57

GST: A CHALLENGE TO FISCAL FEDERALISM

VRANDA RELLAN & AADISHA SHETTY

STUDENTS OF SYMBIOSIS LAW SCHOOL HYDERABAD

ABSTRACT

Many nations have embraced the adoption of the Goods and Services Tax (GST) as a landmark development in indirect taxation that will simplify the convoluted tax system and improve revenue collection. However, discussions and worries about its implementation have surfaced, notably in relation to fiscal federalism. The division of taxing and spending responsibilities between the federal government and local/state governments is known as fiscal federalism[1]. The problems of fiscal federalism provided by the GST framework are discussed in this abstract. It starts by looking at the development of indirect taxation structures in federal countries and the historical background of fiscal federalism. In order to emphasise their significance in preserving an effective and constructive fiscal relationship between various levels of government, the study digs into the fundamental concepts of federalism in finance, such as both horizontal and vertical fiscal imbalances and transfer payments among governments. The thesis also talks about how states are having a hard time transitioning to the new GST regime, especially in terms of their fiscal independence and income collection.

It investigates how the GST may affect state budgets, service provisions, and policymaking. As a possible response to the problems the GST presents for fiscal federalism, the article offers several alternative remedies towards its conclusion. In order to achieve both effectiveness and equity in the allocation of resources, it promotes more cooperation and communication between federal and state governments. The study makes reform recommendations for enhancing state fiscal sovereignty while preserving the advantages of a harmonised tax system[2].

1. INTRODUCTION

One of the biggest tax reforms in Indian history, the Goods and Services Tax (GST), is without a doubt. A single, streamlined tax system was intended to replace the intricate web of federal and state taxes when it was introduced on July 1, 2017, with the goal of transforming the nation's indirect tax system. By establishing a unified and integrated market, the GST sought to do away with cascading taxes, improve convenience in conducting business, and stimulate economic growth. Nevertheless, despite its lofty objectives, India's fiscal federalism principles have been put to various tests by the implementation of the GST[3].

1.1 Background:

India is a diversified society characterised by its federal structure of government. A reasonable and fair allocation of authority is guaranteed by the Constitution of the nation, which divides duties and authority between the federal authorities and individual state governments. This division also applies to financial affairs, giving the federal government and the states the authority to implement and collect taxes on a variety of topics.

States need to have this financial freedom because it enables them to handle their developmental demands and modify policies to fit local conditions. India's indirect taxation system was infamous for its fragmentation and complexity before the introduction of the GST. Numerous taxes, including centralised excise duty, service taxes, and value added tax (VAT), were imposed at different points along the supply chain. Cascading taxes—where one tax was imposed on top of another—were the outcome of this complex tax framework, which caused taxation to increase inexorably. As a result, there were inefficient procedures, tax fraud, and negative effects on enterprises, which restrained economic growth[4].

It was predicted that the implementation of the GST would finally bring in a new age of reformed taxes and budgetary reduction. It sought to incorporate majority of indirect taxes into a single, all-encompassing tax system. Thus, it was anticipated that GST would end the tax cascade and simplify the overall taxation system. Additionally, the GST aimed to unify the market by easing the flow of goods and amenities across the border between states.

A key tax reform in India is the Goods and Services Tax (GST), which has the potential to completely transform the country's indirect taxation structure and spur economic expansion. Nevertheless, it is impossible to ignore the difficulties it has brought to fiscal federalism. The fundamental principles of fiscal federalism have been put to the test by the loss of state fiscal sovereignty, unequal revenue distribution, disagreements, difficult compliance processes, and revenue sharing concerns. Both the national and state governments must cooperate in order to overcome these issues and guarantee the long-term success of the GST.

---

[1] M. Kour, k. Chaudhary, S. Singh, & B. Kaur, A study on impact of GST after its implementation, (2016). International Journal of Innovative studies in sociology and humanities, 1(2), 17-24

[2] Nayyar., Singh, A Comprehensive Analysis of Goods and Services Tax (GST) in India, 2018, Indian Journal of Finance, 12(2)

[3] Garg, Basic concepts and features of goods and services tax in India, 2017, International Journal of Scientific Research and Management (IJSRM), 2 (2),542 - 549.

[4] Chakraborty, & P.K. Rao, Goods and services tax in India: An assessment of the base, Jan 2, 2022 Economic and Political Weekly, 45 (1), 49 - 54.

Maintaining the nation's cooperative federal structure will depend on finding a balance between a single tax system and safeguarding the economic autonomy of the states. By addressing these issues and maximising the benefits of the GST, India could set the road for a more effective and fair tax system that promotes economic growth and benefits all facets of society[1].

2. ORIGINS AND RATIONALE OF GST IN INDIA

The early 2000s saw the formation of a committee by the government to research and provide recommendations for changes to the nation's taxation structure, which eventually led to the creation of the Goods and Services Tax (GST) in India. The group, which was presided over by the previous head of finance ministry Vijay Kelkar, he put forward the proposal of enacting GST as a replacement for the current intricate and cascading tax system. Years of discussions, debates and talks between both the national and state governments resulted in the introduction and passage of the Constitution (122nd Amendment) Bill in 2016, clearing the pathway for the implementation of GST on July 1, 2017.

The fundamental justification for the implementation of the GST in India was to provide a more effective and straightforward tax structure that would benefit companies, consumers, and the economy. GST sought to simplify the system of taxation and do rid of the compounding effect of taxes by combining numerous National and State taxes, such as as excise duties, taxes on services, value added taxes, along with other taxes, into a single tax. As a result, businesses would pay less overall in taxes, increasing the competitiveness of Indian goods and services both locally and abroad. By abolishing interstate tax barriers and enabling unrestricted movement of goods and services across state borders, GST also aimed towards establishing a common national market. It was anticipated that this economic integration would promote investment, trade, and commerce, as well as economic growth in general[2].

GST also aims to promote compliance with taxes while minimising tax evasion using technology, the introduction of the idea of Input Tax Credit (ITC), along with the establishment of an effective structure for the administration of taxes. Despite some initial difficulties, the introduction of GST marked a significant stride in the country's tax reforms, redefining and reshaping the indirect tax system and enhancing business environment and economic growth.

2.1 Pre-GST Taxation Structure in India

The taxation structure in India was characterised by a complicated and several-layered system of various indirect taxes levied by both the national and state governments up until the enactment of the Goods and Services Tax (GST) in July 2017. This arrangement produced an unintended impact of taxes, wherein taxes have been imposed on top of other taxes, increasing costs for enterprises, and causing an uneven distribution of tax rates among states[3].

The Centralised Excise Duty, that was imposed on the manufacture or production of commodities within the nation, was one of the main indirect taxes at the central level. According to how items were categorised under the Central Excise Tariff Act, the rates of excise duty changed. In addition, the national government levied customs taxes on products exported from and imported into the nation. The kind of the items affected the customs duty rates.

Another significant tax levied at the federal level and applied to a variety of services offered by service providers was the service tax. At the national level, the tax rate was constant and applicable to all the services that were taxable. The central government was largely responsible for collecting the service tax money. Value Added Tax (VAT) referred to a substantial tax imposed on the sale of commodities inside a state at the state level. There were differences in tax rates between states as a result of each state having its own VAT rules and rates.

States also imposed additional taxes in addition to the VAT, further complicating the tax structure, including entry charges, luxury taxes, entertainment taxes, and octroi. An additional tax levied on the supply of commodities during interstate trade or commerce was the Central Sales Tax (CST)[4]. It was imposed by the federal government, but the exporting state oversaw collecting and keeping it. Along with the taxes, several central tariffs and costs and cesses were levied on certain products and services, including an education cess and a clean energy cess. The intricate nature of the taxation system was further complicated by these extra taxes, which also increased the tax burden on consumers and enterprises. Prior to the introduction of the GST, there were numerous inefficiencies in the tax system, including evasion of taxes, tax cascading, and a lack of transparency.

Multiple state-specific levies made it more difficult for commodities and services to travel freely across state borders. The Indian government implemented the GST to address these issues and produce a more streamlined and consistent tax system. The majority of the national and state-level indirect taxes were replaced by the GST, which established an integrated and uniform tax structure with the goals of streamlining taxation, lowering the cost of compliance, and promoting the development of the economy.

2.2 Need for Tax Reforms and Introduction of GST

By looking at some of the difficulties and constraints that many nations' current tax systems face, it is possible to comprehend the necessity for tax changes and the adoption of the Goods and Services Tax (GST). With the goal of replacing various

[1] D.K. Adhana, Goods and services tax (GST): A panacea for Indian economy, 2015, International Journal of Engineering & Management Research, 5 (4), 332 - 338.
[2] S. Dani, A research paper on an impact of goods and service tax (GST) on Indian economy, 2016, Business and Economics Journal, 7(4), 1-2
[3] GST in India: Not the end but start of the journey, 2022 International Journal of Commerce and Management. 8. 51-56.
[4] R. Gupta, Impact of GST in Indian Economy, 2018, INTERNATIONAL JOURNAL OF TRADE & COMMERCE- IIARTC.

indirect taxes and establishing a single tax system, the GST is a unified and holistic indirect tax system[1]. Here are a few main justifications for reforming taxes and the introduction of the GST:

1. Simplifying and rationalising: Many nations have complex, disjointed tax structures with a wide range of indirect taxes, including excise taxes, service taxes, sales taxes, value-added taxes (VAT), etc. Due to this intricacy, the tax collection procedure is inefficient and burdensome for firms to comply with. By combining several taxes into one, the GST streamlines the tax system and makes it simpler for businesses to adhere to tax laws.
2. Expansion of the Tax Base: Due to traditional tax systems' frequently constrained tax bases, only a small portion of the economy pays taxes, while the majority is exempt from paying any taxes. As a result, the conforming taxpayers must pay a larger tax burden. With its application at every point in the supply chain, GST broadens the tax base by ensnaring a larger share of economic activity and lowering tax evasion[2].
3. Tax Cascade Elimination: Prior to the introduction of the GST, different indirect taxes were imposed at various points along the supply chain, which resulted in tax cascades or "tax on tax." The total amount of taxes imposed on commodities and services increased as a result. GST eliminates tax cascading and improves the efficiency of the entire tax system by simply charging tax on value addition at each stage.
4. Fostering Economic Growth: The development of the economy can be influenced favourably by a well-designed tax structure. GST can improve corporate competitiveness and draw investment, establishing a clear tax environment while removing inconsistencies and lowering the cost of compliance, hence supporting economic growth.
5. Increasing Tax Revenue: By reducing tax evasion and broadening the tax base, GST has the capability to increase tax revenues. The government can use the additional funds for infrastructure improvements, public welfare programmes, and other crucial services.
6. Promoting the Formalisation of the Economy: Since enterprises must adhere to tax laws, the GST encourages them to become part of the official economy. Both enterprises and the government profit from the formalisation since it improves record-keeping, increases transparency, and opens up formal credit channels.
7. Promoting Investment and Trade: A unified tax structure, such as the GST, lowers interstate barriers and does away with double taxation on the transit of services and goods between states. Through this simplification, trade between various states and areas is improved, and investments are encouraged.
8. Adherence to International Best Practises: The GST or other value-added tax systems have been effectively implemented in numerous nations throughout the world. By implementing GST, a nation's tax system will be in line with worldwide best practises and will be easier to integrate into frameworks for international commerce and investment.

Despite these advantages, the implementation of the GST may encounter initial difficulties, such as administrative changes, transitional problems, and opposition from industries. The GST, however, has the potential to significantly accelerate economic growth, tax system simplification, and efficiency with adequate design, stakeholder involvement, and good implementation.

2.3 Objectives and Expected Outcomes of GST Implementation

In India, the delivery of goods and services is subject to the comprehensive indirect tax known as the Goods and Services Tax (GST). With the intention of streamlining the tax code, increasing transparency, and spurring economic progress, the GST went into effect on July 1, 2017. The following are the GST implementation's goals and anticipated results:

- Simplifying the Tax System
  Objective: With the introduction of the GST, the basic objective was to replace the various indirect taxes levied by both the national and state governments using a single, uniform tax system.
  Expected Result: The tax system can be made simpler for businesses to comply with by reducing complexity and the cascading effect of taxes.
- Expanding the Tax Base
  Objective: By encompassing both commodities and services, the GST attempts to expand the scope of economic activities subject to taxation.
  Expected Result: The government can enhance revenue collections with a larger tax base, which will result in stronger fiscal consolidation and less tax evasion.
- Tax Barriers are Eliminated:
  Objective: By combining different state taxes, the GST aims to eliminate interstate obstacles and create a single, nationwide market.
  Expected Result: This encourages unrestricted trade and investment by making it easier for products and services to travel freely across state borders.
- Simplified Conformance
  Objective: By replacing several tax files with a single, online platform, the GST streamlines firms' compliance procedures.
  Expected Result: By making the compliance procedure simpler, firms will have less work to do and more entities will be enticed to participate in the formal economy.
- Promoting Investment and Economic Development
  Objective: The GST intends to increase investment, increase productivity, and promote overall economic growth by streamlining the tax structure.
  Expected Result: A more favourable to businesses tax climate may encourage more spending and other economic activity, which would boost GDP growth.
- Decreased Tax Evasion

[1] Ms Reshmi Kamra, GST -an Indian Prospective, Research Review International Journal of Multidisciplinary written, Volume 3, issue 10 October 2018.
[2] G, Garg, Impact of GST on various sectors of Indian economy. *Research Review International Journal of Multidisciplinary.* 2019;4(3):668–673.

Objective: To reduce tax evasion, GST creates a comprehensive technology-driven system that allows for better surveillance and analysis of transactions.

Expected Result: By reducing tax evasion, the GST is anticipated to increase tax revenues and level the playing field for enterprises

It is important to remember that depending on how well the implementation process goes, the state of the economy, and other external factors, the projected effects of the implementation of the GST may differ. Overall, continual review, improvement, and adaptation are essential to the long-term effectiveness of GST in order to handle any issues that may occur throughout implementation.

3. Impact of GST on the Federal Structure of Taxation

The federal tax system in India has been significantly impacted by the introduction of the Goods and Services Tax (GST). India had a convoluted and fragmented tax structure before to the implementation of the GST, with both the federal and state governments levying several indirect taxes. As a result, there were problems with administrative complexity, tax evasion, and cascading taxes.

The whole indirect tax system witnessed a significant upheaval after the enactment of GST. Service Tax, Central Excise Duty, VAT, along with additional state and national indirect taxes are all included in the comprehensive, destination-based GST tax. The national and state governments each levy and collect GST on their respective parts of the supply, adhering to the dual GST model[1].

3.1 Centralization of Indirect Taxes under GST

Indirect taxes in India have been significantly centralised under the Goods and Services Tax (GST) regime. Before the introduction of GST, the tax system was dispersed since both the federal government and the state governments assessed and collected their own indirect taxes. A sizable chunk of indirect taxes has been harmonised and centralised with the implementation of the GST.

The centre and the states each levy and collect GST on their respective shares of supply under the dual GST model that governs GST. The Central Excise Duty, Service Tax, Additional Excise Duties, Special Additional Duty of Customs, and other central taxes have been incorporated into the GST. State taxes like the Value Added Tax (VAT), Central Sales Tax, Entertainment Tax, and Octroi, on the other hand, have been absorbed.

The GST's concentration of indirect taxes provides the following benefits:

- Streamlined tax structure: The amalgamation of many taxes into one tax- GST has streamlined the tax code, making it simpler for companies to adhere to tax laws.
- A continuous credit for input tax among goods and services under GST eliminates the cascading impact of taxes, lowering the total burden of taxes on customers.
- Encouraging Ease of Conducting Business: The removal of tax obstacles as a result of a unified tax structure across states has encouraged the free flow of products and services across the nation and made it easier to conduct business.

3.2 Redistribution of Taxing Powers between Centre and States

The allocation of taxation authority between the federal and state governments is one of the key modifications brought about by the GST. GST has paved the way for cooperative federalism in the area of taxes by establishing an equitable tax base between the federal government and the states.

Tax rates, deductions, and other policy choices are made by the GST Council, which is made up of Centre and state delegates. This promotes collaborative decision-making by guaranteeing that the federal government and the states both have a voice in the development and enforcement of the tax structure.

Important details relating the division of taxing authority:

- Dual GST Model: On intra-state purchases, state governments collect State Goods and Services Tax (SGST), while the federal government collects Central Goods and Services Tax (CGST). The centre imposes and collects the Integrated Goods and Services Tax (IGST) on inter-state purchases. The IGST money is then divided between the federal government and the states.
- IGST Revenue Sharing: According to a formula established by the GST Council, the centre and the states split the IGST revenue. The cash is distributed fairly between the generating and consuming states thanks to this formula.
- Mechanism for Compensation The compensatory mechanism was designed to alleviate states' concerns about revenue loss during the early years of the introduction of the GST. Based on a predetermined formula, the centre reimburses governments for any revenue shortfall.

3.3 Changes in Taxation Responsibilities and Implications

The introduction of GST has significantly altered tax obligations and ramifications for the federal government and the states:

a. Loss of Autonomy: States have lost some budgetary autonomy as a result of the centralization of some taxes. However, they retain the authority to charge and receive taxes on commodities that are not covered by GST, like petroleum and alcohol[2].

---

[1] Ramya, & Sivasakthi, GST and its impact on various sectors, 2017, Journal of Management and NTATION Science, 1, 65-69.

[2] Building construction before and after GST, "IRJET-V5I4322" as conference paper presented at Thakur College of Engineering and Technology, April 2018

b. Revenue effects: The GST has had diverse revenue effects for different states. Due to greater compliance and expansion of the economy, some states have seen a rise in tax collections, but others have had revenue difficulties, particularly in the early stages of the implementation of the GST.

c. Cooperative Federalism: Since decisions about tax rates and other policy-related issues are reached by consensus in the GST Council, GST has encouraged mutually beneficial federalism in India's tax system.

d. Ease of Compliance: The introduction of the GST has resulted in a single tax system for businesses, which has made compliance easier and lessened the burden of different taxes and filings.

e. Support for Economic Growth: Increased integration in the economy and growth have been facilitated by the rationalisation of taxation and the removal of restrictions on the movement of products and services between states.

The indirect tax system in India has undergone a paradigm shift as a result of the GST, fostering harmonisation, cooperative federalism, and corporate accessibility. GST continues to develop despite its difficulties as stakeholders collaborate to address problems and enhance the effectiveness of the taxation system.

4. Implications on Revenue Sharing Mechanism

The revenue sharing system between the federal government and the state governments was significantly impacted by the introduction of the Goods and Services Tax (GST) in India. One of the most profound impacts was the introduction of a single GST, which replaced several indirect taxes. By dividing the GST money collected between the centre and the states according to a pre-established formula, this simplified revenue sharing while lowering complications and disagreements. The income sharing mechanism considered variables including population size, per capita income, and financial capacity to ensure a fair and equal transfer of resources across states and to support balanced economic growth throughout the nation.

The enhanced efficiency and openness of revenue collection was another consequence. Due to the computerised recording of transactions by means of GSTN, GST increased accountability and decreased tax evasion. For both the federal government and the state governments, this resulted in enhanced tax administration and higher revenue collection. The elimination of the cascading impact of taxes by the GST also encouraged a more effective tax system and increased revenue that benefited both the federal government and the states.

Additionally, the elimination of interstate trade obstacles and the establishment of an uninterrupted flow of products and services aided in economic development. Businesses would have less to worry about in terms of compliance, which would improve compliance and broaden the tax base. By encouraging firms to register under the GST system and claim input tax credits, this transition from the informal to the formal economy helped governments raise more money. To maintain the smooth operation of the GST revenue sharing mechanism and to promote long-term economic growth in the country, problems such early revenue inequalities, administrative issues, and rate rationalisation needed constant attention[1].

4.1 GST and Revenue-Sharing Effects:

The revenue sharing arrangement between the federal government and the state governments was significantly impacted by the implementation of the Goods and Services Tax (GST) in India. The Central GST (CGST), State GST (SGST), and Integrated GST (IGST), which are applied to intra-state transactions and inter-state transactions, respectively, are the two GST models that make up the GST system.

The following succinct statement sums up how the GST has affected revenue sharing:

- Unified Tax System: GST created a more simplified and effective revenue-sharing system by replacing various indirect taxes at the federal and provincial levels with a single tax. In order to ensure a more equitable distribution of resources across states, the GST revenue is now distributed according to a predetermined formula that takes into consideration variables including population, per capita income, and fiscal capacity.
- Tax Cascading Eliminated: The GST did away with the practise of levying additional taxes on top of one another at various points throughout the supply chain. The national and state governments benefited from the reduction in tax cascading since it increased overall tax efficiency and revenue collection.
- Increased Revenue Collection: Tax compliance and collection were increased by the GST's uniform and streamlined tax system. Both the federal government and state governments saw a gain in their tax revenues as a result of increased compliance and fewer chances for tax evasion, which allowed for a more equitable distribution of those funds thanks to the integrated tax structure.
- Compensation Mechanism: During the early years of the GST's implementation, some states experienced revenue shortfalls as a result of the changeover from the old tax structure to the GST. This problem was addressed by the introduction of a compensation process, which made sure that states were reimbursed for any revenue losses experienced during the transitional period. During the initial phases of the implementation of the GST, this system assisted in maintaining stability in revenue sharing.

4.2 Problems with GST Resource Allocation to States:

Although the GST significantly improved the income sharing system, there were difficulties with allocating money to the states:

[1] Dermdaly, The Problem With "revenue share"2009

- Initial Revenue Disparities: The transition from the old tax system to the GST temporarily affected the revenue of some states during the early stages of the implementation of the GST. Although beneficial, the compensation method did not entirely resolve concerns about tax revenue inequities across states.
- Compensation Disputes: The payment of reimbursement under the GST has been the subject of disputes between the federal and state governments. Fiscal disputes between the centre and the states resulted from claims made by several states that they were not fairly compensated for revenue losses they experienced during the transition period[1].
- Rate Rationalization: To respond to sector-specific demands and economic situations, the GST Council has the power to change tax rates. However, it might be difficult to come to an agreement on rate modifications, which can have an impact on state financial planning and uncertainty in income estimates.
- Administrative and Compliance issues: Some states, particularly those with less developed tax administration, have trouble successfully adopting the GST. Some governments found it difficult to expand the competence of tax authorities and provide them with the necessary training for the transition to a new tax regime[2].
- Cross-Border Transactions: When products or services pass through several states, it can be challenging to monitor and ensure that the IGST is being applied.

Even though GST has improved the revenue-sharing structure overall by streamlining the tax code and guaranteeing a fair allocation of funds across states, overcoming these obstacles will require constant coordination and communication between the federal and state governments. In the GST era, ongoing efforts are required to improve compliance, simplify administration, and promote economic development and expansion throughout all states.

5. Effect on State Autonomy and Fiscal Decision-making

In federal structures, where authorities and duties are shared amongst the national government and state or regional governments, the impact on autonomy for state governments and fiscal decision-making is a crucial part of governance. In such systems, economic issues are critical in establishing state autonomy and their ability to make autonomous financial decisions. State governments' fiscal capacities are directly impacted by the distribution of financial resources, revenue-sharing arrangements, and national fiscal policies.

By influencing the fiscal environment in which states function, central fiscal policies can have a substantial impact on state autonomy. For instance, modifications to tax laws and revenue-sharing agreements may have an impact on the state-available revenue sources. State autonomy may be undermined and their capacity to effectively address regional objectives may be hampered if national fiscal decisions severely restrict state revenue production or provide little room for discretionary spending.

Another element that may have an impact on state autonomy is interstate budgetary competitiveness. States may use aggressive tax incentives and rates to entice enterprises and investment. Despite the fact that this might increase state income and promote economic growth, it could also result in a "race to the bottom" where governments gradually cut back on their potential revenue.[3] As a result, their ability to make sound financial decisions could be seriously impacted by the desire to maintain their competitiveness, which could jeopardise their long-term economic stability.

In order to strike a balance between state sovereignty and federal coordination, fiscal federalism principles are essential. In order to resolve regional inequities and assist states in carrying out their fiscal obligations, the federal government can use tools like fiscal transfers and grants. State autonomy, however, may be affected by how these resources are distributed and the restrictions placed on their usage. To guarantee efficient governance and long-term fiscal decision-making within a federal system, it is crucial to strike an appropriate balance amid fiscal cooperation and independence.

5.1 GST's Impact on State Fiscal Powers

State fiscal authority was significantly impacted by the implementation of the Goods and Services Tax (GST) in India. Value Added Tax (VAT), Entry Tax, and Octroi were just a few of the state-level taxes that could be imposed prior to the implementation of the GST. Many of these state-level levies were absorbed into the consolidated GST regime when GST was implemented. State's former taxing authority was reduced as a result.

The national government as well as the state governments each have a part of the authority for levying and collecting tariffs on the sale and purchase of commodities and services under the GST system. The central and state government officials that make up the GST Council are very important in making decisions about tax rates, exemptions, and other related issues. This cooperative approach permits states to influence the GST structure, but it additionally implies that certain fiscal actions are made at the federal level, restricting the exclusive fiscal authority of individual states.

It's important to remember that the GST has benefited states as well. Economic integration has been facilitated and compliance costs have decreased by the uniform tax system and easy movement of products and services across state lines. The GST has given states access to a larger tax base, allowing them to raise money more effectively. The GST compensation mechanism also makes sure that any revenue losses experienced by states during the first few years of implementation are fully reimbursed.

5.2 GST Balance between State Autonomy and Central Coordination

Finding an appropriate equilibrium between individual state autonomy and national integration under the GST regime is a difficulty. States still maintain a lot of control over the administration of the GST, including enrolment, assessment, and audit

[1] Risk-neutral pricing approach for evaluating BOT highway projects with government minimum revenue guarantee options. *J. Constr. Eng. Manag.* 2012, *138*, 545–557.
[2] Narula, GST—A milestone in Indian tax regime. *International Journal in Multidisciplinary and Academic Research.* 2016;5(6):1–8.
[3] Abrate, Nicolau, Viglia,, The impact of dynamic price variability on revenue maximization. *Tour. Manag.* 2019, *74*, 224–233.

of taxpayers, despite the fact that the subsumption of state-level taxes has reduced some of their exclusive fiscal authority. The dual control method, which involves the monitoring of taxpayers by both the federal and state tax authorities, is intended to guarantee coordination and cooperation between the various governmental levels.

In order to preserve consistency among states and take into account regional differences and unique demands, the GST Council's responsibility becomes vital in harmonising tax rates and policies. States can use it as a forum to express their issues and interests as a whole. The creation of an equitable and impartial GST system that promotes growth and development in the economy across the nation may be difficult to achieve among distinct states with different economic interests.

State governments can still use some authority beyond the GST framework in order to preserve their fiscal independence and solve regional inequalities. They are free to charge and collect taxes on items and services like alcohol and petroleum products that are not covered by the GST.

Under the GST, maintaining a balance between state autonomy and central coordination calls for ongoing communication, collaboration, and regular evaluations of the tax system to take into account changing economic and financial realities. GST will be successful if a cooperative fiscal framework is established that enables the federal government and the states to cooperate for national economic growth while honouring the distinct requirements and goals of each state.

6. Challenges Faced by States in Implementing GST

For the states, the Goods and Services Tax (GST) implementation in India faced a number of difficulties. First off, considerable administrative and technical changes were needed to make the transition from an earlier complicated taxation system to the unified GST regime. The IT infrastructure of the GST system, the GST Network (GSTN), required states to integrate their procedures, train staff, and modify their tax administration systems[1]. The lengthy and complicated nature of this process initially made adherence and collecting taxes problematic.

The ability of states to generate money was also impacted by the loss of their exclusive fiscal authority brought on by the GST's inclusion of state-level levies. The GST implied a loss of financial autonomy for the states because they were dependent on certain taxes as important revenue sources. Some states nonetheless had trouble meeting their financial obligations despite the compensation mechanism being in place to cover any revenue shortages during the first years of the GST's introduction, particularly in the face of unforeseen economic disruptions.

Thirdly, coordination and administrative challenges arose as a result of the dual control system, which assigns responsibility for taxpayer monitoring to both the federal and state tax authorities. To reduce duplication of effort and speed tax enforcement, it was crucial to ensure effective coordination and information exchange between the central and state authorities. The GST Council's numerous stakeholders, comprising representatives of states with a range of interests and concerns, faced a persistent challenge in maintaining consistency and unanimity in decision-making.

In general, the difficulties states encountered in introducing GST were due to the complexity of changing to a single tax system, adjusting to a reduction in their budgetary authority, and collaborating with the national government and other states when making decisions. Despite these difficulties, the GST is an important step towards developing a single national market, improving tax efficiency, and promoting economic convergence in India.

6.1 Administrative Issues

The administrative changes required to shift from the previous system of taxes to the GST regime were one of the key problems faced by states in adopting GST. State tax offices needed to be reorganised, staff needed to be trained, and processes needed to be integrated with the GSTN. It was a significant administrative effort to make this shift, which entailed upgrading taxpayer information, tax codes, and compliance procedures. Additionally, in order to ensure efficient tax administration and prevent duplication of effort, states had to set up coordination procedures between state and federal tax authorities. Tax paperwork, enrolment, and taxpayer education had difficulties during the first phase of GST implementation, necessitating ongoing supervision and assistance[2].

6.2 Technical and Infrastructure Difficulties

The efficient exchange of data and a solid technological foundation were essential for the GST's successful implementation. When integrating their current systems with the GSTN, states encountered technological difficulties. Interactions between taxpayers and the GST portal were originally impeded by challenges like network outages, system bugs, and connectivity issues. Critical considerations were securing sensitive taxpayer data and expanding the IT system in order to manage a large number of taxpayers. To safeguard taxpayer information and uphold the authenticity of the tax system, states had to invest in modernising their electronic systems and knowledge of cybersecurity.

6.3 Economic Difficulties and Their Effect on States

The introduction of the GST affected states' economies both favourably and unfavourably. States that benefited and those that suffered as a result of the GST's change from origin-based to destination-based taxes were the winners and losers in terms of revenue distribution. States with a greater reliance on production and manufacturing taxes saw a decline in revenue, whilst states with a higher foundation of consumption saw an increase. This led to differences in state budgetary capacities, which had an impact on their ability to finance public services and development initiatives. Due to adaptations to new tax structures, the early

[1] Gaspar, Jaramillo, & Wingender, *Tax capacity and growth: Is there a tipping point?* 2016, International Monetary Fund.

[2] The New Indian Express. (2021). Four years of GST: The good, bad, and ugly

phase of the GST implementation also saw interruptions in supply chains and corporate operations, creating short-term economic uncertainty.

Additionally, the GST compensatory mechanism attempted to compensate states for revenue losses sustained during the first few years of the GST's implementation. However, the COVID-19 pandemic's effects and delays in getting compensation put additional burden on public budgets. States had difficulties in maintaining growth and development in their economies due to the need to effectively manage their budgets and adjust to changes in revenue sources[1].

7. Improving Fiscal Federalism in the Face of GST

In a nation with a federal structure like India, the introduction of the Goods and Services Tax (GST) has created an incredible opportunity to improve fiscal federalism. GST streamlines the administration of taxes and revenue collection by replacing a disjointed indirect tax structure with a single indirect tax system. By redistributing fiscal authority between the federal and state governments, it may encourage cooperative federalism.

First, the GST has made it possible for the federal and state governments' fiscal relations to be more harmonious. Both levels of government impose the tax at the same time, with the central government levying the Central GST (CGST) and the states levying the State GST (SGST). In addition, an integrated goods and services tax (IGST) is charged on interstate transactions, with the centre and the states splitting the proceeds. The segregation of tax collection promotes budgetary cooperation between the federal government and the states and guarantees a more equitable allocation of money.

Second, GST has reduced conflicts between states over taxes. Prior to this, there were numerous points of entry for commodities and various tax rates, which resulted in tax cascading and numerous administrative challenges. With the implementation of the GST, state tax rates have been uniformed and there is now a smooth movement of products and services throughout state lines. This simplification has increased economic efficiency and state collaboration by lowering compliance costs for firms and promoting interstate trade.

Thirdly, the GST Council, which is made up of representatives from the centre and the states, is a key player in the decision-making process for GST-related issues. This collaborative structure makes sure that the states and the federal government both have a vote in deciding how to administer taxes and determine tax rates and exemptions. The Council meets frequently to discuss topics and reach decisions using a consensus-building process, encouraging communication and collaboration amongst all parties[2].

In the case of an Indian federal system, the GST has significantly improved fiscal federalism. The GST Council has enhanced the fiscal connections between the national and state governments by promoting cooperative federalism, eliminating inter-state conflict over taxes, and facilitating meaningful decision-making. As a result, GST has been crucial in improving India's taxation system and revenue collection's efficiency and effectiveness, as well as encouraging a more unified and collaborative fiscal framework.

7.1 Encouraging Coordination and Cooperation Among Governments

The act of encouraging coordination and cooperation between governments, including those at the national, regional, and local levels, is known as "inter-governmental collaboration and coordination." Efficiencies, efficacy, and general governance are all intended to be enhanced by this collaborative approach. Dealing with problems that cross administrative boundaries, such as environmental preservation, disaster management, and growth of infrastructure, requires intergovernmental coordination.

Governments can combine their resources and skills to better handle difficult problems by promoting communication, exchanging information, and coordinating actions. Additionally, it assists in eliminating redundant efforts and incompatible policies, resulting in a more integrated and cogent approach to governance.

7.2 State Empowerment and Capacity Building

Strengthening the capacities and resources of specific states or provinces within a country is the focus of capacity building and state empowerment. This involves offering technical support, guidance, monetary support, and other resources to help them address diverse economic, social, and environmental concerns on their own.

The objective is to make sure that every state has the infrastructure, know-how, and resources required to effectively implement policies, make decisions, and serve its population. Administration, governmental affairs, health care, education, and sustainable development are just a few of the areas that capacity building can address.

Giving states more autonomy and power to run their own affairs entails holding them responsible for their decisions while simultaneously increasing their decision-making power. By being more decentralised, a government may be better able to respond to the needs and goals of the local community, promoting regional growth and overall societal advancement.

7.3 Cooperative Decision-Making Process for Tax Policy

A cooperative strategy for tax policy and decision-making comprises including a variety of stakeholders, such as government representatives, taxpayers, corporations, and specialists, in the process of designing and enacting tax policies. The goal is to develop a tax system that is more equitable, transparent, and effective for everyone concerned.

[1] World Bank. (2019). The World Bank in India: Overview. Accessed online April 24th, 2020

[2] Roychowdhury, Vat and GST in India—A note. *Paradigm.* 2012;16(1):80–87

In this strategy, governments hold public hearings, consultations, and dialogues to solicit feedback from businesses and taxpayers on potential tax reforms or modifications. Decisions can be made more wisely by identifying potential unintended consequences and considering other viewpoints.

As citizens feel more involved in determining the direction of the tax system, collaborative tax policy-making can aid in fostering public trust and compliance. As a result, a more equal and efficient tax system may be developed by identifying tax evasion and loopholes.

8. Recommendations

- Clearly Defined Revenue Sharing structure: - To achieve equitable distribution of GST income, the federal government and state governments must define a clear and equitable revenue-sharing structure.
- Dispute settlement Mechanism: - Establish an effective and impartial dispute settlement process to handle disputes over GST among states as well as among states and the federal government.
- Standardised Tax Structure: - Continually review and simplify the GST taxation system to reduce complexity and the number of tax slabs while ensuring compliance.
- Regular Consultations: - Promote regular discussions and consultations between the federal and state governments so that issues may be addressed, best practises can be shared, and decisions can be made jointly.
- Data Sharing and openness: To increase openness and guarantee proper tax collection, put in place systems for the exchange of pertinent tax data between the federal and state governments.
- Fiscal Obligation and Debt limitations: - Adopt financial responsibility and debt limitations for states to ensure responsible financial management as well as avoid exorbitant borrowing that could put a strain on their budget[1].
- Converging of GST Rates: Aim for GST rate convergence over time to reduce state tax rate arbitrage while preserving uniform framework of taxes.
- Sector-Specific Considerations: - Take into account the distinctive qualities of various industries and sectors when deciding on GST rates and exemptions, maintaining fairness and competitiveness.
- Periodic Review: Conduct ongoing analyses of the enactment of GST and the effects it has had on federalism in finance in order to make the required corrections and advancements.
- Increasing the power of the GST Council to make decisions: - Ensure that state representatives actively participate in developing GST policy by increasing the GST Council's power to make decisions.

By encouraging collaboration and fair income distribution between the federal and state governments, these policy approaches collectively seek to improve the viability and efficacy of fiscal federalism under the GST regime.

9. Conclusion

Notwithstanding the fact that the Goods and Services Tax (GST) was implemented with the intention of streamlining taxation and promoting economic cohesion, the old Indian system of fiscal federalism has been significantly challenged. The allocation of revenue and the balance of power between the federal and state governments have been affected by the move towards a single tax system. The difficulty is in maintaining the precarious balance between ensuring state autonomy and a centralised tax collection process. The challenges of reconciling financial federalism with the need of a single tax structure are highlighted by the complexity of multi-tier rates of taxation, revenue-sharing disagreements, and the requirement for integrated managerial decisions within the GST Council.

Navigating these difficulties calls for a nuanced strategy that considers the worries of the states while preserving the broader objectives of national economic integration. A durable equilibrium must be reached with the help of efficient dispute resolution procedures, open revenue-sharing arrangements, and ongoing communication between national and state authorities. Achieving this balance would be crucial if fiscal federalism is to retain its cooperative nature while maximising the long-term growth and development potential of a well-implemented GST in India.

[1] Financial Express. (2019). Economic Survey 2019: Taxes not keeping up pace with growth as GST collection falls short of target