



## Terms of Reference for 16th Finance Commission

**For Prelims:** [Sixteenth Finance Commission](#), [Consolidated Fund of India](#), [Grants-in-aid](#), [Panchayats and Municipalities](#), [Gross State Domestic Product](#), [Centrally Sponsored Schemes](#), Criteria for Devolution of funds.

**For Mains:** Major Terms of Reference for 16<sup>th</sup> Finance Commission, Key Recommendations of 15th Finance Commission.

**Source:** [TH](#)

### Why in News?

Recently, the **Union Cabinet** has given the green light to the **terms of reference (ToR) for the Sixteenth Finance Commission**.

- This commission holds the critical responsibility of recommending the **formula for revenue distribution between the Centre and the States** for the upcoming five-year period starting from **April 1, 2026**.

### What are the Major Terms of Reference for 16th Finance Commission?

- **Division of Tax Proceeds:** Recommending the **distribution of taxes between the Union Government and the States** under **Chapter I, Part XII of the Constitution**.
  - This includes the **allocation of shares among the States** from these tax proceeds.
- **Principles for Grants-in-Aid:** Establishing the **principles governing grants-in-aid to the States from the Consolidated Fund of India**.
  - This encompasses determining the amounts to be provided to the States as grants-in-aid, specifically under **Article 275 of the Constitution**, for purposes beyond those outlined in the **provisos to clause (1) of that article**.
- **Enhancing State Funds for Local Bodies:** Identifying measures to enhance the **Consolidated Fund of a State**.
  - This is aimed at **supplementing the resources available to Panchayats and Municipalities within the State**, based on recommendations made by the State's own Finance Commission.
- **Evaluation of Disaster Management Financing:** The Commission **may review the current financing structures related to Disaster Management initiatives**.
  - This involves examining the funds created under the **Disaster Management Act, 2005**, and presenting suitable recommendations for improvements or alterations.

### What is the Finance Commission?

- **About:**
  - The Finance Commission in India is a constitutional body established under **Article 280 of the Indian Constitution**.

- Its primary function is to **recommend the distribution of financial resources** between the central government and the state governments.
- The **Fifteenth Finance Commission** was constituted on **27<sup>th</sup> November, 2017**. It made recommendations covering the period of six years commencing on **1st April, 2020** through its Interim and Final Reports.
  - The recommendations of the Fifteenth Finance Commission are valid up to the financial year **2025-26**.

▪ **Criteria for Devolution:**

| Criteria                | 14 <sup>th</sup> FC (2015-20) | 15 <sup>th</sup> FC (2020-21) | 15 <sup>th</sup> FC (2021-26) |
|-------------------------|-------------------------------|-------------------------------|-------------------------------|
| Income Distance         | 50.0                          | 45.0                          | 45.0                          |
| Area                    | 15.0                          | 15.0                          | 15.0                          |
| Population (1971)       | 17.5                          | -                             | -                             |
| Population (2011)#      | 10.0                          | 15.0                          | 15.0                          |
| Demographic Performance | -                             | 12.5                          | 12.5                          |
| Forest Cover            | 7.5                           | -                             | -                             |
| Forest and Ecology      | -                             | 10.0                          | 10.0                          |
| Tax and fiscal efforts* | -                             | 2.5                           | 2.5                           |
| <b>Total</b>            | <b>100</b>                    | <b>100</b>                    | <b>100</b>                    |

**Note**

'**Population (1971)**' was considered only for the 14th Finance Commission, while 'Population (2011)' and 'Tax and fiscal efforts' were introduced by the 15th Finance Commission. The figures represent the weightage in percentage for each criterion during the specified periods.

▪ **Key Recommendations of 15<sup>th</sup> Finance Commission:**

- **Share of States in Central Taxes:** The Commission proposed maintaining the **states' share in central taxes at 41% for the 2021-26 period**, a slight reduction from the 42% allocated during 2015-20 by the 14th Finance Commission.
  - This **1% adjustment aims to accommodate the newly formed union territories of Jammu and Kashmir and Ladakh** from the central resources.
- **Fiscal Deficit and Debt Levels:** The Commission recommended that the Centre aims to limit its fiscal deficit to **4% of GDP by 2025-26**.
  - For states, it advised specific fiscal deficit limits as a percentage of **Gross State Domestic Product (GSDP)** for different years within the 2021-26 period.
  - States not fully utilizing the sanctioned borrowing limits in the initial four years (2021-25) can access the remaining amount in subsequent years.
- **Other Recommendations:**
  - **Defense and Internal Security Funding:** The report suggests establishing a **Modernisation Fund for Defence and Internal Security (MFDIS)**, non-lapsable and funded primarily through the Consolidated Fund of India and other sources.
  - **Centrally Sponsored Schemes (CSS):** Recommendations include setting a **threshold for annual CSS allocations, third-party evaluations, transparent funding patterns**, and stable financial allocations to phase out redundant schemes.

**Conclusion**

With the **ToRs now approved**, the stage is set for the commission to embark on its mandate, contributing decisively to the **financial architecture that underpins India's federal structure**.

## UPSC Civil Services Examination, Previous Year Question (PYQ)

### Prelims

**Q. Consider the following: (2023)**

1. Demographic performance
2. Forest and ecology
3. Governance reforms
4. Stable government
5. Tax and fiscal efforts

**For the horizontal tax devolution, the Fifteenth Finance Commission used how many of the above as criteria other than population area and income distance?**

- (a) Only two
- (b) Only three
- (c) Only four
- (d) All five

**Ans: (b)**

### Mains

**Q. Discuss the recommendations of the 13th Finance Commission which have been a departure from the previous commissions for strengthening the local government finances. (2013)**

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