

ARTICLE ON

CENTRE-STATE FISCAL RELATIONS IN THE LIGHT OF SARKARIA COMMISSION RECOMMENDATIONS: A STUDY

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INDEX OF ABBREVIATION

AIR – All India Report

A.P – Andhra Pradesh

Art – Article

Bom- Bombay

F.C – Finance Commission

Guj – Gujarat

Ker – Kerala

Ltd – Limited

SCC – Supreme Court Cases

U.P – Uttar Pradesh

Vol – Volume

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1. Introduction To Centre State Fiscal Relation

In the present constitution of India there is ample scope to show that Indian government follows a federal system but with all necessary provisions it is unitary in nature.¹ Tax sharing is a concept emerged out of the financial relation mentioned above which evolved for a better functioning of the government function. No system of federation can be successful unless both the Union and State have at their disposal adequate financial resources to enable them to discharge their respective responsibility under the constitution.²

2. Historical Background of Constitutional Provisions

When British Crown took over the control over Indian government from East India company it lead to a highly centralized system in 1858. The Governor-General-in-Council retained complete control over Provincial resources as well as expenditure. The Provincial Governments remained entirely dependent on annual allotments by the Central Government for the maintenance of their administration. It was soon realized that decentralization was necessary for governing country of sub-continental dimensions like India and the first step in this direction was taken in 1870. Necessity of separating the resources of the Central and Provincial Governments to support Provincial enfranchisement led to tax sharing system and subsequently to distribution of revenue³

3. Constitutional Provision

Chapter XII deals with financial relation between union and states with provisions in the constitution from article 268 to article 293.⁴ Financial arrangements under the Constitution have two main aspects. One relates to distribution of taxation heads, and the other to distribution of revenues and sharing of resources between the Union and the States. Articles 246⁵, 248⁶ and 265⁷, read with the Legislative Lists I and II, constitute the core of the first aspect, while the main provisions relating to the second aspect are contained in Chapters I and II of Part XII of the

¹ Sinha, R.K Fiscal Federalism in India.

² Servaii., Constitution of India

³ The Montagu-Chelmsford Report, Government of India Act, 1919

⁴ M.P jain Constitution of India

⁵ Subject matter of law made by the parliament and by legislature of states

⁶ Residuary power of legislation.

⁷ Taxation by authority of law

Constitution.⁸ Indian Constitution makes a clear distinction between the legislative power to levy a tax and power to appropriate the proceeds of a tax so levied.⁹

3.1 Distribution of Revenue

- Certain stamp duties and duties of excise on medical and toilet preparations mentioned in the Union List are to be levied by the Union but collected by the States and the proceeds shall not form part of the Consolidated Fund of India but assigned to the States which is collected.¹⁰
- Tax shall be levied and collected by the Union but assigned to the States, within which they are levied.¹¹
- Taxes levied and collected by the Union but shared with the States, viz., on non-agricultural income.¹² A nexus between land, agricultural operation and income has to be established.¹³ The receipt of sale of agricultural land is not agricultural income and the assessee is bound to pay capital gain tax on such sales for the relevant assessment year.¹⁴ Income derived without human labor does not fall under it.¹⁵
- Taxes which are levied and collected by the Union but may be shared with the States, if Parliament by law so provides, viz., Union Excise Duties.¹⁶
- Taxes on professional, trade, calling and employment.¹⁷¹⁸ Main purpose of this article is not to amend that power but to merely provide that such a tax is not invalid on the ground that it relates to income tax.¹⁹ Where however, the exercise of power by the state is referable to any other entry, the limitation in Article 276(2) has no relevance,²⁰ thus article 276 does not apply to taxes which is referable to entry 49 and 60 and amongst other items to Entry

⁸ Arvind P. Datar constitution of India.

⁹ M.P Jain Constitution of India.

¹⁰ Article 268 of Constitution of India

¹¹ Article 269(1) of Constitution of India

¹² Article 270 of Constitution of India

¹³ Cit v. K.S. Imam Saheb, 1969 71 ITR 742, 744

¹⁴ Singhai Rakesh Kumar v. Union of India (2001) 1 SCC 364

¹⁵ CIT v. Benoy Kumar, AIR 1957 SC 768

¹⁶ Article 272 of Constitution of India

¹⁷ Article 276 of Constitution of India.

¹⁸ Found on entry 60 of state list

¹⁹ Arvind P. Datar commentary of Constitution of India.

²⁰ R.R. Engineering Co. v. Zila Parishad, AIR 1980 SC 1088

58,²¹ taxes on cinematograph shows,²² on entry of goods.²³ A tax on profession is imposed if anyone carried on a profession²⁴ while income tax is imposed when there is income from that profession irrespective of any income generated²⁵, so a professional tax falls outside the scope of income tax²⁶ and this not invalid on the grounds that it is on income tax²⁷. The court went into the essential character of tax sought to be masqueraded as professional tax²⁸ and where it is found that tax partook more of the character on an income tax, it held to be income tax.²⁹ When tax levied exceeds the maxim limit by article 276(2) the court will reduce it to a permissible amount.³⁰ If a local authority imposes taxes in excess, it will exceed its jurisdiction³¹ and a serious question for consideration may arise whether it is anything other than income tax³². It should also be noted that ban extends only to excess of tax and not to earlier stages.³³ Language used in Article 276 indicates that the constitution used the word “any one person” in juxtaposition with any one municipal authority or its instrumentalities.³⁴ The same person may be engaged in more than one of the items suggested in Article 276; such imposition of tax on more than one can be tax³⁵

- Pre-constitutional taxes levied by states to be continued in the same way³⁶ even if subject of union list until any further provision.³⁷ Provided it satisfies the following condition³⁸ :
 - i. If necessary resolution were not passed by municipal committee and impose a tax it cannot be said “was being levied lawfully” before commencement on constitution.³⁹
 - ii. The identity on the body and the rate of tax remains intact. .⁴⁰

²¹ R.R engineering co. V. Zila Parishad, AIR 1980 SC 1088

²² Western India Theaters ltd. V. cantonment board, poona, AIR 1959 SC 582

²³ Bangalore woolen, Cotton and Silk Mills co.ltd v. Corporation of City of Bangalore, AIR 1962 SC 562,565

²⁴ Arvid P. Datar commentary of Constitution of India. Art 276 “tax on profession”

²⁵ Western U.P Electric Power & supplycompany ltd. V. Toen Area, Jaswan Nagar, AIR 1957 All. 433, 436(DB).

²⁶ Kamta Prasad Agarwall v. ex. Officer, Ballabgarh, AIR SC 685,686

²⁷ Cantonment Board v. Krishna Bricks and Lime Factory(1996) 6 SCC 72,79

²⁸ Arvid P. Datar commentary of Constitution of India. Art 276 “tax on profession”

²⁹ RajagopalachariC. V. The corporation of Madras AIR 1964 SC 1172

³⁰ Abraham v State of Travancore, A 58 kar. 129 AIR 1958 (134).

³¹ Bharat Kala Bhandar(P) ltd v. Municipal Committee, Dhamangaon, AIR 1966 SC 249, 262

³² Disrtict Board of Farukkabad v. Parad Dutt, AIR 1948 All 382, 386 (FB).

³³ Bharat Kala Bhandar(P) ltd v. Municipal Committee, Dhamangaon, AIR 1966 SC 249, 257

³⁴ Kamta Prasad Agarwall v. Executive officer, ballabgarh, AIR 1974 SC 685, 686, 687

³⁵ Kamta Prasad Agarwall v. Executive officer, ballabgarh, AIR 1974 SC 685, 687

³⁶ Union of India v. maharaja Kishangarh Mills Ltd. AIR 1961 SC 683, 688

³⁷ Article 277 of Constitution Of India.

³⁸ Arvind P. Datar Commentary on Constitution Of India art 277.

³⁹ Arvind P. Datar Commentary on Constitution Of India art 277.

⁴⁰ Ram Krishna Ram Nath v. Janpad Sabha, AIR 1962 SC 1073

It can no further levy tax⁴¹ if parliament has made a law to the contrary.⁴²

- The Union Government is required to give grants-in-aid to the States for the welfare of the Scheduled Tribes and for raising the level of administration in the Scheduled Areas and separately for Assam.⁴³
- Parliament has exclusive power to make laws in respect of the public debt of India and in respect of foreign loans.⁴⁴ The executive power of union however extends to borrowing upon the security of Consolidated Fund of India⁴⁵ and those of States extend to limits of Consolidated of States.⁴⁶
- Article 286 - Difficulties have arrived when sale has taken place in different states, and by applying *territorial nexus*⁴⁷ states tax may levy tax on sale⁴⁸. As long as law made by state legislature is applicable to the person residing within its territory, it cannot be considered as extra territorial.⁴⁹ The theory of territorial nexus could be equally applicable to sales tax legislation.⁵⁰

The legislative power of the Parliament to levy taxes and duties is contained in article 245 and 246

(1).⁵¹ Art 286 sought to avoid double taxation and was subject judicial interpretation in State of Bombay v. United Motors Ltd⁵². States are prohibited from taxing interstate sales.⁵³ This resulted in dealer in one state being subject to sales tax jurisdiction and procedure of other state with which they had dealing in the normal course of their business,⁵⁴ and for this reason union took to itself the exclusive legislative and executive power in respect to taxes on inter-state trade.⁵⁵

⁴¹ Adyaksha Mathur Babu's Sakti Oushadhal Dacca (P) ltd. V. Union of India AIR 1963 SC 622, 626.

⁴² Orissa cement limited v. State of Orissa, AIR 1991 SC 1676

⁴³ Article 275 of Constitution of India.

⁴⁴ Entry 35 & 37 of List I

⁴⁵ Art 292 of Indian Constitution

⁴⁶ Art 293 of Indian Constitution

⁴⁷ State law's may be applied to other State when there is direct relation between such laws and States

⁴⁸ M.P Jain, Indian Constitutional Law, Part IV, Ch. XI, Sec J(a). pg.686

⁴⁹ State of Bambaay v. R.M.D. Chamarbaugwala, AIR 1957 SC 699

⁵⁰ Tata Iron and Steel Co. Ltd. V. State of Bihar, AIR SC 1958 SC 152

⁵¹ CIT v. K. Srinivasam AIR 1972 SC 491,494

⁵² AIR 1953 SC 252

⁵³ Article 286 of Constitution of India

⁵⁴ Arvind P. Datar commentary on Constitution of India art. 268

⁵⁵ Entry 92A of Union List

Service Tax:

Tax on service has become a development in recent times as it is a major source for both union and states. Let's put some light on how and on whom tax is levied:

- (i) To a client, by an advertising agency in relation to advertisements in any manner".⁵⁶ Corresponding Entry in List-II of the Constitution– “Taxes on advertisements published in the newspapers [and advertisements broadcast by radio or television]”,⁵⁷
- (ii) To a customer, by a courier agency in relation to door-to-door transportation of time-sensitive documents, goods or articles”,⁵⁸. Corresponding Entry in List-II of the Constitution – Entry 56 – “Taxes on goods and passengers carried by road or on inland waterways”.
- (iii) “To a client, by a mandap keeper in relation to the use of a mandap in any manner including the facilities provided to the client in relation to such use and also services, if any, rendered as a caterer”,⁵⁹. Corresponding Entry in List-II of the Constitution – Entry 49 – “Taxes on lands and buildings”
- (iv) “to any person, by a rent-a-cab scheme operator in relation to the renting of a cab”,⁶⁰. Corresponding Entry in List-II of the Constitution – Entry 57 – “Taxes on vehicles, whether mechanically propelled or not; suitable for use of roads, including tram-cars.”⁶¹
- (v) “To any person, by a mechanized slaughter house in relation to the slaughtering of bovine animals.”⁶²

3.2 Distribution of Taxation power

No taxation can be levied unless it is related to the heads of the taxation in List I and II.⁶³ The residuary power of taxation vests in the Union.⁶⁴ Allocation of the heads of taxation between the Union and the States is based on the broad principle that taxes which are location-specific have

⁵⁶ Section 65(48)(e) of Finance Act, 1994 (Act 32 of 1994)

⁵⁷ Entry 55 of list II

⁵⁸ Section 65(48)(f) – Finance Act, 1994 (Act 32 of 1994)

⁵⁹ Section 65(48)(m) – Finance Act, 1994 (Act 32 of 1994)

⁶⁰ Section 65(48)(o) – Finance Act, 1994 (Act 32 of 1994)

⁶¹ Entry 35 of List III

⁶² Section 65(48)(za) – Finance Act, 1994 (Act 32 of 1994)

⁶³ Article 246 and 265 of Constitution of India.

⁶⁴ Entry 97 of union List

been assigned to the States. Those taxes in relation to inter-State trade and commerce in which the tax-payer can gain or evade tax by shifting his habitat, or where the place of residence is not a correct guide to the true incidence of tax, have been vested in the Union.

3.2.1 Union List

82. Taxes on income other than agricultural income

Parliament is empowered to make laws with respect to taxes on income for the whole of India.⁶⁵ No restriction can be imposed in respect of retrospective legislation.⁶⁶ If any state tax related to income derived by a person from trade or profession, it may be a tax on income falling with the exclusive jurisdiction of the Parliament.⁶⁷ Taxation under Entry 60 of List II is excluded from taxes under this entry.⁶⁸ Amending a taxing statute by incorporating an amending provision in an Act in neither violation of Article 246(1) nor of entry 82 of Union list.⁶⁹ “Income” includes not only actually accrued but also which is supposed to be notionally accrued.⁷⁰ The meaning of “agricultural income, as given in constitution⁷¹ has to be adopted regardless of any other consideration.⁷²

83 A duty of custom is a tax on export and import. It cannot be a tax on property.⁷³

84 Duties of excise on tobacco and other goods manufactured or produced in India except—

(a) Alcoholic liquors for human consumption;

(b) Opium, Indian hemp and other narcotic drugs and narcotics; but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

Where there is no nexus between the levy of tax and manufacture, it cannot be termed as duty of excise.⁷⁴ It can be imposed at and stage as long as the character of impost is not lost.⁷⁵ But it will not cease be a duty of excise even if the levy is borne by producer or

⁶⁵ Article 245 and 246 of Constitution of India.

⁶⁶ Union of India v. Madan Gopal Kabra AIR 1954 SC 158,162

⁶⁷ Western U.P Electric Power & supply Company , AIR 1957 SC 433, 436

⁶⁸ Arvind P. Datar Constitution of India.

⁶⁹ Madurai district Central Co-operative Bank v. Third ITO, AIR 1975 SC 2016,2020

⁷⁰ CIT v. Bhogilal Laherchand, AIR 1954 SC 155, 157

⁷¹ Article 366(1) of Constitution of India.

⁷² CIT v. Benoy Kumar Sahas Roy , AIR 1957 SC 768, 773

⁷³ In Re Sea Customs Act, AIR 1963 SC 1760,1775

⁷⁴ Abdul Kadir v. State of Karela, AIR 1976 SC 182,189

⁷⁵ Jall R.C v. Union of India, AIR 1962 SC 1281

manufacturer.⁷⁶ It is no be understood that such levy is not goods and not sales of goods and it can even be levied retrospectively.⁷⁷

85. Corporation taxes. The mere fact that incidence of sales tax falls on corporation does not make the tax, a corporation tax.⁷⁸

86 Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies. Tax under this entry is a personal tax and is assessed on the individual and the capital value of the assets is arrived after deducting the liabilities.⁷⁹ The determining factor whether it is agricultural land or not is not to see the capacity of land but the number of years of non-cultivation.⁸⁰

Entry 87⁸¹ and 88⁸² should to be read together. Tax on gifts will not be covered under this entry.⁸³ "Succession" is taking a property from the deceased; estate duty falls upon the property whoever may be the successor to the property on the death of a previous owner.⁸⁴ The levy on both Estate Duty and Succession Duty is on the same object. But while in the case of the former, monetary worth of the entire estate would be the base, the succession duty is in connection to the value of individual shares transferring on to the successors.⁸⁵

89. The word terminal is the jurisdictional limit of municipal area and not the origin or destination.⁸⁶ Prior to Indian Constitution levy of terminal tax and octroi was permitted within one item.⁸⁷ By subsequent amendment these two items⁸⁸ were dealt separately⁸⁹ with a clear distinction.⁹⁰ Both these tax are distinct and can be imposed simultaneously.⁹¹ It does not apply to

⁷⁶ British India Corporation Ltd. V CCE, AIR 1963 SC 104

⁷⁷ Chotabhai Jethabai Patel v. Union of India AIR 1962 SC 1006

⁷⁸ Central potteries Ltd v. State of Madhya Pradesh, AIR 191960 Bom. 470

⁷⁹ Union of India v. H.S Dhillon, AIR 1972 SC 1061

⁸⁰ Rasiklal Chimanlal Nargi v. Commissioner v. Commissioner of wealth tax , Gujarat, AIR 191965 Gujarat 259,262.

⁸¹ Duties on property other than agricultural land.

⁸² Duties on succession of property on than agricultural land.

⁸³ Sesharatnam v. Gift Tax Officer, AIR 1960 AP 115,119

⁸⁴ In the matter of duty on Non-Agricultural Property AIR 1944 FC 73

⁸⁵ Arvind P. Datar Commentary on Constitution of India supra, VII

⁸⁶ *Corpus Juris* vol 62 p. 729

⁸⁷ Government of India Act, 1915 amended in 1919 (rules)

⁸⁸ Entry 58 and 59 of List II and 89 of Union list

⁸⁹ Government of India Act, 1935

⁹⁰ Central India Spinning, weaving and Manufacturing co. Ltd. V. Municipal Committee, wardha AIR 1958 SC 341

⁹¹ Central India Spinning, weaving and Manufacturing co. Ltd. V. Municipal Committee, wardha AIR 1958 SC 341

goods merely in transits through municipal limits and which have their terminus elsewhere.⁹² It is not sustainable where goods are neither loaded nor unloaded in a municipality area.⁹³ However, tax would be levied if goods have failed to reach its destination and stored for an indefinite period.⁹⁴ It is suggested by few that State should be made competent to levy tax under this entry.

91 Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts. Power to levy stamp duty is a concurrent power.⁹⁵ The power to prescribe rate of stamp duty fall within this entry and Entry 63 of List II for instruments mentioned in that respective entry.⁹⁶ In any way, both parliament and state legislature are competent to make laws relating to stamp duty subject to Article 254⁹⁷

3.2.2 State List

45 Land-revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues. State government is competent to make an amendment and levy tax when the Union government has not chosen to levy any tax.⁹⁸

46 Taxes on agricultural income.

47 Duties in respect of succession to agricultural land.

48 Estate duty in respect of agricultural land.

49 Taxes on lands and buildings.

50 Taxes-on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

⁹² Punjab Flour and General Mills Co. Ltd v Chief Officer, Corporation of City of Lahore, AIR 1947 SC 14

⁹³ Central India Spinning, weaving and Manufacturing co. Ltd. V. Municipal Committee, wardha AIR 1958 SC 341

⁹⁴ Man Mohan Tuli v. Delhi Municipality, AIR 1981 SC 341

⁹⁵ Entry 44 of Concurrent List.

⁹⁶ Bar Council v. State of U.P, AIR 1973 SC 231

⁹⁷ State law should not be inconsistent with law passed by the parliament.

⁹⁸ The Associated Cement Companies v. Government of Andhra Pradesh , AIR 1983 AP 234, 237

51. 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.

52 Taxes on the entry of goods into a local area for consumption, use or sale therein.

53 Taxes on the consumption or sale of electricity.

54 Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

55 Taxes on advertisements other than advertisements published in the newspaper and advertisements broadcast by radio or television.

56 Taxes on goods and passengers carried by road or on inland waterways.

4. Problems / Complaints by state:-

The issue many of us are dealing is whether India follows a federal or quasi federal form of government. Professor K.C. Where, a renowned constitutional authority has described Indian constitution as quasi-federal on the account that both union and state enjoy power on intervention in the affair of state in a number of matters⁹⁹. But we have authorities who had recognized it as federal, as we have seen it in *kesavananda bharati*¹⁰⁰ case. The institution of the Finance Commission has been one of the major success stories of the Constitution. The broad terms of reference as laid down in Indian Constitution¹⁰¹ are unexceptionable. State government have suggested an *in toto* implementation of finance commission recommendation. They have also criticized the so called “gap-filling” approach by finance commission and for not taking states into confidence while laying down the terms of reference.¹⁰² In constitutional amendment it was provided to give certain

⁹⁹Taxman, The Constitution of India, select and perception. Pg 119

¹⁰⁰AIR 1973 SC 1461

¹⁰¹ Art. 288(3) of Constitution Of India

¹⁰²Sarkaria Commission report.

percentage to state of the taxes collected.¹⁰³ However, surcharges do not form part of the divisible pool. Cesses are intended for specific purposes and the States can have no complaint if the money is spent on predetermined purposes. Surcharges can be regarded as a not so thinly veiled device to deny the States their share in receipts from such surcharges. Keeping in view the complexity of the present national and international situation which has placed additional burden on the Union, the Commission would not recommend any constitutional amendment to make surcharges shareable but would expect public policy to move decisively in the direction of doing away with the surcharges as part of the Union's fiscal armory. This policy has been questioned by regular interval it is recommended by the states that this surcharge to be shared with states to increase their source of revenue. But by doing so union might find itself in financial deficit. So, a balance needs to be made in relation to these two aspects.

4.1 Service Tax:

In recent years, services have emerged as the dominant component in the gross domestic product (GDP). Yet there is no mention in the Constitution in any list¹⁰⁴ enabling any level of government to tax services. The Union has used the residuary power to levy taxes on selected services.¹⁰⁵ Such a residuary power has been expressly conferred by parliament.¹⁰⁶

4.2 Distribution of Revenue:

In the evidence of the State government some political parties have criticized that the resources allocated to states are not adequate to enable them to discharge their responsibility. The State Governments, as well as some all-India political parties have claimed that not only the States' resources are relatively inelastic but also that their tax-base is narrow. For example the yield from Land Revenue including cesses, etc. for all States in 1951-52 was about Rs. 49 crore comprising 21.3 per cent of their own tax revenue and in 1984-85 it did about Rs. 318 crores constitute only 2.6 per cent of their own tax revenue.¹⁰⁷ The sates have argued that they have been given the responsibility without enough financial assistance from centre. States argue that in order to enable them to discharge their responsibilities properly, there is need for ensuring correspondence between

¹⁰³ Art. 270(2) of Constitution Of India

¹⁰⁴ Union List, State List, Concurrent List

¹⁰⁵ Union List entry 97

¹⁰⁶ State of west Bengal v. Kesoram Industries Ltd., (2004) 10 SCC 201

¹⁰⁷ Sarkaria commission recommendation report chapter X para 10.3.01

their obligations and resources. And due to this heavy dependence it results in erosion of jurisdiction and authority. Some political parties have also emphasized that the States' resources should be commensurate with their expenditure needs. Indeed, an all-India political party has observed: "If States suffer from inadequacy of financial resources and powers, the autonomy of States faces severe constraints and the federal character of the Constitution is also jeopardized".¹⁰⁸ Few states believe that the constitutional scheme needs to go under radical change as is not serving properly. Some states argued for enlargement of taxation power of states in relation to art. 268 and 269 as well as removal of restriction on states taxation power. The states power to levy tax¹⁰⁹ has been subject to few restrictions with a view to keep inter-state and international trade and commerce free from haphazard state taxation. First, state is debarred from levying a tax on interstate sale or purchase. Secondly, no state can tax sale or purchase taking place outside the state. Third, state is debarred from taxing on sale and purchase in the course of import and export.¹¹⁰

4.3 Corporation Tax:

Non inclusion on corporation tax in the divisible pool has been criticized by state government, It is also suggested by few state that the corporation tax should be sharable with states and this would help many problem but these suggestion cannot be accepted as it is completely against legislative powers / competency as it is a well known fact that no tax can be levied beyond the tax entry. It has also been suggested that the residuary power being given to the states.

4.4 Excise Duties:

It is alleged that the Union Government has levied separate excise duties on commodities thus keeping these revenues outside the purview of sharing. Some of the States have alleged that the Union Government has not been showing sufficient interest in raising revenues from Income Tax, 85 per cent of which is now sharable with the States. On the other hand, through the Special Bearer Bonds Scheme, the Union Government mobilized resources for its exclusive use which would have been otherwise shared by the States, if better compliance of Income Tax Act had been enforced. Income tax has been a major issue as it excludes agricultural income which at times leads to double taxation. Many States have complained against the increases in

¹⁰⁸ Sarkaria commission recommendation report chapter X para 10.3..05

¹⁰⁹ Entry 54 of List II

¹¹⁰ Hoechst Pharmaceuticals Ltd. V. state of Bihar, AIR 1983 SC 1019. These sales are not taxable by a state but they may be taken into account to compute the gross turnover of dealers requiring them to register themselves for purpose of payment of surcharge over the sales tax payable by them.

administered prices, e.g., of petroleum and coal, unilaterally made by the Union instead of increasing excise duties, which would have been sharable with them.¹¹¹

4.5 Restriction on taxing power:

States have alleged that the modified art. 269 have adversely affected them. It takes away the power of the States to levy tax on essential goods by authorizing Parliament to impose restrictions by law on the States to impose tax on sale or purchase of goods declared by

Parliament to be of special importance in inter-State trade and commerce.¹¹² Political parties have asked for deletion of Entries 92A¹¹³ List I and their transfer to the State List. It has also suggested modification of clauses (3)(a)¹¹⁴ and (b)¹¹⁵ of Article 286 and removal of limitations imposed on the power of the States to levy tax on the sale or purchase of goods imposed under Article 286 read with Article 269 and Entry 92A of List I.

4.6 Borrowing Power:

States have been criticized many times for excess market borrowing. "During 2011-12, the government raised excess market loans than required for financing its fiscal deficit. As a result, the cash balance of the state as on March 31, 2012, stood at Rs 18,632 crore, which was 24% higher than previous year.¹¹⁶ Government's expenditure for 2011-12 stood over Rs 80,200 crore against the approval of Rs 85,700 crore, resulting in non-utilization of funds of about Rs 5,500 crore. RBI has stated that managing state dept will be tough in FY14.

¹¹¹ Sarkaria Commission recommendation report chapter X complains by states regarding administrative price para 10.03.16

¹¹² Modified art. 269 by the Sixth and Forty-Sixth Amendment Acts.

¹¹³ Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.

¹¹⁴ Any law of a State shall, in so far as it imposes, or authorizes the imposition of, tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter State trade or commerce.

¹¹⁵ a tax on the sale or purchase of goods, being a tax of the nature referred to in sub clause (b), sub clause (c) or sub clause (d) of clause 29 A of Article 366, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify.

¹¹⁶ <http://www.indianexpress.com/news/cag-slams-state-govt-for-excess-market-borrowings/1097520/>

4.7 Indebtedness of States:

Some States have complained that the present pattern of Union transfers, with preponderance of loans, is completely out of line with their pattern of expenditure and repayment capacity and have demanded a review.¹¹⁷ At present stage 3 of the most indebted states in India are west Bengal (1.92 lakh crore), Uttar Pradesh (1.58 lakh crore) and Gujarat government (1,38,978 cr). Gujarat is expected to reach 1.76 lakh crore in 2013-14. In 2001-2002 it was 45,301, and now this figure has multiplied 4 times in last 11 years. This indicated the failure of all recommendation, scheme till date to give fiscal assistance. Divided among Gujarat's six crore population, it comes to a debt of Rs 23,163 per capita. Gujarat government pays Rs 34.50 cr interest every day to repay this debt. Much of the spending is on showpiece infrastructure projects, while spending on health and other social sectors are low.¹¹⁸

5. Summary of Sarkaria Commission recommendation:-

- Items covered Article 286 does not form a buoyant source of revenue i.e excise duty. Union should in consultation with state government revise imposition on these duties and revenue raised should be separately specified in the budget.
- The monetary limit under 276(2) should be revised upward.¹¹⁹
- Entry 60 of list II to be revised upwards.¹²⁰
- Corporation tax¹²¹ to be made sharable with states and in that consequent share of states in income and union tax to be brought down.
- Surcharge on income tax should not be levied by union except for special purpose.
- Substantial expenditure is incurred by both the Union and the State Governments on schemes. The concerned Governments should take into account the high opportunity-cost of such schemes and to examine whether any important development are compromised due to such diversion of scarce resources.
- The Finance Commission Cell/Division should monitor the behavior of States' finances and estimate annually the deviation from the norms evolved by finance commission to help the

¹¹⁷ Sarkaria Commission report

¹¹⁸ <http://www.indiatvnews.com/business/india/modi-s-gujarat-bears-the-third-highest-debt-burden-after-bengal-- 5216.html>

¹¹⁹ Monetary limit of Rs. 2500/-

¹²⁰ in relation to tax on trade, professional

¹²¹ Entry 85 of Union List

planning commission to bring before the National Economic and Development Council this deviation and then can Economic and Development Council monitor effectively and evolve consensus on the mobilization of resources.

- Union government should bring constitutional amendment regarding consignment tax.
- Yield from certain duties and union excise duties under special act of parliament have remained outside of divisible pool. While it has become necessary for union to levy duties in special needs, it should only be levied in special needs.
- Items covered by Article 269 to raise resources appear to be limited. An Expert Committee should be constituted to enquire into and review consulting States.
- The Union Government should signify its acceptance of the Finance Commission's recommendation in regard to the grant in lieu of the Railway Passenger Fare Tax also, along with other items.
- In a calamitous situation, relief must be given immediately the States should have a reasonable discretion to make inter-district or inter-sectoral adjustments. Relief assistance should be beyond financial years. Assistance required till June / July should be decided in beginning so that it can be properly planned.
- The Union Government should give its consent freely to States for borrowing from banks and financial institutions for periods less than one year under Clause (4) of Article 293.
- Treatment of small savings loan is a matter of judgment by the Finance Commission vis-à-vis to the over-all debt burden of the States. With increase in small savings there is a surplus every year after repayment of due loans, the Union is not called upon to repay any loan not already covered by the net transfer principle. When the outgo is greater than the inflow, the States would be responsible for their share of the net small savings collections. If a formula is adopted for such recoupment of revenue from the States, the recommendations of the Finance Commission will be workable. This aspect will have to be examined by the National Economic and Development Council.

6. Suggestion and development regarding in imbalance in fiscal structure:

6.1 Service Tax:

It is necessary to enhance the revenue potential of the States in view of their major responsibilities for social and physical infrastructure. It might be worthwhile to provide explicitly for taxing power for the States in respect of certain specified services. For the Union also an explicit entry would be helpful, rather than leaving it to the residuary power of entry 97. However, it may be better to first let a consensus list of services to be taxed by the States come into force to be treated as the exclusive domain of the States, even if the formal taxing power is exercised by the Union. The Commission recommends specific enumeration of services that may become amenable to taxation by the States. This is necessary with a view to augmenting the resource pool of the States. The Commission recommends an appropriate amendment to the Constitution in this behalf to include certain taxes, now levied and collected by the Union, to be enabled to be levied and collected by the States.¹²²

6.2 Distribution of Revenue:

It has been suggested that for this purpose, more rational system of savings and credit allocation should be evolved and the powers and scope of various institutions—Finance Commission, Planning Commission and the National Development Council—should be suitably redefined.¹²³ But that does not call for division for areas of taxation as it according to many states will make rich states richer and poor states poorer. The Union Ministry of Finance also holds that the "Present system has a sound rational basis and may not require any alteration."¹²⁴

6.3 Excise Duties

Revenues from Union Excise Duties¹²⁵, are being shared on the recommendations of the Finance Commission. Agricultural income for the purpose of taxation means agricultural income as defined under Indian income tax act.¹²⁶ This mechanism has been devised to avoid conflict between union and state legislative competency in respect of agricultural income.¹²⁷ For Example in the case of income derived from tea grown, 40% will go to income tax and rest 60% will be deemed for

¹²² Finance Commission

¹²³ Sarkaria commission recommendation report chapter X para 10.3.03

¹²⁴ Sarkaria commission recommendation report chapter X para 10.3..09

¹²⁵ levied under Article 272 of Constitution of India

¹²⁶ Supra C. M.P jain Constitution of India pg. 630

¹²⁷ CIT v. Williamson Financial Service, (2008) 2 SCC 202

agricultural income.¹²⁸ In accordance with the judicial view that the entries are not “power” but “field of legislation”, it has been held that entry 82 does not only authorize the imposition of income-tax but also authorizes making of a law to prevent invasion of the tax imposed.

6.4 Restriction on taxation:

6.4.1 Interstate trade and commerce :

The suggestion's made by states and political parties is not acceptable as the Constitution (Sixth Amendment) Act, 1956 was enacted to promote free trade and commerce which otherwise would lead to double taxation and difficulties faced by traders which was reiterated in *Bengal Immunity Co. v. State Of Bihar*¹²⁹. But this does not weaken by any mean fiscal status of states as the power to access remains with states¹³⁰. Purpose of Central Act is not collection but regulation on tax.¹³¹

6.4.2 Restriction on taxation of government property:

State cannot tax government property¹³², but this don't not mean states are losing revenue as claimed by few states¹³³ as immunity only applies to department of central government and not to incorporated companies¹³⁴ though it can be said that states loses revenue from department of central government but it does not exercise complete immunity i.e. government is only the share holder and not owner even in case where it has subscribed to entire share. Thus property owned by such bodies is not exempted from state taxation.¹³⁵

6.5 Market Borrowing

Provisions as regards finance are to an extent a copy of the similar provisions in the Government of India Act, 1935, and this is inevitable. Hence the control over finance by union is maintained and this to everyone would appear to violate principle of federalism. Technically the objection is valid. But a study of various constitutions will reveal that practically in all such countries they are vested towards centralization. There is no particular sanctity in any particular form of federal finance. Our form of government must be based on our own preference and if the pattern adopted

¹²⁸ Commissioner of Income Tax. V. Willaimson Financial Service,

¹²⁹ AIR 1955 SC 661

¹³⁰ Tax sharing

¹³¹ M.P Jain, Indian Constitutional Law, Part IV, Ch. XI, Sec J(b). pg.688

¹³² Art. 285 of Indian Constitution

¹³³ Sarkaria Commission report. para 10.3.19

¹³⁴ M.P Jain, Indian Constitutional Law. Pg 692-693

¹³⁵ Food Corporation Of India v. Municipal Committee AIR 1999 SC 2573

works well in practice we should content.¹³⁶ Now if we go by the working principle of commission, finance commission has give 80-90% weightage and planning commission has given 60% weightage to population of state for distribution of revenue between states and union while National Development Council has no fixed principle. Heads of tax assigned to states are more in number but they yield less revenue as compared to heads assigned to union. It is argued that fiscal condition of states has not been satisfactory from past few years because of this centralization of finances. States are reluctant to make full use of the power vested in them to levy and collect tax.¹³⁷ More financial power to the states in not a public demand but only a political issue.

6.6 Entry 87 and 88

The Fifth and the Eighth Finance Commissions, made a point that as Estate Duty was then being levied, it was not worth to levy Succession Duty also.¹³⁸ Estate Duty should be outlawed as it had failed in both its objectives, specifically, to mitigate the building up of prominent wealth and raising reasonable resources.¹³⁹ It had noted that 96.8 per cent of the assesseees in 1980-81 related to the estates whose 'principal value' was less than Rs. 3 lakhs.¹⁴⁰ In the financial year 1985-86, Estate Duty was abolished¹⁴¹ in view of its meager yield (gross collections Rs. 22.50 crores in 1984-1985).¹⁴² If any person has property in more than one state it is better to be felt with union¹⁴³ and if tax is levied by state it has to deal with different tax codes and regulation and it might give up to a unhealthy competition among states.¹⁴⁴ Uniformity in the main principles of law with respect to these duties is essential in the national interest.¹⁴⁵ Moreover, the net proceeds of Estate Duty till it was abolished¹⁴⁶ were being allocated to and distributed among the States¹⁴⁷ on the basis of formulae recommended by Finance Commission.¹⁴⁸ In view of these

¹³⁶ Remark by Shri N.R. Shankar, President of Expert committee appointed by constituent assembly.

¹³⁷ Tax on agricultural income and agricultural wealth.

¹³⁸ Finance Commission report (1968)

¹³⁹ The Economic Administration Reforms Commission report 1981-1983

¹⁴⁰ The Economic Administration Reforms Commission report 1980-1981

¹⁴¹ The Economic Administration Reforms Commission report 1985-1986

¹⁴² RBI handbook 1985

¹⁴³ De, D.J Indian Constitutional Law

¹⁴⁴ Fiscal relation recommendation by sarkaria commission.

¹⁴⁵ Bakshi, P.M. Constitution of India., Supra ,.Fiscal relation

¹⁴⁶ 25th Aug 2008 parliamentary debates

¹⁴⁷ Finance Commission report 1985

¹⁴⁸ Estate Duty Abolition bill 25th Aug 1985

considerations we are unable to support the plea that Entries 87 and 88 be shifted from List I to List II.

6.7 Entry 89 of List I

One of the most important developments in post-independence period is the emergence of a vast common market. Transport sector constitutes an important element in the basic infrastructure and its development is vital for the growth of the economy.¹⁴⁹ Uniform rate-structure and policies with respect to them are desirable to ensure that free flow of inter-State trade is not hampered by discriminatory and differential trade barriers raised by the States.¹⁵⁰ Further, the suggestion under consideration carries greater scope for raising revenue by the advanced States with well-organized transport services and would discourage already under-utilized transport in less-developed areas.¹⁵¹ Finally in spite of these taxes being within the competence of the Union¹⁵², we do not think that there is much scope for raising revenue from the terminal taxes on goods and passengers. In view of the above considerations, we are of the view that the power to levy terminal taxes on goods and passengers carried by railway, sea or air should remain with the Union Government.

6.8 Entry 60 of List II

Any levy under this entry should not exceed Rs 2,500/-¹⁵³ should be struck down.¹⁵⁴ It is wide enough to include service¹⁵⁵ even if the employee is a income tax payer.¹⁵⁶ Pension ion is excluded as it is only for past service¹⁵⁷. Because of the limit imposed¹⁵⁸ yield from such tax becomes a minor source. After advocating from both sides, view point is that there is a need of upward revision of the limit imposed¹⁵⁹ in the view of persistent inflation and with consideration of linkage between its incidence and that of Income Tax.

¹⁴⁹ (Eds) Howes , Stephen Lahir, Ashok K. Stern, Nicholas State-level Reforms in India Towards More Effective Government -Delhi: Mcmillan, 2004

¹⁵⁰ State Level Fiscal Reforms In the Indian Economy by Srivastava, D.K.

¹⁵¹ Fiscal Federalism in India: Some Issues by Gurumurthi, S.,

¹⁵² Finance Commission report

¹⁵³ Article 276(2) of Constitution Of India

¹⁵⁴ Antony v. Excise Commissioner, board of revenue, Trivandrum AIR 1965 Ker 8

¹⁵⁵ Arvind P. datar Constitution Of India. P 2214 state list

¹⁵⁶ Kamta Prasad v. Executive Officer, AIR 1974 SC 685

¹⁵⁷ Rajagopalchari C. v. Corporation Of Madras AIR 1964 SC 1172

¹⁵⁸ Limit of 2,500/- under 276(2)of Constitution of India

¹⁵⁹ 276(2)of Constitution of India

7. Development since Sarkaria Commission Recommendation:

Report submitted by the Sarkaria Commission in the late eighties, crucial changes have taken place in the Indian economy having a bearing on the Centre-State relations.¹⁶⁰ Issues examined by the Sarkaria Commission like the inclusion of company tax in the separable pool of Central taxes have since been resolved.¹⁶¹ Many other issues rose by that Commission, such as, levy of cesses and surcharges on Central taxes, plan formulation, pattern of plan assistance, CSS, regional development and increase of local bodies are applicable even today.¹⁶² A number of new issues have come to the fore in the wake of economic reforms introduced in the country in the early nineties.¹⁶³ There are also developments outside the realm of economic reforms.¹⁶⁴

7.1 Economic Development:

Development in economy gave way to market-oriented economic policies. The focus has shifted from public investment to promoting private investment. The shift in economic policy has been a major contributory factor in putting the Indian economy on a higher growth. One such major repercussion is the greater role cast on the States in economic development. With the major portion of investment envisaged to come from the private sector in the Five-Year Plans, States are required to put in place the necessary enabling conditions.¹⁶⁵

7.2 Changes in Tax Sharing:

The States were particularly peeved by the exclusion of income tax paid by the companies from the divisible pool¹⁶⁶.

Article 270 of the Constitution was amended in 2000¹⁶⁷ to provide for the sharing of net proceeds of all Union taxes and duties except those referred to in Articles 268 and 26 and cesses and surcharges referred to in Article 271.¹⁶⁸ This has resulted in a more rational division of net proceeds of Central taxes between the Union and the States. The new dispensation has enabled the States to share the

¹⁶⁰ 2nd commission on Centre State Fiscal Relation's Report

¹⁶¹ 80th Amendment to the Constitution.

¹⁶² Punchhi Commission report

¹⁶³ 12th finance Commission's report

¹⁶⁴ Punchhi Commission report

¹⁶⁵ provision of adequate infrastructure to attract private investments

¹⁶⁶ amendment of the Income Tax Act in 1959

¹⁶⁷ 80th Amendment

overall buoyancy of Central taxes. The States, by and large, have favored the sharing of all Union taxes and their grievance is now restricted to the percentage share devolved to them.

7.3 Introduction of Tax service:

With introduction of tax service¹⁶⁹ it now accounts for over 50% of GDP.¹⁷⁰

7.4 Constitutional Amendment:

Conferring of statutory status to rural and urban local bodies,¹⁷¹ Article 243 provides for the constitution of elected rural and urban local bodies was provided.¹⁷² The Article also provides for the constitution of a State Election Commission in each State entrusted with the responsibility of holding regular elections to these local bodies. Finance Commission was authorized to review the finances of the local bodies and to make recommendations on the principles of distribution of net proceeds of taxes between the State Government and the local bodies and the principles governing grants-in-aid to local bodies.¹⁷³ Central Finance Commission was authorized to make its recommendations regarding the augmentation of the Consolidated Fund of a State to supplement the resources of local bodies on the basis of the recommendations made by the Finance Commission of the State.¹⁷⁴

7.5 Tax reform

Value Added Tax was introduced as an indirect sales tax.¹⁷⁵ It put an end to the cascading effect of sales taxation and rate wars among States, which was a zero-sum game and heralded a spirit of cooperation among States.¹⁷⁶ Union has also proposed introduction of Goods and Service tax shortly to be levied by both union and state,¹⁷⁷ making tax administration uncomplicated, more industry friendly and more transparent. It is moving towards an integrated market rather from the narrow perspective of loss of autonomy of States. Even, if there is a loss of some autonomy, it is the result of voluntary abdication on the part of States for their common good.¹⁷⁸

¹⁶⁹ In 1994

¹⁷⁰ Punchhi Commission report 2010

¹⁷¹ The 73rd and 74th Amendments to the Constitution in 1993

¹⁷² Amendment of Article 243 of Constitution of India in 73rd and 74th amendment in 1993

¹⁷³ Article 243(I) (1) of Constitution of India

¹⁷⁴ Re amendment of Article 280 of Constitution of India.

¹⁷⁵ Dated April 1 2005 by constitutional amendment

¹⁷⁶ Punchhi commission report on centre state fiscal relation

¹⁷⁷ To be listed in concurrent list

¹⁷⁸ Centre state fiscal relation : a study in level of development.

7.6 Changing Pattern of Plan Assistance to states:

Two changes have been made in relation to central plan assistance to states.

- Reduced budgetary support to the State Plan
- Significant change in the pattern of plan assistance.

Besides the reduction in the budgetary support to the State Plans, the composition of the budgetary support has undergone major changes over the years. The share of normal plan assistance in the total budgetary support to the State Plan has come down drastically and that of CSS, additional Central assistance and special plan assistance has gone up considerably.

7.7 Borrowing to States:

The Centre terminated on lending to States from 2005-06 on account Central Plan assistance.¹⁷⁹ Prior to 2005-06, the Centre was dispensing normal plan assistance in the grant-loan ratio of 30:70 in the case of General Category States (GCS) and in the ratio of 90:10 in the case of Special Category States (SCS).¹⁸⁰ States are now allocated additional market borrowings in lieu of loan component of normal Central assistance. Termination of on lending by the Centre has cast a burden on the States in terms shorter duration of the market borrowings. The Central loans had a repayment period spread over 25 years with a moratorium of five years in repayment. In contrast, the market loans have a repayment period of 10 years with a bullet repayment at the end of the tenth year. This will result in bunching of repayments for the States.

Earlier small saving collections were being credited to the Consolidated Fund of India and the Centre was extending loans to a State against small saving collections in that State. National Small Savings Fund (NSSF) was created in the Public Account¹⁸¹ with the Centre taking on the responsibility of servicing outstanding small saving deposits from the date NSSF became operational. The share of the States in net small saving collections was increased from 66.66 per cent to 75 per cent in April 1987 and further to 80 per cent from April 2000.¹⁸² From April 2002 to March 2007, the entire net collections under small savings were being invested in securities issued by the State Governments.¹⁸³ States' borrowings against net small saving collections are

¹⁷⁹ Following the recommendations of FC-XII,

¹⁸⁰ Punchi Commission report supra.,3.8.01

¹⁸¹ On 1st April 1999 in the public account of India NSSF was created.

¹⁸² By the requests of State Governments

¹⁸³ <http://indiabudget.nic.in/es2001-02/chapt2002/chap23.pdf>

no more treated as loans from the Centre following the setting up of NSSF.¹⁸⁴ With these changes, excluding small saving loans from the purview of consolidation and relief offered on outstanding Central loans to States.¹⁸⁵

8. Problems outstanding relating to fiscal relation in the present scenario.

Even after the recommendation made by sarkaria commission there still some loopholes in the fiscal relation as these recommendations are not binding on the parliament.

8.1 Vertical Imbalance in resource sharing:

The States have criticized that the resource deficit has not been overcome even after the recommendation of sarkaria commission.¹⁸⁶ States have demanded an increase in their share of Central taxes from 29.5 per cent to 50 per cent.¹⁸⁷ There is a clear need to realign the resources in favor of States. There are clear advantages in empowering the States fiscally. ‘When the emphasis is on social justice, there is no escape from realignment of resources in favour of States, because services and programs which are at the core of a more equitable social order come within the purview of the States under the Constitution.’¹⁸⁸

8.2 Growing Central Expenditure on Functions in the State List

Fifth of the expenditure incurred by the Centre was on subjects, which were in the domain of the States.¹⁸⁹ With the introduction of new Central Plan Schemes and new CSS, this proportion would have gone up considerably.¹⁹⁰ A number of developments have resulted in increasing Central expenditure on State subjects. These are increasing discretionary transfers¹⁹¹. Growing discretionary transfers from the Centre have severely constrained the States in drawing and implementing schemes according to their priorities and the felt needs of people. A comprehensive review of all transfers to States with a view to minimizing the component of discretionary transfers, particularly those channeled through CSS is recommended.¹⁹²

¹⁸⁴ Punchhi Commission report supra., 3.8.02

¹⁸⁵ On recommendation of Finance Commissions

¹⁸⁶ Sarkaria commission report

¹⁸⁷ Questionnaire conducted by punchhi Commission

¹⁸⁸ Sixth Finance Commission (FC-VI) report

¹⁸⁹ Report of the Twelfth Finance Commission.

¹⁹⁰ Report of FC-XII

¹⁹¹ in the form of assistance for CSS, special plan assistance and special Central assistance.

¹⁹² Recommendation made by Punchhi Commission.

8.3 Macroeconomics Stabilization:

the wake of the countercyclical measures initiated to neutralize the impact of the global downturn in the last two years, the Centre has raised fiscal deficit targets of States to 3.5 per cent of GSDP in 2008-09 and further to 4.0 per cent of GSDP in 2009-10 and accordingly raised the market borrowing limits of States.¹⁹³ It was reported that the Government of India had put on hold the decision relating to the revision of royalty rates on major minerals as well as the conversion of rates into ad valorem system in the interest of maintaining price stability.¹⁹⁴

Macroeconomic management is the responsibility of the Union Government¹⁹⁵ and that States should be properly compensated for any additional expenditure they bear or revenue loss they suffer on account of measures taken by the Union to maintain macroeconomic stability.¹⁹⁶

8.4 Taxes under 268 and 269:

States have alleged that Centre has not been exploiting the revenue potential of taxes listed under Articles 268 and 269. There is a scope for raising the rates of duties in respect of bill of lading, letters of credit and the policies of general insurance.¹⁹⁷ As regards duties of excise on medicinal and toilet preparations, the Commission indicated that it did not have data to suggest specific increases in the rates.¹⁹⁸

8.5 Article 276(2):

Under Article 276 (2), tax on professions, trades, callings and employments shall not exceed Rs. 2, 500 per annum. The Sarkaria Commission recommended rising of the then existing limit of profession tax. As income and salary levels are increasing, a limit on the profession tax constraints revenue mobilizations. In most States, proceeds from profession tax are devolved to the local bodies. There is a consensus on the need to empower local bodies in terms of financial resources to enable them to discharge their responsibilities. 2nd commission on centre state fiscal relation recommends that the current ceiling on profession tax should be completely done away with by a Constitutional amendment.

¹⁹³ Report submitted by punchhi Commission

¹⁹⁴ Economic Times, June 4, 2008

¹⁹⁵ as per the Constitution of India

¹⁹⁶ punchhi Commission recommendation

¹⁹⁷ Report of the Eighth Finance Commission

¹⁹⁸ FC-VIII.

CONCLUSION

There have been subsequent changes in the fiscal relation between Union and States from time to time by constitutional amendment as discussed above. The recommendations of Sarkaria Commissions are not binding so it is difficult to sort out all the issues directly and this is where the Union gets a discretionary power to amend. In relation to the problems relating to Centre-State fiscal relation the following could be the solution:

States should be properly compensated for any additional expenditure they bear or revenue loss they suffer on account of measures taken by the Union to maintain macroeconomic stability. Higher Central transfers to backward States will enable them to improve their physical and human infrastructure and greater focus on the issues of governance in the less developed States of the country. The Terms of Reference of future Finance Commissions should be formulated in such a way that the additional commitments of States on account of pay revision are fully taken into account. The current ceiling on profession tax should be completely done away with by a Constitutional amendment. We hope that this would initiate a discussion among political parties and organizations and help in the emergence of a common platform to bring about a restructuring of Centre-State relations.

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