Goods and Services Tax (GST) and Centre-State Financial Relations: An Analysis

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Abstract

In India, the adoption of the Goods and Services Tax (GST) has radically transformed the financial interactions between the Centre and the States. This transformation from a complicated structure that existed prior to the GST to one that is built for cooperative federalism has occurred. In spite of the fact that the Goods and Services Tax (GST) has been effective in integrating indirect taxes into a single framework and has promoted more collaboration through the GST Council, it has also centralized some taxation authorities, which has led to concerns regarding the fiscal autonomy of states. According to the findings of the research, the Goods and Services Tax (GST) has not only enhanced interdependence and improved tax efficiency, but it has also generated issues relating to revenue unpredictability, revenue distribution, and the requirement for constant coordination in order to strike a balance between the fiscal demands of the nation and those of the regions.

Unitary qualities make the Indian constitution quasi-federal. It promotes cooperative federalism by dividing legislative, administrative, and financial power between the center and the states. The GST was introduced under the 101st amendment act of 2016 to strengthen center-state finances through cooperative federalism. The GST was introduced to eliminate double taxes and simplify state tax regulations. GST is a crucial step toward a one-nation, one-tax system in India. Recently, the GST regime has hurt center-state ties. Due to the compensation mechanism created by this amendment, states have lost financial autonomy and become more dependent on the central. The article focuses on the dynamic connection between the state and the center, which underpins India's federal system, the concerns and obstacles facing the GST regime, and ways to overcome them to make GST effective in the long run.

1. Introduction

The constitution of India stipulates the establishment of a federal government, which is distinguished from the state governments by a distinct division of power and authority between the two tiers of government, namely the central government and the state governments. Granville Austin asserts that the Constitution of India was maybe the first Constituent assembly to adhere to what A.H. Birch and other others have referred to as "Cooperative federalism" from the very beginning. Due to the fact that India is made up of numerous states, each of which has its own distinct cultural, political, and economic variety, the implementation of the concept of cooperative federalism in India is of the utmost importance. The notion of cooperative federalism is one that functions to enhance the connection between the central government and the states, as well as the interaction between the states and the local governments in India. According to the cooperative federalism principle, all governmental bodies are required to take action and collaborate in order to address social, political, economic, and civic challenges that are shared by all of them. The designers of the Indian Constitution intended to encourage a coordinated approach to the administration of government by delegating significant authorities and duties to both the Indian central government and the individual states. According

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to the cooperative federalism philosophy, the goal is to establish a link that is both stable and reliable between the federal government and the states. The governance of any nation with many tiers of government must facilitate collaboration among them to enhance the country's administration. Part IX of the Indian Constitution explicitly delineates the separation of legislative, administrative, and executive powers of the government. Furthermore, under the 7th Schedule of the Indian Constitution, powers are allocated between federal and state lists, while a concurrent list confers some residual functions to the Centre.

In a move toward cooperative federalism, the federal and state governments of India have pooled their taxing powers to establish a single tax system under the Goods and Services Tax (GST) regime, which came into effect through the 101st Amendment Act of 2016. The goal is to bring India closer to its goal of economic unity. 2 This is in line with the changes made to the Indian constitution. In addition, the new GST regime mandated that both the federal and state governments follow the GST Council's recommendations. It was unanimously decided that states would be compensated from a pooled GST compensation fund for the first five years, which ended in June 2022, in the event that they incur revenue shortfalls during the transition to the new indirect taxes' regime.

2. **Impacts of GST on Centre-State financial relations:**

- Shift towards cooperative federalism: GST was implemented as an experiment in cooperative federalism, creating institutional mechanisms like the GST Council to ensure joint decision-making on the structure and operation of the tax system.
- Increased interdependence: The integration of indirect taxes has blurred the previous lines of taxation and created a more interdependent relationship between the Centre and states.
- Centralization of power: While states have a role in the GST Council, the move to a unified system has led to a centralization of taxation powers, impacting states' previous autonomy to levy certain taxes.
- Revenue uncertainty and disparities: States have expressed concerns about revenue uncertainty and disparities in revenue, especially consumer states that have experienced significant declines in revenue post-GST.
- Need for compensation and adjustments: The GST Act includes provisions for state compensation, but disputes have arisen regarding the distribution of taxes like Integrated GST (IGST), as shown in studies focusing on states like Kerala.
- Simplification and efficiency: GST aimed to simplify the indirect tax structure, reduce cascading effects, and increase efficiency, which has been a key objective of the reform.
- Ongoing challenges: Despite the design for cooperation, political disagreements and mistrust between the Centre and states continue to pose challenges for the effective functioning of the system, requiring continuous dialogue and adjustments to the system's design
- Impact on Cost Savings and Productivity Gains: Impact on Saving: With the goal of consolidating many indirect taxes into one comprehensive system, the Goods and Services Tax (GST) in India is a major overhaul of the country's tax system. Although it is a relatively new phenomenon, the Goods and Services Tax (GST) has greatly improved efficiency and reduced costs. The GST is still evolving in terms of its operating details and structure; therefore, its full effects are not yet known. The diverse political and economic climate in India makes the process of implementing a widely acknowledged change intrinsically difficult and ongoing. Nevertheless, stakeholders' widespread support for GST indicates that it will likely remain in place, despite the difficulties in making the required adjustments. Nevertheless, the implementation of the Goods and Services Tax (GST) offers a multitude of significant advantages, notwithstanding the difficulties connected with correctly measuring them. As a consequence of the adoption of the Goods and Services Tax (GST), numerous consumption taxes have been successfully unified, which has led to a decrease in both administrative and compliance expenditures. This is the most important advantage. This unification makes the tax environment more straightforward, which in turn improves the efficiency of the government's administrative processes and makes it easier for businesses to increase their operational efficiency.
- Impact on Revenue Collections in India: The initial goal of the Goods and Services Tax (GST) in India was to have little effect on revenue in the near term. However, it was anticipated that increased compliance with the GST would result in significant revenue gains over the course of time. On the other hand, it is not possible

to conduct a complete analysis of the financial ramifications within a period of two years, particularly when considering the multiple rate adjustments that occurred during this time period. Nevertheless, this time period offers vital insights into the actions that need to be made in order to increase revenue efficiency in both the immediate future and the intermediate future.

3. GST and Centre-State Financial Relations:

There is practically little overlap between the two realms of the Constitution, which clearly delineates the boundaries between the budgetary powers of the Centre and those of the States at the present time. On the other hand, the states have the authority to impose taxes on the sale of commodities, while the central government has the authority to impose taxes on the production of goods (with the exception of alcoholic liquor for human use, opium, and other illegal substances). In the event of transactions that take place across states, the Central Government has the authority to impose a tax known as the Central transactions Tax; however, they are responsible for collecting and keeping the whole amount of the tax. With regard to services, the only entity that possesses the authority to impose a service tax is the Centre. This tax is levied and collected by the Centre as extra taxes of customs, which is in addition to the Basic Customs Duty. This is due to the fact that the States do not have the authority to impose any tax on the sale or purchase of products during the process of their importation into or exportation from India. The excise charges, sales tax, state value-added tax, and other taxes that are collected on the same domestic goods are brought into balance by this extra duty of customs, which is generally referred to as CVD and SAD. If the Goods and Services Tax (GST) were to be implemented, the Constitution would need to be amended in order to provide both the central government and the states the authority to impose and collect the GST. For the purpose of levying the Goods and Services Tax (GST), the assignment of concurrent authority to the Centre and the States would need the establishment of a one-of-a-kind institutional mechanism. This mechanism would guarantee that decisions regarding the structure, design, and operation of the GST are made jointly by the two entities. Additionally, in order for such a system to be effective, it must be able to exercise constitutional authority.

In spite of the fact that sales tax was imposed on transactions (both purchases and sales) that took place within the authority of the state territory, it was also applied to sales that took place across states. In order to govern the taxation of inter-state sales between dealers or between dealers and customers, a legislation that was designated as the Central State Tax (CST) was established in the Parliament. This law was given the name "Central State Tax." The Centre was supposed to collect the revenues of the inter-state tax; however, with the implementation of the Central Sales Tax (CST), a rate of CST was supposed to be charged on sales that occurred across states, and the proceeds were supposed to be retained by the state. At the beginning, the rate of CST was one percent; at the present time, the rate is four percent. Because the CST was applied to sales, the transportation of goods from one state to another as consignments was exempt from any CST in the state that was exporting the items. According to the most recent revision, the value-added tax (VAT) as a multi-point tax system has taken the place of the central sales tax (CST), which was a single point of taxation. The value-added tax was defined in each and every Union and State territory. All of the complications that were associated with double taxing on the items were addressed by the state value-added tax. In an effort to lessen the burden of taxes, the manufacturers were given the opportunity to take use of the input tax credit. On the other hand, individual services were subject to a variety of tax rates, depending on the type of service. Since this was the case, the services were divided into one hundred different categories. In addition, the items that fall under the Central Excise Tariff Act of 1985 are categorized according to the HSN nomenclature, although the services are not classified on any such standardized basis.

4. Impact on states' fiscal autonomy

This equilibrium has been significantly disrupted as a result of the implementation of the Goods and Services Tax (GST) in 2017. This tax has been implemented in order to centralize indirect taxes under a single framework, in which the federal government and state governments share jurisdiction over taxation. In spite of the fact that the Goods and Services Tax (GST) is intended to streamline the tax system and further the integration of the national economy, it poses significant concerns regarding the changing character of Indian federalism.

As the GST Council plays a major role in selecting exemptions, setting tax rates, and distributing income, academics worry that the Goods and Services Tax (GST) may diminish the fiscal autonomy that states have historically enjoyed (Bansal, 2022; Ghosh, 2022) [2, 8]. The Goods and Services Tax (GST) Council has played a crucial role in redefining the dynamics of federalism in India, which has resulted in a considerable influence on the budgetary sovereignty of individual states. The Goods and Services Tax Council was established in accordance with Article 279A of the Constitution. It is comprised of representatives from both the central government and state governments, including the Minister of Finance for the Union and the Ministers of Finance for the states. As a result of the fact that this organization is responsible with providing recommendations about tax rates, the structure of the Goods and Services Tax (GST), and the distribution of revenues, it plays an essential role in the implementation of the GST across the country. By virtue of its constitutional status, the Goods and Services Tax (GST) Council is assigned with the responsibility of directing, managing, and applying the GST in India. It had its inaugural meeting on September 22-23, 2016, and it continues to meet on a regular basis to discuss a variety of issues that are associated with the Goods and Services Tax (GST). Determining tax rates, establishing exemptions and thresholds, and developing administrative processes are important roles of the Council.

The Council uses a consensus-based method to make decisions. In particular, three-quarters of the members present and voting must approve any decision using weighted votes. As a sign of their dedication to cooperative federalism, the states pool their voting power and give the federal government a third of the total. The centralization of taxation authorities, which has resulted in a reduction in the fiscal autonomy of states, is one of the most noteworthy repercussions that has been brought about by the formation of the GST Council. A number of indirect taxes, like as the Value-Added Tax (VAT) and the entrance tax, were levied by the states prior to the implementation of the Goods and Services Tax (GST), which gave them the ability to customize tax rates and policies to their particular economic circumstances.

However, as a result of the Goods and Services Tax (GST) regime, states have given up a significant portion of this autonomy. They are no longer able to unilaterally change their tax rates or create their indirect tax systems. As an alternative, they are obligated to follow to the rates and rules that have been established by the GST Council. This council operates on a decision-making process that is based on consensus, and the central government has great influence owing to the weighted voting power that it possesses. According to the GST Council's collective decision-making mechanism, states will no longer have the authority to choose the laws that govern their indirect taxes. The ability of state governments to respond to the economic demands of their respective communities while still maintaining their budgetary independence has been called into question as a result of this trend. For instance, states are no longer able to freely change the Goods and Services Tax (GST) rates for certain items, which restricts their ability to earn money based on the economic situations of their respective regions. Stamp duty and other municipal levies are examples of taxes that are not included in the scope of the Goods and Services Tax (GST). The only fiscal autonomy that is still in place refers to these taxes.

5. Conclusion

This study investigates the effects of the Goods and Services Tax (GST) on fiscal federalism in Kerala, indicating both advantages and disadvantages. Although the dual GST model has resulted in more equal revenue sharing between the Union and the states, it has also resulted in differences in the costs of commerce between states and between states due to the fact that different tax rates have been implemented. According to these findings, there is a pressing requirement for a more unified tax system in order to eliminate economic inefficiencies. In addition to this, the study highlights the importance of having more transparent legislative frameworks in order to reconcile contradictions that exist between central and state legislation. In further study, these challenges might be investigated across a wider range of states, which would contribute to a more connected economic system. In conclusion, the successful implementation of the Goods and Services Tax (GST) necessitates careful and exhaustive preparation, solid regulatory frameworks, and flexible tactics in order to successfully handle the issues that are specific to a variety of industries and interstate dynamics. The evidence shows that the Goods and Services Tax (GST) has the potential to make a major contribution to economic development, improved compliance, and a more efficient tax system if it is implemented and administered appropriately. On the other hand, it is very necessary to participate in ongoing examination and revision in order to guarantee that the Goods and Services Tax (GST) successfully accomplish its targeted goals while simultaneously reducing the adverse effects on a variety of economic sectors and regional incomes.

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