CHAPTER 3

INCOME-TAX

3.1 Under item (a) of paragraph 4 of the President's Order dated the 29th February, 1968, this Commission is required to make recommendations 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 Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds." Under this item we have to consider the distribution of: (1) taxes on income other than agricultural income, in accordance with Article 270 of the Constitution, and (2) Union duties of excise which may be divided between the Union and the States under Article 272 of the Constitution, if Parliament by law so provides. In this Chapter we shall deal with the distribution of proceeds of taxes on income other than agricultural income.

3.2 In this connection we may refer at the outset to the question of inclusion of Advance Tax collections in determining the proceeds of income-tax during the same financial year for the purpose of distribution between the Union and the States. The practice in this regard has hitherto been that Advance Tax collections under the income-tax law have been taken into account in determining the net proceeds of income-tax only on completion of regular assessments. In 1948 it was decided to credit advance tax collections to the revenue head "Taxes on Income". At that time the Government of India decided after consulting the Comptroller and Auditor-General that it was not necessary to change the existing practice of including advance tax collections in the divisible pool only on completion of assessments. This decision was communicated to the then Provincial Governments in January, 1949. Successive Finance Commissions have recommended the distribution between the Union and the States of the net proceeds of income-tax having regard to the estimates of net proceeds furnished by the Government of India on this basis. The Comptroller and Auditor-General of India has also been certifying the net proceeds under Article 279(1) of the Constitution for the years upto 1966-67 on this basis.

3.3 In their memoranda submitted to us soon after our appointment, some of the State Governments represented that the advance tax collections should form part of the divisible pool in the same year in which they are collected and that their distribution should not be deferred till the completion of assessments. Thereupon we took up this question with the Comptroller and Auditor-General and the Government of India. On examination of the question the Government of India now consider that the advance tax collections made in a financial year should be taken into account in determining the net proceeds of income-tax in that year and not be left over for

such determination on completion of regular assessments in subsequent years as hitherto. The President has therefore made a supplementary reference to us under his Order dated 1st May, 1969 (reproduced in Chapter 1) which requires us to make recommendations regarding the distribution of the advance tax already collected and not included in the net proceeds of the years upto 1966-67, as certified by the Comptroller and Auditor-General, and also the changes, if any, in the distribution between the Union and the States of the income-tax collected during the years 1967-68 and 1968-69 in the event of the Comptroller and Auditor-General certifying the net proceeds of those years after taking into account the advance tax collected in the respective years. We are also required to make recommendations regarding the distribution of the net proceeds of income-tax in the years 1969-70 to 1973-74 as determined on the revised basis.

3.4 Soon after the receipt of the Presidential Order dated 1st May, 1969, we requested all the State Governments and the Government of India to furnish their views and suggestions on the supplementary reference received by us. Their replies have been taken into account in framing our recommendations.

I. Unadjusted balance of advance tax collections upto 1966-67

3.5 Item (a) of the supplementary reference relates to the distribution of the unadjusted amount of advance tax collected under the income-tax law during the years upto 1966-67. One State has expressed the view that since the determination of the net proceeds of income-tax under Article 279 is outside the functions of the Finance Commission and has to be made by the Comptroller and Auditor-General according to law, the Presidential Orders issued from time to time on the basis of the recommendations made by the respective Finance Commissions have not lost their validity merely because of the realisation that an error was committed in computing the divisible pool, and the correct amount of net proceeds should therefore be distributed in accordance with the respective Presidential Orders. It is not practicable to proceed on this basis for the reasons explained in the succeeding paragraph.

3.6 The collections of advance tax during the years upto 1966-67 were being accounted for under a distinct minor head "Advance Payments of Tax" under the major head "IV-Taxes on Income other than Corporation Tax". As and when each assessment of income-tax was completed, the amount of advance tax, if any, was being adjusted by transfer from the minor head "Advance Payments of Tax" to the respective minor heads, such as (i) "Income Tax—Ordinary Collections" and (ii) "Surcharge (Union)", after refunding the excess payment, if any, to the assessee. The adjustments were so made for all assessments completed during each year, without accounting separately for the amounts of advance tax collections in different previous years. The balance of advance tax collected in the years upto 1966-67 and not included in the net proceeds of those years as certified by the Comptroller and Auditor-General thus includes amounts actually collected over a number of years as advance tax payments both towards ordinary income-tax, which is divisible between the Union and the States, and towards the Union surcharge

on income-tax. It is, therefore, not possible to determine what amounts comprised in the unadjusted balance at the end of 1966-67 are relatable to the actual collection of advance tax in each of the earlier years upto that year.

3.7 We have ascertained from the Comptroller and Auditor-General that the total unadjusted amount of advance tax outstanding at the end of the financial year 1966-67 was Rs. 387·74 crores. As different rates of surcharge have been in force during different years, the exact amount pertaining to the Union surcharge which forms part of the unadjusted balance of advance tax collections cannot be determined until assessments in all cases relating to those years are completed. However, on an analysis of the aggregate amounts of advance tax collections, adjustments and refunds reflected in the accounts of each year, and having regard to the different rates of surcharge in force during each year, the Comptroller and Auditor-General has calculated the portion of the unadjusted balance relating to the Union surcharge, on an approximate basis, as Rs. 16·62 crores. This would leave an amount of Rs. 371·12 crores as ordinary income-tax, to be divided between the Union and the States subject to adjustment in due course, if necessary.

3.8 Some amounts relatable to the unadjusted balance of advance tax collections would become due for refund to the assessees on completion of regular assessments made during the years 1967-68 onwards. Though the actual refunds made on the basis of assessments during any year, whether in respect of advance tax or ordinary tax collections or Union surcharge, are relatable to collections made in earlier years, they are actually paid out of the collections received as proceeds of tax during that year and they cannot be adjusted against the proceeds of the earlier years. The refunds relatable to the unadjusted portion of advance tax collections would, accordingly be paid out of the proceeds of the subsequent years, and would be taken into account in reduction of the gross collections in determining the proceeds of income-tax in those years. It therefore appears that the whole amount of Rs. 371·12 crores, representing the divisible portion of the unadjusted amount of advance tax collections, is available for distribution under item (a) of the supplementary reference.

3.9 The first question that we have to consider is what percentage of this amount should be assigned to the States, after excluding the proceeds attributable to Union territories. A view has been expressed that since the collections comprising the unadjusted balance formed part of the income-tax proceeds of a number of years which had not been included in the divisible pool, the percentage constituting the States' share should be worked out on the basis of the Presidential Orders applicable to the ordinary income-tax collections of the respective years. Another view is that since the practice upto this time has been to give to the States the percentage share applicable to the year in which the advance tax collections get adjusted and treated as part of the proceeds after completion of assessments, the unadjusted advance tax collections, which would be brought into the divisible pool now on adoption of the revised procedure from 1967-68, should be distributed between the Union and the States on the same basis as is adopted for distribution of the net proceeds of income-tax

for that year. Accordingly some States have urged that 75 per cent of the net collections of the entire accumulated balance of advance tax collections should be allocated to the States.

3.10 The States' share of the net proceeds of income-tax after excluding the proceeds attributable to Union territories was 50 per cent during the years 1949-50 to 1951-52, 55 per cent during the years 1952-53 to 1956-57, 60 per cent during 1957-58 to 1961-62, 66 2/3 per cent during 1962-63 to 1965-66, and 75 per cent thereafter. As explained above, there are practical difficulties in dividing the balance of advance tax collections on the basis of the percentage applicable from time to time to the respective earlier years upto 1966-67 since it is not possible to ascertain the actual amount of unadjusted advance tax collections which pertains to each year and is included in the total unadjusted balance of advance tax collections at the end of 1966-67.

3.11 We considered whether some percentage between 50 and 75 per cent could be adopted as being equitable to both the Union and the States. It has been argued by some of the States that the greater part of the accumulations of unadjusted advance tax collections represents the share of the States unpaid to them for many years, and that they could have had the use and benefit of the money or saved a part of the interest liability incurred by them if it had been received by them earlier. Whatever portion of the balance we might recommend as the States' share, we have, under the terms of the supplementary reference, to take into account the effect of our recommendations on the devolutions and grants to be recommended by us for the five year period from 1969-70 to 1973-74. We, therefore, consider that it would be proper if the share of the States out of the divisible portion of unadjusted advance tax collections upto the year 1966-67 is determined at 75 per cent. The Fourth Finance Commission had recommended this percentage as the share to be assigned to the States, and we are also recommending the same percentage for the years 1967-68 and 1968-69, *vide* paragraph 3.15 below.

3.12 As regards the distribution among the States of the States' share of the accumulated advance tax collections, the views expressed by many of them are on the same lines as those indicated above. Some States suggested that the amount relatable to each of the years upto 1966-67 should be distributed among the States in accordance with the scheme of distribution applicable to the relevant year. Some States are of opinion that since arrears are being paid now, the *inter se* distribution should also be on the basis of the Presidential Order in force at present. One State expressed the view that the distribution among the States should be made on the same principles as we might recommend for the years 1969-70 to 1973-74.

3.13 We have already mentioned certain practical difficulties involved in determining the States' share of the unadjusted balance on the basis of the Presidential Orders applicable to the respective earlier years upto 1966-67. There are additional complications in working out individual States' shares of the percentage assigned to the States, in view of the reorganisation of States and formation of

new States at different times during this period. On these considerations, and consistent with our recommendation in regard to the share to be assigned to the States out of the unadjusted balance of advance tax collections, we consider that the distribution of the States' share of the unadjusted balance among the States should also follow the same basis that is applicable to the distribution of the States' share of the net proceeds of income-tax in the year 1967-68. On this basis, the portion of the unadjusted balance which is attributable to Union territories may be fixed at 2½ per cent, with necessary adjustment in respect of Chandigarh and the areas transferred to Himachal Pradesh, in accordance with the provisions of the Punjab Reorganisation Act, 1966.

3.14 In regard to the manner of payment of the States' respective shares to them, one suggestion which has been made is to make suitable payments according to the amounts which may be adjusted on the basis of assessments during each year. Other alternatives would be either to pay the whole amount in one lump sum, or to spread the payment over a number of instalments. We are not in agreement with the first suggestion as it is not in keeping with the revised basis now adopted for determining the net proceeds of income-tax, according to which inclusion of the advance tax collections is not to be regulated with reference to the completion of assessments. Moreover, such a procedure would involve uncertainty regarding the actual sums which would become payable from year to year. However, we consider that payment of the whole of the States' share of unadjusted balance of advance tax collections in a single year is likely to strain the ways and means position of the Government of India unduly. We therefore consider that it would on the whole be fair and reasonable to provide for payment of the States' share in three equal annual instalments. The determination of the net proceeds of income-tax in the years 1967-68 and 1968-69 on the revised basis would have the result of substantial amounts becoming payable to the States during the current year and in 1970-71 as arrears of their share after adjusting the amounts paid to them on the earlier basis. In view of this and also as an equitable arrangement for spreading the additional burden on the Government of India over a period of years, we consider that the annual instalments of the States' share in respect of the unadjusted amount of advance tax collections upto the year 1966-67 may be paid to the States during each of the years from 1971-72 to 1973-74.

II. Distribution of net proceeds of income-tax in 1967-68 and 1968-69

3.15 We now turn to item (b) of the supplementary reference which relates to the distribution between the Union and the States of the net proceeds of income-tax in the years 1967-68 and 1968-69. In the event of the net proceeds of income-tax in these years being certified by the Comptroller and Auditor-General after taking into account the advance tax collected in the respective years, such collections will form part of the certified net proceeds going into the divisible pool, while no adjustments would be made in respect of advance tax collections of previous years. Under clause (b) of the supplementary reference made to us, it is open to us to suggest changes in the distribution between the Union and the States of the net proceeds of

income-tax determined for these years on the revised basis. The Fourth Finance Commission had made its recommendations for the five-year period including these two years having regard to the forecast of the net proceeds which had been furnished by the Government of India on the basis of the earlier practice of excluding advance tax collections until their adjustment after completion of regular assessments. In view of the revised basis now adopted, the size of the divisible pool for these two years will be substantially increased. We do not, however, think it necessary to suggest any change in the distribution between the Union and the States on the ground that the divisible pool would be larger than what was estimated earlier. We have noted that the Fourth Finance Commission had fixed the States' share at 75 per cent after having regard to the necessity of maintaining the interest of the Government of India in the proceeds at a significant level. The scheme of devolution and grants formulated by the Fourth Finance Commission was based on its assessment of the needs and resources of the States and the surplus available with the Union on the basis of such material and information as were then available to it. It would not be expedient to modify only one part of that Commission's recommendations without a review of the whole question. Payments have also been made to the States on the basis of the departmental estimates of receipts in accordance with the recommendations of Fourth Finance Commission. We therefore consider it desirable that the percentage distribution between the Union and the States of the net proceeds of income-tax in the years 1967-68 and 1968-69 should remain unchanged, and we do not suggest any modification therein. We have, in making our calculations, assumed that the balance of the States' share of the net proceeds of income-tax in these two years would be paid to them in the years 1969-70 and 1970-71 respectively when the net proceeds have been certified by the Comptroller and Auditor-General.

III. **Distribution of net proceeds of income-tax in 1969-70 to 1973-74**

3.16 We shall now consider item (c) of the supplementary reference, read with item (a) of paragraph 4 of the Presidential Order dated the 29th February, 1968. The provisions of Article 270 read with Article 280(3) of the Constitution require us to make recommendations in regard to the following matters:—

(a) The percentage of the net proceeds of taxes on income other than agricultural income to be assigned to the States within which such taxes are leviable;

(b) The manner of distribution among the States of the percentage of such net proceeds assigned to them; and

(c) The portion of the net proceeds which shall be deemed to represent proceeds attributable to Union territories.

3.17 According to the existing scheme of distribution, 2½ per cent of the net proceeds of income-tax are deemed to represent proceeds attributable to Union territories. Of the balance, 75 per cent is assigned to the States and the distribution among the States is made according to prescribed percentage shares, determined 80 per cent on the basis of population of the States and 20 per cent on the basis

of collections within the States. The Union also retains a portion of the prescribed share of former Punjab State in respect of Chandigarh and part of Himachal Pradesh, in accordance with the Punjab Reorganisation Act, 1966.

3.18 We may at outset refer briefly to the views placed before us by the State Governments. Most of them suggested an increase in the percentage to be assigned to the States, the suggestions varying from 80 per cent to 100 per cent of the net proceeds. Some of them have also suggested that the net proceeds to be divided between the Union and the States should include a part or the whole of the proceeds of corporation tax and the surcharge at present levied on income-tax for Union purposes, or alternatively, that the Union surcharge should be merged with the basic rates of income-tax. We note that similar views were expressed by States before the earlier Finance Commissions also.

3.19 On the question of allocation between the States of the percentage share assigned to the States together, seven States have suggested that it should be distributed solely on the basis of population. Others have suggested a weightage to population ranging from 50 per cent to 90 per cent, with suitable weightage to other criteria suggested, such as collections, area, urban population, and the States' *per capita* income. Only one State has expressed the view that the existing scheme of distribution may continue.

3.20 The Third and the Fourth Finance Commissions, when they recommended an increase in the States' share of income-tax from 60 per cent to 66⅔ per cent and from 66⅔ per cent to 75 per cent respectively had already taken due notice of the States' representation about the shrinkage of the divisible pool due to the reclassification in 1959 of income-tax paid by companies as corporation tax. We consider that no further increase in the States' share on this ground only is necessary.

3.21 The States' complaint regarding surcharge for Union purposes is that it has continued for a long time and they suggest that it should be merged in the basic rates. They have pointed out that the continuance for a long time of a surcharge wholly retained by the Union does in practice have the result of reducing the percentage share assigned to the States. In this regard the specific provision in Article 271 of the Constitution clearly permits such a levy, and it cannot be said that the quantum of the surcharge is such as to reduce unduly the scope of the divisible pool. Nor does the language of that Article warrant the assumption that such surcharge must be related to requirements of a temporary nature only. We think that the grievance expressed by the States in this regard is a matter for the Government of India to consider.

3.22 As regards the size of the States' share, we appreciate the desire of the State Governments to have an increased share of receipts from this source in view of their greater and growing needs. However, we are in agreement with the view expressed by the Third and Fourth Finance Commissions that :

> "In the case of a divisible tax in which there is 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 interest in the yield of that tax."

We feel that on this principle any further increase in the States' share should be considered only if there is sufficiently strong justification therefor having regard to the scheme of devolution of taxes as a whole. So far as the present five-year period is concerned, the revised basis for determining the proceeds of income-tax by including advance tax collections without waiting for regular assessments has already resulted in increasing the size of the divisible pool so that the amounts which would be assigned to the States on the existing basis of 75 per cent would be larger. We do not therefore think it necessary to suggest any increase in the States' share of the net proceeds.

3.23 As regards the principles of distribution among the States of their share of the divisible pool, the principles adopted by the First Finance Commission were that the distribution should be made 80 per cent on the basis of population and 20 per cent on the basis of collection. It considered that the elements which should enter into an appropriate scheme of distribution should be firstly, a general measure of need as furnished by population, and secondly, contribution. That Commission adopted the figures of collections to measure the factor of contribution although it was recognised that such figures were only an inadequate and partial measure of contribution.

3.24 The Third and Fourth Finance Commissions had also adopted the same principles, but the Second Finance Commission was of the view that the principle of collection was not an equitable basis of distribution and should be completely abandoned in favour of population. In coming to this conclusion that Commission took into account the diminished significance of land revenue as a source of States revenues and the greater financial strength of urbanised and industrially developed States. It was also impressed by the consideration that income-tax was paid by a small portion of the population and the bulk of the tax arose out of business incomes which, in the context of economic integration of the country and disappearance of barriers to inter-State trade, was derived from the country as a whole. In order, however, to avoid a sudden break with the recommendations of the First Finance Commission, the Second Finance Commission recommended that the States' share should be distributed 90 per cent on the basis of population and 10 per cent on the basis of collection.

3.25 The Third Finance Commission restored the 20 per cent weightage given to the factor of contribution as indicated by collections, on the grounds, firstly, that there was a case for weightage to collection in the field of taxes on personal income which included incomes of local origin, as had been recognised even by the Second Finance Commission; and secondly, that with the exclusion from the divisible pool of the income-tax paid by companies which would largely have accrued from incomes of all-India origin, a higher percentage than before of the income-tax collections would relate to incomes of local origin.

3.26 The Fourth Finance Commission agreed with the earlier Commissions that only the two factors of population and contribution

were relevant to the distribution scheme; and though contribution was not synonymous with collection, in the absence of suitable data necessary for correct determination of the contribution of each State collection must be taken as the only available indicator of contribution. That Commission did not recommend any change in the relative weightage given by the Third Finance Commission to the two factors of population and collection, as it felt that a sense of certainty and stability should prevail as regards the principles to be adopted in the distribution of income-tax.

3.27 While continuity in the principles of distribution of shareable taxes is desirable, we find it difficult to agree with the observation of the Fourth Finance Commission that the question of principles of distribution should not be reopened everytime a new Finance Commission is appointed. Considerable changes are likely to take place during the period between the appointment of two Finance Commissions in the economic and fiscal situation and the relative needs and resources of the States. We feel that the appointment of a new Finance Commission should provide an opportunity for fresh consideration of various problems in the light of changed circumstances and available information, with due regard to the desirability of maintaining continuity as far as possible. There is nothing wrong in principle in reviewing the basis of distribution of taxes by each Finance Commission. We have, therefore, considered the matter *de novo*.

3.28 The views urged before us by the State Governments indicate a sharp divergence of opinion regarding the factor of contribution or collection. The more developed States have urged that the factor of contribution should be given greater weightage than at present. In support of this it has been pointed out that as a result of exclusion of income-tax paid by companies, a greater portion of the income-tax collections pertains to incomes of local origin. One State has estimated that about 40 per cent of the total income-tax collections in the country are paid by assessees having income not exceeding Rs. 40,000 and it is claimed that this percentage may be taken as the minimum portion attributable to incomes of local origin. A study made by us in this connection, however, indicated that this would not be true in respect of all the States. Some of the States have objected to the concept of need being adopted in the distribution of shareable taxes, on the ground that devolution of proceeds of tax resources is quite distinct from financial assistance from the Union which should be regulated only under Articles 275 and 282 of the Constitution. It is argued that even if relative needs are to be taken into account, the industrially advanced States should receive a larger share to meet their additional liabilities due to law and order problems, concentrations of industrial labour, urban population, and higher cost of administrative and social services.

3.29 On the other hand, many of the other States have expressed the view that the factor of collection should be eliminated altogether, while some have urged that the weightage given to collection should be reduced. They have pointed out that nearly three-fourths of the income-tax collections are made only from four industrially advanced States, and that the existing weightage to collection gives

a disproportionate benefit to such States. The contention of the more industrially advanced and urbanised States that they have to incur extra expenditure on problems of concentration of industrial labour, etc., is countered by the argument that greater industrial development also enables such States to collect larger revenues from sales taxes and other State levies, and that the fiscal advantages far outweigh any extra liabilities for maintenance of law and order, provision of services, etc.

3.30 It is also pointed out that the level of industrial development in a State is dependent on several historical and other factors and is greatly affected by policies and decisions taken in the context of national Plans of development; it does not depend only on State policies or the initiative of local people. If a large portion of the divisible pool is made over to the more advanced States, it can only result in an enhancement of the existing disparities in social and economic development of various States.

3.31 The arguments for and against contribution being taken as a factor have been effectively dealt with by the First Finance Commission and we need not go over the same ground. Successive Finance Commissions have recommended the distribution of a part of the proceeds of taxes on income on the basis of contribution as roughly indicated by collection. This manner of allocation to the States of a part of taxes on non-agricultural income contributed by them can, in a sense, be regarded as the counterpart in the non-agricultural sector of the taxes on agricultural income which under the Constitution can be levied by the States themselves. It would not therefore be proper to eliminate the factor of contribution entirely. At the same time we have to take into account the increasing economic unity of the country and interdependence of different regions and the growing impact of development undertaken through National Plans. The increasing needs of States arising from committed expenditure related to Plan schemes and other factors affecting the country as a whole also require that there should be greater weightage to the factor of population, which is a general measure of need. Some modification in the weightage to contribution is also justified on the ground that the size of the divisible pool of income-tax will now be enhanced due to the inclusion of advance tax collections in the proceeds of the same financial year. Having regard to broader considerations of equity and the main purpose of devolution, which is to secure a more balanced correspondence between needs and resources of States in widely different circumstances, we feel that the present weightage to contribution which results in marked disparities between more and less developed States should be reduced. We are, therefore, of opinion that the weightage given to the factor of contribution should be fixed at 10 per cent and the weightage to population should be increased to 90 per cent.

3.32 As regards measurement of the factor of contribution, it is difficult in the absence of suitable statistics to form a direct estimate of the contribution to the income-tax pool made by incomes of local origin in each State. The criterion of collection hitherto adopted as a measure of contribution has been recognised to be inadequate and unsatisfactory. Firstly, it does not make any allowance for incomes originating outside the State. It is well-known that the place of

collection is determined by convenience of the assessees without reference to origin of incomes. Industrialists and other persons with high personal incomes derive profits from activities all over the country. Secondly, the large amounts of deduction of tax at source on dividends, interest payments and in other cases, give undue benefit of larger collections to States having metropolitan and industrial centres, insofar as the collections relate to assessees residing in other States. On the other hand any refunds payable in respect of such assessees go to reduce still further the figures of collections of those States where they reside. Moreover, the figures of collection may include large overpayments or underpayments which are adjusted only on assessments. We have considered the matter carefully and it appears to us that, instead of figures of collections, the statistics of assessments in different States, after making allowance for reductions on account of appellate orders, references, revisions, rectifications, etc., would provide a more reliable basis to measure the factor of contribution. Accordingly, we consider that during the quinquennium from 1969-70 to 1973-74, 90 per cent of the States' share of the divisible pool of income-tax should be distributed among them on the basis of population, and the remaining 10 per cent on the basis of figures of assessments after allowing for reductions on account of appellate orders, references, revisions, rectifications, etc.

3.33 The previous Commissions have expressed respective shares of States, worked out on the principles adopted by them, in terms of fixed percentages. For the sake of convenience, we propose to continue this practice. In working out the percentage share of each State we have taken the population figures according to the 1961 Census and the average of the assessments made during the three years ending with 1964-65 which are the latest years for which firm figures are available, after adjustment for reductions on account of appellate orders, etc. during the same years.

3.34 We further recommend that 2·6 per cent of the net proceeds of income-tax should be deemed to be the portion of such proceeds attributable to Union territories. We have arrived at this figure by allocating to the Union territories as at present constituted, taken together, the share which would have accrued to them had they collectively been entitled to a share of income-tax on the same basis that we have recommended for the distribution of States' share among them.

3.35 We accordingly make the following recommendations :—

(a) In respect of distribution of the unadjusted balance of advance tax collections upto the year 1966-67 :

(i) Out of the amount of such advance tax collections, as determined by the Comptroller and Auditor-General of India, a sum equal to 2½ (two and a half) per cent thereof be deemed to be the portion which represents the proceeds attributable to Union territories, as constituted immediately prior to the Punjab Reorganisation Act, 1966;

(ii) The percentage of the amount of advance tax as determined by the Comptroller and Auditor-General of

India except the portion attributable to Union territories, to be assigned to the States should be 75 (seventy-five) per cent;

(iii) The distribution among the States *inter se* of the share assigned to the States should be made on the basis of the percentages recommended by the Fourth Finance Commission, with appropriate adjustments in regard to the share of reorganised Punjab and Haryana States and Union territories in accordance with the Punjab Reorganisation Act, 1966;

(iv) The share of each State should be paid to the State Government in three equal annual instalments during the years from 1971-72 to 1973-74;

(b) In respect of distribution between the Union and the States of the net proceeds of income-tax in the years 1967-68 and 1968-69, there should be no change in the distribution as prescribed in the Constitution (Distribution of Revenues) Order, 1965, in the event of the said net proceeds being certified by the Comptroller and Auditor-General of India on the revised basis;

(c) In respect of the distribution of net proceeds of income-tax in the financial years from 1969-70 to 1973-74 :

(i) Out of the net proceeds of taxes on income in each financial year, a sum equal to 2·6 per cent thereof be deemed to be the portion which represents the proceeds attributable to Union territories;

(ii) The percentage of the net proceeds of taxes on income, except the portion which represents proceeds attributable to Union territories, to be assigned to the States should be 75 (seventy-five) per cent; and

(iii) The distribution among the States *inter se* of the share assigned to the States in respect of each financial year should be made on the basis of the following percentages :—

States	Percentage
Andhra Pradesh	8·01
Assam	2·67
Bihar	9·99
Gujarat	5·13
Haryana	1·73
Jammu & Kashmir	0·79
Kerala	3·83
Madhya Pradesh	7·09
Maharashtra	11·34
Mysore	5·40
Nagaland	0·08
Orissa	3·75
Punjab	2·55
Rajasthan	4·34
Tamil Nadu	8·18
Uttar Pradesh	16·01
West Bengal	9·11
Total	100·00