Chapter V

FINANCIAL RELATIONS: A SHORT REVIEW OF THE WORKING OF THE FINANCE COMMISSIONS

Several factors have led to the current state of financial relations between the Centre and the States in India. There is first the history of British administration in India. Next, the varieties in population, culture, economic development, and natural resources have also added to the problem of delineating a uniform standard for services and living all over the country. Changes in the political scene affected the process of planning after it was introduced in the early years of independence. It is interesting to note that documents of the period concerned have given some account of the centrifugal forces at work. The financial accounts have not always been very uniform, but they serve their purpose in so far as they are also indications of the prevailing political climate.

Perhaps the most remarkable feature of Centre-State relations in the financial sphere has been the heavy dependence of the States on the Centre. The budgetary deficits tell their own story. While in 1951-52 the deficit was only ₹41.93 crores, or 12% of the expenditure of the States, it shot up incredibly to ₹1064.60 crores or 40% of the States' expenditure in 1968-69. The deficits are met by the Centre — another reason for the denudation of autonomy.
This was put right by inter-Governmental transfers like tax devolutions, assignments and statutory grants. Discretionary grants can also be made under Article 282. The Planning Commission has accordingly made huge discretionary grants and loans to the States (or has advised the Centre to so).

THE BRITISH SYSTEM

The British unitary system of Government was evident in the workings of Indian public finance before the Montague-Chelmsford reforms enabled certain provincial Ministers to exercise control over Departments in their areas. The Central secretariat by and large retained most powers. The reforms, however, gave the provinces a share in income-tax collections and excise. The arrangement was to plough back to the Centre the surpluses which would accrue from the new system of devolution.

The 1935 Act, however, made the provincial Governments responsible for the administration of all subjects with exceptions notably in the cases of foreign affairs and defence. But the Governors of the Provinces, in the exercise of their individual judgment or discretionary powers had to act under the control and direction of the Governor-General, and through him, of the Secretary of State. The princely States, which were beyond the purview of the Instrument of Accession (as almost all were), could rule in their own ways whereas the provinces fell within the
jurisdiction of the Governor-General and his council who were in turn directly under the British Crown. It was an arrangement under which the conditions pertaining to India were seriously overlooked. It tilted the scales unambiguously in favour of the Centre.

At this juncture, an expert, Sir Otto Nimeyer, was summoned to make certain recommendations which were later implemented by an order in Council. According to his recommendations, 50% of the income-tax from the divisible pool was to be distributed among the States. This, coupled with revenue contribution to the States, would amount to Rs. 15 crores. From the sixth year, the amount kept from the States would be reduced by one-sixth each year so that by the end of 10 years the States would get exactly one half. This scheme was disturbed again in 1940-41 when, owing to the war, the Centre once again obtained more from the divisible pool.

Sir Otto was flexible in his approach to the question. The scale was fixed partly on the basis of residence and partly on population. The requirements of backward areas also served as one of the criteria for allocation. This resulted in neglect of certain industrial areas like Bengal and Bombay.

Sir Otto recommended that the Centre retain for a period of five years out of the provincial share a share equivalent to
the amount by which the Central share plus the annual contribution made by the Railways to Central revenues would fall short of Rs. 13 Crores a year. On the expiry of five years, the amount retained should be returned gradually to the provinces over a period of five years. Regarding the distribution of the export duty on jute and jute goods, he suggested that the share of the provinces should be raised from 50 to 62½ of the net proceeds of the duty. In addition, he recommended grants-in-aid for a limited period to the United Provinces, Assam, North-West Frontier Province, Sind and Orissa, the amounts varying from Rs. 25 lakhs to Rs. 105 lakhs. Regarding outstanding debts of the provinces to the Centre he recommended that all debts contracted prior to April 1, 1936, by Bengal, Bihar, Assam, Orissa and the N.W.F.P. be wholly cancelled and that the outstanding debt of the Central Province be substantially reduced.

When the popular Ministries in the Provinces resigned with the outbreak of World War II relations with the Central executive were disturbed. With an amendment to the Distribution of Revenue Order (1941) the Centre was permitted to retain Rs. 4.5 crores, accruing from Railway contributions included in the distributable surplus, every year till 1945–46. The provincial shares were raised till they reached one-half in 1950–51. During the War the Central Government levied surcharges on income-tax
whose proceeds did not form a part of the divisible pool. In 1944-45 the surcharge yielded Rs. 33 crores to the Central Government.

Partition caused the scheme of income-tax devolutions to be revised. Sind and the NWFP ceased to be part of India. Punjab, Bengal and Assam were also affected. Bengal lost heavily as the provincial share of jute duty was reduced from 62½% to 20% of the yield. Accordingly, a new Redistribution Order was passed to amend the Niemeyer Award again. Grants-in-aid were fixed for Orissa and Assam.

Deshmukh Award (1950-1952): Mr. Deshmukh gave greater weightage to population. Article 273 of the 1950 Constitution had ensured that in lieu of export duty on jute and jute products, prescribed sums were to be given as grants-in-aid to Assam, Bihar, Orissa and West Bengal for 10 years from the commencement of the Constitution or for the duration of the export duty on jute, whichever was earlier. All these States resented the reduction on shares from 62½% to 20%. The First Finance Commission prescribed Rs. 315 lakhs to be distributed among the four provinces on the basis of jute grown from 1952-53 onwards.

The Niemeyer and Deshmukh awards proved that the method
of settling questions on sharing taxes and other balancing
devices was widely accepted.

Grants: Under the Government of India Act, 1935, a
special procedure had been laid down for grants-in-aid which
could be prescribed by an order-in-council and increased under
a specific procedure. Section 150 permitted grants for purposes
beyond the legislative sphere. From 1944-45 onwards grants were
disbursed on a substantial scale to assist the "grow more food
campaign". A new category of sizable grants relating to
community projects were started.

When British paramountcy lapsed, the States became
technically independent entities. Between 1935 and 1950 a
major change was effected by Sardar Patel who brought them
under Indian control. Some 500 States were reduced to 16. The
First Finance Commission subsequently decided that there had to
be ultimate uniformity in tax powers and functions throughout
India. It decided that, with immediate effect, tax powers and
functions should be allocated to the Indian States on the same
basis as those to the erstwhile Indian provinces.

Later, the First Finance Commission decided that the
problem of the reconstituted States was no longer a special one
and its needs could be looked after by its own formulae for backward States. It also decided that if a State got revenue grants, it should not, in addition, be entitled to a share in taxes.

TAX DISTRIBUTION

In the present Constitution, tax powers are enumerated in List I and List II of the Seventh Schedule. No tax is mentioned in the Concurrent List.

Articles 268 to 281 deal with the distribution of revenue between the Union and the States. In the Seventh Schedule items 82 to 92(a) in the Union List and items 45 to 63 in the State List refer to sources of taxation. The Constitutional provisions for making revenues and financial resources available to the States include the following: Articles 268, 269, 270, 271, 272, 275, 282 and 293 (1-3). Regarding sources of revenue (duties and taxes) the States are to some extent dependent on the Union. The Union has levied taxes on all the items mentioned in Article 268. Under Article 246 there are the enumerated powers of Parliament and State legislatures, along with those in the Concurrent List. List I of the Union List in the 7th Schedule provides the Union's rights of taxation. Items 82 to 92A of the List mentions subjects on which the Union can levy taxes. In List II of the Seventh Schedule, 45 to 63 deal with the powers of taxation of the States. Items 43, 44 and 47 in the Concurrent List deal with certain aspects of
taxation. The Union also has the residuary power to tax any matter not provided for in any of the Lists taking into consideration Item 97 of List I of the 7th Schedule read with Article 248. The financial relations between the Union and the States must be seen in the light of Part XII containing Articles 264 to 307.

It has been pointed out that the taxing powers of the Union and the States have been completely separated and made mutually exclusive. The distribution of subjects between the Union and the States in two Lists demarcates and delimits their respective taxing jurisdiction.

Progressive or heavy all-India taxes, the general Income-tax, Company taxation, Capital taxation (exclusive of agriculture) wealth and expenditure taxes, customs duties (including export duties) excises (excluding those on alcoholic drinks), terminal taxes on goods or passengers by sea, air, rail, taxes on railway fares and freights, taxes on transactions in Stock Exchanges (except stamp duties), taxes on goods in inter-State commerce, etc., belong to the Union.

The States have with them land revenue, agricultural income-tax, estate and succession duties on agricultural property, taxes on land and buildings, restrictive taxes, sales and purchase taxes, electricity and entertainment dues, taxes on advertisement
vehicle taxes, taxes on professions, and trade and calling, among others. While there is no concurrent taxing power, there is provision for the Union levying and collecting certain specified taxes for the benefit of the States, there is also provision for the yield of certain Central taxes being shared with the States. The States retain the proceeds of their levies wholly and receive in addition certain sums both as of Constitutional right and as assignments from the Union. The taxes levied and collected by the Union thus fall into four well-defined categories: (i) taxes, the proceeds of which are wholly retained by it; (ii) taxes, the net proceeds of which are wholly assigned to the States; (iii) taxes, the net proceeds of which are compulsorily shared with the States and (iv) taxes, the proceeds of which may be shared with the States if Parliament so decides.

The wider net of economic relations, however, embraces the orders and conventions which grew up around the role of the Planning Commission and also by the simple fact that through the grants under Article 282 the Centre can control the size and shape of the activities which are constitutionally defined as State subjects.

The important point is that a large chunk of what may be regarded as investment for social development has to be undertaken.
by the State Governments. The Centre has the responsibility for all the major development projects with all-India significance but grass root development work is within the responsibilities of the State Governments. At present the total developmental expenditure of the State Governments is nearly three times their non-developmental expenditure. This expenditure raises the question of financing. Such financing comes (1) from the State's own taxing powers, (2) from shared taxes and grants as recommended by the Finance Commissions, (3) from Plan grants received from the Centre on the lines determined by the Planning Commission and (4) from borrowing.

While the historically most important taxing power of the States — land revenue — has fallen in relative position, the basis of State Finance now is the taxation of sales transactions. All the States together earn around Rs. 200 crores from land revenue, while State excises bring in about Rs. 500 crores and sales tax is nearly Rs. 2,400 crores. The increased expenditures of the State Governments and their inadequate resources have made them dependent on the Centre.

The Finance Commission takes into account the non-Plan expenditure of the States, which includes all non-developmental expenditure and committed developmental expenditure flowing from Plan projects. When tax shares do not meet the non-Plan
deficits (of the States) the Finance Commissions recommend
grants-in-aid under Article 275. This is supposed to balance
the States’ non-Plan budgets, but in reality some States have
large surpluses even without devolution of taxes. The States
with non-Plan surpluses carry these surpluses to their Plan
accounts. State Plan budgets are financed by non-Plan surpluses,
receipts from new taxation, profits from State Government enter-
prises and grants and loans from the Centre.

The Plan grants are given under Article 282 and they
depend on the population factor. The total amounts of these
grants are about Rs. 750 crores annually. These grants determine
the lines along which the Plan funds are to be spent. Further-
more, even after the relief obtained under the Sixth Finance
Commission, the debt burden in terms of annual servicing remains
heavy. Article 293 empowers the States to borrow from the market,
but is subject to the consent of the Centre if any State has an
outstanding debt. This in effect means the Centre decides when
and how much the State can borrow.

The unequal financial position of the States and their
dependence on Central funds are not conducive to the growth of
a truly federal Government.

One important Central tax is compulsorily shared, viz.
the income tax, excluding the agricultural income tax which
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belongs exclusively to the States. Article 268 specifies duties to be levied by the Union but collected and appropriated by the States. These are stamp duties and excise duties on medical and toilet preparations. A number of other duties like succession and estate duties on non-agricultural property, terminal taxes on goods and passengers, taxes on railway fares and freights, taxes on newspapers and advertisements therein, taxes on goods in inter-State trade, etc, are to be levied and collected by the Union but the proceeds are to be entirely assigned to the States under Art.269.

THE FINANCE COMMISSIONS

The Finance Commissions are unique. They do not have any exact precedent. (It has no parallel in other Federations). The closest approximation can be found in the Commonwealth Grants Commission of Australia. The Indian Finance Commission is appointed by the President at the expiration of every fifth year or at such earlier time as he considers necessary. Article 280 of the Constitution lays down the provisions regulating the composition and functions of the Finance Commission. Such a Commission can not of itself change tax-sharing between the Union and the States, but can make recommendations thereon to the President. Its recommendations on such distribution as well as for specific grants, have been accepted by the Central Government. Union-State relations in general terms or even the financial provisions of Part XII of the
Constitution cannot be reviewed by the Commission. The Constitution has kept the scope of tax revenues of the States purposely outside its review.

Two major gaps have been revealed in the working of the Commissions. It gives grants only in aid of revenue. Grants-in-aid of capital expenditure or loans are held to be outside its purview.

It is however essential that the Constitution provide scope for flexible balancing devices and that a substantial part of these should be within the purview of the Commission which could base its recommendations on an overall view.

In recent years the capital expenditures of the States has been increasing very rapidly — even more rapidly than revenue expenditure. A substantial portion of these expenditures is met from Central assistance. But the Finance Commissions cannot recommend on such expenditures.

A SHORT REVIEW OF THE RECOMMENDATIONS OF THE FINANCE COMMISSIONS


The First Finance Commission was appointed in November, 1951, by the President under Article 280(1) of the new Constitution with Mr. K. C. Neogy as the chairman and 4 other members. The
Commission submitted its report in December, 1952.

Before 1-11-1956, Article 280(1) ran as follows: The President shall, within two years from the commencement of the Constitution and thereafter at the expiration of every fifth year or at such time as the President considers necessary, by order constitute a Finance Commission which shall consist of a Chairman and 4 other members to be appointed by the President.

The principal recommendations of the Commission were as follows:

(1) DISTRIBUTION OF INCOME TAX REVENUE:

The Finance Commission decided that the percentage of the proceeds of income tax to be allocated to the States should be raised from 50% to 55% of the divisible pool. With regard to the percentage shares of the various States the Commission took population and collection as the main determining factors. The Commission recommended that 20% should be distributed among the States on the basis of relative collections of States and 80% on the basis of relative population according to the Census of 1951. The percentage shares recommended by the Commission for the important States were as follows:

- Bombay 17.5;
- Uttar Pradesh 15.75;
- Madras 15.25;
- West Bengal 11.25;
- Bihar 9.75;
- Madhya Pradesh 2.25;
- Rajasthan & Orissa 3.5 each;
- Punjab 3.25;
- Assam 2.25;
(2) UNION EXCISE:

In 1951 when the Finance Commission was appointed, Central Excises were yielding a revenue of Rs. 86 crores. Therefore it was natural for the State Governments to place their claims before the Commission for a share. The Commission recommended that 40% of the net proceeds of Union Excise duties on tobacco, matches and vegetable products be allocated to the States and that this percentage be distributed among them on the basis of population.

The Commission recommended that 90% of the States' share of Union excise duties should be distributed on the basis of population, the balance being used for adjustments.

(3) ESTATE DUTY:

The Commission suggested 1% as the share attributable to Union territories, the balance was to be apportioned between immovable property and other property in the ratio of the gross value of all such properties brought into assessment in the year. The sum apportioned to immovable property should be distributed among the States in proportion to the gross value of the immovable property located in each State. The balance of the duty collected was, however, to be distributed according to a percentage formula worked out on the basis of respective population of the States.

(4) TAX ON RAILWAY FARES:

These were to be levied as nearly as possible on the basis of the net proceeds of actual passenger travel within its limits.
which meant that the ultimate emphasis would be on the route-mileage in every State.

(5) GRANTS-IN-AID: Grants made to West Bengal were to be raised from Rs. 105 lakhs (under the Deshmukh Award) to Rs. 150 lakhs; to Assam from Rs. 40 lakhs to Rs. 75 lakhs; to Bihar from Rs. 35 lakhs to Rs. 75 lakhs and to Orissa from Rs. 5 lakhs to Rs. 15 lakhs.

SECOND FINANCE COMMISSION

The Second Finance Commission, with Mr. K. Santhanam as Chairman, submitted its report in September, 1957. All the recommendations were accepted by the Government.

(1) INCOME TAX:

The Commission felt that an increase from 55% to 60% was justified in view of the unanimous desire of the States. This did not include taxes on agricultural income. The Commission also decided to alter the structure of the percentage formula for distributing the divisible pool of the income tax receipts among the States.

The Commission held the view that the actual distribution of the share assigned to the States should be on the basis of population, thus altogether eliminating the factor of collection. It decided that 10% should be on the basis of collection and 90% on the basis of population.
(2) INCOME TAX DIVISIBLE POOL:

The break-up for the income tax divisible pool was as follows:

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uttar Pradesh</td>
<td>16.36%</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>8.12%</td>
</tr>
<tr>
<td>Bombay</td>
<td>15.97%</td>
</tr>
<tr>
<td>Assam</td>
<td>2.44%</td>
</tr>
<tr>
<td>West Bengal</td>
<td>10.08%</td>
</tr>
<tr>
<td>Bihar</td>
<td>9.94%</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>1.13%</td>
</tr>
<tr>
<td>Orissa</td>
<td>3.73%</td>
</tr>
<tr>
<td>Kerala</td>
<td>3.84%</td>
</tr>
<tr>
<td>Punjab</td>
<td>4.24%</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>5.14%</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>4.09%</td>
</tr>
<tr>
<td>Madras</td>
<td>8.40%</td>
</tr>
<tr>
<td>Mysore</td>
<td>5.14%</td>
</tr>
</tbody>
</table>

With population as the main basis and collection used as a shock-absorbing factor, the States of Bombay and West Bengal with larger collection but relatively small population, suffered considerably. Madras was also affected but to a limited extent. Among the principal beneficiaries were the more populous States of U.P., Bihar and Madhya Pradesh.

Union excises: The Commission gave the States, in addition to what had been awarded by the First Finance Commission, a share in the Union excise duties on sugar, tea, coffee, paper and vegetable non-essential oils, recommending that 25% of the net proceeds of all these excise duties be distributed among the States — 90% on the basis of population and 10% being kept for adjustments.
(3) Grants-in-aid in lieu of jute export duty: The Commission decided that grants-in-aid in lieu of jute export duty should be related to the proportion which the revenue from this source bore to the total revenue of the State. The Commission categorically stated that grants-in-aid should be of fixed sums.

The break-up was as follows: The allocation for West Bengal to be raised from Rs. 105 lakhs (as under the Deshmukh Award) to Rs. 150 lakhs, to Assam from Rs. 40 lakhs to Rs. 75 lakhs, to Bihar from Rs. 35 lakhs to Rs. 75 lakhs, and to Orissa Rs. 3 lakhs to Rs. 18 lakhs.

THIRD FINANCE COMMISSION

The 3rd Finance Commission, headed by Mr. A.K. Chanda, submitted its report to the Government in December, 1961. The Commission was constituted by the President in December, 1960.

The report was not unanimous. There was dissent from the member-secretary, Mr. C. R. Kamath, on (a) the payment of special purpose grant for improvement of communications and (b) inclusion of 75% of the revenue component of the State Plans in the recommendations for assistance to the States.

The Government turned down the recommendations for including a part of the Plan assistance to the States in the Commission's scheme of devolution.
The States got $66\frac{2}{3}$ of the income tax pool and 20% of the excise duties. Previously 90% of the income tax pool was distributed according to population and only 10% on the basis of collection. Now 80% was divided on the basis of population and 20% on that of collection. Earlier, the States were entitled to 25% of the net proceeds of Union duties of excise on 8 articles — matches, tobacco, sugar, vegetable products, coffee tea and vegetable non-essential oils.

The Commission, while reducing the percentage to 20%, increased the number of shareable excise items from 8 to 35 by including all articles (other than motor spirit) on which such duties were collected in 1960-61 and including those (but not including silk fabrics) on which they yield was below Rs. 50 lakhs a year. In determining the share of each State, while continuing to regard population as the major factor of distribution, the Commission also took into account the relative financial strength of each State, the disparity in the levels of development reached, the percentage of the Scheduled Castes and Tribes and the Backward Classes, etc.

The entire net proceeds of the additional Excise duties on mill-made textiles, sugar and tobacco, which were levied in replacement of the States sales tax, accrued to the States other than those attributable to the Union Territories.
Therefore, the Commission recommended that 40% of the net proceeds of the duty levied on these items be allocated to the States. For determining the distribution of Central excise to the States, the commission took population as the deciding factor and rejected consumption as the criterion because reliable data about it was unavailable.

State-wise break-up was as follows:

- Uttar Pradesh - 18.28%
- Bombay - 10.37%
- Madras - 16.44%
- West Bengal - 7.16%

Grants-in-aid: The Commission recommended an annual payment of grants-in-aid of ₹ 110.35 crores. Of this amount ₹ 62 crores was expected to fill the revenue gap in the budgets of the State Governments and ₹ 58.35 crores towards 75% of the revenue components of the State Plans.

The Government's acceptance of the Commission's unanimous recommendations for the revenue gap grant of ₹ 62 crores benefited 10 States. Five States — Bihar, Maharashtra, Punjab, U.P. and West Bengal were not entitled to get any share of this grant.

While a few of the recommendations (such as that on income tax) were likely to give the relatively advanced States like West Bengal added benefit, most of the recommendations, especially those on
grants, were weighted in favour of the so-called "backward States" like Orissa and Rajasthan.

The distribution of the annual grant of Rs. 12.6 crores payable to the States in lieu of their share of tax on railway passenger fares was recommended on the principle of compensation to place the States broadly on the same footing as they were before the tax was abolished.

The Commission's recommendations covered four years, beginning from April 1, 1962. Payment of the grant-in-lieu of the tax on railway fares was effective, however, for five years from April 1, 1961 — the date on which the tax was abolished.

FOURTH FINANCE COMMISSION

The Fourth Finance Commission, which was constituted in May, 1964, under the chairmanship of Dr. P.V. Rajamannar (retired Chief Justice of Madras High Court) submitted its report in August, 1965. The report, together with Government's decision, was presented to Parliament in September, 1965, by the Finance Minister.

The Commission raised the State's share of income tax from 66\% to 75\% and the annual grants-in-aid to States from Rs. 110.25 crores to Rs. 121.89 crores.
The Government avoided to accept most of the recommendations of the commission which were urged by the majority of the commission's members.

STATES' SHARE OF TAX AND GRANT IN LIEU OF RAILWAY PASSENGER-FARE TAX:

(a) INCOME TAX: The Commission stepped up the State's share in the divisible pool of revenue from income tax from 66\2/3% to 75%. The share of each State was determined on the basis of 80% for population and 20% for collection.

This was the formula suggested by both the First and Third Commissions, while the Second had put greater weightage on population by raising distribution on this score from 80% to 90%.

(b) EXCISE DUTIES: The States continued to get 20% of the actual collection. They were, however, to get a share of the excise duties on all commodities instead of only 35 commodities as recommended by the Third Commission. The Government accepted the recommendations.

The entire proceeds of additional excise duties, these available to Union territories, on textile, tobacco and sugar, which were levied in lieu of States' sales tax would accrue to the States of the total proceeds the commission retained the share of Union Territories at 1%. The shares of Jammu and Kashmir and
Nagaland were fixed at 1% and .05% respectively.

(c) ESTATE DUTY: The States were to get the net proceeds of the Estate Duty on property other than agricultural land except those attributable to Union Territories. The Commission increased the share attributable to Union Territories from 1% to 2%.

(d) RAILWAY FARE GRANT: Besides a larger share of income tax, excise duties and the whole of the net proceeds of estate duty the States were entitled to get grants in lieu of the loss suffered by them following the abolition of tax on railway passenger fares.

GRANTS-IN-AID: The Commission recommended more liberal grants to the States than the Third Finance Commission. It raised the amount from ₹ 110.25 crores to ₹ 121.89 crores.

GENERAL RECOMMENDATIONS: The Commission suggested the creation of an institutional device of consultations between the Union and the States on common financial interests, the establishment of a permanent organization in the Ministry of Finance for making a continuous study to bring up to date information on various matters required by the Finance Commissions and the constitution of a competent body to study in detail the entire problem of indebtedness of States and allied aspects.
The commission was constituted in February, 1968 under the chairmanship of Sri Mahavir Tyagi and submitted its final report on July 1969. In evolving a scheme of devolution to cover the budgetary deficits of States as assessed by it, the commission agreed with the view of earlier commissions that as far as possible these should be covered by devolution of taxes rather than by grants. The commission accordingly enlarged the divisible pool of income tax by adding advance tax collections and of excise duties by including (from 1972-73) special excise duties.

The States' share in the divisible pool, however, were retained at 75% in the case of income tax and 20% in the case of excise duties.

Devolution of taxes and duties: (a) Income Tax: For the period of 1969-70 to 1973-74 the States' share in the divisible pool of revenue from income tax was retained at 75%. The Commission provided for payment of the very large arrears of advance tax collecting (amounting to over Rs. 400 crores) in phased instalments during the Fourth Plan period. As a result the total share of the States in income tax revenue went up from Rs. 194 crores in 1968-69 to Rs. 293 crores in 1969-70 and expected to rise further to Rs. 350 crores during 1970-71.

(b) Excise Duties: As far as excise duties were concerned there was no change in the share of the States and it continued at 20%.
of the actual collection. The commission however somewhat enlarged the share of the divisible pool by recommending inclusion of the proceeds of special excise duties. In regard to the distribution of additional excise duties the commission gave equal weightage to population and sales tax collections.

The commission raised the share attributable to Union Territories and Nagaland from 1% and .05% to 2.05% and .09% respectively, but reduced the share payable to Jammu and Kashmir from 1.5% to .83%.

(c) Estate Duty: The share of Union Territories in the net proceeds of Estate Duty was raised from 2% to 3%. The principle governing the distribution of the balance of the duty among the States, however, remained the same as recommended by the Fourth Finance Commission.

(d) 'Railway fare grant': In regard to allocation among States of the grant in lieu of tax on railway passenger fares also the principles remained the same as recommended by the Fourth Finance Commission.

(e) Grants-in-aid: The commission reduced the quantum of statutory grants to about Rs. 638 crores for the period 1969-70 to 1973-74 from Rs. 703 crores (for the period 1966-67 to 1970-71) recommended by the Fourth Commission. The number of States eligible for grants was also less (10 against 11 under the Fourth
Finance Commission). The commission recommended grants on a sliding scale, the quantum diminishing from about ₹ 153 crores in 1969-70 to ₹ 102 crores in 1973-74.

The commission recommended grants of varying amounts to the following 10 States: Andhra Pradesh, Assam, Jammu and Kashmir, Kerala, Mysore, Nagaland, Orissa, Rajasthan, Tamil Nadu and West Bengal. The assumption behind the recommendation of grants was that these States would make suitable measures to improve their finances. They were also of the view that almost no incentive was provided to those States which managed their affairs well. For instance West Bengal agreed to raise additional resources of ₹ 80 crores and Tamil Nadu ₹ 85 crores. While West Bengal was given ₹ 72.62 crores as grants Tamil Nadu obtained ₹ 22.82 crores. It appears that grants were given mainly on the basis of pressing financial needs arising out of special problems.

THE SIXTH FINANCE COMMISSION

The Sixth Finance Commission was constituted in June, 1972 under the chairmanship of Sri Brahmananda Reddy. It submitted its final report on December, 1973. The Commission was appointed a year ahead of schedule to enable its award to be implemented during the same period as the Fifth Five Year Plan.
The Commission raised the States' share of the net proceeds of income tax from 75% to 80%; it did not recommend any change in the States' share of excise duties.

But, there was to be a total transfer of Rs. 9608.85 crores to the States during the Fifth Plan period. Grants totalling Rs. 2,609.61 crores would be made to 14 States to cover the estimated non-Plan deficit in the five years even after allowing for devolution of taxes. The tax devolution to the States during the Fifth Plan period would amount to Rs. 7,099.24 crores. The Government accepted the recommendations of the Commission on devolution of tax receipts, debt relief and grants-in-aid to the States covering the period from April 1, 1974 to March 31, 1979.

Devolution of taxes and duties: The SFC had recommended a transfer of Rs. 5,315.90 crores to the States during 1969-74. The share of the States from income tax proceeds was raised from 75% to 80%. The States' share of taxes was expected to increase from Rs. 4,605 crores to Rs. 7099.24 crores and grants from Rs. 710.99 crores to Rs. 2,609.61 crores.

The States' share of excise duties would continue to be 20% of the total net proceeds. The auxiliary excise duties introduced from 1973-74 would also be shared with the States as in the case of basic Union excise duties from 1976-77.
Backwardness: The Commission considered 'backwardness' as a condition for larger grants. Relative per capita income (25%) and population (75%) were the two criteria adopted by the Commission for determining the share of each State in the divisible pool for backwardness. The weightage given to backwardness was 20%.

The net proceeds of additional excise duties other than those attributable to Union Territories accrued to the States. The entire net proceeds after deducting the portion attributable to the Union territories should be distributed among the States on the basis of population, State domestic product at State current prices and production of the commodities subject to additional excise duties in the ratio of 70:20:10. There was no change in the existing principles of distribution of estate duty and grant in lieu of the repealed tax on railway passenger fare. In regard to grant on account of wealth tax on agricultural property the commission's recommendation was that the amount should be distributed among the States in proportion to the value of agricultural property located in each State and brought to assessment in that year.

Drought Relief: It urged that provisions should be made on a much larger scale for the development of drought and flood-prone areas in the Fifth Plan both in the Central and State sectors. The assistance provided to the States for purpose of relief should be subject to the overall ceiling on Central assistance for the
Plan period as a whole.

Debt Relief to the States: The Commission recommended debt relief amounting to ₹1,969.62 crores to the States. With this relief, the bulk of the non-Plan capital gaps of most States over the Fifth Plan period would be covered. The commission recommended changes in the terms of repayment of Central loans.

Grants-in-aid: The Commission's recommendations, accepted by the Government, involved an addition to the States resources of ₹2,077 crores. Of this ₹1,850 crores were accounted for by the statutory grants-in-aid and ₹227 crores by tax devolution. The grant-in-aid received by Orissa, Assam and West Bengal under Article 275 were ₹305 crores, ₹255 crores and ₹235 crores, respectively. Seven States including Gujarat, Madhya Pradesh, Maharashtra, Punjab and Tamil Nadu did not get any grants-in-aid under this Article (275).
References

3. Ibid, p. 9
8. Dutta Bhabatosh, Parlance, December 1977, Article on 'Economic Relations'.