CHAPTER II
THEORETICAL FRAMEWORK FOR THE OCTROI PROBLEM

2.1 LOCAL SELF GOVERNMENT ENTITY

LOCAL Self Government is the creation of Indian Democratic Republic country with the intention of maximum social welfare. The Central Government acts on the widely spread national level, whereas the State Government acts on the State level. It becomes impossible for Central Government and also for State Government to look after the local basic needs and to tackle the day to day problems possessing local character e.g. the construction and maintenance of roads, the provision of clean and adequate water, electric supply, street lighting, sanitation, the provision of primary education, health facilities etc. Local Self Government helps at this critical juncture in looking after the local needs and performing the duties effectively and efficiently in solving the local problems of a specific local character, with the intention of attaining maximum social welfare. These institutions of Community
Government are progressively involved in the wider process of development and nation building. Not restricting themselves to the traditional function of providing civic amenities, the Local Self Governments now undertake developmental planning leading to the comprehensive community building. Thus the Local Self Governments help the Central Government by working at the bottom level of the society in achieving the national plans. Hence these local bodies are recognised to be of great importance in the political system. These local bodies play an important role in decentralisation of the administration of certain functions pertaining to local areas such as districts, cities or villages.

The delegation of local functions to local bodies also relieves the Government of a large amount of administrative work which can not be adequately performed from a distance and enables it to concentrate on major schemes which it alone can undertake. Local Self Government also makes democracy more meaningful to the people. Inaugurating the Conference of Ministers of Local Self Government in August, 1958, the late Prime
Minister Mr. Pandit Jawaharlal Nehru said, "Local Self Government is and must be the basis of any true system of democracy. We have got rather into the habit of thinking of democracy at the top and not so much below. Democracy at the top will not be a success unless it is built on this foundation from below." *

Local Self Government play a vital part in economic planning too. Both planning and its implementation became more realistic and effective with the participation of the people at local levels in matters which are closely related to them. Today, India is facing a problem of rapid urbanisation, due to which the Local Self Government have to shoulder various types of responsibilities to render more effective and efficient civic facilities both beneficial and of onerous nature.

* Ref : Report of the Local Finance Enquiry Committee
Finance assuming salience to the Local Self Government's institutions. To realise an important role in all-round development of urban area and to live up to the expectations, these service oriented institutions need an assured and adequate revenue, preferably collected locally. To the extent the sources of revenue are local, the local authorities gain independence. To the extent these are predictable, the authorities can effectively plan for future development. To the extent the sources are evenly spread, they receive wider support. It is this local nature of revenue that helps these Local Self Governments to become more as expressions of State at local level, than as 'extensions of Government' at local level, less as agencies.
of administrative decentralization, and more as partners in the larger process of development, providing infrastructure for socio-economic change, taking initiative to tackle problems of urbanization, initiating effective measures to minimize the social cost of change.

According to the 'World Development Report, 1988' of the World Bank, canons of sound local finance are as follows:

i) The cost of providing local services should be recovered, to the extent possible, from the charges on the beneficiaries. Such charges should be related to individual consumption or whether this is not possible, to a measure of individual benefit received,

ii) Services whose costs can not be recovered from charges can be financed from general taxes - property, business and sales - levied within the relevant jurisdictions,

iii) If the benefits of local services spill over into other jurisdictions or produce
nation-wide benefits, then grants from higher level governments should finance such services in proportion to their outside benefits, and

iv) Borrowing is an appropriate way to finance at least some local capital investment, provided macro economic fiscal balance is maintained.

Thus the Local Self Government requires continuous and adequate local finance for providing best possible civic services with the ultimate object of "democratic decentralisation" and "development from below". The provision of sufficient and adequate local finance will ultimately help in strengthening the roots of Local Self Government.

2.3 - LOCAL REVENUE

Local revenue composed of internal and external sources is linked with the functions, the local bodies are expected to perform and these are provided in the
State Local Government Acts. The Acts express the content of agency functions and the scope of own functions which are reflected in the Schedule of obligatory and discretionary duties.

The internal sources of revenue comprise local taxes, licence fees, income from local utilities while external sources cover grants-in-aid and loans. Local taxes are either raised, collected and spent locally or raised locally and collected centrally but spent locally or raised and collected centrally but shared locally.

Tax resources generally cover property tax including service charges, terminal tax, profession tax, entertainment tax, vehicle tax etc. State Governments have a tendency to take over some of these taxes e.g. entertainment tax, profession tax etc; or announce exemption in consideration of its impact on weaker sections e.g. bicycle tax. Non-tax resources comprise fees, fines, realization under special acts and income from commercial or local enterprises undertaken by local bodies. Non-tax resources are not of much significance to local finance pattern, though revenue from
commercial and local enterprises has a potential to grow. Sharing of taxes to some extent, but grants-in-aid are of significance as these are linked with functions of national priority.

There is no separate list of taxes to be imposed by local bodies. Certain taxes have, however, in practice, been left to the local bodies in practically every State.

The Local Finance Enquiry Committee, 1951, recommended that certain sources should by convention be reserved for local bodies, included in State list.

The Taxation Enquiry Commission was also of the view that certain taxes should, in effect, be reserved for local bodies and whenever State Governments are imposing them, they should gradually withdraw from the field.

2.4 - PLACE OF OCTROI IN LOCAL REVENUE

In general, Local Self Governments have the following different major sources of local revenues:
i) Octroi

ii) Wealth tax, taxes on houses and lands

iii) Other taxes and duties

iv) Fees from educational institutions

v) Receipts from markets and slaughter houses

vi) Government grants-in-aid

vii) Miscellaneous receipts

Local revenue

Octroi duty is the very important source of which goes directly to a civic body.

Octroi is neither a new tax nor a sectarian levy.

"Octroi", as defined under the Bombay Provincial Municipal Corporations Act, 1949 means a cess on the entry of the goods into the limits of a city for consumption, use or sale therein. According to the Maharashtra Municipalities (Octroi) Rules, 1968, "Octroi Naka" means a place appointed by a council for levy and collection of Octroi; "Entrance Naka" means the octroi naka at which the goods arrive for the purpose of their import; "Exit Naka" means the octroi naka at which the goods arrive for the purpose of their export; "Octroi
"Officer" means a municipal officer or servant in-charge of or attached to an octroi naka and includes any officer serving in the octroi department of the council or any officer authorised or designated in this behalf by the chief officer.

Schedules under these Rules classify the commodities and prescribe maximum and minimum rates of octroi which can be fixed by a Council. The ad-valorem rates are between 0.5% to 4.0%. Generally octroi is paid in cash at the point of entry in the local area and manufacturers are permitted to keep a current account. For cash payment, there are no returns required to be filed and as such no records are to be maintained. However, assessment of octroi for current account holders is made on the basis of invoices to be submitted after the closure of the month. After scrutiny, the council issues the bill which is to be immediately settled.

The finances of most of the Local Municipal Bodies are so precarious that they are not in a position to provide even the minimum civic services and amenities. They find octroi as an elastic source of revenue, purely
local in nature, as the funds from this source increase along with the growth in trade, commerce and industrial activities. Also, as octroi is collected daily, the civic bodies get sufficient income on a daily basis, which takes care of their ways and means position. Octroi, thus, serves as a financial cushion for most of the local municipal bodies.
**TABLE NO.1**

MUNICIPAL SOURCES OF INCOME IN MAHARASHTRA - 1980-81

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Sources of Income</th>
<th>Total Income (Rs. in crores)</th>
<th>As a Percentage to the total income(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Octroi</td>
<td>174.57</td>
<td>41.48</td>
</tr>
<tr>
<td>2</td>
<td>Wealth Tax, taxes on houses and lands</td>
<td>119.87</td>
<td>28.48</td>
</tr>
<tr>
<td>3</td>
<td>Other Taxes and duties</td>
<td>16.58</td>
<td>3.97</td>
</tr>
<tr>
<td>4</td>
<td>Fees from Educational Institutions</td>
<td>0.50</td>
<td>-</td>
</tr>
<tr>
<td>5</td>
<td>Weekly markets and slaughter houses</td>
<td>7.43</td>
<td>1.77</td>
</tr>
<tr>
<td>6</td>
<td>Governments Grant-in-Aid</td>
<td>51.65</td>
<td>12.40</td>
</tr>
<tr>
<td>7</td>
<td>Miscellaneous receipts</td>
<td>50.24</td>
<td>11.90</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>420.84</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Thus, octroi collection constitutes the major source of income as pointed out in the above mentioned Table No.1 indicating Municipal Sources of Income in the State of Maharashtra for 1980-81.

The above mentioned information is presented in the 'Pie Chart' shown in Fig. No.1 to get a clearer perception of the situation.
Pie chart showing proportion of different sources of income in total income

- Octroi
- Miscellaneous
- Wealth tax, taxes on houses and lands
- Other taxes and duties
- Fees from educational institutions
- Weekly markets and slaughter houses

Fig. No. 1
Out of total revenue of Rs.420.84 crores, Rs.174.57 crores is only from octroi which is 56.06% to total revenue. This shows that octroi is the life blood of the local municipal bodies from the viewpoint of finance.

Local finances assume importance as they promote accountability and equity by effectively linking the benefits of services with their costs, and in the case of local finance, octroi has been the growing and hence important but controversial source of revenue, in the Indian Municipal Tax structure. Over the years, octroi revenue collection has been increasing faster than those from other sources of revenue. In 1968-69 the share of octroi in the revenue receipts of municipal corporations in Maharashtra was about 28.60%. In the last two years this share has increased to more than 50%.

The importance of octroi in the finances of local municipal bodies can be seen from its share in total revenue of local municipal bodies, for the year 1986-87, as shown in Table No.2.
**TABLE NO. 2**

PERCENTAGE OF OCTROI INCOME TO THE TOTAL REVENUE OF DIFFERENT MUNICIPAL BODIES, 1986-87.

<table>
<thead>
<tr>
<th>Municipal Body</th>
<th>Total Revenue (Rs.in crores)</th>
<th>Octroi Income (Rs.in crores)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bombay Municipal Corpn.</td>
<td>864.05</td>
<td>230.78</td>
<td>26.70</td>
</tr>
<tr>
<td>2. Pune Municipal Corpn.</td>
<td>48.00</td>
<td>30.98</td>
<td>64.54</td>
</tr>
<tr>
<td>3. Nagpur Municipal Corpn.</td>
<td>37.57</td>
<td>19.02</td>
<td>50.55</td>
</tr>
<tr>
<td>4. Solapur Municipal Corpn.</td>
<td>15.48</td>
<td>5.45</td>
<td>35.20</td>
</tr>
<tr>
<td>5. Kolhapur Municipal Corpn.</td>
<td>13.38</td>
<td>10.49</td>
<td>78.42</td>
</tr>
<tr>
<td>6. Thane Municipal Corpn.</td>
<td>35.91</td>
<td>21.74</td>
<td>60.53</td>
</tr>
<tr>
<td>8. Pimpri-Chinchwad</td>
<td>31.12</td>
<td>23.07</td>
<td>74.13</td>
</tr>
<tr>
<td>Municipal Corporation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Aurangabad Municipal</td>
<td>12.62</td>
<td>5.55</td>
<td>43.99</td>
</tr>
<tr>
<td>Corporation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Amravati Municipal</td>
<td>8.61</td>
<td>3.01</td>
<td>34.95</td>
</tr>
<tr>
<td>Corpn.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A) All Corporations</td>
<td>1,103.38</td>
<td>371.65</td>
<td>33.68</td>
</tr>
<tr>
<td>B) All Municipal Councils</td>
<td>209.37</td>
<td>78.01</td>
<td>37.26</td>
</tr>
<tr>
<td>C) All Municipal Bodies</td>
<td>1,312.75</td>
<td>449.66</td>
<td>34.25</td>
</tr>
</tbody>
</table>

2.5 - CHARACTERISTICS OF OCTROI

Octroi levy can be assessed from following specific criteria regarding the ideal tax system *

i) Convenient: Octroi is highly convenient. It is paid in small amount and only at the time of goods entrance in the area of local body. As the octroi levy is included in the price of commodity, the burden of this tax is not felt very much by the tax payer. The amount of levy is generally collected from the manufacturers, importers or sellers. It is convenient for taxpayers and also for the collection machinery.

ii) Elastic: Octroi is not only the main source of income to Local Self Government but it is highly elastic levy. It is a definite source of income. The revenue from octroi levy can be increased. By charging levy on luxurious items, income can be increased sufficiently. The rates of common consumption goods and luxurious goods can easily be changed.

* Vide: 'Public Finance' - Dr. B.P. Tyagi
iii) **No Evasion**: Octroi is generally difficult to evade as it is included in the price of the articles and commodities.

iv) **Can be Progressive**: Octroi levy can be made progressive by means of imposing heavy taxes on luxurious items and exempting articles of common consumption.

v) **Wide Coverage**: Octroi levy is charged on all types of goods and commodities at different rates hence it becomes broad based levy.

vi) **Productive**: Octroi levy seems to be productive as octroi revenue rises automatically by imposing and increasing small amount of levy, yields a substantial amount of revenue. The development of city assists to increase the revenue from octroi accordingly.

vii) **Liquidity**: Octroi imparts liquidity to local municipal bodies as the cash revenue is available on daily basis i.e. around the clock to meet the current expenses.
viii) **No arrears**: Octroi duty is collected at the entry of the commodity in the local area, thus octroi do not create the problem of arrears.

ix) **Buoyancy**: Octroi levy shows high buoyancy.

x) **Low Cost of Collection**: Octroi collection cost is also very low as compared to its revenue collection.

The above specific features appearing in the octroi levy proves that as a form of indirect taxation owes all the features of ideal tax system.

### 2.6 - THE OCTROI PROBLEM

Octroi which has been a significant source of income to the local bodies, has created a very strong position in revenue structure of local finance. Even though it is criticised and condemned as 'immoral', 'obnoxious' and 'a levy that has every vice'. It has several demerits such as abetting corruption, prolonged delay in transportation, making consumer goods costlier, colossal -
waste of fuel and traffic hazards on national highways, the levy works against industrial decogestion in urban belt. Although some hard critics have tersely defined octroi as nothing less than "highway robbery", it is true that octroi which is a British legacy, is an irksome, retrograde and primitive form of taxation.

And hence there has been a strenuous demand for the abolition of octroi in the State of Maharashtra, one of the most progressive State in the country, because of the strong criticism on its method of assessment, levy and collection.

Inspite of the obnoxious effects of octroi on the local economy, it continues on the grounds that it is a state subject and the Local Self Government needs adequate local finance through ever increasing local revenues. Today it has become an important revenue source of income to local bodies as it constitutes 50% to 60% share in their total revenue. Even the annual growth rate of octroi is upto 20% per year. Therefore, if as a policy matter, the state has to abolish octroi,
the immediate problem is how to compensate the income loss to local municipal body.

Hence it is advisable to search for new income resources as the conditions prevailing for the abolition of octroi and the expected revenue from alternatives suggested to octroi are uncertain. It should also be noted that an alternative tax in place of Octroi will not necessarily be free from the defects in and maladies of octroi administration.