

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the principles governing the distribution amongst the States of the grant to be made available in lieu of tax under the repealed Railway Passenger Fares Tax Act, 1957.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of the Second Finance Commission were to hold good upto 1961-62, the Railway Passenger Fares Tax Act was repealed in 1961 and the Tax was merged in the basic fares with effect from 1st April, 1961.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

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 about 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

the argument of Jammu and Kashmir that the additional earnings from passenger fares arising from extension of the railway line to Jammu should be taken into account in the determination of the grant is unassailable, we are handicapped by the absence of any information on passenger earnings in this extended section, which became operative only from October, 1972. We are not, therefore, in a position to take the extended route length into account. But here again, this decision should cause no serious concern because Jammu and Kashmir, in terms of our award, is entitled to a grant under Article 275(1) of the Constitution. What they possibly lose under the grant in lieu of railway passenger fares is made good to them by the grant payable under Article 275(1) of the Constitution. The existing principles of distribution, which are substantially the same as those formulated by the Second Finance Commission, have stood the test of time. In the continuing absence of statistics on passenger earnings in each State on account of actual travel within its limits, the allocation of passenger earnings from non-suburban services from each gauge for each railway zone separately among the States according to route length lying within each State would be the most equitable basis for distribution of the grant.

7. We have accordingly worked out the percentage shares of different States on the basis of statistics of gauge-wise route length of railways in each State and the actual passenger earnings from non-suburban traffic for each zonal railway for the four years ending 1971-72. They are as follows :—

States	Percentage share
1. Andhra Pradesh	8.01
2. Assam	2.70
3. Bihar	10.58
4. Gujarat	7.47
5. Haryana	2.57
6. Himachal Pradesh	0.17
7. Jammu and Kashmir	0.02
8. Karnataka	3.47
9. Kerala	1.61
10. Madhya Pradesh	9.89
11. Maharashtra *	8.87
12. Manipur	—
13. Meghalaya	—
14. Nagaland	0.01
15. Orissa	2.24
16. Punjab	5.06
17. Rajasthan	6.59
18. Tamil Nadu	5.14
19. Tripura	0.02
20. Uttar Pradesh	19.85
21. West Bengal	5.73
	100.00

We recommend that the grant to be made available to the States in lieu of tax under the repealed Railway Passenger Fares Tax Act, 1957 be distributed in accordance with these percentages.

8. The recommendations of the Railway Convention Committee on the quantum of the grant allocable among the States are to be in force only till the end of 1973-74. It is not known on what basis the Railway Convention Committee would determine the grant payable to the States in lieu of railway passenger fares for the period covered by our award. We have, therefore, contented ourselves with recommending the percentage share of each State. The grant to be made available to the States in lieu of the repealed tax on railway passenger fares should be distributed in accordance with the percentages indicated above. Meanwhile, for purposes of assessment of revenue gaps of States, we have assumed that the grant in lieu of Railway passenger fares tax would be maintained at Rs. 16.25 crores.

9. Almost all State Governments have drawn our attention forcefully to the inequity involved in the replacement of tax on railway passenger fares by a fixed grant. In providing for an impost on passenger fares as one of the taxes to be levied by the Centre and assigned to the States under Article 269 of the Constitution, the architects of the Constitution had presumably intended to give the States access to a modest share of the growing revenues of the railways. This objective has been thwarted by the substitution of railway passenger fares tax by a fixed lump sum grant. We are impressed with the force of these arguments put forward by the State Governments. It is difficult to rebut their contention that they have been deprived of a potentially elastic source of revenue by a unilateral decision of the Central Government. We are aware that the Railway Convention Committee of 1971 did consider the question of enhancement of the grant in lieu of tax on passenger fares, but had concluded that there was no scope for stepping up the grant in view of the financial position of the Railways. We also recognise that the Railways, as forcefully urged by them before the Railway Convention Committee, have to bear many social burden such as subsidised passenger fares on suburban railways, movement at less than the economical cost of certain articles like foodgrains and bulky raw materials and maintenance of uneconomic railway lines often under pressure from State Governments themselves. But we are not concerned here with the larger aspects of the working and financial results of the Railways. Making due allowance for the difficulties faced by the Railways, that are not dissimilar to those confronting many other public utilities in Central and State sectors, the fact remains that if the tax on passenger fares had continued, the actual collections during 1969-70 and 1970-71 would have amounted to about Rs. 24.46 crores and Rs. 26.17 crores respectively. On the basis of the figures made available to us for 1971-72, 1972-73(RE) and 1973-74(BE), we estimate that the tax would have amounted to approximately Rs. 31 crores, Rs. 33 crores and Rs. 36.5 crores respectively on the presumption that roughly 10.7 per cent

of non-suburban passenger fares would represent the tax element. Looked at from the narrow angle of ensuring the profitability of Railways, it is true that the levy of a tax on passenger fares would curtail the scope for enhancement of fares. But from the broader economic standpoint there is absolutely no difference between the revision of railway fares and imposition of a tax on passenger fares. As such a tax has been specifically mentioned in Article 269 of the Constitution, it is not unreasonable to argue that whatever potential there may be for mobilising additional revenues from passenger traffic should in part be tapped through a levy under Article 269 of the Constitution for the benefit of the States.

10. Though the question of reimposition of tax on passenger fares or corresponding enhancement of the grant payable in lieu of the tax may not strictly come within our purview, we have deemed it desirable to invite the attention of the Government of India to the strong views expressed by the State Governments, because we are also convinced that the grievance of the State Governments is real and needs to be redressed early. We also feel that the repeal of the passenger tax and its replacement by a fixed grant was not quite in accordance with the spirit, if not the letter, of the provisions of Article 269 of the Constitution. It will be in the larger interests of healthy development of cooperative federalism in the country if the point of view of the States is given due

recognition in taking decisions on issues of this nature. We would, therefore, urge that the Government of India should redetermine the amount of grant payable in lieu of tax on passenger fares in terms of what the States could have got if the railway passenger fares tax had continued in its original form. The additional loss to the Centre or gain to the States may only be of a marginal nature. But it will have a significantly favourable impact on Centre-State financial relations. We appreciate the social burden which the Railways are currently bearing. It cannot, however, be seriously disputed that many other enterprises in public sector are also constrained to bear similar burdens. But this has not deterred the Central Government from imposing or enhancing, for example, excise duties on products of such enterprises. It should also be remembered that States do get a share of such increases in excise duties. The only question that may be of relevance to the reimposition of the tax on passenger fares or in the alternative enhancement of the passenger fares to enable the Railways to make a larger grant available for distribution among the States is whether the demand for railway travel is sufficiently elastic and whether the fares would admit of upward revision. Past experience indicates that railway passenger fares should surely admit of some increase. We also feel that any proposals for reimposition of railway passenger fares tax or enhancement of passenger fares would be justifiable to the extent that such enhancement is linked specifically with the payment of larger grants to the States.