CHAPTER III
CENTRE–STATE FISCAL RELATIONS:
AN ANALYSIS OF THE
CONSTITUTIONAL PROVISIONS AND PRACTICES

When the constitutional provisions relating to Centre-State financial relations were debated in the Constituent Assembly, it received a great deal of attention in the hands of the framers of the Constitution. State autonomy in the financial sphere was a matter of serious concern to many members.¹ Debating on the provisions in the draft constitution regarding fiscal powers of the States, many of them asserted that the provisions would have the effect of placing the States in a position of financial subordination to the Centre or leave them with inadequate resources. As per K. Santhanam, “the provinces will be beggars at the doors of the Centre.”² According to Sir A. Ramaswami Mudaliar, provisions relating to fiscal transfers were highly unfavourable to the states. While the States were to carry the burden of nation-building activities, their financial resources would not commensurate with their responsibilities.³

The Constituent Assembly referred the financial provisions in the Draft Constitution to an Expert Committee of three under the chairmanship of Nalini Ranjan Sarkar in November 1947. The expert

¹ The concern of the members who were for more autonomy to the States was best expressed by Biswanath Das, while speaking on the Report of the Expert Committee, (under the Chairmanship of N.R. Sarkar) in the following words: “The needs of the provinces are almost unlimited, particularly in relation to welfare services and general development. If these services, on which the improvement of human well-being and increase of the country’s productive capacity so much depend, are to be properly planned and executed, it is necessary to place at the disposal of provincial Governments adequate resources of their own, without their having to depend on the variable munificence or affluence of the Centre.” C.A.D., Vol. IX, p. 275.
² C.A.D. Vol. III, p. 55
³ Ibid., Vol. IV, pp. 80-85
committee submitted its report to the President of the Constituent Assembly on 5 December 1947. The Committee took the Government of India Act, 1935, as the starting point of its work and did not recommend any major changes in the list of taxes in the Federal Legislative List as recommended by the Union Powers Committee. It recommended that the basic features of its scheme should be embodied in the Constitution itself. Regarding the distribution of the proceeds of taxes among the provinces, it tried to make the whole arrangement as automatic and free from interference as possible, but provided for periodic review so that the method of apportionment could be adapted to changing conditions from time to time. It also provided for grants-in-aid to the weaker provinces and provinces in difficulty. In framing the provisions relating to the financial powers of the Union and the State Governments in the Constitution, the Constituent Assembly decided to take the Government of India Act, 1935 as the basis on which such provisions were to be framed.4

In the Constituent Assembly, while the desire to have a strong Centre was more or less universal, the perception of State autonomy was by no means inadequately represented. The framers of the Constitution had to strike a balance between these two almost incompatible elements. In this endeavor, they were to take into account various important factors such as regional disparities and specific developmental priorities of various regions, peculiar social and political

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4 The adoption of the Government of India Act, 1935 as the basis of the fiscal relations between the Union and the State had some advantages such as continuity, clarity etc. But there was a disadvantage that certain provisions that were opposed to a true fiscal federal set up were also retained in the Constitution. In fact, there was no serious search for an alternative system different from the one followed under the Government of India Act, 1935.
structure of the nation, economic development of the country and all the
more the great hopes of people of the infant republic.

**Distribution of Responsibilities on the Basis of Benefit Incidence**

The principles of Public Finance relating to fiscal federalism state that if there are no cost differences between centralised and decentralised provision of a public good, it will be more efficient for a local government (whose jurisdiction coincides with the area of incidence of benefit from that public good) to provide that good. If only economic aspect is to be considered, services that are nationwide in their benefit incidence (such as national defence) should be provided nationally. Services with local benefits (such as street lights) should be provided by local units, still others (such as highways) should be provided for on a regional basis. The spatially limited nature of benefit incidence thus calls for a fiscal structure composed of multiple service units, each covering a different-sized region within which the supply of a particular service is determined and financed. While the allocative functions may be shared between the Union and State Governments (with a substantial or even a larger share going to the latter), the stabilisation and redistributive functions have to be assigned largely to the Central Government. Stabilisation involves macro-economic policies and can be formulated and implemented only by the Central Government.

A survey of the functional subjects enumerated in the legislative lists of the Seventh Schedule to the Constitution makes it clear that the

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5 W.E. Oates, *Fiscal Federalism* (1972), p.35. The principle regarding distribution of subjects on the basis of benefit incidence is commonly known as 'Decentralisation Theorem'


7 Relating to the provisions of Public services.
Constitution has, in allocating various subjects between the Union and State Legislatures, taken into consideration the above principles. The subjects are classified on the basis of geographical benefit incidence, and are given place in various legislative lists. Those subjects that have benefit incidence nationally, are included in the Union List and those subjects that have solely local benefit incidence are given place in the State List. The subjects with a multi level benefit incidence or those subjects for which simultaneous involvement of Central and sub-Central governments are necessary, are included in the Concurrent List.8

**Distribution of Fiscal Resources: Principles and Practice**

In assigning various fiscal powers to different levels of governments, apart from efficiency and economic rationales, which are the primary considerations, several other factors are also relevant and are to be taken into account. Since redistribution being primarily the function of the Union government, nation-wide progressive taxes have to be assigned to it. Taxing powers to Union and State Governments are to be fixed on the basis of the relative tax base. Taxes with local base are to be allotted to State Governments and taxes with national base are to be allotted to the Union Government. If a tax can be easily evaded by shifting the residence from one state to another, as in the case of Income Tax, such taxes should surely be under the jurisdiction of the Union. However, considering the economic disparities among the States, some exceptions may be made. While allocating taxing powers in a federation, those subjects, which may suffer multiple tax burden,

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8 Illustrative lists of developmental subjects (other than financial subjects) included in Lists I, II and III of the Seventh Schedule to the Constitution are given in APPENDIX-II
should be granted to the Union Government. In a country with great regional disparities, due to which the horizontal revenue imbalances will be great, the Union Government should have substantial surplus of revenue so that it can deliver the role of an equaliser effectively.

Constitutional division of taxing powers between the Centre and the States rests on economic and administrative rationale. Taxes with inter-State base and those in the case of which all India uniformity in rates is desirable to facilitate industry and trade are vested in the Central Government. Also, taxes, which a taxpayer can evade by shifting his habitat, or where the place of residence is not a correct guide to the true incidence of a tax, belong to the Centre. Taxes, which are location-specific and relate to subjects of local consumption, are with the States. The purpose of distribution of the powers of taxation between the Centre and the States is to minimize tax problems in a federal set up such as double taxation, tax rivalry among States, duplicate tax administration, excessive compliance costs and tax evasion. The basic principle in distribution of resources between the Union and the States has been to avoid conflict of tax jurisdiction and to provide sufficient resources to the Union and State Governments to carry out the functions and obligations allotted to them in the Legislative Lists. The deficits in the State resources are perceived to be made good by transfer of resources from the Union Government on the recommendations of the Finance Commission.

The Union Government has power to levy taxes and duties on the subjects given in Entries 32 to 92B and under Entry 97 in the Union List and the State Governments have similar power in respect of items

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enumerated in Entries 45 to 63 in the State List. Residuary powers of legislation including taxation belong to the Union Parliament as per Entry 97 of List I. List III contains only three entries relating to taxation, which do not have much significance from the revenue point of view. Entry 35 is about 'principles on which taxes on mechanically propelled vehicles are to be levied'. Entry 40 deals with the Stamp Duties other than duties or fees collected by means of judicial stamps, except the rates of Stamp Duty. Entry 47 empowers the governments to levy fees in respect of any of the matters in the Concurrent List except the fee taken in any Court.

DISTRIBUTION OF REVENUE RESOURCES BETWEEN THE UNION AND THE STATE GOVERNMENTS

The scheme of Fiscal Federalism under Indian Constitution is mainly three fold: (i) Distribution of revenue resources between Union and State Governments, (ii) Sharing of Tax revenue between the Union and State Governments, and (iii) Grants-in-aid. The details of such distribution and transfers are discussed below.

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10 List of taxes and duties enumerated in Lists I and II of the Seventh Schedule to the Constitution is given as APPENDIX- III.
11 Entries 35, 40 and 47 of the Concurrent List
12 Entry 57 of the State List empowers the State Legislature to levy 'tax on all kinds of vehicles, mechanically propelled or not'. Explaining the relation between Entry 57 of List II and Entry 35 of List III, the Supreme Court observed that the power to levy taxes on vehicles solely with the State Legislature, but Parliament may lay down the principles on which taxes may be levied on mechanically propelled vehicles. B.A. Jayaram v. Union of India A.I.R. 1983 S.C. 1605.
13 Rate of Stamp Duties are fixed by Parliament under Entry 91 of List I on documents such as Bills of Exchange, Cheques etc. Stamp Duties on other instruments are fixed by State Legislatures under Entry 63 of State List.
The Constitution (Eightieth Amendment) Act, 2000\(^{14}\) has made radical changes\(^{15}\) with regard to the sharing of resources between the Union and State Governments.\(^{16}\) Prior to this amendment, the Income Tax was compulsorily sharable with the States while sharing of Excise Duties was optional. The Corporation Tax and Customs Duties were exclusively earmarked for the Union. Subsequent to the amendment, all central taxes except some Duties and Taxes\(^{17}\) were made shareable with the States.

**Taxes and Duties Levied, Collected and Retained by the Union\(^{18}\)**

About two-thirds of total tax collections in India go to the Central Exchequer. Out of the major sources of tax revenue of the Central Government, Personal Income tax, Corporation Tax, Wealth Tax, and Gift Tax are the direct taxes while Excise and Customs duties are the indirect taxes. During the last fifty years, indirect taxes came to occupy a dominant place in Central finances. Table 1.1 gives the details of various taxes under the exclusive jurisdiction of the Union Government from 1950-51 to 2000-01.

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\(^{14}\) Hereinafter mentioned as "the Amendment Act, 2000"

\(^{15}\) Article 269 was amended, Article 270 was substituted and Article 272 was omitted.

\(^{16}\) The Tenth Finance Commission recommended for an alternate formula of devolution of resources from the Union to the States whereby all the Central Taxes other than those levied by the Centre but which are appropriated to the States would be in the divisible pool. In conformity with this recommendation, the Amendment Act, 2000 was passed by the Parliament.

\(^{17}\) They are Duties and Taxes under Articles 268 and 269 respectively and surcharge on taxes and duties referred to in Article 271 and any Cess levied for specific purposes under any law made by the Parliament.

\(^{18}\) Entries 82 to 92A in the Union List of the 7th Schedule to the Constitution of India.
TABLE 1.1

TAX COLLECTION OF THE UNION GOVERNMENT
1950-51 TO 2000-01

(Rs. in Crore)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Personal Income Tax</td>
<td>132</td>
<td>166</td>
<td>473</td>
<td>1440</td>
<td>5371</td>
<td>31764</td>
</tr>
<tr>
<td>Corporation Tax</td>
<td>40</td>
<td>111</td>
<td>371</td>
<td>1311</td>
<td>5335</td>
<td>25177</td>
</tr>
<tr>
<td>Excise Duties</td>
<td>68</td>
<td>414</td>
<td>1759</td>
<td>6500</td>
<td>24514</td>
<td>68526</td>
</tr>
<tr>
<td>Customs Duties</td>
<td>157</td>
<td>170</td>
<td>524</td>
<td>3409</td>
<td>20644</td>
<td>47542</td>
</tr>
<tr>
<td>Service Tax</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2613</td>
<td>(1.47)</td>
</tr>
<tr>
<td>Other Taxes*</td>
<td>2</td>
<td>13</td>
<td>28</td>
<td>478</td>
<td>1649</td>
<td>2453</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>399</strong></td>
<td><strong>874</strong></td>
<td><strong>3153</strong></td>
<td><strong>13138</strong></td>
<td><strong>57513</strong></td>
<td><strong>178085</strong></td>
</tr>
</tbody>
</table>

* Include Wealth tax, Estate duty, Gift tax etc.
Figures in parentheses indicate percentage share of the total tax collection.

Source: RBI Bulletin, relevant years.

Under Entry 82\(^{19}\) of List I of the Seventh Schedule to the Constitution, the Union Government is empowered to levy tax on income other than agricultural income. In 1950-51, personal income tax accounted for one-third (33.08 percent) of Central tax collections. However, the relative contribution declined over years and was less than one-tenth (9.34 percent) in 1990-91. However, it has grown to 17.84 percent of the total tax collection in 2000-01.

Entry 83\(^{20}\) of Union List entitles the Union Government to enact laws for levying duties of customs including export duties. During pre-Independence days and even during the early post-Independence period, customs duties formed the mainstay of Central tax revenues. However, the share of customs revenue in Centre’s total tax collections dropped from 39.35 per cent in 1950-51 to as low as 16.62 per cent in 1970-71. Since then customs revenue has maintained an upward swing, accounting for 35.89 per cent of Central taxes in the year 1990-91.

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\(^{19}\) Entry 82 runs as "Tax on income other than agricultural income"

\(^{20}\) Entry 83 runs as "Duties of customs including export duties"
However, in the post liberalization period, the relative share of this impost has been reduced to 26.70 percent in 2000-01.

Entry 84 of List I of the Seventh Schedule to the Constitution entitles the Union Government to make laws to levy excise duties on tobacco and other manufactured goods except alcoholic liquor for human consumption, opium, Indian hemp, narcotic drugs and other narcotics.\(^2\) Union Excise Duties contribute significantly to the tax revenue of the Central Government. During the last fifty years, there is a phenomenal rise in its relative share in the total tax collection of the Union Government. In 1950-51, excise revenue accounted for a modest 17.04 percent of total Central tax collections. The proportionate share shot up to 55.79 percent in 1970-71. It declined to 42.62 percent in 1990-91, and further down to 38.48 percent in 2000-01. The decline in the relative share of excise duties from the nineties is mainly due to the rationalisation of the rate structure of the excisable commodities.

Entry 85 of List I of the Seventh Schedule to the Constitution empowers the Union Government to make laws to levy corporation tax, which is the tax payable by the Companies. The contribution of corporation tax to the total tax revenue of the Union Government in 1950-51 was only 10.03 percent, which has become 14.14 percent in 2000-01, after a decline in the previous two decades.

Wealth Tax and Gift Tax are capital taxes of the Central Government without much revenue significance. Wealth Tax Act, 1957, which came into force from April 1, 1957 imposed as annual tax on the net wealth. Wealth Tax Act, 1957 was amended from time to

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\(^2\) However, as per Entry 82 of List I, the Union Government can levy excise duties on medicinal and toilet preparations containing alcohol or other narcotics, which are excluded from the taxing power of the Union under entry 82.
time by the annual Finance Acts and other legislations pertaining to direct taxes. A tax on inter vivos gifts was imposed in India under the Gift Tax Act, 1958, which came into force on April 1, 1958. It was enacted as part of integrated scheme of taxation of income, wealth, expenditure, and gifts, and was intended also to supplement the imposition of estate duty with effect from October 15, 1953. The 1998-99 Budget abolished the gift tax.

Drawing power from Article 248 and Entry 97 of List I of the Seventh Schedule to the Constitution, the Union Government had sought to levy Service Tax in the Finance Act of 1994. The legal provisions for this levy are incorporated in clauses 64 to 96 of Chapter V of the Finance Bill, 1994. This is not a tax on any profession, calling or employment; but it is, in respect of the service rendered. The collection of Service tax for the year 1994-95 was only Rs. 407 crores, which was increased to Rs. 2613 crores for the year 2000-01. The revised estimate for the year 2001-02 and the budget estimate for the year 2002-03 aimed at collecting Rs. 3600 crores and Rs. 6026 respectively under this head.

Apart from the above levies, the Union Government is empowered to impose surcharge on the duties and taxes referred to in Articles 269 and 270 and such surcharge will form part of the Consolidated Fund of India notwithstanding the fact that the taxes and duties under Articles 269 and 270 are sharable with the State Governments.

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22 Residuary powers of legislation
23 Additi Advertising V. Union of India 1998 (98) ELT 14
24 CMIE March 2002
Taxes and Duties Levied, Collected and Retained by the States

From a modest amount of Rs. 220 crores in 1950-51, revenue from States' taxes has grown consistently over the years and has reached Rs.117982 crores in the 2000-01. Table. 1.2 gives the picture of the growth as well as the decline of different taxes under the jurisdiction of the State governments.

TABLE 1.2
TAX COLLECTION OF THE STATE GOVERNMENTS
1950-51 TO 2000-01

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Income Tax</td>
<td>(1.36)</td>
<td>10</td>
<td>10</td>
<td>45</td>
<td>198</td>
<td>107</td>
</tr>
<tr>
<td>Stamps &amp; Registration</td>
<td>(11.82)</td>
<td>43</td>
<td>122</td>
<td>425</td>
<td>2112</td>
<td>9675</td>
</tr>
<tr>
<td>Land Revenue</td>
<td>(22.27)</td>
<td>97</td>
<td>113</td>
<td>145</td>
<td>607</td>
<td>1415</td>
</tr>
<tr>
<td>Sales Tax</td>
<td>(26.37)</td>
<td>156</td>
<td>755</td>
<td>3887</td>
<td>17667</td>
<td>73364</td>
</tr>
<tr>
<td>Excise Duty</td>
<td>(21.82)</td>
<td>53</td>
<td>194</td>
<td>824</td>
<td>4795</td>
<td>16036</td>
</tr>
<tr>
<td>Tax on vehicles</td>
<td>(3.18)</td>
<td>33</td>
<td>104</td>
<td>415</td>
<td>1566</td>
<td>6666</td>
</tr>
<tr>
<td>Other Taxes*</td>
<td>(13.16)</td>
<td>55</td>
<td>229</td>
<td>871</td>
<td>2960</td>
<td>10719</td>
</tr>
<tr>
<td>Total</td>
<td>220</td>
<td>452</td>
<td>1527</td>
<td>6813</td>
<td>29895</td>
<td>117982</td>
</tr>
</tbody>
</table>

*Includes Profession Tax, Entry Tax, Urban immovable property tax, Taxes on passengers and goods, Electricity duty, Entertainment Tax and Cess on sugarcane etc.

Figures in parentheses indicate percentage share of the total tax collection

Source: CMIE, Public Finance, relevant issues

There is no direct tax that can claim a prominent place in the tax systems of the States. Major portion of the total tax revenue of the States is contributed by indirect taxes.

Entry 45 of the State List enables the State Governments to levy land revenue. Land revenue, which had an important place in the States’ tax revenue during the pre-Independence years, became

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25 Entries 45 to 63 in the State List of the 7th Schedule to the Constitution of India
26 Entry 45 of the State List runs as: “Land revenue, including the assessment and collection of revenue, the maintenance of and records, survey for revenue purposes and records of rights, and alienation of revenues”
insignificant over the years. In 1950-51 the relative share of land revenue in the total collection of taxes was 22.27 percent whereas the same shrank to an unimportant share of 1.20 percent in 2000-01. It is evident from the figures that this levy has been declining every decade.

Vide entry 46 of List II of the Seventh Schedule to the Constitution, States are entitled to make laws to levy tax on agricultural income. Tax on income is a divided subject. Although under entry 82 of the Union List, the Union Government is competent to make law to levy income tax, such levy shall be only on personal income other than agricultural income. Presently, about half a dozen States levy tax on agricultural income, in three of them it is confined to plantation crops, and in all cases the revenue is meager. In 1950-51 it contributed 1.36 percent of total tax collection of the States but the share was reduced to 0.09 percent in 2000-01.27

Under entry 5128 of List II in the Seventh Schedule to the Constitution, the States are empowered to levy excise duties on certain commodities. Excise duty is also a subject divided between the Union and State Governments. The State’s power to levy excise duties is limited to alcohol for human consumption and opium, Indian hemp,

27 Of course, there is a laxity on the side of the States to levy this tax effectively. Non-levy of Agricultural Income Tax has, apart from revenue shortage, problems such as facilitating evasion of Income Tax. The Direct Tax Enquiry Committee in its Final Report (December, 1971) recommended the imposition of Agricultural Income Tax as a means of preventing evasion of Income Tax on non-agricultural income and also to redress the injustice by bearing the full burden of agricultural development schemes. Report of the Direct Tax Enquiry Committee 1971, pp. 40-42

28 Entry 51 of State List runs as “Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:-
(a) alcoholic liquors for human consumption;
(b) opium, Indian hemp and other narcotic drugs and narcotics;
but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry”. 
other narcotic drugs and narcotics if they are manufactured or produced within that State. The States can impose countervailing duties on similar goods manufactured or produced elsewhere in India. However, States are not to levy excise duties on medicinal and toilet preparations containing alcohol or other narcotics, which are exclusively reserved for the Union Government. After Sales tax, State excise duties are the most important source of States' own tax revenue. Though second in importance, their relative revenue significance has declined over the years from 21.82 percent in 1950-51 to 13.59 percent in 2000-01.

As per entry 54 of List II of the Seventh Schedule to the Constitution, the States are eligible to enact laws to tax sale or purchase of goods other than newspapers where such sale is not in the course of interstate trade or commerce. Entry 54 as originally stood did not differentiate between tax on interstate and intrastate sale. In *Bengal Immunity Co. Ltd. V. State of Bihar* 30 the Supreme Court by interpreting Article 286 of the Constitution held that the States have no power to levy tax on the sale or purchase of goods where such sale or purchase was in the course of interstate trade or commerce. Consequent to this decision, Entry 54 of State list was amended by the Constitution (Sixth Amendment) Act, 1956 and the taxing power of the State was restricted to intrastate sale/purchase of goods alone. By the same constitutional amendment, Entry 92A was inserted in the Union list whereby the power to levy sale or purchase of goods in the course of interstate trade or commerce was allotted to Union Parliament. Thus, the power to levy sales tax is divided between the Union and State

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29 Entry 54 runs as "Tax on the sale or purchase of goods other than newspaper subject to the provisions of entry 92A of List I"
30 A.I.R. 1955 S.C. 661
Governments. By the Constitution (Forty-Sixth Amendment) Act, 1982, Clause (29A) was inserted in Article 366. According to Clause (29A) of Article 366, tax on the sale or purchase of goods includes various transactions, which are not ordinarily understood as sale of goods. They are deemed sales and the states are, by this constitution amendment, empowered to tax such transactions. Although, Entry 54 of State list is a legislative entry with no restriction on the states power to levy tax on the sale or purchase of goods, which is not in the course of interstate trade or commerce, due to certain other provisions this power is restricted. Articles 286 of the Constitution prevents the State from imposing tax on the sale or purchase of goods in the course of import into or export out of the territory of India. Moreover, the State Government’s power to levy tax on the sale or purchase of goods, which are declared as having special importance in the course of interstate trade or commerce, shall be subject to such restrictions and conditions as Parliament may by law specify. Taxes on the sale or

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31 As per Clause (29A) of Article 366 of the Constitution, tax on the following transactions are also deemed to be tax on the sale or purchase of goods: (a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration; (b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract; (c) a tax on the delivery of goods or hire purchase or any system of payment by instalments; (d) a tax on the transfer of right to use any goods for any purpose for cash, deferred payment or other valuable consideration; (e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration; and (f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service or service, is for cash, deferred payment or other valuable consideration.

32 Section 14 of the Central Sales Tax Act, 1956 (74 of 1956) gives the list of goods, which are declared as having special importance in the course of interstate trade or commerce. Section 15 specifies the restrictions with regard to the levy of tax on the sale or purchase of such goods.
purchase of newspapers are within the jurisdiction of the Union Government vide entry 92 of Union List.

Tax on the sale or purchase of goods is the prominent source of tax revenue of the States. The importance of sales tax in the State’s own tax revenue is increasing. Deep and consistent growth has been registered by the sales tax collection and it forms the mainstay of States’ tax revenue. In 1950-51, the relative share of sales tax was 26.37 percent whereas it is 52.18 percent in 2000-01.

Entry 63\textsuperscript{33} of the State List enables the State Government to make laws to prescribe the rates of stamp duties on those instruments, which are not specified in the Union List. The power to levy Stamp Duties is divided between the Union and State Governments. Ten instruments are exclusively kept under the jurisdiction of the Union Government and the States have power to levy stamp duties only on other instruments. Registration and Stamp Duties have contributed 11.82 percent of the total own tax revenue of the States in 1950-51. However, contribution of this levy was declining in the coming decades up to 1990-91. There is an increasing trend from 1990-91 and the contribution in 2000-01 was 8.20 percent of the total own tax revenue of the States.

Under entry 57\textsuperscript{34} of List II in the Seventh Schedule State Governments are empowered to levy taxes on vehicles suitable for use on roads. In 1950-51, this levy accounted for 3.18 per cent of the total tax revenue and it grew to 5.65 percent in 2000-01.

\textsuperscript{33} Entry 63 of the State List runs as “Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.”

\textsuperscript{34} Entry 57 of the State List runs as “Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tram-cars subject to the provisions of Entry 35 of List III.”
Entry 52\textsuperscript{35} of List II of the Seventh Schedule empowers the State Governments to levy tax on the entry of goods into a local area for consumption, use or sale therein. Though this levy is not significant from the revenue point of view, it is used by the states to check unfettered inflow of goods from outside the state. Under entry 62 of List II in the Seventh Schedule of the Constitution, States are empowered to levy taxes on entertainment. This levy also does not contribute much to the exchequer. Other minor taxes and duties include duties in respect of succession to agricultural land,\textsuperscript{36} taxes on land and buildings,\textsuperscript{37} taxes on mineral rights,\textsuperscript{38} taxes on the consumption of electricity,\textsuperscript{39} taxes on advertisements other than advertisements published in newspapers and advertisements broadcast by radio and television,\textsuperscript{40} taxes on professions, trades, calling and employment,\textsuperscript{41} taxes on luxuries,\textsuperscript{42} etc. All these taxes together contributed 13.18 percent of the total own tax revenue of the States in 1950-51. The relative share of these taxes and duties went up to 15 percent in 1970-71. In 1990-91 and 2000-01, the share came down to 9.87 percent and 9.09 percent respectively.

It is evident from Tables 1.1 and 1.2 that the subjects of taxes under the jurisdiction of the Union and the State Governments vary considerably in its elasticity. Out of the major tax resources of State governments, only sales tax has a substantial degree of elasticity.

\begin{itemize}
\item \textsuperscript{35} Entry 52 of the State List reads as \textquote{Tax on the entry of goods into local area for consumption, use or sale therein.}
\item \textsuperscript{36} Entry 47 of State List
\item \textsuperscript{37} Entry 49 of State List
\item \textsuperscript{38} Entry 50 of State List
\item \textsuperscript{39} Entry 53 of State List
\item \textsuperscript{40} Entry 55 of State List
\item \textsuperscript{41} Entry 60 of State List. Article 276 has imposed a restriction with regard to the ceiling of this tax. It should not exceed Rs. 2500/- per annum.
\item \textsuperscript{42} Entry 62 of State List
\end{itemize}
whereas in the case of Union government, the subjects of major taxes have considerable elasticity.

Although the power to legislate upon various fiscal subjects are distributed between the Union and the State Governments by Union List and State List in the Seventh Schedule respectively, the whole taxes and duties levied by the Union are not fully assigned to the Central Government. Certain categories of taxes, which are levied by the Union government, are appropriated to the State Governments. Articles 268 and 269 of the Constitution specify various taxes and duties, which are within the exclusive legislative jurisdiction of the Union Parliament but the proceeds are wholly assigned to the States. They can be divided into two categories such as (1) Duties levied by the Union, but collected and appropriated by the States, and (2) Taxes levied and collected by the Union but assigned to the States.

**Duties levied by Union, but collected and appropriated by States**

Under Article 268, the stamp duties on ten instruments and duties of excise on medicinal and toilet preparations shall be levied by the Union but shall be collected and appropriated by the States. Stamp duties are levied by the Union Government on bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies, and receipts. The levy and collection of Stamp Duty is governed by the Indian Stamp Duty Act, 1899. Considering the importance of these instruments, the rates of such instruments are not changed frequently. Eighth Finance Commission, after considering various aspects related to it, did not favour the raising of rates of Stamp duty on bills of exchange,

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43 Article 268
promissory notes, life insurance policies, transfer of shares, debentures, proxies, and receipts. The Commission also disapproved the re-imposition of stamp duty on cheques.\textsuperscript{44} However, the Commission favoured the raising of rates of stamp duty on bills of lading, letters of credit, and policies of general insurance.

Although excise duty on alcoholic liquors for human consumption, opium, Indian hemp, narcotic drugs and other narcotics is a subject allotted to the State Legislature, the duties of excise on medicinal and toilet preparation containing alcohol and narcotics are levied by the Union. But these duties are collected and appropriated by the States. Duties on medicinal and toilet preparations are imposed under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955.

**Taxes levied and collected by the Union but assigned to the States**\textsuperscript{45}

Article 269 deals with the taxes, which are levied and collected by the Union but assigned to the States. Originally, Article 269 contained six types of taxes and duties, which were to be levied by the Union Government. Consequent to the decision in 'Bengal Immunity Co.'\textsuperscript{46} case, Constitution (Sixth Amendment) Act, 1956 was passed by the Parliament whereby substantial amendments were brought with regard to the taxing power of the State on the sale or purchase of goods. Article 269 was amended by the above constitutional amendment and clause (1) (g) was inserted. Clause (1) (g) of Article 269 prescribed that tax on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of interstate trade or commerce shall be levied by the Union but the same shall be assigned

\textsuperscript{44} Stamp duty was payable on cheques prior to 1927 but was withdrawn in that year.

\textsuperscript{45} Article 269

\textsuperscript{46} *Bengal Immunity Co. Ltd.* v. *State of Bihar*, (1955) 6 STC 446
to the States. By the Constitution (Forty Sixth Amendment) Act, 1982, clause (1) (h) was inserted in Article 269. Clause (1) (h) provided for taxes on the consignment of goods (whether such consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-state trade or commerce. After the Constitution (Forty Sixth Amendment) Act, 1982, the following eight types of taxes and duties were to be levied by the Union Government the proceeds of which were entitled to the States.

(a) duties in respect of succession to property other than agricultural land
(b) estate duty in respect of property other than agricultural land
(c) terminal taxes on goods or passengers carried by railway, sea or air
(d) taxes on railway fares and freights
(e) taxes other than stamp duties on transactions in stock exchanges and future markets
(f) taxes on the sale or purchase of newspapers and on advertisements published therein
(g) taxes on the sale or purchase on goods other than newspapers where such sale or purchase takes place in the course on interstate trade or commerce
(h) taxes on the consignment of goods (whether such consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-state trade or commerce.

The duties mentioned under Article 269 (1) (a) and (b) pertained to estate duty, and succession duty in respect of property other than agricultural land. The incidence of duty in both the cases was

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47 List I of the Seventh Schedule to the Constitution also was amended to this effect by inserting entry 92A
48 Inserted by the Constitution (Sixth Amendment) Act, 1956
49 Inserted by the Constitution (Forty-sixth) Amendment Act, 1982
succession to the property on the death of the owner and the only difference was that in the case of estate duty, the value of the whole estate, even if situated in more than one State, was taken as the base for assessment whereas the succession duty was computed on the value of individual shares passing on to the successors. Estate Duty was levied under the Estate Duty Act, 1953 on the capital value of all property passing on the death of any person on or after October 15, 1953. However, Estate duty was abolished with effect from March 16, 1985 following the recommendations of the Economic Administration Reforms Commission, 1981-83.

Article 269(1) (c) pertained to terminal taxes on goods and passengers carried by railway, sea or air and correspond to entry 89 of List I. Clause (1) (d) pertained to tax on the railway fares and freights. Under the provisions of the Railway Passenger Fares Tax Act, 1957, tax on railway fares was levied. The Second Finance Commission observed that the proceeds of this tax should be distributed to the States on the principles that each State should be enabled to get as nearly as possible the share of the net proceeds on account of the actual passengers travel on railways within its limits. It recommended that each state should be allocated on the basis of the passenger earnings from non-suburban services for each gauge of each railway zone separately among the states covered by it according to the route length falling within each state. The basis was accepted by the Government of India. However, on the basis of recommendation by the Railway Convention Committee, the Railway Passenger Fares Tax Act was

50 The Estate Duty was abolished on the ground that it had failed to achieve the goals, viz. to reduce the accumulation of dynastic wealth and raise resources for the Government.
repealed in 1961\textsuperscript{51} and the tax was merged in the basic fares with effect from April 1, 1961. Arrangement was made to compensate the states for the losses suffered by them from 1961-62 to 1965-66. The railways agreed to make an ad hoc grant of Rs. 12.5 crores a year to States in lieu of the tax for a period of five years from 1961-62 to 1965-66. The successive Finance Commissions have recommended for the amount to be distributed among the states and have laid down the basis of distribution.

Article 269(1) (e) related to ‘taxes other than stamp duties on transactions in stock exchanges and future markets’ that corresponded to entry 90 of List I. This subject was with significant revenue potential especially in view of the growing stock markets. However, the Eighth Finance Commission opined against the levy of taxes on transactions in stock exchange and future markets.

Article 269 (1) (f) referred to ‘taxes on the sale or purchase of newspapers and on advertisements published therein’, which corresponded to entry 92 of List I. Though a tax on the sale or purchase of newspapers is generally not appreciated, the advertisements published therein could be taxed without public protest. Fifth and Eighth Finance Commissions also had recommend for tax on advertisements published in newspapers.

\textsuperscript{51} The Railway Convention Committee made the recommendation on the basis of plea of the Railway Board that the levy of passenger fares tax had limited the scope for raising passenger fares.
Clause (1) (g) deals with the tax on the sale or purchase of goods other than newspapers where such sale or purchase is in the course of interstate trade or commerce.\(^5^2\)

Article 269(1) (h), corresponding to entry 92B of List I, referred to taxes on consignment of goods in the course of inter-State trade. Since the Central Sales Tax Act, 1956 (74 of 1956) does not seek to tax interstate movement of goods, which is not as a result of sale, it has helped the tax evaders to show sale of goods as consignment from one State to another. Constitution (Forty sixth Amendment) Act, 1982 empowered the Parliament to levy ‘taxes on consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or Commerce.’ by inserting entry 92B in List I of the Seventh Schedule and simultaneously amending Article 269 by inserting sub-clause 269(1) (h). Ever since, the States have been pressing the Centre to levy the tax, the net proceeds of which were entirely assignable to States. The Commission on Centre-State Relations, 1988, also impressed upon the Government to “bring in suitable legislation in this regard without further loss of time”.\(^5^3\)

The Amendment Act, 2000 amended Article 269 radically. The provisions relating to taxes, which are levied by the Union but assigned to the States, were deleted except the provisions relating to the Central Sales Tax and Consignment Tax. In these cases also the Union Parliament has enacted the law to levy tax on the interstate sale of

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\(^5^2\) Section 3 of the Central Sales Tax Act, 1956 (74 of 1956) formulates the principles to determine when a sale or purchase takes place in the course of interstate trade or commerce.

goods. In the case of tax on consignment, there is no levy in the absence of central legislation. Prior to the Amendment Act, 2000, the States were entitled to the proceeds of these taxes and duties whereas the Constitution amendment converted these taxes and duties except Central Sales Tax and Consignment Tax, entirely as Union Taxes and Duties and since they form part of the divisible pool of the Union Taxes and Duties, the States are eligible only for a share of it.

**Taxes and Duties Levied and Collected by Union but Shared with the States**

Prior to the Constitution Eightieth Amendment, tax on income other than agricultural income was compulsorily shareable and duties of Union Excise were shareable optionally if the Parliament by law so provided. This system was totally altered by the Amendment Act, 2000 and the separation of taxes and duties as compulsory sharing and optional sharing was done away with. The Constitution eightieth amendment introduced a system of a single divisible pool and mandatory sharing of it between the Union and State Governments.

Article 270 of the Constitution makes provision for the sharing of taxes, which are levied and collected by the Union, between the Union Government and the State Governments. Taxes, which are assigned to be shared, were different prior to and after the Amendment Act, 2000. The scheme of tax sharing that originally existed in the Constitution was radically altered by the above constitutional amendment. Hence,

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54 Article 270. An inconsistency may be felt here. The divisible pool of taxes and duties is the same as given in (i) above except the surcharge and cess levied on such taxes or duties. Hence, the share of the Union Government in the taxes and duties on the subjects given in the Union List is only that amount which is the balance after allotting the share of the States. This is the situation after the Amendment Act, 2000.

55 Article 270 (pre amended)

56 Article 272 (pre amended)
the system that existed prior to the Constitution Eightieth Amendment and the system introduced by the amendment are examined below.

Sharing of Taxes and Duties Prior to Constitution Eightieth Amendment

As per the pre-amended Article 270, tax on income other than agricultural income was levied and collected by the Government of India and the same was distributed between the Union and the States. Prescribed percentage\(^{57}\) of the net proceeds of such tax in any financial year was assigned to the States within which that tax was leviable. The Finance Commissions were assigned the responsibility to recommend the share of income tax that was to be transferred to the States. However, a tax on income did not include corporation tax. The proceeds attributable to Union Territories, taxes payable in respect of Union emoluments and any surcharge, which might be levied for the purpose of the Union, were also kept out of the divisible pool.\(^{58}\)

Under the pre-amended Article 272, Union Excise Duties were shareable between the Union and the State Governments if the Parliament by law provided for it. Though sharing of this duty was permissive in nature, all the Finance Commissions had recommended for including a portion of it in the shareable resources, of course, under various criteria.

The share in net proceeds of income tax and excise duties assigned to the states, as recommended by various Finance Commissions, are given in Table 1.3.

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\(^{57}\) The Constitution (Distribution of Revenue) Order, 1979 (G.O. 112)

\(^{58}\) Articles 270(2),(3),(4) and Article 271(pre-amended)
### TABLE 1.3

**STATES' SHARE IN NET PROCEEDS OF CENTRAL TAXES**

<table>
<thead>
<tr>
<th>Finance Commission</th>
<th>Income Tax</th>
<th>Union Excise Duties</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>55%</td>
<td>40% 3 articles</td>
</tr>
<tr>
<td>Second</td>
<td>60%</td>
<td>25% 8 articles</td>
</tr>
<tr>
<td>Third</td>
<td>66.66%</td>
<td>20% 35 articles</td>
</tr>
<tr>
<td>Fourth</td>
<td>75%</td>
<td>20% all articles</td>
</tr>
<tr>
<td>Fifth</td>
<td>75%</td>
<td><strong>20% all articles</strong></td>
</tr>
<tr>
<td>Sixth</td>
<td>80%</td>
<td><strong>20% all articles</strong></td>
</tr>
<tr>
<td>Seventh</td>
<td>85%</td>
<td>40% all articles</td>
</tr>
<tr>
<td>Eighth</td>
<td>85%</td>
<td>45% all articles</td>
</tr>
<tr>
<td>Ninth</td>
<td>85%</td>
<td>45% all articles</td>
</tr>
<tr>
<td>Tenth</td>
<td>77.5%</td>
<td>47.5% all articles</td>
</tr>
</tbody>
</table>

*Including special excise duties. **Including auxiliary duties

Source: Reports of Finance Commissions.

It can be seen that over the period of time there was a considerable increase in the share of the states in the net proceeds of the Income Tax. It was only 55 percent under the recommendation of the **First Finance Commission** and it was augmented to a pretty good share of 85 percent by three consecutive Finance Commissions. However, the **Tenth Finance Commission** reduced the share to 77.5 percent.

Two basic problems existed in relation to the sharing of income tax between the Union and the State Governments. One was the continuation of Union surcharge on a permanent basis, the proceeds of which, were not shareable. The other problem was that the income tax paid by the companies in the corporation tax, was not shareable with the States.59 Despite persistent demands by the States, these problems were never solved.

In the case of Excise Duties, the First Commission fixed the share of the States at 40 percent of the net proceeds of duty on tobacco,  

59 Sub-clause (a) of clause (4) of Article 270 (pre-amended). Till 1959, the income tax paid by the companies was a sharable item. It was taken out of the divisible pool on the reason of cascading.
matches, and vegetable products. Gradually the number of articles considered for the purpose of the divisible pool was increased and the share was consequently enlarged. The Fourth Finance Commission, for the first time, recommended for assigning 20% of the net proceeds of the excise duty collected on all articles. The Seventh Finance Commission enhanced the share of the states to 40 percent of the net proceeds of duties on all commodities excepting the duty on the generation of electricity.

Sharing of Taxes and Duties Subsequent to Constitution Eightieth Amendment

The Amendment Act, 2000 radically altered Article 270 and repealed Article 272. Subsequent to this amendment, the system followed till then for the sharing of taxes and duties was fundamentally changed. Present system of sharing of taxes between the Union and State Governments is discussed below.

All taxes and duties referred to in the Union List shall be levied and collected by the Union Government and the same shall be distributed between the Union and the State Governments. However, the sharable taxes and duties do not include duties and taxes referred to in Articles 268 and 269 respectively and surcharge on taxes and duties referred to in Article 271 and any cess levied for any specific purposes under any law made by the Parliament. The net proceeds of sharable taxes and duties shall be distributed between the Union and State Governments at prescribed percentage by the President of India after considering the recommendations of the Finance Commission.

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60 Article 270 was amended with retrospective effect from 1-4-1996 and Article 272 was amended with effect from 9-6-2000.
Sharing of the net proceeds of all taxes and duties levied and collected by the Union Government was proposed by the Tenth Finance Commission. The Commission recommended that 29 percent of the gross receipts of the Union Government should be transferred to the States.\textsuperscript{61} Eleventh Finance Commission recommended for the sharing of the net proceeds of all shareable taxes and duties levied and collected by the Union Government with the States. It recommended for the devolution of 28 percent of the net proceeds of all shareable Union taxes and duties for each of the five years starting from 2000-01 and ending in 2004-05. The Commission further recommended for the devolution of 1.5 percent of the net proceeds of all shareable Union taxes and duties as a compensation for not levying sales tax on sugar, textiles and tobacco by the States.\textsuperscript{62}

The original constitutional scheme of sharing of Personal Income Tax with the States compulsorily and sharing of Union Excise Duties with the States optionally is no more available. The divisible pool of the Central taxes and duties now include all those taxes and duties, which were exclusively assigned to the Union Government.\textsuperscript{63} Although the divisible pool is widened, the shares of the States have not increased considerably for the reason that the recommended percentage share of

\textsuperscript{61} The recommendation for 29 percent of the gross receipt of the Union Government included 3 percent in lieu of additional excise duties. The Commission arrived at this alternative scheme of devolution after considering the share of States in aggregate Central Tax Revenue for the periods commencing from 1979-80 and the recommendations by the Sarkaria Commission on Centre-State Relations and the Chelliah Committee on Tax Reforms. Report of the Eleventh Finance Commission, para, 13.14

\textsuperscript{62} Consequent to the deletion of Article 272 by the Amendment Act, 2000, the ADE on Sugar, Textiles and Tobacco cannot be passed on to the States. They have become part of the shareable Union taxes and duties under Article 270. Hence a separate recommendation was made by the Eleventh Finance Commission for the compensation to the States.

\textsuperscript{63} Although taxes and duties under Articles 268 and 269 were levied by the Union, they were assigned to the States.
the States in the divisible pool was accordingly adjusted. The surcharge on taxes and duties under Articles 268 and 269 and cess on any central subject are still kept for the exclusive use of the Union Government.

**GRANTS-IN-AID**

Despite tax sharing and assignment of certain tax resources exclusively to the states, the total resources of the States are not sufficient to meet their budgetary needs. This situation might have been visualized by the founding fathers of the Indian Constitution, which prompted them to incorporate such provisions in the Constitution whereby the state revenues are supported by additional grants. The Constitution makes provisions for the transfer of resources by way of grants-in-aid under two categories such as (i) Grants-in-aid given on the recommendations of the Finance Commission, and (ii) Discretionary grants-in-aid given by the Government of India for specific purposes.

**Grants-in-aid of the revenues of the States**

Article 275 provides for Grants-in-Aid of the state revenue from the Union. Grants-in-Aid of the state revenue are unconditional and it is channelised through the Finance Commission.

The First Finance Commission set out the general principles of allocating grants to the states, which the succeeding Commissions have endorsed and applied with some modification in methodology in each case. The general principle set out for fixing the share of the states in

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64 Article 275 (1) runs as “Such sum as Parliament may by law provide shall be charged on the Consolidated Fund of India in each year as grants-in-aid of the revenues of such States as Parliament may determine to be in need of assistance, and different sums may be fixed for different States.”

65 Proviso to Article 275 (2)
the statutory grants is that in fixing the share of the states the major considerations of the Finance Commissions must be

(a) covering of fiscal gaps of the states after devolution
(b) tax efforts of the states
(c) narrowing disparities between developed and less developed states
(d) burden on the states due to particular position/matters of national importance.

These principles, as opined by various Commissions, are not exhaustive and inflexible. But no Finance Commission has so far rejected any of these principles as insignificant while working out the formulae for the distribution of grants between the states.

Discretionary Grants-in-Aid for specific purposes

Grants-in-Aid under Article 282 are outside the purview of the Finance Commission. They are conditional and granted to meet specific purposes.

Grants under Article 282 have become the crucial part of the financial planning of the states. Substantial part of their revenue receipts belongs to this grant which is allotted for implementing the centrally sponsored projects and is used to regulate the fiscal relations between the Union and State Governments. The capital grants to the states for executing their part of the plans are made under this Article. This type of central grants had existed in the pre independence period also.

66 Article 282 provides that "The Union or a State may make any grant for any public purpose, notwithstanding that the purpose is not one with respect to which Parliament or the Legislature of the State as the case may be, make laws."

67 Supra, Chapter II, p.77.
Under Article 282, the Union Government has the power to make discretionary grants to the States to enable them to carry out certain special purposes, such as improvement of the backward classes or to progress social services or to support them in executing some specified schemes or programmes. They may be plan grants or non-plan grants and may pertain to any subject of any of the three lists in the Seventh Schedule to the Constitution.

Because of the overwhelming importance of the discretionary grants in the fiscal planning of the states, they are not viewed positively. It is argued that the provision for discretionary grants promotes the unitary trends and through these grants, the Union Government very often encroaches upon the autonomy of the states. It is also pointed out that they are working as incentives for the slackness on the part of the states in resource mobilisation.

Up to the Third Plan, the approach of the Planning Commission in respect of plan grants had been mostly economic. With the Fourth Plan, this approach has been radically changed. In September 1968 the National Development Council laid down the criteria for devolution of grants to the states as follows: "After providing for the requirements of the States of Assam, Nagaland and Jammu and Kashmir, the Central assistance to remaining States for the fourth Plan be distributed to the extent of 60 percent on the basis of their population, 10 percent on their per capita income if below the national average, and 10 percent on the basis of tax effort in relation to per capita income, and that another 10

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69 In the Third Five Year Plan it was asserted that taking of "consistent and timely decisions regarding the optimum use of resources, the economies of scale and location, and regional distribution of economic activity" was the prime importance. Report of the Third Five Year Plan, p. 21
percent to be allotted in proportion to the commitments in respect of major continuing irrigation and power projects. The remaining 10 percent ...should be distributed among the States so as to assist them in tackling certain special problems, like those relating to metropolitan areas, floods, chronically draught affected areas and tribal areas. This came to be known as Gadgil Formula, after the name of the then Vice-Chairman of the Planning Commission.

With the Fourth Plan, the grant from the Union Government has not been earmarked for any specific schemes or projects in contrast to the earlier system of devolution. Since the devolution of grants from the fourth plan onwards being in block loans and grants, the states have been free to decide the direction and manner of their plan expenditure. Only when national priorities are involved, some expenditures are assigned specifically to certain projects and schemes. The total transfers from the Union Government to the State Governments from 1952 to 2000 are given in Table 1.4.

**TABLE 1.4**

**TRANSFER OF RESOURCES FROM CENTRE TO STATES**

<table>
<thead>
<tr>
<th>Finance Commissions &amp; (Period)</th>
<th>Share in Central Taxes</th>
<th>Grants from the Centre (Art.275)</th>
<th>Discretionary Grants from the Centre (Art.282)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>First (1952-57)</td>
<td>362 (62.31)</td>
<td>50 (8.61)</td>
<td>169 (29.08)</td>
<td>581</td>
</tr>
<tr>
<td>Second (1957-62)</td>
<td>852 (52.99)</td>
<td>197 (12.25)</td>
<td>559 (34.76)</td>
<td>1608</td>
</tr>
<tr>
<td>Third (1962-66)</td>
<td>1068 (49.51)</td>
<td>244 (11.32)</td>
<td>845 (38.17)</td>
<td>2157</td>
</tr>
<tr>
<td>Fourth (1966-69)</td>
<td>1323 (48.32)</td>
<td>422 (15.41)</td>
<td>993 (36.27)</td>
<td>2738</td>
</tr>
<tr>
<td>Fifth (1969-74)</td>
<td>4605 (53.58)</td>
<td>711 (8.27)</td>
<td>3279 (36.15)</td>
<td>8595</td>
</tr>
<tr>
<td>Sixth (1974-79)</td>
<td>7099 (45.31)</td>
<td>2510 (16.03)</td>
<td>6057 (38.66)</td>
<td>15666</td>
</tr>
<tr>
<td>Seventh (1979-84)</td>
<td>19233 (54.44)</td>
<td>1610 (4.56)</td>
<td>14489 (41.00)</td>
<td>35332</td>
</tr>
<tr>
<td>Eighth (1984-89)</td>
<td>35683 (47.58)</td>
<td>3769 (5.02)</td>
<td>35548 (47.40)</td>
<td>7500</td>
</tr>
<tr>
<td>Ninth (1989-95)</td>
<td>99667 (64.13)</td>
<td>20031 (12.89)</td>
<td>35723 (22.98)</td>
<td>155421</td>
</tr>
</tbody>
</table>

Figures in parentheses indicate the relative share in the total transfers.

Source: Finance Commission Reports

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70 Report of the Fourth Five Year Plan 1969-74, pp. 54-55
It is evident from the figures given in Table 1.4 that over the period, the discretionary grants to the states have grown considerably in comparison to the statutory grants under Article 275. From the relative share of 29.08 percent of the total transfers to the states in 1952-57 it enlarged to 31.15 percent in 1995-2000 whereas the statutory grants, during the same period came down from 8.61 percent to 6.17 percent. Except for the period coming under the First, Second and Ninth Finance Commissions, the Grants under Article 282 were above 35 percent of the total transfer from the Centre. During the Seventh and Eighth Finance Commission periods it was above 40 percent. On the other hand, in the case of Grants-in-Aid under Article 275, during the First, Fifth, Seventh, Eighth and Tenth Finance Commission periods, it was less than 10 percent of the total transfer from the Centre. Only during the Fourth and Sixth Finance Commission periods, Grants-in-Aid under Article 275 were above 15 percent of the total transfer from the Centre. Under the Seventh Finance Commission period it was only 4.56 percent of the total transfer from the Centre. In the case of share in Central Taxes also similar trend is seen. Between Second and Ninth Finance Commission periods, there was a declining trend. During this period the discretionary grants increased in their relative share.

**ADE IN LIEU OF SALES TAX**

Pursuant to the decision of the National Development Council in December 1956, it was decided to replace sales tax on sugar, textiles and tobacco by ADE and to distribute the revenues derived there from among the states. In order to achieve this objective the Additional Duties of Excise (Goods of Special Importance) Act, 1957 was enacted by the Parliament. The first Schedule of the Act prescribed the rate of
tax and the second Schedule laid down the scheme of distribution of the net proceeds of the levy among the states. Consequent to the deletion of Article 272 and amendment in Article 270 by the Amendment Act, 2000, the ADE has become one of the divisible Central taxes and duties and separate devolution of this levy has become impossible. The Eleventh Finance Commission, considering this aspect, recommended to merge this levy with the basic excise duties. The Eleventh Finance Commission, however, recommended 1.5 percent of the net proceeds of the divisible Central taxes and duties to be transferred to the States as compensation for not levying tax on the sale or purchase of sugar, textiles and tobacco.\(^71\) The Commission categorically recommended that any State levying sales tax on sugar, textiles and tobacco would not be entitled for the share of 1.5 percent in this regard.\(^72\)

The Additional Duties of Excise (Goods of Special Importance) Act, 1957 has not prevented the states from levying tax on the sale or purchase of sugar, textiles and tobacco. However, the states are not interested in substituting the present levy with the sales tax mainly for two reasons. Firstly, such States will not be eligible to receive the share of Central taxes earmarked as grant in lieu of sales tax and secondly, since these commodities are included under section 14 of the Central Sales Tax Act, 1956, the maximum rate of sales tax that can be imposed is limited to 4 percent.\(^73\)

\(^71\) Report of the Eleventh Finance Commission, Para 6.16
\(^72\) ibid
\(^73\) As per section 15 of the CST Act, 1956, the states cannot impose sales tax on such commodities at a rate more than four percent. Prior to the CST (Amendment) Act, 2002, there was one more restriction that these commodities could not be taxed at more than one point of sale.
GRANTS IN LIEU OF TAX ON RAILWAY PASSENGER FARES

Consequent to the repeal of the Railway Passenger Fares Tax Act in 1961, the levy of tax on the railway passengers’ fares, the net proceeds of which was fully assigned to the states, was done away with. However, the railways agreed to make an ad hoc grant of Rs. 12.5 crores a year to States in lieu of the tax for a period of five years from 1961-62 to 1965-66. This grant continued and its amount was successively raised.74

In the Terms of Reference of the Eleventh Finance Commission, the Commission was asked to suggest the changes, if any, with regard to the grants to be made available to the States in lieu of the tax under the repealed Railway Passenger Fares Act, 1957.75 Due to the Amendment Act, 2000, this has become irrelevant and the Eleventh Finance Commission did not make any recommendation in this regard.

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74 The Third, Fourth and Fifth Finance Commissions determined the grant on the basis of passenger earnings of each railway zone based on the actual route length in each state. The Fifth Finance Commission concluded that the grants payable to states would have been Rs. 25 crores per annum when the ad-hoc grant was fixed at Rs. 12.5 crores per annum in 1961. As per the Commission, the grant that was raised to Rs. 16.25 crores in 1965 was also not adequate. The sixth Commission assumed that the grant would be maintained at Rs. 16.25 crores. The Eighth Finance Commission recommended that the states should be paid 10.7 percent of the present non-suburban passenger earnings by way of grant in lieu of the tax. It recommended for paying Rs. 94.68 crores per annum in this account. The Ninth Finance Commission retained the quantum of grant at Rs. 95 crores for the year 1989-90. In its Second Report, the Commission recommended that the quantum should be Rs. 150 crores annually for the year of 1990-95. The Tenth Finance Commission recommended that Rs. 380 crores per annum should be paid to the states in this behalf.

75 SO No.557 (E) dated July 3, 1998, Para 7
DEVOLUTION OF FISCAL RESOURCES – AGENCIES AND MECHANISM

The Finance Commission

The constitution has not only specified the resources which are to be transferred from the Union to the States but also has identified the agency for recommending the amount to be transferred and the modus operandi of such transfers. Article 280 of the Indian Constitution enjoins the President to constitute a Finance Commission at the expiration of every fifth year (or earlier) to make recommendations to the President about:

1. the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them and the allocation between the States of the respective shares of such proceeds;

2. the principles which should govern the grants-in-aid of the revenue of the States out of the Consolidated Fund of India;

3. the measures needed to augment the Consolidated Fund of a State to supplement the resources of the panchayats in the State on the basis of the recommendations made by the Finance Commission of the State;\(^76\)

4. the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State;\(^77\)

5. any other matter which the President may like to refer in the interest of sound finance.

The Commission is required to be composed of a Chairman and four members. The qualification, etc., of the members are laid down by

\(^{76}\) Inserted by the Constitution (Seventy-third Amendment) Act, 1992, S.3 (w.e.f. 24-4-1993)

\(^{77}\) Inserted by the Constitution (Seventy-fourth Amendment) Act, 1992, S.3 (w.e.f. 1-6-1993)

The recommendations of the Finance Commissions are not obligatory.\(^{78}\) The recommendations are open to the President and he can depart from them. But as B.N. Rau puts it, it is unwise to depart from them.\(^{79}\) Except on rare occasions, the recommendations have been by and large accepted by the President.

The First Finance Commission was set up in 1951 and it submitted the Report in 1952. Eleven Finance Commissions have given their recommendations so far, covering a period of 53 years from 1952-53 to 2000-05. The substantive tasks of any Finance Commission relate to the mandatory and permissive sharing of taxes with the states under Article 270 and 272 respectively and grants-in-aid of the revenues of states under Article 275. However, under sub-clause (d) of clause (3) of Article 280 the President can refer any other matter to the Commission.

Since the Second Finance Commission onwards the devolution through the Finance Commission has become very substantial.\(^{80}\) Out of the total transfers from the Union to the States, the tax sharing alone was 64.13 percent and 62.68 percent during the Ninth and Tenth Finance Commissions respectively. However, in the case of grants, the importance of the Finance Commission has been gradually decreased due to the role of Planning Commission in this field.

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\(^{78}\) C.A.D. Vol. IX pp. 325-326


\(^{80}\) Supra, Table 1.4
The Planning Commission

The Planning Commission was brought into existence by a Resolution of the Parliament on March 15, 1950. The Resolution declares that the Planning Commission is vested with the task of formulating a plan for the most effective and balanced utilization of the country's resources and to appraise, from time to time, the progress achieved in the execution of each stage of the plan and recommend adjustments of policy and measures that such appraisal may show to be necessary.

Since the Planning Commission is not bound by any statutory provisions, its activities are wider than that of the Finance Commission. It has a wide perspective as it formulates the plans for the nation as well as for the states. Its activities are invariably connected with additional resource mobilization for the plan set forward by it. In the earlier period, the Planning Commission gave Plan assistance to fill the gap in a State's assessed financial resources and the estimated Plan outlay. By the end of the Third Plan, this system was felt faulty and some states felt discriminated. Moreover, the activities of the Planning Commission were taken as an infringement on the autonomy of the states. To overcome this situation, the National Development Council evolved a formula for giving block assistance to fourteen states (non-backward states) under which the assistance is 70 percent loan and 30 percent grant, and the states are free to utilize it, as they like.81

81 The Planning Commission, even after the above exercise, is not free from criticism. The major charge is that the main objective of Planning in a federal set up, that is reducing the disparities between the rich and poor states have not been achieved. From another point of view, it has been alleged that large amount of resources are earmarked for centrally sponsored schemes and the states have very little to do with such schemes, which is in fact not in conformity with the 1900f federal principles.
However, one aspect is glaring. That is the duplication of authorities in resource transfer from the Union to the States. The Finance Commission and the Planning Commission operate in the same field and the Planning Commission with unfettered control over the resources is capable to shadow the Finance Commission, which is a constitutional body.

FISCAL FEDERALISM UNDER OTHER CONSTITUTIONS: AN OVERVIEW

An understanding of the principles of fiscal federalism in other federations shall be helpful to evaluate the problems of Centre-State financial relations under Indian Constitution and will be useful to identify the feasible options to restructure the federal fiscal arrangements. A brief sketch of the federal fiscal relations existing under the Constitutions of Australia, Canada and United States of America is made below.

Australia

The basic outlines of the Australian federal system are set out in the Constitution of 1901. The major subjects coming under the jurisdiction of the Commonwealth (Central) Government are foreign trade, defence, immigration, interstate trade and commerce, currency and banking, maritime activities, posts and telegraphs and social security payments. Important State subjects are education, health, public safety, transport, community and social services.

The Commonwealth Government has the power to levy all taxes. The State Governments also have the powers of taxation concurrently except in the case of customs and excise duty. The major State taxes are pay roll tax, stamp duties and motor tax. Despite the concurrent powers
of taxation, there are very little overlapping between the Commonwealth Government and the State Government.\textsuperscript{82} The problem of vertical tax overlapping has been resolved mainly through tax assignment and coordination.\textsuperscript{83} The problem of overlapping of tax bases has been kept at minimum as all major taxes are assigned to the Commonwealth Government and although the States have concurrent powers to levy indirect taxes except customs and excises, the Courts' ruling that sales tax fall into the excepted category virtually rules out concurrency.\textsuperscript{84}

The revenue resources within the jurisdiction of the States are inadequate to meet the expenditure of the States. The deficiencies in the States' revenue are met through transfer of resources from the Commonwealth Government. The Australian federal system provides for correction, both vertical and horizontal imbalances, through tax sharing arrangements and specific purpose grants.\textsuperscript{85} The resource transfer from the Commonwealth Government to the States are determined and regulated by three agencies namely Commonwealth Grants Commission, Statutory Commissions and Australian Loan Council.

The fiscal deficiencies of the States are solved by three methods; they are (1) sharing of tax revenue of the Commonwealth Government with the State Governments, (2) providing specific grants to the States mainly to meet their plan expenditure; and (3) granting loans.

\textsuperscript{82} See B.P.R. Vithal and M.L. Sastry, Fiscal Federalism in India (2001), p. 26
\textsuperscript{83} M. Govinda Rao, Indian Fiscal Federalism from a Comparative Perspective (1993), p. 8
\textsuperscript{84} "Studies in Comparative Federalism: Australia, Canada, the United States and West Germany", Advisory Commission on Intergovernmental Relations (1981)
\textsuperscript{85} B.P.R. Vithal and M.L. Sastry, op.cit., p. 26

The tax sharing grants are fixed share of tax revenues of the Commonwealth and they are distributed among the States unconditionally. The amount of tax that is to be transferred to the States is computed by the Commonwealth Grants Commission on the basis of relativities. The Commonwealth Grants Commission is a permanent, statutory authority.\textsuperscript{86} It conducts extensive research, on the basis of which, it makes important changes in the equalizing provisions from time to time, which eventually gets adopted. Estimating disabilities of the States periodically is one of the major functions of the Commission. The calculation of each State’s per capita share of tax sharing funds consist three elements namely: (1) the basic entitlement to offset vertical imbalances; (2) the revenue disability; and (3) the expenditure or cost disability. As result of using these factors in determining the share of a State in the grants from the Central Government, all the States are enabled to provide certain standards of public services.

The States depend mainly on the ‘Specific purpose grants’ to meet the plan expenditure. There are many ‘specific purpose grants’; the major ones are grants for education, housing, health, and roads. The ratio of most of the ‘specific purpose grants’ is 50:50.

The Australian Loan Council also plays a vital role in the fiscal administration of the States. It is intended for the centralized

\textsuperscript{86} Commonwealth Grants Commission performs identical functions of the Finance Commission in India. But unlike the Finance Commission in India, it is not a constitutional body.
supervision of the increased capital accounts of the States. The entire public sector borrowings are subject to the control of this Council. The States receives loans at subsidized rates of interest and they have to repay only two thirds of the borrowed funds.

Canada

Under the Canadian Constitution, the national (Federal) and Provincial Governments are vested with exclusive powers. The major subjects under the Federal Government include railways, harbours, internal trade, and subjects of national importance. The Provinces have jurisdiction on education, health, welfare, property and civil rights, and ownership and exploitation of natural resources. Most of the residual powers vest with the Federal Government.

The Federal Government has power to impose tax on any subject. The provinces are given access to all forms of direct taxation. The major taxes of the Federal Government are income tax on personal income and corporate income, succession and estate taxes, manufacturer's sales taxes, customs duties, excise duties and export tax on oil. The major tax revenues of the Provinces are retail sales tax, tax on personal and corporate income, succession and gift tax, health and social insurance levies, and property tax. Since the Federal Government as well as the Provincial Governments have access to almost all taxes,

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87 Canada was born out of the British North America Act, 1867. In 1982 the Constitution Act 1982 was passed, which renamed the British North America Act as the Constitution Act, 1867.

88 Section 91 (3) of the Canadian Constitution allows the Federal Government to raise revenues "by any mode or system of taxation."

89 Section 92(2) of the Canadian Constitution gives the Provinces the right to "direct taxation within the Province in order to the raising of revenues for provincial purposes".
there is a considerable degree of overlapping in this field. However, in the case of personal and corporate income tax these two governments have achieved harmony through tax collection agreements and no element of income is taxed by more than one government. Sales tax in the form of goods and services tax is levied by the Federal and the Provincial Governments. It is a multi staged value added tax.

The striking feature of the Canadian federalism is the high degree of vertical and horizontal imbalances. The uneven spread of natural resources, high public expenditures by the Provincial Governments have resulted in these imbalances.

The high degree of vertical and horizontal imbalances has called for resource transfers from the Federal Government to the Provincial Governments for filling their resource gap. The transfers are mainly of three types, viz., (a) Equalisation Grants (b) Canada Health and Social Transfers and (c) Territorial Formula Financing. In addition, there is a small and new facility called the Health Reform Fund.

Federal and Provincial Governments have concurrent jurisdiction on the same tax bases, and both tiers collect personal and corporate income taxes as well as taxes on goods and services or some form of sales tax. It is only the customs duties and some excises that are used exclusively by the Federal Government.

Until recently, the Federal Government collected the provincial personal income tax (PIT) in all provinces except Quebec. The provinces were free to determine their own rates, but they had to use federal levels of exemptions, deductions, and the rate structure. In 1999, the Federal Government agreed to collect provincial PITs at any rates imposed by them so long as they use the federal tax base as the base for provincial PIT also.


The Federal Government has been assigned with the responsibilities of foreign affairs, defence, international trade, airlines and railways. The responsibilities of the Provincial Governments are mainly relating to education, health, municipal institutions, social welfare, police, natural resources, and highways. Since the majority of the resource-intensive expenditure responsibility rest with the Provinces, in spite of their access to considerable financial resources, there is still a vertical revenue imbalance between the revenue capacity and expenditure responsibilities of the Provinces vis-à-vis the Federal Government.

Hereinafter mentioned as “CHST”
The equalization grants are for equalizing the fiscal capacities. Since 1982, these grants are mandated in the Constitution. These grants are made to fiscally weak Provinces to increase their fiscal capabilities to the average level. If the per capita revenue potential of a Province is less than the average per capita revenue potential of all the Provinces taken together, that Province will get Equalisation grants to raise the Province to the average level. The amount to be transferred under this head is determined by applying the average revenue effort to the difference between standard base and the actual base for that province with respect to the various revenue sources. This exercise is done for all revenue bases used by the provinces.

The CHST is instituted in 1996-97 by replacing two earlier transfer programmes, the Established Programmes Financing and the Canada Assistance Plans. It is the largest federal transfer to the provinces and territories. Although these transfers have acquired the form of a specific purpose grant, they may be treated as correcting the vertical imbalance in as much as every province receives a share in these transfers. The CHST transfers help the functions of the provinces in health care, secondary education, social assistance and social services. These transfers imply a great degree of equalisation since the determining principle for the CHST transfers effectively becomes the per capita amounts.

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95 Hereinafter mentioned as “TFF”
96 Section 36 (2) of the Constitution commits the Federal Government to the “principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.”
97 This produces an estimate of revenue which is higher than the actual revenue for provinces that have ‘below average’ capacity.
The TFF is meant to compensate certain provinces for the higher per capita cost of providing services due to adverse demographic situation and extreme weather conditions. It takes into account the difference between the expenditure needs and own resources of the territorial governments.

The tax agreements between the Federal Government and the Provincial Governments have assured the latter of a revenue 'floor'. Stabilisation Payments are made to the Provinces to ensure this revenue 'floor'. The Federal Government has also agreed to protect the Provinces from any revenue loss due to any change in the personal income tax structure.

Besides the above, the Federal and Provincial Governments have agreed to share the cost of various activities through conditional matching grants.

Provinces in Canada can borrow from the domestic market or even from abroad. However, they do not borrow from the Federal Government. Their ability to borrow from the market depends entirely on the assessment by the market and from the credit ratings that they may receive.

The federal fiscal relations in Canada have evolved through a non-Constitutional process. Most of the fiscal arrangements between the two tiers of governments are evolved through negotiations between them. The important feature of the fiscal federalism under Canadian Constitution is that the discussions, consultations and agreements between the Federal Authorities and the Provincial Authorities play a

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98 In 1977, the Federal Government has surrendered one percentage of point of its revenue from personal income tax to the Provincial Governments under this scheme.
more important role than the Constitutional provisions in making the fiscal set up stronger.

The heart of the Canadian transfer system is equalisation. Apart from equalisation grants, the CHST also serves the objective of equalisation as Provinces are able to spend in per capita terms close to each other. Together, these transfers are able to eliminate to a considerable extent both vertical and horizontal imbalances. While the CHST is based almost entirely on per capita expenditures, equalisation grants utilise an elaborate system of normative determination of capacities. Vertical imbalances are corrected through tax assignment and grants. Since, in Canada almost all tax bases are common to both levels of governments, the vertical imbalance is corrected through a special purpose grant, the CHST. Even after the determination of the actual transfers in any given year, calculations remain open for four years where amounts are adjusted in view of the revision of the relevant data. In the Canadian system there is no constitutional body to fix the devolution of resources from the Federal Government to the Provincial Governments. Most decisions are arrived at through discussions and consultations.99

United States of America

In the American federal system, besides the Federal Government and the State Governments, the local governments also have an important place. Under the American Constitution, defence, international relations, postal service, space research and technology are subjects exclusively under the jurisdiction of the Federal Government. The States have the powers to legislate for health, welfare, safety and

morals of their residents. In all other areas, Federal, State and Local Governments have concurrent powers. The Federal Government bears a larger share of responsibility on air transportation and exploitation of natural resources. In the case of highways and public welfare, the State Governments have a larger responsibility.

The peculiar aspect of the tax structure of USA is that all the three layers of government exercise concurrent powers of taxation. The same tax resource is tapped by all the three governments simultaneously. The main source of revenue of the Federal Government is tax on personal income, which contributes more than seventy percent of its total tax collections. The States mainly rely on tax on personal income and sales taxes. These two sources together contribute more than eighty percent of its tax revenue. The main source of revenue of the local governments is property taxes. Although in the majority of the States the tax bases are not identical to the Federal Government's, in respect of both corporate and individual income taxes, the differences are not significant enough to cause major distortions. In the levy of taxes on goods and services considerable degree of vertical coordination between the federal and state levels has been achieved to make the tax system simple and transparent. The Federal Government does not levy any broad based internal indirect tax and the States have the exclusive right to levy sales tax.

The fiscal federal structure in the United States of America is not free from vertical and horizontal imbalances. In order to meet these imbalances, resources are transferred from the Federal Government to

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the State Governments as well as to the Local Governments. Resources are mainly transferred through three kinds of instruments namely (a) Categorical Grants, (b) Block Grants, and (c) General Revenue Sharing.

Categorical Grants are mainly of two types namely, Formula based grants and Project based grants. Formula based grants are given to achieve an objective for a well-defined target group. Most of the formula based grants are made to State Governments but some grants under this category are made to the Local Governments only. Most common formula grants are in the area of education, ground transportation, training and employment.

Project based grants are made available for particular projects in some specified area of public service. Project based grants require competitive applications from the potential recipients.

Block grants are provided for use in broad functional areas of community development such as partnership for health, law enforcement assistance, comprehensive employment and training, and social services. Block grants are distributed on the basis of specific statutory based formula.

General revenue sharing is granting of fixed sum of money to the States and local bodies for general purposes. These amounts do not vary with federal revenue. Considering the total federal grants to the States, these grants are not significant. The State Governments have to pass two thirds of these grants to the local bodies. Transfer of resources under this scheme has not helped to reduce the horizontal imbalances.

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102 Grants-in-Aid under the American Constitution has a very long history and it has played a very great role in balancing the financial position of the various units of government. For details see P.P. Aggarwal, The System of Grants-In-Aid in India (1959), p.65.
The American federal system has not evolved an overall set of procedures for inter-governmental fiscal relations. The continuous consultations between the governments and the 'Advisory Council on Inter-governmental Relations' have helped to solve certain inter-governmental fiscal problems.

From the above analysis it is clear that vertical fiscal imbalance is a common feature seen in all federations. This is mainly due to the principle of comparative advantage implicit in the assignment of tax powers and expenditure functions among different layers of government. But these federations have developed institutional and functional mechanisms to overcome this impasse and have, to a great extent, succeeded.

In the case of Indian Constitution, it encompasses all the essential requisites of a strong fiscal federal polity. Clear demarcation of legislative powers, which include tax-raising powers, provision for devolution of resources from national government to sub-national governments in support of revenue, independent constitutional body to determine the quantum of resources to be transferred from the Central Government to the State Governments, flexible constitution amenable to amendments etc., are the major positive aspects of the Constitution. The federal fiscal principles enshrined in the constitution are in no way weak from the theoretical point of view. But it is not enough to say that, in law, the Constitution is federal; what is important is whether the Constitution functions as a federal government. For the law of the Constitution is one thing; the practice is another.\textsuperscript{103} The saying is more appropriate in the case of fiscal governance in a federal Constitution.

\textsuperscript{103} Wheare, \textit{Federal Government} (1947), p.19