

CHAPTER 5

ADDITIONAL DUTIES OF EXCISE

5.1 Before we turn to the question of grants under Article 275 of the Constitution, we wish to deal with items (e), (f) and (g) of paragraph 4 of the Order of the President dated the 29th February, 1969, which relate to additional duties of excise. Under these items we are required to make recommendations as to the desirability or otherwise of maintaining the existing arrangements in regard to the levy of additional duties of excise on textiles, sugar and tobacco in lieu of States' sales taxes thereon, with or without any modifications, and the scope for extending such arrangements to other items or commodities. We are also asked, irrespective of the recommendation which we may make regarding maintaining the existing arrangements, to recommend to what extent changes, if any, should be made in the principles of distribution of the net proceeds of the existing additional excise duties, provided that the share of each State is not less than the revenue realised from the levy of sales tax on these items for the financial year 1956-57 in that State. In the case of the items or commodities which we may recommend for extension of such arrangements, we have further to recommend the principles which should govern the distribution of the net proceeds of additional excise duties thereon among the States.

5.2 The Additional Duties of Excise (Goods of Special Importance) Act, 1957, was enacted in pursuance of a decision taken by the National Development Council in December, 1956, and the recommendations of the Second Finance Commission regarding distribution of the net proceeds among the States. Under the Act, additional duties of excise in lieu of sales taxes then being levied by State Governments on mill-made textiles (except pure silk fabrics), sugar and tobacco came to be levied and collected by the Union, and the levy was extended subsequently to cover pure silk fabrics other than those manufactured on handlooms. The Act laid down the rates of duties chargeable on these items and also the scheme of distribution of the net proceeds among the States by way of payment of certain guaranteed amounts to each State and distribution of the excess by way of percentage shares. The Act does not debar the State Governments from levying sales tax on the specified commodities; but it provides that if, in any year, a State Government levies a tax on the sale or purchase of such commodities, no sums shall be paid to that State in that year as its share out of the net proceeds of additional excise duties, unless the Government of India by special order directs otherwise.

5.3 The main considerations which appear to have weighed in favour of the substitution of State sales taxes on these commodities by the levy of additional excise duties by the Union, were the minimisation of chances of leakage and evasion, and the convenience to

4.13 We, therefore, recommend that—

- (a) during each of the years, 1969-70 to 1971-72 a sum equivalent to 20 (twenty) per cent of the net proceeds of Union duties of excise on all articles levied and collected in that year, excluding special excises, regulatory duties and duties and cesses levied under special Acts and earmarked for special purposes, should be paid out of the Consolidated Fund of India to the States;
- (b) during the years 1972-73 and 1973-74, a sum equivalent to 20 (twenty) per cent of the net proceeds of Union duties of excise on all articles levied and collected in the respective year, including special excises, but excluding regulatory duties and duties and cesses levied under special Acts and earmarked for special purposes, should be paid out of the Consolidated Fund of India to the States; and
- (c) the distribution among the States of the sum payable to the States in respect of each financial year should be made on the basis of the following percentages:—

State	Percentage
Andhra Pradesh	7.15
Assam	2.51
Bihar	13.81
Gujarat	4.17
Haryana	1.49
Jammu & Kashmir	1.12
Kerala	4.28
Madhya Pradesh	8.48
Maharashtra	7.93
Mysore	4.65
Nagaland	0.08
Orissa	4.72
Punjab	2.17
Rajasthan	5.28
Tamil Nadu	6.50
Uttar Pradesh	18.82
West Bengal	6.84
TOTAL	<u>100.00</u>

trade and industry resulting from a levy at the point of production. It was also expected that the scheme would enable the Government of India to have more effective control on the total incidence of commodity taxation and to ensure uniformity in the inter-State incidence of taxation. It was felt that due to less evasion the revenue realised from the Central levies would be more than the total collections from State sales taxes on these commodities, even though the incidence of the additional excise duties was somewhat lower than the then prevailing average incidence of the sales taxes levied by States on the commodities.

5.4 The present scheme has been in operation for more than a decade and we may now examine how far it has worked to the satisfaction of the parties concerned.

5.5 Two States, Jammu & Kashmir and Nagaland, were in favour of maintaining the existing arrangements and also extending them to cover more items. Most of the other States have expressed before us their dissatisfaction with the manner in which the scheme of additional excise duties has worked. They complained that the Government of India, while increasing basic excise duties and introducing special excise duties on the same commodities, had kept unchanged the rates of the additional excise duties. The States pointed out that they had suffered loss of potential increase in revenue by surrendering their right to levy sales tax. Whereas the sales tax rates are *ad valorem*, the additional excise duties have been largely specific, due to which they have lost the advantage of a price-elastic source of revenue. During the past decade the sales tax rates on similar commodities have also been increased. The States contended that they have thus been put to a double disadvantage. It is necessary to examine these contentions of the States which they had also voiced in similar terms before the Fourth Finance Commission.

5.6 During the period 1958-59 to 1968-69, there were practically no changes in basic excise duties on sugar; but there were increases in basic duties on tobacco, unmanufactured and manufactured. The basic excise duties on textiles have also been adjusted a number of times. In addition, special excise duties have been levied on tobacco. The rates of additional excise duties have remained practically unchanged, except for some increase in the case of cigars and cigarettes. The result has been that between 1958-59 and 1967-68, the revenue from basic and special excise duties on these three commodities increased by more than 70 per cent, while that from additional excise duties increased only by 45 per cent.

5.7 The average incidence of additional excise duties in 1966-67 worked out to 1.98 per cent on textiles, 2.93 per cent on unmanufactured tobacco and 7.12 per cent on cigars and cigarettes. The additional excise duty on cigarettes has since been increased, and a 4 per cent *ad valorem* duty is levied on sugar. The comparative rates of sales tax levied at a single point in some of the States on

allied commodities like kerosene, matches, tea, coffee, etc, are as under:—

	Rates of single point sales tax
Foodgrains	1% to 3%
Kerosene	3% to 7%
Matches	3% to 7%
Vanaspati	5% to 10%
Gur	2% to 7%
Butter & Ghee	3% to 4%
Tea	2% to 8%
Coffee	4% to 8%
Leather goods	5% to 10%

These rates are generally higher than the incidence of additional excise duties and it appears that if the States had been free to exercise their power to levy sales tax on textiles, sugar and tobacco, many of them would have been able to realise more tax revenue from them. The producing States would also have derived the benefit of Central sales tax on exports of these commodities to other States.

5.8 A number of States who had suggested discontinuance of the Scheme, during our discussions with them expressed their willingness to agree to its continuance if certain modifications were made so as to enhance the yield from the additional excise duties adequately. Some of them have suggested for this purpose that the rates of duty should be directly related to the rates of basic and special excise duties, while other States have suggested that they may be reviewed so as to reflect the increase in prices of the commodities in question and the average incidence of States sales taxes on similar items. About half the number of States have urged that the existing arrangements should be discontinued and they should be free to levy sales tax on these commodities themselves. They were not in favour of continuing the scheme even if modifications are made to increase the rates of duty.

5.9 We put it to the States that the rates of basic excise duties on sugar and textiles were regulated from time to time on considerations of economic policy and not merely on the basis of revenue requirements. The States sales taxes are not usually modified in this manner. While the feasibility of raising rates of additional excise duties could be considered when the basic or special duties are increased, no useful purpose would be served by any formal linking of the two.

5.10 There is force in the argument of the States that the rates of additional excise duties being specific, their incidence has not

kept pace with that of States sales taxes on similar commodities. To meet this point, the rates could be turned into *ad valorem* rates, as has been already done in the case of sugar and cigarettes; and even specific rates could be revised periodically having regard to changes in prices. The rates could also be modified to reflect changes in the sales tax rates on corresponding commodities in the States as a whole. Some of the States to whom we put this suggestion were doubtful about the possibility of such an arrangement. They, however, said that they would be agreeable if satisfactory arrangements in this regard could be made, but they were generally averse to extending the arrangement to other commodities. Eight of the States were insistent on the system being discontinued. They pointed out that under the existing arrangement they do not have freedom to increase revenue from taxation of these commodities in the light of their own requirements and judgement. Since these commodities cover a considerable part of the States' field of sales taxation they keenly desire to have once more the authority to levy sales tax themselves.

5.11 Under the provisions of Section 7 of the Additional Duties of Excise (Goods of Special Importance) Act, 1957, as originally enacted, the items on which additional duties of excise are leviable were declared as goods of special importance in inter-State trade and commerce and the levy of sales tax thereon was made subject to the restrictions specified in Section 14 of the Central Sales Tax Act, 1956. Section 7 of the former Act of 1957 was repealed by the Central Sales Tax (Second Amendment) Act, 1958 and these items were added to the list of declared goods. Some of the State Governments who wanted the additional excise duties to be withdrawn, pointed out to us that the other goods of special importance like coal, unmanufactured cotton, etc., are industrial raw materials or intermediate goods and belong to a category different from textiles, sugar and tobacco, which are consumer goods. They demanded that these restrictions, which had originally been enacted as an integral part of the present arrangements, should also be withdrawn when these arrangements are discontinued, so as to restore to the States unrestricted power to levy sales taxes as on other similar items. We have no doubt that the Government of India will consider this matter if and when the need arises.

5.12 We also discussed this subject with representatives of various Chambers of Commerce and other trade organisations. They generally expressed the view that the existing arrangements have resulted in considerable administrative convenience and have brought relief to the commercial community. They suggested, therefore, that the scheme should be continued; and some of them also proposed its extension to other commodities like iron and steel, cement and paper. Other items suggested to us for this purpose are kerosene, matches and tea. To meet the grievances of the States, some of the Chambers were agreeable to the conversion of the rates of duty into *ad valorem* rates where possible, and periodical revision of rates in other cases.

5.13 During our discussions with the representatives of the Government of India they expressed the view that, on the whole, the arrangements had worked satisfactorily. As regards the main grievance of the States about the growth of revenue from additional excises having been comparatively small, they felt that the matter could be gone into by the Government of India. The recent conversion of rates of duty on sugar into *ad valorem* rates would secure for the States the benefit of higher yield with increase in prices. It was stated that while the Government of India derives no revenue from the scheme, they would like it to be continued, if possible, because indirect taxation, particularly on items of mass consumption, could serve as an instrument of fiscal policy.

5.14 The rationale of the present scheme of additional excises in lieu of sales taxes and the advantages which it was expected to bring, hold good even now. But although a scheme of uniform levy of excise duties in lieu of sales taxes at varying rates on commodities of common consumption might have its own advantages, we consider that the full utility of such a scheme cannot be realised unless the arrangements could be extended to other important commodities also. This could, however, be achieved only if the States were agreeable to such extension. In view of the general opposition of the States, there is obviously no scope for extending the arrangements to other items or commodities in the foreseeable future. Moreover, as rightly pointed out by the Fourth Finance Commission, such a scheme is essentially in the nature of a tax rental agreement between the Union and the States, the operation of which is contingent upon the parties agreeing between themselves. Many States now keenly desire that the power to levy sales tax on these items should revert to them to enable them to make maximum efforts to raise greater resources under their own powers of taxation. While there may be advantages in the present scheme, inasmuch as the States are generally opposed to it, we consider that it would not be desirable to continue the scheme unless the Government of India, after discussing the matter further with the State Governments, can arrive at a general agreement for its continuance with suitable modifications. We would suggest that such discussions with the State Governments may be held as soon as possible.

5.15 This brings us to the question whether any changes should be made in the principles governing the distribution of the net proceeds of additional excise duties leviable under the 1957 Act if the existing arrangements are to continue. In any scheme of distribution for this purpose, it is necessary to see that each State gets a share not less than the revenue realised by it from levy of sales tax on these three items for the year 1956-57. The minimum amounts to be guaranteed to each State were first determined by the Second Finance Commission. Though the State Governments represented to the Third Finance Commission that the amounts should be reassessed, that Commission did not reopen the question. It only increased the amounts suitably to cover pure silk fabrics to which the arrangements has been extended, and divided the share of Bombay State between the new Maharashtra and Gujarat States. The Fourth Finance Commission confirmed the same amounts to be guaranteed to each State. We also decided that it was not possible

to reopen the question of determining the amounts which should be deemed to represent the revenue realised by each State from sales tax on these items in 1956-57. We have only worked out the shares of the new States of Punjab and Haryana on the basis of the amount guaranteed to the former Punjab State.

5.16 Like the earlier Commissions, we have examined the question whether guaranteed amounts should first be set apart from the net proceeds and the balance then distributed among the States on suitable principles, or whether the entire net proceeds should be distributed on suitable principles subject to ensuring that no State gets less than the guaranteed amount as its share. The previous Commissions adopted the first method as they felt that the alternative procedure might create difficulties in case some State's share fell short of the guaranteed amount. On the basis of the forecast of receipts from this source furnished by the Government of India it appeared to us that this difficulty was not likely to arise. We could not, however, altogether rule out such a contingency. We decided, therefore, to continue the practice already followed in this regard.

5.17 At present, one per cent of the net proceeds are retained as being attributable to Union territories, and 1.5 per cent and 0.05 per cent of the net proceeds are paid to Jammu and Kashmir and Nagaland as their respective shares. These percentages appear to have been adopted on an ad hoc basis. We consider that it will be more appropriate to determine the shares of these two States and the portion of the net proceeds attributable to Union territories on the basis of their respective populations. On this basis the portion to be retained by the Union as being attributable to Union territories will be 2.05 per cent of the net proceeds, while the shares of Jammu and Kashmir and Nagaland will be 0.83 per cent and 0.09 per cent thereof respectively.

5.18 In regard to the principles for distribution of the balance of the net proceeds of additional excise duties after excluding the total of the guaranteed amounts, the Fourth Finance Commission took the view that figures of collection of all sales taxes were more directly indicative of the contribution made by each State to the divisible surplus, than population. The figures of total sales tax collections have, however, certain limitations for this purpose. Sales taxes are levied at different rates and according to different systems in various States. On the other hand, the additional excise duties on sugar, textiles and tobacco are levied at uniform rates at a single point. Further, the rates of sales taxes vary with the nature of commodities. They are the lowest in case of raw materials and intermediate goods, higher on semi-luxuries than on necessities, and the highest on luxuries. Sugar and the bulk of textiles belong to the group of necessities while tobacco may be regarded as a semi-luxury. The richer States are likely to get larger sales tax realisations because of their higher consumption of luxuries and semi-luxuries. It is not possible to make allowances for all these variable factors in adjusting the figures of sales tax collections for this purpose. We can only exclude the realisations on inter-State sales, which are due to exports outside the States.

5.19 Theoretically, the best way of distributing the additional excise duties would be on the basis of consumption. The agreement reached at the National Development Council approving the scheme of additional excise duties on these three commodities had mentioned consumption as the basis of sharing. The data of Statewise consumption compiled by the Central Statistical Organisation include figures for these commodities, *vide* Tables 50—52. Sugar is being taxed at 4 per cent *ad valorem* and price differences between different varieties are not large. Figures of sugar consumption by different States are available. In the case of cotton textiles, on which additional excise duties are levied at different rates on a quantitative basis from 3.6 paise to 15.5 paise per sq. metre, only the figures of total expenditure on clothing could be obtained. The statistics regarding tobacco are in terms of quantities of cigarettes consumed. According to the rates of duty in force at present, unmanufactured tobacco is being taxed at three different rates ranging from 6 paise to Rs. 1.10 per Kg. Cigarettes are liable to additional excise duty at rates varying from 5 per cent to 23 per cent, and the actual amounts of duty work out to something from less than 37 paise to more than Rs. 5.75 per thousand. Consumption figures cannot, therefore, furnish us with a satisfactory basis for distribution of proceeds of the additional excise duties. Considering all the circumstances, we have come to the conclusion that the excess of proceeds of additional excise duties over the guaranteed amounts should be distributed partly on the basis of sales tax collections (excluding inter-State sales tax) during the years 1965-66 to 1967-68, and partly on the basis of population. We have, accordingly worked out the percentage shares of States (other than Jammu and Kashmir and Nagaland) on this basis with equal weightage to sales tax collections and population. The shares of the States have been expressed in terms of percentage of the excess amount after payment of the guaranteed amounts.

5.20 As we are unable to recommend the extension of the existing arrangements to other items or commodities, the question of considering the principles which should govern the distribution of net proceeds of such additional items mentioned in item (g) of paragraph 4 of the Presidential Order does not arise.

5.21 Accordingly, we recommend that—

- (1) (a) It would not be desirable to maintain the existing arrangements in regard to the levy of additional duties of excise on textiles, sugar and tobacco, unless the Government of India, after discussing the matter further with the State Governments, can arrive at a general agreement for the continuance of the present scheme with suitable modifications;
- (b) While the arrangements are continued, the rates of duties may be made *ad valorem* as far as possible, and may be revised periodically so as to secure reasonable incidence having regard to the prevailing prices and

the general level of sales taxes on similar items levied by the States;

- (2) There is no scope at present for extending such arrangements to other items or commodities;
- (3) The net proceeds of the additional excise duties during each financial year in which the existing arrangements continue, should be distributed to the following basis:—
- A sum equal to 2·05 per cent of such net proceeds be retained by the Union as attributable to Union territories;
 - A sum equal to 0·83 per cent of such net proceeds be paid to the State of Jammu and Kashmir as its share;
 - A sum equal to 0·09 per cent of such net proceeds be paid to the State of Nagaland as its share;
 - Out of the remaining balance of 97·03 per cent of such net proceeds the sums specified below, representing the revenue realised in the financial year 1956-57 by each respective State from the levy of sales taxes on the commodities subject to additional excise duties, be first paid as guaranteed amounts to the following States:—

States	Guaranteed amount (Rs. lakhs)
Andhra Pradesh	235·24
Assam	85·08
Bihar	130·16
Gujarat	323·45
Haryana	65·49
Kerala	95·08
Madhya Pradesh	155·17
Maharashtra	637·77
Mysore	100·10
Orissa	85·10
Punjab	96·07
Rajasthan	90·10
Tamil Nadu	285·34
Uttar Pradesh	575·81
West Bengal	280·41

(e) The balance be distributed among the States other than Jammu and Kashmir and Nagaland in accordance with their respective percentage shares of such balance as under:—

States	Percentage distribution of excess amount
Andhra Pradesh	8·13
Assam	2·47
Bihar	8·40
Gujarat	6·33
Haryana	1·70
Kerala	4·84
Madhya Pradesh	6·34
Maharashtra	13·89
Mysore	6·00
Orissa	3·13
Punjab	2·98
Rajasthan	4·42
Tamil Nadu	9·63
Uttar Pradesh	12·99
West Bengal	8·75
TOTAL	<hr/> 100·00 <hr/>

(f) In case the existing arrangements are discontinued during the course of a financial year, the sums specified in clause (d) above, be reduced *pro rata* in proportion to the period for which the arrangements have continued.