CHAPTER - 4

URBAN FINANCE & RESOURCE MOBILISATION
Despite the growing vexed and vexing problems in urban areas due to various reasons, urbanisation should be treated as a positive, historical force and Urban Local Governments should make every effort to cope with urbanisation and ensure that urban areas deliver a quality life that would enable them to become national assets and engines of economic growth. Urban administration cannot afford to be neglected any longer as it was done earlier. Urban areas demand their firm place on the national agenda.

The problem of urban finance is that the fiscal role of the ULGs in India’s economic framework has never been systematically assessed with the result that the finances of the ULGs have always been in doldrums. The Constitution (74th) Amendment Act, 1992 points towards a larger role for the ULGs in the country’s development affairs and suggests a larger fiscal space for them. The amendment provides a review of the financial position of the ULGs once every five years, recognises the need for and provides for a revenue-sharing arrangement between the ULGs and state
governments, and encourages the ULGs to explore and experiment with revenue-enhancement measures.

The search for additional resources to meet the ever-increasing urban challenges is of paramount importance. Urban India faces daunting challenges. Urban Local Governments have to cope with greater numbers, plan to provide basic services needed for a fast growing urban population, find resources to meet the cost of required urban development and maintenance of urban services, augment the infrastructure, respond to urbanisation of poverty, protect and preserve urban environment and retain their competitive edge. Cities have to prepare themselves to face these enormously complex challenges systematically, effectively and efficiently.

Among the challenges the urban communities face, the more important ones are:

1) Environmental deterioration.
2) Population growth due to accelerating rural urban-migration.
3) Rising unemployment.
4) Economic deprivation, the low quality of life of slum dwellers and isolation of persons of ill-health.
5) Inaccessibility to improved services.

The most important felt needs of the urban areas in the country are:

1) Augmentation of drinking water supply, extension of distribution lines to unserved areas and replacement of decrepit water supply distribution lines;
(2) Slum networking to improve civic amenities in all urban slums;

(3) Widening of all thoroughfares and providing traffic dividers with central lighting for efficient traffic management;

(4) New shopping complexes to meet the requirements of ever-increasing trade and commerce as well as providing petty shops to small traders to remove hawkers and encroachers of road margins; and

(5) Protection of environment by effective control of pollution.

In this urban scenario Urban Local Governments are made responsible for providing civic amenities to the public like access to safe drinking water, sanitation, health care, prevention of the spread of communicable diseases, transport, employment generation etc. They are accountable for efficient management of these services and thus, accountability of Urban Local Governments to the public becomes paramount. The rationale for this demand for accountability is the autonomy of the Urban Local Governments to function as full-fledged local self-governments duly fulfilling the objectives set forth in the Constitution (74th) Amendment Act, 1992. But in the prevailing situation Urban Local Governments are unable to assimilate and fulfil the aspirations of ratepayers with a positive outlook, foresighted planning and prudent fiscal management. It is, therefore, important to study the origin of the problem of inefficiency and incapacity of Urban Local Governments, and work out suitable solutions to overcome these deficiencies in order to achieve the objectives set for, and to work to the best satisfaction of urban dwellers.
Financial Resources of Urban Local Governments

Cities are reservoirs of major financial resources such as income tax, corporation tax, service tax, customs duty, excise tax, value added tax, stamp duty on registration, entertainment tax, profession tax, motor vehicle tax etc. But the ULGs are not given their due share of all these taxes except a few. The Government has to realise the close relationship between urbanisation and economic growth and ensure that the positive effects of urbanisation are not affected by neglect of urban life. It is the responsibility of governments-central, state and local-to take up all measures to ensure that urban areas continue to contribute more and more too national economy by making urban life more meaningful and purposeful.

The ULGs cannot function effectively without a sound financial administration. In the prevailing financial position of the ULGs, they have to evolve an effective system of financial management. Paucity of funds impedes development of towns and cities. All the committees constituted by the Government of India starting from Local Finance Enquiry Committee in 1951 till the Rural-Urban Relations Committee 1966 concluded that the finances of the ULGs was in a pitiful condition and that measures were required to augment their finances.

Empowerment of the ULGs through financial as well as functional devolution is an important objective of the Constitution (74th) Amendment Act, 1992. Certain states have transferred some of the eighteen functions listed in the Twelfth Schedule to the ULGs but have not at the same time contemplated measures for strengthening them financially. Despite incorporation of these provisions in the local municipal acts in certain states like West Bengal, Madhya Pradesh, Andhra Pradesh etc the over-all progress
of decentralisation of powers and devolution of funds by state governments to the ULGs has been very slow and there is a lot to be done in this regard. Constitutional Amendment for decentralisation of financial powers is not sufficient for augmenting resources of the urban local governments. The central government must provide special capital support to the ULGs in the states which are not in a position to allocate requisite funds to their urban centres for development commensurate with requirement. The small and medium towns need financial support from the centre for their infrastructural projects as their economic bases are not strong enough to generate adequate revenues for the purpose. At the same time the ULGs should contemplate measures to increase the inflow of capital from institutional sources and the private sector. It is the primary responsibility of the ULGs to ensure access to infrastructure to all sections of their population, irrespective of their income and affordability. The government can fulfil this responsibility through subcontracting arrangements with the private sector or by strengthening the ULGs financially, administratively and technically. Such a strengthening of the ULGs helps to generate non-agricultural employment and diversify their economic base, since there is a correlation between the availability of urban infrastructure and amenities and manufacturing activities. In view of the increased responsibilities of the ULGs coupled with their poor financial base and lack of local financial sources, the governments have to make available to them additional financial resources to enable them meet urban development and financing shortfalls in towns and cities. It is difficult for the ULGs to provide urban basic services without adequate cash flow from tax resources or other charges. Since direct user charges are not affordable by a majority of the urban dwellers, the government should be the legitimate financier of these
services. The State Finance Commissions constituted under Article 243Y of the Constitution are required to review the financial position of the ULGs and make recommendations to the government as to the measures needed to improve their financial position. But the efforts of the S.F.Cs. seem to have not given the expected result.

In regard to the devolution of funds from the government to the ULGs there should be a systematic method of transfer of state resources to support the developmental activities of the ULGs. At present the new urban infrastructure projects are funded through budgetary support from the central and state governments laid down in the five-year plans and annual plans, but it is inadequate. In order to fill the gap between supply and demand of urban infrastructure services the government has no alternative but to increase the allocations of resources for the most basic services. The devolution of additional finances to the ULGs is further necessitated by the dissatisfaction with the quality of urban infrastructure services which is constantly pushing investment out of the fringes of prominent urban agglomerations.

The principal criterion for assessing the performance of the ULGs is the mobilisation of their internal resources. Urban Local Governments in India are always starved of the required finance to discharge their statutory responsibilities. Lack of finance is always a major impediment to improving urban infrastructure. Most of the major sources of finances are with the State or Central Government. Urban Local Governments have to depend on the benevolence of the Central or State Governments for grants. As the Central and State Governments have gradually usurped their financial resources, their financial position has been going from
bad to worse with the result they are unable to fulfil their constitutional obligations.

While the functions, responsibilities and even challenges the ULGs have to face have been increasing from to time their financial base remains as fragile as ever. The abolition of octroi and the imposition of Rent Control Act have added to the difficulties of the ULGs with the result that they are not able to maintain even the existing urban basic services properly. The ULGs have, therefore, to find innovative measures of generating resources and set their organisations in order through prudent financial practices.

The Government of India has introduced certain measures to help urban infrastructure such as tax exemption for municipal bonds, fiscal incentives for private sector participation in urban infrastructure etc. Though these measures indicate the possibilities of change, mark the beginning of change, and also indicate further possibilities of change, the change is yet to make an impact. Certain states and cities in the country have introduced taxation and accounting reforms, set up State Finance Commissions to suggest devolution of funds to the ULGs for urban infrastructure and encourage private sector participation in civic services. Even these steps have not given the efficacy to the required level.

In Andhra Pradesh (a) animal and vehicle tax; (b) octroi (c) commodity market cess and (d) profession tax are some of the taxes which were listed among the Municipal Laws which the Urban Local Governments were formerly empowered to levy asses and collect and utilise for development. But some of these taxes were abolished and the others were taken over by the State Government. While the upper ceiling fixed on the Local Bodies' share of these taxes has further deteriorated their financial
position, the statutory responsibilities of Urban Local Governments have further increased over the years without a corresponding increase in the devolution of finances and efforts to build up the capacity of Urban Local Governments at the municipal level.

While the expenditure for provision of essential civic services in towns and cities, commensurate with the requirements of expanding areas, is increasing, there is no betterment in their finance base, particularly in states like Andhra Pradesh. Thus, Urban Local Governments face severe financial crunch. What is worse, the ULGs have not been prudent in their expenditure and in minimising wasteful expenditure and financial irregularities. The elected bodies generally oppose enhancement of the tax base since the electorate have voted them to power on a promise of service without any financial burden to them. Thus the capacity of the Urban Local Governments will automatically continue to suffer as long as they do not set themselves right through prudent financial practices and innovative measures for generating financial resources.

State Governments under the guise of some policy reform, without a corresponding compensation, have usurped taxes, which, previously the ULBs were empowered to collect. When certain municipal taxes gained good potential they were taken over by the State. The State exercises abnormal control over local governments without giving them a free hand to raise their resources from various sources. Besides, the services provided by the ULGs are charged at the rates fixed by the State Government which do not even cover the cost of services. In such cases, there is no budgetary support from the State to compensate for the deficiency. Thus the ULGs have to fend for themselves. This very often results in poor quality of service.
This situation could be remedied by a resource sharing mechanism, which lays emphasis on the urban government's maintaining better financial discipline and ensuring better realisation of its revenues.

- The ULGs should be empowered to make all municipal services cost-effective.
- Where the income from the services rendered is less than the cost of the services, the deficit should be filled by grants from the State.
- Resources raised by the ULGs should be utilised exclusively for maintenance of services.
- All capital works, developmental works, recreation facilities should be financed by the Central and State governments in the form of grants.
- The ULGs should have an effective machinery to realise their revenues and should be empowered by law to disconnect essential services like electricity, water supply, drainage etc. for tax defaulters/ evaders in order to ensure cent per cent realisation of revenues.

Urban Local Bodies have to take up initiatives like tax exemption to Municipal Bonds, fiscal incentives for private sector participation in Urban Infrastructure Development and so on. Certain Urban Local Bodies in India have introduced certain financial reforms like floating Municipal Bonds, allowing private sector participation in civic services, levying user charges for providing additional services to private institutions. These measures, however, are not sufficient to meet the increasing cost of urban civic services to the best satisfaction of urban dwellers.

The Urban Local Governments in Andhra Pradesh have long been demanding the State Government to apportion a share of all
State revenues to them including a share of sales tax proceeds, a share of motor vehicle tax and a reasonable amount of annual road grant for the upkeep and maintenance of thoroughfares in municipal areas.

The Twelfth schedule of the Constitution of India enumerates 18 functions as belonging to the legitimate domain of Urban Local Governments.

1) Urban planning including town planning.
2) Regulation of land use and construction of buildings
3) Planning for economic and social development
4) Roads and bridges
5) Water Supply for domestic, industrial and commercial purposes;
6) Public Health, Sanitation, conservancy and solid waste management
7) Fire Services
8) Urban Forestry, protection of environment and promotion of ecological aspects;
9) Safeguarding the interests of weaker sections of society, including the handicapped and the mentally retarded;
10) Slum improvement and up gradation;
11) Urban poverty alleviation;
12) Provision of urban amenities and facilities such as parks, gardens and play-grounds;
13) Promotion of cultural, educational and aesthetic aspects;
14) Burials and burial grounds, cremations, cremation ghats/grounds and electric crematoria;
15) Cattle pounds, prevention of cruelty to animals;
16) Vital statistics including registration of births and deaths;
17) Public amenities including streetlighting, parking lots, bus stops and public conveniences;
18) Regulation of slaughterhouses and tanneries.

These constitutional obligations of Urban Local Governments clearly spell out the role they have to play in bringing about sustained development to keep pace with increasing urbanisation. They have, therefore, to identify the service beneficiaries and measure the service benefits in respect of the above mentioned functions, so as to make them user charge financing. In order to make certain services cost-effective, certain reforms have to be initiated in the property tax levy and collection.

1. Collection of water charges on metered system which substantially improves the revenue from water supply;
2. Levy of drainage and sewerage charges at such rate as would meet the cost of operation and maintenance of the services;
3. Levy and assessment of House tax at such rates that major services like roads, conservancy, street lighting etc. become cost-effective;
4. In respect of other services cross-subsidisation needs for the urban poor should be provided;
5. The funds required for projects/services of town-wide or city-wide importance to be linked to the general component of the property tax; and
6. Transport development levy to be levied as a component of property tax in order to improve transport projects in urban areas.
In order to improve financial resources of Urban Local Governments so as to keep pace with the budgetary requirement for essential services, the following measures are suggested:

1. The Budget requirement for providing essential services should be assessed by a valuation committee consisting of experts in the area of service in the department concerned and municipal officials.

2. The cost of providing water supply, sewerage and drainage services shall be linked to water, sewerage and drainage charges.

3. In respect of other services the estimated cost of services shall be calculated and should be apportioned into components of property tax.

"Infrastructure projects are generally capital intensive and have long gestation period. The financial structure should, therefore, provide a proper framework for resource mobilization, phasing of project expenditure in relation to resource raising ability, servicing and maintenance requirements, cash flow and risk management. In this regard a commercialisation approach needs to be followed which should attract finance from non-traditional sources including debit/equity from multilateral funding agencies. A schedule for recovering user charges is an important determinant for a feasible cash flow profile of the project and for making it a commercially viable project. Commercialisation of projects would necessarily require government support and it should be perceived as complementary and not supplementary to the development efforts by the private sector."
SOURCES OF REVENUE TO URBAN LOCAL BODIES

(I) Taxes: (a) House Tax; (b) Water Tax; (c) Vacant Land Tax

(II) Non-Taxes: (a) Animal & Vehicle Tax; (b) Excess Water Tax; (c) Drainage Cess; (d) Market fees; (e) Slaughter House lease; (f) Shop Room Rents; (g) Encroachment fees; (h) Advertisement Tax; (i) Building Licence fees; (j) Dangerous & Offensive Trade License fees; and (k) Miscellaneous Receipts.

(III) Assigned Revenues: (a) Entertainment Tax; (b) Surcharge on Stamp duty; (c) Profession Tax

(IV) Non Plan Grants: (a) Per Capita Grant; (b) Profession Tax Compensation; (c) Offset Loss Compensation; (d) Motor Vehicle Tax

(V) Plan Grants: (a) Environmental Improvement of Urban Slums; (b) Assembly Constituency Development Programme Grant; (c) Member of Parliament Local Area Development Grant; (d) Swarna Jayanti Sahari Rojgar Yojana Grant; (e) Flood Relief Grant; (f) Road Widening Grant; (g) Urban Infrastructure Development for Small and Medium Towns Grant; (h) Tap Connection Donations; (i) Integrated Low Cost Sanitation Scheme Grant; (j) Clean & Green; (k) Building Regulation Fees; (l) Cost of Land; (m) Drought Relief Grant; (n) Rain Water Harvesting Grant; (o) School Building Grant

Despite tremendous potential of income assured from property tax, it is not fully exploited by the ULGs. Direct taxes levied and collected from the public are felt an unbearable burden. Urban local governments have, therefore, to look into indirect taxes, assigned revenues and government grants.
Resource Mobilisation

Resources have to be mobilised not only for enabling urban local governments to function effectively but also to tide over the inadequacy of governmental (both national and state) assistance. There are possibilities for mobilization of additional financial resources at the local level both through taxation and through charging for services. In most of the ULGs in India real property should be the main local tax base; but in certain Urban Local Governments its tremendous potential is not fully exploited. That is why property tax revenues have been allowed to decline in real terms in many states particularly because of improper property valuation.

As regards charging for services, emphasis has been laid in recent years on the need for cost recovery and appropriate charging policies for urban projects and urban services. “There are strong reasons from both the points of view of economic efficiency and equity for charging at least marginal costs, if not full cost recovery, for such urban services as water, sewerage, land development and urban transport”8 Urban Local Governments should adopt a methodology for appropriate pricing policies of urban services. Once these are reasonably well developed, they can easily be implemented (e.g. in 1998, Guntur Municipal Corporation had resolved to collect user charges for collection of garbage from bulk garbage generating units in order to meet the cost of providing additional vehicles and men for clearing the bulk garbage generated, which was cost-effective and had given good results). Cost recovery has certain risks like excluding the poor etc. but it is inevitable and unavoidable for Urban Local Governments to adopt it in respect of certain essential services which cannot be satisfactorily maintained unless the methodology for cost recovery is adopted (e.g. in most of the municipalities and corporations
such as Kurnool, Guntur, Anantapur etc in Andhra Pradesh, the expenditure incurred on protected water supply is double the income derived from it, with the result the Urban Local Governments have to divert other funds to water supply maintenance to meet the cost of supply to the entire population in the town/city).

There are several problems in local revenue administration. Despite a fine array of local revenue sources their potential is not fully exploited due to ineffective systems of valuation, assessment, collection and enforcement.

The devolution of funds from central to local administration is another area of consideration. The release of funds project-wise to local administration has not been effective. Most of the local projects have not been fully financed by the centre with the result that the projects either remain incomplete or take an inordinately long time for completion. The pattern of central-local financial relations should be such as to ensure that grant distribution systems are not only equitable between the regions, but they should be so designed as to provide correct incentives to local governments to mobilise local revenues and to pursue appropriate policies.

The establishment of a Municipal Development Fund is very essential to finance local development projects. The Urban Local Bodies till now have relied on ad hoc capital flows from the central government for their development projects. The establishment of the Municipal Development Fund enables Urban Local Governments take out loans to finance development projects as required. Such funds can provide a mechanism for recycling
investment resources and for mobilizing additional resources from the public.

Most of the urban development programmes and service delivery measures "face severe constraints in mobilisation of local resources, mainly because the local tax base is usually very narrowly prescribed...some increase in revenue yields can generally be achieved through increasing the effectiveness of existing systems and procedures. However, it will ultimately be necessary to broaden the local government tax base by enhancing local government taxation powers."  

The reforms in property tax have not been effective. Dissatisfied with the ambiguity in the rules of property tax, certain states including Andhra Pradesh, Tamilnadu, Gujarat, Karnataka and Bihar undertook property tax reforms in order to fully exploit the property tax potential and to remove subjectivity in the determination of the hypothetical annual rental value.

Suggested Reforms in Property Tax

1 Tax Base

The significant problem of Municipal property taxation pertains to the basis of taxation. The fixation of tax base is the first question to be tackled in property tax reforms. There are two alternatives suggested: one is Annual Rental Value and the other is Capital Value. The shift from rental-value based taxation to capital-value based taxation is expected to improve the yield of tax since the capital value of buildings increases faster than their rental value. Another advantage of it is that it will obviate the necessity of arriving at a hypothetical rental value. But this system would abnormally increase the tax with the result that protest from cash-poor and property-rich rate payers is unavoidable, while the
capital value system is inevitable and is the only adoptable system for assessing vacant land tax.

2 Tax Vs Service Charges

Almost all Urban Local Governments in India have been faced with endemic problems of poor cost recovery and low quality of services. Certain essential services are not cost-effective. For example, protected water supply. Hence certain Urban Local Governments have attempted to link certain service costs to municipal user charges and benefit taxes. Recently there is considerable pressure from the public to make the Urban Local Governments and officials accountable for the use of public money. Urban managers have to focus their attention on user charges and cost recovery. This needs to establish a link between the costs of services and charges imposed or taxes levied. Levy of reasonable user charges by urban local bodies is necessary in order that the full cost of operation and maintenance is collected by the U.L.Gs. There are certain services like protected water supply, clearance of bulk garbage from bulk garbage generating units, sewerage etc, which can be measured and for which the beneficiaries can be identified and can be financed through direct user charges so that the services would be cost-effective and the quality of services can be maintained at a high level.

3 Vacant Land Tax

Vacant Land Tax is levied to discourage owners of lands to keep them vacant to avoid their misuse and to encourage housing. There has been an unearned increase in land values. But Urban Local Governments are unable to tap even a fraction of it. Further vacant land is taxed at a rate much higher than land with built-up property with the result that evasion of tax by vacant landowners has become the rule rather than the exception. Besides, such
owners often do not reside within municipal limits and thus collection of vacant land tax from them poses another serious problem. A huge demand from Vacant Land Tax remains accumulated in the Assessment registers since Vacant Land Tax is assessed @ 1.00 per cent of the capital value of the land and with poor collection. In view of this inherent problem certain Urban Local Governments (e.g. Guntur and Kurnool Municipal Corporations) have decided to collect Vacant Land Tax at the time of granting permission for construction of building in the vacant land in question by adopting the following criteria:

1) In respect of vacant lands in approved layouts, from the date of approval of the layout;
2) In respect of vacant lands in built-up area, for the last five years.
3) In respect of vacant lands on which assessment has already been made, from the year of such assessment.

4. **Property Tax Administration**

   Property Tax is a major source of income to Urban Local Governments. Several experiments were made during the last two decades to rationalize the administration of property tax in order to maximize the yield and minimise dissatisfaction to the genuine taxpayer. Urban Local Governments have the responsibility to ensure that while a genuine taxpayer is not overburdened with arbitrary taxation the potential of this major source of income to them is fully exploited.

   Property tax levied on the property owner is undoubtedly a financial burden to the taxpayer since the tax is paid directly without any service received directly. It is, therefore, of interest to study as to how to assess, collect and account for the property tax
levied and collected. This tax is assessed and levied on immovable or tangible property. It consists of tax for general purpose, for water, for lighting and for sanitation. Different methods are in vogue to fix the tax base in different states of India. Certain State Governments have prescribed the maximum and minimum rates between which a Municipality or a Municipal Corporation can levy and assess property tax. The Andhra Pradesh Municipalities Act 1965 prescribes a maximum limit to annual property tax on residential buildings at 25 per cent and non-residential buildings at 33 per cent of the net annual rental value.

The power of Urban Local Governments to levy property tax is circumscribed by a number of limitations—either by State legislation or Central Act. For instance, Central Government properties are exempted from payment of property tax to the ULG resulting in considerable loss of revenue though Urban Local Governments provide services to the localities exclusively occupied by Central Government Properties. Hence all public utility undertakings of the Central Government and Port Trust properties have to be taxed at least for the services provided. Private educational institutions are exempted from payment of property tax although they are collecting rent from their pupils. This results in loss to the ULGs.

**Property Tax System in Andhra Pradesh**

The Method of Property Tax administration in Andhra Pradesh has passed through many changing phases during the last three decades. After the Andhra Pradesh Municipalities Act came into force in 1965, the first quinquennial revision of property taxes was conducted in all the Municipalities in the state in 1970. Under the system the annual rental value of the buildings or portion of the buildings occupied by the owners was arrived at 9% of the
capital value of the buildings or portion of the buildings while the rental values of the rented portion were calculated on the basis of the hypothetical rent for which it was reasonably expected to be let out from month to month or from year to year. This rental value is not the actual rent paid by the tenant to the landlord, but a reasonable rent arrived at based on the rental values prevailing in the locality for similar buildings.

The capital value system of Property Tax Administration had resulted in an abnormal increase of property tax on every holding necessitating the inevitable withdrawal of the system. After its withdrawal, the state Government ordered a quinquennial revision of Property Tax in one fifth of the Municipalities in the state every year on a staggering basis in a phased manner. Under this system every building was assessed together with its site and other adjacent premises occupied as an appurtenance thereto and the annual rental value of lands and buildings was deemed to be the gross annual rent at which they were reasonably expected to be let out from month to month or from year to year with reference to its location, type of construction, plinth area of the building, nature of use to which it is put and such other criteria as may be prescribed.

This system of Property Tax Administration worked well. But it involved the discretion of the assessing officer in arriving at a reasonable/hypothetical rent at which the property might be expected to be let out from month to month or from year to year and as such the assessment of hypothetical rent differed from one assessing officer to another. The discretionary power of the assessing officers led to corruption, miscalculation of rental value and such other irregularities. After several years of intellectual exercise, the Government has amended the provisions relating to
the calculation of rental values based on the plinth area of the property in order to:

1. Remove the discretion on the part of assessing officers in the levy of tax thereby avoiding arbitrary taxation,
2. Delink property tax from Rent Control Act provisions,
3. Simplify the procedures relating to assessment and levy of tax, and

In this system the entire Municipal area is divided into convenient territorial zones based on the availability of civic amenities like water supply, street lighting, roads and drains, markets and shopping centres, educational institutions banks, postal services, public offices, medical institutions, factories and industries and such other relevant facts. After dividing the Municipality into territorial zones, the buildings situated in each zone are classified into six categories viz., 1. RCC posh buildings 2. RCC ordinary buildings 3. Madras Terraced or Jack Arch roofed or Stone slab roofed buildings 4. Mangalore tile roofed or asbestos roofed buildings or G.I. roofed buildings 5. Country tiled buildings 6. Huts (Thatched roof accommodation). After classifying the buildings based on their type of construction, they are further classified into six categories taking into consideration the nature of use of the buildings, viz., (a) Residential (b) Shops (c) Public Use like office complexes, Educational Institutions, Hospitals, Nursing Homes and Banks (d) Commercial purposes like Hotels, Lodges, Restaurant etc., (e) Industrial purpose like Factories, Mills, Workshops and other industries and (f) Cinema Theatres and places of entertainment. Based on the above criteria of type of construction and nature of use of buildings there are 36 categories.
of rental values arrived at for each zone. For the purpose of arriving at rental values a survey is conducted taking into consideration the actually let out buildings and the actual rents paid by the tenants. The assessing officer then arrives at the monthly rent of each category in a zone per square metre plinth area and notifies the rates for fixation of monthly rental value of buildings in a zone for information of the public.

A comparative study of the old and new systems of assessment of buildings to property tax will enable us to reach a proper conclusion. In the old system (which withstood the test of time and which was the result of several experiments and which remarkably improved the financial position of Municipalities and Municipal Corporations from 1978 to 1984) the assessing officer would make a personal inspection of each and every property, determine the reasonable rental value of the building taking into consideration the nature of construction, use to which it was put, the location of the buildings, the rental values prevailing for similar buildings in the locality. The rental value of exactly similar buildings also differed from one another, since the location of the building, length of time occupied by tenants, proximity to highways would determine the rent apart from the amenities and accommodation in the buildings. Hence, the rental value of each building had to be determined separately by considering various factors. Contrary to this well-established system of fixing the rental values of buildings, the new system introduced in 1993 provided for a uniform rental value for all similar buildings in a particular zone, which extends to several kilometres, without considering the various aspects described above. This results in abnormal underassessment of certain buildings which were fetching exorbitant rents, while it results in arbitrary increase in respect of buildings the rental value of which was comparatively low due to
distance from developed areas and lack of facilities. The new system resulted in reduction of the existing tax on commercial buildings and industrial houses, while the already existing high tax was further increased on old residential buildings. The net result for the whole Municipal area due to the revision of taxes on the new system was a slight increase over the existing tax demand benefiting many rate payers and hard hitting a few others. Contrary to this new system, the old system enabled the increase of property tax demand by more than 100 per cent without causing the slightest burden to any taxpayer. But the new system has not given the expected potential.

When the new system was proposed without any concessions, it led to a multi-fold increase of the existing tax rousing cries of anguish of the ratepayers all over the state. Then the Government came forward with a concession to limit the increase of tax to 75 per cent over post 1983 assessments and 100 per cent over pre-1983 assessments. This again resulted in continuing the existing discrepancies since a grossly under-assessed building would continue to enjoy grossly low increase while an arbitrarily assessed building would suffer arbitrary increase. Furthermore, a building constructed just before the commencement of the new system would enjoy the limitation of increase of tax to 75 per cent over the existing tax, while a building constructed just after 1993 juxtaposed to it would be heavily taxed since it would not have limitation in the assessment and levy of tax.

It is necessary to take up property tax reforms from time to time as to ensure reasonable assessment of property tax to fully exploit its potential and to avoid arbitrariness in its assessment.
The property tax administrators should be accountable to the rate payers and should play a responsible role in sensitising them by making the system transparent, providing for self-assessment of tax by rate payers themselves, avoiding arbitrariness in taxation and by such other measures which minimise discrimination and maximize efficiency in the levy, assessment and collection of taxes.

**Patna Experiment**

Patna Municipal Corporation has revised rates of property tax in order to prevent its tax assessing authorities from constantly harassing property owners and to avoid threats of arbitrary taxation. The Annual Rental Value (ARV) according to the Patna Municipal Corporation Act 1951 is "the gross annual rent at which the holding may reasonably be expected to be let". Since no Rules were framed till 1993, properties (holdings) were assessed to property tax inconsistently and irrationally by the tax inspectors. The rate of taxation is as follows.

- **Holding Tax (Tax for General purpose)** : 12.50 Per cent of the ARV.
- **Scavenging Tax** : 10.00 Per cent of the ARV.
- **Water Tax** : 10.00 Per cent of the ARV.
- **Education Cess** : 6.25 Per cent of the ARV.
- **Health Cess** : 5.00 Per cent of the ARV.

**Total** : 43.75 Per cent of the ARV.

The exorbitant rate of taxation led to arbitrary and unreasonable assessment of properties by the tax officials leading to corruption besides heavily taxing a genuine taxpayer. The need for a simple tax structure with lower rates of taxation acceptable to the tax payers was keenly felt. The Rules relating to taxation were amended in 1993 and the rate of tax was reduced from 43.75 per
cent to a mere 9.00 percent of the Annual Rental Value. As per the amended Rule, the Annual Rental Value is defined as the rent that a holding is capable of fetching over a period of one year, and the rates of taxation are as follows:

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<tr>
<th>Tax Type</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holding Tax</td>
<td>2.50 Per cent of the ARV.</td>
</tr>
<tr>
<td>Scavenging Tax</td>
<td>2.00 Per cent of the ARV.</td>
</tr>
<tr>
<td>Water Tax</td>
<td>2.00 Per cent of the ARV.</td>
</tr>
<tr>
<td>Education Cess</td>
<td>1.25 Per cent of the ARV.</td>
</tr>
<tr>
<td>Health Cess:</td>
<td>1.25 Per cent of the ARV.</td>
</tr>
<tr>
<td>Total</td>
<td>9.00 Percent of the ARV.</td>
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In order to assess the annual rental value of a building under the new system, an area based assessment method was introduced totally eliminating the powers of discretion of tax officials. The definite criteria for assessment included (i) Location of the holding (property) (ii) Use of the holding, (iii) Type of construction and (iv) Carpet area of the holding. The new Rules eliminated any scope for arbitrary, erroneous, subjective and monocratic assessment of property tax. The locality was defined as (1) Principal Main Roads (2) Main Roads and (3) Other Roads; for ascertaining the use of buildings, they were categorised as (i) Commercial or Industrial holdings; (ii) Residential holding and (iii) All other holdings not falling in the first two categories. In respect of the type of construction the buildings were classified into three categories, viz., (i) Pucca Buildings with R.C.C. Roof; (ii) Pucca Building with Asbestos or Corrugated sheets and (iii) Other Buildings which did not fall in the above two categories. Thus, it became a matrix of three multiplied by three multiplied by three. The Corporation would notify the rate per square foot for each kind of construction, type of use and each location.
This method of taxation had a number of practical disadvantages over the previous method of determining the Annual Rental Value. In brief (1) the new system divided the buildings (holdings) into only three categories while there were several categories in respect of the nature of construction; (2) the uses of buildings were divided into only three categories while the holdings were used for different purposes all of which did not have the same rental values; and (3) dividing the city into locations based on the type of roads would not do justice in the determination of rental value.

The Classification of buildings based on the nature of construction and use is no doubt an endless quest. But the Patna example of classification into three rigid categories is an over-simplification of a complex issue. The classification need not be too elaborate and at the same time need not be over-simplified either.

The Patna experiment, however, achieved the object of eliminating the discretionary powers of the assessing authority in the calculation of Annual Rental Value of holdings. The new system of property taxation became acceptable to the ratepayers because of its corruption-free nature, its simplicity and the lower rate of taxation, besides its transparency.

The reduction of tax from 43.75 per cent to 9.0 per cent of the Annual Rental Value remarkably increased the demand to Rs.17.00 crores from the earlier Rs.4.00 crores. This is, however, not universally acceptable or achievable since the increase in demand due to reduction of tax rate was only due to largescale evasion of tax by tax payers when the tax rate was high. In respect of Urban Local Governments where the collection of property tax demand was
as high as 90 to 98 per cent, reduction of tax rate would lead to
decrease of demand (tax yield) considerably leading Urban Local
Governments to financial bankruptcy.

**Kolkata System**

The method of assessment of property tax in Kolkata was
based on the annual rental value of a building. The assessment
was based on the discretionary powers of the assessing authority
giving scope for subjectivity. The system suffered from inherent
legal lacuna, inviting excessive litigation, thus resulting in loss of
revenue to the Municipal Corporation. There was no transparency
in the system and left no scope for self-assessment. It suppressed
the actual rent and property value due to the absence of a well-
regulated real estate market. The low rent paid by the long-
standing tenants, irrespective of other considerations like the
nature of construction, location of the building, rents paid for
similar buildings in the vicinity etc. led to low taxation, thus
disabling the Municipal Corporation from fully exploiting the
potential under property tax. There was no well-established
procedure for the determination of annual rental value and
assessment of property tax. Thus, a genuine taxpayer was likely to
be burdened while a tax evader enjoyed low tax benefit. This
system was almost similar to the system that prevailed in Andhra
Pradesh before the introduction of the Restructuring of Property
tax in 1993. Kolkata Municipal Corporation, after an in-depth
study and discussion of various successful practices, decided to
adopt the Unit Area System, which is a simple method of
arithmetical calculation of property tax based on the area of the
building, adopting the unit area value or unit area tax for the
category of building. The system makes it possible for the
ratepayers to assess their properties to tax by themselves and file
self-assessment forms.
The unique advantage of the Unit Area System is that it simplifies the concept of assessment, removes subjectivity, is transparent and easily understood, raises sustainable revenue demand and enables efficient tax administration and monitoring.

In this system of assessment, the entire urban area is divided into specific areas and each area is categorised into five classes based on scientifically verifiable nine (9) mandatory factors and 4 optional factors with points on gradation scales. Each ward is divided into sub-wards on the basis of perceivable parameters and along some principal roads of the ward. The factors taken into consideration for categorisation of wards into sub-wards are: Average Rental Value; Market Value of land; Water Supply position; Drainage system; Conservancy services; Availability of medical and educational facilities and entertainment centres; Availability of transport facilities; Average width of street; Daily Market facilities; Locality of the building and the type locality like Posh area, City Central area or Commercial area etc.; Economic status of the residents; Availability of park, playground, greenery etc.

There are five multiplicative factors considered for calculation of tax according to their distinctive features:

- Means of access to the building/property
- Occupancy
- Structure or nature of construction
- Age of the Property
- Nature of usage.

(The proposal is with the Government of West Bengal for approval)
5. **Financial Decentralization**

Urban local bodies have only limited sources of raising revenue and are perennially searching for funds to provide basic services. In fact, most of the municipal councils are not in a position even to pay salaries to their employees for several months and are unable even to meet the expenditure for maintenance of essential services with minimum standards. Under these circumstances the question of undertaking capital works and even essential maintenance work is a distant idea. This in turn fosters financial irregularities and money earmarked for specific projects and external funds are diverted to pay salaries. The problem is compounded further as the execution of projects is put off, often resulting in reduced rates of return or a serious disturbance in cash flows. State governments under the guise of some policy reform, without a corresponding compensation, have usurped several taxes, which were previously with the urban bodies. Often, when a municipal tax starts gaining potential it has been converted into a state tax (Motor vehicle tax, Profession Tax, marketing cess etc). Further the services provided by the urban governments are being charged for at rates fixed by the state governments, which, in most cases do not cover the costs. In such cases no budgetary support comes forth from state governments and the municipalities are left to fend for themselves. This has in all situations led to lower quality of services. The situation could be remedied by a resource sharing mechanism, which lays emphasis on urban governments maintaining better financial discipline and ensuring better realisation of their revenues. Often grants to urban governments are not based on technical principles and are politically motivated.

Certain municipalities deliberately avoid repaying loans and utilise their revenues irresponsibly, with the hope that the state
would bail them out in any case. When the financial crisis in certain ULGs became very critical the state government released *ad hoc* grant to temporarily bail those ULGs out of their crises. These grants, however, did not specify any performance standards nor did they set any specific objectives for the urban governments in return. The situation warrants greater financial autonomy to the local governments duly enhancing their power to levy taxes as well as set the rates of taxation and user charges to ensure sustainability of the project under the strict oversight of local representatives and civil society. However, mere handing down of power by itself is not likely to yield the desired results.

The current capacity of urban local governments to assess taxes and collect them in time leaves a lot to be desired. The complexity of the property tax system also results in unfair assessments and provides opportunities for seeking higher rents. The issue is compounded by improper accounting practices. At any given time it is impossible for the government to list the arrears due and this has allowed the municipal staff to desist from collecting the same. The budget process in most of the ULGs has also been turned into a mere formality. There is hardly any attempt to stick to the allocations made in the budget and the elected bodies are hardly aware of the goings on. Non-adherence to the budget process has in turn affected project performance, as the budgeted projects do not receive cash flows at the designated time which causes delays, increases costs and consequently reduces the rates of return. Hence it is imperative to ensure financial discipline. This indicates the necessity to build capacity in financial management, which has so far been in the hands of unqualified municipal staff. In addition, the elected body also needs to play a more active role in monitoring the performance of the staff and punish those who err.
The increasing cost of urban services necessitates the need for strengthening the financial viability of municipalities and reducing their dependence on central/state government funds. The important considerations in this regard are:

1) to enhance local government's revenue generation capability and its borrowing capacity; and
2) to increase the cost-effectiveness of local government expenditure, both of investment and maintenance.

The U.L.Gs. have to take up measures for improving municipal revenue generation capability and operation and maintenance of existing services. Emphasis is to be laid on increasing the efficiency of urban infrastructure investment, with measures relating to increasing revenue generation capacity as necessary complements to secure the financing of investment programme. All revenue enhancement measures have to be directed at improving existing systems and procedures of valuation, assessment and collection systems of revenue accounting.

**CURRENT EFFORTS**

The Indian parliament has amended the constitution to give urban governments a constitutional status as opposed to their being mere creatures of a state enactment. However, other than placing them in the constitution and ordaining regular elections, the impact of the amendment has been minimal. The state governments still have overriding powers over the ULGs. Their finances are tied up in a similar manner.

Unless urban local governments achieve the required financial viability they cannot meet the demand for core urban services required for expanding urban areas. Furthermore, the
services must be provided as economic goods rather than as welfare measures so that the services would be cost-effective and infrastructure development and maintenance would be sustainable. This necessitates the modification of the existing tax structure and introducing or bringing in innovative financial measures to keep urban finances on a recurring base.

**IMPROVEMENT OF URBAN FINANCE**

**Water Tax**

In almost all the ULGs in India including the four Metropolitan Cities, there is a heavy loss of revenue in respect of tax collected for the supply of protected water. In no single ULG, the income from water tax is equal to the expenditure incurred for supplying protected water. In certain lower grade ULGs there has always been wide protest against collecting water charges on metered system with the result that there is a wide gap between expenditure on and income from water supply. The deficit is met from other sources. Besides the loss of revenue there is a heavy loss of safe drinking water due to unauthorized water tap connections given to the public by the field level staff who are interested in illegal earnings. The mismanagement of water supply system by the field level staff is largely responsible for heavy financial deficit in the ULGs. Efforts to arrest this trend have not been sincere and honest since often local politicians are involved in the deliberate irregularities.

When a survey of civic amenities available and required to residents was conducted in Guntur Municipal Corporation in 1998, about one third of the total water tap connections in the city were found to be unauthorized ones. Regularization of these connections duly collecting double the water supply tap connection charges
brought adequate revenue to the Municipal Corporation and could be utilized for development. In order to prevent the loss of revenue from this source, the Corporation introduced an integrated demand notice for all taxes and fees that each taxpayer had to pay to the Municipal Corporation. This has enabled the Municipal Corporation improve its revenue as well as timely collection of taxes.

**NON-TAXES**

Every ULG collects various fees and charges under different non-tax sources. The most important of them are Excess Water Charges, Drainage Cess, Market fees, Shop Room rents, Encroachment fees and Dangerous & Offensive Trade License fees. These are major sources of income directly collected by the ULGs after property tax. Most of the ULGs do not properly watch the income from the above sources.

(a) **Excess Water Charges**

Use of excess water or bulk usage of water is quite common in major industries, well-established business houses, firms etc., but the Municipal authorities collect water charges from them on a flat rate system without providing metres to measure the quantity of water used. Consumers of bulk quantity of water bribe the field level staff who manage to collect water charges at the flat rate with the result that the ULGs incur heavy loss of revenue. This loss can be avoided by introducing metered water tap connections so that water charges can be collected for the actual quantity of water consumed.

(b) **Drainage Cess**

Drainage cess is levied from building owners for each drainage connection provided to the building. This cess is levied if,
and only if, there is an underground drainage system with sewerage treatment plant. Towns/cities which have this system must concentrate on this considerable source of income.

(c) **Market Fees and Shop Room Rents**

This is another major source of income to the ULGs. Though the revenue from the market fee is considerably large, inadequate and inefficient officials are passive in realising the full amount from it. Every year the ULGs conduct auction of lease hold rights of collection of fees in the market. The bidders offer huge amounts at the time of bid but, by taking advantage of the lacunae in the law or by conniving with the revenue officials, evade payment of a part of the lease amount, thus causing considerable financial loss to the ULGs. Income from shop room rents is an equally important source of income. Though there would no loss of income from this source if properly collected, the revenue collection staff with an ulterior motive delay timely collection of shop room rents and it results sometimes in inordinate delay in the collection of revenue from this important source. Another way of loss of revenue is delay in renewing the lease of shop rooms at an enhanced rent or in re-auctioning the shop rooms which would fetch a higher rent on par with the prevailing rental values for similar shop rooms in the vicinity.

In certain towns and cities of Andhra Pradesh it is very often observed that the rents fetched for municipal shop rooms is comparatively much less than the rents fetched for similar private shop rooms in the vicinity. Whenever the municipal authorities try to rectify the anomaly the local politicians deter the officials either though political power or muscle power from enhancing the shop room rents, despite steep rise in the private shop room rents. If this obstacle can be successfully overcome by the use of official exercise
of legitimate authority, this would be a reliable and recurring source of income to the ULGs.

The Government of Andhra Pradesh issued an order in July, 1998 to put municipal shop rooms to auction for goodwill and the goodwill so realised should be kept in a separate account in the bank and be exclusively utilised for the construction of remunerative enterprises as per the existing demand. This had resulted in realizing adequate income for developmental activities. Certain shop rooms in Guntur, Kurnool and other Municipal Corporations were thus leased out through auction against goodwill. The income it fetched was double the cost of the construction of shop rooms.

(d) Encroachment Fees

Encroachment fees fetch considerable income to the ULGs if properly assessed. Most of the municipal sites and road margins are encroached upon by business establishments, and they are classified as unobjectionable encroachments. Since there would be no immediate necessity to remove these encroachments, encroachment fees can be levied and collected from encroachers of municipal lands to realize an adequate revenue.

(e) Advertisement tax

It is another major source of income to the ULGs particularly to big corporations. While the advertisement tax directly collected from advertisers has yielded only a nominal income, privatization of collection of this tax through open auction of right to collect it can yield a substantial income to the ULGs. The potential under this component can be fully realized only if the probable income is assessed taking into consideration each and every advertisement within the precincts of the municipal area.
(f) **Building Licence Fees**

Another important source of income is Building Licence fees. Municipal authorities generally mismanage Building Licence fees by miscalculation of the fees that can be levied, misinterpreting the rates prescribed for different types of constructions in different localities. In fast growing urban areas building activity is very high where a huge income can be expected from building licence fees.

It has been observed that there is a largescale misappropriation of building licence fees in certain ULGs in Andhra Pradesh by appending duplicate or fake bank receipts in support of the building licence fees. It was detected in Kakinada Municipal Corporation that the staff dealing with calculation and collection of building licence fee had not remitted the fees collected from the applicants and managed to mislead the licensing authority by producing fake receipts that resulted in loss of revenue to the municipal treasury. The subsequent detection of this fraud led to the suspension of the erring officials and disciplinary action against them. It cannot be ruled out that there are several similar cases yet to be unearthed. The municipal authorities at the higher level should, therefore, evolve an effective method of ensuring correct calculation of the building licence fee payable with each building application and remittance of the fees so collected to the respective head of account to avoid possible loss of revenue from this important source of income to the ULBs.

(g) **Dangerous & Offensive Trade Licence Fees**

In respect of Dangerous & Offensive trade licence fees, most of the trades in urban areas are generally not assessed and licence fee collected by the field level health staff. During 2001 all the Municipal commissioners in Andhra Pradesh were directed to assess the probable number of trades that could be expected to be
functioning in their towns or cities. Each family or household may be expected to eke out livelihood either from employment in the public sector or the private sector or by carrying on a trade. Thus, fifty per cent of the households in every town may be expected to carry on a trade for its livelihood. When a case study was made of the urban areas of the Rayalaseema region of Andhra Pradesh consisting of 17 ULBs (2001-02), it was observed that even in big towns and prospective Municipal Corporations like Tirupati, the number of D&O Trades levied and assessed to licence fees was not even five per cent of the total number of households, while they were better assessed in a smaller town like Nandyal (Kurnool district). As a thumb rule, it may be expected that every household will have a source of income. Even presuming that half of the households are employed either in the public sector or the private sector and agriculture, the remaining households should have a trade which must be licensed under D&O Trade Licence. It, therefore, follows that the number of D&O Trade Licences should be approximately equal to half of the households in a municipal area. There is a large scale loss of revenue from this important source of income mainly due to the non-listing of trades for collection of licence fees from the traders by the licensing authorities and awful corruption among the field level staff of the ULBs.

Preparation of an inventory of the existing trades in every urban area by a private agency will considerably improve income to the ULG from this source.

In order to raise revenues, the actions that need to be taken are enhancing the taxation and revenue raising powers of the ULGs; creation of special funds for infrastructure development; provision of statutory payment to local governments from fixed
percentage of recurrent revenues of central and state government departments' budget as grants, thus giving urban local governments more flexibility to meet local needs and demands. The Government of Tamil Nadu has created such a fund which could be utilised exclusively for creating infrastructure facilities in urban areas. All other states will do better in this aspect by creating such a fund by pooling up sufficient funds from various sources—central government grants, state government grants and mobilisation of local resources. The central and state governments must also provide technical assistance and training to officials of the ULGs in improving tax administration and collection procedure and improving revenues from the existing resources; empower the ULGs to draw from nationalized banks or credit authorities to provide services and facilities for which users can be changed so that the services become cost-effective and the loan can be repaid with the revenue generated from user charges.
References


5. Amitabh Kundu, op. cited, p.38.


