

ment is free to formulate any principles of distribution in respect of these taxes, we consider that, to the extent to which they can be reasonably ascertained or estimated, each State should receive, as nearly as may be, from these taxes the amounts which it would have raised if it had the power to levy and collect them.

44. The recommendations of the Commission thus fall under the following categories for the purpose of implementation:

- (i) those that have to be implemented only by Presidential order, namely, those relating to the distribution of income tax and grants-in-aid in lieu of assignment of any share of the net proceeds of export duty on jute and jute products;
- (ii) those that may be implemented by law of Parliament and until enactment of such law, by Presidential order, namely, those relating to the grants-in-aid under the substantive portion of article 275;
- (iii) those that have to be implemented by law of Parliament alone, namely, those relating to the distribution of excise duties, estate duty, tax on railway fares and the additional duties of excise; and
- (iv) lastly, those that may be implemented by executive order, namely, those relating to the modifications of rates of interest and the terms of repayment of loans.

V. Recent Trends in Federal Finance

45. It may be useful at this point to review the recent trends in federal finance in some other countries. In Chapter IV of their report, the first Finance Commission have traced briefly the experience of other federations in relation to shared revenues. We do not propose to cover the same ground again, but shall review the subsequent developments in a somewhat wider perspective.

46. In the United States, financial relations between the Union and the States have recently been the subject-matter of study and review by a Congressional Commission on Intergovernmental Relations. The report of the Commission, made in June 1955, is a valuable study in the problem of federal financial relations in that country. It contains many important recommendations regarding the principles on which grants should be made to the States and the conditions that should govern them. The Commission hold that, in the context

of the constitutional development of the United States, conditional grants represent a basically sound technique despite their piecemeal development and hotch-potch appearance. They emphasise that grants should be made only for clearly indicated and important national objectives, that they should be given for broad purposes like public health or welfare rather than for highly specialised schemes, that allocations should be flexible in relation to specific schemes or activities covered by those broad purposes and that matching requirements should take into account the economic conditions in the units and their fiscal capacity.

47. In Canada, the pattern of financial relations between the Dominion and the Provinces has been the subject of criticism in recent years. As the periods for which individual and corporate income taxes and the succession duties were rented from the Provinces by the Dominion were due to expire early in 1957, re-examination of the position became necessary. Meanwhile, a Royal Commission of Enquiry on Constitutional Problems (the Tremblay Commission) is understood to have suggested the transfer back from the Federation to the Provinces of the right to levy taxes in the fields which are now rented. It is also reported to have suggested that responsibility for welfare functions like unemployment insurance, old-age security, and family allowances should remain with the Provinces.

48. The Federal-Provincial Tax Sharing Arrangements Act, 1956 has modified to some extent the former scheme of compensation for the surrender by the Provinces of individual income taxes, corporation income taxes and succession duties, as provided in the Tax Rental Agreements Act of 1952. Each Provincial government has been given the option to choose the most favourable of three alternatives. These are:

- (1) a Province will be entitled to compensation at not less than the amount due under the 1952 agreement suitably adjusted for population growth;
- (2) it may get 95 per cent of the payments actually made to it in certain preceding periods;
- (3) it will be entitled to get compensation according to a new formula by which a Province will obtain the sum of three rental payments, that is to say, (a) 9 per cent on corporation incomes in the Province, (b) 10 per cent on individual

incomes earned within the Province or on incomes accruing within or without the Province to residents in the Province, and (c) 50 per cent of the proceeds of the Dominion succession duty chargeable on property attributable to a Province. If necessary, a tax equilisation payment will also be made to a Province to raise the per capita payment to it to the average per capita payment to the two wealthiest Provinces.

49. In spite of these attractive terms, Quebec has stayed out of these arrangements and Ontario has agreed to rent only the individual income tax field. The other eight Provinces have agreed to vacate the entire field of income and inheritance taxes.

50. In Australia, only income tax has been taken over by the Commonwealth from the States. The scheme of compensation for the surrender of taxing powers by the States was originally laid down in the States Grants (Tax Reimbursement) Act, 1946, but the compensation payments due to the States have increased in recent years, not only because the formula for distribution, authorised by the 1946 Act, contemplated an increase in proportion to the growth of population and the increase in average wages per employed person, but also because *ad hoc* additions to the total amount of compensation payable according to the formula have been made every year. The settled pattern now seems to be for Parliament to pass every year, a States Grants (Special Financial Assistance) Act fixing the total sum of the compensation payable in that year and also the minimum payments for particular States, in case this is considered necessary. For the fiscal year ended June 1957, the compensation payments were about £A 174 millions, compared with the original sum of £A 40 millions mentioned in the 1946 Act.

51. Turning to West Germany, some aspects of the financial relations between the Federal Government and the Laender (States) are of interest. By the Basic Law of the Constitution adopted in March 1949, besides the yield from monopolies, the taxes accruing to the Federation are customs duties, excise taxes with the exception of the beer tax, transportation tax, turnover tax and capital levies for non-recurrent purposes. The State list includes the beer tax, taxes on transactions with the exception of the transportation tax and turnover tax, income and corporation taxes, property tax, inheritance tax, taxes on real estate and on business, and taxes with localised application. This distribution leaves the Federal Government in deficit. It has, therefore, no resources with which to assist the poorer States.

Provision has consequently been made in the Basic Law by which the Federation may, by legislation which requires the consent of the Bundesrat, claim part of the income and corporation taxes to cover federal deficits and subsidies which are to be granted to State governments to meet expenditure in the fields of education, public health and welfare.

52. In order to assist the States with lower tax revenues and to equalise the burden of expenditure, the Federation has also been empowered to grant subsidies, obtaining the funds, if necessary, from specific taxes accruing to the States. Federal legislation, which requires the consent of the Bundesrat, determines which taxes will be utilised for this purpose, and in what amounts, and according to what scale the subsidies will be distributed among the States for equalisation.

53. For the purpose of equalisation, the tax capacity index and the equalisation index of every State are fixed according to prescribed formulae. The former is fixed according to the total tax revenue of the State after some adjustments, while the equalisation index is found by multiplying the federal average tax capacity index per inhabitant by the population figure of the respective State, subject to certain adjustments. The States with a tax capacity index greater than the equalisation index have to pay to the Federation a sum determined in accordance with a prescribed formula and the amounts so collected are distributed to the States whose tax capacity index is less than the equalisation index.

54. The tendency towards centralisation has been viewed with increasing disfavour in Switzerland, where the proposals to transfer from the Cantons to the Federation, by means of formal constitutional amendment, the purchase tax, certain stamp duties and the direct taxes on income were vetoed in a referendum in December 1953. These proposals envisaged that in the distribution of the centralised taxes, the poorer Cantons should benefit; and those Cantons did in fact support the proposals. The opposition to the formal transfer of taxing powers from the units to the centre was, however, widespread and it prevailed.

55. In the Nigerian Federation, the distribution of revenues has been based on the principle of origin or derivation. Out of the central taxes mentioned in the constitution of Nigeria as revised in 1954, the import duty on motor spirit in its entirety, half the import and excise duties on tobacco, one half of all the other import duties, half

the export duties, half the excise duty on beer, the proceeds of personal income tax, and mining royalties were devolved on the constituent regions and distributed as nearly as possible by origin. This scheme of distribution is now due for revision

56. The Rhodesian constitution provides, among other things, for the devolution to the States of not less than thirty-six per cent of the federal taxes on income and export duties, and not less than two-thirds of the sales and turn-over taxes.

57. We may refer finally to the constitution of Pakistan, which came into force in March, 1956. While the pattern of federal financial relations embodied in this constitution is generally similar to that of the Indian Constitution, there are some differences. Sales taxes are centralised and railways provincialised; there is no provision for the distribution of estate duty on non-agricultural property, while there is a permissive provision enabling the Federal Government to distribute any export duty or any specified tax. The Pakistan constitution provides also for the appointment of a Finance Commission. Pending the recommendations of that Commission, the existing scheme of distribution of revenues as adopted at the time of the unification of West Pakistan has been maintained, subject to a minor adjustment on account of the collections attributable to federally-administered territories.

58. A noticeable trend in all federations has been the progressive increase in the size of federal payments to the states. For the three major federations which have been referred to in the earlier paragraphs of this Section, this growth is illustrated by the figures set out in the following table :

	Fiscal year 1951-52	Fiscal year 1956-57
<i>U. S. A.</i> (in \$ millions)		
Net federal expenditure in aid of States and local governments	2,604	3,317*
<i>CANADA</i> (in \$ millions)		
Tax rental payments and statutory subsidies	1 12	395 6
Grants for unemployment assistance, old-age assistance, pensions and allowances for blind and disabled persons, health grants, and university grants	37.3**	92.5

	Fiscal year	Fiscal year
	1951-52	1956-57

AUSTRALIA (in £A millions)

Tax reimbursements, special financial assistance, special grants and payments under the financial agreement,	162.30	204.82
Commonwealth aid for roads, grants to universities, and grants for long-service leave in the coal-mining industry, encouragement of meat production, Western Australia water works, mental institutions and imported houses, price control reimbursement and tuberculosis benefits .	20.59	38.93***

*Excludes grants from the federal highway trust fund, estimated at \$ 1,137 millions in fiscal year 1957.

**Excludes \$ 77.2 millions on account of old-age pensions as they have since been federalised.

***Excludes £A 14.77 millions paid to the States from the National Welfare Fund, £A 1.36 millions paid on account of agricultural and other services and £A 14.23 millions paid for assistance to primary producers.

NOTE.—Figures for Australia under column 2 are for 1952-53.

VI. Principles of Grants-in-aid

59. Article 280(3) (b) of the Constitution casts on us the duty of recommending the principles which should govern the grants-in-aid of the revenues of the States.

60. It would be interesting to recall the scope of grants-in-aid in the scheme of devolution under the Government of India Act, 1935, which set the pattern for such devolution. Sir Otto Niemeyer, on whose award the scheme was based, treated grants-in-aid as a form of residuary assistance for certain Provinces after taking into account the sharing of taxes and the adjustment of debt. While estimating the overall fiscal need of a Province, he took note of the differences in administrative needs which, he thought, could not be obliterated by Central assistance on a basis common to all the Provinces. He recognised the responsibility of each Province to ensure budgetary equilibrium and was anxious to set those Provinces, which were suffering from chronic budgetary deficits, on an even financial keel, without endangering the solvency of the Central Government. He took an integrated view of the finances of the Centre and the Provinces and recognised that any scheme of devolution, which