Article

Fiscal Federalism in India

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Abstract: Countries are categorised as federal or unitary based on their level of autonomy in governance. Federalism is a political system in which constituent entities have autonomy to the point that sovereignty is shared by the union and the 'units' (commonly referred to as states). So, a state contains states. The term 'federation' etymologically refers to a union or league formed by agreement. However, fiscal federalism is not limited to federal nations. It is mainly concerned with the allocation of tasks and resources between two (or more) levels of government (or administrative divisions), regardless of whether the state is nominally federal or not. Inter-governmental resource transfer occurs due to differences in fiscal capability and requirements across governments at various levels. Fiscal federalism principles apply in most countries, including those that are not formally federal. Richard Musgrave, an American economist born in Germany, coined the phrase 'fiscal federalism" in 1959. In 1999, Wallace E. Oakes described fiscal federalism as "understanding which functions and instruments are best centralised and which are best placed in the sphere of decentralised levels of government. This notion is applicable to all types of government: unitary, federal, and confederal." A 9-judges panel of the Supreme Court of India has recently promulgated its ruling – pertaining to the case of Mineral Area Development Authority – elucidating the legal framework concerning the prerogatives of the states to levy taxes on minerals and land and buildings, both of which represent distinct taxation authorities of the states. The panel was tasked with evaluating the validity of a 1989 ruling rendered by a 7-judges panel, which had been subsequently revisited in 2004 by a 5-judges panel and subsequently cast in doubt in 2011, necessitating its referral for consideration. Consequently, this 9-judges panel ruling addresses a protracted controversy persisted for decades. The ramifications of this ruling, however, extend significantly beyond the immediate context. It clarifies the prerogatives and constraints of the states regarding their taxing authority over land in general and mineral rights specifically, thereby lifting the limitations imposed by the 1989 ruling and those preceding it chronologically. A range of other constitutionally pertinent propositions emerge from the ruling, which underscore its significance. This research discusses the 'fiscal federalism' in the light of the landmark judgement delivered in July 2024, regarding the states' power to tax the minerals.

Keywords: fiscal federalism; India; Indian constitution; general sales tax; Mines and Minerals (Development and Regulation) Act; Indian states; mineral area development authority

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1. Introduction

The political organization of countries can be federal or unitary, depending on the self-governance afforded to their internal divisions. Federalism is a government framework where the individual entities within a state enjoy considerable autonomy. This results in a division of authoritative power between the central government and these sub-national units, commonly called states or provinces. Essentially, a federal state comprises constituent states in its framework. The word 'federation' is derived from terms that denote a union or alliance created through mutual agreement. However, the fiscal federalism concept is beyond politically federal countries. It mainly deals with how responsibilities and financial resources are distributed among various levels of government or administrative bodies, irrespective of a nation's political classification as federal. For instance, the People's Republic of China is a unitary state politically, still, it has an intricate administrative structure including provinces, prefectures, counties, and townships, each with specific responsibilities and sources of revenue. As a result, there are inter-government transfers of resources due to differences in fiscal capacity and requirements among these government levels. Therefore, budgetary federalism principles are applicable and relevant in most countries, even those not recognized as federal in their political framework (Jaiswal 2013).

India is a federal entity in which the functions and responsibilities of the union and state governments are distinctly articulated within the constitution. This deliberate allocation of duties is intended to foster political, economic, and administrative efficacy. The Government of India Act of 1919 can be regarded as the inception of contemporary federalism, as it established a clear demarcation of revenue responsibilities between the central and provincial governments. Subsequent advancements towards the establishment of fiscal federalism occurred with the enactment of the Government of India Act in 1935, which not only delineated the jurisdictional allocation of revenue between the union and the states but also introduced provisions for revenue sharing and transfers. Given that these federal frameworks were instituted under colonial governance, a predisposition favoring a robust central authority, complemented by a degree of flexibility, was necessary. Indian constitution adopted on January 26, 1950, preserved these characteristics. The nation faced the dual challenges of unifying states characterized by cultural, linguistic, ethnic, economic, and geographic diversity—arguably unparalleled globally—while simultaneously striving for rapid economic growth, social justice, and equitable regional development (Aziz 2010).

Article 246 of the Indian Constitution, as described in the Seventh Schedule, divides government tasks into three separate categories: the union list, the state list, and the concurrent list.[1] The union list contains matters that fall exclusively under the legislative authority of the central government, such as monetary policy, banking, national defense, international relations—including global trade and diplomacy—and subjects of national importance or those involving inter-state affairs. The state list comprises areas more directly related to public welfare at the state level, including law enforcement, public health services, local governance, agriculture, infrastructure, land administration, and the management of water resources. The concurrent list features subjects central and state governments may enact laws on. These include marriage and succession, personal laws, property rights (excluding agricultural land), social and economic planning, labor relations, social welfare, education, electricity, and the production and trade of certain regulated goods and industries identified by Parliament as requiring central oversight.

While the constitution provides a federal structure with a division of powers, the central government often holds dominant influence, especially in areas deemed vital for national interests. This two-tier federal arrangement was further extended in 1993 with the passage of the 73rd and 74th Constitutional Amendments, which established formal recognition for rural (Panchayati Raj) and urban (Municipal) local governments.

The assignment of expenditure responsibilities and revenue-generating powers across various levels of government is guided by the principle of enhancing overall public welfare. This involves devolving spending authority to local governments to reflect local needs better, while centralizing tax collection at the national level to optimize efficiency and reduce administrative costs. As a result, many federal systems follow a structure in which subnational governments are responsible for providing a significant percentage of public services. However, the federal government retains major revenue-raising capabilities. Although state governments may have the legal power to raise money, real variations in tax sources and service delivery costs lead to fiscal imbalances. Usually, financial transfer between governments solves two main problems: horizontal fiscal imbalance (HFI), which relates to fiscal inequalities among states, and vertical fiscal imbalance (VFI), which indicates a discrepancy between the revenue and expenditure responsibilities of different levels of government. Poorly planned transfers could aggravate rather than help to lower budgetary disparities. The Goods and Services Tax (GST) has been adopted by several countries as a complete indirect tax to simplify tax collecting and boost income generating. But in India, especially on how GST affects the federal distribution of fiscal authority, its implementation has spurred ongoing controversy. Crucially for this debate is fiscal federalism, which emphasizes allocating income and expenditure responsibilities among several tiers of government. Interpretation of the Mines and Minerals (Development and Regulation) Act, 1957 (MMDR Act), the classification and type of royalties paid, and the relevance of clauses in the Seventh Schedule of the Indian Constitution were covered in this case. Supported by an 8:1 majority, the ruling marks a major advance in the constitutional debate on the separation of legislative and financial power between the union and states.

Fiscal federalism has received more attention within India's constitutional framework. In his earlier decision in Union of India v. Mohit Minerals Pvt. Ltd., Justice D.Y. Chandrachud described fiscal federalism as a critical component of the Indian federal structure.[2] He dismissed the Union government's claim that the recommendations of the Goods and Services Tax (GST) Council were obligatory for states. However, this judgment did not delve into fiscal federalism's broader consequences or framework. The recent ruling fills this void by systematically exploring the principles and scope of fiscal federalism, marking a first in terms of judicial elaboration on this subject.

Once again spearheaded by Chief Justice Dr. D.Y. Chandrachud, the majority ruling builds upon the foundation established in Mohit Minerals to explicitly define and endorse fiscal federalism as a vital constitutional principle. Instead of seeking to modify the established distribution of legislative powers, which has traditionally favored the union, the judgment sustains the asymmetric structure envisioned by the constitution's framers. It adopts a balanced interpretive stance that honors the autonomy of the states while cautioning against overly broad interpretations of legislative competence that favor the center. Significantly, the court also asserts that the authorities allotted to State legislatures should not be restricted by implied limitations, thereby reinforcing the integrity of the federal structure.

Despite the clarity and progressive nature of the ruling, one element has caused concern: the interpretation of the term "limitation." The Court determined that this term could encompass complete prohibition. This perspective seems to conflict with fiscal federalism principles that the ruling otherwise upholds. The author contends that such an expansive interpretation undermines the federal character of the Constitution, especially considering that the rest of the judgment advocates for an understanding of legislative powers through the perspective of cooperative federalism. Utilizing a consistent interpretive standard for the term "limitation" would have better aligned with the broader federal vision of the judgment.

While the ruling marks a significant advancement in reinforcing the role of States within India's constitutional framework, its lasting effects will hinge on how these principles are applied in future judicial and political contexts. The judgment paves the way for a more nuanced and balanced federalism but leaves unresolved questions regarding the consistency of its implementation.

[1] The Constitution of India, 1949, Art.246

[2] 2022 (61) GSTL 257 (SC)

2. Theory of Fiscal Federalism and India

According to Richard Musgrave's public finance theory, the national government handles functions related to economic stabilization and income redistribution efficiently. Conversely, resource allocation tasks, those involving the distribution of goods and services, are more effectively conducted by sub-national entities like state and local governments. Theoretical frameworks indicate that the central government should manage taxation on highly mobile economic bases, such as corporate income or excise taxes on manufactured goods. On the other hand, regional governments should concentrate on taxes levied on less mobile bases, such as property, agricultural income, or consumption. This division mitigates the risk of individuals or entities relocating to avoid taxes—a concept called “voting with one’s feet.”

Even with a fair allocation of Union tax revenue, some states might experience budget deficits. To cover these shortfalls, the central government provides additional help through grants-in-aid. However, there is a trade-off between tax devolution and such grants: an increase in the share of tax revenues assigned to states reduces the fiscal space available for grants. Tax devolution is typically viewed as a right established by constitutional mandates, while grants are often considered discretionary transfers.

Globally, multi-tiered government structures are prevalent. These structures are constitutionally defined in certain nations, including India, Brazil, and Switzerland. In India, financial transfers can proceed directly from the central authority to local bodies, which may themselves be further subdivided. Upon receiving grants from the Union, states are required to allocate the appropriate portion to local governments. State Finance Commissions are established to guide the distribution of tax revenues and grants-in-aid among local government institutions in their areas of jurisdiction. Another type of fiscal transfer, termed a grant-in-lieu, is given as compensation when a higher authority requests a state to refrain from imposing a particular tax.

India is unique globally due to its extensive and dynamic local governance system, which comprises nearly 240,000 Panchayats and over 4,000 urban municipalities. These regional entities are represented by over 3 million elected officials, forming an essential part of India’s democratic framework. Indian Constitution clearly defines the taxation powers of the Union and the States through the Union and State Lists in the Seventh Schedule under Article 246. Notably, the Concurrent List does not include any taxation provisions. Nevertheless, the Goods and Services Tax (GST) introduction demanded a collaborative legislative framework, prompting the addition of Article 246A through the 101st Constitutional Amendment in August 2016.[3] This amendment allowed the Union to legislate for Central GST (CGST) and Integrated GST (IGST), while empowering states to establish laws regarding State GST (SGST). Aside from limited duties, surcharges, and cesses exclusively retained by the Union, most taxes the central government imposes, and collectors are subject to distribution between the Union and the states, based on the Finance Commission's recommendations.

States in India also gain advantages from provisions that are intended to organize and assist their local governments. Initially, the Union government was required to distribute the proceeds from certain taxes; however, reforms after 2000 have broadened this requirement, necessitating the central government to provide a larger share of its tax revenue to the States. Nevertheless, revenues from cesses and surcharges, though collected alongside regular taxes, are not included in the divisible pool of central taxes. This exclusion has grown more significant, as the proportion of these non-divisible levies in the Union's total tax receipt increased from around 7.5% in 2000–01 to over 13% by 2013–14. The central government defends this stance by claiming that cesses and surcharges are imposed for dedicated purposes and are therefore constitutionally exempt from revenue sharing.

Currently, the Union levies taxes on personal and corporate income, excise duties (particularly on petroleum and tobacco), customs duties, and the Central Goods and Services Tax (CGST), all shared with the States. States, in turn, levy taxes such as the State GST (SGST), Value Added Tax (VAT) on specific items like alcohol and petroleum, vehicle taxes, and stamp duties. However, the revenue generated from agricultural income tax and land revenue for state finances remains limited. Besides tax sharing, the Constitution—under Articles 275[4] and 282[5]—requires the Union to provide grants-in-aid to the States. There is also a specific provision for compensatory grants (grants-in-lieu of taxes) for states such as Assam, Bihar, Odisha, and West Bengal, which export jute and similar products.

Besides, governments obtain income from non-tax sources. These consist of dividends from state-owned enterprises and royalties or fees collected for utilizing natural resources such as minerals and telecommunications spectrum. Administrative departments also accumulate revenue through various fines and service charges. Moreover, governments receive interest on loans extended to other public entities, state-owned enterprises, and government employees. Considering the expected presence of both vertical (between different levels of government) and horizontal (among states) fiscal imbalances, the Constitution—through Article 280—requires the President to establish a Finance Commission (FC) every five years.[6] The main function of the Commission is to advise on the distribution of financial resources between the Centre and the States. Under Articles 243I[7] and 243Y,[8] every State is obligated to establish a State Finance Commission every five years.

3. Inter-Governmental Transfers in India

The transfer of funds from the Centre to the States is mainly facilitated by the recommendations of the Central Finance Commission and the disbursements provided by Union Ministries. Similarly, transfers from States to local governments are governed by recommendations from the respective State Finance Commissions. From 1950 to 2014, the Planning Commission was instrumental in distributing plan-based financial assistance to States, while the Finance Commission concentrated on allocating non-plan grants and tax revenues. A considerable restructuring took place after the Planning Commission was replaced by NITI Aayog,

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[3] The Constitution of India, 1949, Art.246A
[4] The Constitution of India, 1949, Art.275
[5] The Constitution of India, 1949, Art.282
[6] The Constitution of India, 1949, Art.280
[7] The Constitution of India, 1949, Art. 243I
[8] The Constitution of India, 1949, Art. 243Y

which does not manage budget allocations. As a result, the share of net Union tax revenue allocated to States rose from 32% under the 13th Finance Commission to 42% according to the recommendations of the 14th and 15th Commissions.

3.1 Central Finance Commission

Throughout various Finance Commissions—from the 10th to the 15th—there has been a steady increase in the States' share of Union tax revenues. This share has gradually risen from 29% to 29.5%, 30.5%, 32%, and 42%. Two main viewpoints have emerged in determining fair resource distribution: one favors higher allocations for more populous States, while the other advocates for additional resources for States with larger land areas. Economic backwardness is often cited as a critical criterion for higher allocations, along with the notion that States exhibiting better fiscal performance should also receive more central assistance.

3.2 Union Ministries

Union Ministries operate within the boundaries set by the Union, State, and Concurrent Lists. Numerous topics outlined in the Concurrent List fall under State authority but are also managed by Union Ministries through various initiatives. These initiatives are typically classified as Central Sector (CS) schemes and Centrally Sponsored Schemes (CSS). CS schemes are entirely formulated, carried out, and financed by the Centre, usually addressing subjects in the Union List. In contrast, CSS are created by the Union but implemented by the States, with costs distributed in predetermined ratios—such as 50:50, 70:30, 75:25, or 90:10—between the two governmental levels. CSS target comprehensive development areas like education (for instance, mid-day meal programs), health, housing, irrigation, rural development, employment, and environmental protection.

3.3 State Finance Commissions

The Constitution mandates the establishment of State Finance Commissions (SFCs) every five years, but adherence to this requirement has been inconsistent. While some States, such as Kerala and Sikkim, have received reports from their fifth SFCs, others—including Maharashtra, West Bengal, Karnataka, and Haryana—are still waiting for the results of their fourth. Moreover, SFCs have not been very effective overall. State governments are notoriously slow to submit Action Taken Reports (ATRs), and their terms of reference are usually vague. ATRs are typically not up to the SFCs' standards when they are produced.

4. Impact of GST on Fiscal Federalism

Indian government started tax reforms in the early 2000s by forming a committee to examine and suggest changes. Former Finance Secretary Vijay Kelkar spearheaded this campaign, and his team pushed for the introduction of a Goods and Services Tax (GST) to replace the convoluted and multi-tiered indirect tax system that is in place now. This concept aims to mitigate the inefficiencies and cascading effects brought about by the current tax system. The Constitution (122nd Amendment) Bill was introduced and passed in 2016, paving the way for the GST to go into effect on July 1, 2017, after extensive discussions and coordination between federal and state authorities.

The GSTs aimed to establish a more efficient, transparent, and effective tax system that would benefit businesses, boost the economy, and alleviate consumer hardship. By consolidating federal and state taxes, including excise duty, service tax, value-added tax (VAT), and various cesses, into a single framework, the GST sought to reduce the tax-on-tax effect. The goal of this change was to make Indian goods and services more competitive in both domestic and international markets by lowering the overall tax burden on businesses. To enhance tax administration, boost transparency, and lessen the possibility of tax evasion, systems like the Input Tax Credit (ITC) and digital tools for compliance and monitoring were put into place.

India's fiscal federal system was characterized by a convoluted and disjointed allocation of tax authorities and responsibilities between the Union and State governments prior to the Goods and Services Tax (GST) being implemented in 2017. Fiscal interactions between the Union and its member states are governed by Articles 270 and 280. According to Article 270, the states must receive a portion of the Union tax revenue. The Finance Commission was established concurrently by Article 280, and it creates tax-sharing plans and provides grants-in-aid to the States.[9] Cooperative federalism, which promotes collaboration between the two tiers of government to improve economic results and lessen regional disparities, was the goal of this fiscal framework's creation. Indirect taxes like VAT, CST, excise taxes, and service taxes were a part of the tax structure prior to the introduction of the GST.

The formation of the GST Council was a significant institutional achievement within this federal framework. The Council, which is made up of the Union Finance Minister and members from all States and Union Territories, can decide major GST issues like tax rates, exemptions, and revenue-sharing agreements. The Council operates on a consensual basis, embracing the ideas of cooperative federalism. To assist states during the initial transition to GST, the central government established a compensation mechanism to mitigate potential revenue shortfalls, ensuring that states would be compensated for any deficits resulting from expected revenue increases in the early years following GST implementation.

GST is a significant change in India's indirect tax structure. GST aims to create a unified and effective tax system by combining numerous indirect taxes formerly levied by different levels of government, such as VAT, excise, and service tax. GST superseded the previous origin-based taxing strategy by a multi-stage, destination-based tax at each value-added step. It comprises two parts: Central GST (CGST) for intra-state transactions collected by the central government, and State GST (SGST) imposed by state administrations. Imports and interstate transactions are subject to the Union's Integrated GST (IGST), which is distributed to the state that consumes it. Input tax credits were transferred smoothly thanks to this arrangement, which lessened the tax burden on final consumers by reducing the cascading effect of taxes.

The GST structure does not cover certain commodities. Alcohol for human use is free from GST. Petroleum products are excluded, though, and further discussions with the GST Council are still ongoing. Both GST and federal excise duty apply to tobacco products. GST duties are not applied to small businesses whose revenues fall below a specific threshold. The Composition Scheme reduces regulatory obligations by offering qualifying small taxpayers simpler tax payment options at reduced rates. By enabling

9 The Constitution of India, 1949, Art. 270

electronic registration, filing, and payment, the Goods and Services Tax Network (GSTN) has encouraged a digital approach to tax administration.

The President must establish the GST Council within 60 days of the Constitution's passage, according to Article 279A (1). The Council was formally established on September 12, 2016, after the notice of Article 279A on September 10, 2016. The Union Finance Minister (who also acts as Chairperson), the Minister of State for Finance or Revenue, and the relevant Finance or Taxation Ministers or their representatives from each state make up this body, which is composed of delegates from the Union and every State.

Four Commissioners, one Additional Secretary, the Chairperson of the Central Board of Excise and Customs (CBEC) as a permanent invitee with no vote, and the Secretary of Revenue as its ex-officio Secretary make up the Secretariat. India's indirect tax system has undergone significant change because of the Goods and Services Tax (GST). The GST unifies several indirect taxes under a single framework, replacing the previously disjointed and convoluted tax structure. However, the implementation of GST, especially during the fiscal year, presented considerable challenges, particularly for the micro, small, and medium enterprises (MSME) sector. The transition to digital compliance, which required online registration and return submissions, proved challenging for smaller businesses inexperienced with such systems. Companies were required to modernize their accounting systems to comply with GST legislation, which resulted in increased costs for software acquisitions and employee training. Relevant tax rates increased from 15% to roughly 18–20% after services were added to the GST system. Customers were subject to a higher tax burden because of this increase.

The fact that essential goods like fuel and diesel are not covered by GST is another significant disadvantage. Producers' ability to offset these costs against their output tax obligation is thus limited because they are unable to claim input tax credits for these items. For industries that depend on these commodities, this restriction raises operating costs and decreases cost-efficiency. It is expected that the GST's structural advantages—such as its ability to increase transparency, streamline taxes, and foster a more integrated economy—will outweigh its immediate drawbacks and lead to a progressive fiscal reform for India. (Ranawat and Gaurav 2019). The separation of powers between the Union and the States demonstrates how important federalism is to the Indian Constitution.[10]

These quasi-federal characteristics are noticeable in India's fiscal federalism structure, which regulates the allocation of responsibilities and revenue-raising powers between the Centre and the States. This distribution is outlined in the Seventh Schedule of the Constitution, which categorizes subjects into three lists: Union, State, and Concurrent. The Union List, consisting of 97 items, covers matters of national significance and is exclusively legislated by the central government. The State List includes 66 items concerning local and regional matters, while the Concurrent List, comprising 47 items, allows both the Union and States to legislate on mutual concerns. Although the Concurrent List adds some adaptability to the federal system, taxation powers are clearly delineated between the Union and the States (Jain 1964).

India could have learned valuable lessons by examining the experiences of other federal nations that have implemented comparable tax reforms. For example, in Canada, the federal government oversees all indirect taxes, while the provinces are in charge of direct taxes, resulting in a structure that promotes provincial autonomy and restricts central intrusion. Similarly, in Australia, the federal government collects over 75% of taxes but redistributes them using a predetermined structure, allowing consumers to perceive a unified tax while states maintain some power inside the GST system. United States, which is sometimes cited as a leading form of federalism, has decided not to implement a national GST system, instead retaining the fiscal power of its various states. These countries have effectively retained the integrity of their federal systems by permitting subnational organizations to retain taxing authority. (Jaiswal 2013)

In contrast, India's GST architecture has a centralized component that might jeopardize state authority. A key problem is the organization and operation of the GST Council, which is established by Article 279A of the Constitution. This Council, which includes members from both the Union and the States, oversees making major GST decisions. However, its voting structure gives the Union government considerable power. As per Article 279A (9), any decision requires a three-fourths majority of those present and voting, with the Union government holding a one-third share of the votes while the States collectively hold the remaining two-thirds.[11] This arrangement effectively provides the Centre with veto power, as its approval is essential for any decision to pass, raising concerns about the balance of power and the democratic representation of States within the Council (Singh 2016).

Another problem is dispute resolution. In the event of differences over the Council's recommendations, the same body is responsible for developing a method to resolve these issues. This setup undermines the principle of natural justice, particularly the doctrine of *nemo judex in causa sua*—meaning no one should serve as a judge in their own matter. These procedural issues indicate that the GST Council's framework may hinder States' capacity to effectively advocate for their interests, thereby further diminishing the federal equilibrium. The current system does not obligate the Union government to take State viewpoints into account, risking the marginalization of those whose interests do not align with national aims. Tensions have already surfaced, particularly between producing and consuming States, with the former frequently arguing that the GST structure places them at a disadvantage by reallocating the tax base towards consumption rather than production.

Vote distribution within the Council mirrors a longstanding tendency in the Indian Constitution to prioritize the Centre over the States. While this arrangement aligns with the notion of cooperative federalism, in which both levels of government work together, it also fosters a centralizing inclination. Undoubtedly, the 101st Constitutional Amendment, which introduced GST, has profoundly transformed the landscape of fiscal federalism in India (Drèze 2014).

5. Mineral Area Development Authority v. SAIL

The current set of appeals pertains to allocating legislative authority between the Union and the States to tax mineral rights. The legislative provision central to the current inquiry is Entry 50 of List II of the Seventh Schedule of the Constitution. This entry

[10] SR Bommai v. Union of India, 1994 AIR 1918
[11] The Constitution of India, 1949, Art.279A (9)

addresses taxation on mineral rights, albeit subject to "any limitations imposed by Parliament by law relating to mineral development." The governance of mines and mineral development is delineated within the Union List (Entry 54 of List I) and the State List (Entry 23 of List II) of the Seventh Schedule. The delegation of this subject to the State legislatures under Entry 23 of List II is conditioned upon the stipulations of Entry 54 of List I.

Parliament promulgated the Mines and Minerals (Development and Regulation) Act, 1957, exercising its legislative authority as conferred by Article 246 of the Constitution. The subject matter predominantly encompassed by this legislation is directly associated with Entry 54 of List I. Section 9 stipulates that the holder of a mining lease must remit royalties on any mineral extracted or utilized from the designated lease area at prescribed rates and in the case of India Cement Ltd. v. State of Tamil Nadu,[12] a seven-Judge Bench of this Court determined that royalty qualifies as a tax and that state legislatures do not possess the authority to impose taxes on mineral rights, given that the MMDR Act governs the subject matter. The Court further asserted that the State legislature cannot employ royalties as a tax measure on mineral-bearing lands under Entry 49 of List II. Subsequently, in State of West Bengal v. Kesoram Industries Ltd.,[13] a Constitution Bench of this Court concluded that the ruling in India Cement arose from an inadvertent misinterpretation and clarified that royalty does not constitute a tax.

In the wake of the judgments rendered in the judgments mentioned above, the state legislatures availed themselves of their legislative authority to impose taxes on mineral-bearing land by Entry 49 of List II, utilizing the mineral value or royalty as the determinant for the tax assessment. States including Rajasthan and Uttar Pradesh endeavored to impose environmental and health cess and fees for transporting coal and dust extracted from mining operations. The constitutional legitimacy of these financial impositions was contested before the High Courts because they exceeded the legislative jurisdiction conferred upon the state legislatures. These levies were criticized for contravening the legal principles established in the India Cement.

A pertinent case in this context is Civil Appeal No. 4056-64 of 1999, in which the petitioners initially submitted writ petitions to the High Court of Judicature at Patna, contesting the constitutionality of the Bihar Coal Mining Area Development Authority (Amendment) Act 1992 and the Bihar Mineral Area Development Authority (Land Use Tax) Rules 1994, which instituted a tax on land utilized for mining activities. Invoking the precedent set in India Cement (supra), the High Court upheld the petition, determining that the tax fell outside the parameters of Entry 49 of List II of the Seventh Schedule. The validity of the High Court's ruling was subsequently challenged before this Court.

The issue was subsequently referred to a nine-judge bench of the Supreme Court, with the primary questions identified for examination revolving around the interpretation of the concepts of royalty concerning tax, the classification of royalty as a tax, and the respective powers of both state and central governments to assert rights over the contested subject matter. In addressing the matter with a decisive 8:1 majority, Indian Supreme Court determined that, in light of Entry 54 of the Union List, Parliament possesses the authority to legislate a statute that restricts (which may extend to the prohibition of) the prerogatives of the States (as delineated in Entry 50 of the State List) to impose and collect taxes on mineral rights. Nevertheless, the majority also asserted that the "royalty" established under the MMDR Act does not constitute a tax on mineral rights, and no restriction exists within the MMDR Act regarding the states' right to impose such a tax. In other words, it was elucidated that without any explicit limitation enacted by Parliament, the States' capacity to tax mineral rights remains unrestricted. Additionally, in furtherance of the taxing prerogatives of the States (as per Entry 49 of the State List), the majority concluded that the States are entitled to utilize the mineral value of land as a basis for levying taxes on land and buildings, which, being an independent taxing authority of the States, is not subject to any constraints, unlike their authority to impose taxes on mineral rights. This ruling possesses extensive ramifications for diverse domains of jurisprudence. It is, therefore, imperative to scrutinize it from multiple vantage points.

This ruling is anticipated to incite a contentious struggle between the taxation policies and regulations of mineral-rich States vis-à-vis those of the Union and other States that will be affected by this ruling. It is plausible to foresee amendments to the MMDR Act being proposed to mitigate the repercussions of this decision, potentially institute limitations that may range from dilution to a complete moratorium on the mineral taxation powers of the States, as imposed by the Parliament. However, the magnitude of such amendments will be contingent upon the political and economic negotiations among these pivotal governance stakeholders.

There exists a significant probability that this decision will influence the development of the Goods and Services Tax (GST) framework. Despite being characterized as 'one nation one tax,' the GST has persisted without integrating numerous indirect taxes; notable exceptions include mineral and land taxes, which remain outside its purview. Nevertheless, the Constitution grants the GST Council the authority to propose adding additional taxes. Given the substantial repercussions of this decision and the probable alterations in the taxation systems of the States following this ruling, it is conceivable that deliberations will progress towards incorporating these taxes within the ambit of GST.

6. Challenges of Fiscal Federalism in India

Several complex issues are currently plaguing India's fiscal federalism. The Seventh Schedule, which outlines the constitutional framework, uses three distinct lists to assign legislative and financial responsibilities to different levels of government. The Concurrent List permits both levels to enact laws, with central legislation taking precedence in cases of disagreement; the Union List refers to issues that are exclusively within the purview of the federal government; and the State List encompasses issues that fall under state jurisdiction. But gradually, the Concurrent List grew, eventually intruding on territory that was initially set aside for the states. Constitutional amendments like the 42nd Amendment of 1975, which transferred crucial sectors like forestry and education from the State List to the Concurrent List, have contributed to this trend. This invasion has occurred through official revisions and entitlement laws. In India, centrally enacted laws guaranteeing individual rights in traditionally state-run industries have increased recently. This tendency is illustrated by laws like the National Food Security Act of 2013, the Right to Education

[12] (1990) 1 SCC 12
[13] (2004) 10 SCC 201

Act of 2009, and the Mahatma Gandhi National Rural Employment Guarantee Act of 2005. Given that the three main areas—employment, education, and nutrition—were originally under the purview of the state, these modifications imply that subnational authorities ought to have been actively involved in budgetary decision-making.

Another issue is Article 282 of the Constitution, which authorizes the union or the states to provide grants for any public purpose, even those outside their own legislative power. While this offers flexibility, it has increased centrally sponsored schemes in areas constitutionally assigned to the states. The validity of many of these schemes relies on the broad interpretation or the overreach of Article 282. The Planning Commission, which operated until it was succeeded by NITI Aayog, depended on this article to execute centrally sponsored programs. This strategy resulted in a centralized planning model that undermined the financial autonomy of the states.

Fiscal imbalances are another major issue. The Fifteenth Finance Commission was assigned the task of assessing the current debt levels at both the central and state tiers, recommending a framework for fiscal consolidation. As per the revised Fiscal Responsibility and Budget Management (FRBM) Act, the central government must meet fiscal objectives of keeping total government debt below 60% of GDP and ensuring that central government debt stays under 40% of GDP by the end of the fiscal year 2024–25. The revised projection for 2018–19 estimated central debt at 48.4% of GDP, with plans to lower this to 48% in the budget for 2019–20. At the state level in 2017, average debt stood at 25.1% of gross state domestic product (GSDP), with significant variations, such as Punjab at 42.8% and Chhattisgarh at 17%. Since 2014, the overall debt burden of states and union territories has been increasing, primarily due to central programs like the Ujwal DISCOM Assurance Yojana (UDAY) and various agricultural loan waiver initiatives.

A growing concern in fiscal federalism is the use of cesses and surcharges, which are not distributed to states even though they are becoming a larger portion of the central government's gross tax revenue. Non-tax revenues are omitted from the divisible pool. This pattern raises issues regarding the fairness and transparency of the revenue-sharing framework. Although these procedures may have a legal basis, their execution weakens the fiscal devolution and might be seen as a financial plan to limit the states' share of federal resources.

The Goods and Services Tax (GST), which went into effect on July 1, 2017, established a coherent tax structure aimed at combining different indirect taxes, such as excise duty, service tax, sales tax, and entrance taxes, under the idea of "one nation, one market." In accordance with Article 279A (1) of the Constitution, the GST Council was established to oversee the coordination and execution of GST policy. Delegates from the federal and state governments make up this body. As part of its mandate, the Council sets the Central GST (CGST) and State GST (SGST) tax rates and makes sure that states continue to participate in the formulation of national economic policy. However, states now have less authority to determine tax rates for subjects that were previously included in the State List because of this action.

Previously, states had the authority to determine tax rates that reflected their financial resources and needs. Reliance on the central government for budgetary support has grown because of the inability to adjust tax rates to meet developmental imperatives. The centralization of financial power brought about by the implementation of the GST, which promoted uniformity and integration but also undermined the states' capacity to pursue independent fiscal agendas, is highlighted by this change in the fiscal landscape. To preserve fair and efficient governance at all governmental levels, structural and operational problems with India's overall fiscal federalism framework must be resolved.

7. Conclusions

Indian scenario highlights the responsibility of constitutional structures that are influenced by political and economic factors. The inherent adaptability within the system can be tactically utilized by both the center and the states to obtain a more significant allocation based on the political leverage each government wields. Federal transfers in India clearly demonstrate that states have successfully secured higher allocations when they displayed increased political assertiveness, as seen during the era of the Seventh Finance Commission award. Another example was evident during the enactment of the 80th amendment to the Indian constitution. Some disagreement over resource allocation between the Centre and the States is expected in any federal system. However, this federal framework should serve as a cohesive element that maintains the federation's integrity. The flexibility of the system should not be excessively tested in any direction. India's federal financial structure has played a crucial role in promoting financial unity within federalism. Empirical data does not suggest that States have faced fiscal inequalities due to the operational dynamics of the federal structure and the related transfers. This significant judicial decision indicates that states can offer a variety of incentives—both fiscal and non-fiscal—to attract a range of mining activities within their territories. Additionally, states have a direct revenue source from mining operations, thereby reducing their dependence on the central government. This change promotes increased autonomy for states, as they are no longer reliant on the central authority for financial support. On the flip side, this scenario may result in tax policies and other fiscal incentives lacking uniformity, creating disparities among states. As a result, given the limited number of states rich in minerals, miners might find themselves compelled to conduct mining activities in these areas, potentially facing hefty tax obligations if they operate in these specific states, which could ultimately lead to a monopolization of the mining market by a few states. It permits states to impose taxes in addition to other charges that miners might already encounter, which could significantly raise mining costs. Parliament can take a cautious stance, contemplating amendments to the MMDR Act to reclaim its power to tax minerals or to impose future limitations on the taxation powers of the states. It is prudent for mining companies to consult specialized legal advisors regarding the options accessible before making investments in the mining sector. By interpreting the taxation powers of the states, the supreme court's majority ruling has granted extensive authority for states to impose taxes on mineral rights and real property. Conversely, while highlighting the potential impacts of unrestricted taxing powers by the states on national progress, the majority ruling has stressed the need to limit these powers through parliamentary legislation. This has shaped the resulting conclusion, with the majority reversing earlier rulings that limited states' taxing authority, while the minority advocates for maintaining the existing framework. Ultimately, the constitutional interpretation established in the majority ruling is set to define for future generations the scope and boundaries of various legislative issues and how both the Union and the States exercise their legislative powers.

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