

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-

ingly recommend that 75 per cent of the net proceeds in any financial year 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 :—

States	Percentage
Andhra Pradesh	7.37
Assam	2.44
Bihar	9.04
Gujarat	5.29
Jammu & Kashmir	0.73
Kerala	3.59
Madhya Pradesh	6.47
Madras	8.34
Maharashtra	14.28
Mysore	3.14
Nagaland	0.07
Orissa	3.40
Punjab	4.36
Rajasthan	3.97
Uttar Pradesh	14.60
West Bengal	10.91
Total	100.00

41. As regards the percentage to be fixed under clause (3) of article 270 which shall be deemed to represent proceeds attributable to Union territories, we recommend that this should be prescribed as two and a half per cent of the net proceeds of the tax. We have arrived at this figure by allocating to the Union territories 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, namely, 80 per cent population and 20 per cent collection, as that recommended by us in respect of the States.

## CHAPTER 6

### UNION EXCISE DUTIES

42. Under sub-clause (a) of clause (3) of article 280 of the Constitution, the Finance Commission is required to make recommendations to the President as to the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be divided between them under the provisions of Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds. Union excise duties, which are referred to in the Constitution in article 272 and entry No. 84 in List I (Union List) of the Seventh Schedule, fall in the category of taxes which 'may be' distributed between the Centre and the States and hence the entire subject of their division between the Centre and the States on the one hand and as between different States on the other, comes within the purview of the Commission.

43. The first question we had to consider was whether the States should at all be given a share out of Union excises. We note that under the Constitution the distribution of proceeds of Union excise duties between the Centre and the States is merely permissive and does not stand on the same footing as the compulsory assignment to the States of proceeds of taxes enumerated under article 269 of the Constitution or compulsory distribution between the Centre and the States of the proceeds of income tax under article 270 of the Constitution. The States thus do not have a constitutional right to claim a share out of the proceeds of Union excises. It is for Parliament to decide if the States should at all be given a share. In taking a decision however, Parliament is required to take into account the recommendations of the Finance Commission on this subject made available to it under sub-clause (a) of clause (3) of article 280 of the Constitution. The factual position is that ever since 1952-53, the States have been getting a share out of Union excise proceeds. The first three Finance Commissions had taken the view that having regard to the growing requirements of funds by the States for developmental and other essential services, recourse to permissive sharing contemplated under article 272 of the Constitution was not only justified but even necessary. We endorse this view.

44. The next question that we had to consider was: Which of the excisable commodities should be selected for the distribution of proceeds between the Centre and the States and what percentage of the total proceeds on those commodities should be made over to the States? Before giving our recommendations on this aspect, we would state the legal and constitutional position in regard to the excise levy. Articles 246 and 272 of the Constitution empower the Union Government to levy and collect excise duties on all goods manufactured or produced in India, excepting alcoholic liquors for human consumption and opium, Indian hemp, and other narcotic drugs and narcotics. This power is exercised by the Union Government through certain enactments, the most important of them being the Central Excises and Salt Act, 1944. The Union excise levies which are currently in operation could be grouped under the following categories: \*

- (i) Basic excise duties on a large number of items levied under the Central Excises and Salt Act 1944 as amended from time to time by the Finance Acts of each year;
- (ii) Cesses or excise duties levied on certain goods under special Acts\*, the proceeds of the duty being earmarked for specified uses, for example, excise duty or cess on the production of copra, oil extracted from oilseeds, salt, coal, iron ore, rubber, mill-made cloth, etc.
- (iii) Additional duties of excise in lieu of sales taxes on sugar, tobacco and textiles under the Additional Duties of Excise (Goods of Special Importance) Act, 1957;
- (iv) Additional duties of excise on motor spirit, kerosene, refined diesel oils and vaporising oil, diesel oil not otherwise specified and furnace oil under the Mineral Oils (Additional Duties of Excise and Customs) Act, 1958;

\*Some of the special Acts are listed below:

- (1) The Indian Coconut Committee Act, 1944.
- (2) The Indian Oilseeds Committee Act, 1946.
- (3) The Coal Mines Labour Welfare Fund Act, 1947.
- (4) The Coal Mines (Conservation and Safety) Act, 1952.
- (5) The Rubber Act, 1947.
- (6) The Rubber (Amendment) Act, 1960.
- (7) The Iron Ore Mines Labour Welfare Cess Act, 1961.
- (8) Khadi and other Handloom Industries Development (Additional Excise Duties on Cloth) Act, 1953.
- (9) Dhoties (Additional Excise) Act, 1953.
- (10) Cotton Fabrics (Additional Excise Duty) Act, 1957.

- (v) Special duties of excise on certain goods levied for the first time in March 1963 in the form of surcharges on basic duties on certain items under the Finance Act of 1963 and later amended by subsequent Finance Acts; and
- (vi) Regulatory duties of excise levied under the Finance Acts, the purpose of the provision being to give to the Executive, powers to vary rates of duties on any item within certain limits.

All the above levies are imposed in exercise of the legislative power given to the Union Government under article 246 of the Constitution, read with item 84 in List I of the Seventh Schedule and therefore fall within the scope of article 272.

45. The additional duties of excise in lieu of sales taxes on sugar, tobacco and textiles levied under the Additional Duties of Excise (Goods of Special Importance) Act, 1957 fall in a distinct category as the net proceeds of these levies are wholly paid to the States after retaining a small portion representing the share attributable to Union territories. We discuss the issues connected with these duties in a separate chapter.

46. The special duties of excise levied under the Finance Acts are of recent origin. These were introduced in 1963 in the context of the National Emergency and the present position is that the proceeds of these duties are earmarked exclusively for Union purposes and are not sharable with the States. It has been contended that the proceeds of special duties of excise should also be made sharable with the States. We take the view that it is open to us to suggest that proceeds of special excises should also be shared with the States. This would not at all be repugnant to the constitutional position as the Constitution nowhere lays down, as indeed it does in article 271 for taxes falling under articles 269 and 270, that surcharges on excises would be exclusively for the use of the Union. So far as the legal ban under the Finance Acts is concerned, that is something that can always be reviewed by Parliament, particularly in the light of such recommendations as the Finance Commission may make. On practical considerations, however, we think that it would be desirable to keep the proceeds of special duties of excise outside the sharing scheme. These duties are renewed on a year to year basis and are not on the same footing as the basic duties of excise under the Central Excises and Salt Act, 1944. Further, if the object of including these duties in the sharing scheme is to enable the States to have larger resources, this