The Fifteenth Finance Commission submits its report for 2020-21 to the President

Syllabus subtopic: Statutory, regulatory and various quasi-judicial bodies


Prelims and Mains focus: about the 15th finance commission, its recommendations and functions

Background

The XV Finance Commission was constituted by the President of India under Article 280 of the Constitution on 27 November 2017 to make recommendations for a period of five years from 1st April 2020 to 31 March 2025. The Commission had a wide ranging Terms of Reference contained in the Presidential Notification.

What is the Finance Commission?

The Finance Commission is constituted by the President under article 280 of the Constitution, mainly to give its recommendations on distribution of tax revenues between the Union and the States and amongst the States themselves.

Two distinctive features of the Commission’s work involve redressing the vertical imbalances between the taxation powers and expenditure responsibilities of the centre and the States respectively and equalization of all public services across the States.

Functions of the Finance Commission

It is the duty of the Commission to make recommendations to the President as to:

1. the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them and the allocation between the States of the respective shares of such proceeds;
2. the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;

3. the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State;

4. any other matter referred to the Commission by the President in the interests of sound finance.

The Commission determines its procedure and have such powers in the performance of their functions as Parliament may by law confer on them.

Appointment of the Finance Commission and the qualifications for Members

The Finance Commission is appointed by the President under Article 280 of the Constitution. As per the provisions contained in the Finance Commission [Miscellaneous Provisions] Act, 1951 and The Finance Commission (Salaries & Allowances) Rules, 1951, the Chairman of the Commission is selected from among persons who have had experience in public affairs, and the four other members are selected from among persons who:

- are, or have been, or are qualified to be appointed as Judges of a High Court; or
- have special knowledge of the finances and accounts of Government; or
- have had wide experience in financial matters and in administration; or
- have special knowledge of economics

The recommendations of the Finance Commission are implemented as under:

Those to be implemented by an order of the President:

- The recommendations relating to distribution of Union Taxes and Duties and Grants-in-aid fall in this category.
- Those to be implemented by executive orders:
- Other recommendations to be made by the Finance Commission, as per its Terms of Reference

Commissions constituted so far

The First Finance Commission was constituted vide Presidential Order dated 22.11.1951 under the chairmanship of Shri K.C. Neogy on 6th April, 1952. Fifteenth Finance Commissions have been Constituted so far at intervals of every five years.
Need for a Finance Commission

The Indian federal system allows for the division of power and responsibilities between the centre and states. Correspondingly, the taxation powers are also broadly divided between the centre and states. State legislatures may devolve some of their taxation powers to local bodies.

Formula used for distribution:

The share in central taxes is distributed among states based on a formula. Previous Finance Commissions have considered various factors to determine the criteria such as the population and income needs of states, their area and infrastructure, etc. Further, the weightage assigned to each criterion has varied with each Finance Commission.

The criteria used by the 11th to 14th Finance Commissions are:

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<th>Criteria</th>
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<th>13th</th>
<th>14th</th>
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<tr>
<td>Income Distance</td>
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<tr>
<td>Population 2011</td>
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<tr>
<td>Index of Infrastructure</td>
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<tr>
<td>Fiscal Discipline</td>
<td>7.5</td>
<td>7.5</td>
<td>17.5</td>
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<td>Tax Effort</td>
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<td>Fiscal Capacity Discipline</td>
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<td>47.5</td>
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<tr>
<td>Area</td>
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<td>Forest Cover</td>
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<td>7.5</td>
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<td><strong>Total</strong></td>
<td>100</td>
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Source: Reports of the 1st to 14th Finance Commissions; P.R.S.

Population is an indicator of the expenditure needs of a state. Over the years, Finance Commissions have used population data of the 1971 Census. The 14th Finance Commission used the 2011 population data, in addition to the 1971 data. The 15th Finance Commission has been mandated to use data from the 2011 Census.
**Area** is used as a criterion as a state with larger area has to incur additional administrative costs to deliver services.

**Income distance** is the difference between the per capita income of a state with the average per capita income of all states. States with lower per capita income may be given a higher share to maintain equity among states.

**Forest cover** indicates that states with large forest covers bear the cost of not having area available for other economic activities. Therefore, the rationale is that these states may be given a higher share.

**Grants-in-Aid:**

Besides the taxes devolved to states, **another source of transfers from the centre to states is grants-in-aid**. As per the recommendations of the 14th Finance Commission, grants-in-aid constitute 12% of the central transfers to states. The 14th Finance Commission had recommended grants to states for three purposes: (i) disaster relief, (ii) local bodies, and (iii) revenue deficit.

**The 15th Finance Commission**
HOW TAXES ARE SPLIT

Distribution of tax proceeds

- Article 280 of the Constitution mandates the finance commission to recommend the distribution of the net proceeds of taxes between the Centre and the states every five years.
- 15th Finance Commission’s recommendations on tax sharing between Centre and states are to kick in from April 2020.

With GST, states now get 50% of the kitty.