

CHAPTER V ADDITIONAL DUTIES OF EXCISE

Under paragraph 4(c) of the Order of the President defining our terms of reference, we are required to recommend the changes, if any, to be made in the principles governing the distribution of the net proceeds in any financial year of additional duties of excise in lieu of sales tax on cotton fabrics, woollen fabrics, rayon or artificial silk fabrics, sugar and tobacco including manufactured tobacco. The scheme of distribution has however to be so devised as to guarantee to every State in each of the financial years from 1974-75 to 1978-79 an amount not less than the revenue realised by it from the levy of the sales tax on these commodities in the financial year 1956-57.

2. The arrangements now in force for the levy of additional excise duties in lieu of sales tax on the commodities mentioned above are the outcome of a decision taken by the National Development Council in December, 1956. The National Development Council decided on replacement of sales tax on these commodities by additional excise duties in the interests of convenience to trade and avoidance of tax evasion. While even now the States remain free to re-impose sales tax subject only to the possible forfeiture of their share of revenues from additional excise duties on these commodities, the declaration of these goods as 'goods of special importance' by Section 14 of the Central Sales Tax Act, 1956, acts as an effective deterrent against the States reverting to the old pattern of levy of sales tax. The effect of this legislative provision is to restrict the levy of sales tax to the limit specified therein (currently 3 per cent). Sales tax on these commodities can also be levied at only one stage and the local sales tax is to be refunded if such goods subsequently become subject to inter-State sales tax. State Governments are thus effectively prevented from reimposing sales tax on these commodities, though their constitutional right to levy sales tax remains unimpaired.

3. The scheme of levy of additional excise duties in lieu of sales tax has now been in force for over 15 years. All available evidence indicates that the continuance of the scheme is welcomed by trade and industry who have in fact frequently pleaded for its extension to other commodities. But till quite recently, most of the State Governments would seem to have had reservations about the utility of the existing system. Dissatisfaction of the State Governments with the inadequate exploitation of the revenue potential of the additional excise duties on these commodities by the Union Government led the Government of India to request the last Finance Commission to investigate and report on the desirability or otherwise of continuing the scheme of levy of additional excise duties in replacement of sales tax. Later in

the wake of the recommendations of the Fifth Finance Commission, the whole question was considered by a representative group of Central and State Government officials. In the light of the proposals made by that group, the National Development Council at its meeting held on 28-12-1970 agreed to the continuance of the present arrangements subject to certain conditions. The main condition stipulated by the National Development Council for the continuance of the scheme was that the incidence of the additional excise duties should be stepped up to 10.8 per cent of the value of the clearances within a period of two or three years.

4. These recommendations were accepted by the Government of India and have since been implemented through successive Finance Acts. Accordingly the yield from additional excise duties which amounted to only Rs. 52.68 crores in 1968-69 rose to Rs. 105.97 crores by 1971-72 and is expected to rise further to Rs. 168.78 crores in 1973-74. It is clear from the memoranda submitted to us by the State Governments that they are by and large now satisfied with the manner in which Government of India have implemented the recommendations of the National Development Council and that they do not seek any material change in the present scheme of levy of additional excise duties. Andhra Pradesh however urged that the existing practice should be given up and the States permitted to levy sales tax without any restriction. Uttar Pradesh also wanted that the constitutional right of the State Government to levy sales tax on these commodities should be restored. West Bengal sought discontinuance of the present system, if the conditions stipulated by the National Development Council were not accepted fully by the Government of India. In any case, the question of continuance or otherwise of additional excise duties does not come within our purview. We are only concerned with the limited issue of formulating a proper scheme of distribution of the revenues from additional excise duties among the States.

5. We sought the views of the State Governments on the principles to be followed in the distribution of additional duties of excise. Gujarat, Haryana, Maharashtra and West Bengal desired that the excess of the proceeds of additional excise duties over the guaranteed amount should be distributed entirely on the basis of the proportion of sales tax revenue realised in each State to the aggregate of sales tax collections in all the States taken together. In other words they seemed to favour the re-instatement of the principles of distribution recommended by the Fourth Finance Commission. Bihar, Himachal Pradesh, Madhya Pradesh, Orissa and Rajasthan invited our attention to the absence of reliable Statewise data

16. A related issue to which we have devoted considerable thought is whether on the basis of per capita income, States should be classified into two categories—advanced and backward—States below the national average being regarded backward and those above the average as advanced. It may be recalled that the Fifth Finance Commission had adopted such an approach in determining the allocation of a portion of Union excise duties. The approach favoured by the last Commission affected most adversely those States whose per capita income happened to be just above the dividing line. This precise division is open to objection particularly in view of the known margins of errors in national income data. This approach also needlessly heightens the conflict of interest among different States. In view of these considerations, we recommend that while the weightage for backwardness should be raised from 20 per cent to 25 per cent, the *inter se* distribution of this portion of Union excise duties should be in relation to the 'distance' of a State's per capita income from that of the State with the highest per capita income multiplied by the population of the State concerned according to 1971 census.

17. The balance of 75 per cent of the States' share of the divisible pool of Union excise duties should be distributed on the basis of population of the States according to 1971 census.

18. We have worked out the relative shares of the States in terms of percentages according to the principles enunciated above.

19. We therefore recommend that:

- (a) during each of the years 1974-75 and 1975-76, 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 auxiliary duties of excise 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 1976-77, 1977-78 and 1978-79, 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 auxiliary duties of excise, but excluding 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:—

States	Percentage
1. Andhra Pradesh	8.16
2. Assam	2.71
3. Bihar	11.47
4. Gujarat	4.57
5. Haryana	1.53
6. Himachal Pradesh	0.63
7. Jammu & Kashmir	0.90
8. Karnataka	5.45
9. Kerala	3.86
10. Madhya Pradesh	8.15
11. Maharashtra	8.58
12. Manipur	0.21
13. Meghalaya	0.19
14. Nagaland	0.11
15. Orissa	4.06
16. Punjab	1.87
17. Rajasthan	5.00
18. Tamil Nadu	7.43
19. Tripura	0.30
20. Uttar Pradesh	17.03
21. West Bengal	7.79
TOTAL	100.00

on consumption of these commodities and urged that the excess over the guaranteed amount should therefore be distributed on the basis of population. Bihar also pleaded for suitable enhancement of the guaranteed amount, while Himachal Pradesh and Kerala did not want any reservation of guaranteed amount. Since distribution solely on the basis of population might entail a sudden disruption of the present scheme of distribution, Orissa urged that at least 75 per cent of the surplus available after providing the guaranteed amount and an appropriate share to the Union Territories, Jammu & Kashmir and Nagaland should be distributed in proportion to the population of a State. Assam pleaded for continuance of the existing principles. Uttar Pradesh wanted the proceeds to be distributed in the same ratio as guaranteed amount of each State to the total guaranteed sum. Andhra Pradesh suggested that the revenue from additional excise duties should correspond to what the State could have got if they had the power to levy sales tax. They also argued that raw tobacco should be deleted from the list of goods of special importance so as to empower the States to levy suitable sales tax without any restriction on the commodity. While urging that its share should not be less than 1½ per cent of the net proceeds, Jammu & Kashmir urged that the growth in sales tax revenues of the State should be a broad guide in determining the amounts to be allocated out of the proceeds of the additional excise duties. Kerala put forward an altogether different approach. It urged that the proportion of general sales tax collection to consumption expenditure should be adopted as the base for distribution. If, however, the consumption data are not available, figures of State income should be adopted for the purpose of working out a similar ratio. Punjab did not suggest any specific principle of distribution but only wanted the State to be fully compensated for the loss of sales tax revenue on these commodities even if it entailed a further step up of the incidence of the additional excise duties beyond 10.8 per cent of the value of clearances. Three States Manipur, Meghalaya and Tamil Nadu did not put forward any specific suggestions on the principles to be followed for distribution. Tamil Nadu has pleaded for the power to levy sales tax upto 3 per cent without forfeiture of their share in additional excise duties. Their argument was that the right of the States to levy at least a marginal sales tax on these commodities should be recognised. This suggestion as well as the other suggestion of Andhra Pradesh about deletion of raw tobacco from the list of 'declared goods' does not come within our purview.

6. The first issue we have to consider is whether it is possible or necessary to re-determine the yield in 1956-57 from sales tax on the commodities subject to additional excise duties for purposes of guaranteeing to the States concerned the amounts so determined. The Third, Fourth and Fifth Finance Commissions accepted the estimates worked out by the Second Finance Commission and did not consider it feasible in view of the lapse of time to reassess the likely yield in 1956-57 of sales tax on the commodities on which additional excise duties have been imposed. In view of the further lapse of time, we find it impossible to frame any

fresh estimates of the likely yield of sales tax in 1956-57 on these commodities and on that basis re-determine the guaranteed amounts. It is also significant that barring one State, none has asked for any such reassessment. We have, therefore, adopted the estimates worked out by the Second Finance Commission subject to the subsequent adjustments made by the Third Finance Commission in view of the bifurcation of Bombay State into Maharashtra and Gujarat and by the Fifth Finance Commission in view of the formation of the new States of Punjab and Haryana. We have to make a similar apportionment of the sum guaranteed to Assam between Assam and Meghalaya. We find that the President has by an order issued under Section 49 of the North Eastern Areas (Reorganisation) Act 1971, fixed Meghalaya's share at Rs. 5.51 lakhs reducing correspondingly Assam's share to Rs. 79.57 lakhs on the basis of population. Later in this chapter, we are suggesting that the proceeds of additional excise duties should be distributed among the States on the basis of 70 per cent weightage for population, 20 per cent for State income and 10 per cent for production. If these principles are applied, the original share of the composite State of Assam in the yield from Sales tax would be apportionable between Meghalaya and Assam in the ratio of 1:14.25. Accordingly, we determine the yield of sales tax on these commodities in 1956-57 in the area at present comprised in Meghalaya to Rs. 5.58 lakhs and that in the area now comprised in Assam to Rs. 79.50 lakhs. These are the amounts that would need to be guaranteed to Assam and Meghalaya.

7. The next important issue that arises for consideration is whether the 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 whatever principles are considered appropriate subject to the overriding proviso that no State should get in any year less than the guaranteed amount as its share. The earlier Commissions have preferred the first alternative. They presumably felt that unless the guaranteed amounts were first set apart and the balance alone distributed among the States, there was the risk of the share of some of the States falling short of the guaranteed amount. However well founded this apprehension may have been earlier, we are convinced that there is now absolutely no risk of the share of any State not coming up to the guaranteed amount. The expected net proceeds of additional excise duties during the forecast period after excluding the share attributable to Union Territories on the existing basis has been estimated at Rs. 1037 crores as against the guaranteed amount of Rs. 32.40 crores per annum or Rs. 162 crores over the same five year period. In other words, the guaranteed amount works out to about 16 per cent of the anticipated distributable part of additional excise duties. We, therefore, feel there is no need to set apart the guaranteed amounts and distribute the balance alone among States. The initial reservation of guaranteed amounts confers and unintended advantage on certain States and introduces an avoidable element of distortion in the scheme of distribution of additional excise duties.

8. As regards the basis of distribution of additional excise duties among the States, the view has gained general acceptance among the Finance Commissions that every State should be enabled to get the equivalent of what it would have secured if it had not surrendered its power to levy sales tax on these commodities. In other words, the Finance Commissions have recognised the principle of compensation to be the only valid principle in the distribution of the additional excise duties. Other considerations such as preferential treatment for backward States, however valid in relation to allocation of other Central taxes, are totally irrelevant to any scheme of distribution of additional excise duties. Their levy by the Centre is in pursuance of what is equivalent to a tax rental agreement.

9. A second proposition which would again seem to be incontrovertible is that State-wise figures of consumption of the commodities on which additional excise duties are levied would afford by far the best indication of the potential loss of revenue sustained by their surrender of authority to levy sales tax on them. The earlier Finance Commissions would seem to have differed only on how the relative levels of consumption of these commodities in the several States are to be assessed. The Second Finance Commission, which incidentally was the first to deal with the problem of distribution of additional excise duties among the States, recommended that the distribution of additional excise duties should be on the basis of the then available consumption figures with population as a correctional factor in view of the infirmities in the data on consumption. The Third Finance Commission felt that since additional excise duties were being levied in lieu of sales tax it would be equitable to distribute collections in excess of guaranteed amounts partly on the basis of percentage increases in the collection of sales tax in each State since 1957-58 and partly on the basis of population. The Fourth Finance Commission altogether abandoned population as a relevant factor and rested its scheme of distribution of additional excise duties wholly on the realisation of sales tax revenue in each State. The last Commission recognised certain limitations in taking the revenue from sales tax which is derived from a wide range of commodities comprising luxuries, semi-luxuries, raw materials and intermediate goods as indicative of the contribution made by each State to the aggregate revenue from additional excise duties. As the available statistics on consumption of these commodities did not in their view provide an unassailable basis for distribution of additional excise duties, the Commission held that the best formula for distribution of additional excise duties would be one that gave equal weightage to both sales tax collections and population.

10. We have examined afresh what the most equitable basis would be for allocation of the proceeds of additional excise duties among the States. Theoretically there cannot be any dispute that figures of consumption of these commodities, if available, would be the best possible indicator of what each State could have mobilised if it had retained its power to levy sales tax on these commodities. We therefore examined

in the first instance the available statistics of State-wise consumption of the commodities to which additional excise duties are applicable. Additional excise duties on cotton textiles are specific duties levied according to the metreage at varying rates on different varieties of fabrics. The available figures on consumption of textiles are, however, in terms of the value of cloth consumed and even these are confined only to cotton fabrics, and State-wise estimates of consumption of woollen fabrics, rayon and artificial silk fabrics are not available. In the case of cigarettes, consumption data are available only in terms of number of cigarettes consumed, while the additional excise duties on them are levied at varying *ad valorem* rates. State-wise figures of consumption of sugar are available and these have been arrived at on the basis of despatches of sugar by factories to the consuming States. From what has been stated, it is clear that consumption figures as available, except possibly in the case of sugar, cannot be regarded as providing an equitable and firm basis for distribution of the proceeds of additional excise duties.

11. Like the earlier Commissions, we are also thus constrained to identify some indirect but reasonably reliable indicators of the level of consumption of these commodities in different States. Of the various possible indirect indicators of levels of consumption we have no hesitation in rejecting sales tax collections as of any relevance at all. As recognised by the Fifth Finance Commission, sales tax is applicable to a wide range of commodities comprising luxuries, semi-luxuries, raw materials, intermediate goods and the like. Sales tax revenue derived from these commodities may be a measure of the tax effort of the State Governments. But it does not provide even an indirect clue to the levels of consumption of textiles, sugar and tobacco on which additional excise duties are being levied in lieu of sales tax. It is true that compensation for the loss of revenue from sales tax on these commodities is the only equitable criterion for distribution of additional excise duties. But we do not consider revenue from sales tax on other commodities in respect of which the State Governments have retained the power to levy sales tax as providing any basis for determination of the likely receipts from textiles, tobacco and sugar on which they have abstained from levying sales tax.

12. We have, therefore, to look for some better indices of consumption of these commodities. There cannot be serious room for argument that consumption is directly related to levels of income. Latest available data on State Domestic Product may, therefore, be taken to provide a broad indication of the likely consumption of these commodities. However, it is also necessary to recognise that the consumption of tobacco and possibly even of sugar depends, apart from levels of income, on the habits of people, their social mores and other intangible factors. As regards textiles, the coarser varieties of cloth should be deemed to be among necessities of life, the consumption of which is more likely to depend on population rather than on State domestic product. Having regard to these considerations, we feel that population and the average of State Domestic Product for the three years

1967-68 to 1969-70 should be taken together as providing reasonable basis for assessment of the levels of consumption, population being given considerably higher weightage.

13. It is arguable that if the States had not surrendered their power to levy sales tax on textiles, sugar and tobacco, they would have also had the authority to levy sales tax on these commodities sold in the course of inter-State transactions. In other words, the States would have to be compensated not merely for the loss of revenue from sales tax on these commodities consumed within the State but also on that portion of the production, if any, of these commodities that is 'exported' to other States. The sales tax leviable on these three commodities 'exported' to other States would, however, normally be subject to a ceiling of three per cent which is the rate applicable under the Central Sales Tax Act to inter-State sales to recognised dealers and Government departments. The present rate of additional excise duties on these commodities works out to about 10.8 per cent of the value of clearances. In view of this, while production of these commodities in different States has to be given a measure of weightage, the weightage should however be comparatively small in view of the ceiling on rates at which inter-State sales tax can be charged. Having regard to all the considerations set out above, we feel that by far the most equitable basis for distribution of additional excise duties would be to allocate the proceeds of additional excise duties on the basis of population, State Domestic Product at State current prices and production in the ratio of 70:20:10. We have worked out the relative percentage share of each State on this basis.

14. We have also to determine the net proceeds of additional excise duties attributable to Union Territories. The Fifth Finance Commission had recommended that a sum equal to 2.05 per cent of the net proceeds of the additional excise duties should be retained by the Union as attributable to Union Territories. Likewise the share payable to Jammu & Kashmir and Nagaland have also to be determined as these States were not parties to the original agreement of replacement of sales tax by additional excise duties on these three commodities. We feel that it would be appropriate to determine the share of these two States as also that of Himachal Pradesh, Manipur, Meghalaya and Tripura which became full-fledged States after the Fifth Finance Commission had submitted its report and the proportion attributable to the Union Territories as now constituted on the same basis as applicable to other States, namely 70 per cent weightage for population, 20 per cent for State

Domestic Product and 10 per cent for production. On this basis the portion to be retained by the Union, as being attributable to Union Territories, will be 1.41 per cent of the net proceeds.

15. Accordingly, we recommend that:—

- (i) There is no need to set apart any guaranteed amounts to the States as in our opinion there is no risk of the share of any State in the net proceeds of additional excise duties falling short of the revenue realised from the levy of the sales tax on the commodities subject to additional duties of excise in lieu of sales tax for the financial year 1956-57 in that State;
- (ii) The net proceeds of the additional excise duties during each financial year be distributed on the following basis:—
 - (a) A sum equal to 1.41 per cent of such net proceeds be retained by the Union as attributable to Union Territories;
 - (b) The balance of 98.59 per cent of such net proceeds be distributed among the States in accordance with their respective percentage shares of such balance as under:—

States	Percentage of distribution
1. Andhra Pradesh	8.39
2. Assam	2.47
3. Bihar	9.36
4. Gujarat	5.91
5. Haryana	1.94
6. Himachal Pradesh	0.59
7. Jammu & Kashmir	0.73
8. Karnataka	5.62
9. Kerala	3.58
10. Madhya Pradesh	6.98
11. Maharashtra	11.65
12. Manipur	0.17
13. Meghalaya	0.17
14. Nagaland	0.08
15. Orissa	3.59
16. Punjab	2.68
17. Rajasthan	4.17
18. Tamil Nadu	7.27
19. Tripura	0.25
20. Uttar Pradesh	16.10
21. West Bengal	8.30
	100.00

CHAPTER VI
GRANT IN LIEU OF TAX ON RAILWAY
PASSENGER FARES

Under paragraph 4(c) of the Order of the President delimiting our terms of reference, we are called upon to make recommendations in regard to the changes, if any, to be made in the principles governing the distribution amongst the States of the grant to be made available in lieu of tax under the repealed Railway Passenger Fares Tax Act, 1957.

2. Tax on railway passenger fares is among the category of taxes which are levied and collected by the Union but are assignable to the States in terms of Article 269(d) of the Constitution. A tax on the railway passenger fares was for the first time levied under the provisions of Railway Passenger Fares Tax Act, 1957. Soon thereafter, the Second Finance Commission was asked to go into the principles which should govern the distribution of the net proceeds of the tax among the States. In formulating its recommendations in this regard, the Commission was guided by the cardinal principle that each State should be enabled to get as nearly as possible the share of the net proceeds on account of the actual passenger travel on railways within its limits. In its judgment, this objective could be secured by allocating the passenger earnings from non-suburban services for each gauge of each railway zone separately among the States covered by it according to the route length falling within each State.

3. Though the recommendations of the Second Finance Commission were to hold good upto 1961-62, the Railway Passenger Fares Tax Act was repealed in 1961 and the Tax was merged in the basic fares with effect from 1st April, 1961. It may be relevant to mention here that this was done in pursuance of the recommendations of the Railway Convention Committee before whom the Railway Board had argued that the levy of passenger fares tax had limited the scope for raising passenger fares. Though the levy on passenger fares was thus given up, the Government of India decided to make an *ad hoc* grant of Rs. 12.5 crores a year to States in lieu of the tax for a period of five years from 1961-62 to 1965-66. This grant was later raised to Rs. 16.25 crores from 1966-67 and has since then continued at the same level. The Third, Fourth and Fifth Commissions, which were asked to deal with the distribution of this *ad hoc* grant, were of the view that it should be on the principle of compensation so as to place the States broadly on the same footing that prevailed prior to the repeal of the Act. Accordingly, the grant is now being distributed with reference to the share of each State as arrived at by allocating the passenger earnings of each railway zone on the basis of the actual route length in each State.

4. While responding to our request for their views on the principles of distribution of this grant, almost

all the States have also made a vehement plea against the grant being frozen at Rs. 16.25 crores per year and have urged that we should recommend to the Government of India enhancement of the grant *pari passu* with the increase in earnings from passenger fares.

5. As regards the principles of distribution, many of the State Governments are in favour of continuance of the existing principles without any change. Some of the States which are deficient in rail facilities have urged that while distribution of 80 per cent of the grant might be made on the existing principles, the balance of 20 per cent should be distributed among the States whose railway mileage in terms of area is below the all-India average in proportion to the shortfall from such average multiplied by the area of the State concerned. One of the States has contended that, in determining the share of the States, due allowance should be made for track mileage in each State as against purely route mileage as the former affords better index of intensity of traffic. Some States have also pleaded that the lack of adequate railway facilities in a State and the consequential expenditure on roads to meet the demands of traffic should be allowed for determining the *inter se* distribution of the grant. Meghalaya, which has no railway line at present, has urged that a minimum sum out of the grant should be set apart for distribution among such States as do not have railway lines. Manipur which has also no railway line at present has suggested population as criterion for distribution of the grant among States which have no railway lines. Jammu and Kashmir would like its share to be fixed at a higher figure and increased in the same proportion as the increase in the length of railways in the State. The Fifth Finance Commission had fixed the grant due to Jammu and Kashmir at Rs. 16,000 at a time when the railway line was only upto Kathua. As the link has now been extended upto Jammu, the State should be given its legitimate share of the earnings of the railways on this account.

6. We have considered the pros and cons of the various suggestions put forward by the State Governments carefully. Since the principles of distribution of *ad hoc* grant in lieu of the repealed tax should be so designed as to place the States on more or less the same footing as when the tax was in force, States in which there are no railways can have no claim on this grant. Manipur and Meghalaya, the only two States which are adversely affected by the application of this principle, qualify for grants under Article 275(1) in terms of our assessment of their requirements for the forecast period. Their exclusion from any share in lieu of passenger fares tax would, therefore, mean no real hardship to them. Likewise, while