

# Opinion: Supreme Court's ruling on GST deepens the churn in the tax regime

M Govinda Rao writes: Placing Centre and states on equal footing in the GST Council could expedite reforms through negotiation.

Written by **M Govinda Rao** | New Delhi

Updated: May 26, 2022 10:19:02 am



Last week, the Supreme Court ruled that the decisions taken by the GST Council are merely recommendations with “persuasive value” and are not binding. The ruling has opened up serious questions on the stability and certainty of the structure and operation of GST which is still evolving. Although the judgment related to the longstanding dispute over the levy of IGST (integrated GST) on ocean freight charges paid by importers, the larger issue of the enforceability of the GST Council’s decisions has wide repercussions.

The court has rejected the Centre’s contention that the entire structure of GST would crumble if the Council’s decisions were not treated as enforceable. While the states, notably those ruled by non-BJP parties, have welcomed the judgment stating that this is the triumph of cooperative federalism and provides them enough scope to have a say in the decisions, the revenue secretary has clarified that the SC has merely stated the obvious, and, in effect, does not alter the ground situation. All the decisions taken in the Council are based on consensus (except the one on lotteries) by the Union and states (and Union Territories with legislatures), and that spirit will continue to guide the deliberations and decisions in the Council.

In some ways, the verdict states the obvious. Article 246-A inserted after the 122nd constitutional amendment states, “Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of every state, have the power to make laws with respect to the GST imposed by the Union or by such state.” Thus, the power to levy the central GST (CGST) vests with Parliament, the power to levy state GST (SGST) vests with state legislatures and Parliament has exclusive power to make laws with respect to the GST on items that are part of inter-state trade or commerce. Thus, the GST Council is only an advisory body and the actual decisions regarding model GST levies, principles of levy, apportionment of GST levied on inter-state supplies, principles relating to place of supply, exemptions and rate structure and any special provisions will have to be taken by either Parliament in the case of CGST and IGST or the states in the case of SGST.

Taken to the extreme, this can open a can of worms. In effect, decisions on the structure and operation of the tax can be made by the Centre and individual states without discussion and deliberation in the Council and both can ignore any recommendation made by the Council.

Now, an important objective of the GST reform was to achieve harmonisation in the levy of domestic consumption taxes by both the Centre and states surrendering their tax autonomy. But the judgment reiterates that the sovereign right to levy the tax still exists with the Union and state governments and it is for them to consider the recommendations of the Council. In other words, the chance of having a harmonised GST and reforms in the tax regime will crucially depend upon continued negotiation and bargaining between the Union and states. Put in another way, intergovernmental cooperation has been kept alive to ensure a harmonised GST and unless both the Centre and the states see the gains, reforms will be hard to come by and if the Centre desires the reforms more than the states, it will have to ensure a “buy in” from the states to agree for the reform.

But, given that the GST Council has been declared as only an advisory body with a persuasive value, what happens to the dream of having a harmonised one nation, one tax, if a state or a group of states decides to deviate?

Past experience shows that it is unlikely to happen. But the judgment paves the way for more intensive bargaining and negotiations, placing states on an equal footing with the Centre in taking decisions on the structure and operations of the tax. At present, decisions get approved in the GST Council when passed by a majority of three-fourths of the weighted votes of the members present and voting, with the Centre having one-third weight and individual states (and UTs) having an equal share of the remaining two-thirds weight. However, in the past, all decisions in the Council have been taken by consensus (except in the case of determining the rate on lotteries), and the Supreme Court decision reinforces this convention. In some ways, this is like the recommendations of the Finance Commission on tax devolution and grants, which by convention, have always been accepted and implemented by the government.

The Opposition-ruled states are elated with the decision not because they want discretion to change the structure, but because it increases their bargaining strength. The immediate impact of this will be bargaining by states for extending the period of compensation for the loss of revenue. As the five-year period of compensation gets over at the end of June and as the tax structure is yet to stabilise, states have been demanding the extension of the compensation period by another two-three years and this decision will now help the states to bargain hard for the extension.

However, though the period of collecting compensation cess has been extended till March 2026 to meet the interest and repayment requirements of the funds borrowed from the RBI to meet the compensation requirements, the lasting solution lies in increasing the revenue productivity of the tax by pruning the list of exempted items, rationalising the rates and taking administrative measures. These reforms will require strengthening the cooperative spirit.

The Supreme Court’s decision that the Union and the states have “equal, simultaneous and unique powers” to enact GST laws and that the recommendations of the GST Council are not binding on them will have significant implications in determining the nature of the tax which is still evolving. Moreover, this has come at a time when reforms have to be set in motion and hopefully, the Court’s decision will strengthen the cooperative spirit in reforming the domestic consumption tax system in the country.

The writer is chief economic advisor, Brickwork Ratings. He was member, 14th Finance Commission and former director, NIPFP. Views are personal