



PART V  
THE UNION

# CENTER STATE RELATIONS

## Doctrine of territorial nexus

- The state legislature in general has no authority to create laws for extra-territorial operations. This limitation on the state legislature, though, is subject to one exception, called the doctrine of territorial nexus.
- If it is known that the entity is **adequately connected** to the territory of the state the laws passed by the state legislature would have an effect beyond the geographical borders of the state.

To invoke this doctrine, 2 conditions must be satisfied:

- 1) Such an entity must have extra-territorial operations in the state.
- 2) The entity and the territory of the state must have a valid nexus

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## **Exceptions to the territorial jurisdiction of laws made by the Parliament:**

- a. With respect to some of the UTs, such as the Andaman and Nicobar Islands, Lakshadweep, etc (A-240) regulations may be made by the President for the peace, progress and good government
- b. Under schedule V, the Governor of a state may restrict or modify the application of Parliamentary laws to the scheduled areas.
- c. Under schedule VI, the Governor of Assam by a public notification may declare that an Act of Parliament shall not apply to an autonomous district or apply with such modifications as specified in the notification. Similar powers have been vested to President with respect to autonomous districts and regions in Meghalaya, Mizoram and Tripura
- d. Under 371A and 371G, a law relating to certain matters would be applicable in the State of Nagaland and Mizoram only if approval has been provided by Naga state Assembly and the Mizo State Assembly respectively.

# CENTER STATE RELATIONS

## The doctrine of pith and substance

- Pith- nature, substance- essential part
- The doctrine places emphasis on the fact that it is the real subject matter which is to be challenged and not its incidental effects on another field.
- Pith denotes the 'essence of something' or the 'true nature', while substance states 'the most significant or essential part of something.'
- Hence, it can be stated that the very doctrine of pith and substance relates to finding out the true nature of a statute.

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## The doctrine of pith and substance

- Situations in which the doctrine is applied— It is applied in the circumstances where the subject matter of list I seem to be conflicting with the subject matter of list II.
- The reason behind adopting the doctrine— The powers of the legislature would be sternly limited if every law is declared invalid on the ground that it encroaches upon another law.
- Provision for a degree of flexibility— It takes under consideration the fact as to whether the state has the power to make a law that involves a subject mentioned in the Union List of the constitution.
- The first judgment which upheld the doctrine— It was in the case of State of Bombay v. F. N Balsara that the doctrine was first applied.

# CENTER STATE RELATIONS

## Doctrine of colorable legislation

- It is based on the maxim that “what cannot be done directly, cannot also be done indirectly”.
- This doctrine of colorable legislation is applied when a Legislature does not have the right to make law upon a particular subject but indirectly makes one.
- The Court has laid down certain tests for discovering whether any particular Act constitutes colorable legislation.

# CENTER STATE RELATIONS

## The doctrine of harmonious construction

- This rule is used to avoid any inconsistency and repugnancy within a section or between a section and other parts of a statute.
- The rule follows a very simple premise that every statute has a purpose and intent as per law, and should be read as a whole.
- The interpretation which is consistent with all the provisions and makes the enactment consistent shall prevail.
- The doctrine follows a settled rule that an interpretation that results in injustice, hardship, inconvenience, and anomaly should be avoided.

# CENTER STATE RELATIONS

## Issues in legislative relations

- Some States have expressed reservation to the existing system of division of legislative powers and sought a fresh look. Over a period of time, they felt, the Union has enriched its powers at the cost of the States.
- States have also expressed concerns over transfer of entries from List II to List III
- Bills reserved for president's considerations limit the role of state legislatures
- Invoking article 253 without consultation with the states



# CENTER STATE RELATIONS

## Recommendations of Sarkaria Commission:

- Resolve the issues of concurrent jurisdiction with mutual consultation.
- On a concurrent subject, the Union should enact only that legislation where they feel that uniformity of policy is required.
- Prior to enacting legislation on the concurrent list, Parliament should consult the States.
- The views of the State and Inter-State council should be taken when the bill is presented in Parliament.
- Except for matters related to taxation, residuary powers should be placed in the Concurrent List.

# Different Types of Funds

## Consolidated Fund

- It includes all the revenues received by the Government, receipts of interests and repayment of the loans given by the Government, and all the advances or new loans raised by the Government.
- All the expenditures of the Government are met through the Consolidated Fund except in cases of unforeseen circumstances.
- Further, no amount of money can be taken out of consolidated funds by the Government without the authorization from the parliament

# Different Types of Funds

## Public Account

Public Account of India or State shall constitute of all the other public revenue obtained by the Government of India or the Government of State, or on the behalf of the Government. Such money received as the case may be either included in the public account of India or in the public account of the state.

It basically includes certain specific transactions, such as small saving collections, provident funds, etc. In the case of public funds, the Government is performing the duty similar to a banker as the funds kept in the Public Account does not belong to the Government, and the Government will have to pay back this money in future to the persons and authorities who have deposited it. Therefore, there is no requirement of obtaining any authorization from the parliament before withdrawing money from the public account.

# Different Types of Funds

## Contingency Fund

As per article 267, the Parliament or State legislature by law may constitute a contingent fund for the purpose of meeting urgent or unforeseen circumstances fund titled as the "Contingency Fund of India"/State.

The fund is in a form of imprest. The fund is under the disposal of the President of India and it does not require any prior sanction or approval from the Parliament. Though afterwards, the expenditure needs to be authorised by the Parliament under Article 115 or Article 116.

Further, with the approval of the parliament, the Government has to replenish the contingency fund by drawing out an equal proportion of sum from the consolidated fund. Present limit of contingency fund is Rs.30,000 crore

The Contingency Fund of India exists for disasters and related unforeseen expenditures.

# Financial Relations between Center and states

## Fiscal Imbalance between Center and States

- 15th Finance Commission noted that the states had only 37.3% of the resources but were responsible for 62.4 % of the expenditure. Most of the expenditure-intensive subjects are with the states.
- The number of subjects for taxation is considerably more in the case of the Union when compared to the states.
- Subjects under the consideration of the Union are more elastic in nature. Therefore, with the growth of the economy, a natural increase is witnessed in the Center's tax collection.
- Union has powers to impose cess and surcharges, that it does not share with the states.
- States cannot borrow money from outside of India and in case a state owes a loan repayment to the center, it cannot raise more money without the permission of the Union.
- States have been reluctant to utilize their taxation powers properly including agriculture.

Cess is tax on tax and is applied only for health, education and infrastructure.  
Surcharge is applied on 50lakh or more annual income.

# Financial Relations between Center and states

## Article 268- Duties levied by the Union but collected and appropriated by the State

It includes stamp duties on bills of exchange, cheques and promissory notes as levied by the Government of India.

### Which fund does this collection go to?

These taxes are not included in the consolidated fund of India and appropriated by the same state in which it was levied. In the case of Union territories the fund shall be appropriated to the Government of India.

All the decisions regarding levying and appropriation of these duties rest with the central government as it forms a part of the union list.

# Financial Relations between Center and states

## Article 269 Taxes levied and collected by the Union but assigned to the States

Includes all the taxes on the “sale or purchase of goods” and “taxes on the consignment of goods” except those included in Article 269 A.

- 1) The expression “taxes on the sale or purchase of goods” does not imply on all kinds of trade but essentially refers to the taxes that are levied on inter-state sale or purchase of all kinds of goods except newspapers.
- 2) The expression “taxes on the consignment of goods” refers to tax duty levied on the consignment of goods when happening in the course of Inter-state trade. It includes both the cases even when the consignment is to the person making it or to any other person.

# Financial Relations between Center and states

## Article 269-A Levy and Collection of Goods and Services Tax in Course of Inter-State Trade or Commerce

- The Goods and Services Tax (GST) on supplies in the course of inter-state trade or commerce are levied and collected by the Centre.
- But, this tax is divided between the Centre and the States in the manner provided by Parliament on the recommendations of the GST Council.

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# Financial Relations between Center and states

## Article 270- Taxes levied and collected by the Union and distributed between the Union and the States

It may include taxes such as:

- Excise Duty on Non-GST products, Income Tax, Basic Customs Duty etc.

These transfers are:

- (i) Determined through a formula proposed by the Finance Commission;
- (ii) Unconditional; and
- (iii) Not designed to affect any expenditure or other preference at the subnational level.

Post the introduction of the Goods and Services Tax (GST), Articles 270(1-A) and 270(1-B) were added by way of amendments, to include the amounts collected and apportioned to the Union under GST in the above pool

Fourteenth Finance Commission had recommended that 42% of the divisible pool will be distributed to the states as an unconditional transfer

# Financial Relations between Center and states

## Article 271 – Surcharge on certain duties and taxes for purposes of the Union

1. Parliament has the power to increase any duty or tax anytime by levying a surcharge except in the case of GST mentioned under Article 246A.
2. All the proceeds obtained from the surcharges will be part of the consolidated fund of India.
3. The Article has its basis in the Government of India Act, 1935.
4. Further, no authority has the power to prevent the Parliament from imposing a surcharge

# Financial Relations between Center and states

## Article 275 – Statutory grants also called as Post Devolution Revenue Deficit Grant

These grants are given from the CFI as determined by the Parliament on the recommendation of Finance Commission to the specific states who are in need of assistance.

1. Under this, different amounts of grants are fixed for different states. The eligibility of States to receive this grant and the quantum of grant is decided by the Commission based on the gap between assessment of revenue and expenditure of the State. Grants are primarily intended to correct Inter-State disparities in financial resources and to coordinate the maintenance and expansion of the welfare schemes of the State Governments on a uniform national level. Can be conditional or unconditional, since there is no specific constitutional specification. Can be given for capital or revenue grants, and there is nothing to prevent conditions from being imposed on any such grants.
2. There are two provisos to clause (1) dealing with grant of aid to states to meet the costs to the states for any developmental scheme approved by the government of India for the welfare of scheduled areas and scheduled tribes, with a special focus on Assam. In these matters recommendations of Finance Commission are not to be followed.

# Financial Relations between Center and states

## Article 282- Discretionary Grants

It empowers both the Centre and the states to make any grants for any public purpose, even if it is not within their respective legislative competence.

Under this provision, the Centre makes grants to the states. These grants are known as discretionary grants, the reason being that the Centre is under no obligation to give these grants and the matter lies within its discretion.

The centre used to make these grants on the recommendations of the planning commission. Further, during the planning commission era, the sum under discretionary grants were even bigger than the statutory grants

## Serves the following purpose:

1. To help the state financially to fulfil plan targets;
2. To give some leverage to the Centre to influence and coordinate state action to implement the national plan.

# Financial Relations between Center and states

CSS :- Centrally sponsored scheme

NDC:- National development council

## Concerns with Discretionary Grants

- According to the Budget for 2021-22, up to 23 per cent of the total fiscal transfers to states are were through the route of CSS.
- Inhibits states from exercising policy priorities over subjects that are constitutionally within their legislative and executive domain.
- Transfers are discretionary and non-transparent in terms of how they have been formulated.
- States are required to match a high proportion of the CSS grant, as well as maintain it thereafter, increasing its fiscal burden
- After the dissolution of Planning Commission and the NDC, CSSs are made and effected by concerned ministries of the central government

The 15th Finance Commission has expressed concern over CSSs prevalent in health care and education which have the effect of offsetting the advantages of Article 275 grants.

- Attempts have been made to reduce and consolidate existing CSS. At present, the number of CSS stands at twenty eight following the recommendations regarding the rationalisation of CSS published by Niti Aayog in 2015.

# Financial Relations between Center and states

## The other side of discretionary grants

- Attempts have been made to reduce and consolidate existing CSS. At present, the number of CSS stands at twenty eight following the recommendations regarding the rationalisation of CSS published by Niti Aayog in 2015.
- However, despite the controversy surrounding the schemes, CSS play an important role in fiscal transfers, as they are designed to promote important national development goals, such as that of education, health, employment, literacy and poverty alleviation.

## Conclusion

- CSS implementation should be improved by ensuring better monitoring mechanisms
- Should be flexible enough to allow innovation by the states

# Financial Relations between Center and states

## Grants to local bodies

- The Thirteenth Finance Commission recommended that a percentage of the divisible pool be set-aside for local bodies and be given to them as a grant-in-aid under Article 275
- However, the Fourteenth Finance Commission suggested a fixed grant under Article 275, taking a view that the Constitution did not permit the Finance Commission to make grants through local bodies through devolution. It recommended for the grants to local bodies to be made in the form of a fixed/basic grant (90% of the grant), and a performance-based grant (10% of the grant). For Municipalities this figure is 80:20

# Financial Relations between Center and states

## **Article 279 A- GST Council**

Empowers the president of India to constitute a Council named Goods and Services Tax Council (GST Council) within 60 days after the commencement of the 101st Constitution Amendment Act, 2016.

## **Objective**

It shall seek to ensure a uniform system of GST to avoid any conflict or confusion, and the development of a harmonized national market for goods and services.

## **Process of Decision-making**

The decision shall be taken by at least three- fourth majority out of which:

- The vote of the Central Government will have one-third of the weightage.
- The vote of all the State Governments shall account for two-third of weightage.



# Financial Relations between Center and states

## Finance Commission ( [Article-280](#) )

The Constitution recognizes that the assigned revenue powers are inadequate to meet expenditure responsibilities of the state governments and provides for the mechanism to transfer funds from the Union to state governments by way of tax devolution and grants in aid. To effect the transfers on an objective basis, the Constitution provides for the appointment of the Finance Commission every five years

The composition of Finance Commission is mentioned under the **Finance Commission Act, 1951** which when read with provisions of **Article 280** lays down that the Commission basically consists of five members out of which there will be one Chairman, as appointed by the President of India. The criteria for selection of the Chairman is that he/she should have a special understanding of public affairs while the members shall possess the following qualifications:

1. He/she may be either a judge of a High Court or qualified enough to be appointed so.
2. He/She must have deep knowledge of the finance and accounts of the Government.
3. He/She must be experienced in the field of financial matters and in administration; or
4. He/ She must have a special understanding of economics.

# Financial Relations between Center and states

## Significance of the Finance Commission

1. Finance Commission has played an imperative role in strengthening and improvising the fiscal federal structure of India.
2. Union Government has also been receptive towards the recommendations of the Finance Commission and accepted them at large.
3. The Commission along with giving recommendations on the subjects already mentioned has also suggested and gave its views regarding various other financial issues such as returns of the public undertakings, debt burdens of the States.
4. It has also settled many complicated financial issues from time to time-related to financial issues between the Union and States.

# Financial Relations between Center and states

## Criticism of the Finance Commission

1. Ad-hoc body and no concept of institutional memory
2. No mechanism with the Finance Commission to determine if the state has made any efforts to raise their revenues.
3. Data quality is a major concern w.r.t functioning of the Finance Commission
4. Criteria for vertical distribution has varied from one commission to other

## Conclusion

Thus, all in all, the Finance Commission has been successful in bringing dynamic and progressive changes in the financial relations between the Centre and the States as per the changing time. However, there still have been demands from the states that more resources must be allocated to poor states than rich states in order to level inter-regional financial disparities.

# Financial Relations between Center and states

## 15<sup>th</sup> Finance Commission

1. It has recommended maintaining the vertical devolution at 41% - the same as in its interim report for 2020-21.
2. For horizontal devolution, it has suggested 12.5% weightage to demographic performance, 45% to income, 15% each to population and area, 10% to forest and ecology and 2.5% to tax and fiscal efforts.
3. The number of states qualifying for the revenue deficit grants decreases from 17 in FY22, the first year of the award period to 6 in FY26, the last year.
4. Performance-based grants for incubation of new cities and health grants to local governments. In grants for Urban local bodies, basic grants are proposed only for cities/towns having a population of less than a million.
5. For Million-Plus cities, 100% of the grants are performance-linked through the Million-Plus Cities Challenge Fund (MCF). MCF amount is linked to the performance of these cities in improving their air quality and meeting the service level benchmarks for urban drinking water supply, sanitation and solid waste management.

# Financial Relations between Center and states

## 15<sup>th</sup> Finance Commission

6. The 15th FC has also accepted the Centre's suggestion to set up a non-lapsable dedicated fund to support defence and internal security modernisation. While a major part of the fund will be funded from the Consolidated Fund of India, rest of the amount will be generated from measures such as disinvestment of defence public sector enterprises, and monetisation of defence lands.

7. Not acceded to the demand of the States that they be permitted to borrow larger sums to meet their immediate fiscal strain, and do so without being subjected to conditions.

8. Primary healthcare expenditure should be two-thirds of the total health expenditure by 2022. Centrally sponsored schemes (CSS) in health should be flexible enough to allow states to adapt and innovate. Focus of CSS in health should be shifted from inputs to outcome. All India Medical and Health Service should be established.

# Financial Relations between Center and states



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# Financial Relations between Center and states

## **Borrowing power of the Central Government**

The Central Government has almost unlimited powers in terms of borrowing. The law imposes no restrictions on the Centre in relation to both national and international borrowing. It is subject to only some restrictions which are to be fixed by the parliament by the law (Article 292).

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# Financial Relations between Center and states

## Borrowing Power of the State Government

In India, the borrowing powers enjoyed by the state government are much less in comparison to the Central Government. As there are various kinds of territorial and other limitations on the borrowing powers of the state.

The Indian States are not allowed to raise loans outside India and only have the option to raise loans either from the Government of India or through public loans. But essentially speaking, it is a very difficult and lengthy process for the State to raise a public loan, as it essentially needs a prior consent of the Government of India which cannot be issued if a part of a loan advanced to the State by the Union government or any guarantee in respect to it is still outstanding.

This leaves the States having no independent borrowing powers. It compels the states to comply with numerous conditions resulting in extreme dependence on the Central Government's permission to obtain loans from the public, financial institutions or from the Centre itself.

Therefore this inequitable distribution in borrowing power is still an issue and a prime concern which needs to be addressed keeping in mind the changing dynamics of the financial relations between the States and the Centre.



# Financial Relations between Center and states

## Way Ahead

Undoubtedly we can say that no state can afford to work without the active financial assistance of the central government. It is also an undeniable fact that Indian states do enjoy relatively a lower degree of economical independence as the dependence on the Centre is indeed much greater than any other federations in the world which can also be substantiated by considering the following points:

- First and foremost, that state does not have power under the constitution to obtain any foreign assistance and any foreign assistance which is quite massive is channelised through the central government. So any decision regarding allocation of such assistance rests in the hands of the Union Government.
- Secondly, there is no provision in the constitution which enables the states to sign any agreement with any international agency or organisation.
- Thirdly, the Central Government has the power to bring any subject from the State to the concurrent list thereby depriving the former of many of its financial resources.

*“Magic is believing in yourself. If you can make that happen, you can make anything happen.”*



THANKS!

Any questions?

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