

CHAPTER IX

GRANT IN LIEU OF TAX ON RAILWAY PASSENGER FARES

9.1 Paragraph 6(c) 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governing the distribution among the States of the grant to be made available to them in lieu of the tax under the repealed Railway Passenger Fares Act, 1957.

9.2 A tax on railway passenger fares is one of the taxes mentioned in Article 269 of the Constitution, which are levied and collected by the Government of India but assigned to the States. Such a tax was levied by the Railway Passenger Fares Act for the first time in 1957. By an additional term of reference, the Second Finance Commission, which was then at work, was requested to recommend the principles that should govern the distribution among the States of the net proceeds of that tax. Whilst dealing with the taxes mentioned in Article 269(2) that Commission said:

"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, such 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".

Applying this principle to the tax on railway passenger fares, the Commission said:

"Although article 269 does not rule out any principle of distribution, we think that for this tax the principle should be such as to secure for each State, as nearly as possible, the share of the net proceeds on account of the actual passenger travel on railways within its limits".

The Commission then evolved a formula for determining the 'actual passenger travel' within a State.

9.3 The recommendations of the Second Finance Commission were to be in force upto 1961-62. But, the Railway Passenger Fares Act was repealed in 1961, and the tax were merged in the basic fares with effect from 1st April, 1961. This decision of the Government, to merge the tax with the fare, was based on the recommendations of the Railway Convention Committee, before whom the Railway Board had put forth the plea that the levy of the tax had curtailed the scope for raising passenger fares. In order to compensate the States for the loss of the tax, the Government of India decided, again, on the recommendation of the Railway Convention Committee, to make an ad hoc grant of Rs. 12.50 crores a year to the States, in lieu of the tax, for the five year period 1961-62 to 1965-66. The grant was raised to Rs. 16.25 crores per annum from 1966-67. It was stationary at that level until it was, again, raised to Rs. 23.12 crores for the period 1980-81 to 1983-84 in accordance with the recommendation contained in the Seventh Report of the Railway Convention Committee, 1980.

9.4 Each Finance Commission, beginning with the Third, has been asked to make recommendations as to the principles that should govern the distribution of that grant among the States. All the Commissions upto, and including the Sixth, adopted substantially the same formula for distributing the grant as the Second Finance Commission had adopted for distributing the tax.

9.5 The Seventh Finance Commission accepted the same underlying principle as its predecessors. It said:

"The general principle for the distribution of proceeds of taxes and duties under Article 269 as enunciated by the Commissions in the past is that each State should receive from such taxes, as nearly as may be, the amounts which it would have raised if it had the power to levy and collect them."

themselves. According to it, this could best be ensured if State-wise location of the property subject to tax or duty, was taken into account.

8.6 The Seventh Finance Commission considered the question whether it would be possible to extend the principle of location to movable property also. It said that, "the rules framed under the Estate Duty Act lay down the manner in which properties other than immovable property, which are held abroad, should be treated for the purpose of determining location. These are principles which are well established, and can equally be applied for the determination of the location of such properties in India". It, therefore, recommended that "the net proceeds of estate duty in respect of property other than agricultural land brought to assessment in each of the years from 1979-80 to 1983-84, should be distributed among the States in proportion to the gross value of the immovable property as also property other than immovable property taken together located in each State, excepting in regard to property located abroad". In respect of movable property located abroad that Commission said that it should be deemed to be in the State where it was brought to assessment.

8.7 That Commission expressed the hope that the Government of India would issue instructions to the concerned authorities to ensure that statistics would thereafter be compiled in a manner which would enable the share of each State to be computed in accordance with its recommendations.

8.8 In their memoranda submitted to us, a large majority of States have favoured continuance of the existing principles of distribution. They are Andhra Pradesh, Bihar, Gujarat, Haryana, Kerala, Karnataka, Maharashtra, Manipur, Meghalaya, Nagaland, Punjab, Rajasthan, Tamil Nadu, Tripura and Uttar Pradesh. The Estate Duty Act, 1953 has not yet been extended to Sikkim, and consequently that State is not entitled to a share in the net proceeds of estate duty. However, in its memorandum submitted to us the Government of Sikkim has expressed its agreement with the existing principles of distribution. The Government of West Bengal has not expressed any views about the principles of distribution of estate duty. Though the remaining five States (namely, Assam, Himachal Pradesh, Jammu & Kashmir, Madhya Pradesh and Orissa) have not agreed with the principles of distribution enunciated by the Seventh Finance Commission, they have broadly endorsed the approach of the Sixth Finance Commission, except Jammu and Kashmir, which wants backwardness of a State to be also one of the criteria in the distribution of the proceeds from estate duty.

8.9 Under Article 269(2) of the Constitution the distribution of the duty or tax among the States has to be "in accordance with such principles . . . as may be formulated by Parliament by law". It is obvious from the words of that Article which we have quoted that the Finance Commission is free to recommend any principle for distribution, which it thinks appropriate. The previous Commissions have also taken the same view.

With regard to estate duty we are in agreement with the Seventh Finance Commission, and do not recommend any change in the existing principle of distribution. In other words, we think, that the principle of location of property should be applied to all kinds of properties, whether immovable or movable. There can be no difficulty in determining the location of immovable property. So far as movable property is concerned its location can be determined in accordance with the rules framed under the Estate Duty Act, 1953. As for property located abroad, it should be deemed to be located in the State where it is brought to assessment. Sikkim will also have a share in the proceeds if and when the Estate Duty Act is made applicable in that State. The share of Union territories will be determined in the same manner as that of the States, taking the Union territories as one unit for this purpose.

8.10 We are not attempting to determine the percentage share of States on the basis of our recommendations, but leaving it to the Ministry of Finance to distribute every year the net proceeds of estate duty, in respect of property other than agricultural land, in the light of the principles recommended by us. We are also not taking into account the receipt of this duty for purposes of determining the revenue position of the States after devolution but are leaving the proceeds to be utilised for the State Plans.

But, in the application of this principle it applied a different formula, as appears from the following passage:

"In the light of this principle, we have given consideration to the question as to what the principles of distribution should be. If the tax had continued and were to be collected by the States, each State would be competent to collect tax only on railway fares paid within that State, irrespective of the States through which the journeys may be performed. There can be no extra-territorial collection by any State. Railway passenger fares are paid in advance before the commencement of the journey. The tax was collected at source and was a percentage of the fare. It, therefore, appears to us that the most appropriate distribution of the grant in lieu of the tax would be in proportion to the non-suburban passenger earnings from traffic originating in each State."

The Commission also relied on section 6 of the Railway Passenger Fares Act 1971, which provided for the distribution of a similar tax among the States on a similar formula.

9.6 The States in their memoranda have expressed divergent views. About one third are in favour of retaining the formula adopted by the Seventh Finance Commission. An equal number want a return to the formula of the earlier Commissions. Three States, namely, Himachal Pradesh, Meghalaya and Tamil Nadu have urged that population should also be considered as a factor for distribution. Whilst Himachal Pradesh would have population as the sole factor, Meghalaya and Tamil Nadu have suggested 50 per cent weightage to population 50 per cent to passenger earnings in the States. Manipur and Sikkim have demanded that States which do not have railways, but have out-agencies, should also receive a share in the grant as they contribute to the railway's earnings.

9.7 We think that the formula adopted by the Seventh Finance Commission was right. Article 269(d) of the Constitution refers, inter alia, to 'Taxes on railway fares and freights'. The same words are repeated in Entry 89 of the Union List in the Seventh Schedule of the Constitution. These words must be contrasted with the words in Entry 56 of the State List. That entry speaks of 'Taxes on goods and passengers carried by road or on inland waterways'. The crucial distinction to be borne in mind is that whereas Article 269(d) of the Constitution, and Entry 89 in the Union List, refer to a tax on 'fares and freights' Entry 56 of the State List refers to a tax on goods and passengers carried'. The former tax can be levied only by the Union, the latter only by the States. The tax which the States are empowered to impose is commonly referred to as a 'transport' or 'carriage' tax.

In accordance with the principle that a State should be given what it would have got if it had power to levy the tax, the assumption to be made is that the States have power to levy a tax on 'fares'. On that assumption, it immediately follows that each State would have got the tax recovered on the fare paid within its boundaries. The taxable event is the payment of the fare. The length or the course of the journey, for which it is paid, is totally irrelevant. Since the whole fare is paid within the State, and that is what attracts the tax, no question of extra-territoriality arises. Therefore, in accordance with the principle of restitution to the States, which all Commissions have accepted, the distribution must necessarily be in accordance with the fare collected.

It is of the utmost importance that, throughout the reasoning, a tax on 'fares' should not be confused with a tax on 'transport' and 'carriage'. Further, the quantification of either of those taxes may be made to depend on the fare. That only serves to measure the tax. Their intrinsic nature, and the consequences which flow therefrom, still remain different.

9.8 We agree with Manipur and Sikkim that they are entitled to a share in the grant on the basis of their out-agency collections. Having regard to rule 3 laid down in section 4 of the repealed 1957 Act, they would have obtained the tax collected, at their out-agencies, in respect of the fare attributable to the actual journey by railway.

9.9 There remains one other question. Though our terms of reference do not specifically call for any suggestions or recommendations as to the quantum of the grant, a recommendation in the Seventh Report of the Railway Convention Committee 1980, which has been approved by Parliament, clearly implies that we should do so (vide Annexure IX. 1). According to that recommendation, a sum of Rs. 23.12 crores is to be paid annually to the States for the period 1980-84 in lieu of a tax on railway passenger fares, and a further increase in the quantum of the grant could be considered on the basis of the recommendations of the Eighth Finance Commission. Therefore, we feel bound to deal with the quantum of the grant.

9.10 All the States were agitated over the smallness of the grant being given to them, in lieu of the tax on railway passenger fares. Many of them even asked for the re-imposition of the tax.

9.11 We drew the attention of the Ministry of Finance to the recommendations contained in the Seventh Report of the Railway Convention Committee 1980, which were approved by Parliament (Annexure IX. 1). The Ministry requested that, in considering the question of the quantum of the grant, we should take note of the losses incurred by the Railways in having to run uneconomic railway lines and the running of metropolitan services. We think, that while revising the fare structure, from time to time, the Railways must have already taken such losses into account. A pertinent answer has been given by Punjab, Uttar Pradesh and Bihar. They say that similar kinds of social burdens are borne by them in running road transport and other public utility services.

9.12 After considering all the relevant aspects, we think, that the States should be compensated by being given a grant equivalent to the tax element in the present non-suburban passenger earnings. Both the Sixth and Seventh Finance Commissions found that the tax element in the fare structure, when the tax was in force, was, on an average, 10.7 per cent. This was confirmed by officers of the Railway Board in the course of the discussions we had with them. We, therefore, recommend that the States should be paid 10.7 per cent of the present non-suburban passenger earnings by way of grant in lieu of the tax.

The latest year for which separate State-wise figures of suburban and non-suburban passenger earnings have been made available to us, is 1981-82. The non-suburban passenger earnings in that year were Rs. 884.89 crores. Hence, we recommend, that 10.7 per cent of this amount, viz. Rs. 94.68 crores, or say Rs. 95 crores, be paid to the States annually as a grant in lieu of the tax on railway passenger fares, during the period covered by our Report.

Having regard to the difficult financial position of the railways, and their increasing burdens resulting from mounting operational costs, we have refrained from suggesting an annual increase in the quantum of the grant during the period covered by our Report.

9.13 We have obtained from the Railway Board the State-wise passenger earnings on the basis of originating stations located in each State for the Years 1978-79 to 1981-82. We have taken the average earnings of each State over these four years and worked out the proportion it bears to the average earnings of all States taken together and determined the shares of States accordingly (Annexure IX. 2).

9.14 In conclusion, we wish to refer to a communication received by us, towards the end of December 1983, from the Railway Board. This letter invites our attention to certain recommendations contained in Part XI of the Report of the Railway Reforms Committee, submitted in October, 1983. That Committee made an in-depth study of certain uneconomic railway lines, and identified 40 railway routes, where adequate road transport services had been developed to cater to the transport needs of the areas. The Committee had, therefore, recommended a fresh dialogue with the State Governments with a view to closing down these uneconomic lines. It had further suggested that, in the event of States not agreeing to close down those lines, they should be made to share 50 per cent of the losses from out of the grant given to States in lieu of the tax on railway passenger fares. The Railway Board, therefore, requested us to fix a period of two years for ascertaining the reactions of the State Governments and to permit it, in the event that the States did not agree to the closure of the lines, to effect adjustments of the losses on account of these lines, from 1986-87 onwards, out of the grants payable to them in lieu of a tax on railway passenger fares.

9.15 There is a difficulty in dealing with this request. The letter of the Railway Board was received rather late for us to obtain the views of the States. It would obviously be improper for us to reach any conclusion without giving them an opportunity to express their views. In these circumstances, we are unable to accede to the request of the Railway Board, and we leave this issue to be resolved by negotiations between the Government of India and the States concerned.

9.16 To sum up, we recommend that:

- (a) the annual quantum of the grant in lieu of a tax on railway passenger fares be raised to Rs. 95 crores in each of the years 1984-85 to 1988-89; and
- (b) the shares of States be allocated in the same proportion as the average of the non-suburban passenger earnings in each State in the years 1978-79 to 1981-82 bears to the average of the

aggregate non-suburban passenger earnings of all States in those years. On this basis, the shares of States would be as follows:-

| <u>STATE</u> | <u>Percentage share</u> | <u>STATE</u> | <u>Percentage share</u> |
|---------------------|-------------------------|-------------------|-------------------------|
| 1. Andhra Pradesh | 7.68 | 12. Manipur | 0.02 |
| 2. Assam | 2.03 | 13. Meghalaya | 0.05 |
| 3. Bihar | 9.51 | 14. Nagaland | 0.16 |
| 4. Gujarat | 6.67 | 15. Orissa | 1.58 |
| 5. Haryana | 1.84 | 16. Punjab | 3.88 |
| 6. Himachal Pradesh | 0.14 | 17. Rajasthan | 4.87 |
| 7. Jammu & Kashmir | 0.95 | 18. Sikkim | 0.01** |
| 8. Karnataka | 3.43 | 19. Tamil Nadu | 6.61 |
| 9. Kerala | 3.18 | 20. Tripura | 0.04 |
| 10. Madhya Pradesh | 5.85 | 21. Uttar Pradesh | 17.85 |
| 11. Maharashtra | 15.70 | 22. West Bengal | 7.95 |
| | | <u>Total:</u> | <u>100.00</u> |

** Rounded to 0.01 Actual percentage works out to 0.0045.

9.17 Shri A. R. Shirali has some reservations on the recommendation regarding the quantum of the grant. He feels that determination of the grant on the basis of the amount of non-suburban passenger earnings implies that the tax is still in force, which is not the case. He sees considerable force in the view taken by the Seventh Finance Commission that the growth in non-suburban passenger traffic is a major element in the growth of passenger earnings. He is, therefore, of the opinion that, in the determination of the quantum of the grant, greater weightage should be given to growth in passenger traffic and a lesser weightage to growth in passenger earnings. The non-suburban passenger traffic (in million passenger k. m.) in 1981-82 was 2.58 times that in 1961-62; the non-suburban passenger earnings in 1981-82 were 6.44 times than those in 1961-62. Even if equal weightage were given to the two factors, the quantum of the grant would work out, Rs. 12.5 crores being the grant in 1961-62, to $\frac{12.5 \times 2.58 + 12.5 \times 6.44}{2}$ = Rs. 56.38 crores, which could be rounded off to Rs. 60 crores.

CHAPTER X

GRANT ON ACCOUNT OF WEALTH TAX ON AGRICULTURAL PROPERTY

10.1 We are required by paragraph 6(d) of the President's Order, to suggest changes, if any, in the principles governing the distribution among the States of the grant to be made available to them on account of wealth tax on agricultural property.

10.2 Wealth tax on agricultural property was first imposed with effect from the assessment year 1970-71. This was done by amending Section 2(e) of the Wealth Tax Act, 1957 by the Finance Act, 1969. The tax was applicable over the whole of India, except Jammu & Kashmir.

10.3 Wealth tax is not one of those taxes which, under the provisions of the Constitution, is to be shared with the States. Nor, is it levied by the Centre for the benefit of the States. Nevertheless, the Central Government decided of its own accord that the net proceeds of wealth tax on agricultural property should be made over to the States in the form of grants-in-aid.

10.4 The Sixth Finance Commission was the first to be asked to make recommendations regarding the principles on which these grants should be made to the States. That Commission took the view that wealth tax on agricultural property was similar to estate duty chargeable on immovable property. It, therefore, recommended that the grant on account of wealth tax on agricultural property should be distributed among the States in proportion to the value of the agricultural property located in each State. It did not consider either population or collection as an appropriate basis for determining the share of the States, for, the former had no relation to the value of the agricultural property brought to charge and the latter could include tax paid on property located outside the State. The Sixth Finance Commission did not think that the backwardness or developmental needs of a State were germane for the purpose of distribution. Having regard to the comparatively low and uncertain yield from this tax, the Sixth Finance Commission left out of account the grants likely to be paid to the States while computing their revenue position after devolution. The grants were left to be treated as a resource for the State Plans.

10.5 The Seventh Finance Commission was required to suggest changes, if any, in the existing principles of distribution of these grants. It noted that, though the Sixth Finance Commission's recommendation was accepted by the Government of India, the grants were actually made to the States on an altogether different basis. This was because the Central Board of Direct Taxes found that a disproportionately large amount of work would be involved in maintaining the statistics of wealth tax assessments in such a manner as would permit it to ascertain the value of agricultural property located in each State and brought to assessment in any year. Moreover, from the assessment year 1975-76, the separate exemption given to agricultural land was withdrawn and agricultural property then stood on the same footing as any other asset. This made even more difficult the segregation of the tax attributable to agricultural property from the tax on all the assets. In 1976, the Union Ministry of Finance, therefore, decided that distribution of the grants to the States from 1974-75 onwards should be in proportion to the value of agricultural property brought to assessment in any State to the total value of such assessments in all States taken together.

10.6 The Seventh Finance Commission also observed that there were inexplicably wide differences between the collections shown in the Finance Accounts of the Central Government prepared by the Comptroller and Auditor General and those reported to the Commission. That Commission therefore expressed the hope that these matters would be looked into, and that the Government of India would take adequate measures to ensure that the States received their proper share of the grants.

10.7 The Seventh Finance Commission stated that, in the normal course, it would have suggested continuance of the principles recommended by the Sixth Finance Commission. However, considering the difficulties encountered by the Central Board of Direct Taxes and the Ministry of Finance in giving effect to the recommendation of the Sixth Finance Commission, it recommended that the share of each