

## IV. DEVOLUTION OF UNION TAXES/DUTIES

### (i) *Income-tax*

26. Article 270(1) of the Constitution provides for the obligatory participation of the Union and the States in the proceeds of taxes on income other than agricultural income. Corporation tax, the proceeds attributable to Union territories and taxes payable in respect of Union emoluments are specifically excluded from distribution.

27. 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.

28. Before we deal with them, we should like to summarise briefly the views placed before us by the State Governments. All the States have pointed out that, as a result of a change brought about in the Income-tax Act by the Finance Act of 1959, the income-tax paid by companies is now classified as corporation tax and is thus excluded from the pool of income-tax hitherto available for distribution. This, they represent, has deprived them of an expanding source of revenue to which they had hitherto a constitutional entitlement. The submission has, therefore, been made to us that we should take into account at least such part of the corporation tax as is attributable to this yield, if not the entire tax.

29. Suggestion has also been made that the surcharge on income-tax levied under article 271, which has been in force for about the last 15 years, should now be merged in the basic rates. It was urged that this would abate partly the impact of the loss sustained, as this would indirectly bring within the pool of distribution an excluded amount.

30. We, however, made it clear to the State Governments that the recommendations that we would make should necessarily be

in accordance with the provisions of the Constitution and our terms of reference. We also pointed out that other measures were available to take account of the shrinkage of the distributable pool. While appreciating this position, all the States claimed that the percentage of the tax to be assigned to them should be substantially increased; some even suggested that the entire net proceeds should be assigned to the States. We suggested that, in the case of a divisible tax in which there was obligatory participation between the Union and the States, a sound maxim to adopt would be that all participating Governments, more particularly the one responsible for levy and collection, should have a significant continuing interest in the yield of the tax. The States generally appreciated this point of view, but, variously suggested that a devolution of the order of 70 to 90 per cent would be appropriate. On the considerations mentioned above, we feel, however, that it should be adequate if  $66\frac{2}{3}$  per cent of the net proceeds of this tax be assigned for distribution to the States.

31. The question of distribution of the share assigned to the States is not only a complicated issue but a controversial one. Widely divergent views have been expressed, ranging from distribution entirely on the basis of collection to distribution wholly on the basis of population. In between, there are suggestions that population should be weighed to take account of the proportion of scheduled castes and tribes and backward classes in the population, that the area of the State should be a relevant consideration, and that its backwardness should not be ignored. There are also suggestions that distribution should be based on considerations of population as also collection in various proportions.

32. We are in general agreement with our predecessors that the relevant considerations are population and collection. We did not find it feasible to introduce other factors in the distribution of this tax. In all previous schemes of distribution, there has been a blending of these two principles, but in different proportions. While the first Finance Commission recommended that distribution of the States' share should be on the basis of 20 per cent for collection and 80 per cent for population, the second Commission reduced the element of collection to 10 per cent and expressed the view that in due course the factor of collection should be eliminated altogether and distribution be made entirely on the basis of population.

33. We have considered the matter *de novo*. The second Commission itself recognised that "there may be a case for weightage

being given to collection in the restricted field of personal income-tax". The first Commission had gone further and stated: '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'. We consider that these statements have a force. In our view, while population should remain the main factor for the distribution of the net proceeds of income-tax amongst the States, the factor of contribution should receive adequate recognition. It has been urged before us by the industrial and urban States, in whose territory large amounts are collected by way of income-tax, that they should have an incentive and the wherewithal to maintain the environments which would preserve and promote industrial and trade activities.

34. Since the second Finance Commission made its recommendations, the taxes on income paid by companies have been excluded from the divisible pool. Bulk of this tax paid by companies would have accrued from income of all-India origin. With the exclusion of this element from the divisible pool, a higher percentage than before of the total yield of income-tax now represents tax derived from incomes of local origin.

35. We consider, therefore, that a higher weightage should be given to the factor of contribution in the distribution of income-tax than that recommended by the second Commission. We have also been impressed with the submission that the industrial States having larger collections have problems of their own. Large concentration of population, more particularly of industrial labour, creates problems of law and order and gives rise to an increased demand for the administrative and social services. Further, the unit cost of providing these services is larger in such areas than elsewhere, more particularly in the non-urbanised parts.

36. Taking all these considerations into account, we feel that it would be fair and equitable to restore the formula of the first Commission for the distribution of income-tax, namely, 80 per cent on the basis of population and 20 per cent on the basis of collection.

37. As regards the actual manner of distribution of the States' share in each year, we agree with the earlier Commissions that it will be convenient both to the States and to the Union if the shares are expressed as fixed percentages. We recommend that two-thirds, that is to say  $66\frac{2}{3}$  per cent of the net proceeds in any financial

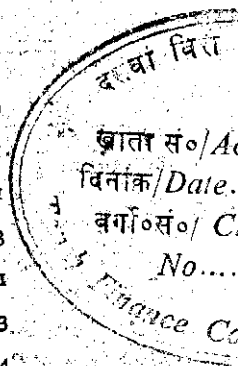
ar of taxes on income other than agricultural income, except in so far as those proceeds represent proceeds attributable to Union territories or to taxes payable in respect of Union emoluments, be assigned to the States and distributed among them in the following manner:

State	Percentage
Andhra Pradesh	7.71 ✓
Assam	2.44
Bihar	9.33
Gujarat	4.78
Jammu and Kashmir	0.70
Kerala	3.55
Madhya Pradesh	6.41
Madras	8.13
Maharashtra	13.41
Mysore	5.13
Orissa	3.44
Punjab	4.49
Rajasthan	3.97
Uttar Pradesh	14.42
West Bengal	12.09

38. We further recommend that 2.5 per cent of the net proceeds of the income-tax be prescribed as the net proceeds attributable to Union territories.

### (ii) Union Excise Duties

39. Article 272 of the Constitution empowers Parliament to provide by legislation the distribution to the States of the whole or a part of the net proceeds of the Union duties of excise on specified commodities, prescribing, at the same time, the principles on which the distribution should be made. This permissive provision was embodied in our Constitution to provide for additional financial assistance to the States, should the necessity arise to augment sums which could be made available under other provisions of the Constitution.



40. Till April 1952, the proceeds of this duty were not brought into distribution and were retained wholly by the Union. The first Finance Commission broke new ground by recommending the sharing of the proceeds of duties on three commodities between the Union and the States. It was presumably influenced in this conclusion by the growing financial needs of the States in fulfilling a complementary role in the development of the national economy and the provision of a higher level of social services. The second Commission expanded the list of duties to eight commodities as in their view the taxes on income were ceasing to be an expanding source of revenue and increasing dependence should be placed for purposes of devolution on the growing source of excise revenue. The impact of planning on the States also called for a larger measure of devolution which could be suitably provided by using the permissive provisions of article 272 more extensively.

41. The yield of the duty in the financial year 1951-52 was only Rs. 86 crores, but, it has yielded Rs. 383 crores in the year 1960-61. The range and depth of this duty was further enhanced in the year 1961-62. It is becoming evident that further expansion of this source of revenue is inescapable to meet the growing fiscal needs of our developing economy.

42. We consider that a more extensive use of article 272 for affording assistance to the States is not only justified but is even necessary. For one thing, the shrinkage in the divisible pool of income-tax has to be taken into account; for another, the larger revenue gaps caused by the impact of the committed expenditure of two successive plans have to be filled.

43. Three alternatives have been canvassed before us, namely, the distribution should cover the proceeds of Union excise duties on (i) articles of common consumption, (ii) consumer goods, and (iii) all the commodities on the present list. The majority of States have demanded that the entire net proceeds of Union excises should be made divisible. The arguments they adduce in support are two-fold:

- (a) the expansion of the range of commodities subjected to Union excises from time to time and the increasing incidence of the duty have an impact on the levy and collection of sales tax. This in itself is a justification enough to give recognition to the interdependence of the two

levies by making the entire proceeds of Union excise duties divisible. Additionally, sales tax constitutes the only significant flexible source of revenue available to them and this flexibility is subjected to restraint by the excise policy of the Union Government; and

- (b) the rate of duty on certain articles of common consumption, like cotton textiles, is variable and has, in fact, been varied from time to time depending on the stock position and market conditions. Similar considerations may arise in the case of sugar also. If a broader base is adopted for distribution, the buoyancy on certain articles will make good the shortfall on others, maintaining a steady flow of assistance.

44. We have been impressed by the logic of this approach. We consider that the inadequacy of resources that has developed in the States is attributable mainly to the planning process and this inadequacy may become more pronounced with the completion of each successive Plan for some years to come. The viability of the States could best be secured by a larger devolution of the Union excise duties and this should be effected by providing for the participation of the States, by convention, in the proceeds of all Union excises. It would give a great deal of psychological satisfaction to the States and dissipate any suspicion that the Union is pursuing a policy of excessive centralisation of resources. We consider that 20 per cent of the net proceeds of Union duties of excise on all commodities on which such duties are collected, would be appropriate for the purpose we have in view. For purposes of our distribution, we have included all the commodities on which duties were collected in 1960-61 being the last year preceding the third five year Plan, excluding (except silk fabrics) those on which the yield was below Rs. 50 lakhs a year. We exclude, however, from this computation the duty on motor spirit, as we propose elsewhere that a sum of Rs. 36 crores being about 20 per cent of its yield should be utilised for maintenance and improvement of communications and distributed as a special purpose grant.

45. We have considered the other two alternatives also, but have felt that there is no particular virtue or advantage in their adoption. Selection of a list of consumer goods might well be questioned; nor would it provide a more satisfactory basis of distribution. Similarly, limiting devolution to articles in common use, such as cotton textiles,

sugar, etc., would not, in the present situation, assure the States of a stable yield.

46. We now turn to the distribution of the States' share of the divisible excises. The first Commission had suggested that consumption of taxed commodities could provide a suitable basis for distribution, but, in the absence of reliable data, they adopted population as the basis. Confronted with the same situation of non-availability of reliable statistics, the second Commission felt that population was the best basis to adopt, more particularly, as distribution on consumption, even if the relevant data were available, would benefit the more urbanised and, in their view, therefore, the financially stronger States. Both the Commissions were considering a limited range of commodities which could be classified as consumer goods; but, we propose to include, in devolution, producer goods and intermediaries also. Consumption would not, in our view, be the correct criterion to apply for distribution.

47. We consider that while population should continue to be the major factor of distribution, the relative financial weaknesses of the States, the disparity in the levels of development reached, the percentage of scheduled castes and tribes and backward classes in their population, etc. should also be taken into account in determining the share to be allocated to each State individually. In other words, we feel that in this permissive participation, an attempt should be made to bring all the States, as far as possible, to a comparable level of financial balance. We recommend, therefore, that under article 272 of the Constitution, a sum equal to 20 per cent of the net proceeds of the Union duties of excise on all articles scheduled below be paid out of the Consolidated Fund of India to the States and distributed among them as given below:

*Schedule of articles*

1. Sugar.
2. Coffee.
3. Tea.
4. Tobacco.
5. Kerosene.
6. Refined diesel oils and vaporizing oils.

7. Diesel oil, not otherwise specified.
8. Furnace oil.
9. Asphalt and Bitumen.
10. Vegetable non-essential oils.
11. Vegetable products.
12. Pigments, colours, paints, enamels, varnishes, blacks and cellulose lacquers.
13. Soap.
14. Tyres and tubes.
15. Paper.
16. Rayon and synthetic fibres and yarn.
17. Cotton fabrics.
18. Silk fabrics.
19. Woollen fabrics.
20. Rayon or artificial silk fabrics.
21. Cement.
22. Pig Iron.
23. Steel ingots.
24. Aluminium.
25. Tin plate and tin sheets including tin taggers and cuttings of such plate, sheets or taggers.
26. Internal combustion engines.
27. Electric motors and parts thereof.
28. Electric Batteries and parts thereof.
29. Electric lighting bulbs and fluorescent lighting bulbs.
30. Electric fans.
31. Motor vehicles.
32. Cycles, parts of cycles other than motor cycles.
33. Footwear.



34. Cinematograph films exposed.

35. Matches.

*Schedule of distribution*

State	Percentage
Andhra Pradesh . . . . .	8.23
Assam . . . . .	4.73
Bihar . . . . .	11.56
Gujarat . . . . .	6.45
Jammu and Kashmir . . . . .	2.02
Kerala . . . . .	5.46
Madhya Pradesh . . . . .	8.46
Madras . . . . .	6.08
Maharashtra . . . . .	5.73
Mysore . . . . .	5.82
Orissa . . . . .	7.07
Punjab . . . . .	6.71
Rajasthan . . . . .	5.93
Uttar Pradesh . . . . .	10.68
West Bengal . . . . .	5.07