

## CHAPTER 4

### UNION EXCISE DUTIES

4.1 As mentioned earlier in paragraph 3.1 we have to consider under item (a) of paragraph 4 of the President's Order dated the 29th February, 1968, the distribution between the Union and the States of the net proceeds of taxes on income other than agricultural income and of Union duties of excise. The distribution of income-tax has been dealt with in Chapter 3. We shall now consider the distribution of the net proceeds of Union excise duties under Article 272 of the Constitution in this Chapter.

4.2 Under Article 272, if Parliament by law so provides, the whole or part of the net proceeds of any Union excise duty can be paid out of the Consolidated Fund of India and distributed among the States to which the law imposing the duty extends. Thus, the sharing of proceeds of Union excise duties by the Union with the States has been left to be decided by Parliament. For this purpose, Parliament is required to lay down the principles of distribution among the States after taking into account the recommendations of the Finance Commission under sub-clause (a) of clause (3) of Article 280.

4.3 In accordance with the recommendations of the earlier Finance Commissions, the States have been getting a share out of the proceeds of Union excise duties as part of the devolution of taxes recommended by the Commissions. The sharing of Union excise duties was considered necessary by the earlier Commissions in order to meet the growing needs of the States mainly by devolution of tax revenues, so that both the Union and the States may share in what elasticity the divided taxes possess, and the payment of grants under Article 275 may be required to a lesser extent. It was also considered desirable to widen the field of devolution by having more than one divisible tax so as to secure a balanced scheme of devolution under which the different buoyancy of each tax may not affect the scheme unduly, and on the whole a more even distribution may prevail over a period of years. Moreover, it was felt that income-tax which is compulsorily divisible under the provisions of Article 270, had a limited scope for expansion while the requirements of the States for expenditure were growing at an increasing pace, particularly due to implementation of National Plans of development. It was therefore considered necessary to provide for increased devolution to the States by a share of Union excise duties under the enabling provisions of Article 272.

4.4 The size of devolution under Union excise duties has been increasing under the recommendations of successive Finance Commissions, which have extended the sharing to more and more items though they have generally reduced the percentage share of the States out of the total proceeds of duties on such larger number of

items. The First Finance Commission recommended the distribution among the States of 40 per cent of the duties on three items, namely, matches, tobacco and vegetable products. The Second Finance Commission added five more items, namely, sugar, tea, coffee, paper and vegetable non-essential oils, and reduced the States' share to 25 per cent. The Third Finance Commission recommended that 20 per cent of the proceeds of all Union excise duties which were then being levied, should be shared with the States, excluding only those items of which the yield was then below Rs. 50 lakhs a year. It also excluded the duty on motor spirit for which a separate scheme for distribution of grants for maintenance and improvement of communications was recommended. The main reasons for extending the scope of sharing to all excise duties was to secure the participation of the States, by convention, in the proceeds of the whole field of Union excises, so that the Union and the States may have a common interest therein which would be conducive to better psychological satisfaction to the States. It would also provide a broader base for distribution, in which the buoyancy of yield on some articles may make good the shortfall on others, so as to maintain a steady flow of assistance. The Fourth Finance Commission recommended the sharing of Union excise duties on all items including even those on which the yield was less than Rs. 50 lakhs per year, and also new commodities on which the excise duties might be levied during the five years, 1966—71. The Commission did not bring within the scheme of sharing certain categories of excise duties, namely, cesses levied on certain goods under special Acts, regulatory duties of excise levied under the Finance Acts, and the special duties of excise on certain articles which were being levied from 1963 in the form of surcharges on basic duties on certain items.

4.5 In their memoranda submitted to us, the State Governments have generally asked for an increase in their share of the proceeds of excise duties from 20 per cent to higher levels ranging from 30 to 50 per cent. One State has suggested that 30 per cent of the duties on petroleum products should be separately shared only among the States producing crude oil, the remaining 70 per cent being included in the general divisible pool. Another State has suggested that at least 60 per cent of the yield from duty on motor spirit should be separately distributed as a special grant to States which are backward in road communications. Many States have also demanded that the special duties of excise levied on certain articles in addition to basic duty, which are now retained entirely by the Union, should also be brought within the divisible pool and shared with the States.

4.6 We will first consider the question of sharing special excise duties. These duties are being levied from 1963, and the proceeds are earmarked exclusively for Union purposes by a provision included in the Finance Acts under which they are levied. The States had represented to the Fourth Finance Commission also that these should be made shareable. That Commission took the view that it was open to it to suggest that these duties should also be shared with the States and as far as the legal provision made in the Finance Acts is concerned, it considered that such provision could always be modified by Parliament, particularly in the light of the

recommendations that the Finance Commission may make. The Third and Fourth Finance Commissions extended the principle of sharing to all basic excise duties mainly with a view to securing the participation and common interest of both the Union and the States in this field of taxation so that both may have proportionate benefits from its buoyancy. The Fourth Finance Commission did not, however, suggest the extension of the scheme of sharing to special duties of excise as these duties had been introduced recently in the context of National Emergency; that Commission felt that the object of enlarging the size of the States' share of excise duties could equally well be achieved by suggesting a larger share for the States out of the total proceeds of basic duties. That Commission has observed as under :—

"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...."

"We, however, suggest that in future the resort by the Union Government to Special excises should not be the rule but the exception...."

4.7 The representatives of the Government of India with whom we discussed this question explained that the need for special excise duties had not disappeared. In this connection, they referred to increased defence expenditure, the necessity of subsidising exports and the cost of the Central Police Force. They stated that what was important in this regard was not whether the proceeds of special excise duties should be distributed or not among the States, but that the percentage share of the States should be so fixed as not to cut into the essential requirements of the Union.

4.8 The special excise duties have now been in existence for more than six years since they were first levied in 1963. We agree with the Fourth Finance Commission that such special excise duties should not be the rule but the exception, and are of opinion that if these duties are continued on a long term basis it would be desirable to include them along with other duties in the divisible proceeds. This will fulfil the main purpose of securing a common interest of the Union and the States in the whole field of excise taxation which the Third and Fourth Commissions had kept in view while making their recommendations as explained in paragraphs 4.4 and 4.6 above. While we consider that the inclusion of special excise duties in the divisible pool is desirable in principle, we have not thought it necessary to recommend any change in the present arrangements for the first three years from 1969-70 for the reason explained in the succeeding paragraph.

4.9 In making our recommendations relating to the distribution of proceeds of income-tax, we have assumed that the balance of the States' share of such proceeds pertaining to the years 1967-68 and 1968-69, resulting mainly from the increase due to inclusion of advance tax in the proceeds on the revised basis, will be paid to them

\*Report of the Finance Commission, 1965, para 46.

\*\*Report of the Finance Commission, 1965, para 52.

in 1969-70 and 1970-71 respectively. The States' share of the unjust amount of advance tax collections upto 1966-67 would be paid to them in three equal instalments from 1971-72. Considering the growing requirements of the States, we think that some further increase in the devolutions during the last two years 1972-73 and 1973-74 would be necessary. We, therefore, recommend that the proceeds of special excise duties should be included in the divisible proceeds from the year 1972-73 if such special duties are continued till that year. Having regard to the resources of the Government of India (including the likely additional taxation as indicated in the Draft Fourth Five Year Plan) and the demands thereon on account of expenditure on civil administration, defence and border security, debt servicing and other committed expenditures or liabilities, as also to the revenue resources and expenditure of the States and the estimated yield from basic excise duties and special excise duties, we consider that the share of the States should remain at 20 per cent of the divisible proceeds in each of the five years.

4.10 As regards the distribution of the States' share, the First Finance Commission adopted the basis of their respective population. It felt that the object of having an equitable distribution to augment the resources of States could be best achieved by distribution on the basis of population. That Commission was not able to consider consumption, which had been suggested as a basis for distribution, as no reliable statistics of consumption were available. The Second Finance Commission also could not consider the basis of consumption in the absence of necessary data. It noted, however, that while the figures of consumption, if available may provide a suitable basis of distribution, it must be borne in mind that such distribution would operate in favour of the more urbanised States which are already in a position to raise more substantial revenues from sales tax on such consumption. On the whole it preferred that the distribution should be made on the basis of population. It was, however, felt necessary by that Commission to apply a corrective in favour of particular States who would otherwise have been left in a less advantageous position. The shares of States were worked out 90 per cent on basis of population and 10 per cent was used for making certain adjustments in favour of particular States. The Third Finance Commission considered that while population should continue to be the major factor, other factors like the relative financial weakness of the States, disparity in the levels of development, percentage of scheduled castes and tribes and backward classes population, etc., should also be taken into account. The Fourth Finance Commission considered that while consumption or distribution could be taken as a factor for distribution, there were no reliable statistics on the basis of which this could be done. It did not favour the suggestion of using indirect data like ratio of urban population for measuring consumption. It felt that population should be a major factor in determining the distribution, and relative economic and social backwardness should also be taken into account. It however considered that relative financial weakness as measured by revenue deficit should not be taken as an element in sharing taxes. That Commission took population as a general measure of need of States and distributed the States' share 80 per cent on the basis of population and the remaining 20 per cent on the basis of

social and economic backwardness of the States as assessed on the basis of selective factors as under:—

- (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 population of Scheduled Castes and Tribes to total population.

The exact manner in which these factors have been combined was not indicated in the Fourth Finance Commission's Report.

4.11 Various views on this question have been expressed by the States before us. Two States favour continuance of the scheme laid down by the Fourth Finance Commission. Some States have urged that economic backwardness is not a suitable criterion for devolution of taxes. One State has suggested that the distribution should be made on the basis of population and urban population, so as to reflect the higher consumption for urban areas. Another State has suggested that the distribution should be entirely on the basis of consumption which may be measured by total sales-tax collections. Two States have suggested that the criteria should be population and per capita income. One of them suggested per capita income to be used for giving a share only to the States below the average level, while the other suggested inverse per capita income as the basis. Other States have suggested different weightages to be assigned to population and economic backwardness, some of them also suggesting certain criteria by which economic backwardness might be measured. One State has suggested that all the three factors—population, economic backwardness and contribution—should be given suitable weightage. One of the States has expressed the view that the distribution should be mainly regulated by the financial needs of the States and some portion of the States' share may be distributed on the basis of the degree of tax effort achieved by the States, as an incentive.

4.12 In considering this question of distribution among the States it is necessary to keep in mind the main purpose of devolution, which is to augment the resources of States in an equitable manner to enable them to meet their growing needs. Such needs depend mainly on the size of the States' populations, their relative income and resources and their levels of economic development. The principle of contribution is not appropriate as a factor in the distribution among the States of a tax that is shared on a discretionary basis, as is the case with Union excise duties. As observed by the Second Finance Commission, the fact of consumption would operate to the disadvantage of less urbanised States which are not in a position to raise revenues from sales tax to the same extent as more urbanised States. We therefore consider that consumption is not

a suitable factor for this purpose, and that the distribution should be based mainly on population, along with some criteria to take into account lower potential for raising resources and relative backwardness in economic and social development. We feel that as a broad measure of needs of different States, due regard should be had to criteria like population and suitable indicators of backwardness, rather than the relative financial weakness or budgetary deficits of the States. At the same time, since the States having less per capita incomes have lower potential for raising resources and are therefore placed at a disadvantage as compared to the States with higher per capita income, we consider it reasonable that some portion of the States' share should be distributed to States with per capita income less than the average of all States. For this purpose we have utilised the figures of per capita income of States for the years 1962-63 to 1964-65, prepared by the Central Statistical Organisation, which were made available to us. Having regard to these considerations, we are of opinion that the States' share of Union excise duties should be distributed among them on the following basis:—

(1) 80 per cent on the basis of population of respective States;

(2) Out of the remaining 20 per cent—

(a)  $\frac{2}{3}$ rd should be distributed among States whose per capita income is below the average per capita income of all States in proportion to the shortfall of the State's per capita income from all States' average, multiplied by the population of the State. For this purpose, Nagaland, for which the requisite per capita income statistics are not available, should be equated with Assam.

(b)  $\frac{1}{3}$ rd should be distributed according to the integrated index of backwardness on the basis of the following six criteria, viz.,

- (i) Scheduled tribes population;
- (ii) Number of factory workers per lakh population;
- (iii) Net irrigated area per cultivator;
- (iv) Length of railways and surfaced roads per 100 square kilometres;
- (v) Shortfall in number of school-going children as compared to those of school going age;
- (vi) Number of hospital beds per 1,000 population.

On this basis, the percentage shares of each of the States out of the total States' shares have been worked out, as indicated in the succeeding paragraph. In working out these shares, we used the inverse of indicators for items (ii), (iii), (iv) and (vi) above, after applying some moderation in the case of States where an indicator was less than one third or more than three times of the average for all the States, and combined them with equal weightage to each along with the remaining indicators.

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>

**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