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Through the Lens of Legality Evolution of Fiscal Federalism in India and Comparative Insights from the United States

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ABSTRACT

Indian federalism is a judicious balance of power between the Union and the States, as provided in the Seventh Schedule of the Constitution in the Union, State, and Concurrent Lists. It was through the Government of India Act, 1935, that the federal concept was introduced for the first time, an important shift from the previous unitary system. The Indian Constitution framers converted this colonial model into a cooperative federation that guarantees both regional autonomy and national unity. Under this constitutional setup, fiscal federalism—a concept popularised by Richard Musgrave in 1959—takes on cardinal significance by regulating the financial relationships and revenue-sharing arrangements between different levels of governments. This article critically reviews India’s constitutional and judicial development of fiscal federalism in a doctrinal and comparative perspective. It assesses how provisions of the Constitution, Finance Commissions, and judicial decisions have influenced Centre–State fiscal relations over time. The research also weighs the benefits of fiscal decentralisation—such as responsiveness to local diversity, administrative efficiency, and innovation—against its intrinsic challenges, including fiscal imbalance, limited accountability, and capacity constraints at the subnational level.

Casting a comparative view from the US, the study showcases the similarities and differences between two different federal traditions. With qualitative and analytical analysis, the study examines if India’s fiscal federal model can successfully balance state autonomy and national unity. It also discusses how judicial intervention and institutional design have reordered intergovernmental financial relationships, especially in the context of the Goods and Services Tax (GST) regime.

Finally, the paper concludes that India’s fiscal federalism is still a developing and adaptive concept—one that continuously tries to reconcile equity, efficiency, and unity within the intricate framework of cooperative federalism.

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I. BACKGROUND OF FISCAL FEDERALISM AND THE INDIAN CONSTITUTION

In the words of Y.V. Reddy, former RBI Governor, India's fiscal federalism has matured through a "combination of cooperation, coordination, and sometimes confrontation"

Federalism can be defined as a distribution of powers between the central and state governments. The constitution of India enumerates various items on which the legislatures may legislate, i.e. Union List, Concurrent List and State List in the VII Schedule of the Constitution.³ The three legislative lists respectively enumerated the powers in the Parliament, the state legislature, and both concurrently. However, if any of the three lists did not cover a matter, it would be treated as a residuary power of the Parliament.⁴

Till the year 1935, India had a unitary form of government. The Government of India Act, 1935, for the first time envisaged a federal scheme for India, and used the word 'Federation', even though the decentralisation and devolution of power had started with the Government of India Act, 1919.⁵ The federal system here is not a result of any treaty or agreement. The unitary system of government was converted into a federal one by giving certain powers and responsibilities to the states under the Indian Constitution.⁶ Fiscal federalism means financial relationships between governments within a federal system of government. *Richard Musgrave*, a German-born American economist, coined the term in 1959. Fiscal federalism addresses the division of government functions and financial relationships between governments. The fiscal federalism theory states that a federal system of government can be efficient and effective in addressing the issues governments have to deal with today, for instance, fair distribution of income, effective allocation of resources, and a stable economy. Since states and localities are not equally funded, intervention of the federal government is required. In such areas, the need for fiscal federalism is emphasised.

Fiscal federalism reflects the evolving relationship among levels of government, influenced by historical context. It reshaped traditional intergovernmental ties, with budgets and financial decisions driving cooperation. Through taxes, grants, and transfers, federal and state governments share responsibilities, while national policies also regulate, subsidise, provide services, redistribute income, and support state autonomy.

The following are the **advantages** of fiscal decentralisation:

³ M.P. Singh V.N. Shukla's Constitution of India 794 (EBC, 2017).

⁴ Ibid.

⁵ The Government of India Act, 1919, introduced the diarchy or dual government. M.P. Singh, Outlines of Indian Legal and Constitutional History 169 (Wadhwa and Co., Nagpur, 2003).

⁶ Fiscal Federalism, *Britannica*, <https://www.britannica.com/money/fiscal-federalism> (last visited July 28, 2025).

1. Local and regional *diversity* can be considered.
2. *Reduced planning* and *administrative expenses*;
3. *Competition among local governments* benefits organisational and political innovation, and more effective politics since citizens have greater influence.

Fiscal federalism has several **disadvantages**, too:

1. *Absence of accountability* of local and state governments to the people;
2. *Absence of qualified personnel*.
3. *Relative autonomy* of the local governments from the nation's government.
4. *Unavailability of public expenditure infrastructure at the local level*.

This research employs a ***doctrinal and comparative methodology*** and primarily examines sources of law, constitutional text, and judicial decisions.

The purpose is to critically assess the constitutional framing of fiscal federalism in India, exploring how its development has been informed by judicial interpretation and whether the evolution of fiscal federalism strikes an appropriate balance based on financial autonomy at the state level, while also advancing national cohesion.

This study will also provide contextual comparisons with the United States, which has followed a federalist tradition. For these purposes, *a qualitative legal and historical, analytical template* will be employed, incorporating historical aspects and observations based on discussions within the Constitutional Convention, court deliberations, as well as contemporary approaches to policy analysis (such as Finance Commissions and provisions on a GST regime).

The research questions for this study are

How has fiscal federalism in India evolved developmentally in the context of constitutional and judicial development?

What role the Supreme Court of India has played in reenvisioning the balance of power?

And what lessons or comparative insight can be taken from the United States in framing the arrangements and trajectories, given the local professional landscape? All these questions have been systematically answered by the research study conducted.

Literature Review

Indian fiscal federalism research incorporates normative theory, institutional research, judicial interpretation, and comparison. Musgrave and Oates focused on differential central and local

government roles, while Tiebout's model posited that welfare would increase with interjurisdictional competition, albeit not practically. Parikh and Weingast proposed market-preserving federalism, claiming India does not live up to their standards owing to central dominance, bailouts, and poor budget discipline. Indian intellectuals such as Jain, Hicks, and Bagchi pointed out structural imbalances, colonial finance legacies, and defects in the Finance Commission and Planning Commission practices. Rao and Singh provided policy responses, including open transfers, harmonised taxation, and tightening borrowing regulations. Central doctrinal works by M.P. Jain, Granville Austin, B.P.R. Vithal, and M. Govinda Rao chart the history of fiscal arrangements and the need for reforms, while Y.V. Reddy's research brings the debate up to date on GST and FRBM matters. Judicially, *Mineral Area Development Authority v. SAIL* (2024) fortified states' fiscal autonomy, establishing it as central to sovereignty. The U.S. is comparatively more example-like in displaying state-level fiscal independence under dual federalism, in contrast to India's federally directed "union of states." Ambedkar's constitutional design intentionally centralised taxation as a means to foster redistribution as well as national integration, instilling cooperative as opposed to dual federalism.

Roots of Fiscal Federalism in India

India's enormous diversity places fiscal federalism at the core of administration. Based on the Constitution, it balances national integration with regional autonomy. The quasi-federal system awards asymmetric fiscal powers to the Centre, and the significant inter-regional disparities render financial administration complex, necessitating solutions to counter disparities and promote cooperative federalism.

On one hand, there is a push for centralisation, where the central government takes charge to reduce these inequalities by supporting less-developed states. On the other hand, there is a strong need for decentralisation, where states have the freedom to address their own unique challenges and priorities. This constant balancing act between promoting national equity and respecting regional diversity is at the heart of India's fiscal federalism.⁷ The Indian economy is subject to severe competition among jurisdictions, and thus, cooperation becomes imperative. Low incomes and harsh regional contrasts also call for active state intervention. In addition to the provision of public services, the government has taken on the role of spearheading national economic development, both as an entrepreneur and a catalyst.⁸

⁷ National Institute of Public Finance & Policy (NIPFP), *Indian Fiscal Federalism – Major Issues*, Working Paper No. 260 (2019), https://www.nipfp.org.in/media/documents/3_Indian_Fiscal_Federalism.pdf (last visited Jul. 28, 2025).

⁸Y. Venugopal Reddy, *India and the Global Financial Crisis: Managing Money and Finance 2009* (Orient Blackswan 2009).

II. CONSTITUTIONAL PROVISIONS AND THE DYNAMICS OF FISCAL FEDERALISM

The Seventh Schedule Framework: ⁹The Constitution's Seventh Schedule under Article 246 divides powers into Union, State, and Concurrent Lists, guiding legislative competence. The Union List covers national matters and significant revenue sources like income tax, customs, and excise, granting the Centre a strong fiscal base and dominant position, shaping India's fiscal federalism.

Key fiscal entries in the Union List include Entry 82¹⁰ (income tax, excluding agricultural income), Entry 83 (customs duties), Entry 84¹¹ (excise duties on most goods), Entry 85¹² (corporation tax), Entry 92A¹³ (inter-state goods tax, now largely under GST), and Entry 97¹⁴ (residuary taxation powers). These provisions ensure a stable fiscal foundation for the Union, while States, with restricted taxing powers, face a vertical fiscal imbalance. Their expenditures outweigh revenue capability, forcing dependency on central transfers made by way of the Finance Commission, grants-in-aid, and several Centrally Sponsored Schemes.

The State List (List II)¹⁵ includes local and regional matters such as public health, police, agriculture, and land. Fiscal powers in this list are limited to areas like land revenue, agricultural income tax, stamp duties (excluding on non-agricultural property transfers), and taxes on goods and passengers carried by road or inland waterways.¹⁶

The Concurrent List¹⁷ allows the Union and the States to legislate on education, forests, trade unions, and labour welfare. These are the matters wherein both governments can legislate.

Although direct taxation powers are largely absent in this list, it covers high-expenditure functional domains like Entry 20 (Economic and social planning)¹⁸, Entry 23 (Social security and insurance)¹⁹, Entry 25 (Education)²⁰, Entry 29 (Prevention of inter-State spread of infectious diseases)²¹, and Entry 42 (Acquisition and requisitioning of property)²². In legislative

⁹ https://d19k0hz679a7ts.cloudfront.net/value_added_material/Seventh-Schedule-of-the-Indian-Constitution.pdf (accessed July 30, 2025).

¹⁰ INDIA CONST. sch. VII, list I, entry 82.

¹¹ INDIA CONST. sch. VII, list I, entry 84.

¹² INDIA CONST. sch. VII, list I, entry 85.

¹³ INDIA CONST. sch. VII, list I, entry 92A.

¹⁴ INDIA CONST. sch. VII, list I, entry 97.

¹⁵ INDIA CONST. sch. VII, list II.

¹⁶ *Ibid.*

¹⁷ INDIA CONST. sch. VII, list III.

¹⁸ INDIA CONST. sch. VII, list III, entry 20.

¹⁹ INDIA CONST. sch. VII, list III, entry 23.

²⁰ INDIA CONST. sch. VII, list III, entry 25.

²¹ INDIA CONST. sch. VII, list III, entry 29.

²² INDIA CONST. sch. VII, list III, entry 42.

conflict under the Concurrent List, Article 254²³ precedes Union laws unless the State law has received Presidential assent. The overlap in these domains often results in the Centre's fiscal dominance, further influencing the balance of fiscal federalism in favour of the union.

Balancing the Scales: The Role of the Finance Commission: As per Article 280²⁴ of the Constitution, the Finance Commission is constituted by the President every five years or sooner to recommend:

- (i) The distribution and allocation between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them.
- (ii) The principles governing the grants-in-aid to States from the Consolidated Fund of India and the amounts to be paid as such grants under Article 275²⁵; and
- (iii) Any other such matter as referred by the President. Under the sub-clause

With time, the Finance Commissions have been charged with a variety of other tasks. They cover suggesting how to distribute excise duty proceeds that substituted for sales tax on products such as sugar, textiles, and tobacco; suggesting grants to States for revenue lost due to the abolition of railway passenger fare taxes; offering suggestions for distributing estate duty revenue on non-agricultural property prior to its abolition in 1986 and substituting for the loss of wealth tax on agricultural land; examining States' debt burden and capital deficits to suggest remedies; dealing with unauthorised State overdrafts with the RBI and suggesting safeguards; evaluating disaster relief financing mechanisms; and investigating revenue possibilities from taxes and duties under Article 269.²⁶ and from duties under Article 268²⁷ of the Constitution, which had not been levied at the time.

It has been observed that Presidential orders suggesting the terms for the Finance Commissions have attempted to impose constraints on their role and limit independent thought. With the increasing emphasis on developmental planning, especially after the Third Finance Commission²⁸, these terms began restricting the Commission's primary focus to studying States' non-Plan revenue budgets. Although the terms of reference of the Ninth Finance Commission²⁹ did not explicitly include such limitations, it too was unable to fully escape the convention of

²³ INDIA CONST. art. 254.

²⁴ INDIA CONST. art. 280.

²⁵ INDIA CONST. art. 275.

²⁶ INDIA CONST. art. 269.

²⁷ INDIA CONST. art. 268.

²⁸ Raja J. Chelliah et al., *Trends in Taxation in Developing Countries* (Allied Publishers 1981)., I.S. Gulati, *Centre-State Financial Relations: An Economic Analysis of Indian Federalism* (Lancers Publishers 1973).

²⁹ Ninth Finance Commission, *Report of the Ninth Finance Commission* (Gov't of India 1989).

evaluating non-Plan expenditures separately from Plan expenditures. This practice had evolved. This narrowing of scope, however, lacks constitutional justification, as Article 275³⁰ does not preclude grants for revenue expenditures on Plan schemes nor prohibit grants for capital purposes. Indeed, the Chairman of the Fourth Finance Commission acknowledged this, noting that the language of the Constitution does not support such exclusions. Nevertheless, the Commission refrained from broadening its recommendations out of concern that doing so would blur the functional boundary between the Finance Commission and the Planning Commission, thereby adopting a much narrower role than the Constitution prescribes. This self-imposed limitation reflects a degree of deference to convention and perceived jurisdictional boundaries.³¹ Notably, the Ninth Finance Commission's terms of reference became particularly controversial, with critics arguing that the normative approach prescribed was presented more as a directive than a guideline, and "that the terms were discriminatory against the States."³²

Distribution of Assigned Taxes and Revenue Sharing: Revenue Sharing Between Centre and States in India is regulated through constitutional provisions, mainly Articles 268 to 281 of the Indian Constitution, and is implemented through Finance Commissions. The scheme indicates India's quasi-federal nature, where the Centre and the States have specified taxing powers, but the Centre appropriates most taxes.³³ The central government and states together raise about 20% of GDP in consolidated government revenue, two-thirds of which accrue to the central government and one-third to states. As expenditure is almost equal, states have a significant vertical fiscal imbalance. Revenue sharing plugs this gap to some extent. Non-agricultural, non-corporate income tax has to be shared constitutionally, but other revenues, such as excise duties, can be shared at the discretion of Parliament. Finance commissions make share recommendations for five years, and these are generally approved.

Historically, the share of income tax revenue in the states used to increase, but the Tenth Finance Commission (1995–2000) lowered it to 77.5% from 85%. Distribution among states is not according to the derivation principle; rather, it is determined by a finance commission formula, which in effect amounts to general grants. For 1995–2000, the formula gave weights to population (20%), per capita income (60%), area (5%), infrastructure requirement (5%), and effort of taxation (10%). Duty sharing rose to 47.5%, of which 40% was shared like income tax and 7.5% shared in proportion to nonplan deficits.

³⁰ INDIA CONST. art. 275.

³¹ M. Govinda Rao, *Some Aspects of Indian Federalism: A Fiscal Analysis* (Allied Publishers 1981).

³² B.P.R. Vithal & M.L. Sastry, *Fiscal Federalism in India* (Academic Foundation 1987).

³³ Richard Hemming, Neven Mates & Barry Potter, India, in Teresa Ter-Minassian (ed.), *Fiscal Federalism in Theory & Practice* ch. 21 (Int'l Monetary Fund 1997).

This data is sufficient to infer that there is a limited but explicit attempt to link shared revenues to the degree of vertical imbalance. Revenues from excises on textiles, tobacco, and sugar are distributed based on estimated local consumption. A total of about 55 per cent of shared revenue is transferred from the central government to state governments.

A notable example is the additional excise duty imposed instead of sales tax on certain commodities, such as sugar, textiles, and tobacco. This arrangement emerged as a tax rental scheme in 1956. States voluntarily relinquished their right to levy sales tax on these items in return for the Centre imposing additional excise duties and transferring the full proceeds to them. The Centre also assured compensation to each State, with the principle of apportionment approximating the revenue each State would have generated had it retained the sales tax powers. Similarly, the Constitution authorised the Centre to tax railway passenger fares and transfer the proceeds to the States. However, this tax was repealed, and successive Finance Commissions were asked to recommend grants-in-lieu. In the case of taxes covered under Article 269, such as estate duty on non-agricultural property and wealth tax on agricultural land (now abolished), all proceeds would be passed on to the States.

The Finance Commissions had eventually determined that the guiding principle for distributing these taxes among the States should be based on the place of origin or accrual. Consequently, such taxes were distributed using the best available proxies to determine where the revenue accrued. Two significant concerns have emerged regarding the system of allocated taxes in India, which are, first, the States have expressed dissatisfaction with the operation of the tax rental arrangement, particularly the Centre's failure to revise the rates of additional excise duties as promised. Despite commitments made by the Central Government to the States, the dispute as to some states getting less revenue from the centre has always been a contentious issue. In the National Development Council, to raise the incidence of these duties to 10.8% of the value of cleared goods, the rate remained at 9.87% at the end of 1987–88, only marginally increasing to 10.7% in 1988–89, just below the promised threshold. This perceived lack of commitment from the Centre has undermined the States' confidence and impeded broader efforts at tax harmonisation. The dissatisfaction also derailed the implementation of committee recommendations in 1983 to extend additional excise duties to more commodities.

The second issue is the States' concern as to the Centre has not fully utilised the taxable bases as available under Article 269. In particular, States have advocated for the taxation of newspaper advertisements and the inclusion of advertisements broadcast on radio and television, which will be possible by way of a constitutional amendment to expand the scope of Article

269(1)(f).³⁴ While the Eighth Finance Commission (1983) acknowledged this issue, it downplayed the potential revenue gains. However, the Sarkaria Commission supported amending the Constitution to enable taxation of advertisements across all media platforms, thus expanding the States' revenue base under Article 269. Taxes in India include non-corporate income tax and Union excise duty. After deducting revenues from specified items such as duties on Union emoluments and surcharges, the net receipts from non-corporate income tax are to be mandatorily distributed between the Centre and the States as mandated by Articles 270 and 271 of the Constitution.

In contrast, in the case of the revenue from Union excise duties, it may be divided between the Centre and the States under Article 272. The Finance Commission is tasked to determine the exact proportionate shares of the Centre and the individual States, as well as the principles and criteria for distribution. The respective shares and the distribution bases for income tax and excise duties among the States are detailed in Annexures I and II. A notable aspect of tax devolution proposed by the Finance Commissions is that, although the criteria used for allocating tax shares differ from those applied in providing grants-in-aid, the economic objectives underlying both mechanisms are not stated to be distinct.³⁵ Tax devolution has generally been based on broad economic indicators, whereas grants-in-aid are designed to address the residual fiscal disadvantages of States as determined by the Commissions. Even within tax devolution, different conceptual approaches were followed for allocating the net proceeds from non-corporate income tax compulsorily shareable under the Constitution, and Union excise duties, which were not until the Seventh Finance Commission.

The criteria employed for shared tax devolution have been contentious, with significant debate around key issues such as: (i) whether the 'contribution' factor—based on how much revenue a State generates is relevant in determining its share of income tax; (ii) whether the inclusion of a 'backwardness' factor is appropriate for tax devolution; and (iii) what constitutes the most suitable indicator of backwardness for equitable allocation.

Vertical Imbalance: ³⁶The share of states in the divisible pool of centre taxes is important for reinforcing fiscal independence. Nevertheless, the Centre–State distribution of powers under the Seventh Schedule has created a fiscal deficit and major vertical imbalance. States earned only 37.3% of resources but incurred 62.4% of expenditure, as per the Fifteenth Finance

³⁴ INDIA CONST. art. 269(1)(f).

³⁵ M. Govinda Rao, *Intergovernmental Transfers and Fiscal Policy in India* (Institute for Social and Economic Change 1987).

³⁶ "Finance Commission of India: Its Functions, Role & Members," NextIAS Blog (Dec. 2023).

Commission.³⁷ While finance commissions seek to bridge this gap, increasing cess and surcharges out of sharing have actually decreased the divisible pool, while grants-in-aid have increased at a greater rate than tax devolution.³⁸

Horizontal Distribution:³⁹This refers to the allocation of resources among states. The Finance Commission makes this recommendation based on a formula to ensure equitable distribution of funds and foster balanced development across the regions.⁴⁰The FC is constituted to look into issues in implementing fiscal federalism policies. It emphasises assessing and correcting the vertical and horizontal imbalances in this regard. Despite good intentions and thorough analyses of fiscal scenarios, relatively weaker states often find themselves discriminated against.⁴¹ As per Buchanan (1950)⁴²States vary in fiscal capacity, with low-income states facing greater fiscal pressure than high-income states. However, broad compliance with the universal applicability of the criteria suggested initially by FCs in the past undermines these differences among states.

Grant in Aid to States:

⁴³Finance Commission grants offer more transfers to the states needing support or improvement, e.g., justice delivery or statistical infrastructure. They help stimulate inclusive growth and eradicate regional disparities. Grants-in-aid play two roles: bridging revenue gaps following devolution and enhancing poor public services. While the first one is an example of general-purpose transfers, the latter are specific-purpose, non-matching grants. Under Article 275, the grants were not only to counterbalance fiscal disadvantages but also to cover budget deficits and bring services to benchmark levels, albeit while monitoring was poor.

III. JUDICIAL TRENDS TOWARDS FISCAL FEDERALISM:

The Supreme Court has given numerous judgments on the issue of fiscal federalism; however, the Court has always upheld the States' powers to exercise their federal rights in order to secure revenue for their functioning. And it is the Supreme Court that has maintained a balance between both sides, and this is reflected in the decisions rendered by the Hon'ble Court.

The landmark case of *R.M.D.C. (Mysore) Private, Ltd. v. State of Mysore*,⁴⁴ The appellants,

³⁷ Raghunandan Kotha et al., *Cesses and Surcharges: Implications for the Indian Fiscal Federalism* (2018).

³⁸ Rakesh Mohan, *India's Economy: Performance and Challenges* (Penguin Random House 2020).

³⁹ "Finance Commission of India: Its Functions, Role & Members," NextIAS Blog (Dec. 31, 2023).

⁴⁰ Barna Ganguli & B.A.K. Sinha, 16th Finance Commission: Towards Vertical and Horizontal Balance, Ideas for India (2024).

⁴¹ K.R. Shyam Sundar Das & R. Mishra, *Public Finance in India: Theory and Practice* (Deep & Deep Publications 2008).

⁴² James M. Buchanan, *Fiscal Theory and Political Economy: Selected Essays* (Univ. of N.C. Press 1950).

⁴³ Finance Commission of India: Its Functions, Role & Members, NextIAS Blog (Dec. 31, 2023), <https://www.nextias.com/blog/finance-commission-of-india/>

⁴⁴ *R.M.D.C. (Mysore) Private, Ltd. v. State of Mysore*, AIR 1962 SC 594.

R.M.D.C. (Mysore) Private, Ltd., challenged the validity of the Mysore Lotteries and Prize Competitions Control and Tax Act, asserting that the central Prize Competitions Act undermined their legislative competence. The crux of the matter revolved around whether the state retained its authority to impose taxes on prize competitions despite adopting the central regulatory framework. The Supreme Court dismissed the appellants' challenges, thereby upholding the Mysore Act as amended. The Court held that while the control and regulation of prize competitions fell under central jurisdiction through Article 252 of the Constitution, the state's power to impose taxes on such activities remained intact under separate constitutional provisions. The resolutions passed by the Mysore Legislature were deemed not to have surrendered the state's taxing authority, as the power to regulate and tax is distinct and independently enumerated in the Constitution. The Court meticulously analysed the constitutional provisions, particularly focusing on Article 252, which governs the delegation of legislative powers from states to the Parliament, allowing uniform regulation across states without relinquishing other legislative authorities, and the Mysore Legislature's adoption of the Central Act under Article 252 pertained solely to the regulatory aspects of prize competitions. It did not encompass the state's autonomous power to levy taxes under Entry 62 of the State List. It distinctly covers "Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling." The Court emphasised that the legislative resolutions did not surrender the state's taxing authority and remain intact as a separate constitutional entitlement.

The Mineral Area Development Authority v. Steel Authority of India Ltd.⁴⁵ It is a milestone Supreme Court ruling upholding the jurisdiction of States to impose taxes on mineral rights and mineral-bearing property under Entries 49 and 50 of the State List, separately from the royalties paid by the Union under the Mines and Minerals (Development and Regulation) Act, 1957 (MMDR Act). The Court ruled that these royalties were not "taxes" but contractual dues, hence would not bar extra levies by States. The judgment dismissed the contention that State taxation usurps Parliament's legislative jurisdiction or national mineral policy. Although Justice B.V. Nagarathna differed, cautioning that state-level levies may lead to double taxation and tax distortion, the 8:1 majority upheld State fiscal independence. To counter retrospective fiscal burdens, the Court permitted tax claims only from 1 April 2005, exempted penalties and interest until 25 July 2024, and authorised staggered payment spread over 12 years from April 2026. This decision considerably strengthens the constitutional doctrine of fiscal federalism to ensure that states have considerable control over taxing natural resources unless restricted explicitly

⁴⁵ The Mineral Area Development Authority v. Steel Authority of India Ltd (2024) 8 S.C.R. 540.

by parliamentary law.

In the case of the *State of Bombay v. R.M.D. Chamarbaugwala*⁴⁶ Like the *R.M.D.C. Mysore v State of Mysore* revolved around the lotteries, prize, and Tax Act. The doctrine of territorial nexus under Article 245 and Article 301 related to trade, commerce and intercourse was determined. It was held while deciding the validity of the Bombay Lotteries Act, that it would be necessary to decide whether it was with respect to the topic assigned to the state legislature to legislate, whether there is a sufficient territorial nexus to entitle the State Legislature to collect tax from the petitioners who carried on the prize competitions through the medium of a newspaper which was printed and published outside the State of Bombay. The Court held that the prize competitions as conducted by the Petitioners are gambling and that being illegal, they cannot be regarded as trade commerce, and as such, the petitioners cannot claim any fundamental right under Article. 19(1)(g) in respect of such competitions, nor are they entitled to the protection of Art 301.

Another vital case related to fiscal diversion is the *State of Kerala v Union of India*. This case involves a constitutional challenge by the State of Kerala against the Union of India concerning fiscal autonomy and the interpretation of Articles 131 and 293 of the Constitution of India. The State disputes the Union's borrowing restrictions, including a Net Borrowing Ceiling applied across various fiscal liabilities. Kerala sought interim relief to borrow funds, claiming that the Union exceeded its authority under Article 293. The case raises crucial constitutional questions on federal fiscal relations, judicial review, and fiscal decentralisation within the Indian federal system. While the Supreme Court referred the substantive issues to a larger Bench, the request for interim relief was denied, emphasising the triple-test for granting injunctions and the balance of convenience favouring the Union. The Kerala state government brought a suit under Article 131 of the Constitution, alleging that the Union government acted unjustifiably in curtailing its facility to borrow money by mandating a Net Borrowing Ceiling. Kerala stated that this was against its constitutional financial autonomy under Article 293, particularly as it was required to borrow money (INR 26,226 crores) to discharge compelling obligations such as pensions and subsidies. The Centre government countered by stating that Kerala had borrowed more than permitted in previous years, and restricting state borrowing was necessary to ensure economic stability for the nation. The Supreme Court declined to provide Kerala with immediate relief (no permission for interim borrowing), holding that Kerala did not satisfy the prescribed legal test (the "triple test": solid legal case, balance of convenience, and risk of irreparable damage).

⁴⁶ *State of Bombay v. R.M.D. Chamarbaugwala*, AIR 1957 SC 699, 1957 SCR 874

However, the Court recognised that the case presented significant constitutional issues relating to fiscal federalism, which will be adjudicated subsequently by a larger Constitution Bench. By and large, the judgment is balanced, preserving national economic health while leaving it open to a fuller examination of the Centre-State constitutional relationship regarding borrowing powers.

IV. REDEFINING INSTITUTIONAL ROLES

Absorbing the planning aspect in Indian fiscal federalism has raised to the surface a variety of issues of significance. The challenges of realising the goals of intergovernmental transfers on account of dichotomous functioning, at times at cross purposes, have already been pointed out.⁴⁷ The inefficiencies resulting from overlap and duplication in the operations of the two Commissions have also been highlighted.⁴⁸ Also highlighted is the fear expressed regarding assigning a statutory body, the Finance Commission, a much less significant role compared to what is provided in the Constitution and the rise of a political body, the Planning Commission, as an important allocator of funds and, more significantly, as also regarding the growing role of discretionary factors in federal transfers.⁴⁹ The "capital account" issue of the States identified earlier has also been referred to as a "fallout" of the planning process.⁵⁰ The two-pronged operation of multiple agencies has been mentioned as one of the significant factors for the lack of development of a rational criterion for intergovernmental transfers. Considering this, it is rather strongly believed in certain circles that there is an imperative call for institutional reform.⁵¹

Scholars of Indian federal finance have, from time to time, made a variety of proposals for reforming the institutional framework. Khatkhate and Bhatt proposed a total reclassification of assistance and reorganisation of institutions, providing that a permanent Finance Commission administer statutory grants and assistance to agriculture, Centrally Sponsored Schemes be scheme-based under the Planning Commission, and sectoral projects be financed via loans by a proposed National Development Bank.⁵² Lakdawala and Bhargava had made similar proposals, which Sastry and Eapen reaffirmed.⁵³ In contrast, Thimmaiah argued that a permanent Finance

⁴⁷ M. Govinda Rao & Vandana Aggarwal, *Intergovernmental Fiscal Transfers in India: Some Issues of Design and Measurement*, Working Paper No. 5/90, Nat'l Inst. of Pub. Fin. & Pol'y (1990).

⁴⁸ *Ibid.*

⁴⁹ M. Govinda Rao, *Fiscal Federalism in Theory and Practice*, ch. 21 (Int'l Monetary Fund 1997), <https://www.elibrary.imf.org/display/book/9781557756633/ch021.xml>.

⁵⁰ M.G. Thimmaiah, *Union-State Financial Relations in India* (1976).

⁵¹ *Ibid.*

⁵² B.S. Khatkhate & V.V. Bhatt, *Institutional Arrangements for Centre-State Financial Relations in India*, 5 *Indian Econ. Rev.* 213 (1970).

⁵³ George Eapen, *Federal Finance in India* (1969).

Commission was unnecessary if a dedicated cell were created in the Planning Commission for continuous federal finance studies.⁵⁴ Grewal and Bagchi suggested that a permanent Finance Commission should handle all transfers, while the Planning Commission should devolve capital transfers.⁵⁵ Alternatively, V.K.R.V. Rao recommended that both Commissions be located on a statutory basis with proper demarcation of roles. A National Loans Organisation, inspired by Australia's Loan Council, should be established to manage market borrowing and central loans.⁵⁶ However, Thimmaiah argued again that institutional differences between India and Australia weaken the case for such a body.⁵⁷ Despite elaborate discussion, no consensus has emerged regarding the rational reorganisation of these institutions, and institutional reforms aimed at improving the design and delivery of transfer schemes remain elusive. A significant change was brought about in the year 2014 when the Planning Commission was decommissioned and, in its place, the NITI Aayog was constituted, which now acts as the planning body that is chaired by the Prime Minister himself.

V. COMPARISON WITH THE SYSTEM IN THE UNITED STATES

The United States and India represent two different approaches to federalism. The U.S. operates under a dual federal model, allowing states significant control over their finances. States can collect their own income, property, and sales taxes. The federal government mainly influences them through conditional grants and spending programs. The Supreme Court, starting with *McCulloch v. Maryland*, has maintained federal dominance and state financial independence. In contrast, India's federalism, which Granville Austin calls "cooperative federalism," concentrates financial powers at the national level. The Seventh Schedule gives the Union authority over important taxes like income, customs, and corporate taxes. As a result, states rely on transfers from the Finance Commission, GST revenues, and centrally sponsored schemes. However, recent court rulings, such as *Mineral Area Development Authority v. SAIL* (2024), have started to support the financial independence of states, recognising fiscal federalism as an essential part of Indian federalism. Therefore, while federalism in the U.S. depends on state self-sufficiency and strict budget limits, Indian federalism shows a negotiated balance between national unity and state reliance. What we can undertake from the US model and incorporate into our system is giving states their deserved share in the GST proceeds, as per their needs and population ratio, and this disbursement must be done in a time-bound manner in order to avoid

⁵⁴ M.G. Thimmaiah, *Union-State Financial Relations in India* (1978).

⁵⁵ J.S. Grewal, *Centre-State Financial Relations in India* (1975); Amiya Kumar Bagchi, *Centre-State Relations in India: A Review of Recent Trends*, 12 *Econ. & Pol. Weekly* 89 (1977).

⁵⁶ V.K.R.V. Rao, *Transfer of Resources from the Centre to the States in India*, 8 *Indian J. Pub. Admin.* 1 (1973).

⁵⁷ M.G. Thimmaiah, *Union-State Financial Relations in India* (1976).

any disputes between the state and the union with regards to the disbursement of these funds.

VI. CONCLUSION

This research, guided by the identified questions, shows that Indian fiscal federalism has evolved through constitutional design, institutional mechanisms like the Finance Commissions, and judicial decisions culminating in the MADA judgment that strengthened state autonomy. The comparative study with the U.S. demonstrates how state fiscal independence, credible budget rules, and conditional federal spending create a disciplined yet flexible framework. Answering the research questions, it is clear that: (i) India's fiscal federalism has shifted from a centralizing model to gradually recognizing state autonomy; (ii) the MADA verdict marks an important moment in reinforcing the fiscal independence of states; (iii) compared to the U.S., Indian states still depend on the Union for revenue, although cooperative mechanisms aim to maintain fairness; and (iv) reforms to improve transparency in transfers, tighten budget constraints, and enable states to generate sustainable revenues are necessary. Therefore, a new model of cooperative federalism, taking lessons from U.S. fiscal discipline while addressing India's social and economic diversity, is the way forward.
