

UNITING THE REGIME BY UPSETTING THE STRUCTURE: IS THE GOODS AND SERVICES TAX ANTITHETICAL TO THE BASIC STRUCTURE DOCTRINE?

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ABSTRACT

The Constitution (One Hundred and First Amendment) Act, 2016 that provides a framework for the levy of Goods and Services Tax in India has re-cast India's federal structure in a manner that is fundamentally damaging to the basic structure of the Constitution of India. The fiscal policies of the State are now subject to the approval granted by the GST Council and to challenge the same approval or rejection, it would be the same Council that would decide its fate. The aggrieved States have not been given any proper dispute resolution mechanism. I would, in my paper argue that federalism is an indispensable and integral part of the Basic Structure Doctrine and then narrate that the 101st Amendment to the Constitution is antithetical to said federal structure. The reasons would be twofold: One, The GST Council makes States subordinate to the Union in matters of taxation, which has never been the principal position in the Constitution and Two, a State aggrieved by the decision of the GST Council has no effective legal remedy. The paper would also give a comparative analysis and perspective to other jurisdictions on the same issue. The study in this paper is purely doctrinal, specifically focusing on the institution of the GST Council and the dispute resolution mechanism contained therein. Therefore, I would argue that if the validity of the 101st Amendment Act with the institutions created through it is challenged in Court, it ought to not clear judicial scrutiny and might fail the test of the Basic Structure Doctrine, as being against the spirit of Federalism enshrined in the Constitution of India.

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I. INTRODUCTION

The Indian Government recently restructured the taxation regime by amending the Constitution to make way for The Constitution (One Hundred and First Amendment) Act, 2016, (“Amendment Act”). This amendment was enacted to introduce the Goods and Services Tax (GST).

The amendment also created institutions which will significantly affect the federal nature of the Constitution and, it also pours down new powers to Parliament and State Legislatures.

Initially the Constitution had a different view on taxation of goods and services supplied within India. The levying of tax on sale and movement of goods was under the purview of the States,¹ while excise on manufacture and customs duty was the exclusive scope of the legislative powers of Parliament.² The judgement of the Hon’ble Supreme Court in *T.N. Kalyana Mandapam Assn. v. Union of India*,³ held that service tax as a subject matter was the “residuary power” of the Union, the Constitution (Eighty-eight Amendment) Act, 2003 introduced Entry 92C, which clarified that the Union had exclusive power to levy a service tax.

The decision of Hon’ble Supreme Court in *Kalyana Mandapam* led to a Constitutional Amendment being introduced, which gave Union the power to levy service tax, therefore the framers of the Constitution were justified for not including taxation matters in the Concurrent List, i.e. List III of the Seventh Schedule. This was to mean that the taxation regime was two different spheres, Union and State. Though the Hon’ble Supreme

¹ INDIA CONST. sch. VII, list II, entries 54, 52.

² *Id.*, sch VII, list I, entries 83, 84.

³ *T.N. Kalyana Mandapam Assn. v. Union of India*, (2004) 5 SCC 632.

Court has held that the State and the Centre can tax, not the same activity, but different “aspects” of the same.⁴ The Constitution thus, gave the states an independent taxation power which was a basic factor in the federal polity of the Constitution.

The Hon’ble Supreme Court in *S.R. Bommai v. Union of India*,⁵ held that the federal structure of the Constitution of India is part of the basic structure doctrine, and hence cannot be overridden or abrogated by a constitutional amendment.

The 101st Amendment Act gives power to the Union and the State to impose taxes on supply of goods and supply of services, respectively. This change by way of the amendment has express implications for the federal character of the Constitution and hence needs to be checked through the lenses of the Hon’ble Supreme Court, keeping in view the decision in *S.R. Bommai*.

The author argues that the 101st Amendment Act goes against the federal nature of the Constitution, hence violating its Basic Structure. The reasons for the same being: One, The GST Council makes States subordinate to the Union in matters of taxation, which has never been the principal position in the Constitution and Two, any State which is aggrieved by the decision of the GST Council has to come back to it, hence giving it no effective legal remedy. The composition of the Council includes the Finance Minister of the Union, the Minister of State for Finance and all Finance Ministers from respective State Governments.⁶ Article 279A (4) of the Indian Constitution gives the authority to the

⁴ Federation of Hotel & Restaurant Assn. of India v. Union of India, (1989) 3 SCC 634.

⁵ *S.R. Bommai v. Union of India*, (1994) 3 SCC 1.

⁶ INDIA CONST. art. 279A, cl.1.

Council to issue “recommendations” on a diverse area of matters. The decisions taken by the Council need to be of 3/4th of the weighted votes of the members who are present and voting,⁷ and Article 279A (11) provides for the dispute resolution mechanism which would be established by the Council, adjudicating such disputes which arise from the recommendations of the GST Council.⁸

The article, in a purely doctrinal form will argue that the 101st Amendment Act violates the basic structure doctrine by affecting the federal structure as the Goods and Services Tax Council (GST Council) as its dispute resolution mechanism does not stand to clear the test of the basic structure doctrine, and will be drawing a comparison to the Australian GST guidelines. It is important to note that the author does not in any way concern the paper in a way to show that the GST *per se* violates the Constitution, only to the extent that the GST council, as formulated is *ultra vires* the Constitution.

II. FEDERALISM: AN INTEGRAL PART OF THE BASIC STRUCTURE

A. Government of India Act of 1919 and 1935

The Government of India Act, 1919 and the Government of India Act, 1935 laid the foundation of the Indian Constitution and had first introduced the concept of separate legislative powers for the “Union” and the “Provinces”, with a dispute resolution mechanism called the Federal

⁷ *Id.*, art. 279A, cl. 9.

⁸ *Id.*, art 279A, cl. 11.

Court to adjudicate any events where the Union or the provinces exceed their powers.⁹

As far as the subject of taxation is concerned, the actual list reserved for the States is remarkably similar to the Government of India Act, 1935. The 13 taxing entries in List II of the Seventh Schedule of the Government of India Act, 1935 are reproduced without much change in List II of the Seventh Schedule of the Constitution of India. The only additional subjects under which States could levy taxes under the Constitution are: taxes on mineral rights, taxes on consumption and sale of electricity, and taxes on vehicles.

B. The Federalism in the Constitution of India

Article 1(1) of the Constitution of India describes India as a Union of States, where the states can be renamed and the boundaries altered and they form an integral part of the Union. The Centre appoints the Governors to the States and has the power to dismiss State Governments through Article 356 on the recommendation of the Governor, a power that has much been abused. Article 254 provides that if a conflicting law has been made by the States over the Union, on a matter in the Concurrent List, the Union Law will prevail. This shows that the idea of Federalism as enshrined, is tilted towards the Union.

The features which entail such a quasi-federal structure of the Indian Constitution is that, a) the Constitution gives the States a plenary

⁹ Government of India Act, 1935, No. 2, Acts of Imperial Legislature, 1935, available at http://legislative.gov.in/sites/default/files/legislative_references/GOI%20act%201935.pdf (India), § 204.

legislative authority, and not the Parliament;¹⁰ b) the executive power vested in the State is plenary;¹¹ c) the Constitutional power to levy tax to gain revenue for themselves is vested in the State;¹² d) the States have the freedom to delineate their own budget¹³ and, the States have their own fields of legislation and a common one with the Union.¹⁴

III. THE BASIC STRUCTURE DOCTRINE: AS ENVISAGED IN THE INDIAN CONSTITUTION

The Basic Structure doctrine was not debated by the Constituent Assembly, but was only propounded by the Hon'ble Supreme Court in 1973. There was political and legal disagreement over the extent of the amending powers of the Parliament and it was in *Kesavananda Bharati v. State of Kerala*¹⁵ in 1973 that the Hon'ble Supreme Court limited the extent of amending powers to not "Damage and Destroy" the "Basic Features of the Constitution".

The major test to understand and evaluate amendments was laid down in the case of *Indira Nehru Gandhi v. Raj Narain*,¹⁶ where it was held that free and fair elections are a part of the Basic Structure Doctrine which even the amending power of the Parliament must respect. The scope of the Basic Structure doctrine was questioned in *State of Karnataka v. Union of India*,¹⁷ for it to be applied outside the Constitutional

¹⁰ Maharaj Umeg Singh v. State of Bombay, (1955) 2 SCR 164.

¹¹ N.K. Chauhan v. State of Gujarat, (1977) 1 SCC 308.

¹² INDIA CONST. sch VII, list II, entries 45-63.

¹³ *Id.*, art. 202.

¹⁴ *Id.*, art. 246. cl. 2 & 3.

¹⁵ Kesavananda Bharati v. State of Kerala, (1973) 4 SCC 225.

¹⁶ Indira Gandhi v. Raj Narain, (1975) Supp SCC 1.

¹⁷ State of Karnataka v. Union of India, (1977) 4 SCC 608.

Amendments. The seven judge bench of the Apex Court held that an inquiry be constituted and such act was considered to be contrary to the basic structure of the Constitution. Since then, the basic structure doctrine has attracted much attention, nationally and internationally, and has become a controversial issue in the constitutional discourse in India.

A. Federalism as a Part of the Basic Structure Doctrine

A long conundrum of federalism, indeed being a part of the Basic Structure was clarified by the Hon'ble Supreme Court only in 1994 in the *S.R. Bommai judgement*¹⁸ delivered by nine judges (6:3). Six opinions were delivered between the nine judges out of which four went deep in examining and justifying the federal character of the Constitution of India. The judgement also clears the confusion that the basic structure doctrine can not only be used to invalidate constitutional amendments but beyond the same. Justice Sawant and Justice Kuldip Singh held that “Democracy” and “Federalism” are part of the basic structure of the Constitution.¹⁹ Justice Ahmadi and Justice Ramaswamy held that the federalism that India follows is “Quasi-Federal” with respect to the relation between States and the Centre, *per-se*. Justice Reddy and Justice Agrawal held that the federal character of the Constitution does inherently have a bias recognising the Union, but the States are not mere appendages.²⁰

It will be more than necessary to cite the constitutional scholar H.M. Seervai, where he elaborates that the Indian Constitution is more than federal in the following ways;

¹⁸ S.R. Bommai v. Union of India, (1994) 3 SCC 1.

¹⁹ *Id.*, at ¶ 112.

²⁰ *Id.*, at ¶ 216.

The view that unimportant matters were assigned to the States cannot be sustained in face of the very important subjects assigned to the States in List II, and the same applies to taxing powers of the States, which are made mutually exclusive of the taxing powers of the Union so that ordinarily the States have independent source of revenue of their own. The legislative entries relating to taxes in List II show that the sources of revenue available to the States are substantial and would increasingly become more substantial. In addition to the exclusive taxing powers of the States, the States become entitled either to appropriate taxes collected by the Union or to a share in the taxes collected by the Union.²¹

Justice Ramaswamy and Justice Ahmadi had also expressed their views on the real meaning of federalism being the division of legislative and executive powers of a State from those of the Union. The federal powers that a State enjoys in its own sphere are sovereign and paramount. They also noted that “Indian Federalism” is unlike the federalism in United States of America or Canada.

The Hon’ble Supreme Court has indeed recognised the federal character of the Indian Constitution as a “basic feature”, supplementing that the principle of judicial review can never be entirely taken off the decisions of constitutional functionaries.²²

In the matters of taxation, the judgement of the Hon’ble Supreme Court in *State of West Bengal v. Kesoram Industries Ltd.*,²³ is of much relevance. The Hon’ble Supreme Court in 2004 re-iterated the importance and powers of the State Governments in levying and imposing taxes on

²¹ H.M. SEERVAI, CONSTITUTIONAL LAW OF INDIA 301 (4th ed., Cambridge University Press 1994).

²² M.P. Singh, *The Federal Scheme*, in THE OXFORD HANDBOOK OF THE INDIAN CONSTITUTION 464-66 (Sujit Choudhary et. al. eds.).

²³ *State of West Bengal v. Kesoram Industries*, (2004) 10 SCC 201.

mineral rights. It is important to note that such power to regulate and control such minerals is with the Union. The Hon'ble Court held that the Seventh Schedule, List I and II were to be constructed harmoniously and iterated that the power of the Union to regulate and control could not have taken away the rights of the State Government to levy and collect such taxes. Such harmonious construction by the Court was based on the federal character of the Indian Constitution.

In *Kesoram*,²⁴ the Hon'ble Supreme Court did not expressly discuss whether federalism is a basic feature of the Constitution of India as the position has been settled in cases such as *Indira Gandhi v. Raj Narain*,²⁵ *S.R. Bommai v. Union of India*,²⁶ and *Kesavananda Bharti v. State of Kerala*,²⁷ where the court has sufficiently held that federalism is a basic structure constituent, but *Kesoram* portrays that the Courts work on the assumption that judicial interpretation of the Constitution must work towards strengthening the federal structure of the Constitution,²⁸ and by not "whittling down" the power of the States.

The judicial interpretation regarding federalism in the cases mentioned above may be summarised in the following points:

- a) The federal structure of the Constitution is a basic feature which cannot be abrogated by the amending power of Parliament.
- b) The separation and division of powers between the States and the Union, to create a sovereign sphere is an essential feature of Federalism.

²⁴ State of West Bengal v. Kesoram Industries, (2004) 10 SCC 201.

²⁵ Indira Gandhi v. Raj Narain, (1975) Supp SCC 1.

²⁶ S.R. Bommai v. Union of India, (1994) 3 SCC 1.

²⁷ Kesavananda Bharati v. State of Kerala, (1973) 4 SCC 225.

²⁸ State of West Bengal v. Kesoram Industries, (2004) 10 SCC 201, ¶ 289.

- c) The power of the States to levy tax by law is a plenary federal power granted by the Constitution.
- d) The sovereignty that States enjoy is inviolate under the Indian Constitution, except for situations where the rule of the Constitution is itself obsolete.
- e) Though there exists a strong skewed bias towards the Centre (Union), the Constitution of India still envisages a federal polity.

Therefore, the 101st Amendment Act by introducing the GST Council, is abrogating the States' sovereignty when it comes to the sphere of taxation. The author would be showing that the GST Council by providing the Union with a machinery to dictate the taxation policies of a State, has kept the States below par the Union in the scope of taxation.

IV. THE NOT-SO-BASIC STRUCTURE OF THE 101ST AMENDMENT ACT

A. The Legal Infirmities with the Goods and Services Tax Council (GST Council)

The GST Council was created to resolve problems of implementation of the GST throughout India, by the 101st Amendment Act. As the composition of the GST Council provides for the Union having one-third of the votes while all states combined have two-thirds of the total number of votes required to take a call on any matter listed before the Council,²⁹ makes it the first inequality which is enjoyed by the Union.

²⁹ INDIA CONST. art. 279A, cl. 9(a).

The important part to note here is whether the “recommendations” of the GST Council are binding upon the Union and States, or not. There exists a scope of confusion over such “recommendations”, as usually and legally, it would mean that such recommendation is non-binding on the parties concerned.³⁰

Article 279A(4) clause (4), (5) and (11); Article 269A(1); Section 18 of the 101st Amendment Act along-with the Explanation to Article 246A uses the term “recommendations” in context of the GST Council, which shows that the States and the Union have the option to not be bound by the decision of the GST Council. But it is pertinent to note that the construction of words must be interpreted in the context in which they occur³¹ and with the same mindset of the legislation.³²

Also, Article 279A (11) provides for a dispute resolution mechanism which would again show that such recommendations are supposed to be binding. It is of relevance that if the recommendations are not binding, then there would exist no such legal dispute for it to be adjudicated by the Council. Hence, it is to be seen that such recommendation of the Council is indeed binding on the States, and so there exists two main reasons for it to be constitutionally infirm.

First, the upper hand and hegemony of the Parliament over the State is reasserted by the way the disputes are to be handled by the GST Council over the recommendations. The 101st Amendment Act gives the Council the power to itself set up the dispute resolution mechanism, and does not provide for any other way. This will again be a hurdle as the

³⁰ Naraindas Indurkha v. State of Madhya Pradesh, (1974) 4 SCC 788.

³¹ Ram Narayanmor v. State of Maharashtra, (1964) 5 SCR 1064.

³² Pratap Singh v. State of Jharkhand, (2005) 3 SCC 551.

Union has the major hand of one-third of the votes and hence the Union will dominate the way a dispute is adjudicated or even after it is challenged. The Union will always use this veto power to influence its decisions over the States, leaving them with little or no effective legal remedy.

That the GST Council makes the States subordinate is not the only constitutional challenge it faces. The dispute resolution mechanism also falls short of the test propounded by the Hon'ble Supreme Court where it had struck down the 99th Amendment Act, 2015 for the reason that the appointment of judges will not be done by the Government which is the litigator in the highest number of cases before it.³³

Second, Article 279A (9) lays the foundation of the recommendations, as only those would be passed which get three-fourths majority. As already mentioned above, the Union enjoys an unequal power in the GST Council which is supposed to give equal representation. The votes are weighted where the majority is at three-fourths and the Union Government itself has one-third, while all the other States combined have a power of two-thirds of the total votes. This effectively gives the Union, a veto in the Council over all the "recommendations" as it is impossible to get a majority if the Union does not vote in favour, even if all the States do so.

The federal structure of the Constitution of India does not provide for the Union making decisions for the subjects which fall under List II of the Seventh Schedule, except when the States give express consent,³⁴ or

³³ Supreme Court Advocates-on-Record Assn. v. Union of India, (2016) 5 SCC 1, 497.

³⁴ INDIA CONST. art. 249, cl. 1.

when an emergency is in force.³⁵ Considering once again the kinds of subjects that the GST Council has the power to make binding recommendations on, it implies that the Union Government has veto power over the law making functions of the States. Such a concept is entirely alien to the federal structure of the Constitution of India. The mechanism which allows the Union to determine and direct the tax policies of a State through a binding “recommendation” of the Council is unlikely to pass the “basic structure” test in that it could amount to a violation of the Constitution’s basic feature of federalism. It directly infringes and violates one of the fundamental tenets of the Constitution’s federal structure which is the political sovereignty of the State.

Another important fact to be noted is that such a feature was not present in the earlier bill which was the Constitution (115th Amendment) Bill, 2011, which mandated that decisions of the Council to be taken on the consensus of all the parties.³⁶ It was only in the seventy-third report published by the Standing Committee on Finance, 15th Lok Sabha, where such recommendation was adopted from, as getting the States and the Union on a consensus would have been problematic and time consuming.³⁷

The Amendment Bill proposed that the decisions of the Council were to be pronounced on consensus and it was more constitutionally sound, as it treats the Union and the States as equals, instead of giving more voting rights to one so that they can enjoy a power, equalling a veto.

³⁵ *Id.*, art. 250, cl.1.

³⁶ Constitution (One Hundred and Fifteenth) Bill 2011, art. 279A cl. 8.

³⁷ STANDING COMMITTEE ON FINANCE, 15TH LOK SABHA, SEVENTY THIRD REPORT ON THE CONSTITUTION (ONE HUNDRED FIFTEENTH AMENDMENT) BILL, 2011.

There was no reasoning or rationale provided as to why was such a mechanism changed, just a solitary line in the Standing Committee Report that it would be difficult to manage a consensus sometimes was included to justify such a change.

Irrespective of whether the Supreme Court is ultimately going to hold the 101st Amendment Act as being constitutionally valid or otherwise, the fact remains that the GST, in order to be functional, requires a massive, coordinated effort on the part of the Union and the States. This requires both the Union and the States to be on the same page as regards the benefits and drawbacks of the GST and its operation. A GST Council which is riven by distrust between parties and suspicion about the motives of the other is unlikely to perform this coordination function with any real effect. The GST Council, as presently structured, seems to deprive States of a real say in the decision making around the GST.

V. A COMPARATIVE ANALYSIS OF THE GST

The Australian Constitution gives the power to levy tax concurrent to both, the Commonwealth and the State.³⁸ GST in Australia is levied by only the Commonwealth Government and not by the States, which does not mean that the States do not enjoy the benefits of the revenue so collected.

The Principles for the Reform of Commonwealth State Financial Relations was entered to in 1999 and more or less is similar in function to List I and List II of the Seventh Schedule of the Constitution of India. It

³⁸ *Australian Constitution* s 90.

also gives a revenue-sharing agreement between the States and the Commonwealth Government of the revenues being levied out of the GST. It is important to note that Ss. 1-3 of the A New Tax System (Good and Services Tax) Act, 1999 has laid down that the rate and base for the GST will be in accordance with the Principles for the Reform of Commonwealth State Financial Relations, by the Commonwealth. The same sections also provide that the revenue from the GST will be distributed to the States and other units.³⁹

The most important and relevant for the Indian context is Part 3 of the Principles for the Reform of Commonwealth State Financial Relations, which talk about the ‘Management of the GST Rate’ and the ‘GST Base’.⁴⁰ This mentions that any changes to the base or rate will be done with the consensus of the Commonwealth, Territory and the States.

In the Indian context, it is important to note that GST does not require the States to be subordinate to the Union when it comes to their taxation powers, as we have observed in the Australian scenario. By the enactment of the GST in Australia, the States or the Territories have not become subordinate to the Union and neither have they lost out on their taxing powers. Therefore, it is not a Constitutional principle that the Union needs to have an unequal power, just because sometimes, it may be difficult to reach a consensus with the States, so the Union gets a veto power to break the deadlock.

³⁹ Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, 1999, pt. 2, at 7-9.

⁴⁰ Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, 1999, pt. 3, at 31-34.

VI. CONCLUSION

In the present time, there has not been much public debate about the structure of the GST Council and its problems. With the present voting structure, it is likely to say that if the proposals have any disagreement, may get an instant veto, without further discussion, if the Union feels like it. By now the “producer States” and the “consumer States” have already started to have problems and disagreements, where the producers allege that the GST is against their position and interests, fundamentally.⁴¹

The 101st Amendment Act does not again, entirely foreclose the decision or the favours of the States, as the Union alone cannot constitute three-fourths majority, but the solution to the same would lead to the dispute not getting addressed properly, as the States will focus on getting their presence felt with the Union, rather than actual dispute redressal.

That said, the 101st Amendment Act does not entirely foreclose the possibility of the States having a say in the decision making process in the GST Council. The Union still needs a majority of the States present and voting to agree with it in order to be able to take the decisions it wishes to in the context of the GST Council. Arguably this still provides some space for States to bargain with the Union and might save the 101st Amendment Act from being struck down. However, this risks creating “winners” and “losers” among the States in respect of the decisions taken by the GST Council. The “losers”, the ones who may be adversely affected by a decision of the Council, will still have no effective remedy

⁴¹ C P Chandrasekhar & Jayati Ghosh, *GST Regime proving to be Troublesome for States*, THE HINDU BUSINESS LINE (Feb. 18, 2020), <https://www.thehindubusinessline.com/opinion/columns/c-p-chandrasekhar/gst-regime-proving-to-be-troublesome-for-states/article29262036.ece>.

against the decisions of the GST Council given that the same decision making structure which went against them will also decide how their grievances will be addressed.

To re-iterate: India's federal character is not one of "administrative convenience". It is the result of specific historical circumstances leading up to the enactment of the Constitution. Indeed, as Ramaswamy J. recognized in his judgment in *S. R. Bommai*, a federal government was the Constitution makers' attempt at finding an effective way to govern a country as vast and diverse as India.⁴² In attempting a large scale (and probably necessary) reform of indirect taxation, it would seem as if the federal character of the Constitution has been needlessly tampered with by the Union. If went unchecked by the Hon'ble Supreme Court, this could lead to grave repercussions for the upcoming near future of India.

⁴² *S.R. Bommai v. Union of India*, (1994) 3 SCC 1, ¶ 156.