CHAPTER VI
CONCLUSION

The great objectives, declared in the Preamble of the Constitution, contain the basic structure of the Constitution and these ideals should be treated as fundamental in the governance of the Country. It was recognized by the framers of the Constitution that a federal system of governance would be more suitable for the successful realisation of the Constitutional goals, and accordingly the functional responsibilities were assigned to various layers of governments. In the process of distribution of functional subjects to different governments, the Constitution has assigned majority of subjects, which are directly related to social and economic developments, to the State Governments. Since the State Governments will be having the correct information regarding the factual situations existing in different social sectors, they will be able to launch apposite programmes. For the effective implementation of programmes relating to such subjects, revenue resources are also provided by the Constitution through assigning certain subjects of taxation exclusively to the State Governments. However, considering the possibility of mismatch between the expenditure relating to the functional subjects under the jurisdiction of the States and the revenue resources made available to them, provisions are made in the Constitution for the devolution of resources from the Union to the States and to make such transfers as judicious as possible, an independent constitutional agency is constituted to determine the quantum and modus operandi of such transfers.

The study reveals that the operation of fiscal federalism for more than half a century has failed to achieve the goals set by the Constitution. The

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balance sheet of federal fiscal governance under the Indian Constitution presents a very distressing picture in the case of State finances. Escalating revenue deficits, burgeoning GFD, mounting debts, frequent closing of Government Treasuries, reduction of public expenditure in developmental sectors, and in some cases the catastrophic debt traps are the indicators of the State public finances. Since nineteen eighties the fiscal position of the States is facing serious crisis. As the States are entrusted with the important functional subjects of social development, reduction in expenditures in these sectors has adversely affected the development of the nation as a whole.

An elaborate survey of the fiscal governance of the country under the British rule explains that the fiscal federalism under the Indian Constitution is historical in nature. The British rule for about a century gave us the system of financial federalism, although it was initiated and preserved to serve the interests of the colonial administration.

The period between the Government of India Act, 1919 and the Government of India Act, 1935 witnessed a plethora of committees and commissions to study and make recommendations to remodel the financial relations between the Central Government and the Provincial Governments. The recommendations of these Committees and Commissions resulted in the enactment of the Government of India Act, 1935, which was a real breakthrough in this field. Elaborate distribution of functional subjects as well as subjects of taxation between the Federal Government and the Provincial Governments were, for the first time, introduced by the Government of India Act, 1935. But, there is no evidence to show that the division of powers of taxation under the Government of India Act, 1935, was intended to provide adequate resources of revenue to the Provinces for enabling them to deliver optimal services to the society in the functional areas allotted to them. The
real motive behind the arrangement was to strengthen the imperialistic finance and to keep the Provincial administration subservient to the Union Government.

The study proves that throughout the British Rule, the financial relations between the Union Government and the Provincial Governments were regulated predominantly by two principles: Administrative convenience and financial authoritarianism of the Centre. The priorities were never good governance or progressive development of the society.

When a new Constitution was to be framed for the Country, the Constituent Assembly, without any second thought, adopted federalism as the basis of fiscal governance in India. In the social, economic and political perspective, the decision was rational and scientific. In a vast country, which is culturally, linguistically, geographically and economically varied substantially, no other system could have been more realistic and judicious.

The Constituent Assembly accepted the Government of India Act, 1935, as the basis of Centre-State financial relations and the principles and schemes followed by that Act were incorporated in the new Constitution. However, despite the political turbulence that compelled the Constituent Assembly to lean more in favour of centralisation, its decision to adopt the Government of India Act, 1935 as the basis of fiscal federalism under the Indian Constitution was not appropriate. Politically and economically the decision had some drawbacks. On the political side, it gave a message that there was not going to be any significant change in the Centre-State financial relations and the role of the Union Government would be identical with that of the British Government during the colonial rule. On the economic side, the message was that the States would be treated as they were treated in the British rule and hence their approaches in the fiscal sector need not be of
financial propriety or functional efficiency. Majority of the members of the Constituent Assembly - many of them were great leaders of freedom struggle - accepted the scheme of fiscal federalism followed by the British colonialists, as suitable to independent India, without a demur. The Government of India Act, 1935, which was condemned as not worth the paper on which it was printed\(^2\) was acknowledged as the basic document for the fiscal governance of the Republic of India.

When the country was heading towards independence, the future Constitution of the Country was conceived as one with strong federal structure wherein the powers of the Union would be limited to subjects of national importance and the federating units would have powers in all other subjects, including residuary power. Even in the initial stage of the Constituent Assembly, this concept was well recognised. However, in the process of drafting of the Constitution, these ideals were rejected and in the field of Centre-State fiscal relations, the Government of India Act, 1935 was taken as the model. This historically incorrect and politically wrong decision helped to set the trend of centralisation in the field of Centre-State financial relations under the Indian Constitution.

The distribution of the subjects of taxation under the Constitution of India has followed the scheme designed by the Government of India Act, 1935. The Union Government retained the most elastic and developing subjects of taxation whereas in the case of States, except general Sales Tax, inelastic and less buoyant subjects were allotted. A comparative analysis of data relating to the tax revenue of the Union and the State Governments from 1980-81 to 2000-01 makes it clear that in the case of the States, sales tax is the only considerable source of tax revenue whereas in the case of

\(^2\) *Supra*, Chapter II, f.n.87.
Union Government, corporation tax, customs duties and excise duties contribute significantly. The contribution of sales tax to the own tax revenue of the States is above sixty percent and the State excise duties, which is the second largest tax revenue, contribute between ten to fifteen percent only. On the other hand, personal income tax, corporation tax, customs duties and excise duties together contribute more than ninety percent of the tax revenue of the Union Government. It is also made clear that the contribution of many subjects of taxation under the jurisdiction of the States has declined substantially.

A comparative analysis of the figures of the revenue and expenditure of the Union and the State Governments in relation to the combined revenue and expenditure makes it clear that while the revenue receipt of the Union is between 55 percent and 60 percent of the combined revenue, its expenditure is between 49 percent and 55 percent of the combined expenditure. On the other hand, the revenue receipt of the States is between 40 percent and 46 percent of the combined revenue their expenditure is between 44 percent and 51 percent of the combined expenditure.

The study makes it clear that the own revenue of the States is sufficient to cater less than 50 percent of the total expenditure of the States. The resources available under the present constitutional provisions proved to be thoroughly inadequate. In the years 1999-2000 and 2000-01, it contributed to less than 45 percent of total expenditure of the States. The fiscal stress arising out of this situation compelled the States to depend heavily on external sources of revenue. The wide gap between the functional obligations and the resources available pushed the States into a serious fiscal crisis.

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The study shows that due to inadequacy of resources, the States are forced to reduce their expenditures in the developmental sectors. On the other hand, the expenditures in the non-developmental sectors increased substantially. In 1980-81 the percentage share of developmental expenditure and the non-developmental expenditure in the total expenditure was 70.1 and 18.8 respectively while the same was 60.6 and 34.2 respectively in 2000-01. It is argued that the present pattern of expenditure is highly inimical to the welfare interests of the people.

The most alarming feature of the State finances is the mounting fiscal deficits. The Revenue Deficit of the States reached a traumatic position. During the year 1987-88, the Revenue Deficit of the States was Rs. 1088.1 crores whereas the same burgeoned to Rs. 51315.2 crores in 2000-01; i.e. 47 times growth in 14 years. During the same period, the growth of developmental expenditure was only 4.96 times. Similarly, the GFD of the States also grew on an alarming scale. In the year 1980-81, the GFD had only been Rs. 3713 crores whereas the same was Rs. 89532 crores in 2000-01. In relation to the GDP also the GFD presented a distressing figure. In 1980-81, the GFD was 2.6 percent of the GDP whereas in the year 2000-01 it was 4.3 percent of the GDP. It is shown that the Revenue Deficit of the States was only 0.3 percent of the GDP in 1987-88 but it burgeoned to 2.5 percent in 2000-01.

In order to fill the resource gaps of the States, the Constitution has provided for the fiscal transfers from the States in the form of share in the Central Taxes and Grants-in-Aid as recommended by the Finance Commission. However, the fiscal devolution from the Centre to the States as share in the Central Taxes and Grants-in-Aid has not been sufficient to replenish the gaps of the States’ revenue. The study reveals that the receipts
of the States on account of share in central taxes have a lesser growth rate compared to the growth rates of the tax revenue of the Union and the State Governments. While the major taxes of the Union Government record an average annual growth rate of 18 percent the devolution of central taxes to the States records only an average annual growth rate of 14.2 percent. It is shown that there is a considerable fluctuation in the case of statutory grants. The growth rate in this sector is also not promising. During the period from 1980-81 to 2000-01, eight years recorded negative growth rate. It is made clear that the devolution of revenue from the Union to the States is not commensurate with the fiscal requirements of the States. During the period under study, for nine years, the transfer of resources from the Union to the States was less than 60 percent of the total revenue receipts of the Union. For eleven years it was between 60 percent and 65 percent of the total revenue receipts of the Union.

Financing of the GFD by the States has in fact worsened the situation. The study makes it clear that the loans and advances from the Centre, instead of reducing the fiscal stress of the States, have amplified the crisis. In many years, the repayment of loans and payment of interests of the previous loans by the States have transcended the loans credited in those years. In 2000-01, total loans by the States from the Centre amounted to Rs. 18966.2 crores while the repayment of the previous loans and the payment of interests on the previous loans in that year was Rs. 37969.4 crores. The study reveals that the total repayment in that year was 200.2 percent of the receipts and the net receipts of the States on account of loans from the Centre are in the negative. The States are virtually thrown into a debt trap. The Constitutional principles of Centre-State financial relations are grossly violated in this sector. The problem of deficiency in the States' revenue is
callously exploited by the Union Government. In this sense, the Union Government, in place of the role of a benefactor of the State Revenue, is acting as a ruthless moneylender.

Although the Constitution provides for a Finance Commission to make recommendations regarding the devolution of resources from the Union to the States, over the years the role of the Finance Commission has been reduced due to the extra constitutional practices prevailing in this field. Due to the limited role of the Finance Commission in the fiscal devolution, the amount transferred as per the recommendations of the Finance Commission has been inadequate to meet the additional revenue requirements of the States. The transfers by the Finance Commission are surpassed by the transfers through the Planning Commission. The study reveals that from 1980-81 to 2000-01, the transfer of resources by the Finance Commission was less than 50 percent of the gross transfer except for two years. In some years it was less than 40 percent of the gross transfer. In the case of transfer by the Planning Commission, it was always above 50 percent of the gross transfer except for two years. It is shown that in some years the share of transfer by the Planning Commission in the total transfer was above 60 percent. Due to the lack of link and co-ordination between these two agencies, the real purpose of fiscal transfers from the Centre to the States has been defeated.

The constitutional scheme of Centre-State financial relations has resulted in fiscal centralisation and vertical and horizontal revenue imbalances. It is made clear that there are wide interstate disparities in the revenue resources and consequent differences in the developmental indicators. Details of fifteen major Indian States make it amply clear that in the fiscal matters, the Indian States vary considerably. While some States
have better per capita revenue resources, the capacity of certain other States in this sector is miserably low. The study shows that the differences in the revenue resources have reflected in the expenditure of the States in the developmental sectors. The high-income group States expend considerably in the developmental sectors while the expenditure of the low-income group States remain very low in these areas. This brings out the fact that the arrangements made by the Constitution to minimise the horizontal revenue imbalances and to eliminate the consequent developmental crisis have not functioned effectively.

Sales Tax has the major say in the tax revenue resources available within the jurisdiction of the States. But the unscientific and complex system of levy of tax on the commodities and services has created serious dent in the tax revenue of the States. The study highlights the major issues relating to the tax on the sale or purchase of goods. Although the power to levy tax on the sale or purchase of goods is generally assigned to the States, there are lot of areas where this power is either restricted or taken away completely. The centripetal bias of the Constitution has put some barriers against the States in exercising this power. In addition to this, the central enactments have created further restrictions on the States’ power to levy tax on the sale or purchase of goods. Also there are instances where the Union Government has seized this power from the States in certain areas. Bifurcation of goods and services and levying tax on them by different governments has made the system complex and affect the revenue resources of the States adversely. The study makes it clear that the constitutional scheme relating to the levy of tax on the commodities and services is unscientific and irrational and argues for a thorough restructuring of the scheme.
A probe into the fiscal problems of the State of Kerala has brought to light several significant aspects. Apart from the common problems faced by all the other Indian States, the State of Kerala, due to its peculiar social development pattern suffers from a special problem of sustainability of the achievements in view of low economic growth and high fiscal crisis. In the ‘Kerala Model Development’, the role of the State Government cannot be disputed. The commendable achievements in the basic social sectors are the results of deliberate public expenditures in the relevant fields. However, due to extreme financial crisis of the State Governments, the expenditure pattern has been changed and the social sectors like education, public health etc., are getting lesser priority. This will inevitably result in the degeneration of the social order, which the State has developed through purposeful social intervention supported by the public finance. The achievements of the State are in conformity with the objectives of the Constitution and they are to be defended irrespective of the economic background of the State. The economic structure of the State is feeble mainly due to lack of investments in the primary and secondary sectors. The State could not do it due to its enlarged spending in the social developmental sectors. This situation confirms the position that the revenue resources of the States are inadequate to meet the expenditure in the social and economic developmental sectors simultaneously.

The problems of Centre-State financial relations under the Indian Constitution are fundamental in nature. The theoretical and practical spheres of Indian fiscal federalism suffer from certain basic weaknesses. In some areas inconsistencies between the constitutional objectives and the constitutional practices are obvious. Also there are extra-constitutional practices in this field, which are opposed to the principles of fiscal relations
between the Union and the State Governments as perceived by the Constitution.

The foregoing discussion makes it clear that the root cause of frailty of the fiscal relations between the Union and the State Governments lies in the Constitution itself. Hence the search for solutions should start from the Constitution itself. But, in such an approach a basic question arises, i.e., since the Constitution is the primary law of the land, what should be the yardstick or standard to evaluate the validity of the Constitutional provisions dealing with the fiscal federalism? In this regard the sole test should be whether the existing provisions are capable of achieving the Constitutional goals or not. This study takes such a stand.

The Constitution is the supreme political document of the country, which specifies certain objectives and lays down the measures through which they are to be achieved. Hence the objectives, as specified in the Preamble and Part IV, are of paramount consideration and, in case, the provisions of any law including the Constitutional provisions, act as obstacles to the realisation of the constitutional objectives, such provisions should be amended so as to make them consistent with the objectives. In the case of ordinary statutes, this does not pose any serious problem but in the case of Constitution, the issue is a complicated one. The discrepancy between the constitutional objectives and certain provisions of the Constitution can arise due to changes in the political and economic situation in the society or the discrepancy may be observed only on a review after a reasonable time of practical implementation of the provisions. In view of the constant nature of the objectives, as opposed to amendment under Article
what is necessary is the evaluation of the constitutional provisions from time to time and making appropriate amendments to make them capable of achieving the Constitutional goals. Such amendments make the Constitution an organic document in contrast to a collection of dead letters. Viewed from this angle, the constitutional provisions regarding fiscal federalism demand a serious review on the basis of its functional capabilities. As the Centre-State financial relations under the Indian Constitution has resulted in fiscal crisis of the States and as the graph of social development has not registered any significant growth, modifications in all the relevant fields have become mandatory.

Tax on the sale or purchase of goods is the only subject of taxation with the States, which has considerable elasticity. But the States are not in a position to tap the entire potential of this subject due to restrictions and conditions imposed by the Constitution as well as by the Union laws. Article 286 prevents the States from imposing tax on the sale or purchase of goods where such sale or purchase takes place outside the State or in the course of import into or export out of the territory of India. Similarly, the States are restricted from levying sales tax on goods declared as having special importance in the course of interstate trade or commerce and transfer of goods related to works contract, hire purchase and right to use.

A scientific system of sales taxation should be destination-based in contrast to origin-based. In this sense, preventing the States from levying tax on the sale or purchase in the course of import is not proper. When goods are imported and the same are consumed in the course of manufacturing of other goods or used for any purpose other than for sale, the State to which such goods are imported lose tax at one point of transaction. Making use of the

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loopholes in Section 5 (2) of the Central Sales Tax Act, 1956, tax avoidance is rampant in this sector. When goods are sold by transfer of documents of title to goods before crossing the *Customs Frontiers of India*,⁴ such sale shall be deemed to be a sale in the course of import. When goods are imported to the country and before taking the goods out of the area of Customs Station, if sale of such goods are effected to the customers by transfer of documents of title to goods, that sale cannot be taxed since it is a sale deemed to be in the course of import. Considering these aspects, sub-clause (b) of clause (1) of Article 286 may be amended by deleting the part that exempts sale or purchase of goods in the course of import from sales taxation.

The restriction on the power of the States to levy tax on the sale or purchase of *declared goods*⁵ is without any rationale. The goods are declared as having special importance in the course of interstate trade or commerce and the restriction is in respect of tax on the intrastate sale or purchase. When such goods are sold interstate, the States are not eligible to tax it, for, tax on such transaction is levied by the Union Government and the rates are as low as four percent. On the basis of the Constitutional restriction, Section 15 of the Central Sales Tax Act, 1956 prescribes that the maximum rate of tax that can be imposed on the sale or purchase of declared goods shall be 4 percent. In the present commercial context, this restriction is meaningless and should be removed. Hence, sub-clause (a) of clause (3) of Article 286 should be deleted.

Sub-clause (b) of clause (3) of Article 286 mandates that the levy of tax by the States on transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract, or on delivery

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⁴ As defined under Section 2 (ab) of the Central Sales Tax Act, 1956
⁵ As defined under Section 2 (c) of the Central Sales Tax Act, 1956
of goods on hire purchase or any system of payment by instalments, or on transfer of the right to use any goods for any purpose for cash, deferred payment or other valuable consideration shall be subject to the restrictions specified by the Union law enacted for that purpose. This restriction is also in respect of intrastate transactions. Since these transactions are deemed sales as per clause (29A) of Article 366, any transaction of this nature in the course of interstate trade or commerce shall attract the restrictions applicable to the levy of tax on interstate sale of goods. Although the Parliament has not, so far, enacted any law to specify the restrictions in this field, it provides for an opportunity for encroachment upon the power of the States to levy tax on such transactions. Hence, sub-clause (b) of clause (3) of Article 286 may be deleted.

The power to levy ‘tax on commodities and services’ are divided between the Union Government and the State Governments. This system is defective for it creates obstacles in tapping the potential fully, results in multiple taxation and cascading, causes administrative complexities and makes the evasion easier. Tax on commodities and services should be a single levy and that must be given to the State Governments.

Tax on the sale or purchase of goods is given in entry 54 of List II of the Seventh Schedule to the Constitution. But, tax on the sale or purchase of newspapers and tax on the sale or purchase of goods in the course of interstate trade or commerce are excluded from the jurisdiction of the States. These levies are put in the Union List under entries 92 and 92A respectively. In the case of taxes on the sale or purchase of newspapers and on advertisements published therein, in spite of that entry in the Union List since the inception of the Constitution, the Union Government has not taken any step to enact a law to levy taxes on these items. A combined reading of
Entry 92 of Union List, and sub-clause (f) and clause (2) of Article 269\(^6\) reveals the real Constitutional intention regarding these levies. Although, for the uniformity of rate and procedure, the power to levy these taxes was given to the Union Government, the actual beneficiaries of such levies are the State Governments. Due to inertia on the part of the Union Government this high potential revenue was denied to the State Governments. But, subsequent to the amendment of Article 269 by the Amendment Act, 2000 the position is different. Now the entire revenue from these taxes forms part of the Consolidated Fund of India and the States are entitled only for a share of it. This situation runs counter to the constitutional scheme regarding these levies. Taxes on the sale or purchase of newspapers and on the advertisements published therein should be made a state subject by deleting entry 92 from the Union List and by making appropriate amendments in Entry 54 of the State List.

Regarding the excise duties, major portion are levied by the Union Government and only a minor part is allotted to the State Governments. Excise duty is a tax on commodity, levied and collected at the time of manufacture. Considering the nature of levy, excise duty should go along with the sales tax. There is neither economic nor administrative rationale for granting the power to levy excise duty to the Union Government. Entire excise duty should be brought under the jurisdiction of the State Governments. Entry 84 of Union List should be deleted and Entry 51 of the State List should be amended suitably to take in all types of excise duties. Once the power to impose the excise duties is granted to the States, the

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\(^6\) Prior to the Amendment Act, 2000
Medicinal and Toilet Preparations (Excise Duties) Act, 1955 becomes irrelevant\(^7\) and hence it must be abolished.

Levy of tax on services by the Union Government creates serious legal and administrative problems. Drawing power from Entry 97 of the Union List, the Union Government has imposed tax on services and more and more services are brought into the tax net. Services are ordinarily transferred along with goods and vice versa. Transfer of goods and transfer of services are closely connected and in many cases they cannot be easily distinguished. In this context, tax on services and tax on sale or purchase of goods are to be levied together. The power to tax on the services must be given to the States. Specific entry to this effect must be included in the State List.

Two major problems in the field of tax on goods and services are multiple taxation and cascading of taxes. This can be, to a very great extent, avoided by granting set off to the tax or duty paid in the earlier transaction. Such a system is already available under the Central Excise Duties. Once the Excise Duty, Sales Tax, Service Tax, Entry Tax etc., are brought under a single enactment of ‘Tax on Goods and Services’, the input tax credit system can be easily administered and the problem of cascading can be avoided. The system becomes most simplified and due to the self-policing mechanism inherent in the system, the chances of evasion are also least.

Considering the complexities involved in the interstate trade or commerce, the Central Sales Tax Act, 1956 should be maintained, of course with the amendments mentioned above. The basic problem with the central sales tax is cascading of tax. The selling price of the goods that is imported

\(^7\) In such a situation a separate enactment dealing with excise duty on the medicinal and toilet preparation is not necessary.
from another State includes the Central Sales Tax already paid in the selling State. When the goods are sold subsequently, tax is calculated on the sale price in which the Central Sales Tax paid in another State is merged. Since the Central Sales Tax is paid in a State other than the State where it is ultimately sold, input tax credit for the Central Sales Tax cannot be granted by the consuming State. In order to overcome this problem, interstate purchases must be the taxable event instead of interstate sales. The original Constitutional scheme was to levy tax on interstate purchases. Article 286 of the Constitution, prior to the Constitution (Sixth Amendment) Act, 1956 empowered those States to tax the interstate sale of goods wherein the goods were ultimately delivered for consumption. When interstate purchases are made taxable, the purchasing dealer should be made liable to pay tax to that State in which such goods are sold or consumed ultimately. In this system, there is no problem in granting input tax credit to the dealer as the State Government which is making credit for the tax on the interstate purchase and the State Government receiving tax on the local sale or purchase are one and the same. The problem of cascading can be solved in this way. To effect the above proposal, no Constitutional amendment is necessary but the Central Sales Tax Act, 1956 is to be thoroughly amended. The Central Sales Tax Act should be converted into Central Purchases Tax Act. The tax incidence should be the purchase of goods in the course of interstate trade or commerce and the liability to pay tax should be on the dealer, who effects the interstate purchases, on his turnover, which should be the aggregate of purchase price instead of sale price.

Devolution of resources from the Centre as share in the Central Taxes and Duties constitutes a significant portion of States' Revenue. Prior to the Amendment Act, 2000, Personal Income Tax was compulsorily shareable
with the States and Union Excise Duties were optionally shareable. Constitution Eightieth Amendment made all the taxes and duties levied by the Union as sharable with the States. But the sharable pool does not include surcharge imposed on the Central Taxes and Duties including the surcharge on taxes and duties mentioned in Articles 268 and 269. Despite the persistent demands by the States to make the surcharge as a divisible item, there was no positive step in this direction. Although the surcharges on Union Taxes and Duties contribute significantly to the Consolidated Fund of India, the States are kept away from the benefits of this levy. In a federal Constitution, which stipulates for devolution of resources from the Centre to the States, it is a violation of the basic principle to keep a portion of tax or duty exclusively for the Union Government. In the case of any exclusive and particular demand for any specific subject, the Union Government is competent to impose cess for such purpose and such cess is made indivisible under Article 270. Since levy of surcharge on any tax or duty is nothing but a levy of tax or duty, it must be shared with the States. The surcharge must be made as a part of the sharable pool of the Union Taxes and Duties. In order to make the surcharge on taxes and duties sharable with the States, appropriate amendment in Clause (1) of Article 270 should be made.

Subsequent to the amendment of Article 269 by the Amendment Act, 2000, only two types of taxes are levied and collected by the Union but are assigned to the States. They are tax on the sale or purchase of goods in the course of interstate trade or commerce and tax on the consignment of goods. To levy tax on the sale or purchase of goods in the course of interstate trade or commerce, the Parliament has enacted the Central Sales Tax Act, 1956 whereas in the case of tax on consignment transfer there is no law available. Moreover, the interstate consignment transfers are specifically exempted
from tax under the Central Sales Tax Act, 1956. This situation has not only reduced the revenue of the States but also has given opportunities for tax evasion. The solution is the enactment of law by the Union Parliament to tax the consignment transfer. But the experience in this field asserts that the Union Government is less interested in making such a law. This subject of taxation was present under Article 269 since 1982, but the Union Government has not taken any step to make a law to levy tax on consignment. The approach of the Union Government in respect of other taxes under Article 269, except Central Sales Tax, also has been the same. The Union Parliament should, without any further delay, enact the law for levying tax on consignment transfer. Until the Union Parliament enacts a law for the levy of tax on the consignment transfer, the States should be compensated for the loss suffered by them in this regard. Determining the amount of grants in lieu of consignment tax should be included in the Terms of Reference of the Finance Commissions.

Article 274 of the Constitution provides that any Bill, which purports to amend or vary Union Taxes or Duties in which the States are interested, can be moved in the Parliament only on the recommendation of the President of India. The States are interested in all the Union Taxes and Duties except the surcharge on such taxes and duties. Article 274 speaks only about the Bill to amend or vary the Union Taxes and Duties. It doesn’t impose any restriction on the Union Government’s executive power to reduce or exempt any tax or duty to any class of persons or transactions. Exemption or reduction in the rates of taxes or duties is ordinarily granted through Government Notifications in exercise of the executive power of the Union Government. Plenty of notifications are issued by the Union Government granting exemptions or reduction in the rates of taxes or duties.
to various classes of taxpayers. The mandate under Article 274 is circumvented by the exercise of the executive power of the Union. Since the exemption or reduction is done through the Government Notifications, the States are unaware of it and they are ignorant about the amount involved in such exemptions and reductions. Unless some check is imposed on this power, the purpose of Article 274 will not be served. The Union Government should not have any executive power to exempt or reduce the rates of any tax or duty through a Government Notification. Any such exemption or reduction should be granted only through the Finance Act of the Union. A separate chapter in the Finance Act can be devoted solely for this purpose. The provisions in the Union enactments, which empower the Union Government to issue notifications to exempt or reduce the rates of taxes to any particular class of taxpayers, should be deleted.

The system of levying ADE on textiles, sugar and tobacco has been harmful to the States’ revenue. Grants from the Union Government for not levying Sales Tax on these commodities had never been corresponding to the amount of Sales Tax, which the States would have received had they levied Sales Tax on these commodities. Moreover, consequent to Constitution Eightieth Amendment, the ADE forms part of the divisible pool of the Central Taxes and States are only entitled for a share in it. The Eleventh Finance Commission has recommended for merging the ADE with the basic Excise Duties. Such an event will result in considerable reduction of revenue from this sector. Since the States are entitled for the entire Sales Tax on these commodities, they should be allowed to levy it. The Additional Duties on Excise (Goods of Special Importance) Act, 1957, which is the main obstacle in levying Sales Tax on sugar, textiles and tobacco, must be abolished.
Article 286 of the Constitution precludes the States from levying tax on the sale or purchase of good in the course of export out of the territory of India. Clause (2) of Article 286 enjoins the Parliament to formulate principles for determining when a sale or purchase of goods takes place in the course of export out of the territory of India. Under sub-section (3) of section 5 of the Central Sales Tax Act, 1956, last sale or purchase of goods occasioning export shall also be deemed to be a sale in the course of export. By declaring the penultimate sale or purchase of goods as sale or purchase in the course of export out of the territory of India, State Revenue suffers considerable losses. In fact sale of goods as described, under sub-section (3) of section 5 of the Central Sales Tax Act, 1956 is not an export sale but a sale for export. It is a sale taking place within a State and the States is, except for the deeming provision and consequent prevention, entitled to receive the tax on it. Granting exemption from sales tax on the export sale is, in the economic perspective, reasonable, since such a consideration may encourage the exports from India. That is achieved under sub-section (1) of section 5 of the Central Sales Tax Act, 1956. But exemption from sales tax to the last sale or purchase of goods preceding export is at the cost of States’ revenue. As sub-section (3) of section 5 of the Central Sales Tax Act, 1956 is a direct inroad in to the States’ revenue it must be deleted.

In the field of devolution of resources from the Centre to the States, the major problem is duplication of agencies. The Finance Commission and the Planning Commission ultimately perform the same act of deciding and regulating the resource transfer from the Centre to the States. While the Finance Commission recommends the amounts to be transferred to the States to fill up the revenue gaps of the States, the Planning Commission recommends the amount required for the implementation of various plans.
Apart from these two agencies, various Central Ministries transfer resources to the States for the purpose of executing the plans developed by them. The functions of the Finance Commission and the Planning Commission are complementary to each other. In an under-developed country, with vast geographical and economic variations, the importance of centralised planning needs no emphasis. Due to mismatch between functional liabilities assigned to, and fiscal resources available with, the States, the necessity of resource transfer from the Centre to the States goes without saying. But what is lacking is a comprehensive approach to the problems of the States. Plan funds are routed to the States without taking into account the fiscal position of the States and fiscal resources are transferred to the States without considering the plan requirements of the States. Unless there is a holistic approach to the problems of the States, the situation is likely to be worsened.

The total transfer of resources from the Centre to the States, plan as well as non-plan, should be determined and regulated by a single agency. Since the functions of the Finance Commission and the Planning Commission are of vital importance, these two bodies should be merged into one. As the Finance Commission is the agency perceived by the Constitution to decide the matters relating to the devolution of resources from the Centre to the States, it must be maintained. But the operations of the Finance Commission are to be widened by taking over the functions of the Planning Commission also. Finance Commission under Article 280 is constituted once in five years to make recommendations regarding the distribution of Union Taxes between the Union and the States and to recommend the principles that should govern the grants-in-aid of the revenue of the States out of the Consolidated Fund of India. Due to the impermanent nature of the Finance Commission, there is no independent agency during the period when the
Finance Commission is not functioning, to monitor the fiscal sector of the country and to make recommendations to solve the issues related to it. In order to overcome the above problems, the Finance Commission should be made a permanent body with enlarged functional areas. Such a Finance Commission should conduct continuous and extensive studies about the fiscal sectors as well as various other areas that should provide the basis of policy formulation of the Union and State Governments. Plan funds as well as non-plan funds to the States should be as per the recommendations of the Finance Commission. It should be an independent constitutional body assigned with the combined functions of the present Planning Commission and the Finance Commission. Similar bodies are available elsewhere in the world. Common Wealth Grants Commission under the Australian Constitution is a body entrusted with similar responsibilities. Article 280 of the Constitution should be suitably amended to constitute a permanent Finance Commission with wider functional areas and responsibilities.

From the point of view of the States, the most important and immediate requirement is to bring down their Revenue Deficit to zero. Temporary measures like reduction in plan expenditure etc., will be counterproductive. Unless fundamental changes are imported into the Centre-State financial relations under the Constitution, the issues cannot be solved permanently. There must be a re-distribution of revenue resources between the Union and the State Governments. Granting of power to the States to levy Excise Duties and Service Tax itself will solve the problem of Revenue Deficits of the States. In 2000-01 the total collection of Central Excise Duties and Service Tax together was Rs. 52371 crores while the total Revenue Deficits of the States amounted to Rs. 51315 crores.
GFD and the financing of it has created serious fiscal stress to the State Governments. The loans from the Centre and internal market have worsened the financial position further. The debts of the States are mounting in an alarming scale. In many years, the States have to avail loans only to pay back the existing loans along with the interest liabilities. Considering the magnitude of the debts outstanding against the States, Tenth Finance Commission had made certain recommendations to write off some portion of Central loans on the basis of fiscal performance of the States. Only those repayments pertained to Central loans during 1989-95 and those outstanding as on 31st March, 1995 was covered under this scheme. Eleventh Finance Commission extended the coverage of the scheme to the Central loans during 1995-2000 and those outstanding as on 31st March 2000 and the amount that could be written off was enhanced. In spite of these relief measures, the debts outstanding have mounted to a very distressing position.

Ninth, Tenth and Eleventh Finance Commissions have recommended for setting up a sinking fund for the amortisation of States’ debts. But this has not materialised yet. In order to salvage the State finances from the burgeoning debts, it is necessary to develop a package of debt relief. As recommended by the Ninth, Tenth and Eleventh Finance Commissions, a sinking fund should be immediately set up for each State and annual contribution to that fund by the State should be fixed on the basis of the repayment liability of the loans by the State for a period of next ten years. There must be contribution by the Centre also to the sinking fund. Repayment of loans must be from the sinking fund. Interest liability of the Central loans, which is outstanding as on the date of setting up of the sinking fund must be written off. For the future loans to the States, a regulating authority must be constituted, which should monitor the requirements of the
States and raise loans at reduced rates of interests to the States. The proposed regulating authority should be either a statutory body or a part of the permanent Finance Commission as suggested above. In this case the experiences of the Australian Loan Council will be of great help.

In the case of the State of Kerala, a peculiar situation is prevailing. The State has achieved a higher standard of social development than that achieved by the other Indian States. But, due to dearth of resources, the revenue expenditures in the social sectors are getting reduced, which will certainly result in the reversal of the achievements in such sectors. While making allocation of grants to the States, such States, which have made considerable achievements in the social sectors but are unable to maintain it due to lack of revenue should be considered specially and a maintenance grant should be allotted to them.

The study reveals that under the present Centre-State financial relations under the Constitution, the fiscal status of the States are in doldrums. Apart from the intrinsic problems in the Constitution, the extra constitutional practices have worsened the situation. In this area there is a wide gap between the constitutional objectives and practices. This has resulted in the failure of the total system. Academicians, policy makers, and many senior bureaucrats of the States, with whom the researcher had occasions for deliberations, were unanimous on the point that the Centre-State financial relations under the Indian Constitution is centripetal and it has contributed for the traumatic fiscal situation of the States. They were also of the view that unless basic changes are brought in to the federal fiscal system, the problems of fiscal crisis of the States will remain unresolved.
The object of allocating subjects of social developments to the States has not been achieved mainly due to the resource gaps felt by the States. The fiscal crises of the States have tended them to withdraw gradually from the social service sector. In view of the backward economy of the nation, such a step would be catastrophic. It is obvious that the great goals of the Constitution cannot be achieved without correcting the basic defects comprised in the federal fiscal system. Since the problems are fundamental in nature and the root cause lies in the Constitution, correction should begin from the Constitution itself. Nonetheless, all the sectors related to the fiscal federalism also demand thorough scrutiny and appropriate corrections.