COURSE TITLE: LOCAL SELF GOVERNMENT

COURSE -424

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UNIT – IV

FINANCE OF LOCAL GOVERNMENT

REVENUES AND TAXATION

Taxes cess etc, which may be levied by village Panchayat

Every village panchayat may levy in its area a 145[property tax] a profession tax, an advertisement tax and an entertainment tax.

Service tax shall be levied at the rate fixed by the village panchayat, subject to the minimum rate prescribed for sanitation, water supply, scavenging, street lighting and drainage wherever such services are provided by the Village Panchayat.

A duty shall also be levied in every village panchayat area on transfers of property in accordance with the provisions of section 206.
3A. 146[A village panchayat may levy from land owner, a land conversion cess at such rates and in such manner as prescribed in respect of paddy fields, marshy lands, pond or wet land which he was holding and has been converted into garden

land or land on which there is a building.
Explanation. - Nothing in this section shall be deemed as affecting any of the provisions of Kerala Land Utilisation Order, 1967.

(i) A show tax shall be levied on all shows within the village panchayat area at the rates prescribed by Government in this behalf.

To make the decentralization successful, fiscal systems that make governments accountable to their citizens are needed . The accountability of PRIs to its citizens can be ensured only if they augment their own resources to provide public services. While all three tiers of Panchayats in India have been empowered to raise revenues, it varies across states. The Centre for Budget and Policy Studies (CBPS) claims that Gram Panchayats are empowered with the most number of taxation powers as compared to district and intermediate panchayats and property tax forms the most important source of own source revenue (CBPS 2014). Raising of own source revenue by PRIs has several benefits. It establishes panchayats as local government, reduces dependence on State and Central government, enables panchayats to deliver basic services, helps them fill resource gaps at the panchayat level in addressing local needs. From governance point of view, raising OSR such as taxes, fees and user charges makes the panchayat accountable to the public and also enhances citizen’s participation in the decision making. For example, increased proportion of the own revenues in the public service expenditure was seen to have resulted in increased participation in Gram Sabha (GS) meetings and has impacted quantity and quality of public services . The Study on Review of Panchayat Finances commissioned by the Fourteenth Finance

Commission pointed out that there was potential for rural local bodies to raise much larger revenues by reforming the property tax systems (Ministry of Finance, 2015). The Fourtheenth Finance Commission found that in one State the gram panchayats played an advisory role and had no powers to collect tax or non-tax revenue and in four others they had powers to collect revenues but were not doing so. Of the remaining States, two accounted for most of the revenues collected at the gram panchayat level. The Commission further observed that for the local bodies to function effectively as institutions of local self-governance, it is important that they augment their own sources of revenue (Ministry of Finance, 2015). GP can earn its own revenue through taxation depending upon the devolution made by the State Government. Several studies on different states have shown that power which can give financial autonomy to panchayats is not devolved to them. Even if the power is given, there are several difficulties while exercising the power. The strategy of strengthening of panchayats is inextricably intertwined with empowering them to raise revenues from tax and non-tax sources assigned to them. In several states, this is a neglected aspect of panchayat empowerment (Rao and Rao, 2008). Whereas Anand Sahasranaman (2012) says "many Gram Panchayats are today in a position to substantially finance themselves and build a culture of self sufficiency, independence and accountability to their citizens". Apart from this, there have been several attempts to identify the determinants of Own Source Revenue of Gram Panchayats. Most of them have clearly identified a relationship of OSR with economic development (CBPS, 2013). But, a report of the Kerala Public Expenditure Committee (February, 2018) had observed that own tax revenue growth is higher than that of the nominal GSDP in 2015-16. This shows the potential source of augmentation of revenue is more for Panchayats. It may also be not true that large inflow of scheme funds and untied grant discourage local governments from raising own taxes for various reasons. A study conducted in West Bengal suggested that own source revenues and intergovernmental transfers do not substitute for one another but rather are complementary. On the other hand, increased proportion of the own revenues in the public service expenditure was seen to have resulted in increased participation in Gram Sabha meetings and has impacted quantity and quality of public services . Considering the poor status of OSR generation by Gram Panchayats the Fourteenth Finance Commission recommended for providing performance grants to address the following issues: (i) making available reliable data on local bodies' receipt and expenditure through audited accounts; and (ii) improvement in own revenues.

Revenue collected by a Gram Panchayat through tax and non-tax sources is called Own Source Revenue (OSR) of the Gram Panchayat. Financial power of Panchayats that is derived from the ‘State List’ is not obligatory. States are also empowered in their respective Panchayat Acts to suspend the levy of any Panchayat tax/fee at any time and to extend exemption areas of any Panchayat tax. Revenue sharing arrangement between State-Panchayats are not made mandatory in the Constitution except for the provision for setting up of SFC at five year intervals for recommending revenue share and devolution of grants from the States to Panchayats and Municipalities. As per the present statute, operationalization of the financial power of Panchayats, depends on the enabling framework (i.e., fixing tax base, tax rates, provision for tax rates revision, tax administration and tax enforcement) to be provided by the States in their respective Financial Rules.

Among three tiers of Panchayats, Gram Panchayat (GP) have been given most of the taxation powers compared to other two tiers viz. Intermediate Panchayats (IPs) and Zila Panchayats (ZPs). Own source of tax revenue of GPs normally includes following items although it varies from one State to another: (i) Land and building tax/House tax (LBT) (ii) Profession tax, (iii) Entertainment tax, (iii) Advertisement tax. There are different types of non-tax revenue that GPs are authorized to levy. Normally non-tax revenue can be classified into three types of viz. (i) User-Charges (ii) Registration and other fees (iii) One-time fee.

The source of revenue of the Municipal Council are mentioned below:
1. Taxes on water, houses, markets, and vehicles.
2. Grants from State Government.
3. Taxes on education.
4. Taxes on agricultural land for the specific purpose.
5. Professional taxes.

The dissimilar nature of rural and urban governments is apparent from their differing revenue structures: in the former about 89 per cent of revenues are derived from the states, while in the latter about 81 per cent of revenues are internally generated, with local taxation claiming about 55 per cent and nontax revenues about 27 per cent in 1976-77 . By 1986-87 the dependence of urban local governments on external assistance had increased from 19 per cent to 23 per cent. This was related to the declining share of nontax revenues trend which is likely to continue. On the other hand, substantial reduction of external dependence in the revenue structure of rural governments must await radical restructuring of their tax competence, mainly through the assignment of land revenues. Until this happens, rural local government will not develop its own personality, while urban local governments will continue to be marginalised in generally unified Soviet-type fiscal arrangement. state-wise breakdown of local government revenues indicates that three states (Maharashtra, Gujarat, and West Bengal) account for about two-thirds of rural government revenue, while among urban authorities the situation is more variegated, with only one state (Maharashtra) claiming disproportionate share of 39 per cent This is mainly due to the importance of octroi in internal revenue (Maharashtra and Uttar Pradesh) and larger external assistance (Maharashtra, Madhya Pradesh, and West Bengal). In Madhya Pradesh the urban authorities claim more external assistance (43 per cent) due to their share of compensation for the state entry tax. Maharashtra's dominant reliance on internal revenue for both tax and nontax sources (86 per cent both rural and urban) also is striking. The internal revenue mobilization picture of local authorities is diverse: among rural governments the best performers are Kerala and Uttar Pradesh (61 per cent each), followed by Himachal Pradesh (53 per cent), while among urban governments the highest ratings belong to Haryana (99 per cent), Karnataka (95 per cent), and Punjab (92 per cent). The worst states in terms of rural government revenue mobilization are West Bengal and Orissa (3 per cent each), followed by Bihar (8 per cent); in urban government the worst state is again Bihar (less than 40 per cent), while others are way above (Table 4.5). Per-capita revenues of the various tiers of rural government and types of urban government show their relative fiscal resilience: the village and area authorities are more effective in rural government, while the municipal corporations and councils are effective in urban government. The town and notified authorities are shade better than the village councils in terms of revenue performance . On an overall basis, there seems to be need to enhance minimum revenues of rural authorities substantially (at least five-fold), while the urban authorities need minimum of half of this level of revenues. This would imply increased tax devolution to the rural authorities and increased assistance for the urban authorities . Detailed look at the revenue competence of rural authorities shows the need for strengthening their compulsory taxation capabilities through assignment of land revenue and devolution of land cess . Local government tax powers include 27 state taxes for rural governments (20 exclusive and concurrent) and 20 state taxes for urban governments (9 exclusive and 11 concurrent), as detailed in Table 4.9. Only minor state taxes have been allocated to rural governments, while urban governments have access to major taxes (including the central terminal tax). Only two taxes, octroi (exclusive) and property taxes (concurrent) account for about 90 per cent of municipal tax revenues -- 70 per cent under octroi and 20% under property taxes (NIUA, 1989). Apart from limited tax powers, urban local governments are experiencing increasing state intrusions into their tax domains, covering virtually all the important taxes devolved to them. Earlier, under the Government of India Act, 1919, there was a separate "local tax list" for exclusive utilization by local governments; this was abolished with the introduction of provincial autonomy under the Government of India Act, 1935, reaffirmed in the Constitution of 1951. Various commissions and committees have suggested revival of the local tax list through consensus or under constitutional amendment. Under the 1989 bills this is left to the judgment of the mandatory state finance commission for each state. The productivity of local taxes is low. In rural governments, this is partly due to the absence of compulsory list of taxes and prescribed minimum rate of levy; in urban governments, there is reluctance to levy high rates of compulsory direct taxes (property and service taxes). The tax collection performance of local governments is also low (around 30 per cent for rural governments and 50 per cent for urban governments). In the non-octroi states in the eastern and north-eastern areas, the tax collection performance of the urban governments is relatively unsatisfactory (NIUA, 1989). The remedy seems to lie in variety of directions. On the internal side, innovative management and system of incentives and penalties are important (Delhi Municipal Corporation achieved 96 per cent improvement in 1986/87); on the external side, local tax performance could be included as a factor in determining the level of general or incentive grants to local government (as in Gujarat). Considering the small share of local taxes in the total taxes levied in India (5 per cent), it is unlikely that greater utilization of these taxes would materially affect total tax incidence. In any case, the per capita tax incidence of octroi is negligible and the incidence of property tax may be mildly progressive (NCAER, 1980). The buoyancy of local taxes also compares well with similar state and central taxes. Among possible tax-related reforms, there is case for imposition of poll tax to defray the cost of providing package of local community services that emphasizes local voter-accountability. Such tax has replaced domestic rating in the UK and is being levied in Nigeria and Papua-New Guinea. In the Indian context, poll tax would have considerable merit in the PRIs and in the smaller MAs where either the land rate or the property tax is difficult to operate. Its extension to larger MAs would, however, be difficult in the absence of requisite information on assessable adults "resident" in local area. This is apart from the requirement of large exemptions to unemployables and acceptance of the tax in cash or in labour. Once poll tax succeeds in the smaller MAs, its extension to the larger MAs could be considered to partly relieve the burden of property tax. The local taxes on professions, trades, callings and employment are being increasingly taken over by the states, and, in spite of the recent increase in their taxable limit to Rs. 2,500 from the earlier Rs. 250, they are rarely utilized to their full potential. There is need to raise the taxable limit of the professions tax to the full extent of income exempted from income-tax (now Rs. 18,000) and utilise this as lower level income-tax (LLIT), as is done in many countries in southern Africa. Municipal corporations at least should be allowed to use the professions tax as an assigned tax, leaving the rest for sharing with other local authorities on derivative principles. This would widen the local tax base and the own income of the local authorities in a situation when the other two major local taxes (octroi and property tax) are faltering. The issue of abolition of local octroi came up almost simultaneously with the introduction of local government in the country. During the colonial era the central government pressed for its abolition, while the provincial governments steadily extended its scope (Tinker, 1967). The debate continued after independence, and few state governments are now actively considering its abolition, mainly due to the pressure of the transport lobby. Octroi was replaced by state wide entry tax in Madhya Pradesh (1977) and Karnataka (1979); by terminal toll in Jammu Kashmir (1990); and by surcharge on the state sales tax in Uttar Pradesh (1991). Abolition of octroi has been advocated because of several problems associated with it: (1) hindrance to trade, (2) corruption at the checkposts, (3) high cost of collection, and (4) wastage of time and fuel. The present emphasis is on: (1) the adverse effect of local trade barriers on the national economy and (2) avoidance of the cascading effect of the tax due to its coverage of raw materials and intermediate goods. Despite these shortcomings, octroi continues to be levied in out of the 25 states in the country (Table 4.10). It is interesting to note that while some of the major octroi-states are now thinking of its abolition (Gujarat, Maharashtra and Rajasthan), some other non-octroi states have either opted for it (Manipur, Meghalaya, and Orissa), or imposed trans-local octroi or entiy tax to mobilize additional local revenue (West Bengal and Assam). The experience with the working of the state gentry tax in Madhya Pradesh shows several shortcomings, including (1) its limited nature, (2) its coverage of intermediate goods, (3) its partial revenue retention by the state, the compensation being based on a fixed percentage of revenue growth, (4) its adverse effect on the liquidity of local finances, and (5) its erosion of local fiscal autonomy. The other two basic objections against the entry tax are that (1) it is of doubtful constitutional validity, since octroi is local tax whereas entry tax is not, and (2) the replacement of check-post collection by return-based collection does not remove the adverse economic consequences of internal trade restrictions. Substitution of octroi by terminal toll is retrograde step since the latter is imposed not only on goods but also on passengers carried by road. surcharge on sales tax makes the impost too heavy on the existing dutiable goods already subjected to the state sales tax. Replacement of octroi by new tax is contingent on the following conditions: (1) the replacement should be return-based, (2) it should be revenue neutral, (3) it should not be more regressive, (4) it should ensure free flow of internal trade, and (5) it should be local levy. So far the search for viable local tax substitute for octroi has proved elusive, as all of the possible alternatives -- with the exception of business property tax -- entail overlapping tax jurisdictions . The business property tax cannot be counted upon due to the lack of evidence of market value for property use or transfer. local surcharge on sales tax could be allowed to the metropolitan cities, unless terminal taxes are imposed therein; for the other local authorities, state surcharge seems to be practical replacement. Both these may eventually entail the transformation of state indirect taxes into retail value-added tax, shared between the states and local governments under fixed formula, as in France.