

CHAPTER II

SPECIFIC MATTERS CONCERNING "FEDERAL" REVENUES
AND "FEDERAL" SERVICE DEPARTMENTS

9. With effect from the prescribed date, the Centre will take over all "federal" sources of Revenue and all "federal" items of expenditure in States, together with the administration of the Departments concerned. The Centre must also take over all current outstandings (including pending assessments, refunds and arrears), liabilities, claims, etc., and all productive and unproductive Capital Assets connected with these Departments. (The question of consequential financial adjustments, if any, required on capital account between the Centre and the States is dealt with in Chapter III below).

"Federal" Revenues and Expenditure, and the administration of federal departments to go to the Centre.

Even if, for administrative or other reasons, the actual taking over of some of the Service Departments is postponed for some time, the *financial* responsibility for those Departments and, therefore, *financial* control over them, must be assumed by the Centre as from the prescribed date.

10. Matters of general importance arising in most States in connection with the taking over by the Centre of "federal" subjects,—with the exception of those relating to taxes on income—are dealt with below ; problems connected with taxes on income have been dealt with in the Annexure appended to Part I of our Report. Matters affecting particular States only are referred to in the respective Scheme-Reports.

Scope of this Chapter.

11. Our recommendations concerning the general issues which will arise in connection with all "federal" subjects in most States are as follows :—

Matters affecting all "federal" subjects.

- (1) The permanent staff wholly (or substantially) engaged on work connected with "federal" subjects in States on the prescribed date should be taken over by the Centre in appropriate grades and upon terms not less advantageous than in the service of the States. Temporary staff so engaged should also be similarly absorbed so far as possible, having due regard to their suitability. The States attach considerable importance to this point, and would be glad to release all such staff consistent, of course, with their own requirements in those departments (such as Excise) where the subjects dealt with are both "federal" and "provincial".

Staff :

One safeguard is however necessary in order to avoid any embarrassment to the Centre in absorbing the State staffs in the manner suggested. Simultaneously with the publication of this Report, the State Governments should be requested to issue orders to the effect that no confirmations, promotions or new appointments (permanent or temporary) should ordinarily be made in any department dealing wholly or substantially with "federal" subjects; and that any promotions or new appointments which may be absolutely essential and unavoidable should be expressly on strictly temporary terms and subject to reversal, cancellation or termination after the prescribed date. Also, no revision of pay scales in "federal" departments, whether generally or in particular cases, should be undertaken, except in so far as it may form part of a general revision of pay scales in the State Services as a whole.

States' rights
to "federal" re-
venues to cease:

(2) With effect from the prescribed date, all "rights and immunities" enjoyed or claimed by the States, whether expressly or by usage, and whether relating to "federal" revenues and taxes generally (present or future), or to specific matters such as Railways, Customs, Posts and Telegraphs, Opium, Salt, etc. will terminate and must be extinguished. Thereafter, their constitutional position in respect of these matters should be the same as that of Provinces under the new Constitution of India.

All existing arrangements with individual States for pooling, sharing, division or apportionment of "federal" revenues, taxes and receipts—e.g., Customs, Central Excises, Railway revenues of "worked lines", interest on Railway "loans" (whether with or without a share of profits), Salt Duty "compensations", Opium "royalties", Telegraph receipts—and all existing forms of *ad hoc* payments and subsidies in respect of "federal" matters should terminate on the prescribed date.

There will then remain outstanding, at the prescribed date, the division and apportionment between the Centre and the States (under existing arrangements) of "federal" revenues, taxes and receipts—such as those referred to above—collected up to that date. The amounts involved will, in the aggregate, be considerable. These "outstandings" should be dealt with in accordance with the proposals made in paragraph 21 below.

Application of
Indian rates of
taxes, duties,
fees, charges,
etc.

(3) Except as regards Income-tax (*vide* Annexure to Part I of our Report), we see no difficulty in the way of the Centre's imposing its full range of "federal" taxes, excises, duties, fees, charges, Post and Telegraph rates etc., in States, save where the administration of any particular "federal" Service (e.g., the "Anchal" post in the Travancor-Cochin Union) is continued through the agency of the States.

(4) In most States, the Rulers, subordinate chiefs drawing “ political pensions ”, certain other individuals and corporations, and most State-operated commercial or industrial undertakings enjoy various taxation immunities and privileges—of which the most important relate to taxes on income. Our recommendations as regards the future treatment of the privileges and immunities connected with taxes on income are contained in the Annexure appended to Part I of our Report ; all other taxation privileges should be dealt with along similar lines. The broad principles which, we recommend, should be observed in this connection, are as follows :—

“Immunities”
from “federal”
taxation :

- (i) The special privileges and immunities of the Rulers in the matter of federal taxation are largely of a political nature and should be dealt with on that basis ; their financial value is comparatively small.
- (ii) Any special financial privileges and immunities (affecting “ federal ” revenues) conferred by the States upon other individuals and corporations should ordinarily be continued on the same terms by the Centre, subject to a maximum period of ten (or fifteen) years, and subject also to limiting in other ways any such concessions as may be extravagant or against the public interest. It goes without saying that any general concessions which the Centre itself may accord to persons and corporations in the Provinces should of course be available also on similar terms to persons and corporations in States, if they should be more favourable than those (if any) already accorded by the States themselves.
- (iii) The special privileges and immunities of *existing* State-operated undertakings should be continued if possible ;—failing which, they should be terminated upon terms to be mutually agreed.

(5) Apart from the *Constitutional* requirements in connection with the integration of federal finances in States—*vide* paragraphs 37 and 40 of Part I of our Report—certain important issues of a legal nature will arise in connection with the actual taking over of “ federal ” subjects in the States by the Centre.

Legal require-
ments for trans-
fer of “federal”
subjects:

This is a difficult subject upon which we are not qualified to offer competent advice. We have endeavoured, however, to indicate below the main features of what we conceive will be required in order to establish “ continuity of proceedings ” in regard to all “ federal ” subjects—whether relating to revenues, expenditure or Service Departments—at the point of their transition from the States to the Centre; the special technical requirements of the departments concerned

with taxes on income are set out separately in the Annexure appended to Part I of our Report.

- (a) Almost every "federal" subject is dealt with in the States, as in the rest of India, under powers conferred by appropriate legislation consisting of relevant Codes, Acts, Ordinances and Statutory Rules and Regulations. Subject to the limitations indicated below,—which are designed to secure legal "continuity" of pending proceedings and "finality and validity" of completed proceedings under the pre-existing State legislation—we think the whole body of State legislation relating to "federal" subjects should be repealed and the corresponding body of Central legislation extended *proprio vigore* to the States, with effect from the prescribed date, or as and when the administration of particular "federal" subjects is assumed by the Centre.
- (b) For the above purpose, as well as for future "federal" administration in States, it may be necessary specifically to extend not merely the legislative, but also the executive and administrative competence of the Centre, its officers and "authorities", and the judicial authority of its Courts, to the territories of the States.
- (c) Such State Courts (except Courts of *final* appeal from orders of the State High Courts) as may in fact correspond to particular grades and classes of "British Indian" Courts (Civil and Criminal) may have to be statutorily "recognised" as "corresponding judicial authorities" for purpose of dealing with cases arising in the States under the "federal" laws of the Union of India, and the Supreme Court in India will have to be made the Court of final appeal from decisions of the State High Courts to the same extent as in the case of Provincial High Courts.
- (d) Those sections of the various Indian Acts and Ordinances which set out their territorial "extent of application" will require amending so as to include State territories with effect from the prescribed date.
- (e) It will be necessary to provide that all matters and proceedings pending under, or arising out of, the pre-existing State Acts shall be disposed of under *those* Acts, by, so far as may be, the "corresponding authorities", (nominated by the Chief Executive Authority), under the corresponding Indian Acts.

12. We now deal with certain matters arising in connection with particular "federal" subjects, other than taxes on income.

Specific matters affecting particular "federal" subjects :

(1) **Customs.**—The administration of Customs at all ports and land-customs frontiers, where it is not already centrally administered, should be taken over by the Centre on the prescribed date.

(2) **Opium.**—Opium is cultivated in some of the Covenanted States in Rajasthan and Madhya Bharat. The cultivation and manufacture of opium being a federal subject, the Centre should take it over from the prescribed date, whereafter the issue of opium for sale in these States will be done in the same way and on the same terms as in Provinces.

The opium revenue of these States is derived from—

- (i) internal consumption in the States ;
- (ii) export to other States in India ; and
- (iii) sale to the Government of India.

So much of the total opium-revenue as is attributable to cultivation and manufacture must be treated as "federal"; as this is not separately accounted for, it has been computed (for the purpose of our Scheme-Reports) on the total production at Rs. 3/- per seer which is the standard margin of "Royalty" or profit allowed by the Government of India on its purchases of opium from the States.

The establishments, if any, exclusively engaged in the States on the cultivation and manufacture of opium must be transferred to the Government of India and their cost to the States in the "basic period" treated, for computational purposes, as expenditure which will be saved to the States on federal financial integration.

(3) **Central Excise Duties.**—(i) In some of the covenanted States of the Rajasthan Union a system of "Royalties" is in force in connection with certain industrial enterprises; similar arrangements may exist in other States also. These should be dealt with as follows :—

- (a) "Royalties" on the exploitation of minerals,—whether based on the tonnage of ore lifted or on the tonnage of ore dispatched or consumed for manufacturing processes,—must be regarded as "provincial" revenue which the State is entitled to retain.
- (b) "Royalties" based on the *value* of sales—whether of minerals, ores or manufactured products—are similarly "provincial" revenues (of the nature of Sales Tax) which the State is entitled to retain either in that form or as part of the general Sales Tax.

(c) "Royalties" based on production (other than mining of ores), or on the *quantity* of production sold (other than ores or minerals sold as such), must however be regarded as an Excise Duty of a "federal" nature. Such duties cannot be imposed by, or for the benefit of the States after the prescribed date; they must therefore be terminated with effect from that date, and replaced by such Central Excise Duties (if any) as may be levied by the Centre throughout India on such articles.

(ii) Reference may be made here to the difficulty experienced by us in computing the "Central Excise" revenue of the States in cases where, under existing arrangements, the collections are pooled with those of the Government of India and shared according to an agreed formula. The appropriate shares of the States have not yet been determined for the last three years in respect of certain commodities and the matter is stated to be still under consideration. We suggest that the Government of India should take special steps to expedite a final settlement in these cases. The computations in connection with the federal financial integration scheme cannot be completed until the exact amounts to be allocated to the different States as their share of "Central Excise" are settled in respect of the "basic period" adopted in our calculations.

(iii) Certain States are deriving revenue in the form of miscellaneous licence fees in connection with the sale of tobacco. We have treated such receipts as 'provincial', and have accordingly left them out of account in our computations of revenue that would be lost on federal financial integration.

(4) Taxes (other than Stamp Duties) upon transactions in Stock Exchanges and "Futures" markets.—In Indore and Gwalior States, transactions in Stock Exchanges and in certain 'futures' markets are subjected to tax, other than stamp duties, in accordance with the pre-existing law of the States. Since this is a "federal" tax under the Draft constitution, its imposition must terminate with effect from the date of federal financial integration, all pending cases being disposed of in accordance with the pre-existing law. It will perhaps be best to entrust this to the Madhya Bharat Government itself as agents of the Central Government.

In Saurashtra also, some revenue is derived by way of taxation of transactions in gold, not of the nature of sales tax or turnover tax, but of the nature of "taxes other than stamp duties" on gold contracts.

We are not aware of any other States which similarly collect taxes in the 'federal' list other than those at present levied by the Central Government itself. If any such taxes exist, they must be discontinued upon federal financial integration and pending cases disposed of under the pre-existing State law.

(5) **Salt.**—There is no salt duty in any of the States covered by our Report ; and any expenditure which may be incurred in connection with the arrangements for procurement, manufacture or distribution of salt has been ignored in our computations.

In most cases, the payments formerly made by the Government of India to various States in Northern India in connection with salt manufacture and distribution have been continued under the Standstill agreements ; it is understood however that the original agreements in this respect are at present under review by the Government of India in view of the abolition of the salt duty within "British India".

The various 'Salt' payments and concessions made by the Government of India to the States may be classified under the following heads :—

- (a) Payments in lieu of duty on salt required for consumption in the States ; supply of salt duty-free or at concessional rates. (There are also some small payments of compensation on account of loss of salt revenue to Chiefs and Jagirdars : these payments will also fall under this category).
- (b) Compensation for prohibition of salt manufacture within the States by any agency other than the Government of India, *i.e.* for surrender of rights of manufacture.
- (c) Payments for services rendered (prevention of illicit manufacture, import and export etc.).
- (d) Payments relating to lease amounts and Royalty in respect of salt sources in Rajasthan.

Item (a) represents compensation for refraining from levying salt duty and is bound to disappear in any case, irrespective of federal financial integration, as this is a "federal" subject and the Centre will not itself levy any salt duty ; on the other hand, it is possible to regard such compensation as revenue that will be 'lost' to the State somewhat in the same way as "internal customs" inasmuch as the State will be precluded from levying any duty on salt to make up for the loss. The amount involved has therefore been taken into account in our computation of the effects of federal financial integration in such cases.

Payments falling in categories (b), (c) and (d) have been left out of account in our integration calculations, as any revision of such

payments will be matters for separate negotiation and settlement between the Government of India and the States, in the light of the policy of the Government of India in regard to the manufacture and distribution of salt by Union and non-Union agencies.

(6) **Railways.**—In cases where Railways owned by Indian States are worked as part of the Indian State Railway system, no *administrative* problem will arise in connection with federal financial integration. In all other cases the Central Government must take over the entire railway system including any “worked” lines together with all the staff, assets, liabilities and Funds. The balances under all the Railway Funds and connected Deposit and Suspense heads should be computed as on the prescribed date and brought on to the books of the Government of India (Railway Board). The treatment of these balances under the scheme of allocation and apportionment of Assets and Liabilities is explained in Chapter III.

(7) **State Postal Systems : Telecommunication Departments in states.** These Departments should be taken over on the same lines as recommended above in the case of Railways. In the case of Travancore and Cochin, however, we have recommended a sympathetic examination of the State Governments’ request that their “Anchal” (postal) service should be continued under agency arrangements with them, even after federal financial integration. We have dealt with the question in some detail in our Second Interim Report.

In regard to agreements with private companies which operate telephone services in some States, the rights and obligations of the respective State Governments under the agreements must be transferred to the Government of India.

(8) **Postal Immunities.**—Certain States have been enjoying postal “immunities” or concessions in the form of either a free supply of service postage stamps up to a prescribed annual limit and/or the free conveyance of the official correspondence of the State within State limits. These *will cease* from the prescribed date; for that reason, the annual value of these concessions has been taken into account in our Scheme-Reports as “revenue” which will be lost to the State.

(9) **Currency.**—Apart from Hyderabad, the only State which has a substantial circulation of local currency is Travancore, concerning which we have already reported in detail in our Second Interim Report. Briefly, our proposals are that the State Mint should be taken over by the Centre, together with all the assets, outstandings and liabilities connected therewith, (including stocks on hand in the form of

bullion, base metal and unissued coins) ; further issue of local currency should be discontinued ; and Indian Rupees and subsidiary coins made legal tender, at a fixed rate of exchange with the local Currency, without immediately demonetising the State coins now in circulation. When, as a result of free convertibility into Indian coins, a substantial part of the local coinage has been withdrawn, the question of demonetising it may be taken up in consultation with the Reserve Bank.

The loss involved by the gradual withdrawal of the local coinage and its ultimate demonetisation should be borne by the Government of India as a "capital" loss of a "federal" character, resulting from federal financial integration.

Jaipur and Jodhpur are minting gold mohurs ; but these are not legal tender coins. In certain other States there is some circulation of local coins of small denomination but the volume in circulation is not substantial and fresh minting has been discontinued. In the circumstances, no special action is necessary in such cases ; the existing coins in circulation may be gradually withdrawn and ultimately demonetised.

(10) **Defence.**—It has been explained in paragraph 23 of Part I of our Report that the Military expenditure to be taken over by the Central Government upon integration of federal finances would be that relating to regular or I.S.F. Units only. This implies that the State Governments may deal with any irregulars or non-I.S.F. units in such manner as they think fit, whether in the matter of re-organisation or reduction in size of these units and/or their replacement in whole or in part by such non-military forces as the State Governments may think proper.

(11) **Civil Aviation.**—Along with this Department, the Centre must assume responsibility for the future development and maintenance of aerodromes. The construction and maintenance of any but small and unimportant aerodromes will be beyond the resources of the States, as modern aerodromes of normal size are expensive to construct and maintain, having regard to the fact that they have to be equipped with technical and residential buildings, operational equipment, flying control, etc. in accordance with the standards prescribed by the International Civil Aviation Organisation.

The Government of India's scheme of financial assistance to flying clubs must of course, be extended to the flying clubs in the States.

(12) **Broadcasting.**—In planning the development of an all-India net work of broadcasting stations, the Centre must include the requirements in State territories on the same basis as in Provinces.

(13) **Audit and Accounts.**—In our separate Report relating to Travancore and Cochin and in our Scheme-Report for Mysore, we

have assumed that the audit and accounts departments will continue to be administered by the States. This is in accordance with their own wishes in the matter. The expenditure on audit and accounts in these States has therefore been treated as a "provincial" charge with the exception of an estimated portion relating to "federal" transactions which must be borne by the Centre. If, at a future date, the Centre should take over the entire responsibility for audit and accounts in these States, our computations in the Scheme-Reports concerning them should be so revised as to include the entire cost of the Department as expenditure transferred to the Centre.

In all other cases, we have assumed that the States would prefer to have their audit and accounts arrangements taken over by the Centre, and organised as an integral part of the Indian Audit and Accounts Department directly under the Auditor-General of India; our Scheme-Report computations are accordingly based on the transfer of the entire expenditure on Audit and Accounts to the Centre.

(14) **Interest.**—The *net* amount of income under the head "interest" which will accrue to the Centre, and which will be lost to the States, after federal financial integration will be—

- (a) the amount of interest receivable on liquid investments actually allotted to the Centre under the plan for the allocation of assets and liabilities (*vide* Chapter III), *minus*
- (b) the amount of interest payable annually on interest-bearing liabilities and funded obligations assigned to the Centre under that plan.

The *net* amount (which may be a minus figure) will have to be taken into account in the final computations to be made in accordance with our Scheme-Report, as revenue lost to the States upon federal financial integration.

(15) **Pensions.**—The pensionary liability in respect of personnel belonging to the I.S.F. or to "federal" Civil Departments who have retired before the date of federal financial integration, will devolve on the Centre as the "successor" Government in all "federal" matters. From a practical point of view, however, it will serve no useful purpose to disturb the existing arrangements in the States for such payments. We therefore recommend that these payments (a complete list of which should be compiled as on the prescribed date), should continue to be made by the respective States on the Central Government's account. Pensions in respect of personnel who retire on or after the date of financial integration will however be payable in the ordinary way by the Centre.