

Terms of References a Tool to Control Finance Commission

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Abstract

The President of India holds significant fiscal powers under the Constitution, particularly in matters related to financial distribution between the Union and the States. These powers include the appointment of the Finance Commission under Article 280, setting its Terms of Reference (ToR), and deciding on tax devolution and grants-in-aid based on the Commission's recommendations. The intent of the Constituent Assembly in granting these powers was to ensure financial stability, equitable distribution of resources, and a mechanism to balance Union-State fiscal relations. The framers envisioned that the Finance Commission would serve as an independent expert body guiding financial allocations, while the President would act as a constitutional authority to implement these recommendations in a fair and non-political manner.

However, in practice, the President's power in framing ToRs has often been influenced by the Union Government's fiscal and political priorities, leading to concerns over financial centralization. Over time, the scope of Finance Commissions has expanded beyond tax-sharing to include broader economic policies, sometimes imposing conditions that favor Union interests over State autonomy. Notable instances, such as the Fifteenth Finance Commission's ToR, which included defense funding and demographic changes, have sparked criticism that the Finance Commission is being used as a policy tool rather than an independent fiscal body. This paper examines the evolution of presidential power in financial matters, the shifting role of the Finance Commission, and the implications of ToR modifications on India's fiscal federalism, highlighting the need for greater transparency, State consultation, and institutional safeguards to preserve the original intent of the Constitution.

Keywords: fiscal federalism, TOR , finance commission, constituent assembly, taxing powers.

INTRODUCTION

The idea of Indian fiscal federalism depicts the delicate balance of financial power that lies between the Union and the states, which influences the country's economic framework. Being the constitutional head president have a key role in fiscal federalism though presented as figurehead acting on advise of the council of ministers. He is entrusted with the authority to decide on fiscal policy, allocation of resources, and economic stability. Certain provisions of the constitution grant president discretionary powers in financial matters- including passage of money bill, recommending to financial commission or imposition of financial emergency. In the constitutional debates that occurred while drafting of the constitution, the drafters of the constitution wanted to establish a system that would ensure financial cooperation with strong central base. There has been controversy regarding the scope and impact of these presidential powers, that is, whether or not they sufficiently help keep fiscal control or is there any arbitrary use of

power or the powers provided are they actually sufficient for the fiscal needs of the country. By analyzing constitutional provisions, the intended purposes of the Constituent assembly, and the real implications of those provisions, this paper will analyze the president's role in federal fiscal system.

In the analysis, significant presidential financial decisions, both favorable and unfavorable, will be studied to determine if these powers adhere to the principles of federalism or if they need to be revised. By reading this paper, one will be better informed about the influence that the President has exerted on India's fiscal policies and the consequences that this has for the future of federal governance.

Fiscal federalism in India

Fiscal federalism refers to the relationship between the union and state and how financial resources are allocated, revenue are collected and how financial responsibilities are shared among different levels of government. This ensures that the fiscal resources are shared fairly and it functions effectively and it maintains economic stability.

Fiscal federalism in India is guided by the constitution which clearly demarcates the powers between the centre and the state under the 7th schedule. Union list includes income tax, corporate tax, custom duties and excise duties, which are levied and collected by the central government. The state list allows states to collect taxes on agriculture income, state excise, stamp duty, land revenue, and motor vehicle taxes whereas concurrent list contains subjects where both have authority.

The establishment of the finance commission recommends the distribution of financial resources fairly. Finance commission draws the guidelines and principle on the basis of which the tax is shared between union and states. The union government also provides grant in aid to financially weaker states and special grants are given for tribal welfare, disaster relief and developmental projects. The GST introduced in 2017 has further changed the nature of fiscal federalism by introducing uniform tax structure and replaced multiple indirect taxes.

2 types of fiscal federalism can be differentiated – co-operative and competitive fiscal federalism.

In competitive federalism the states compete with each other to attract investments and improve governance, and achieve higher economic growth. And in this form of federalism center also rewards the well performing states. States adopt best practices to outperform other states. “Competitive federalism” refers to the existence and desirability of competition among governments and jurisdictions in a federal political system. Competition among governments can be defined as rivalry whereby each government attempts to obtain some scarce benefit or resource (e.g., foreign investment) or to avoid a certain cost (e.g., a large welfare population). Such competition is likely to occur in a federal system characterized by non centralization, by substantial self-governing authority on the part of the system's constituent governments (e.g., states or provinces) as well as the national government, and by population mobility between the system's constituent governments (e.g., many individuals moving from one state to another). Competition is likely to be stifled when a federal system is highly centralized, constituent governments enjoy little power, and population mobility is low.”¹ Generally there are 2 types of competition i.e vertical and horizontal either the competition will be between the states or the competition can also be between the state and the union.

In co-operative federalism the union and state work together instead of competition. This emphasizes

¹ John Kincaid ‘Competitive Federalism | Center for the Study of Federalism’ <<https://federalism.org/encyclopedia/no-topic/competitive-federalism/>> accessed 14 March 2025.

collaboration, coordination and joint decision making. it ensures that all states get the economic benefit. Indian constitution provides for the creation of inter state council to facilitate centre – state cooperation on policy issues. GST council is a classic example of cooperative fiscal federalism. GST is the largest ever tax reform in the fiscal history of India that focuses on cooperation instead of self-interests and usher in fiscal federalism and which is said to enable both the centre and states to levy a sales tax on goods and services and thereby turn the whole country as a market and lead to uniformity in taxes on goods and services. It requires both centre and state government to sacrifice their fiscal autonomy in favor of a collective decision-making process.²

Cooperative federalism also shows union state partnership development with several centrally sponsored schemes that involves financial and administrative cooperation between centre and state that measurably focuses on national development and states participate in it very actively.³ These schemes balances financial responsibility between centre and the state. In the time of crisis also cooperative federalism becomes more crucial and requires a coordination between centre and state. Despite its benefits cooperative federalism has its own challenges- there is always centre dominance in decision making, delay in financial transfers to the states and the main challenge is political conflicts between the state.

However, in practice, India has been moving towards greater fiscal centralization, weakening the spirit of cooperative federalism. Decisions on GST compensation, centrally controlled financial transfers, and reduced State autonomy in taxation have been points of contention. Many States argue that the Union government is taking a larger share of resources, leaving them with financial constraints.

Role of president in fiscal matters – constitutional provisions

Article 280⁴ – this article establishes the finance commission which is one of the key institutions of the fiscal federalism. President of India is given the power to constitute a finance commission within 2 years from the date of commencement of the constitution and subsequently he has to do it every five years or if needed then can do it earlier than 5 years. The members of the finance commission consist of a chairman and 4 members who are appointed by the president. The qualification and selection process can be determined by law thorough law.⁵

The commission has been tasked with making recommendation to the president on various financial matters such as –

1. The commission is to determine the net proceeds of taxes should be divided between the union and states and how much each state should receive
2. Commission is to recommend and formulate principles governing grant in aid from consolidated fund of India to the states. This is essential for the financially weaker people states to maintain economic stability and provide public services.
3. Commission is required to recommend measures to increase state funds to support panchayati raj – this provision was included by 73rd constitutional amendment.
4. Any other matters as required by the president's recommendation.

² Umakanta Sahu, 'Co-Operative Federalism in India' (2019) 7(3) IJCRT 207 <www.ijcrt.org>

³ Verney D. (2011). India in search...of a new regime. In Frankle Francine R., Hasan Zoya, Bhargava Rajeev, & Arora Balbeer (Eds), *Transforming India: Social and political dynamics of democracy* (p. 426). New Delhi: Oxford University Press.

⁴ Constitution of India, art 280.

⁵ Bakshi P. M. (2002). *The Constitution of India*. Delhi: Universal Law Publishing.

The finance commission is independent in determining its own procedure for conducting assessment and making recommendation.

The commission's recommendations are advisory in nature yet carry a lot of significance in maintaining fiscal harmony.⁶

Article 281⁷ – the presidents after receiving the recommendation have to present the report before both house of parliament and ensure that the recommendations are thoroughly scrutinized. President must also provide an explanatory memorandum explaining the action taken on the recommendations. This provision ensures that executive is accountable for its decisions.

Article 267⁸ – parliament can establish a contingency fund through legislation, the fund will be at the disposal of the president but such withdrawal has to be later approved by parliament.

Article 270⁹ – this article defines the distribution of taxes between union and states its establishes mechanism of levying, collecting and sharing of taxes from union list. In this article the meaning of word prescribed was established which was later used in other articles. Here the power was given to president as to the sharing of taxes until the 1st finance commission was constituted and after that it will be prescribed by finance commission on the recommendation of finance commission. This power was given in few other articles as well like 273 that establish the grants in lieu of jute products.

Article 274¹⁰ – This article talks about requirement of president's recommendation before introducing certain finance bills in house of parliament.

Article 275¹¹ – this article provides grant-in-aids from the consolidated fund of India to states. Until parliament makes a law for grant in aid, the president has the power to provide financial assistance through an order. After the constitution of finance commission it will be done on recommendation of finance commission.

Article 279¹² – Article 279 defines the term net proceeds of taxes and duties and establishes the procedure for certifying and distributing these proceeds between union and state. A law made by parliament or an order made by the president can decide on hoe taxes are to be calculated and other matters.

Constituent assembly intent

“First Prime Minister Jawaharlal Nehru explained president's position in the Constituent Assembly by saying: We want to emphasize the ministerial character of the government that power really resides in the ministry and legislature and not in the President as such. At the same time we do not want the President to be just a mere a figurehead like the [pre-vth Republic] French President. We do not want him to have any real power but we have made his position one of great authority and dignity.”¹³

This section of the article discusses about the debates of constituent assemble and the intention behind giving such powers to the president mainly under article 270, 274, 275, and 280

⁶ Kulshreshtha V. D. (1970). A plea for the study of powers of the President of India. *Journal of the Indian Law Institute*, 12(3), 400–410.

⁷ Constitution of India, art 281

⁸ Constitution of India, art 267

⁹ Constitution of India, art 270

¹⁰ Constitution of India, art 274

¹¹ Constitution of India, art 275

¹² Constitution of India, art 279

¹³ Tyagi, R. (2017). The President of India: The Constitutional Head with Discretionary Powers. *Indian Journal of Public Administration*, 63(3), 330-351. <https://doi.org/10.1177/0019556117720618> (Original work published 2017)

The debate around article 251(now article 270) in the constituent assembly was centered around the extent of financial powers granted to the president in matters of revenue distribution between the union and the states.¹⁴ The main concern among the members was that whether the president should have discretionary authority to allocate the revenues or should it be left to the parliament. Here shibban lal saxena led the opposition against president's discretion, they argued that it should be done by the parliament instead of the president.¹⁵ His primary argument was that power to distribute tax revenue was a very significant matter to be left on executive. He feared it would weaken the federalism by making states dependent on the centre which will in turn limit their financial autonomy. They also argued parliament being the representative body will be the suitable body to make decision of tax allocation with fairness their concerns were emphasized on centralization of the power.

On the other hand B.R Ambedkar strongly defend the provision granting discretion to the president, stating that the finance commission would act as an individual expert body to guide financial distribution which will not lead to unfairness or politically motivated allocations. Allowing finance commission to make the recommendation and then leaving it to president to make the decisions maintained flexibility. He further justified central control by emphasizing that a weak Centre could lead to financial instability, as States might demand excessive shares of revenue without considering the broader national economic framework. It also avoids dead locks.¹⁶ Ultimately, the amendment seeking to transfer revenue distribution authority from the President to Parliament was rejected. The final provision retained the President's discretion, but with mandatory consultation with the Finance Commission to ensure fairness. The Finance Commission was established as an expert advisory body, but its recommendations were not made binding. This ensured that the Union retained ultimate control over financial allocations while preventing arbitrary allocations. At the same time, Parliament retained the power to legislate on tax-sharing rules, ensuring checks and balances on executive authority. The debate resulted in a compromise that attempted to balance financial centralization with federal principles.

While incorporating article 274 also there was a debate on the power given to president. Under this section it required the president's recommendation before introducing bills affecting taxation on agricultural income and state financial interests. DR B.R. Ambedkar explained that this provision was necessary to prevent parliament from introducing bills that could alter revenue allocations without the executive oversight. Few opposed the requirement of presidential recommendation, arguing that members of parliament should be free to introduce bills and should not be under the control of the executive. He warned this would be excessive power to the executive limiting parliament's ability to address unfair taxation on states. Despite all the opposition the article was adopted without any further amendments, making it a constitutional requirement to take presidents recommendation before introducing a bill. It ensures state financial harmony by preventing ad-hoc changes in tax distribution.

The debate over draft article 255 (now article 275) was very significant in shaping India's fiscal federalism by establishment a framework for grant – in – aids to states requiring financial assistance. The primacy focus to ensure that economically weaker states, from consolidated fund of India. A key aspect to a debate was the president to prescribe financial grants. The power was given to president to ensure the states with financial distress could receive immediate assistance without procedural delays.

¹⁴ Constituent Assembly Debates (4 August 1949, vol IX)

¹⁵ Markandan K. C. (1969). The office of the President of the Indian Union: A probe into the intentions of the founding fathers. *Journal of Constitutional and Parliamentary Studies*, 3(3), 72.

¹⁶ BR Ambedkar, Constituent Assembly Debates (10 August 1949, vol IX).

This provision was particularly relevant in the post-independence period when several States faced severe economic difficulties and lacked sufficient revenue-generation capacity. The Constituent Assembly recognized the need for a mechanism to provide swift financial aid, ensuring that underdeveloped and resource-deficient States could participate in national growth on an equitable basis. The debate was regarding the extent of presidential authority over fiscal matters given to the president and concerns about excessive centralization. Naziruddin Ahmad and Shibban Lal Saxena strongly opposed the provision, arguing that it weakens parliamentary control and diminishes the role of elected representatives in financial decision making. Their concerns stemmed from a broader apprehension about the concentration of financial power at the Centre, which could potentially undermine State autonomy. They feared that, without proper legislative oversight, the President—acting on the advice of the Union government—might favor some States over others based on political considerations rather than genuine economic need. In response, Ambedkar emphasized the delays of granting power under parliamentary control. He reassured members that the President would act based on the Finance Commission's recommendations, which were formulated through objective financial assessments rather than political motives.

The debate over Article 260 (now Article 280) was mainly focused on defining the powers of the President in financial matters. One of the most important issues was whether the President should have complete discretion in revenue allocation or the recommendations of the Finance Commission should be binding. Hridaya Nath Kunzru argued that granting the Finance Commission excessive power over excise duties could weaken the power of the Union government. Ambedkar defended the Finance Commission, stating that it acted as a buffer between the President and the State, preventing political allocation and ensuring fiscal stability. He also said that the President should have the power to refer the matters to the Finance Commission rather than allowing it to act independently.

Another important debate was on the President's authority to set the Terms of Reference (TOR) for the Finance Commission. Concerns were that giving unilateral power to the President to formulate TOR gives a wide power to the President which can be used to restrict the scope of the Finance Commission and taking away its power as an independent advisory body. Ambedkar defended this provision by saying that the President, as a constitutional head of the State, should have the power over the issues of finances in the country. They argued that without a structured TOR, the Finance Commission may cross its jurisdiction over time. The President was granted the authority to define the TOR of the Finance Commission but it should ensure that the Commission works in the interest of sound finance.

To deal with the misuse of power by the President under Article 280, Article 281 was introduced, which requires the President to present the recommendations of the Finance Commission to Parliament along with an explanatory memorandum.

Evolution of the Terms of Reference (ToR) of the Finance Commission: A Gradual Shift in Presidential Discretion from the 1st to the 16th Finance Commission

Article 280 of the Indian Constitution defines the TOR of the Finance Commission. The President, in consultation with the Union Government, sets forth the TOR for each Finance Commission, which determines the scope and jurisdiction of that particular Finance Commission. The TORs have been continuously evolving and changing in nature according to the fiscal needs of the country. The initial TORs mainly focused on tax devolution and grants-in-aid, and it gradually shifted towards performance-based incentives and structural changes. Until the 4th Finance Commission, the President kept the scope narrow and no economic restructuring suggestions were

included. From 5th fc onwards president extended the scope to include economic restructuring and introduced economic performance parameter which signals greater federal oversight. In 14th fc report president's role became more interventionist. Decentralization was promoted but with greater accountability requirements.

A significant shift occurred with the Thirteenth Finance Commission (2007), where the President directed the Commission to review the fiscal roadmap, integrate environmental sustainability in economic planning, and consider new fiscal obligations such as debt consolidation and relief measures. This marked a clear departure from the Finance Commission's traditional role as a body primarily concerned with fiscal transfers; instead, it was now being asked to recommend broad policy interventions aligned with the Union Government's economic strategies. Furthermore, the president expanded the tor to include the defense and internal security expenditure of the union government, raising concerns that finance commission is being used as a shield to justify increased financial centralization rather than focusing on equitable state financing.

Is finance commission being controlled beyond constitutional mandate

Finance commission established under article 280 of the Indian constitution is meant to be an independent constitutional body. It was tasked with ensuring fair vertical distribution of financial resources, addressing horizontal imbalances and recommending grant in aids however over time presidents TOR controlled the work of finance commission beyond constitutional mandate. Tors included performance based incentives, sector specific funding which led to prioritize centers fiscal agenda rather than focusing on center state financial distribution. Tor also restricted commissions ability to recommend revenue enhancing measures which made finance commission a passive allocator of resources rather than active adviser on financial stability. Multiple times finance commission has expressed discontent over presidential control NK singh chairman of 15th FC have expressed concerns of inclusion of defense and security funding goes beyond constitutional mandate.

Conclusion

The powers given to the president for fiscal matters is adequate but it needs regular scrutiny so that the powers cannot be used beyond constitution or arbitrarily. The power of formulating tor should be focused as it should not restrict finance commission as it is an expert body which needs space and freedom to work instead of tors which limits the scope of the expert body. This has led to concerns that the Finance Commission is no longer an independent arbiter of fiscal transfers, but rather a tool for the Centre to direct State finances in a manner that suits national economic policies rather than regional needs. The use of presidential power in framing ToRs has increasingly led to criticism, with States arguing that these commissions are becoming instruments of policy enforcement rather than neutral financial bodies. The trend of expanding and contracting the Finance Commission's scope based on the Centre's fiscal priorities has undermined the spirit of cooperative federalism, making States increasingly dependent on the Union Government for financial resources. The original intent of the Finance Commission, to ensure equitable fiscal transfers and balance the financial needs of States, has been gradually altered, often favoring stronger Central control. While some reforms have improved fiscal governance, many Finance Commissions have faced challenges due to politically motivated ToRs that constrain their ability to function independently.