

States' Right to Fiscal Autonomy vs Uniformity in Taxation

Why in news?

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A recent nine-judge bench of the Supreme Court, in the context of entry tax, has upheld states' right to financial autonomy when it comes to designing their fiscal legislation.

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What was the judgment?

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- The judgment among other things held that Article 301 of the Constitution does not apply to taxes. . (Free trade between states ensured in Article 301)

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- Therefore, the imposition of entry tax cannot be said to be a restriction on freedom of trade and commerce.

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- The court has also overruled the concept of 'compensatory taxes' (developed in earlier decisions) holding that the concept of 'compensatory taxes' does not have any juristic basis.

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- **(What are compensatory taxes?** Taxes are compensatory and valid if they are collected to provide certain service to the taxpaying units. A test for deciding whether a tax is compensatory or not is to enquire "whether the traders are having the use of certain facilities for the better conduct of their business and paying not patently much more than what is required for providing the facilities.")

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- Article 304 states that the Legislature of a State may by law

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(a) impose on goods imported from other States or the Union territories any tax to which similar goods manufactured or produced in that State are subject, so, however, as not to discriminate between goods so imported and goods so

manufactured or produced; and

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(b) impose such reasonable restrictions on the freedom of trade, commerce or intercourse with or within that State as may be required in the public interest: Provided that **no Bill or amendment** for the purposes of the clause **shall be introduced** or moved in the Legislature of a State **without the previous sanction of the President.**

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- The court states that Article 304(a) and 304(b) **are to be read separately and the states do not require Presidential assent to impose entry tax.**

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Will the judgment reduce the number of litigations?

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- However, this landmark decision of the Supreme Court does not really put an end to the entry tax litigations. Because the validity of individual state law has to be decided by the smaller bench of the apex court based on guidelines laid down in this case.

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- That is, **if entry tax is discriminatory in nature, it will still be unconstitutional.**

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- For example, if entry tax is imposed on particular goods entering into the local area of a state and **there is no corresponding levy on the same goods manufactured within the state**, it is discriminatory, in which case the entry tax law of that state might still be unconstitutional.

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How this will affect GST?

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- Uniform and harmonious tax laws throughout the country are a key objective of the proposed goods and services tax (GST) laws as it would integrate India into a common national market.

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- However, such need for harmonization is often viewed by states in direct conflict with the principles of fiscal autonomy as incorporated in the Constitution of India.
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- To achieve such objectives, a GST Council has been established to make recommendations in relation to GST, including the rates of tax, exemptions, and model GST laws. (The GST Council consists of the Union Finance Minister, the Union Minister of State in charge of revenue or Finance, and the Minister in charge of Finance or Taxation of each State government.)
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- However, in terms of the current constitutional scheme, **such recommendations are not binding on the Centre or the states** and they are expected to follow the same uniformly in the spirit of cooperative federalism.
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- In the scheme of Indian federal and political structure, it is expected that any such recommendations may not be acceptable to one or more states.
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- While the GST Council itself has been empowered to resolve any such disputes arising out of its recommendations, ultimately the Supreme Court would have the final say on such dispute.
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- If the Supreme Court upholds the sovereign right of states to administer their GST laws in a consequent judgment, it would be a huge blow on the basic premise of GST — **uniformity and harmonization** — and would lead to similar distortions as prevalent under the current tax regime.
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- The Centre, states and the GST Council should agree to and **decide on an effective dispute resolution mechanism**, which would make it difficult for the Centre or states to evade the recommendations of the GST Council and would preserve the basic feature of GST - One Nation One Tax.
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