



STUDY ON OWN REVENUES OF URBAN LOCAL BODIES IN TAMIL NADU

Draft Inception Report
June, 2016

*This report has been prepared by the Centre for Development Finance, IFMR LEAD, Chennai for the Fifth State Finance Commission, Government of Tamil Nadu



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1. Introduction

The Fourteenth Central Finance Commission, Government of India, while noting the paucity of resources for the delivery of basic services entrusted with urban local bodies (ULB) also underscores the untapped potential of own sources of revenues among ULBs. From a reform as well as administration standpoint, Property tax continues to be the predominant source of revenue for most ULBs, while other sources of Own Revenues are comparatively underexploited by ULBs.

Professional tax is widely recognized as the major sources of own revenues for municipalities in Tamil Nadu. Currently professional tax income is 14.34 % of the own income in municipal corporations¹. According to Government of Tamil Nadu's Fourth SFC report, there is 'untapped potential in respect of traders, self-employed, private employers and employees'. The report also highlighted that there is a need in increased collaboration of ULBs with income tax department, labour department, commercial tax department etc. to increase overall assesses in the state, along with rate revisions for increased revenues. Land-based fiscal instruments are identified as an important tax measure for augmenting municipal finances. However, in the aspect of vacant land taxes, both the SFC and CFC highlighted lack of systemic approach of listing vacant lands and that vacant land tax is demanded only when owners approach authorities for approval of building plans

User Charges are one of the major sources of non-tax revenues for municipalities. The provision of public utility services such as water, sewerage, parks, parking etc. entails a cost which needs to be recovered essentially by the municipalities especially since these are major urban infrastructure investments and need regular maintenance. Over the years, collection of user charges have increased, yet there is disconnect between the user charges levied and the level of service provided by ULBs². Both the SFC and Fourteenth CFC in the past have recommended that service charges should at least recover operation and maintenance costs from the beneficiaries. However, public finance literature in India suggest that these own revenue sources are not exploited to their maximum potential and often are inadequate to recover even their servicing costs. Most ULBs fail to use measures to augment the own revenue sources due to 'the single-tax dominated system (i.e. property tax)' and 'low or near zero productivity of many municipal taxes'³ keeping the size of municipal tax and non-tax system small.

With this background, the recently constituted Fifth State Finance Commission, Government of Tamil Nadu, entered into an understanding with CDF - IFMR LEAD to undertake an analytical study on Own Revenues of ULBs in Tamil Nadu. For purposes of the research, we will be reviewing all Own Revenue items (see Annexure 1 Table 2) other than Property Tax.

Based on our discussions with the SFC and the Memorandum of Understanding signed between the Fifth SFC, GoTN and CDF-IFMR LEAD, we understand the scope of our work to have the following objectives:

¹ Same as above

² Fourth State Finance Commission Report, Government of Tamil Nadu, October 2013

³ Same as above

- Review the financial position and performance of each category of ULBs⁴ in Tamil Nadu relating to Own Revenues (taxes other than property taxes and non-tax income sources, excluding grants, loans and devolution)
- Provide recommendations on the untapped potential of Own Revenues and possible mechanisms for maximizing these financial sources

2. Methodology

The methodology has been devised on the basis of discussions with the SFC and information provided by the SFC on income data gathered from ULBs. The Own Revenues will be analyzed for each Municipal Corporation and by category and grade⁵ for the Municipalities and Town Panchayats. Data will be analyzed at median levels for each category and grade of ULB, with specific attention paid to the level of variation or dispersion⁶ of revenues within each of these ULB categories. The assessment will involve the following steps:

1. Review of the financial position and performance of each group of ULB (Town Panchayats, Municipalities, Municipal Corporations) as of 31/3/2015 on specific components of Own Revenues (revenue items identified within our scope):
 - Analyse the following components of Own Revenues:
 - professional tax
 - vacant land tax
 - advertisement tax
 - other tax revenues
 - water supply user charges
 - sewerage user charges
 - other non-tax revenues (includes only Own Revenues)
 - All above components would be analysed at the absolute and per capita levels
 - Growth trend analysis will be carried out with the data provided by the SFC for the periods 2010-11 to 2014-15 for each category of ULB taking the median value for each category
 - Analysis of collection efficiencies (ratio of collection against demand), coverage ratios and cost recovery ratios (where available)
 - Analysis of composition of above Own Revenue items (Tax & Non-tax) and their proportion to Total Own Revenues and Total Revenues

⁴ Municipal Corporation, Municipalities, Town Panchayats

⁵ Based on their Own Revenues and Population, Municipalities and Town Panchayats are classified into different grades. Municipalities into five grades – Special Grade, Selection Grade, First Grade, Second Grade and Third Grade; Town Panchayats into four grades – Special Grade, Selection Grade, Grade I and Grade II

⁶ Assessed through standard deviation, which is a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Very high values of standard deviation for a majority of the revenue items indicates that revenues are quite spread apart among the ULB categories

2. Projections for award period for 2016-17 to 2020-21 - Calculate growth rates (5 yearly and annual) for each of the ULB on all the above financial indicators and use the mean growth rate of each ULB for the entire period in a particular category to derive an average growth rate for that category. This average will be used to derive projections for the period.
3. Based on broad literature review and review of best practices on municipal finance reforms across the country, identify select non-financial indicators impacting performance of identified Own Revenue items, such as use of GIS mapping to improve tax coverage, e-Governance systems to improve assessment quality, periodicity in the review and revision of user charges and tax ceilings (in conformance to policy guidelines), periodicity in the review and upgradation of property listing, especially for the purpose of Vacant Land tax, types of exemptions allowed on other Own Revenue sources, types of user base that are captured within major Own Revenue items (and potential for revising the same to include newer user categories)
4. Both the financial and non-financial indicators of performance will be reviewed in the context of functions transferred to ULBs by the state government and the corresponding taxation powers assigned and actually levied within the different categories of ULBs. Annexure 1 has a compilation of functions transferred and taxation powers based on the Municipal Act of the Government of Tamil Nadu (to be validated by the Fifth SFC).
5. For financial analysis in the per capita terms, population from Census 2011 and population estimates for 2015 provided by SFC will be used to compute population estimates for each year (both assessment and projection period) on the basis of compound growth rate method of population projection
6. For time series analysis, we would use deflators to express the financial variables at constant prices

To analyze the Own Revenues of ULBs, we will rely on financial data⁷ and non-financial data⁸ gathered by the Fifth SFC. We also hope that discussions with key officials at the Fifth SFC, Municipal Corporations, Commissionerate of Municipal Administration, Directorate of Town Panchayats, and Local Fund Audit will help substantiate secondary research and clarify any data gaps critical to our assessment.

⁷ Demand and collection data from audited ULB financial statements on Own Revenue items such as Professional Tax, Vacant Land Tax, Entertainment Tax, Advertisement Tax, and Fees and User Charges

⁸ Tax rates, Periodicity of levy, Tax base, Exemptions allowed, etc.

3. Outline of Report

There would be three reports, one each on the municipal corporations, municipalities and town panchayats. The outline of each report would be the following:

1) Chapter 1: Introduction

This chapter will provide a background and context to the study and will detail out the methodology and data collection processed followed for carrying out the analysis of ULB non-tax revenues.

2) Chapter 2: Findings on Own Revenues of ULBs in Tamil Nadu: A Cross Section Study

This chapter analyses the financial variables for the most recent year 2014-15. This will include a review of the financial position and performance of each group of ULB (Town Panchayats, Municipalities, Municipal Corporations) as of 31/3/2015 on specific components of Own Revenues (as identified within our scope). Primarily the findings and chapter output will correspond to point 1 under the methodology section above

3) Chapter 3: Findings on Own Revenues of ULBs in Tamil Nadu: A Time Series Analysis

This chapter will present study findings and analysis primarily around growth trends of major non-tax and user charge items during the review period of the SFC (2010-11 to 2014-15). The chapter output will also include financial projections for the award period of the SFC (2016-17 to 2020-21). The projections will be computed on the basis of growth trends during the review period and if data is available, will also take into consideration growth trends during the 4th SFC period. This mainly corresponds to point 2 under the methodology section above

4) Chapter 4: Assessment of non-financial indicators of Own Revenue items

This chapter will present our findings from best practices in the levy of non-tax revenues and user charges by ULBs across the country. Based on public finance literature review, qualitative indicators corresponding to optimal own revenues will be identified. Based on data shared and discussions with select ULB departments, this chapter output will outline our findings corresponding to these indicators among ULBs in Tamil Nadu ULBs. This output will correspond to point 4 under methodology section above

5) Chapter 5: Concluding Remarks

Based on our findings and analysis, this chapter output will include a summary conclusions and indicative recommendations on the Own Revenue sources of ULBs for the award period of the SFC

4. Key Personnel, Timeline and Deliverables

The project commenced in June 2016. The following personnel have been constituted for executing the project:

SI No	Name of the staff	Role in project	Official Designation
1	Sujatha Srinivasan	Project Lead	Senior Research Manager, IFMR LEAD
2	Ramya Teerpathi	Senior Researcher	Senior Researcher, IFMR LEAD
3	Ankur Gautam	Researcher	Researcher, IFMR LEAD
4	Dr. K Shanmugam	Advisor	Professor, IFMR

The major project outputs would be the working papers/reports encompassing the scope outlined above and a related presentation for dissemination and use by the Fifth SFC, GoTN. It is understood that the required time of completion of the study is 3 months. The initial datasets for the study were received on June 20, 2016. We will ensure that CDF would put its best efforts to complete the report within 3 months of receiving the datasets. Any data changes and related delays in obtaining the final data will likely have implications on project completion within the stipulated duration. We would place a request for extension if and when needed at a future date.

We anticipate submission of deliverables based on the schedule below:

Timeline	Deliverable	Remarks
20/6/2016		Initial datasets received
2 weeks from receipt of initial dataset (4/7/2016)	Inception Report	First draft submitted on 30/6/2016. Draft revision submitted on 14/7/2016
10 weeks from receipt of initial dataset (31/8/2016)	Primary Research Report	
12 weeks from receipt of initial dataset (14/9/2016)	Submission of Draft Final Report	
30/9/2016	Submission of Final Report	

30/8/2016

Annexure 1: Functions Transferred to ULBs and Taxation Powers

Table 1: Functions Transferred to the Municipalities by way of Rules/Notifications/Orders of the State Government

Core Functions
Roads and bridges
Water supply for domestic, industrial and commercial purposes
Public health, sanitation conservancy and solid waste management
Burials and burial grounds, cremation grounds and electric crematoriums
Public amenities including street lighting, parking lots, bus stops and public conveniences
Welfare Functions
Slum improvement and upgradation
Provision of urban amenities and facilities such as parks, gardens and playgrounds
Cattle pounds and prevention of cruelty to animals
Urban Development Functions
Urban planning, including town planning
Regulation of land use and construction of buildings
Planning for economic and social development
Vital statistics including registration of births and deaths
Regulation of slaughter houses and tanneries

Source: Municipal Acts, Government of Tamil Nadu

Study on Own Revenues of ULBs in Tamil Nadu for Fifth SFC: Inception Report

Table 2: Taxation Powers Assigned and Actually Levied in Municipalities

	Heads of Revenues: Tax/Non tax/Fees/User charges
1	Property tax
	a. Tax for general purposes
	b. Water supply and Drainage Tax
	c. Education Tax
2	Vacant Land Tax
3	Profession tax
4	Pilgrim Tax
5	Tax on Carriages & Animals
6	Tax on Carts
7	Advertisement tax
8	Entertainment tax
9	Timber tax
10	Dangerous and Offensive Trade License Fees
11	Licence fee under Fee of Act
12	Building Licence Fee
13	Encroachment Fee
14	Lamp/Advertisement Fee
15	Bus Stand Fees
16	Cart Stand Fees/Taxi Stand Fees
17	Survey fees
18	Cinema Theatre Fees
19	Development charges
20	Fisheries Rental
21	Fairs & Festivals
22	Tourist Bus Fees
23	Rent from Travellers Bungalow & Rest Houses
24	Road Cutting Restoration Charges
25	Demolition charges for unauthorized construction & building service charges
26	Other income
27	Cost of Tender Schedule, printed forms sold at SEVAI MAIYAM
28	Magisterial fines
29	Natural Calamities Grant
30	Birth/Death Registration fees
31	Penalties & Bank charges for Dishonored cheque
32	Law charges & Court cost recoveries
33	Hire charges

	Heads of Revenues: Tax/Non tax/Fees/User charges
34	Sale of Compost manure
35	Sale of scraps
36	Receipt from Hospitals and dispensaries
37	Lands & Buildings (Entry fees)
38	Income from road margin
39	Septic tank cleaning charges
40	Library Cess
41	Ferry Services
42	Fines & Penalty
43	Cable TV (Track rent including OFC)
44	Markets
45	Shops
46	Slaughter house fees
47	Kalyanamandapam
48	Lodge/Rest Houses
49	Pay & Use Latrines
50	Avenue Trees
51	Insurance claim amount
52	Quarters rent
53	Water Charges
	(i) Excess Water Charges
	(ii) Tap rate Charges
	(iii) Other water income (through lorries)
54	Sewerage/Sanitation (connection charges)
55	Sewerage forms
56	Sale of rubbish/compost/Garbage
57	Burial ground/Burning ghat/Electrical Crematorium/Gasifier Crematorium
58	Silt clearance
59	Leasing of lands
60	Miscellaneous recoveries
61	Interest from Bank
62	Dividend on shares
63	Rents on lands and buildings