

## **CHAPTER- IV**

### **ALTERNATIVES TO OCTROI**

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## **CHAPTER 4**

### **ALTERNATIVES TO OCTROI**

#### **4.1 ALTERNATIVES TO OCTROI:**

As the alternatives are not clear, the octroi removal is being delayed in some states. For the academic economists the debate is inconclusive and still needs to be explained in the fiscal self-sufficiency of local self-governments and resource mobilization. More particularly with the experiment of decentralization, evaluation not only octroi but also every other local tax needs a new look. The finances of urban local bodies are dependent on this source of tax revenue and alternative suggested to octroi, has to be on revenue, yielding as octroi. In case this does not happen the revenues of the urban local bodies are hampered and this has an adverse impact on the spending capacity of this layer of government.

Octroi was the major source of revenue to the urban local bodies in Karnataka prior to its abolition in 1979. Revenue yield from Octroi to the urban local bodies at the time of its abolition was about Rs. 24 crores and the rate of growth of this revenue was about 14.8 percent. To make good the loss consequent on the abolition of Octroi, the government of Karnataka accepted the following alternative-:

- 1) Surcharge of 10% on sales tax.
- 2) Levy of entry tax at the rate of 2% on certain items like textiles, sugar and tobacco on which sales tax is not leviable.
- 3) Levy of 10% surcharge on motor vehicles tax.

The revenue expected from these alternatives was about Rs. 12 crores from surcharge on sales tax. Rs 7% crores from entry tax and Rs. 4 to 5 crores from surcharge on Motor vehicles tax. Loss of Rs.24 crores consequent on the abolition of Octroi was expected to be made good this way. It was also decided that the revenues raised through these resources would go to the states consolidated fund out of which urban local bodies would be paid Octroi compensation grant., of the three sources accepted as alternatives to Octroi, only the surcharge on motor

vehicles tax has not been levied, even though it is the transport section which has benefited most from Octroi abolition, with effect from 1979, a surcharge on sales tax at 10% was introduced and the Karnataka tax on entry to good into local areas for consumption use or sale there in Act 1979 was passed which enabled the government to levy entry on which enabled the government to levy entry tax ranging from 1 to 2% on textiles, tobacco and sugar on which sales tax is not leviable. Though the Act, enabled the government to levy entry tax from 1<sup>st</sup> June 1979, the actual enforcement of the act had to be postponed to 1<sup>st</sup> oct 1980 because of litigation.

Both of in respect of surcharge on sales tax and the entry tax certain changes have been brought about over the years. In addition to surcharge of surcharge 10% on sales tax the state government started levying rural development cess of 10% on sales tax from April 1984, from 1985, merging surcharge and rural development cess, a new levy called development cess of 30 % of sales tax was levied, which has been subsequently merged with the basic sales tax. By merging the surcharge with the basic sales tax, the government is no doubt getting additional revenue, but surcharge which was levied as an alternative to Octroi has lost its separate identity.

Entry tax that is another alternatives to Octroi has also undergone change since its enforcement it 1980. The initially proposed rate of 2% was reduced to 1% when the entry tax was levied for the first time. Further, with a view to raising more revenue to be transferred to urban local bodies, the number of items on which entry tax is leviable on 16 items at the rate of 1 to 2 % and from April 1983 to oct 1984. It was leviable on ten categories of goods at the rate of 1 to 2 % and oct 1984, it is leviable on eight categories of good at 2%. The Karnataka Taxation Review Committee 1981 had recommended both enlarging the list of commodities subject of entry tax and raising the rates of tax and the implementation of the same has considerably widened the scope of the entry tax.

The originally proposed tax supplements such as surcharge on sales tax, entry tax and surcharge on motor vehicles tax were quite

appropriate. Though such tax supplements have some drawbacks, they are undoubtedly better than other possible alternatives like tax sharing and independent sources for urban local bodies. Tax sharing may not ensure adequate flow of funds to urban local bodies and the problem would be similar to that the relationship between the center and state. The problem with regard to any independent sources of revenue to the urban local bodies apart a part from those which are already there, is that they would overlap with the taxes levied either by the union government or the state government and that would go against the Indian system of non overlapping tax assignment.<sup>1</sup>

Government has already abolished Octroi in municipal councils in the year 1999. However; much more substantial since their projected net revenue from Octroi during 2005-06 was Rs.4962 corers.

Since municipal finances depend heavily on Octroi income, it will not be possible for them to discharge their responsibilities unless they are given an equally potent alternative revenue source or are compensated in perpetuity the state budget. The latter is not possible due to state's own developmental commitments and the heavy debt burden.

One merit in Octroi tax is that its incidence falls largely on the residents of the very city. Any alternatives to Octroi should, therefore, ideally be such that its burden falls on the residents of that city alone.

#### **4.2 CHARACTERISTICS OF ALTERNATIVES TO OCTROI:**

The alternatives to Octroi should have the following characteristics:-

- 1) It should not have the same defect as Octroi.
- 2) The local revenue potential should not be changed.
- 3) The administration should be easy.
- 4) Financial autonomy of municipal bodies should not be weakened.

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<sup>1</sup> Dr.Sreekantaradhy.B.S (1988)v-'Octroi :Is there ,A case for its Reintroduction in Karnataka', Semina Paper, Shivaji University, Kolhapur

## **A) Suggested Alternatives-:**

Alternatives suggested to Octroi levy by different study groups and committees are as follow.

- 1) Entry tax 2) Multipoint Turnover tax 3) Municipal sales tax 4) Surcharge on sales tax 5) Compensatory levies 6) Compensatory Grants 7) other available alternatives.

### **1) Entry Tax-:**

The government of Maharashtra has introduced a turnover tax as its revenue source last year and trade and industry is not at all that happy about it. It creates the same difficulties as Octroi both to administration and the traders. In addition to it, having cascading result as it would be a multipoint levy.

### **2) Municipal Sales Tax-:**

Municipal sales tax on results will create the same difficulties as Octroi both to administration and the traders to keep two a/c 1) Municipal sale and 2) Outside Municipal sale bodies at the cost of smaller ones. Further sales tax base cannot be as wide as Octroi. Because it cannot include the declared goods and those that are subject to central sales tax levy. The bodies will create problems of accounting and administration and leave room for complaints.

### **3) Compensatory Levies-:**

Compensatory levies either by municipalities or state government will increase inquiry in other sectors and the yields cannot proportionately rise.

### **4) State Grants-“**

A state grant in lieu of Octroi through alternative has to be made good by the state in save other head and municipal bodies will face problem of liquidity manoeuvrability etc.

### **5) Other available value alternative-:**

The other available value alternatives to Octroi are as follow.

- 1) The introduction of user's fees and development charges are worth- introducing. These may also help to increase vertical enquiry

- 2) Entertainment tax can also be made substantial revenue to local bodies. If the power of levying it is transferred from state government to the local bodies.
- 3) At present motor vehicle registration tax is being collected and appropriated by the state government by the state government and very small portion being distributed among the urban local bodies. There is a strong case for giving larger proceeds of this tax to local bodies.
- 4) Restructuring the rate of property tax could also raise sizeable revenue. Property tax is elastic in character, progressive in nature and has favorable income distribution effects.

To sum up, Octroi should no doubt be abolished. But, it could better be eliminated by rationalizing some of the existing taxes under the authority of civic bodies.<sup>2</sup>

Municipal commissions have given some thought to alternatives levies consequent on the abolition of Octroi. But, some of them are not very much convinced of their success. Alternative levy is nothing not substituting Octroi with some other tax which has not its drawbacks,. But has all its merits. The tax substitution process can be concerned in two different ways -:

**1) Tax substitution at state level.**

**2) Tax substitution at local level.**

State level substitution conceptually, cannot be considered as a substitution, unless by some legal reasoning. We may treat this as a case of tax transfer. The state government may in lieu of Octroi, levy any other tax of similar characteristic, or increase of rate of an existing tax. A new levies or rate revision by the state has their own repercussion. To the extent that the alternatives levy can mobilize

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<sup>2</sup> Prof.Mahamuni V.V (1988)-'Alternatives to Octroi' National Seminar,Shivaji University, Kolhapur

funds equal to the grant compensation. We may say that the decision has been followed up well.<sup>3</sup>

#### **4.3 PROPERTY TAX AS AN ALTERNATIVE TO OCTROI:**

- 1) While the various alternatives were being disused, at one stage a view was presented that reformed in the taxes being currently levied by the urban local bodies. Notably property tax. Should not be accounted as a substitute for Octroi. The additional revenue arising from property tax is the own revenue of urban local bodies and should continue to remain so. The alternatives for Octroi should be from amongst altogether new resources.
- 2) The fallacy of this view is only apparent. The substitute resources will have to be collected from the same set of local citizens. The cumulative revenue that is collected today from Octroi and property tax may perhaps have to be collected under a single head. This may well lead to redistribution of tax burden to an extent. However, the quantum of burden will not change and the redistribution of tax burden will be only amongst the citizens of the same urban local bodies.
- 3) The Group deliberated if the reform of property taxes has the potential to yield additional revenue which equals or exceeds 50% of the octroi revenue some member of the group, who are municipal commissioners are confident that property taxes are grossly underrated and loss of octroi revenue. In fact, can be compensated in full through property tax reform alone.
- 4) It was also noted that octroi as a tax in the BMC was introduced in 1965. Prior to that only "town duty" was being levied on a very few items, at that time yield from property tax was the mainstay of municipal tax revenue for municipal. e.g. in 1964. Total revenue of BMC was Rs.23.64 corer, out of which Rs.18.59 corer were from property tax while Rs.1.54 corers only were from "town duty". Property taxes accounted for only 6.53%.

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<sup>3</sup> Dr.Rao.N.R (1988)- A Historical and Constitutional Exposition of Octroi the Problem' National Seminar, Shivaji University , Kolhapur

- 5) It would be instructive to examine the data from Mumbai regarding property tax with a view to guess timating the likely rate at which property tax may have to be collected for the 50% abolition to octroi. In the year 2001-02 for which data is available is respect of all properties excluding special class of properties (e.g. storage tanks of oil and dairy companies, salt pan lands etc. and slum properties), total area of built up properties was 12.06 corer square meters of this the area of residential properties was 3.86 corer square meters. On the basis of the ready reckoned employed for stamp duty for 2001-02, corresponding capital values of these properties were rs.2, 71,551 corer and Rs. 2,19,845 corer respectively aggregating to Rs. 4,91,936 corer. It will be reasonable to assume a 20% appreciation in property values as per ready reckoned (The increase may be much more in actual terms in the markets).
- 6) There are a few corporation areas where the property tax collection are extremely low and no reasonable increase in the rates of property tax will be able to yield the revenue required for abolition of 50% octroi. It is clear that corporations will have to revise their user charges. While the potential for uses charges is not significantly large in Mumbai and Pune, it is substantial in all other corporation areas. It would therefore, be necessary to institutionalize the levy and recovered of sustainable user charges. Since ready recovers are issued every year, capital values of properties can be revised every two to three year to secure proper buoyancy in property tax collections.

A comprehensive reform of property taxes will certainly yield considerable revenue with strong potential for growth. The group felt that the additional revenue accruing from reform of property tax should be one of the components of the compensation for octroi, especially if increase of property tax incidence accompanies the corresponding reduction abolition in octroi.



#### **4.4 ALTERNATIVES TO OCTROI: PROPOSAL OF CESS:**

##### **1) What is cess -:**

Cess means a cess on the entry of the goods into the limits of the city for consumption, use or sale therein. Cess is nothing but octroi under different nomenclature cess; like octroi is an entry tax in nature i.e. it is leviable on entry of goods into the area of this corporation for the purpose of consumption, use or sale therein.

##### **2) How is it different from Octroi-:**

In the new system there are no check posts i.e. "Nakas" for collection of tax and, therefore, it involves no stoppage of vehicles. A 'Dealer' liable to pay cess, on the basis of his exceeding the prescribed limit of the turnover either of all his sales or all purchases affected during a financial year is required to get himself registered with corporation.

##### **3) Who is liable to pay cess under the cess system-:**

The Bombay Provincial Municipal Corporation Rules 1996, liability to pay cess has been cast upon a 'dealer'. The term dealer has been defined under clause (16 A) of section 2 of the Act. 'Dealer' means any person who whether for commission remuneration or otherwise imports, Buyers or sells any goods in the city for purpose of his business and includes factor, Broker commission Agent, Auctioneer, central government, state government, society club.

##### **4) Rate of Cess-:**

The cess is require be paid on all goods specified in schedule 'A'.

The current rates of cess for financial year 2006-2007 are as under-:

- 1) Agriculture produce a) 0.2% ad.valorem
- 2) Wines spirit and beer b) 2.0% ad.valorem
- 3) All other taxable goods c) 1.0% ad. Valorem

##### **5) Advantages for cess payers-:**

- 1) Get in touch with the cess authorities and get yours if registered with the corporation if you are liable to pay cess.
- 2) Maintain proper books of accounts.

- 3) If you are a registered dealer, submit your return within the prescribed time and also pay the proper amount of cess due while submitting the returns.
- 4) If you are purchasing goods from local dealers i.e those with the area of the NMMC, make sure that they are holding cess registration in order to avoid cess liability in respect of such purchases.
- 5) Get yourself assessed by the concerned cess authority at the Earliest and thereby get yourself relieved of the worry of any additional liability towards cess, interest and penalty at later date.

**6) Disadvantage for cess payers-;**

- 1) Delay cess registration and invite penal provision.
- 2) Delay your cess payment and incur additional burden of penal interest a) 24% and b) 36% per annum as also that of penalty.
- 3) Knowingly furnish false returns or produce false accounts or issue or produce false bills, cash memos, declarations certificates or willfully attempt in any manner to evade cess or to fail without sufficient cause to furnish any return any information and commit offence punishable with an imprisonment for a term which may extend to two years and with fine.
- 4) Address your appeals to the municipal commissioner as appellate powers are vested with civil courts, seek waiver of interest or penalty, as the commissioner is not empowered to do so.
- 5) Compel the taxman to knock at your door.<sup>4</sup>

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<sup>4</sup> Department of Cess (2008)-'Information Brochure' Published by Kolhapur Municipal Corporation

## **4.5 CONCLUSIONS:**

Comparison between cess and octroi is difficult to make and at best only superficial in nature. One thing is certain; both aim at entry of goods into local area for local purposes. Cash and day-to-day receipts dominate Octroi collections but cess collections on the other hand tend to be non-cash and bunchy type of collection.

Replacement of octroi with cess could be a possible solution, as cess would contribute to the tune of 80% of the octroi revenue. This implementation could be carried out in two phases, starting with the metros, and class one cities in the first phase and slowly across the remaining cities in the second phase.

After drafting its feet over abolition of Octroi in major cities governed by municipal corporations, the states governments had decided to get rid of the duty in 15 smaller cities. Hower, the catch in the decision is that these entire 15 municipal corporations belong to the 'D' category. They went to avoid the problem of state traders and so they decided about sub tax system to give relief to the traders of the state.

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