Kerala rejects state Finance Commission's views on tax devolution

This comes after the state government delayed the presentation of the State Finance Commission report in the legislative assembly by two years

Business Standard | New Delhi, April 16, 2018

Even as Kerala chief minister Pinarayi Vijayan argues for re-framing the terms of reference of the 15th Central Finance Commission, his own government has rejected most of the recommendations of the state finance commission on tax devolution, says the chairman of the state finance commission.

This comes after the state government delayed the presentation of the State Finance Commission report in the legislative assembly by two years.

The 5th State Finance Commission of Kerala was set up under the chairmanship of B A Prakash, former professor of economics at the University of Kerala, James Varghese, principal secretary, local self-government department and V K Baby, special secretary finance.

The commission submitted the first part of its report which dealt with tax devolution to local bodies, including panchayats and municipalities in December 2015. The second part of the report that dealt with other matters was submitted in March 2016. The award period was 5 years from 2016-17 to 2020-21.

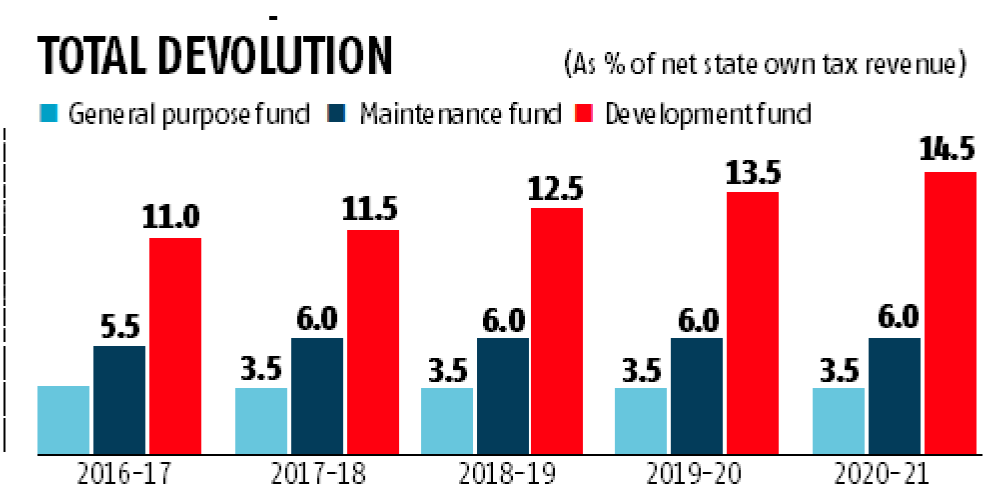
However, "the Kerala government delayed the presentation of the 5th State Finance Commission report in the legislative assembly by two years. The report on action taken with respect to the recommendations of the commission was placed before the Kerala legislative assembly on February 7, 2018. And the recommendations of the 5th State Finance Commission have not been implemented for two years," said BA Prakash, chairman of the commission. The state has rejected most of the recommendations of the 5th State Finance Commission on the tax devolution front, he added.

“At one level, the state is questioning the terms of reference of the 15th Central Finance Commission, while on the other, it is not accepting the recommendations of the State Finance Commission,” Prakash said.

The two most contentious recommendations of the commission are the basis for calculating the amount to be transferred to local bodies through the development fund and the financial year to be taken into consideration for the estimating the share of local bodies.

The Kerala government devolves resources to local bodies through three channels: A general purpose fund, a maintenance fund and a development fund. The amount transferred via the first two channels is based on the state’s own tax revenue collections, while the latter is based on the plan size.

Now, the commission has recommended that transfers to local bodies through the development fund should also be based on the state’s own tax revenue. For 2016-17, the commission recommended that 11 per cent of states’ own tax revenue be transferred to the development fund. This was recommended to be increased to 14.5 per cent by 2020-21.



Source: 5th State Finance Commission

Conversations with former Kerala state officials reveal the government was apprehensive about accepting the recommendation since it would lead to a greater fiscal burden on the state during times of stress. According to the Kerala state budget, the state’s fiscal deficit rose to 4.3 per cent in 2016-17, against a budgeted 3.5 per cent. It has managed to bring it down to 3.3 per cent in 2017-18 (revised estimate).

Part of the increase in financial burden can be traced to the state accepting the recommendations of the 10th state pay commission which involved an additional financial commitment of Rs 77 billion, say experts

The other area of disagreement was the fiscal year on which the devolution was to be calculated. Previous state finance commissions had recommended that the devolution be based on the state's own tax revenue numbers that were received two years ago i.e. the devolution for 2018-19 would be worked on the basis of the state's own tax revenue in 2016-17. The commission had rejected this practise and argued the devolution be based on the fiscal year's estimate for own tax revenue rather than that of two years ago.

There were differences of opinion on this recommendation as well. A former Kerala government officer told *Business Standard* that the tax revenue numbers of two years ago are 'actuals' and not 'estimates'. They are audited numbers and more reliable. Thus the government has decided to continue with the practice of taking revenues of two years ago.