

Chapter-VI

DEVOLUTION AND GRANTS-IN-AID

6.1 The terms of reference mandated the Commission to make recommendations as to the principles which should govern:

- (i) the distribution between the State of Assam and the Panchayats/ Municipalities of the net proceeds of the taxes, duties, tolls and fees, leviable by the State, which may be divided between them and the allocation between the Panchayats/ Municipalities at all levels of their respective shares of such proceeds;
- (ii) the determination of the taxes, duties, tolls and fees, which may be assigned to, or appropriated by, the Panchayats/ Municipalities;
- (iii) the grants-in-aid to the Panchayats/ Municipalities from the Consolidated Fund of the State.

6.2 The terms of reference also state that in making its recommendations, the Commission shall have regard, among other considerations, to:

- (a) the objective of balancing the receipts and expenditures on revenue account of both the local bodies as a whole and the State Government and each local body;
- (b) the resources of the State Government and the demands thereon, in particular, on account of expenditure on maintenance of law and order, civil administration, debt servicing and other committed expenditures;
- (c) the revenue resources of the local bodies for the five years commencing on 1st April, 2001 on the basis of the level of collection made during 1998-1999 from taxes, duties, tolls, fees, cess, etc. levied by them;
- (d) the potential for raising additional revenue from the existing sources available to them; and
- (e) the scope for better financial management consistent with efficiency and economy in expenditures.

Devolution of Taxes :

6.3 Under the present dispensation, the State taxes that are being shared with the local bodies on the basis of statutory provisions and executive decisions are motor vehicles tax, entertainment tax, land revenue and local rates. These transfers are, by and large, based on the principle of sharing of taxes by origin. As per Section 26 of the Assam Panchayat Act, 1994, land revenue and local rates are to be shared with the GPs. On the other hand, Section 184 of the Guwahati Municipal Corporation Act, 1971, provides that

the proceeds of motor vehicles tax, entertainment tax, land revenue and local rates collected within the GMC areas, net of collection costs, are to be shared with GMC.

6.4 Local bodies have been receiving shares of MV tax, entertainment tax, land revenue and local rates, from time to time. However, it appears that the implementation of the existing statutory provisions in this regard have been tardy, with the amounts actually transferred depending on the existing budgetary provisions and on the ways and means position of the State. In fact, the transfers to the rural and urban bodies are mostly being done on an adhoc basis with the actual amounts released varying from year to year, apart from being considerably lower than the entitlements. As can be seen from **table 6.1** below, there were no transfers on account of land revenue to the rural local bodies over the period from 1996-97 to 2000-01; however, in 2001-02, a sum of Rs.1.00 crore was released to the GPs. It is reported that GMC has not received any share of land revenue and local rate despite the provisions of the GMC Act 1971. On the other hand, GMC has been receiving very substantial amounts of transfers on account of entertainment tax. But, as pointed out above, the amounts actually released to GMC have fluctuated from year to year depending upon the budgetary and cash flow position of the State. It is to be noted that apart from GMC, no other ULBs are entitled to a share in entertainment tax as per the existing statutes.

Table-6.1

Transfer of Taxes by Origin to Local Bodies Under Head of Account 3604.

(Rs.in lakhs)

	Tax Head	95-96	96-97	97-98	98-99	99-00	00-01	01-02
1	Land Revenue	5.00	----	----	----	----	----	100.00
2	Entertainment Tax	221.05	77.46	----	307.00	327.23	410.07	69.33
3	MV Tax	530.00	142.00	----	702.82	336.00	425.08	23.62
4	Others	200.00	187.00	----	----	----	48.33	195.60
	TOTAL:	956.05	406.46	----	1009.82	663.23	883.48	388.55

Source : Finance Accounts, 2001-02, Government of Assam.

6.5 The Commission observed that the provision of the GMC Act, which stipulates that MV tax collections in Guwahati city are to be transferred to GMC, is not being implemented in the manner envisaged in the Act. Instead, as per a decision of the State Cabinet, 30% of the total MV tax collections of the State Government are to be shared amongst all ULBs including GMC. This divisible pool is to be distributed amongst the districts on the basis of the number of registered vehicles. The share of each district is further divided amongst all ULBs in the district on the basis of their population. As such, the share of MV tax that GMC has been receiving in recent times is considerably lower than its entitlement as per statutory provisions.

6.6 Be that as it may, this Commission is not in favour of the implementation of the existing statutory provisions for the transfer of MV tax to GMC, as these provisions are based on the principle of sharing of taxes by origin. The Commission noted that vehicles from all over Kamrup district are registered in Guwahati because the registration authority, i.e, the Office of the District Transport Officer, is located at the district head quarters. Also, since Guwahati is the commercial hub of the State, many vehicles from outside Guwahati are registered in the city. As such, other local bodies where the vehicles are actually operating should also logically be entitled to a share of the MV tax. However, the existing enactment does not provide for the transfer of MV tax collections to local bodies other than GMC. Apart from these arguments, this Commission feels that, as pointed out in Chapter-II, derivation based tax sharing limits local government autonomy. A more serious disadvantage is that the sharing of taxes by origin are counter equalizing in nature, as local body governments endowed with larger tax bases will benefit from larger transfers. Since derivation based tax sharing runs counter to the principles of equity and autonomy, this Commission recommends that the existing statutory provisions for the transfer of MV tax to GMC be revoked. Instead, the Commission is of the opinion that the sharing of taxes including MV tax should be determined through a formula based approach.

6.7 The present policy for the sharing of MV tax amongst ULBs, which is based on a Cabinet decision, also advocates the sharing of MV tax by using a formula based approach. However, the criteria adopted for the distribution of MV tax collections appear to be limited as well as inappropriate. Moreover, this Commission prefers the global sharing of all tax revenues to the sharing of individual taxes for reasons elaborated below.

6.8 While reviewing the existing arrangements for sharing of taxes, the Commission found that the prevailing procedures for the transfer of tax revenues to local bodies to be lengthy and cumbersome, and involving, quite unnecessarily, several government departments. As a matter of fact, the nodal directorates have to prepare and send the proposals for sanction to the concerned administrative departments (for instance, Guwahati Development Department), who, in turn, have to obtain the approval of the concerned department which administers the collection of taxes (for instance, Transport Department in the case of MV tax). After the tax collecting administrative department clears the proposal, Finance Department would have to be moved firstly, for according concurrence, and secondly, for issue of ceiling. The concerned nodal department (i.e., GDD) would then be in a position to draw the sanctioned amount. It is only after completing all the aforesaid procedures that the concerned administrative department (i.e., GDD) will be able to draw and disburse the share of taxes to the concerned local bodies.

6.9 The Commission took note of the anomalies, both in design and in procedure, of the prevailing system of tax sharing between the State Government and the local bodies. It felt that the existing arrangements for sharing of taxes by origin, in practice, runs counter to the spirit of the 73rd and 74th Constitutional Amendments. The primary objective of these

Constitutional amendments is to ensure effective decentralization, increased empowerment, and greater autonomy of the rural and urban local bodies. It is to be noted that the powers for the determination of tax rates and tax base, among others, in respect of taxes that are shared on the principle of origin is vested with the State Government and not with the local bodies. Keeping in view this objective, the Commission strongly feels that the existing system of tax sharing between the State and local body governments encompassing the sharing of MV tax, entertainment tax, land revenue and local rates, be replaced by global sharing of all State taxes on the basis of objectively defined formula. As mentioned in Chapter-II, a formula based approach facilitates the determination of resource transfers on the basis of select objective quantitative criteria. In fact, the selection of criteria can be governed by the objective of promoting equity, efficiency, autonomy, and fiscal discipline. This approach will not only enable simplification of the present cumbersome procedures but will also ensure greater transparency and certainty in the distribution of resources. Moreover, the mechanism of global sharing would enable the local governments to enjoy the benefit of buoyancy in the aggregate tax revenues of the State instead of individual taxes as at present.

6.10 Having decided the approach, the next issue before the Commission is to design the system of transfer of revenues from the State Government to the rural and urban local bodies by appropriately structuring the horizontal and vertical dimensions of the transfers. Vertical transfers from the State Government to the rural and urban local bodies require the determination of the proportion of the aggregate collection of taxes and duties of the State Government which will be set aside for the constitution of the divisible pool. In this regard, the FSFC recommended devolution at the rate of 2% of the aggregate tax revenues of the State during their award period from 1996-97 to 2000-01. Apart from that, an additional 10% of the collections from MV tax was recommended for sharing with the RLBs.

6.11 The Constitutional amendments envisage that local bodies, both rural and urban, should function as independent institutions of self government. Keeping in view the spirit of the Constitutional amendments, it is imperative to place the local bodies on a sound financial footing. The functions entrusted to them under the Eleventh and Twelfth Schedules of the Constitution appear to be enormous, while the locally available sources of revenue suffer from low yield. Moreover, local bodies, particularly the rural ones, are in a fledgeling state. Until they become properly functional, their dependence on budgetary support from the State Government will be overwhelming.

6.12 In determining the size of the divisible pool, the Commission is also required to take into account the resources of the State Government and the demands thereon. In this regard, it is abundantly clear from Chapter-V which, reviews the State finances, that the State has been passing through a severe financial crisis since the last decade. Moreover, it appears from the budget of the State Government that currently substantial amounts are being spent under State plan, decentralized planning and non plan on the subjects which have been, or are to be, transferred to the local bodies. The

amount provided under non plan includes grants-in-aid for meeting the salary liabilities of the provincialised panchayat employees. The current level of budgetary expenditure incurred by the State Government for rural and urban development should justifiably be taken into account in determining the appropriate size of the divisible pool.

6.13 On the other hand, as mentioned earlier, the requirements of the PRIs to meet their Constitutional obligations following the 73rd and 74th amendments have also to be fully provided for. The Commission has, therefore, attempted to balance the fiscal requirements of the local bodies with that of the State Government. Keeping in view the extremely difficult financial position of the State Government, and taking into account the fiscal capacities of the local bodies, the Second State Finance Commission recommends that 3.5% of the aggregate collection of State taxes and duties be devolved annually to local bodies, both rural and urban.

6.14 The terms of reference stipulate that the recommendations of the Commission shall cover the period of five years commencing from 1st April, 2001 and ending on 31st March, 2006. As reported by the Accountant General, the actual collection of taxes and duties of the State Government for the financial year 2001-02 is Rs.1556.98 crores. At the recommended rate of 3.5%, the divisible pool for sharing with the local bodies works out to Rs. 5449.43 lakhs for the year 2001-02. The estimated size of the divisible pool, comprising the tax revenues to be shared with the rural and urban local bodies, on the basis of the projections of the Medium Term Fiscal Reforms Programme (MTFRP) of the Government of Assam is shown in table 6.2 below :

Table 6.2

Fiscal year	2001-02 Actual	2002-03 Estimates	2003-04 Estimates	2004-05 Estimates	2005-06 Estimates	2001-06 Total
Projected tax revenues (Rs. In crores)	1556.98	1732.60	1954.68	2203.32	2489.75	9937.33
Estimated divisible pool (Rs. In crores)	54.4943	60.6410	68.4138	77.1162	87.1412	347.8065

N.B. Estimates upto 2004-05 are as per MTFRP projections. Estimates for 2005-06 have been arrived at by applying the growth rate used in MTFRP projections.

The divisible pool for 2001-02 has been worked out on the basis of actual collection of State taxes, while that for the remaining four years are based on estimated figures. As such, the actual releases to the local bodies for these years should be regularized as soon as actual figures of collection are received from the Accountant General.

6.15 The determination of an appropriate formula, based on selected criteria for rational allocation of the divisible pool, depends largely on the availability of reliable and adequate data. The Commission sought data on population, geographical area, per capita income, people below poverty line,

tax effort, infrastructural facilities available and important social indicators up to the GP level. Since virtually no database is being maintained by the RLBs and as the information base of the ULBs is also extremely limited, the Commission faced enormous constraints in designing a suitable formula for distribution. In fact, apart from population, no other data, even information on geographical area, is presently available in respect of GPs. In respect of ULBs, limited data like population, area, length of surfaced roads, pucca drains, and number of streetlights were made available by Urban Development and Guwahati Development Departments. As regards tax effort, the Commission was able to get data on annual tax demand of each ULB, but found that the tax demand estimates were not determined on the basis of any rational or scientific principle. The Commission was also able to secure data on tax collections for three years, i.e., 1999-2000 to 2001-02, for each ULB along with their respective population as per 2001 census. The Commission, therefore, decided to adopt actual per capita tax collection figures as a proxy for tax effort. In doing so, the average of tax collections for the three years was divided by population in respect of each ULB.

6.16 The exercise for the determination of the allocation of each individual local body, rural as well as urban, entailed the following :

- (a) The rural-urban distribution of the divisible pool, i.e., creation of separate divisible pools for the RLBs and ULBs respectively.
- (b) In respect of RLBs :
 - (i) the horizontal distribution of the divisible pool for RLBs as between different districts (except hill districts);
 - (ii) the vertical distribution of the district-wise allocations as between different tiers of RLBs, viz, ZP, APs and GPs ;
 - (iii) the horizontal distribution of the district AP and GP allocations as between individual APs and GPs.
- (c) In respect of ULBs, the horizontal distribution of the divisible pool for ULBs as between the individual municipal corporation, and municipal boards and town committees.

6.17 At the first instance, the Commission decided to apportion the divisible pool consisting of 3.5% of the aggregate tax revenues of the State, between the rural and urban local bodies on the basis of population as per 1991 census, excluding the hill areas.

6.18 After apportioning the divisible pool between the rural and urban local bodies, the devolution to each individual rural and urban local body was determined by following the procedure explained in para 6.16 above. In the case of RLBs, the rural divisible pool was allocated to all the districts, except the hill districts, on the basis of three indicators, viz, population, geographical area, and per capita Net District Domestic Product (NDDP). Since rural-urban bifurcation of NDDP was not available, the per capita NDDP from primary sector net of mining and quarrying for the year 2000-01 at constant (1993-94) prices has been taken as a proxy for district rural income. Although, it would have been desirable to include an infrastructural

index, suitable data on infrastructural facilities in rural areas across the districts were not available. The district-wise allocation of the rural divisible pool has been undertaken on the basis of a composite index derived by taking a weighted average of the following three criteria :

Rural population (1991 census)	50%
Rural area	25%
Per capita NDDP of primary sector net of mining and quarrying (distance method)	25%

6.19 After determination of the district-wise allocation for RLBs, these allocations have been vertically distributed as between the three tiers of the PRI, viz, ZP, APs and GPs in the ratio 10:30:60. The vertical distribution has been done after taking into account the duties and responsibilities of each tier.

6.20 In the final stage of devolution of revenues to RLBs, the shares allocated to APs and GPs in each district have been distributed to individual AP and GP respectively on the basis of population as per 1991 census.

6.21 In the case of ULBs, the urban divisible pool has been allocated horizontally among the GMC, municipal boards and town committees on the basis of a composite index of population, area, index of infrastructure, and per capita tax collection. The infrastructure index has been constructed by using three indicators, viz, length of surfaced roads, length of pucca drains and number of streetlights, giving equal weight to each indicator. The four criteria, along with their individual weights, used for the construction of the composite index for the horizontal distribution of the divisible pool among the individual ULBs are as follows:

Population (as per 1991 census)	50%
Area	25%
Infrastructure index	12.5%
Per capita tax collection	12.5%

6.22 The estimated annual devolution of tax revenues to each individual RLB and ULB may be seen in the statements at **Annexure VI-1 to VI-6**. The Commission stresses that the devolution of funds to local bodies should be made unconditionally without any linkage to the fulfilment of any terms and conditions by the State Government. The amount devolved from the divisible pool will be an additionality over and above other allocations that may be made to them under plan and non-plan.

6.23 As observed earlier, the present procedure of sanction and release of shared taxes is long and circuitous involving several departments of the Government. There is, however, sufficient scope to simplify procedures and to eliminate delays. In this connection, the procedure for release of the share of Central taxes and duties to the State Governments by the Government of India through the Union Finance Ministry is worth mentioning. The Commission suggests that the Finance Department of the State Government similarly sanction and release the amount due to the local bodies on the

basis of the recommendations of the SSFC. The Finance Department should also explore the possibility of opening personal ledger accounts for each individual RLB and ULB to facilitate prompt credit of the share of state taxes due to be transferred to them.

Grants-in-aid :

6.24 Over the years, the Central Finance Commissions have adopted the following approach in the matter of recommending grants-in-aid to the states:

- (i) to cover the assessed deficit on non plan revenue account, after devolution of taxes and duties;
- (ii) to upgrade standards of administration with a view to correcting disparities in the availability of administrative and social services between the developed and the less-developed states; and
- (iii) to meet expenditure on account of any special problem.

6.25 It would appear from the above guidelines, that one of the considerations for providing grants-in-aid is to cover the deficit on non-plan revenue account. However, as mentioned in Chapter-II, this Commission has chosen to eschew the gap filling approach due to the inadequacy of up-to-date and reliable data. As revenue gaps have not been estimated, the Commission has not recommended any grant for meeting revenue deficit.

6.26 RLBs have been receiving grants-in-aid from the State Government for the payment of salaries to the provincialised panchayat staff. While the Commission recommends that this grant-in-aid from the State Government to meet the salaries of provincialised panchayat employees continues, this should, however, be reduced in phases over time. The PRIs have been entrusted with considerable revenue raising powers and should be able to meet an increasing part of the salary expenditure from their own resources. We expect that the panchayat bodies will become financially stronger and fully functional by the next financial year. Therefore, as mentioned in Chapter-III, the grants-in-aid to panchayat bodies for payment of salaries should be reduced by 5% for the next two successive years i.e., 2004-05 and 2005-06.

6.27 In the case of ULBs, the Commission is of the opinion that the finances of GMC and other local bodies will be adversely affected by the recommendations to revoke the present arrangements for sharing of MV tax, entertainment tax, land revenue and local rates. The revenues of GMC have also been seriously affected by the State Government's decision to close GMC check gates and parking places as mentioned in Chapter-IV. The Commission recommends a grant-in-aid of Rs.10.00 crores annually, of which GMC will receive Rs.5.00 crores and the remaining Rs.5.00 crores should be allocated to other ULBs on the basis of their population as per 1991 census.

EFC Award-Rural Local Bodies :

6.28 The Eleventh Finance Commission (EFC) recommended grants-in-aid for panchayats for the period 2000-05 amounting to Rs.22514.65 lakhs for the general areas and Rs.830.10 lakhs for the Sixth Schedule areas. The year-wise break up is Rs.4502.93 lakhs for the general areas and Rs.166.02 lakhs for Sixth Schedule areas. Against the recommended amount, the grants-in-aid released so far by the Centre is reported to be Rs.7004.00 lakhs.

6.29 Out of the grants recommended by the EFC, a certain portion is earmarked for the maintenance of accounts and the creation of database by the PRIs. This amount would be the first charge on grants-in-aid recommended by them. After providing for the earmarked amount, the balance should be utilized for maintenance of core civic services.

6.30 The amount recommended for the maintenance of accounts by the panchayats is Rs.107.64 lakhs per year, at the flat rate of Rs.4000.00 for each panchayat body. This amount is to be provided only to those GPs and APs which do not have any trained accounts staff on their pay roll; no amount of grant has been recommended for ZPs. As the approved staffing pattern for APs and GPs does not provide for any post of accountant, the Commission recommends the distribution of the amount of Rs.107.64 lakhs equally at the rate of Rs.4000.00 for each AP and GP over the award period of EFC.

6.31 The amount recommended by the EFC for creation of database by the PRIs is Rs.216.50 lakhs per year. However, this amount is recommended for 2489 GPs, 202 APs, 21 ZPs and the 2 Autonomous District Councils constituted under the Sixth Schedule. The Commission recommends that this EFC grant be shared equally amongst all PRIs including the two Autonomous District Councils, the individual entitlement being Rs.7977.00 per annum. After setting aside the amount earmarked for the District Councils, the balance amount should be released to the RLBs. As regards the Autonomous District Councils, the Government of Assam may consider separately the release of the earmarked funds to these Councils.

6.32 The remaining EFC grant for RLBs, after adjusting the grants for the maintenance of accounts and creation of data base stands at Rs.4178.79 lakhs per year. This amount is to be distributed among the RLBs annually on the basis of the recommendations of the State Finance Commission. These grants recommended by the EFC for panchayats are meant for the purpose of maintenance of civic services in the rural areas which include provision of primary education, primary health, safe drinking water, street lighting, sanitation, drainage, scavenging, cremation and burial grounds, public conveniences and other common property resources. The grants-in-aid are untied subject to the condition that they are not to be utilized for the payment of salaries and wages. The intermediate and district level panchayats are not entitled to these grants, if they do not have any direct

responsibility in maintenance of civic services. The Commission recommends that the EFC grants of Rs.4178.79 lakhs for maintenance of civic services be distributed among the GPs, APs, and ZPs, annually on the basis of the formula for vertical and horizontal distribution already recommended by this Commission in respect of devolution of State taxes and duties to RLBs as stated in paras 6.18 to 6.20.

EFC Award- Urban Local Bodies :

6.33 The EFC recommended grants-in-aid to the ULBs for the five year period 2000-05 amounting to Rs.2154.20 lakhs, of which Rs.2063.30 lakhs is for general areas and Rs.90.90 lakhs is for Sixth Schedule areas. The year-wise break up is Rs.412.66 lakhs for the general areas and Rs.18.18 lakhs for the Sixth Schedule areas. Against the recommended amount, the grants-in-aid released by Government of India till date is reported to be Rs.435.00 lakhs.

6.34 Out of the above grants recommended by the EFC, a portion is earmarked for the maintenance of accounts and the creation of database by the ULBs. This amount would be the first charge on grants-in-aid recommended by them. After providing for the assigned amount, the balance should be utilized for maintenance of civic services.

6.35 In regard to ULBs, no fund is specifically earmarked for maintenance of accounts. However, if any urban local body does not have regular staff for accounts keeping, specific grants are to be provided to it for this purpose. The Commission recommends that grants-in-aid of Rs.4000.00 per year should be provided to those ULBs which do not have any regular accounts staff on their pay roll.

6.36 The amount recommended by the EFC for the creation of database by the ULBs is Rs.6.30 lakhs per year. The Commission recommends that this fund be distributed equally at a flat rate among the ULBs.

6.37 After making the required adjustments for the earmarked part of the EFC grant from the total grant of Rs.412.66 lakhs per year, the remaining amount is to be utilized by the ULBs for maintenance of civic services. The grants are untied subject to the condition that they are not to be utilized for the payment of salaries and wages. The Commission recommends that the non-earmarked portion of the EFC grants meant for the maintenance of civic services be distributed among the ULBs annually on the basis of the formula for horizontal distribution already recommended by this Commission in respect of devolution of State taxes and duties to ULBs as stated in para 6.21.