

GST and the Constitutional Conundrum

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The much awaited Goods & Services Tax, intended to transform India into a single marketplace as similar taxes have transformed Canada and the European Union, may have one unintended consequence : turning India's constitution from being described as 'Federal with a Unitary Bias' to a 'Constitution for the Union with a Federal Bias'.

Ahead of the passage of the GST, protesting against the vexatious system of multiple taxation at various stages in different states, some ingenious businessmen came up with the slogan of "One nation, One Tax." The process of unifying the country's market started with VAT in the beginning of this century. However, states remained staunchly independent in their taxation policy, in some cases led by their own fiscal imperatives and this created a situation where VAT was often supplemented by a variety of taxes, leading to India being described as one of the highest taxed nations.

The slogan was, of course, a reaction to the absence of a seamless scheme of taxation which smoothens the course of commerce and not a reflection of the process of constitution making in the aftermath of independence and partition. India's decision to be a federation with a Unitary bias was

coloured by its own experiences during partition, when seditious tendencies threatened to render apart the nascent state still in its infancy.

Many who were involved in the proceedings of the Constituent Assembly as well as independent observers have often opined that the Assembly was possibly obsessively focused on the need for ensuring the unity and integrity of the new nation. In fact, in one lengthy debate, Syamanadan Sahaya, MP from Bihar argued "In the matter of financial adjustments between Provinces and the Centre, I think that the Provinces have not been treated as well as they should be. In fact, I have a feeling that in this matter, the Provinces are worse off than in the days of the 1935 Act. The responsibilities of the Provinces, their commitments and their sphere for introducing ameliorative measures for the people are greater than even those of the Centre and as such, they should have been given sufficient scope in the field of taxation."

However, the fear of excessive federalism was cogently argued as being against the spirit of One India and the framework which thus came out tended to focus legislative and taxation powers with the centre rather than with the states. Indeed, Pt Hridaynath Kunzru, MP from the United Provinces placed the Unitary debate in focus

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in the same debate arguing : “The financial and administrative stability of the provinces depends to no small extent on the position of the Centre. It would be short-sighted of the provinces to demand a larger share from the Centre, regardless of the effect that their claims would have on the position of the Central Government.”

In the early years, with most states run by Congress Ministries in sync with the Union Government led by Pandit Jawaharlal Nehru never sought to question this arrangement. From the 1960s, when alternate Governments emerged in states, there have been challenges which sought greater powers for the federal units.

States currently have the right to tax a wide range of goods and professions through a variety of taxes, levies and charges, which states have over time very cleverly enlarged taking advantage of loose drafting of legislations. Bengal for instance, levies a charge on coal sold outside its borders. Other states had introduced an entry tax for goods coming from across its borders. These to any consumer or business are indeed anachronisms.

However, this ability of raising higher taxes gave states which were efficient, the ability to raise larger resources to address problems unique to them or in some cases to squander larger resources. The State of Tamil Nadu, which opposed many clauses in the GST had a point when it said that it had implemented wide ranging social sector reforms on the back of cash generated from its taxation programme.

It is true that the Southern states have done remarkably well in there social parameters – its health and education parameters have helped catapult it way ahead of its rivals and are comparable to that of OECD countries. In the words of economist Jean Dreze “Kerala and Tamil Nadu routinely come at — or near — the top in rankings of summary development indexes, they also surpass other States in terms of the speed of improvement.”

Even more than the states, it would be municipal bodies which could

levy many taxes independently and earn handsomely, for instance, the Mumbai Corporations huge income from Octroi duty which will be financially challenged with the roll out of the GST, their power to tax would be virtually decimated. Recognising this, the Ministry of Urban Development has asked for a 25 to 30 per cent share for all urban local bodies in the state’s share of the nation-wide goods and services tax.

The combination of these two Acts – the GST Constitution Amendment and the FRBM Act - in turn, turns the states’ Chief Ministers and Cabinets into political executives charged with implementation of programmes within their respective provinces, but without the right to consider how to raise funds for such programmes or even to scale up their programmes without the connivance of the central government.

While GST is expected to be divided between the Centre and states based on a mutually acceptable formula, the Ministry has argued that urban local bodies will have to deal with a huge fiscal gap once local body tax, octroi and other entry taxes are scrapped to make way for the new taxation system.

Besides this, legally speaking, the GST Amendment Act effectively transfers the power of taxation over large swathes of possible taxation to an unelected body. Effectively, the GST Council, set up by the Act, takes on the power of deciding tax rates



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from both the Union Parliament and state legislatures and these have to be implemented across the country. Without going into the issue of weightage of voting powers within the GST Council, the fact remains that this Council will now be the Supreme legislative body in determining tax rates on all goods and services through the length and breadth of the country and not the directly or indirectly elected Members of Parliament and State legislature. In essence, this will be like an educated super-body elected by Electors.

Not only this, the snuffing out of a variety of taxes which the state levied by subsuming them in the GST and the early bias which the Constitution imbibed by granting the Union taxation powers over income and over residual matters, means the state executive and legislature will have little say over what taxes can be raised in their respective states.

A Fiscal Responsibility and Budget Management Act also caps the amount of money which a state may raise through bonds or market loans. While the measure was indeed necessary given the propensity of Indian states to rush into indebtedness which would have put even Greece to shame, the measure does stop a potential Dr B C Roy or a Sir Visvesveraya or a Partap Singh Kairon from turning to debt as an instrument to address their state's extraordinary needs for development funds.

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The power to tax is the crux of the argument of "sovereignty", succinctly made during the American War of Independence which the Continental states waged. The Finance Minister, a polished constitution lawyer himself very deftly and aptly handled the objections raised to the move by stating that: "For some of those who felt that this was surrendering their sovereignty, this was, in fact, pooling in of sovereignty of the states at the Centre."

However, it would do well to remember that the world has not yet totally embraced GST as a panacea for its fiscal ills. In fact, the United States itself has, as yet, not agreed to usher in any form of GST. Possibly because of the federal nature of its constitution. In fact, the plethora of taxes levied by US federal authorities, States and other municipal governments are often bewildering for a newcomer. Especially since direct taxes fall in the purview of the states in that country, unlike in India, where it is levied by the Central Government and then shared with states according to a set formula.

State and local taxable income is determined under state law, though often based on federal taxable income calculations. Yet, in some cases, this is not so, with states devising alternative measures of calculating taxable income, or even alternative taxes. Confusing as this may be, the total measure of taxation on individuals still work out to 24.8 per cent of GDP, compared to India's 16.6 per cent.

In fact, in Canada where the GST was introduced in the last century, the provinces have the power over direct taxes, while the federal Government has the power to tax indirect taxes, which is why the change over to GST did not entail any impact on state powers.

It is yet to be seen how the Indian polity will respond to the challenge to the eventual implementation of the Goods and Services tax. It could well accept the taxation powers which have now evolved or chafe at the bit and seek a change from the new status quo.

In case, states eventually decide to seek a fiscal arrangement which is less straight-jacketed they could then either chose the Australian model, where 75 per cent of all taxes are raised by the federal or commonwealth government and distributed through a very sophisticated mechanism akin to that established by India's Finance Commissions or opt for the Canadian model, with India's states swapping the power to levy indirect taxes with the Centre and instead taking over the power to tax direct incomes or to devise a new system altogether.

What the future holds for India's taxation laws is something which the Indian polity would determine in its own unique manner. However for the present, the churn which has produced GST will for many years to come well define India's federal relations. □

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YE-173/2016