



EAST INDIA (CONSTITUTIONAL REFORMS)

Report of the  
Federal Finance Committee

Dated 28th March, 1932

*Presented by the Secretary of State for India  
to Parliament by Command of His Majesty  
May, 1932*

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# FEDERAL FINANCE COMMITTEE.

## REPORT.

To The Right Honourable Sir SAMUEL HOARE, Bt., G.B.E.,  
C.M.G., M.P., His Majesty's Secretary of State for India.

SIR,

We were appointed by His Majesty's Government for the purpose explained in the following letter which was addressed by the Prime Minister to our Chairman on the 22nd December, 1931 :—

On behalf of His Majesty's Government I have to state, for the information and guidance of yourself, as Chairman of the Federal Finance Committee, and of your colleagues, the objects for which the Committee has been constituted, and to indicate the matters on which it is required to report.

As you are aware, a sub-Committee of the Federal Structure Committee was appointed under the chairmanship of Lord Peel to examine the question of Federal Finance, and the principles embodied in the Report of that sub-Committee were endorsed by the parent Committee as a suitable basis on which this part of the constitution should be drafted. It is thus upon the Report presented by Lord Peel's Committee that the labours of your Committee will be based, but you should observe that the recommendations embodied in that Report regarding the functions of the Expert Committees were modified by the Federal Structure Committee.

By far the most important task to be undertaken by your Committee will be to subject to the test of figures the suggested classification of revenues, and to estimate the probable financial position of the Federal and of the Provincial Governments under the proposed scheme. On the estimate so prepared it will be the duty of your Committee to advise as to the adjustments, if any, which should equitably be made between the Federal Government and the Provinces. Difficult as this would be if conditions were normal, His Majesty's Government realise that at a time when the Indian budgets, both central and provincial, have been thrown so completely out of gear, the difficulty of the task is immensely increased. Nevertheless, as every precaution must be taken to ensure, so far as possible,

financial equilibrium in the new Governments in India, this examination must be made, as it is essential that the best advice on this vital question should be available before the relevant portion of the constitution is drafted.

In addition to its main work, your Committee will also be required to examine and advise on a number of other connected matters referred to in the Reports of Lord Peel's Committee and of the Federal Structure Committee, of which I may mention the treatment of the pre-federation debt, powers of taxation, new sources of revenue, treatment of provincial contributions—if such contributions be found necessary—the emergency powers of the Federal Government, borrowing powers and the division of pension charges.

Having completed our enquiry into the matters referred for our consideration, we now have the honour to forward our Report for submission to His Majesty's Government.

## I.

### INTRODUCTION.

1. We assembled in New Delhi on the 1st February last and have since held forty-five meetings there. For the most part our deliberations have been based on materials supplied to us in the form of memoranda prepared in the Departments of the Government of India and by the Provincial Governments. We have supplemented this written evidence by personal consultation with the responsible officials, including representatives of each of the Provincial Governments, who were kind enough to come to Delhi for the purpose. It would have been impossible, in the time at our disposal, to receive formal evidence from non-official sources on the various economic and constitutional problems which must arise in connection with any enquiry into public finance, nor have we regarded such an extended investigation as falling within the scope of our duties. We have, however, so far as possible, endeavoured to acquaint ourselves informally with the general trend of non-official opinion, as well as with all facts bearing upon our main enquiry.

2. Throughout our work we have received the most cordial and invaluable assistance both from the Government of India and from the Provincial Governments, and we should like to express our deep sense of indebtedness to all the officers concerned. Our sittings have been held at a time of year when all the Departments connected with finance are already overburdened with work and must find it almost impossible to meet any additional demands upon their time and energies. Yet, short as was the notice given to them, we found on our arrival a mass of material specially prepared for us by the Government of India; similar material was furnished to us by all the Provincial Governments within the first three weeks

of our sittings; and the Finance Members or Secretaries of the Provincial Governments were good enough to undertake the long journeys necessary to give us their personal advice and assistance. In all cases, the material laid before us, whether orally or in writing, has been clear and comprehensive, and we have been impressed by the efficiency shown in its preparation. We hope that all the gentlemen concerned will accept this expression of our very sincere thanks.

3. We take this opportunity of expressing our thanks also to our two Secretaries, Mr. K. Anderson of the India Office and Mr. Sanjiva Row of the Finance Department of the Government of India, who have rendered us invaluable service in the preparation of our Report and in all parts of our work. We must further acknowledge the unfailing assistance rendered, at great pressure, by our staff, under the superintendence of Kanwar Sardar Singh.

## II.

### FEDERAL AND PROVINCIAL FORECASTS.

#### (i) *Basis of the Forecasts.*

4. Our duty is two fold : first, to estimate the probable financial position of the Federal Government and the Provinces of British India in the early years of the Federation, and to suggest adjustments between them ; and, secondly, to advise on certain aspects of federal finance, mainly on matters affecting the future relationship between the Federal Government and the constituent Units.

5. In carrying out our first and main function we have been faced, not only with the inherent difficulties of estimating revenue and expenditure for some years ahead, but also with the special difficulty that, owing partly to the world economic crisis and partly to certain internal difficulties, all Indian budgets, central and provincial, have been thrown completely out of gear. The yield of the main heads of revenue has been substantially reduced ; emergency taxation has been imposed ; cuts in pay have been made for a limited period only ; while, under many heads of expenditure, severe retrenchments, some temporary and others permanent, have been effected.

6. In these circumstances, the actuals of the past two years and the budget estimate of 1932-33 afford no reliable guide in forecasting the future position, and it is necessary not only to allow for emergency taxation and retrenchment but also to make certain assumptions in regard to the general economic situation. Broadly, we assume that the present depression will come to an end and that there will follow a period of reviving trade accompanied by a gradual increase of prices which, if they do not reach the pre-slump level,

will rise appreciably higher than the level now prevailing. We have tried, in short, to estimate revenue and expenditure in the early years of the Federation under more or less normal conditions; and although our discussions with official representatives of the various Governments have to some extent centred upon the year 1935-36, we desire to make it clear that we are not in any way attempting to frame a budget for that year or venturing any suggestion as to the actual date of federation. Moreover, although we have presented our forecasts in the form of a review of the position in a single year, we have not lost sight of the fact that it is not a single year, but a series of years, that is in question. We have accordingly made suitable allowances in our general conclusions for any variable factors or tendencies which appear to us to be of importance.

7. Whatever the actual date of federation may be, we assume that as the forecast has been prepared at a time when conditions are exceptional, the data on which our proposals are based will be reviewed immediately before the establishment of the Federation in the light of the information then available; and our conclusions should be held to be subject to the result of such a review.

(ii) *The Federal Forecast.*

8. Our first step has been to prepare a forecast of the revenue and expenditure of the Federal Government. For this purpose we have been furnished by the Government of India with the fullest materials bearing on all heads of revenue and expenditure, but we alone have been responsible for bringing them together in a combined forecast. The forecast which we give below must not, therefore, be taken as necessarily representing the views of the Government of India. In Appendix I we have set out the main considerations which have influenced our calculations, but we should like to make one general observation on the forecast as a whole.

9. While we have scrutinised each head of revenue and expenditure in detail, we recognise that, taking each head by itself, the possible margin of error is very wide. Taking all heads together, however, we consider that, on the general assumptions made by us our estimate fairly represents the probable financial position of the Federal Government in the early days of federation. It has also to be remembered that our revenue forecast throughout has, generally speaking, been based on the rates of taxation imposed by the First Finance Act of 1931; that is to say, we have not taken into account the special surcharges on customs, income-tax and salt at present in force. This is an assumption which, in all the circumstances, we feel obliged to make; but we do not wish to be understood to be expressing the view that the present level of taxation ought necessarily to be reduced. On the contrary, we think it might be wise to regard some at least of these surcharges as a possible reserve.

10. In the following Table we have, for convenience, given net figures as far as possible on either side of the budget, and items relating to the Chief Commissioner's Provinces and Centrally Administered Areas have been grouped so far as the complications arising from their connection with the Central Government permit. We have assumed that Burma will be separated from India, and have estimated the results of this change on such materials as are available; but, apart from this and the transfer to the Provinces of expenditure on their own accounts and audit, we have not allowed for the effects of future constitutional changes. Thus, income-tax revenue is included in full and also the State contributions, and no provision is made for any additional expenditure directly due to the establishment of a federal system.

TABLE I.  
*The Federal Forecast.*

<i>Revenue.</i>				<i>Expenditure.</i>			
(Rs. Lakhs.)				(Rs. Lakhs.)			
Customs	...	...	51,20	Debt Services :			
Collection	...	...	90	Interest (net)	...	..	11,25
Net	...	...	50,30	Sinking Fund	...	...	6,50
Salt	...	...	6,70	Posts and Telegraphs (net)	...	...	Nil
Expenditure...	...	...	1,15	Military Budget (net)...	...	...	47,00
Net	...	...	5,55	Frontier Watch and Ward	...	...	1,70
Opium	...	...	78	Civil Administration, including Territorial and Political Pensions but excluding other pensions and cost of collecting revenue, and allowing 60 for provincialisation of accounts and audit	...	...	6,85
Manufacture	...	...	73	Pensions	...	...	2,65
Net	...	...	05	N.W.F.P. Subvention...	...	...	1,00
Railways (net)	...	...	5,00	Civil Works	...	...	1,60
Currency and Mint (net)	...	...	3,80	Chief Commissioner's Provinces and Central Areas	...	...	2,86
Miscellaneous :				Revenue	...	...	1,31
Ordinary	...	...	1,66	Net	...	...	1,55
Reparations	...	...	30				
Total...	...	...	1,96	Total Expenditure	...	...	80,10
State Contributions	...	...	74				
Income Taxes	...	...	18,00				
Collection	...	...	80				
Net	...	...	17,20				
Total Revenue	...	...	84,60				
				Surplus	...	...	4,50

(iii) *The Provincial Forecasts.*

11. Our next task has been to attempt to forecast the financial position of the Provincial Governments on a similar basis. Here we have had before us actual forecasts of provincial budgets for the years 1933-34 to 1937-38. After a careful scrutiny of these forecasts in consultation with the representatives of the Governments concerned, we think that, on the same basis as we have adopted for



our federal forecast, and allowing for the transfer of liability for accounts and audit, the figures in the following Table approximately represent the probable future position of each Government.

TABLE II.  
*The Provincial Forecasts.*

<i>Province.</i>	<i>Surplus (+) or Deficit (-). (Rs. lakhs.)</i>
Madras ... ..	- 20
Bombay ... ..	- 65
Bengal ... ..	- 2,00
United Provinces ... ..	+ 25*
Punjab ... ..	+ 30*
Bihar and Orissa ... ..	- 70
Central Provinces ... ..	- 17
Assam ... ..	- 65

12. The contrast between our estimates for a federal surplus and for an aggregate provincial deficit of a considerable amount is partly accounted for by the fact that provincial sources of revenue are, for the most part, comparatively inelastic and cannot be expected to respond as quickly as central revenues to a recovery in economic conditions.

13. In arriving at these figures we have assumed that commercial stamps will not be federalised. Our reasons for this assumption are given in Section III of our Report. We have also assumed, in making our estimate for Bombay, that Sind will be constituted a separate Province without any subvention from the Presidency Government, and that the separation will result in a net saving to Bombay of between 90 and 100 lakhs; and we have also taken into account the financial separation of Aden from Bombay. We refer in Section V to the effect on federal finances of the separation of Sind. The financial position of the North-West Frontier Province has already been investigated by the Government of India and its deficit is represented by the subvention included in Table I.

14. A number of points have been brought to our attention by the Provincial Governments which have for some time been in dispute between them and the Government of India, including the question of the pre-Reform irrigation debt. We do not feel entitled to make recommendations on these points, and we have not taken them into consideration in our proposals.

15. We add three general observations on the provincial forecasts.

16. *Excise.*—In compiling the forecasts which were placed before us, the Provincial Governments have, generally speaking, assumed that the present economic depression will continue, or at least that

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\* In estimating for these surpluses we have adopted the figures placed before us by the Governments concerned.

recovery from it will be slower than we have assumed for the purposes of this Report. We have revised the revenue forecasts generally to correspond with our own assumptions and have, in particular, increased to some extent the estimates of excise revenue. Even so the estimates of receipts from excise on country liquor are, we think, still very low and appear to reflect in varying degrees, a deliberate policy tending to reduce or even extinguish this source of revenue. It would be beyond our competence to enter into the merits of that policy, but the evidence submitted to us seems to indicate that, in pursuing it, the Provincial Governments are sacrificing revenue without effecting a corresponding restriction of consumption. The decline in revenue appears to have been accompanied, almost everywhere, by an increase in illicit distillation. It will, we think, be generally agreed that a Province which deliberately foregoes revenue in this manner cannot fairly ask for special treatment in the distribution of income-tax at the expense of other Provinces.

17. *Expenditure.*—We have not taken into account the possibility of economies other than those already adopted by the Provincial Governments. Some further retrenchments may be possible within the frame-work of the existing administrative system; but, in view of the economies recently effected by Provincial Governments, it would probably be unsafe to suppose that further savings of this kind, effected during the next three or four years, will do more than balance any increased expenditure directly due to the introduction of the new reforms. Substantial reductions in existing expenditure could only be brought about by a comprehensive re-organisation of the system of administration. Measures of this kind are possible; they are being actively considered by at least one Provincial Government, while another has appointed a special retrenchment committee for this purpose; but we have not felt able to make any definite allowance for the effect of such re-organisation.

18. These remarks have a special application to Bengal. After making the same adjustments in the revenue estimates of Bengal as we had made in those of other Provinces, we found that the Bengal Government was still anticipating a permanent deficit equal to about three-fifths of any share in the total proceeds of income-tax which can fairly be claimed by the Presidency, and about one crore more than it can hope to receive out of those proceeds in the early years of federation, except by special treatment at the expense of other Provinces. We fully appreciate the difficulties through which Bengal is now passing, but we cannot believe that the Bengal Government and Legislature have no means at their disposal, whether of economy or of increased taxation, to reduce a deficit of this magnitude; and, in the hope that measures will be devised to meet the situation we have felt justified in reducing the anticipated deficit by about 40 lakhs. As we shall show

later, it is probable that even the deficit which we have accepted for the purpose of our estimate can only be wiped out at the expense of other Provinces, and even so the Presidency would be left with no margin for financing new policies.

19. *The General Financial Position of the Provinces.*—These considerations lead us to add a general warning. Our anticipations of normal provincial revenue and expenditure in the early years of federation do not, and cannot, take account of what may happen during the period before the Federation is established. Our estimates show that, on the basis of their present revenues, most of the Provinces will be in a difficult position at the outset of federation, even if they balance their budgets during the intervening period and carry over into federation only the liabilities which they have already incurred, including those in respect of budget deficits up to 31st March, 1932. If, during the intervening period, they continue to accumulate deficits year by year, the position will become quite unmanageable and the prospects of real provincial autonomy will *pro tanto* be endangered. We realise the special difficulties which confront each Province, but we cannot refrain from observing that Bihar and Orissa, which has certainly not the least difficulties to contend with, hopes to balance its budget for 1932-33 at the cost of severe retrenchment in all its services. If, as we hope to show, the Provinces can be provided with a substantial addition to their revenues when the proceeds of income-tax begin to be distributed, it is of the utmost importance that they should make, during the intervening period, the sacrifices necessary to enable them to take full advantage of the prospective improvement in their position. Otherwise, the additional expenditure required to provide for the service of further loans, taken to cover deficits, may mortgage the new revenue to such an extent that in many cases provincial autonomy would start under the most unfavourable conditions.

20. We regard it, therefore, as essential that the Government of India and the Local Governments should give this matter their immediate attention, and should endeavour to concert measures to secure equilibrium in the provinces during the intervening period.

21. It is hardly necessary to add that our forecast of federal finances depends upon the assumption that the Government of India, too, will find it possible to pursue, in the intervening period, a policy which will not jeopardise the initial federal surplus anticipated by us. Indeed, it will be apparent from the later sections of our Report that the surplus we anticipate is itself inadequate, and the Government of India may well have to consider how that surplus can be not only realised, but increased.

## III.

## PROSPECTS OF ADDITIONAL REVENUE.

22. From our examination of the probable financial position of the Federation it seems clear that the transfer of all income-tax receipts to the Provinces in the manner contemplated by the Peel Committee would leave the Federal Government with a large deficit; and as that deficit would be out of all proportion to any possibilities of retrenchment, we must turn, as previous committees have turned, to the examination of possible new sources of revenue, federal or provincial.

(i) *Federal.*(a) *Excise on Tobacco.*

23. The present position in regard to this tax appears to be that a substantial revenue may be expected from a system of vend licences and fees, but that an excise duty imposed in the near future could not be relied on to yield a substantial revenue. There is general agreement that such a duty could not be imposed on the cultivator, and it is doubtful whether a duty on the manufactured product could be successful while manufacture continues to be so largely carried on in small establishments and even as a domestic industry. Vend licences and fees can obviously be imposed only by the Governments of the Units, and their imposition by the Provincial Governments is now being encouraged by the Government of India. The difficulties in the way of a federal excise may be overcome in course of time, but it would be unsafe for us to rely on this in the near future.

(b) *Excise on Matches.*

24. The imposition of an excise duty on matches is already under active consideration, and we feel justified in contemplating the existence of such a duty from the outset of federation. We are advised that the probable net yield of the tax for all-India at a reasonable rate, with due allowance for reduced consumption, would be about 3 crores, of which at least 2.50 crores would be raised in British India.

(c) *Other Excises.*

25. It is possible that other excise duties may occupy an important place in the fiscal policy of India in the future, but we do not feel warranted in relying upon the introduction of such measures in the early years of federation.

(d) *Monopolies.*

26. We have examined the suggestion, made at the Round Table Conference, that federal revenues should be augmented by a few selected monopolies. From the fiscal point of view it is only in

very special circumstances that a monopoly, whether of production, manufacture or sale, is to be preferred to an excise duty as a means of raising revenue. Except in so far as the proposals already noticed in regard to tobacco may be regarded as a monopoly, we can suggest no new commodity to which the monopoly method could be applied with advantage. The manufacture of arms and explosives, which has been suggested as a possible monopoly, is already subject to license. Public utility monopolies stand on rather a different footing; but the only new federal monopoly of this kind that has been suggested to us is broadcasting, the revenue from which must be entirely problematical.

(e) *Commercial Stamps.*

27. In the Peel Report it was observed that " There is much to be said for federalising Commercial Stamps on the lines of various proposals made in the past ", but no definite recommendation was made. We have examined this suggestion, but on the whole we cannot recommend it, at least as an immediate measure.

28. The yield of certain stamp duties which might be placed in this category was, in 1930-31, slightly more than one crore. This was a sub-normal year, and the normal yield should be somewhat higher. In 1930-31 about 40 per cent. of the yield was received by Bombay (one-eighth of this being attributable to Sind), 27 per cent. by Bengal and 12 per cent. by Madras. The loss of revenue resulting from the federalisation of these duties would therefore be unevenly distributed, and their federalisation would not ease the problem of distributing income-tax.

29. Further, there are obvious difficulties in the way of separating stamp duties into two classes, commercial and non-commercial. It could only be done by means of a schedule, and a large element of purely arbitrary selection would be involved. The simple constitutional solution would be to class all stamp duties as provincial sources of revenue.

30. We have given some attention to the question, considered by the Federal Structure Committee, whether the Provincial Governments should be given power also to fix the rates of duty on all stamps, or whether legislation on this subject should be reserved, wholly or partially, to the Federal Government. We suggest that the Federal Government should retain the power to legislate on behalf of the Provinces in regard to those stamp duties which are the subject of legislation by the Central Government at the date of federation. The duties which are now the subject of central legislation are those on acknowledgments, bills of exchange, share certificates, cheques (not now dutiable), delivery orders in respect of goods, letters of allotment of shares, letters of credit, insurance policies, promissory notes, proxies, receipts and shipping orders. We understand that proposals have been under consideration for

adding other duties to this list, and would suggest that, if any such additions are contemplated, they should be made before the establishment of the Federation.

31. We ought to add, in this connection, that difficulties already arise in estimating the share of each Province in the proceeds from the sale of postage stamps for use on taxed documents; and these difficulties may be expected to lead to considerable friction with the Provincial Governments unless a more satisfactory system can be devised.

32. Finally, in proposing that the proceeds of commercial stamps should be assigned to the Units, we have to some extent been influenced by a doubt whether the problems arising from the imposition of federal stamp duties in the States might not be disproportionate to the revenue involved. We do not, however, wish to prejudge the possibility that, as part of the general federation settlement with the States, it might be found desirable to include these duties among the sources of federal revenue. This consideration might well outweigh the reasons which have led us to recommend that commercial stamps should not be made a source of federal revenue.

(f) *Corporation Tax.*

33. We shall comment on this tax in Sections V and VI of our Report. From the financial point of view, however, it seems clear that, if a corporation tax were imposed on companies registered in the States on the same basis as the present super-tax on companies in British India, the yield at present would be negligible.

(ii) *Provincial.*

(a) *Taxation of Tobacco.*

34. We have already dealt briefly with this question and have suggested that the taxation of tobacco, otherwise than by excise on production or manufacture, should rest with the Units, but that the Federal Government should be given the right to impose a general federal excise. This distinction is, we think, justified by the fact that *ex hypothesi* the introduction of excise duties on manufacture will be difficult, if not impossible, until manufacture becomes more highly industrialised; and as that development takes place an excise levied at the factory by one Unit of the Federation would be a tax on consumers in other Units. It will be seen from our later proposals in regard to powers of taxation that the federalisation of tobacco excise would not preclude the Federal Government from assigning the proceeds to the Units, if it so desired.

35. There is, unfortunately, no material which would enable us to estimate the yield of any of these forms of taxation. The

provincial taxes will take some time to mature, but eventually they may be expected to form at least a very useful additional source of provincial revenue.

(b) *Succession Duties.*

36. Bombay is, we believe, the only Provincial Government which has attempted legislation for the imposition of succession duties, and the attempt was unsuccessful. We understand that even that Government would have preferred that legislation should have been undertaken by the Government of India. We propose elsewhere that succession duties should be classed among taxes leviable by the Federal Government for the benefit of the Units; but clearly the facts would not justify reliance on them as a source of revenue in the near future.

(c) *Terminal Taxes.*

37. We have been asked to weigh the issues which arise from the proposal to introduce terminal taxes generally as an additional source of revenue for the Provinces. As the arguments for and against this proposal have been so fully set forth in previous reports, it scarcely seems necessary to re-state them here. The feature of such taxation which has impressed us most seriously is its operation as, in effect, a surcharge on railway freights. Where municipal octrois are in force, there appears to be a tendency to substitute for the general levy of dues on all goods entering the municipal boundaries the simpler alternative of a terminal tax collected at the railway station, and there is already a danger that this habit may result in diversion of traffic to the roads. We therefore recommend that, if terminal taxes are to be regarded as a permanent part of the financial structure, they should be imposed by the Federal Legislature for the benefit of the Units. Such terminal taxes as are already in existence (mainly as municipal taxes) will fall into much the same category as other taxes classed as federal which, at the time of federation, are being levied by certain Units; but though it may be necessary for this reason to authorise the municipalities and Provinces concerned to continue to raise these taxes, they should be allowed to do so only within limits laid down by the Federal Legislature. Assam and Bihar and Orissa are the two Provinces which, having few or no municipal taxes of the kind at present, are most desirous of deriving provincial revenue from this source. While we do not rule out the possibility of terminal taxes in these two Provinces and elsewhere as a temporary expedient, in view of the practice which has grown up in various parts of India, we are not prepared to regard terminal taxes as a normal source of revenue.



(d) *Taxation of Agricultural Incomes.*

38. We have not considered the broad issues of policy involved in the taxation of agricultural incomes, but we have considered, as we were commissioned to do, the more limited question of "the possibility of empowering individual Provinces, if they so desire, to raise, or appropriate the proceeds of, a tax on agricultural incomes". In view of the close connection between this subject and land revenue, we agree that the right to impose such taxation should rest with the Provinces. For the same reason, we think that this right should be restricted to the taxation of income originating in the Province concerned. There will presumably be no difficulty in drafting into the constitution a definition of agricultural income which has so long been recognised in Indian income-tax law and practice.

39. We are not prepared to express a final opinion as to whether agricultural and non-agricultural income should be aggregated for the purpose of determining the right of the assessee to exemption and the rate of taxation to which he is liable on either section of his income; and we doubt whether any provision need be inserted in the constitution on this point since we are advised that, in practice, it would scarcely be possible for either the Federal or a Provincial Government to take into consideration income not liable to taxation by it, except with the consent and co-operation of the other Government.

40. We are aware of no reliable data for estimating the yield of such taxation.

(iii) *Conclusion.*

41. In this survey of possible sources of additional revenue we have deliberately left out of account the question whether or to what extent it would be possible to increase the yield of existing taxes. We have confined ourselves to an examination of new sources, and in this field the results of our survey are not encouraging. We have found that such provincial taxes as appear to be within the sphere of practical politics in the immediate future cannot be relied on to yield any substantial early additions to provincial revenues. In using the phrase "practical politics", we are not, of course, expressing an opinion as to whether this or that tax ought or ought not to be imposed, or even as to whether it is or is not likely to be imposed by the legislatures of autonomous Provinces when these are constituted. We are only noting the fact that the opposition to certain forms of taxation, or the difficulty of their imposition, is still so great that they are not likely to be adopted soon enough to influence the financial situation at the time when the Federation comes into being. In the federal sphere, the excise on matches is the only tax which we feel justified in taking into account as an immediate reinforcement of federal



revenues. With this reinforcement, according to our figures, those revenues would yield a surplus of about 7·50 crores, including the whole proceeds of taxes on income as federal revenue and if the whole revenue from the new excise were paid into the federal fisc, or about 7·00 crores if only its yield in British India were taken into account. In what follows we take the latter figure, without prejudging the issue whether the excise duty on matches should be a federal tax in the full sense of the term.

#### IV.

#### DEBT, PENSIONS AND " CENTRAL CHARGES " .

42. Before considering what settlement can be effected with the Provinces on the basis of the figures at which we have arrived, we have to examine whether the whole of the pre-federation debt will be covered by assets to be taken over by the Federal Government, how pension charges should be allocated, and whether any other part of the expenditure of the Federal Government should be regarded as expenditure on non-federal services, i.e., as a " central charge " .

##### (i) *Pre-federation Debt.*

43. The valuation of the assets to be taken over by the Federal Government is a matter rather of judgment than of strict fact-finding in view of the uncertainty as to the basis of valuation which should be adopted. Valuation cannot, in all cases, proceed on a purely *commercial* basis—that is to say, on an estimation of earning capacity—for although the accounts of some departments have been commercialised, some of them are not administered for the purpose of profit. One instance is the Posts and Telegraphs Department, where the object is so to adjust rates that receipts will just balance expenditure. Again, the earning power of the railways classed as " strategic " is affected by the fact that they are an essential element in the scheme of national defence; and even in the case of railways classed as " commercial " , which have in the past afforded substantial support to general revenues, a declared policy of reducing rates and fares when financial conditions permit renders it difficult, if not impossible, to estimate their full earning capacity. Nor would it be reasonable in such cases to adopt the cost of *replacement* as the basis of valuation, for if the railways had to be rebuilt and the other commercial departments of the Federation equipped afresh, the cost at present-day prices would largely exceed the original outlay.

44. We are driven, therefore, in the case of the commercial departments, to adopt as our basis of valuation the *capital* shown as debited to those departments in the statement of the public debt of India; and, in all the circumstances, this seems to be a reasonable basis. On 31st March 1931 (the date to which the following

statistics refer) this figure stood at 7,67,63·17 lakhs. Adding to it the interest-earning debts due from the Provincial Governments (1,51,82·53 lakhs) as well as other interest-earning advances (19,45·18 lakhs) we reach a total of 9,38,90·88 lakhs. The sums outstanding in respect of the commutation of pensions (1,89·95 lakhs) would bring this total to 9,40,80·83 lakhs.

45. We now deal with the other state property which the Federal Government will inherit. Such assets, though in some cases yielding a return in the form of rents, and in others enabling Government to avoid expenditure charged to revenue which otherwise would have to be incurred, cannot be valued on any commercial basis, as they represent, to a large extent, dead assets. Nevertheless they must be taken into account, as without them Government could not properly function. Complete lists of state property falling into this category do not exist, nor is information available in all cases as to the original cost or book value. In the case of New Delhi and the Bombay Military Lands, the figure of the cost (19,88·38 lakhs) can fairly be accepted in view of the recent date of the transactions; and, for present purposes, we take the book value (87,44·00 lakhs) for all the civil and military properties and other miscellaneous items which find a place in such registers as are maintained, although, in our judgment, the book value of several items understates the real value. The lists, however, are very incomplete; and no account is taken of such assets as forests, most of the military lands, R.A.F. buildings and landing grounds, certain stores, plant of the Public Works Department, furniture, libraries and museums, nor, of course, of roads and bridges. The original cost or the replacement value of these properties must be very large indeed; but we have no materials on which we can form even an approximate estimate of the amount involved.

46. The total value, therefore, of the identifiable assets to be taken over by the Federal Government which we have considered so far amounts to 10,48,13·21 lakhs without taking into account the numerous items for which no data are available.

47. There is still another identifiable portion of the public debt of India associated with another class of assets. Following the return of large numbers of silver rupees from circulation in recent years, a portion of the silver holding in the Paper Currency Reserve has been sold. These sales have created a gap in the Reserve amounting to the difference between the nominal value of the rupees melted down and the price realised for the silver. This gap might have been made good by the transfer of securities from the Gold Standard Reserve, as that Reserve had been built up in the past from the profits of coinage. Instead of this procedure being followed, *ad hoc* Treasury Bills were created and placed in the Paper Currency Reserve. This portion of the public debt of India is therefore associated with currency assets (including in this term

the Gold Standard Reserve), which are not being taken into account as assets for the purposes of our calculations. As the Federation will, either directly or through a Reserve Bank, take over these assets, it is right that it should also assume responsibility for this portion of the public debt. The loss on the sale of silver up to 31st March, 1931, amounted to Rs.14,97·81 lakhs. Had this loss been met from the Gold Standard Reserve, the currency assets to be taken over would have been correspondingly reduced and this portion of the debt would not have existed. Adding this item, the total value of the identifiable assets is increased to 10,63,11·02 lakhs.

48. Turning, now, to the amount involved if the whole of the pre-federation liabilities were assumed by the Federal Government, we have ascertained that the debt position of the Government of India on 31st March, 1931—the latest date for which actuals are available—was as follows:—

	<i>Lakhs.</i>
Interest-bearing liabilities ... ..	11,87,47·85
Non-interest-bearing liabilities ... ..	29,89·28
	<hr/>
	12,17,37·13
Less liquid assets ... ..	34,69·96
	<hr/>
Total liabilities ... ..	11,82,67·17
	<hr/>

Interest-bearing liabilities include not only loans, sterling and rupee, and Treasury Bills held by the public and in the Paper Currency Reserve, but also the balance of the War Contribution, Railway Debenture Stock and Railway Annuities, Post Office Savings Bank deposits, Cash Certificates, Provident and certain Family Pension Funds, Depreciation and Reserve Funds and interest-bearing provincial balances. Non-interest-bearing liabilities of a liquid nature include a variety of items, such as deposits and provincial balances which do not bear interest, the amounts due to certain non-interest-earning funds, uncashed cheques and accrued discount on Treasury Bills; while liquid assets include cash balances, repayable advances and the sinking fund investment account for certain loans.

49. In the above statement, the public debt has been taken at its nominal figure. This debt, carrying, as it does, an over-all rate of interest of 4·29 per cent., might, for the purpose of assessing the present-day capital liability, not unreasonably be written down on a 5 per cent. basis by something like 170 crores; or, viewing the matter in another way, if the irredeemable loans raised at 3½, 3 and 2½ per cent. were reassessed on the same basis, the figure of indebtedness would be reduced by about 145 crores.

50. Having regard to this and to the fact that our figure of 10,63,11·02 lakhs takes no account of a large and valuable block of

assets, we do not hesitate to report that, if the Federal Government assumed responsibility for the whole of the pre-federation debt, its obligations would be covered by the assets also taken over. It will also be evident from other parts of our Report that the service of the debt will be fully covered by the sources of revenue which will remain at the disposal of the Federal Government.

51. We are satisfied that, if Burma is separated from India, a division of the liabilities and assets somewhat on the basis suggested in the Howard-Nixon Memorandum\* will not, so far as the future Federation is concerned, have any invalidating effect on the conclusion at which we have arrived.

(ii) *Civil Pensions.*

52. In Appendix II we have attempted to analyse the civil non-effective charges at present falling on the central budget and, starting from the assumption, adopted by the Peel Committee, that pensions awarded in respect of service in a department or office which will be federal are a proper federal liability, to describe and evaluate the items which constitute the balance of those charges.

53. The existing civil pension charge can be classified as follows :—

	<i>Approximate cost in 1930-31. Lakhs.</i>
(1) Political and Territorial Pensions ... ..	32
(2) Pensions paid in respect of members of contributory funds now closed ... ..	67
(3) Pensions paid in respect of members of the I.C.S. Family Pension Fund and the Bengal Pilot Service Fund ... ..	8
(4) Ordinary Pensions, including miscellaneous adjustments ... ..	1,66
	2,73

Of these, the first are not pensions in the ordinary sense of the term, and are clearly a federal charge.

54. The Bengal Pilot Service Fund is self-supporting in that the cost of pensions is covered by the fees received from the users of the pilot service. The I.C.S. Family Fund, though at present included in the budget of the Government of India, may, for our present purpose, more accurately be regarded as an interest-bearing debt owed by Government to a solvent fund constituted out of the subscriptions of the members and liable for all out-goings. We have included this *pro forma* debt in the review of the pre-federation

\* Memorandum on the Financial Questions arising out of the proposed separation of Burma from India (Published by the Government of India)

debt in the previous section. Whether, in fact, the fund is actually treated in this way and removed from the federal budget, or not, is immaterial to the argument. The correct allocation of the whole liability as federal is not affected.

55. As regards the closed funds, the assets having at various dates been taken over by the Government of India, the liabilities are at any rate partially debt liabilities. Unfortunately, it is not possible to ascertain either the present residual value of the assets taken over or the extent to which the actual liability in respect of the members of the funds exceeds that residual value. Rather more than half the annual charge is in respect of military (and Royal Indian Marine) funds, and is accordingly a proper federal charge in any event. The balance—some 29 lakhs a year—relates almost entirely to the Bengal, Madras and Bombay Civil Funds. This liability, in so far as it is not covered by the assets taken over, is clearly not a federal liability; but, inasmuch as the funds were closed nearly fifty years ago, the annual charge must fall very rapidly and should soon disappear entirely.

56. We have now to determine what part of the annual charge for ordinary pensions is properly federal. As explained in detail in Appendix II, pensions awarded since 1st April, 1921, whether paid in India or elsewhere, have been allocated between the Central Government and the Provinces strictly on the basis of the pensioners' service. On the other hand, in the case of pensions awarded prior to 1st April, 1921, while, broadly speaking, each Province was made liable for payments to all pensioners resident within its borders, the Government of India accepted responsibility for the payment of all pensions outside India. The present charge in respect of pensions paid out of India is some 80 to 90 lakhs per annum. As indicated in Appendix II, we estimate that about five-sixths of this is in respect of service in the Provinces. The charge is rapidly falling (it has fallen by roughly 50 per cent. since 1st April, 1921), while, as regards pensions paid in India by the Provinces, there appears to be no need for reallocation.

57. The conclusion, then, is that, at the beginning of federation, there will be a rapidly declining non-effective liability in respect of ordinary and family pensions which is not likely to exceed 80 or 90 lakhs per annum. This liability should, theoretically, be apportioned between the various Provinces. Such an allocation, even if the necessary records exist, would, however, involve an expenditure of labour out of all proportion to the theoretical improvement in the presentation of the true position. It seems clear that the Federal Government will in effect retain out of the proceeds of income-tax paid only in British India a much larger sum than the annual liability for pensions which are properly a charge against

British India alone, at least for so long as such liability is of sufficient magnitude to be worthy of consideration. We therefore recommend that no attempt be made to show this "central" liability of some 80 or 90 lakhs as a separate item in the superannuation charges (of something over  $2\frac{1}{2}$  crores per annum) which will appear in the federal budget.

(iii) "Central Charges".

58. If our recommendations as to debt and pensions are accepted, we feel justified in assuming that no section of opinion in India is likely to think it worth while to separate out of the federal budget such minor items of expenditure as may, at the present moment, be held to be incurred mainly on behalf of the Provinces. The cost of the Income-tax Department, including pensions, will of course be treated as a deduction from the yield of taxes on income.

V.

DISTRIBUTION OF INCOME-TAX.

(i) *Preliminary Remarks.*

59. Having made a forecast of the financial position and having dealt with the pre-federation debt and pension charges, we are now in a position to examine the important question what settlement the Federal Government will be able to effect with the Provinces on the basis of our estimates. We must observe, however, that we have no knowledge what provision may have to be made for at least three factors :—

- (a) Any concurrent settlement with the States ;
- (b) the separation of Sind ; and
- (c) additional expenditure directly due to the establishment of a federal system.

The first two points are under investigation by other Committees while, as to the third, it is clearly impossible to estimate the cost of a Federal Legislature or a Federal Court the constitution of which has not yet been determined. On this latter point, however, we feel bound to remark that we hope the cost of introducing the new reforms will be reduced to a minimum, both at the Centre and in the Provinces. The opinion is widely held in India that the cost of government already exceeds what can properly be borne by a predominantly agricultural country, and it would be deplorable if the first result of the reforms were a large addition to the overhead charges of government. If we may venture to say so, much may depend on the example set in this matter by the Federal to the Provincial Governments.

60. In these circumstances we propose to approach the problem from another angle and to consider what is the minimum sum re-

quired to put the Provinces in a fair position to begin their work under the new federal system.

61. The Peel Committee recommended that taxes on income should be transferred to the Provinces, with the exception of corporation tax which, it was suggested, might, in certain circumstances, be retained by the Federal Government. The present super-tax on companies is a corporation tax; but it would obviously be undesirable to define a particular kind of corporation tax in a permanent constitution, and we confess that we are unable to devise any definition appropriate to such a constitution except the wide one of a tax on the profits of companies. We shall return to this question in the next section of our Report; but, for our present purpose, we assume that corporation tax will be federalised and that its yield will be equal to that of the present super-tax on companies.

62. In addition, the Federal Government should also obviously retain tax paid by residents in the Federally Administered Areas, and we think it should be allowed to retain tax paid on the salaries of federal officers.

63. The Peel Committee also recommended that the whole of the taxes on income to be transferred to the provinces should be so transferred at the outset of federation, and that any resultant federal deficit should be met from provincial contributions. It is clear from our estimates that, on this basis, there would in fact be a very substantial deficit. We shall state our proposals in terms of the method recommended by the Peel Committee; but it will be seen that, under our proposals, this method, amounts, in practice, to a transfer to each Province of a percentage of the share of income-tax estimated to be attributable to it.

64. Finally, the Peel Committee recommended that the constitution should specifically provide for the extinction of provincial contributions by annual stages over a definite period, such as ten or fifteen years. We have considered this recommendation with the greatest care, and have come to the conclusion that, on the data now available, it is impossible to specify an annual rate of reduction of contributions or a definite period within which it could be anticipated with reasonable certainty that the natural growth of existing federal revenues, at the rates of taxation we have assumed, would enable the Federal Government to extinguish contributions altogether.

#### (ii) *Principles of Distribution.*

65. It is important to select a proper basis of distribution of income-tax receipts. This must satisfy three fundamental tests:—

(a) It should be simple, easily understood and administratively workable.



(b) It should give results as between Province and Province which are likely to be accepted as fair on the whole.

(c) It should not be incompatible with the idea of a federation of autonomous units.

We shall now consider how far the various bases that have been suggested satisfy the above tests.

66. The Central Board of Revenue has furnished us with an expert review of the various possible methods of distribution, from which it would appear that an allocation on the basis of *collections* (or of the income brought under assessment) would lead to gross injustice as between Province and Province. Companies (often operating over large areas) are assessed at a single place, namely, the head office, which, in most cases, is located in the industrially more advanced Provinces; and interest on securities held all over the country is paid by the Public Debt Offices in Calcutta, Bombay and Madras. We see no reason why, merely because of the accident that income is assessed or tax collected there, these Provinces should benefit at the cost of others in which the income accrues or the tax-payer resides. This basis must, therefore, be ruled out.

67. Distribution by *population* has equally no scientific basis; but, as will be seen later, it can be adopted with advantage for the distribution of taxes on certain forms of income which cannot easily be assigned to any particular locality, such as the undistributed profits of companies and the income of non-residents.

68. There is no doubt much to be said in theory for the basis of *origin*, but we are satisfied that it would not be administratively workable in respect of the income of individuals and, even in respect of the income of companies, would be workable only if the allocation were to be made wholly on arbitrary lines, either by investing income-tax officers with unlimited discretion or by laying down uniform rules of allocation, irrespective of widely varying conditions. We cannot, therefore, recommend the adoption of this method.

69. There remains the basis of *residence* in one of two forms, either the basis of personal incomes (assessed or assessable) in each Province, or the amount of income-tax on such income attributable to each Province. In making the choice between these two alternatives, it is relevant to consider what would happen if each Province were raising its own taxation; and we have no hesitation in adopting the basis of the tax actually paid as being the more appropriate in the circumstances.

70. What has to be done, therefore, is to credit each Province with the tax paid by persons resident in it (i.e., by individuals, Hindu undivided families, unregistered firms and certain associations), including tax on dividends received by them from companies. This gives rise to no difficulty in regard to personal super-tax since, generally speaking, super-tax is not collected at source



but after formal assessment. In respect of ordinary income-tax, however, we are advised that there are practical difficulties in ascertaining the amount of tax actually creditable to each Province. A substantial part of the ordinary income-tax is collected at source; and it often happens that no formal assessment is made on the tax-payer (i.e., the recipient of the income) either because the income-tax authorities are satisfied that he has no other source of income or, it may be, because the person evades assessment. While we cannot recommend that increased expenditure on income-tax establishments should be incurred merely to make formal assessments which bring no additional revenue, we are of opinion that the system of statistics now in being should be modified before the inauguration of the Federation in such a way as to facilitate the ascertainment of the personal income-tax creditable to each Province. This system, if suitably modified, could, in our opinion, reduce the element of estimation to a minimum.

71. Pending the collection of such statistics, the only practicable course appears to be to throw all the personal income-tax (i.e. excluding personal super-tax) into a common pool and to distribute this pool between the Provinces on the basis of the best estimate that can be made from time to time, having regard to formally assessed incomes and to the probable amount of incomes paying tax at source, but not formally assessed, in each Province. Personal super-tax, as already stated, should be credited to the Province in which the assessment is made.

72. As regards tax on income other than "personal income" (i.e., the income of non-residents and undistributed profits of companies), we are of opinion that, in view of the difficulty of tracing the origin of such income, the proceeds should be distributed on the basis of population. This would incidentally help, to some extent, the poorer Provinces with large populations like Bihar and Orissa and the United Provinces.

73. The plan that we have suggested above appears to satisfy the first two criteria referred to in our opening paragraph, and we may now examine how far it satisfies the third criterion. It is obviously neither possible nor necessary to work out the results of all the possible schemes of taxation of incomes that the Provinces might evolve if they were independent states. They could, however, tax only *persons* within their jurisdiction, and *things* within their jurisdiction, i.e., tax on the basis of residence or on that of origin; and all schemes of income-tax ultimately rest on these two bases in some form or other, whether singly or in combination. The co-existence of varying systems in the different Units would undoubtedly give rise to various problems of double taxation, in regard to which a Province would, if it desired to give relief, have to negotiate with other Provinces. All schemes of

relief from double taxation, however, are of the nature of compromises, and not, therefore, likely to be strictly logical or consistent; and it is consequently impossible to determine *a priori* what exactly would happen if each Province levied tax as an independent state. But what we are concerned with is not so much what the Provinces would actually do if they were independent states as whether our scheme is inherently consistent with the idea of provincial autonomy. A system of taxation resting primarily on the basis of residence, with reciprocal exemptions for residents of other states, which is the essential feature of our scheme, does not, in our opinion, conflict with this idea. Indeed, such arrangements as between independent states are not without precedent, and are in fact favoured by the balance of expert opinion.

(iii) *The Distribution Proposed.*

74. On the basis that we have recommended and on the data available to us, we estimate that the proceeds of taxes on income would be divided between the Federal Government and the Provinces in the following manner:—

	<i>In lakhs.</i>
Total gross yield of income-tax ... ..	18,00
Less cost of collection ... ..	80
	—
Net yield ... ..	17,20
	—
Super-tax on companies, tax on salaries of federal officers and personal income-tax and super-tax levied in Federal Areas (to be retained by the Federal Government) ... ..	3,70
Balance available for distribution to the Provinces	13,50

Of this sum, about Rs. 2,00 lakhs represent collections of personal super-tax (i.e. other than company super-tax) and would be distributed on the basis of actual collections from residents. Of the balance of 11,50, about one-seventh would approximately represent the estimated tax on the undistributed profits of companies and on the incomes of persons resident outside British India; and we suggest that this fraction of the income-tax receipts should be distributed on the basis of population. The remaining six-sevenths would be distributed on the basis of the estimated share of personal income-tax creditable to each Province. The following Table sets out the position. (The data on which the percentages have been calculated are explained in Appendix III.)

TABLE III.

*Distribution of Income-tax.*

(In lakhs of rupees.)

Province.	2 crores on collections of personal super-tax.	$\frac{1}{7}$ of 11½ crores on population basis.	$\frac{6}{7}$ of 11½ crores on basis of personal income-tax without federal salaries.	Total.
1.	2.	3.	4.	5.
Madras ... ..	7	30	1,46	1,83
Bombay* ... ..	50	14	2,79	3,43
Bengal ... ..	1,10	32	2,63	4,05
United Provinces ... ..	8	31	84	1,23
Punjab ... ..	2	15	74	91
Bihar and Orissa ... ..	18	24	65	1,07
Central Provinces ... ..	3	10	46	59
Assam ... ..	1	6	22	29
North-West Frontier Province.†	1	2	7	10
Total ...	2,00	1,64	9,86	13,50

\* Includes Sind. Figures for the latter in respect of Columns 2 and 4 are not readily available, but are roughly estimated at about one-sixteenth (under both the Columns together) of the total figure for Bombay plus Sind.

† The share due to the North-West Frontier Province will presumably go in reduction of the subvention to that Province.

75. At this stage we desire to emphasise that the percentages given in Table III are estimates only and are not intended to be precise figures for insertion in the constitution. The super-tax figures, of course, represent actual collections, and would be so referred to in the constitution or in statutory rules under the constitution. The figures we have given may be affected in the future by trade conditions. Even in the case of income-tax, it may not be necessary to lay down any percentages if it be found possible for the Central Board of Revenue to evolve a system under which the proceeds of the tax could be distributed each year on the ascertained figures of, say, the preceding year instead of on estimates. On the other hand, if, as we suggest later, the contributions from the Provinces are fixed in proportion to the shares of income-tax made over to them, it might be an advantage, from the point of view of the stability of the provincial budgets, that the share (i.e., percentages) of income-tax due to the Provinces should not be altered from year to year, even if readily ascertainable, but be fixed for a term of years, the percentages due to each Province being revised (say) every five years on the basis of the figures of personal income-tax for the previous quinquennium as

disclosed by the income-tax statistics. In view of the incomplete data on which our estimates have been made, a special review would, in any case, be necessary at the time the Federation is established in order to fix the initial percentages. If it is considered necessary that the percentages to be used as the basis of distribution from time to time should be finally determined by some independent authority, we would suggest that this might be done by the Auditor General.

(iv) *Basis of Contributions.*

76. We have now to consider on what basis the total contribution to be taken from the Provinces should be allocated among them.

77. We have studied the scheme of the Meston Settlement with a view to adapting it, if possible, to the solution of our problem, since, in spite of the difference created by the advent of federation, our problem has some affinity with that considered by the Meston Committee.

78. Under the Meston Settlement there were two fundamental scales of contributions—the initial scale which was fixed arbitrarily but with reference, primarily, to the additional resources at the disposal of each Province as a consequence of the reallocation of heads of revenue under the Reforms, and the “standard” scale which was calculated with reference to all relevant factors, namely, wealth (both actual and potential), taxable capacity, the revenue of the Provincial Government and its possible expansion, the standard of expenditure, liability to famine, etc. The “standard” scale was to be reached gradually in seven years by nearly equal steps. Bihar and Orissa, which in view of its specially bad financial position was allowed to start with no contribution, made no contributions at any time; and from 1922-23 onwards the Government of India remitted also the contribution of Bengal. All the contributions were extinguished in 1927-28 and effect was never given to the ultimate “standard” scale of contributions recommended by the Meston Committee.

79. Our problem is more akin to that which the Meston Committee had to consider in respect of the first seven years of the Montagu-Chelmsford Reforms than to the permanent scale of contributions which that Committee had to determine; and, even if we could revise their “standard” scale by re-valuing the factors which they took into consideration and bringing into account the addition to provincial revenues derived from income-tax, the application of such a scale would leave some Provinces in deficit or with too small a margin of increased revenue. In the circumstances, we have been driven, as the Meston Committee were driven in respect of the transitional period, to the expedient of assessing the contributions primarily with reference to the additional resources of the Provincial Governments—in other words, in proportion to their shares of income-tax.

80. We have already indicated that we should prefer the income-tax collected each year to be distributed, not on the actual ascertained percentages of each year, but on percentages based on the actual figures for a series of years and fixed for a term of (say) five years. We consider that the aggregate contributions to be paid by the Provinces to the Federation should be a fixed sum which should be reduced gradually as and when the Federal Government can afford to do so. This aggregate should be apportioned among the Provinces, at the same intervals of five years, in proportion to their shares of income-tax and super-tax; and the sums thus assigned to each Province should remain subject at any time to rateable reduction in the event of a reduction of the aggregate contribution.

(v) *The Contributions Proposed.*

81. The following Table sets out the results of applying these principles on the assumption that the Federal Government will be unable, at the outset, to devote more than five crores to the settlement with the Provinces; or, in other words, that the Provinces will have at first to contribute  $8\frac{1}{2}$  crores to the Federal Government.

TABLE IV—A.

*Contributions (in lakhs).*

Province.	Surplus (+) or deficit (—) on the basis of present provincial revenues (See Section II).	Share of income-tax.	Full contribution payable proportionately to the amount under column 3.	Surplus (+) or deficit (—) if full contribution is paid.
1.	2.	3.	4.	5.
Madras ... ..	— 20	1,83	1,15	+ 48
Bombay (excluding Sind).	— 65	3,22	2,03	+ 54
Bengal ... ..	—2,00	4,05	2,55	— 50
United Provinces ...	+ 25	1,23	78	+ 70
Punjab ... ..	+ 30	91	57	+ 64
Bihar and Orissa ...	— 70	1,07	68	— 31
Central Provinces ...	— 17	59	37	+ 5
Assam ... ..	— 65	29	18	— 54
North-West Frontier Province.*	—	10	6	—
Sind.* ... ..	—	21	13	—

\* The shares due to the North-West Frontier Province and to Sind will presumably be taken into account in fixing any subventions to these Provinces.

82. If our estimates are approximately correct, our plan will thus leave three Provinces in deficit. If contributions could be reduced rateably by  $2\frac{1}{2}$  crores in the aggregate—i.e., if the Federal Government could devote  $7\frac{1}{2}$  crores to the settlement with the Provinces—

Bengal would be left with a surplus of about 25 lakhs, and a little less than 25 lakhs would be required to wipe out the deficit of Bihar and Orissa and to remit to Assam the whole of its contribution—a sum which could be distributed rateably among the other Provinces without arousing any serious sense of grievance. If contributions could be reduced by 1 crore in the aggregate—i.e., if the Federal Government could devote 6 crores to the settlement with the Provinces—this reduction would be approximately sufficient to wipe out the deficits of Bengal and Bihar and Orissa and to remit the contribution of Assam, if the benefit of the reduction were given wholly to these three Provinces. If no more than 5 crores are available for the settlement with the Provinces and if, nevertheless, it is desired to fill the deficits of Bengal and Bihar and Orissa and to remit the whole contribution of Assam, this can only be done by reducing the share of the 5 crores which would go to the other Provinces.

83. Bengal has frequently put forward a claim to a share, in some form, of the proceeds from taxation on the export of jute. Assam, too, has recently claimed the excise duty on kerosene and motor spirit produced within its borders. These or any similar proposals raise highly controversial questions of principle; but as in any case, they could only result in delaying *pro tanto* the remission of provincial contributions, we have not felt able to take them into account for the purposes of our scheme.

84. We have considered other proposals which might to some extent conceal the realities of the situation, but it seems better to state frankly that the only method of relieving the deficit Provinces is to spread the charge over the other Provinces. The charge ought to be spread in proportion to the amount of income-tax received by each Province, but so as not to convert any of their surpluses into a deficit. If a remission of 50 lakhs were made to Bengal, 33 lakhs to Bihar and Orissa, and 18 lakhs (the whole contribution) to Assam, the results would be as shown in the following Table.

TABLE IV—B.  
*Contributions (in lakhs).*

Province.	Full contribution payable.	Contribution proposed.	Final surplus.
Madras ... ..	1,15	1,41	22
Bombay ... ..	2,03	2,48	9
Bengal ... ..	2,55	2,05	nil
United Provinces ... ..	78	95	53
Punjab ... ..	57	70	51
Bihar and Orissa ... ..	68	35	2
Central Provinces ... ..	37	37	5
Assam ... ..	18	nil	—36

85. If this procedure were adopted, we should hope that the preferential treatment of certain Provinces in the matter of contributions would only be temporary; but so long as it continues we think that the extinction of the excess contributions of the Provinces which are contributing more than their share should be regarded as a first charge on any sum available to the Federal Government for the reduction of contributions.

86. Assam is in a special position since, obviously, no special treatment within the limits of a scheme for distributing income-tax will meet its needs. If its whole contribution is remitted, it will still be left with a deficit of 36 lakhs. This figure would be reduced by about 10 lakhs if the Government of India were to relieve the Province of certain charges in respect of frontier tracts on the lines of proposals recently made by the Government of Assam. A possible further source of revenue would be a terminal tax, the yield of which is estimated by the Provincial Government at about 20 lakhs. For the rest, we can only make a suggestion. Assam appears to present one peculiar feature, not present in the same degree in any other Province, namely, that it is comparatively undeveloped and cannot itself afford to raise the capital necessary for its development. It is at least possible that Assam might be made self-supporting in the future by a well-considered programme of development and land settlement financed by federal loans, possibly on terms which would take account of the immediate difficulties of the Province during the period until the development becomes effective. We suggest that the Government of India should examine this possibility in consultation with the Government of Assam.

(vi) *Conclusion.*

87. We conclude that—(1)  $7\frac{1}{2}$  crores is the amount required to carry out a logical distribution of income-tax among the Provinces with special treatment only for the two Provinces which are generally recognised to be in need of such treatment.

(2) 6 crores would be sufficient to give special treatment to Bengal as well as to these two Provinces, while leaving Madras, Bombay, the United Provinces and the Punjab each with a substantial surplus ranging from about 45 lakhs to about 70 lakhs.

(3) On the basis of 5 crores, a method of distribution can be devised which, while calling for temporary sacrifices from these four Provinces, would enable every Province except Assam to balance its budget.

88. On our estimated federal surplus of 7 crores, a net distribution of 5 crores would leave 2 crores available for the contingencies to which we have referred. We can express no opinion as to whether this balance will prove more than sufficient to meet those contingencies, but we should hope that any new expenditure arising out of the establishment of the Federation, including the separation of Sind, will not exceed about one crore.



*(vii) Concluding Remarks on the Settlement.*

89. In this survey of federal and provincial finance we have endeavoured to confine ourselves as strictly as possible to the study and presentation of facts. We have deliberately refrained from arguments or speculations which might lead to fresh debate and postpone a decision. It may not be out of place here if we draw attention to one or two of the conclusions which appear to arise from the facts.

90. The facts seem to show, in the first place, that, given a recovery from the present abnormal economic conditions, the financial scheme outlined in the Peel Report provides a foundation on which an Indian Federation can be established and can begin its work. Under that scheme it will apparently be possible to give relief to the Provinces, commensurate in amount with their most urgent needs, and compatible in form with their dignity as autonomous Units.

91. But the facts show also that this relief to the Provinces not only need not, but cannot, be given at the expense of the other Units. If, in our survey of possible federal taxes, we had found any new source of revenue, other than the excise duty on matches, which could be placed at the disposal of the Federal Government to replace taxes on income in the immediate future, we should have felt bound to report the fact, whatever might be our opinion as to the advisability of using new federal taxation for this purpose. What we have found is that the obstacles in the way of widening the basis of all-India taxation in present circumstances arise primarily from the economic conditions and the economic policy of British India, not from any conflict of policy between British India and the States. In referring to considerations of practical politics, we have in mind public opinion in British India, not public opinion in the States. In leaving open the question of the appropriation by the Federal Government of the proceeds of a new excise duty on matches so far as those proceeds are derived from the match industry in the States, we have had in mind simply the possibility, and indeed the hope, that such a duty may be imposed by co-operation between the Government of India and the State Governments before the establishment of federation; and we have refrained in all our calculations from assuming the surrender by any Unit of an existing source of revenue.

92. In other words, we have found, as a matter of fact, that the Federal Government will not have at its command, at the outset of federation, large reserves wherewith to satisfy claims, whether of the Provinces or of the States, which the Government of India have hitherto found themselves unable to meet. This fact has a bearing on the problem of equalising burdens as between all Units of the Federation. The principle of equality is accepted by all



sections of opinion. It is not our function to interpret that principle. We can only report that, on the facts as we have found them, the Provinces will have for some time to contribute, in one form or another, a considerable sum out of their income-tax receipts towards the finances of the Federal Government. The question whether, or to what extent, this special contribution from the Provinces can be regarded as balanced by any special burdens borne by the States is one which can only be decided when His Majesty's Government have all the necessary facts before them. But whatever may be the decision on this point, it seems clear that the power of the Federal Government to redress inequalities will be limited by intractable facts.

93. Perhaps this conclusion points to another. It is doubtful whether a jealous comparison of relative burdens offers a sound basis for a successful partnership. Each partner in a new enterprise must bring something substantial into the common pool and may expect to derive solid advantages from the partnership commensurate with his contribution; but, if these conditions are fulfilled, the partners will be unwise to insist on a meticulous equality. They will probably find it best to take their associates as they are. Similarly a new federation may find, at the commencement of its existence, that the conception of maintaining the *status quo* in non-essentials is a better guide to policy than any ambitious ideals of equality or uniformity.

## VI.

### POWERS OF TAXATION.

#### (i) *Allocation of Powers and Lists of Sources of Revenue.*

94. Hitherto, as we have already remarked, the facts which we have found point to the maintenance, in practice, of the *status quo* in matters of taxation as between British India and the States. We have not recommended the raising of new federal taxation for the purpose either of distributing income-tax to the Provinces or of meeting any admitted claims of individual States, whatever these may be. Those who fear that new federal taxation might be necessary for such purposes may perhaps be reassured by the fact that we have been led to this conclusion, not by any preconceived ideas of our own, but by a study of the facts.

95. Now, however, we have to consider a somewhat different question. Every government working under a fixed constitution must have powers of taxation which are not merely commensurate with its normal functions, but also sufficient to support its credit both at home and among the nations of the world. A government whose revenues are inelastic, or whose powers are so restricted that it cannot maintain a proper balance between direct and indirect taxation, will be in danger of finding that its credit is as inelastic

as its revenues and as restricted as its powers of taxation. Purely emergency powers are insufficient to avert this danger; the powers required are rather powers for the *prevention* of emergencies. However much they may be recognised to be powers held in reserve against abnormal occurrences, the government must be able, if necessary, to use them farsightedly, not merely to remedy a dangerous position when a crisis has arisen, but when possible to obviate the occurrence of the crisis itself. The true guarantee of the Units against the unnecessary use of such powers—a guarantee which was found effective by the United States of America for more than a hundred years—lies in the strict limitation of federal functions and in the reluctance of a federal legislature, representing the people and governments of autonomous units, to vote new federal taxes except in case of absolute necessity.

96. The Peel Committee contemplated that the necessary re-inforcement of federal revenues might be found in excise duties and in a corporation tax. The arguments in favour of reserving the field of excise to the Federal Government, with the exception of duties on certain classes of commodities, are very strong. They are taxes on consumption which, in economic theory, should not be levied by the government of one unit on the consumers of another. It is also desirable to reserve this part of the field of taxation for the Federal Government, whose finances would otherwise be unduly dependent upon external customs. It will, however, be observed that nearly all the excise duties which would be reserved to the Federal Government under the proposals of the Peel Committee are duties which would, in all probability, be imposed only as a set-off against a decline of customs revenue resulting from a successful protectionist policy. The only exceptions are the existing duties on petroleum products and the proposed duties on matches and tobacco, and we have reported that the Federal Government may find it impossible to impose a tobacco excise for some time to come.

97. The recommendation of the Peel Committee in regard to corporation tax rested solely, as we understand it, on the assumption that this form of income-tax and no other would be acceptable to the States. We think it possible that many of the States would agree to the imposition of a corporation tax by the Federal Government, but that they would be reluctant to allow the Federal Government to appropriate the proceeds accruing in their territories. If this should prove to be the case, the advantages of giving a tax like the present super-tax on companies a distinct place in the constitution would largely disappear. We have already pointed out that the constitutional definition of such a tax would probably have to be wider than was contemplated by the Peel Committee.

98. If it were found necessary to abandon the idea of corporation tax as a federal source of revenue, the proceeds of the tax could be distributed to the Provinces on the same basis as personal income-tax (one-seventh in proportion to population and six-sevenths in

proportion to personal income-tax assessed on residents), the provincial contributions being correspondingly increased. But, if this were done, the Federal Government would lose the one tax which could be relied on at present to compensate it for a fall in customs revenue.

99. We therefore venture to make a suggestion which we do not think is inconsistent with the principles laid down by the Peel Committee, and is, indeed, in harmony with their desire to secure " a considerable degree of elasticity in the financial framework ". One fact which has come out clearly in our investigations is the widespread recognition of the need for uniformity of taxation throughout India in certain fields. It is for this reason that we have already suggested that the Federal Government should retain the power of legislation in regard to certain sources of revenue levied for the benefit of the Units. The allocation to the Federal Government of the *power* of taxation in these fields in no sense implies that the actual *collection* of the taxes concerned should necessarily be placed in the hands of federal officers, and it may be worth noting that the collection of the existing duty on petroleum products in British India is carried out by officers in the service of the Provincial Governments.

100. Our suggestion is that the Federal Government should have a general power to impose a surcharge for its own purposes on any tax levied by it in this way for the benefit of the Units. If this suggestion were adopted, it would, we think, be necessary to accord to the Units, on their side, some interest in the proceeds of federal excises, and to provide that the Federal Government should be at liberty to assign the whole or any part of the proceeds to them, as may be laid down in the Federal Act imposing the particular duty.

101. This proposal, if adopted, would, of course, result in anomalies so long as taxes imposed for the benefit of the Units were not levied uniformly throughout the Federation; but, as we have seen, an anomaly of precisely this kind must in any case exist in regard to income-tax for some time after the Federation is established, quite apart from any question of the fiscal policies of the States. Whatever those policies may be, the Federal Government will in any case be obliged to retain, in the form of contributions, a much larger percentage of the proceeds of income-tax attributable to the Provinces than would be involved in a mere federal surcharge. It will be observed that we have not sought to justify this retention of a percentage of income-tax receipts as a federal source of revenue during the early years of the Federation by any theoretical considerations. We have not, for instance, suggested that it should be regarded as a special contribution from British India towards pre-federation pension charges or the service of the pre-federation debt. On the other hand, we have not discussed whether, or in what sense, the Provinces can be regarded as having a right to the proceeds of income-tax. Having found the facts, we have been

content to present them as facts. It seems inevitable that the Federation must be established, in large measure, upon the basis of the *status quo*; but if the different fiscal policies of the partners in federation are recognised from the outset in a spirit of mutual accommodation, there can be little doubt that those policies will tend to approximate to each other as time goes on.

102. On this basis, we append three lists of sources of revenue in regard to which the power of legislation should rest with the Federal Government :—

I. Sources reserved to the Federation.

II. Excise Duties.

III. Taxes leviable for the benefit of the Units subject to a right of federal surcharge.

103. All the rights thus reserved to the Federal Government may, of course, be subject to exceptions in favour of the States, whether in respect of their treaty rights, or in respect of taxes now levied by them, or in respect of special postal and currency rights, or otherwise. We have not been required to report on the manner in which such exceptions should be embodied in the constitution or in the treaties with the States, and we therefore only note that our lists must be read with this general qualification.

104. In Appendix IV, we also give, as we are required to do, a list of other sources of revenue. This list may serve as a basis for any specific schedule of sources reserved to the Units which it may be decided to insert in the constitution. It includes sources which are or may be open to local authorities, since in constitutional theory local government taxes are provincial or state taxes, and in practice the two cannot be delimited as separate spheres. We must, however, point out that this fourth list cannot be regarded as exhaustive and that the taxes included in all four lists overlap at various points. We doubt the possibility of drawing up a completely comprehensive list of taxes not included in the first three lists; and the definition of the taxes in all the lists, so as to avoid litigation resulting from the conflict of jurisdiction, must in any case be a matter of legal draftsmanship.

#### SOURCES OF REVENUE IN REGARD TO WHICH THE RIGHT OF LEGISLATION RESTS WITH THE FEDERAL GOVERNMENT, SUBJECT TO STATE RIGHTS.

##### I.—SOURCES RESERVED TO THE FEDERATION.

1. Revenue from the public domain vested in the Federal Government, including lands, buildings, mines, forests, and any other real property of the Federation.

2. Revenue from federal enterprises, including railways, aviation, posts and telegraphs, opium and salt manufacture, and other undertakings of the Federation.

3. Profits arising from the management of federal currency, banking profits, revenue from investments or loans, payments to the Federal Government in discharge of debt, and federal lotteries.

4. Fines and penalties arising in respect of subjects administered by the Federal Government.

5. Fees levied in the course of discharging the functions committed to the Federal Government, such as fees of the Federal Court, port, pilotage and lighthouse dues, and fees for the registration of companies.

6. External customs duties and export duties.

7. Excise on salt.

8. Taxes on immigrants.

9. All sources of revenue within the Federally Administered Areas.

10. Contributions from the Units of the Federation as prescribed in the constitution.

11. Any other receipts accruing in respect of federal subjects.

## II.—EXCISE DUTIES.\*

Excise duties, excluding those on salt (see List D), and on alcoholic liquors, narcotics (other than tobacco), and drugs† (see Appendix IV).

## III.—TAXES LEVIABLE FOR THE BENEFIT OF THE UNITS SUBJECT TO A RIGHT OF FEDERAL SURCHARGE.

*Note.*—The following classification, (a) and (b), merely represents what we assume may be the actual position in regard to these taxes at the outset of federation, and not necessarily a permanent constitutional classification.

### (a) *In British India.*

1. Taxes on personal income other than agricultural; death or succession duties other than duties in respect of succession to land; taxes on personal capital other than land; and taxes on mineral rights.

2. Terminal taxes on railway-, water- or air-borne goods and passengers, and taxes on railway tickets and goods freights.

3. Stamp duties on certain transactions (see paragraph 30 above).

### (b) *In the Federation as a whole.*

Taxes on the income or capital of corporations.

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\* See paragraphs 96 and 100 above.

† We think that excises on all drugs, whether "dangerous" or other, should rest with the Units, including taxes on proprietary medicines and the like.

(ii) *Questions relating to the Taxes in List III.*

105. The above scheme of allocation need not affect the substance of our proposals either for the distribution of income-tax or for the assessment of provincial contributions. The only change in our proposals would be that the Federal Government would not retain the proceeds of the super-tax on companies, which would be assigned to the Provinces together with other taxes on income; but the Federal Government would retain instead, as a general surcharge on all income-tax attributable to the Provinces (i.e., tax other than that on federal officers and residents in Federal Areas), a sum of approximately the same amount. The yield which we have assumed for the super-tax on companies in paragraph 74 above is  $2\frac{1}{2}$  crores.

106. There are obvious defects in any system based upon the principle of taxation by one government for the benefit of other governments. If, however, that system is to be applied to income-tax in the interests of uniformity, the inclusion of the other items in list III appears to be either consequential or of slight comparative importance. It is possible that the existence of a federal right of surcharge may tend to make such a system work more smoothly, as giving the Federal Government a common interest with the Governments of the Units. We are clear, however, that if the Federal Government is to retain the right of legislation in the interests of uniformity, it must also retain responsibility for the laws which it passes. In this matter we are faced by a clear choice of policies. If uniformity is the main desideratum, the power of taxation can be left wholly with the Federal Government. If it is considered more important to place responsibility for raising revenue on the government which is to enjoy the proceeds, the power can be left wholly with the Governments of the Units. If a compromise be desired, the Governments of the Units, as well as the Federal Government, can be given a power of surcharge on the standard rates, either by the constitution or by delegation from the Federal Government, and either in the form of a percentage on the standard rates or to the extent of any reduction in those rates which may be made by the Federal Government. What we feel cannot be done is to purchase uniformity at the price of inflexibility, by prohibiting the Federal Government from changing the rates except with the consent of a majority of the Governments of the Units, secured through some form of special constitutional procedure.

107. We have found considerable conflict of opinion as to the desirability of giving the Provinces a right of surcharge on the standard rates of income-tax. On the whole, we think that the Federal Legislature should have power to authorise the Units to impose a surcharge on any of the taxes in List III within such limits as it may think fit.

(iii) *Other Questions arising out of the proposed Allocation of Powers.*

108. To some extent the allocation of powers of taxation depends upon the allocation of other powers between the Federation and the Units. For instance, the power to establish monopolies cannot be regarded solely, or even mainly, as a power of taxation, and it will be observed that we have been obliged to leave the classification of federal and other public enterprises open in our lists.

109. While, as already stated, we do not regard our lists as completely exhaustive, we feel that they are sufficiently comprehensive to reduce the problem of unspecified taxes to very small dimensions. We note the suggestion, made by the Peel Committee, that the right to levy such taxes should rest with the Units but that the Units should exercise this right only in so far as the taxes imposed do not conflict with the federal scheme of taxation. We feel that this suggestion might, in practice, create more doubts than it removes.

110. It will be necessary to include in the constitution some provision in regard to taxes classified as federal which, at the date of federation, are already being levied by one or more of the Units. This problem arises, no doubt, particularly in the States, but it exists also in British India; for we do not see how some of the professional or "status" taxes levied in the Provinces for municipal purposes can be regarded otherwise than as taxes on income. Whatever special provision may be made in the constitution or otherwise to save the existing rights of the States, we think that the Federal Government should have power to provide by law, temporarily or permanently, that an existing tax imposed by a Unit shall not be invalidated by reason of the fact that it falls within the category of taxes reserved to the Federal Government. This will not, of course, meet the case of an existing tax of a kind prohibited altogether by the constitution. Apart from such taxes levied by States, we may mention the fact that there is at least one provincial tax—the municipal cotton cess in Bombay—which, being in effect a transit duty, appears in its present form to fall within this category.

## VII.

### OTHER QUESTIONS.

111. It remains for us to consider a number of other questions referred to us.

#### (i) *Emergency Contributions.*

112. We are asked to report on the principle of allocation to be adopted for the contributions which it is contemplated may be



called for from the Units by the Federation in an emergency. Our task is not to define an "emergency"; but it is, we think, essential that the expression should cover economic emergencies, such as the danger of a default on the public debt or a currency crisis, as well as political emergencies, such as internal disorder or war, and that the special procedure, if any, for declaring an emergency should be speedy in operation.

113. Three possible bases of allocation suggest themselves: (1) the revenue of the Units; (2) their population; and (3) a formula based upon a scientific survey of their relative taxable capacity. The most satisfactory permanent provision would obviously be the third; but, in the absence of some such survey undertaken in connection with a general census of production, the first appears to be the best solution. The revenue of each Unit would have to be determined on a comparable basis, and such a basis might be laid down by the Auditor General. The application of this criterion would present no difficulty in the case of the Provinces. Any Units which are unable to present returns to the Federal Government on the lines laid down by the Auditor General might be assessed on a population basis, the amount of the total contribution being divided for this purpose in proportion to population between these Units and those accepting the revenue basis.

(ii) *Grants from Federal Surpluses.*

114. The recommendation of paragraph 14 of the Peel Report is that, in the event of the Federal Government's ultimately finding "that Federal revenues yield an apparently permanent surplus," it should "be free, as a possible alternative to the reduction of taxation, to allocate the surplus proceeds to the constituent Units." It was thought desirable that "the constitution itself should lay down the proportions in which funds thus available should be divided among the Units."

115. It is clear that the situation contemplated by the Peel Committee could not arise until any prescribed process of extinguishing provincial or State contributions had been completed. If, thereafter, the Federal Government desired to make a general distribution of a part or the whole of any recurring surplus to the Units on some pre-determined basis, we suggest that, as the surplus would arise mainly from taxes on consumption, the distribution should be made on a population basis. It would, of course, be open to the Federal Government to distribute any part of such a surplus for specific purposes on any basis which might be determined by the Federal Legislature.



(iii) *Borrowing Powers.*

116. The Peel Committee expressed the view in paragraph 22 of their Report that "there must apparently be a constitutional right in a Province to raise loans in India upon the security of its own revenues." We recognise the constitutional propriety of this proposition as well as the political arguments in favour of it, but we are bound to point out its implications. It appears to involve vesting a Province with independent power to pledge provincial revenues which, as stated in the same paragraph of the Peel Report, form part of the security for the whole corpus of the federal debt, and which, moreover, form the sole security for the loans made by the Federal Government to the Province itself. We attach particular importance to this latter point, for the obligations of the Provinces to the Provincial Loans Fund have been treated in our Report, as in previous discussions on this subject, as assets covering an equivalent part of the pre-federation debt. The right of the Federal Government to call for contributions from the Units in case of emergency may perhaps afford some guarantee of the general federal debt, as suggested by the Peel Committee, but it scarcely constitutes a sufficient guarantee of the debts owed by individual Provinces to the Federal Government itself. We feel, therefore, that it is difficult wholly to disregard the considered views of the Finance Department of the Government of India expressed in paragraph 42 (3) of a memorandum\* submitted to the last Session of the Round Table Conference.

117. From the purely financial point of view it would, of course, be desirable that, so long as the security for the pre-federation debt includes the revenues of the Provinces, the latter should only be allowed to borrow with the consent of the Federal Government; but if this limitation of provincial autonomy is regarded as politically inexpedient, we suggest that a middle course, based on the distinction between the general debt of the Federal Government and loans made to the Units by the Federal Government, might provide a suitable compromise. We presume that all Units will have a general right to apply to the Federal Government, as the Provincial Governments now apply to the Government of India, for the loans they require, subject to the Federal Government's being satisfied that they are able to offer adequate security for such loans; and in that case the present Provincial Loans Fund will become a Federal Loans Fund. This being so, we suggest that the Government of every Federal Unit should have the right of independent borrowing recommended by the Peel Committee, subject to a general obligation to give the Federal Government notice of its intention and an opportunity to offer advice. We doubt whether the power of control, suggested by the Peel Committee, over the time at which a Unit may issue a loan, could be expressed in the constitution in any more

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\* Reproduced in Proceedings of Federal Structure and Minorities Committees, page 506 (Published by H.M. Stationery Office, 1932.)

definite form than this. If, however, a Federal Unit has loans outstanding with the Federal Government (whether or not such loans were raised before the date of federation), its right of independent borrowing should be regarded as in abeyance, and it should be obliged to obtain the consent of the Federal Government for any further loan which it desires to raise.

118. As regards the machinery required to carry out these principles, we think that preliminary consultation between the Units participating in the Federal Loans Fund will be desirable for the purpose of avoiding excessive and conflicting applications to the Federal Government for loans; and if an Inter-State Council be set up for the purpose of securing co-ordination in certain fields of administration, this body might usefully be employed for that object. Such a body, however, should not have the right to consider applications for loans on behalf of the Federal Government; still less could it be the authority for raising loans. It seems clear that only the Federal Government can have authority to raise or make loans. In raising loans, it will no doubt take such expert advice as may seem to it useful in the particular circumstances. In making loans to the Federal Units, however, we think it should be required to follow a definite procedure. All applications for such loans should be referred by it to a body of Loan Commissioners. This, we consider, should be an expert and impartial, not a representative body. Apart from other considerations, some Provincial Governments at any rate would certainly be unwilling that their applications should be considered by representatives of other Provinces, and States Governments may be expected to feel at least an equal reluctance. Applications from Units having loans outstanding from the Federal Loans Fund for consent to independent borrowing should also be referred to these Commissioners. The decision on all applications should, however, rest with the Federal Government itself, which should have full discretion to fix the terms of any loan it may grant to a Unit and to attach such conditions as it may think fit. It should also have the right to attach conditions to any consent it may give to independent borrowing by any Unit.

(iv) *Immunity of Federal Property.*

119. The Peel Committee agreed in principle to the proposition that no form of taxation should be levied by any Unit of the Federation on the property of the Federal Government, but felt some difficulty as to the precise form in which such an immunity could be expressed in the constitution. These, of course, are matters for a constitutional lawyer and as such hardly fall within our competence. We would observe, however, that no difficulty appears to have been experienced in other federations, as is shown for example, by

Article 125 of the British North America Act (1), Article 114 of the Commonwealth of Australia Act (2), and Article 10 of the Constitution of Brazil (3)\*. This being the case, we doubt whether anything more is necessary than a general provision in the constitution, and we also doubt whether a distinction between provincial and municipal taxation, even if it were practicable, would be appropriate to a federal constitution. The exact application of the principle can, we think, be left to the judgment of the Federal Government itself. We suggest, therefore, that the wording of the constitutional clause should be on the following lines:—

“ No property belonging to the Federal Government shall be liable to taxation without the consent of that Government.”

120. It will be observed that the clauses of other federal constitutions referred to above provide for a reciprocal exemption for the property both of the Federation and of its Units. If it is thought desirable to adopt the principle of reciprocity, the exemption in the case of the Units should, we think, be confined to land and buildings and should not confer, for instance, an immunity from customs duty on imported stores. †

## VIII.

### CONCLUDING NOTE.

121. We may, perhaps, be allowed to conclude with a word of general explanation. We have based our labours, as we were required to do, upon the Peel Report, and have kept in mind, throughout our enquiry, the restricted view of our functions advanced by the Federal Structure Committee of the Round Table Conference. These restrictions may not have materially affected our findings since, as we have pointed out, the whole problem of federal finance is in any case narrowly restricted by the facts of the situation. It remains true, however, that the assumptions from

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\* (1) British North America Act, Article 125 :

No Lands or Property belonging to Canada or any Province shall be liable to Taxation.

(2) Commonwealth of Australia Constitution Act, Article 114 :

A State shall not, without the consent of the Parliament of the Commonwealth, raise or maintain any naval or military force, or impose any tax on property of any kind belonging to the Commonwealth, nor shall the Commonwealth impose any tax on property of any kind belonging to a State.

(3) Constitution of the United States of Brazil, Article 10 :

The States are prohibited from taxing Federal property and revenues or services undertaken on account of the Union, and *vice versa*.

† This recommendation is not, of course, intended to affect the existing courtesy concessions which, we understand, are enjoyed by certain Rulers of Indian States.

which we have started were not chosen by us, but laid down for us. We feel it is right to emphasise this, if only because some of us may be concerned, in one way or another, with future discussions on some of the issues arising in connection with our Report. We should like, therefore, to make it clear that our Report must not be read as committing us individually to a particular view on any question of principle or policy, and that on any such question each of us retains complete liberty of action. Our Report merely embodies a considered judgment on the facts and figures which have formed the subject of our enquiry and on their application to a system of finance prescribed for us.

We have, etc.,

EUSTACE PERCY,  
Chairman.

L. J. KERSHAW.

A. HYDARI.

K. N. HAKSAR.

F. P. ROBINSON.

V. S. SUNDARAM.

K. SANJIVA ROW,

K. ANDERSON,

Secretaries.

New Delhi,

28th March, 1932.

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## APPENDIX I.

## NOTES ON THE FEDERAL FORECAST.

## (i) CUSTOMS.

*General.*

Each individual item of revenue under this major head has been scrutinised in the light of all relevant statistics and of the probable developments in the near future.

The maintenance of the existing tariff, omitting the emergency surcharges, has been assumed. The rates upon which our estimate is based are accordingly those laid down by the First Finance Act of 1931, except in regard to machinery, coal-tar dyes, raw cotton, and certain minor items, for all of which we have taken the rates of the Supplementary Finance Act of the same year. It has also been assumed, purely for the purpose of these calculations, that trade with Burma will be free, and that kerosene from Burma will pay the present rate of excise duty (2½ as. per gallon) and not the present rate of customs duty (3 as. per gallon).

We recognise the possibility of reduction in, or the removal of, the duties on machinery, coal-tar dyes and raw cotton; and against this possibility we set off the possibility of customs duties being levied, either in full or at reduced rates, on trade with Burma.

We also understand that the Government of India are considering the possibility of establishing land customs stations on the Afghan and certain other external frontiers where customs duties are not now levied, and if this be done the additional yield would amount to a substantial sum. We have not, however, taken this into account, but have preferred to treat it as a margin of safety against over-estimating.

*Sugar, Cotton Piece-goods and Iron and Steel.*—The revenue under these three principal protected items is bound to fall substantially if the protective policy is successful, and we have made the necessary allowance for this after studying the facts relating to consumption and local production.

*Motor and Allied Trades.*—We have assumed that the same share of the revenue from petrol duty will be allocated to the Road Fund as at present.

It is unlikely that there will be the rapid expansion of revenue under this head which was forecasted in the Note of the Central Board of Revenue attached to the Government of India's Despatch on Reforms\*, and we have allowed only for a moderate increase. It is not improbable that the diversion of a larger proportion of the proceeds of these duties than at present to a programme of road development might, in the long run—though not immediately—result in a substantial increase in revenue.

We should, perhaps, add that we have received some evidence suggesting that the present burden of taxation, especially taxation by local authorities in certain Provinces, is unduly severe, and that some co-ordination of policy is desirable if the growth of motor traffic is not to be impeded.

*Silver.*—There is some reason to believe that, with the changing habits of the people, the money spent on silver may be diverted to the purchase of other luxuries. We have, therefore, made a conservative estimate of revenue from this head.

*Jute.*—Under this head also we have made a conservative estimate and have adopted a figure well below what has been reached in the past.

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\* Dated 20 September 1930, published as Cmd. 3700 of 1930.

## (ii) SALT.

No account has been taken of the special protective duty on imported salt, which is distributed to the Provinces.

## (iii) OPIUM.

The figure under this head assumes that, when exports cease, opium will be sold to Provincial Governments by the Ghazipur Factory at cost price. (The Centrally Administered Areas have been treated as "provincial" for the purpose of the statement.) The only net revenue, therefore, will be that from Burma if, as has been assumed, supplies are sold to that country at the same price as to colonial and foreign Governments. There are other possible sources of revenue, such as medical opium, but these seem too small and speculative to be taken into account.

## (iv) RAILWAYS.

In assuming a sum of five crores as a contribution from the Railways to general revenues, we have regarded it as axiomatic that the Federal Government cannot acquiesce in the Railways being less than self-supporting. Indeed, this principle has been recognised in certain suggestions which have been made to us. It has, for example, been suggested, on the one hand, that the Railways, instead of paying a contribution to general revenues, should themselves assume direct responsibility for the amortisation of that part of the public debt which represents capital at charge in the Railways. The sum of five crores which we have assumed as the Railway Contribution is rather less than the amount set aside each year in the central budget for this purpose. Alternatively, it has been suggested that, if the capital in the Railways is regarded as an investment, the Central Government is entitled to expect to receive, in the form of interest at a higher rate than the rate at which it borrows, a sum sufficient to provide, not only for the interest which it has itself to pay, but also for the writing down of the capital invested as a reserve against obsolescence. If interest were charged at 5 per cent., the difference would materially exceed five crores. We do not wish to associate ourselves definitely with either of these suggestions, but, having regard to all the relevant factors, it seems clear that, unless the Railways contribute a sum of the order of five crores to federal revenues, they would be receiving what would in effect be a subsidy from those revenues; and from our examination of the material submitted to us, we believe that the Railways should be able, in fact, to provide a contribution of this magnitude.

## (v) CURRENCY AND MINT.

The normal revenue under this head, whether derived directly from the profits of currency management or indirectly from a share in the profits of a Reserve Bank constituted in accordance with the scheme embodied in the Reserve Bank Bill of 1928, may be expected to be about 3·80 crores, and we have adopted this figure. In the three years immediately following the establishment of a Reserve Bank, however, there will be a temporary reduction in the Government's receipts, amounting in the aggregate to about four crores. In a forecast such as we are attempting it seems justifiable to ignore this temporary fluctuation and to regard the loss of four crores, spread over the three years, as part of the cost of establishing the Reserve Bank. A possible way of providing for this temporary loss of revenue would be to establish a reserve fund in the years preceding the establishment of the Bank.

## (vi) MISCELLANEOUS REVENUE.

We have retained an entry for Reparations and on the other hand have made provision for expenditure on account of War Contribution.

## (vii) TAXES ON INCOME.

The estimate under this head is based on the revenue which might have been realised in an average pre-slump year if the rates imposed in March, 1931, had been in operation, an appropriate deduction being made on account of the separation of Burma. If full allowance were made for all the following factors, the net result would be an increase in the estimate:—

(a) The retention of the Rs. 1,000-2,000 zone of taxable income.

(b) Amendments of the law which have been under consideration, such as the taxation of foreign investments and the removal of the exemption from company super-tax now enjoyed by companies in respect of the first Rs. 50,000 of their income.

(c) Increased efficiency of collection.

(d) The decrease in revenue which would result if Government were to allow the carry-forward of business losses, relieve companies from super-tax on their income from investments in other companies, and allow the deduction of company super-tax in assessing the profits of companies to income-tax.

## (viii) DEBT SERVICES.

(a) *Net Interest.*

This entry represents the total interest paid by Government on its borrowings less interest receipts from the various departments, Provinces, States and individuals to whom Government has lent money. It is assumed that no change will be made in the arrangements governing the rate of interest charged to commercial departments; that, on balance, net receipts from Provinces, States and individuals will also remain unchanged; and, although this must necessarily be pure conjecture, that future long-term borrowing will be on a 6 per cent. basis.

(b) *Reduction and Avoidance of Debt.*

The calculation has been made on the assumption that no change is made in the scheme now in operation.

## (ix) POSTS AND TELEGRAPHS.

We have assumed that the Government of India will be successful in their declared policy of making this Department self-supporting.

## (x) MILITARY BUDGET.

Our estimate under this head is based on the 1932-33 budget figure, allowance being made for restoration of pay-cuts, resumption of normal building and stores programmes, and the separation of Burma. No provision has been made for non-recurrent expenditure on the completion of the special re-equipment programme, the cost of which would be about 3 crores.



## (xi) NORTH-WEST FRONTIER PROVINCE SUBVENTION.

We have adopted unchanged the figure included in the 1932-33 Budget.

## (xii) CIVIL WORKS.

This figure includes expenditure on the Road Fund, which is fed from the duty on motor spirit, and allows for the restoration of the normal level of maintenance expenditure.

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 APPENDIX II.
 

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## ALLOCATION OF PENSION CHARGES.

(i) *Introductory.*

1. Among our terms of reference, we have been charged with the duty of investigating the allocation of civil pension charges between "Federal" and "Central." The relevant passages in paragraph 5 of the Report of Lord Peel's Committee are as follows:—

" . . . . 'Central' expenditure, broadly speaking, will consist of three categories:—

" (1) . . . . .

" (2) A share in pre-Federation obligations in respect of civil pensions.

" (3) . . . . .

" As regards (2), the allocation of 'Central' civil pension charges (not debited to the Provinces) between Federal and 'Central' is a point which should be investigated by the Expert Committee. *There seems no reason why the Federation should not be charged in respect of the pensions of officers who were previously employed on duties which, in future, will fall within the scope of Federal activities, but there may be a case for making the balance a 'Central' charge.*"

2. It will be apparent from this extract that we are not concerned with military pensions (i.e., the pensions included in the Army Budget), which the Peel Committee contemplated would in any case be a federal liability; nor need we have regard to the accrued pension liability in respect of serving officers, as the pensions of such officers can be suitably allocated when the officer retires.

3. The civil non-effective charges in the budget of the Central Government fall under two major heads, namely, "Superannuation Allowances and Pensions," and "Territorial and Political Pensions." The charges and receipts under each of these two heads during the year 1930-31 are tabulated and classified in the following statements.

TABLE A.

*Account of Charges and Receipts in respect of Superannuation, Retired and Compassionate Allowances and Pensions during the year 1930-31.—Central.*

No. (1)	Items. (2)	Charges in		Receipts in		Net (charges— receipts). (7)	Remarks. (8)
		India. (3)	England. (4)	India. (5)	England. (6)		
		Rs.	£	Rs.	£	Rs.	
		I.—ORDINARY PENSIONS.					
1	* Superannuation and Retired allowances.	86,69,636	1,075,261	5,91,884	—	—	* Includes equated payments of commutations, gratuities and concessions to I.C.S. Officers for past annuity contributions, and pensions, etc., on retirement of officers of the following classes :— India office and other Home Service; Superannuation; Compensation (on reduction of staff); Compassionate and Injury; Gratuities under the Superannuation Act, 1909; Judges of the High Courts in India; Bishops of Madras and Bombay; Indian Civil Service; Other Civil Services in India; Military and Marine officers in respect of civil employment; Bengal Pilot Service.
2	Compassionate allowances ...	1,66,276	9,430	—	—	—	
3	Pensions for Distinguished and meritorious services.	16,898	1,839	—	—	—	
4	Donations to Provident Funds of non-pensionable officers.	1,29,024	—	—	—	—	
5	Covenanted Civil Service Pensions.	2,222	—	—	—	—	
		89,84,056	1,086,530	5,91,884	—	—	
		= Rs. 1,44,87,067					
	Total ordinary pensions ...	Rs. 2,34,71,123		Rs. 5,91,884		2,28,79,239	
	Less recovery from Commercial Departments ...					66,36,613	
						net Rs. 1,62,42,626	

[continued.]

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TABLE A—continued.

No.	Items.	Charges in		Receipts in		Net (charges— receipts). (7)	Remarks. (8)
		India. (3)	England. (4)	India. (5)	England. (6)		
(1)	(2)	Rs.	£	Rs.	£	Rs.	
II.—FAMILY PENSIONS.							
1. Closed Funds—Military.							
6	Military Fund ... ..	6,598	—	—	—	—	
7	Bengal Military Fund ... ..	—	73,462	—	353	—	
8	Madras Military Fund ... ..	—	96,002	—	225	—	
9	Bombay Military Fund . ...	—	57,374	—	209	—	
10	Military Orphan Fund ... ..	24,723	—	1,36,997	—	—	
11	Bengal Military Orphan Society	—	43,877	—	303	—	
12	Medical Retiring Fund ... ..	1,587	—	—	—	—	
13	Madras Medical Fund ... ..	361	17,540	—	—	—	
14	Marine Pension Fund ... ..	—	—	12,618	—	—	
15	Indian Navy Fund ... ..	—	6,399	—	1	—	
		33,269	294,654	1,49,615	1,091	—	
		= Rs. 39,28,720		= Rs. 14,547			
	Total closed Funds—Military ...	Rs. 39,61,989		Rs. 1,64,162		37,97,827	

		2. Closed Funds—Civil.				
16	India Office Provident Fund ...	—	8,608	—	520	—
17	Home Service ... ..	—	3,189	—	3,522	—
18	Bengal, Madras and Bombay Civil Funds.	20,208	209,499	—	175	—
		20,208	221,296	—	4,217	—
		= Rs. 29,50,613		= Rs. 56,227		
Total closed Funds—Civil ...		Rs. 29,70,821		Rs. 56,227		29,14,594
Total closed Funds ... Military and Civil ... }		Rs. 69,32,810		Rs. 2,20,389		67,12,421
		3. Open Funds.				
19	I.C.S. Family Pensions... ..	60,984	106,087	5,98,257	9,449	—
20	Bengal Pilot Service Family Pensions.	—	3,652	—	—	—
		60,984	109,739	5,98,257	9,449	—
		= Rs. 14,63,186		= Rs. 1,25,987		
Total open Funds ... ..		Rs. 15,24,170		Rs. 7,24,244		7,99,926
Total Family Pensions ...		Rs. 84,56,980		Rs. 9,44,633		75,12,347
21	Total Family and Ordinary Pensions.	3,19,28,103		15,36,517		2,37,54,973
Add Miscellaneous items which include <i>inter alia</i> adjustments on account of Exchange and Refunds.		4,85,091		69,189		4,15,902
Grand Total ... ..						2,41,70,875

TABLE B.

*Account of Territorial and Political Pensions for the year 1930-31.*

						<i>Amount paid</i>	
						<i>in India.</i>	<i>in England.</i>
						<i>Rs.</i>	<i>£</i>
1. Pensions to members of former Ruling Families	...	...	...	...	...	10,49,044	8,456
2. Miscellaneous Pensions	...	...	...	...	...	19,24,031	—
3. Charitable Allowances	...	...	...	...	...	67,746	—
Total						30,40,821	8,456
						= Rs.1,12,745	
Exchange	...	...	...	...	...	1,433	
Grand Total						Rs.31,54,999	
Receipts						Nil.	

4. The items in Table A have been divided into three groups, viz., Ordinary Pensions, Closed Funds and Open Funds, and we now proceed to deal with each group in turn.

(ii) *Ordinary Pensions.*

5. Item 4 in Table A represents the amount adjusted annually to the credit of the provident funds of non-pensionable serving officers. It is, therefore, in a different category from non-effective payments in respect of past service and does not require to be analysed for the purpose of allocation between federal and central. On the other hand, items 1, 2, 3 and 5 in the same Table, which constitute what may be called the regular civil pension list of the Central Government, include pensions granted both in respect of service under the Central Government, and in respect of service under the Provincial Governments. The history of the matter is as follows.

6. Prior to 1st April, 1921, the division of civil pension charges between the Government of India and the Provincial Governments was arbitrary, being based upon administrative convenience. All pensions drawn outside India, irrespective of whether the pensioner had served in a Province or directly under the Government of India, were finally debited to the Central Government. Pensions paid in India, irrespective of the Government under which the pensioner had served, were (subject to certain exceptions in the case of payments made in Calcutta City) borne by the Province in which the pensioner resided and drew the pension. The Meston Committee considered whether the incidence of these pension charges should not be re-adjusted so as to make each Government bear the pensions of its own servants, but recommended that, while in regard to future pensions (i.e., pensions sanctioned on or after 1st April, 1921) each Government should bear the pensions of its servants, the apportionment of past pensions should not be disturbed, this fact being taken into account in the new financial settlement between the Provinces and the Central Government. The recommendation of the Meston Committee was accepted.

7. The civil pensions now paid by the Government of India (Central Government) accordingly fall, broadly speaking, into two separate categories:—

A.—*Pensions sanctioned on or after 1st April, 1921.*—These consist of the pensions of officers who had served wholly under the Central Government and the appropriate share (on the basis of length of service) of pensions of officers who had served for part of their service only under the Central Government; and

B.—*Pensions sanctioned before 1st April, 1921.*—These consist of (a) pensions in course of payment outside India on 31st March, 1921; (b) pensions in course of payment in Centrally Administered Areas on that date; and (c) pensions in course of payment in Calcutta City on that date in respect of service in certain Central Departments.

8. The above description of the two categories is not strictly accurate because the original allocation has been complicated by the adjustments which are made from time to time between Provincial Governments *inter se*, and with the Central Government, by the payment of commuted lump sums when a pensioner changes his residence (and consequently the place of payment of his pension) from the jurisdiction of one Government to that of another, or when a Government desires to pay off, once for all, its liability for a share in a joint pension. As a result of such adjustments, the present pension charges of the Central Government include certain provincial pensions in respect of which the Central Government has previously received the commuted value. On the other hand, certain central pension charges have been finally extinguished by the payment, in the past, of commuted values to Provincial Governments. The effect of these modifications will be considered later.

9. As regards pensions sanctioned on or after 1st April, 1921, there is little doubt that, with few exceptions, they relate to service rendered in departments which will in future be federal. The only important exception is the Income-tax Department which, from the point of view of pensions, is a very young department. It was formed gradually between the years 1921 and 1926, mostly with directly-recruited young men, although there was a small nucleus staff from the Land Revenue Departments of the Provinces. The pension charges already in existence on account of service in this Department must be quite small and they will presumably be so when the Federation is started. We are advised that the ascertainment of the exact share of existing pensions attributable to service in the Income-tax Department would involve the examination of a very large number of pension records throughout all the Provinces, and that it is more than probable that some of the necessary records may not be available. In the circumstances, and especially in view of the probable smallness of the figure, we have not thought it necessary to ask that this work should be undertaken at the present stage. We assume that, after the Federal Government is established, new pensions in respect of service rendered in this Department, whether before or after federation, will be a charge on income-tax collections. The other two exceptions relate to the Archaeological and Zoological Survey Departments. As regards these, we assume that the pension liability will follow the liability for the effective cost of the Departments, which the Peel Committee contemplated would in fact be a federal charge even if no agreement were reached to federalise them, and that in these circumstances it is not necessary to attempt to estimate the pension charge, which must in any case be insignificant.

10. We are left with pensions sanctioned before 1st April, 1921. These constitute the most important item, and it will be convenient to consider separately

- (1) pensions paid in India, and
- (2) pensions paid outside India.

(1) *Pensions sanctioned before 1st April, 1921, and paid outside India.*

11. The expenditure in 1920-21 on the four most important items in this class (which accounted for 95 per cent. of the total) was £1,213,922 (Rs. 1,81 lakhs). We are informed by the High Commissioner that the corresponding charge in February, 1932, was £626,980 (Rs. 84 lakhs) per annum.

12. A large part of these pensions undoubtedly relates to service rendered under Provincial Governments; and in view of the magnitude of the sum involved, it is necessary to attempt to ascertain how much. The only accurate method of ascertaining the exact share debitable to Provincial Governments would be to examine the "history of services" of each of the pensioners, but even if the necessary records were forthcoming, this would be an inordinately heavy task. The next best criterion (for which there is ample precedent) would probably be to apportion the pension charge in the ratio of the relative pay-bills for the Superior Civil Services of the Central and Provincial Governments in 1920-21 or, failing the above, the relative pay-bills for all establishments during 1920-21. Since, under the system of accounting adopted, the necessary information could only be obtained by a special analysis of the detailed accounts of the Government of India and the Provincial Governments kept by various Accountants General, we have not been able to adopt either of these methods. A rough estimate can, however, be made by taking the total expenditure in and about 1920-21 of Provincial Governments and of the Government of India on Departments (viz., collection of revenue, civil administration, currency and mint and posts and telegraphs) in which the bulk of the expenditure is on salaries. Figures on this basis, which have been supplied to us by the Finance Department, suggest that about one-sixth of the 84 lakhs referred to above relates to service under the Central Government and the balance to service under Provincial Governments. One-sixth of the charge should accordingly be borne by the Federal Government, since it relates to services which will be federal, while the balance would be "Central."

13. It should be added that the sterling pensions have already run for about eleven years, so that their present value is estimated not to exceed Rs. 6 crores. The value will be still smaller by the time the Federation comes into being.

(2) *Pensions sanctioned before 1st April, 1921, and paid in India.*

14. A special investigation made on our behalf by the Accountant General, Central Revenues, shows that the pensions paid by him under this class amount to about Rs. 4½ lakhs per annum at the present date. The corresponding expenditure on his books during the year 1920-21 was just under Rs. 18 lakhs. The central pensions paid by other Accountants General in 1920-21 cannot readily be ascertained; but it appears that about 3 to 3½ lakhs were paid on this account in 1930-31. Having regard to the expectation of life in India and to the fact that those pensions have already run for eleven years, during which time the pensions paid by the Accountant General, Central Revenues, have fallen from Rs. 18 lakhs to Rs. 4½ lakhs, it may be assumed that this charge will practically disappear in the course of the next few years. There is no material available to us from which it might be possible to allocate these pensions, aggregating 7½ to 8 lakhs, with reference to the service of the pensioners. In any case, if such an allocation were attempted, it would be necessary to make a similar allocation of pensions paid out of provincial funds by other Accountants General. On the following assumptions, viz., (a) that the Central Government took over in 1921 a little over two-fifths in all of the total pensions then in existence, (b) that the true share of the Central Government ought to have been between one-sixth and one-seventh of the whole, and (c) that pensions paid in India as a whole are dying out at the same rate as the pensions on the books of the Accountant General, Central Revenues, a rough calculation shows that the amount of the pensions now paid by the Central Government in India differs from the proper figure by a few lakhs. In the circumstances, a detailed investigation appears to be unnecessary.



15. There remain the pensions now paid by the Central Government which were originally paid by a Provincial Government. Detailed figures of inter-governmental adjustments of commuted values (which take place frequently) are not available; but the Central Government, having received the commuted value of the pension from the Provincial Government and *vice versa*, the residual pension liability is in reality a debt liability, and as such would naturally be federal. If this is not sufficient to settle the matter, it is almost certain that, as a result of commutation, more Central Government pensions have become a provincial liability than *vice versa*.

16. Taking all these facts into account, it does not seem unreasonable to assume a figure of the order of 70 lakhs as the approximate "Central" liability at the present time in respect of ordinary pensions awarded before 1st April, 1921.

(iii) *Family Fund Pensions.*

(a) *Closed Funds.*

17. A brief account of the funds falling under this class is given below :—

No.	Name of fund.	Started in.	Net expenditure in 1930-31.	Remarks.
1	Military Fund ...	1770 ... .. <i>Military.</i>	Rs. 6,598	Designed for payment of pensions to officers and men in the military service of the East India Co., and to their widows.
2	Bengal, Madras and Bombay Military Funds.	Early in the 19th Century. Taken over by Government in 1866.	30,14,012	Family pension funds for military officers.
3	Military Orphan Fund.	—	—1,12,274	
4	Bengal Military Orphan Society.	1856. Taken over by Government, 1866.	5,80,987	
5	Medical Retiring Fund.	—	1,587	
6	Madras Medical Fund.	Early in 19th Century. Taken over by Government, 1866.	2,34,228	
7	Marine Pension Fund.	—	—12,618	
8	Indian Navy Fund	—	85,307	
1	India Office Provident Fund.	1877 ... .. <i>Civil.</i>	1,07,840	To provide pensions to widows and orphans of persons on the home establishment of the Secretary of State and of the Auditor of Home Accounts.

No.	Name of fund.	Started in.	Net expenditure in 1930-31.	Remarks.
2	Home Service ...	<i>Civil—cont.</i> —	Rs. —4,440	Pensions of widows and families of officers of the Home Service, from funds (established by the East India Co.), to which the officers subscribed.
3	Bengal, Madras and Bombay Civil Funds.	Early 19th century	28,11,194	Initially purely charitable concerns, they developed into mutual insurance associations under the management of trustees. They received aid from the Company and later on from Government.

These funds, broadly speaking, were mutual insurance funds, the pensions being paid out of subscriptions by officers, supplemented, in some cases, by subventions from Government. Most of the funds were closed to new entrants many years ago, and have been merged in the Government revenue accounts, Government taking over both the assets and the liabilities. Of the total expenditure in 1930-31 of Rs. 67,12,421, considerably more than half, namely, Rs. 37,97,827, related to officers in the Army and the Royal Indian Marine, both of which will, in future, be federal services. In so far, therefore, as the present payments are in part covered by the assets taken over, the liability might be regarded as a debt liability; and, in so far as they are not so covered, the liability is still federal, because the Army and the Royal Indian Marine are to be federal subjects.

18. As regards the balance, practically the whole of the expenditure relates to the Bengal, Madras and Bombay Civil Funds. The assets of these funds were merged in the resources of Government, and to the extent to which these assets covered the liabilities, the future payments, as in the case of the funds dealt with in the preceding paragraph, could be regarded as a debt liability. The balance, if any, of the liability is theoretically central. The gross payments on account of the funds were, in round figures, £266,000 in 1910-11; £253,000 in 1920-21; and £209,000 in 1930-31. The funds were closed to new entrants in the eighties of the last century; and the payments may therefore be expected to continue so long as children of officers who entered the service at that time are living. There is little doubt, however, that the reduction in the expenditure in future will be more rapid than in the past, and, in any case, the present value of the liabilities is not likely to exceed a few crores.

(b) *Open Funds.*

19. There are only two funds in this class, viz., the Bengal Pilot Service and the I.C.S. Family Pension Funds. Since pilotage will presumably be a federal subject, at least so far as the Bengal Pilot Service is concerned, it is immaterial whether the receipts and expenditure on account of this fund continue to be included in the Government revenue accounts or whether a separate fund is formed for the purpose. In any case, a separate *pro forma* account is now maintained for the pilotage service and the fees are fixed so as to cover expenses. In that account, provision is made for these family pensions so that the cost of the pensions is recovered from the users of the service.

20. The I.C.S. Family Pension Fund, on the other hand, presents difficulties. The receipts and expenditure are incorporated as an integral part of the revenue accounts of Government, but there is a periodical actuarial investigation of the assets and liabilities on the hypothesis that all contributions had been paid to a fund, earning interest. A *pro forma* account exists, showing the amount of Government's liability to the hypothetical fund on this basis; and, in the light of the actuarial investigations, subscriptions and concessions are altered from time to time. In addition to the pensions earned by the members' contributions, Government pays additional benefits, limited in the aggregate to £35,000 a year. This limit has never been reached and Government's liability under this provision is now about £12,500 per annum. We are informed that it is already in the contemplation of the Government of India to distribute among Provincial Governments their share of this charge of £12,500. Any remaining liability will only relate to officers employed on duties which in future will be federal (with the exception of the income-tax and other minor services referred to in paragraph 9 above). In addition to the above concession, the Government of India makes good to the fund the loss due to the concessions given to officers who retire on proportionate pensions. The amount so met, up to 31st March, 1928, was about £15,000, of which the greater share will presumably be debitable to the Provinces.

21. The Government's *pro forma* capital liability to the I.C.S. Family Pension Fund has been estimated at £3,750,000 on 31st March, 1931. Under the present arrangement this liability does not appear anywhere in the Government accounts, and consequently the latter do not show any adjustments on account of interest on these balances. It would seem that, for the present purpose, the proper method of dealing with this class of pension is to assume that the receipts and payments are removed from the revenue accounts and that a true interest-bearing fund is constituted, out of which all payments are made. The matter then passes from the realm of pensions to the realm of debt. A *pro forma* liability for the capital charge was, in fact, included in the statement of debt submitted to the Committee by the Finance Department. If this suggestion is adopted, it is not essential to assume that in future the interest on the balance of the fund will, in fact, be debited in the revenue accounts of Government every year. So long as subscriptions and concessions are altered from time to time in the light of actuarial investigation, which assumes payment of interest by Government on the balance of the fund, it is immaterial to the Government revenue account, in the long run, whether the receipts and expenditure of the fund are passed through this account or whether these items are excluded and interest alone is paid on the balance of the fund. In the immediate future, however, in view of the fact that the "peak" figure of pensions has not yet been reached, the result of

eliminating the transactions of the fund from the revenue account would be to add about Rs. 17 lakhs a year to the net expenditure of Government as shown below:—

	<i>Rs. Lakhs.</i>
Receipts in 1930-31 ... ..	7.10
Expenditure (including additional pensions paid by Government) ... ..	14.72
	7.62
Net expenditure ...	7.62

If a separate fund were formed and interest adjusted, the interest (at 5 per cent.—the present rate allowed to the contributors—on £3½ million) would be, say, 25 lakhs, so that the net effect of the change on the revenue budget would be a loss of about 17½ lakhs. This deterioration in the budget position is due to the fact that, at present, the net outgoings are less than the interest on the capital value of the fund. It will be off-set in later years, for if the present system continues the net expenditure of Government will ultimately exceed the interest payable on the balance of the fund. In either alternative, as already stated, the bulk of the additional pensions given by Government and of the loss made good to the fund on account of officers retiring on proportionate pensions would be debitable to Provincial Governments, relieving the central budget of about Rs. 1.5 lakhs (maximum about Rs. 4.25 lakhs) on account of the additional pensions, and of a varying figure on account of the loss due to officers retiring on proportionate pensions. The balance of these items would, of course, be a proper federal charge.

22. It only remains to deal with Territorial and Political Pensions (see Table B above). It is stated in the Finance and Revenue Accounts that the items recorded under this head are pensions and charitable allowances granted, for reasons of state, to members of former ruling families and to non-officials whose services, descent or connection are such that, on general grounds of policy, it is desirable for Government to extend to them some measure of assistance or recognition. These pensions, therefore, are essentially of the nature of political expenditure and would presumably be a federal charge.

23. All the above calculations are theoretically subject to adjustment if Burma is separated. According to Sir Henry Howard, 5.055 per cent. of the civil pension charges of the Government of India should be debited to Burma; while, according to Mr. Nixon, 10.5 per cent. should be so debited. The difference in the amount of the ultimate "Central" charge is therefore immaterial.

## APPENDIX III.

## DISTRIBUTION OF INCOME-TAX.

1. We have taken "personal" income to include all income except the undistributed profits of companies and the income of persons residing outside British India. That is, it includes the "total income" (including income taxed at source like dividends of companies and profits of firms) of all individuals and Hindu undivided families, and such part of the incomes of firms, and of associations not being firms companies or Hindu undivided families, as are not assessed in the hands of partners and members.

2. The published statistics of the Income-tax Department deal primarily with figures of assessed income without completely distinguishing between "personal" income and other income. The Central Board of Revenue has obtained, during the last few years, certain figures of "personal" income in each Province; but these, too, are not complete enough for our purpose, inasmuch as they refer only to *formally* assessed incomes of individuals and Hindu undivided families and exclude, not only incomes not formally assessed, but also the entire incomes of unregistered firms and certain associations, some of which should be included under "personal" income. Further, these statistics do not show the extent to which salaries of officers of departments which will be federal in future have been included in the provincial figures.

3. We have been advised that it was not possible for the Income-tax Department to furnish, within the short time available, accurate figures on the basis required by us. In the circumstances, the Table given below has been compiled according to the best estimate we can make on the basis of the existing statistics. The Table, therefore, must not be taken as exactly representing the percentages due to each Province; and it is necessary, as pointed out in the body of the Report, that the figures should be reviewed in the light of more complete and up-to-date statistics before any distribution of income-tax is actually made to the Provinces.

TABLE C.  
DISTRIBUTION OF INCOME-TAX.

Province.	Percentages.				Rupees (in lakhs).			Remarks.
	Population.	Total personal income.	Personal income-tax including tax on federal salaries.	Personal income-tax without tax on federal salaries.	Collections, income-tax, including tax on federal salaries.	Collections, personal super-tax.	Collections, company super-tax.*	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Madras ... ..	18.32	15.00	14.54	14.81	126.0	7	7.4	* The double income-tax relief given to companies has been wholly shown under Column 8 in order to simplify calculations.
Bombay (including Sind)	8.70	27.25	27.84	28.30	271.0	50	39.25	
Bengal ... ..	19.64	24.25	26.18	26.68	352.0	110	93.7	
United Provinces ...	18.98	9.00	8.86	8.50	72.0	3	3.63	
Punjab ... ..	9.24	9.50	8.17	7.48	61.5	2	2.17	
Bihar and Orissa ...	14.73	5.75	6.37	6.60	41.5	18	0.22	
Central Provinces ...	6.06	4.75	4.57	4.70	36.5	3	1.19	
Assam ... ..	3.38	2.50	2.22	2.20	34.0	1	0.93	
North-West Frontier Province	0.95	2.00	1.25	0.73	9.0	1	—	

Column 2 based on 1931 census ; Columns 3, 4 and 5 on the average figures of the five years 1926-27 to 1930-31 ; and Columns 6, 7 and 8 on the figures of the six years 1925-26 to 1930-31 (adjusted in the case of Column 7 with reference to figures of earlier years).

## APPENDIX IV.

## SOURCES OF REVENUE RESERVED TO THE UNITS.\*

1. Revenue from the public domain, including lands, buildings, mines, forests, fisheries, and any other real property belonging to the Units.
2. Revenue from public enterprises such as irrigation, electric power and water supply, markets, slaughter houses, drainage, tolls and ferries, and other undertakings of the Units.
3. Profits from banking and investments, loans and advances and state lotteries.
4. Fines and penalties arising in respect of subjects administered by the Governments of the Units.
5. Fees levied in the course of discharging the functions exercised by the Governments of the Units and local authorities, such as court fees, including all fees for judicial or quasi-judicial processes, local rates and dues, fees for the registration of vehicles, licences to possess fire-arms and to drive automobiles, licensing of common carriers, fees for the registration of births, deaths and marriages, and of documents.
6. Capitation taxes other than taxes on immigrants.
7. Taxes on land, including death or succession duties in respect of succession to land.
8. Taxes on personal property and circumstance, such as taxes on houses, animals, hearths, windows, vehicles; chaukidari taxes; sumptuary taxes; and taxes on trades, professions and callings.
9. Taxes on employment, such as taxes on menials and domestic servants.
10. Excises on alcoholic liquors, narcotics (other than tobacco) and drugs, and taxes on consumption not otherwise provided for, such as cesses on the entry of goods into a local area, taxes on the sale of commodities and on turnover, and taxes on advertisements.
11. Taxes on agricultural incomes.
12. Stamp duties other than those provided for in List III.
13. Taxes on entertainments and amusements, betting, gambling and private lotteries.
14. Any other receipts accruing in respect of subjects administered by the Units.
15. Also, in the case of the States, any sources of revenue not specified above but referred to in paragraph 103 of Section VI of the Report.

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\* This list of revenues includes those both of the Governments of the Units and of all local authorities subordinate to them.



