Centre State Relations in India

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Week 06: Financial Relations: Allocation of Taxing Power; Distribution of Revenue, Goods and Services Tax, GST Council

Lecture 29: Consolidated Fund of India & States, Contingency Fund of India & States and Exemptions

Greetings to all of you. We have been discussing financial relations in which we have discussed the principles of distribution of revenue between the Centre and the States and also we have discussed that how constitutional body Finance Commission undertakes this exercise of revenue distribution between the Centre and the States and what parameters the Finance Commission looks into it for such distribution. Today, we shall be discussing about government account in order to have a kind of comprehensive understanding on the subject. Today, we thought of discussing that what is the structure of government account, what are the purposes, types of account, Consolidated Fund and Contingency Funds of India and the States, division of Consolidated Fund, exemption from taxes, and doctrine of inter-governmental immunity and then we will see that how all these have a kind of impact on a federal relation. So, this is in a way in order to have a holistic understanding on fiscal relations, financial relations so we thought of discussing this topic in this course. Now, when you look at the financial relations, it plays a significant role in managing the financial planning as well as financial management of the country and therefore, in that regard government accounts has got an integral role to play on the issue of management and governance structure on financial side.

It plays an important role in shaping up the economic landscape and also to give guidance that how the natural resources or public resources are to be utilized and how we can ensure that there shall be an efficient and effective utilization of public resources. In this regard, what is important

is that there shall be a kind of transparent financial system, which shall talk about resource allocation in an efficient way and also it is to be seen that whatever disparity is there on the developmental front that disparity needs to be addressed through equitable development across the regions. ~~reasons~~ Also it is essential to look at the issue of promoting fiscal federalism where the States which are not financially very strong they need desirable support from the Center to improve the financial health to look into the overall financial management so that the life of people living in those States can also have a minimum dignity and minimum threshold with regard to providing basic amenities are to be maintained and that is why what you find is that this government account plays an important role in promoting good governance and also to ensure that there is a kind of ordering done on the matter of such financial management. So what is the purpose of accounting when you look at it? The purpose of accounting is to know the revenues that what are the sources from where there is money is being generated for the government, tax revenues or non-tax revenues which are collected throughout a year so that accordingly expenditure can be planned by the government. So to second is to know the expenditure on different atoms and then what talks about is to ascertain how much loans and deposits government has to pay to its creditors and how much of this government has to receive from its debtor.

So this is the purpose of accounting when you look at it in order to make it very clear that what is the receipt, what is expenditure and if there is any shortfall how to address that shortfall or if some money has been lent then what shall be the way and how that money shall be recovered. So this is what is the purpose of accounting when you look at the structuring of government account the Controller and Auditor General is been asked with the responsibility to do the accounting and auditing for the government and that is what president brings into existence by virtue of Article 150 of the Constitution. So the President has on the advice of the Controller and Auditor General under this Article has framed the Accounting Rules in the year 1990 which relates to accounts of both the Central and the States. Government Accounting Rules 1992 has laid down which talks about the forms of the accounts to be submitted which shall include also the accounts of the States. So the form of accounts of the Union, States and Union Territory shall be devised in such a way so that the constitutional mandate is to be followed and then you have

also Union Territories Act of 1963 which talks about maintaining the account vis-a-vis those Union Territories.

And the Rules also list out which is there in some of the provisions and Sections which are attached with this Union Territories Act of 1963. So this is what is with regard to the core structuring of government account when you look at it this Government Accounting Rules in Chapter 3 talks about the core structuring basic structuring of the government account which we will be discussing. Then Rule 20 it says is that for the accounting purpose the calendar should be followed in terms of 1st April to 31st March what we call it as a financial year. And another core structuring is that the accounting shall be maintained in Indian currency that is rupees. It also says that there shall be kind of different divisions of accounts in order to maintain a kind of smoothness in that structuring. So structure of government account when you look at it is provided in the constitution that it can be under 3 broad headings Consolidated Fund of India and State, Contingency Fund of India and State and Public Account.

These are 3 broad headings on which the government account is been maintained. Consolidated Fund of India is provided in Article 266 which says that there shall be Consolidated Fund of India and Public Accounts of India. Article 266(1) says that all the revenues received, all loans raised by the issue of treasury bills, loans or ways and means advances and all monies received by the government in repayment of loans shall form a Consolidated Fund that shall if it is with regard to Central shall be Consolidated Fund of India and with regard to the State then it shall be known as Consolidated Fund of the State that is what is the 1st category of government accounting. Then you find that to Article 261 is subject to Article 267 and other provisions of Part XII of the Constitution which we will be discussing. Article 266(3) says that no monies out of Consolidated Fund of India or a State shall be appropriated except in accordance with the law and for the purposes and the manner provided in the Constitution.

So there has to be a proper legislative backing for withdrawing the money from Consolidated Fund of India or of a State. We know very well that legislature has got a control over the finances and therefore not even a single paisa can be spent without the authorization of the legislature. So this is what is the overall structuring of Consolidated Fund when you look at. It is both on revenue side and the capital, public debt or loan side. On revenue side it is about the

receipt and expenditure from where the receipt is coming tax, non-tax and grants in aid and at the expenditure side it is general services, social services, economic services, grants in aid and contribution is there. On capital public debt and loan again receipt and expenditure where you find again this general services, economic services, social services, public debts, loans and advances inter-State settlement transferred to Contingency Fund this is what is the kind of structuring which is given with regard to the Consolidated Fund. What is the division of Consolidated Fund when you look at it? It comprises of two sections revenue is one section and the other is the capital one. So revenue is like a recurring one where capital has got a kind of one time arrangement where things are been done for creation of asset and all that is how also we try to understand between revenue and capital, but here in this case when you look at the capital it also includes public debts, loans and advances and then these are further categorized between receipts that what money is coming and what is being planned in terms of expenditure. So revenue receipts are divided into three sections tax revenue, non-tax revenue and grants in aid and contributions which are coming.

These three sectors are further divided into sub sectors like taxes on income and expenditure, fiscal services, capital receipts sections does not contain any sections sectors or sub sectors. The revenue expenditure section is divided again into four sectors general services, social services, economic services and grants in aid and contributions. Capital expenditure is again sub divided into sub section seven sub sections- general services, social services, economic services, public debts, loans and then the inter-State settlement whatever is done and transferred to Contingency Funds that is what it done. Contingency Fund is separate from Consolidated Fund which has been created as the name suggests for contingent purposes.

So, Article 267 deals with Contingency Fund. Article 267(1) says that Parliament may by law establish a Contingency Fund in the nature of an interest. The Fund shall be placed at the disposal of the President to enable advances to be made by him for the purpose of meeting unforeseen expenditure pending authorization of such expenditure by Parliament by law under Article 115 or Article 116. Similar provision is there with regard to the State under Article 267(2) which says that Contingency Fund in the nature of an interest by the State nature at the disposal of the Governor. Parliament has made a law Contingency Fund of India Act 1950 in pursuant to Article 267(1). Section 3 provides that the custody and withdrawals of Contingency

Fund of India where it says that it shall be held on behalf of the President by a Secretary to the Government of India in the Ministry of Finance. It also says that advances shall be made out to meet unforeseen expenditures pending authorization of such expenditure by Parliament.

So, unforeseen circumstances like natural disaster happening or some kind of calamity happening in such situation money can be spent from this and as you have seen Section 3 categorically says that the authorization is there with the President to do the needful by the same time what is requires is that once the expenditure is done then the necessary information is to be given to the Parliament with regard to Contingency Fund. So, the States have also made a law on contingency fund for example, you have a Jharkhand Assembly which has enacted a law Jharkhand Contingency Fund Act in the year 2001 and then for example, West Bengal has enacted Contingency Fund of West Bengal Act way back in 1950. So, Contingency Fund is for unforeseen circumstances as the law says and the government allocates funds for this. Under this heading one for Centre as of now under the latest Financial Bill the corpus of Contingency Fund has gone up to 30000 crore prior to that it was 500 crore. So, this is what the government creates a corpus and then authorizes the President to meet the expenditure in an unforeseen crisis that is the provisions with regard to law on contingency. Public accounts are a separate heading which was created in 1950 Constitution.

Public account is some different from Consolidated Fund and Contingency in India. In fact, there was no reference of public accounts prior to 1950 Constitution. Public accounts provide for all other public monies which are received by or on behalf of the government of India or a State and shall be credited to the public account of India or the public account of the State as the case may be. The expenditure which has been made out of this Fund is not subject to any vote in the legislature whereas you have seen Consolidated Fund of India vote of the legislature is important for any kind of withdrawal and then for Contingency Fund though impressed amount is given to the President but then once it is been done there is a necessary information and detailing out is to be submitted on the floor of the House. When it comes to public accounting no such control is there of the legislature.

So, what is seen is that that whatever money is coming under this heading government acts as a banker or a trustee. So, transactions relating to debt other than debt in Part I, deposits, advances,

reserve funds, remittances and suspense form public account. So, these are the kind of sources through which public accounts gets created. For example, so Small Savings Provident Fund and Reserve Funds, Deposit and Advances, Suspense and Miscellaneous, Remittances and Cash Balance this is what it says. The sectors are further sub divided into sub sectors and then as I said that public account is not subject to the voting of the legislature.

So, no such you know legislative approval is required for the same. So, who has got a custody on this matter Consolidated and Contingency and Public Accounts? Article 283 envisages the custody of Consolidated Fund, Contingency Fund and money is credited to the Public Account. When you read Article 283(1) provides that custody payment and withdrawal of money from the 3 accounts shall be regulated by a law made by the Parliament or the regulated by the Rules made by the President until law is enacted in this regard. Similar provision goes for the State in Article 283(2) which says that for all the 3 accounts there shall be law made by the State Legislature or there has to be a rule from the Governor until law is made in this regard. Then let us come to another important area of federal relations between the Centre and the State which is known as the immunity to the instrumentality where the idea is that neither the federal government nor the state government should unnecessarily exercise taxing authority to impede the growth and the progress of government entities be it the Central or the State government. So under Part 2 there is a heading called Miscellaneous Financial Provisions which talks about certain tax exemptions.

These exemptions are for promoting healthier relationship between the Union and the States. Articles 285 and 289 of the Constitution talks about the doctrine of immunity of instrumentalities or intergovernmental immunity. So Articles 285, 287, 288 and 289 provides for such exemptions from taxing. So Union’s property is exempted under Article. It says that property of the Union shall be exempted from all taxes imposed by a State and Article 285(1) says that Parliament to enact a law for removing the exemption and then Union’s property continue to be taxed if the State level is taxed prior to the commencement of the Constitution. So if it is already been taxed then there is something which continues to happen but then otherwise it says that property of the Union shall be exempted.

You can very well visualize that in fiscal relation it is important that both the sets of government

they are working in coordination and therefore no such measures shall be allowed or permitted which otherwise may cause obstructions in the growth of the nation and that is why it is been correctly provided that property of the Union shall be exempted from the tax, they shall not be subjected to the tax to be imposed by the State government. States income and property exempted under Article 289. Article 289 exempts the property and income of a State from the Union taxation. So it is vice versa where the Union's property cannot be taxed by the State in a similar way the property of the State cannot be subjected to the Union taxation. Article 289(2) says that it permits taxation of trade or business activities carried on either by the State itself or on behalf of the State that is what it says. So when you look at it what it says that if there is some trading activities undertaken by the instrumentality of the State then that shall not be exempted from the taxation law. So, Parliament can create an exemption for trade or business which is incidental to the ordinary function of the trade. If something which is where the trade or business is just an incidental element to the core activities then in such a situation such exemption is allowed under Article 289(3).

So when you look at the scheme you can very well find out that if the State instrumentality is into trading or business activities then they are not to be exempted they shall not be enjoying the immunity whereas a State property shall enjoy the immunity under Article 289(1). So this doctrine of inter-governmental immunity is a very prominent one which has got its genesis from the judicial pronouncement in United States and the entire idea behind this inter-governmental immunity is to build a stronger relationship between the federation and the federating units. It is also to ensure that unnecessarily there should not be any kind of bottlenecks created by the Centre or by the Union by invoking taxing authorities. So it is based on that immunity from taxation to properties to functions and instrumentalities of one level of government when it operates within the jurisdiction of another level of government in a federal system and that is what when you look at it the famous observation made in McCullough v. Maryland where you find that Chief Justice Marshall says that the States could not tax or control a federal instrumentality and this is something again in detail elaborated in New Delhi Municipal Council Case where the court has adopted this doctrine of intergovernmental immunity and agreed with the idea that this kind of inter-governmental immunity is very important for respecting the constituent units of the federal system. Then the majority in this New Delhi Municipal

Corporation has said that the property of States situated in Delhi and levy of property of tax on such properties is invalid if the property of the tax is not acquired for the purpose of trade or business. So trade or business if it is there then there is an exception created it is not a case of trade and business then such exception shall not be allowed.

So if the levy of tax is on property used or occupied for trade or business then that is something which is permitted by virtue of Article 289(2) otherwise Article 289(1) makes a very absolute provision where it says that that instrumentality of the State are not to be subjected to any kind of tax regime. So that is what is important and when you look at New Delhi Municipal Corporation Case it makes a distinction based on what is the sovereign function, what is the governmental function on the one hand and what is commercial function or non-governmental function on the other hand. So when you look at the exemption from taxation which is given under Article 287 it says no law of State shall impose tax on consumption or sale of electricity except by law made by the Parliament and Article 287(a) and 287(b) where it says that the consumption of electricity is done by the Government of India or sold to Government of India or consumed in matters relating to railway. So on the matter of electricity there are exceptions created possibly because of the national interest that's what categorically Article 287 provides for. Article 288 further says that no State shall impose tax on water or electricity distributed consumed or sold by any authority established by any law either existing or made by the Parliament for the purpose of inter-State river or river valley. Clause 2 says that legislature by law may impose tax but no law shall have any effect unless it is been reserved for consideration and received assent to the President.

If the law provides for fixation of rates by means of Rules to be made under the law then such law shall provide for previous consent of the President before making that law operational. So you can very well look at it that certain exemption is been given but at the same time if the subject matter touches upon the issues of trade or generating revenue then with regard to that taxation law can be made applicable but then a procedural requirement is laid down where it says that there is a need to obtain the consent from the President, there is a need to receive the assent from the President in this matter. So how do federal relations work on this matter? The scheming is like this - there is a unitary principle where you find that there is a kind of clear exemption inter-governmental immunity where Union properties cannot be taxed but on the issue of taxing

of Union property it says that State cannot tax the Union properties without the consent of the Union. So you would find that there is no equal bargaining position between the Union and the States on the inter-governmental immunity issue. For the purpose of taxing Union's property there is an absolute embargo whereas when it comes to taxing Union's property by the State it says that you need to obtain the consent of the Union. Then further there is a holding together approach also where you find that exemption from taxation to the State property is qualified where it qualified under Clause 2 and Clause 3 where a Union has been given the power to tax where something has to do with trade and business activities and then on the matter of national interest that is railways, water and electricity again which is used for inter-State river development then that is again exempted from taxation.

So, that is an important scheme and that is how you find that the issue of inter-governmental immunity is working in India in the constitutional scheme. These are the references for this session. Thank you very much.