

## CHAPTER VII

### ADDITIONAL DUTIES OF EXCISE

7.1 Paragraph 6(b) of the President's Order invites our suggestions on the changes, if any, to be made in the principles governing the distribution among the States of the net proceeds in any financial year of the additional excise duties leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in replacement of sales tax levied formerly by the State Governments on each of the following commodities namely: (i) cotton fabrics; (ii) woollen fabrics; (iii) rayon or artificial silk fabrics; (iv) sugar and (v) tobacco including manufactured tobacco. The proviso to clause (b) lays down that the share accruing to each State shall not be less than the revenue realised from the levy of sales tax on these commodities in the financial year 1956-57 in that State.

7.2 This levy was the result of an agreement reached in the National Development Council in December, 1956, by which the States agreed to refrain from exercising their power to levy sales tax on the commodities mentioned above in lieu of a share in additional excise duties to be levied by the Centre. Their decision was recorded as follows:-

"The National Development Council agreed unanimously that sales tax levied in States on mill-made textiles, tobacco including manufactured tobacco, and sugar should be replaced by a surcharge on the Central excise duties on these articles, the income derived therefrom being distributed among States on the basis of consumption, subject to the present income derived by States being assured. The method of sharing and distribution should be referred to the Finance Commission." \*

Accordingly, additional duties of excise have since then been levied and collected by the Centre, and the entire net proceeds, other than the proceeds attributable to Union territories, are distributed amongst the States. As observed by previous Finance Commissions, the agreement is in the nature of a tax rental. Theoretically, the States are even now free to reimpose sales tax on the afore-mentioned commodities but there are two disincentives. First, a State which chooses to reimpose sales tax would lose its share in the proceeds from additional excise duties unless the Central Government otherwise directs. Secondly, in view of sections 14 and 15 of the Central Sales Tax Act, which declares these goods to be goods of special importance in inter-state trade and commerce, the rate of sales tax, even if reimposed by the States, cannot exceed 4 per cent.

7.3 Having regard to the understanding on the basis of which these additional excise duties came to be levied, the only proper principle on which to allocate shares to the States would obviously be the consumption of the said commodities in each State. The problem is, how to ascertain the figures of consumption. This problem was also faced by the previous Finance Commissions.

7.4 However, before describing the solutions found by the earlier Finance Commissions, and the views of the States thereon, we propose to deal with the matter of the guaranteed amount. The agreement reached at the National Development Council (December, 1956) guaranteed that the shares of the States would not be less than the revenue they were deriving from the sales tax on these commodities in 1956-57. The proviso to paragraph 6(b) of the President's Order incorporates that guarantee in our terms of reference.

The Second, Third, Fourth and Fifth Finance Commissions decided to first set apart the guaranteed amount, representing the shares of the States on the basis of what they were realising from sales tax on these commodities in 1956-57 and applied the principles of distribution evolved by them only to the excess over the guaranteed amount. The Sixth and Seventh Finance Commissions observed that setting apart the guaranteed amount first and then distributing the balance might confer an advantage on some States that was not intended by the agreement of the National Development Council. They, therefore, decided to dispense with this procedure, because they felt that the revenues from additional

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\* Page 24 Summary Record of the Eighth Meeting of the National Development Council - (December - 1956) - Planning Commission, (Government of India)

excise duties had attained such large proportions that, whatever be the principles of distribution adopted by them, the States would in any case, not receive less than the guaranteed amount. We agree with this reasoning. The revenues from additional duties of excise in lieu of the sales tax have now crossed Rs. 670 crores in the Revised estimates 1983-84. Whatever be the basis of distribution, every State is bound to get more than what it was realising as sales tax on these commodities in 1956-57 for, the aggregate of the guaranteed amount for all States is only of the order of about Rs. 35 crores. We, therefore, do not see any necessity for setting apart the guaranteed amount first. Only four States, namely, Gujarat, Karnataka, Maharashtra and Uttar Pradesh have argued in favour of first setting apart the guaranteed amount. The others have no complaint against the method adopted by the Sixth and Seventh Finance Commissions.

7.5 As regards the principles of distribution, the Second Finance Commission, which was the first to deal with this question, recommended that the shares of the States in additional duties of excise should be on the basis of the then available consumption figures, with population used as a corrective factor for moderating the deficiencies in the data on consumption. The Third Finance Commission was of the opinion that as additional duties of excise were being levied in lieu of sales tax, it would not be right to ignore sales tax collections altogether. It, therefore, recommended that the receipts of additional excise duties in excess of the guaranteed amount, be distributed among the States partly on the basis of the percentage increase in the collection of sales tax in each State since 1957-58 and partly on the basis of population. It was not indicated what relative weightages were assigned to these two factors. The Fourth Finance Commission dispensed with population as a factor, and relied exclusively on realisations of sales tax revenue in each State. It determined the shares on the basis of the proportion of sales tax revenue in each State to total sales tax collections of all the States over the years 1961-62 to 1963-64. The Fifth Finance Commission felt that while sales tax collection was a relevant factor, it would be necessary to exclude inter-State sales tax which was realised on 'exports' outside the State. It also restored population as a factor for distribution, and recommended that equal weightage be given to both these factors.

7.6 The Sixth Finance Commission, however, took the view that sales tax revenue did not provide even an indirect indication of the levels of consumption of textiles, sugar and tobacco because sales tax was levied on a host of commodities ranging from luxury goods to semi-luxuries, raw materials and intermediate goods. That Commission, therefore, decided to exclude sales tax collections from the principles of distribution and sought other indices of consumption.

7.7 It thought, the premise that consumption was directly related to levels of income could not be doubted, and hence decided to adopt State Domestic Product (SDP) as one of the factors. It also recognised that sugar, textiles and tobacco were in a sense articles of mass consumption and their consumption was dictated by social habits and manners. Hence population as a factor could not be ignored. But, where the Sixth Finance Commission differed from the earlier Finance Commissions, was in giving a weightage to production also. In doing so it was influenced by the consideration that had sales tax not been given up, the States would have also taxed sales of these commodities 'exported' to other States; therefore, the portion of production relating to the 'export' of these commodities also deserved to be taken into account. The Sixth Finance Commission, therefore, determined the shares of the States on the basis of three factors, namely, population, SDP and production with weightages of 70 per cent, 20 per cent and 10 per cent respectively attached to them. It assigned a relatively low weightage to production, recognising that there was a ceiling on the rates at which inter-State sales tax could be levied.

7.8 Agreeing with the earlier Finance Commissions that the consumption of these articles in the different States would be the most suitable basis for distribution of the receipts of additional excise duties among them, the Seventh Finance Commission examined whether the household expenditure surveys of the National Sample Survey, could give an adequate and reliable measure of consumption of these articles in each State. The Commission even got the National Sample Survey Organisation (NSSO) to make a special compilation for it. Though this survey included a large variety of items of household consumption of sugar, tobacco and textiles, the Seventh Finance Commission found that the description of these items was different from that of articles subject to additional duties of excise. The Seventh Finance Commission enlisted the help of the Central Board of Excise and Customs to rearrange the data to make the consumer expenditure survey conform as closely as possible to the articles on which additional excise duties were leviable. However, the estimates so obtained, after rearrangement of the data did not tally with the estimates of private final consumption at current prices of the Central Statistical Organisation (CSO) and the Finance Commission could find no adequate explanations for these differences. It further found that the NSSO's estimates did not also agree with the data of production of

sugar, tobacco and textiles, and the discrepancies were not accountable. It also observed that the NSSO consumer expenditure surveys did not fully capture the expenditure of the higher income groups and therefore, were not likely to provide acceptable estimates of consumption of the varieties of tobacco and textiles which contribute to a substantial extent, to the revenues from additional excise duties. It also noticed that NSSO's surveys in any case covered only household expenditure, whereas both in the case of sugar and textiles non-household consumption was also significant. Moreover, the Commission was not inclined to use NSSO's data relating to 1972-73 for a period which would commence seven years later. The Seventh Finance Commission, therefore, found itself unable to use the consumption estimates provided by the NSSO and CSO. Hence, it had to devise other means of assessing consumption. In doing so, it adopted different bases for sugar and for textiles and tobacco.

7.9 In respect of sugar, the Seventh Finance Commission decided to treat the despatches to the States as an acceptable measure of consumption. Accordingly, it relied on the average of despatches of sugar to each State in the three years ending 1976-77 as representing a fair approximation of consumption in that State. As regards textiles and tobacco, that Finance Commission failed to find a similar method for estimating consumption in each State. Nor did it see any merit in the suggestion of some States that sales tax collections in a State would provide a reasonable basis for estimating consumption of the articles subject to additional excise. It was of the opinion that the sales tax collections in the different States were a doubtful measure of the relativities between them in the matter of consumption of textiles and tobacco. It, therefore, preferred to rely on the generally accepted proposition that higher income levels would lead to higher consumption of textiles and tobacco, specially the varieties which contribute the major part of revenue from additional excise duties. Thus, it multiplied the average per capita SDP of each State, for the three years ending 1975-76, by the population of the State according to the 1971 census, and worked out the percentage share of this product of each State in the corresponding all States' total figure.

7.10 We turn next to the views of the States. Andhra Pradesh, Punjab and Sikkim favour the approach of the Seventh Finance Commission, while Assam favours that of the Sixth Finance Commission. Bihar prefers additional duties of excise to be distributed among the States on the same principles as suggested by it for the distribution of basic excise duties. Gujarat, Karnataka and Uttar Pradesh would like the excess over the guaranteed amount to be distributed in the same proportion as the guaranteed amount. Uttar Pradesh has added that, in the alternative, population should be the sole criterion. Haryana and Tamil Nadu have expressed themselves in favour of the distribution being made in proportion to the sales tax revenue of each State to total sales tax collections in all States. Himachal Pradesh agrees that consumption of these commodities would be the rational basis for distribution of the proceeds, but adds that neither sales tax nor per capita SDP correctly indicate relative consumption in the various States. It further desires that 20 per cent additional share should be given to hill States for tobacco and textiles, over and above their share on the per capita domestic product basis, in case that principle is adopted. In respect of sugar, it has suggested that both official and private despatches should be taken into account.

Jammu and Kashmir considers that the criteria adopted by the Seventh Finance Commission were disadvantageous to it. It has proposed that inter-State distribution should be related to the trend in growth of sales tax collections, so that a State is fully compensated for not levying the tax on these commodities. Kerala has merely said that consumption should be the basis for distribution. Madhya Pradesh is in favour of the Seventh Finance Commission's approach in respect of sugar, but for textiles and tobacco it suggests that the distribution should be on the basis of population alone. Maharashtra has suggested that the proceeds from the excise duty on sugar should be distributed with equal weightage attached to inter-State sales tax collections and consumption as represented by despatches. In regard to tobacco and textiles it has proposed equal weightage to inter-State sales tax collections and consumption represented by SDP. Manipur prefers the Seventh Finance Commission's approach for sugar, but for tobacco and textiles it has urged that the data on actual consumption of these commodities in hill States should be reviewed, if necessary, by having a special random survey conducted. Meghalaya has suggested 70 per cent weightage to population and 30 per cent to backwardness in regard to textiles and tobacco. Nagaland would like 20 per cent of the net proceeds to be set apart exclusively for the hill States, as it claims that consumption of these commodities in the hill areas is higher than in the plains. For the balance of 80 per cent, it has proposed that it be distributed with 75 per cent weightage to population and per capita SDP, and 25 per cent weightage to backwardness.

Orissa has suggested that the distribution be done on the basis of population alone. Rajasthan agrees that consumption should be the basic criterion for distribution, and has suggested that if the

National Sample Survey data are not acceptable or are not considered reliable, then average despatches of sugar be taken into account in respect of sugar, and population in respect of textiles and tobacco. Tripura, like Bihar, would like the same principles of distribution to be adopted for basic duties of excise and additional duties of excise in lieu of sales tax, and favours the formula which was used by the Seventh Finance Commission for basic duties of excise, with the slight modification that appropriate weightage should also be given for the proportion of scheduled tribe population in excess of the All-India average. West Bengal has not made any specific suggestions.

7.11 Our endeavours to obtain reliable estimates of consumption have not met with any greater success than those of the last Finance Commission. We, too, sought data from the National Sample Survey Organisation. They furnished to us estimates of consumption of sugar, textiles, and tobacco, in the different States, based on the 32nd round and relying on a sample survey conducted during July, 1977 to June, 1978. We are, however, not satisfied that this would be a correct basis for estimating consumption in different States. As pointed out by the last Finance Commission, the NSSO survey covers only household consumption, whereas there is a significant consumption of sugar and textiles outside the household sector.

7.12 We also obtained information from the Ministry of Commerce (Department of Textiles) as to the estimated per capita purchases of textiles in different States during 1981. Apart from the fact that there were significant gaps in the data, the figures probably relate to purchases of all textiles whereas additional duties of excise are leviable only on specified categories of textiles. Our attempts to obtain State-wise figures of consumption of mill-made textiles from certain associations of textile units like South India Textile Research Association, Bombay Textile Research Association, Ahmedabad Textile Industries Research Association etc., have not yielded any useful results.

7.13 With due deference to the previous Finance Commission, we do not consider that despatches of sugar to different States would provide a satisfactory basis for estimating consumption therein. In support of our view, we would cite merely one objection raised by the Government of Meghalaya. They pointed out that, the consumption centres in Meghalaya are supplied by the markets in Assam because of their proximity, and, hence, consumption in Meghalaya would get reflected in the despatches to Assam. Therefore, it would not be correct to estimate the consumption in a State on the basis of despatches thereto. Clearly, if consumption is estimated on the basis of despatches, distortions can well occur, where the markets in one State cater to the needs of the consumers in another.

7.14 The different factors used by the previous Finance Commissions for estimating consumption were sales tax collections, either including or excluding inter-State sales tax, despatches of sugar, production, State Domestic Product and population. Without repeating the well known objections to the use of sales tax collections for estimating consumption, suffice it to say that we agree with the Sixth and Seventh Finance Commissions on this point. As already stated, we are unable to accept the despatches of sugar to a State as a satisfactory basis for estimating consumption of that commodity in different States. We do not consider production as an appropriate criterion for distributing additional excise duties among the States, because the additional duty of excise is in replacement of sales tax, which is essentially a tax on consumption.

We accept the proposition that the higher the State income, the consumption of sugar, textiles, and tobacco will tend to increase. State Domestic Product, therefore, appears to us to be a relevant factor for distribution of proceeds of the duty among the States.

7.15 While it is reasonable to expect a positive relationship between the State Domestic Product and consumption of these commodities, it is difficult to be precise about this relationship. Again, a relationship based on household consumption data from sample surveys cannot hold good across the States in a large country like ours with wide variations in climatic conditions, dietetic habits, tastes etc. Since factors other than SDP are important in influencing consumption of these commodities, we think that significant weightage should also be given to population as an independent factor for distribution of the proceeds of the duty among the States. Accordingly, we recommend that the shares of the States in the additional duties of excise for all the three commodities viz. Sugar, Textiles and Tobacco, be distributed by giving equal weightage to SDP and population. We have worked out the shares of the States on this basis taking the average SDP of the States for the years 1976-77 to 1978-79 and the population figures as given in 1971 census.

7.16 As regards Sikkim, this State was given a share for the first time by the Seventh Finance Commission in respect of sugar and tobacco, though Sikkim was not a party to the original agreement,

reached at the meeting of the National Development Council in December 1956, as Sikkim was not then a part of the Indian Union. In making this recommendation, the Seventh Finance Commission proceeded on the principle that the essential prerequisite for a State to qualify for a share, was that it should have kept in abeyance, its right to charge sales tax on these commodities. As no sales tax was levied on sugar and tobacco in Sikkim, the Seventh Finance Commission granted it a share in the proceeds of the levies on these two commodities, but withheld it in respect of textiles as sales tax was being charged in that State on cotton, woollen, rayon and artificial silk fabrics. The Seventh Finance Commission added that as and when sales tax on textiles was given up in Sikkim, it would be entitled to a share for this also. We concur with the last Finance Commission that the sine qua non for a State to be eligible for a share in additional duties of excise, is that it should have refrained from exercising its right to levy sales tax on these commodities. As Sikkim has since given up the levy of sales tax on textiles also, we recommend that Sikkim be given a share in the net proceeds alongwith the other States.

7.17 As regards the share of Union territories, we recommend that all Union territories be treated as one unit, and their share determined on the same basis as that of the States. Accordingly, the share of Union territories amounting to 2.391 per cent, of the net proceeds of the additional duties of excise on sugar, textiles and on tobacco in each year from 1984-85 to 1988-89 should be retained by the Central Government as attributable to the Union territories. We recommend that the balance be distributed among the States in accordance with the percentages given below :

<u>State</u>	<u>Percentage</u>	<u>State</u>	<u>Percentage</u>
1. Andhra Pradesh	7.504	12. Manipur	0.178
2. Assam	2.566	13. Meghalaya	0.183
3. Bihar	8.627	14. Nagaland	0.098
4. Gujarat	5.941	15. Orissa	3.653
5. Haryana	2.488	16. Punjab	3.675
6. Himachal Pradesh	0.663	17. Rajasthan	4.827
7. Jammu & Kashmir	0.853	18. Sikkim	0.039
8. Karnataka	5.561	19. Tamil Nadu	7.549
9. Kerala	3.963	20. Tripura	0.287
10. Madhya Pradesh	6.942	21. Uttar Pradesh	14.318
11. Maharashtra	11.461	22. West Bengal	8.624
		Total	<u>100.000</u>

7.18 There remains the question of the Centre not fulfilling the assurances given to the States in regard to additional duties of excise. As will be recalled, two assurances were given: first, that the proceeds from additional duties of excise would attain atleast 10.8 per cent of the value of clearances; and secondly, that the ratio between basic duties of excise and additional duties of excise on these three commodities would not be greater than 2:1. While in recent years the Centre has fulfilled the latter assurance, the first still remains unfulfilled. There is no doubt that the States are rather agitated by the fact that the former assurance has not yet been implemented; so much so, that they have even suggested to us that the losses in revenue sustained by them on account of non-fulfilment of that assurance should be made good by way of grants-in-aid. However, we are informed by the Union Ministry of Finance that a Standing Review Committee for Additional Excise Duty was set up with the Secretary, Planning Commission, as its Chairman. The Finance Secretaries of all the States were Members thereof. This Committee has recommended that the incidence of 10.8 per cent of the value of clearances in respect of additional excise duty may be achieved by 1989-90 in three stages i.e. 8.5 per cent by 1984-85, 9.75 per cent by 1987-88 and 10.8 per cent by 1989-90. The Ministry of Finance have further indicated that, as it is a long term matter, decisions may have to be taken on a year to year basis. We trust that the latest recommendations made by the Standing Review Committee will be implemented by the Centre within the time schedule contemplated.

## CHAPTER VIII

### ESTATE DUTY IN RESPECT OF PROPERTY OTHER THAN AGRICULTURAL LAND

8.1 Paragraph 6 (a) of the President's Order, requires us to suggest changes, if any, to be made in the principles governing the distribution among the States of the net proceeds in any financial year of estate duty in respect of property other than agricultural land.

8.2 Estate duty on property other than agricultural land, is one of the taxes and duties mentioned in Article 269 of the Constitution, which are to be levied and collected by the Government of India, and the net proceeds of which, except to the extent attributable to Union territories, are assigned to the States within which the duty is leviable in that year. Further, the net proceeds are to be distributed amongst the States in accordance with such principles of distribution as may be formulated by Parliament by law.

8.3 The Second Finance Commission examined for the first time the principles that should govern the distribution of the net proceeds of estate duty among the States. In determining the principles of distribution of both estate duty and the tax on railway passenger fares, that Commission was guided by what it believed would be, the most equitable manner of distributing the taxes levied under Article 269 of the Constitution. It said, "Except in relation to the Union territories and to the extent of a Central surcharge, if any, the Union Government have no share in these taxes and are entrusted merely with their levy, collection and distribution. It is obvious that these taxes have been placed under the Union Government to ensure uniformity of taxation and convenience of collection. As regards distribution, though Parliament is free to formulate any principles of distribution in respect of these taxes, we consider that, to the extent to which they can be reasonably ascertained or estimated, each State should receive, as nearly as may be, from these taxes the amounts which it would have raised if it had the power to levy and collect them". In consonance with these observations, it took the view that for estate duty which is a tax on property, the location of the property would be the most appropriate principle for distribution. It, however, appreciated that it would not be possible to apply this principle to the estate duty attributable to the movable property forming part of the estate and in regard to this component some other principle was necessary. Hence, it recommended that : (i) out of the net proceeds of estate duty in any financial year, the proceeds attributable to Union territories be first retained by the Union; (ii) the balance be apportioned between immovable property and other property in the ratio of the gross value of all such properties brought into assessment in that year; (iii) the sum thus apportioned to immovable property be distributed among the States in proportion to the gross value of the immovable property located in each State; and (iv) the sum apportioned to property other than immovable property be distributed among the States in proportion to their population.

The succeeding four Commissions endorsed this approach.

8.4 The Seventh Finance Commission concurred with the views of the earlier Commissions that in the distribution of the proceeds of estate duty, each State should get, as nearly as possible, a share equivalent to what it would have obtained had it the power to levy and collect the duty. It also observed that it would be incorrect to fix the share of a State in proportion to the collections of the duty in that State, as the collections may include a duty assessed on properties located in other States.

8.5 In discussions with the Union Ministry of Finance and the Central Board of Direct Taxes (CBDT), the Seventh Finance Commission realised that in the State-wise statistics of the value of property brought to assessment, the demands raised, etc. furnished to it by the CBDT did not represent the location of the assessed property but were based on the assessments made in the different States. This, it noted, was due to certain difficulties faced by the Department in compiling the requisite statistics. While recognising that the Department of Revenue might have difficulties in collecting relevant statistics, the Seventh Finance Commission emphasised that the difficulties, whatever be their nature, should not be allowed to frustrate the principle that the States should get in respect of a tax or duty falling under Article 269 what they would have obtained if they had the power to levy and collect it