

Finance Commission and Resource Sharing Between Union State Governments

History of Finance Commission:

- Finance commission is a quasi-Judicial body set up under Article 280 of the Indian Constitution.
- It was Established in the year 1951, to define the fiscal relationship framework Between the Centre and the state.
- Finance Commission aims to reduce the fiscal imbalances between the Centre and the states (Vertical Imbalance) and also between the States (horizontal imbalance). It Promotes inclusiveness.
- A Finance Commission is set up Once in every 5 years. It is normally Constituted two years before the Period. It is a temporary Body.
- The 14th Finance Commission was Set up in 2013. Its recommendations Were valid for the period from 1st April 2015 to 31st March 2020.
- The 15th Finance Commission has been set up in November 2017.
- Its recommendations will be implemented starting 1 April 2020.

Functions of Finance Commission of India:

- Article 280 (3) speaks about the Functions of the Finance Commission.
- The Article states that it shall be the duty of the commission to make the recommendations to the President as to:
 - The distribution between the Union and the States of the net proceeds of Taxes, which may be divided between them and the allocation among the States of the respective shares of such Proceeds;
 - To determine the quantum of grants-In-aid to be given by the centre to states [Article 275 (1)] and to evolve the principles governing the eligibility of the state for such grant-in-aid;
- Any other matter referred to the commission by the President of India in the interest of sound finance.
- Several Issues like debt relief, financing of Calamity relief of states, additional Excise duties, etc.
- Have been referred to the Commission invoking this clause.

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UNIT - VI - INDIAN ECONOMY**

Criteria	14 Finance Commission (2015-2020)	15 Finance Commission (2020-2021)
Income Distance	50.0	45.0
Population - 1971	17.5	-
Population - 2011	10.0	15.0
Area	15.0	15.0
Forest Cover	7.5	-
Forest and Ecology	-	10.0
Demographic Performance	-	12.5
Tax Effort		2.5
Total	100	100

Resource sharing between Union and State Government:

- Federal finance refers to the system of assigning the source of revenue to the Central as well as State Governments for the efficient discharge of their respective Functions i.e. clear-cut division is made regarding the allocation of resources of Revenue between the central and state Authorities.

Division of Powers:

- In our Constitution, there is a clear division of powers so that none violates its limits and tries to encroach upon the functions of the other and functions within own sphere of responsibilities.
- There are three lists Enumerated in the Seventh Schedule of Constitution.
- They are: The Union list, The State list and the Concurrent List.
- The Union List consists of 100 subjects of national importance such as Defence, Railways, Post and Telegraph, etc.
- The State List consists of 61 subjects of local interest such as Public Health, Police etc.
- The Concurrent List has 52 subjects Important to both the Union and the State, such as Electricity, Trade Union, Economic and Social Planning, central State Financial Relationship.

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UNIT – VI – INDIAN ECONOMY**

Union Sources:

- Corporation tax
- Currency, coinage and legal tender, foreign exchange.
- Duties of customs including export Duties.
- Duties of excise on tobacco and certain Goods manufactured or produced in India.
- Estate duty in respect of property other than agricultural land.
- Fees in respect of any of the matters in The Union List, but not including any Fees taken in any Court.
- Foreign Loans.
- Lotteries organized by the Government of India or the Government of a State.
- Post Office Savings Bank.
- Posts and Telegraphs, telephones, Wireless, Broadcasting and other forms of communication.
- Property of the Union.
- Public Debt of the Union.
- Railways.
- Rates of stamp duty in respect of Bills of Exchange, Cheques, Promissory Notes, etc.
- Reserve Bank of India.
- Taxes on income other than agricultural Income.
- Taxes on the capital value of the Assets, exclusive of agricultural land of Individuals and companies.
- Taxes other than stamp duties on Transactions in stock exchanges and Future markets.
- Taxes on the sale or purchase of Newspapers and on advertisements Published therein.
- Terminal taxes on goods or passengers, Carried by railways, sea or air.

State Sources:

- Capitation tax

- Duties in respect of succession to Agricultural land.
- Duties of excise on certain goods Produced or manufactured in the State, Such as alcoholic liquids, opium, etc.
- Estate duty in respect of agricultural Land.
- Fees in respect of any of the matters in The State List, but not including fees Taken in any Court.
- Land Revenue.
- Rates of stamp duty in respect of Documents other than those specified in the Union List.
- Taxes on agricultural income.
- Taxes on land and buildings.
- Taxes on mineral rights, subject to Limitations impose by Parliament Relating to mineral development.
- Taxes on the consumption or sale of electricity.
- Taxes on the entry of goods into a Local area for consumption, use or sale Therein. Taxes on the sale and purchase of Goods other than newspapers.
- Taxes on the advertisements other than those published in newspapers.
- Taxes on goods and passengers carried by road or on inland waterways.
- Taxes on vehicles.
- Taxes on animals and boats.
- Taxes on professions, trades, callings and employments.
- Taxes on luxuries, including taxes on Entertainments, amusements, betting and gambling.
- Tolls.

Taxes Levied and Collected by the Union but Assigned to the States (Art.269):

- Duties in respect of succession to Property other than agricultural land.
- Estate duty in respect of property other than agricultural land.
- Taxes on railway fares and freights.
- Taxes other than stamp duties on transactions in stock exchanges and Future markets.

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UNIT – VI – INDIAN ECONOMY**

- Taxes on the sale or purchase of newspapers and on advertisements Published therein.
- Terminal taxes on goods or passengers carried by railways, sea or air.
- Taxes on the sale or purchase of goods other than newspapers where such sale or purchase taxes place in the course of Inter-State trade or commerce.

Duties levied by the Union but Collected and Appropriated by the States (Art.268)

- Stamp duties and duties of excise on Medicinal and toilet preparation (those Mentioned in the Union List) shall be levied by the Government of India but shall be collected.
 - In the case where such duties are Leviable within any Union territory, by The Government of India.
 - In other cases, by the States within which such duties are respectively leviable.
- Taxes which are Levied and Collected by the Union but which may be Distributed between the Union and The States (Arts.270 and 272)
 - Taxes on income other than agricultural Income.
 - Union duties of excise other than such Duties of excise on medicinal and Toilet preparations as are mentioned In the Union List and collected by the Government of India.
 - “Taxes on income” does not include Corporation tax.
 - The distribution of Income-tax proceeds between the Union and the States is made on the Recommendations of the Finance Commission.

Principles of Federal Finance:

In the case of federal system of finance, the following main principles must be applied:

- Principle of Independence.
- Principle of Equity.
- Principle of Uniformity.
- Principle of Adequacy.
- Principle of Fiscal Access.

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UNIT – VI – INDIAN ECONOMY

- Principle of Integration and Coordination.
- Principle of Efficiency.
- Principle of Administrative Economy.
- Principle of Accountability.
- **Principle of Independence**
 - Under the system of federal finance, a government should be autonomous and free about the internal financial matters concerned.
 - It means each Government should have separate sources of revenue, Authority to levy taxes, to borrow Money and to meet the expenditure.
 - The Government should normally enjoy Autonomy in fiscal matters.
- **Principle of Equity**
 - From the point of view of equity, the resources should be distributed among the different states so that each state receives a fair share of revenue.
- **Principle of Uniformity:**
 - In a federal system, each state should contribute equal tax payments for federal Finance.
 - But this principle cannot be followed in practice because the taxable capacity of each unit is not of the same.
- **Principle of Adequacy of Resources**
 - The principle of adequacy means that the resources of each Government i.e. Central and State should be adequate to carry out its functions effectively.
 - Here adequacy must be decided with reference to both current as well as future needs.
 - Besides, the resources should be elastic in order to meet the growing needs and unforeseen expenditure like war, floods Etc.
- **Principle of Fiscal Access:**
 - In a federal system, there should be possibility for the Central and State Governments to develop new source of Revenue within their prescribed fields to meet the growing financial needs.

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UNIT – VI – INDIAN ECONOMY

- In Nutshell, the resources should grow with the increase in the responsibilities of the Government.
- **Principle of Integration and Coordination:**
 - The financial system as a whole should be well integrated.
 - There should be perfect coordination among different Layers of the financial system of the Country.
 - Then only the federal system will survive.
 - This should be done in such a way to promote the overall economic Development of the country.
- **Principle of Efficiency:**
 - The financial system should be well Organized and efficiently administered.
 - There should be no scope for evasion and Fraud.
 - No one should be taxed more than once in a year.
 - Double taxation should be avoided.
- **Principle of Administrative**
 - Economy is the important criterion of any federal financial system.
 - That is, the cost of collection should be at the Minimum level and the major portion of revenue should be made available for the other expenditure outlays of the Governments.
- **Principle of Accountability**
 - Each Government should be accountable to its own legislature for its financial decisions i.e the Central to the Parliament and the State to the Assembly.

Local Finance:

- Local finance refers to the finance of local bodies in India.
- There is a large Variety of local bodies in India.

We have the following main four local bodies which are functioning today in our country:

Types of Local Bodies:

- Village Panchayats

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UNIT – VI – INDIAN ECONOMY

- District Boards or ZilaParishads
- Municipalities
- Municipal Corporations

Village Panchayats:

Establishment:

- The jurisdiction of A panchayat is usually confined to one Revenue village.
- In some cases, though not very frequently, two or more small Villages are grouped under one panchayat.
- The establishment of panchayat raj is the avowed policy of most states in India.

Functions:

- The functions of panchayats range over a wide area including civil, economic and so on.
- Thus, small disputes may be disposed of by panchayats on the spot.
- Roads, primary schools, village Dispensaries etc.
- Are to be managed by Panchayats.
- The supply of water, both for drinking and irrigation, falls within their field of responsibility, and in some cases Farming, marketing, storage, etc.
- Are entrusted to them.
- Sources of revenue of Village Panchayats the following are the sources of Revenue of village panchayats.
 - General property tax,
 - Taxes on land,
 - Profession tax, and
 - Tax on animals and vehicles.
- Other taxes include service tax, Octroi, theatre tax, pilgrim tax, tax on Marriage, tax on birth and deaths, and Labour tax.
- As a matter of fact, taxes are Levied by the panchayats only with the Sanction of the state government, and there are certain limits in respect of tax Rates which have to be observed.

District Boards or Zila Parishads:

Establishment:

- In rural areas, district Boards or Zila Parishads are established at District level.
- The territorial jurisdiction of a district board is generally a revenue District.

Functions:

- In Tamil Nadu, the Zila Parishad Is a co-ordinating body which exercises General supervision over the working of Panchayat Samitis and advises them on Implementation of Development Schemes.
- Sources of revenue of District Boards
 - Grants-in-aid from the state Government.
 - Land Cesses.
 - Toll, fees etc.
 - Income from the property and loans from the state governments.
 - Grants for the centrally sponsored Schemes relating to development Work.
 - Income from fairs and exhibitions.
 - Property tax and other taxes which the state governments may authorise the district boards.

Municipalities:

Establishment and Functions:

- The Municipalities are bodies or institutions which are established in urban areas for looking after local affairs, such as, Sanitation, public health, local roads, Lighting, water supply, cleaning of streets, Maintenance of parks and gardens, Maintenance of hospitals, dispensaries and veterinary hospitals, provision of drainage, provision of primary education, Organising of fairs and exhibitions Etc.
- However, all these functions are performed subject to the control of the State government.
 - Sources of revenue of municipalities
 - Taxes on property

- Taxes on goods,
- Octroi and terminal tax
- Personal taxes, taxes on profession,
- Trades and employment
- Taxes on vehicles and animals
- Theatre or show tax, and
- Grants-in-aid from state government.

Municipal Corporations:

Establishment and Functions:

- The municipal corporations have Wide powers and enjoy greater freedom as Compared to municipalities.
- The municipal corporations are usually entrusted with the functions, such as, water supply and drainage, lighting, roads, slum clearance, housing and town planning etc.
- The Rapid increase in the population of cities has definitely added to the functions of municipal corporations.

Sources of revenue of Corporations:

- Tax on property,
- Tax on vehicles and animals,
- Tax on trades, calling and employment,
- Theatre and show tax,
- Taxes on goods brought into the cities
- Taxes on advertisements,
- Octroi and terminal tax etc.
- The corporations have a fair degree of freedom in respect of their choice and Modification of these taxes, subject to the Maximum and minimum rates laid down by the law.