Inter-State Variations in Central Tax Distribution

For Prelims: 15th Finance Commission, Central Tax Distribution, Horizontal equity, Article 280 of the Constitution.

For Mains: Taxes Distribution Among States, Recommendations of 15th Finance Commission.

Why in News?

Critics argue that the **15th Finance Commission** formula is skewed in favour of some states, resulting in wide **inter-state variations.**

- **Tamil Nadu gets back only 29 paise for every one rupee it gives to the Centre**, while **Uttar Pradesh gets ₹2.73** and **Bihar gets back ₹7.06.**

How Taxes are Distributed Among States?

- **About:**
    - The **Centre collects taxes from states and distributes it among them based** on the **Finance Commission's (XVFC) formula.**
- **XVFC Formula:**
    - The **XVFC** formula is based on each state's needs (**population, area and forest and ecology**), equity (per capita income **difference**), and performance (**own tax revenue and lower fertility rate**).
- **Weightage:**
    - Needs are given **40% weightage, equity 45%**, **and performance 15%.**
    - The XVFC introduced the **fertility rate component to reward states** that have reduced fertility levels, but this has a **lower weightage than equity and needs.**
- **Arguments:**
    - Critics argue that this formula **favours some northern states**, as the population is given higher weightage.
        - The southern states' share has **consistently declined in successive Finance Commissions.**
    - Some argue that transfers enable a state to provide comparable levels of services and ensure **horizontal equity.**
        - However, others contend that the **formula should not adversely impact a state's efficiency and progress.**

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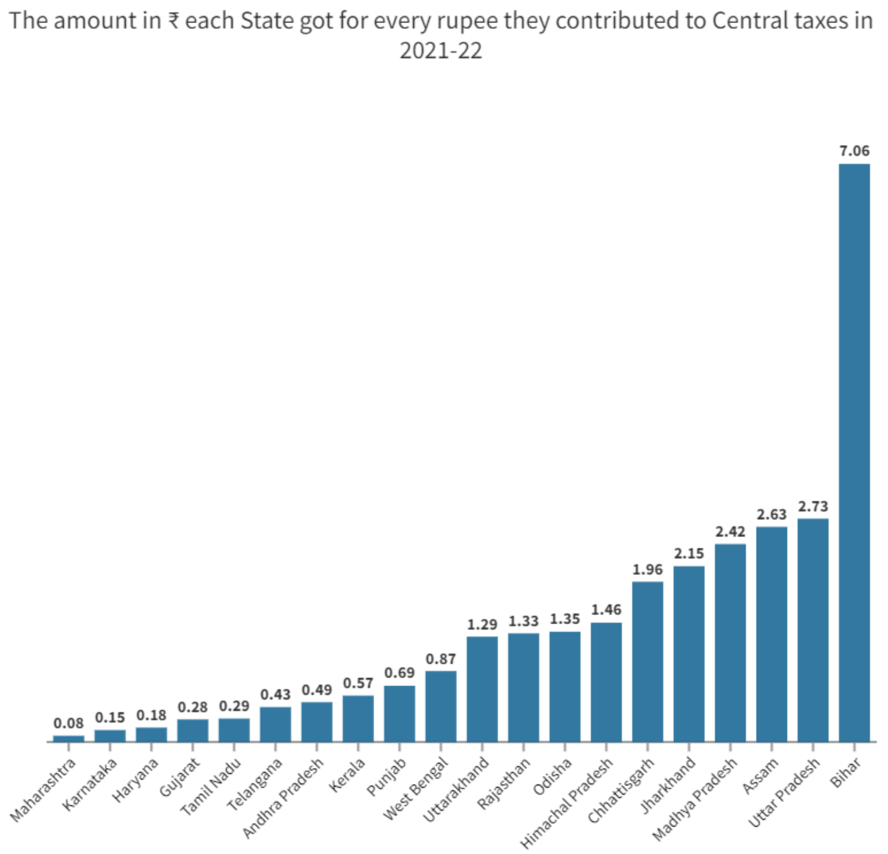

What is the 15th Finance Commission?

- **About:**
  - The **Finance Commission (FC)** is a constitutional body that determines the **method and formula for distributing the tax proceeds between the Centre and states**, and among the states as per the constitutional arrangement and present requirements.
- **Constitutionality:**
  - Under **Article 280 of the Constitution**, the **President of India** is required to constitute a **Finance Commission** at an interval of five years or earlier.
- **15th Finance Commission**
  - The **15th Finance Commission** was constituted by the President of India in November 2017, under the chairmanship of **NK Singh.**
  - Its recommendations will cover a period of five years from the year **2021-22 to 2025-26.**
    - The government accepted the **15th Finance Commission's recommendation** to **maintain the States' share in the divisible pool of taxes to 41%** for the **five-year period starting 2021-22.**

UPSC Civil Services Examination, Previous Year Question (PYQ)

Q. How have the recommendations of the 14th Finance Commission of India enabled the States to improve their fiscal position? **(2021)**

Source: TH