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GST GOVERNANCE AND FISCAL FEDERALISM IN INDIA: A CRITICAL STUDY OF COOPERATIVE TAX ADMINISTRATION AFTER THE 101ST CONSTITUTIONAL AMENDMENT

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ABSTRACT

The passage of the Constitution (One Hundred and First Amendment) Act, 2016, followed by the introduction of the Goods and Services Tax (GST) regime in 2017, is considered among the most important financial reforms undertaken in independent India. Envisioned under the slogan “One Nation, One Tax,” the GST was intended to move away from the complex system of indirect taxes and towards a more uniform, destination-based tax system. Although GST was intended mainly as a financial measure to ease taxation and ensure the formation of a national market, it also resulted in major constitutional changes.

The present work seeks to critically analyse GST governance along with its impact on fiscal federalism in India post the 101st Constitutional Amendment. It will seek to assess how the introduction of the power of concurrent taxation and the creation of the GST council as an administrative body to manage indirect taxes have led to a constitutional change within India. The study attempts to examine whether the GST regime has indeed led to cooperative federalism in India via collaborative decision-making, or whether it has merely made fiscal federalism weaker. Emphasis will be laid on the voting system at the GST council, the constitutionality of GST compensation provisions and the dependency of States on the Central Government for finances.

*In addition, the research analyses the conflicts that arose amid the outbreak of the novel coronavirus disease, specifically concerning delayed disbursements of compensation money, along with discussing critical judgments, particularly in the landmark case of *Union of India v. Mohit Minerals Pvt. Ltd.*, where the apex court clarified that recommendations of the GST Council are non-binding in nature, thus reinforcing the federal nature of the Constitution. With the aid of a doctrinal and analytical methodology, this paper seeks to demonstrate that,*

although GST has made a significant contribution to achieving economic harmony and operational effectiveness, it has also significantly reduced the degree of fiscal independence enjoyed by the States.

Keywords- *Fiscal Federalism, Goods and Services Tax (GST), Cooperative Federalism, GST Council, Constitutional Amendment, Centre–State Financial Relations.*

INTRODUCTION

The introduction of the GST is considered to be one of the most revolutionary constitutional and economic changes in independent India. Passed as the Constitution (One Hundred and First Amendment) Act, 2016, the GST was intended to become a full-fledged system of indirect taxes that would help integrate India as an open common market. Nevertheless, in addition to the obvious economic implications, this change became highly influential in terms of the redistribution of fiscal powers between the central and state governments. In the context of the establishment of the GST Council, legislative changes, and increased reliance on the central system of revenue generation, this has become an example of modern cooperative federalism.

1. BACKGROUND OF FISCAL FEDERALISM IN INDIA

The constitution of India adopts a federal system whereby the distribution of legislative, executive, and financial powers takes place between the Union and State governments.¹ The concept of fiscal federalism is critical to this framework due to the need for financial independence for the States to carry out their duties as per the Constitution.² The Constitution of India has elaborate provisions for distributing taxing power between various tiers of government in the Seventh Schedule and Articles 268 to 293.³ In the past, the Union government had the jurisdiction over taxes like customs duties, corporation tax, income tax, and excise duties, while the States had taxing power over indirect taxes like sales tax, VAT, luxury tax, entertainment tax, and entry tax.⁴

The system of federal taxes before the introduction of GST was characterised by a blend of national economic integration and regional economic freedom.⁵ The regional governments had considerable powers to generate their own income through taxes in accordance with their

¹ INDIA CONST. pmb.; INDIA CONST. arts. 245–263.

² M. Govinda Rao & Nirvikar Singh, *Political Economy of Federalism in India* 17–25 (Oxford Univ. Press 2005).

³ INDIA CONST. sched. VII; INDIA CONST. arts. 268–293.

⁴ H.M. Seervai, *Constitutional Law of India* vol. 3, 3021–24 (4th ed. 1996).

⁵ K.C. Wheare, *Federal Government* 10–14 (4th ed. 1963).

economic requirements.⁶ On the other hand, the existence of several indirect taxes resulted in inefficiency in the economic system. The existing system of taxes was heavily criticised on grounds of cascading of taxes, complex procedure, non-uniformity across States, and impediments to inter-state commerce.⁷ In light of this, the system of indirect taxes was found to be inappropriate for the needs of a modern economic system.

2. EVOLUTION OF THE GOODS AND SERVICES TAX IN INDIA

The suggestion to implement a unified system of Goods and Services Tax in India came up as part of overall economic reforms that were taken up in the wake of liberalisation.⁸ This recommendation was first made by the Kelkar Task Force on Indirect Taxes in the year 2003, when the concept of implementing a single indirect tax regime based on value added was put forth.⁹ In the follow-up negotiations between the Union and State governments, the Empowered Committee of State Finance Ministers was formed.¹⁰

Following lengthy political negotiations and constitutional deliberations, Parliament passed the Constitution (One Hundred and First Amendment) Act, 2016, which became effective from 8th September 2016.¹¹ It included three new provisions, namely Article 246A, 269A, and 279A to the Constitution and laid down the new fiscal framework for India.¹² The introduction of GST came into effect on 1st July 2017 as a destination-based indirect tax system intended to replace all the existing state and federal taxes.¹³

The introduction of GST was not only an instance of tax reform but a constitutional change that had an impact on the allocation of fiscal powers between the Centre and the States.¹⁴ The establishment of the dual GST system through CGST, SGST, and IGST was meant to ensure the development of a common market for the country.¹⁵

⁶ M.P. Jain, *Indian Constitutional Law* 856–59 (8th ed. 2018).

⁷ Vijay Kelkar, *Report of the Task Force on Indirect Taxes* 47–52 (Ministry of Finance 2003).

⁸ Y.V. Reddy, Economic Reforms and Fiscal Federalism in India, 37(8) *ECON. & POL. WKLY.* 709 (2002).

⁹ Vijay Kelkar, *Report of the Task Force on Indirect Taxes* 61–67 (Ministry of Finance 2003).

¹⁰ Empowered Committee of State Finance Ministers, *First Discussion Paper on Goods and Services Tax in India* (2009).

¹¹ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

¹² INDIA CONST. arts. 246A, 269A & 279A.

¹³ Central Goods and Services Tax Act, No. 12 of 2017.

¹⁴ P. Chakraborty, GST and Fiscal Federalism: Issues for the States, 52(2) *ECON. & POL. WKLY.* 69 (2017).

¹⁵ Goods and Services Tax Council Secretariat, *GST: Concept and Status* (2017).

3. CONSTITUTIONAL TRANSFORMATION UNDER THE 101st AMENDMENT

The introduction of the 101st Constitutional Amendment Act brought a drastic change in the historical pattern of tax distribution between the centre and state governments of the Indian Union.¹⁶ Before the introduction of GST, the jurisdiction over indirect taxation remained strictly segregated among the Union and the State governments through the Union List and the State List of the Seventh Schedule.¹⁷ The inclusion of Article 246A gave concurrent legislative powers to both Parliament and State legislatures in relation to GST.¹⁸ On the other hand, Article 269A provided the Union government the right to impose and collect GST on inter-state trade and commerce.¹⁹

Constitutional reform has led to the emergence of a new approach to fiscal federalism that involves coordination among the levels of government and joint control of taxation.²⁰ While previously, States had individual control of certain indirect taxes, under the GST system, decisions have to be made in a coordinated manner through institutional processes.²¹ This shift has led to constitutional arguments over whether GST promotes cooperative federalism or limits State autonomy through fiscal centralisation.²²

4. GST COUNCIL AND THE IDEA OF COOPERATIVE FEDERALISM

The GST Council is at the heart of India's post-GST regime.²³ As per Article 279A, the GST council includes the finance minister of the Union and the states, along with the minister of state for finance of the Union.²⁴ Its functions are to issue recommendations on issues such as tax rate, exemption, model GST law, and procedures.²⁵

The Council has been portrayed as an embodiment of cooperative federalism through its role as a platform for dialogue and consensus between the Centre and States.²⁶ This is due to the weighted voting system in the Council, where the Union Government gets one-third voting rights, and the State Governments get two-thirds voting rights, with key decisions requiring a

¹⁶ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

¹⁷ INDIA CONST. sched. VII.

¹⁸ INDIA CONST. art. 246A.

¹⁹ INDIA CONST. arts. 269A & 279A.

²⁰ Louise Tillin, *Indian Federalism* 143–47 (Oxford Univ. Press 2019).

²¹ Bibek Debroy & Aditya Sinha, GST and Fiscal Relations in India, 56(44) ECON. & POL. WKLY. 14 (2021).

²² Sujit Choudhry et al., *The Oxford Handbook of the Indian Constitution* 1049–56 (Oxford Univ. Press 2016).

²³ INDIA CONST. art. 279A.

²⁴ Id.

²⁵ Id.

²⁶ NITI Aayog, *Cooperative Federalism in India* (2017).

three-quarters majority.²⁷ Despite this seeming conducive to cooperation, opponents contend that the Union Government has significant control over GST policies.²⁸

Thus, the practical workings of the GST Council have given rise to significant issues related to fiscal democracy, the involvement of States, and the Constitution's federalism.²⁹ Several States have pointed out problems such as delays in payment of compensation, inflexibility in tax policies, and dependence on the Centre for revenue distribution.³⁰ These issues came into prominence during the COVID-19 pandemic period due to extreme economic disruptions.³¹

5. RESEARCH PROBLEM AND SCOPE OF THE STUDY

The introduction of GST has sparked considerable scholarly and constitutional controversy over its implications for the nature of India's federal system.³² While proponents of GST highlight its importance in promoting economic integration, efficiency in tax administration, and greater transparency, opponents argue that the new policy framework undermines State financial autonomy and extends central government influence in tax matters.³³ This conflict between economic harmonisation and federalism under the Constitution forms the core research question of this study.

This paper critically examines whether the post-GST framework genuinely reflects cooperative federalism or whether it has gradually transformed into a system of coercive fiscal centralisation.³⁴ The study focuses on the constitutional amendments introduced by the 101st Amendment Act, the functioning of the GST Council, judicial interpretation of GST-related disputes, and the evolving financial relationship between the Centre and the States.³⁵ Particular emphasis is placed on the constitutional and practical implications of GST governance after the Supreme Court's decision in *Union of India v. Mohit Minerals Pvt. Ltd.*³⁶

²⁷ INDIA CONST. art. 279A(9).

²⁸ M. Govinda Rao, GST in India: Progress and Challenges, 53(51) ECON. & POL. WKLY. 10 (2018).

²⁹ Arghya Sengupta, Federalism and the GST Council, 5 INDIAN L. REV. 112 (2021).

³⁰ Fifteenth Finance Commission, *Report for 2021–2026* vol. I (2020).

³¹ *Id.*

³² P.D.T. Achary, GST and the Changing Federal Structure of India, 55(3) J. CONST. & PARLIAMENTARY STUD. 44 (2021).

³³ P. Chakraborty, GST Compensation and Fiscal Stress in States, 55(35) ECON. & POL. WKLY. 23 (2020).

³⁴ M. Govinda Rao & Nirvikar Singh, *The Political Economy of Federalism in India* 301–15 (Oxford Univ. Press 2005).

³⁵ *Id.*

³⁶ *Union of India v. Mohit Minerals Pvt. Ltd.*, (2022) 10 SCC 700.

6. OBJECTIVES OF THE STUDY

Key research objectives for the study include the following:

1. To consider the constitutional reform in India with regard to the introduction of fiscal federalism under the 101st Constitutional Amendment.³⁷
2. To consider the structure, functions, and activities of the GST Council in terms of cooperative federalism.³⁸
3. To consider the effects of GST on the fiscal autonomy and powers of States regarding their revenues.³⁹
4. To consider the judicial perspectives on GST governance and relations between the Centre and State.⁴⁰
5. To critically analyse whether GST encourages cooperative federalism or causes fiscal centralisation.⁴¹

CONCEPTUAL FOUNDATIONS OF FISCAL FEDERALISM IN INDIA

1. MEANING AND NATURE OF FISCAL FEDERALISM

"Fiscal federalism" implies the allocation of financial power and duties among various governmental tiers in the context of a federal political system. Fiscal federalism establishes how the power to levy taxes, spending obligations, and the sharing of revenues should be allocated between the Union and the sub-national governments.⁴² Fiscal federalism is a constitutional arrangement in India designed to maintain the balance between national economic integrity and regional autonomy. Fiscal federalism is a reflection of the larger federal design of the political system in India, where the Centre and the State operate in separate spheres of power.

In contrast to traditional federations that are characterised by high fiscal autonomy for their component states, Indian fiscal federalism has always shown itself as having a pronounced penchant towards centralisation. The Constitution gives the Union power to levy taxes on

³⁷ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

³⁸ INDIA CONST. art. 279A.

³⁹ P. Chakraborty, GST and Fiscal Federalism: Issues for the States, 52(2) ECON. & POL. WKLY. 69 (2017).

⁴⁰ Union of India v. Mohit Minerals Pvt. Ltd., (2022) 10 SCC 700.

⁴¹ Louise Tillin, *Indian Federalism* 143–47 (Oxford Univ. Press 2019).

⁴² Richard A. Musgrave, *The Theory of Public Finance* 179–83 (1959).

elastic sources of income such as customs duties, corporation tax, and income tax, while the states have relied on indirect taxation and grants from the Central government.⁴³ The resulting fiscal disparity has led to the development of India's intergovernmental fiscal relations through constitutional means like tax devolution, grants-in-aid, and the Finance Commission.

Fiscal federalism in India thus extends beyond just financial distribution and also comprises politics, administration, and governance. The implementation of GST has been another major change that has further altered this system through the replacement of the taxation rights of the states with a unified fiscal power regime.

2. CONSTITUTIONAL FRAMEWORK AND FINANCIAL RELATIONS

There is a detailed framework provided by the Constitution of India regarding financial relations between the Union and the states in Part XII of the Constitution, consisting of Articles 264 to 293.⁴⁴ This forms the constitutional basis of tax powers, revenue distribution, borrowing power, and grants-in-aid. Another way of dividing legislative jurisdiction has been provided in the Seventh Schedule through three Lists.

In the pre-GST era, the powers given under the Union List allowed Parliament to collect taxes like customs duty, excise duty, service tax, and corporate tax, whereas taxes like sales tax, entry tax, entertainment tax, and luxury tax fell under the ambit of state control.⁴⁵ The idea behind such distribution was that states must have enough funds to carry out their duties independently.

Article 280 establishes the Finance Commission, which plays a very important role in India's fiscal federal system. The Finance Commission makes recommendations regarding how much of the tax revenue will be shared between the central government and the state governments, and attempts to redress regional disparities by making grants and allocating resources.⁴⁶ The Finance Commission has become increasingly significant in ensuring coordination in fiscal matters between states.

However, with all these constitutional provisions ensuring a balance between both levels of government, the fiscal federalism of India has traditionally been biased towards the Centre since important powers for revenue raising have always resided with the Central Government.⁴⁷

⁴³ M. Govinda Rao & Nirvikar Singh, *Political Economy of Federalism in India* 42–49 (Oxford Univ. Press 2005).

⁴⁴ INDIA CONST. arts. 264–293.

⁴⁵ INDIA CONST. sched. VII.

⁴⁶ INDIA CONST. art. 280.

⁴⁷ H.M. Seervai, *Constitutional Law of India* vol. 3, 3031–35 (4th ed. 1996).

Often, the States depend on transfers from the Centre and Central government schemes to fulfil their developmental responsibilities. This trend has sparked endless discussions about the fiscal autonomy of States in India.

3. THEORIES OF FISCAL FEDERALISM

Fiscal federalism, from a theoretical perspective, is mainly concerned with the effective assignment of financing roles among various levels of government. As per Richard Musgrave, there are three main purposes of public finance, which are allocation, distribution, and stabilisation.⁴⁸ As per the theory of Richard Musgrave, economic stabilisation and redistribution should be the responsibility of the national government, whereas the allocation role is better fulfilled by the local governments.

In the same way, Wallace Oates developed the Decentralisation theorem that claims that local authorities tend to be better when it comes to the provision of public goods since they have the ability to design policies based on the local demands.⁴⁹ This means that decentralisation of fiscal systems improves democracy, efficiency, and regionalism. Too much decentralisation, however, leads to regional inequalities.

The Indian case study demonstrates a dynamic balance of both centralisation and decentralisation. Despite the acknowledgement of regional autonomy in federal constitutionalism, economic planning and nation-building in the past have favoured financial centralisation.⁵⁰ The advent of GST accentuated this controversy in that it endeavoured to achieve uniformity in tax rates in India, but at the same time restricted the taxing powers of the states.

The contradiction in the theory of efficiency versus autonomy is key in the discussion about GST today. Proponents of GST stress efficiency, ease of business, and simplicity of taxation, but their opponents claim that too much centralisation violates the principles of federalism by reducing the fiscal freedom of states.⁵¹

⁴⁸ Richard A. Musgrave, *The Theory of Public Finance* 181–85 (1959).

⁴⁹ Wallace E. Oates, *Fiscal Federalism* 32–35 (1972).

⁵⁰ Granville Austin, *Working a Democratic Constitution* 632–36 (Oxford Univ. Press 1999).

⁵¹ P. Chakraborty, GST and Fiscal Federalism: Issues for the States, 52(2) *ECON. & POL. WKLY.* 69 (2017).

4. COOPERATIVE FEDERALISM AND FISCAL GOVERNANCE

The term "cooperative federalism" can be defined as the governance structure that allows various levels of government to cooperate in decision-making and implementation of policies rather than work in clearly defined areas.⁵² Cooperative federalism has been developing in India over time because of the growing economic interdependence between the Central and State governments.

Financial administration assumes great importance in cooperative federalism due to the fact that financial capability influences the ability of the governments to formulate and implement public policies. The Finance Commission, the Inter-State Council, and NITI Aayog have been known to foster dialogues among governments at various administrative levels over the years.⁵³ The GST Council is an important institution representing cooperative fiscal federalism in India.

The GST model provided for a cooperative approach to indirect taxation based on a shared sovereignty model, in which both the Centre and the States had to act collectively to manage taxes and formulate policies.⁵⁴ The constitutional requirement of consultation and consensus among members of the GST Council was meant to ensure that decision-making would not be done unilaterally but rather through cooperation.

It is contended that GST has led to a diminution in the independent financial autonomy of several states and rendered them financially dependent on the Union government.⁵⁵ This problem became particularly prominent during the time of the COVID-19 outbreak, when delayed compensation payments left many states in a dire fiscal situation. This has raised the crucial constitutional question of whether GST has really promoted cooperative federalism or merely perpetuates the Union's supremacy in the guise of cooperation.

5. FISCAL AUTONOMY AND THE FEDERAL BALANCE

Financial freedom is an integral part of any federation because political power devoid of financial freedom loses constitutional relevance.⁵⁶ For States to make policy decisions in accordance with their own requirements and socio-economic circumstances, they must have

⁵² K.C. Wheare, *Federal Government* 93–96 (4th ed. 1963).

⁵³ NITI Aayog, *Cooperative Federalism in India* (2017).

⁵⁴ INDIA CONST. art. 279A.

⁵⁵ Fifteenth Finance Commission, *Report for 2021–2026* vol. I (2020).

⁵⁶ M.P. Jain, *Indian Constitutional Law* 861–64 (8th ed. 2018).

enough leeway in terms of revenue generation. The GST was preceded by an era in which the States had considerable scope in terms of making indirect tax policies.

However, the introduction of GST brought about a drastic change in this structure through the incorporation of many state-level taxes under one umbrella.⁵⁷ This implied that states gave up their taxing autonomy in favour of becoming part of a streamlined national tax system. Although this improved consistency and eliminated tax barriers, it also restricted the fiscal autonomy of the states.

The conflict between financial sovereignty and economic coordination is what underpins the GST issue. While economic coordination can enhance efficiency through a single tax system, too much coordination might undermine the spirit of federalism, according to the Constitution.⁵⁸ The problem is in achieving balance, whereby economic coordination does not obliterate state sovereignty.

However, the observations made by the Supreme Court of India in the case of *Union of India v. Mohit Minerals Pvt. Ltd.* have further cemented the fact that the concept of Indian federalism cannot be understood solely through the lens of a unitary system and that States hold constitutional importance even in the context of GST.⁵⁹ The court has made it clear that recommendations by the GST Council lack legal sanctity.

THE 101st CONSTITUTIONAL AMENDMENT AND RESTRUCTURING OF TAXATION POWERS

1. INTRODUCTION

The Goods and Services Tax (Constitution One Hundred and First Amendment) Act, 2016, brought about an unprecedented change in India's indirect taxation regime through constitutional provisions introducing the Goods and Services Tax (GST).⁶⁰ This change can be attributed to a significant modification in the concept of fiscal federalism as far as taxation is concerned, since it resulted in the modification of the powers of tax levying that had been distributed in a certain manner between the Union and the States.⁶¹

⁵⁷ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

⁵⁸ Louise Tillin, *Indian Federalism* 145–48 (Oxford Univ. Press 2019).

⁵⁹ *Union of India v. Mohit Minerals Pvt. Ltd.*, (2022) 10 SCC 700.

⁶⁰ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

⁶¹ INDIA CONST. sched. VII.

Objectives included fostering a common national market, avoiding cascaded taxation, and streamlining tax administration. Nevertheless, the Amendment had substantial implications for the fiscal independence of the States due to the consolidation of various state taxes under a centrally organised tax system.⁶²

2. CONSTITUTIONAL CHANGES INTRODUCED BY THE AMENDMENT

The Constitution was amended by adding Articles 246A, 269A, and 279A through the 101st Amendment to the Constitution.⁶³ Article 246A conferred concurrent legislative powers on both the Parliament and State Legislatures to enact legislation regarding GST.⁶⁴ This was contrary to the previous arrangement under which the Centre and States had exclusive powers of taxation.

Section 269A gave the Union power to impose and collect GST on all matters relating to trade and commerce amongst different states, but at the same time, ensured that the distribution of revenues amongst the Centre and the states was also taken care of.⁶⁵

The GST Council was constituted through Article 279A as an integral part of the Constitution that would provide recommendations on GST rates, exceptions, model laws, and administrative guidelines.⁶⁶ The Council became an important instrument for decision-making concerning the operation of GST in India.

The amendment also excluded or amended a number of items in the Seventh Schedule.⁶⁷ For instance, entry tax, entertainment tax, luxury tax, and other indirect state taxes came under GST. As a result, the State governments could no longer exercise independent control over these sources of their income.

3. DUAL GST STRUCTURE IN INDIA

GST in India follows the dual GST system, keeping in mind the federal setup of its Constitution.⁶⁸ This system involves the levy of GST at both the Central and State levels. It comprises three types of GST, which are:

⁶² P. Chakraborty, GST and Fiscal Federalism: Issues for the States, 52(2) ECON. & POL. WKLY. 69 (2017).

⁶³ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

⁶⁴ INDIA CONST. art. 246A.

⁶⁵ INDIA CONST. art. 269A.

⁶⁶ INDIA CONST. art. 279A.

⁶⁷ INDIA CONST. sched. VII.

⁶⁸ Goods and Services Tax Council Secretariat, *GST: Concept and Status* (2017).

- Central Goods and Services Tax (CGST): This tax is collected by the Union government.
- State Goods and Services Tax (SGST): This tax is collected by State governments.
- Integrated Goods and Services Tax (IGST): This is used for the inter-state movement of goods and services.⁶⁹

It should be noted that India follows a dual GST system in an attempt to maintain fiscal involvement of States despite the need for uniformity in indirect taxation throughout the nation, unlike some other countries adopting unitary GST systems.⁷⁰

Nonetheless, in spite of the apparent parallel nature of tax powers, the GST model calls for coordination between the Centre and the states at large. The rate structure, process, and administration in GST are decided by collective negotiations in the GST Council.⁷¹ Consequently, there is very little room left for independent state discretion to formulate their tax policy.

4. GST COMPENSATION MECHANISM

In order to ensure that the States would give their consent to the introduction of GST, the government of the Union devised a compensation scheme, which would compensate States with an increase in GST collection by 14% annually over the next five years.⁷² This scheme was enacted via the enactment of the Goods and Services Tax (Compensation to States) Act, 2017.⁷³ The funds required for making the compensations were raised from the GST compensation cess imposed on certain goods.

This was done with the aim of ensuring that any loss faced by the States because of losing their capacity to impose independent taxes was compensated.⁷⁴ At first glance, this scheme was an embodiment of cooperative federalism in action, since the States were assured of financial safety during the transition phase.

⁶⁹ Central Goods and Services Tax Act, No. 12 of 2017.

⁷⁰ Louise Tillin, *Indian Federalism* 145–47 (Oxford Univ. Press 2019).

⁷¹ INDIA CONST. art. 279A.

⁷² Goods and Services Tax (Compensation to States) Act, No. 15 of 2017.

⁷³ *Id.*

⁷⁴ Fifteenth Finance Commission, *Report for 2021–2026* vol. I (2020).

However, serious issues arose during the COVID-19 crisis, as the economic downturn caused a reduction in GST collections, and the States claimed that the government of the Union had failed to honour its duties towards providing financial security to them.⁷⁵

5. IMPACT ON FISCAL FEDERALISM

Amendment 101 of the Constitution changed the fiscal federalism in India, from fiscal autonomy to joint fiscal competence.⁷⁶ Though it helped in increasing economic integration and tax harmonisation, the reform also reduced the scope of independent revenues for states.

Prior to GST, states had significant powers to determine indirect tax policies with VAT and other state-level taxes.⁷⁷ Post GST, however, important decisions regarding taxation were subject to collective decision-making via the GST Council. Therefore, states were forced to depend on fiscal transfers from the centre for financial stability.

As such, the amendment has instituted a new system of fiscal federalism based on coordination, not autonomy.⁷⁸ While proponents regard such a change as critical for economic efficiency at the national level, critics contend that such an amendment undermines the concept of federal balance because of the financial power vested in the Union Government.

The constitutionality and viability of this system are still the basis of discussions regarding cooperative federalism in modern-day India.

GST GOVERNANCE, FISCAL AUTONOMY AND THE FUTURE OF THE COOPERATIVE FEDERALISM

1. GST COUNCIL AND COOPERATIVE FEDERALISM

The introduction of GST was a huge step towards reforming the fiscal federal structure of India through the sharing of taxing power by the Union and the States.⁷⁹ The GST regime was anchored institutionally by the GST Council constituted under Article 279A of the Constitution.⁸⁰ The GST Council comprises the Union Finance Minister, Union Minister of State for Finance, and one representative each of all the States.⁸¹ The Council is vested with

⁷⁵ Fifteenth Finance Commission, *Report for 2021–2026* vol. I (2020).

⁷⁶ M. Govinda Rao, GST in India: Progress and Challenges, 53(51) ECON. & POL. WKLY. 10 (2018).

⁷⁷ M.P. Jain, *Indian Constitutional Law* 861–63 (8th ed. 2018).

⁷⁸ Arghya Sengupta, Federalism and the GST Council, 5 INDIAN L. REV. 112 (2021).

⁷⁹ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

⁸⁰ INDIA CONST. art. 279A.

⁸¹ *Id.*

the power of making recommendations on various issues pertaining to GST, such as the rate of tax, the exempted category, thresholds, models, etc.⁸²

The GST Council is said to be a constitutional embodiment of cooperative federalism, since it encourages consultation and decision-making through cooperation in the domain of indirect taxation.⁸³ In contrast to the scenario under the pre-GST system, which involved the exercise of tax powers by both the Centre and States separately, the GST system calls for ongoing cooperation among various governmental levels.^{fn6} The voting system also embodies this spirit of cooperation. While the Union has one-third of the vote, the States have two-thirds of it.

During the early years of the GST, the Council was applauded for operating on the basis of consensus and not voting.⁸⁴ Critical decisions relating to tax rationalisation, compliance measures, and measures during the pandemic have been taken after consultations between the Centre and the States. This approach has made a significant contribution towards establishing a common national market by overcoming indirect tax barriers.

Nonetheless, whether cooperative federalism works effectively in the context of GST is conditioned by issues of finances and politics between different governments.⁸⁵ There is a growing suspicion that the Council operates in such a way as to be dominated by the Union government, considering its relatively superior financial and administrative positions.⁸⁶ As a consequence, disputes over the centralisation of finance are now a part of GST discussions.

2. FISCAL AUTONOMY OF STATES AFTER GST

Financial autonomy is a critical element of the federal structure due to the need for State governments to have the financial resources that will enable them to achieve development objectives.⁸⁷ Before the introduction of GST, the States had control over indirect taxes such as VAT, luxury tax, entry tax, and entertainment tax.⁸⁸

However, the introduction of GST has disrupted this pattern by bringing all the levies of the states under one single system of national taxation.⁸⁹ Even though Article 246A empowers

⁸² INDIA CONST. art. 279A(4).

⁸³ NITI Aayog, *Cooperative Federalism in India* (2017).

⁸⁴ INDIA CONST. art. 279A(9).

⁸⁵ M. Govinda Rao, GST in India: Progress and Challenges, 53(51) ECON. & POL. WKLY. 10 (2018).

⁸⁶ Arghya Sengupta, Federalism and the GST Council, 5 INDIAN L. REV. 112 (2021).

⁸⁷ M.P. Jain, *Indian Constitutional Law* 861–63 (8th ed. 2018).

⁸⁸ INDIA CONST. sched. VII.

⁸⁹ The Constitution (One Hundred and First Amendment) Act, No. 101 of 2016.

Parliament and State Legislatures with concurrent powers of taxation, the actual use of such powers hinges upon the recommendations of the GST Council.⁹⁰ Therefore, states have very little freedom to make independent decisions regarding tax rate determination or imposition of indirect taxes.

Due to the diminishing fiscal flexibility, States have become more financially dependent on the flow of revenues from the Centre and GST compensation.⁹¹ Some of the states feel that this change will be detrimental to the federal structure as visualised in the Constitution. Moreover, the States cannot address their economic challenges using the tax system alone.

Nevertheless, the advocates of GST assert that fiscal harmonisation was essential for the abolition of cascaded taxes, better compliance, and ease of doing business across states.⁹² According to them, the fragmented state tax policies had been creating economic inefficiencies and were impeding the creation of a unified national market. Consequently, the controversy over fiscal autonomy in light of GST represents the underlying conflict within the constitution.

3. JUDICIAL INTERPRETATION AND CONSTITUTIONAL CHALLENGES

The validity and operational aspects of the GST system have raised major judicial issues about federalism and legislative powers. The landmark judicial decision in this context was delivered in *Union of India v. Mohit Minerals Pvt. Ltd.*⁹³ The case dealt with whether the recommendations issued by the GST Council are binding on the Union and States.

It is pertinent to note that the recommendations made by the GST Council carry significant weight but are non-binding in nature.⁹⁴ This was due to the fact that under Article 246A, both Parliament and State Legislatures have been granted legislative powers simultaneously.⁹⁵ The Court argued that making the recommendations made by the GST Council obligatory would go against the federal constitution.

The ruling was important constitutionally since it reinforced the fact that the Indian federal system cannot be seen as unitary in its true sense.⁹⁶ The Court held that the GST scheme

⁹⁰ INDIA CONST. arts. 246A & 279A.

⁹¹ P. Chakraborty, GST and Fiscal Federalism: Issues for the States, 52(2) ECON. & POL. WKLY. 69 (2017).

⁹² Vijay Kelkar, *Report of the Task Force on Indirect Taxes* (Ministry of Finance 2003).

⁹³ *Union of India v. Mohit Minerals Pvt. Ltd.*, (2022) 10 SCC 700.

⁹⁴ *Id.*

⁹⁵ INDIA CONST. art. 246A.

⁹⁶ *Union of India v. Mohit Minerals Pvt. Ltd.*, (2022) 10 SCC 700.

operates based on “dialogue and cooperation” and not through the subordination of the states under the Union government.

Nevertheless, constitutional problems persist with respect to questions of compensation, administration, and the degree of independence that can be exercised by the States through GST legislation.⁹⁷ Such problems reflect the continuing nature of the constitutional problem of balancing federalism and economic integration.

4. GST COMPENSATION CRISIS AND EMERGING CENTRE-STATE CONFLICTS

In order to ensure the adoption of GST by the states, the Central government committed itself to compensate for any losses that might accrue due to the introduction of GST for five years.⁹⁸ The commitment was included through the enactment of the Goods and Services Tax (Compensation to States) Act, 2017.⁹⁹ The state governments were promised a growth rate of 14% annually, while the compensation would be raised through a GST compensation cess.

The payment mechanism was indeed reflective of cooperative federalism in its early stage, as it took into consideration the economic burden that States would have to bear owing to their sacrifice of independent taxation power.¹⁰⁰ The coronavirus pandemic, however, laid bare certain shortcomings of the GST regime and created an atmosphere of conflict between the Centre and some States.¹⁰¹

Several states claimed that the delayed compensation was contrary to the commitments made while negotiating the GST and adversely affected their finances.¹⁰² The federal government contended that due to exceptional economic conditions, it was difficult for them to honour the commitments regarding compensation. This dispute became one of the major disputes between the Centre and the States in terms of finance.

The compensation controversy brought to light the growing reliance of states on the central financial machinery and showed the weakness of cooperative federalism under adverse

⁹⁷ Louise Tillin, *Indian Federalism* 148–50 (Oxford Univ. Press 2019).

⁹⁸ Goods and Services Tax (Compensation to States) Act, No. 15 of 2017.

⁹⁹ *Id.*

¹⁰⁰ Fifteenth Finance Commission, *Report for 2021–2026* vol. I (2020).

¹⁰¹ P. Chakraborty, GST Compensation and Fiscal Stress in States, 55(35) *ECON. & POL. WKLY.* 23 (2020).

¹⁰² *Id.*

economic circumstances.¹⁰³ It further proved that effective fiscal cooperation does not depend merely on constitutional structures but also on confidence and financial responsibility.

5. CRITICAL EVALUATION: COOPERATIVE OR COERCIVE FEDERALISM?

However, the GST framework reflects an intricate scenario of Indian federalism. First, the GST framework has been quite successful in terms of promoting economic integration, mitigating the problem of cascading taxes, improving the compliance framework, and reinforcing the goal of a single national market.¹⁰⁴ Second, the GST Council has offered a platform for continuous engagement between the Centre and the States.

However, on the flip side, GST is seen as having slowly morphed fiscal federalism into coercive federalism.¹⁰⁵ The States have given up their power to tax, while not getting the same degree of fiscal independence under the new dispensation. Given that most tax policy decisions need unanimous agreement, States have little ability to make independent fiscal decisions for themselves.

In addition to this, the disparity in terms of financial muscle between the Centre and the State Governments exacerbates this issue. The delay in compensation payments, increased dependency on transfers from the Centre, and central control over the administration of taxes have only reinforced the impression that the Union Government enjoys significant power in the GST regime.¹⁰⁶

This means that while the GST model theoretically embraces cooperative federalism, its implementation often involves principles of fiscal centralisation. The difficulty arises in guaranteeing that the use of cooperation does not undermine the constitutional provision for state sovereignty.

CONCLUSION AND RECOMMENDATIONS

The implementation of GST via the 101st Constitutional Amendment marked a turning point in India's fiscal federalism by establishing a uniform system of indirect taxes that is grounded on cooperative federalism between the Centre and States. The GST Council has been a vital institution that facilitated consultation and coordination within the realm of fiscal policy. On

¹⁰³ M. Govinda Rao & Nirvikar Singh, *Political Economy of Federalism in India* 301–05 (Oxford Univ. Press 2005).

¹⁰⁴ Vijay Kelkar, *Report of the Task Force on Indirect Taxes* (Ministry of Finance 2003).

¹⁰⁵ Arghya Sengupta, *Federalism and the GST Council*, 5 INDIAN L. REV. 112 (2021).

¹⁰⁶ Louise Tillin, *Indian Federalism* 149–50 (Oxford Univ. Press 2019).

the other hand, the GST framework has made significant changes to the fiscal autonomy of States.

The evolution of judicial thinking, exemplified by the judgment in *Union of India vs. Mohit Minerals Pvt. Ltd.*, reconfirmed the federal nature of the Indian Constitution and established that cooperative federalism does not override the legislative powers of the states. However, conflicts regarding compensation and centralised policy decisions remain a hurdle in balancing efficiency and federalism.

In order for cooperative federalism to be strengthened through GST, there are various changes that need to be made. First of all, there needs to be a change in the compensation formula in order to provide more financial certainty to the States.¹⁰⁷ Secondly, there needs to be greater latitude for States on issues of taxation where it pertains to their own regional economy.¹⁰⁸ Thirdly, decisions made by the GST council must be based on consensus.¹⁰⁹

The long-term success of the GST will depend on striking a balance between economic integration that does not affect the federal nature of the Indian constitution.

¹⁰⁷ Fifteenth Finance Commission, *Report for 2021–2026* vol. I (2020).

¹⁰⁸ M.P. Jain, *Indian Constitutional Law* 864–65 (8th ed. 2018).

¹⁰⁹ NITI Aayog, *Cooperative Federalism in India* (2017).