Chapter 9

Local Governments

9.1 The terms of reference (ToR) of this Finance Commission require us to recommend "the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State, on the basis of the recommendations made by the Finance Commission of the State."

9.2 Thus, we are expected to recommend, on the basis of the recommendations of the State Finance Commissions (SFCs), measures to supplement resources of duly constituted panchayats and municipalities. These measures could be recommendations on both grants in aid as well as suggestions for steps to be taken by the States in this regard. The measures are intended to add to the resources of panchayats and municipalities and by implication there is no stipulation about the criteria or the quantum of the grant that should be recommended.

Approach of Previous Finance Commissions

Framework for Recommendations

9.3 The FC-X did not have a ToR for local bodies but it gave an award regarding this as panchayats and municipalities were to discharge the new role assigned to them under the Constitution during its award period. Starting from the FC-XI, all subsequent Finance Commissions had ToR identical to those of this Finance Commission on panchayats and municipalities. In addition, the FC-XI was explicitly given the latitude to make its' own assessment in the matter in cases where SFC reports were not available.

9.4 For several reasons, the previous Finance Commissions could not base their recommendations entirely on the SFC reports. These included variations in the approaches adopted by the SFCs, difference in the periods covered by individual SFCs, non-synchronisation of the SFC report periods with that of the Finance Commission report and the quality of SFC reports. Under the circumstances, the previous Finance Commissions recommended ad-hoc grants and suggested the steps that State Governments could take to augment the consolidated fund of States to supplement the resources of local bodies.

Quantum of Flows

9.5 The FC-X recommended a grant of Rs. 4,380.93 crore for panchayats, estimated at the rate of Rs. 100 per capita of rural population as per the 1971 Census. A grant of Rs. 1,000 crore was recommended for municipalities. The FC-XI recommended a grant of Rs. 8,000 crore for panchayats and Rs. 2,000 crore for municipalities. The FC-XII allocated a grant of Rs. 20,000 crore for panchayats and Rs. 5,000 for municipalities. The FC-XIII recommended a percentage of the divisible pool for local bodies, estimated at Rs. 87,519 crore for the entire award period, after converting it into grant-in-aid under Article 275 of the Constitution. For each year of the award period, the grant was to be determined on the basis of the divisible pool of the previous year. Of this, the grant to panchayats was Rs. 63,051 crore and the grant to municipalities was Rs. 23,111 crore, while a special area grant of Rs. 1,357 crore was given to the Schedule V and Schedule VI areas as well as other areas excluded from the operation of Part IX and Part IX A of the Constitution.

Basis of Horizontal Distribution

9.6 The FC-X distributed its award exclusively on the basis of population (based on the 1971 Census). The FC-XI assigned a weight of 40 per cent to population (1991 Census), 10 per cent to area and 20 per cent to distance from highest per capita income. The FC-XII retained the weights used by FC-XI for each of these three criteria, but used the 2001 population data for distribution. The FC-XIII increased the weight attached to population to 50 per cent and retained the weight assigned to area at 10 per cent. While they retained the weight assigned to distance from the highest per capita income at 20 per cent for urban local bodies, for rural local bodies this was reduced to 10 per cent and a new criteria- proportion of scheduled caste and scheduled tribe population - with a weight 10 percent was introduced. Apart from these three common criteria, others like index of decentralisation, revenue effort, index of deprivation, index of devolution and Finance Commission grant utilisation index have been used by different Finance Commissions. In the distribution of grants, factors such as population, area and deprivation related indices take into account the resource needs of the States. Other criteria such as index of decentralisation, index of devolution, revenue mobilisation linked the quantum of grants to the efforts of States to decentralise or to empower the local bodies.

Performance Requirements Associated with Grants

9.7 The FC-X stipulated that State Governments should prepare suitable schemes and issue detailed guidelines for utilisation of the grants. The local bodies were required to raise matching contributions for the purpose. No grant amount was to be used for expenditure on salaries and wages. The FC-XI stipulated that the first charge on the grants should be maintenance of accounts and audit, followed by the development of a financial database. The remaining amounts were to be utilised for maintenance of core services - provision of primary education, primary health care, safe drinking water, street lighting and sanitation including drainage and scavenging facilities, maintenance of cremation and burial grounds, public conveniences and other common property resources. These grants were untied, barring the stipulation prohibiting the payment of salaries and wages. The grants were to be distributed between rural and urban local bodies, on the principles recommended by SFCs.

9.8 The FC-XII stipulated that panchayats should use the grants to improve service delivery relating to water supply and sanitation. In towns with a population of over 100,000, 50 per cent of the grant was to be earmarked for solid waste management schemes in public-private-partnership (PPP) mode. The urban and rural local bodies were also expected to give high priority to expenditure for the creation of database on local body finances and maintenance of accounts through the use of modern technology and management systems.

9.9 The FC-XIII provided grants for rural and urban local bodies in two parts - a general basic grant and a general performance grant. No conditions were set for accessing the basic grant. However, the FC-XIII set six conditions for panchayats to access the performance grant and nine conditions in the case of urban local bodies. All these conditions had to be met in each of the award years. In the case of States with Schedule V and VI areas, and the area exempted from the purview of Part IX and Part IX-A of the Constitution, a special area grant was provided without distinguishing between rural and urban areas. This grant also had two components - a special area basic grant and a special area performance grant. Four conditions had to be met to avail the latter. In case States were unable to draw their performance grant, the amount not drawn was to be redistributed in a specified manner. Both the general basic grant and the general performance grant were allocated to rural and urban local bodies on the basis of the 2001 population figures.

Accounts and Audit

9.10 Previous Finance Commissions have highlighted the lack of reliable financial data on panchayats and municipalities and the difficulty in realistically assessing the requirement of resources for carrying out core functions and development expenditure. The FC-XI noted the need for improvement of accounts as, over a period of time, progressively larger funds would flow to local bodies, and suggested the heads of account under which funds flow to local bodies should be streamlined. The FC-XI recommended that the Comptroller and Auditor General of India (C&AG) should be entrusted with the responsibility of exercising control and supervision over the maintenance of accounts and audit of all tiers of rural and urban local bodies and that the C&AG's audit report should be placed before a committee of the state legislature. It also recommended grants to States for the compilation of accounts and creation of a database on local body finances. Subsequent Finance Commissions also stressed the need for proper accounts and audit. The maintenance of accounts of local bodies and entrusting technical guidance and supervision over audit to the C&AG were among the conditions that States had to fulfil in order to draw the performance grants recommended by FC-XIII.

Treatment of Excluded Areas

9.11 The previous Finance Commissions did consider the provision of grants to areas not covered by the 73rd and 74th amendments to the Constitution. While providing grants to these excluded areas, the FC-X noted that even in the States not required to have panchayats, the additional amounts would be required to be given to supplement the resources of similar local level representative bodies. The FC-XI stipulated that its award for excluded areas should be made available to the respective States only after the relevant legislative measures for extension of the provisions of the 73rd and 74th amendments to such areas are completed. After noting the proposal for amending Schedule VI of the Constitution to include extension of certain provisions of the 73rd and 74th amendments to these excluded areas under consideration in the Ministry of Home Affairs, the FC-XII did not indicate separate grants for normal and excluded areas and left it to the States to distribute the grants between them. After considering Parts IX and IX-A, Articles 244, 280 and 275 of the Constitution, the FC-XIII also recommended grants for excluded areas.

Measures for Augmenting States' Consolidated Funds

9.12 In order to augment the Consolidated Funds of States, the FC-XI suggested imposition of taxes on land and farm incomes, surcharge or cess on state taxes, levy of professions tax, improving efficiency of collection of property tax, assignment of a buoyant tax in lieu of octroi when it is abolished, levy of service charges and periodic revision therein. The FC-XII identified fourteen best practices, which included the following: (i) measures for augmenting resources of panchayats such as compulsory levy of major taxes and exploring all non-tax revenue sources; (ii) obligatory levy of user charges; (iii) insistence on collection of minimum revenue and providing incentive grants for collections beyond this prescribed minimum amount; (iv) identifying revenue-generating common property resources and ensuring adequate income from them; and (v) giving powers to intermediate or district panchayats to levy tax or cess or surcharge on agricultural holdings. The FC-XIII suggested that the States could do the following: (a) mandate some or all local taxes as obligatory at non-zero rates of levy; (b) provide matching grants for revenues raised; (c) explore market based financing through the issue of municipal bonds; and (d) share mining royalties with the local body in whose jurisdiction the income originates. It also suggested that the departments of the Union and State Governments could pay appropriate service charges to local bodies for civic services.

Views of Stakeholders

Views of the State Governments

9.13 In the memoranda presented to us, the States appreciated the grants for local bodies recommended by the previous Finance Commissions and were in favour of these being enhanced. A majority of States advocated that the local body grant should be specified as a percentage of the divisible pool, as was done by the FC-XIII. One State suggested increasing the grant to as much as 9 per cent of the divisible pool, while nearly half the States favoured increase to 5 per cent. Some States advocated specific sums of money as grants.

9.14 The criteria for horizontal distribution suggested by the States include area, index of devolution or decentralisation, scheduled caste and scheduled tribe population, income distance, Finance Commission grant utilisation, poverty ratio, fiscal discipline, index of deprivation, revenue effort, per capita transfer of funds, proportion of own resources transferred to local bodies, population and average population growth between 1971 and 2011. A majority of States did not indicate which census figure should be taken for the population criteria; of those that did some advocated use of the 2011 Census and a few suggested the 1971 Census data.

9.15 An overwhelming majority of States submitted that the conditions attached to grants either be dropped or reduced in number. A few suggested that the conditions stipulated should have flexibility in their application to accommodate local conditions. Some States suggested that if conditions were to be imposed, these could relate to timely release of grants to local bodies, entrusting technical guidance and supervision over audit to the C&AG and limiting the use of grants for core services. A few States proposed that the existing time limit for the release of grants to local bodies be increased.

9.16 While half the States did not express any specific view on the use of performance grants, some were against performance grants itself. Another suggestion was that the conditions imposed for accessing these grants should be linked to the performance of the local body only, with flexibility given for local conditions. Most of the States submitted that only a few conditions should be used and releases should be in proportion to the number of conditions fulfilled, rather than being linked to the fulfilment of all the conditions. A few States were of the view that the bulk of the local body grants should be in the form of a general grant and only a smaller percentage should be given as a performance grant. Some other States urged that the limit on professions tax should be raised by Parliament and the local bodies should be allowed to recover service charges from Union Government properties.

9.17 A majority of the States sought grants for provision as well as maintenance of basic civic amenities. Others sought support for the construction of panchayat buildings, information technology (IT) infrastructure, e-governance, capacity building and honorarium for elected representatives. Other purposes for which support was sought included preparation of financial database, improving tax collections, accounting systems, public health and education.

9.18 For urban areas, a majority of States sought support for basic civic services while a few sought support for traffic management and parking lots, implementing e-governance, construction of municipal buildings, fire services, disaster management, public health and preparation of master plans.

Views of Representatives of Local Bodies

9.19 In their interaction with this Commission, the representatives of panchayats and municipalities in an overwhelming majority of States mentioned that they faced a paucity of funds for carrying out their own mandated functions. Most of them stated that the grants given to panchayats and municipalities should be untied. In almost all States these local body representatives sought funds for the improvement of basic services - water supply, sanitation, sewerage, storm water drainage, solid waste management, roads and street lighting, parks and playgrounds, burial and cremation grounds. Shortage of staff was another issue highlighted by them in a majority of the States.

9.20 In some States, the panchayat representatives expressed the need for further empowerment of panchayats to enable them to function as institutions of local self-government. A number of panchayat representatives sought support specifically for training and capacity building of their staff, for construction of training centres, for IT infrastructure, internet connectivity, buildings for panchayats as well as their repair and maintenance, salary for staff and honorarium for elected members.

9.21 Representatives of municipalities in a few States sought support for capacity building and training, public transport and infrastructure such as flyovers and roads, parks and playgrounds, maintenance of assets, salary for staff and honorarium for elected members. In some States, the representatives highlighted the need for special dispensation for pilgrim centres and for the protection of heritage sites.

9.22 In a few States, the municipal and panchayat representatives suggested that the grant for local bodies should be determined as a percentage of the divisible pool. While the municipal representatives favoured setting the share at 5 per cent, suggestions from the panchayat representatives on this ranged from 6 per cent to 20 per cent.

9.23 The local body representatives of only two States raised the issue of the population data to be used for determining the quantum of local body grants, with those of one State favouring the use of the 1971 population data and those of the other favouring the 2011 data. In a few States, the local body representatives demanded that they should be allowed to levy service charges on the Union Government's properties and that the limit on professions tax should be raised so that their revenues can increase further.

Consultations with State Finance Commissions

9.24 We held discussions on the working of the SFCs with Chairpersons and Member Secretaries of the sitting SFCs or the last SFCs that had submitted reports to the States. It emerged that States had constituted SFCs at different times and with varying regularity. As a result, the latest SFC constituted across States (barring one state) ranged from the second SFC to the fifth SFC. In certain States, the latest reports submitted by the SFC were still under consideration by State Governments. In other States, the SFCs were yet to submit their reports.

9.25 It was noticed that sometimes the State Governments rejected SFC reports without recording reasons. In some States, even when the recommendations were accepted, the timeframe for implementation was not specified in the Action Taken Report presented to the legislature. Some Chairpersons highlighted the fact that the financial recommendations get acted upon while those dealing with systemic improvements are seldom addressed. They pointed out that lack of coordination between the finance department and those dealing with rural and urban affairs hinders the implementation of measures for augmentation of resources suggested by the SFC.

9.26 The Chairpersons of SFCs mentioned that the basic services that can be considered by us for support could include water supply, sanitation, solid waste management, drainage, public toilets, street lighting and maintenance of roads. They were of the view that the basic grant by the Finance Commission should be untied and should be allocated within each State according to the formula laid down by the respective SFC. They informed us that they had taken recourse to conditional grants and performance grants and favoured linking of Finance Commission grants with some conditionalities. They were of the view that if performance grants are given, there should be a few conditions and these should be transparent. They were also in favour of incentivising revenue mobilisation. Some of them expressed concern over the abolition of buoyant taxes such as property tax in their States. A few of them indicated that revenue incentivising measures have not been successful in their States. There was a general view that for such measures to be successful, the corpus for incentive grants should be large enough to induce the local bodies to act in this direction.

9.27 The SFC chairpersons felt that the Finance Commission could support several measures to improve the capacity of local bodies, including funding municipal cadres, setting up of training institutes and IT infrastructure. Other measures suggested by them included providing support for preparation of simple accounts and data formats, benchmarking of basic services and setting up of data collection centres in State Governments.

9.28 The chairpersons submitted that promotion of accountability and transparency is important and social audits and public disclosure need to be encouraged. They were of the view that the Finance Commission could use recommendations in their reports to fulfil its constitutional mandate.

Views of the Union Government

9.29 The Ministry of Panchayati Raj of the Union Government sought support for initiatives aimed at improving governance, such as setting standards for delivery of core civic services and surveillance for monitoring actual service delivery. In order to promote the participation of citizens in local self-governance, it sought funds for conducting gram sabha meetings, payment of honorarium, travel allowance, daily allowance, sitting fee for elected members and some remuneration also for motivators engaged to ensure participation of all residents in gram sabha meetings. The Ministry also suggested funding the expenditure on secretariat staff for gram panchayats and for information communication technology (ICT) personnel at the intermediate panchayat level.

9.30 The Ministry sought assistance for States to set up supporting institutions such as Panchayat Finance Cells for compiling and analysing data on panchayat finances and helping panchayats improve their own revenue mobilisation as well as state-level regulators for determining tax rates and advising on fees or user charges for services.

9.31 Both the Ministry of Panchayati Raj and the Ministry of Rural Development sought support for capacity building of the panchayats. The Ministry of Panchayati Raj pointed out that capacity building was needed for delivering core services like water supply and sanitation assigned under various Acts, Rules and executive orders. The Ministry of Rural Development expressed the need to expand the infrastructure available for capacity building of elected representatives and functionaries of panchayats and requested a sum of Rs. 1886.50 crore for States for setting up district-level training centres for this purpose.

9.32 The Ministry of Drinking Water and Sanitation pointed out that the poor quality of water supply was adversely affecting people's health in rural areas, as the coverage of piped water supply was low and the capital assets created earlier had eroded and needed maintenance. The Ministry informed us that the problem of handling and disposal of solid and liquid waste including septage management would be important challenges before panchayats in the days to come. It pointed out that capital investment had to be increased to achieve and sustain the goal of covering 90 per cent rural population with piped water supply by 2022.

9.33 The Ministry of Panchayati Raj suggested that 4 per cent of the divisible pool be given to the local governments and that the vertical allocation of the grant should be 5 per cent for the State, 10 per cent for zilla parishad, 10 per cent for intermediate panchayats and 75 per cent for gram panchayats. Where no intermediate panchayat exists, the share of Gram Panchayats should be 85 per cent. For the horizontal distribution of grants across States, the Ministry suggested the following criteria and weights: population 50 per cent, scheduled caste and scheduled tribe population 10 per cent, geographic area 10 per cent, distance from national human development index (HDI) value 15 per cent and index of decentralisation 15 per cent.

9.34 The Ministry of Panchayati Raj supported the concept of basic and performance grants as proposed by the FC-XIII and advocated a ratio of 2:1 between the basic grant and the performance grant. It observed that the recommendations of the previous Finance Commission that States fulfil all conditions before becoming eligible for the performance grant led to many States forfeiting their share of the grant. To overcome this, the Ministry suggested that the performance grants should be disbursed in proportion to the conditions fulfilled by the states.

9.35 The Ministry of Drinking Water and Sanitation submitted that grants to local bodies could include conditionalities like the devolution by State Governments of funds, functions and functionaries in the rural drinking water and sanitation sectors to local bodies. It advocated that the management devolution index it had constructed may be used as an indicator for devolving funds to local bodies. The Ministry suggested that panchayats should give priority to spending on operation and maintenance of rural water supply and sanitation from the Finance Commissions' grants. However, the Ministry of Rural Development did not favour attaching conditions to grants except for improvement in service delivery.

9.36 The Ministry of Panchayati Raj submitted that capacity building was a major issue that needed attention in Schedule V areas and requested us to consider further strengthening of panchayats in these areas. It stated that in the case of areas falling outside Part IX of the Constitution, as in the North-east States, entities like Village Councils or Village Development Boards or District Councils could be considered eligible for grants. However, they would be required to satisfy certain conditions including being duly constituted through elections and reservations to ensure adequate representation for women.

9.37 Drawing our attention to the ToR's mandate that our recommendations be based on those of the SFC reports, the Ministry of Panchayati Raj pointed out that the quality of SFC reports has improved over the years. It therefore suggested that we may consider the latest SFC reports while making specific recommendations even if the period of these reports are not synchronous with our award period.

9.38 The Ministry of Urban Development drew our attention to the rapid urbanisation and submitted that this needs to be facilitated to sustain momentum of economic growth. It pointed out that basic services such as drinking water, sewerage, solid waste management, roads and street lights must be provided for all, with services related to water and sanitation meeting the Ministry's service delivery benchmarks.

9.39 The Ministry observed that while Finance Commission grants to urban local bodies have been growing over a period of time, these are inadequate to meet the operation and maintenance requirements of these bodies. It sought devolution of 3 per cent of the net proceeds of the divisible pool to urban local bodies. The Ministry pointed out that the conditions imposed by the FC-XIII for drawing performance grants were such that States had to fulfil all nine conditions each year. As most of the States were unable to fulfil all the conditions each year, these grants could not be availed. It felt that performance grants should be used for improving performance in the spheres of revenue augmentation, revenue productivity and revenue administration and added that conditions on grants should be limited to the areas of critical importance and should be oriented towards outputs.

9.40 The Ministry of Housing and Urban Poverty Alleviation indicated that the urban local bodies had limited capacity to implement poverty alleviation programmes and that there was a need for capacity building. The Ministry stated that funds should be made available to urban local bodies to maintain infrastructure created under different schemes of the Union Ministries. It also pointed out that the use of 1971 population data by the Finance Commission will not reflect the current urban reality as the urban population growth after that year has been phenomenal.

9.41 The Ministry of Finance urged that the grants recommended to urban local bodies be linked to a prescribed fiscal roadmap, including revenue generation and rationalisation of workforce.

Studies Commissioned

9.42 We commissioned studies on finances of municipalities and finances of panchayats through the Administrative Staff College of India (ASCI), Hyderabad and the Centre for Policy Research (CPR), New Delhi respectively. The data collected by us from the States was entrusted to these institutions to assess the gap in resources for the delivery of basic services. Both the studies revealed several gaps in the data provided by the States, as a result of which they had to rely largely on the use of secondary data to work out the resource gaps for the next five years.

9.43 The study on Municipal Finances and Service Delivery by ASCI highlighted the fact that governing cities is becoming a challenge because of inadequate finances, weak institutional framework and lack of capacity for service delivery. It suggested that a separate municipal revenue list should be inserted in the Constitution to assign assured and sustainable sources of income to urban local bodies. The suggested sources include property tax, vacant land tax, service charge on State and Union properties, trade licensing and building permission fee. The study expressed the view that urban local bodies should tap all resources allowed to them under the statutes to bridge the gap in finances and that they should prioritise property tax reforms in order to improve finances. It added that they needed to review their service charges and periodically revise them in line with service improvements to meet the escalating costs. The study also proposed that State Governments should remove restrictions on borrowings by urban local bodies.

9.44 The study on Review of Panchayat Finances highlighted the existence of a robust legal framework backed by activity mapping orders for the allocation of core functions to rural local bodies across the states. However, the study observed that this did not necessarily mean that the rural local bodies were equipped to undertake these functions. It added that the States had tended to empower village and district level panchayats more than the intermediate level panchayats in their enactments. The study suggested that the time for placement of an audit report of local bodies before State legislatures should be reduced to nine months. It also suggested that district-wise budget supplements could be prepared and circulated to enable the rural local bodies to know the details of funds entitlements in advance. The study also pointed out that there was potential for rural local bodies to raise much larger revenues by reforming the property tax systems.

Issues and Recommendations

Data Collection

9.45 Finance Commissions since the FC-XI have sought data from States on finances of local bodies but were hampered by the lack of reliable data. We recognised the difficulty in obtaining the data in a useable form from all panchayats and municipalities and, therefore, requested State Governments to collect information on a sample of the local bodies. Using two-stage sampling, 30 per cent of the districts were selected in the twenty-six states considered by us. In these districts, all zilla panchayats, 30 per cent of intermediate panchayats and 15 per cent of gram panchayats were selected, again using a simple random sampling. For the urban local body sample, all municipal corporations in the state, 30 per cent of the municipalities and 15 per cent of the nagar panchayats (the Tier 3 urban local bodies) were chosen. This was done using the probability proportional to size method of sampling from the same districts that were used for drawing the rural sample. The 2001 population data was chosen as the auxiliary variable. Despite our concerted effort, we found that the quality of the data that was supplied to us varied across States and was not in a useable form. **We were, therefore, handicapped, like the previous Finance Commissions, in using the supplied data to determine the resource gap at the level of rural and urban local bodies.**

Relying on the reports of the State Finance Commissions

9.46 For reasons beyond their control, the previous Finance Commissions had to make their recommendations independent of the SFC reports. In fact, they recommended that the Constitution be amended either to delete the requirement for the Finance Commission to base its recommendations on SFC reports or to require it to recommend merely keeping in view the SFC reports but not based on them. **The Constitution has not been amended so far and we have, therefore, decided to study the working of SFCs in depth and make it central to our recommendations in this regard.**

9.47 The Constitution allows the SFCs to determine their procedures. Therefore, they are free to choose their approach towards the determination of the requirement of local body finances within the respective States. Given the wide socio-economic, geographic diversity and also variation in the roles that are assigned to panchayats and municipalities across States, the diverse and often State-specific recommendations of SFCs may not provide a uniform basis for recommendations applicable to all States, though they may provide some ground for assessment of needs by us.

9.48 We have noted the submission of the Ministry of Panchayati Raj that we may consider the latest SFC reports even if they are not synchronous with our award period and then make specific recommendations. Five State Governments had made similar suggestions. The chairpersons of SFCs have also submitted that we can rely on the latest SFC reports to fulfil our mandate.

9.49 After a careful consideration of the provisions of the Constitution and views of various stakeholders, we propose to recommend measures for augmenting the Consolidated Fund of the State to supplement resources of panchayats and municipalities on basis of the recommendations of the SFCs. Doing so could mean either recommending grants using the data available in the

SFC reports, or addressing the common concerns raised in them on grants or other measures. We could not use the financial data in the SFC reports fully due to the fact that reports available to us were for different periods with some containing data nearly a decade old. It would not be reasonable to provide for the current resource requirements of the local bodies based on this data. **In our opinion, under the circumstances, recommendations that address common issues raised in SFC reports constitute recommendations made on the basis of the State Finance Commission report.**

Analysis of SFC reports

9.50 The Constitution provides for setting up of the SFCs within one year from the commencement of the Constitution (73rd Amendment) Act 1992, and, thereafter, at the expiry of every fifth year. Therefore, as per Constitutional provisions, setting up of a fourth SFC became due in the year 2009-10. Available information shows that two States have constituted the fifth SFC, while eleven have constituted the fourth. Six States have constituted the third SFC, six have set up the second SFC and one is yet to do so.

9.51 We noted that SFCs have faced several constraints in their functioning such as data availability, poor quality of available data, reconstitution of SFCs more than once during their tenure, shortage of staff and administrative resources and support. Despite facing such challenges, the SFCs have carried on and submitted their reports. They have recommended devolution of taxes, duties and grants to local bodies and also provided grants to panchayats and municipalities for meeting staff costs, maintenance of office and residential buildings, maintenance of basic infrastructure and other assets and also for the creation of financial database and capacity building.

9.52 A majority of SFCs have made recommendations to encourage local bodies to improve own revenue collections. Towards that end, they have sought to incentivise improvement in revenue mobilisation by providing performance grants, matching grants and cash awards to local bodies. Some SFCs have included incentive for own revenue mobilisation in the devolution formula. They have also indicated the action that the States and local bodies need to take to facilitate own revenue mobilisation by local bodies. The SFCs have stressed the need for proper accounting and auditing of local bodies. Finally, one of the key concerns SFCs have highlighted is that the local bodies need to improve the delivery of basic services to their residents.

9.53 Some of the SFCs have flagged issues for the consideration of the Finance Commission. These issues fall under two broad heads. The first relates to the Finance Commission recommending steps that would help the SFCs in the discharge of their functions. The second relates to the Finance Commission taking a view on certain factors while recommending measures for supplementing local body resources. The requests falling in the first category include: (i) setting up of an independent national agency for support of a common platform for exchange of information between SFCs; (ii) design of simpler accounts and data formats; (iii) studies on governance issues with respect to local self-governments and (iv) supporting studies on standards of essential civic services to help future SFCs assess the performance of local bodies in their core functions. In the second category are requests to the Finance Commission to consider doing the following: (i) use the 2011 Census data for the allocation of grants; (ii) provide grants for knowledge transfer and capacity enhancement; (iii) increase grants for audit, accounts and database, solid waste management and sanitation; and (iv) take cognisance of the large transfers being made to the local bodies by the states. One SFC has requested the Finance Commission to take steps to make local bodies aware of the purpose of the Finance Commission grants.

9.54 **In our view, a common issue that emerges from SFC reports is the need to have reliable data on the finances of local bodies in order to enable all stakeholders to make informed decisions. For this, the compilation of accounts and their audit assumes importance. Another common issue is that the local bodies need to be encouraged to generate own revenues and to improve the quality of basic services they deliver.**

Giving Priority to Basic Services

9.55 Since the FC-XI, Finance Commissions have stressed the improvement of basic services provided by the local bodies to their constituents. In our discussions with representatives of local bodies, there was a strong consensus amongst the participants in favour of providing more funds for drinking water, sanitation, drainage, local roads, school buildings, solid waste management, street lighting, maintenance of burial and cremation grounds and parks. The States, in their memoranda to us, have also highlighted the need to support provision of these basic services relating to water, sanitation and solid waste management. Ministries of the Union Government also made similar points, with the Ministry of Drinking Water and Sanitation and Ministry of Urban Development focussing on adequate provisioning for drinking water and waste management. The Ministry of Drinking Water and Sanitation pointed out that managing solid and liquid waste including septage will be a challenge for the panchayats in the future. The Ministry of Urban Development submitted that basic services in urban areas needed to meet national level benchmarks set by it. The need for supporting these services has been brought out in most of the SFC reports, as well as in our consultations with the chairpersons of SFCs.

9.56 Improvements in the quality of basic services are likely to lead to an increase in the willingness of citizens to pay for the services. We are of the view that the measures that we recommend, including the grants to the local bodies, should go towards supporting and strengthening the delivery of basic services - water supply, sanitation including septage management, sewerage, storm water drainage and solid waste management, street lighting, local body roads and footpaths, parks, playgrounds, burial and cremation grounds. We recognise that the relevant statutes governing the local bodies would normally include these basic services. **Therefore, we recommend that the local bodies should be required to spend the grants only on the basic services within the functions assigned to them under relevant legislations.**

Accounts and Audit

9.57 Successive Finance Commissions have expressed concern on the near absence of financial data and its poor quality, wherever it is available. The C&AG informed us that in most States there are rules and regulations with regard to the formats of accounts for both rural and urban local bodies. However, the time schedule for completion of accounts was not being adhered to in a number of States. There were large gaps in monitoring mechanisms regarding schedule of preparation and finalisation of accounts. As a result, there are large arrears in local bodies' accounts. In PRIASoft, the accounting software used by several States for the compilation of panchayat accounts, 38 per cent gram panchayats had not closed their annual accounts for 2012-13 even by

February 2014. Similarly, accounts of 2010-11 and 2011-12 were open and not complete for 43 per cent and 36 per cent of gram panchayats respectively. A similar situation was prevailing in other tiers of panchayats.

9.58 We were informed that one of the conditions of the FC-XIII for rural local bodies and municipalities to avail the performance grant was that they should maintain accounts based on the accounting framework and codification pattern consistent with the Model Panchayati Raj Accounting System and the National Municipal Accounts Manual respectively. While most States had self-certified the adoption of the accounting framework, the C&AG informed that the actual maintenance of accounts still needed improvement.

9.59 We were informed that the C&AG is now providing technical guidance and support to primary auditors in twenty-six states. The audit reports were being submitted to the State Government or State Legislature in twenty-one states, while the first audit report was under preparation in another five. Seventeen states had entrusted technical guidance and support to the C&AG or enhanced the scope of entrustment of this during 2011-13. The C&AG informed that in most of the States, system improvement regarding audit of local bodies by the primary auditor with technical guidance and support of C&AG was slowly gaining momentum and, over a period of time, its effectiveness is going to bear fruit.

9.60 We are of the opinion that proper accounts are the starting point for financial accountability. Non-maintenance or delayed compilation of annual accounts means compromised accountability. It also implies that reliable financial data for determining the need for resources for local bodies is not available. We observe that it has been more than twenty years that municipalities and panchayats were sought to be empowered, through a Constitutional amendment, to act as institutions of local self-governance and also to provide certain basic services to citizens. It is inconceivable, and certainly not desirable, that local bodies seek an ever increasing share of public moneys and yet continue to keep themselves beyond the ambit of accountability and responsibility for the public money placed with them.

9.61 We also note that on account of the efforts of the past Finance Commissions, there has been progress in the keeping of accounts and audit under the technical guidance and support of the C&AG. We also note the fact that further progress in this regard is needed. We, therefore, are of the opinion that it is necessary to continue the efforts initiated by past Finance Commissions for improving the maintenance of accounts, their audit and disclosure. For this, we have built suitable incentives in our performance grants. **We recommend that the books of accounts prepared by the local bodies should distinctly capture income on account of own taxes and non-taxes, assigned taxes, devolution and grants from the State, grants from the Finance Commission and grants for any agency functions assigned by the Union and State Governments. In addition to the above, we also recommend that the technical guidance and support arrangements by the C&AG should be continued and the States should take action to facilitate local bodies to compile accounts and have them audited in time.**

Grants to Local Bodies

Criteria for determination of grants to panchayats and municipalities

9.62 In the past, Finance Commissions have used two types of criteria for determining grants to States for panchayats and municipalities. The first related to the need for resources and the second related to the extent of devolution or decentralisation to local bodies by the States. We have examined requests put before us to use an index or indices based on extent of devolution or decentralisation for determining States' share of the grant for municipalities and panchayats. We noted that there are several practical difficulties in considering an appropriate index or indices for devolution, without assuming that there is an optimal model of devolution or decentralisation that is uniformly applicable to all States, irrespective of their socio-political and institutional context. Even assuming that such an index could be designed, it is not easy to assess the actual level of devolution relative to the optimal level, due to the unavailability of accurate, reliable information of the ground position.

9.63 Under the Constitution, the State legislature has the discretion to assign functions to panchayats and municipalities. We note that the overall scheme of the Constitutional provisions give primacy to the role of the States in this regard, by placing local government squarely in the State list. We have noted significant diversity in the legal, institutional and financial aspects of assignment of functions to panchayats and municipalities. In our view, neither the ToR nor the Constitution permits the Finance Commission to play any role in the devolution of powers to panchayats and municipalities or to promote a particular model of decentralisation. **Therefore, we considered it appropriate not to use an index or indices of devolution or decentralisation for the purpose of transfer of resources to States for panchayats and municipalities.**

9.64 Population and area are criteria used by past Finance Commissions that reflect need for resources. All the previous four Finance Commissions have used population and, barring the FC-X, all others have used area. The measures recommended or the grants given are ultimately intended to supplement the resources of panchayats and municipalities. The purpose of such supplementing is to aid these institutions in their primary function to deliver basic civic services. Therefore, we have used criteria that reflect needs in order to determine the grants to panchayats and municipalities, namely population and area. The delivery of basic civic services is related to the current population to be served within the administrative jurisdiction of the local body. Area is also relevant from the viewpoint of the costs of delivering such services. **Therefore, we recommend distribution of grants to the States using 2011 population data with weight of 90 per cent and area with weight of 10 per cent. The grant to each State will be divided into two - a grant to duly constituted gram panchayats and a grant to duly constituted municipalities, on the basis of urban and rural population of that State using the data of Census 2011.**

Quantum of grants

9.65 The FC-XIII recognised the need to support the local bodies through a predictable and buoyant source of revenue. It considered the demand by the States and local bodies for giving a share from the divisible pool to the latter. As the legal opinion provided to the FC-XIII indicated that this was inconsistent with the provisions of the Constitution, the Commission recommended that the local bodies be transferred a percentage of the divisible pool of the previous year as stipulated by it, after converting this share into grants-in-aid under Article 275 of the Constitution. It had estimated this amount to be Rs. 87,519 crore for five years from 2010 to 2015.

9.66 We noted that States appreciated the fact that the FC-XIII had acknowledged the need for providing local bodies with a predictable, buoyant source of revenue and had recommended a grant which was equivalent to a specified percentage of the divisible pool. Most States have indicated that 5 per cent of the divisible pool should be given as grants to the local bodies.

9.67 Four SFCs whose recommendation periods are coterminous with ours have sought support ranging from Rs. 270 crore to Rs. 1,20,992 crore for the five-year period, 2015-20. In terms of per capita per annum, this ranges from Rs. 195 a year to Rs. 1,211 a year.

9.68 We note that the local bodies need to spend not only on the provision of basic services to the people, but also require support for administrative infrastructure and capacity building. In deciding the quantum of the grant, we have given importance to stability and predictability of resources that should flow to the local bodies. We have taken a pragmatic view on supplementing the resources of panchayats and municipalities. We are proposing a level of support that will provide financial stability to the local bodies through assured transfers for planning and delivering of basic services smoothly and effectively.

9.69 **We have worked out the total size of the grant to be Rs. 2,87,436 crore for the period 2015-20, constituting an assistance of Rs. 488 per capita per annum at an aggregate level. Of this, the grant recommended to panchayats is Rs. 2,00,292.2 crore and that to municipalities is Rs. 87,143.8 crore. The grant assessed by us for each State for each year is fixed.** This will ensure stable flow of resources at predictable intervals. The grants recommended by us should enhance resources available with gram panchayats and municipalities to enable them to discharge their statutorily assigned functions.

9.70 **We have recommended grants in two parts - a basic grant and a performance grant for duly constituted gram panchayats and municipalities. In the case of gram panchayats, 90 per cent of the grant will be the basic grant and 10 per cent will be the performance grant. In the case of municipalities, the division between basic and performance grant will be on a 80:20 basis. The shares of the States for these grants are set out in Annex 9.1.**

Basic grants

9.71 The own resources of gram panchayats and municipalities are meagre. They are required, as per the relevant statutes, to deliver a number of core services to their constituents. In addition, they have been assigned numerous agency functions by Union and State Governments. However, they depend on devolution from the State Government and grants from the State and Union Governments for providing core services. The purpose of the basic grant is to provide a measure of unconditional support to the gram panchayats and municipalities for delivering the basic functions assigned to them under their respective statutes. The grant provided is intended to be used to improve the status of basic civic services including water supply, sanitation including septage management, sewerage and solid waste management, storm water drainage, maintenance of community assets, maintenance of roads, footpaths and street-lighting, and burial and cremation grounds.

9.72 **The grants that we recommend should go to gram panchayats, which are directly responsible for the delivery of basic services, without any share for other levels. We expect that the State Governments will take care of the needs of the other levels. The earmarked basic grants for gram panchayats will be distributed among them, using the formula prescribed by the respective SFCs for the distribution of resources. Similarly, the basic grant for urban local bodies will be divided into tier-wise shares and distributed across each tier, namely the municipal corporations, municipalities (the tier II urban local bodies) and the nagar panchayats (the tier III local bodies) using the formula given by the respective SFCs. The State Governments should apply the distribution formula of the most recent SFC, whose recommendations have been accepted.**

9.73 **In case the SFC formula is not available, then the share of each gram panchayat as specified above should be distributed across the entities using 2011 population with a weight of 90 per cent and area with a weight of 10 per cent. In the case of urban local bodies, the share of each of the three tiers will be determined on the basis of population of 2011 with a weight of 90 per cent and area with a weight of 10 per cent, and then distributed among the entities in each tier in proportion to the population of 2011 and area in the ratio of 90:10.**

Performance Grants

9.74 Our analysis of the data on gram panchayat revenues provided to us by the States showed that in one State the gram panchayats played an advisory role and had no powers to collect tax or non-tax revenue and in four others they had powers to collect revenues but were not doing so. Of the remaining States, two accounted for most of the revenues collected at the gram panchayat level. For the local bodies to function effectively as institutions of local self-governance, it is important that they augment their own sources of revenue.

9.75 A common issue raised by most SFCs is that their work was hampered by lack of reliable data on receipts and expenditure at the local body level. The studies commissioned by us on panchayats and municipal finances faced similar problems. We note that despite the last three Finance Commissions raising the issue of reliable data and accounts and providing grants to address the issue, not much has happened. In our opinion, this is not a satisfactory state of affairs. **Therefore, we are providing performance grants to address the following issues: (i) making available reliable data on local bodies' receipt and expenditure through audited accounts; and (ii) improvement in own revenues. In addition, the urban local bodies will have to measure and publish service level benchmarks for basic services. These performance grants will be disbursed from the second year of our award period, that is, 2016-17 onwards, so as to enable sufficient time to State Governments and the local bodies to put in place a scheme and mechanism for implementation. The details of the performance grants are given in the paragraphs that follow.**

Performance grant - rural

9.76 **To be eligible for performance grants, the gram panchayats will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which the gram panchayat seeks to claim the performance grant. It will also have to**

show an increase in the own revenues of the local body over the preceding year, as reflected in the audited accounts. To illustrate, the audited accounts required for performance grants in 2016-17 will be for the year 2014-15; for performance grants in 2017-18, the audited accounts will be for the year 2015-16; for performance grants in 2018-19, the audited accounts will be for 2016-17; and for performance grants in 2019-20, the audited accounts will be for 2017-18.

9.77 The underlying objective of the grant is to initiate action at the grassroots level for compilation of data so that all stakeholders have access to reliable information for decision making. At the same time, it enhances accountability of the local self-government institutions to the public. We are conscious that the revenue generation by gram panchayats is at different levels. **Therefore, we are of the opinion that it may be better that the detailed procedure for disbursal of the performance grant to gram panchayats based on revenue improvement be designed by the State Governments concerned, keeping in view the two conditions given above. The operational criteria, including the quantum of incentive to be given, is left to the discretion of the State Governments. In case some amount of the performance grant remains after disbursement to the eligible gram panchayats, this undisbursed amount should be distributed on an equitable basis among all the eligible gram panchayats. The scheme for disbursement of the performance grant will be notified by the State Governments latest by March 2016, in order to enable the preparation of the eligibility list of local bodies entitled to them. The concerned Ministries of the Union Government will also be informed in order to facilitate release of the instalment of performance grants.**

Performance grant - urban

9.78 As in the case of the performance grant for gram panchayats, **a detailed procedure for the disbursal of the performance grant to urban local bodies would have to be designed by the State Government concerned, subject to certain eligibility criteria. To be eligible, the urban local body will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which it seeks to claim the performance grant. It will also have to show an increase in own revenues over the preceding year, as reflected in these audited accounts. In addition, it must publish the service level benchmarks relating to basic urban services each year for the period of the award and make it publically available. The service level benchmarks of the Ministry of Urban Development may be used for this purpose. The improvement in revenues will be determined on the basis of these audited accounts and on no other basis. For computing the increase in own revenues in a particular year, the proceeds from octroi and entry tax must be excluded. In case some amount of the performance grant remains after disbursement to the eligible urban local bodies, the undisbursed amount should be distributed on an equitable basis among all the eligible urban local bodies that had fulfilled the conditions for getting the performance grant.**

9.79 **These guidelines for the disbursement of the rural and urban performance grants will remain in force for the period of our award. We recommend that the Union Government accept the detailed procedure prepared by the State which incorporates our broad guidelines without imposing any further conditions.**

Trust-Based Approach to Release of Grants

9.80 We recognise that there is a need to trust and have respect for local bodies as institutions of local self-government. **Hence, we recommend that no further conditions or directions other than those indicated by us should be imposed either by the Union or the State Government for the release of funds.**

9.81 **The grants recommended by us shall be released in two instalments each year in June and October. This will enable timely flows to local bodies during the year, enabling them to plan and execute the works better. We recommend that 50 per cent of the basic grant for the year be released to the State as the first instalment of the year. The remaining basic grant and the full performance grant for the year may be released as the second instalment for the year. The States should release the grants to the gram panchayats and municipalities within fifteen days of it being credited to their account by the Union Government. In case of delay, the State Government must release the instalment with interest paid from its own funds.**

9.82 Central to the trust-based approach adopted by us is the understanding that the local bodies will discharge their statutory functions with all due care. The publishing of service level data and preparation and audit of accounts will provide the necessary transparency and accountability in this regard. **We recommend that stern action should be ensured if irregularities in the application of funds are noticed or pointed out.**

Strengthening Role of SFCs

9.83 During our interaction with the States, local bodies and SFCs we noticed that there is wide variation in the assignment of functions, funds and functionaries across States. Given this diversity of functional assignments to local bodies across States, it is not feasible for the Finance Commission to carry out a detailed assessment of the finances of local bodies in each State nor has such a role been assigned to it under the ToR or the Constitution. The Constitution envisages that the needs of local bodies within the State shall be assessed in detail by the SFC, which will recommend the required transfer of resources from the State to them. Therefore, it is appropriate that the needs of local bodies are assessed in detail by the SFC.

9.84 The SFC chairpersons have pointed out that despite the passage of time, SFCs in many States continue to work with a lot of disadvantages. Given the considerations set out in the preceding paragraph, we are of the opinion that there is a need for States to facilitate the effective working of SFCs. **Therefore, we recommend that the State Governments should strengthen SFCs. This would involve timely constitution, proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report before State legislatures, with action taken notes.**

Measures to Augment the Consolidated Fund of States

9.85 The ToR mandates us to identify and recommend measures needed to augment the Consolidated Fund of States. In addition to the grants that we have recommended, we have suggested the actionable measures that the State Governments and the local bodies can take to improve their own revenues, based on our examination of SFC reports. There is certainly a need to streamline revenue administration in the States in order to improve own resources of panchayats and municipalities.

9.86 States have classified levies assigned to local bodies as compulsory or optional. However, the classification is different across States. Per capita income from both tax and non-tax sources also varies widely. In the case of own revenue collections by local bodies, the bulk of overall collections were accounted for by local bodies in a few States. **We notice that there is considerable scope for the local bodies to improve revenues from own sources by taking steps as recommended by the SFCs and the Finance Commissions. In our view, States need to take the measures illustrated below to further augment the resources at the State and local bodies' level.**

Tax measures

Property tax

9.87 Property tax is recognised as the major source of revenue for local bodies the world over. However, we noted from the SFC reports that local bodies in a few States have not been given the powers to levy this tax so far; legislations for this purpose have either not been passed or still remain under consideration of those State Governments. In some other States, the panchayats are unable to levy this tax because the necessary regulations have not been framed. In most States where tax is being levied, the rates have not been revised periodically. The list of taxable properties is not being updated and a large number of properties remain outside the tax net.

9.88 A few SFCs have also pointed out that the tax is levied on annual rental value, which leads to lower buoyancy. Often State Governments have issued orders staying the adoption of revised assessment lists or have reduced the rental values. A few SFCs have pointed out that there is a need to review the exemptions that have been granted.

9.89 The study on municipal finances commissioned by us showed that the revenues from property tax of 478 sampled municipalities had risen from Rs. 5,555 crore in 2007-08 to Rs. 10,192 crore in 2012-13. The study indicates that the per capita revenue from property tax varied from Rs. 42 to Rs. 1,677 across States. The study on panchayat finances observed that nearly half of the States reported nil collections from property tax while the others reported low collections. The study has underlined that the potential for collection of property tax has not been fully tapped and suggested that panchayats can raise much more revenues even at the modest rates applicable to the existing tax base. **In our view, States need to ensure property tax reforms including objective determination of the base and its regular revision to adjust for inflation, strengthening of mechanisms for assessment, levy and collection and improving billing and collection efficiency.**

9.90 Review of SFC reports shows that States use different methods for the levy of property tax. However, we have noted that there is a convergence of views in SFC reports that property tax should be levied on plinth area basis. We endorse the views of the SFCs that all the State Governments should empower the panchayats and municipalities to levy property tax on this basis. **We suggest that the existing rules be reviewed and amplified to facilitate the levy of**

property tax and the granting of exemptions be minimised. The assessment of properties may be done every four or five years and the urban local bodies should introduce the system of self-assessment. We recommend that action be taken by the States to share information regarding property tax among the municipalities, State and Union Governments.

Use of Land-based Instruments

9.91 Some SFCs have observed that the urban local bodies do not have a systemic approach to listing of vacant lands. Therefore, such lands often go untaxed and the vacant land tax is demanded only when owners approach authorities for approval of building plans. The SFCs have observed the need to rationalise the rates of taxes on vacant land and have suggested that the tax be fixed as a percentage of the tax on buildings, depending on the class of the city. In our view, this tax, if administered properly, has the potential to earn large revenues for the urban local bodies. **We suggest that the levy of vacant land tax by peri-urban panchayats be considered. In addition, a part of land conversion charges can be shared by State Governments with municipalities and panchayats.**

9.92 Some SFCs have observed that betterment tax is available to both gram panchayats and municipalities as an optional tax. In rural areas, the tax was linked to the improvement in property under schemes carried out by the gram panchayat. As such works were generally small, these did not result in any appreciable improvement in the value of the property and so the tax realised does not increase substantially. The urban local bodies were generally not levying this tax, even though they are allowed to. **We, therefore, recommend that the States should review the position and prepare a clear framework of rules for the levy of betterment tax.**

Advertisement tax

9.93 The reports of some SFCs revealed the fact that panchayats reported low income from advertisement in cases where it was being collected by the district administration for passing on to the panchayats. Even in cases where the panchayats were empowered to collect the tax, most of them were not doing so. In the case of urban local bodies, the tax had two components - tax on hoardings and the tax on advertisements on buses, cars, lamp posts and compound walls. The SFCs also pointed out that in some States, relevant legislation allowed the municipal corporations to collect advertisement tax, but did not give powers to the Tier II and III municipalities to levy the tax. **We are of the view that there is no reason why the incomes of local bodies from advertisement tax cannot increase significantly. In this context, we suggest that States may like to consider steps to empower local bodies to impose this tax and improve own revenues from this source.**

Entertainment tax

9.94 The study on municipal finances indicates that the collection of entertainment tax reported by urban local bodies was low. Three States accounted for most of the collections reported by the States. The study suggests that States should exploit entertainment tax effectively through improved methods of levy and collection. In our view, the entertainment tax legislation and rules in States require a comprehensive review. Newer forms of entertainment such as boat rides, cable television and internet cafes should be brought into the entertainment tax net and no exemptions should be given without compensating local bodies for the loss. **We, therefore, recommend that States review the structure of entertainment tax and take action to increase its scope to cover more and newer forms of entertainment.**

Tax on professions, trades, callings and employments

9.95 Article 276 of the Constitution provides for the levy of a tax on professions, trades, callings and employments for the benefit of the State or local bodies at a rate not exceeding Rs. 2,500 per tax payer per annum. The States, SFCs and local bodies have expressed the view that this tax can be a major source of income for the local bodies if the ceiling can be raised periodically and the tax can be collected efficiently.

9.96 At present, twenty-one states impose professions tax through various laws, adhering to the limit of Rs. 2,500. The coverage of the tax varies - it is generally applicable to all persons engaged in any employment or in any profession in some States, but only to certain specified professions in others. In some States, the tax is levied and collected by the State Government alone, while in others such as Kerala and Tamil Nadu, local bodies also levy and collect the tax under the State legislation. In our view, the low contribution of professions tax to the revenues of the State is largely due to poor collection mechanisms and enforcement at the State level as well as the low limit fixed. The FC-XI had suggested that the rates should be suitably revised to bring them nearer to the ceiling prescribed under the Constitution. They further recommended that the ceiling had been fixed in 1988 by amending the Constitution and needed suitable enhancement. The Commission suggested that Parliament should be empowered to fix this ceiling without going in for a Constitutional amendment each time. Even after fourteen years, no action has been taken to enhance the ceiling on professions tax.

9.97 In our view, professions tax could be one of the important sources of revenue for local bodies, if they are allowed to levy and collect it under the State legislations within the ceilings set by the Parliament. To arrive at a reasonable estimation of the ceiling for professions tax we considered three methods. First, was to index the ceiling on professions tax to the annual growth rate of per capita nominal GSDP. The second method was to consider the historic growth of professions tax in between 1935 and 1988 and from 1950 to 1988 using compound annual growth rate for the two periods as well as the trend growth rate from 1935 to 1988. The third method was to index it to the per capita emoluments of public sector employees. These methods yielded different estimates for the ceiling. **Therefore, taking into consideration all factors, we recommend raising the ceiling from Rs. 2,500 to Rs. 12,000 per annum. We further recommend that Article 276(2) of the Constitution may be amended to increase the limits on the imposition of professions tax by States. The amendment may also vest the power to impose limits on Parliament with the caveat that the limits should adhere to the Finance Commission's recommendations and the Union Government should prescribe a uniform limit for all States.**

Non-Tax Measures

9.98 We noted that the SFC reports have identified the main issues that affect the income of gram panchayats from non-tax revenue sources. First, certain productive assets such as village ponds and orchards, which can generate revenues, have not been assigned to the gram panchayats in some States. Similarly, in some States, gram panchayats do not get incomes from market fees because these are assigned to market committees. Second, rates of fees have not been revised for several years, in some cases for more than five to six decades. Thirdly, in certain States the rural local bodies were unable to collect tolls, fees and duties as the rules for this purpose had not been framed and notified. To improve incomes by obtaining better rates, one SFC suggested that the annual sale value should be determined before auctioning common resources such as fisheries, ponds, ferries, markets and halls for rent. **In this context, we recommend that State Governments take action to assign productive local assets to the panchayats, put in place enabling rules for collection and institute systems so that they can obtain the best returns while leasing or renting common resources.**

9.99 The study on municipal finances pointed out that the urban local bodies are reporting an increase in user charges collected. However, the study suggested that the user charges need rationalisation and also need to be linked with improvement in service levels. We noted that the SFCs have observed that there was a need in urban areas to rationalise and collect charges for basic services provided and that the charges should be so fixed such that the local body is able to recover at least the operation and maintenance cost of the services from the beneficiaries. The SFCs have also stressed on the need to review and periodically update the charges and fees for all the services being provided by the local bodies. Some SFCs have pointed out the need to educate elected representatives, local body functionaries as well as the general public on the importance of own revenues for local bodies and the need to pay for improved delivery of public services. **We recommend that the urban local bodies rationalise their service charges in a way that they are able to at least recover the operation and maintenance costs from the beneficiaries.**

Income from cess or royalty on minor minerals

9.100 Royalty or cess on royalty on minor minerals is shared by some States with local bodies, mainly panchayats. In one State, the royalty on sand had been removed and regulation of sand mining had been entrusted to panchayats. In a few States where royalties were shared, SFCs have observed that the full amounts of the share were not being released to the local bodies. Another SFC noted that the revenues from royalty on minor minerals had not grown in proportion to the increase in the consumption of materials. The SFC of another State pointed out that only Class C municipalities were allowed a share of the cess on royalty.

9.101 **We are of the view that mining puts a burden on the local environment and infrastructure, and, therefore, it is appropriate that some of the income from royalties be shared with the local body in whose jurisdiction the mining is done. This would help the local body ameliorate the effects of mining on the local population.**

Service charges on government property

9.102 Article 285(1) of the Constitution exempts all properties of the Union Government from all taxes imposed by a State or any other authority within a State, unless Parliament expressly provides for such levy by law. The FC-XI had recommended that all government properties of the Union as well as the States should be subject to levy of user charges which should be regulated by suitable legislations. The FC-XIII had urged that the Union Government and the State Governments issue executive instructions that all their respective departments pay appropriate service charges to the local bodies. In a number of States, local body representatives pointed out that the local bodies needed to be compensated for the civic services they provided. **In this context, we recommend that the Union and State Governments examine in depth the issue of properly compensating local bodies for the civic services provided by them to government properties and take necessary action, including enacting suitable legislation, in this regard.**

9.103 **We are of the view that the local bodies are not able to meet even a fraction of their expenditure on providing basic services and have largely become dependent on the transfer of one fund or another. While we have sought to incentivise additional resource mobilisation through the performance grants, there is a need for the States to empower the local bodies to collect tax and non-tax receipts. To implement the measures outlined above, the State Governments may have to bring in necessary legislations as appropriate. In some cases, the State Governments may need to frame rules and fix rates of levy to allow the local bodies to effectively tap the existing sources of revenues. Alternatively, the local bodies may be given powers to decide the rates themselves, subject to a floor and ceiling rate set by the State. Besides, the State Government should not provide exemptions to any entity from the tax and non-tax levies that are in the jurisdiction of local bodies. In cases where the grant of such an exemption becomes necessary, the local bodies should be compensated for the loss.**

Issue of Municipal Bonds

9.104 The resource requirements of local bodies for the delivery of basic services and creation of infrastructure are too large and no single source may be able to provide all the funds needed for this. In this context, we note that the Finance Commission's role is only to supplement the resources of the panchayats and municipalities, not substitute them. It is for the local bodies, particularly the urban local bodies, to take appropriate action, with the support of the State Governments, to augment their own revenue sources and also explore sources of borrowings, including issuance of bonds for meeting huge requirements for provision of basic civic services and creation of urban infrastructure.

9.105 The study on municipal finances points out that only ten States reported borrowings by urban local bodies. Of the Rs. 920 crore borrowed by them in 2012-13, Rs. 854 crore was borrowed by municipal corporations. Of these, municipal corporations in Madhya Pradesh and Maharashtra accounted for Rs. 548 crore. The study observes that market or institutional borrowings are less popular among urban local bodies. The study recommends that State Governments should remove restrictions on the borrowing powers of urban local bodies and give them freedom to mobilise resources, based on their credit ratings.

9.106 We note that the market for municipal securities has grown slowly but noticeably after the Corporation of Ahmedabad issued bonds. Since 1998, local bodies in other cities like Nashik, Nagpur, Ludhiana, and Madurai have accessed the capital markets through municipal bonds. In most cases, bond proceeds have been used to fund water and sewerage schemes or road projects. Tamil Nadu and Karnataka have experimented with pooled financing with an intermediary, set up by the State, borrowing for the purpose of on lending to small municipalities which may not be able to access the capital market on their own.

9.107 **In India, the market for municipal bonds is insignificant and the municipal bonds have played a limited role as a source of finance for funding urban infrastructure projects. We recommend that local bodies and States explore the issuance of municipal bonds as a source of finance with suitable support from the Union Government. The States may allow the larger municipal corporations to directly approach the markets while an intermediary could be set up to assist medium and small municipalities who may not have the capacity to access the markets directly.**

Excluded Areas

9.108 After detailed deliberations on the existing provisions in the Constitution and the ToR, we conclude that we cannot recommend grants to areas where Part IX and Part IX A do not apply, and also where the States have not enacted laws for establishing duly-elected panchayats and municipalities.

9.109 Areas under Schedule VI in Meghalaya, Mizoram, Tripura and Assam, the areas in the hill districts of Manipur, rural areas of Nagaland and Mizoram will remain outside the ambit of the measures we have recommended for panchayats and municipalities. However, we note the weight of the argument put before us by the concerned States that these areas are in pressing need of assistance. We note that the Constitution mandates the Union Government to play a direct role in supporting the development of these areas. However, going by the quantum of the assistance given over the years to these regions by the Ministries in Union Government, we note that the intervention of the Union Government under the proviso to Article 275(1) has been very limited.

9.110 **We urge the Union Government to consider a larger, sustained and more effective direct intervention for the upgradation of administration as well as development of the areas covered under the proviso to Article 275(1) and excluded from the consideration of Finance Commissions in the ToR, in order to bring such areas on par with other areas.**

Recommendations

i. We recommend that the local bodies should be required to spend the grants only on the basic services within the functions assigned to them under relevant legislations. (para 9.56)

ii. We recommend that the books of accounts prepared by the local bodies should distinctly capture income on account of own taxes and non-taxes, assigned taxes, devolution and grants from the State, grants from the Finance Commission and grants for any agency functions assigned by the Union and State Governments. In addition to the above, we also recommend that the technical guidance and support arrangements by the C&AG should be continued and the States should take action to facilitate local bodies to compile accounts and have them audited in time. (para 9.61)

iii. We recommend distribution of grants to the States using 2011 population data with weight of 90 per cent and area with weight of 10 per cent. The grant to each State will be divided into two - a grant to duly constituted gram panchayats and a grant to duly constituted municipalities, on the basis of urban and rural population of that State using the data of Census 2011. (para 9.64)

iv. We have worked out the total size of the grant to be Rs. 2,87,436 crore for the period 2015-20, constituting an assistance of Rs. 488 per capita per annum at an aggregate level. Of this, the grant recommended to panchayats is Rs. 2,00,292.2 crore and that to municipalities is Rs. 87,143.8 crore. The grant assessed by us for each State for each year is fixed. (para 9.69)

v. We have recommended grants in two parts - a basic grant and a performance grant for duly constituted gram panchayats and municipalities. In the case of gram panchayats, 90 per cent of the grant will be the basic grant and 10 per cent will be the performance grant. In the case of municipalities, the division between basic and performance grant will be on a 80:20 basis. The shares of the States for these grants are set out in Annex 9.1. (para 9.70)

vi. We recommend that the grants should go to gram panchayats, which are directly responsible for the delivery of basic services, without any share for other levels. We expect that the State Governments will take care of the needs of the other levels. The earmarked basic grants for gram panchayats will be distributed among them, using the formula prescribed by the respective SFCs for the distribution of resources. Similarly, the basic grant for urban local bodies will be divided into tier-wise shares and distributed across each tier, namely the municipal corporations, municipalities (the tier II urban local bodies) and the nagar panchayats (the tier III local bodies) using the formula given by the respective SFCs. The State Governments should apply the distribution formula of the most recent SFC, whose recommendations have been accepted. (para 9.72)

vii. In case the SFC formula is not available, then the share of each gram panchayat as specified above should be distributed across the entities using 2011 population with a weight of 90 per cent and area with a weight of 10 per cent. In the case of urban local bodies, the share of each of the three tiers will be determined on the basis of population of 2011 with a weight of 90 per cent and area with a weight of 10 per cent, and then distributed among the entities in each tier in proportion to the population of 2011 and area in the ratio of 90:10. (para 9.73)

viii. We are providing performance grants to address the following issues: (i) making available reliable data on local bodies' receipt and expenditure through audited accounts; and (ii) improvement in own revenues. In addition, the urban local bodies will have to measure and publish service level benchmarks for basic services. These performance grants will be disbursed from the second year of our award period, that is, 2016-17 onwards, so as to enable sufficient time to State Governments and the local bodies to put in place a scheme and mechanism for implementation. (para 9.75)

ix. To be eligible for performance grants, the gram panchayats will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which the gram panchayat seeks to claim the performance grant. It will also have to show an increase in the own revenues of the local body over the preceding year, as reflected in the audited accounts. To illustrate, the audited accounts required for performance grants in 2016-17 will be for the year 2014-15; for performance grants in 2017-18, the audited accounts will be for the year 2015-16; for performance grants in 2018-19, the audited accounts will be for 2016-17; and for performance grants in 2019-20, the audited accounts will be for 2017-18. (para 9.76)

x. We are of the opinion that it may be better that the detailed procedure for disbursal of the performance grant to gram panchayats based on revenue improvement be designed by the State Governments concerned, keeping in view the two conditions given above. The operational criteria, including the quantum of incentive to be given, is left to the discretion of the State Governments. In case some amount of the performance grant remains after disbursement to the eligible gram panchayats, this undisbursed amount should be distributed on an equitable basis among all the eligible gram panchayats. The scheme for disbursement of the performance grant will be notified by the State Governments latest by March 2016, in order to enable the preparation of the eligibility list of local bodies entitled to them. The concerned Ministries of the Union Government will also be informed in order to facilitate release of the instalment of performance grants. (para 9.77)

xi. A detailed procedure for the disbursal of the performance grant to urban local bodies would have to be designed by the State Governments concerned, subject to certain eligibility criteria. To be eligible, the urban local body will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which it seeks to claim the performance grant. It will also have to show an increase in own revenues over the preceding year, as reflected in these audited accounts. In addition, it must publish the service level benchmarks relating to basic urban services each year for the period of the award and make it publically available. The service level benchmarks of the Ministry of Urban Development may be used for this purpose. The improvement in revenues will be determined on the basis of these audited accounts and on no other basis. For computing the increase in own revenues in a particular year, the proceeds from octroi and entry tax must be excluded. In case some amount of the performance grant remains after disbursement to the eligible urban local bodies, the undisbursed amount should be distributed on an equitable basis among all the eligible urban local bodies that had fulfilled the conditions for getting the performance grant. (para 9.78)

xii. These guidelines for the disbursement of the rural and urban performance grants will remain in force for the period of our award. We recommend that the Union Government accept the detailed procedure prepared by the State which incorporates our broad guidelines without imposing any further conditions. (para 9.79)

xiii. We recommend that no further conditions or directions other than those indicated by us should be imposed either by the Union or the State Governments for the release of funds. (para 9.80)

xiv. The grants recommended by us shall be released in two instalments each year in June and October. This will enable timely flows to local bodies during the year, enabling them to plan and execute the works better. We recommend that 50 per cent of the basic grant for the year be released to the State as the first instalment of the year. The remaining basic grant and the full performance grant for the year may be released as the second instalment for the year. The States should release the grants to the gram panchayats and municipalities within fifteen days of it being credited to their account by the Union Government. In case of delay, the State Governments must release the instalment with interest paid from its own funds. (para 9.81)

xv. We recommend that stern action should be ensured if irregularities in the application of funds are noticed or pointed out. (para 9.82)

xvi. We recommend that the State Governments should strengthen SFCs. This would involve timely constitution, proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report before State legislature, with action taken notes. (para 9.84)

xvii. We suggest that the existing rules be reviewed and amplified to facilitate the levy of property tax and the granting of exemptions be minimised. The assessment of properties may be done every four or five years and the urban local bodies should introduce the system of self-assessment. We recommend that action be taken by the States to share information regarding property tax among the municipalities, State and Union Governments. (para 9.90)

xviii. We suggest that the levy of vacant land tax by peri-urban panchayats be considered. In addition, a part of land conversion charges can be shared by State Governments with municipalities and panchayats. (para. 9.91)

xix. We recommend that the States should review the position and prepare a clear framework of rules for the levy of betterment tax. (para 9.92)

xx. We suggest that States may like to consider steps to empower local bodies to impose advertisement tax and improve own revenues from this source. (para 9.93)

xxi. We recommend that States review the structure of entertainment tax and take action to increase its scope to cover more and newer forms of entertainment. (para 9.94)

xxii. We recommend raising the ceiling of professions tax from Rs. 2,500 to Rs. 12,000 per annum. We further recommend that Article 276(2) of the Constitution may be amended to increase the limits on the imposition of professions tax by States. The amendment may also vest the power to impose limits on Parliament with the caveat that the limits should adhere to the Finance Commission's recommendations and the Union Government should prescribe a uniform limit for all States. (para 9.97)

xxiii. We recommend that State Governments take action to assign productive local assets to the panchayats, put in place enabling rules for collection and institute systems so that they can obtain the best returns while leasing or renting common resources. (para 9.98)

xxiv. We recommend that the urban local bodies rationalise their service charges in a way that they are able to at least recover the operation and maintenance costs from the beneficiaries. (para 9.99)

xxv. We are of the view that mining puts a burden on the local environment and infrastructure, and, therefore, it is appropriate that some of the income from royalties be shared with the local body in whose jurisdiction the mining is done. This would help the local body ameliorate the effects of mining on the local population. (para 9.101)

xxvi. We recommend that the Union and State Governments examine in depth the issue of properly compensating local bodies for the civic services provided by them to government properties and take necessary action, including enacting suitable legislation, in this regard. (para 9.102)

xxvii. We recommend that the local bodies and States explore the issuance of municipal bonds as a source of finance with suitable support from the Union Government. The States may allow the larger municipal corporations to directly approach the markets while an intermediary could be set up to assist medium and small municipalities who may not have the capacity to access the markets directly. (para 9.107)

xxviii. We urge the Union Government to consider a larger, sustained and more effective direct intervention for the upgradation of administration as well as development of the areas covered under the proviso to Article 275(1) and excluded from the consideration of Finance Commissions in the ToR, in order to bring such areas on par with other areas. (para 9.110)

8. As service tax is not levied in the State of Jammu & Kashmir, proceeds cannot be assigned to this State. We have worked out the share of each of the remaining twenty-eight States in the net proceeds of service taxes and presented this in Table 8.3.

(para 8.31)

Local Governments

9. We recommend that the local bodies should be required to spend the grants only on the basic services within the functions assigned to them under relevant legislations.

(para 9.56)

10. We recommend that the books of accounts prepared by the local bodies should distinctly capture income on account of own taxes and non-taxes, assigned taxes, devolution and grants from the State, grants from the Finance Commission and grants for any agency functions assigned by the Union and State Governments. In addition to the above, we also recommend that the technical guidance and support arrangements by the C&AG should be continued and the States should take action to facilitate local bodies to compile accounts and have them audited in time.

(para 9.61)

11. We recommend distribution of grants to the States using 2011 population data with weight of 90 per cent and area with weight of 10 per cent. The grant to each state will be divided into two, a grant to duly constituted gram panchayats and a grant to duly constituted municipalities, on the basis of urban and rural population of that state using the data of census 2011.

(para 9.64)

12. We have worked out the total size of the grant to be Rs.2,87,436 crore for the period 2015-20, constituting an assistance of Rs. 488 per capita per annum at an aggregate level. Of this, the grant recommended to panchayats is Rs.2,00,292.20 crore and that to municipalities is Rs.87,143.80 crore. The grant assessed by us for each state for each year is fixed.

(para 9.69)

13. We have recommended grants in two parts - a basic grant and a performance grant for duly constituted gram panchayats and municipalities. In the case of gram panchayats, 90 per cent of the grant will be the basic grant and 10 per cent will be the performance grant. In the case of municipalities, the division between basic and performance grant will be on a 80:20 basis. The shares of the States for these grants are set out in Annex 9.1.

(para 9.70)

14. The grants that we recommend should go to gram panchayats, which are directly responsible for the delivery of basic services, without any share for other levels. We expect that the State Governments will take care of the needs of the other levels. The earmarked basic grants for gram panchayats will be distributed among them, using the formula prescribed by the respective SFCs for the distribution of resources. Similarly, the basic grant for urban local bodies will be

divided into tier-wise shares and distributed across each tier, namely the municipal corporations, municipalities (the tier II urban local bodies) and the nagar panchayats (the tier III local bodies) using the formula given by the respective SFCs. The State Government should apply the distribution formula of the most recent SFC, whose recommendations have been accepted.

(para 9.72)

15. In case the SFC formula is not available, then the share of each gram panchayat as specified above should be distributed across the entities using 2011 population with a weight of 90 per cent and area with a weight of 10 percent. In the case of urban local bodies, the share of each of the three tiers will be determined on the basis of population of 2011 with a weight of 90 per cent and area with a weight of 10 per cent and then distributed among the entities in each tier in proportion to the population of 2011 and area in the ratio of 90:10.

(para 9.73)

16. We are providing performance grants to address the following issues: (i) making available reliable data on local bodies' receipt and expenditure through audited accounts; and (ii) improvement in own revenues. In addition, the urban local bodies will have to measure and publish service level benchmarks for basic services. These performance grants will be disbursed from the second year of our award period, that is, 2016-17 onwards so as to enable sufficient time to State Governments and the local bodies to put in place a scheme and mechanism for implementation.

(para 9.75)

17. To be eligible for performance grants, the gram panchayats will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which the gram panchayat seeks to claim the performance grant. It will also have to show an increase in the own revenues of the local body over the preceding year, as reflected in the audited accounts. To illustrate, the audited accounts required for performance grants in 2016-17 will be for the year 2014-15; for performance grants in 2017-18, the audited accounts will be for the year 2015-16; for performance grants in 2018-19, the audited accounts will be for 2016-17; and for performance grants in 2019-20, the audited accounts will be for 2017-18.

(para 9.76)

18. We are of the opinion that it may be better that the detailed procedure for disbursal of the performance grant to gram panchayats based on revenue improvement be designed by the State Government concerned, keeping in view the two conditions given above. The operational criteria, including the quantum of incentive to be given, is left to the discretion of the State Governments. In case some amount of the performance grant remains after disbursement to the eligible gram panchayats, this undisbursed amount should be distributed on an equitable basis among all the eligible gram panchayats. The scheme for disbursement of the performance grant will be notified by the State Governments latest by March 2016, in order to enable the preparation of the eligibility list of local bodies entitled to them. The concerned Ministries of the Union Government will also be informed in order to facilitate release of the instalment of performance grants.

(para 9.77)

19. A detailed procedure for the disbursal of the performance grant to urban local bodies would have to be designed by the State Government concerned, subject to certain eligibility criteria. To be eligible, the urban local body will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which it seeks to claim the performance grant. It will also have to show an increase in the own revenues over the preceding year, as reflected in these audited accounts. In addition, it must publish the service level benchmarks relating to basic urban services each year for the period of the award and make it publically available. The service level benchmarks of the Ministry of Urban Development may be used for this purpose. The improvement in revenues will be determined on the basis of these audited accounts and on no other basis. For computing the increase in own revenues in a particular year, the proceeds from octroi and entry tax must be excluded. In case some amount of the performance grant remains after disbursement to the eligible urban local bodies, the undisbursed amount should be distributed on an equitable basis among all the eligible urban local bodies that had fulfilled the conditions for getting the performance grant.

(para 9.78)

20. These guidelines for the disbursement of the rural and urban performance grants will remain in force for the period of our award. We recommend that the Union Government accept the detailed procedure prepared by the State which incorporates our broad guidelines without imposing any further conditions.

(para 9.79)

21. We recommend that no further conditions or directions other than those indicated by us should be imposed either by the Union or the State Government for the release of funds.

(para 9.80)

22. The grants recommended by us shall be released in two instalments each year in June and October. This will enable timely flows to local bodies during the year, enabling them to plan and execute the works better. We recommend that 50 per cent of the basic grant for the year be released to the State as the first instalment of the year. The remaining basic grant and the full performance grant for the year may be released as the second instalment for the year. The States should release the grants to the gram panchayats and municipalities within fifteen days of it being credited to their account by the Union Government. In case of delay, the State Government must release the instalment with interest paid from its own funds.

(para 9.81)

23. We recommend that stern action should be ensured if irregularities in the application of funds are noticed or pointed out.

(para 9.82)

24. We recommend that the State Governments should strengthen SFCs. This would involve timely constitution, proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report before State legislature, with action taken notes.

(para 9.84)

25. We suggest that the existing rules be reviewed and amplified to facilitate the levy of property tax and the granting of exemptions be minimised. The assessment of properties may be done every four or five years and the urban local bodies should introduce the system of self-assessment. We recommend that action be taken by the States to share information regarding property tax among the municipalities, State and Union Governments.

(para 9.90)

26. We suggest that the levy of vacant land tax by peri-urban panchayats be considered. In addition, a part of land conversion charges can be shared by State Governments with municipalities and panchayats.

(para 9.91)

27. We recommend that the States should review the position and prepare a clear framework of rules for the levy of betterment tax.

(para 9.92)

28. We suggest that States may like to consider steps to empower local bodies to impose advertisement tax and improve own revenues from this source.

(para 9.93)

29. We recommend that States review the structure of entertainment tax and take action to increase its scope to cover more and newer forms of entertainment.

(para 9.94)

30. We recommend raising the ceiling of professions tax from Rs. 2500 per annum to Rs. 12,000 per annum. We further recommend that Article 276(2) of the Constitution may be amended to increase the limits on the imposition of professions tax by States. The amendment may also vest the power to impose limits on the Parliament with the caveat that the limits should adhere to the Finance Commission's recommendations and the Union Government should prescribe a uniform limit for all states.

(para 9.97)

31. We recommend that State Governments take action to assign productive local assets to the panchayats, put in place enabling rules for collection and institute systems so that they can obtain the best returns while leasing or renting common resources.

(para 9.98)

32. We recommend that the urban local bodies rationalise their service charges in a way that they are able to at least recover the operation and maintenance costs from the beneficiaries.

(para 9.99)

33. We are of the view that mining puts a burden on the local environment and infrastructure, and, therefore, it is appropriate that some of the income from royalties be shared with the local

body in whose jurisdiction the mining is done. This would help the local body ameliorate the effects of mining on the local population.

(para 9.101)

34. We recommend that the Union and State Governments examine in depth the issue of properly compensating local bodies for the civic services provided by them to government properties and take necessary action, including enacting suitable legislation, in this regard.

(para 9.102)

35. We recommend that local bodies and States explore the issuance of municipal bonds as a source of finance with suitable support from the Union Government. The States may allow the larger municipal corporations to directly approach the markets while an intermediary could be set up to assist medium and small municipalities who may not have the capacity to access the markets directly.

(9.107)

36. We urge the Union Government to consider a larger, sustained and more effective direct intervention for the up-gradation of administration as well as development of the areas covered under the proviso to Article 275(1) and excluded from the consideration of Finance Commissions in the ToR, in order to bring such areas on par with other areas.

(para 9.110)

Disaster Management

37. The financing of the NDRF has so far been almost wholly through the levy of cess on selected items, but if the cesses are discontinued or when they are subsumed under the GST in future, we recommend that the Union Government consider ensuring an assured source of funding for the NDRF.

(para 10.26)

38. While making appropriations into the NDRF, we recommend that past trends of outflows from it should be taken into account by the Union Government to ensure adequacy of the Fund in order to assure timely availability and release of funds to the States.

(para 10.27)

39. Recognizing that contributions from the public and institutions could be another source of financing the NDRF, we recommend that a decision on granting tax exemption to private contributions to the NDRF be expedited and that the Union Government consider invoking the use of Schedule VII of the Companies (Corporate Social Responsibility Policy) Rules 2014 as an enabling provision for financing the NDRF.

(paras 10.28 and 10.29)

Annex.9.1
(Para 9.70)

Grants to Local Bodies

(i) State-wise Area, Population and Weights Assigned

Sl.No.	Particulars	Area		Population (in million)				Population Ratio (%)		Weights (%)		
		000 sq. km	Inter Se Shares (%)	Total	Rural	Urban	Inter Se Shares (%)	Rural	Urban	Area (10%)	Population (90%)	Total
1	Andhra Pradesh	160.20	5.06	49.39	34.78	14.61	4.19	70.42	29.58	0.506	3.770	4.276
2	Arunachal Pradesh	83.74	2.65	1.38	1.07	0.32	0.12	77.06	22.94	0.265	0.106	0.370
3	Assam	54.14	1.71	26.87	22.79	4.08	2.28	84.80	15.20	0.171	2.051	2.222
4	Bihar	94.16	2.97	104.10	92.34	11.76	8.83	88.71	11.29	0.297	7.946	8.243
5	Chhattisgarh	135.19	4.27	25.55	19.61	5.94	2.17	76.76	23.24	0.427	1.950	2.377
6	Goa	3.70	0.12	1.46	0.55	0.91	0.12	37.83	62.17	0.012	0.111	0.123
7	Gujarat	196.24	6.20	60.44	34.69	25.75	5.13	57.40	42.60	0.620	4.613	5.233
8	Haryana	44.21	1.40	25.35	16.51	8.84	2.15	65.12	34.88	0.140	1.935	2.075
9	Himachal Pradesh	55.67	1.76	6.86	6.18	0.69	0.58	89.97	10.03	0.176	0.524	0.700
10	Jammu & Kashmir	222.24	7.02	12.54	9.11	3.43	1.06	72.62	27.38	0.702	0.957	1.659
11	Jharkhand	79.72	2.52	32.99	25.06	7.93	2.80	75.95	24.05	0.252	2.518	2.770
12	Karnataka	191.79	6.06	61.10	37.47	23.63	5.18	61.33	38.67	0.606	4.663	5.269
13	Kerala	38.85	1.23	33.41	17.47	15.93	2.83	52.30	47.70	0.123	2.550	2.673
14	Madhya Pradesh	308.25	9.74	72.63	52.56	20.07	6.16	72.37	27.63	0.974	5.544	6.517
15	Maharashtra	307.71	9.72	112.37	61.56	50.82	9.53	54.78	45.22	0.972	8.577	9.549
16	Manipur	2.24	0.07	1.63	0.89	0.74	0.14	54.40	45.60	0.007	0.125	0.132
17	Meghalaya	0.01	0.00	0.14	0.00	0.14	0.01	0.00	100.00	0.000	0.011	0.011
18	Mizoram	0.53	0.02	0.53	0.00	0.53	0.04	0.00	100.00	0.002	0.040	0.042
19	Nagaland	0.24	0.01	0.57	0.00	0.57	0.05	0.00	100.00	0.001	0.044	0.044
20	Odisha	155.71	4.92	41.97	34.97	7.00	3.56	83.31	16.69	0.492	3.204	3.696
21	Punjab	50.36	1.59	27.74	17.34	10.40	2.35	62.52	37.48	0.159	2.118	2.277
22	Rajasthan	342.24	10.81	68.55	51.50	17.05	5.81	75.13	24.87	1.081	5.232	6.313
23	Sikkim	7.10	0.22	0.61	0.46	0.15	0.05	74.85	25.15	0.022	0.047	0.069
24	Tamil Nadu	130.06	4.11	72.15	37.23	34.92	6.12	51.60	48.40	0.411	5.507	5.918
25	Telangana	114.84	3.63	35.19	21.59	13.61	2.98	61.33	38.67	0.363	2.686	3.049
26	Tripura	3.35	0.11	2.41	1.45	0.96	0.20	60.07	39.93	0.011	0.184	0.194
27	Uttar Pradesh	240.93	7.61	199.81	155.32	44.50	16.95	77.73	22.27	0.761	15.251	16.013
28	Uttrakhand	53.48	1.69	10.09	7.04	3.05	0.86	69.77	30.23	0.169	0.770	0.939
29	West Bengal	88.75	2.80	91.28	62.18	29.09	7.74	68.13	31.87	0.280	6.967	7.247
	Total	**3165.68**	**100.00**	**1179.11**	**821.69**	**357.42**	**100.00**	**69.69**	**30.31**	**10.000**	**90.000**	**100.000**

Annex 9.1
(Para 9.70)

Grants to Local Bodies

(ii) State-wise Share - Basic Grants

(Rs. crore)

Sl. No.	States	Rural Local Bodies						Urban Local Bodies					
		2015-16	2016-17	2017-18	2018-19	2019-20	2015-20	2015-16	2016-17	2017-18	2018-19	2019-20	2015-20
1	Andhra Pradesh	934.34	1293.75	1494.81	1729.23	2336.56	**7788.68**	348.92	483.14	558.23	645.77	872.57	**2908.64**
2	Arunachal Pradesh	88.52	122.58	141.62	163.83	221.38	**737.93**	23.42	32.43	37.47	43.34	58.56	**195.22**
3	Assam	584.80	809.76	935.60	1082.32	1462.45	**4874.92**	93.14	128.97	149.01	172.38	232.92	**776.43**
4	Bihar	2269.18	3142.08	3630.39	4199.71	5674.70	**18916.05**	256.83	355.63	410.90	475.34	642.28	**2140.99**
5	Chhattisgarh	566.18	783.98	905.81	1047.86	1415.89	**4719.72**	152.39	211.01	243.80	282.04	381.09	**1270.33**
6	Goa	14.44	20.00	23.10	26.73	36.12	**120.39**	21.10	29.21	33.76	39.05	52.76	**175.88**
7	Gujarat	932.25	1290.86	1491.47	1725.36	2331.33	**7771.26**	614.91	851.45	983.77	1138.05	1537.74	**5125.91**
8	Haryana	419.28	580.57	670.80	775.99	1048.53	**3495.17**	199.61	276.39	319.35	369.43	499.18	**1663.95**
9	Himachal Pradesh	195.39	270.56	312.60	361.63	488.64	**1628.82**	19.36	26.81	30.98	35.84	48.42	**161.42**
10	Jammu & Kashmir	373.96	517.81	598.29	692.11	935.19	**3117.36**	125.30	173.50	200.46	231.90	313.35	**1044.51**
11	Jharkhand	652.83	903.96	1044.45	1208.24	1632.59	**5442.07**	183.74	254.42	293.95	340.05	459.48	**1531.64**
12	Karnataka	1002.85	1388.62	1604.42	1856.02	2507.88	**8359.79**	562.08	778.29	899.25	1040.27	1405.62	**4685.50**
13	Kerala	433.76	600.62	693.96	802.78	1084.73	**3615.85**	351.66	486.94	562.61	650.84	879.42	**2931.48**
14	Madhya Pradesh	1463.61	2026.62	2341.57	2708.78	3660.14	**12200.72**	496.79	687.89	794.80	919.44	1242.36	**4141.27**
15	Maharashtra	1623.32	2247.77	2597.10	3004.37	4059.55	**13532.11**	1191.24	1649.49	1905.83	2204.70	2979.02	**9930.29**
16	Manipur	22.25	30.80	35.59	41.17	55.63	**185.44**	16.57	22.95	26.52	30.67	41.45	**138.16**
17	Meghalaya	0.00	0.00	0.00	0.00	0.00	**0.00**	3.03	4.19	4.84	5.60	7.57	**25.22**
18	Mizoram	0.00	0.00	0.00	0.00	0.00	**0.00**	11.54	15.97	18.46	21.35	28.85	**96.17**
19	Nagaland	0.00	0.00	0.00	0.00	0.00	**0.00**	12.23	16.94	19.57	22.64	30.59	**101.98**
20	Odisha	955.52	1323.09	1528.71	1768.44	2389.54	**7965.28**	170.10	235.54	272.14	314.82	425.39	**1417.98**
21	Punjab	441.70	611.61	706.66	817.48	1104.58	**3682.02**	235.41	325.96	376.62	435.68	588.69	**1962.35**
22	Rajasthan	1471.95	2038.17	2354.92	2724.22	3681.01	**12270.27**	433.12	599.73	692.93	801.60	1083.13	**3610.50**
23	Sikkim	16.03	22.20	25.65	29.67	40.09	**133.64**	4.79	6.63	7.66	8.86	11.98	**39.92**
24	Tamil Nadu	947.65	1312.19	1516.12	1753.87	2369.86	**7899.69**	790.04	1093.95	1263.96	1462.18	1975.71	**6585.85**
25	Telangana	580.34	803.58	928.47	1074.07	1451.30	**4837.75**	325.23	450.33	520.32	601.92	813.32	**2711.12**
26	Tripura	36.24	50.18	57.98	67.07	90.63	**302.11**	21.41	29.65	34.25	39.63	53.54	**178.48**
27	Uttar Pradesh	3862.60	5348.45	6179.65	7148.74	9659.47	**32198.90**	983.60	1361.97	1573.63	1820.41	2459.76	**8199.37**
28	Uttrakhand	203.26	281.45	325.19	376.19	508.31	**1694.42**	78.29	108.41	125.26	144.90	195.79	**652.66**
29	West Bengal	1532.21	2121.61	2451.33	2835.75	3831.70	**12772.60**	637.21	882.33	1019.45	1179.32	1593.51	**5311.81**
	Total	**21624.46**	**29942.86**	**34596.25**	**40021.65**	**54077.76**	**180262.98**	**8363.06**	**11580.12**	**13379.78**	**15478.00**	**20914.08**	**69715.04**

Annex.9.1
(Para 9.70)

Grants to Local Bodies

(iii) State-wise Share - Performance Grants

(Rs. crore)

Sl. No.	States	Rural Local Bodies					Urban Local Bodies				
		2016-17	2017-18	2018-19	2019-20	2016-20	2016-17	2017-18	2018-19	2019-20	2016-20
1	Andhra Pradesh	169.70	192.04	218.09	285.57	**865.41**	142.59	161.36	183.25	239.95	**727.16**
2	Arunachal Pradesh	16.08	18.20	20.66	27.06	**81.99**	9.57	10.83	12.30	16.10	**48.81**
3	Assam	106.22	120.20	136.50	178.74	**541.66**	38.06	43.07	48.92	64.05	**194.11**
4	Bihar	412.15	466.41	529.67	693.55	**2101.78**	104.96	118.78	134.89	176.62	**535.25**
5	Chhattisgarh	102.84	116.37	132.16	173.05	**524.41**	62.28	70.47	80.03	104.80	**317.58**
6	Goa	2.62	2.97	3.37	4.41	**13.38**	8.62	9.76	11.08	14.51	**43.97**
7	Gujarat	169.32	191.61	217.60	284.93	**863.47**	251.29	284.37	322.94	422.87	**1281.48**
8	Haryana	76.15	86.18	97.87	128.15	**388.35**	81.57	92.31	104.83	137.27	**415.99**
9	Himachal Pradesh	35.49	40.16	45.61	59.72	**180.98**	7.91	8.95	10.17	13.32	**40.35**
10	Jammu & Kashmir	67.92	76.86	87.29	114.3	**346.37**	51.21	57.95	65.81	86.17	**261.13**
11	Jharkhand	118.57	134.18	152.38	199.53	**604.67**	75.09	84.97	96.50	126.35	**382.91**
12	Karnataka	182.15	206.13	234.08	306.51	**928.87**	229.70	259.94	295.20	386.54	**1171.38**
13	Kerala	78.78	89.16	101.25	132.57	**401.76**	143.71	162.63	184.69	241.83	**732.87**
14	Madhya Pradesh	265.84	300.83	341.63	447.34	**1355.64**	203.02	229.75	260.91	341.64	**1035.32**
15	Maharashtra	294.84	333.66	378.91	496.15	**1503.57**	486.82	550.91	625.63	819.21	**2482.57**
16	Manipur	4.04	4.57	5.19	6.80	**20.60**	6.77	7.66	8.70	11.40	**34.54**
17	Meghalaya	0	0	0	0	**0**	1.24	1.40	1.59	2.08	**6.30**
18	Mizoram	0	0	0	0	**0**	4.71	5.34	6.06	7.93	**24.04**
19	Nagaland	0	0	0	0	**0**	5.00	5.66	6.43	8.41	**25.50**
20	Odisha	173.55	196.40	223.04	292.05	**885.03**	69.52	78.67	89.34	116.98	**354.50**
21	Punjab	80.23	90.79	103.10	135.00	**409.11**	96.20	108.87	123.63	161.89	**490.59**
22	Rajasthan	267.35	302.55	343.58	449.89	**1363.36**	177.00	200.30	227.47	297.85	**902.62**
23	Sikkim	2.91	3.30	3.74	4.90	**14.85**	1.96	2.21	2.52	3.29	**9.98**
24	Tamil Nadu	172.12	194.78	221.20	289.64	**877.74**	322.87	365.37	414.92	543.31	**1646.46**
25	Telangana	105.41	119.28	135.46	177.38	**537.53**	132.91	150.41	170.81	223.66	**677.78**
26	Tripura	6.58	7.45	8.46	11.08	**33.57**	8.75	9.90	11.24	14.72	**44.62**
27	Uttar Pradesh	701.57	793.92	901.60	1180.57	**3577.66**	401.97	454.88	516.58	676.42	**2049.84**
28	Uttrakhand	36.92	41.78	47.45	62.13	**188.27**	32.00	36.21	41.12	53.84	**163.17**
29	West Bengal	278.30	314.93	357.64	468.31	**1419.18**	260.41	294.69	334.66	438.20	**1327.95**
	Total	**3927.66**	**4444.71**	**5047.53**	**6609.32**	**20029.22**	**3417.72**	**3867.64**	**4392.19**	**5751.21**	**17428.76**