CENTRE-STATE FINANCIAL RELATIONS ROAD AHEAD

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ABSTRACT

India, a quasi-federal system divides the power and responsibility between Centre and States with regard to taxation, its' distribution, grant-in-aid and utilization for social schemes.

The main focus of the article is fiscal federalism in social welfare schemes, and new steps or recommendations made in the 14th Finance Commission Report regarding basis of flow or grant of funds to states and distribution of proceeds between states and centre for carrying out different welfare schemes.

INTRODUCTION

The division of power between the union and the state government with respect to finance and property named as financial relation and Article 268 to 293 in part XII of the constitution deals with Centre-State financial relations. Apart from these articles, there are some provisions enlisted in the 7th schedule defining List –I is Union list, List – II is State list and List – III is Concurrent list giving rise power to both Union and State on same subject.[1]

The financial relation between centre and states can be understood through various heads such as –

i) Allocation of taxing powers between centre and states
ii) Distribution of tax revenues between centre and states
iii) Distribution of non-tax revenues
iv) Grant –in-aid to the states
v) Borrowings by the Centre and the States
vi) Finance Commission, Planning Commission and Niti Aayog
vii) Effects of emergencies in Centre-State financial relations
viii) GST Bill
ix) Analysis of social welfare schemes in fiscal federalism – welfare schemes in the field of education, women welfare, employment policies, etc.

ALLOCATION OF TAX POWER BETWEEN CENTRE AND STATES

In a federal system of government, the subject related to taxing power between the centre and the states are divided in three different lists namely, Union list I of VII schedule by Central

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[1] http://www.jstor.org/stable4412238?seq=1#page_scan_tab_contents

government, List II by the State government, however, the subject matter in the Concurrent list III can be taxed by both the Centre and the States.[2]

a) Central Taxes – Entry 82 to 92 B of the List I includes the subject matters on which the Parliament has exclusive power for tax imposition. Such as[3]:
   i) Taxes on income other than agricultural earnings – The Centre can impose tax on all incomes except agricultural income as it is taxable by the state government under entry – 46 of List II. Income includes all profits or gain whether it is of capital nature or revenue nature.
   ii) Custom duty on import and export from the country is taxable by the Central government.
   iii) The Centre is empowered to levy duties of excise on tobacco and other goods manufactured in India except Alcoholic liquor, Opium, Indian hemp and narcotics as taxable by state under entry- 51, List II in form of sales tax.[4]
   iv) Excise duty is restricted on manufactured or produced goods which does not include processed goods.
   v) Centre imposes corporation tax on income payable by companies under article 366(6). E-85, L-I.
   vi) Centre can impose wealth tax i.e total capital value of assets. The taxes will be on capital value of assets exclusive of agricultural land of individual and companies.. E-86.
   vii) Estate duties on property except agricultural land E-87.
   viii) Duties on succession of property (E-88), Terminal taxes on goods or passengers carried by railway (E-89), Taxes on stamp duties on transactions (E-90), taxes on bills of exchange, cheques (E-91).
   ix) Taxes on sale or purchase of newspapers and advertisements published therein (E-92). Taxes on sale/purchase of goods (E-92 A).
   x) Taxes on consignment of goods in inter-state trade (92 B). Taxes on services (92 C). Fees on any matter in the Union list under entry-77 L-I.

State Taxes – The subject matters in the List – II of VII Schedule of the Indian Constitution are covered under state taxation such as –

i) Land revenue including assessment and collection of revenue, maintenance of land records, survey for revenue purposes E-46.
ii) Taxes on agricultural income (E-46), Duties in respect of succession to agricultural income and estate duty on the same (E-47)
iii) Taxes on lands, buildings (E-49), taxes on mineral rights (E-50).

[2] M.P. Jain. Indian Constitutional Law at pg 629, 6th Ed, 2010 Refer Para 3-5
[3] P.M. Bakshi. The Constitution of India, Universal Law, 9th Ed, 2009, 4 Entry 83, List I, 5 Entry 84, List I
[4] Supra N 2, refer pg 631, para 10 & page 632, para 1-3, Supra N 2, refer pg 636, para 6.

iv) Duties of excise on following goods manufactured within the state such as liquor, opium, Indian hemp and narcotic drugs (E-51).
v) Taxes on entry of goods into a local area for consumption, use or sale (E-52). Taxes on consumption or sale of electricity (E-53).
vi) Taxes on sale or purchase of goods (E-54), Taxes on advertisement broadcast by radio or television (E-55).
vii) Taxes on goods and passengers carried by roads or inland waterways (E-56). Taxes on vehicles for use on roads (E-57).
viii) Taxes on animals and boats (E-58), Tolls (E-59).
ix) Taxes on profession, trades, callings and employments (E-60), Capitation taxes (E-61). Taxes on luxuries, entertainments, betting and gambling (E-62).
x) Taxes like Octori tax, entry tax, terminal tax levied by local bodies and the Octori tax is taken by the state only.

Concurrent List Taxes –

The subjects enlisted in the List – III of the VII Schedule which are constituted of the joint domain of State governments or Union territories of India and the Central Government of India for taxation are discussed as under –

i) Taxes on mechanically propelled vehicles (E-42).
ii) Taxes on Stamp duties other than duties or fees collected by means of judicial stamps, excluding rates of stamp duties (E-43).
iii) Taxes or fees in respect of any of the matters in the list but no inclusion of fees taken in any court (E-44).

Distribution of Tax Revenue Between The Centre And The States

The 80th Amendment of 2000 and the 88th Amendment of 2003 have made changes in the scheme of the tax revenue distribution between the Centre and the States.

The 80th Amendment was brought in action by giving effect to recommendations of the 10th Finance Commission. According to the Commission, the total revenue obtained from the Central taxes and duties 29 percent should go to the States. This is known as the Alternate Scheme of Devolution. The 88th Amendment has added a new Article 268 dealing with service tax.

a) Taxes levied by the Centre but collected and appropriated by the States (Article 268). Following duties are collected within a state like Stamp duties on exchanges, cheques, promissory notes, policies of insurance, transfer of shares. Excise duties on medicinal and toilet preparations containing alcohol and narcotics.
b) Service tax levied by the Centre but collected and appropriated by the Centre and the States (Article 268-A). Taxes on services are levied by the Centre but their proceeds are

collected as well as appropriated by both the Centre and the States in accordance of the principles.

c) Taxes levied and collected by the Centre but assigned to the States (Article 269) Following taxes fall under the category –
   i) Taxes on sale or purchase of goods other than newspapers in the course of inter-state trade or commerce.
   ii) Taxes on consignment of goods in the course of inter-state trade.
d) Taxes levied and collected by the Centre but distributed between the Centre and the States (Article 270). Duties and taxes referred to Article 268, 268 –A, Surcharge on taxes and duties referred in Article 271, Any cess levied for specific purposes.
e) Surcharge on certain taxes and duties for purpose of the Union (Article 271) The Parliament can at any time levy the surcharges on taxes and duties referred to Article 269 and 270.

Distribution of Non-Tax Revenues --

The revenue obtained by the government from sources other than tax is called Non-Tax Revenue. The sources are such as –

i) A fee is charged by public authorities for rendering services to the citizens. For example, fees charged for issuing of passports, driving licenses, etc.

ii) Fines or Penalties are imposed for breach of law or for failure to observe some regulations like taxes, fines are compulsory payments without quid pro quo. Though fines are not a major source of revenue for the government.

iii) Surplus from Public Enterprises – The Government of India has set up several public sector enterprises to provide public goods and services, out of which some public enterprises do make a great deal of profits or dividends that are utilized by the government for public expenditure. This happens because the government gets prices and consequently profits from selling goods and services.

iv) Special assessment of betterment levy is a kind of special charge levied on communities who are beneficiaries of certain government activities. For example, due to a public park in community or locality, due to construction of a road.

v) Grants and Gifts are voluntary contributions by individuals or institutions to the government. Gifts are significant source of revenue during war and emergency. A grant from one government to another is an important source of revenue now-a-days.

vi) Deficit Financing – Deficit means an excess of public expenditure over public revenue. This excess may be compensated by borrowings from the market, from abroad, by the central bank creating currency. The government may force various individuals or institutions to lend to it at a much lower rate than the market would have offered.[5]

Distribution of Non-tax Revenues from Centre and States

The Centre – The receipts from following major sources of non-tax revenues of the Centre such as

i) Posts and Telegraphs
ii) Railways
iii) Banking
iv) Broadcasting
v) Coinage and Currency
vi) Central Public Sector Enterprises
vii) Central escheat and lapse

The States – The receipts from the following major sources non-tax revenues of the states. 53

i) Irrigation
ii) Forests
iii) Fisheries
iv) State Public Sector Enterprises
v) State escheat and lapse

Grants-In-Aid To The States

The Constitution of India provides for grants-in-aid to the States from the Central resources besides sharing of taxes between them. Two types of grants-in-aid are statutory grants and discretionary grants. 54

i) Statutory Grants – Article 275 empowers the Parliament to make grants to the states which are in need of financial assistance. These sums are charged on the Consolidated Fund of India every year. Besides, specific grants for promoting the welfare of the scheduled tribes in a state including the state of Assam.
ii) Discretionary Grants – Article 282 empowers both the Centre and the States to make any grants for specific public purpose. Under this category, the Centre makes grants to the states on recommendations of the Planning Commission or reconstituted as NITI Aayog.

[5] M.Lakshmikant, Indian Policy for Civil Services Examination, Mc Grow Hill 4th Ed. 2015, Eighteenth reprint 2015, at pg 14.9, Para 2.

These grants have a two-fold purpose; to help the state financially fulfill plan targets and to give some leverage to the Centre for coordination of state action.

Hence, the Planning Commission (NITI Aayog) has assumed greater significance than the Finance Commission in Centre-State financial relations.

iii) Other Grants – The Constitution also provided another type of grants-in-aid but for a temporary period. It is a grant in lieu of export duties on jute and its products to the states of Assam, Bihar, Orissa, and West Bengal.

Borrowings By The Centre And The States

The executive power of the Centre extends to borrowing upon the security of the Consolidated Fund of India within limits, if any, from time to time may be fixed by the laws of the Parliament and so may be fixed.

Similarly, the executive power of a State extends to borrowing upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be so fixed.

The Government of India may subject to some conditions as laid down by or under any law made by the Parliament.

The Centre can make loans to any state so long as any limits fixed under Article 292 are not exceeded. Any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India.

But a State may not raise any loan without the consent of the Government of India if there is already outstanding of a loan against that state or its predecessor government.

Consent under Article 293(4) may be granted by the Government of India subject to such conditions. If any, as the GOI may think fit to impose.[6]

Recommendations of Different Finance Commissions

With respect to Centre-State borrowing powers the recommendations of the finance commissions are as follow -

i) The 2nd Finance Commission recommended that matters will be simplified and labour and accounts will be saved by consolidation of loans and rationalization of rate of interest or terms of payments.

ii) The 7th Finance Commission recommended – write off of over Rs. 942 crores of Central loans to States, loans in perpetuity, relief in debt-repayment upto Rs. 2155 crores within 5 years.

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[6] http://interstatecouncil.nic.in/sarkariaChapterX.pdf (last accessed on 12 February, 2016)

iii) The 10th Finance Commission mentioned three disturbing features of debt profile – debt funds used for meeting revenue expenditure, loan funds used for unproductive enterprises, for government owned assets no provision for depreciation or amortization of funds leading to repayment of loans out of fresh borrowings.

iv) The 11th Finance Commission recommended for fixing limits on total borrowings, guarantee by Centre to States.

v) The 12th Finance Commission said each state must enact a fiscal responsibility legislation prescribing specific annual target to eliminate revenue deficit or reducing fiscal deficit on basis of reduction of borrowings and guarantees.

vi) The 13th Finance Commission said the share of market borrowing of the states should be increased from low proportion of about 15% to 33.33% and then steadily to 50% within a period of five years.[7]

vii) The 14th Finance Commission said in light of risks arising from guarantees, off-budget borrowings and accumulated losses of financially weak public sector enterprises while assessing the debt position of states, both the centre and state governments should adopt a template for collating, analyzing and annually reporting the total extended public debt in respective budgets as a supplement to the budget document.[8]

Conclusion

The Constitutional provisions control the financial relations between the Centre and the States. The income sources of the Central Government are mentioned in the Union list such as income tax, agriculture income, customs and excise duty.

The income sources of the State government are mentioned in the State list like land revenue, taxes on vehicles, sales tax etc.

On the other hand, there are certain taxes which are levied by the Centre but are collected and appropriated by the States. These taxes are stamp duties and duties of excise on medicinal and toilet preparations.

Besides, there are some substantive provisions such as Article 280 dealing with constitution of a Finance Commission for the distribution of revenue between the Centre and the States.

However, 73rd and 74th Amendments explain that there is a provision for the constitution of the Consolidated Fund of the state from which resources are to be provided to the village, Panchayats and Municipalities.

According to Article 360, during the proclamation of financial emergency, the President of India can give financial directives to the States. The Centre can supplement the financial resources for

[7] http://cpim.org/marxist/200802_marxist_cpim-13-finance%20commission.pdf(last accessed on 11 March 2016)

[8] http://iksa.in/gs3/14th-finance-commission-summary-of-recommendations-2044(last accessed on 16 January, 2016)

the states through two other means besides distribution of tax revenues. These are such as
i) Advancement of Central loans.
ii) Grants-in-Aid given to the States.

After the liberalization, the Centre has acquired more importance in developing industries and enhancing the economic growth of the country. In this endeavor the present Central Government has taken a step ahead through the development of means of communication for bringing in the balanced and rapid economic growth and stability.