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GST - An Opportunity to Abolish Octroi in Maharashtra (India)

Arvind Kumar Ph.D Scholar, Indian Institute of Foreign Trade

KEYWORDS

Introduction: An Overview
Every municipal authority has to perform a lot of statutory and social functions. In order to maintain its jurisdiction area it levies fee, tax etc. One such levy is Octroi. This denotes a charge or levy on the entry of some goods into a particular municipal limit or any other jurisdiction as specified by law, for its use or consumption or for sale purpose.

Even though the benevolent motive behind levy of Octroi remains the development of that area, however this is seen by trade/Industry as an hindrance to trade, leading to undue delay and avoidable menace. Octroi is an irritant tax. It interrupts the free flow of goods. It prevents integration and unification of market economy This ultimately becomes a cost of business, raising the transaction cost. There is the general perception that such a taxation breeds grounds for corruption. A lot of traders, transporters and public at large have protested against this menace but not much have been achieved. **Shortcomings of Octroi:** The octroi *nakas* (check post) for physical verification of vehicles entering municipal limits cost the trade and commerce in terms of fuel and time at the same time imposes a barrier on free flow of goods. Octroi levy makes any goods entering the municipal limits costlier. It sticks to the cost, thereby leading to cascading effect (tax on tax). For instance goods originating from other States (or from non-municipal/rural area) entering municipal area will bear the Octroi levy, thus making the goods expensive by that much amount. The octroi system has often been termed to be "distorting" "obnoxious" and "wasteful" (adofbusiness.com).

Octroi has a long history. During Roman era it was known as "vectigalia" (Thomas Ingram, 1911). These 'vectigalia' were either a tax on the entry of goods or were on departure to the provinces. Later, during the 12^{th} - 13th centuries, when the towns started getting their independence, they also asserted their right to establish and levy local taxes. From the 14^{th} century onwards, the French towns were granted the right to tax their jurisdiction. Later in 1647 by way of an ordinance of Cardinal Mazarin ordered the proceeds of the octroi to be paid into the public treasury, and at on other occasions the government claimed a certain percentage of the value of product. However this practice was abandoned in 1852. As on date globally, it is levied only in Ethiopia and in one state of India i.e State of Maharashtra. The legal premise of levy of Octroi in India emanates from the Constitution of India (1950) wherein State list (Seventh Schedule) of Article 246 lays down - "*Taxes on the entry of goods into a local area for consumption use or sale therein*." Based on this proviso many States started leving Octroi. Octroi has its inherent shortcomings. Almost all the Commissions, that studied the issue of local finances, unanimously recommended abolition of Octroi (M Govind Rao 1984). It has been argued (Behl et.al 1975) that Octroi can provide disincentive for metropolitan integration because consolidation of fragmented local authorities would automatically reduce the octroi tax base by de-taxing intra metropolitan commodity flows. From the standpoint of efficiency, the octroi is therefore an unmitigated disaster (P.227).

States soon realized that Octroi is regressive to trade and commerce and thus began phasing it out. As on date, octroi exists only in the state of Maharashtra. The demand for abolition of Octroi in Maharashtra, one of the most progressive state, has been growing with every passing day. More so when adoption of Goods and Services (GST) in India now seems reality and so many indirect taxes being subsumed into it is only logical to demand abolition of Octroi and subsuming it into GST.

The resistance by Maharashtra Government towards abolishing Octroi is mainly on account of its revenue implications. Octroi yields high revenue to the tune of about Rs. 15000 crore. This revenue source is the back bone of developmental activities in the concerned municipal areas. In absence of this revenue source it will be difficult for the municipal authorities to discharge their responsibilities unless they are given an alternative revenue source or are suitably compensated by the Government. Historically, these local bodies have been maintain its area with the funds raised by these local levy. Octroi, as a tax in the Bombay Municipal Corporation (BMC) came into practice since 1965. Prior to that 'town duty' was being levied to garner funds for local bodies. This was levied only on a very few items. At that time revenue from property tax was the major source of municipal tax revenue for Mumbai. For instance, in 1964, total revenue of BMC was Rs.23.64 Crore, out of which Rs. 18.59 Crore were from property tax while Rs. 1.54 Crore only were from 'town duty'. Property taxes accounted for 78.61% of total municipal revenue while town duty accounted for only 6.53%[1]. After 1965 Octroi became important tool of local tax revenue. In 2015-16, Bombay Municipal corporation (BMC), with budget of Rs 33,700 crore, collected Rs 6276 crore from Octroi alone[2]. Most of this money is spent on various developmental projects in Greater Mumbai. The remaining municipal corporations of Maharashtra together collects around Rs. 7000 crore. As per Mumbai City Development Plan 2005-2025[3], Octroi revenue would contribute 60% of the development projects in Mumbai area. Hence Octroi remains a major source of revenue for local development. Besides Mumbai Octroi is levied in 22 more municipal areas of Maharashtra.

Octroi abolished from other Indian States:
It is a fact that not all states could collect as much revenue from Octroi as did Maharashtra, yet considering the undesirable effects of Octroi on trade and commerce the States gradually abolished Octroi. Though some states did put in place some alternate revenue source, others simply preferred to do away with it. Tamil Nadu in order to compensate its losses resulting from abolition of Octroi, introduced an entry tax of 2% and an additional Land and Building Tax. Kerala began levying Land and Building Tax to compensate for losses. Punjab simply abolished Octroi without imposing any additional source of levy. In Rajasthan, the Octroi was levied under section 65(b) of the Rajasthan Panchayati Raj Act, 1994. They finally abolished it in August 1998. The government in order to compensate the local bodies, levied surcharge on the sales tax. The municipal corporations of Chennai and Trivandrum while abolishing Octroi enhanced Entertainment tax and Property tax. In Kolkata, Octroi loss was compensated by trans-

ferring the entire state Entertainment Tax to the local bodies apart from 16% of Sales Tax and the Development Grant. Besides, the municipal corporations were given power to issue trade licenses and levy higher toll tax on heavy vehicles. Gujarat phased out Octroi in November 2007 and as per the suggestions given by the state finance commission, village panchayats were given a grant equivalent to the average of the past three years octroi revenue along with an annual increase of 7%.

Hence it is only logical that local bodies of Maharashtra will need alternate source of local revenue or appropriate compensation. In the next section we analyse the possibility of alternate revenue source for Maharashtra in lieu to abolition of Octroi.

The Maharashtra Case : Options for abolition of Octroi

On wide scale public demand Government of Maharashtra constituted a study group to suggest set of proposals for the phased removal of octroi. The committee submitted its report titled "Report of the Study group for Devising Alternatives to Octroi" on 20th May, 2006. It recommended a scheme to levy alternate taxes to offset losses incurred by abolition of Octroi and addressed the possibility of raising equivalent revenue from various other sources like:

Property tax
Profession tax
Additional VAT
Increase in stamp duty

The Maharashtra government has not been able to implement these recommendations due to inherent problems in these measures.

It must be appreciated that **Property tax rates** are regularly revised to levy the optimum tax on public. Any extra burden may have negative impact. The All India average of property tax collection is Rs. 486 per capita. When we look at property tax values for the municipalities of Mumbai and Pune which are already way ahead of the national average with a per capita property tax of Rs. 1134.0 and Rs. 811 per capita. If the rates are raised higher in these municipalities it would burden the common man and may induce tax evasion.

Similarly **Stamp Duty rise** may slow down the transaction in the real estate sector. There could be chances that people may get their property registered in other states where the rate is cheaper. As per Indian Stamp Act, a person can get any property registered in a State where he owns any piece of property[4]. Hence a person from Bihar or Bengal staying in Mumbai may prefer to register Mumbai property at Bihar or West Bengal if Maharashtra Stamp duty is very high.

VAT or putting additional VAT will lead to trade diversion. At present Maharashtra levies 12.5% uniform VAT rate. If it is raised by 2-3%, people will prefer to buy goods from neighbouring States resulting in loss of VAT revenue to States. Hence it is not advisable to raise VAT rates in order to maintain uniformity and avoid trde diversion.

We are then left with option of **Profession Tax**. While above three taxes required amendment in State Acts any change in Profession tax would need Constitutional Amendment. We will discuss this option in next section.

There has been stray suggestions by academics, scholars or trade bodies. As per *adofbusiness.com* an online business portal - apart from above options following alternate measures can be resorted to in lieu of Octroi in Maharashtra:

Imposition of Entry Tax

- Levy of Cess
- Revision in User Charges
- Issuance of Municipal Bonds
- Creation of a Municipal Development Fund
- Tax on Vacant Land
- Imposition of Pollution Tax
- Roof top tax as in Nepal

These suggestions appears to be more like wishful thinking and lacks logic, legal and practical premise to implement them. The Entry tax has ben struck down by Supreme court whenever it is imposed by States.

The Supreme Court in *Atiabari Tea Company Limited*[5] had come to the conclusion that "..the freedom provided by Article 301 of the Constitution is related only to the movement part of the trade….. Thus the Entry Tax cannot be levied at all where the goods meant for being sold, used or consumed come to rest after the movement of the goods ceases in the 'local area'…"

As regards Cess revenue we all know that it is mandated to be used for a specific purpose and not for general development. For instance education cess revenue will be spent only on education development and not for area development. Issuance of municipal bonds may not generate interest in poor municipal areas and these bonds will leave a large obligation on the Government to redeem it in future. Similarly other levies like Pollution tax, roof top tax, tax on vacant land will burden the people who are not related or are not the beneficiaries of a particular municipal areas.

Therefore we are left with option of:

Subsuming Octroi in the proposed GST and claim compensation from Central Government as per formula and design of GST, or/and;

Abolish Octroi and raise the ceiling of Profession tax from current Rs 2500 per annum to Rs. 10,000 per annum to offset the resultant revenue loss

Subsume Octroi into GST

Government of India is committed to introduce Goods and Services tax (GST) in the country very soon. A Constitution (Amendment) Bill is under discussion of Rajya Sabha for final passage of the Bill. Finance Minister Shri Arun Jaitely is confident of getting the bill passed in coming Monsoon session of Parliament.[6]

As per proposed GST model following Central and State taxes are getting subsumed into GST as is shown in Table -1 below:

Table -1 : Taxes subsumed in GST[7]

Central Taxes	State taxes
Central Excise Duty	VAT
Additional Excise Duties	Entertainment tax
Surcharges and Cess	Luxury tax
Service Tax	Taxes on lottery, betting and gambling
Countervailing Duty (CVD)	State Cesses and Surcharges
Special Additional Duty of Customs	Entry tax not in lieu of Octroi.

There is therefore opportunity to abolish Octroi or get subsumed into GST. In turn it can demand compensation from the Central Government. The Cabinet while approving GST proposal has clarified (Economic Times, July, 2015) that compensation to States in case of loss of revenue would be given for five years. The only hitch that would rest with the States would be the scenario after 5 years, when Central Government would stop compensating for revenue losses. In other words this option would be a short term measure, meanwhile the local bodies would have to start some other revenue source to generate its resources. At present there appears no solution or measures with municipal bodies to raise around Rs. 15000 crore by way of new legislations.

Abolish Octroi and raise profession tax ceiling:

The Study Group -2006 in its study to abolish Octroi had suggested raising Profession tax to offset Octroi revenue loss. As per Economic Survey of Maharashtra (2015-16) they collect around Rs. 1500 crore by way of Professional Tax revenue, where as its population[8] is more than 11.22 crore. (about Rs.130 per capita per annum). It is therefore evident that profession tax be raised if the municipalities of Maharashtra have to keep serving the people well in absence of Octroi revenue.

We will now analyse the proposal of raising profession tax in detail and suggest the road ahead.

Profession Tax is the tax that is imposed on professions and employment including service, even though the employee is already paying income-tax or the taxable income is computed according to the provision of income tax act. It may also be imposed on trades or callings, e.g. persons carrying on the trade of husking, milling or grinding of grains or on the subject matter of trade e.g. each bale of ginned cotton, or on income arising from trade or profession.

The article 276 of "The constitution of India" authorises a state or a local authority in a state to levy a tax on profession, trades, callings and employment; for which the corresponding legislative Entry is 60 of list II.

The said Article is reproduced as under:
"(1) Notwithstanding anything in article 246, no law of the Legislature of a State relating to taxes for the benefit of the State or of a municipality, district board, local board or other local authority therein respect of profession, trades, callings or employments shall be invalid on the ground that it relates to a tax on income.

(2) The total amount payable in respect of any one person to the state or any one municipality, district board, local board or other local authority in the state by way of taxes on professions, trades, callings and employments shall not exceed two thousand and five hundred rupees (Rs. 2500) per annum."

It is interesting to delve into genesis of how the ceiling of rs.2500/- per annum came into being. The Profession Tax came into existence under Government of India Act, 1935 with Rs.50/- per annum as the maximum limit. With the independence of India came Constitution of India in 1950, according to which the maximum rate of Profession tax was Rs. 250/- per annum. Finally in 1988, vide Constitution (sixtieth amendment) Bill, the limit was raised to Rs. 2500/- There has been no increase thereafter. It also worth noting this is a unique Article in Constitution where tax rate amount is mentioned instead of making general provision of taxation.

At the time of drafting Constitution, Local Finance Enquiry Committee – (1949) gave recommendations to the Constituent Assembly stating that "*..we consider that present limit of Rs 250 is very low and should be increased to Rs.1000.*" In fact when erstwhile Government of India Act 1935 (Article 256 : Profession Tax) was being amended for adopting it in Constitution of India, a long discussion took place in Constituent Assembly on 9th August, 1949. While Dr. Ambedkar proposed raising the limit from Rs. 50 to Rs. 250 only, there were a section of members who wanted this to be raised to Rs. 1000 while some even wanted to put the ceiling at Rs. 2500 so as to financially empower the local municipalities. However the Assembly in its wisdom thought Rs. 250 per annum as appropriate ceiling for profession tax. It is therefore obvious that the present limit of Rs. 2500 per annum is highly inadequate for the municipalities to perform its function efficiently. However raising the ceiling any further would once again require us to undergo the tedious process of Constitution amendment. We therefore look for proper justification to go for this amendment.

Enhance Profession Tax ceiling : the justification
The increase in rates of profession is much awaited issue not only in case of Maharashtra but many other states over the time have demanded this change. We look into comparative changes in following economic parameters during last 28 years (since 1988), so as to assuage any clamour about rise in the ceiling:

- Increasing revenue need by Local Bodies
- Price index trends,
- Salary trends.
- Gold prices trends
- Silver prices trends

More revenue needed for maintaining Local municipal area:
With increase in population, trade & commerce the local bodies need more revenue to provide the basic infrastructure like roads, sanitation facilities, public parks etc. Therefore Profession Tax hike can be a major source to finance this revenue need.

Price Index Trend
The price index trends are very important indicator of various economic variables to asses purchasing power parity and inflation. We look at the Wholesale Price Index for past 25 years as available with Ministry of Commerce & Industry[9].

Table -2 : WPI Trends

S.No.	Financial Year	WPI for All Commodities (Base: 1993-94=100)
1	1988-89	62.23
2	1993-94	100.00
3	1999-00	145.30
4	2009-10	242.80
5	2015-16	330.20

From the table-2 above the rise in WPI trend in India is evident. In the FY 1988-89 it was 62.23 which increased to 330.20 in FY 2015-16. This is an increase of more than 5 times from 1988 level.

(c)Pay Scales of Government Employees
Central Government, every 10 years revises the salary of all the Govt. employees keeping in mind the inflation trends and purchasing power parity. Table -3 shows trend in last three pay commissions.

Table -3 : Pay Scale Trend from 1988- 2006 (three pay commissions)

		Pay scales			
SL.No.	SERVICE	4th CPC (1986)	5th CPC (1996)	6th CPC (2006)	INCREASE **(from 4th to 6th)**
1	IAS	2,200	8,000	21,000	9.54 times
2	GROUP D STAFF	750	2,550	6,660	8.8 times
3	TGT	1,400	7,500	15,600	11.14 times
5	SERVICE CHIEF	9,000	30,000	90,000	10 times

Source :- 4th and 6th Pay Commission Report, Ministry of Finance

Hence from table-3 we notice that the Pay scale of Govt employees have on an average increased nearly 10 times during past 25 years. The private sector wages and salary hikes are also more or less aligned with the Govt salary, however the tax on profession remain same i.e maximum Rs 200 per month which is insignificant in current times.

Gold Prices Trends
Gold prices in a country are important indicators of economic scenario of the country. It reflects to a great extend the purchasing capacity, paying capacities and the various other variables. The table below shows the gold prices changes from yr 1986- 2015; for Mumbai and London. The changes in Mumbai will show the change in India. In 1986 the gold price was Rs. 2323.49 per 10 gms. which has increased to over Rs 29625/- per 10 gms (24 carat) as on date[10]. **There has been increase by nearly 12 times.**

(e)Silver Prices Trends

Similar to gold, silver price is also an important variable as silver is also counted among precious and valuable metals the prices of silver per kg have given in the table below. It shows a major increase in silver prices as in 1987-88 it was Rs. 5538.83 per kg which increased to around Rs.40,000/- per kg[11] i.e **nearly 7 times increase.**

Table – 4: Summary comparison

Sl. No	Particulars	Quantum of Increase (1988 to 2015)
1	WPI trend	5 times
2	Govt employee salary	10 times
3	Gold price trend	12 times
4	Silver price trend	7 times

From table -4 it is obvious that all the economic indicators have grown by more than 5 times and the salary which is to be taxed has grown by 10 times. Hence it would be logical to enhance the Profession tax by four times i.e. from Rs. 2500 to Rs.10000 per annum. In any case the Constitution provision only gives the upper ceiling and it is upto the States to notify the rates as per their economic parameters.

Conclusion

There is no denying the fact that Octroi or even the Local Body Tax (LBT) remains a hindrance in the seamless flow of trade and commerce. Not only it is tax burden but it generates cascading effect as well. While States and the Municipalities have their limitations in abolishing Octroi, as this would limit their finance and would lead to neglect of developmental activities. The options like raising property tax and Stamp Duty etc. are unrealistic as they are already very high and any further hike would induce people towards tax evasion or the shifting of real estate business to other areas to evade stamp duties. Similarly raising VAT or levying service (presently Central subject) tax is burdensome and unpractical. Subsuming Octroi into proposed GST is a better option but is only a short term measure as the compensation from Government would be available only for five years.

Hence the best and permanent solution to compensate Octroi revenue loss is to enhance the Profession tax ceiling four times to Rs.10000 per annum. This will generate more revenues than the Octroi collection foregone. The Profession tax is progressive tax. We analysed the comparative indexes of economic parameters so as to justify the rise in the profession tax.

Amending Constitution is a tiresome task. Even a small amendment (here, from Rs 2500 to Rs 10000) require passing of the amendment by 2/3rd majority from both the Houses and then to be ratified by not less than half the number of States/UTs. It is therefore also suggested that Constitution proviso should shpu;d be amended so as to offer only enabling provision for notifying the profession tax from time to time.

It is therefore an opportunity to add one more amendment in the GST Constitutional Amendment Bill, 2015 so that this amendment is also carried out along with the pace of GST Bill. This move will benefit not only Maharashtra but many States like Punjab Haryana where even the rich agriculturists are exempt from income tax and the States would be able to collect profession tax from them.

Such a progressive step will go long way in boosting seamless trade and commerce across the country.

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