

RESOURCE SHARING : DEVOLUTION AND DISTRIBUTION

Introduction

5.1 The distribution of the net proceeds of income tax which "are to be", and of the net proceeds of Union excise duties which "may be" divided between the Union and the States under Chapter I of Part XII of the Constitution is the centre-piece of the deliberations of Finance Commissions. Related to this is the issue of determining the respective shares of the States in the distributable proceeds of these two taxes.

5.2 Para 4(ii) of our terms of reference requires us to have regard to "the resources of the Central Government and the demands thereon, in particular, on account of expenditure on civil administration, defence and border security, debt-servicing and other committed expenditure or liabilities".

5.3 In addition, the Central Government has, in a memorandum to us, separately drawn our attention both to the limited scope for adjustment in its expenditure and the likely downward impact on tax revenues in the context of structural reforms in indirect taxation, especially those related to customs duties. The States, on the other hand, have sought larger devolution through upward revisions in their shares in the net shareable proceeds of both income tax and the Union excise duties. In making our recommendations, we have taken into account the overall fiscal scenario of the economy and the submissions of the Central and State Governments.

5.4 We have already discussed the resource position of the State Governments and the Central Government in Chapters III and IV respectively. We now go on to deal with the specific issues relating to the devolution of income tax and Union excise duties and make our recommendations pertaining to the aggregate share of all States in the net proceeds of these taxes, and their individual shares in respect of both the taxes.

Income tax

5.5 Under the provisions of article 280(3)(a), read with article 270 of the Constitution, our task with respect to income tax is to make recommendations in regard to three matters, viz.

- the percentage of the "net distributable proceeds" which shall represent the proceeds attributable to the Union Territories ;
- the percentage of the divisible pool of the "net proceeds" of income tax to be assigned to the States; and
- the share of each State in the divisible pool.

5.6 Under article 270(3) of the Constitution, the share of the net proceeds of income tax "attributable to the Union Territories" has to be prescribed. Previous Finance Commissions had adopted the practice of treating all Union Territories together as a group, and determining their joint share by applying the same principles as for the other States. As would be evident in the ensuing discussion, we have used some allocative criteria for the States for which adequate corresponding information for the Union Territories is not available. We have, therefore, decided to determine their share on the basis of population. We recommend that the share attributable to the Union Territories in the net

distributable proceeds of income tax for each of the financial years during 1995-2000 should be 0.927 per cent.

5.7 The present share of the States in the net proceeds of income tax is eighty five percent. It would be useful to review the path that this ratio has traversed through the recommendations of earlier Commissions. The States' share out of the net proceeds of income tax was fixed at 55 per cent by the First Commission. The succeeding three Commissions enlarged the share progressively to 60 per cent, 66 2/3 per cent and 75 per cent. While recommending the increase in the States' share, the Third and Fourth Commissions took due note of the representation of the States about the need for making good in some measure the loss sustained by them on account of the non-inclusion of corporation tax in the divisible pool consequent upon the reclassification brought about in the Income Tax Act in 1959. The Fifth Commission did not recommend any further increase in the States' share, on the ground, among others, that the divisible pool of income tax would for the first time also include advance tax collections. Arrears pertaining to the advance tax collections were distributed among the States in three instalments during the period covered by the recommendations of that Commission.

5.8 The Sixth Commission raised the States' share from 75 to 80 per cent taking into consideration various factors including the fact that the arrears referred to above were no longer available. The share of the States was further increased to 85 per cent by the Seventh Commission keeping in view the States' grievance in regard to the levy of surcharge by the Centre as a normal tax revenue measure. The Eighth and the Ninth Commissions let it remain at 85 per cent.

5.9 Notwithstanding its present high level, a number of States have sought an increase in the States' share in income tax. While Bihar has favoured a figure of hundred per cent, Arunachal Pradesh, Goa, Madhya Pradesh, Punjab and Uttar Pradesh have indicated a figure of 95 per cent. Gujarat, Nagaland, Orissa, Tripura and West Bengal have called for an upward revision in this share to 90 per cent. Rajasthan and Tamil Nadu stressed the need for an increase in the share. Andhra Pradesh, Assam, Himachal Pradesh and Kerala have not suggested any change in the existing share of 85 per cent. Mizoram has proposed a reduced share of 65 per cent in favour of a larger flow of resources through grants-in-aid.

5.10 Haryana and Karnataka have suggested that the proceeds of corporation tax and income tax be pooled and the share of the States may be fixed at 50 per cent. Alternatively, Karnataka would like that 85 per cent and 15 per cent shares respectively out of the net yields from income tax and corporation tax be distributed among the States. Maharashtra is in favour of reducing the States' share to 75 per cent provided 20 per cent of the proceeds of the corporation tax are also simultaneously shared. However, pending a Constitutional amendment to this effect, the State would not want any change in the existing share of 85 per cent. Haryana, Punjab and West Bengal have even suggested that till the Constitution is amended, a compensatory grant equal to a specified percentage of the net proceeds may be

recommended in lieu of sharing the corporation tax with the States.

5.11 The main grounds on which the States have pleaded for an enhancement in the share of income tax proceeds may be summarised as below:

- i) As compared to income tax, corporation tax has turned out to be more buoyant but its proceeds, which were shareable prior to the Income Tax Act amendment in 1959, have been excluded from the divisible pool.
- ii) States were losing revenue due to the surcharge on income tax being continued by the Centre as a normal source of revenue.
- iii) Various kinds of reliefs and concessions being provided in the Central budget almost every year and periodic increases in the basic exemption limit for income tax have led to a shrinkage of the divisible pool.
- iv) The expenditure responsibilities of the States, particularly for infrastructure, have grown in the wake of economic liberalisation.

5.12 The States have been pleading for inclusion of the proceeds from corporation tax in the divisible pool for a long time now. We understand their desire to share the proceeds of corporation tax. This issue deserves to be seen in the wider context of diversifying and broadening the base of tax devolution. We have given our views in this regard in the alternative scheme of devolution suggested in Chapter XIII.

5.13 A number of States have raised the issue regarding the reintroduction of surcharge on income tax in 1987-88. The States have pointed out that instead of the measure being used for meeting any emergent requirements of a specific nature, the surcharge was being continued by the Centre as a normal source of revenue. In the process, the States were losing considerable revenue which would have been available to them had it been integrated into the income tax rates. We note that the Centre has completely withdrawn the surcharge on income tax from the financial year 1994-95. We, nevertheless, would like to emphasise that the surcharge on income tax should not be levied except to meet emergent requirements for limited periods.

5.14 States have been critical of the allocation of the 'cost of collection' as between income tax and corporation tax. This cost is deducted from the proceeds of income tax while working out the share of States. They regarded as unfair the ratio of 7:1 which was fixed on the basis of the findings of an expert committee set up in 1985 at the suggestion of the Eighth Commission. Some States have suggested allocation of the collection charges in proportion to the yields from income tax and corporation tax. A few States desire that due weightage be given to the workload involved under the respective taxes. The Ninth Commission, before which the States had made similar suggestions, had felt that there was need to re-examine the entire matter taking into account factors such as the introduction of simplified procedures of assessment and the nature and complexity of the cases involved under the respective taxes.

5.15 In pursuance of the observations made by the Ninth Commission in its first Report, an Expert Committee headed by Shri M.M.B. Annavi, Additional Deputy Comptroller and Auditor General of India was constituted by the Government of India on the 8th of June, 1989 to examine the apportionment of the cost of collection between income tax and corporation tax. The committee has observed in its report that:

- a) the number of officers deployed in the collection of corporation tax and income tax is in the ratio of 255:1926 or 1:7.5;

- b) the ratio between the number of officers engaged in assessment of corporation tax and income tax in mixed circles, after segregation, works out to 1:6.52; and,
- c) there has been no significant reduction in the workload involved in individual assessments with the introduction of a summary assessment scheme with effect from 1st April, 1989 because every individual return is required to be physically checked to detect arithmetical errors, and examine the admissibility of deductions.

5.16 The Committee after analysing various parameters which could have a bearing on the cost of collection concluded that it would be reasonable to apportion the cost of collection of corporation tax and income tax in the ratio of 1:6.5. This ratio has been worked out after a detailed study by experts which included representatives of the State governments. It is being used currently. This may be considered acceptable.

5.17 The States have further contended that the receipts from 'penalties' and 'interest receipts', which form part of the "miscellaneous receipts", should be included in the divisible pool of income tax. The Eighth Commission had recommended the inclusion of these receipts in the divisible pool on the ground that since the power to levy penalties and recover interest under the Income Tax Act emanates from the power to levy income tax itself, these two classes of receipts must fall within the concept of 'income-tax' as that term is used in article 270 of the Constitution. The Ninth Commission examined the matter de novo, and keeping in view the pronouncements of the Supreme Court on the subject and other relevant factors, recommended that receipts on account of 'penalties' and 'interest receipts' should form part of the divisible pool of income tax.

5.18 We have been informed by the Ministry of Finance that the matter is under their active consideration. We are of the opinion that the receipts on account of interest recoveries and penalties form part of the divisible pool and should be shared with the States. We, therefore, recommend that this should be done with effect from 1st April, 1995.

5.19 Karnataka, Rajasthan and Tamil Nadu have contended that the receipts from pre-emptive purchases of immovable properties represent accretions to capital gains and should, therefore, form part of the income tax pool for purposes of sharing. On a representation made by the Tamil Nadu Government, this matter was examined by the Ninth Commission in its first Report. The Commission felt that, as this was a matter of accounting procedure, it would be appropriate if the matter was settled in consultation with the Comptroller and Auditor General of India. Now more States have raised this issue with us. They have pointed out that the amount involved may be significant and the device of using pre-emptive purchases under the Income tax Act is now widely spread in many metropolitan towns. They argue that the proceeds arising out of the scheme are in the nature of capital gains and should be shared with the States. The Ministry of Finance has expressed the view that these receipts do not form part of the shareable proceeds of income tax. We are of the same opinion.

5.20 We now return to the key issue of determining the share of the States in the net proceeds of income tax. Having considered this matter at length, we have come to the conclusion that our recommendation in the matter should be guided by two considerations, viz.

- i) that the authority that levies and administers the tax should have a significant and tangible interest in its yield, and

- ii) that any change in the share on this account should not materially affect the level of overall devolution to the States.

In other words, any downward revision in the share of States in the net proceeds of income tax should be mirrored in a revenue equivalent increase in their share in the net proceeds of Union excise duties.

5.21 Accordingly, we recommend that the share of States in the net proceeds of income tax be fixed at 77.5 per cent. We later recommend a suitable increase in the share of the States in Union excise duties. These changes reflect our concern that the Centre retains adequate interest in income tax.

Union Excise Duties

5.22 Entry 84 of list I (Union List) of the Seventh Schedule read with article 272 of the Constitution vests in Parliament the power to levy Union excise duties. The article also provides for the sharing of the net proceeds of these duties with the States, if Parliament by law so provides.

5.23 The sharing of Union excise duties started with the First Commission itself, although the beginning was modest. It was restricted to 40 per cent of just three commodities, viz. tobacco, matches and vegetable products.

5.24 Since then, the sharing of the net proceeds of Union excise duties has become a regular feature, with successive Finance Commissions devolving larger amounts to the States, through either upward revisions of the coverage of the shareable items, or by increasing the magnitude of the States' share. The Second Commission extended the list of shareable commodities to eight but reduced the States' share to 25 per cent. The Third Commission reduced the States' share to 20 per cent but enlarged the list of shareable items to 35, the yield from each of which was Rs.50 lakh or more per year. Since the Fourth Commission, the coverage of items for States' share has been near - universal, but the States' share was limited to 20 per cent. The Seventh Commission doubled the States' share to 40 per cent on the ground that if the States had sufficient resources with them their dependence on the Centre would be reduced. The Eighth Commission raised this share to 45 per cent, but the increment of 5 per cent was used for meeting the assessed post-devolution deficits of the States. The Ninth Commission let the overall share remain at 45 per cent, but used 5 per cent and 7.425 per cent from it for deficit-based devolution, in its First and Second Reports, respectively. In effect, therefore, the portion of the net proceeds of Union excise duties from which all States receive a share was 40 per cent for the Eighth Commission. It remained so in the one year (1989-90) report of the Ninth Commission, but it was reduced to 37.575 per cent in its second report pertaining to the period 1990-95.

5.25 States have generally asked for an upward revision in their share in the net proceeds of Union excise duties from the present 45 per cent to 55 per cent and even 60 per cent. They have also pleaded for an enlargement of the divisible pool by including cesses levied under specific Acts, and a portion (20 per cent) of the yield from administered prices which are periodically increased by the Government. Some State Governments argue that instead of raising the administered prices, the Government should raise the excise duty tariff on the concerned product. This will automatically entitle the States to a share in the proceeds.

5.26 It may be noted that, in the context of the greater market orientation of the economy, the scope for the Central Government to raise administered prices would be progressively constrained except in cases where it might have a monopoly. We would

suggest that even in these cases, decisions to raise administered prices should aim at minimising budgetary support and increasing operational efficiency of the concerned public enterprises.

5.27 As regards the inclusion of revenues from the cesses in the divisible pool, it may be mentioned that a cess is levied on a specified commodity and is governed by a special Act of Parliament with the stipulation that it should be utilised for the development of the specific industry, the products of which bear the cess. The proceeds of such cesses cannot, therefore, be shared with the States.

5.28 Having regard to the views of the Central and the State Governments in the matter, and having recommended a decrease in the States' share of the net proceeds of income tax, we further recommend that the share of States in the net proceeds of Union excise duties be raised to 47.5 per cent.

Distribution of Divisible Amounts

5.29 The criteria for determining the inter se shares of States in income tax and Union excise duties have tended to converge since the recommendations of the Seventh Commission. However, 10 per cent of the distributable amount of income tax was allocated amongst the States on the basis of contribution and a portion of Union excise duties set aside for distribution according to assessed deficits. The convergence of the criteria determining the shares of States in the remaining portion of these two taxes is a move in the right direction. We now consider the determination of the inter se shares of States in income tax and excise duties.

5.30 For the distribution of the net proceeds of income tax among the States, successive Finance Commissions, till the Seventh Commission, gave weightage to 'population' as a major factor and 'contribution' as a minor factor. The Eighth and the Ninth Commissions gave a weight of 10 per cent to the factor of contribution in the distribution of the net proceeds of income tax, but reduced the weight of population substantially.

5.31 In their memoranda submitted to us, while nine States have favoured providing a weightage ranging from 10 per cent to 45 per cent to the 'contribution' factor, fourteen States are against including it at all in the distribution criteria. As for the 'population' factor, while eighteen States have recommended its retention, there is wide divergence in the views regarding the weightage to be given to it. Haryana and Punjab want to increase the weightage to 100 and 80 per cent, respectively. Maharashtra has suggested 55 per cent, while Karnataka, Kerala, Nagaland and Uttar Pradesh want it kept at 50 per cent. The other States have proposed weights ranging from 20 per cent to 40 per cent.

5.32 A number of States have argued before us, as also before previous Finance Commissions, that there is no case for attaching any weight to the factor of 'contribution'. While discussing the subject, the Eighth Commission had noted that the basic argument in favour of including this as a factor in determining the inter se shares was premised on a portion of income having a 'local origin' such as that arising from State emoluments, small businesses, retail trade and house property. However, the same report had noted the views of one of its members, "Dr. C.H. Hanumantha Rao feels that there is no case for distributing part of the States' share of income tax among the States on the basis of contribution." (para 5.20, page 43, Report of the Eighth Finance Commission). Earlier Dr. Raj Krishna, as a member of the Seventh Commission, had observed in his minute of dissent "...it is important to perceive that the State in which income seems to originate for the purpose of assessment is not necessarily the State where this income originates in a more

fundamental economic sense." (emphasis in original; page 114, Report of the Seventh Finance Commission).

5.33 The generation of income, especially non-agriculture income, is a spatially interdependent activity. The linkages run through the input side as well as the demand side. An output being produced in a specific place may be using inputs produced in various other locations. The income generated from the sale of this output also depends on the incomes of consumers who may be spatially dispersed throughout the country. The country as a whole represents a common economic space and market, and growing interdependence in economic activities has considerably weakened the case for locally originating incomes in the non-agricultural sector. We are, therefore, persuaded there is no need to retain contribution as a criterion of distribution. Besides, the only factor that now stands in the way of a common formula for distribution of the two taxes is this component of 'contribution' in the case of income tax. Accordingly, we have not used 'contribution' as a factor in determining the respective shares of States in the distributable amount of the net proceeds of income tax. To the extent, however, that 'contribution' is interpreted as 'collection', it is the effort of the States in collecting their own taxes that is relevant rather than a tax levied and collected by the Centre. We have recognised this while recommending later that tax effort of the States, which necessarily includes collection effort, be a factor with a weight of 10 per cent in the distribution of the divisible pool.

5.34 Since the recommendations of the Eighth Commission, the allocative criterion determining the shares of States has mainly made use of an information base comprising population and per capita incomes of the States. The three criteria derived from this information base are, the population criterion, the distance criterion, and the inverse of income criterion, which has sometimes been called the income adjusted total population (IATP) criterion. In addition, the Ninth Commission had used an index of poverty, in their first report, and an index of backwardness in their second report.

5.35 Andhra Pradesh, Assam, Bihar, Goa, Karnataka, Kerala, Madhya Pradesh, Manipur, Meghalaya, Nagaland, Orissa, Rajasthan, Tamil Nadu and Uttar Pradesh have suggested inclusion of such criteria as would take into account the relative backwardness of the States, e.g., composite index of backwardness, distance of per capita income of a State from the highest per capita income and inverse of per capita income weighted by population. Some States have suggested that 'area' and 'index of infrastructure' are relevant factors in this context.

5.36 Arunachal Pradesh, Assam, Meghalaya and Kerala have urged that a certain percentage of the divisible proceeds be reserved for distribution among the revenue deficit States, while Himachal Pradesh, Manipur, Mizoram and Nagaland have suggested that a specified percentage be pre-empted for exclusive distribution among the special category States.

5.37 The Eighth and the Ninth Commissions (First Report) evolved an approach whereby 90 per cent of the divisible pool of income tax and 40 per cent of the net proceeds of Union excise duties were distributed among the States on the basis of a common formula. In the second report of the Ninth Commission, although the approach was the same, there was some variation in the relative weights assigned to different criteria for the two taxes, as summarised in Table 1.

Table 1

Distribution Criteria:Relative Weights

COMMISSION CRITERIA	EIGHTH Income tax*	NINTH First Report UED**	NINTH Second Report	
			Income	UED#
Population	25	25	25	29.94
Distance	50	50	50	40.12
Inverse Income	25	12.5	12.5	14.97
Poverty/Backwardness		12.5	12.5	14.97
	100	100.0	100.0	100.00

* relates to 90 per cent of the States' share.

** relates to 40 per cent of the net proceeds of UED.

relates to 37.575 per cent of the net proceeds of UED.

Weights in the last column are derived by multiplying the weights as given in Para 5.36 of the second report of the Ninth Commission by a factor of (100/83.5).

5.38 Evidently, the distance and the inverse income formulae, which utilise the same information base, namely, population and per capita income, have jointly carried a very high weight. Yet because of the common information base in the two formulae, viz. inverse income and distance, both of which are progressive, the issue of their relative merit requires further discussion.

5.39 The population criterion allocates the same per capita share or transfer to a State, independent of its ranking in the income-scale. By itself, therefore, it is not a progressive criterion. When progressivity is imparted to the allocative criterion, as in the case of the distance or the inverse-income, the lower income States are allotted a higher share in per capita terms. This is achieved only by a corresponding reduction in the per capita share of higher income States, i.e. States with more than average per capita income. We find that, compared to the distance formula, in the inverse income formula, owing to the implicit convexity in it, the middle income States have to bear a relatively higher burden of this adjustment. This may be interpreted as a deficiency of the inverse-income formula (see Appendix 4).

5.40 We have, therefore, decided to use the distance formula for generating progressivity in distribution that hitherto was being achieved by a conjunction of the two formulae. In view of the shares already given jointly to the two formulae in the earlier awards, we have decided to give a weight of 60 per cent to the distance formula. In the pure version of the formula, the highest income State would not get any share because its distance measured from its own income would be zero. Presently, as for the Ninth Commission, this State happens to be Goa. Like them, we have decided to measure the distances from the per capita income of Punjab, giving it, and Goa, the notional distance between the per capita SDP of Punjab and that of the next highest income State, viz. Maharashtra. The respective 'distances' are multiplied by the population of the States, and the share of a State is obtained by dividing the product by the sum of such products for all the States. This procedure of multiplying an index by respective populations, and deriving shares according to such products has been called 'scaling' in the following paragraphs.

5.41 For the population criterion, we have given a weight of 20 per cent. This is a marginal reduction from the weight of 22.5 (i.e. 25 per cent of 90 per cent) used by the Ninth Commission.

Since as a scale factor, its influence, in any case, is spread across all formulae, we consider that this adjustment is of relatively minor importance.

5.42 Some States have urged us to use 'area' as one of the distribution criteria. Earlier Commissions had also considered this issue. The argument in favour of using area depends primarily on the additional administrative and other costs that a State with a larger area has to incur in order to deliver a comparable standard of service to its citizens. However, we also recognise that this difference in the costs of providing services may increase with the size of a State but only at a decreasing rate. Beyond a point, increment in costs may, in fact, become negligible. At the same time, there are many States with a very small area. Nevertheless they have to incur certain minimum costs in establishing the framework of governmental machinery. Many of these smaller States are in hilly terrain, and the costs there may be higher because of the nature of the terrain. Taking these considerations into account, we are of the opinion that although area as a factor may be used, certain adjustments may be required at the upper and lower ends. We thought that it would be relevant to use an adjustment procedure whereby no State gets a share higher than 10 per cent at the upper end, and no State gets a share less than 2 per cent at the lower end. The shares of other States are derived accordingly. We have assigned a small weight of 5 per cent to area.

5.43 The Ninth Commission had used in its first report, an index of poverty, and in the second report, an index of backwardness for imparting greater progressivity to the devolution scheme. From the very beginning of our deliberations, we have been of the opinion, that some corrections are required for the relative disparities in infrastructure as between the States. For this purpose, we had commissioned a study with a view to obtaining a set of indices which would reflect inter-State differentials in infrastructure. The study was carried out by a group of eminent economists. We appreciate that they estimated for us a number of alternative indices despite the difficulties in obtaining relevant data and setting up a suitable methodology for the purpose.

5.44 The index of infrastructure that we have utilised, reflects the relative achievement of a State in providing an economic and social infrastructure to its citizens. The economic infrastructure here consists of a number of sub-sectors, viz. agriculture, banking, electricity, and transport and communications. The social infrastructure consists of education and health. An aggregate index was derived pertaining to these subsectors. The relevant details are given in Appendix 5. For utilising this infrastructure index (which assigns a higher share to a State with better infrastructure) as an allocative criterion, we have used the distance method, as in the case of the distance formula described earlier, and scaled these distances with population, so as to derive the respective shares of the States. A State lower on the infrastructure scale gets a higher share, because its distance is measured by the difference of the value of its own index from that of the highest indexed State. The highest indexed State, itself gets a notional distance equal to its distance from the next highest reading. We have decided to give this factor a weight of 5 per cent.

5.45 Our terms of reference direct our attention to 'the tax efforts made by the States.' Measurement of tax effort on a comparable basis among the States is not a straightforward exercise because tax effort must be related to some notion of tax potential, and there are differences in the nature and composition of tax-bases among the States. Given the data constraints on a

suitably disaggregated information base pertaining to different tax-bases, our choice has been narrowed down to using per capita state domestic product as a proxy for the aggregate tax-base. Tax effort could then be measured by the ratio of per capita own tax revenue of a State to its per capita income. We felt that there was still a need to provide for an adjustment for States with poorer tax bases. If the tax effort ratio as defined above is divided by per capita income, it would imply that if a poorer State exploits its tax-base as much as a richer State, it gets an additional positive consideration in the formula. Thus, using an index of tax effort, as measured by the ratio of per capita own tax revenue to the square of per capita income, the respective shares are worked out after scaling by population. We have decided to give this index a weight of 10 per cent. Basic data relating to all the criteria are given in Annexures V.1 to V.5.

5.46 While the criteria explained above shall apply to the entire divisible pool of income tax, we have decided to reserve a portion of Union excise duties to be distributed on the basis of deficits as assessed by us. The Eighth Commission had set apart 5 per cent in the 45 per cent share recommended by it for distribution among deficit States. These percentages were retained in the first report of the Ninth Commission. In its second report that Commission incorporated this 'deficit-based' devolution in the overall devolution formula. It recommended that 16.5 per cent of the 45 per cent, i.e. 7.425 per cent of the net proceeds of the Union excise duties be used for distribution among the 'deficit' States. Apart from the difference in the manner in which these percentages are stated, there is no effective difference in the two procedures. We have decided to keep apart 7.5 per cent out of the 47.5 per cent of Union excise duties assigned to the States for distribution amongst States assessed by us to be deficit. This deficit has been assessed after taking into account devolution of income tax and 40 per cent of the net proceeds of Union excise duties, and after taking into account shares of States in additional excise duties and grant in lieu of tax on railway passenger fares, in each of the years during the period 1995-2000, as a proportion of the total deficit so assessed for all the States.

5.47 To summarise, the criteria for determining the inter se shares of the States in the shareable proceeds of income tax are based on the following indices :

- i) 20 per cent on the basis of population of 1971 as explained in para 5.41;
- ii) 60 per cent on the basis of distance of per capita income as explained in para 5.40;
- iii) 5 per cent on the basis of 'area adjusted' as explained in para 5.42;
- iv) 5 per cent on the basis of index of infrastructure as explained in para 5.44;
- v) 10 per cent on the basis of tax effort as explained in para 5.45;

We thus recommend that for each financial year in the period 1995-96 to 1999-2000

- a) Out of the net distributable proceeds of income tax, a sum equal to 0.927 per cent shall be deemed to represent the proceeds attributable to Union Territories.
- b) The share of the net proceeds of income tax assigned to the States shall be 77.5 per cent.
- c) The distribution among States of the share assigned to them in each financial year should be on the basis of the percentages shown in Table 2 .

Table 2

Income Tax : Shares of States 1995 - 2000

State	Per cent
Andhra Pradesh	8.465
Arunachal Pradesh	0.170
Assam	2.784
Bihar	12.861
Goa	0.180
Gujarat	4.046
Haryana	1.238
Himachal Pradesh	0.704
Jammu & Kashmir	1.097
Karnataka	5.339
Kerala	3.875
Madhya Pradesh	8.290
Maharashtra	6.126
Manipur	0.282
Meghalaya	0.283
Mizoram	0.149
Nagaland	0.181
Orissa	4.495
Punjab	1.461
Rajasthan	5.551
Sikkim	0.126
Tamil Nadu	6.637
Tripura	0.378
Uttar Pradesh	17.811
West Bengal	7.471
TOTAL	100.000

5.48 We have used the same set of criteria for distribution of 40 per cent of the net proceeds of Union excise duties. Accordingly we recommend that 40 per cent of the net proceeds of Union excise duties during each financial year in the period 1995-96 to 1999-2000, should be distributed as per the shares in Table 3.

Table 3

40 per cent of Union Excise Duties : Shares of States 1995 - 2000

State	Per cent
Andhra Pradesh	8.465
Arunachal Pradesh	0.170
Assam	2.784
Bihar	12.861
Goa	0.180
Gujarat	4.046
Haryana	1.238
Himachal Pradesh	0.704
Jammu & Kashmir	1.097
Karnataka	5.339
Kerala	3.875
Madhya Pradesh	8.290
Maharashtra	6.126
Manipur	0.282
Meghalaya	0.283
Mizoram	0.149
Nagaland	0.181
Orissa	4.495
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Rajasthan	5.551
Sikkim	0.126
Tamil Nadu	6.637
Tripura	0.378
Uttar Pradesh	17.811
West Bengal	7.471
TOTAL	100.000

5.49 We also recommend that the remaining 7.5 per cent of the net proceeds of Union excise duties be distributed among the States in accordance with the shares specified by us for each financial year in the period 1995-96 to 1999-2000 as given in Table 4.

Table 4

Shares of States in 7.5 per cent of the net proceeds of Union Excise Duties

State	(per cent)				
	1995-96	1996-97	1997-98	1998-99	1999-2000
(1)	(2)	(3)	(4)	(5)	(6)
Andhra Pradesh	12.069	7.988	0.000	0.000	0.000
Arunachal Pradesh	3.410	4.300	5.871	6.224	6.667
Assam	8.543	9.836	11.849	10.748	9.290
Bihar	6.434	2.965	0.000	0.000	0.000
Goa	0.973	1.058	1.161	0.917	0.604
Himachal Pradesh	8.816	10.744	14.057	14.230	14.338
Jammu & Kashmir	13.366	16.491	21.985	22.741	23.700
Manipur	3.930	4.891	6.602	6.917	7.348
Meghalaya	3.590	4.403	5.815	5.994	6.130
Mizoram	3.676	4.628	6.278	6.784	7.074
Nagaland	5.818	7.417	10.247	11.072	12.025
Orissa	4.815	5.248	4.934	2.773	0.680
Rajasthan	0.835	0.000	0.000	0.000	0.000
Sikkim	1.199	1.473	1.938	1.982	2.055
Tripura	5.465	6.807	9.263	9.618	10.089
Uttar Pradesh	17.061	11.751	0.000	0.000	0.000
TOTAL	100.000	100.000	100.000	100.000	100.000