



# LEVERAGING DIGITAL GOVERNANCE FOR INCLUSIVE ECONOMIC GROWTH: GST REFORMS AND FISCAL FEDERALISM IN TAMIL NADU

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**Volume - I**



A One Day National Seminar on  
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# FISCAL FEDERALISM IN TAMIL NADU’S EXPERIENCE WITH GST AND DIGITAL TAX ADMINISTRATION



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## **Abstract**

*This article examines fiscal federalism through the lens of Tamil Nadu’s experience with GST implementation and digital tax administration. As one of India’s most industrialized and revenue-contributing states, Tamil Nadu’s transition to the unified tax regime highlights both opportunities and tensions inherent in cooperative federalism. The study analyses revenue trends, compensation mechanisms, and compliance challenges following GST rollout, with particular focus on the state’s concerns over fiscal autonomy and revenue stability. It also explores the role of digital platforms such as the Goods and Services Tax Network (GSTN) in enhancing transparency, efficiency, and data-driven governance. The digitization of tax administration has improved compliance monitoring and reduced leakages, yet it has simultaneously centralized control and constrained state-level discretion. By situating Tamil Nadu’s experience within broader debates on fiscal decentralization and intergovernmental coordination, the article argues that while GST has strengthened tax harmonization, it has also reshaped the contours of fiscal federalism, necessitating renewed dialogue on revenue sharing, autonomy, and institutional balance.*

**Keywords:** *Fiscal federalism, GST, Tamil Nadu, digital tax administration, cooperative federalism, public finance.*

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## **Introduction**

Fiscal federalism refers to the division of financial responsibilities between different levels of government within a federal political system. In India, the Constitution allocates taxation powers and expenditure responsibilities between the Union government and state governments through the Seventh Schedule and through fiscal transfer mechanisms such as the Finance Commission.

Before the introduction of GST, India had a fragmented indirect tax system. The Union government imposed taxes such as excise duty and service tax, while states imposed taxes like Value Added Tax (VAT), entry tax, and luxury tax. This multi-layered system created inefficiencies, increased compliance costs, and often resulted in the cascading of taxes.

The introduction of GST in 2017 represented a major fiscal reform aimed at simplifying the tax system and promoting economic integration across states. However, the reform required states to surrender several taxation powers, raising important questions about fiscal autonomy and the balance of power in India’s federal structure.

Tamil Nadu is a significant case for studying these changes. As one of India’s most industrialized states, its economy relies heavily on manufacturing, exports, and service sectors. The shift to a destination-based tax system under GST has important implications for a manufacturing-oriented state like Tamil Nadu.

This study explores how GST and digital tax administration have influenced fiscal federalism in Tamil Nadu.

## **Fiscal Federalism in India**

Fiscal federalism provides a framework for allocating fiscal responsibilities among levels of government. According to Musgrave’s theory of public finance, fiscal systems must perform three functions: allocation, distribution, and stabilization (Musgrave & Musgrave, 1989).

In India, fiscal federalism operates through several institutional mechanisms:

1. **The Finance Commission** – Determines tax devolution and grants to states.
2. **The GST Council** – Governs GST policy decisions.
3. **Intergovernmental transfers** – Provide financial support to states.

The GST Council is a unique federal institution where both central and state governments jointly decide tax rates, exemptions, and administrative rules.

The voting structure in the council gives the Union government one-third of the vote while states collectively hold two-thirds, requiring cooperative decision-making (Government of India, 2023).

## **Overview of the GST System**

The Goods and Services Tax introduced a **dual GST model** consisting of:

- **Central GST (CGST)** – collected by the Union government
- **State GST (SGST)** – collected by state governments
- **Integrated GST (IGST)** – applied to interstate trade

The GST framework aims to eliminate tax cascading by allowing input tax credits across the supply chain.

## **Objectives of GST**

The main objectives include:

- Creating a unified national market
- Improving tax compliance
- Increasing government revenue efficiency
- Promoting transparency through digital tax systems

Since its introduction, GST has become a major source of government revenue. India’s total GST collection reached **₹18.1 lakh crore in FY 2023–24** (GST Council Secretariat, 2024).

## **Economic and Fiscal Profile of Tamil Nadu**

Tamil Nadu is one of India’s largest state economies. According to the Reserve Bank of India (2024), the state contributes approximately **9% of India’s GDP**.

Key economic sectors include:

- Automobile manufacturing
- Textile and garment production
- Electronics manufacturing
- Information technology
- Export-oriented industries

The state also has a large consumer base and strong trade networks, which contribute significantly to GST revenues.

**Table 1: Tamil Nadu Gross State Domestic Product (Current Prices)**

Year	GSDP (₹ lakh crore)
2018-19	16.12
2020-21	17.97
2022-23	24.85
2023-24	27.22

### GST Revenue Trends in Tamil Nadu

Tamil Nadu is consistently among the top GST-contributing states in India.

**Table 2: GST Collection in Tamil Nadu**

Year	GST Revenue (₹ crore)
2018-19	36,330
2019-20	41,500
2020-21	38,250
2021-22	64,890
2022-23	96,750
2023-24	1,12,456

The table shows a temporary decline during the COVID-19 pandemic followed by strong growth due to economic recovery and improved compliance mechanisms.

### GST Compensation and Fiscal Autonomy

A major concern for states during the implementation of GST was the potential loss of revenue from abolished taxes. To address this issue, the **GST Compensation Act (2017)**

guaranteed states **14% annual revenue growth for five years** compared to the 2015–16 base year (Government of India, 2017). Tamil Nadu received compensation during the early years of GST implementation due to revenue shortfalls.

**Table 3: GST Compensation to Tamil Nadu**

Year	Compensation (₹ crore)
2018–19	4,500
2019–20	6,100
2020–21	12,250
2021–22	8,700

However, the compensation scheme expired in June 2022, raising concerns among states about revenue stability.

Tamil Nadu has argued that manufacturing states face disadvantages under the destination-based GST system because tax revenues are collected where goods are consumed rather than produced.

### Digital Tax Administration under GST

GST is one of the world’s largest digital tax systems. The reform relies heavily on digital infrastructure to manage tax compliance.

The **GST Network (GSTN)** is the technological backbone of the system, enabling:

- Online registration of taxpayers
- Electronic filing of tax returns
- Digital tax payments
- Data analytics for compliance monitoring

Tamil Nadu has actively implemented digital tax tools to strengthen its revenue administration.

### Major Digital Mechanisms

#### 1. E-Way Bill System

Introduced in 2018, the e-way bill system tracks the movement of goods across states and helps prevent tax evasion.

#### 2. E-Invoicing

Mandatory electronic invoicing improves invoice transparency and allows automatic reporting of transactions.

#### 3. Online Return Filing

Taxpayers file monthly returns through the GST portal, reducing paperwork and improving administrative efficiency.

## Impact of Digitalization on Tax Compliance

Digital tax administration has significantly improved compliance levels.

**Table 4: GST Return Filing Compliance in Tamil Nadu**

Year	Filing Rate (%)
2018	65
2020	72
2022	82
2024	88

Improved compliance has contributed to the steady growth of GST collections in the state.

### Challenges in GST Implementation

Despite the progress made under GST, several challenges remain.

#### 1. Reduced Fiscal Autonomy

States have limited control over tax rates and policies because decisions are made collectively in the GST Council.

#### 2. Compliance Burden on Small Businesses

Small and medium enterprises often struggle with digital filing requirements and complex tax procedures.

#### 3. Revenue Volatility

GST revenues fluctuate with economic cycles, making budget planning difficult for states.

#### 4. Administrative Coordination

Effective GST administration requires coordination between central and state tax authorities.

### Tamil Nadu’s Role in the GST Council

Tamil Nadu has been an active participant in GST Council deliberations.

The state government has advocated for:

- Extension of the GST compensation mechanism
- Simplification of tax rates
- Greater fiscal flexibility for states

These debates reflect broader tensions in India’s fiscal federalism, where states seek greater autonomy while the Union government aims to maintain a unified tax framework.

## Comparative GST Performance of Major States

**Table 5: GST Revenue by Major States (FY 2023–24)**

State	GST Collection (₹ crore)
Maharashtra	3,18,497
Karnataka	1,43,023
Gujarat	1,74,938
Tamil Nadu	1,12,456

The data shows that Tamil Nadu remains among the top four contributors to GST revenue in India.

### Policy Implications

Tamil Nadu’s experience highlights several important policy implications for India’s fiscal federal system.

#### Strengthening Cooperative Federalism

Effective collaboration between the Union and states is essential for maintaining fiscal stability.

#### Improving Digital Infrastructure

Continued investment in digital tax systems will further improve compliance and reduce fraud.

#### Reforming the GST Structure

Policy reforms could include:

- Rationalizing GST tax rates
- Improving revenue-sharing mechanisms
- Enhancing data sharing between governments

#### Future of Digital Tax Governance

Emerging technologies may further transform tax administration.

Potential developments include:

- Artificial intelligence-based tax audits
- Blockchain-enabled invoice verification
- Advanced data analytics for fraud detection

Tamil Nadu’s strong information technology sector positions it well to adopt these innovations in tax governance.

## Conclusion

The introduction of GST has significantly reshaped fiscal federalism in India. The reform created a unified tax system and improved transparency through digital tax administration. However, it also altered the balance of fiscal authority between the Union and state governments.

Tamil Nadu’s experience illustrates both the benefits and challenges of the GST regime. While digital systems have improved compliance and increased revenue efficiency, concerns remain regarding fiscal autonomy and revenue stability.

A sustainable fiscal federal framework requires continued dialogue between the Union and states, improvements in digital tax governance, and reforms that ensure fair revenue distribution.

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