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# FINANCING URBAN LOCAL BODIES IN KARNATAKA

**Shashank Atreya**

**Alok Prasanna Kumar**

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## ABOUT THE AUTHORS

**Alok Prasanna Kumar** is a **Senior Resident Fellow** at the Vidhi Centre for Legal Policy, Bengaluru

**Shashank Atreya** is a **Research Fellow** at the Vidhi Centre for Legal Policy, Bengaluru

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# I. EXECUTIVE SUMMARY

Financing of urban local bodies in India is a subject which has received much attention from result, services to the citizens suffer. In Karnataka, governments in the past have undertaken a series of efforts to improve the financial situation of the urban local bodies (“ULBs”). However, these efforts have remained piecemeal as the insitutional structure and framework of various authorities inovolved remain unchanged, allowing only a limited impact to take place.

This report undertakes a study of the legal and regulatory framework governing the financing of ULBs in Karnataka, in an effort to identify and address those legal impediments that restrict the ULBs from being financially independent. The scope of this study is limited to those ULBs which are declared as City Corporations under the Karnataka Municipal Corporations Act , 1976 (“KMC Act”).

## 1. Property Tax

1. Mangaluru city corporation is the least efficient in collecting property tax, while Bengaluru is most efficient. This may be attributed to the initiatives such as self assessment scheme and online payment portal undertaken by Bruhat Bengaluru Mahanagar Palike (“BBMP”). Due to limited property tax realization, grants across the four cities has been upwards of 60 % barring Mangaluru.
2. The Central Valuation Committee(“CVC”) which determines the guidance value for the calculation of property tax has numerous shortcomings in its governing framework. The Sub-Committees working under the CVC is not mandated to consult the urban local bodies(“ULBs”) or the City Corporations. Definition of key terms such as house sites and commercial area have remained undefined, resulting in loss of potential revenue.
3. Demand notice for the recovery of property tax are often challenged before courts. The framework for property tax dispute resolution under the KMC Act is arachic and limits the success of revenue recovery. The KMC Act may be amended to set up a

dedicated property tax tribunal and barring the jurisdiction of Civil Court or retain the jurisdiction of the civil court and mandate the deposit of the disputed tax amount prior to the admission of challenge (Maharashtra).

4. To strengthen the process of self-assessment scheme amendments to section 108 and 108A of the KMC Act may be carried out to fine citizens who delibretly under assess.
5. With increasing urban jurisdiction, ability to bring all properties under the property tax net is a cause of major concern to the ULBs and especially Bruhat Bengaluru Mahanagara Palike. Extending the Urban Property Ownership Record Scheme to Bengaluru and remaining parts of Karnataka would allow fresh survey and assessment of properties, resulting in systematic property tax levy.

## 2. Water Charges

1. None of the selected cities fare upwards of 50 % in water collection efficiency. With urban water supply in Karnataka being funded by loans from World Bank and Asian Development Bank, there is pressure of repayment; inefficient water charge collection requires the ULBs to utilize alternate heads of revenue to repay.
2. To ensure smooth implementation of water supply scheme. Establish a project management committee to facilitate the participation of ULBs
3. One of the significant concerns that results in financial pressure on the ULBs is high levels of non-revenue water. Non-revenue water cells at each ULBs may be established and performance of water audit be mandated.
4. To monitor the contracts entered into by the ULBs for maintenance of urban water supply infrastructure and suggest periodic revision of water charges an urban water supply regulator may be established.

### 3. Advertisement Tax

1. Levy of advertisement tax in urban local bodies, apart from Bengaluru, is limited due to the absence of rules/bye-laws to govern its levy. To facilitate periodic collection of advertisement taxes, there is an urgent need for Directorate of Municipal Administration to draft rules/bye-laws for the levy and collection of advertisement tax.
2. Establish an Advertising Regulation Committee which will undertake the responsibility of compliance and suggesting tax rate revision.
3. Establish an Advertisement Tax Enforcement Committee headed by Karnataka Administrative Service (“KAS”) officer to ensure stringent collection.

### 4. Debt Financing Infrastructure

1. Draft a debt limitation policy under the KMC Act to facilitate quick access to loans for the ULBs.
2. Develop a regulatory framework for raising money through regulatory bonds and amend certain guidelines issued by central institutions dealing with municipal bonds

### 5. Professional Tax

1. Proceeds from professional tax may be earmarked to ULBs, in accordance with the revenue sharing arrangement suggested by the State Finance Commission.

### 6. Fiscal Control and Accountability

1. Amend the Karnataka local fund authorities and fiscal responsibility Act, 2003 to establish fiscal review committee under the Chairmanship of the secretary Urban Development Department Government of Karnataka to periodically monitor the finances of the ULBs and City Corporations.

## II. INTRODUCTION

Cities across the world play a crucial role in driving economic and social change. Municipal administrations are entrusted with the important task of providing civic amenities and services which help improve the quality of urban life. To do this, authorities need significant financial resources and independence.<sup>1</sup> In India, the constant growth of cities has resulted in immense pressure on City Corporations, impacting the delivery of services to the citizenry. These factors pose challenges to urban authorities looking to effectively govern and ensure smooth administration.<sup>2</sup>

Population growth in cities has been due to large internal migration of citizens from rural and semi-urban areas to urban areas. Based on the 2011 census figures released by Government of India, out of 100 internal migrants, 36 shift to urban areas. With urban areas witnessing rapid growth, 18 out of 100 migrants shift between urban areas. This constant addition to population creates an increase in demand for public services and infrastructure while also requiring its regular maintenance.<sup>3</sup> As per the report by McKinsey Global Institute, it is predicted that Indian cities need \$1.2 trillion of additional capital investment by 2030.<sup>4</sup> It is also expected that India will add another 497 million persons to its urban population between 2010 and 2050.<sup>5</sup>

To administer growing cities strong governing institutions with substantial financial and decisional autonomy are absolutely necessary. Such institutions must have a proper legal

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<sup>1</sup> Sir Amyas Morse KCB (C&AG, House of Commons), 'The impact of funding reductions on local authorities' (2014) National Audit Office, <<https://www.nao.org.uk/wp-content/uploads/2014/11/Impact-of-funding-reductions-on-local-authorities.pdf>> Last accessed 15 November 2017

<sup>2</sup> 'Capacity building for decentralized urban governance' (2007) United Nations Development Program < [http://www.in.undp.org/content/dam/india/docs/urban\\_governance.pdf](http://www.in.undp.org/content/dam/india/docs/urban_governance.pdf)> Last accessed 15<sup>th</sup> November 2017

<sup>3</sup> Ram Bhagat, 'Urban Migration Trends, Challenges and Opportunities in India' (2014), International Institute for Population Sciences, <[https://www.iom.int/sites/default/files/our\\_work/ICP/MPR/WMR-2015-Background-Paper-RBhagat.pdf](https://www.iom.int/sites/default/files/our_work/ICP/MPR/WMR-2015-Background-Paper-RBhagat.pdf)> Last accessed 22 November 2017

<sup>4</sup> 'India's urban awakening: Building inclusive cities, sustaining economic growth', The McKinsey Global Institute, (2010) <[https://www.mckinsey.com/~media/.../MGI\\_Indias\\_urban\\_awakening\\_full\\_report.ashx](https://www.mckinsey.com/~media/.../MGI_Indias_urban_awakening_full_report.ashx)> Last accessed 15 November 2017

<sup>5</sup> *Ibid.*

framework that makes them accountable to the residents they serve, provide multiple avenues of revenue, and ensure fiscal discipline.

## 1. History of Municipal Governance in India

Cities have a long history in India. The earliest urban settlements of the Indus Valley Civilization have been dated back to the third millennium BCE. The organization of streets, the standardization of bricks, weights and roads all suggest some form of local governance which was responsible for urban areas.<sup>6</sup> References to highly organized systems of local governance can be found in Vedic writings such as the *Upanishads*, *Kautilya's Arthashastra* and in epics such as *Ramayana* and *Mahabharat*. However, during freedom struggle, this was galvanized in Gandhi's work *Hind Swaraj* where he conceptualized a village republic or 'Gram Swaraj' based on his readings of India's rich countryside and its history. In ancient times, these village governments functioned as small republics and such communities stood the test of time, lasting through the change of rule from the Aryans to the British and finally flourishing under constitutional mandate in independent India.<sup>7</sup>

Under Mughal rule, the pivot of urban administration was the city *kotwal* whose duties and powers were wide ranging. It included functions now assigned to the municipal boards, some of which being regulation of property prices, and ensuring law and order in the city. At the village level, *panchayats* continued to govern and settle majority of the disputes, with minimal interference from superior governing institutions.<sup>8</sup>

The Municipal Town Corporation Act of 1835 passed by the British Parliament became the first modern legal mechanism dealing exclusively with local governance. Provisions of the act were adopted in the Municipal Charter of 1842 for the city of Madras, which established municipalities and by 1870 about 200 municipalities were functioning in British India. This

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<sup>6</sup> Ashok Kumar H and Dr T.M Mahesh "Rural Local Governance in Karnataka: Issues and Trends"( International Journal of Humanities and Social Science Invention, April 2013)< [http://www.ijhssi.org/papers/v2\(4\)/version-5/B240713.pdf](http://www.ijhssi.org/papers/v2(4)/version-5/B240713.pdf)> Last accessed 31<sup>st</sup> January 2018

<sup>7</sup> Michael Tharakan, 'Gandhian and Marxist Approaches to Decentralised Governance in India: Points of Similarity', *Social Scientist* (2012) 40, no. 9/10, 47-60

<sup>8</sup> R.P. Pandey, 'Administration of Justice through Kotwal during the Moghul Period', the *Indian Journal of Political Science* (1964) 25, no. 3/4 152-56. <<http://www.jstor.org/stable/41854026>> Last accessed 23rd November 2017

was followed by the release of the Montague Chelmsford Report under the Government of India Act, 1919 which mandated a Chairman of the municipalities, and the responsibility of day-to-day administration to be entrusted to a Commissioner, who would be appointed by the State Government. The 1919 reforms did not determine the extent of oversight the Government can exercise in the administration of local affairs, making the municipalities subservient to the Government. In 1935, the Government of India Act limited the powers of the Government in matters of local affairs by granting provisional autonomy to the municipalities.<sup>9</sup>

The present system of municipal governance in India is reflective of the tumultuous history of Indian governance. During the British Administration, there was an element of continuity of features of Mughal style of governance, as the structure laid down in the Hastings' Plan of 1772 had a unique mix of European and Mughal styles. Yet, the colonial authorities had anxieties of their own; they faced a foreign land with unfamiliar institutions.<sup>10</sup> The system was further improvised, in Lord Ripon's Resolution in 1882, to centralize governing powers while retaining the fundamental principles of local governance as laid down through the ages.<sup>11</sup>

Post-independence, the constitutional framers were unsure of the extent of autonomy that may be vested with the municipalities, and hence created a constitutional obligation under the Directive Principles of State Policy through Article 40 of the Constitution to establish self-governing institutions without mandating it.<sup>12</sup> The Balwant Rai Mehta, G.V.K Rao, and L.M. Singhvi Committees were set up by the Central Government in 1957, 1986 and 1986 respectively to study the scope of local self-governance in India. These reports followed by the eighth five-year plan, initiated reforms at the local governance level. Soon, efforts were

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<sup>9</sup> Mani Shankar Aiyar, 'Local Government in India and China' (2010) *The Brown Journal of World Affairs*, no. 1 221-32. <<http://www.jstor.org/stable/24590768>> Last accessed 23rd November 2017

<sup>10</sup> Jon E. Wilson, 'Anxieties of distance: Codification in early colonial Bengal', *Modern Intellectual History* (2007) 4(1), pp.7-23.

<sup>11</sup> S. N Mallik, 'Local Self-Government in India.' *The Annals of the American Academy of Political and Social Science* 145 (1929): 36-44. <<http://www.jstor.org/stable/1016884>> Last accessed 10<sup>th</sup> January 2018.

<sup>12</sup> Rosen, Mark D. 'The Outer Limits of Community Self-Governance in Residential Associations, Municipalities, and Indian Country: A Liberal Theory' (1998) *Virginia Law Review*, vol. 84, no. 6, pp. 1053-1144 <[www.jstor.org/stable/1073695](http://www.jstor.org/stable/1073695)> Last accessed 29th January 2018.

made by Prime Ministers Rajiv Gandhi and VP Singh to introduce constitutional amendments which did not succeed.<sup>13</sup> Finally under Prime Minister Narasimha Rao, the 73<sup>rd</sup> and 74<sup>th</sup> amendments were passed which ultimately provided constitutional recognition to Panchayathi Raj Institutions (“PRIs”) and Urban Local Bodies (“ULBs”).

## **2. Objective & Features of the 73<sup>rd</sup> and 74<sup>th</sup> Amendments**

Popularly known as the *Nagarpalika Act*, the 74<sup>th</sup> Amendment to the Constitution was passed by Parliament on 22<sup>nd</sup> December 1993, just after the 73<sup>rd</sup> Constitutional Amendment Act (known as the *Panchayati Raj Act*).

The 74<sup>th</sup> amendment constitutionally recognizes ULBs and provides a list of responsibilities it is required to undertake. Together, the 73<sup>rd</sup> and 74<sup>th</sup> provide a mechanism for local self-governance at multiple tiers. While India has come a long way since these constitutional amendments, going back to the objective of these amendments and the purpose they sought to achieve will provide directions to policy makers while dealing with new urban challenges.

The spirit of the 74<sup>th</sup> amendment was to bring about a change in urban local governance as participation of citizens in local governance was limited and existing structure had high influence of the Union Government on local issues.<sup>14</sup> The Eighth Plan (1992-1997) recognized the essential need to involve residents in the process of local governance by limiting the dependence on the Government (Union and State) for development activities.<sup>15</sup> The plan aimed to formulate institutional strategies, which would create and strengthen ULBs and vest with them adequate financial resources, technical/managerial inputs, and decision-making authority. The Plan also elaborated the need for bringing about systematic involvement and active participation of the people in developmental activities. The plan was followed by the 74<sup>th</sup> amendment, which voiced the following principles.<sup>16</sup>

<sup>13</sup> Michael Tharakan, see n (7).

<sup>14</sup> Buddhadeb Ghosh, ‘Decentralization: A Constitutional Mandate or Rhetoric?’ (2010) *Economic and Political Weekly*, Vol. 45, <<http://www.jstor.org/stable/25742099>> Last accessed 15<sup>th</sup> November 2017

<sup>15</sup> Soumen Bagchi, ‘Myth of Empowering Urban Local Bodies’ (1999) *Economic and Political Weekly*, Vol. 34, No. 37 <<http://www.jstor.org/stable/4408392>> Last accessed 15<sup>th</sup> November 2017

<sup>16</sup> Anuradha Sharma and D Leena, ‘Analyzing the 74<sup>th</sup> Constitutional Amendment Act, 1992’ (Hazards Centre, 2007)

- (a) Decentralized institutions have the capacity to diagnose the needs of the areas, interact with the governmental agencies in order to draw need based local plans, and to implement those plans in close cooperation and guidance with the State Government.
- (b) Create local authorities and make them accountable to the local community. These authorities are better placed to improve the delivery systems in administering schemes and programs drawn up when responding to the felt needs of the people, and to optimize the benefits reaching those for whom they are meant.

The provisions of the 74<sup>th</sup> amendment range from Article 243P to Article 243ZG. Under Article 243Q urban areas of a State are required to be governed by a Municipal Corporation/Municipality/Nagar Panchayats and the State is required to frame law defining the powers and functions of such corporations/municipalities. Under Article 243S, Ward Committees are required to be established in urban areas with more than 3 lakh population. They are required to function under the aegis of Municipal Corporation. Article 243W lists the powers, authorities and responsibilities of municipalities, which are principles upon which Municipal Corporation Acts are legislated in various states. Article 243X deals with the finances of the corporation by empowering it to collect certain taxes, which may be determined by the State. It also under Article 243X that corporations eligible for grants-in-aid from the Central and State Governments. Article 243Y given the State Finance Commission (“SFC”), established under Article 243I, the power to recommend the extent of grants to be provided by the State Government to urban local bodies. SFC’s also have the responsibility to suggest methods to improve self-financing options of local bodies. Article 243I also requires the Governor of state to place every recommendation made by the Commission before the Legislature of the State. In absence of constitutional powers of taxation for ULBs, the role of the SFC becomes important.

The amendments further confer power upon States in the form of Schedule XII to enlarge the domain of local bodies and include functions with distributional consequences. This

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<[http://www.hazardscentre.com/hazards\\_publications/pdf/urban\\_governance\\_resistance/govt\\_by\\_people.pdf](http://www.hazardscentre.com/hazards_publications/pdf/urban_governance_resistance/govt_by_people.pdf)> Last accessed 15<sup>th</sup> November 2017

schedule includes key functions such as urban and town planning, road building, water supply and maintaining public health and sanitation.

### ***3. Theory and Practice of Municipal Finance in India***

ULBs in India have limited scope to generate sufficient revenue. While the 74<sup>th</sup> amendment may allow for autonomy in elections to local bodies, the allocation of functions, responsibilities and financial powers are vested in the State Government.<sup>17</sup> The 74<sup>th</sup> amendment in the provisions relating to finances introduces the concept of fiscal federalism, which theoretically discusses the sharing of financial resources between the Centre-State-local bodies. The concept is built on the framework of financial autonomy at each level of governance, supported by stringent accountability norms. However, in practice, the framework for the sharing of finances between the State Government and local bodies, provides limited decisional autonomy for the ULBs resulting in excessive reliance on the State Government funding.

For a viable and responsible fiscal future, cities in India must make maximum use of tax revenues, which include those exclusive taxes that may be levied and collected by the corporation, such as property and advertisement tax. In addition, they also need to maximize collection from non-tax revenues, which include water charges, trade licenses and town planning fees. With improved self-financing options, cities should theoretically be able to fund citizen services individually and increase accountability of local officials to their constituencies.<sup>18</sup> However, this is a distant reality in India. The various tax and non-tax revenues are not efficiently collected and enforced, increasing reliance on the State/Central Government grants to deliver basic municipal functions.

International best practices indicate that own revenues should be supplemented by central and state government transfers to support the implementation of central/state government

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<sup>17</sup> Anuradha Sharma and D Leena, see n (16).

<sup>18</sup> 'Challenges of local government financing in developing countries' (2015) United Nations Human Settlement Program, <[https://sustainabledevelopment.un.org/content/documents/1732The%20Challenge%20of%20Local%20Government%20Financing%20in%20Developing%20Countries%20\\_3.pdf](https://sustainabledevelopment.un.org/content/documents/1732The%20Challenge%20of%20Local%20Government%20Financing%20in%20Developing%20Countries%20_3.pdf)> Last accessed 15 November 2017

schemes. In India, intergovernmental transfers exceed own revenues of ULBs. This trend is cultured in the system of urban governance and hence local bodies do not see a purpose in improving local revenues, as the State Government will ultimately finance majority of the welfare schemes.<sup>19</sup>

Experts in the field of urban governance<sup>20</sup> have suggested that taxes levied by the local bodies can be improved and made a buoyant source of income, if the following principles are adhered to in determining the levy and rate of tax:

- (a) The rate of taxes should be in proportion to the economic base;
- (b) The rate of taxes should be horizontally equitable; providing equal treatment to tax payers in similar circumstances;
- (c) The rate of taxes should be relatively efficient, causing low distortions in economic activity;
- (d) The rate of taxes should be relatively low in administration and compliance costs.

#### ***4. Urban Governance in Karnataka***

37% of the population in Karnataka live in urban areas, which is above the national average of 31.2%.<sup>21</sup> ULBs which have a large urban area are governed by the Karnataka Municipal Corporation Act, 1976 (“KMC Act”). Currently nine ULBs are governed under the KMC Act. Below figures provide the category/hierarchy wise ULBs in the State.

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<sup>19</sup> Anuradha Sharma and D Leena, See n (16).

<sup>20</sup> *Ibid.*

<sup>21</sup> ‘Economic Survey of Karnataka’ (2016) (Ministry of Program and Planning, Government of Karnataka), <[http://des.kar.nic.in/docs/Economic%20Survey%202015-16\\_English%20Final.pdf](http://des.kar.nic.in/docs/Economic%20Survey%202015-16_English%20Final.pdf)> Last accessed 15 November 2017.

*Category and Hierarchy wise ULBs in Karnataka as on March 2016.<sup>22</sup>*

Sl.No	Urban Local Bodies	Number of ULBs
1.	City Corporations	9
2.	City Municipal Councils	43
3.	Town Municipal Council	94
4.	Town Panchayat	68
5.	Notified Area Committee	4

In 1994, Karnataka amended the KMC Act to meet the requirements of the 74th Amendment. Since then, the KMC Act has been amended 22 times, with 7 amendments dealing with finances of the ULBs. These amendments have only tinkered with the Act, without undertaking reforms which alter the financial relationship between the ULBs and the state government.

### ***5. Highlights of the KMC Act***

The KMC Act was enacted with an intention to consolidate the Bangalore Municipal Corporation Act, 1949 and the Hubli-Dharwar Municipal Corporation functioning under the Bombay Provincial Municipal Corporations Act, 1949 as in force in the Belgaum Area. The KMC Act under sections 7, 11 and 14 establishes three standing committees and the post of municipal commissioner. It confers certain administrative powers to the Mayor and the Deputy Mayor under sections 60 and 61, while having the State Government exercise

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22 'Report of the Comptroller and Auditor General of India on Local Bodies' (2017) Government of Karnataka Report No. 5 of the year 2017, <[http://www.cag.gov.in/sites/default/files/audit\\_report\\_files/Report\\_No.5\\_of\\_2017\\_-\\_Local\\_Bodies\\_Government\\_of\\_Karnataka.pdf](http://www.cag.gov.in/sites/default/files/audit_report_files/Report_No.5_of_2017_-_Local_Bodies_Government_of_Karnataka.pdf)> Last accessed: 29 January 2018.

oversight over the functioning of the authorities under Chapter IX of the Act. Under section 103 it confers taxing powers on the corporation, and lists the various taxes it can levy.

Under sections 58 and 59 of the KMC Act, corporations are required to perform certain obligatory and discretionary functions. Some of the obligatory functions of ULBs are as below;

1. Lighting public streets, places and buildings
2. Sanitation
3. Supply of drinking water
4. Registering births and deaths
5. Construction and maintenance of roads, drains, etc.

Some of the main discretionary functions are as below;

1. Maintenance and establishment of public parks
2. Maintenance of public library
3. Constructing, establishing of homes for the disabled and destitute persons etc.

Some of the above functions despite being in the exclusive domain of the ULBs are performed by various parastatal bodies, who work under the administrative supervision of the state government.<sup>23</sup> To finance functions provided under section 58 and 59, the City Corporations (Ex Mysore and Mangalore) and ULBs (Ex Bidar and Chickmagalur) can levy certain taxes and collect fees. The list of sources of revenues under the KMC Act are provided below:

### ***6. List of Tax and Non-Tax Revenues***

1. Property tax is leviable under sections 108 and 108A of the KMC Act and is levied on all properties within the municipal limits based on the market value of the property.

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<sup>23</sup> **Electricity**-Bengaluru, Bangalore Electricity Supply Company; Mysore- Chamundeshwari Electricity Supply Company; Mangalore- Mangalore Electricity Supply Company; Mangalore- Karnataka Electricity Board; **Urban Water Supply**- Bengaluru- Bangalore Water Supply and Sewerage Board; Rest of Karnataka, Karnataka Urban Water Supply and Sewerage Board

2. Advertisement tax is leviable under section 134 and procedure for collection is specified under Section 139 of the Act. It is collected on all external advertisement hoardings put up within the municipal limit of the city, apart from
3. Water charges are leviable under section 191 of the Act and water supply is a service that is provided under section 57 of the Act. In all urban areas apart from Bengaluru, establishing the infrastructure for the supply of water is carried out by the Karnataka Urban Water Supply and Drainage Board whereas the collection of water charges is the responsibility of the ULB.
4. Trade license fee is chargeable under section 374 of the KMC Act and is required to be paid for undertaking any business, as listed under the Act, within the municipal area.
5. Town planning and building fee under section 423 of the KMC Act is a charge required to be paid for the development of city master plans and inspection of buildings to ensure its compliance to building bye-law norms.
6. Other fees levied periodically.

## ***7. Grants & Loans***

1. Tied and untied grant as per the recommendations of the State Finance Commission.
2. Special grants for schemes earmarked in the state budget.
3. Central Government grants as per the recommendation of Ministry of Urban Development.
5. Loans by multilateral banks and Karnataka Urban Infrastructure Development Financial Corporation.

Based on the above list of revenues for the ULBs in Karnataka, this report undertakes a systematic study to understand the legal impediments which restrict efficient collection and levy of taxes. The ULBs in the absence of efficient collection of tax and fee rely on State Government funding, resulting in limited decisional and governing autonomy. With improved self-financing options, ULBs will be accountable to the citizens it immediately serves and will efficiently deliver services without the need to rely on State/Central Governments' funding.

However, the existing sources of self-generating revenues are limited and considering the rapid development of the cities chosen in this report, this report studies the new avenues of income from multiple jurisdictions and suggests a regulatory framework for their application in the context of Karnataka.

## ***8. Structure and Methodology of the Report***

This report undertakes a close scrutiny of the KMC Act and other corresponding state legislations which have an impact on the finances of ULBs in Karnataka. It will also study the role of the State Finance Commission over the past years, its terms of reference and the rules for appointment of its member to suggest measures for strengthening the institution. For the purposes of this report, the study will focus on ULBs in Bengaluru, Mysuru, Mangaluru and Davangere. The cities of Mysuru and Mangaluru have been selected as they are the second and third largest cities in Karnataka after Bengaluru; Davangere has been selected considering the extent of its dependence on state government funds.

### **(a) Methodology**

This study adopts a mixed methodology and has two components; desk-based research and field research. As part of desk research, this report extracted primary data from receipts and payment statement of Bengaluru, Mysuru, Mangaluru, Davangere City Corporations. The statements were found on the respective city corporation website.

1. Secondary data: The report analyzes the rules and bye laws issued under the KMC Act. Further, it looks at corresponding municipal corporation acts, rules and bye-laws issued by States of Punjab, Tamil Nadu, Kerala, West Bengal, Maharashtra and Odisha among many others. The present report is also based on an analysis of the budget and finances of various cities. It also studies the various judgments of the Karnataka High Court pertaining to municipal finance. To understand the financial positions of the ULBs, the report relies on the publicly available financial documents of the City Corporations. While the Karnataka Municipal Budgeting and Accounting Rules, 2006 (“KMBAR, 2006”) mandate publication of the budget documents, not all ULBs have adhered to it. As per the rules, the following financial documents have to be prepared by the ULBs:

1. Annual Performance Report
2. Balance Sheets for the financial year
3. Receipts and Payments
4. Income and Expenditure
5. Audit Report

From amongst the cities chosen in the report, only Davangere has publicly disclosed all mandated financial documents. Mangaluru and Mysuru have not published their income and expenditure reports. Hence, to maintain consistency in the analysis, the report analyzes statement of receipts and payments for the year 2015-16 to understand the financial position of the chosen ULBs. For the city of Mysuru, the receipts and payments do not provide the tax breakup and hence, the report relies on newspaper articles to understand the tax breakup. To verify the details in the article, an unstructured interview through phone call with Mysuru Deputy Commissioner (Revenue) was conducted, and the tax numbers were confirmed.

Since the KMBAR, 2006 do not apply to Bruhata Bengaluru Mahanagara Palike (“BBMP”), the report relies on Janaagraha’s BBMP performance report to understand the financial position of ULBs in Bengaluru.<sup>24</sup>

Further, for the purposes of financial analysis, overall revenue of a corporation is the sum of revenues from all avenues, which will be compared to the own revenue generated by the corporation, which is the sum of revenues from tax and non-tax receipts.

To calculate the efficiency of the tax and water charge collection, the demand is calculated as per the projections recorded in the audit report of the Karnataka Accountant General (“KAG”) and also on the basis of unstructured telephonic interviews with revenue officers of various cities.

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<sup>24</sup> Janaagraha, ‘BBMP Budget Brief 2015-16’  
<<https://www.ichangemycity.com/theme/images/openworks/city-brief.pdf>> Last accessed 24<sup>th</sup> January 2018.

2. The second component of this report is field research, where officials of the local corporation of Bengaluru were met and discussions were held with experts in the field of urban governance.

Vidhi Centre for Legal Policy also organized a round table discussion to discuss the initial findings of this report. The discussion had the participation from the following organizations

1. Janaagraha
2. Indian Institute of Human Settlements
3. Centre for Law and Policy Research
4. Office of Deputy Accountant General, Karnataka (Local Body Audit)
5. Deccan Herald

The participants provided suggestions on the various issues covered by the report, and the key suggestions discussed have been included in the report, in the respective chapters.

### **(b) Study of Bengaluru**

Reforms for Bengaluru will be dealt with in a separate sub-chapter, while an analysis of its financial position will be done jointly with other cities. This is due to the influence the city of Bengaluru has in Karnataka: it contributes 33.6 % of the State Gross Domestic Product, is the largest city with the maximum number of residents in Karnataka,<sup>25</sup> and has the largest city corporation of the State. Additionally, the regulatory framework has also accorded a unique status to Bengaluru on numerous occasions owing to its size and influence in the state. Therefore, a separate study of Bengaluru will be in line with its position as the primate city of the State of Karnataka.

### **(c) Research Questions**

This study has two broad research questions:

1. What is the nature of the financial relationship between Government of Karnataka and the Urban Local Bodies in Karnataka?

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<sup>25</sup> 'Report of the Comptroller and Auditor General of India on Local Bodies', see n (22).

2. What are the legal impediments towards successful realization of the States' property tax and advertisement tax potential?
3. What are legal and administrative impediments towards successful collection of water charges and provision of 24x7 urban water supply?
4. What are the legal impediments towards facilitating ULBs access to loans and open market for borrowing additional financial resources?

#### **(d) Chapterization**

The chapters in this report will be as follows:

##### ***(i) Urban Financing in Karnataka: Bengaluru, Mysuru, Mangaluru & Davangere***

This chapter will analyze the financial position of each city and compare the extent of property tax and water charge collection in the cities. It will also study the extent of dependence on State and Central Government grants by city, to suggest appropriate reforms.

##### ***(ii) Suggested ways forward***

This chapter will address the issues pertaining to property tax and water tax administration in the cities, and highlight the various new avenues that may be developed to increase the revenues of the city corporation.

##### ***(iii) Strengthening the State Finance Commission***

This chapter will review the past reports of the State Finance Commission and analyze its role in the context of municipal finance. It will study the terms of reference and framework of the institution to recommend areas which require strengthening.

## III. ANALYZING THE FINANCES OF URBAN LOCAL BODIES IN KARNATAKA – BENGALURU, MYSURU, MANGALURU AND DAVANGERE

### 1. Introduction

This chapter analyzes the receipts and payments of the selected ULBs, which are City Corporations, for the financial year 2015-16 to understand the various sources of revenues and the extent of grant provided by the State and the Central Governments. Receipts and payments are the amounts actually received and paid respectively for a particular accounting year. This report will provide a strict understanding of the extent of revenues received for a particular year, as it excludes factors such as depreciation and outstanding income.<sup>26</sup>

The revenue generated from all avenues will be compared with those earned from tax and fees to analyze the extent of own revenue generated. This will also account for the extent of reliance by the ULBs on grants by the Central and the State Governments. Further, the following order will be followed through the course of this chapter while analyzing finances:

1. Bruhat Bengaluru Mahanagara Palike
2. Mysuru City Corporation
3. Mangaluru City Corporation
4. Davangere City Corporation

The analysis will be followed by key points and takeaways from each city. The revenue heads for all the City Corporations stem from the KMC Act which provides for uniform taxing policy across the State. Therefore, the major sources of taxes are common, while levy of certain charges are city specific. This structure allows the report to compare the finances of each city uniformly, identify trends and suggest appropriate reform. For this purpose, this chapter will

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<sup>26</sup>A detailed explanation of considering the receipts and payments has been provided in page 14 and 15 of this report.

rely on the KAG report to compare the revenue collected with the demand projected for each particular revenue head.<sup>27</sup>

## **2. Analyzing the finances of Bruhat Bengaluru Mahanagara Palike**

For the financial year 2015-16, the BBMP had a revenue inflow of Rs. 6340 Crores.<sup>28</sup>

Upon analysis of the financial documents, property tax collection for the financial year 2015-16 stood at Rs. 1031.8 Crores, while collection from advertisement tax stood at Rs. 4 Crores. Collection from various fees levied as per the KMC Act, stood at Rs. 860 Crores. The below table mentions the extent of revenues from various heads.

Source: Janaagraha, BBMP Budget Brief for 2015-16

Sl.No	Particulars	Amount (In crores)
1.	Property tax	1031.8
2.	Beggary, Library, health cess	324
3.	Building plan fees	182
4.	Engineering works fees	349
5.	Town Planning fees	329
6.	Advertisement tax	4
7.	Betterment charges, loans etc	250
8.	Grants	4235.8
<b>TOTAL</b>		<b>6340 (Rounded off)</b>

<sup>27</sup> The Karnataka Accountant General under the aegis of the Comptroller Auditor General conducts financial and performance audit reports of various Panchayati Raj Institutions and Urban Local Bodies.

<sup>28</sup> Janaagraha, 'Analysis of the BBMP Budget' (I Change My City, Bangalore, 29<sup>th</sup> March 2016) <<https://www.ichangemycity.com/bangalore/news/mycitymybudget-analysis-of-bbmp-budget-for-the-year-2016-2017>> Last accessed 15<sup>th</sup> November 2017

As per the records of the BBMP, indicated in the above table, a total sum of Rs. 2469.8 Crores has been generated as own revenue by BBMP. However, the various cesses that have been collected as per section 4 of Karnataka Health Cess Act, 1962, section 30 of Karnataka Public Libraries Act, 1965 and section 31 of Karnataka Beggary Cess Act, 1975 are required to be remitted to the State Government, and only 10 % of the overall collection may be retained by the corporation as charges. Hence, revised own revenue would stand at Rs. 2178.2 Crores.

Out of the own revenue generated by BBMP, the contribution of property tax stands at 47.3 %, and is 16.27 % when compared to the overall revenue of the corporation.

The contribution of the State and Central Governments stood at Rs. 4235.8 Crores, which is 66.8 % of the overall revenue, while own revenue stood at 33.2 % of the overall revenue.

In terms of expenditure, 86 % of the own revenue was used to pay old bills and salaries of the corporation employees, while the remaining 14 % was spent towards various projects as announced in the 2015-16 budget.

### ***3. Analyzing the finances of Mysuru City Corporation***

For the financial year 2015-16, Mysuru City Corporation (“MCC”) had a total revenue inflow of Rs. 446.2 Crores,<sup>29</sup> out of which grants from State and Central Governments stood at Rs. 292 Crores. Collection, from property tax was Rs. 65 Crores, advertisement tax revenues stood at 2.5 Crores, and water charges was Rs. 45 Crores.

The contribution from grants stood at 65.6 % of the overall revenue, while collection of own revenue stood at 34.4 %.

The table in the following page indicates the revenues against various heads.

<sup>29</sup> ‘Balance sheet for the year 2015-16’ (Mysore City Corporation, 2016), <[http://www.mysorecity.mrc.gov.in/sites/mysorecity.mrc.gov.in/files/bs-15-16\\_0.pdf](http://www.mysorecity.mrc.gov.in/sites/mysorecity.mrc.gov.in/files/bs-15-16_0.pdf)> Last accessed 15<sup>th</sup> November 2017

Sl. No.	Particulars	Amount (In Crores)
1	Property Tax	65
2	Advertisement Tax	2.5
3	Water Charges	45
4	Grants (General Grants)	189.5
5	Grants (Specific)	102.9
6	Rent, Fees & Other charges	28.5
7	Other Income (Dividend & Interest etc.)	12.8
	<b>TOTAL</b>	<b>446(Rounded off)</b>

Source: Receipts and Payments, Mysuru City Corporation for 2015-16

The table above indicates that the property tax collected during the year is the largest source of own revenue for MCC, amounting to 42 % of the own revenue. Water charges are the second largest source amounting to 29 % of the own revenue. Income from other sources such as rent from municipal properties, dividends and interest received during the year amounted to 27 % of the own revenue. The remaining 2 % constituted advertisement tax.

The Mysuru City Corporation incurred an expenditure of Rs. 154 Crores on operation and maintenance which include payment of salaries, payment of old and current bills and upkeep of current infrastructure; this amounts to 108 % of the own revenue generated. This indicates high reliance on State Government (65.5%) for financing development schemes.

#### 4. Analyzing the finances of Mangaluru City Corporation

For the financial year 2015-16, the total revenue inflow to the Mangaluru City Corporation stood at Rs. 258.45 Crores.<sup>30</sup> Out of which, Rs. 128.15 Crores was received as grants from the State and Central Governments, which is about 49.6 % of the overall revenue. Own revenues for the corporation stood at Rs. 130.3 Crores, which is 50.4 % of the overall revenue.

Revenues from property tax stood at Rs. 29.39 Crores, which is 22.5 % of the own revenue. The second largest revenue for the corporation is from the collection of water charges, which was at Rs. 39.10 Crores constituting 30.1 % of the own revenue.

The below table indicates the revenues against various heads.

Sl. No.	Particulars	Amount(In crores)
1	Property Tax	29.39
2	Advertisement Tax	2.38
3	Rental Income from Municipal Properties	2.43
4	Fees, User Charges and Other Charges	36.86
5	Water Charges	39.10
6	Other income	20.07
7	Grants and Contribution	128.15
	<b>TOTAL</b>	<b>258(Rounded off)</b>

Source: Receipts and Payments, Mangaluru City Corporation for 2015-16

<sup>30</sup> 'Receipts and Payments for the year 2015-16' (Mangaluru City Corporation, 2016), <<http://www.mangalorecity.mrc.gov.in/sites/mangalorecity.mrc.gov.in/files/APR%2015-16%20%284%29.pdf>>

The Mangaluru City Corporation incurs an expenditure of Rs. 120.1 Crores on operation and maintenance which include payment of salaries, old and current bills and upkeep of current infrastructure. This amounts to 75.87 % of the own revenue generated.

While the Mangaluru City Corporation's own revenue is slightly more than the grants received, it does not imply a healthy financial state. The largest source of revenue is user charges for the various services provided, and the buoyancy of tax revenues are limited.

Fees and taxes are conceptually distinct as premised on the legal principle of quid pro quo. Tax is devoid of quid pro quo, wherein any benefit accrued to individuals is incidental and not primary, and the revenue earned in tax is not required to be spent in a particular way. Fees, however, are charged for a special service provided to individuals. As laid down by the Supreme Court in *Corporation of Calcutta v. Liberty Cinema*, fee is exclusively for a service provided and the proceeds of a fee cannot be used for purposes other than the service that is sought to be provided.<sup>31</sup> In the context of Mangaluru City Corporation, the revenue from fees and charges exceed the tax revenues. While this may indicate improved revenues, it does not reflect in usable revenue for development and infrastructure purposes.

### ***5. Analyzing the finances of Davanagere Corporation***

For the financial year 2015-16, Davanagere City Corporation had a revenue inflow of Rs. 90.67 Crores. The grants by the State and the Central Government stood at Rs. 64.33 Crores, which is 70.95 % of the overall revenue including own revenue. Total own revenue generated amounts to Rs. 26.34 crores which is 29.05 % of the total income of Davanagere City Corporation.

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<sup>31</sup> [1965]2SCR477

Sl. No.	Particulars	AMOUNT (In crores)
1.	Property Tax	11.66
2.	Advertisement Tax	0.39
3.	Total tax Collected	12.05
4.	Total Water charges and fund collected.	7.08
5.	Rent	1.58
6.	Fees and charges	4.27
7.	Sale charges	0.07
8.	Interest received	1.09
9.	Other income	0.2
10.	Grants (State/Central Government)	64.33
	<b>TOTAL</b>	<b>91(Rounded off)</b>

Source: Davangere Municipal Corporation, 2015-16

From the revenue generated by the corporation, property tax individually stood at 44 %, with a collection of Rs. 11.66 Crores.

Davangere has a low share of revenue from property tax. The collection of property tax stood at 12.8 % of the overall revenue.

Collection from Water charges stood at Rs. 7.08 Crores, amounting to 7.8 % of overall revenue and 26 % of own revenue. Water fund acquired through grants amount to Rs. 8.8 crores, which is 13 % of total grants received for the year 2015-2016.

In terms of expenditure, the corporation incurs 85 % of its own revenue to meet expenses for salaries, wages and administrative expenses, whereas the remaining 15 % is utilized for infrastructural developments.

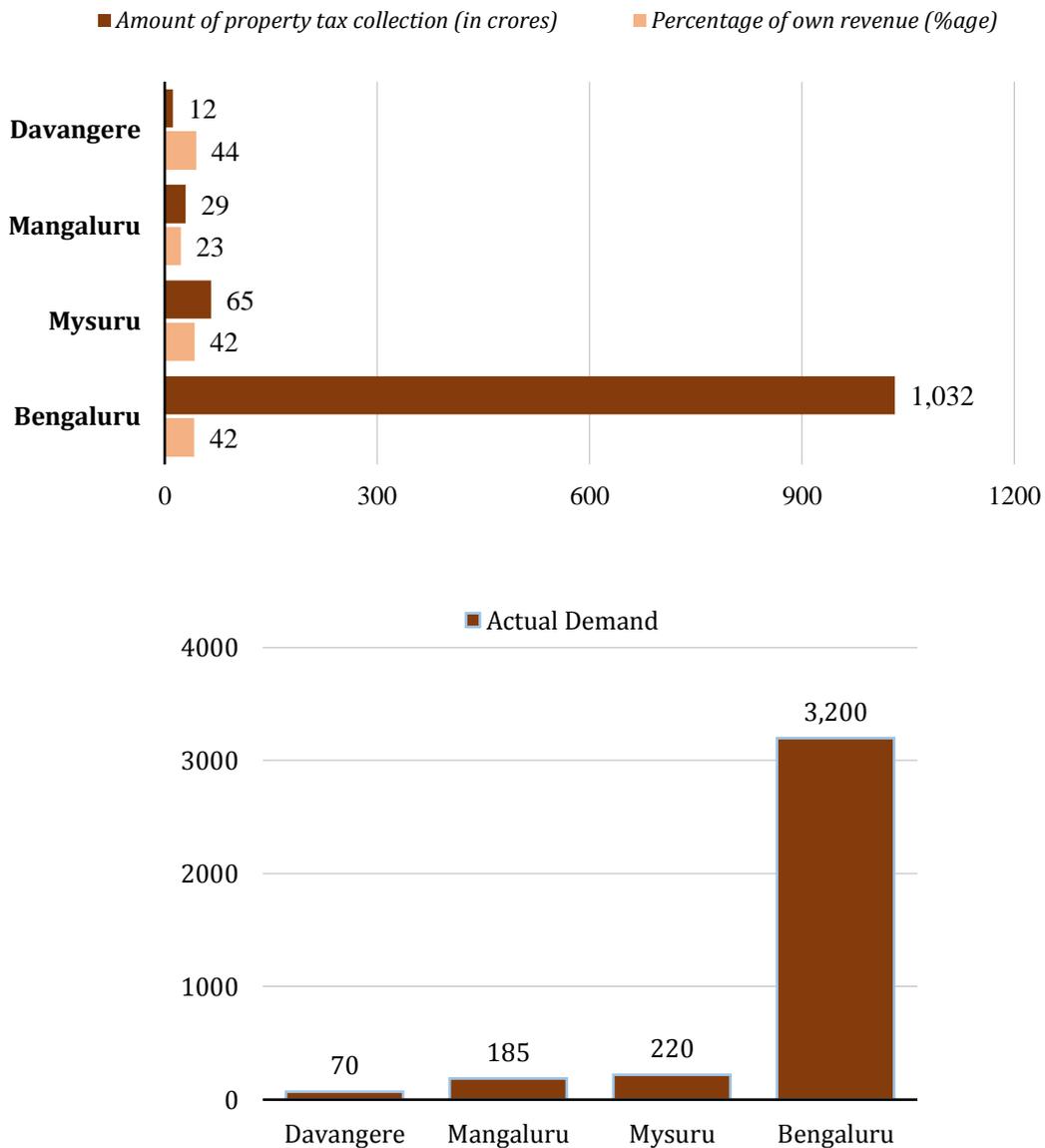
## 6. Key Points and Analysis

From the above city specific analysis, there are commonalities that can be drawn to understand a pattern. This pattern will indicate the areas of reform based on which subsequent chapters of this report will be drafted.

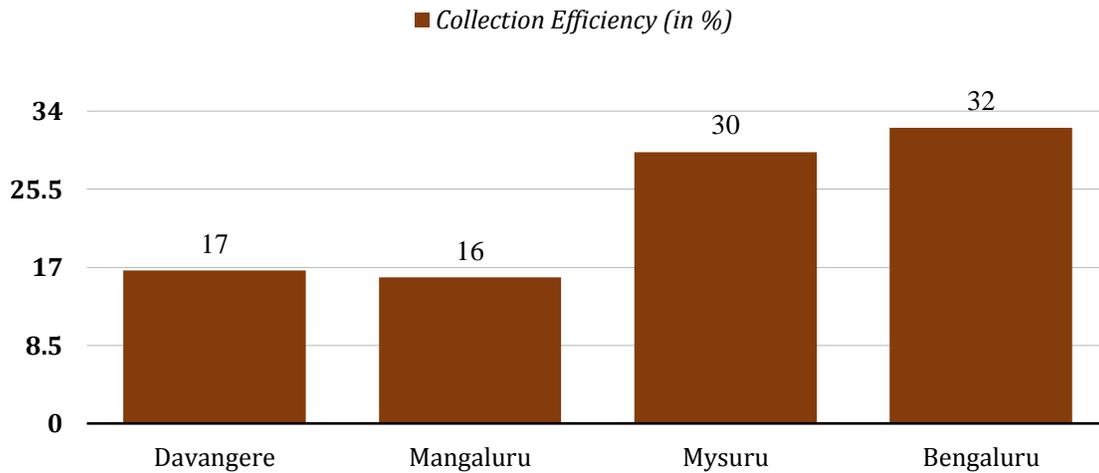
### (a) Efficiency in collection of property tax

The demand calculated in the below figures is based on the revenue estimate provided in the budget document, report by the KAG and interviews with officers of the City Corporations.

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<sup>32</sup> 'Report of the Comptroller and Auditor General of India on Local Bodies', see n (22).



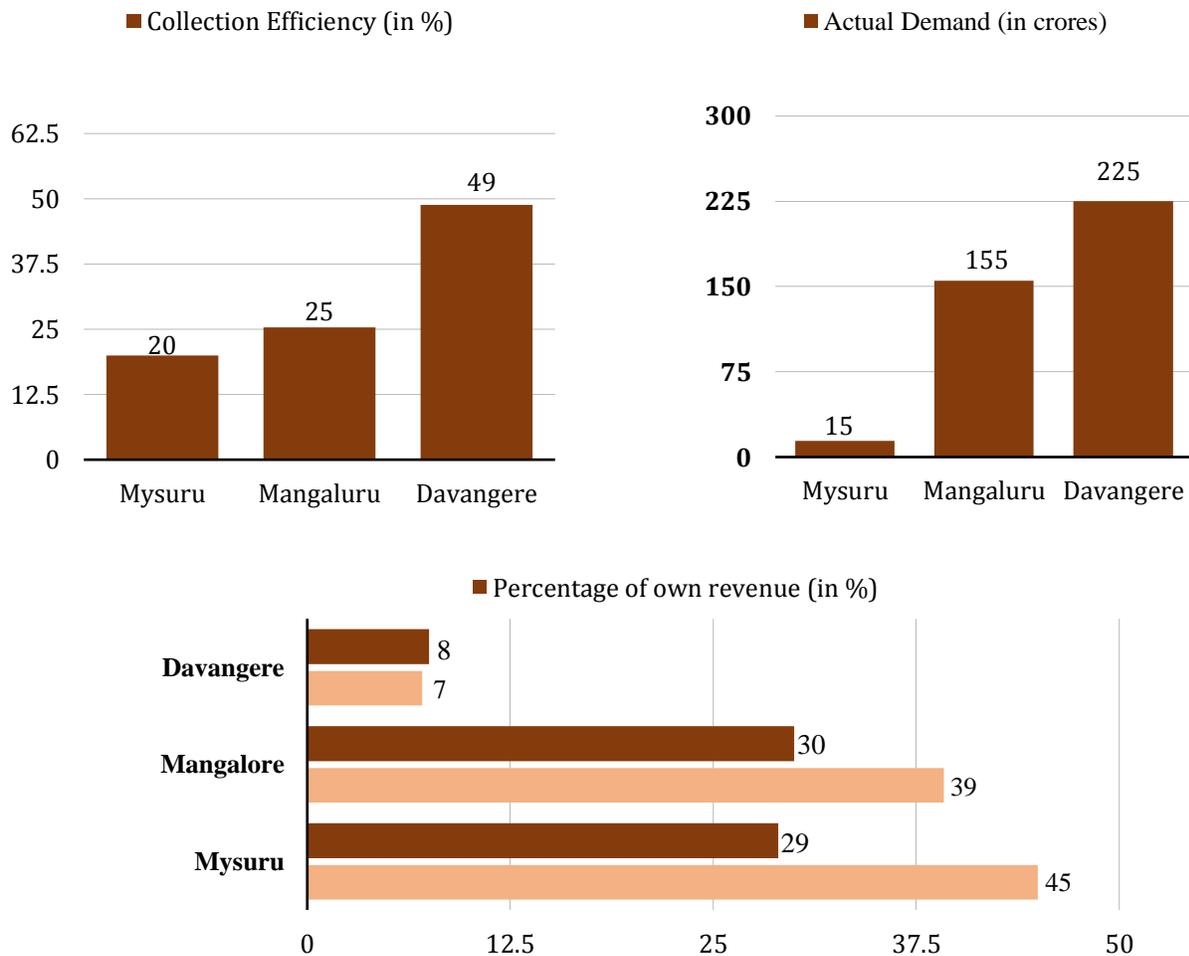
Based on the above graphs, the following key points emerge

1. Mangaluru has the lowest collection efficiency, while Bengaluru has the highest. This may be attributed to the initiatives such as self-assessment scheme and online payment, facility undertaken by the BBMP. Further, Davangere has the largest percentage of property tax in comparison to the own revenue generated, while Mangaluru has the lowest.
2. None of the cities cross the 50 % margin, which is a worrying trend.
3. There is a strong need to improve enforcement of property taxes to better the collection rate and re-structure the governance of property tax in the State.

### **(b) Efficiency in collection of water charges**

All the selected cities, apart from Bengaluru incur expenditure on water works and charge a fee for the service. Based on the actual demand of water charges calculated by the KAG and interviews with the officers of the city corporation the below graph analyzes the collection efficiency.<sup>33</sup>

<sup>33</sup> 'Report of the Comptroller and Auditor General of India on Local Bodies', see n (22).



Based on the above data, the following key points emerge

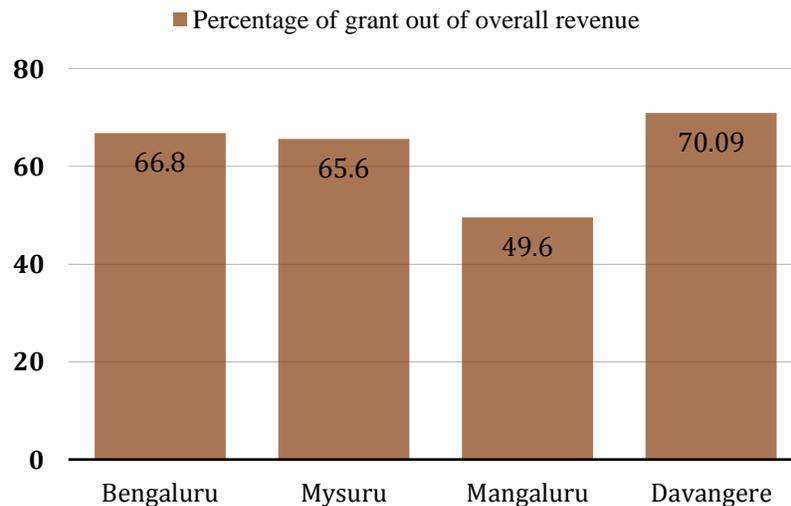
1. None of the selected cities cross the 50 % margin in collection efficiency. With urban water supply in Karnataka being funded by a loan issued by World Bank, there is pressure of repayment.<sup>34</sup> Inefficient water charge collection will then require the ULBs to utilize alternate heads of revenue to pay.

<sup>34</sup> Vicky Walters, *Water, Democracy and Neoliberalism in India: The Power to Reform* (Routledge Publication 2013)

2. Due to limited collection efficiency there is a strong need to demystify the complex urban water supply framework in Karnataka.

### (c) Reliance on State and Central Government Grants

In the city specific analysis, the extent of grant from the State and Central Governments has been highlighted. The graph below compares it across the 4 selected cities



Based on which the following key points emerge

1. The reliance on grants across the four cities has been upwards of 60 %, barring Mangaluru where the concern is on the revenue from taxes being much lower than fees and charges. The global ratio for inter-governmental transfers and municipal revenue is 20:80.<sup>35</sup> Therefore the situation in the selected cities is alarming.
2. From the above table and figures mentioned earlier, it is evident that the complete potential of the current sources of revenue have not been met. To address this, strengthening of the regulatory structure governing the levy and collection of tax requires an overhaul.

<sup>35</sup> 'Understanding Municipal Finances of Johannesburg' (City of Johannesburg) <<https://municipalmoney.gov.za/profiles/municipality-JHB-city-of-johannesburg/#resources>> Last accessed 23<sup>rd</sup> November 2017

3. This trend also indicates that the existing avenues of revenue will not suffice for the municipal corporation to be self-sufficient. Therefore, new avenues will have to be developed and supported by a strong regulatory framework.

## IV. REGULATORY AND STRUCTURAL REFORMS TO LEVY AND COLLECTION OF PROPERTY TAX IN KARNATAKA

### 1. Introduction

Property tax in Karnataka is levied under section 103 of the KMC Act, the rate and procedure to levy is provided for under section 108 and 108A of the KMC Act. Section 109 of the KMC Act deals with the method of assessment of property tax and makes a reference to the Karnataka Stamp Act, 1957 to determine the rate of levy. Further under section 423 of the KMC Act, each city corporation has framed its respective building bye laws and under section 421 of the KMC Act, rules for the levy and collection of property tax have been issued.

While the building bye-laws are city specific, the property tax rules for Mangaluru, Mysuru and Davangere are common. Bengaluru has dedicated rules and bye-laws for property tax and buildings respectively.

Karnataka was among the first few states which introduced the Self-Assessment Scheme (“SAS”) for the payment of property tax. The scheme allows citizens to self-assess and determine the property tax payable, as opposed to the conventional method requiring a citizen to approach the local body office and seek assistance in determining the tax. The Karnataka High Court in 2000, however, made SAS optional and since then both system function in the State.<sup>36</sup>

#### (a) Importance of property tax to municipal financing

Property tax is the single most important own tax of ULBs in India. On an average, property tax constituted 16 % of total municipal revenues and 30 % of own municipal revenues in

<sup>36</sup> Bangalore Mahanagara Nagareeka Kriyasamithi v. State of Karnataka, Writ Petition No 17094/2000

India in 2012-13. Property tax GDP ratio ranged between 0.16 and 0.24 % in 36 largest municipal corporations in India.<sup>37</sup>

International comparisons reveal that property tax is grossly under exploited in India. In the year 2000, GDP ratio of property tax was 2.12 % for developed countries, 0.68 % for transitional countries and 0.60 % for developing countries. Only 63 % of the universe of assessed properties were paying property tax in India.<sup>38</sup> Further, as against the house properties actually assessed, collection efficiency was as low as 37 %. This untapped potential of property tax suggests that the country has a significant opportunity to augment municipal revenues by improving the design and collection of property tax.<sup>39</sup>

### **(b) Merits of property tax**

The high correlation between property ownership and income makes property tax a progressive tax. Land and capital are predominantly owned by the more affluent sections of society. The burden of property tax thus falls on upper and middle income households. This exerts pressure on municipalities to be responsible to their taxpayers for the provision of services commensurate with the taxes paid.<sup>40</sup>

Despite theoretical merits, in practice, property taxes suffer from many difficulties. They are often levied on subjective or judgmental basis. Benefits from property taxes are hard to observe as assessment and enforcements costs tend to be high and exemptions from property tax are granted to various types of properties.<sup>41</sup>

### **(c) Property tax in Karnataka**

Property tax in Karnataka has gone through a series of reforms. From abolishing the rent control acts to moving to a self-assessed scheme, the State Government's commitment to

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<sup>37</sup> Prasanna K Mohanty, *Financing Cities in India Municipal Reforms, Fiscal Accountability and Urban Infrastructure* (Sage Publications, 2017)

<sup>38</sup> Prasanna K Mohanty, see n (38).

<sup>39</sup> *Ibid.*

<sup>40</sup> Jay K Rosengard, 'Principles of property tax reforms' (2012) <[https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/MRCBG\\_FWP\\_2012\\_10-2012\\_Rosengard\\_Tax\\_Reform.pdf](https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/MRCBG_FWP_2012_10-2012_Rosengard_Tax_Reform.pdf)> Last accessed 24<sup>th</sup> January 2018

<sup>41</sup> *Ibid.*

reforming property tax base is laudable. However, despite reforms there are fundamental concerns which continue to plague the property tax structure in the State.<sup>42</sup>

Problems with property taxation in India relate to tax base, tax rate, tax coverage, exemptions, valuation, assessment, billing, collection, enforcement and dispute resolution.

## 2. Property Tax Rates

In most of the cities including Bengaluru, Mumbai and Delhi, tax assessment is linked to the market rental or capital values.<sup>43</sup> Capital value is the probable price that would have been paid for the property at the date of the valuation. Whereas guidance value is the property rate fixed by the government based on the facilities and infrastructure of a locality. The guidance value of the property is the basis on which property tax is calculated. If the guidance value is closer to the market value, higher are the property tax revenues for the municipal administration.

Property tax in Karnataka is linked to the guidance value published under the Karnataka Stamp Act, 1957. The current system of property tax is based on unit area method, which links the tax payable to the market value of a particular property. Subsequent to a report by the Committee of state finance ministers in 1996<sup>44</sup> wherein it was recommended that a proper system be in place for the determination of market values of property, multiple State Governments amended their respective Stamp Act to revise the structure. Karnataka in 2001 amended its Stamp Act to insert a new section, 45B which establishes a Central Valuation Committee (“CVC”). In 2003, rules for the working of the committee were issued by the State

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<sup>42</sup> Aditya Bharadwaj & S.N Vijetha, ‘Property tax debacle: both public and BBMP to be blamed’ *The Hindu* (Bengaluru, 16<sup>th</sup> September 2016) <<http://www.thehindu.com/news/cities/bangalore/Property-tax-debacle-both-public-and-BBMP-to-be-blamed/article14408297.ece>> Last accessed: 30<sup>th</sup> January 2018.

<sup>43</sup> Isher Judge Ahluwalia & P. K. Mohanty ‘Unlocking Land Value for Financing Urban Development in India’, Indian Council for Research on International Economic Relations, <[http://icrier.org/Urbanisation/pdf/Ahluwalia%20and%20Mohanty\\_Unlocking\\_Land\\_%20Value.pdf](http://icrier.org/Urbanisation/pdf/Ahluwalia%20and%20Mohanty_Unlocking_Land_%20Value.pdf)> Last accessed 24<sup>th</sup> January 2017

<sup>44</sup> ‘Report of the committee of State finance Ministers on Stamp Duty Reform’ (1996) National Institute of Public Finance and Policy, <[http://www.nipfp.org.in/media/medialibrary/2014/11/Report\\_of\\_the\\_Committee\\_of\\_State\\_Finance\\_Ministers\\_on\\_Stamp\\_Duty\\_Reform.pdf](http://www.nipfp.org.in/media/medialibrary/2014/11/Report_of_the_Committee_of_State_Finance_Ministers_on_Stamp_Duty_Reform.pdf)> Last accessed 15<sup>th</sup> November 2017

Government.<sup>45</sup> The guidance value determined by the CVC is applicable for the calculation of multiple other taxes apart from property tax, such as capital gains under Income Tax Act, 1961 and levy of stamp duty transfer of immovable property. Therefore, the criteria to determine guidance value is not exclusive to property tax. With property tax being the largest source of own revenue for multiple local bodies in Karnataka, absence of dedicated criteria to determine property tax impacts municipal finances.

The 13<sup>th</sup> Finance Commission observed the limited realization of property tax revenues and suggested that States focus on improving the system of assessment and standardization of properties which include appropriate calculation of guidance value.<sup>46</sup>

### (a) Working of the committee

The Karnataka Stamp (Central Valuation Committee) Rules, 2003 (“2003 Rules”) empowers the committee to determine the market value of various areas in Karnataka. For this purpose, it is assisted by various sub-committees at the district level, who recommend revision of rates to the central committee.

Rule 3 of the 2003 Rules lists the composition of the CVC. A closer look at the composition indicates that it does not have representation from ULBs in Karnataka apart from Bengaluru. The composition is Bengaluru centric with representatives from both BBMP and Bengaluru Development Authority. The impact of this composition may be understood by the number of revisions authorized by the committee for the city of Bengaluru, 9 revisions since 2003; latest revision for Mysuru was in 2006 and for Mangaluru & Davangere was in 2003.

This practice of having members of institutions from the state capital as a majority in the CVC, is unique to Karnataka. In the state of Tamil Nadu, the CVC under its 2010 rules has

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<sup>45</sup> Karnataka Stamp (Central Valuation Committee) Rules, 2003, <[http://202.138.101.165/karigr/actsrules/stamprules/kar\\_stamp\\_1992.html](http://202.138.101.165/karigr/actsrules/stamprules/kar_stamp_1992.html)> Last accessed 15<sup>th</sup> November 2017

<sup>46</sup> Report of the 13<sup>th</sup> Finance Commission <[http://fincomindia.nic.in/writereaddata%5Chtml\\_en\\_files%5Coldcommission\\_html/fincom13/tfc/Chapter10.pdf](http://fincomindia.nic.in/writereaddata%5Chtml_en_files%5Coldcommission_html/fincom13/tfc/Chapter10.pdf)> Last accessed 12<sup>th</sup> December 2017

representation from the local bodies,<sup>47</sup> West Bengal Central Valuation Committee Board Act, 1978, which is the regulatory benchmark for determining guidance value as per the 13<sup>th</sup> finance commission, has mandatory representation of directors of 4 local bodies in the State.<sup>48</sup>

### **(b) Working of the sub-committee**

Under rule 4 of the 2003 Rules, CVC may establish such sub-committees in each district, which *may* include representations from the department of Revenue, Survey and settlement, Public works and the Municipal Councils or Town Panchayats. The sub-committee is supervised and under the administrative control of the registrar of the district. Further, for the determination of the market value, the sub-committee is guided by the provisions under rule 6 which provide criteria to determine the value for a specific type of land.

In practice, the involvement of the City Corporations in the determination of the guidance value is limited and structure of the sub-committee itself does not *mandate* consultation with the representatives of the local bodies. While reviewing working of CVC Rules in other states, the structure in Andhra Pradesh is particularly systematic, as it allows for maximum consultations and mandates representation from City Corporations. Under the Andhra Pradesh Revision of Market Value Guidelines Rules, 1998 composition of committees are specific to an urban area and the Commissioner of Municipal Corporation or his authorized representatives *shall* be members of the sub-committee.<sup>49</sup>

Based on the author's interaction with the revenue officers of the City Corporations, it was understood that since the sub-committee reports to the registrar of a district, there is a threat of under valuation of the property. Also periodic revisions of the market prices do not reach the CVC. The undervaluation of properties and questions regarding integrity of the

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<sup>47</sup> Tamil Nadu Stamp (Central Valuation Committee) Rules, 2011,  
<<http://www.stationeryprinting.tn.gov.in/extraordinary/2010/165-Ex-III-1a.pdf>> Last accessed 15<sup>th</sup> November 2017

<sup>48</sup> West Bengal Central Valuation Committee Board Act, 1978  
<[http://www.wbja.nic.in/wbja\\_adm/files/The%20West%20Bengal%20Central%20Valuation%20Board%20Act,%201978.pdf](http://www.wbja.nic.in/wbja_adm/files/The%20West%20Bengal%20Central%20Valuation%20Board%20Act,%201978.pdf)> Last accessed 15<sup>th</sup> November 2017

<sup>49</sup> Andhra Pradesh Revision of Market Value Guidelines Rules, 1998,  
<<http://www.bareactslive.com/AP/AP045.HTM>> Last accessed 12<sup>th</sup> December 2017

office of sub-registrar have also been observed by the Karnataka High Court in the case of *Smt. B. Razia Razak v. The District Registrar, Prevention of Undervaluation of the Instruments* where-in the court commented that it '*cannot help but take note of the fact that the office of Sub-Registrar and Office of the District Registrar for determination of under valuation are notorious for their nefarious activities and have been subject matter of adverse scrutiny and comment by vigilant institutions like the Lokayuktha for corruption and bribery charges*'.<sup>50</sup> In a detailed survey by the World Bank, which interviewed individuals who have interacted or visited the office of sub-registrar, it was observed that the credibility of the institution is underwhelming.<sup>51</sup>

### (c) Lack of definitions under the rules

The sub-committees at the district level are required to assess the market value based on the principles laid down under rule 6, which include area of the land and value of the adjacent land among many other criteria. Further, as per rule 6 clause 2, a converted agriculture land is required to be valued at a rate higher than agricultural land.<sup>52</sup>

While, rule 6 lays down guidelines to assess value of a 'land' and house site, these terms have not been defined. Hence in practice, lands converted for non-agricultural purposes continue to be treated as agricultural lands.<sup>53</sup>

Additionally, under rule 6, the sub committees are required to prepare the statement of rates for different types of areas, including commercial. However, under the 2003 Rules there is

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<sup>50</sup> AIR2003Kant486.

<sup>51</sup> 'India: A citizen Report Card on Karnataka's Governance' (2010) World Bank & Public Affairs Centre, <<http://siteresources.worldbank.org/INTPCENG/1143333-1116505690049/20509270/karnataka.pdf>> Last accessed 15<sup>th</sup> November 2017; Comptroller Auditor General of India and Karnataka Accountant General, Audit Report of Stamp Duty & Registration Fee (2016) <<http://agkar.cag.gov.in/docs/Chapters%20English%20RSA%202016/Chapter-III.pdf>> Last accessed 30th January 2018.

<sup>52</sup> Rule 6(2): "*The suggestions for the estimation of market value of non-agricultural and industrial lands in general may also be separately indicated either as multiple of the rate for agricultural land or square feet considering the location of the property namely Municipality / corporation or village. Normally the values for lands converted for non-agricultural use in a village not near to a town/city, may be estimated per square feet*".

<sup>53</sup> *Ibid.*

no criteria to define commercial area. Therefore, parameters applicable to determine guidance value of house sites are used to assess commercial areas.

These shortcomings have an impact on the revenue of the city corporation. Therefore, appropriate amendments need to be carried out by the State Government.

#### **(d) Situation specific to Bengaluru**

The CVC has issued special instructions for the valuation of properties for Bengaluru. It specifies a list of guidelines for developed and undeveloped areas, while not defining criteria for classifying lands as developed and undeveloped.

### **2.1 Solution and way forward**

1. The composition of the CVC will have to be revised, to include representatives of all ULBs. The structure suggested by the 13<sup>th</sup> finance commission requiring valuation boards to be in line with the West Bengal Central Valuation Board will be an appropriate step forward.
2. The framework of the sub-committee may be revised and best practices followed in Andhra Pradesh may be followed. This will require amendments to the 2003 Rules to *mandate* representation from Municipal Corporations. The specific sub-committees may be established for rural and urban areas, and the composition of such committees to be area specific. The sub-committees may be structured to require the commissioner of an ULB to be the chairman and the sub-registrar to be the member convener.
3. The term land and house sites will have to be defined. Dedicated guidelines for commercial areas will have to be drafted. Further to ensure appropriate valuation a reference to the market plan prepared by city development authorities may be made by amending the rules. The master plan, drafted under section 9 of the Karnataka Town and Country Planning Act, 1961, provides guidance to facilitate development in various parts of the cities by earmarking areas as residential or commercial. This may be done to ensure orderly growth and as per law it is required to be prepared by involving the participation of residents. This will ensure the guidance value to be

reflective of the true market value, and with periodic revision in the master plan the guidance value will accordingly change. Further, there is also a need to specify the criteria to determine an area as developed and underdeveloped, in the context of Bengaluru

4. Currently the sub-committee does not have a framework to consider the objections to the valuation prepared. It is left to the discretion of the secretary of the sub-committee. This leads to the filing of numerous writ-petitions and stay orders being issued to the revised valuation. Therefore, it would be suitable that the Stamp Rules be amended to have detailed process for hearing objections, preventing unnecessary litigation.

### 3.1 Property Tax Litigation

The KMC Act under section 113 provides a mechanism to issue a demand notice to a person who is liable to pay tax under section 112-A of the Act. Further, section 113 also provides for an appeal mechanism in the event of a person seeking to challenge the demand notice. The procedure and condition for filing an appeal is provided under section 133(3) read with schedule III part 3 of the Act. As per the procedure provided under rule 18 of schedule III, a person who seeks to challenge a notice may approach the concerned district court having jurisdiction over the area in which the property is situated.

While demand notices are being regularly issued to tax defaulters, these are often challenged before the district court and potential revenue for the corporation then becomes dependent on the long and delayed litigation process.<sup>54</sup> The Act, while providing a detailed procedure for the appeal process, lacks a pre-appeal deposit provision, which requires the person challenging the demand notice to deposit the amount in dispute with the corporation and subsequent to which the court can entertain any appeal pertaining to the demand notice.

The principle of pre-appeal deposit may be found under Order XLI Rule 3(3) of the civil procedure code in cases of appeal against a decree for payment of money, where the

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<sup>54</sup> 'BBMP to issue demand notices to tax defaulters' (New Indian Express, 11<sup>th</sup> November 2017) <<http://www.newindianexpress.com/cities/bengaluru/2017/nov/11/bbmp-to-issue-demand-notices-to-tax-defaulters-1698285.html>> Last accessed 04th December 2017

appellant within the time limit decided by the court is required to deposit the amount in dispute or furnish a security equivalent to disputed amount prior to admission of the appeal.

This provision is reflected in certain other Karnataka State legislations, for instance in the Karnataka Land Revenue Act, 1964 under section 174, a purchaser of immovable property aggrieved by any decision taken under the Karnataka Land Revenue Act, is required to deposit 25 % of the amount in contention with the Deputy Commissioner (Revenue). Further in the Karnataka Cooperative Societies Act, 1959 under section 105(2) of the Karnataka Appellate Authority is required to admit an appeal from the Registrar of Societies/State Government/Award of arbitrator or liquidator only if 25 % of the disputed amount is deposited with concerned society. In other states, a pre-appeal deposit provision is reflected in their city corporation acts itself. The Mumbai Municipal Corporation Act (erstwhile Bombay Municipal Corporation Act, 1888) under section 217(3) stipulates the requirement of the appellant to deposit the entire disputed amount with the commissioner, as a pre-requisite to the admission of appeal. In Tamil Nadu, the property tax dispute resolution bars the jurisdiction of the civil court and a taxation appeals committee is established. Under the Chennai District Municipalities Act, 1920 property tax demand notice is required to be challenged before the Taxation Appeals Committee under section 124-I and no further appeal is permitted.

### **3.1 Solution and way forward**

#### ***(a) Method 1***

It is suggested that schedule III of the KMC Act be amended to include a pre-appeal deposit provision or a security of an equal amount prior to the admission of the appeal. The quantum of deposit may be appropriately decided, by reviewing the provisions in other States.

#### ***(b) Method 2***

While the effort to efficiently collect property tax might be stalled by court interventions, reforming the property tax dispute resolution structure may allow quicker and efficient collection of taxes. Under the BBMP Advertisement Tax Rules, 2006 a standing committee

for appeals is established which will hear aggrieved parties who wish to challenge the advertisement tax demand notice. The parties aggrieved by the decision of the appeals committee are only left with the option of approaching the High Court under its writ jurisdiction, which will review if the procedure under the law has been complied and will not look at the facts in questions; therefore the process of recovery is faster.

Along the lines of the framework established for adjudicating advertisement tax disputes, it is suggested that the Karnataka Appellate Tribunal be vested with the jurisdiction to hear disputes pertaining to property tax levy and demand notice. This would require amendments to Part III of the KMC Act which lays down rules for the collection of property tax. Specifically rule 27 and 28 would need amendment, ousting the jurisdiction of the civil court and vest it with KAT. .

The above suggested methods are mutually exclusive. While the reforms to the dispute resolution system is an urgent need, the department of urban development Government of Karnataka will have to make a detailed enquiry on which method would be most appropriate.

## 4. Property Tax Calculation and Property Ownership

### (a) Introduction

Self-assessment Scheme (“SAS”), introduced in 2002 was done after much debate and discussion among the civil society and the State Government. It was a major reform and a process that would significantly improve the revenues of the corporation.<sup>55</sup> The scheme was introduced in Karnataka with an amendment to the KMC Act in 2001 after its successful implementation in Patna. Mysuru and Davangere moved to the SAS scheme in 2004 while Mangaluru only adopted the system in 2009. The framework of the SAS was based on the objective that people will voluntarily calculate the value of the property and pay taxes.<sup>56</sup>

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<sup>55</sup> Simanti Bandyopadhyay, ‘Property Tax Reforms in India: A Comparison of Delhi & Bangalore’ (International Centre For Public Policy, October 2013) <<https://scholarworks.gsu.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1046&context=icepp>> Last accessed 15<sup>th</sup> November 2017

<sup>56</sup> *Ibid.*

### (b) Working of the self-assessment scheme

Some of the concerns with the scheme raised by the officers of the City Corporations have been mentioned below

1. Citizens under value the properties and do not comply with the valuations rates provided.<sup>57</sup>
2. With the KMC Act providing 50% rebating if a property is occupied by the owner, citizens wrongly declare themselves as occupants of the property to take benefit of this section.<sup>58</sup>
3. Corporations do not have a method to verify if the properties are being undervalued and right declarations have been made.
4. The property tax rules require the authorities to conduct a random scrutiny of properties to check on the misuse of the SAS. There is however a limit of 10% of the overall properties in particular zone which may be subject to random scrutiny. Experts in the field have indicated that the random scrutiny rule is used to target a certain class of properties and is a tool for harassment.<sup>59</sup>

Further, collection and enforcement of property tax is another area of concern faced by the corporation.

### 4.1 Solutions and way forward

To address the above concerns, there must be a mechanism to prevent owners from deliberately undervaluing the properties. Currently under section 122A (b) fine may be imposed for *under paying property tax and not under valuing*. Therefore, it is suggested that an amendment to section 122A (b) be carried out, to make undervaluation of property an offence under the law. This has been done under the Bihar Municipal Corporation Act,

<sup>57</sup> 'Erred in property tax declaration? Here's your chance to correct it' *The Times of India* (Bengaluru, 13<sup>th</sup> December 2016) < <https://timesofindia.indiatimes.com/city/bengaluru/Erred-in-property-tax-declaration-Heres-your-chance-to-correct-it/articleshow/55948483.cms> > Last accessed 24<sup>th</sup> January 2017

<sup>58</sup> K. V. Aditya Bharadwaj and S. N. Vijetha, see n (43).

<sup>59</sup> Round table discussion held by the authors on 28<sup>th</sup> December 2017 at Bengaluru

wherein any owner or assessee who wilfully suppresses material information while assessing, and pays property tax at the undervalued rate, will be required to pay an appropriate fine. Rule 13 sub-rule 3 of the Bihar Municipal Property Tax Rules may be referred.<sup>60</sup> Appropriate provisions for under assessing properties from the Bihar Municipal Property Tax Rules are mentioned below

- Not exceeding two times ***the amount of difference between the property tax assessed and the property tax paid*** along with his return in the case of knowingly submitting an incomplete or incorrect return.
- If any owner of ***the holding or assessee wilfully suppresses material information essential for assessment of holding tax or under assesses the holding tax such persons shall be liable for payment of difference between the amount payable and the self-assessed tax and also a fine of one hundred percent of such differential amount***

The recovery of municipal taxes is a major concern in Karnataka.<sup>61</sup> While section 113 of the KMC Act provides a mechanism for the demand and payment of property tax, it is restricted as provisions for attachment of property and issuing of body warrant do not exist.<sup>62</sup> It is suggested that section 113 of the Act be amended to include the following powers<sup>63</sup>

1. Issue of warrant for attachment, distress and sale of movable property for recovery of tax dues;
2. Issue of warrant for attachment and realization from the bank accounts and other financial instruments held, individually or jointly, in the name of the defaulter;

<sup>60</sup> 'Bihar Municipal Property Tax Rules, 2011' <<http://urban.bih.nic.in/Acts/AR-01-08-05-2013.pdf>> Last accessed 15<sup>th</sup> November 2017

<sup>61</sup> R Krishna Kumar, 'Property Tax issues to dominate Mysore Grahakara Parishat Meet' (The Hindu, 20<sup>th</sup> February 2016) <<http://www.thehindu.com/news/national/karnataka/property-tax-issues-to-dominate-mysore-grahakara-parishat-meet/article8260304.ece>> Last accessed 15<sup>th</sup> November 2017

<sup>62</sup> 'Pay property tax or lose assets: BBMP' (Times of India, 15<sup>th</sup> March 2017) <<https://timesofindia.indiatimes.com/city/bengaluru/pay-property-tax-or-lose-assets-bbmp/articleshow/57641350.cms>> Last accessed 30<sup>th</sup> November 2017

<sup>63</sup> Simanti Bandyopadhyay, 'Property Tax Reforms in India: A Comparison of Delhi & Bangalore' (2013) International Centre For Public Policy, <<https://scholarworks.gsu.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1046&context=icepp>> Last accessed 15<sup>th</sup> November 2017

## 5. Eliminating B Khata System & Extending Urban Property Ownership Record scheme to Bengaluru and improving the property tax base of other cities

### (a) Introduction

A “khata” is a document that identifies property owners having an account with the municipality for paying taxes. What makes it important is that it identifies the person liable for paying property tax. The details of a khata include the property owners' name, size of property, location, and built up area all of which is essentially required to calculate the tax payable on that property.

In Bengaluru there are two types of khatas issued, A and B. This difference in type is due to Rule 11 of the BBMP Property Tax Rules, according to which a register is required to be maintained and under which properties assessed will be mentioned under Form A and those un-assessed shall be under Form B. Further, those assessed are eligible for a Property Identification Number (“PID”).<sup>64</sup>

The assessed properties are those which are compliant with the building bye laws and have clear title. While those unassessed, are not in compliance with either one of them. Further, the purpose of issuing a *khata* to those unassessed is to tax illegitimate properties which continue to enjoy the civic amenities.

Karnataka High Court, in the landmark judgment of *Smt. Shanta Gad vs. Assistant Revenue Officer* declared issuance of a “B khata” to be bad in law and inconsistent with section 108A.<sup>65</sup> While laying down a detailed comment on this subject, Justice Ram Mohan Reddy indicated that section 108A does not permit making such distinction. The court subsequently directed the BBMP to issue PID to all properties irrespective of it being assessed or unassessed.

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<sup>64</sup> *Ibid.*

<sup>65</sup> Writ Petition No. 6734/2013, Karnataka High Court.

However despite the court's ruling, the corporation is unable to issue A *khata* and PID Numbers to all property owners. This is due to lack of current survey of the properties in Karnataka and a robust regulatory framework to regularize illegal constructions.

### 5.1 Solution and way forward

This may be addressed through the following manner:<sup>66</sup> Extend the Urban Property Ownership Record (“UPOR”) scheme under the Karnataka Land Revenue Act to Bengaluru and other cities in Karnataka. UPOR is an initiative of the department of revenue and implemented by the department of survey and land records. The scheme ensures a fresh survey of all properties, help determine title of a property and its compliance to building norms. UPOR presents a mutually benefitting scheme with residents receiving confirmation of titles, and the ULBs having the requisite data to improve the property tax net. While UPOR has features which can ULBs to systematically levy property tax, its potential has not yet been tested. This report at the outset suggests considering the scheme as one among many other methods of increasing property tax net.

A resurvey of properties will provide ULBs with latest data to levy tax and especially in Bengaluru allow BBMP to issue A *khata* to all properties.

#### Key Points

- Mandatory representation from 4 local bodies in the central valuation committee.
- Re-structure the working and the composition of sub-committee. Chairman/head of the sub-committee to be the commissioner, with the sub-registrar as the member secretary.
- Define terms such as Land, house sites and commercial areas.
- Base the guidance value on the master plan of a city prepared by the development authority.
- Refer property tax disputes to the standing committee of finance and bar the jurisdiction of the civil court.
- Alternatively, mandate deposit of disputed amount prior to appeal.
- Stringent provision to levy penalty on individuals who deliberately under assess.
- Inserting a provision for Attachment of immovable property, in the event of defaulting of payment.
- Extend the urban property ownership record scheme to all cities. Allowing fresh survey of properties and confirming land titles for individual (Win-Win). This will also facilitate issuance of A *khata* to all property owners.

## V. REFORMS TO THE FRAMEWORK FOR SUPPLY OF WATER IN URBAN AREAS AND COLLECTION OF WATER CHARGES

### 1. Understanding urban water supply financing

The water charges collected constituted second largest source of own revenue for the City Corporations of Mangaluru, Mysuru and Davangere. Despite which the collection is not close to the demand projected. The key to successful water governance is efficient financial management, this will ensure 24x7 water supply and its judicious usage.

In Bengaluru, the water supply is completely managed by the Bengaluru water supply and sewerage board (“BWSSB”) with no role played by BBMP in urban water supply.

The urban water supply in Karnataka involves multiple agencies and statutory bodies, and the framework for its governance is complex. Under the Jawaharlal Nehru National Urban Renewal Mission (“JNNURM”) and now the Atal Mission on Rejuvenation of Urban Territories (“AMRUT”), ULBs are required to recover the costs of water supply services through “reasonable user charges”. The costs have been defined to mean those expenses incurred for operation and maintenance of urban water supply, while the capital costs for urban water supply infrastructure are completely funded by State/Central Government grants.<sup>67</sup>

The term “Operation and maintenance of urban water supply” includes, collection of water charges, installation and maintenance of water meters and providing water supply connections to new households.

This chapter analyzes the framework to understand the role performed by various agencies and statutory bodies in supply of water to urban households. While analyzing the legal

<sup>67</sup> ‘Cost recovery in Urban Water Services: Select Experiences in Indian Cities’ (2011) World Bank, Water and Sanitation Program, <<https://www.wsp.org/sites/wsp.org/files/publications/WSP-Cost-Recovery-Urban-Water-Services.pdf>> Last accessed 23rd November 2017

framework of the various segments of urban water supply in the State, it highlights the concerns which restrict water supplying agencies and bodies financially, from performing their functions efficiently. These concerns are followed by potential solutions.

## **2. Framework for Governance of Urban Water Supply in Karnataka**

### **(a) Role of Karnataka Urban Infrastructure Development Financial Corporation**

Financing of urban water supply in Karnataka involves funding from multi-lateral banks such as World Bank and Asian Development Bank which provide periodic low interest loans for the development of urban water supply infrastructure in the state. The funding from these banks are under the Karnataka Urban Water Supply Modernization Project Scheme (“KUWSMP”).<sup>68</sup> To disburse the funds received under the KUWSMP scheme, Karnataka Urban Infrastructure Development Financial Corporation (“KUIDFC”) is the nodal authority. It also monitors the performance of the water schemes.

### **(b) Role of Karnataka Urban Water Supply and Drainage Board**

In 1974, the Karnataka Urban Water Supply and Drainage Board was established under the Karnataka Urban Water Supply and Drainage Board Act, 1974 (“KUWSDB, Act”) primarily to coordinate the activities of water supply by planning, developing and coordinating implementation of urban water supply schemes in Karnataka. In 1981, noticing the lack of expertise in managing urban water supply infrastructure by the ULBs, the State Government amended the KUWSDB Act to provide an option to the ULB to entrust responsibilities of managing urban water supply infrastructure to KUWSDB.

KUWSDB develops water supply schemes for various cities either upon the request of the ULBs or as a direction from the State Government. The water supply scheme provides the infrastructure for supply of water from source (river) to reservoir which is usually within the municipal limits or just outside. Subsequently, on completion of the water supply scheme the project is handed over to the ULBs which are responsible to provide water connections

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<sup>68</sup> Details of the project may be accessed here:

<<http://www.worldbank.org/en/country/india/brief/karnataka-urban-water-supply-modernization-project-brief>> Last accessed 15<sup>th</sup> November 2017

to various household from the reservoir, install meters accordingly and collect water charges.

### 3. Financial Framework for Infrastructure Development

Finances infrastructure for urban water supply are structured to accommodate multiple investment and planning agencies. KUIDFC provides a loan to partly finance the expenses, while the remaining financing is undertaken by State and Central Government grants. KUWSDB under section 16, has its primary function to coordinate the implementation of urban water supply schemes. It receives funds from KUIDFC and State/Central Governments for the development of infrastructure, it then tenders this responsibility to the lowest bidding private contractors. KUWSDB and KUIDFC jointly maintain an oversight of the infrastructure works. Upon completion of the infrastructure development, it is handed over to the ULB for its management and maintenance.

While the primary responsibility, under section 17 of the KUWSDB Act is to coordinate urban water supply infrastructure activities,<sup>69</sup> an amendment in 1981 provided an option to the ULBs under section 17 to alternatively engage KUWSDB for management of urban water supply as well.

Noticing the shortage of personnel in the ULBs for the management of water supply the State Government in 2005, drafted the Karnataka Municipal Corporation (Water Supply) Rules which provided a framework to privatize management of water supply in the cities, allowing ULBs to issue tenders, and outsource its operational and maintenance functions.

#### (a) Concerns and issues

The current framework in Karnataka (apart from Bengaluru) requires the ULBs under section 20 of the KUWSDB Act to authorize, through an internal resolution, the water supply scheme prepared by KUWSDB and while authorizing review the financials of the scheme and its ability to incur associated cost. However, during the implementation of the water supply scheme there is no participation of the host ULB. This results in hasty execution of the works

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<sup>69</sup> The ULB's decision to engage KUWSDB is subject to the approval of the State Government.

contract and upon the handing over of the project the ULB is unaware of the technicalities of the project.

Thus the collection of water charges and metering and providing new water connections are managed by the ULBs, and the efficiency of which is dependent on the implementation of the water supply scheme by KUWSDB.

Therefore, the efficient collection of water charges by the ULB is dependent on the performance of various agencies and bodies.

This complex arrangement may be noticed in the case of Mysuru wherein, the water supply contract was handed over to Jamshedpur Utilities & Services Company. The functions entrusted to the private party for water supply, under the contract with the ULB, are in the nature of section 17 of the KUWSDB Act and include the important function of metering and water charges collection.<sup>70</sup>

In Mangaluru and Davangere, the respective City Corporations have awarded the contract of managing water supply to KUWSDB.

### **(b) Position in Bengaluru**

The framework for supply of water in Bengaluru is distinct from one the one which has been established for the remaining part of the State. Urban water supply in the State of Karnataka is the complete prerogative of the BWSSB established under the BWSSB Act, 1964. There is no role of the city corporation, BBMP, in the establishment, maintenance and financing of water supply in the city. This unique status of BWSSB can be traced by referring to the statement and objectives of the 1964 Act. It indicates that this completely autonomous body is the result of a World Bank grant in 1964 which linked the grant to the establishment of an independent and autonomous water and sewerage supply body. Under section 26 of the Act, BWSSB will undertake all water supply and drainage works and it will cease to be under the jurisdiction of the BBMP. Sections 16- 25 allows the BWSSB to manage its finance and levy water charge for performing all its functions.

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<sup>70</sup> *Ibid.*

The grants from World Bank under the KUWISP scheme, is directly provided to the BWSSB by KUIDFC and governed by an MOU. Further, the BWSSB under section 127 of the Act may further outsource its functions to private parties upon entering into a contract.

#### 4. Situation of water supply in Mysuru/ Mangaluru/ Davangere

##### (a) Mysuru

Mysuru city water supply is suffering from many serious problems. A significant portion of customers do not have meters and most of the existing meters do not work properly. There is plenty of leakage all over the city.<sup>71</sup> As a result of these factors, only a fraction of the water pumped into the city gets billed. In addition to this, multiple households do not pay their water bills. Therefore, Mysuru City Corporation (“MCC”) is recovering only a portion of the cost incurred on supply water to households.

In 2008, JUSCO bagged a six-year performance-based water management contract for Mysuru city. JUSCO entered into the tripartite contract agreement with Mysuru City Corporation (MCC) and KUWSDB. This contract was the largest water supply project being executed through public private partnership (PPP) model in India. As per various reports the agreement was supposed to benefit the MCC as well the citizens as it planned to regularize the present water supply with day-long supply, increase the MCC revenue, regularize unauthorized and non-metered connections which number around 1.3 lakh and improve mobilization of water charges with JUSCO issuing computerized bills every month. However, the contract that was entered into suffered from various defects, it was non-performance based and by 2015, the mandate of 24X7 water supply was not achieved. By the end of the contract period, less than half the water consumers in the city were footing the entire cost of water supply in Mysuru.<sup>72</sup>

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<sup>71</sup> CS Sharada Prasad, ‘JUSCO debate : Change of management of Mysore's water supply’ (India Water Portal, 26<sup>th</sup> May 2009) <<http://www.indiawaterportal.org/articles/jusco-debate-change-management-mysore-water-supply>> Last accessed 15<sup>th</sup> November 2017

<sup>72</sup> Gouri S, ‘Meter or no meter Mysore City Corporation makes its money’ *Business Standard* (Mysore, 28th January 2013) <[http://www.business-standard.com/article/economy-policy/meter-or-no-meter-mysore-city-corporation-makes-its-money-106042701004\\_1.html](http://www.business-standard.com/article/economy-policy/meter-or-no-meter-mysore-city-corporation-makes-its-money-106042701004_1.html)> Last accessed 15<sup>th</sup> November 2017

With the end of JUSCO contract, MCC is considering of handing the responsibility of city water works to KUSWDB.<sup>73</sup>

Further, the revision of water tariff was suggested by the city corporation in 2012 and once again in 2014; however, these requests have not met the approval of the State Government.

### **(b) Mangaluru**

The water supply works in Mangaluru is managed by the KUSWDB. However, as indicated in chapter 2 the water charge collection is 36 % of the overall demand. However, the situation in Mangaluru is distinct from other cities, the domestic water supply is dominated by private tankers and hence the demand for urban water supply is limited.<sup>74</sup> Further, 100% metering has not been achieved in Mangaluru forcing the corporation to let go potential revenue.

The industries in the city are largest users of urban water supply, and they are the largest defaulter. KUWSDB has outsourced the bill collection responsibility in Mangaluru, and the private agencies are not efficiently discharging their contractual responsibilities.<sup>75</sup>

### **(c) Davangere**

Water supply works in Davangere is managed by KUWSDB. The situation in Davangere is common to Mangaluru, with coverage of metering and collection of bills being the concerns.

## **5. Situation of Water Supply in Bengaluru**

Water supply works in Bengaluru is managed by BWSSB. Out of 1325 million liters of water BWSSB supplies to the city on a daily basis, 46 % are estimated to be non-revenue or unaccounted water.<sup>76</sup>

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<sup>73</sup> *Ibid.*

<sup>74</sup> Vinobha KT, '50000 Consumers owe 20.64 Crore to the Mangalore City Corporation in water bills' *Times of India* (Mangaluru, August 10<sup>th</sup> 2017) <<https://timesofindia.indiatimes.com/city/mangaluru/50000-consumers-owe-rs-20-64-crore-to-mcc-towards-water-bills/articleshow/60004755.cms>> Last accessed 15<sup>th</sup> November 2017

<sup>75</sup> *Ibid.*

<sup>76</sup> Shamala K.M "Massive project to fix water leaks underway"(Citizen Matters, March 4th 2013)<<http://bengaluru.citizenmatters.in/4979-bwssb-project-to-check-water-theft-and-leakage-4979>> Last accessed 31st January 2017

Poor recovery of operational, maintenance costs from user charges is attributed to the inefficiency of water supply management in Bengaluru city. BWSSB charges water tariff at Rs. 7 per kiloliter of water. However, supplying of 1 kiloliter of water costs Rs. 40 which indicates that current tariff for water supply services is insufficient even to meet the O&M costs of BWSSB; therefore, the Board is perennially dependent on the state government for funding.<sup>77</sup>

### (a) Non-Revenue Water

This concern is common to all cities studied in this report. Non-Revenue Water (“NRW”) is the difference between the volume of water put into the water distribution system and the volume that is billed to consumer. Originally the term “unaccounted for water” was used but on the recommendation of the Water Loss Task Force established by the International Water Association, the term “non-revenue water” was used instead. NRW comprises of two components –

- a. Physical (or real) losses: Leakage from all parts of the system and overflows utility’s reservoirs.
- b. Commercial (or apparent) losses: caused by customer meter under registration, data handling errors and theft of water in various forms.

For the city of Mysuru 66 % of the water fed into the distribution is non-revenue.<sup>78</sup> In Mangalore although official figures are not available, it was confirmed to the authors of this report, by the officers of the city corporation that it is in upwards of 50 %. In Davanagere the non-revenue water stood at 71 % and hence, despite multiple initiatives, 24\*7 water supply has not been successfully implemented. In Bengaluru, as mentioned earlier, 46 % of the water is non-revenue.<sup>79</sup>

<sup>77</sup> Krishna Raj, ‘Where All the Water Has Gone? An Analysis of Unreliable Water Supply in Bangalore City’ (Institute of Social and Economic Change, 2013) <<http://www.isec.ac.in/WP%20307%20-%20Krishna%20Raj.pdf>> Last accessed 15<sup>th</sup> November 2017

<sup>78</sup> Innovative Hub for Urban Water, Sanitation & Hygiene Solutions in India, ‘City Fact Sheet: Mysore’ (IRC Wash, 2016) <[https://www.ircwash.org/sites/default/files/mysore\\_0.pdf](https://www.ircwash.org/sites/default/files/mysore_0.pdf)> Last accessed: November 30<sup>th</sup> 2017

<sup>79</sup> Afshan Yasmeen, ‘46 p.c. of Bengaluru’s water not accounted for’ *The Hindu* (Bengaluru, 16<sup>th</sup> July 2016) <<http://www.thehindu.com/news/cities/bangalore/46-p.c.-of-Bengaluru%E2%80%99s-water-not-accounted-for/article14493010.ece>> Last accessed 30<sup>th</sup> November 2017

## **(b) Issues and concerns**

Based on the above discussions number of issues arise. While the issues spread over multiple domains, this chapter will however cover those which impact the financing of urban water supply

1. Important functions such as metering and water charge collection are outsourced or sub-contracted, which impacts the revenue of the state government.
2. High levels of non-revenue water
3. Representatives of the ULBs are not involved during the period of infrastructure development.
4. Citizens do not pay for requisite water charges and there are limited enforcement measures under the act.
5. Determination of water tariff is left to State Government. Further, while the State Government has the final decision on the issue of water pricing, if efficiency in water charge collection is ensured then requirement of revising water rates multiple times will not arise.
6. Lack of a guiding urban water supply policy.

## **6. Solutions and way forward**

### **(a) Establishing a project management committee for ULBs in Karnataka**

While reviewing the governance of water supply in other states this study finds the Maharashtra Jeevan Authority Act, 1976 an excellent framework. Under section 22 of the Maharashtra Jeevan Authority Act, 1976, the State Government may direct the water authority to coordinate its activities with the local body by setting up a committee with representation from the water authority and local body. A similar set up may be adopted by the Government of Karnataka in each district, where a water supply scheme is planned to execute. A project management committee may be established by carrying out necessary amendments to the KUWSDB and BWSSB Acts.

1. ULB/BBMP
2. KUIDFC

3. KUWSDB
4. Individual with special knowledge in finance
5. Individual with special knowledge in urban water supply.

The project management committee will supervise the work of the private contractor and ensure coordinating with the ULB while preparing the detailed project report for the water supply scheme and a joint oversight to ensure its successful implementation. Thus, with the representation of the ULB, the transition of the maintenance of infrastructure will be smooth and enforcement and collection of water charges will be efficient.

### **(b) Performing water audit**

Water auditing helps quantifying water usage and supply. It provides the means to develop precision in schemes for water conservation, water use efficiency and water management.<sup>80</sup> Water audit will help determine the amount of water lost from a distribution system due to leakage and other reasons such as theft, unauthorized or illegal withdrawals from the systems and the cost of such losses to the utility. Comprehensive water audit gives a detailed profile of the distribution system and water users, thereby facilitating easier and effective management of the resources with improved reliability.<sup>81</sup>

In light of the large amounts of non-revenue water in the cities, it is suggested that the KAG undertake a financial and performance audit of BWSSB and KUWSDB.

### **(c) Establishing an urban water supply regulator**

There is a strong need to set up regulatory institution for setting standards, monitoring performance, adjusting tariffs. The ministry of urban development in policy advisory, issued a note in 2012, which touches upon this suggestion, while not providing any detailed

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<sup>80</sup> Sturman, J. and Ho, G.E. and Mathew, K, *Water Auditing and Water Conservation* (IWA Publishing, 2004)

<sup>81</sup> 'General guidelines for water audit & water conservation' (2005) Central Water Commission, <<http://www.cwc.gov.in/main/downloads/Water%20Audit%20&%20Water%20Conservation%20Final.pdf>> Last accessed: 30<sup>th</sup> November 2017

discussion on it. The report relies on few suggestions made by the International Environment Law Research Centre, on establishing a water regulator at State levels.<sup>82</sup>

Some states such as Kerala, Gujarat, Uttar Pradesh, Arunachal Pradesh and Maharashtra have established a water resources regulatory authority, however they deal with water resources allocation and do not regulate delivery of water services in the state.

In addition, best practices from Chile may also be considered. Chile had concerns of inefficient water billing and high price, which led to the increase of alternate methods of water supply, causing major stress on the resources and water supply agencies going into financial stress. Post this, the water sector in Chile underwent major changes as a result of decentralization and market reforms. Over the last 30 years, the Chilean government has successfully incorporated private participation in the urban water and sanitation sector and implemented a stringent regulator that has contributed to cost recovery and affordability of the reform.<sup>83</sup>

Therefore, given that fresh water is a scarce natural resource, yet essential for human life, and given the need to financially empower bodies that provide water supply services, a water regulator in the state would be necessary to ensure that allocation of water usage is done in a manner that serves larger public interest, balancing these concerns.

#### **(d) Role and functions of the water regulator**

The proposed water regulator would exclusively deal with urban water supply, it would have the following functions:<sup>84</sup>

1. Fix and regulate the water tariff system based on the principles of cost recovery, reducing subsidies and judicious water usage.

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<sup>82</sup> Sujith Koonan & Lovleen Bhullar, 'Water Regulatory Authorities in India, The Way Forward?' (2012-04) International Environmental Law Research Centre <<http://www.ielrc.org/content/p1204.pdf>> Last accessed 15<sup>th</sup> November 2017

<sup>83</sup> Ariel Dinar, Víctor Pochat and José Albiac-Murillo, *Global Issues in Water Policy Water Pricing Experiences and Innovations* (Springer International Publishing, 2015)

<sup>84</sup> Tamil Nadu Urban Local Bodies Licensing of Hoardings and Levy and Collection of Advertisement Tax Rules, 2003, <[http://www.tn.gov.in/dtp/gopdf/6\\_23.pdf](http://www.tn.gov.in/dtp/gopdf/6_23.pdf)> Last accessed November 15<sup>th</sup> 2017

2. Developing model contracts for ULBs for the purposes of privatizing maintenance of water supply
3. To approve potential contracts between the ULBs and private parties, and govern sub-contracting.

### *Membership of authority*

The effectiveness of water regulatory authorities is premised on its members. The authority must have representation from all stakeholders, including State Government, ULBs, DMA and experts in the field.

#### **Key Points**

- Establish a project management committee during the execution of the water supply scheme, with representation from ULB, KUWSDB and private agencies. This will ensure smooth handover.
- Contracts for collection of water charges to be performance based, and a committee/regulator should mandatorily vet the contract prior to the ULB entering into one.
- Establish a Non-Revenue water cell with representation from ULB, private agency and KUWSDB. This will ensure leakage mapping and ascertaining of liability.
- Periodically perform water audit by an independent agency or Karnataka Accountant General.
- Establish an urban water resources regulatory authority with the responsibility to liaison between the ULB and the State Government for periodic revision in prices.
- The regulatory authority may also vet the contracts the ULB's are entering into.
- Revise the Karnataka Urban Water Supply Policy, 2003.

## VI. REFORMS TO THE FRAMEWORK FOR LEVY AND COLLECTION OF ADVERTISEMENT TAX

### 1. Introduction

Section 134 of the KMC Act empowers the Municipal Corporation to levy advertisement tax. Sections 135 to 138 regulate the display of advertisement of cities, while section 139 provides a mechanism to collect tax on advertisement.

Revenue from advertisement tax is largely untapped across various cities in Karnataka. It has a considerable potential to become a one of the primary sources of revenue for Municipalities. To achieve this City Corporations and ULBs need to build an inventory of advertisements and a tracking mechanism. They need to be permitted to levy taxes on hoardings as well as advertisements separately.

The KAG audit report of the cities of Mangaluru and Davangere indicate that potential revenue from advertisement tax is being let go due to the absence of a regulatory structure. Upon interaction with the Mysuru Deputy Commissioner of Revenue, the author was informed that the situation in Mysuru is similar with revenue up to 2.5 crores not being realized.

Further, in the absence of rates fixed by these CCs/CMC, the minimum rate of `7,000 per annum being levied by BBMP has been adopted by the urban local bodies.<sup>85</sup>

City Corporation	Number of Advertisement Hoardings	Tax leviable	Cess at 26%	Loss of Revenue
Davangere	122	8.54	2.22	10.76
Mangaluru	763	53.41	13.89	67.30

<sup>85</sup> 'Report of the Comptroller and Auditor General of India on Local Bodies', see n (22).

Source: Report of the Comptroller and Auditor General of India on Local Bodies in Karnataka

In response to this loss of revenue, the Directorate of Municipal Administration must issue advertisement tax rules and bye-laws which may be implemented by the City Corporations.

## 2. Collection of Advertisement Tax in Bengaluru

Advertisement tax for BBMP has the potential to be the second largest source of revenue after property tax. On analyzing the balance sheet of BBMP, we understand that only a paltry 4 crores have been collected for the year 2015-16 whereas the advertisement tax estimate for the year 2016-17 is at 146 crores – which is an increase of 3550%.<sup>86</sup>

The advertisement bye-laws issued by BBMP regulate the display of advertisement of the city.<sup>87</sup> They also lay down the procedure and mechanism for seeking permission and payment of relevant fee. Further, they also specify fines to be paid in the event of breaching any provision of the bye-laws.

While States such as Tamil Nadu and Andhra Pradesh have rules<sup>88</sup> to regulate advertisement, and the levy of corresponding tax, in Bengaluru advertisements are regulated by the Advertisement Bye-Laws, 2006. In 2014, amendments in the bye laws pertaining<sup>89</sup> to the illegal hoardings in the city were carried; however a copy of these amendments are not available in public domain. This chapter will analyze the various observations made by the Karnataka High Court in the enforcement of advertisement tax in city, to understand the key issues that restrict the corporation from efficiently collecting advertisement tax.

## 3. Judicial Observations of Advertisement Tax in Bengaluru

Since the time the bye-laws have been force, there have been numerous litigations in the Karnataka High Court pertaining to the provisions under the bye-laws and the Karnataka

<sup>86</sup> Trends in Municipal Finance in India, (Reserve Bank of India) <<https://rbidocs.rbi.org.in/rdocs/Content/PDFs/82506.pdf>> Last accessed November 15<sup>th</sup> 2017

<sup>87</sup> From Rule 3 to Rule 8 of the 2006 BBMP Advertisement Bye-laws

<sup>88</sup> Tamil Nadu Urban Local Bodies Licensing of Hoardings and Levy and Collection of Advertisement Tax Rules, 2003, <[http://www.tn.gov.in/dtp/gopdf/6\\_23.pdf](http://www.tn.gov.in/dtp/gopdf/6_23.pdf)> Last accessed November 15<sup>th</sup> 2017

<sup>89</sup> BBMP Advertisement Bye-Laws, 2006, <<http://bbmp.gov.in/documents/10180/511714/Bye-Law+2006+English.pdf/2ca74401-6c54-4e67-8475-9724033761be>> Last accessed November 15<sup>th</sup> 2017

Municipal Corporation Act. The High Court has on numerous occasions, highlighted the lack of active collection of advertisement taxes in the city. In the case of *M/S Rai Advertising v. BBMP*, the court hauled up the BBMP for not issuing demand notices for the collection of advertisement taxes, and noted a potential loss of Rs. 25 Crores to the corporation.<sup>90</sup> Further, Justice Vineet Kothari in October 2017 directed the joint commissioner revenue of BBMP to file an affidavit before the High Court explaining efforts made to collect advertisement tax. The court noted that Rs. 285.6 Crores is expected to be collected by the corporation.<sup>91</sup> This order by the High Court was in pursuance of a status report by BBMP indicating that 67 advertising agencies in Bangalore are yet to be served demand notices and the collections have been limited.

Under the 2006 bye-laws, the framework for enforcement is limited as it does not grant much power on the authorities. There is no dedicated procedure for enforcement as it is left to discretion of the commissioner.

Further, in the case of *Hutchison Essar v. BBMP*, the facts were, companies whose hoardings were put up by shops and establishment had been issued notice to pay the requisite advertisement tax; these notices were challenged.<sup>92</sup> The high court held the respective shops and establishment as the appropriate taxable body and not companies. Subsequent to this judgment, enforcement of advertisement tax on shops and establishment is a concern as many don't pay and are ignorant of the existence of such taxes.

From the above observations, the following points emerge

1. The BBMP is unable to enforce the advertisement bye-laws, despite multiple judicial directions to this effect.
2. The BBMP is unable to track the list of hoardings and advertisement agencies that are required to be taxed.

## 4. Solutions and way forward

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<sup>90</sup> Writ Petitions No.17681-17690 of 2013, Karnataka High Court

<sup>91</sup> Writ Petition No. 52123 of 2016, Karnataka High Court

<sup>92</sup> Writ Petition No.9039 of 2007, Karnataka High Court

### (a) Structural changes

It is suggested that an advertisement regulation committee be established under the bye-laws. The proposed committee will prepare advertisement/zoning plans indicating the categories of advertisement devices permissible in different areas. It will also undertake the responsibility of periodically revising the advertisement rates. Further, it will also have the responsibility to ensure the implementation of the bye laws. The committee will have the commissioner as its ex-officio chairman, and other members would include executive engineer, urban planning experts, joint commissioner revenue and a representative from the State Government.

A similar structure has been provided for under the Jalandhar Advertisement Bye-laws, 2015<sup>93</sup>

### (b) Improving enforcement

With large amounts of tax dues to be recovered, the current system of enforcement specified requires an overhaul. Under the bye-laws, the commissioner is required to direct the officers to enforce the payment of advertisement, it is suggested that the bye-laws be amended to provide guidance for the enforcement.

1. Amend section 139 of the KMC Act, to insert a penal provision to punish those who have defaulted on the payment of advertisement tax.
2. Appoint a director of enforcement (Advertisement) of the same rank as the Joint Commissioner, with all the revenue officers reporting to him/her. This appointment must be followed by necessary amendments in the 2006 bye-laws.
3. Director of enforcement may be a serving KAS officer.<sup>94</sup>

<sup>93</sup> Jalandhar Advertisement Tax, Bye-laws Government of Punjab, <<http://mcjalandhar.in/advertisement-byelaws.pdf>> Last accessed 15<sup>th</sup> November 2017

<sup>94</sup> Commissioner A.S Mathai's reports on Advertisement Tax in Bengaluru (Citizen Matters, Bangalore, 12<sup>th</sup> June 2016) <<http://bengaluru.citizenmatters.in/reports-on-bbmp-s-illegal-advertisement-hoardings-by-k-mathai-8434>> Last accessed 15<sup>th</sup> November 2017

4. Director of enforcement may order any of the revenue officers, to file a criminal complaint under section 139 if they are persistent defaulters.

### Key Points

- This report voices the urgent need of drafting rules/byelaws for advertisement tax for areas under DMA's jurisdiction.
- Currently the Joint Commissioner Revenue and few BBMP officials have the responsibility to collect taxes and ensure compliance. The working of the officers is ad-hoc with limited structure.
- It is suggested that an advertisement regulation committee be established, under the advertisement tax bye-laws to ensure compliance of the bye-laws.
- Establish an enforcement committee headed by a district judge or KAS officer to undertake systematic efforts for collecting taxes.

## VII. NEW AVENUES FOR RAISING REVENUES

### 1. Debt financing infrastructure

#### (a) Introduction

As is evident from previous chapters, ULBs currently rely heavily on their own revenue grants which they receive from the State and Central Governments, while their own revenues support only a fraction of their costs. For the scale of infrastructure development and up-gradation that is required to sustain the population growth, multiple avenues of revenue must be developed which may be accessed quickly while not adding significant financial burden for its repayment.<sup>95</sup> To facilitate this ULBs must have greater financial autonomy to borrow money from institutions and open market.

#### (b) Loans and Borrowing by ULBs

##### *Issues and Concern*

Under section 154 of the KMC Act, the corporation is allowed to borrow money for the following purposes.

1. For the construction of works
2. For the acquisition of lands and buildings
3. Pay off any debt due to Government
4. Repay a loan previously raised under this Act or any other law previously in force:

Any money borrowed through loan or debenture under section 154 of the KMC Act and the terms of such borrowing will require the sanction of the State Government. With 216 ULBs in Karnataka, such sanction often is time consuming and there are no criteria to determine a request for borrowing.<sup>96</sup> In states such as Odisha, Bihar and Rajasthan, the concurrence of the State Government prior to borrowing is not a requirement. These states have issued debt

<sup>95</sup> 'Local Government Finance and Bond Market' (2003) Asian Development Bank, <<https://www.adb.org/sites/default/files/publication/27942/loc-govt-fin-bond-mkts.pdf>> Last accessed November 15<sup>th</sup> 2017

<sup>96</sup> Kala S Sridhar, Venugopal Reddy and Pavan Srinath, *Changing the Urban Face of Karnataka: Evidence from Three Urban Development Programmes* (Public Affairs Centre 2011)

limitation policies, the provisions of which require the ULBs to comply with various pre-requisites, mentioned in the debt limitation policy, before borrowing money.

## 1.1 Solutions and way forward

Mandating State Government approval throttles the ability of ULBs to raise money to address immediate or even long term concerns. Government approvals are time consuming. To address this, amendments to sections 154(2) and 154(3) must be carried out to de-link the requirement of State Government approval for borrowing money, and a comprehensive debt limitation policy may be drafted which will provide stringent pre-requisites.

### (a) Raising funds through municipal bonds

The municipal bonds program in India has not met with significant success due to the persistent problem of poor credit-worthiness of municipalities. The Nashik Municipal Corporation is the first municipal body whose bonds traded in the secondary market. In 2001, the Ministry of Finance (MoF) amended Section 10 (15) (viii) of the Income Tax Act, to exempt purchase of municipal bonds issued by the municipal corporations from tax. Municipal bonds like any other open market offering are required to be backed by a guarantee. Due to limited financial assets of the ULBs, the State Government steps in to act as a guarantor. In the absence of a regulatory framework, raising money through this route is a complex process and requires multiple chains of approvals where significant political consideration is involved and hence only few cities in India have managed to successfully raise funds.<sup>97</sup>

The experience of the United States reveals that properly structured municipal bonds can become a key instrument to finance the ever growing needs of urban infrastructure in India. To support it, a robust regulatory framework for municipal bonds needs to be developed by the State Government.<sup>98</sup>

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<sup>97</sup> Shamika Ravi and Ankit Bhatia, 'Municipal Bond Market Could Be the Answer to Financing Woes of Smart Cities' *The Wire* (7th September 2017) <<https://thewire.in/64452/financing-smart-cities-a-case-for-municipal-bonds-market/>> Last accessed 20<sup>th</sup> December 2017

<sup>98</sup> Prasanna K Mohanty, see n (38).

### (b) Working of municipal bonds

States in India including Karnataka currently, do not have a regulatory framework for issuing and raising revenue from municipal bonds. Rajasthan in the 2008 ordinance to amend its municipalities act carried a provision dealing with municipal bonds. However this was not reflected in the 2009 amending act.<sup>99</sup> In Karnataka, the KUIDFC, has undertaken the initiative to raise money for ULBs through the pool financing scheme. This scheme, allows multiple urban local bodies to approach the market, jointly and through an institution, to raise finance. The approach faces the following shortcomings:

1. Project specific, KUIDFC utilized the pool financing scheme to fund multiple ULBs' water supply scheme programs.
2. Raising money through pool financing is through an intermediary.
3. ULBs are unable to raise money individually to cater to city level projects.

## 2. Developing a Regulatory Framework for Municipal Bonds: Theory and International Perspective.

Internationally, there are three main approaches to the regulation and control of municipal bonds<sup>100</sup>.

**(a) Market based**- Where decisions about municipal borrowings are made by the borrowers and lenders within an overall legal framework and with some level of administrative oversight, but without transaction specific higher level authorization or detailed rules regarding the amounts and terms of borrowing transactions.

**(b) Rules based**- Where decisions about borrowing are made within a more tightly circumscribed set of parameters outlined in a detailed set of rules that are constant. Higher-

<sup>99</sup> 2008 Rajasthan Municipalities Act Amendment Ordinance available here <<http://www.janaagraha.org/asics/report/Rajasthan-CPL-Act.pdf>>

<sup>100</sup> 'Developing a regulatory framework for municipal borrowing in India' (2011) Volume 1, The World Bank <<http://documents.worldbank.org/curated/en/132101468281673152/pdf/671200WP0v10P10ipal0Borrowing0Vol01.pdf>> Last accessed November 15<sup>th</sup> 2017

level approval of specific transactions may be required, but this is largely limited to compliance with the rules themselves rather than the underlying merits of the transaction or the investment that it is funding.

**(b) Direct control system-** Where the emphasis is on the ad-hoc approval of specific municipal transactions by higher levels of government, which have extensive discretionary powers in respect of the approval process

No country in the world represents any of these systems in its purest form. Rather, the three systems are best understood as tendencies or points on a triangular spectrum. The actual system that can be found in specific countries comprise a concrete mix of these approaches to a greater or lesser degree. In Serbia, the authorization process is confined to scrutiny of the transaction and its compliance with the rules and does not extend to an assessment of the merits of the proposed borrowing or the specific investment that it may be funding. In Poland and Hungary, the investor runs the risk of ensuring the loan is in full compliance with the rules as stipulated.<sup>101</sup>

### *State guarantees for municipal bonds*

The regulatory framework may address the various procedural concerns of raising revenue through municipal bonds. However, structurally such bonds may be possible only if there is guarantee provided. As indicated previously, the State Government is often the guarantor.

With the State Government as the guarantor, it assumes a larger say in the functioning of ULBs and impacts autonomy of local bodies. Further, State Government guarantees are subject to political consideration and is not decided on need basis.<sup>102</sup>

## **2.1 Solution and way forward**

### **(a) State level reform**

In the context of Karnataka, it is suggested that a rule based regulatory mechanism be developed. The chief advantage of rules based approaches are that they are transparent and

<sup>101</sup> 'Developing a regulatory framework for municipal borrowing in India', see n (106).

<sup>102</sup> *Ibid.*

even-handed, and provide an environment in which both investor and borrowers can relatively easily gauge transaction risk. To implement this mechanism, the Directorate of Municipal Corporation (For all ULBs apart from BBMP) and Urban Development Department, Government of Karnataka (for BBMP) would be required to develop a set of rules to regulate municipal bonds. The rules may establish a committee with representation from the local bodies, Government of Karnataka and individuals with special knowledge to determine an application for issuing municipal bonds which may be determined in line with the debt limitation policy.

### **(b) Central level reform**

While it is crucial to initiate state level reforms, there are few legal impediments in the central level regulations that restrict the potential of municipal bonds.

Insurance Regulatory Development Authority guidelines classify all municipal bonds as non-governmental securities that need to be rated at least A+ to be eligible for inclusion in an insurance company's investment portfolio. Based on this, the Pension Fund Regulatory and Development Authority have designated municipal bonds as non-governmental securities as class c instruments. Municipal bonds thus have to compete with other class c instruments, which may have higher yields than municipal bonds. These instruments make municipal bonds unattractive within the same asset class.

To address this, it is suggested that a new asset class called "rated municipal securities" be included in both IRDA and PFRDA's guidelines.

### **(c) Security and collateral**

The above regulations discourage utilizing State Government as a guarantor, since it would then require the ULBs themselves to pledge their properties to raise money from municipal bonds. This would however cause major concerns, as ULBs are both statutory and constitutional entities; they cannot be wound up or liquidated in the usual manner. While the usual debt recovery and security enforcement mechanisms are not effective against ULBs, the state governments are vested with overwhelming but ill-specified powers to intervene in ULB operations to settle debt recovery proceedings.

To address the above concern, it is suggested that municipal assets are classified as essential and non-essential for the provision of mandated services. The municipal bond rules should provide for the distinction between essential municipal assets and commercial/non-essential municipal assets. To establish such distinction, the rules may rely on the discretionary and obligatory functions mentioned under sections 56 and 57 of the KMC Act. The KMC Act through an amendment to section 154 allow ULBs to raise money through municipal bonds subject to the rules developed and committee established for that purpose.

#### **(d) Enforcement**

The KMC Act may vest the High Court with original jurisdiction to hear any dispute pertaining to municipal bonds.

### **3. Professional tax**

#### ***Introduction***

At present, twenty-one states impose professional tax through various laws, adhering to the limit of Rs. 2,500 imposed under the Constitution. The coverage of the tax varies; it is generally applicable to all persons engaged in any employment or in any profession. In some States, it is limited to certain specified professions in others. The tax is levied and collected by the State Government alone (Maharashtra and Karnataka), while in others such as Kerala and Tamil Nadu, local bodies also levy and collect the tax. In Karnataka, the levy of professional tax is provided under the Karnataka Tax on Professions, Trades, Callings and Employments Act, 1976. The commercial taxes department is the relevant authority tasked with the responsibility of collection. In the year 2015-16, Karnataka collected a total of Rs. 900 Crores from professional tax, which is 1.26 % of the overall revenue of the state.<sup>103</sup>

Upon tracing the history of professional tax in India, it is understood that the framers specifically retained this taxing provision in the constitution as the then chairman of the drafting committee felt that multiple municipalities were surviving due to the provision.<sup>104</sup>

<sup>103</sup> 'Report of the Comptroller and Auditor General of India on Local Bodies', see n (22).

<sup>104</sup> Alok Prasanna Kumar, Ananya Kapoor and Yashaswini Mittal, 'On Widening the Taxing Powers of the State' (2014) Vidhi Centre for Legal Policy,

In multiple international jurisdictions such as Switzerland and Mexico, professional tax is levied and collected by the municipal bodies.<sup>105</sup>

There would be a large scale impact on the finances of local bodies in Karnataka if the proceeds from professional tax are distributed among the various local bodies.

### 3.1 Solutions and way forward

An amendment to section 103 of the KMC Act may be carried out, allowing the urban local bodies to levy professional tax. Accordingly, appropriate rules/bye-laws be drafted. To facilitate this smoothly it would require the state to also carry out necessary amendments to the Karnataka Tax on Professions, Trades, Callings and Employment Act, 1976.

#### Key Points

- Control of State Government for the raising of loans by the ULB's must be watered down.
- Draft a debt limitation policy which will mention stringent compliance requirements prior to raising a loan.
- The practice of State Government acting as guarantor must stop.
- ULB's must be allowed to pledge assets subsequent to qualifying its assets as essential and non-essential.
- Establish a committee with representation from DMA, UDD, ULB and GOK which will determine municipal bond requests by ULB's based on the debt limitation policy.
- This report suggests earmarking proceeds from professional tax to the ULB's. This would require an amendment to the Karnataka Tax on Professions, Trades, Callings and Employments Act, 1976.

<[https://static1.squarespace.com/static/551ea026e4b0adba21a8f9df/t/5573f702e4b04dc410457cdf/1433663234750/141010\\_Professional+Tax.pdf](https://static1.squarespace.com/static/551ea026e4b0adba21a8f9df/t/5573f702e4b04dc410457cdf/1433663234750/141010_Professional+Tax.pdf)> Last accessed 29<sup>th</sup> January 2018

<sup>105</sup> *Ibid.*

## VIII. STRENGTHNING THE FINANCIAL ACCOUNTABILITY OF URBAN LOCAL BODIES

### 1. Introduction

This chapter in its previous sections has dealt with numerous ways local bodies in Karnataka can improve revenue. Some of these suggestions are based on the principle of local bodies having sufficient autonomy to take key decisions, with the State Government maintaining a general oversight body with limited interference in the affairs of the local body.

While a fiscally autonomous local body helps improve own revenue, such autonomy should be exercised responsibly. The KMC Act from section 150 deals with accounts and audits of local bodies in the State. State Government under section 151 has prescribed the following financial rules for the corporation

1. Karnataka Municipalities Accounting and Budgeting Rules, 2006
2. Karnataka Municipal Accounting Manual
3. Opening Balance Sheet Preparation Guidelines
4. Karnataka Municipal Asset Management and Valuation Methodology
5. Karnataka Municipal Accounts Audit Manual

The Karnataka Municipalities Accounting and Budgeting Rules, 2006(KMB Rules) do not apply to BBMP in spite of numerous representations made by civil societies in Karnataka to extend these rules to the BBMP. This report also voices the urgent need to extent the KIMB Rules to BBMP.

Studies by financial experts indicate that the above rules and guidelines set high standards in fiscal discipline. However, despite these progressive regulations, local bodies in Karnataka do not have the capacity to adhere to them.<sup>106</sup>

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<sup>106</sup>Report of the Comptroller and Auditor General of India on Local Bodies' (2015) Karnataka, Report No. 2 of the year 2015, <[http://www.cag.gov.in/sites/default/files/audit\\_report\\_files/Karnataka\\_Local\\_Bodies\\_Report\\_2\\_2015\\_chap\\_5.pdf](http://www.cag.gov.in/sites/default/files/audit_report_files/Karnataka_Local_Bodies_Report_2_2015_chap_5.pdf)> Last accessed 15<sup>th</sup> November 2017

To ensure fiscal sustainability of local body finances, ULB's are required to develop medium term and long term fiscal plan under the Karnataka Local Fund Authorities Fiscal Responsibility Act, 2003. While, this is a progressive step, ULBs do not implement the provisions laid down.

## 2. Solutions and way forward

The current framework requires the local bodies to maintain their financial accounts by adhering to the KMB Rules. The Karnataka State Audit and Accounts Department ("KSAAD") is the nodal agency which assists the ULB's in maintaining the requisite financial documents and preparing budgets. However, in practice due to limited capacity and shortage of skilled staff they are unable to comply with the provisions. This report voices the urgent need to increase the number of qualified manpower to maintain better fiscal discipline

To ensure ULBs develop medium and long term fiscal plan, there requires both structural and financial change. It is suggested that an amendment to the Karnataka Local Fund Authorities Fiscal Responsibility Act, 2003 may be carried out to set up fiscal management review committee. This has been done under the Karnataka Fiscal Responsibility Act, 2002 which is applicable to Government of Karnataka. The committee may be headed by the secretary of urban development department, Government of Karnataka and review fiscal and debt position of the ULBs, progress on its fiscal correction path and advice corrective measures as required.

### Key points

- Increase recruitment of qualified personnel to finance departments to ensure compliance to KMAB Rules, 2006
- Ensure the compliance of the Karnataka Local Fund Authorities Fiscal Responsibility Act, 2003 through the Karnataka State Audit and Accounts Department
- Set up a fiscal management review committee under the Karnataka Local Fund Authorities Fiscal Responsibility Act, 2003 to periodically monitor municipal finances and reporting.

## IX. CONCLUSION AND IMPLEMENTATION PLAN

### CONCLUSION

This report studies the finances of the ULB and links the legal framework to understand the reason behind the financial underperformance of ULBs in Karnataka. It closely studies the regulatory framework of property tax, urban water supply, advertisement tax, loans and borrowings, municipal bonds and fiscal responsibility of ULBs in Karnataka.

Collection of property tax has issues of enforcement, undervaluation and limited scope to bring new properties within the tax net. To address these issues this report suggests a structured approach to revise the working of the Central Valuation Committee. To improve collection efficiency this report suggests amendments to the KMC Act to penalize undervaluation of properties and attach immovable properties of property tax defaulters, as done in other States. With ULBs and City Corporations facing challenges in adding new properties to the tax net and identifying existing properties which have violated the building bye-laws, this report suggests extending the Urban Property Ownership Record Scheme to all cities in Karnataka. Lastly, to reduce property tax litigation and ensure speedy disposal of cases this report suggests amending the KMC Act to either include a pre-appeal deposit or vest the jurisdiction for property tax disputes with the Karnataka Appellate Tribunal.

In Mysore, Mangaluru and Davangere the ULBs and the City Corporations collect the water charges. The efficiency in collecting water charges has direct correlation on the success of the execution of water supply scheme and leakages in water supply. To address this, the report suggests establishing a project management committee with representation from all stakeholders including ULBs, KUWSDB/BWSSB and State Government. As a larger reform to improve urban water supply this report suggests establishing an urban water supply regulator.

Currently for the City Corporations and ULBs under the DMAs jurisdiction, there are no rules or byelaws to govern the levy of advertisement tax. This report voices the urgent need to draft such rules or bye-laws to allow ULBs to maximize their revenues from advertisement tax. To enable stringent implementation of the advertisement tax bye-laws in Bengaluru, this

report suggests establishing an advertisement tax regulation committee under the chairmanship of the BBMP commissioner. To ensure efficient collection of the tax an enforcement committee headed by a serving KAS officer may be established.

As cities progress and face the burden of increasing population, there must also be an increase in the avenues of income. This report suggests an overhaul in the regulatory framework pertaining to loans and borrowings. It also provides a draft regulatory framework to allow ULBs and City Corporations to access the open market and raise finances.

Lastly, to ensure there is accountability and fiscal discipline this report suggests certain amendments to the Karnataka Local Fund Authorities and Fiscal Responsibilities Act, 2003.

The below is a detailed implementation plan of the recommendations suggested.

## 1. PROPERTY TAX

SI No	Action point	Point of change	Implementing authority	Short/Medium/Long term
1.	Reforms to the central valuation committee	Amendment to the Central Valuation Committee Rules, 2003	Department of Revenue ("DOR").	Short
2.	Reforms to the property tax dispute resolution system, provision for levy of fine under self-assessment scheme, attachment of	Amendment to the Karnataka Municipal Corporation Act, 1976("KMC, Act")	To be placed before the Karnataka Legislature through urban development department("UDD")	Medium

	immovable property			
3.	Increasing property tax net in Bengaluru.	Extension of urban property ownership record scheme to Bengaluru	DOR and department of survey settlements and land records	Medium
4.	Reforms to property tax online payment system	Model E-governance tenders	Directorate of Municipal Administration("DMA") and Bruhata Bengaluru Mahanagara Palike("BBMP")	Short

## 2. WATER CHARGES

Sl No	Action point	Point of change	Implementing authority	Short/Medium/Long term
1.	Participation of urban local bodies in the implementation of water supply scheme	Establish a project management committee	Karnataka Urban Water Supply and Sewerage Board("KUWSDB")/urban local bodies("ULB")/UDD	Short

2.	Reduce non-revenue water	Set up a non-revenue water cell and perform water audit	ULB/KUWSDB  Karnataka Urban Infrastructure Development Finance Corporation("KUIDFC")	Short
3.	Revision of periodic water chargers and regulate contracts of the	Establish an urban water resources regulatory authority.	To be placed before the Karnataka Legislature through UDD with support from KUIDFC	Long
4.	Revise the Karnataka Urban water supply policy,2003	In line with recent developments	UDD	Short

### 3. ADVERTISEMENT TAX

S No	Action point	Point of change	Implementing authority	Short/Medium/Long term
1.	Issue rules/byelaws for advertisement tax	Rules/bye-laws will facilitate levy of advertisement tax	DMA	Short

2.	Enforcement of advertisement tax	Establish an advertisement tax enforcement committee headed by a retired district court judge or KAS officer	BBMP	Short
3.	Ensuring compliance of advertisement tax bye-laws and periodic revision of prices	Establish an advertisement regulation committee	BBMP	Short

#### 4. NEW AVENUES OF REVENUE

Sl No	Action point	Point of change	Implementing authority	Short/Medium/Long term
1.	Ease the process of obtaining approval for loans and borrowings for ULBs	Amend the KMC act to base approvals on a debt limitation policy,	To be placed before the Karnataka Legislature through urban development department("UDD")	Medium

2.	Promote borrowing through municipal	Multi-dimensional approach with amendments to the KMC act and rules	KUIDFC/UDD/DMA/BBMP And such proposals to be placed before the Karnataka Legislature	Long
3.	Earmark proceeds from professional tax to ULBs	Amendments to the KMC Act and Karnataka Tax on Professions, Trades, Callings and Employments Act, 1976	To be placed before the Karnataka Legislature through urban development department("UDD")	Long
4.	Strategically collect development impact fee	Reforms to the Akrama-Sakrama scheme	DMA/BBMP	Medium

## 5. ENSURING FISCAL CONTROL

SI No	Action point	Point of change	Implementing authority	Short/Medium/Long term
1.	Increase qualified staff to monitor finances of ULBs	Increase recruitment	UDD/DMA/BBMP	Medium

2.	Ensure compliance of Karnataka Local Body Fiscal Responsibility Act, 2003("KLBRC Act)	Amend the KLBRC Act to set up fiscal review committee as done at State Government level.	To be placed before the Karnataka Legislature through urban development department("UDD")	Medium
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# Vidhi

Centre For Legal Policy

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Please direct all correspondence to:  
Shashank Atreya  
[shashank.atreya@vidhilegalpolicy.in](mailto:shashank.atreya@vidhilegalpolicy.in)  
Vidhi Centre for Legal Policy,  
No 43, Residency road, Ashok Nagar  
Bengaluru Karnataka-560025