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Fiscal federalism: On taxing mineral rights

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It is not often that fiscal federalism finds a prominent place in judicial discourse. The Supreme Court judgment, holding by an overwhelming majority of 8:1 that the States can tax mineral rights and mineral-bearing lands, is a truly landmark ruling, as it protects their legislative domain from interference by Parliament. For decades, it was believed that the States were denuded of their power to impose any tax on mineral resources extracted from their land because of the prevalence of a central law, the Mines and Minerals (Development and Regulation) Act, 1957. Even though the right to tax mineral rights is conferred on the States through Entry 50 in the State List of the Seventh Schedule, it was made "subject to any limitations imposed by Parliament by law relating to mineral development". The Union government argued that the very existence of its 1957 law was a limitation on the States' power to tax mineral rights, but Chief Justice of India, Dr. D.Y. Chandrachud, writing for the Bench, examined the Act's provisions to conclude that it contained no such limitation. The royalty envisaged by the 1957 Act was held to be not a tax at all. The Union was hoping that once royalty was accepted as a tax, it would wholly occupy the field and thus remove the States' scope for taxing mineral rights. However, the Court chose to see royalty as a contractual consideration for enjoyment of mineral rights. Also, it ruled that States could tax mineral-bearing lands under Entry 49, a general power to tax lands.

Proponents of fiscal federalism and autonomy will particularly welcome the fact that the judgment opens up a significant new taxation avenue for the States, and the observation that any dilution of the taxation powers of the States would adversely affect their ability to deliver welfare schemes and services to the people. However, Justice B. V. Nagarathna, in her dissent, argues that if the Court did not recognise the central law as a limitation on the State's taxation powers, it would have undesirable consequences as States would enter into an unhealthy competition to derive additional revenue, resulting in an uneven and uncoordinated spike in the cost of minerals; and purchasers of minerals paying too much, leading to an increase in the price of industrial products. Further, the national market may be exploited for arbitrage. Given these implications, it is possible that the Centre may seek to amend the law to impose explicit limitations on the States' taxation power or even prohibit them from imposing a tax on mineral rights. However, such a move may result in mining activities being left wholly out of the tax net, as the majority has also held that Parliament lacks the legislative competence to tax mineral rights.

What are Constitutional Provisions Related to Centre-State Financial Relations?

Constitutional Framework (Part XII)

- The Indian Constitution delineates comprehensive provisions governing the distribution of taxes, non-tax revenues, borrowing powers, and grants-in-aid between the Centre and the States.
- Articles 268 to 293 specifically address financial relations, outlining the mechanisms for fiscal transactions and allocations.

Article 269A (Goods and Services Tax - GST)

- GST was introduced by The Constitution (101st Amendment) Act, 2016.
- Article 269A says that GST on supplies in the course of inter-State trade or commerce shall be levied and collected by the Government of India and such tax shall be divided between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Article 275 (Post Devolution Revenue Deficit Grants)

- Under Article 275, the central government exercises discretionary authority to transfer funds to state governments for specific purposes or schemes, ensuring financial support where necessary.

Article 280 (The Finance Commission)

- Constitutionally mandated under Article 280, the Finance Commission plays a pivotal role in recommending the distribution of tax revenues between the Centre and States.
- Beyond tax devolution, it advises on enhancing state finances, promoting fiscal discipline, and ensuring overall fiscal stability.

What are the Challenges by Fiscal Federalism in India?

- Despite recommendations from the 14th and 15th Finance Commissions (FCs) suggesting 42% and 41% of net tax revenue for States, their actual share of gross tax revenue dwindled to 35% in 2015-16 and further to 30% by 2023-24 (Budget Estimates).
- As per budget estimates, for 2024-25, Gross Tax Revenue (GTR) is projected to grow at 11.7% over 2023-24 at Rs 38.40 lakh crore (11.8% of GDP). Thus with increasing GTR states share should vary to meet their fiscal needs.
- States have witnessed a decline in their ability to independently set tax rates on revenue sources, particularly evident post the adoption of value-added tax (VAT) for intra-state trade.
- This shift along with introduction of GST has curtailed states' capacity to tailor tax policies to local economic conditions. Further, timely disbursable of GST compensation dues has been flagged by states at several occasions.
- Financial aid provided to States saw a decrease from Rs 1.95 lakh crore in 2015-16 to Rs 1.65 lakh crore in 2023-24. Consequently, the combined proportion of statutory financial transfers to the Union government's gross tax revenue declined from 48.2% to 35.32%.

Expected Question for Prelims

Que. Consider the following statements with reference to the constitutional provisions related to Centre-State finances:

1. Article 269A deals with the levy and collection of Goods and Services Tax (GST) by the Government of India.
2. Under Article 275, the Central Government transfers funds to the State Governments for specific purposes or schemes.

Which of the statements given above is/are correct?

(a) Only 1 (b) Only 2

(c) Both 1 and 2 (d) Neither 1 nor 2

Answer : C

Mains Expected Question & Format

Que.: 'The recent decision of the Supreme Court regarding taxing mineral rights has given a new direction to fiscal federalism.' In the context of this statement, explain the implication of the present decision of the Supreme Court.

Answer's Approach:

- In the first part of the answer, define fiscal federalism with constitutional provisions.
- In the second part, analyze the Supreme Court's decision on taxing mineral rights and its effects.
- Finally give a conclusion giving suggestions.

Note: - The question of the main examination given for practice is designed keeping in mind the upcoming UPSC mains examination. Therefore, to get an answer to this question, you can take the help of this source as well as other sources related to this topic.