

DIVISIBLE POOL OF TAX COLLECTIONS - ECONOMY

NEWS: The **16th Finance Commission**, whose recommendations take effect from **FY 2026–27**, is under increasing pressure to **reassess the formula** used to divide the **divisible pool of tax collections** between the **Centre and the States**.

WHAT'S IN THE NEWS?

What is the Divisible Pool of Taxes?

- The **Divisible Pool** refers to the portion of gross tax revenue collected by the Union Government that is **shared with the States**.
- It includes **all central taxes**, excluding **surcharges** and **cesses** levied for specific purposes.
- Before distribution, **collection charges** are deducted from the gross tax revenue.

Present Share and Recent Demands

- **Current Share (Vertical Devolution):** States receive **41%** of the divisible pool, as per the **15th Finance Commission's** recommendation for the period **2021–2026**.
- **Demand from States: 22 out of 28 States**, including those governed by the ruling party at the Centre, have urged the **16th Finance Commission** to raise this share to **50%**.
- This demand arises from concerns about the **declining effective share** of States due to the increasing reliance on **cesses and surcharges**.

Cess and Surcharge: A Key Point of Contention

- **Cesses and surcharges** are **not included** in the divisible pool.
- Their share in the Centre's gross tax revenue has increased from **12.8% in 2011–12** to **18.5% in 2022–23**, reducing the **effective share of States**.
- As a result, the actual amount States receive from central taxes has dropped from **around 35% (2015–2020)** to **nearly 31% (2020–2024)**, despite the nominal 41% devolution rate.

Cess – Features and Implications

- A **cess** is a **specific tax levy** imposed for a **targeted purpose** (e.g., education cess, health cess).
- Although credited to the **Consolidated Fund of India**, it must be spent only on the **designated purpose**.
- **Not part of the divisible pool**, so the Union government is **not obligated to share it** with States.

Surcharge – Features and Implications

- A **surcharge** is an **additional charge** on existing taxes, typically on **higher income groups or specific entities**.
- Like cesses, surcharges are credited to the **Consolidated Fund**, but are **not shareable** with States.

- Allows the Centre to raise additional funds **without altering base tax rates**, yet sidesteps fiscal sharing mechanisms.

Devolution Structure

a. Vertical Devolution

- Refers to the **allocation of central tax revenue** between the Union and all the States **collectively**.
- The percentage decided by the Finance Commission determines the **total pool for States**.
- The current share is **41%**, as per the **15th Finance Commission** (2021–2026).

b. Horizontal Devolution

- Refers to the **distribution of the States' share (41%)** among **individual States**.
- Based on criteria such as:
 - **Population**
 - **Income distance**
 - **Forest cover**
 - **Demographic performance**
- Criticised by **better-performing States** (e.g., southern States) as it **penalises efficiency**, rewarding need over performance.

Key Constitutional Provisions

- **Article 268:** Union levies certain duties (e.g., stamp duties), but States **collect and retain** the revenue.
- **Article 269:** Taxes on **inter-State trade** are levied and collected by the Union, but **assigned to States**.
- **Article 270:** Specifies which **Union taxes** are **shared** with States (excluding Articles 268, 269 and surcharges).
- **Article 271:** Permits Parliament to levy **surcharges** on taxes for Union needs; proceeds **not shareable**.
- **Article 280:** Mandates the creation of a **Finance Commission** every five years to **recommend financial distribution** between Centre and States.

Finance Commission – Structure and Role

- A **constitutional body** established under **Article 280**.
- Appointed by the **President of India** every **five years** or as required.
- **Composition:**
 - **Chairman** with experience in public affairs.

- **Four members**, at least one of whom must have expertise in:
 - Judicial knowledge (HC judge or qualified)
 - Government finance and accounts
 - Financial administration
 - Economics
- **Functions:**
 - Recommends **tax devolution** between Centre and States.
 - Advises on **grants-in-aid**, fiscal consolidation, and Centre–State financial relations.
- **Removal:** A member can be removed by the President for reasons such as **unsound mind**, **immorality**, or **conflict of interest**.

16th Finance Commission (FC-XVI)

- Constituted to recommend the **devolution formula** for the five-year period beginning **April 1, 2026**.
- **Chairman: Arvind Panagariya**, economist and former Vice-Chairman of NITI Aayog.
- **Deadline for submission of report: 31 October 2025.**

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