CHAPTER 8

GRANT ON ACCOUNT OF WEALTH TAX ON AGRICULTURAL PROPERTY

In terms of paragraph 6(d) of the Presidential Order we are to suggest changes, if any, in the principles governing the distribution among the States of a grant to be made available to them on account of wealth tax on agricultural property.

2. Wealth tax on agricultural property was introduced with effect from assessment year 1970-71 by amending Section 2(e) of the Wealth Tax Act, 1957. The amendment was a part of the measures in the Finance Act of 1969. Prior to this amendment, assets defined for the purposes of the wealth tax did not include agricultural property. The effect of the amendment of the Wealth Tax Act in 1969 was that agricultural property stood included in the properties taxable under the Act. This amendment is not applicable to the State of Jammu & Kashmir.

3. Wealth tax is not one of the taxes and duties which, under the provisions of the Constitution, are to be shared with the States either on an obligatory or permissive basis. Nor is it a tax levied or collected by the Centre and assigned to the States. However, when agricultural property was made liable to wealth tax as aforesaid the Central Government decided on its own that the net proceeds of the tax on agricultural land would be passed on to the States as grants-in-aid.

4. The Sixth Commission was required to recommend the principles for the distribution among the States of the grant for the five years from 1974-75 to 1978-79. That Commission took the amount of grant as equivalent to the net collections of wealth tax on agricultural property reduced by the net collections attributable to the Union territories. It considered the tax as being comparable in its incidence to estate duty in so far as the latter related to immovable property. It observed that the location of the property brought to assessment would be clearly identifiable in each case and would provide a reliable basis for the distribution of the proceeds among the States. It recommended accordingly that the grant should be distributed among the States in proportion to the value of agricultural property situated in each State and brought to assessment each year. It did not consider population as an appropriate basis for distribution, since it would have no bearing on the extent or value of agricultural property brought within the tax net. Backwardness of a State of its need for development was also considered as not relevant. The Sixth Commission noted further that collection of the tax would not be an appropriate basis as collection in a State may in some cases relate to property located outside the State.

5. Before making its recommendation the Sixth Commission had consulted the Central Board of Direct Taxes in regard to statistics then maintained by the Department and the possibility of maintaining statistics for agricultural property in each State brought to assessment. While that Commission was informed that the data were not readily available, it observed that it had no doubt that arrangements could easily be made for compilation of the relevant statistics relating to agricultural property located in each State and brought to assessment in a year.

6. The Sixth Commission's recommendations were accepted by the Government of India, to be effective in relation to the net collections in each year from 1974-75 to 1978-79. As we have been informed by the Union Ministry of Finance, the Government of India decided for the years 1970-71 to 1973-74, to adopt the population ratio as the basis for distribution of the grant among the States. For these four years the total amount of the grant payable to the

as the tax element, the collections would have been Rs. 56. 21 crores in 1976-77, Rs. 61. 17 crores in 1977-78 and Rs. 63. 22 crores in 1978-79(BE). Non-suburban passenger traffic in terms of passenger kilometres increased from 68617 million in 1961-62 to 126754 million in 1976-77, or by a factor of 1. 85. Average earnings per passenger per kilometre are estimated to have gone up from 2. 01 p. in 1961-62 to 4. 03 p. in 1976-77 for non-suburban passenger traffic, i. e. by a factor of 2. Non-suburban passenger earnings increased from Rs. 137. 73 crores in 1961-62 to Rs. 525. 30 crores in 1976-77 i. e. by a factor of 3. 8. On the other hand, the amount of grant in lieu of the tax, fixed at Rs. 12. 50 crores when the tax was abolished in 1961, was raised once to Rs. 16. 25 crores in 1966, and has been stagnant at that figure since then.

14. The Finance Commission may not be the competent body to advise whether it would be appropriate to re-impose the railway passenger fare tax as has been urged by at least one State Government. Nevertheless, we do appreciate the force of the argument put forward by almost all State Governments that a fixed grant is not an adequate replacement of a tax on railway fares, since it does not take into account the considerable buoyancy in the earnings of the Indian Railways caused by the rapid increase in passenger traffic. The increase in average earnings per passenger kilometre from 2. 01 paise to 4. 03 paise mentioned earlier may have come about because of fare increases necessitated by higher working expenses in the form of increased fuel charges, payment of higher emoluments to Railway personnel, increased costs of stores and spares etc. As such, it may be difficult to insist on a corresponding increase in the grant payable to the States. Even so, we cannot ignore the substantial increase that has taken place in the extent of passenger traffic since 1961-62 as reflected by the figures of non-suburban passenger kilometres. We feel that the States are entitled to their due share arising from the growth in non-suburban passenger traffic by a factor of 1. 85 since 1961-62 as it is a major element responsible for the overall increase in passenger earnings from this traffic by a factor as high as 3. 8 since 1961-62. The factor of 1. 85 would represent a grant of about Rs. 30 crores a year.

15. However, we also appreciate that the Indian Railways as the largest departmental undertaking should be enabled to operate at a profit and should be in a sufficiently strong financial position to service the loans granted for their developmental projects, including the construction of new lines, for which State Governments themselves make repeated demands. We also appreciate the social obligations of the Railways e. g. carriage of suburban traffic and of essential commodities, sometimes at a loss. On the other hand, there is also force in the point urged upon us by one of the State Governments that they also have to bear substantial financial burdens on account of the operations of the Railways, for instance, for the dispersal of traffic carried by the Railways at the destinations.

16. We would suggest that having regard to the various factors mentioned above, the Government of India should specifically refer the question of increasing the quantum of the grant in lieu of the railway passenger fares tax, to the appropriate Railway Convention Committee. Since this Committee carefully examines the overall financial position of the Railways, the dividend payments that should be made to General Revenues, as also the contributions of the Railways to the Depreciation, Development, Pension and other Funds, we can reasonably expect that the Committee would judiciously consider, in the light of the facts stated above, the question of increasing the grant payable to the States.

States was estimated at Rs. 2 crores only. In the implementation of the Sixth Finance Commission's recommendation, the Central Board of Direct Taxes found that the statistics of wealth tax assessments maintained by it would not enable it to ascertain the value of agricultural property located in each State and brought to assessment in a year, without taking upon itself considerable amount of additional work. Besides, with effect from the assessment year 1975-76, the separate exemption available till then in respect of agricultural land was done away with and the exemption for agricultural property was linked with the exemption for other types of assets. One of the results was that the derivation of the element of tax on and the calculation of the value of agricultural property in the total property brought to assessment from 1975-76 became a complicated matter. The Union Ministry of Finance, therefore, decided in 1976 that the distribution of the grants to the States, in relation to the years from 1974-75, should be in proportion to the value of agricultural property brought into assessment in the States where the assessments took place. The recommendation of the Sixth Commission, which was accepted by the Central Government, was that the distribution should be in proportion to the value of the property located in each State and brought to assessment. The Central Government had laid the Report of that Commission before Parliament in December 1973, together with its decisions on the recommendations in the Report. We have been informed that the Ministry of Finance felt that the distribution of the grant in this modified manner could be deemed to be substantial compliance with the recommendations of the Sixth Commission. Whatever the considerations which impelled the Government to take this decision, we are not sure how far it could be deemed to be substantial compliance with the recommendation of the Sixth Commission. This apart, it also seems to us that in the method which the Government of India has adopted, the amount attributable to Union Territories might be larger than in proportion to the value of agricultural property located in the Union Territories and brought to assessment.

7. In the case of the Wealth tax on agricultural property, it is not obligatory to obtain a certificate of the net receipts from the Comptroller & Auditor General. The question does arise, however, whether the amount of the grant in each year on account of Wealth tax on agricultural property should not be consistent with the collections shown in the Finance Accounts of the Central Government prepared by the Comptroller & Auditor General and reported to Parliament. We find that the collections of Wealth tax in 1975-76, according to the Finance Accounts, were Rs. 53.73 crores, of which Rs. 4.59 crores were shown as being on account of agricultural property. According to the information given to us by the Ministry of Finance, however, they have taken Rs. 0.91 crore as the collection of Wealth tax on agricultural property in that year and the shares of the States have been distributed on that basis. We hope that the Government of India would look into this matter.

8. We would suggest that in a matter involving fiscal transfers from the Centre to the States, the Government of India should take measures which would ensure that the due shares of the States in the realised revenue are determined and paid to them without undue delay.

9. We have carefully considered whether any change should be made in the principles for the distribution among the States of the grant on account of Wealth tax on agricultural property in the light of the above and after taking into account the difficulties expressed by the Union Ministry of Finance and the Central Board of Direct Taxes in the compilation of statistics. We have taken note of the complexities involved in calculating the element attributable to agricultural property out of the total Wealth tax collections, following the amendment in the law with effect from 1975-76 by which the exemption for agricultural property became linked with the exemption for other assets. We have also noted that, according to the Ministry of Finance, the receipts on account of Wealth tax on agricultural property in the years 1979-80 to 1983-84, projected in line with the departmental figure of Rs. 0.91 crore for 1975-76, would be very small and shares therein would make no material

difference to the States. Though, in the normal course, we would have suggested the continuance of the principle recommended by the Sixth Commission, in the circumstances brought out above, we recommend that the share of each State in the grant in each of the years from 1979-80 to 1983-84 should be an amount equivalent to the net collection in that State in each year. Sikkim will also become entitled to a share in the grant in accordance with this recommendation, if and when the levy of the Wealth tax is extended to that State in the period covered by our report.

10. Considering the very small amounts involved, and also the fact that it is not possible at present to estimate what the shares of the States would be in each year in the future, we have decided to ignore the shares out of this grant from our computations of the revenue receipts of the States in the period covered by our report.

CPAPTER 9

CENTRE-STATE FINANCIAL RELATIONS AND OUR SCHEME OF TRANSFERS TO THE STATES

The Finance Commission derives its being from Article 280 of the Constitution. This Article, in Part XII of the Constitution is basic to the fabric of Centre-State financial relations. Its position in Chapter I of Part XII of the Constitution gives a clear indication of its place and functions in the overall scheme of Centre-State relations, which is particularly spelt out from Articles 268 to 281. The sequence of the matters dealt with by these Articles is significant. Article 268 refers to the duties levied by the Union but collected and appropriated by the States. Article 269 lists the taxes levied and collected by the Union but are assigned to the States. In the case of the taxes and duties referred to in these Articles the Central Government has no discretion to retain any part of the proceeds. Article 270 refers to income tax levied and collected by the Union and distributed between the Union and the States. That proportion of the proceeds of the income tax which is distributable among the States have been treated as assigned to the States and does not form part of the Consolidated Fund of India. Article 270-also specifies that the distribution of the share of the States *inter se* will be prescribed by the President by Order after considering the recommendations of the Finance Commission. Article 272 refers to Union duties of excise levied and collected by the Government of India, which may be shared with the States if the Parliament by law so provides. Article 275 speaks of grants-in-aid of the revenues of the States as Parliament may determine to be in need of assistance. The sums of such grants-in-aid shall be charged on the Consolidated Fund of India. The meaning of this sequence is clear, in that, firstly, the need of transfer of resources raised by the Centre to the States is recognised and made part of the Constitution; secondly in the case of the taxes which are to be divided or may be divided between the Centre and the States, it is the Finance Commission which has to make recommendations in regard to the allocation of the respective shares between the Union on the one hand and the States on the other, and also in regard to the principles for deciding the shares of the States *inter se*. The Commission also has to recommend the principles which should govern the grants-in-aid to the States under Article 275. These two duties are mandatory. The President can also refer other matters to the Commission in the interest of sound finance.

2. While the Commission's discretion in the matter of making recommendations on these maters is not limited in the Constitution, it also seems clear that the Commission has little discretion to make transfers beyond the scheme laid out in Chapter I of Part XII of the Constitution. We have kept this position in mind throughout our deliberations. On a careful review and after full consideration we are of the view that the framework of Centre-State Financial relations embodied in the Constitution has stood the test of time and has worked fairly and smoothly.

3. Our terms of reference are different from those of the earlier Commissions in one important respect. For the first time, the considerations set out in paragraph 5 of the Presidential Order are to be kept in mind while making recommendations in in regard to sharing of taxes and also in the determination of grants-in-aid. For the earlier Commissions, similar "considerations" were applicable only when the Commissions were determining the amounts of grants-in-aid. A few of the States have brought up this point in their memoranda to us, and also in our discussions with them. In their view, the entitlement to shares of taxes should have nothing to do with the considerations

mentioned in paragraph 5 of the Presidential Order. Such a view would be difficult to sustain as we have to estimate the requirements of all the States uniformly within the Constitutional framework of Centre-State financial relations. The Commissions in the past had also in practice made their assessments of the revenue requirements of the States on uniform considerations. The change in our terms of reference compared to those of the earlier Commissions is, in a sense, a purely formal one, recognising the past practice. Further tax shares and grants-in-aid under article 275 have always been inextricably linked in the schemes of transfer of the past Commissions. Actually, grants under article 275 were determined and recommended for the purpose of making up the revenue requirements of the States to the extent that they had not been met by the tax shares.

4. Some of the States further contended that it was incorrect for the President i.e., the Government of India, to ask the Commission to keep in mind a set of stated "considerations" as in para 5 of the Presidential Order. The argument was that these were constraints on the Commission, which has to hold the balance between the Centre and the States and therefore the Central Government ought not to indicate what considerations should be kept in mind by the Commission. This view would have some validity if the considerations set out in the Order were in fact constraints, or prescribed procedures which were not already inherent in the established practice. For instance quite clearly any Commission has to keep in mind the essential demands on the Centre's resources. It is also a well-established practice by now that the Finance Commissions refrain from considering the financing of the Central and State Plans. These are the matters referred to in clauses (i) and (ii) of para 5 of the Presidential Order. The rest of the clauses of this paragraph, except clause (vi), refer specifically to a number of items covering both the receipts and the expenditure on revenue account, which any Commission necessarily has to take into account. The Commission's freedom to take into account other factors is not inhibited. The only special feature in paragraph 5 is clause (vi) which asks the Commission to take into account the requirement of backward States for upgrading standards of administration in non-developmental sectors and services. The developmental area is excluded as being in the domain of the Planning Commission. The clause is in consonance with the widely accepted thesis that regional imbalances should be mitigated and redressed to the extent possible. It is, therefore, reasonable to take the view, which in fact we have taken, that the contents of paragraph 5 of the Presidential Order were not constraints on the Commission in any way.

5. We have given attention to the principles which should govern the grants-in-aid of the revenues of the States under Article 275. A set of principles was adopted by the first Commission. These were broadly endorsed by subsequent Commissions. Some of those principles were more in the nature of guidelines for the internal work in the Commissions in the matter of the re-assessment of the revenue forecasts of the States. Some related to areas which have since then become clearly established as being within the purview of the Planning Commission. The later Finance Commissions also had serious difficulties in the application of some of these principles, for instance, measurement of the effects of economy and efficiency in expenditure, or assessment of the comparative tax efforts of the States. In the present circumstances we believe that the following should be the principles for grants-in-aid under Article 275 :-

(a) Grants-in-aid may, in the first place, be given to States to enable them to cover fiscal gaps, if any are left after devolution of taxes and duties, so as to enable them to maintain the levels of existing services in the manner considered desirable by us and built in their revenue forecasts. In this connection consideration should