

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	5.14
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

can equally well be achieved by suggesting a larger share to the States out of the basic duties.

47. The regulatory duties of excise which were for the first time introduced in 1961 have not yet become important; no collections were made upto 1964-65. The imposition of these duties is essentially a regulatory measure and we do not think that it is necessary to bring the proceeds of these duties into the sharing scheme.

48. The cesses, or the additional excise duties on items like copra, salt, iron ore, coal, oilseeds, mill-made cloth, fabrics, dhoties, etc. referred to as item (ii) in paragraph 44 above have special objects in view and the proceeds are utilized for only earmarked purposes enumerated in the relevant legislations pertaining to each of these levies. In view of this, the sharing of the proceeds of these levies between the Centre and the States would not be desirable.

49. Under the Mineral Oils (Additional Duties of Excise and Customs) Act, 1958, additional duties are levied on certain mineral oil products. These duties are levied to give effect to the price reductions enforced on the oil distributing companies from time to time and to adjust the benefits accruing to these companies as a result of fluctuations in the "posted prices" of bulk refined products in the Persian Gulf and variations in freights therefrom the Indian ports—ceiling selling prices in the country being built up on the basis of import parity linked with the Persian Gulf. These price reductions and cost and freight accumulations are mopped up and credited to the Government exchequer through the mechanism of these additional duties. The duties are recovered from the oil companies and the benefit of the reduction in cost is not passed on to the consumers. These levies are basically in the nature of excise duties under the Central Excises and Salt Act, 1944. We suggest that for the purpose of distribution of the proceeds between the Centre and the States the yield of the two levies, viz., the basic and the additional may be taken together and the total made sharable in the same manner as the proceeds of the basic excise duties.

50. The first two Finance Commissions confined the sharing scheme to a few selected items: the First Finance Commission to three, viz., tobacco, matches and vegetable products and the Second to eight, viz., tobacco, matches, vegetable products, sugar, tea, coffee, paper and vegetable non-essential oils. The Third Finance Commission's approach to the question of selection of items for sharing was different from that of the earlier Commissions. It accepted in principle

the reasonableness of the demand of the States for participation in the proceeds of all Union excises; for purposes of distribution, however, it included only the commodities on which duties collected in 1960-61 amounted to Rs. 50 lakhs or more. The duty on motor spirit was excluded from the sharing scheme as that Commission had recommended a separate special purpose grant of a corresponding amount for the development of communications. In their representations to us, the States have almost unanimously argued that whatever reservations the last Finance Commission's distribution scheme had should now go and that they should be entitled to a share out of the proceeds of excise duties on all commodities, including the commodities which might be taken up for the levy in the coming quinquennium.

51. The arguments advanced by the States in favour of extending the sharing scheme to all commodities run on the following lines:

- (i) If a coordination between the excise policy of the Union Government and the sales tax policies pursued in the States is at all to be achieved, it would be necessary to put the States in a position in which they have and continue to have a substantial interest in the collection and levy of Union excises. One method of achieving this object would be to make Union excise duties on all commodities sharable with the States;
- (ii) The larger the number of commodities brought within the divisible pool, the greater would be the evenness in the flow of resources to the States, as fluctuations in the yield on certain items would be neutralised by fluctuations in the yield of some other items. The States' requirements are growing and, therefore, an elastic source of revenue like a share in excises on all commodities would go to strengthen their position;
- (iii) As the commodities covered by the Union excise duties are of country-wide consumption, there is no justification for selecting only a few of the commodities for sharing;
- (iv) The system of sharing only selected commodities suffers from the defect that if, for one reason or another, the excise duty on a shared commodity is reduced or abolished and substituted in part or whole by a levy on a related product not included in the sharable list, the States stand to lose. For example, the excise duty on steel ingots was one of the sharable items listed by the Third Finance Commission. For various reasons, the Union Government later

substituted the duty on steel ingots by a levy on iron and steel products, but the States did not get any share out of the new levy although it was in replacement of a levy, proceeds of which were sharable; and

- (v) In any economy where industry is getting diversified, new lines of production will emerge continuously and any formula for the sharing of excise duties should therefore cover such new products.

We find considerable force in the above arguments and therefore, recommend that all Union excise duties currently levied as also those that might be levied in the coming five years should be shared between the Centre and the States.

52. As to the question of sharing special excises, our attitude, as already explained, is that no sharing need be provided. We, however, suggest that in future the resort by the Union Government to special excises should not be the rule but the exception. Any departure from the normal levy of basic excises should be on the basis of provisions expressly inserted by Parliament in the Acts levying the special excises.

53. On the question of the percentage of the proceeds of distributable excises, it has been suggested to us by practically all the States that in order to impart viability to States' finances and to introduce in them a measure of elasticity, a higher proportion than the one recommended by the last Finance Commission should be prescribed for distribution to the States. Some have suggested as high a proportion as 50 per cent. of the net yield from basic and special excises on all commodities. We take the view that in determining the over-all share of the States, due regard has to be given to the requirements of the States on the one hand and the needs of the Union Government on the other. Having considered the issue in this light and keeping in mind the estimates of yield from the existing excise duties in the coming quinquennium as also the requirements of the States, we have come to the conclusion that the States' share out of the distributable excises may be fixed at 20 per cent. of the net proceeds. We would like to stress that the financial significance of the figure of 20 per cent recommended by us is not comparable with that of the same figure recommended by the Third Finance Commission, in as much as we visualize the sharing of the duties on all commodities, including the commodities that might be taken up in the coming quinquennium,

whereas the last Finance Commission had confined the sharing scheme to 35 selected commodities. It appears from the data available before us that if we had confined the sharing to the 35 commodities, we would have fixed the proportion at around 30 per cent, so as to keep the transfer to the States at about the same level as visualized in our present scheme.

54. In regard to the principles for the distribution of the total of the States' share as between different States, the views placed before us are divergent. Some States have argued that the most relevant factor for determining the state-wise allocation would be not 'population' or 'needs', as measured by any other indicator or indicators, but consumption of excisable commodities in each State. Some others have advocated the use of population as the sole criterion. Then, some others have argued that the factor of economic backwardness should be brought in for determining the distribution. And finally there is a suggestion from certain States that following the principles adopted by the last Finance Commission, the factor of 'relative financial weakness' should also be taken into account for determining the State-wise share.

55. The logic behind the proposal for distributing excises on the basis of consumption of excisable commodities is that such a distribution would be in accordance with the 'contribution' that each State has made to the total proceeds. Then it is also pointed out that if ever a large scale substitution of sales taxes by Union excises were to take place, the resistance from the States to 'this substitution would be less if the distribution of excises took into account the 'contribution' factor. It appears to us that there is no case for the adoption of 'contribution' as the sole criterion. One may, however, argue that 'consumption' or 'contribution' should be taken into account by combining this factor with other factors like population and economic and social backwardness. We wish we were in a position to give our considered judgment on this issue, but in the absence of reliable state-wise data regarding consumption of excisable commodities, we find ourselves unable to use 'consumption' or 'contribution' as a factor in the distribution scheme. Some States suggested to us that in the absence of reliable consumption data we could use such factors as the ratio of urban and rural population. We have avoided using such indirect data and we think that it would be more desirable to devise the distribution scheme on the basis of ascertainable factors than on the basis of uncertain indicators. Elsewhere in this report we have emphasized the need for a systematic collection of data bearing on

consumption, particularly consumption of commodities subject to Union excise duties.

56. The proposal for devising the distribution scheme entirely on the basis of 'population' is supported on the ground that population of a State represents the 'needs' of the State and since the sharing of excises with the States is not compulsory under the Constitution and is only permissive, the proceeds of excises should be so distributed between the States that each gets according to its needs. It may also be argued that in the case of some commodities, population is a rough index of total consumption. There is some substance in both these arguments but we do not agree with the view that population is the only index of the needs of a State. There are other factors which are equally relevant. In our view while population should be the major factor for determining the distribution, relative economic and social backwardness of States should also be taken into account.

57. Before we go to define the factors that we have taken into account for determining the relative backwardness of each State, we would like to deal with the suggestion of certain States that following the lead given by the last Finance Commission, we should also take into account the factor of relative financial weakness as measured in terms of revenue deficits. We have stated at the very beginning of our Report that we do not think that it is proper to bring in the element of grant into the distribution scheme of divisible taxes. In our view such non-plan revenue deficits as are left in certain States, after taking into account the share of central taxes on the basis of general and uniform principles applicable to all States, should be covered by explicit grants under article 275 rather than by adjustments in the formulae for distribution of taxes. Another point on which we wish to clarify our stand is that we distinguish between economic and social backwardness of a State and its financial weakness. It is possible that a State may be economically backward and poor in social services and yet it may have fairly comfortable position on revenue account. There are States of this type. In the distribution of proceeds of excise duties we have not taken financial weakness but have taken economic and social backwardness as indicated by the following factors:

- (i) *Per capita* gross value of agricultural production;
- (ii) *Per capita* value added by manufacture;
- (iii) Percentage of workers (as defined in the Census) to the total population;

- (iv) Percentage of enrolment in Classes I to V to the population in age group 6—11;
- (v) Population per hospital bed;
- (vi) Percentage of rural population to total population; and
- (vii) Percentage of the population of Scheduled Castes and Tribes to total population.

58. We consider that it would be adequate if the factor of relative economic backwardness is given weight equivalent to 20 per cent. For the other factor, namely population, we would recommend weight equivalent to 80 per cent. We have worked out a schedule of distribution on this basis, which is set out in the following paragraph.

59. We recommend that under Article 272 of the Constitution, in each of the years 1966-67 to 1970-71, a sum equal to 20 per cent of the net proceeds of the Union duties of excise on all articles levied and collected in that particular year, excepting regulatory duties, special excises and duties and cesses earmarked for special purposes, should be paid out of the Consolidated Fund of India to the States and distributed among them in the following proportion:

#### SCHEDULE OF DISTRIBUTION

States	Percentage
1. Andhra Pradesh	7.77
2. Assam	3.32
3. Bihar	10.03
4. Gujarat	4.80
5. Jammu and Kashmir	2.26
6. Kerala	4.16
7. Madhya Pradesh	7.40
8. Madras	7.18
9. Maharashtra	8.23
10. Mysore	5.41
11. Nagaland	2.21
12. Orissa	4.82
13. Punjab	4.86
14. Rajasthan	5.06
15. Uttar Pradesh	14.98
16. West Bengal	7.51

TOTAL .. 100.00

60. We deal in a later Chapter with the topic covered by para. 4(e) of the Order of the President. The scheme of distribution outlined in this Chapter is in consonance with our views expressed there.

## CHAPTER 7

### ADDITIONAL DUTIES OF EXCISE IN LIEU OF SALES TAX ON SUGAR, TOBACCO AND TEXTILES

61. Paragraph 4(d) of the Order of the President requires us to examine the present distribution scheme in regard to the proceeds of additional duties of excise in lieu of sales tax on cotton fabrics, silk fabrics, rayon or artificial silk fabrics, woollen fabrics, sugar and tobacco (including manufactured tobacco) and to recommend changes, if any, in the principles of distribution. We have however, to ensure that whatever distribution scheme we suggest does guarantee to each State an amount, in each of the financial years 1966-67 to 1970-71, which shall not be less than the revenue realized from the levy of sales tax on these items in the financial year 1956-57 in that State.

62. Before going into the principles of distribution, we would like to state briefly the background and the rationale of the scheme of additional excises. This is important because several non-official organizations and individuals have urged that we should on our own recommend an extension of the scheme of substitution of sales taxes by additional duties of excise to several other commodities, important ones being paper and related items, rubber goods, glass and glass ware, steel products and mineral oils and related items.

63. Under the Constitution, the power to levy Union excise duties is vested in the Union Government and that to levy tax on the sale or purchase of goods, except those in the course of inter-State trade and newspapers, in the State Governments. There is, however, no bar in the Constitution to the Union and the States extending to a larger number of commodities the scope of the present agreement that the Union Government would levy additional duties of excise in lieu of State sales tax.

64. The present arrangement, under which the State Governments do not levy any sales tax on textile, sugar, and tobacco owes its origin to the consensus of opinion that emerged at a meeting of the National Development Council held in December 1956. In anticipation of the Council's decision being implemented by an Act of Parliament, the President asked the Second Finance Commission to make recommendations as to the principles which should govern the distribution among the States of the net proceeds of the additional duties and

the amounts which should be assured to each one of them as the income derived by them from such taxes during the financial year 1956-57. The Council's decision and the recommendations of the Second Finance Commission were implemented through the Additional Duties of Excise (Goods of Special Importance) Act, 1957. The first schedule of the Act prescribed the rates of additional duties of excise and the second the scheme of the distribution of the net proceeds among the States. The Act does not state that the States shall not levy sales taxes on the specified commodities, but merely provides that if in any year any State levies and collects a tax on the sale or purchase of such commodities, no sums shall be paid to that State in that year by way of share out of the net proceeds of the additional duties of excise, unless the Central Government by special order otherwise directs.

65. A scheme of centrally levied additional duties of excise in replacement of States' sales taxes combined with a distribution scheme is essentially in the nature of a tax rental agreement. It can come into operation or be expanded in coverage only if the Union and the States agree amongst themselves. The Finance Commission comes into the picture only for the purpose of determining the principles of distribution of the net proceeds. The present scheme has been in operation for almost eight years. During this period certain merits and disadvantages of the scheme have come to light. At present, on the one hand there is a demand from the trade and other interests that the scheme be expanded so as to cover some additional items and on the other almost all the States have argued before us that the operation of the scheme has not benefited them to the extent they initially hoped and that they would be disinclined to get the scheme expanded in coverage unless certain safeguards are provided to protect not only their existing revenues but also the prospective increases in their revenues. Some States have second thoughts even about the continuance of the existing arrangements. We deal with these aspects later in this Chapter.

66. The rationale behind the currently operative scheme of additional excises in lieu of sales taxes is that if the tax is levied at the first point, the chances of evasion would be minimized and that a uniform levy at the point of production of such mass consumption items as sugar, tobacco and textiles would be welcome to the trade, industry, and the consumer as it would save them from the administrative complexities involved in the collection and payment of sales