the Centre and the State. This division is done through a written and rigid constitution which ensures that power and authority are not concentrated with a particular level of government. There is also an independent judiciary to keep a check on the powers of both the governments along with the provision of dual citizenship for the state subjects.

Concept of Indian Federation and Centre-State Relations

India gained independence in 1947 after a prolonged independence struggle and in the backdrop of the goriest partition violence. Moreover, the challenge of balancing of diversity with integration to transform India as a nation state was enormous, in wake of uncooperative princely rulers. Therefore, the constitution makers provided for a federal system of government without mentioning it explicitly anywhere in the Constitution. Article 1 of the Indian Constitution states "India, that is Bharat, shall be a Union of States". This means that unlike the USA the Indian federation is not the result of an agreement between the units and also the right of secession from the union has been denied to the states. This arrangement has earned a new name for Indian System when Prof. K. C. Wheare called it a 'Quasi- Federation'. Granville Austin has described the Indian federation as a new kind of federalism peculiar to Indian needs. This arrangement was adopted by the Indian Constitution makers because of the following considerations:

- Keeping in mind the territorial expanse and a wide variety of race, religion, language and other diversities of India a federal state was deemed to be apt for the country
- When it comes to satisfy the needs and demands of diverse groups of its population who live in separate territorial pockets, a federal system is a better option as it provides unity vis-à-vis assuring the autonomy in the matters of local importance.

Legislative Relations (Articles 245-255): The area of jurisdiction of the State Legislatures is restricted to their respective territorial stretches. But the Parliament has been entrusted the power to legislate for the whole or any part of the territory of India i.e. States, Union Territories or any other areas included for the time being in the territory of India. Moreover, the laws made by the Union Parliament govern not only persons and property within the territory of India, but also Indian subjects' resident and

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their property situated anywhere in the world. Only some provisions for scheduled areas, to some extent, limit the territorial jurisdiction of Parliament. As for the subjects of legislation the Constitution has divided them in three lists, the Union list, the State list and the Concurrent List:

- **List I**, or the **Union List**, includes 99 items which are exclusively within the jurisdiction of the Union Legislature, for example, defence, armed forces, arms and ammunition, atomic energy, foreign affairs, coinage, banking and insurance.
- **List II** or the **State List**, contains 61 items or subjects over which the State Legislature enjoys exclusive authority of legislation. These are those subjects of local importance, where variations in law because of local situations are inevitable, for example, State taxes and duties, police, administration of justice, local self-government, public health, agriculture, forests, fisheries, industries and minerals.
- **List III** also called the **Concurrent List**, consists of 52 items, such as criminal law and procedure, civil procedure, marriage, contracts, port trusts, welfare of labour, economic and social planning. Both the Centre and the State governments enjoy equal power of legislation on these subjects. In case of a clash between the laws made by the two governments, the prominence has been given to the Union Laws. However, if the State law was reserved for the assent of the President and has received such assent, then the State law may prevail. But the Parliament is authorized to override such State law by subsequent legislation.

The Constitution vests the residuary power, i.e., the power to legislate with respect to any matter not enumerated in any one of the three Lists in the Union Legislature (Art. 248).

Administrative Relations:

The administrative relations between the Union and the States are studied as under: (i) normal and (ii) emergency conditions:

- **In normal Times:** Even in normal times, the Indian Constitution has allowed the UNION to effectively control the states to ensure that they do not interfere with the legislative and executive policies of the union. Some of these control techniques are implicit in the executive and legislative powers vested in the President, in relation to states, for example, the President of India has power to appoint and dismiss the Governor, (Art. 155-156) and other dignitaries in the state. In the case of legislative relations, the previous sanction of President, to introduce legislation on certain matters is required in the state legislature (Art. 304); assent to specified legislation which must be reserved for his consideration (Art. 31A), instruction of President is required for the Governor to make ordinances relating to specified matters (Art. 213), veto power in respect of other State bills reserved by the Governor (Article 200). Various other arrangements have been made in the Indian Constitution to ensure the control of the Union over States:

- **Directions to the State Governments:** The Union Government has been authorized to give directions to a state government and to secure compliance with them, failing to which, the State Government will have to face imposition of President's rule.
- **Delegation of Union Functions:** The Constitution has also provided for the exchange of mutual administrative functions between the union and the state governments. For example, the President with the consent of the State government may entrust any executive function of the union to the states (Art. 258(1)). While legislating on a Union Subject, Parliament may delegate powers to the state governments and their officers in so far as the statue is applicable in respective states(Art. 258(2)). Conversely, a State government may, with the consent of the Government of India, confer administrative functions upon the latter relating to State Subjects [Art. 258 A].
- **Disputes Relating to Water:** Article 262 authorizes the Parliament to provide by law for adjudication of any dispute or complaint with respect to the uses, distribution or control of the waters of any Inter-State rivers and River Valleys under clause (2) of this Article. Parliament may by law provide that neither the Supreme Court nor any other court shall have any jurisdiction in respect of such disputes and complaints relating to water of Inter-State rivers and River Valleys. Under the Article 262, Parliament passed Inter-State Water Disputes Act, 1956. This Water Disputes Act empowers the Central government to set up a Tribunal for the adjudication of such disputes. The decision of the Tribunal shall be final and binding on the parties to the disputes. Neither Supreme Court nor any other court shall have jurisdiction in respect of any water dispute which may be referred to such a Tribunal under that Act.

- **Inter-State Council (Art. 263):** The President of India is empowered to establish Inter-State Council, if at any time it appears to him that the public interests would be severed thereby. The duty of Inter-State Council is to inquire and advise upon disputes which may have arisen between states. It also investigates and discusses subjects of common interest between the union and states or between two or more states, for instance, research in such matters as agriculture and forestry.
- **Grants-in-aid (Art. 275):** The Constitution of India has given the Parliament the power to make such grants as it may deem necessary to give financial assistance to any state which is in need of such assistance. By means of this, the union can correct Inter-state disparities in financial resources and can exercise control and co-ordination over the welfare schemes of the states on a national scale. The Union government also provides for specific grants for welfare of Scheduled Tribes and development of tribal areas.
- **All India Services (Art. 312):** There are certain services common to the union and the states called 'All India Services', of which the Indian Administrative Service and the Indian Police Service are the existing examples. "The constitution also gives the power to create additional All India Services, if the Council of States declares by a resolution supported by not less than two-thirds of the members present and voting that is necessary or expedient in the national interests".
- There are a few **advisory bodies** at the union level which co-ordinate the activities of the states in India, for example, National Planning Commission (1950) and National Integration Council (1986).
- **In Emergencies:** The Indian Constitution provides for three kinds of emergency situations where the provisions available in the constitution can be pressed into service. These three situations are related to 61 impositions of **National Emergency (Art. 352)** when there is war, threat of war or internal rebellion. The second situation is related to the breakdown of the constitutional machinery in the state where the centre intervenes through the President of India for the imposition of **President's Rule** in the state under **Article 356**. The third situation is related to grave financial crisis and there is need to impose **Financial Emergency** under **Article 360**. The Government of India, under proclamation of emergency, shall acquire the power to give directions to a state, on any matter. Though the state government will not be suspended, but it will be under the complete control of the union executive. During the operation of emergency, Parliament shall have the power to legislate on any matter in the State List. It can modify the provisions of the constitution relating to the allocation of financial resources.

Financial Relations

The financial relations between the Union and the State have been completely overhauled after the Constitution Amendment Act, 2016 (101st Amendment) providing for Goods and Services Tax across the nation. Let us have a look at the arrangements which existed prior to the amendment. The Indian Constitution made a distribution between the legislative power to levy a tax and the power to appropriate the proceeds of a tax so levied.

Distribution of Legislative Powers to levy taxes

The Legislative power to make a law for imposing a tax is divided between the union and the states by means of specific entries in the union and state Legislative Lists in the VII Schedule of the Indian Constitution. For instance, the State Legislature has the power to levy an estate duty in respect of non-agricultural land belongs to Parliament. Similarly, it is the State Legislature which is competent to levy a tax on agricultural income, while the Parliament has the power to levy income tax on all incomes other than agricultural. The residuary power as regards taxation belongs to Parliament and the Gift Tax and Expenditure Tax have been held to derive their authority from this residuary power. There is no concurrent sphere in the matter of tax legislation.

The Distribution of the Tax-Revenue between the Union and the States

Taxes assigned to the Union	Taxes assigned to the State	Taxes levied by the Union but collected and appropriated by the States	Taxes levied and collected by Union but assigned to the States	Taxes levied by the Union but shared with the States
Customs and Exports Duties, Income tax, excise duties on tobacco, jute, etc., corporation tax on value of assets of individual	Land revenue, stamp duty except on documents included in the Union List, Succession duty and Estate duty in respect of agricultural land, Income tax on	Stamp duties on Bills of exchange, Cheques, Promissory Notes, Bills of Landing, Letters of Credit, Policies of Insurance, transfer of Shares, etc; Excise	Duties in respect of succession to property other than agricultural land; estate duty in respect of property other than agricultural land; terminal taxes on goods or passengers	Taxes on income other than agricultural income; excise duties, other than those on medicinal and toilet preparations

companies; estate duty and succession duty in respect of property other than agricultural land.	agricultural land, taxes on goods and passengers carried by road or Island waters, taxes on vehicles used on roads, animals, boats; Taxes on the consumption or sale of electricity; Tolls, taxes on employment; duties on alcoholic liquors for human consumption, opium, Indian hemp and other narcotic drugs; taxes on the entry of goods into a local area: taxes on luxuries, entertainments, amusements, betting and gambling, etc.	duties on medical, toilet preparations, containing alcohol or opium of Indian hemp or other narcotic drugs	carried by rail, sea or air; taxes on railway freights and fares; taxes other than stamp duties on transactions in stock exchanges and future markets; taxes on the sale or purchase of newspapers and on the advertisement published therein.	
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Changes after GST

Since the Goods and Services Tax (GST) is a comprehensive indirect tax on manufacture, sale, as well as consumption of goods and services throughout the country, it will replace taxes collected by Central and state governments. Consequently, it will remove service tax, central excise, VAT and other taxes levied by state governments, incurring loss of revenue on these governments.

Central taxes that would be subsumed under the GST are	State taxes that would be subsumed under the GST are
<ul style="list-style-type: none"> • Central Excise duty • Duties of Excise (Medicinal and Toilet Preparations) • Additional Duties of Excise (Goods of Special Importance) • Additional Duties of Excise (Textiles and Textile Products) • Additional Duties of Customs (commonly known as CVD) • Special Additional Duty of Customs (SAD) • Service Tax • Central Surcharges and Cesses so far as they relate to supply of goods and services 	<ul style="list-style-type: none"> • State VAT • Central Sales Tax • Luxury Tax • Entry Tax (all forms) • Entertainment and Amusement Tax (except when levied by the local bodies) • Taxes on advertisements g. Purchase Tax • Taxes on lotteries, betting and gambling • State Surcharges and Cesses so far as they relate to supply of goods and services

Critical Evaluation of GST's effect on Indian Federalism

The major concern at this point is the effect this new tax regime is going to have on Indian Federalism. Besides subsuming the rights of the States to collect certain taxes by the Union, the States' right to collect tax revenues from firms that have a turnover of up to 1.5 crores or less is also being brought under central control. GST, appears to be an attempt to encroach upon the rights of States to decide taxes according to their socio-economic situations. Moreover, in the wake of national disasters or to acquire funds for welfare schemes to improve people's livelihood, State governments are now at the mercy of the Central government to avail funds.

This new reform also takes away the States' rights or powers to design their tax structure on what rates to impose on what all commodities including on luxury goods and necessity goods. The GST, thus, will block all other options available with the state governments to make up with their deficits and overdrafts, something that the States have been till now relying upon hugely to cope up in accordance to their fiscal policies. With such overarching powers of fund collection at the disposal of the Centre, the State governments, have been brought forcibly under the power of the Union. Such an arrangement is detrimental to the Indian Federal System which was designed to facilitate co-operation between the Centre and the State units irrespective of their respective political controls. The arguments that all these problems regarding the implementation of GST at the Central level and the sharing of revenue with the States shall be solved through the GST appears goofy owing to the fact that the council will remain as a centrally run institution and the major stakeholder will be the centre. There is little or no hope that the State concerns will be properly heard/ addressed in such a body.

This centralized arrangement will have serious outcomes with respect to fiscal autonomy; the States would be deprived of their important source of revenue and their right to decide the tax structure.

Moreover, States would become more dependent on the Centre and this will decrease their responsibility and accountability towards fiscal consolidation. Also, this will reduce the status of the States to a mere spending unit raising serious concerns over fiscal accountability. In a federal system like India (as discussed above), the GST which is being seen as a revolutionary move to unify the taxation mechanism raises alarming structural, procedural and administrative issues. It is also a general observation that no country with a federal structure has been able to have a fully harmonized system of GST. In the Indian System where Centre is collecting 62% of the total tax revenue, assignment of GST to the Centre will increase the power of Centre to collect 83% of the overall tax revenue, giving it a lion's share and leaving the States with meager resources. Under our federal set-up, such a proposition is unacceptable because our Constitution only seeks to control the possible irresponsible behavior of the State Governments, without compromising with their autonomy. GST will be a blow on the financial autonomy of States reducing the Finance Ministers, of the States and at the Centre to distributing agencies with having no power to take policy decisions. Budgets will be mere papers and the GST council, controlled by the Centre, will be all-powerful fiscal authority in the country.

The GST is being imposed at two levels: firstly, at the Central level (CGST) and secondly at the States' level (SGST). But the actual problem under the dual GST pertains to vertical tax externality, i.e., when both the levels of government, Centre and States, levy tax on same base, the tax policy decisions of one, affects the tax base of the other. It can be understood as: when the central government increases the tax levied on a commodity, it adds to the tax payable by the consumer. This in turn results in the decline of the demand for that particular commodity, thus reducing the total tax amount which was to be collected by both the levels of government. Thus, there is a reduction in tax base, which is unhealthy for the tax revenue of the States as well as the Central government. Another drawback of this arrangement is that, the rates for both, the CGST and the SGST, will be fixed by the GST Council, whose members shall comprise of State finance/revenue ministers and chairman will be the Union finance minister. Once the tax rates are fixed by the GST Council, the individual States will no longer enjoy their power to tax whichever commodities they want and at whatever rates they want. This implies that even though the GST will be helpful in expanding the tax net, curbing tax evasion and increasing revenues from tax, it will be highly detrimental to the financial autonomy and State-specific financial planning by governments. Moreover, there is a strong apprehension that the GST will end up profiting big corporate houses only. Similarly, a unilateral approach is against the spirit of Indian federalism.

The beauty of a federal polity is that different political parties can hold power in different states and at the Centre, but they should be able to pursue their different programmes as per their ideologies, without damaging the integrity of the country, and therefore, they are given the freedom to pursue their preferred fiscal policies: while some states may be ready to provide incentives to corporate capital to invest in the state, others may be inclined to raise their tax rates to gather more revenue in order to undertake more welfare expenditure; while others may utilize their fiscal authority for raising revenue for worthwhile programmes. The revenue sources at the disposal of the state governments are indeed limited; they rely heavily on the sales tax which accounts to 80 per cent of the revenues for most states. The states did have a degree of freedom in deciding the rates of the sales tax. The value added tax attempted to curtail that freedom, but like the GST it could not tie the states down to a single uniform rate for all goods and all states. Once it is introduced, the state governments will have no freedom to decide on the rates at which they choose to tax commodities. (If they wish to raise some rate, they would have to approach the GST council where theirs will be only one voice among many, and hence likely to be quite inconsequential). With a uniform GST, and fiscal responsibility legislation restricting the size of their fiscal deficits, the freedom of state governments to pursue divergent economic trajectories will be greatly curtailed for the following simple reason.

The base level of resources available to a state government will be more or less predetermined and not subject to any increase. As the tax rates will also be pre-decided, the only option they are left with for obtaining larger revenue would be to expand the tax base. In a situation where the states have no power to raise tax rates has reduced the scope for enlarging public investment, they would be forced to invite private corporate capital to set up plants in their states to expand the level of activity. This will greatly hamper the scope of state/ [public enterprises while directly favouring expansion of big corporate houses. Talking about the benefits of the GST, which appear more of sheer hype. In fact, Finance Minister's assertion that a shift to the GST will add 2 per cent to the growth rate of the gross domestic product, is based on such assumptions which are never made fully explicit to the people and which are not fully comprehensible. The two major substantial arguments have been advanced : firstly, the GST will simplify and rationalize

the indirect tax system, and secondly, that it would prevent the rat race among states to lower tax rates as a means of attracting private investment. The second argument can be easily written off as a uniform tax rate for all states and all commodities is not adequate for preventing unhealthy competition among the states. But, the real question pertains to the first argument: should we sacrifice a basic feature of our federalism for some unspecified benefits that may arise from the "simplification and rationalization" of our system of indirect taxation? The biggest benefit of the GST is being touted as unifying the "national market"; but the example of USA is worth mentioning. The US does not have a uniform taxation scheme like the GST. The States in the US tax commodities by value, not value added, at different rates, which, vary across commodities within each state. There are a variety of taxes on commodities, within each state. And even the exemption limits for the value of business turnover, below which indirect taxation is not imposed, are not the same across the states. The world's largest capitalist economy has thus functioned well without having a unified national market according to the criteria advanced by the advocates of the GST; and it plans to continue with the same in the future. Therefore, the question naturally arises: if the US can get along without apparently a unified national market, why are we so adamant on it, even at the cost of sacrificing our federal structure?

In fact, the reason why the US functions smoothly with a wide variety of taxes and tax-rates across states is due to the fact it values its federalism. A clear indication of this is the composition of its Senate where each state has an equal number of senators, i.e., two whether it is a big state like New York or California or a small state like Delaware or Rhode Island; no state therefore can complain about its voice not being heard. And it is solely because of this fierce commitment to federalism that keeps the structure intact despite the economic arguments advanced by corporate spokespersons in a country where corporate-financial interests have an overarching impact on the polity. Such commitment to federalism, has never been apparent in India. The Centre uses all kinds of tactics to subjugate the state governments; and the state governments are so exclusively concerned with whatever resources they can occupy that they overlook the principles which are the foundation of Indian Federal structure. But since, the Federal system has been included in the basic structure of our constitution, as propounded in the Keshavananda Bharati verdict, even if all the state governments along with the Central government, at any given time, agree on some measure to abridge it, they have no power to do so. The implementation of the GST, as currently visualized, shall amount to an interference with the "basic structure" of our Constitution. The fact that it may have the support of all the state governments, is definitely not a healthy sign for the federal spirit of our political system. A few existing governments, even if they decide to compromise their freedom and authority to pursue economic trajectories of their choice, should not be warranted to decide for all future governments.

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