

## CHAPTER IV UNION EXCISE DUTIES

Under paragraph 4(a) of the President's Order, we are required to make recommendations on "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 Article 272 of the Constitution, Union excise duties may be divided between the Union and the States, if Parliament by law so provides. Though sharing of the excise duties is of a permissive nature, no satisfactory scheme of fiscal transfers from the Union to the States through tax sharing can be devised, unless Union excise duties are also kept within the ambit of devolution.

2. The participation of States in Union excise revenues started on a rather modest scale with the award of the First Finance Commission which recommended sharing in respect of only three of the major commodities then subject to Union excise duties. In pursuance of the recommendations of successive Finance Commissions, the share of the States in Union excise duties has been progressively enlarged. By the time the Fifth Finance Commission was set up, the States were already sharing the proceeds of all Union excise duties excepting only special excise duties, regulatory duties of excise and cesses on commodities. The Fifth Finance Commission saw no justification for the exclusion of special duties of excise from the divisible pool and recommended that they should also be brought within the scheme of sharing from 1972-73 onwards. The regulatory duties, however, still remained outside the shareable pool. It should, however, be noted that the yield from regulatory duties was nil in 1970-71. No credit was also taken under this head in the budget estimates for 1971-72. But, in the new situation created by large influx of refugees from Bangladesh and hostilities with Pakistan, Government of India invoked the powers available to them under section 12 of the Finance Act of 1971 to levy regulatory duties of excise on certain products such as steel, iron and steel products, copper, zinc, aluminium and unmanufactured tobacco. The yield from these regulatory duties amounted to Rs. 22.88 crores in 1971-72 and was placed at Rs. 80.37 crores in 1972-73 (Revised Estimate).

3. The levy of regulatory duties of excise has been replaced under the Finance Act of 1973 by auxiliary duties on excisable goods. The Finance Act specifically lays down that these auxiliary duties have been levied for purposes of the Union and that the proceeds therefrom shall not be distributed among the States. In his budget speech, the Finance Minister observed that "for certain reasons it is not possible to incorporate the provision in rate tariffs, or make

them part of taxation statutes and they would, therefore, have to be revived from year to year for the present". The States have argued that auxiliary duties are, in pith and substance, indistinguishable from basic duties of excise. They also apprehend that continuance of auxiliary duties as a separate entity may encourage the Centre to raise additional revenues increasingly through enhancement of rates and coverage of auxiliary duties of excise rather than of basic duties. On the basis of existing coverage and rates, the estimated revenue from auxiliary duties of excise over the next five years is of the order of Rs. 720 crores. We recognise that under certain special circumstances the Centre may have to resort to levy of excise duties in a form not shareable with the States, particularly as the Constitution does not, unlike in the case of Income-tax, envisage a surcharge exclusively for purposes of the Union. Nevertheless, we feel that levy of excise duties on a non-shareable basis should be confined to short periods of two or three years at the most to meet the large demands on national exchequer that may unexpectedly arise. We therefore recommend that revenue from auxiliary duties should be brought within the divisible pool from 1976-77 onwards. This will enable the Centre to meet its pressing needs in the immediate future and at the same time allay the apprehensions of the States that auxiliary duties of excise may be resorted to on a larger scale in order to deprive them of their legitimate share in the growth of revenues from Union excise duties.

4. As the buoyancy of Union excise duties in recent years has been significantly higher than that of income-tax, it is understandable that all the States—except Assam—should have pressed for augmentation of the divisible pool of Union excise duties. It is significant that this plea has been made by advanced and backward States alike. Some of the States—Andhra Pradesh, Kerala, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal—have suggested enhancement of the States' share of Union excise duties from the present level of 20 per cent to 50 per cent. Others have urged increases ranging from a minimum of 33 1/3 per cent to 40 per cent. In the course of our discussions with some of the socially and economically backward States that were likely to qualify for grants under Article 275 of the Constitution, we specifically posed the question whether they would not prefer the divisible pool to be kept at a lower level so that the Centre may have larger resources for helping them in their developmental programmes. We also drew their attention to the possibility of increase in revenues accruing to them from increased share of Union excise duties being off-set by corresponding reduction in grants under Article 275. Even such States distinctly preferred larger devolution through share of excise duties but with a more pronounced weightage

share of each State, we have taken the figures of population according to 1971 census and the average of the assessments made during the five years ending with 1972-73, which are the latest years for which firm figures are available, after adjustment for reduction on account of factors such as appellate orders, revisions and refunds during the same period.

12. We further recommend that 1.79 per cent of the net proceeds of income tax may be taken to be the portion of such proceeds attributable to Union Territories. We have worked out this figure by allocating to Union Territories as at present constituted the share which would have accrued to them on the principles of distribution prescribed by us for the States, if the Union Territories had collectively been entitled to share of income tax.

13. We accordingly make the following recommendations in respect of the distribution of the net proceeds of income tax in each of the financial years from 1974-75 to 1978-79 :—

- (1) Out of the net proceeds of taxes on income in each financial year, a sum equal to 1.79 per cent thereof be deemed to represent the proceeds attributable to Union Territories.
- (2) The percentage of the net proceeds of taxes on income, except the portion representing the proceeds attributable to Union Territories, to be assigned to the States, should be eighty.

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

States	Percentage
1. Andhra Pradesh . . . . .	7.76
2. Assam . . . . .	2.54
3. Bihar . . . . .	9.61
4. Gujarat . . . . .	5.55
5. Haryana . . . . .	1.77
6. Himachal Pradesh . . . . .	0.60
7. Jammu & Kashmir . . . . .	0.81
*8. Karnataka . . . . .	5.33 ✓
9. Kerala . . . . .	3.92
10. Madhya Pradesh . . . . .	7.30
11. Maharashtra . . . . .	11.05
12. Manipur . . . . .	0.18
13. Meghalaya . . . . .	0.18
14. Nagaland . . . . .	0.09
15. Orissa . . . . .	3.73
16. Punjab . . . . .	2.75
17. Rajasthan . . . . .	4.50
18. Tamil Nadu . . . . .	7.94
19. Tripura . . . . .	0.27
20. Uttar Pradesh . . . . .	15.23
21. West Bengal . . . . .	8.89
TOTAL . . . . .	100.00

\*Mysore will be renamed as Karnataka with effect from 1-11-1973. As our recommendations are to take effect from 1-4-1974, we have used the name 'Karnataka' in the operative portion of our Report.

for backwardness, because their share of Central revenues would then rise in tune with the rise in prices and higher taxation by the Centre, while grants under Article 275 are set at fixed amounts for the five-year period.

5. We have to strike a balance between the plea of the States for a substantial increase in the divisible pool and the needs of the Centre. We have also to ensure equity in the aggregate transfer of resources as between 'surplus' and 'deficit' States. An enlargement of the divisible pool will confer disproportionately larger benefit on surplus States than on the deficit States. On these and other relevant considerations, we feel that the States' share of all basic duties of excise should be retained at 20 per cent during the period covered by our award. Twenty per cent of the net proceeds of auxiliary duties of excise shall also be shareable from 1976-77 onwards. Revenues from cesses on excisable commodities, levied under special enactments and reserved for special purposes, should however continue to remain excluded from the divisible pool.

6. While there was near unanimity among the States in demanding an increase in the share of Union excise duties, there were naturally wide divergences in their approach to the principles of determination of the relative shares of the States in the divisible pool. Each State was inclined to put forward a formula that would favour it most. Andhra Pradesh and Haryana urged distribution wholly on the basis of population, while Maharashtra and Tamil Nadu pleaded for weightage for urban and rural population in the ratio of 30:70. Their argument was that consumption would be a suitable criterion in the distribution of Union excise duties and in the absence of reliable data on consumption, the broad break-up between urban and rural population would provide a satisfactory indicator of the level of consumption. West Bengal also pressed for population as the sole relevant factor but with weightage of 40 per cent for urban population. Assam, Bihar and Nagaland favoured continuance of the existing arrangements, namely, 80 per cent on population and 20 per cent on the basis of per capita income and index of backwardness. Gujarat argued in favour of distribution of 80 per cent on the basis of population, the balance of 20 per cent being distributed in proportion to sales tax collections. They justified their preference for sales tax collection on the ground that the levy of Union excise duties limits the scope for mobilisation of resources by the States in the form of sales tax. Kerala put forward an altogether new approach in proposing distribution on the basis of population and budgetary needs with equal weightage for both. Mysore contended that the entire distributable tax proceeds should be treated as one unit and allocated among the States—90 per cent on the basis of population and 10 per cent on the basis of development index or relative per capita income. Uttar Pradesh urged that 75 per cent of the divisible pool should be distributed on the basis of population and the remaining 25 per cent only among the States whose per capita income is below the national average in the

inverse ratio of the per capita income. They specifically urged that other indices of backwardness should be ignored altogether, as there was no better measure of backwardness than per capita income. Madhya Pradesh, Maghalaya, Orissa, Rajasthan and Tripura urged that apart from backwardness and population, certain other factors such as percentage of Scheduled Castes and Scheduled Tribes should also be deemed relevant to the distribution of Union excise duties.

7. We have given careful thought to the formulation of principles of distribution of Union excise duties among the States, as it will continue to be by far the most important conduit for transfer of resources from Centre to the States. We agree with the earlier Commissions that collection or contribution would not be an appropriate basis for distribution of excise duties. The two criteria that have gained general acceptance with the earlier Commissions are population and relative social and economic backwardness of the States.

8. A measure of weightage for relative economic backwardness has by now come to be accepted as a legitimate criterion in the distribution of States' share of Union excise duties. As briefly indicated in the earlier paragraphs, some of the States, of course, have argued before us vigorously that relative backwardness of States cannot be a relevant consideration in the distribution of Central taxes. In their view, the distribution of excise duties should be related exclusively to non-discriminatory criteria such as population or consumption and any special help that may be considered necessary should be extended to the backward States through the mechanism of grants-in-aid under Article 275 of the Constitution.

9. We are unable to accept this point of view. The objective of rectifying, to the extent possible, regional imbalances should be recognised as a distinct criterion in determining the principles of fiscal transfers in any federation. We are aware that while regional imbalances cannot be redressed completely through our scheme of devolution alone, our recommendations should nevertheless make a modest contribution to the process of elimination of existing disparities.

10. In view of the continuing need to help States that are economically backward, it becomes essential to evolve some indicators for the measurement of relative economic backwardness. The main issue which we had to consider in this connection was whether per capita income could be taken as the sole indicator of the comparative economic position of different States or whether, in lieu of or in addition to per capita income, other indicators, such as those employed by the Fourth and Fifth Finance Commissions, should also be used. The Central Statistical Organisation has been compiling estimates of State Domestic Product and per capita income on comparable basis and such estimates were used by the last Commission for purposes of distribution of a portion of Union excise duties. At our request, Central Statistical Organisation has furnished us with estimates of State Domestic Product for 1967-68, 1968-69 and

1969-70—the three latest years for which such estimates are available. The Central Statistical Organisation has confirmed that the methodology now followed by them in preparing these estimates is the same as that followed by them earlier in preparing the estimates upto 1964-65 that had formed the basis of recommendations of the Fifth Finance Commission. We, however, felt that in view of divergences in trends of prices among States, it would be more relevant to have figures of State Domestic Product reworked at abstract all-India prices. Accordingly, the Central Statistical Organisation has computed figures of State Domestic Product for the years 1967-68 to 1969-70 using abstract all-India prices.

11. Some of the States have contended before us that per capita income by itself would not be a wholly dependable index of the relative economic position of the States. They have urged that the Commission should take into account some other indicators relating to certain specific areas of economic or social significance. The more important indicators of backwardness suggested by the States, some of them identical with those relied on by the Fourth and Fifth Commissions, are as under:—

- (i) Percentage of rural population to total population of each State.
- (ii) Percentage of scheduled castes population.
- (iii) Percentage of literacy.
- (iv) Enrolment in primary classes I to V as percentage of population in age group 6—11.
- (v) Number of workers registered in factories per lakh of population.
- (vi) Number of registered factories in terms of area.
- (vii) Value added per capita by manufacture.
- (viii) Number of hospitals in terms of area or per lakh of population.
- (ix) Per capita gross value of agricultural production.
- (x) Net irrigated area per cultivator.
- (xi) Percentage of villages with public water supply.
- (xii) Landless agricultural labour in each State.
- (xiii) Installed capacity for generation of electricity.
- (xiv) Number of villages electrified.
- (xv) Percentage of villages electrified.
- (xvi) Per capita consumption of energy.
- (xvii) Motor vehicles per lakh of population.
- (xviii) Length of railways and roads in terms of area.
- (xix) Area of each State.
- (xx) Per capita availability of calories or proteins in different States.

(xxi) Percentage of population below 'poverty line' in each State.

(xxii) Extent of unemployment in each State.

12. This long list, of course, is not exhaustive. Each State was understandably anxious to put forward such indicators as would reflect its own interests more fully.

13. We have carefully considered whether all or any of the indicators set out above could be used in addition to or in substitution of per capita income as a measure of comparative levels of economic and social advance in different States. Even a cursory look at the list would show that most of the indicators put forward by the States refer either to characteristics that are themselves the causes of low per capita income or to characteristics that are direct or indirect consequences of low per capita income. Thus, for example, gross value of agricultural output or the number of workers employed in factories is itself one of the causes for variations in per capita income of the State. Area under irrigation, likewise, has a bearing on agricultural production and, therefore, also on per capita income. There is a high degree of correlation among the several indicators mentioned by the States. If we take into account all of them or a sub-set of them as indicators, we shall be confounding their impact on the criterion of backwardness.

14. The use of indicators relating to social services such as enrolment in schools of children in the age group 6—11, or bed strength in hospital is open to objections of a different nature. Some of the States like Kerala have urged that the adoption of these criteria for the measurement of relative backwardness would place at a disadvantage those States which, despite a poor resource base, have assigned high priority to these services in the past. While some of the advanced States have concentrated their resources on irrigation and power projects, or even repayment of Central loans out of revenue resources, a few of the poorer and middle level States, presumably out of their greater concern for the weaker sections of society, have allocated larger resources for building up social services. We feel that these arguments cannot be wholly ignored. Even granting the need to provide certain States with larger resources to enable them to enlarge social services, it would be much better to do so through a straightforward "mark-up" of the budgetary provisions under the relevant heads, than seek to accomplish the same objective circuitously through weightage for social services in our formula for distribution of Central taxes. There will then be greater certainty also that the additional resources so provided will be utilised for expansion of social services.

15. The assignment of weightage among the different indicators is an intractable issue. Among the numerous indicators put forward before us, we consider per capita income as the best possible yardstick for the measurement of the levels of development. We have taken per capita income as the sole criterion in assessing the relative economic position of the States.

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

## 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