



GOVERNMENT OF INDIA

**Explanatory Memorandum
as to the Action Taken
on the Recommendations
Made by the
Sixteenth Finance Commission**

February, 2026

MINISTRY OF FINANCE
BUDGET DIVISION

**EXPLANATORY MEMORANDUM AS TO THE ACTION
TAKEN ON THE RECOMMENDATIONS MADE BY THE
SIXTEENTH FINANCE COMMISSION IN ITS REPORT
SUBMITTED TO THE PRESIDENT ON
NOVEMBER 17, 2025.**

1. The Sixteenth Finance Commission (XVI-FC) [Commission, henceforth] was constituted on December 31, 2023, by the President, vide Order number S.O. 5533(E) dated December 31, 2023, along with the Terms of Reference. The Commission was required to submit its report by October 31, 2025. The term of the Commission was extended by one month vide Order number S.O. 4640(E) dated October 10, 2025 permitting the Commission to submit its report by November 30, 2025. The Commission submitted its report to the President on November 17, 2025.
2. The Report of the Commission covering the financial years 2026-27 to 2030-31 commencing from April 1, 2026, together with this Explanatory Memorandum as to the action taken on the recommendations of the Commission, is being laid on the Table of the House, in pursuance of Article 281 of the Constitution. Summary of the main recommendations related to sharing of the Net proceeds of Union taxes between the Centre and the States, grants-in-aid of revenue of States under Article 275(1) of the

Constitution, financing of disaster management expenditure, grants to local bodies and other recommendations are contained in this Memorandum. This Memorandum also contains the recommendations related to Path to Macro and Fiscal Stability, Reforms in Power Sector, Containing and Making Subsidies Efficient and Public Sector Enterprise Reforms as contained in the Report submitted by the Commission.

Sharing of Tax Revenues: Vertical Devolution

3. The Commission has recommended to retain the States' share at 41 per cent of the net proceeds (divisible pool) of Union taxes.
4. The Commission has recommended that to bring in more transparency about the divisible pool and the actual devolution every year, the Union Government disclose the data pertaining to net proceeds as certified by CAG under Article 279.

The Government has accepted the above recommendations of the Commission.

Sharing of Tax Revenues: Horizontal Devolution

5. The Commission has determined the inter se share of States, based on population, demographic performance, area, forest, per-capita-income-distance and contribution of the State to Gross Domestic Product (GDP) as criteria. The

formula for horizontal devolution and weights assigned to various criteria as recommended by the Commission are given in Table 8.8 of the Report. The shares of States in horizontal devolution for the award period are given in Table 8.9 of the Report.

The Government has accepted the above recommendations of the Commission.

Assessment of State Finances and Grants-in-aid of Revenues of States

6. The Commission has not recommended revenue deficit grants to States. The Commission has not recommended any sector-specific or State-specific grants. The Commission has observed that State finances in general, and that of tax revenues, committed expenditure and discretionary expenditures in particular shows that there is significant scope of increasing revenues and rationalising expenditure.

The Government takes note of the above assessment of the Commission.

Local Body Grants

7. The Commission has recommended that the grants for Rural Local Bodies (RLBs) be classified into basic and performance components and the grants for Urban Local Bodies (ULBs) be classified into basic, performance,

special infrastructure and urbanisation premium components. The aggregate national grant allocation for basic and performance components, put together has been divided in the ratio of 60:40 between RLBs and ULBs. The Commission has recommended that the division between basic and performance components be divided in the ratio of 80:20 for both RLBs and ULBs.

8. The Commission has recommended total grants for duly constituted Rural Local Bodies (RLBs) and Urban Local Bodies (ULBs) of ₹ 7,91,493 crore for the period 2026-27 to 2030-31. The Commission has determined the inter-se distribution of grants to RLBs among the states based on a 90:10 ratio of projected rural population (2026) and area. For ULBs, the inter-se States' distribution has been determined by a 90:10 ratio of projected urban population (2026) and the Own Source of Revenue (OSR) of ULBs, respectively.
9. The Commission has recommended that concerned State Government shall make allocations for exempted areas on par with the Commission's recommendations with respect to local bodies.
10. The Commission has recommended three entry-level conditions for eligibility of States to claim local body grants. Firstly, there should be a duly constituted body in place as

required in Part IX and Part IX-A of the Constitution. Secondly, online availability in public domain in year T, provisional accounts of all RLBs and ULBs of the State for the fiscal year T-1 and audited accounts for the fiscal year T-2. Thirdly, the Commission recommended that States should comply with the Constitutional provisions pertaining to the regular constitution of State Finance Commission (SFC) on the expiry of five years from the formation of the previous SFC and ensure laying of the Action Taken Report (ATR) in the State Legislature within 6 months of submission of the SFC report.

11. The Commission has recommended that the local body grants for both RLBs and ULBs be divided into basic (80 per cent) and performance (20 per cent) components, with the latter divided into two equal halves (i) RLB/ULB performance component and (ii) State performance component. The Commission has recommended that the basic component be made available to the States upon fulfilment of the three entry-level (eligibility conditions).
12. The recommendations of the Commission on the eligibility for Gram Panchayats, Block Panchayats, District Panchayats, ULBs to receive Performance Components are detailed in paras 10.97, 10.98 and 10.99 of Volume I of the Report. The Commission has recommended the conditions for release of the State Performance Component

at para 10.100 of Volume I of the Report. The Commission's recommendations on the methodology for disbursing the undisbursed portions of a State's local body performance grants in case of unfulfilled performance conditionalities are provided at para 10.101 of Volume I of the Report.

13. The Commission has recommended that 50 per cent of the basic component should be tied and the remaining 50 per cent of the basic component and the entire performance components should remain untied. The tied component should be directed towards 'Sanitation and Solid Waste Management' and/or 'Water Management'.
14. The Commission recommended that no local body should be allowed to spend more than 20 per cent of the untied allocation on the construction and maintenance of roads. Additionally, it recommended that the untied grants should not be used for the payment of salaries or other establishment-related expenditure.
15. The Commission recommended that the total quantum of urbanisation premium, for incentivising rural to urban transitions, to be ₹10,000 crore for the complete award period with a fixed per capita one-time eligibility amount to be ₹2,000 per person (based on Census 2011 population). The Commission recommended that the release of

urbanization premium component be claimed by the State on mergers of peri-urban villages into adjoining larger ULB with existing population not less than One lakh and formulation of an appropriate Rural to Urban transition policy.

16. The Commission recommended a Special Infrastructure Component for selected ULBs with the outlay of ₹56,100 crore to facilitate decisive intervention in comprehensive wastewater management in urban growth centres. The details including eligibility of ULBs for these grants are contained in paras 10.115-10.120 of Volume I of the Report.
17. The Commission recommended that Local Body Grants shall continue to be released in minimum two equal instalments each year, consistent with the existing practice and subject to the fulfilment of the conditions stipulated by the Commission. The Commission further recommended that the Union Government should ensure that where a set of local bodies within the State meet the conditions, the grants due to them are released without waiting for the rest.
18. The Commission recommended that State Governments should ensure the transfer of the grants-in-aid to their respective local bodies within ten working days of their receipt from the Union Government. Any delay in this

transfer beyond the stipulated ten working days shall obligate the State Governments to release the funds along with interest, calculated at the effective rate of interest applicable to market borrowings/State Development Loans for the preceding financial year. The Commission recommended that no further conditions be imposed either by the Union Government or the State Government for release of local body grants other than those explicitly indicated in the Chapter on Local Body Grants of the Report.

19. The detailed recommendations of the Commission related to local bodies grants are contained in Chapter 10 of Volume I of the Report.

The Government has accepted the above recommendations of the Commission.

Financing of Disaster Management

20. The Commission has recommended a total corpus of ₹2,04,401 crore for State Disaster Response Fund (SDRF) and State Disaster Mitigation Fund (SDMF) together, for the award period from 2026-27 to 2030-31. The State-wise allocations recommended by the Commission may be seen in Annexures 11.3 and 11.4 of Volume II of the Report. The Union share in the above corpus is ₹1,55,915.85 crore and the States' share is ₹48,485.15 crore. The Commission

has recommended the cost sharing ratio between the Union and State Governments of 75:25 for Non- Northeastern and Hilly (non-NEH) states and 90:10 for Northeastern and Hilly (NEH) States.

21. The Commission has recommended the corpus should be divided between the SDRF and SD MF in the ratio of 80:20. The Commission recommended an SDRF allocation of ₹1,63,521 crore and SD MF allocation of ₹40,880 crore. The Commission recommended that there be flexibility for reallocation between Response and Relief and Recovery and Reconstruction within SDRF. Preparedness and Capacity Building has been recommended to be covered under SD MF and National Disaster Mitigation Fund (NDMF).
22. The Commission has recommended that the accumulating balance under SDRF should be limited to the extent that if the unspent balance under SDRF exceeds the sum of past three years annual allocation of SDRF, further releases may be temporarily withheld. The funds withheld will be released if the States' balances reduce below the threshold of past three years annual allocation.
23. The Commission has recommended a total allocation of ₹79,406 crore for award period 2026-27 to 2030-31 based upon past expenditures for disaster management at the

national level for National Disaster Response Fund (NDRF) and National Disaster Mitigation Fund (NDMF). The Commission has recommended the graded cost sharing of central assistance through the NDRF (except Response and Relief) and NDMF should be maintained. The Commission recommended that States are to contribute 10 per cent for assistance up to ₹250 crore, 20 per cent for assistance up to ₹500 crore and 25 per cent for all assistance exceeding ₹500 crore. However, NEH States, the Commission recommended, should contribute 10 per cent of central assistance under NDRF and NDMF.

24. The Commission has recommended that the complete feeding and validation of data in National Disaster Management Information System (NDMIS) portal (for a Financial Year by the May 31 of the succeeding year) will be a necessary condition for States to avail the Disaster Management Grant from the second year of the award period, that is 2027-28.
25. The detailed recommendations of the Commission related to Financing Disaster Management are contained in Chapter 11 of Volume I of the Report.

The Government has accepted the above recommendations of the Commission.

Path to Macro and Fiscal Stability

26. The Commission has recommended that States' fiscal deficit should be capped at 3 per cent of their respective GSDP (excluding loans under SASCI) and to ensure the stability of the debts of the State Government, this should be strictly enforced in accordance with clause (3) of Article 293 of the Constitution. The Union Government should reduce its fiscal deficit to 3.5 per cent of GDP by the end of the award period. The Commission has recommended that States should completely discontinue the practice of incurring off-budget borrowings bringing all such borrowings on their budgets. It has suggested a format for reporting off-budget borrowings of States and recommended that lending institutions should provide an alternative source of data to strengthen the reporting framework for off-budget borrowing. The Commission has recommended that Fiscal Responsibility Legislation (FRL) framework of the States be amended to bring uniformity and remove inconsistencies and align them with the fiscal consolidation roadmap of the Commission.

The Government accepts in-principle, the recommendation of the quantum (expressed as a per cent of GSDP) of net borrowing ceilings for the States. Other recommendations of the Commission including those related to Off-Budget Borrowings, amendment to State FRLs, Union Government Fiscal Deficit will be examined separately.

Other recommendations

27. In addition to the above, the Commission has made other recommendations including those on rationalizing the structure of Centrally Sponsored Schemes (Para 6.41 of the Volume I of the Report), Reforms in the Power Sector (Chapter 13 of Volume I), Containing and Making Subsidies Efficient (Chapter 14 of Volume I), Public Sector Enterprise Reforms (Chapter 15 of Volume I) etc.

The Government will examine these recommendations of the Commission in due course.

Implementation

28. Orders on the accepted recommendations under Article 270 of the Constitution relating to share in Union Taxes and duties, grant to local bodies and financing of disaster management will be issued after obtaining the approval of the President. The recommendations related to Path to Macro and Fiscal Stability, Power Sector, Containing and Making Subsidies Efficient, Public Sector Enterprise Reforms, etc. and other recommendations of the Commission will be acted upon in due course.

**New Delhi
February 01, 2026**

**NIRMALA SITHARAMAN
Minister of Finance**