

CHAPTER 4

GRANT IN LIEU OF TAXES ON RAILWAY FARES

27. According to paragraph 4(c) of the Order of the President, the Commission has to make recommendations in regard to "the changes, if any, to be made in the principles governing the distribution among the States of the grant to be made available to the States in lieu of taxes on railway fares".

28. The tax on railway passenger fares was imposed under the Railway Passenger Fare Act, 1957 and the Second Finance Commission was, for the first time, requested to make recommendations as to the principles which should govern the distribution under article 269 of the Constitution of the net proceeds in any financial year of the tax. The Second Finance Commission decided that the proceeds of the tax should be distributed among the States in the ratio of passenger earnings which may be determined with reasonable accuracy by allocating passenger earnings among States on the basis of railway route mileage within each State with due allowance for variation in density of traffic between the various railway zones and as between the various gauges in each zone. Thus the earnings from passenger traffic of each zonal railway (excluding earnings from suburban services) were allocated by route mileage located in each State separately for each gauge. The Second Commission recommended that the proceeds of the tax be distributed in the ratio of Statewise earnings so worked out and indicated each State's share as a fixed percentage applicable for five years from 1957-58.

29. The Railway Passenger Fares Act, 1957 was repealed by Act VIII of 1961 and the tax was merged in the basic fares. The Union Government, however, decided to make an *ad hoc* grant of Rs. 12.50 crores per annum to the States in lieu of the tax for a period of five years from 1961-62 to 1965-66. The Third Finance Commission which was asked to recommend the principles on which the *ad hoc* grant should be distributed, recommended that the distribution should be on the principle of compensation to place the States broadly on the same footing as before and accordingly worked out the distribution of the sum of Rs. 12.50 crores per year.

30. We agree that the distribution of this grant should be on the basis of compensation and that the percentage share of each State in which the tax is leviable should be worked out on the principles enunciated by the Second Finance Commission. In our term of reference on the subject, while we have been asked to make recommendations regarding changes, if any, to be made in the principles governing distribution among States of the grant to be made available to the States in lieu of taxes on railway passenger fares, the actual amount of grant to be distributed has not been indicated. Therefore, instead of recommending the sums payable to each State, we consider it desirable to express the States' shares in percentages. In determining the percentage share as stated below, we have utilized the latest available statistics of railway route length in each State under each gauge and the average annual earnings from passenger traffic (excluding earnings from suburban traffic) for three years ending 1964 for which actuals were available:

Percentage share of each State in grant in lieu of tax on railway passenger fares

<i>States</i>	<i>Percentage share</i>
Andhra Pradesh	9.05
Assam	2.79
Bihar	9.99
Gujarat	7.11
Jammu & Kashmir	—
Kerala	1.85
Madhya Pradesh	9.85
Madras	5.81
Maharashtra	8.98
Mysore	3.98
Nagaland	0.01
Orissa	2.12
Punjab	7.43
Rajasthan	6.40
Uttar Pradesh	18.23
West Bengal	6.40
Total	100.00

25. On the basis of the 1961 Census figures, the percentage will be as follows:

<i>States</i>	<i>Percentage</i>
Andhra Pradesh	8.34
Assam	2.75
Bihar	10.76
Gujarat	4.78
Jammu & Kashmir	0.83
Kerala	3.92
Madhya Pradesh	7.50
Madras	7.80
Maharashtra	9.16
Mysore	5.46
Nagaland	0.09
Orissa	4.07
Punjab	4.70
Rajasthan	4.67
Uttar Pradesh	17.08
West Bengal	8.09
Total	<u>100.00</u>

26. One of the considerations which the Commission is required to take into account in determining the sums to be paid to the States in need of assistance by way of grants-in-aid of their revenues under article 275 is the creation of a fund out of excesses, if any, over a limit to be specified by the Commission, of the net proceeds of estate duty on property other than agricultural land accruing to a State in any financial year, earmarked for the repayment of the State's debt to the Central Government. As the total annual net proceeds of estate duty assignable to the States are only about Rs. 7 crores at the current levels of taxation, it would not be of any practical value to create a fund by contributing a part of these proceeds. The whole question of making provision for amortisation of the debts owed by all the States both to the public and to the Central Government has been dealt with elsewhere in this report.

CHAPTER 3 ESTATE DUTY

23. Paragraph 4(b) of the Order of the President constituting the Fourth Finance Commission requires us to make recommendations in regard to the changes, if any, to be made in the principles governing the distribution among the States under article 269 of the Constitution, of the net proceeds in any financial year of estate duty in respect of property other than agricultural land. We are also required under that article to determine the proceeds attributable to Union territories.

24. A number of suggestions were made by the States in regard to the principles of distribution. The different suggestions were: (i) distribution of estate duty wholly on the basis of population, (ii) distribution partly on the basis of collection and partly on the basis of location, (iii) distribution on the basis of population with weightage to Scheduled Castes and Scheduled Tribes, (iv) distribution on the basis of 80 per cent population and 20 per cent location, and (v) continuance of the existing scheme of distribution. We are in agreement with the principles laid down by the earlier Commissions and recommend the continuance of the following principles: We recommend, however, that the share of Union territories may be raised to two per cent, taking into account population and the value of immovable property assessed in these territories in recent years.

(i) Out of the net proceeds of the duty in each financial year, a sum equal to two per cent be retained by the Union as proceeds attributable to Union territories;

(ii) The balance be apportioned between immovable property and other property in the ratio of the gross value of all such properties brought into assessment in that year;

(iii) The sum thus apportioned to immovable property be distributed among the States in proportion to the gross value of the immovable property located in each State; and

(iv) The sum apportioned to property other than immovable property be distributed among the States in proportion to their population.

31. In view of the fact that the tenure of the present *ad hoc* grant of Rs. 12.50 crores per year expires at the end of 1965-66 and the recommendation of the Railway Convention Committee about the future quantum of grant would be available only by the end of this year, we have adopted the only practical course of recommending each State's share in terms of percentages. However, for calculating the residuary revenue deficit of the States to be covered by grants-in-aid under article 275 of the Constitution, some assumption had to be made about the likely amount of grant to be made available to the States in lieu of taxes on railway fares. In this regard, we considered that the best course would be to adopt the present level of annual grant *viz.*, Rs. 12.50 crores. If, as a result of any increase in the grant the States were to receive larger amounts, such amounts would be available to the States as surplus.

32. While the determination of the quantum of the grant does not lie within our jurisdiction, we feel that it is desirable to place on record the views of the States on this subject. The States have almost unanimously represented to us that fixation of the grant at a particular level has deprived them of a potentially elastic source of revenue and have urged that the level of grant should be raised in the proportion in which the railway passenger earnings have increased since the merger.

CHAPTER 5

INCOME TAX

33. Article 280(3) (a) read with article 270(1) of the Constitution provides that it shall be the duty of the Commission to make recommendations to the President as to the allocation between the Union and the States and the distribution among the States themselves of the "net proceeds" of taxes on income other than agricultural income levied and collected by the Government of India. Corporation tax, the proceeds attributable to Union territories and taxes payable in respect of Union emoluments are excluded from the divisible pool. Accordingly, 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 manner of distribution among the States of their share; and
- (c) the percentage of the "net proceeds" which shall be deemed to represent proceeds attributable to Union territories.

34. Before we deal with them, we give below a brief account of the claims advanced before us by the State Governments on the aforesaid matters affecting them. Practically all the States have urged for an increase in the share to be assigned to them and have pointed out that as a result of the change in the classification of the income-tax paid by companies brought about by the Finance Act, 1959, the rate of growth of the divisible pool has been adversely affected. It was further argued that what the framers of the Constitution had intended to be a flexible and expanding source of revenue to the States had ceased to have the significance that was once contemplated. While the collections from corporation tax have increased by well over 600 per cent in the course of the last 12 years, the corresponding growth in the divisible pool of income tax was less than 50 per cent. Some of the States have reiterated the views placed by them before the previous Commissions that though the Government of India was competent to levy any surcharge, wholly for the purposes of the Union under article 271, such a levy in the very nature of things, was intended to be a temporary measure to

serve a particular situation. It was, therefore, urged that during normal times there should be no need for any surcharge exclusively for the Union. However, if at all such a surcharge was levied, it should as a matter of course be merged with the basic rates after a period of three years.

35. On the question of the percentage of the States' share, while some States did not suggest any change in the existing percentage, some others suggested that the entire net proceeds be assigned to the States. The suggestions by other States fell between these two views. One State proposed that 50 per cent of the proceeds of both income-tax and corporation tax should be assigned to the States. Another view was that the permanent solution to the shrinkage in the divisible pool was suitably to amend the Constitution so as to provide for inclusion of the proceeds from corporation tax in the divisible pool; alternatively, the Centre should make good to the States by way of grants the loss on account of non-inclusion of corporation tax in the divisible pool.

36. We have considered the claims put forward by the States. We are in general agreement with the observation of the Third Finance Commission that in the case of a divisible tax in which there was obligatory participation between the Union and the States, a sound maxim to observe would be that all participating Governments, more particularly the one responsible for levy and collection, should have a significant interest in the yield of that tax. Due note should also be taken of the States' representation about the need for abating in some measure the loss sustained by them, consequent upon the reclassification of income tax paid by companies.

37. The fixation of the States' share should take into account the present level of yield of this source of revenue and its likely future rate of growth; on these points we have accepted the forecasts as supplied to us by the Ministry of Finance. Considering the various facts placed before us, we are of the view that some further increase in the States' share is justified. We accordingly recommend that 75 per cent of the divisible pool of income-tax should be allocated to the States for distribution among them.

38. As regards the principles of distribution of the States' share *inter se*, the views expressed by the States were widely divergent. While some States wanted the share to be distributed entirely on the basis of population, another view was that the distribution should be solely on the basis of collection. The other suggestions made were

that the distribution should be made on the basis of (i) 80 per cent on population and 20 per cent on area; (ii) 75 per cent on population, 15 per cent on area and 10 per cent on collection; (iii) 70 per cent on total population, 20 per cent on collection and 10 per cent on urban population; (iv) population with proper weightage to Scheduled Castes and Tribes, by counting twice over, the Tribal population; (v) population, relative financial weakness and economic backwardness; (vi) 50 per cent on population and 50 per cent on inverse ratio of *per capita* income; and (vii) 50 per cent on population and 50 per cent on collection. Some States were in favour of the continuance of the existing principle, namely, 80 per cent on the basis of population and 20 per cent on the basis of collection.

39. We have no hesitation in rejecting some of the factors, put forward by the States, like area, backwardness and financial weakness and proportion of Scheduled Castes and Tribes in the population as proper bases for a scheme of distribution of the proceeds of income tax among the States. There remain only two factors which we were convinced are relevant, namely, population and contribution. Though contribution is not synonymous with collection, in the absence of data necessary for a correct determination of the contribution of each State, collection must be taken as the only available indicator of contribution. Taking these two factors of population and collection, there can be divergence of opinion as to the relative proportion to be assigned to these two factors. Though we discussed various proportions, we were eventually impressed by the fact that a sense of certainty and stability as regards the principles to be adopted in the distribution of income-tax should prevail. It is not desirable that every time a new Finance Commission is appointed, there should be reopening of the basis of distribution. We have therefore decided that the principle of distribution to individual States of their share in the divisible pool of income-tax proceeds should be the same as recommended by the First Finance Commission and by the Third Finance Commission, that is to say, 80 per cent on the basis of population and 20 per cent on the basis of collection.

40. As regards the actual manner of distribution of the States' share in each year, we feel that it will be convenient both to the States and to the Union if the shares are expressed as fixed percentages. Taking, therefore, the average of the collections of the three years ending with 1963-64, and the population figures according to the 1961 Census, the percentage share of each State in the distributable amount would work out as given in the table below. We accord-