**2 Main Sources of Government Revenue in India**

The following points highlight the two main sources of government revenue in India.

A. **Tax Revenue:**

* Union Excise Duties:

They are, presently, by far the leading source of revenue for the Central Government and are levied on commo­dities produced within the country, but exclu­ding those commodities on which State excise is levied (viz., liquors and narcotic drugs).

The most important commodities from the revenue point of view are sugar, cotton, mill cloth, tobacco, motor spirit, matches and cement.

* Customs:

Customs duties include both import and export duties. These are the second-most important source of revenue for the Central Government.

* Income Tax:

Income tax is at present another important source of revenue for the Central Government. It is levied on the incomes of individuals, Hindu undivided families and unregistered firms.

* Corporation Tax:

The income-tax on the net profits of joint stock companies is called corporation tax.

* Wealth Tax:

It is an annual tax on the net wealth of individuals and Hindu undivided families. It is a progressive tax.

* Gift Tax:

It is a tax on gifts of property by an individual in his lifetime to future succe­ssors.

* Capital Gains Tax:

It is applicable to capital gains resulting from the sale, exchange or transfer of capital assets.

* Hotel Expenditure Tax:

Recently, a new tax has been levied on those who patronise high class hotels.

* Tax on Foreign Travel:

Another new tax levied on foreign travel for conserving foreign exchange as well as to raise revenue.

B. **Non-Tax Revenue:**

* Interest Receipts:

This largest non-tax source of Central Government’s revenue receipts is the interest it earns mainly on the loans it has advanced to State Governments, to financial and industrial enterprises in the public sector.

* Surplus Profits of the Reserve Bank of India (RBI):

The surplus profits of the RBI is also a part of the revenues of the Central Government. In recent years, these have been quite substantial because of the large borro­wing by the Government from the RBI against Treasury Bills for financing the Five-Year Plans.

* Currency, Coinage and Mint:

The Govern­ment also derives income from running the Currency Note Printing Presses. Moreover, profits are made from the circulation of coins — this profit being the difference between the face value of the coins and their manu­facturing cost.

* Railways:

The railways in India are owned and run by the Government of India. Accor­dingly, they pay a fixed dividend to general revenues, i.e., to the Central Government, on the capital invested in the railways. Besides, a part of the net profits made by the railways is also payable to the Central Government.

* Profits of Public Enterprises:

Public enter­prises owned by the Central Government, e.g., the Steel Authority of India (SAIL), Hindustan Machine Tools (HMT), Bharat Heavy Electricals Ltd. (BHEL), State Trading Corporation (STC). The profits of such Public Sector Units (PSUs) are another source of revenue for the Government of India.

* Other Non-Tax Sources of Revenue:

The main source among them is the Departmental Receipts of the various ministries of the Cen­tral Government by way of fees, penalties, etc.

----------------------------------------------------------------------------------------------------------------

**Source of Revenue for Central Government**

* **Source of Tax Revenue for Central Government**:  
  It includes taxes on certain items mentioned in the Union List of the seventh schedule and others.
* **Source of Non Tax Revenue for Central Government. It includes**

Borrowings

Income of government undertaking

Income for government properties

Interest earning on loans and advances

Gifts, donations, grants and aid, etc.

Fees (excluding court fees other than the supreme Court.

**Source of Revenue for State Government**

* **Source of Tax Revenue for State Government**:

Taxes on the items contained in the State List of the seventh Schedule of the Constitution which includes land revenue, taxes on agriculture income, sales tax, etc.

* **Source of Non Tax Revenue for Sate Government:**

It includes

Fee taken in all courses except Supreme Court

Income of government undertakings

Income from State owned property

Borrowings

Royalty from mines, forests, etc.

Grants in Aid.

**TAX STRUCTURE IN INDIA**

tIndia **offers a well-structured tax system for its population.** Taxes are the largest source of income for the government. This money is deployed for various purposes and projects for the development of the nation.

* Taxes are determined by the Central and State Governments along with local authorities like municipal corporations. The government cannot impose any tax unless it is passed as a law.

Here are the salient features of the tax system in India:

1. **Role of the Central and State Government**

* The entire system is clearly demarcated[set **limits or boundaries]** with specific roles for the central and state government.
* The Central Government of India levies taxes such as customs duty, income tax, service tax, and central excise duty.
* The tax structure in India empowers the state governments to levy income tax on agricultural income, professional tax, value added tax (VAT), state excise duty, land revenue and stamp duty. The local bodies are allowed to collect octroi[**toll gate]**, property tax, and other taxes on various services like drainage and water supply.

**2. Types of taxes**

Taxes are classified under two categories namely **direct and indirect taxes**. The largest difference between these **taxes is their implementation**.

* Direct taxes are paid by the assesse[**individual]** while indirect taxes are levied on goods and services.

**Direct taxes**

[Direct taxes](http://www.hdfclife.com/insurance-knowledge-centre/taxation-in-india/direct-tax) are **levied on individuals and corporate entities** and **cannot be transferred to others.** These include income tax, wealth tax, and gift tax.

* **Income tax**
* **As per the Income Tax (IT) Act, 1961** every assessee **whose total income exceeds the maximum exempt limit is liable to pay this tax.**
* The **tax structure and rates a**re annually prescribed by the **Union Budget.** This tax is imposed during each assessment year, which commences on 1st April and ends on 31st March.
* The total income is calculated from various heads such as business and profession, house property, salaries, capital gains, and other sources.
* The assesses are classified as individuals, **Hindu Undivided Family (HUF), association of persons (AOP), body of individuals (BOI), company, firm, local authority**, and artificial judiciary not falling in any other category.
* **Wealth tax**
* This is levied under the Wealth Tax Act, 1957 and is payable every year for benefits derived from the **ownership of property.**
* It is calculated on the market value of the owned property. Assesses are required to pay wealth tax even if the property does not yield any income.
* **Individuals, HUF, and companies are liable to pay wealth tax based on their residential status**.
* **Gift tax**
* According to the Gift Tax Act**, 1958**, individuals receiving monetary gifts or valuables were liable to pay a 30% tax.
* However, this was abolished in 1998 and gifts **received from family members are no** longer liable for such tax.
* However, gifts exceeding a value of INR 50,000 received from any entity other than family members and exempt individuals are taxable according to the new guidelines.
* **Corporate Tax:** Paid by companies and corporations on their profits.
* **Estate Duty:**Paid by an individual in case of inheritance.

**Indirect taxes**

[**Indirect taxes**](http://www.hdfclife.com/insurance-knowledge-centre/taxation-in-india/indirect-tax)**are not directly paid by the assessee to the government authorities. These are levied on goods and services and collected by intermediaries** (those who sell goods or offer services). Here are the most common indirect taxes in India.

* **Value Added Tax (VAT**)

This is levied by the state government and was not imposed by all states when first implemented. Presently, all states levy such tax. It is imposed on goods sold in the state and the rate is decided by the state authorities.

* **Octroi and customs duty**

Imported goods brought into the country are charged with customs duty. Similarly, goods that move from one state to another are liable to octroi charges. This tax is levied by the respective state governments.

* **Excise duty**

**All goods produced domestically are charged with excise duty**. Also known as Central Value Added Tax (CENVAT), this is paid by the manufacturers.

* **Sales Tax:**Paid by a shopkeeper or retailer, who then shifts the tax burden to customers by charging sales tax on goods and services.
* **Service Tax:** Charged on services rendered to consumers, such as food bill in a restaurant

----------------------------------------------------------------------------------------------------------------

**Other government bodies**

The Central Board of Revenue, the apex administrative body established in 1924 was split into Central Board of Excise and Customs (CBEC) and Central Board of Direct Taxes (CBDT) in January 1964.

* **CBEC**

It is **part of the Department of Revenue under the Finance Ministry**. It helps formulate policies for the levy and collection of customs and central excise duty as well as service tax.

* **CBDT**

This body provides inputs for direct taxation in India. It is responsible for administering laws through the Income Tax department.

* CBDT is a statutory body comprising a chairman and six members functioning under the Central Board of Revenue Act, 1963.

The Indian tax system has witnessed several modifications over the years. There has been standardization of [income tax rates](http://www.hdfclife.com/insurance-knowledge-centre/latest-income-tax-slab-and-deductions/) with simpler governing laws enabling common people to understand the same. This has resulted in ease of paying taxes, improved compliance, and enhanced enforcement of the laws.

----------------------------------------------------------------------------------------------------------------

**Difference between Direct and Indirect Taxes**

1. Direct taxes include the taxes that cannot be transferred or shifted to another person, for instance the income tax an individual pays directly to the government. In this case, the burden of the tax falls flatly on the individual who earns a taxable income and cannot shift the tax to others.

Indirect taxes, on the other hand, are taxes which can be shifted to another person. An example would be the Value Added Tax (VAT) that is included in the bill of goods and services that you procure from others. **The initial tax is levied on the manufacturer** or service provider, **who then shifts this tax burden to the consumers** by charging higher prices for the commodity by including taxes in the final price.

1. Direct tax is levied and paid for by individuals, Hindu undivided Families (HUF), firms, companies etc. whereas indirect tax is ultimately paid for by the end-consumer of goods and services.
2. Lack of administration in collection of direct taxes can make tax evasion possible, while indirect taxes cannot be evaded as the taxes are charged on goods and services.
3. Direct tax can help in reducing inflation, whereas indirect tax may enhance inflation.
4. **direct taxes** **put lesser burden over the collection** of amount than indirect taxes, where collection is scattered across parties and consumers’ preferences of goods is distorted from the price variations due to indirect taxes.
5. **Direct taxes** **help in reducing inequalities** and are considered to be progressive while indirect taxes enhance inequalities and are considered to be regressive.
6. Indirect taxes involve lesser administrative costs, while direct taxes have many exemptions and involve higher administrative costs.
7. The most fundamental classification of taxes is based on *who collects* the taxes from the tax payer.

**Direct Taxes**, as the name suggests, are taxes that are **directly paid to the government** by the taxpayer. It is a tax applied on individuals and organizations directly by the government e.g. income tax, corporation tax, wealth tax etc.

**Indirect Taxes** are **applied on the manufacture or sale of goods and services. These are initially paid to the government by an intermediary**, who then adds the amount of the tax paid to the value of the goods / services and passes on the total amount to the end user.

Examples of these are sales tax, service tax, excise duty etc.

**---------------------------------------------------------------**E

**What's the difference between monetary policy and fiscal policy?**

Monetary policy and fiscal policy refer to the two most widely **recognized "tools" used to influence a nation's economic activity.**

* Monetary policy is primarily concerned with the management of interest rates and the total supply of money in circulation and is generally carried out by [central banks](http://www.investopedia.com/terms/c/centralbank.asp) such as the Federal Reserve.
* Fiscal policy is the collective term for the **taxing and spending actions of governments**. In the United States, national fiscal policy is determined by the Executive and Legislative Branches.

**Monetary Policy**

* Central banks have typically used [monetary policy](http://www.investopedia.com/terms/m/monetarypolicy.asp) to either stimulate an economy into faster growth or slow down growth over fears of issues like inflation.
* The theory is that, by incentivizing[**motivate]** individuals and businesses to borrow and spend, monetary policy will cause the economy to grow faster than normal. Conversely, by restricting spending and incentivizing savings, the economy will **grow less quic**kly than normal.
* The Federal Reserve**, also known as the "Fed,"** has frequently used three different policy tools to influence the economy: **opening market operations, changing**[**reserve requirements**](http://www.investopedia.com/terms/r/requiredreserves.asp)**for banks and setting the "discount rate."**
* [**Open market** operations](http://www.investopedia.com/terms/o/openmarketoperations.asp) are **carried out on a daily basis** where the **Fed buys and sells U.S.**[**government bonds**](http://www.investopedia.com/terms/g/government-bond.asp)**to either inject money into the economy or pull money out of circulation**.
* By setting the [reserve ratio](http://www.investopedia.com/terms/r/reserveratio.asp), or the percentage of deposits that banks are required to hold and not lend back out, the Fed directly influences the amount of money created when banks make loans.
* The Fed can **also target changes in the**[**discount rate**](http://www.investopedia.com/terms/d/discountrate.asp), or **the interest rate** charged by the Fed when **making loans to**[**financial institutions**](http://www.investopedia.com/terms/f/financialinstitution.asp)**,** which is intended to impact short-term interest rates across the entire economy.

**Fiscal Policy**

* Generally speaking, the aim of most government fiscal policies is **to target the total level of spending, the total composition of spending,** or both in an economy.
* The two most widely used means of affecting fiscal policy are changes in the **role of government spending or in tax policy.**
* If a government believes there is not enough spending and business activity in an economy, it can increase the amount of money it spends, often referred to as "**stimulus" spending.**
* If there are not enough tax receipts to pay for the spending increases, governments borrow money by issuing [debt securities](http://www.investopedia.com/terms/d/debtsecurity.asp) and, in the process, accumulate debt, or "deficit" spending.

By increasing taxes, governments pull money out of the economy and slow business activity. Governments might instead lower taxes in an effort to encourage more activity, hoping to boost [economic growth](http://www.investopedia.com/terms/e/economicgrowth.asp). When a government spends money or changes tax policy, it must choose where to spend or what to tax. In doing so, government policy can target specific communities, industries, investments or commodities to either favor or discourage. These considerations are often determined based on considerations that are not entirely economic.

Comparison Chart

| **BASIS FOR COMPARISON** | **FISCAL POLICY** | **MONETARY POLICY** |
| --- | --- | --- |
| Meaning | The tool used by the government in which it uses its tax revenue and expenditure policies to affect the economy is known as Fiscal Policy. | The tool used by the central bank to regulate the money supply in the economy is known as Monetary Policy. |
| Administered by | Ministry of Finance | Central Bank |
| Nature | The fiscal policy changes every year. | The change in monetary policy depends on the economic status of the nation. |
| Related to | Government Revenue & Expenditure | Banks & Credit Control |
| Focuses on | Economic Growth | Economic Stability |
| Policy instruments | Tax rates and government spending | Interest rates and credit ratios |
| Political influence | Yes | No |

**Monetary Policy and Fiscal Policy of India**

Article Shared by http://www.economicsdiscussion.net/wp-content/themes/canvas/createimage.php?author=Subho%20Mukherjee&height=20&width=200

**Let us make in-depth study of the relation between monetary policy and fiscal policy of India.**

Monetary policy in a planned economy of India cannot be framed independently of fiscal policy as achieving growth with price stability are the objectives of both these policies.

In India the Reserve Bank of India has often adopted accommodative monetary policy to Government’s fiscal policy.

Prior to 1991 when economic reforms were initiated the basic goal of monetary policy was to neutralize the impact of large fiscal deficits of the Government. To boost public sector investment for accelerating economic growth there was large increase in Government expenditure under various Five Year plans which was financed by borrowing by the Government and deficit financing (i.e., monetatisation of budget deficit).

Both Government borrowing from the market and deficit financ­ing leads to the increase in aggregate demand and have therefore potential for causing inflation. Therefore, to ensure adequate funds to meet the borrowing requirements of the Government the statuary liquidity ratio (SLR) of the banks was raised to the maximum limit of 38.5 per cent. That is, banks were to buy government securities to this extent.

Besides, to check inflation, cash reserve ratio (CRR) of banks was raised to a high level of 15 per cent. The high cash reserve leaves less funds with the banks to lend to the private commercial sector. In this way large expansion of credit for private sector was prevented.

To quote C. Ranga­rajan the former Governor of the Reserve Bank of India, “Until the overall reforms process was initiated in 1991 the basic goal of monetary management took the form of compensatory increase in the cash reserve ratio (CRR) for banks, controls on the growth of commercial credit (mainly to the private enterprises sector) and adjustments of administered interest rates. The fixation of CRR and SLR at their maximum levels crowded out credit for the commercial sector. Thus, even when money supply was growing at a rapid rate, private sector could not get the needed credit for financing industry and trade”.

Explaining the monetary policy adopted prior to reform process of 1991, Dr. Y.V. Reddy, also a former Governor of the Reserve Bank of India writes, “given the command and controlled nature of the Indian economy, the RBI had to resort to direct instruments like interest rate regulation selective credit control and cash Reserve Ratio (CRR) as major policy instruments. These instruments were used to neutralize the monetary impact of the Government is budgetary operations”.

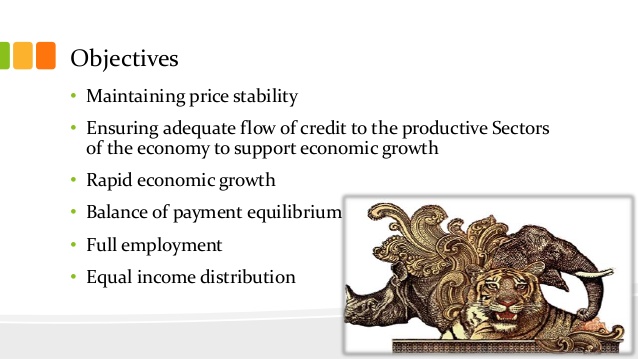
In the recent post-reform years, mainly, 2008-09 accommodative nature of monetary policy to the Government’s fiscal policy may be noted. In October 2008, a severe global financial crisis gripped the world economy following from the bankruptcy of Lehman’s brothers in the US.

This affected the growth of our exports and also led to the capital outflows from the Indian economy leading to the depreciation of the Indian economy and crash in Indian stock market. As a result, industrial and overall growth of the Indian economy started declining.

To check the economic slowdown the Government increased its expenditure, especially on infrastructure projects, and cut indirect taxes such as excise duty service tax to boost private sector investment and expenditure. To supplement and accommodate Government expansionary policy, the Reserve Bank reversed its earlier tight monetary policy in October 2008 and to boost private sector investment it reduced its repo rate from 9 per cent in July 2008 to 7.5 per cent in Oct. 2008 and further to 4.75 per cent in March 2009.

Similarly, RBI reduced cash reserve ratio (CRR) from 9 per cent in July 2008 to 6.5 per cent in Oct. 2008 and further to 5 per cent in March 2009 to make more funds available with banks to buy Government securities for financing sits borrowing and also to the private sector for expanding investment.

Thus, the RBI’s monetary policy has been accomodatory in the sense that it provided support to Government’s fiscal stimulus package to promote investment and growth. When in the later half of 2009-10 inflation rate again started rising the RBI began the process of withdrawing from the accommodative monetary policy stance in Oct. 2009 and started tightening its monetary policy to fight inflation.





**Features of Federal Finance in India (With Statistics)**

Article Shared by http://www.economicsdiscussion.net/wp-content/themes/canvas/createimage.php?author=Nikita%20Dutta&height=20&width=200

* Truly speaking, the fiscal arrangement of any country is largely governed by the **political system** of the country concerned.
* India’s po­litical structure is federal; so its financial sys­tem is also federal in character.
* The essence of the **federal form of government is that each government (Central, Union Territories and State governments) and local-self government is independent of each other with constitution­ally demarcated functions.**
* What is needed is that each **government should have independ­ent sources** **of revenue** and should **have com­mand over resources to meet its needs**.
* The Constitution of India, adopted in 1950, made a clear distinction between the finan­cial jurisdiction of the various governments.
* The various functions of each government have been delineated into three lists: (i) **Un­ion List, (ii) State List, and (iii) Concurrent List. Accordingly, financial powers have been di­vided.**
* Taxes to be levied by the Centre are enu­merated in the Union List and comprise 20 items.
* **Taxes to be levied and collected by the states are mentioned in the State List.**
* Taxes which have an **inter-state base** are levied by the Union Government and those with a local base are levied by the State governments.
* Then there is the **Concurrent List** falling within the jurisdiction of both the Centre and the states.

**1. Sources of Revenue of the Central and State Governments:**

**The sources of revenue of the Union Govern­ment are classified into two parts:**

(i) Tax-revenue, and

(ii) Non-tax revenue.

Let us consider tax revenue only.

Taxes which are levied by the Union Gov­ernment but collected and appropriated by the states are: **stamp duties and excise duties on medical preparations** containing alcohol or narcotics, service tax introduced in 1994-95.

Taxes which are levied and collected by the Union but the entire proceeds of which are assigned to the States are: **succession and es­tate duties, terminal taxes on goods and pas­sengers, taxes on railway freights and fares, taxes on transactions in stock exchange, taxes on the sale** and purchase of newspapers and advertisements therein, etc.

Taxes which are levied and collected by the Union but are shared with the States are: taxes on **income except corporation tax, etc.**

Taxes which are levied, collected and ap­propriated by the Centre or proceeds of which are distributed among the States if situation demands are: **union excise, duties on tobacco, match, etc.**

The major sources of union taxes are taxes on income other than agricultural income, corporation tax, customs duty, excise duty except alcoholic liquors and narcotics not con­tained in medical or toilet preparations, estate and succession duties other than agricultural land, taxes on the capital value of assets, ex­cept agricultural land of individuals and com­panies, rate of stamp duties on financial docu­ments, taxes on railway freights and fares, ter­minal taxes on goods or passengers earned by railway, sea or air, etc.

Likewise, State Governments have both tax-revenues and non-tax revenues to carry out their functions.

Taxes that fall within the jurisdiction of the Slates are: land revenue, agricultural income tax, succession and estate duties on agricul­tural land, taxes on land and buildings, excise on alcoholic liquors and narcotics, taxes on the entry of goods into a local area, taxes on the consumption and sale of electricity, amuse­ment tax, taxes on vehicles, animals and boats, tools, etc. Taxes that are subject to sales tax on commodities have come under value added tax (VAT) net. VAT, introduced in the fiscal year 2005-06 and imposed on about 550 com­modities, have become the largest source of revenue of the State governments.

**2. List of Expenditures of the Central and State Governments:**

Lists of expenditures of both the Union and State Governments are also exhaustive. How­ever, expenditure of these two forms of gov­ernments are classified as Developmental Ex­penditure or Plan Expenditure and Non-De­velopmental Expenditure or Non-Plan ex­penditure.

Non-plan expenditure falls under two broad heads, viz. revenue expenditure and capital expenditure. The former comprises interest payments, defence expenditures, sub­sidies, pensions, other general services (like tax collection), social services (like education, health), economic services (like agriculture, energy, industry, transport and communica­tions, science and technology and environ­ment) and grants to States and Union Territo­ries. The latter includes capital expenditure on defence, loans to public sector undertakings, States, Union Territories, and foreign govern­ments.

Expenditures on agriculture, rural devel­opment, irrigation and flood control, energy, industry and mineral resources, science and technology, etc. are included in Plan Expendi­ture. In addition to these, grants for implemen­tation of Five Year Plans to States and Union Territories are also included in plan expendi­ture.

Annual receipts and expenditures of Gov­ernments are shown in the current account of the budget while receipts and expenditures on capital goods are shown in the capital account. In other words, expenditures for all adminis­trative and social services are shown in the revenue or current account of the budget. Ex­penditures on general services, health and education, subsidies, interest payments are all expenditures on the current account.

On the other hand, expenditures for the purpose of creation of capital goods are shown in the capi­tal account. Expenditures on irrigation, rail­way lines, etc. are capital expenditures. These are treated as plan expenditures or develop­ment expenditures.

Fiscal imbalances witnessed in the 1980s brought havoc to the BOP crisis and fiscal indiscipline (measured by revenue deficit, fis­cal deficit, etc.) in the early months of 1991. Correctives were applied in respect of tax-ex­penditure policies of the Government.

The total expenditure—both revenue and capital expenditures of the Union Government—de­clined from 14.7 p.c. of GDP in 1990-95 to 17.9 p.c. in 2004-07. The most dramatic decline took place in capital expenditure (from 4.6 p.c. of GDP in 1990-95 to 2.4 p.c. of GDP in 2004-7). Such decline in capital expenditure resulted in a low growth in infrastructure investment since the mid-1990s.

**Distribution of Financial Resources:**

The Constitution also makes provision for the set­ting up of a finance commission by the President of India at five years’ interval with the objective of allocating financial resources be­tween the Centre and the States. In other words, the transfer of resources from the Cen­tre to the States is governed by the recommen­dations of the Finance Commission.

However, the present system of allocation of financial resources has created a stir in the economy. Because of the enlargement of du­ties and responsibilities, State Governments think that there have been concentration of fi­nancial powers in the hands of the Central Government. But as far as transfer of resources is concerned, the Union Government is less sympathetic to the State Governments. This has resulted in financial conflicts between the Centre and the States.

**Federal Finance: Concept, Principles and Problems**

**After reading this article you will learn about:- 1. The Concept of Federal Finance 2. Principles of Federal Finance 3. Problems.**

**The Concept of Federal Finance:**

**In usual parlance federation is defined as an association of two or more states**.

* The federal setup is characterized by the existence of a union government (Central government) on the one hand and state government for different constituent units.
* It is a form of political association in which two or more states constitute a political unity with a common government, but in which the member states retain a measures of internal autonomy.
* Encyclopedia Britannica defines fed­eration**“as a form of government in which the essential principle is that there is a union of two or more States under the central body for certain permanent objectives.”**
* Sir Robert Garran defined federation as a foam of government in **which Sovereignty or political power is divided between the central and the local governments,** **so that each of them within its own sphere is independent of the other.**
* As far as functions and resources are concerned the two sets of government are independent.
* **Actual federations are however of different forms**. For example India is more a unitary than federal type, where there is large concentration of power in the hands of central government.

Whereas USA is more of a federal than unitary type Country, Where there is lesser concentration of power with centre and larger exer­cise of power by provincial and local governments.

* Thus depending on the type of federation fiscal responsibilities is shared between central, state and local governments.
* Therefore federal finance means divisions and coordination of different items of income and expenditure between central, state and local govern­ments. This multilevel decentralized fiscal system is known as fiscal federalism.

In this context Dr. R. N. Bhargava opines **“federal finance refers to the finance of the federal as well as of the state governments and the relationship between the two.”** However the concept and definition of federal principles is still a controversial issue.

**Prof. K. C. Wheare states:**

“by the federal principle I mean the method of divid­ing power so that the general and regional governments are each, within a sphere, Co- ordinate and independent.”

**Therefore federation is characterized by certain basic principles like:**

(a) Division of power and functions,

(b) Supremacy of the constitutions,

(c) Constitutional independence of the constituent units, and

(d) Federal predominance.

**Principles of Federal Finance:**

In a federation functions are distributed among different layers of government. Since each government is responsible for its own sphere of activity there should be adequate provision for source of revenue and its efficient administration for discharging the assigned func­tions independently and satisfactory.

Therefore the pool of total rev­enue source should be divided between the centre, state and local governments scientifically and reasonably. This warrants some mu­tually beneficial and sound principles, for the division of revenue source.

What should be the guiding principle regarding the division of functions and resources among different layers of government.

A host of economist provided an array of guiding principles in determining the resource allocation. Prof. Seligman prescribed three principles on the basis of which revenue sources i.e., taxes should be divided between the different layers of government.

**These fundamental principles governing resource allocation are:**

(a) Efficiency,

(b) Suitability, and

(c) Adequacy.

Efficiency norms insist that tax allocation among different layers of government should be decided by the capacity of feasibility to administer the tax effectively. There will be taxes, which can be best administered by the centre. Such taxes should be assigned to the central government. For example income tax in India.

Likewise there are some taxes which can be administered by the state government. Such taxes should be assigned to the state government. Best example is agricultural income tax. Suitability criterion insists that the nature of tax is an important aspect determining allocation.

Taxes will possess wider or narrow jurisdiction. Taxes with narrow jurisdiction should be allocated to regional or local governments rather than central government. The adequacy norms insist that revenue assigned to a particular layer of government should be sufficient to carry out the functions and responsibilities assigned to them.

The non-coordination between functions of government and revenue allocated to discharge the functions generate crucial problem in federal finance. Prof. Seligman in his Essays in Taxation observes” no matter how well intentioned a scheme may be or how completely it may harmonies with the abstract principles of Justice, if the tax does not work administratively, it is doomed to failure”.

Therefore as a matter of fact there are no uniform principles which determine the resource allocation in federal finance.

Prof. B.P Adarkar in his master piece “Principles and Problems of Federal Finance.” laid down three principles governing the working of Federal Finance. Later economists added a few more principles based on certain practical situations.