15th Finance Commission and recommendations

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Why is it in the news?

- The 15th Finance Commission (Chair: Mr N. K. Singh) was required to submit two reports. The first report, consisting of recommendations for the financial year 2020-21, was tabled in Parliament. The final report with recommendations for the **2021-26 periods will** be submitted by October 30, 2020.

What is the Finance Commission?

- The Finance Commission is a constitutionally mandated body that is at the centre of fiscal federalism. Set up under **Article 280** of the Constitution, its core responsibility is to evaluate the state of finances of the Union and State Governments, recommend the sharing of taxes between them, lay down the principles determining the distribution of these taxes among States.
- The Fifteenth Finance Commission was constituted on 27 November 2017 against the backdrop of the abolition of Planning Commission (as also of the distinction between Plan and non-Plan expenditure) and the introduction of the goods and services tax (GST), which has fundamentally redefined federal fiscal relations.

Recommendations of the Finance Commission

- The share of states in the centre's taxes is recommended to be decreased from 42% during the 2015-20 periods to 41% for 2020-21. **The 1% decrease is to provide for the newly formed union territories of Jammu and Kashmir, and Ladakh** from the resources of the central government.

- Criteria for devolution: –**Income distance-45%; Population (2011)-15%; Area-15%; Forest and Ecology-10%; Demographic performance-12.5%; Tax Effort-2.5%.**
- (Income distance is the distance of the state's income from the state with the highest income. The income of a state has been computed as average per capita GSDP during the three-year period between 2015-16 and 2017-18. States with lower per capita income would be given a higher share to maintain equity among states.
- The Demographic Performance criterion has been introduced to reward efforts made by states in controlling their population. It will be computed by using the **reciprocal of the total fertility ratio of each state, scaled by 1971 population data.**
- Tax effort has been used to reward states with higher tax collection efficiency. It has been computed as the **ratio of the average per capita own tax revenue and the average per capita state GDP** during the three-year period between 2014-15 and 2016-17)
- The Commission observed that financing capital expenditure through off-budget borrowings detracts from compliance with the FRBM Act. It recommended that both the central and state governments should make **full disclosure of extra-budgetary borrowings**. The outstanding extra-budgetary liabilities should be clearly identified and eliminated in a time-bound manner.
- The Commission highlighted some challenges with the implementation of the Goods and Services Tax (GST). These include: (i) large shortfall in collections as compared to original forecast, (ii) high volatility in collections, (iii) accumulation of large integrated GST credit, (iv) glitches in invoice and input tax matching, and (v) delay in refunds.