News: Fifteenth Finance Commission (FFC) chairman N.K. Singh on Friday sought a leverage with the Goods and Services Tax (GST) Council, arguing that tax rate cuts and grant of exemptions decided solely by the council affects the FFC’s goal of optimizing revenue targets of the Centre and states.

Prelims and Mains focus: about the Centre-states tussle related to GST and the role of the Finance Commission

Context: The Centre and state governments seem to be on a collision course amid a sharp economic downturn that has eroded their financial positions.

Background:

- The Narendra Modi government is facing the challenge of finding the money for higher welfare spending on schemes such as farmers’ income support, as well as the burden of compensating states, when its own revenue growth is sluggish.
- The FFC recommends a formula for sharing the Centre’s direct and indirect revenues, barring cess.
- The funds needed for compensating states for their GST shortfall are raised through a GST cess on items like tobacco. The central government needs to give GST compensation till 2022, the fifth year of the indirect tax reform.
- The FFC’s formula for revenue sharing is effective for five years from April 2020. An extension of GST compensation to states beyond 2022 will impact the last three years of the period, for which FFC’s recommendations will apply, that is between FY23 and FY26.

Concerns raised by 15th FC:

- Finance commissions look at projections of revenue and spending, but GST rates, exemptions, changes and implementation are the domain of the GST Council. This leads to unsettled questions on the ways to monitor, scrutinize and optimize revenue outcomes.
- The demand from states for extending the GST compensation given to them for revenue shortfall beyond the currently agreed 2022 will also have a bearing on the formula the FFC is set to recommend shortly on how the Centre should share its tax revenue with states.

Significance of FC comments

- Singh’s comments assume significance as they indicate that the FFC’s suggestions for revenue sharing could be more tight-fisted than states expect, which could trigger more
Singh also called for a fresh look at Schedule 7 of the Constitution that assigns lawmaking powers on various subjects to Central and state governments. “The facts and circumstances on fiscal federalism have changed. Time to change our mind,” Singh said.

Singh argued that the nature of governance has changed fundamentally, with the Central government taking the lead in several national priority areas such as drinking water and power supply. He also said an expert group should look into rationalization of centrally-sponsored schemes.