A Fatal Blow to the Goods and Services Tax

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The Supreme Court's judgment in *Union of India v Mohit Minerals (P) Ltd* (2022), while interpreting the 101st Amendment, has weakened the governance framework of the goods and services tax. The Court's approach in the matter has exposed the fatal contradictions of the GST architecture in the Constitution and should prompt a rethink on how the GST framework needs to change to promote true cooperative federalism.

A dispute between the union government and taxpayers on the payment of the integrated goods and services tax (IGST) on ocean freight has snowballed to the extent that the very governance structure of the goods and services tax (GST) may be under threat; how a legal challenge to two notifications issued by the union government on the taxation of ocean freight led to this situation is a complicated situation that requires a bit of untangling.

The Supreme Court in *Union of India v Mohit Minerals (P) Ltd*[1] was hearing an appeal filed by the union government against a Gujarat High Court judgment,[2] which had struck down the two notifications[3] on the ground that they were contrary to the IGST Act, 2017. The judgment authored by Justice D Y Chandrachud on behalf of the bench, which included Justices Surya Kant and Vikram Nath, also examines the meaning of the word "recommendation" as inserted into the Constitution by the Constitution (101st Amendment) Act, 2016 (henceforth the 101st Amendment Act, 2016) and reaches the conclusion that the "recommendations" of the GST Council are not binding on the union and state legislatures.

This is the finding that could potentially lead to the unravelling of the GST Council itself, and in this column, I argue that though the Supreme Court's interpretation of "recommendation" is legally tenable, its consequences have not been fully appreciated by the Court. Part of the problem has been the underlying flaw in the design of the GST Council that, while paying lip service to cooperative federalism, has created the basis for much union–state conflict on this matter.

Background to Mohit Minerals Case

The controversy that culminated in the judgment in Mohit Minerals case began with two notifications issued by the union government in 2017, ostensibly on the recommendations of the GST Council that the IGST be levied on ocean freight. The notifications proposed that even when the payment was made by a foreign party to a foreign supplier of service, the IGST would be collected by way of a "reverse charge" mechanism where the recipient of goods is based in India. To illustrate, if A (an Indian party) purchased goods from B (a foreign party), and B in turn paid C (also a foreign party) to transport the goods to A, the notifications sought to levy IGST on the transaction between B and C but collect the same from A.

As a rule, GST is generally payable by the buyer to the seller who then remits the amount to the government.[4] In exceptional circumstances, the buyer is liable to pay GST on a transaction directly to the government in what is called the "reverse charge mechanism." The GST is also not leviable on transactions that have taken place outside the territory of India and which have no nexus in India.[5] The two notifications of 2017 therefore extended the scope of GST to the furthermost edges of legality—a transaction for services of transport of goods between two foreign parties would be taxed in the hands of the Indian recipient of the goods being transported as IGST.

This levy was challenged by importers of commodities, among others, by way of writ petitions in the Gujarat High Court. Agreeing with the contentions of the petitioners, the high court set aside the two notifications primarily on the grounds of being extraterritorial in nature and that the levy of GST on the person who receives such goods would be contrary to the IGST Act, 2017. Having found that the notifications were without legal basis, the Court proceeded to hold that demanding tax from the petitioners in question would also be a violation of Article 265 of the Constitution, which prohibits taxation without the authority of law.

While the Gujarat High Court did go into a discussion on the history of the GST and how it came in India, the basis

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for the decision remained the union government's lack of legal authority to issue the notification under the IGST Act.

In the Supreme Court, however, the union government took an additional ground for defending the legal validity of the two notifications—that they have been issued on the basis of the recommendation of the GST Council, which is binding on the union and state governments (apart from the legislatures themselves). This contention, however, did not find favour with the union government.

Implications of Mohit Minerals

In rejecting the union government's contention that the "recommendations" of the GST Council are binding on the legislatures and the government, the Court relied on the manner in which decisions are taken in the GST Council. Specifically, the Court noted that the union and the states did not have equal voting powers in the council. Further, decisions of the GST Council would be taken on the basis of a supermajority, that is, three-fourths of the votes cast. The weighted voting system, as provided in Article 279A(9), giving the union one-third of the total votes and all the states two-thirds of the votes means that the union government would never find itself in the minority in any decision taken by the GST Council (Kumar 2016).

In the Court's view, a "recommendation" cannot be binding since it would upset the GST framework and the larger federal structure of the Constitution.

In one sense, the Supreme Court was caught in a cleft stick not of its own-making. On the one hand, interpreting the recommendation to mean a "binding direction" on the union and state legislatures would fundamentally undermine the democratic and federal character of the Constitution. Especially, given that the GST Council allows the union a de facto veto over its decisions. This would have amounted to the state legislatures being put in a subordinate position to the union, acting through the GST Council. Such a state of affairs would go against the basic features of the Constitution, and large parts of the 101st Amendment Act would have had to be struck down as a consequence (Kumar 2016).

On the other hand, by treating the recommendations as "non-binding," the Court would keep the provisions of the 101st amendment alive but substantially dilute them. The Court considered the other places where the Constitution uses the word "recommendation" and notes that in certain instances they are intended to be binding, but in certain instances, not necessarily so. In the specific context of the 101st Amendment, the Court relies on the principles of federalism to hold that the "recommendations" of the GST Council are just non-binding on either the union government or the state legislatures.

Faced with these two choices, the Court chose an interpretation that rendered the 101st Amendment constitutional but potentially opened up the door to the slow dismantling of the GST. The core of the GST system is uniformity in tax rates, classification of goods and services, and the common procedures for assessment across the country. This means close coordination and implementation between the union government and all the states (including Delhi). This is not unprecedented in India—the Empowered Committee of State Finance Ministers set up in 2000 worked towards ensuring uniformity in value added taxes on goods across the states. They managed it through consensus as there was no legal mechanism to break deadlocks in case the states disagreed. This also meant that there was greater effort to obtain consensus on key issues.

However, the GST Council is so structured as to allow for majority decision-making between the union and states; it needs such decisions to be binding in order to ensure uniformity in the GST system. Given that there is no requirement for the union and states to compromise and arrive at a consensus, there has to be some way to get states that disagree to follow the decision of the majority. This is done by making the term "recommendation" binding and having a disputes settlement mechanism to address among states or between the union and states in relation to the implementation of the GST Council's recommendations.

Without this mechanism, the states will be free to interpret and apply the GST Council's recommendations as they see fit, let alone instances where they might ignore it entirely. This argument was raised by the union but brushed by the Court somewhat unsatisfactorily in a long discussion about competitive and cooperative federalism. The Court hopes that the ideal situation it paints of the union and states working together in

harmony on their own, while using the GST Council as only a site of political contestation—without fundamentally dismantling the GST structure for their own ends—will prevail.

Conclusions

The Supreme Court's optimism about the prospects of the GST, consequent to its interpretation, have so far borne out, though it is perhaps too early to say for sure. The GST Council has not met since the judgment, and it will be interesting to see if the states that welcomed the Supreme Court's judgment in Mohit Minerals (Jacob et al 2022) will actually treat the GST Council's decisions as mere "recommendations."

That said, the uniformity and harmony elements of the GST regime do not depend only on the legal and constitutional mechanisms for the same. There is a common system of payment of GST for both union and state components of the GST and a common disbursal mechanism that routes the money to the union and state treasuries, respectively. It will not be so easy to undo this nor will it be easy for all states to set up their own independent collection mechanisms.

Moreover, decisions at the GST Council have, in most cases (*ENS Economic Bureau* 2019),[6] been taken on the basis of consensus which has meant little scope for dissatisfaction within the states over the manner of functioning of the GST Council. There is also the possibility that further disruption in the GST mechanisms, already a source of much trouble for taxpayers, might be appreciated if it is a result of the state trying to collect more revenue.

For all these reasons, the GST regime is safe—for the moment. However, if the recent public back and forth between the union and the states (specifically, the non-Bharatiya Janata Party-ruled ones) on fuel taxes is any indication, fiscal issues are going to be a point of contention between the union and the states. When put under this stress, will the GST mechanism survive? This is an open-ended question but one that can be put to rest by proactive action on the part of the union to address the constitutional defects in the 101st Amendment Act.

NOTES

1 2022 SCC Online SC 657, viewed on 15 June 2022, https://main.sci.gov.in/supremecourt/2020/23083/23083_2020_4_1501_35969_Judgement_19-May-2022.pdf.

2 *M/s Mohit Minerals v Union of India,* 2020 SCC Online Guj 736.

3 Notification 8/2017 dated 27 June 2017, viewed on 15 June 2022, https://cbic-gst.gov.in/pdf/central-tax/notfctn-8-central-tax-english.pdf and Notification 10/2017 dated 28 June 2017, https://cbic-gst.gov.in/pdf/central-tax/notfctn-10-central-tax-english.pdf.

4 See, for instance, Section 9 of the Central Goods and Services Tax, 2017.

5 On the extraterritorial application of tax laws, see *GVK Industries v Income Tax Officer,* 2011 (4) SCC 36.

6 The first time a decision was taken by vote in the GST Council was in December 2019 at the 38th meeting. See *ENS Economic Bureau* (2019).

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