‘An unlimited power to tax involves, necessarily, the power to destroy.’

Deniel Webster.

6.1. Taxes and Economic Growth

It is advisable not to approach the problem of relationship of taxation and economic growth without a thorough theoretical background. It is useful to examine diverse approaches to this relationship having a clear idea of what taxation stands for and what are its consequences. What should be the relationship between taxation and economic growth? Although it may sound obvious that “high taxes are bad for growth,” this relationship has not been entirely trivial, neither in theory, nor in data.

It is, for instance, conceivable, that taxation and government spending lead to higher growth rates. Government redistribution can stimulate savings and investment by redistributing wealth to individuals with a higher marginal propensity to save. It is easy, however, to realize that such redistribution is not feasible for a number of reasons, political and ethical ones in particular. Generally speaking, higher marginal propensity to save can be found among people with higher incomes and redistribution stimulating economic growth would thus in reality be a redistribution from the poor to the rich.\(^{123}\)

6.1.1. Policy Implications

When, we analyze the nature of taxation from a very broad theoretical perspective, without having recourse to mathematical modeling. A simple use of unaided reasoning tells us that taxation always influences economic

activity and distorts smooth functioning of market economy. As a result, one can assert that taxation affects negatively growth rates. This claim holds in standard economic theory as well. For instance, taxation lowers steady state level of output in the Solow model. Moreover, as many scholars demonstrate, taxation in vast majority of cases depresses long-run growth rates in endogenous growth models. One can find that there is a large consensus about the superiority of consumption taxation over income taxation. On a reasonably large interval, lower the taxes are, better it is for the economic growth. Less distortionary the taxes are, better it is for the economic growth. In particular, a tax reform consisting of eliminating distortionary capital income taxation and lowering the tax burden can have important effects as far as economic growth is concerned. These are simple and verifiable positive statements.  

6.2. Role of States in Growth

In the Indian federal set up, the States play an important role in accelerating and sustaining growth. The Indian Constitution assigns important responsibilities to States in many sectors such as agricultural development, infrastructure, poverty alleviation, water supply and irrigation, public order, public health and sanitation. Furthermore, they have concurrent jurisdiction in several areas like education, electricity, economic and social planning and family planning. In view of the larger responsibilities assigned to the States, their expenditure accounts for a substantial portion of the Government sector expenditure (Centre plus States) in India. The comparative position across countries reveals that in India the share of aggregate States’ expenditure in Government sector expenditure is higher than that in several other countries such as Australia, Denmark, Argentina, USA and Germany (World Bank, 2005). The composition of receipts and expenditure of the Government sector in India reveals that while the State Government collect about one-third of the total Government sector receipts, they incur more than three-fourth of the total expenditure on social services and more than half of the total expenditure on

economic services. The States’ ability to undertake and perform the developmental functions adequately and effectively is critically determined by their fiscal position.

6.3. State Finance Framework

In a federal system, the sub-national governments are assigned certain sources of revenues and expenditure responsibilities. In the Indian context, the State Governments have their own independent sources of revenue as well as transfers from the Central Government. Accordingly, the level of resource flow at State level in India is determined by both (i) endogenous factors (i.e., States’ own efforts in generating resources) and (ii) exogenous factors (i.e., the resource transfers from the Central Government). The details of various sources of revenues and expenditure responsibility of State Governments are set out below.

6.3.1. Sources of Revenue: States’ own Tax Revenues

States’ own taxes can be grouped into three parts, viz.,

(i) taxes on commodities and services such as sales tax, State excise, taxes on vehicles and taxes on goods and passengers,

(ii) taxes on property and capital transactions such as stamps and registrations and land revenue, and

(iii) taxes on income such as profession, trade and agricultural income. Among the above, the principal sources of States’ tax revenue are sales tax, State excise and stamps and registration fees. Sales tax alone accounts for nearly two-thirds of the total State’s own tax revenue. Realizing the need for tax reforms, many States have switched over to a Value Added Tax (VAT) regime on the basis of the recommendations of the Empowered Committee of State Finance Ministers with effect from April 1, 2005. VAT may be defined as a tax on the value added at each stage of production and distribution of a commodity.
6.3.2. Sources of Revenue: States’ Own Non-tax Revenues

These include (i) interest receipts, (ii) dividend and profits, (iii) user charges on account of social and economic services, and (iv) general services. The major part of revenues comes from interest receipts, User charges on account of economic services.

6.3.2.1. Current Transfers and Devolution from the Centre

The current transfers and devolution from the Centre include States’ share in the Central taxes and grants. The provision for these transfers to States aims at addressing the vertical imbalance or fiscal gap that stems from asymmetric devolution of functions and tax powers among different Government levels. Furthermore, such transfers aim to secure fiscal equalization among the States which is necessary and imperative in the interest of equity and efficiency.

6.3.3. Expenditure Responsibilities of States

State Governments incur considerable expenditure towards provision of various social and economic services in addition to expenditure requirements towards maintenance of various organs and general administration. The total expenditure comprises of revenue and capital components. Broadly the expenditure which does not result in creation of assets is treated as revenue expenditure. Capital expenditure mainly includes expenditure on acquisition of assets like land, building, machinery etc. and also loans and advances by States mainly to Public Sector Undertakings. Under revenue expenditure, certain items of expenditure, viz., interest payments, pensions outgo, wages and salaries and expenses towards administrative services have downward rigidity.

6.4. Fiscal Indicators

A variety of measures are used to judge the fiscal position of governments which may be as under;
6.4.1. State’s Own Revenue to Revenue Receipts Ratio

SOR/RR ratio shows the extent to which a state enjoys financial autonomy and independence. A high SOR/RR ratio in a state implies effective control of the state on financial resources and hence less dependence on the centre.

The concept of fiscal sustainability should ultimately be in terms of the ability of the state government to generate tax and non-tax revenues to meet expenditures and retire debt. Instead of taking the debt-income ratio for the whole economy, one needs to consider the relevant portion of income in the denominator. The income of a state government consists of state’s own revenue in the form of tax and non-tax revenues and transfers from the centre in the form of state’s share in the tax revenues and grants. Since Finance Commissions have largely been deciding the transfers to states, we should link fiscal sustainability of a state to its own capacity and ability to generate revenues. Hence, it may be proposed replace debt-GSDP ratio by the ratio of debt to state’s own revenues (D/SOR) as the critical indicator for fiscal sustainability of states. If continuation of the current (or target) fiscal behavior of a state can result in a stable finite D/SOR ratio, the state’s fiscal position is technically sustainable.

6.5. Trends in State Taxes

Under State taxes, comparatively the poor performance has been mainly marked in the case of taxes on sales tax, state excise and stamps and registrations. The major reasons behind the inadequate growth in States taxes over the years are;

(i) narrow tax base,
(ii) greater dependence on indirect taxes mainly the sales tax,
(iii) lack of harmonized inter-state tax structure which allowed distortions and rigidities to creep in,
(iv) competitive tax reductions by the States to attract trade and industry. The competitive reduction in taxes led to a mere redistribution of existing capital among the States at the cost of significant revenue foregone,
(v) States inability to levy taxes on services and agricultural income, and
(vi) tax evasion and slackness in the recovery of arrears.

However from a modest amount of Rs. 222 crores in 1950-51, revenue from states’ taxes has grown consistently over the years and was estimated at Rs.5,62,058 crore in the year 2011-’12 budgets of the State Governments. The relative significance of State taxes has changed over the year since Independence in 1947. Land revenue, which contributed 22.1 percent to State taxes in 1950-51, has almost disappeared. In the 2011-12 budgets of the State Governments, the share of Sales Tax i.e. Commercial Taxes in State taxes was estimated at 50.47 percent (Table 6.3) Apart from Sales Taxes other important State taxes are state excise duties, motor vehicle tax, stamp duties and registration fees, entertainment tax, and electricity duties.

6.5.1. States’ Own Revenue and Own Non-Tax Revenue

The States’ own non-tax revenue in terms of GSDP showed deterioration in the last decade. A major reason underlying the sluggish growth in non-tax revenue is the levy of inadequate user charges/cost recoveries. The cost recovery in the case of education and health services has hovered around 1
per cent and 5 per cent, respectively, in the recent period (RBI, 2012). Apart from inappropriate user charges, low or negative returns from investment have adversely affected the growth of States’ own non-tax revenues over the years.  

6.6. State Taxation as Tool for Raising Revenue  

All over the world, raising resources to meet the growing government expenses has been a major issue to tackle with. In an ideal world, the governments would raise just enough resources easily and without causing pains to the society to meet their justified minimum and controlled expenses. Unfortunately, in reality, every Finance Minister or Chancellor has become very unpopular just because he is per se forced to implement suitable fiscal measures to steer the State carefully to ensure its financial health and stability.

Such fiscal policies comprise a mix of instruments that governments can use to target chosen economic goals. Some governments try to set right the disequilibria in wealth/income distribution through these measures, but it is a different story that they fail miserably and ultimately leading to still further deterioration in the wealth/income distribution.

They also in their anxiety to be ever popular do not take or initiate any timely and corrective measures to manage their fiscal position judiciously, which naturally and ultimately lead to detrimental ramifications including near bankruptcy of the very governments themselves.

Some ‘smart’ finance ministers knowing well that they may not last for another term, pass on the job of ‘belling the cat’ to the next finance minister belonging to their own party or the opposition party who is tipped to wrest ‘power’ in the forthcoming polls due to their own or their party’s lackluster performance; the present incumbent in post/power. There has been no uniform solution to this persistent problem.

The Indian experience is no different. It has its own countless insurmountable problems in the fiscal areas. The federal set-up adds to further misery with the tax subjects divided into Central, State, local governments, etc., with the result the tax payer-consumer ends up paying two or more types of taxes on the same goods or services and in some cases, tax on taxes too. In addition, periodic revision in tax slabs affects planning of investors.

Stability in taxation, one of the basic cannons of taxation, is not assured or ensured by any of the finance ministers either in the Centre or in the States. The policy formulations of the most of these finance ministers are unfortunately their respective party-centric rather than country/State-centric. Thus there is a long felt need for a viable long-term fiscal strategy to be debated and developed in India.

6.7. Policy Measures towards States’ taxes

The general approach of the States has been to rationalize and simplify the tax structure, broaden the tax base and impose moderate rates of taxation. States have initiated policy measures towards fiscal empowerment mainly through States own taxes and showed intention to increase the magnitude and efficiency of tax revenue mobilization over the years. The initiated measures by States include enhancement/ restructuring of various taxes such as land revenue, vehicle tax, entertainment tax, sales tax, electricity duty, tax on trades, professional tax, luxury tax and stamp duty. The major policy initiatives are as under;

- Expert Committees/Commissions: A number of States have appointed committee/commission to review the structure of their tax and non-tax revenues. The efforts were also initiated towards computerization of tax/budget departments, treasuries and check-posts in view of the VAT as implemented by the States.
- Introduction of VAT: Realizing the need for tax reforms, most of the States have switched over to a VAT regime on the basis of recommendations of the Empowered Committee of State Finance Ministers with effect from April 1, 2005. VAT may be defined as a tax on the value added at each
stage of production and distribution of a commodity. VAT is inherently efficient than the sales tax or excise duty or any turnover tax. Operationally, application of VAT at a particular stage implies payment of tax by the producer or distributor on the value of his output but with a rebate (or credit) on the taxes paid by him on the inputs.\textsuperscript{129}

- Most of the states have reduced the rates of stamp duty.

\section*{6.7.1. Observations on Policy Measures}

The fiscal policy pursued at State level needs to be mainly focused on;

(i) to broaden tax base including those of agriculture income and to reduce exemptions/concessions,

(ii) administrative and legislative reforms in taxation,

(iii) increase in cost recovery/user charges and returns from public investment,

(iv) public sector undertakings restructuring,

(v) rationalization and containment of both explicit and implicit subsidies,

(vi) expenditure reprioritization towards social and productive sectors and, more importantly,

(vii) institutional reforms. These initiatives would go a long way to bring fiscal discipline and sustainability in the public finance at State level.\textsuperscript{130}

\section*{6.8. State Taxes as Per Cent of GDP}

In 1950-51, state taxes accounted for 2.23 percent of GDP. This percentage started increasing with every passing decade with the growth of tax bases allocated to the states under the constitution. The percentage increased to 2.65 in 1960-61, to 3.38 in 1970-71 and to 4.64 in 1980-81.


Table 6.1 States’ own Taxes a percent of GDP 1990-91 to 2011-12.

<table>
<thead>
<tr>
<th>Year</th>
<th>States’ own taxes</th>
<th>Col. 2 as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>30,145</td>
<td>5.30</td>
</tr>
<tr>
<td>1991-92</td>
<td>35,837</td>
<td>5.49</td>
</tr>
<tr>
<td>1992-93</td>
<td>39,530</td>
<td>5.28</td>
</tr>
<tr>
<td>1993-94</td>
<td>46,219</td>
<td>5.38</td>
</tr>
<tr>
<td>1994-95</td>
<td>55,552</td>
<td>5.49</td>
</tr>
<tr>
<td>1995-96</td>
<td>64,034</td>
<td>5.39</td>
</tr>
<tr>
<td>1996-97</td>
<td>71,294</td>
<td>5.21</td>
</tr>
<tr>
<td>1997-98</td>
<td>81,439</td>
<td>5.35</td>
</tr>
<tr>
<td>1998-99</td>
<td>89,220</td>
<td>5.12</td>
</tr>
<tr>
<td>1999-00</td>
<td>1,02,831</td>
<td>5.31</td>
</tr>
<tr>
<td>2000-01</td>
<td>1,16,717</td>
<td>5.59</td>
</tr>
<tr>
<td>2001-02</td>
<td>1,27,475</td>
<td>5.61</td>
</tr>
<tr>
<td>2002-03</td>
<td>1,40,372</td>
<td>5.70</td>
</tr>
<tr>
<td>2003-04</td>
<td>1,63,406</td>
<td>5.92</td>
</tr>
<tr>
<td>2004-05</td>
<td>1,85,891</td>
<td>5.98</td>
</tr>
<tr>
<td>2005-06</td>
<td>2,21,537</td>
<td>6.00</td>
</tr>
<tr>
<td>2006-07</td>
<td>2,63,195</td>
<td>6.13</td>
</tr>
<tr>
<td>2007-08</td>
<td>2,77,182</td>
<td>5.56</td>
</tr>
<tr>
<td>2008-09</td>
<td>3,10,152</td>
<td>5.51</td>
</tr>
<tr>
<td>2009-10</td>
<td>3,76,316</td>
<td>5.83</td>
</tr>
<tr>
<td>2010-11</td>
<td>4,76,380</td>
<td>6.21</td>
</tr>
<tr>
<td>2011-12</td>
<td>5,62,058</td>
<td>6.26</td>
</tr>
</tbody>
</table>

**Note:** The ratios of GDP since 1950-51 are with reference to new series GDP at market prices.

**Source:** Indian Public Finance Statistics (2011-12), Ministry of Finance, Department of Economic Affairs, Economic Division, July 2012.

On the eve of initiation of economic reforms, State taxes accounted for 5.30 percent of GDP in 1990-91. The percentage fell to a low of 5.12 in 1988-99, owing to tax competition among the States. Of late, the percentage has improved and was estimated at 6.26 in the year 2011-2012 budgets of the State Governments (Table 6.1). This improvement is chiefly attributed to
agreement among the States to implement floor rates of sales tax and to reduce and rationalize various exemptions and concessions.\textsuperscript{131}

6.9. Direct and Indirect Taxes

States own tax revenue has increasingly relied upon indirect taxes at the State level. The ratio of indirect taxes to direct taxes in 1950-51 was 75.2:24.8, dropping to 75.8:24.2 in 1960-61, further down to 91.0:9.0 in 1970-71, and further down to 95.9:4.1 in 1980-81.

During the post-reforms period, the ratio between direct and indirect taxes worsened further. It declined from 95.9:4.1 in 1990-91 to 97.7:2.3 in 2011-12 (Table 6.2). Presently, there is no direct tax of revenue significance at the level of States. This highly unbalanced tax structure is a cause for concern.

6.9.1. States’ Own Taxes: Direct and Indirect Taxes

<table>
<thead>
<tr>
<th>Table 6.2 States’ Own Taxes, Breakup between direct and indirect taxes with percentage shares: 1990-91 to 2011-12.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year</strong></td>
</tr>
<tr>
<td>1990-91</td>
</tr>
<tr>
<td>1991-92</td>
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<tr>
<td>1992-93</td>
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<td>1993-94</td>
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<td>2001-02</td>
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<td>2002-03</td>
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<td>2003-04</td>
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<td>2004-05</td>
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<tr>
<td>2005-06</td>
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<td>2006-07</td>
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<td>2007-08</td>
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<td>2008-09</td>
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<tr>
<td>2009-10</td>
</tr>
<tr>
<td>2010-11</td>
</tr>
<tr>
<td>2011-12</td>
</tr>
</tbody>
</table>

Note: The ratios of GDP since 1950-51 are with reference to new series GDP at market prices.

Source: Indian Public Finance Statistics (2011-12), Ministry of Finance, Department of Economic Affairs, Economic Division, July 2012 Table 1.7.

6.10. Composition of Direct Taxes

There is no direct tax which can claim a prominent place in the tax systems of the states.

Table 6.3: Trends in the Level and Composition of Revenue from States’ Taxes: Selected Years

<table>
<thead>
<tr>
<th>Year</th>
<th>A + B Revenue from States’ taxes.</th>
<th>(Rs. In Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>222 (100.0)</td>
<td></td>
</tr>
<tr>
<td>1960-61</td>
<td>455 (100.0)</td>
<td></td>
</tr>
<tr>
<td>1970-71</td>
<td>1,546 (100.0)</td>
<td></td>
</tr>
<tr>
<td>1980-81</td>
<td>6,665 (100.0)</td>
<td></td>
</tr>
<tr>
<td>1990-91</td>
<td>30,145 (100.0)</td>
<td></td>
</tr>
<tr>
<td>2000-01</td>
<td>1,16,717 (100.0)</td>
<td></td>
</tr>
<tr>
<td>2010-11</td>
<td>5,62,058 (100.0)</td>
<td></td>
</tr>
</tbody>
</table>

A. Direct taxes

- Land revenue
  - 1950-51: 49 (22.1)
  - 1960-61: 97 (21.3)
  - 1970-71: 113 (7.3)
  - 1980-81: 145 (2.2)
  - 1990-91: 607 (2.0)
  - 2000-01: 1,377 (1.2)
  - 2010-11: 6,863 (1.2)

- Agricultural income tax
  - 1950-51: 3 (1.3)
  - 1960-61: 10 (2.2)
  - 1970-71: 10 (0.6)
  - 1980-81: 46 (0.7)
  - 1990-91: 69 (0.6)
  - 2000-01: 76 (0.0)
  - 2010-11: 134 (0.0)

- Other taxes*
  - 1950-51: 167 (75.2)
  - 1960-61: 3 (0.6)
  - 1970-71: 17 (1.1)
  - 1980-81: 80 (1.2)
  - 1990-91: 454 (1.5)
  - 2000-01: 2,004 (1.7)
  - 2010-11: 5,926 (1.1)

B. Indirect taxes

- Sales tax
  - 1950-51: 58 (26.1)
  - 1960-61: 158 (34.7)
  - 1970-71: 755 (48.8)
  - 1980-81: 3,887 (58.3)
  - 1990-91: 16,476 (54.6)
  - 2000-01: 68,386 (58.6)
  - 2010-11: 2,83,713 (50.47)

- State excises
  - 1950-51: 48 (21.6)
  - 1960-61: 53 (11.6)
  - 1970-71: 194 (12.5)
  - 1980-81: 824 (12.4)
  - 1990-91: 4,798 (15.9)
  - 2000-01: 15,825 (13.6)
  - 2010-11: 60,050 (10.7)

- Taxes on vehicles
  - 1950-51: 7 (3.2)
  - 1960-61: 33 (7.2)
  - 1970-71: 104 (6.7)
  - 1980-81: 415 (6.2)
  - 1990-91: 1,535 (5.1)
  - 2000-01: 6,506 (5.6)
  - 2010-11: 23,498 (4.3)

- Stamps and reg. fees
  - 1950-51: 26 (11.7)
  - 1960-61: 43 (9.4)
  - 1970-71: 122 (7.9)
  - 1980-81: 425 (6.4)
  - 1990-91: 2,089 (6.9)
  - 2000-01: 9,343 (8.0)
  - 2010-11: 53,648 (9.5)

- Other taxes**
  - 1950-51: 28 (12.6)
  - 1960-61: 58 (12.7)
  - 1970-71: 231 (14.9)
  - 1980-81: 843 (12.6)
  - 1990-91: 4,017 (13.3)
  - 2000-01: 13,200 (11.3)
  - 2010-11: 1,28,226 (22.8)

#Budget estimates:
* Profession tax, surcharge on cash crops and urban immovable property tax.
** Taxes on passenger goods, electricity duty, entertainment tax etc.

Figure in parentheses indicate corresponding percentages of the total revenue from States’ taxes.


6.10.1. Land Revenue

Land revenue which formed the bulwark of State’s tax revenue during the pre-Independence period and even in the early post-Independence years has
declined in importance over the years (Table 6.3). In some States, land revenue has been abolished altogether.

6.10.1.1. Agricultural Income-Tax

Agricultural income tax, which could have been an important source of revenue for the States, has remained negligible till date..

6.10.2. Composition of Indirect Taxes

6.10.2.1. Sales Tax

An outstanding development in the sphere of state finance since Independence has been the precipitous growth in the relative revenue significance of Sales Tax. It has grown considerably in depth and coverage, and forms, the mainstay of States’ tax revenue. It is levied not only on consumer goods but also on raw materials and capital goods. In 1950-51, the relative share of sales tax was 26.1 per cent; Rs. 58 crore out of a total collection of Rs. 222 crore from States’ taxes. In the budget estimate for 2010-11, this share stood at 50.5 percent (Table 6.3).

Prior to tax reforms initiated in early 1990s, sales tax was characterized by a multiplicity of tax rate and exemptions, lack of uniformity across states, large number of exemptions and concessions, and differing procedures for tax collection. In mid-1990s, most states had agreed to phase out the incentive related exemptions and implement floor rates of sales tax. As part of the nationwide efforts to redesign commodity taxation and the implementation of CENVAT at the level of the Centre, many States had modified their Sales tax regimes to launch a State level VAT under the scheme prepared by the Empowered Committee for this purpose 2005 award most of the States have in true spirit implemented VAT.
6.10.2.2. State Excises

Under entry 51 of List II in the Seventh schedule of the constitution, the States are empowered to levy, “duties of excise on... (a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drug and narcotics; but not including medical and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.” The revenue accrues to the States in the form of license duties from the vendors as well as tax, which can be specific or *ad valorem*.

After Sales tax, State excise duties (on liquors and other narcotics) are the most important source of States’ own revenues. Though second, in importance, their relative revenue significance has declined over the years from 21.6 percent in 1950-51 to 10.7 percent in 2010-11 (Table 6.3). This has happened mainly because of the policy of prohibition adopted in some states from time to time. However, it is difficult to totally prohibit the consumption of alcohol in the States. Attempts as full prohibition lead to illegal production and export of the tax base to neighboring States.

It is noteworthy that while in Western countries the main objective of duties on intoxicants is revenue collection, in India the overriding consideration

6.10.2.3. Taxes on Motor Vehicles

Under entry 57 of List II in the seventh schedule, State Government enjoy the power to levy taxes on vehicles suitable for use on roads. These are levied for registration, permits, driving licenses etc. and are based in type of vehicle (truck, bus, car, scooter etc.). In the 2010-11 budgets, taxes on vehicles accounted for 4.3 percent of tax revenue from states’ own taxes (Table 6.3). In most states a compounded System of motor vehicle tax exists, where a onetime levy is paid for the life of the vehicle. This arrangement has saved the taxpayers from the hassle of interacting with the tax department every year.
6.10.2.4. **Entertainment Tax**

Under entry 62 of List II in the seventh schedule of the constitution, states are empowered to levy taxes on entertainment. Such taxes are levied on the price charged for admission to any place of entertainment such as circus, cinema, theatre, exhibition, variety, show etc. The bulk of revenue from this tax is provided by the cinema shows. Though the tax is collected from the exhibitors, the ultimate burden is borne by the cinegoers. In recent times, entertainment tax has lost its importance due to proliferation of means of home based entertainment, which has also made it difficult to revise tax rates upwards.

6.10.2.5. **Stamp Duty and Registration Fees**

Stamp duty is levied on the registration of property or other conveyances. In the 2010-11 budgets of the State Governments the share of Stamp duty and Registration fees in revenue from own taxes of the States was estimated at 9.5 percent (Table 6.3).

Till recently, the stamp duty rates were quite high in most states and the procedure for evaluating the conveyances were also complicated of late, states have undertaken reforms by reducing the duty rates and streaming procedures for evaluation of properly. After the reduction of rates, the general experience has been revenue-augmenting due to improved compliance of law.

6.10.2.6. **Electricity Duty**

The electricity duty is charged to consumers along with the electricity consumption rates. The rates are meant for the providers of electricity (electricity boards) while the electricity duty is meant for the state treasury.
6.10.2.7. Octroi

Octroi, an important source of revenue for local bodies, is a tax on the energy of goods into local areas from other areas for the purpose of consumption or sale. It is mentioned in entry 52 of List II (State List) in the Seventh Schedule. Industry and trade circles have criticized the constitution of octroi and termed it as a retarding factor in the growth of business and commerce in the country. By obstructing the free movement of vehicles carrying goods, the levy of octroi causes delays and thus hampers industrial progress. Therefore, it is suggested that octroi should be replaced by some other form of taxation; e.g. surcharge on sales tax. Unfortunately, certain State Governments are not favourably disposed to these suggestions and prefer to continue with the controversial levy.

6.10.2.8. Professions Tax

A tax on profession is levied as a fixed amount per person per year on professions. It is a kind of license fee to practice profession. The tax is levied irrespective of the income derived by a person from the profession practiced by him. In India, State Governments are empowered to levy a tax on professions. However, according to Article 276 of the constitution, the total amount-payable in respect of any one person to the State by way of such tax is not to exceed Rs. 2500 per annum.

6.10.3. Local Finance

The Constitution does not reserve any taxes for the local bodies. Since local government is a State subject entry 5 of List II), State Governments may assign any of the taxes in the State List, wholly or partially, to urban local bodies. Taxes usually assigned to local bodies are property taxes, octroi and taxes on professions. Property tax (house tax) is an important source of revenue for local bodies.

Assigning taxes enables State Governments to exercise a degree of Supervision and control over the affairs of city corporations, municipalities,
district boards and other local bodies. These local bodies provide certain public services like basic health and education, construction and maintenance of local roads, sanitation, street lighting and parks. Local Government also receives grants in aid from State Governments and earns non tax revenue from enterprises operated by them.

6.11. Gujarat State at a Glance

With a decadal growth rate of more than 10% (2001-2011), the state of Gujarat has come to establish itself as a strong growth engine for the country. Accounting for about 5% of the country’s population and 6% of land area, the state has metamorphosed into one of the fast growing state economies, overcoming its limitations in resource base and its climatic constraints. The state now contributes more than 7% to India’s GDP; in particular, it for 13% of manufactured and 11% of primary sector output of the country.

Also, at the micro-level, the state records a per capita income of Rs 89,668 (as of 2011-12), well above the national average level of Rs 61,564 for the same year, indicative that benefits of growth are reaching at the individual level.

This update broadly covers the current economic scenario in the state of Gujarat along with the government’s performance in terms of fiscal management; the state recently having announced its budget for 2013-14.

6.11.1. Demographic Factsheet

- **Population:** 6.04 crore persons (as on March 1, 2011), with decadal growth of 19.2% (2001-2011), higher than national level decadal growth rate of 17.6%. Population density of 803 persons per square kilometer, below national average of 382 persons per square kilometer. Birth rate of 21.3%, death rate of 6.7%.
- **Urbanisation:** Gujarat most urbanised state in country (43% of population stays in urban areas)
• **Literacy**: 79.3% (as per Census 2011); with urban literacy at 73.0% and rural literacy at 87.8%

• **Gender ratio**: 918 females per thousand males (Census 2011)

• **Life expectancy**: for males recorded at 64.9 years and for females at 69.0 years

### 6.11.2. A Brief Comparison with India

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Item</th>
<th>Unit</th>
<th>Gujarat</th>
<th>India</th>
<th>% Share of state</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gross Domestic Products</td>
<td>Rs. In Crore</td>
<td>611767</td>
<td>8353495</td>
<td>7.32</td>
</tr>
<tr>
<td></td>
<td>at constant (2004-05) prices</td>
<td>Rs. In Crore</td>
<td>398884</td>
<td>5243582</td>
<td>7.61</td>
</tr>
<tr>
<td>2</td>
<td>Net Domestic Products</td>
<td>Rs. In Crore</td>
<td>533390</td>
<td>7476764</td>
<td>7.13</td>
</tr>
<tr>
<td></td>
<td>at constant (2004-05) prices</td>
<td>Rs. In Crore</td>
<td>342088</td>
<td>4618809</td>
<td>7.41</td>
</tr>
<tr>
<td>3</td>
<td>Per Capita Income</td>
<td>Rs.</td>
<td>89668</td>
<td>61564</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>at constant (2004-05) prices</td>
<td>Rs.</td>
<td>57508</td>
<td>38037</td>
<td>-</td>
</tr>
</tbody>
</table>


Registering an annualised growth rate of 9.1% (in constant terms, CAGR for the period 2008-11), Gujarat has achieved a growth rate well above the national level growth rate of 8.2% for the same period. In terms of current prices, GDP growth in the state has been robust, touching nearly 23.0% in FY11 and 15.3% in FY12 (against a high base of the previous year).

### 6.11.3. Gujarat Economy

Gujarat continues to occupy a distinctive position in the Indian economy. With 5 percent of the country’s population and 6 percent of the country’s geographical area, Gujarat contributes to about 16 percent of industrial production in India. The State has witnessed an annual average growth of 9 percent in the last three years estimated at an average industrial growth of 15 percent for the same period. However, these macroeconomic statistics look much more impressive on a closer look at the industrial landscape of the
State. Accounting for 16 percent of the industrial production of India, Gujarat has demonstrated leadership in many areas of manufacturing and infrastructure sectors. Almost 50 percent of the country’s refined petroleum products and 45 percent of the drugs and pharmaceuticals are from Gujarat. The State’s exports stand at 14 percent of India’s total exports, exhibiting a strong global orientation of the industrial structure.

The above indicators are a result of robust foundation of Gujarat’s economy. At a broad level the following four components have been primarily responsible for the economic vibrancy of the State:

Gujarat, at present, is on industrial boom. New projects are being identified; investments of over Rs. 150,000 across 12 sectors are made by the Gujarat Government over the next few years, aiming at an annual growth of 12-13 per cent by 2015. For all these investments to be realized, it is important to focus on turning this potential to be supported by growth accelerators that could sustain the existing momentum and build new focus areas.

For better analysis of the growth, some key growth accelerators to have over time given any economy the desired push in their growth journey. The identified accelerators were trade, infrastructure, policy, demographics and technology. Here, we have very briefly elaborated on the growth ramifications of these accelerators:

Historically trade is, driven by traditional comparative advantage, provided as key growth accelerator for economic expansion and national differentiation. As economies advance and diversify internally, trade helps to bring economies of scale, better market access and well integrated supply chain for various economic agents of any nation. Singapore is a good example of a nation State to have fully leveraged its geography and made trade as the basis of its growth and development.

The vibrancy and buoyancy of Gujarat’s economy is unmistakably clear today, which is supported by a strong entrepreneurial culture of its people and strong infrastructure focus of its policy makers. All these factors provide the State
with an ideal platform to leapfrog to a much higher growth trajectory, which makes its performance comparable to global benchmarks.

This global comparative perspective is critical for Gujarat to dream bigger and achieve the vision of much improved economic performance. The government of Gujarat is actively working on various initiatives and ideas to continue the momentum at a broader level and gain acceleration for its core industry sectors. Moreover, this can lead to a more broad based improvement in the living standards of all sections of Gujarat’s society, thereby leading to an inclusive growth environment.

Given the impressive achievements of the State so far, it would be beneficial for Gujarat to focus on some key enablers that would fulfill the above mentioned outlook. It appears that the State government needs to focus on enhancing three critical pillars of their economic expansion: global networking and communication, building on the infrastructure and bringing about focused implementation. Global branding, already an advantage for the State, can bring improved investments; especially in sectors that require huge infusion of capital. The existing infrastructure of Gujarat now needs to achieve global standards and this would need active policy intervention. And all of this would require focused and well executed programmed implementation.

6.11.4. Gujarat State Taxation Income

In India States’ own tax revenue collections form roughly 40 percent of the total tax revenue of the country.\textsuperscript{132} The most important tax for the states has been sales tax revenue contributing over 54 percent of their own tax revenue (Figure 6.1). Naturally, all attentions of the state Government to improve the tax growth are focused on sales tax.

However there is wide variation among states in the extent to which they depend on sales tax. In states like Kerala and Goa the dependence on sales tax over 70 percent of own tax revenues, While in States like Sikkim, Mizoram

it is only around 30 percent. It should however be noted that the compositional pattern of state taxes has very little relation with either the size of the State in terms of populations, area or per capita income.

As regards the other taxes, State excise duties yield roughly 18 percent of own taxes, but the share differs widely among the State owing to the variation in the prohibition policy, Stamp and Registration fees contribute about 6.2 percent and Motor Vehicle taxes another 6.4 percent. The shares of these two taxes have been stable over time. Agriculture base taxes such have land revenue and agricultural holding taxes form a negligible 2.6 percent.

Figure 6.1: Composition of State Tax Revenues

<table>
<thead>
<tr>
<th>Composition of State Tax Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax</td>
</tr>
<tr>
<td>Aggricultrual Tax</td>
</tr>
<tr>
<td>Motor Vehicle Tax</td>
</tr>
<tr>
<td>Stamp and Registration</td>
</tr>
<tr>
<td>Other Taxes</td>
</tr>
<tr>
<td>State Excise</td>
</tr>
</tbody>
</table>

6.11.5. Gujarat Revenue Receipts

Tax revenues of the State have been growing at a steady pace. It is observed that while GSDP has grown at a CAGR of 16.74% during the period 2004-05 to 2010-11 (RE), the taxes have registered CAGR of 17.82% during the same period, which indicates buoyant tax revenue. The State’s own tax revenues have been growing at a healthy rate.
Amongst the State’s own tax revenue; Value Added Tax (VAT) is the highest contributor, accounting for 69.22% of the total own tax revenue in 2010-11 (RE). Sales Tax or VAT has grown steadily at an annualized growth rate of 19.33% during 2004-05 to 2010-11 (RE). Land revenue has grown at an annualized growth rate of 36.20% during 2004-05 to 2010-11 (RE). Revenue from Stamps and Registration and Motor Vehicles Tax has also shown steady growth during the year 2004-05 to 2010-11 (RE). As a tax reform measure, the collection of Profession Tax was given to the local bodies.

The State Government has undertaken a series of steps to rationalize various taxes that have led to better compliance and buoyancy in the tax collection.

Table 6.5 State Tax Receipts of Gujarat (Year 2004-05 to 2010-11)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Land Revenue</td>
<td>235 (1.8)</td>
<td>380 (2.4)</td>
<td>409 (2.2)</td>
<td>683 (3.1)</td>
<td>544 (2.3)</td>
<td>1161 (4.3)</td>
<td>1500 (4.3)</td>
</tr>
<tr>
<td>2</td>
<td>Stamps &amp; Registration</td>
<td>963 (7.4)</td>
<td>1153 (7.3)</td>
<td>1425 (7.8)</td>
<td>2018 (9.2)</td>
<td>1729 (7.3)</td>
<td>2557 (9.6)</td>
<td>3500 (10.1)</td>
</tr>
<tr>
<td>3</td>
<td>State Excise</td>
<td>47 (0.4)</td>
<td>48 (0.3)</td>
<td>42 (0.2)</td>
<td>47 (0.2)</td>
<td>49 (0.2)</td>
<td>66 (0.2)</td>
<td>62 (0.2)</td>
</tr>
<tr>
<td>4</td>
<td>Sales Tax / VAT</td>
<td>8309 (64.1)</td>
<td>10562 (67.3)</td>
<td>12817 (69.8)</td>
<td>15105 (69.0)</td>
<td>16810 (71.4)</td>
<td>18200 (68.1)</td>
<td>23996 (69.2)</td>
</tr>
<tr>
<td>5</td>
<td>M V Tax</td>
<td>1061 (8.2)</td>
<td>1154 (7.4)</td>
<td>1191 (6.5)</td>
<td>1310 (6.0)</td>
<td>1382 (5.9)</td>
<td>1543 (5.8)</td>
<td>1725 (5.0)</td>
</tr>
<tr>
<td>6</td>
<td>Taxes on Goods and passengers</td>
<td>160 (1.2)</td>
<td>157 (1.0)</td>
<td>6 (0.0)</td>
<td>152 (0.7)</td>
<td>169 (0.7)</td>
<td>7 (0.0)</td>
<td>275 (0.8)</td>
</tr>
<tr>
<td>7</td>
<td>Electricity Tax</td>
<td>1829 (14.1)</td>
<td>1900 (12.1)</td>
<td>2088 (11.4)</td>
<td>2047 (9.4)</td>
<td>2370 (10.1)</td>
<td>2644 (9.9)</td>
<td>2900 (8.4)</td>
</tr>
<tr>
<td>8</td>
<td>Entertainment Tax</td>
<td>51 (0.4)</td>
<td>44 (0.3)</td>
<td>28 (0.2)</td>
<td>29 (0.1)</td>
<td>35 (0.1)</td>
<td>47 (0.2)</td>
<td>55 (0.2)</td>
</tr>
<tr>
<td>9</td>
<td>Tax on immovable property</td>
<td>0 (0.0)</td>
<td>0 (0.0)</td>
<td>0 (0.0)</td>
<td>111 (0.5)</td>
<td>101 (0.4)</td>
<td>124 (0.5)</td>
<td>127 (0.4)</td>
</tr>
<tr>
<td>10</td>
<td>Other Tax</td>
<td>304 (2.3)</td>
<td>300 (1.9)</td>
<td>369 (2.0)</td>
<td>383 (1.8)</td>
<td>368 (1.6)</td>
<td>391 (1.5)</td>
<td>528 (1.5)</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>12959 (100)</td>
<td>15698 (100)</td>
<td>18375 (100)</td>
<td>21885 (100)</td>
<td>23557 (100)</td>
<td>26740 (100)</td>
<td>34668 (100)</td>
</tr>
</tbody>
</table>
6.11.6. Gujarat is Different from Other States

Much has been written about Gujarat and its growth models. Columnists have argued and counter-argued on Gujarat’s growth story. While some have criticized its growth by comparing it with a low base under developed state like Bihar, others have brought out the all-round performance of Gujarat economies.

The state is one of the most unique growth models in the country. One can say that Gujarat is one of the best states in terms of improved governance in the past decade within the developed states. Results are visible with superior growth in state’s literacy levels, per capita income, and drinking water and sanitation facilities. The report adds that some of the less developed states are witnessing faster improvement but that is because of low base effect.

Following are the five reasons why Gujarat stands out among other Indian states.

(i) A number of Indian states have evolved directly from being an agrarian economy to a service powerhouse without going through a phase where manufacturing dominates, which resulted in no large scale creation of employment. In Gujarat however, manufacturing accounts for 40 per cent of the Gross State Domestic Product (GSDP) as compared to 27 per cent for India. The state also scores better than Maharashtra and Tamil Nadu, which have been witnessing fall in share of industry. Gujarat now accounts for 11-11.5 per cent of the country’s industrial output as compared to 8-8.5 per cent in 2001.

(ii) While industrial growth of Gujarat has been thanks to industry friendly policies, natural advantage of a long coastline and entrepreneurial nature of its people, the present government’s initiative have enabled it to attract a diverse set of industries and industrialists.

(iii) Agriculture contribution is significantly higher than industrialized states like Maharashtra and Tamil Nadu. Agriculture contributes 13 per cent to Gujarat’s GSDP and supports 53 per cent of the population while its contribution to the national agriculture has doubled over the last 10 years. This has been possible by increasing its yields and acreage
under cultivation. Yields in food grains have increased from 827 kgs per hectare in 2001 to 1845 kgs per hectare in 2011, which is almost double the country’s average.

(iv) Unlike other states, Gujarat’s dependence on central government fund is very low. Its own tax revenue as a percentage of total tax revenue is the highest in the country at 84 per cent. Share of central taxes and grants from the centre account for less than 30 per cent of overall revenue receipts for the state.

(v) Unlike trends at national level Gujarat has not replaced spending in education and medical with social security and welfare. The state’s proportion of overall expenditure spent on development activities has remained range bound at 55-65 per cent of revenue expenditure. Spending in agriculture and allied activities has increased from 6 per cent of development expenditure in FY04 to 7.5 per cent in FY12.133

6.11.7. Gujarat Budget 2013-14: Revenue Account Profile

Budget 2013-14, presents actual accounts (A) for the year 2011-12 and revised estimates (RE) for accounts in 2012-13 along with budgeted estimates (BE) for the year 2013-14.

We examine Budget 2013-14 for the state with respect to its revenue and capital accounts and performance thereof.

State of Gujarat in FY12, moved from a revenue deficit position (Rs 5,076 crore in FY11) to a revenue surplus of Rs 3,215 crore in line with the Thirteenth Finance Commission roadmap for fiscal consolidation for state governments.

Revenue surplus of the state has consistently risen and is budgeted at Rs 4,602 crore in FY14. This has been achieved with a combination of tax rationalization measures and expenditure prudence. Looking to this it appears that Gujarat economy is having very optimistic visualization.

Table 6.6: Revenue Account FY12-FY14

<table>
<thead>
<tr>
<th>Revenue A/c Heads</th>
<th>FY12 (A)</th>
<th>FY13 (RE)</th>
<th>FY14 (BE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Receipts</td>
<td>62,959</td>
<td>75,791</td>
<td>85,752</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>52,033</td>
<td>61,749</td>
<td>70,328</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>5,277</td>
<td>5,369</td>
<td>6,380</td>
</tr>
<tr>
<td>Revenue Expenditure</td>
<td>59,744</td>
<td>71,894</td>
<td>81,150</td>
</tr>
<tr>
<td>Development expenditure</td>
<td>38,707</td>
<td>47,390</td>
<td>51,830</td>
</tr>
<tr>
<td>Non-development expenditure</td>
<td>20,837</td>
<td>24,340</td>
<td>29,142</td>
</tr>
<tr>
<td>interest expenses</td>
<td>10,934</td>
<td>12,236</td>
<td>13,659</td>
</tr>
<tr>
<td>Revenue Surplus</td>
<td>3,215</td>
<td>3,897</td>
<td>4,602</td>
</tr>
</tbody>
</table>


- On the tax front, tax relief announced in Budget 2013-14 amounts to Rs 245 crore, while proposed increase in taxes is Rs 289 crore, implying a net gain of Rs 44 crore through tax proposals. While tax rates have not been increased significantly, tax collection efficiency has improved, lending robustness to overall revenue receipts.

- Tax allocations from the centre to states have been sluggish over the years, particularly because central tax collections have moderated against a constrained economic environment. The Thirteenth Finance Commission awarded 3.04% of shareable tax, excluding service tax and 3.09% of shareable service tax to Gujarat. This translates to a share of just 11.0% to 12.0% of central tax allocations in the revenue receipts of the state.

- Non-tax revenue receipts; royalties, fees, user charges, central government compensations to state, etc., is one component that is heavily influenced by extraneous factors. Given that its share in the revenue receipts is just about 7.0% to 8.0%, it does not critically impact budget performance, particularly when in the case of Gujarat own-revenue funds account for 76% to 78% of revenue flows.

- In terms of expenditure, most of the government expenses are developmental in nature and targeted towards funding the creation of
social services (education, health, social development, etc.), which in turn helps support improve quality of human capital in the state.

- In particular, the state has been proactive in curtailing growth in its debt-service obligations and has successfully lowered the growth in interest expenses from 13.6% in FY12 to 11.6% in FY14.

- The state also has additional leg-room on the revenue-side as it completes disbursement of all installment tranches of arrear payments on salary and pension, due on account of implementation of Sixth Pay Commission recommendations as of FY13.