

TAX RENTAL : DISTRIBUTION OF ADDITIONAL DUTIES OF EXCISE

6.1 Paragraph 5 (a) of the President's Order requires us to suggest changes, if any, to be made in the principles governing the distribution among the States of the net proceeds in any financial year of the additional excise duties leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in lieu of the sales tax levied formerly by the States.

6.2 The scheme of the levy of additional excise duties on sugar, tobacco, cotton fabrics, woollen fabrics, and man-made fabrics was the outcome of an agreement reached at the meeting of the National Development Council held in December, 1956, by which the States agreed to refrain from exercising their power to levy sales tax on these commodities in lieu of a share in additional excise duties to be levied by the Centre. In pursuance of the said arrangement, the additional excise duties have, since 1957, been levied and collected by the Centre and the entire net proceeds (after deducting the share of Union Territories) are distributed amongst the States in accordance with the principles of distribution laid down by Finance Commissions from time to time. The arrangement stipulated that the distribution among the States should assure to them the revenue realised in 1956-57 from their respective sales taxes on these articles. Thus the scheme was essentially in the nature of a tax-rental arrangement. While a state has even now the constitutional right to reimpose sales tax on these commodities there are two deterrents. First, in view of sections 14 and 15 of the Central Sales Tax Act (1956), which declare these goods to be goods of special importance in inter-state trade and commerce, the rate of sales tax, even if reimposed by the States, cannot exceed 4 per cent. Secondly, if in any year a State levies sales tax on any of these commodities, no sums will be paid to that State as its share in the proceeds from additional excise duties of that commodity unless the Central Government otherwise directs.

6.3 The Second, Third, Fourth and Fifth Commissions adopted a procedure under which they first set apart the guaranteed level of States' revenue which the States were realising from sales tax on these commodities in 1956-57, and then the balance amount of additional excise duties was distributed according to specific principles. The Second Commission, which was the first to examine this matter, adopted consumption figures along with population as a corrective factor. The Third Commission felt that since the additional duties of excise were being levied in lieu of sales tax, the shares in the additional excise duties in excess of the guaranteed amount, should be determined partly on the basis of percentage increase in the collection of sales tax in each State since 1957-58 and partly on the basis of population. The Fourth Commission was of the view that the collection of sales tax in a State was more directly indicative of the contribution made by each State than population. Hence, that Commission adopted sales tax realised in each State as the sole criterion and dispensed with the factor of population. The Fifth Commission took into consideration certain limitations in relying exclusively on sales tax which was raised from a wide range of commodities comprising luxuries, semi-luxuries, raw materials and intermediate goods and, therefore, assigned equal

weight to both sales tax (excluding inter-State sales tax) and population.

6.4 The Sixth Commission made a departure from the earlier practice of first setting apart the guaranteed amounts as they were convinced that there was no risk of the share of any State not coming up to the guaranteed amount. As regards the basis of distribution, they took the view that the levels of consumption of these commodities would have been the 'best possible indicator' but in the absence of data state domestic product and population were considered to offer a reliable approximation of such levels. But that Commission also felt that the States would have realised sales tax not merely on what was consumed in the State but also on what was produced in the State and sold in the course of inter-state transactions of these commodities. It, therefore, gave a small weight to production. For all these reasons it decided to allocate the shares on the basis of population, state domestic product and production in the ratio of 70:20:10.

6.5 Like the earlier Commissions, the Seventh Commission felt that the appropriate basis for the distribution of revenue from additional excise duties would be the levels of consumption of the dutiable articles in each state. For this purpose, the Commission examined the data compiled by the National Sample Survey Organisation (NSSO) from the consumer expenditure survey of 1972-73 (27th round). However, they did not rely on it because the coverage of the three items in terms of variety in the NSS differed from the description of these items for the purpose of additional excise duties and in the case of sugar and textiles, the non-household consumption which was not reflected in the NSS data, was also considered significant. That Commission finally adopted two separate bases for the distribution of the net proceeds, one for sugar and the other for textiles and tobacco. In the case of sugar, the Commission decided to treat the despatches of sugar to the States as a fair approximation to the consumption of sugar. As regards textiles and tobacco they preferred to rely on the generally accepted proposition that higher income levels would lead to higher consumption of textiles and tobacco, specially the varieties which account for a major part of the revenue from additional excise duties. Accordingly, they determined each State's share in the net proceeds from additional excise duties on textiles and tobacco by multiplying its average per capita SDP for the three years ending 1975-76 by its population according to the 1971 census.

6.6 The Eighth Commission did not favour the use of either the consumption data based on NSS data, or sugar despatches to different States or sales tax revenues. They recommended that the shares of States in the additional excise duties be determined by giving equal weightage to state domestic product and population. The Ninth Commission maintained the view that since the additional excise duties were levied in lieu of sales tax which itself is a tax on consumption, the share of the States should correspond to their share in the consumption of these commodities. Direct and reliable data of State-wise consumption of these commodities, however, could not be obtained by that

Commission. The Commission, therefore, relied on proxies, namely state domestic product and population of the respective States and recommended the shares of individual States by giving equal weightage to these two factors. The Ninth Commission preferred to use 1981 census figures of population because in their view, distribution of additional excise duties was not in the nature of devolution for which census figures for 1971 were to be used as per their terms of reference.

6.7 In their memoranda, the State Governments have not only put forward their suggestions on the principles of distribution of the net proceeds from additional excise duties but also commented upon the manner in which the scheme of replacement of sales tax by additional duties of excise has been operated by the Central Government. Reviewing first the principles of distribution, most State Governments have recognised the situation that in view of the inadequacy of reliable data on the State-wise consumption levels of the three articles, the distribution has to be based on the best available proxies. Karnataka, Kerala, Maharashtra, Tamil Nadu and Manipur have urged that the distribution of the entire proceeds be done on the basis of the proportion which the sales tax revenue of each state bears to the total sales tax revenues of all the States. Gujarat has expressed the view that the distribution be done in proportion to the guaranteed amounts as worked out by the Second Commission. As an alternative, it has suggested a criterion based on trends in the growth of sales tax revenues. Haryana has pointed out that the trend in its sales tax collections showed a very high growth in comparison to that of its share in the additional excise duties and, therefore, suggested that the existing tax-remittance arrangement be scrapped. Alternatively, it has supported the distribution of the proceeds of additional excise duties on the basis of sales tax collections. Bihar, Madhya Pradesh and Orissa have proposed that distribution be done on the basis of population. Uttar Pradesh has also favoured the population factor. In the alternative, it has suggested that the proceeds should be distributed among the States in proportion to their share in the guaranteed amounts. Punjab Government has proposed that distribution among the States be done in the ratio of the respective products of population and average per capita state domestic product.

6.8 Andhra Pradesh wants the existing scheme of tax-remittance arrangement to be revoked as it finds that States have lost heavily due to the delay in setting up the Standing Review Committee as decided by the National Development Council in 1970 and the long period allowed by the Committee for the incidence of additional excise duties to reach the level of 10.8 as a percentage of the value of clearances. For the interim period, it has suggested that the distribution be done in the same manner as recommended by the Ninth Commission. West Bengal has felt that the original rights of the States to levy sales tax on these articles be restored as the Centre has not fulfilled its commitments in time and States have thus lost substantial sums of revenue. Rajasthan has suggested that the distribution be done on the basis of current consumption of the commodities in the light of the NSS data. If this was not feasible, the State Government has suggested that 75 per cent weightage be given to population as projected for 1997 and the balance of 25 per cent be distributed on the basis of per capita income.

6.9 Arunachal Pradesh has suggested that 30 per cent of the proceeds be set apart for distribution among deficit States and the balance be allocated on the basis of population and state domestic product. Similarly Nagaland has also proposed that 20 per cent of the total net proceeds be earmarked in the first instance

for the hill States and the balance be distributed by giving weightage of 75 per cent to population and 25 per cent to state domestic product. Himachal Pradesh has pleaded that the distribution be based on NSS consumption data. Goa and Meghalaya have favoured equal weightage to state domestic product and population. Jammu and Kashmir has expressed the view that the 1993-94 population figures should be used. While Sikkim has suggested the use of identical criteria for the distribution of shares under Union excise duties and additional excise duties, Tripura has suggested that the scheme be abolished and, in the interim period, the distribution of additional excise duties should be on the same criteria as for Union excise duties.

6.10 Before we discuss the principles for the distribution of additional excise duties for 1995-2000, we may refer to the major complaints of the States regarding the manner of the operation of the scheme. The complaints, by and large, relate to the following decisions taken at the meeting of the National Development Council held in December 1970 to discuss the subject of the replacement of sales tax on sugar, tobacco and textiles by additional excise duties:

- i) The ad valorem system of additional excise duties be extended to all items except un-manufactured tobacco.
- ii) The incidence of additional excise duties be raised to 10.8 per cent of the value of clearances as soon as possible during the next two or three years.
- iii) While making upward adjustments in basic excise duties in future, the Government of India should keep in view a ratio of 2:1 between the yield of basic and special excise duties on the one hand and additional excise duties on the other.
- iv) A Standing Review Committee be set up to review the working of the new arrangement at least once a year and make suitable recommendations for its further improvement.

6.11 The implementation of the above decisions remained tardy in the initial stages as would be evident from the fact that the first meeting of the Standing Review Committee was held in February 1981 i.e. after a gap of over ten years. The Committee in its meeting held in November 1981 recommended that the incidence of additional excise duties of 10.8 per cent of the value of clearances may be achieved in three stages viz : 8.5 per cent by 1984-85, 9.75 per cent by 1987-88 and 10.8 per cent by 1989-90. The States have a grievance that delay in setting up the Standing Review Committee amounted to a breach of agreement and has caused them financial loss.

6.12 In regard to the stipulation for moving towards ad valorem system of additional excise duties we find that the duty structure for cotton and man-made fabrics which was based on specific-cum-ad valorem rates has now been converted into ad valorem rates. However, in the case of sugar, bidis and cigarettes, which are major revenue yielding commodities, rates continue to be specific. From the data obtained from the Ministry of Finance which is indicated in Table 1, the ratio between basic and additional excise duties is seen to have satisfied the norm envisaged by the National Development Council. The incidence of additional excise duties as per cent of value of clearances also reached 10.87 in 1989-90 as against the targeted level of 10.8.

Table 1

Year	Ratio between basic* and additional excise duties	Incidence of additional excise duties in terms of per cent of value of clearances
1982-83	1.79:1	7.43
1983-84	1.57:1	8.17
1984-85	1.29:1	8.93
1985-86	1.28:1	8.84
1986-87	1.19:1	9.02
1987-88	1.23:1	9.87
1988-89	1.23:1	10.67
1989-90	1.22:1	10.87

* including special, regulatory and auxiliary duties.

6.13 Having regard to the tax rental nature of the levy, the most appropriate principle to be used for distribution among States is that of compensation for the loss of revenue from sales tax on sugar, textiles and tobacco. Therefore, the demands of certain States to set aside a certain percentage for exclusive distribution among hill States or deficit States, or to adopt identical criteria for the distribution of additional excise duties and Union excise duties cannot be accepted as they are not in keeping with the spirit of the tax-rental scheme.

6.14 It has been well accepted that State-wise figures of consumption of the three articles on which the additional excise duties are levied would closely reflect the potential loss of sales tax revenue sustained by the States. Like the earlier Commissions, we also sought data from the NSSO in regard to State-wise consumption on sugar, textiles and tobacco, based on their latest round of survey. The NSSO furnished to us estimates of household consumption expenditure on clothing, tobacco and sugar based on the 43rd round of the survey carried out by them in 1987-88. The Seventh, Eighth and the Ninth Commissions did not use similar data furnished by the NSSO on earlier occasions owing to various infirmities. The data furnished to us also suffer from similar infirmities. As the estimates relate only to household consumer expenditure, the segment of non-household consumption, which is quite significant, particularly in the case of sugar and textiles, is not covered. Besides, there are discrepancies between the description of the articles on which the additional excise duties were levied and the items covered in the 43rd round of survey. For example, while various types of textiles, textile fabrics and textile articles including those for industrial use were subject to additional excise duties, the household consumption expenditure in the NSS estimates was related only to the category of 'clothing'. Also, there would be a gap of eight years between the year 1987-88, to which the NSS data relate and the year 1995-96 from which our recommendations would be operative. It would be reasonable to assume that the consumption pattern in regard to certain varieties of tobacco and textiles would change over the years. We are unable to use the NSS estimates and are constrained to consider the distribution of additional excise duties on the basis of suitable proxies.

6.15 In evolving our approach for the distribution of the States' shares, we have kept in view the bases adopted by the earlier Commissions, the views of the State Governments and the availability of reliable data for the proxies which would represent a fair approximation to the consumption of the three articles. The commodities on which additional excise duties are levied are articles of mass consumption and accordingly, in our view, population should have a substantial weight in the formula. We also agree with the views of the earlier Commissions that the level of State income has a significant bearing on the consumption of sugar, textiles and tobacco and should be a factor in distribution.

6.16 Since sales tax is a levy on consumption, some of the past Commissions have accepted proportion of sales tax revenues as capturing the consumption levels of the three

commodities. Some of the States are of the same view. The other point of view is that since sales tax is levied on a host of commodities ranging from luxuries to raw materials, the proceeds of this tax do not represent the consumption levels of these three alone. Nevertheless, there is a relationship between consumption, as represented by sales tax, and consumption of these commodities. Accordingly, we feel some weight can be given to sales tax.

6.17 We have worked out the shares of the States by assigning a weight of 50 per cent to population according to the 1991 census, 40 per cent to the average of state domestic product for the three latest years 1987-88 to 1989-90 for which the requisite data is available and 10 per cent to the average collection of State sales tax (excluding inter-State sales tax) for the three years 1990-91 to 1992-93, these being the latest three years for which final accounts are available. The State-wise data are placed at Annexures VI.1 and VI.2

6.18 We agree with the view of the Ninth Commission that distribution of additional excise duty is not in the nature of devolution for which the population figures of 1971 census should be used as per our terms of reference. Hence, we are using the latest census figures of 1991 which are placed at Annexure V.1.

6.19 As regards the share of the Union territories they should be treated as one unit, and their share determined on the same basis as that of all the States. Accordingly, the share of Union territories amounting to 2.203 per cent should be retained by the Central Government. We recommend that the balance should be distributed among the States as shown in Table 2.

Table 2.**Shares in Additional Excise Duties : 1995-2000**

States	Per cent
Andhra Pradesh	7.820
Arunachal Pradesh	0.104
Assam	2.483
Bihar	7.944
Goa	0.232
Gujrat	5.995
Haryana	2.366
Himachal Pradesh	0.595
Jammu & Kashmir	0.856
Karnataka	5.744
Kerala	3.740
Madhya Pradesh	7.236
Maharashtra	12.027
Manipur	0.197
Meghalaya	0.188
Mizoram	0.079
Nagaland	0.137
Orissa	3.345
Punjab	3.422
Rajasthan	4.873
Sikkim	0.053
Tamil Nadu	7.669
Tripura	0.286
Uttar Pradesh	14.573
West Bengal	8.036
TOTAL	100.000

6.20 Successive Commissions have faced difficulties in obtaining reliable and comprehensive data on State-wise consumption of the three articles viz. sugar, textiles and tobacco which attract additional excise duties. We would like to urge the Government of India to take appropriate steps for the regular collection and maintenance of the requisite data on consumption of these commodities, both household and non-household, to facilitate the task of the future Finance Commissions.