



STATE GST COMPENSATION: STATES OR UNION OBLIGATION

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In the fiscal year 2020-21, the Central government of India originally refused to pay the states for genuine and false GST revenue losses. While state governments raced to garner support for their legal and financial arguments for their requests, the Centre recited situational necessity and the want of any responsibilities as justifications for its rejection. It provided the states with two compensation alternatives, both of which included borrowing. The Centre, on the other hand, had pledged the opposite, as shown by GST Council sessions and the 101st Statutory Modification Act. The vow includes the responsibility to provide a steady supply of compensation-credit to states, which is especially onerous given the state's tremendous sacrifice. The formation of statutory tax-fields outside of Roster VII of the Constitution of India, in addition to the Centre's disproportionately dominant role in executing these, was both dependent on the future consideration of the state. The "anti-coercion" doctrine is now recognized in American Statutory law as having its foundation in this. This study shows that this idea has been implicitly enshrined in the Indian Constitution. Hence, GST compensation turns into a statutorily mandated duty, thereby curtailing the Centre's legal latitude. The GST Compensation Act and the GST Statutory Framework will be the main focus of this research.

Keywords: Indirect Tax, GST, Indian economy, Union Obligation, Tax administration, Cascading effect.

I. INTRODUCTION

This study provides the background and the Statutory angle of the Central and State Governments in India on the important issue of the legal and Statutory obligations of the implementation of the GST Tax. The paper begins with a concise summary of the GST Tax and its relevance in the Indian context, followed by a brief overview of the disagreement on its implementation between the States and the Central Governments. The judgment of the SC(supreme court) of India on this issue, the reactions of the various parties involved and the ramifications of this judgment are then discussed in detail, along with the suggestions for the future.



There are concerns regarding the perpetuation of the GST regime. To begin with, the replacement of an old tax administration with a new one must entail some immediate losses. Second, the judgment by the Centre to undertake demonetisation in 2016 resulted in a considerable decrease in state VAT receipts¹ and also certain temporary losses which the States had to accept as par for the course².

The US of America, on the other hand, has already observed federal government efforts to diverge from such statutory obligations obtained via state collaboration. As a fail-safe measure, a statutory regulation was enacted³. When a state decides to give up its legislative privileges in favor of the Union, the latter is said to have 'bought it for a price'⁴.

The GST Compensation Fund was designed to cover these expenses via periodic credits to the states⁵. As previously stated, these credits would compensate the latter for income lost under the prior regime.

II. THE ANTI-COERCION PRINCIPLE IN INDIAN FISCAL SYSTEM

According to legal and economic analysts, Statutory provisions offer rights not just to people, but also to organizations that represent them. However, this is just the beginning. This view of the Constitution is considered a continuation of 'living Statutoryism,' and it originated entirely in the US. A federal or quasi-federal Constitution assumes future institutional bargaining for functional efficiency, with the potential of such rights being transferred over time. Most of the time, this happens between the federal and provincial governments, both of which seem to have substantial claims. These discussions might take place horizontally (between states) or vertically (between nations) or (between the Union and the states).

However, in order to understand this 'inter-mural' bargaining among statutory institutions, the cost of rights transferred in an intergovernmental market must first be defined. This demanded an economic perspective on the legal relationships that bind political entities together. Scholars have developed three standards for seeing legal rights as transferable commodities: responsibility, inalienability, and property⁶.

The accountability rule applies when one party with a superior claim on the right disentitles the present holder. The effect of this regulation is to offer "appropriate compensation" for its loss, as judged unilaterally by the former. The government's purchase of private property under the eminent domain concept is the finest illustration of this⁷. Despite the existence of consenting parties, the inalienability rule forbids entitlements from being exchanged. In such a case, the original entitlement stays unchanged. One example is a limitation on states seceding by giving the Union a share of their income.

The property rule entitlement is diametrically opposed to these. It occurs when a fundamental right may only be transferred for a fee that has been mutually agreed upon. The fundamental assumption is therefore a voluntary transaction in which the



right is seen as a symbolic "property"⁸. On a micro level, this rule is considered to cover a defendant citizen's right to a jury trial under the Sixth Modification to the US Constitution⁹. It may apply at the macro level when the central branch decides to renounce its authority over a certain economic sector in return for a fee¹⁰. For example, broadcasting rights may be auctioned off to states as if they were real estate under the Commerce Clause 24 of the Constitution¹¹. The property rule entitlement is assumed to apply to negotiations over legislative subjects.¹²

This view of the legislative sphere as 'tradeable' is congruent with the literature on 'rights' theory. The most significant classical liberal approach in this respect is the Hohfeldian idea of jural relations. Hohfeld used the phrase 'legal right' to refer to a number of legal relationships, one of which considers right as a kind of 'liberty'¹³. That is, the lack of legal limitations on a certain conduct leads in an entitlement to it on par with a 'right,' even if the legal framework does not specifically indicate so. A Weberian, opportunity-oriented conception of 'right' entails self-disposal freedom as well¹⁴.

A 'transaction' is a state legislator abandoning territory to which it had exclusive power in the larger context of fiscal federalism. This is referred to as 'federalism by contract' in common language¹⁵. To restrict Congress' contractual overreach, the SC(supreme court) of the US ('SCOTUS') finally adopted two public law-equivalent notions of duress and coercion¹⁶. The goal of this rule is to prevent the US Congress from using its greater monetary authority to compel state leaders into defying legislative enactments.¹⁷The anti-coercion rule applies in this circumstance. It forbids Congress from significantly modifying the terms of an agreement after it has been achieved¹⁸. The case of *National Federation of Independent Business v. Sebelius* ('Sebelius') was combined¹⁹.

The federal government sought to extend the Affordable Care Act, a federal programme that subsidises medical facilities and services, inside the chosen states. The SC(supreme court) held, citing precedent, that a promise that resulted in a reorganisation of federal-financial ties in the sphere of a specific Act is analogous to a contract²⁰.The inference was that, unlike a Statutory promise or guarantee, the consequent Statutory contract is more protected by the Court²¹. In healthcare, for example, states have agreed to transfer up responsibility to the federal government in return for a charge²².

This cost was paid in the form of minimal concessions to state sovereignty and the suspension of previously approved state laws on the subject. Even though states were not obligated by law to do so, federal law took priority. The creation of a Statutory contract was the outcome of a negotiated modification of a previous Constitution vow with significant 'costs' borne by states²³. Following this change in posture, the federal government will be unable to take advantage of the states' inability to modify the contract's conditions.



The Court acknowledged the federal accord and created a regulation to assure its implementation. To begin, it claimed that even pre-existing Statutory provisions, such as the Commerce Clause, might be bargained and rebuilt. Second, if states pay the price by giving up both autonomy and legislative power in a particular area of law, the federal branches are much more bound to adopt the new rules. If the courts do not expressly enforce this compact, the states will be obliged to carry out federal policies without the financial support provided by the union. This has been named the anti-coercion principle by scholars, and it has been lauded as the ultimate step in combating the most invasive kinds of coercive federalism²⁴.

In the Indian context too, the anti-coercion concept safeguards the requirements of the contract and prohibits the dominant federal entity from strategically abusing its position. This is predicated on anticipating future coercion after the contract is created by unilaterally imposing a change in terms. Under this contractual approach, the source of the Statutory responsibility is therefore put in the act of cession by the states. While a Statutory promise is often viewed via a dividing compliance-violation lens, the former evaluates the full agreement that led to its development.

The anti-coercion principle serves as a check on contract enforcement, preventing the Indian Union from waffling on the issue of GST compensation. The sequence of transactions, in which the Indian Union government promises future compensation in return for the state's agreement to a harmful transfer of legislative power acts as a contract. States are bound to follow the Union's desired regime since they can only revert to the status quo ante if the relevant Statutory Modification is repealed²⁵. Not only does the Indian Union refuse to provide direct compensation, but it also attempts to 'coerce' states into financially imprudent judgments. It attempted to shift the duty of producing compensating funds to the states. The criminal offence intended by the Indian Union necessitates a remedy of the size envisaged in *Sebelius*, notwithstanding the fact that it has yet to be recognized²⁶. The next portion of the essay will isolate the aspects of the federal contract between the Indian states and the Union in order to demonstrate that the anti-coercion principle applies in this case.

III. POSITIONING THE VALIDITY OF GST

The Constitution (One Hundred and First Modification) Act of 2016 enacted the Goods and Services Tax (GST) in September 2016. (Modification Act). As a consequence, the GST legislation were established, and they went into effect on July 1, 2017. GST Act was adopted as part of these legislation, with two primary goals: (a) compensating states for revenue losses caused by GST implementation, and (b) levying and collecting a cess to cover the Union's compensation commitment.



The SC(supreme court) recently evaluated the legitimacy of this Compensation Act in *Union of India v. Mohit Minerals (P) Ltd.*, and this ruling is significant for many reasons:

(i) As the first SC(supreme court) judgement on GST, it establishes the precedent for judicial scrutiny of GST-related legislation. The IGST Act was passed thanks to the Parliament's authority granted by A.269A(5) and A.286 (2). - Under the CGST Act, "reverse charge" is defined in Section 2(98). The CGST Act defines "receiver" under Section 2(93). Persons who are registered or who are required to be registered under Sections 22 and 24 of the CGST Act are referred to as "taxable persons" in Sections 2(107) and S.2(84) of the CGST Act, respectively. These people are included in different categories in Sections 22 and 24. As a result, the Parliament has not abandoned its crucial legislative role.

(ii) This judgement examines GST in order to contextualise and comprehend the important elements in the legislative system.

(iii) The judgment is made within the framework of the Compensation Act, which is unique in the GST system since it animates a hitherto unknown element of trust between the Union and the States, which is essential to calibrate GST as a "dual tax."

(iv) By confirming the legitimacy, the SC has, in part, validated the changes brought about by GST. This would put an end to a number of cases now proceeding in High Courts, in which the legitimacy of legislation, among other things, is being challenged.

IV. THE GENESIS OF THE GST DISPUTE BETWEEN CENTRE AND STATES

The Modification Act granted both Parliament and the states the authority to impose GST on goods and services rendered. Certain companies, however, are worried that the states would not be able to meet their income demands alone via the adoption of GST. As a consequence, the Union and the States agreed that the former would pay the latter if the latter failed to generate enough income from the GST charge. In addition, petroleum product taxes are now excluded from the GST.

Legal and Statutory Angle

As mentioned, the purpose of this clause was to encourage states to participate in the GST and the main reform; and (ii) encourage states to participate in the GST.

(ii) Protect states from revenue losses caused by the transition from the VAT system to the GST regime.

In support of this arrangement, Parliament established the Compensation Act. Sections 3 to 7 of the Compensation Act required the Union to pay the States if their GST collections did not equal the tax plus a 14% increase above revenue collection in Fiscal Year 2015-2016. The Compensation Act mandated the frequency of



compensation distributions, therefore this had to be established using a certain manner²⁷.

Section 8 of the Compensation Act allows for the imposition of a "goods and services tax compensation cess" (compensation cess) on deliveries for the purpose of delivering this compensation, in addition to the application of GST under the applicable GST statute. The compensation cess will also be deposited to "a non-lapsable pool known as the goods and services tax compensation fund," from which the states would receive compensation, according to Section 10. The Roster to the Compensation Act contains a list of supplies subject to the cess. Tobacco, coal, and aerated water are among the items on this list.

The legality of the Compensation Act and the Rules issued under it has been challenged in a writ suit filed in the Delhi High Court. The petitioner's coal was subject to a cess, which was the subject of the litigation. The High Court granted the petitioner an interim injunction, apparently bringing Parliament's legislative competence in adopting the Compensation Act into doubt. The Government of India (GoI) has appealed the High Court's judgment to the SC(supreme court). A request was also filed to move the case from the High Court to the SC(supreme court). The SC(supreme court) approved the Government of India's request and took over the hearing of the case challenging the validity of the Compensation Act.

The petitioner's arguments in support of its challenge are as follows:

(i) The declared goal of the GST is to consolidate all goods and services taxes, cesses, and surcharges under one roof. As a consequence, implementing a compensatory cess would be contrary to the GST's stated goal.

(ii) The compensation cess is a dubious statute since it cannot be traced back to Section 18 of the Modification Act, which contains no reference to levying a cess to pay the Union's compensation responsibilities. In other words, under the wording of the Modification Act, Parliament does not have the authority to collect a compensating cess²⁸.

(iii) The application of compensation cess amounts to double taxation since the same transaction is subject to both GST and compensation cess. As a consequence, there is "overlapping" in the law, which is prohibited under the Constitution.

Aside from that, the petitioner said that the imported coal was previously subject to a "clean energy cess" levied at the time of importation under prior indirect tax law. If the compensation cess is upheld, the SC(supreme court) was asked if a credit for clean energy cess might be permitted as a set-off against the compensation cess obligation.

The Indian government responded by claiming that compensating cess is a "special kind of tax" and hence a separate sort of GST. The Government of India argued before the SC(supreme court) that since Parliament could impose GST, it could also legislate compensating cess. In addition to relying on Entry 97 of List I of the Seventh Roster of



the Constitution to argue that the levy of the compensation cess could be enacted in the exercise of its residuary powers, the Gol pressed on Article 270 to attribute another legislative enablement for the levy of the compensation cess.

Taking into consideration the opposing views, the SC(supreme court) submitted for judgement the following issues:

- (1) Is the 2017 Goods and Services Tax (Compensation to States Act) within the legislative authority of Parliament?
- (2) Is the 2017 Goods and Services Tax (Compensation to States Act) a breach of the Constitution (One Hundred and First Modification) Act and a violation of the Act's goal?
- (3) Is the 2017 Goods and Services Tax (State Compensation Act) a controversial piece of legislation?
- (4) Is it permissible to impose a compensation to states cess and a GST on the same taxable event?
- (5) Is the petitioner entitled to a set-off in the payment of compensation to the States cess on the basis of the clean energy cess paid by the petitioner until June 30, 2017?"

V. REFLECTIONS ON THE JUDGMENT

This SC(supreme court) judgment is the first in the context of GST, taking into consideration the Statutory framework and legislative approach. As a consequence, it is a considerable advancement and a welcome legal clarification. It's ironic that the strategy has to be framed in terms of a charge (i.e. compensatory cess) that is only temporary and contradicts the proclaimed objective of "one country, one tax." It would have been more appropriate to conduct the evaluation within the context of the Constitution's broad framework for GST imposition. Nonetheless, the legal situation is unaffected since the contours of GST have been fully resolved. The SC(supreme court)'s enactment of Entry 97 of List I of the Seventh Roster reflects the fact that the cess tax does not have to be related to the same legislative sector as the primary levy. In this case, for example, the GST charge may be traced back to Article 246-A, but the compensatory cess can be traced back to Entry 97, although only partially. As a consequence, the primary tax and the cess have independent legislative realms. This declaration, which addresses the Statutory status of "cess" and affirms the legislative competence to collect cess as a sui generis tax, is a major step forward in the cess jurisprudential arena.

However, by holding that compensating cess is essentially a tax rather than a charge, the SC(supreme court) has failed to address the amorphous nature of cess, that is, whether it is a "tax" or a "fee." This difference is significant because, if the levy is in the form of a fee, the payer may use the theory of quid pro quo and claim justification for the levy, but there is no such right in the case of a tax. Instead, in



Mohit Mineral²⁹, the SC(supreme court) differed a previous judgement and affirmed the Statutoryity of the cess by determining that the imposition was a charge rather than a tax. In this instance, the SC(supreme court) rejected this claim only on the grounds that the Government of India has classified compensation cess as a tax. Clearly, executive categorization cannot be used to identify the nature of the tax, and the judgement seems to be deficient in this respect in terms of legal logic³⁰.

In response to the claim that the clean energy cess may be used to discharge the duty for compensation cess, the SC(supreme court) has said categorically that the credit mechanism is fully up to legislative policy³¹. A lot of additional judgements reflect this approach. However, the Court has neglected the reality that GST, in and of itself, represents a shift in the legal landscape. The Empowered Committee of State Finance Ministers' First Discussion Paper on Goods and Services Tax in India³², The core of the GST model makes it clear that at the core of the model is the fundamental motive for transitioning from the VAT model to the GST model of indirect taxes is to prevent the tax cascading effect. Incorporating a value-added tax system with input credit is a cherished goal and, in fact, a stated aim of the GST regime, as had been indicated by several expert committee recommendations and discussions in Parliament throughout the Modification Act's adoption.

Given the circumstances, it may have been more appropriate for the SC(supreme court) to investigate the case more thoroughly to decide if the legislative goal was to deny the benefit of input credit rather than rejecting the claim based merely on a literal interpretation of the language. Indeed, as recently stated by the Gujarat³³ and Madras High Courts³⁴, there is a need to examine the legislative policy behind input credits on the basis of reasonableness while also fully providing for the vested rights obtained under the legislations that have been superseded by GST rules. It is anticipated that the Mohit Mineral judgement³⁵ will not consign this component to a predetermined conclusion, and that the accompanying factors will be addressed in the near future to delineate a maybe more thoughtful and balanced legal stance³⁶. The SC(supreme court)'s ruling in Mohit Mineral is a timely validation³⁷ of the large-scale Statutory modifications made to bring in a new age of indirect taxation.

The SC(supreme court) has cleared the way for the unrestricted execution of GST design as a legislative policy, dismissing all claims and objections to the imposition of the GST compensatory cess. While the challenge in this instance was restricted to a finer-grained aspect of the grand design, the judgement clearly restricts future challenges and thereby sets the tone for judicial examination of GST-related changes. Policymakers should interpret this as a vote of confidence in their abilities to iron out the flaws in the GST design and fully execute the reform. The reasoning of the



Compensation Act also portrays it as a critical component in encapsulating trust between the Union and the States, as well as a promise to implement GST jointly and collaboratively. By upholding the validity of the Compensation Act, the SC(supreme court) has also maintained a key basis for fair fiscal relations between the federal government and the states, furthering GST reform.

VI. THE GST'S PROMISE OF INCREASED REVENUE TO STATES COMES AT THE COST OF THE FEDERAL STRUCTURE OF THE CONSTITUTION

The Constitution (101st Modification) Act, 2016 (101st Modification Act) is a significant revision to India's Statutory framework for taxation by the Union and state governments. The 101st Modification Act, enacted to establish a Statutory framework for the implementation of the Goods and Services Tax (GST). It also establishes institutions that have a impact on the federal character of the Constitution.

When it was first enacted, customs duty and excise on manufacture were within the scope of the Union Parliament's legislative powers³⁸, taxation of goods was solely within the purview of the States³⁹. Lists I and II of the Seventh Roster delineated Union and State taxing authority precisely and explicitly, leaving minimal space for overlap in the sorts of taxes that the Union and States might collect. List III, sometimes known as the "Concurrent List," has no taxing elements, showing that the Statutory framework of taxes meant to share money between the Union and the States⁴⁰. States must have distinct taxation powers in a federal democracy because plenary legislative authority without the capacity to collect taxes and create money is meaningless. Once the GST system takes effect, both the Union and the States will purportedly have the authority to tax the supply of goods and services.

This is a significant departure from the previous, exclusive realms of taxes allocated for the Union and the States under the Statutory arrangement. This shift has significant ramifications for India's federal character, which must be thoroughly addressed. More so given that the SC(supreme court) in *S.R. Bommai v. Union of India*⁴¹ declared the federal character of the Indian Constitution to be a fundamental characteristic of the Indian Constitution, and thus cannot be repealed by Statutory change; Further, a State aggrieved by GST Council rulings has no meaningful legal recourse. As a result, the GST Council's structure violates the fundamental structure of the Constitution and may be overturned by the SC(supreme court) if challenged. This section of research is separated into three sections in order to elaborate on the preceding argument.

VIII. THE WAY FORWARD



In the larger politico-legal sense, this quality includes any conceivable object over which a government may impose control. It might be authority over a legislative domain. When states agree to a Statutory Modification that would deprive them of something in return for a charge, the hypothetical transaction happens. Regardless of any situational changes, once the exchange is accomplished and one of these federal units loses theoretical-proprietary control over a topic, the Union is bound to pay the costs it had pledged to pay.

The same thing occurred when, in line with Article 368, more than half of India's states approved the 101st Modification Bill (2). This required states to abdicate legislative themes that are recognised as Statutorily given legislative rights.

This consent was only obtained by repeated guarantees regarding a fixed cost to be paid until a future date, given both on the floor of the Parliament and afterwards in arguments before an administrative body giving it formal shape. These charges may take the form of a compensation tax, but they are still costs. The amount must be fulfilled, and one approach is to levy a compensation tax. The Centre would be in responsibility of generating the funds, either via the Act or otherwise, but none would be sent to the states.

The Union may engage into an allegedly sovereign-pooling agreement or legitimately acquire sovereignty from states. It will establish or worsen a federal trust deficit if it does not comply by paying the agreed-upon charges. This deficit contradicts the Statutory purpose of developing a trust-based paradigm, as envisioned in Articles 249, 252, and 368, in which federal entities consistently negotiate with one another.

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