CHAPTER IV

DISTRIBUTION OF INCOME-TAX

Constitutional provisions.—Under Article 270 of the Constitution we have to make recommendations to the President in regard to three matters. They are: (1) the percentage of the net proceeds of income-tax which should be assigned to the States, (2) the manner in which the share so assigned shall be distributed among the States and (3) the percentage of the net proceeds of the tax which shall be deemed to represent proceeds attributable to the Part C States.

2. *Present arrangements.*—We have given in Chapter II an account of the developments leading to the provision in Article 270 and the changes that have taken place from time to time in the allocation of income-tax between the Centre and the States. At present fifty per cent of the net proceeds of income-tax, exclusive of the proceeds attributable to Part C States and the proceeds of taxes payable in respect of Union emoluments is assigned to the States. As a transitional arrangement, out of the sums so assigned each Part B State is entitled to receive fifty per cent of the net proceeds of the tax levied and collected in that State while each Part A State, in whose territory former Indian States have been merged, is entitled to receive fifty per cent of the net proceeds of the tax levied and collected in the merged territories within that State. The balance is distributed among the Part A States as follows:—

	Per cent
Assam	3
Bihar	12·5
Bombay	21
Madhya Pradesh	6
Madras	17·5
Orissa	3
Punjab	5·5
Uttar Pradesh	18
West Bengal	13·5

For purposes of working out the divisible pool one per cent of the net proceeds is deemed to be the tax attributable to Part C States. These arrangements will be replaced with effect from the 1st April 1952, by the President, after considering the recommendations of the Finance Commission. We have now to take into account the

54. As at the end of March 1950, six Part A States had outstanding balances of Rs. 91 crores in revenue reserve funds*, which are expected to decline to Rs. 38 crores by the end of the current year, thus:

In crores of rupees at the end of March

	1950	1951	1952 Revised Estimates	1953 Budget Estimates
Madras	33·50	23·32	9·42	0·59
Bombay	17·29	13·29	11·29	8·79
Bihar	14·50	14·50	8·50	5·50
Madhya Pradesh . . .	11·49	11·34	10·74	9·84
Uttar Pradesh	13·00	12·99	12·58	12·58
Assam	1·01	1·01	0·99	0·97
Total . . .	90·79	76·45	53·52	38·27

The balances have been utilised for meeting revenue deficits and financing capital expenditure.

55. Comparable figures of reserves are not available for all Part B States. It is only possible to state that at the time of federal financial integration, most of these States had substantial reserves which have since gone down. The claims of the Centre to a part of these reserves arising out of the allocation of assets and liabilities on financial integration have also still to be met by some States. It would appear that only a small part of the outstanding reserves of Part B States would be available to meet their revenue deficits or capital expenditure.

*Punjab, West Bengal and Orissa have no such funds.

Part A States, as reconstituted after the merger of former Indian States, and the Part B States and to devise a scheme of distribution based on principles uniformly applied to all of them.

3. *Claims by States.*—It will be convenient to give a brief account of the claims advanced before us by the State Governments separately in regard to the two points affecting them on which we are required to make recommendations, namely, the percentage of the net proceeds of income-tax to be assigned to the States and the distribution of the States' share among them. All the Part A States, except Orissa, suggested an increase in the share assigned to the States from 50 per cent as at present to at least 60 per cent. The Governments of Saurashtra, Rajasthan and Hyderabad made the same claim; the Government of Rajasthan further proposed that the divisible pool should include the proceeds of corporation tax as well. The Governments of Travancore-Cochin and Mysore urged that the States' share should be raised to 70 per cent while the Governments of Orissa and the Patiala and East Punjab States Union did not suggest any change in the present percentage. The Government of Madhya Bharat expressed no view on this aspect of the problem.

4. In regard to the distribution of the States' share we received a variety of suggestions from the State Governments. The Government of Bombay suggested that 25 of the States' share of 60 per cent should be allocated on the basis of collection, 25 on the basis of industrial labour and 10 on the basis of other considerations such as need, backwardness, etc. Alternatively, the State Government were prepared to accept the formula for distribution recommended by the Expert Committee on the Financial Provisions of the Constitution. The State Government held that it would be inappropriate to introduce in the distribution of taxes considerations which would apply to grants-in-aid. They were of the view that the basis of population was unscientific and suggested that the contribution of each State should be the main factor in the allocation of income-tax. It was not an accident, they argued, that the bulk of the collections was made in the industrially advanced States. This position had been built up by the capital and enterprise of the citizens of the State concerned; besides, the existence of big industries and the presence of a large and concentrated population of industrial labour created special problems for these States, as for example in regard to law and order. They pointed out that these States had to provide for the welfare and amenities of industrial labour and could claim a fair share of the revenue from income-tax on these considerations.

5. The West Bengal Government claimed that, subject to adjustments in regard to economic allegiance, which they admitted would

be necessary, each State should get back out of the net proceeds attributable to it the percentage share assigned to the States as a whole, the attributability for Part A States being determined for each State in the same manner as for Part C States. They contended that the money raised in one State could not be made available to another State. They relied on the language of Article 270 for their view that the sharing of income-tax was conditioned by the leviability of the tax and they argued that the manner of distribution contemplated by the Article merely required the President, after retaining the Central share, to place the balance in the hands of the Governments in whose respective territories the taxes had been levied or to whom they were attributable, as the case might be, to be disposed of under the control of their respective legislatures. It was not a case of the Centre expending or disposing of the money on any principle of merit but simply the separation of a common pool of money so as to place in the hands of each the share to which it was entitled.

6. The Government of Assam suggested that 35 out of 60 per cent to be assigned to the States should be distributed on the basis of population, adjusted for area or density, 20 on the basis of origin and 5 used for removing any hardships. The Government of Bihar proposed that 80 per cent of the States' share should be distributed on the basis of population and the balance with reference to other factors such as backwardness, the special responsibilities of a State and general financial management of different States. The Government of Madhya Pradesh claimed that the distribution should be on the basis of population with a weightage for the backward classes, scheduled castes and scheduled tribes living in a State. The Government of Madras suggested population as the main criterion, but expressed their willingness to accept any other equitable formula based upon a consideration of the conflicting claims and points of view. The Government of Punjab expressed the view that the needs of a State, not its population or collections in it, should be the determining factor. The Government of Orissa proposed that 50 per cent of the States' share should be distributed on the basis of the inverse ratio of *per capita* income, 35 per cent on the basis of population and 15 per cent on the basis of area. The Government of Uttar Pradesh suggested that the States' share should be distributed on a population basis.

7. Among the Part B States, Travancore-Cochin proposed that 60 per cent of the States' share should be distributed on a population basis, 20 per cent on a collection basis and 20 per cent with reference to other relevant factors such as the progress achieved by a State and not merely a State's backwardness. Rajasthan and Saurashtra both suggested population as the basis; Rajasthan was, however,

prepared for 10 per cent being distributed on the basis of other factors such as backwardness, administrative needs and sparseness of population. Madhya Bharat and the Patiala and East Punjab States Union asked for distribution on the basis of needs and both indicated a sum as their minimum requirement; if population were adopted as the basis of distribution, the Patiala and East Punjab States Union asked for a somewhat higher allocation than its population ratio. Hyderabad and Mysore also suggested population but Mysore wanted some weight to be given to area.

8. *Experience of other Federations.*—Before considering the problem of distribution of income-tax, we may scan the experience of other Federations in this field, though there are important differences in this regard between India and some of the other countries concerned. The peculiarities of the Indian position from the point of view of the significance of foreign experience for our guidance are: (a) the distribution of income-tax has formed a significantly larger proportion of the total annual transference of funds from the Centre to the States in this country than in the other Federations like Australia and Canada; while in the U.S.A., grants are virtually the only form of such transference of resources; (b) of the total income-tax collections of the federal government, a much smaller proportion has been distributed to the States in Australia (in the form of tax reimbursement grants) and in Canada (as tax rental grants) than in India, so that, on the whole, whatever principles apply in regard to the distribution of grants in lieu of income-tax collection in these countries apply over a smaller region of federal financial relations than in this country; (c) in India, the Provinces (Part A States) never possessed any right to tax incomes (other than agricultural income) while in Australia and Canada, the units have never surrendered their constitutional right to levy such taxation, which has only been temporarily suspended; (d) there are, besides, significant differences in the pattern of collections—unlike in the other federations mentioned above, Central income-tax in India is paid by an extremely small proportion of the population; and (e) divisible income-tax in India, with which we are dealing, includes a portion of the tax paid by companies on their income, the balance forming Corporation Tax. A statement of the practices prevailing in other federations may, however, be useful in view of the considerable public interest displayed in the working of the federations as well as for such light as, despite the differences, this might throw on the problem before us.

9. In Australia and Canada, until 1942, the federal government as well as the state governments had under their respective constitutions the right to tax incomes. In both countries, the uniform taxation of incomes by the federal government was an outcome of the

war. It was an essential part of the scheme that the states should be induced temporarily to vacate a field of taxation which they were already occupying in their own right. It was thought necessary to assure the States in Australia and the Provinces in Canada that their share out of the proceeds of the uniform tax would not be less than what they were recovering prior to the imposition of the Commonwealth or the Dominion tax. While uniform income-tax legislation in Canada was based on prior agreement of the Provinces, in Australia it was enacted against the opposition of some States.

10. In Australia, under the States Grants (Income-Tax Reimbursement) Act, 1942, a State not imposing a tax on income was entitled, by way of financial assistance, to grants, the amounts of which were fixed by reference to what each State was raising in exercise of its own constitutional right to tax income. But, technically speaking, there was nothing in the Commonwealth legislation to prevent a State from continuing to levy its own tax on income or reviving it, if it refrained from levying it in any particular year. In that contingency, the State would not qualify for any reimbursement grant. The States were in practice completely ousted from the field of income-tax by reason of the priority given to the liability to pay the Commonwealth tax.

11. Though the uniform tax was to continue in operation until the end of one financial year to commence after the cessation of the war, the scheme is continued till 1957 under an Act of 1946. This Act provided for the payment of a higher aggregate grant, which itself was liable to be increased in proportion to the increase in population and the increase in wages over the average wages in 1946-47. After 1947-48, there was to be a progressive shift in the distribution of the aggregate grant in the course of ten years to an adjusted population basis, *i.e.*, the basis of the respective populations of the States after adjustments which took into account the relative sparsity of population and the number of school children. The arrangement is subject to review in 1953, and proposals are under examination at present with a view to restoring to the States their power to levy income-tax.

12. In Canada, the scheme of uniform taxation was recommended by the Rowell-Sirois Commission. Under the post-war tax rental agreements signed in Canada between the Federal Government and eight Provinces (*i.e.*, including Newfoundland and excluding Quebec and Ontario), minimum payments were guaranteed to the Provinces by the application of either of two general formulae at the option of a Province. The first formula took into account, in addition to fiscal need, the tax capacity or tax potential of a Province. It assured a

Province (1) $12.75 per *capita* according to 1942 population, (2) a sum equal to one-half of the revenue derived by the Province from individual income-tax and corporation tax in 1940 and (3) the statutory subsidy payable to a Province in 1947. The other formula recognised fiscal need as the chief factor and guaranteed (1) $ 15 *per capita* on the 1942 population and (2) the statutory subsidy payable in 1947. The payments to Provinces from year to year have been actually higher than the guaranteed minimum amounts, having been related to national growth as reflected by gross national product and provincial growth as reflected in provincial population. In return, the Provinces agreed to suspend the imposition of individual income-tax for five years and to impose only a 5 per cent uniform corporation income-tax on the same basis as the Dominion tax, to be administered by the Dominion. Seven Provinces which signed the agreement continued to levy a 5 per cent corporation tax. Ontario and Quebec which did not sign the agreement levied a 7 per cent corporation tax, but refrained from imposing an individual income-tax. The new arrangements for the five years beginning 1952-53 are based on revised financial terms which propose an increase of approximately 50 per cent over the guaranteed minimum payments for the Provinces. It appears that nine Provincial Governments including the Government of Ontario (*i.e.*, all Provinces with the exception of Quebec) have reached agreement with the Dominion Government on the basis of the latter's proposals.

13. In the United States, both the Federation and the States enjoy concurrent right of taxation over income. No question of the distribution among the States of the proceeds of an income-tax levied federally has, therefore, arisen. But it is interesting to note that the federal tax in that country is far and away the most important part of taxes on income, the States' taxes yielding only a small fraction of the receipts obtained from the federal tax. There being no equivalent to the distribution of income-tax in that country, the role of balancing factor *viz.*, to bring the functions and resources of the states into better accord, is played by grants.

14. To place the experience of these federations in the sphere of federal finance including shared taxes in perspective, it is necessary to take note of certain outstanding trends in the pattern of distribution of total revenues of these federations. Financial powers as well as the flow of public revenues and expenditure through federal channels, have tended to grow considerably in recent years at the expense of the unit governments. In all the three Federations, U.S.A., Canada and Australia, the percentage of the revenue of the Federal Government to total public revenue fell within a range of forty to fifty per cent in the 'thirties'. The proportion in all the three countries has gone up and is now between two-thirds and three-fourths. Out of the federal revenues a portion flows back again to the States

through shares in taxes or grants-in-aid of various types. The area of federal revenues and expenditure, constitutes the field where the collections in different areas and the flow of expenditure are determined on overall national considerations. In India the proportion of revenues raised by the States to the combined Central and State revenues was 42 per cent in 1950-51.

15. The available information relating to the financial arrangements in Latin American federations is meagre. In Brazil, most of the important taxes are assigned to the nation—customs revenues, taxes on incomes, production and consumption, business transactions and documents. These levies are the bulwark of the Brazilian tax system; therefore, the States are left without a sufficient number of major sources of revenue. This situation is partially corrected, however, by a constitutional provision requiring the federal government to share certain revenues with the States, apportioning the money on the basis of population, area and a number of other factors. In Argentina, the federal government also shares some of its tax receipts directly with the Provinces. The law of 1932 specified that 17½ per cent of the amount collected each year by way of income-tax shall be apportioned among the Provinces and the federal capital. Thirty per cent of the Provinces' share is distributed on the basis of the cost of government in each Province, as shown by its budget; another 30 per cent is paid out on the basis of the revenue of each Province in the year immediately preceding the apportionment; still another 30 per cent is based on population (relying on the 1914 census figures, rather than more recent estimates); and the remaining 10 per cent is alloted in proportion to the amount of income-tax collected in each Province. The federal capital's share is based on the first three factors only, presumably on the ground that it would receive too large an amount if it were permitted to benefit directly from heavy income-tax collections within its limits. Also, 17½ per cent on the sales tax is apportioned on the same four-fold basis. In addition, the Provinces in Argentina refrain from taxing certain articles covered by federal law and are compensated by the Centre with amounts fixed under a complicated formula which in effect transfers revenue from the wealthier to the poorer Provinces through the gradual substitution of population for collection as the basis of allocation of these taxes.

16. *Share to be assigned to States.*—We now revert to a consideration of the three points on which we have to make our recommendations.

17. We shall first deal with the percentage of the net proceeds of income tax to be assigned to the States. We consider it undesirable to concentrate on income-tax as a balancing factor in the adjustment of resources between the Centre and the units. We think that

an increase in the States' share of this tax should not be used as a major factor in the devolution of further revenues to the States. On the other hand, the State Governments have put forward an almost unanimous demand for an increase in the States' share of income-tax. There will now be sixteen participants in the States' share of the divisible pool against nine participants in the past. Besides, owing to the concession given in regard to the application of the full rates of income-tax for a transitional period in some of the Part B States, the revenue from income-tax may be smaller than otherwise while the distribution to all the participating States will have to be on uniform principles. Moreover, the increase in the number of Part C States has resulted in our recommending a somewhat larger percentage than at present of the net proceeds of income-tax as attributable to Part C States. The cost of collection allocable to income-tax is also likely to be slightly more than at present and these factors would, to some extent, go to reduce the amount of the divisible pool. On a consideration of all the circumstances, we have come to the conclusion that some increase in the share assignable to the States is justified although it cannot be of the order suggested by the majority of State Governments. We accordingly recommend that the percentage of the net proceeds of income-tax to be allocated to the States be raised from fifty per cent to fifty-five per cent.

18. *Distribution of States' share.*—Before dealing with the distribution of the States' share among them, we should like to refer to the points raised by the Government of West Bengal about the construction to be placed upon the language of Article 270 of the Constitution. We do not think that the interpretation placed upon this article by the Government of West Bengal can be sustained. The phrase "within which the tax is leviable" appearing in this article only means that a State in which the tax is not leviable has no right to a share at all. This phrase survives from the Government of India Act, 1935, under which there was uncertainty about the Indian States acceding to the federation and the extent of their accession. While Jammu and Kashmir is now a State of the Indian Union the provisions of the Indian Income-tax Act do not apply to that State. Indian income-tax is not leviable in that State which is, therefore, not entitled to any share of this tax. Nor is there, in our view, any warrant for the contention of the West Bengal Government that the "manner" of distribution involves merely the process of returning to each State a proportion of the revenue collected in its area and that it is only the manner in which the money is to be returned, that is to say, the mode of payment, that is left to the determination of the Commission. The West Bengal Government's contention is untenable as the manner of distribution about which we are asked to

make recommendations is different from the manner of making the actual payments about which there is a specific provision in Article 279(2). The fact that a prescribed percentage of a tax does not form part of the Consolidated Fund of India does not *ipso facto* make it or any portion of it part of the Consolidated Fund of any particular State. The share to which each State is entitled would itself depend upon the manner in which the divisible amount is distributed among the States. It may be noted that, although the language of Article 270 closely follows that of section 138 of the Government of India Act, 1935, the scheme for the allocation and distribution of income-tax in the Government of India (Distribution of Revenues) Order, 1936, was never challenged on the ground that the manner of distribution laid down by it did not correctly carry out the intention of section 138 of that Act.

19. We do not think it proper to consider this problem on the assumption of what the Centre and each of the States could have raised by levying the tax concurrently and dividing the proceeds of the Central tax on that basis, as suggested by the Government of West Bengal. The Constitution does not recognise that any State has a right to the income-tax collected or even arising in its area. A State acquires the right to a definite amount of the divisible pool only after the manner of distribution has been prescribed by the President. Until a State can be said to acquire a right to a particular portion of the proceeds not forming part of the Consolidated Fund of India, there is, speaking constitutionally, no question of the transfer to one State of what belongs to another. A right of concurrent taxation in the income-tax field was not enjoyed by any Part A State. The former Indian States had an independent right to tax incomes but even in their case this right was lost under the Constitution as the integration of these States proceeded on the principle that what are now called Part B States should be in the same position as the former Indian Provinces with respect to functions as well as resources, subject, however, to some transitory provisions.

20. In our view, there is no question of considering the distribution of the tax on the basis of returning to a particular State the whole or part of the collections in its area or on the basis of the States having a notional right to the concurrent levy of income-tax. The units in Australia and Canada had to be assured a *quid pro quo* for forgoing the exercise of a right to which they were entitled to under the Constitution. Similar procedure was followed when the Commonwealth entered the field of taxation of entertainments. We do not think that it is right to proceed from the Australian and Canadian concepts of "compensation" or "reimbursement" to deduce any "scientific principle" applicable to all federal systems where there is a uniform income-tax levied centrally but a part of which has to be distributed among the units. There is no question

of any compensation or reimbursement in India where the former Provinces, now Part A States, at any rate, never possessed any right to tax incomes; even in the case of Part B States the integration did not countenance the theory of compensation either in respect of federal assets or federal revenues passing to the Centre. Even if the States had been in a position to levy their own income-tax, it is difficult to forecast what the pattern of distribution of the collections would have been. With a multiplicity of tax jurisdictions all the income which is now assessed to tax in Bombay or Calcutta may not have been taxable in those places.

21. Various bases have been suggested for the distribution of income-tax among the States, the more important of which are:

(i) the *collection* of income-tax in the various States;

(ii) the amount of income-tax realised in respect of incomes, wherever earned, of individuals *resident* in the different States;

(iii) the collection of income-tax in the various States adjusted with reference to the *origin* of the income;

(iv) the relative *population* of each State;

(v) the relative volume of industrial *labour* in each State;

(vi) the relative *per capita* income of the States; and

(vii) the needs of the different States according to various criteria, *e.g.*, area or sparseness of population, economic backwardness or the inverse relative *per capita* income of each State.

22. The first three factors primarily seek to relate the distribution to the respective contributions of the different States to the total proceeds, and are intended to provide the most adequate or convenient measure of such contribution. At the other end are factors like the area of a state in relation to its population, economic backwardness and inverse relative *per capita* income which are specialised measures of needs. Between these categories fall suggestions for the adoption of such factors as population, industrial labour, etc., which are supposed to reflect both the needs and, to an extent, the contribution of the States.

23. The relevance of the factor of contribution in the distribution of a shared tax will be generally acknowledged. It is recognised, however, that collection is an inadequate index of contribution. Some consideration of the facts regarding collection will serve to bring this out clearly. Between them, the two States of Bombay and West Bengal account for nearly three-quarters of the collections of income-tax in the country: of these collections again, about

three-quarters are made within the cities of Bombay and Calcutta. It is clear that the collections of income-tax within the limits of these two cities which account for the greater part of the collections in the country, do not in the main arise on account of activities which are confined to those limits. Nor can the high collections be accounted for by economic activity which is restricted largely to the States of which they are the capitals. Indeed, though it is impossible to indicate in what degree income subjected to tax in these cities should be ascribed to other States, there is no doubt that a substantial part of the tax receipts in these big port cities in fact accrues in respect of incomes originating beyond the boundaries of the respective States. The high collections of income-tax in these all-India cities are due in a large measure to their being in a sense *entrepots* of the country's import and export trade and to the concentration within their confines of the head offices of companies and other concerns operating all over the country. A study of the information collected by us from some of the larger concerns indicates that the bases of income-creation are far more diversified and widely spread over the country than the facts of collection would seem to suggest.

24. Apart from the impracticability of establishing the precise contribution of different regions to a common tax, the doctrine of economic allegiance on which the principle of contribution is based is open to objection when applied to the sharing of the proceeds of a tax among the units of a federation. The bases of residence or origin—in so far as origin can be identified—may be conveniently used for providing relief from double taxation as between two sovereign states, but may not give proper results in the allocation of the proceeds of a Central tax like income-tax among the States of a country. The incomes which are earned in different States in India cannot be put in the same category as incomes earned in different sovereign States. Unlike the incomes earned in the different units of a federation the incomes which are taxable by a sovereign state are not necessarily or directly conditioned by the policies pursued by other States. In a federation the policies of the federal government are mainly conceived in the national interest and these may confer unequal benefits and may impose unequal burdens on the different units. To illustrate the point, Central policies governing the regulation of company operations, the development of railways and ports, tariffs and subsidies, freight rates, food subsidies, control, regulation and location of industries and price control are conceived and operated in the broad national interest. These policies have a bearing on the pattern of development of large-scale enterprise in industry and trade which are important contributory sources of income-tax. Since the benefits which result in the growth of enterprise flow from policies pursued on the ground of national

interest, there is every reason why national considerations should in a large measure influence the sharing of the proceeds of taxes on such enterprise.

25. Another argument in favour of giving collection some importance in the distribution of income-tax is based on the heavier responsibilities of States where large collections are made to look after the problems of law and order and welfare in respect of the concentration of industrial labour in those States. The very concentration of industries and business enterprises in those States, however, leads to increased receipts in the State sphere from such heads as stamps, sales taxes and entertainment duties which directly benefit the State finances.

26. Taking all the considerations into account, we believe that the basis of collections, either unadjusted or adjusted with reference to residence of tax-payers, will not secure by itself an equitable distribution among the various States. We think, besides, that even if it were practicable to ascertain precisely the contribution of the various units to the pool of income-tax, distribution based solely on this criterion might not be satisfactory. It might not substantially conform to the relative responsibility of the various States to provide governmental services to the people. Whatever the theoretical validity of alternative indexes of contribution, a proper scheme of distribution should not overlook the broad purpose of the devolution of revenues to the States, which is to make larger funds available to them to meet their expanding responsibilities in respect of the welfare of their population.

27. In so far as needs should, in our view, form the main criterion of distribution, we consider that only a broad measure of need such as is given by the respective populations of the States is suitable for application in the distribution of the proceeds of a shared tax. Further refinements of the needs criterion or specialised and particular measures of needs should be left for consideration in relation to grants-in-aid, as such factors like area, or sparseness of population, economic backwardness, financial difficulties, special burdens or commitments of a State, etc. are more relevant to the determination of grants-in-aid.

28. There remain the bases of industrial labour and *per capita* national income. It has been argued that the volume of industrial labour in a State reflects both the contribution of a State to the tax-yielding incomes and the State's needs in the way of larger administrative and welfare services. It is, however, in our view only a partial index of either contribution or needs. In regard to the suggested criterion of *per capita* income, there are no figures for individual States and we are unable, in the circumstances, to form

any idea regarding the possible use of such data for the purpose of distribution of income-tax. We wish to emphasise here that we attach the utmost importance to the selection of factors which can be related to definite, unambiguous and authoritative data.

29. The elements which, in our opinion, should enter into the appropriate scheme of distribution of income-tax thus are: (i) a general measure of needs furnished by population, and (ii) contribution. It will be perfectly justifiable, in our view, to give a moderate weight in the scheme of distribution to the factor of contribution. It is pertinent to bear in mind the fact that there is all over the country a core of incomes—particularly in the range of personal and small business incomes—which could be treated as of local origin. Having regard to the essential postulate of definiteness in the factors chosen, the figures of collections furnish the only index available in respect of contribution, though, as the preceding paragraphs indicate, they are an inadequate and partial measure. On a broad view of the position, we propose that twenty per cent. of the States' share of the divisible pool should be distributed among the States on the basis of the relative collections of States and eighty per cent. on the basis of their relative population according to the census of 1951.

30. As regards the actual distribution of the States' share in each year, we consider that it will be convenient, both to the States and to the Centre, if as at present, the shares are expressed as fixed percentages instead of our formula being left to be applied each year. We accordingly propose that the shares of each of the States should be expressed as a percentage of the total States' share. We have applied the formula for distribution which we propose to the actual figures of collections for the three years ending 1950-51 with suitable adjustments in the case of the Part B States; figures of population taken by us relate to the 1951 census. We accordingly recommend that the percentage share of the net proceeds of income-tax assigned to the States should be distributed among them in the following manner:—

State	*Per cent.*
Assam	2·25
Bihar	9·75
Bombay	17·50
Hyderabad	4·50
Madhya Bharat	1·75

State	Per cent
Madhya Pradesh	5·25
Madras	15·25
Mysore	2·25
Orissa	3·50
Patiala and East Punjab States Union	0·75
Punjab	3·25
Rajasthan	3·50
Saurashtra	1·00
Travancore-Cochin	2·50
Uttar Pradesh	15·75
West Bengal	11·25

31. *Share attributable to Part C States.*—As regards the percentage to be fixed under sub-clause (3) of Article 270 in regard to the Part C States we recommend that this should be prescribed as two and three-quarters per cent. of the net proceeds of the tax instead of at one per cent. as at present. We have arrived at this figure by allocating to all the Part C States taken together the share which would have accrued to them collectively had they been entitled to a share of income-tax on the same basis as that adopted by us for the Part A and Part B States.

32. *Cost of collection.*—We should like to draw attention to an incidental point in connection with the calculation of the net proceeds of income-tax. We understand that the practice has been to apportion the cost of collection *pro rata* between income-tax and corporation tax on the basis of the net revenue under these heads. This method of apportionment was originally suggested by Sir Otto Niemeyer. We were informed by the Central Board of Revenue that recent experience indicated that this method did not secure an equitable apportionment of the cost between corporation tax and income-tax, and they suggested an alternative formula for our consideration. This, however, seems to us to be a matter for the Comptroller and Auditor-General to decide, as under Article 279(1) of the Constitution the "net proceeds" in relation to any tax or duty have to be ascertained and certified by him and, in the process, the cost of collection has to be taken into account. In such computations as we have had to make of the net proceeds of income-tax we have, however, allowed for the fact that a somewhat larger share of the cost of collection may be allocable to income-tax than under the present formula.

33. *"Revenue gap grant" of Part A States.*—In making our recommendations in regard to the percentage of the net proceeds of income-tax to be assigned to the States and the distribution of the States' share among them we have taken into account the population and the collections of the "merged areas" included in the various Part A States. As these States will be receiving their share of divisible taxes on a common basis with all the other States, the "revenue gap grants" which the States of Bihar, Bombay, Madhya Pradesh and West Bengal are now receiving in respect of the "merged areas" should be discontinued with effect from the 1st April 1952 and any payments made in the current year should be adjusted against their respective shares of the divisible taxes for the year.