

plan expenditure taken by us for our scheme of devolution. We would ordinarily have done so. But this was not necessary because we have not included in the income available to States the receipts from the new tax on railway fares which, we expect, will meet the interest charges.

96. It was difficult to estimate accurately the addition to the committed expenditure of the States on account of the post-intensive community development and national extension service schemes during the period to be covered by our recommendations. We, however, expect that the revenue accruing to the States out of the net proceeds of the estate duty will be sufficient to meet it.

97. In our scheme of devolution we have sought to close the revenue gap for each State as nearly as possible and we believe that, with reasonable prudence on their part, all the fourteen States should be able to balance their revenue budgets.

IX. Distribution of Income Tax

98. Under article 270, we have to make recommendations in regard to three matters, namely,

- (a) the percentage of the net proceeds of income tax to be assigned to the States;
- (b) the distribution among them of the States' share; and
- (c) the percentage of the net proceeds which shall represent proceeds attributable to Union territories.

Before we deal with them, we should like to summarise briefly the views placed before us by the State Governments on the first two which concern them.

99. The States were unanimous in suggesting an increase in the percentage of the net proceeds now assigned to them. Andhra Pradesh, Assam, Bombay, Madhya Pradesh, Orissa and Uttar Pradesh wanted the States' share to be raised from 55 to 60 per cent. Punjab and Jammu and Kashmir, to 65 per cent. Bihar, Kerala and Mysore, to 70 per cent and Rajasthan to 75 per cent. Madhya Pradesh did not indicate any figure but suggested that the States' share should be materially increased. The West Bengal Government did not suggest any percentage but, concentrated on the principles of distribution. Andhra Pradesh, Kerala and Uttar Pradesh desired the

inclusion of corporation tax in the divisible pool; Andhra Pradesh, in addition, suggested the inclusion in the pool of the Central surcharge and Kerala, the tax on Union emoluments and pensions.

100. As regards the principles of distribution of the States' share there was a wide divergence of opinion. In West Bengal's view, the only method consistent with the language of article 270 of the Constitution was for the prescribed percentage of the net proceeds to be distributed among the States on the basis of attributability, by which they meant collection, adjusted to provide for payments by assesseees of one State into the treasuries of another and for any element of rent or royalty arising in one State and included in the profits assessed in another. Andhra Pradesh, Bihar, Kerala, Madras and Uttar Pradesh suggested population as the sole criterion. Orissa proposed that 80 per cent should be distributed on the basis of population, weighted for the scheduled castes, scheduled tribes, backward classes and rural population, and the balance on the basis of area. Assam proposed that 20 per cent of the States' share should be distributed on the basis of origin as shown by the ratio of the national income arising in the State to the total national income of the country and the balance on the basis of area-cum-population. Rajasthan proposed that 80 per cent of the States' share should be distributed on the basis of population and 10 per cent on the basis of the revenue needs and backwardness of the States, the balance being earmarked for the border States. Punjab did not indicate any specific formula, but suggested that the distribution should take into account the population and needs of a State, a small portion, say 10 per cent, being credited to a development fund for backward States. Mysore suggested the distribution of 10 per cent on the basis of collection and 90 per cent on the basis of population. Jammu and Kashmir proposed that half the States' share should be distributed on the basis of population and the other half on the basis of area. Madhya Pradesh wanted that population weighted for scheduled castes and tribes should be the sole criterion. Bombay suggested that a third of the States' share should be distributed on the basis of population and the balance on the basis of collection, after leaving a small reserve for meeting special needs; if this were not acceptable, the State Government suggested a return to the formula of Sir Otto Niemeyer which, according to them, gave equal weight to population and collection.

101. We shall first deal with the determination of the share of the net proceeds to be assigned to the States. Income tax has ceased

to be an expanding source of revenue it once was. While in future, with the progressive expansion of economic activity and the plugging of tax evasion, there may be some improvement in the yield, it is unlikely that there will be any very large increase in the revenue from this tax. It is obvious that in the changing pattern of Union taxation, income tax cannot be a major factor in the devolution of further revenues to the States. We, nevertheless, feel that some increase in the States' share of this tax is justified in view of the unanimous desire of the States. After a careful review of the matter in all its aspects, we have come to the conclusion that the percentage of the net proceeds assigned to the States should be raised from 55 to 60.

102. Some States have suggested the inclusion of corporation tax, the tax on Union emoluments and the surcharge on income tax levied for Union purposes in the divisible pool. We are unable to consider these suggestions as they are against the provisions of the Constitution.

103. We now turn to the problem of distribution of the share assigned to the States. The claims put forward by the States generally follow those put forward before the last Finance Commission. In their report, our predecessors have exhaustively dealt with the validity of these claims. They have also dealt at some length with the argument advanced by West Bengal, and repeated before us, that the constitutional provisions require the Centre, after retaining the prescribed percentage of the net proceeds allocated to it, to return the balance to the States on the basis of attributability of the tax, which they equate to collection, subject to minor adjustments.

104. We have considered *de novo* all the claims put forward by the States. We find ourselves in substantial agreement with our predecessors that such considerations as the proportion of the scheduled castes and tribes and backward classes in the population, the area of the State, its backwardness etc., are not relevant to a scheme for the distribution of a tax. We also agree, for the reasons given by them, that there is no legal basis for the West Bengal claim that the Union is in some way required to return to the States the income tax attributable to them after retaining its share

105. We may consider the two principles, namely, population and collection, on the basis of which the States' share is now distributed. Population has found the widest measure of support among the

States, while collection has been urged, in the main, by the two industrially advanced States of Bombay and West Bengal. In all previous schemes of distribution, some weight has been given to collection but this has been reduced in favour of population. In our opinion this has been a move in the right direction. Twenty years ago when income tax first came to be distributed, it could have been argued that the agricultural States had a substantial income from, and an expanding source in, land revenue, which had to be balanced by giving a larger share of income tax to the industrial and commercial States. Land revenue has now become a comparatively less important source in all States. The growth of revenue from sales taxes, motor vehicles tax and other taxes like electricity duties and entertainment and passenger taxes, to which the urban population makes a proportionately larger contribution, has created a situation in which the States, which are more urbanised and industrially developed, are in a financially stronger position than those which are not so well developed or urbanised. The main justification for giving a larger share of income tax to the industrial States has, therefore, ceased to exist. Considering that, in this country, income-tax is paid by an infinitesimal portion of the population and that the bulk of the tax arises out of business incomes which, in the context of the economic integration of the country and the disappearance of barriers to inter-state trade, is derived from the country as a whole, the principle of collection can no longer be considered an equitable basis of distribution. While, as pointed out by our predecessors, there may be a case for weightage being given to collection in the restricted field of personal income tax, we have come to the conclusion that, taking all factors into account, collection should be completely abandoned in favour of population as the basis of distribution. This may result in a loss to a few States where collections are concentrated and their revenue position should be safeguarded by taking it into account in the overall devolution. As, however, we do not desire to cause a sudden break in the continuity, we propose that the distribution of the States' share should be 10 per cent on the basis of collection and 90 per cent on the basis of population. This should make it easy to complete, in due course, the process of eliminating the factor of collection altogether and distributing the entire amount of the States' share on the basis of population.

106. In this, as in all other matters, where population has to be taken into account as a factor in the distribution of taxes, we have adopted the population figures of the 1951 census as the only practicable basis. We are aware that a continuous stream of refugees has