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The importance of local taxes in the state budget: A study in the perception of Indian States

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Abstract
The purpose of this article is to determine the importance of local taxes and charges in generating revenue for local budgets, as well as to perform a comparative analysis of Indian states that identify the legal foundation for generating revenue for local budgets through local taxes. The tax structure of India's major states was examined in this study. The purpose of this study is to use a regression model to compare tax revenue growth between states. Tax capacity is found to be influenced by "per capita income, agricultural activity, infrastructure, labor force, and bank credit", whereas tax effort is influenced by government investment on the social sector and central transfers to states. The GST has limited the taxing authority of governments. As a result, the states' revenue mobilization is heavily reliant on their restricted legislative taxes. However, because all states have reached at least 90% of their tax capacity, there is little room for subnational state governments to raise money. The state collects a tax as a contribution. It is a non-punitive, but compulsory and unrequited transfer of resources from the private to the public sector, depending on pre-determined criteria. The Indian states generate about 65 percent of their money from their own sources, with the remaining 35 percent coming from federal transfers. The sole purpose of taxation, according to traditional economists, was to raise income for the state government. Until the present time, the general analysis and conclusions were supplied. To achieve our goals, we used three separate strategies: information synthesis, analytical methods utilizing regression models to calculate data, and synthesis of information to provide literature background. There are also future action recommendations for state tax income.

Keywords: Local taxes, local budget income, inter-states taxes, GST

Introduction

State Finances is an essential topic in today's world since it encompasses both economic and political issues and is heavily influenced by the functioning of both the federal and state governments. The concept of government has evolved, and the current goal of government is to maximize societal welfare. Furthermore, the government wishes to accelerate economic development by mobilizing financial resources. For decades, taxation has been the principal source of revenue for governments all over the world, and India is no exception. The country has a well-structured tax system that employs both progressive and proportional taxation depending on income and other criteria, with national and state governments deciding what is appropriate. It has been observed that delegating some taxing authorities to the states does not provide them with sufficient resources to meet the tasks entrusted to them. As a result, the Constitution dictates that resources be transferred from the federal government to the states.

Economic growth is boosted by the government's expenditure on productive channels, which is funded by direct and indirect taxes. The state's fiscal policy has a huge impact on the social and economic lives of ordinary citizens. And hence, central transfers to states as a percentage of GDP remained stable, while the reliance on domestic resources grew in response to rising expenditure needs. The Union and State Governments' taxing rights are delineated in the Seventh Schedule of the Indian Constitution, while entries 46 through 63 in the State List indicate the things on which States can impose taxes.

The states generally rely on two types of revenue: their own tax revenues and transfers from unions. State governments receive more than 40% of their overall revenue through federal transfers, such as union taxes and grant-in-aid. The 14th Finance Commission raised state tax devolution from 32% to 42%. (Finance Commission [FFC], 2015).

Similarly, by 2017, the union government had reduced the number of Centrally Sponsored Schemes (CSSs) from 66 to 28. CSS's design has also changed, with state government contributions now accounting for 60% of total contributions, up from 50% previously. This could put additional strain on state budgets, particularly in low-income areas. In addition, the new Goods and Services Tax (GST) in India has limited the sovereignty of state governments. GST is imposed and governed by the GST Council, which is led by the Union Finance Minister.

Many federal and state taxes have been absorbed by the GST. As a result, only a few taxes are governed by state legislation. States' tax revenue (OTR) could be cut by 17% as a result of their diminished autonomy. Despite these limitations, state governments must raise tax collection while also rationalizing spending in order to accomplish fiscal consolidation. States accrued debt as a result of insufficient center transfers and OTR in the past, posing a threat to macroeconomic stability. State excise duty, stamp duty, electricity duty, value-added tax (VAT) on petroleum items, car tax, and professional tax are examples of non-GST taxes that states might enact.

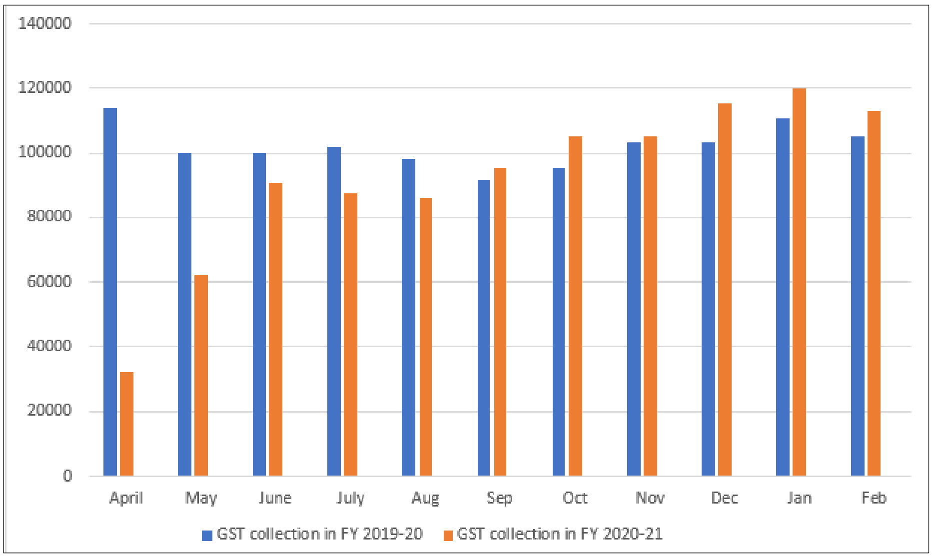
The graph below depicts the monthly gross GST income trends for the year 2021. The table compares the current GST collected in each state in the month of February 2021 to the month of February 2020.

Table 1: In February 2021, state-by-state rise in GST revenues is expected

S.NO.	State	Feb 2020	Feb 2021	Growth
1.	Jammu and Kashmir	316.17	329.89	4%
2.	Himachal Pradesh	620.69	663.12	7%
3.	Punjab	1228.94	1299.37	6%
4.	Chandigarh	172.37	148.5	-14%
5.	Uttarakhand	1280.93	1181.13	-8%
6.	Haryana	5266.43	5589.81	6%
7.	Delhi	3834.75	3727.46	-3%
8.	Rajasthan	2932.09	3223.70	10%
9.	Uttar Pradesh	5775.91	5996.62	4%
10.	Bihar	1120.50	1127.99	1%
11.	Sikkim	182.65	222.35	22%
12.	Arunachal Pradesh	48.36	61.36	27%
13.	Nagaland	24.93	34.83	40%
14.	Manipur	37.36	32.34	-13%
15.	Mizoram	24.84	21.06	-15%
16.	Tripura	63.26	63.25	0%
17.	Meghalaya	156.57	146.5	-6%
18.	Assam	923.87	945.84	2%
19.	West Bengal	3941.54	4334.98	10%
20.	Jharkhand	2070.87	2321.03	12%
21.	Odisha	2790.16	3340.57	20%
22.	Chhattisgarh	2274.41	2453.10	8%
23.	Madhya Pradesh	2621.03	2791.57	7%
24.	Gujarat	7215.54	8221.23	14%
25.	Daman and Diu	94.47	2.61	-97%
26.	Maharashtra	15734.66	16103.50	2%
27.	Karnataka	7413.83	7581.45	2%
28.	Goa	410.61	343.8	-16%
29.	Lakshadweep	2.14	0.46	-79%
30.	Kerala	1754.12	1806.10	3%
31.	Tamil Nadu	6426.49	7008.21	9%
32.	Puducherry	158.86	158.05	-1%
33.	Andaman and Nicobar Island	36.01	23.26	-35%
34.	Telangana	3667.13	3636.44	-1%
35.	Andhra Pradesh	2563.33	2652.57	3%
36.	Ladakh	0	9.06	
37.	Other Territory	145.11	134.33	-7%
38.	Centre Jurisdiction	100.14	129.03	29%
	Grand Total	83581..02	88101.59	5%

***Source*:** Tax Management India.com

Gross GST revenue was Rs. 113143 crores in February 2021, with CGST of Rs. 21092 crores, SCGST of Rs. 27273 crores, IGST of Rs. 55253 crores, and Cess of Rs. 9525 crores. The government has transferred Rs. 22398 crores to CGST and Rs. 17534 crores to SGST as part of a routine settlement. Furthermore, the Centre has agreed to pay Rs. 48000 crores as an IGST ad-hoc settlement, shared 50:50 between the Centre and the States/UTs. After regular and ad-hoc settlements, the total income of the Centre and States in February 2021 is Rs. 67490 crores for the CGST and Rs. 68807 crores for the SGST.



Source: Tax Management India.com

Fig 1: Trends in GST collection in Rs. crore

This article evaluates tax revenue collected by Indian states by using a set of economic, social, demographic, and fiscal indicators based on recent literature. This is how the rest of the paper will be organized. A brief overview of the literature concludes this section. The methodology and summary statistics are covered in this section. The results and comments are in this section. The conclusion is finally delivered in Section.

Literature Review

Table 2: The following is the Literature review for this research

Author/Year	Description
Bonga *et al.* (2015)	They calculated tax buoyancy using a typical regression approach and a dummy variable approach, and determined that the tax system is buoyant, meaning that it is especially responsive to changes in income.
Karnik and Raju (2015) [2]	The sectoral contribution of manufacturing to GSDP and yearly per capita consumption spending were the important drivers in sales tax capacity for 17 major Indian states from 2000-01 to 2010-11. Both characteristics are related to the collection of state sales taxes in a positive and significant way. The SFA models used in this study.
Garg *et al.* (2017) [3]	From 1991–1992 through 2010–2011, researchers looked for reasons for the tax effort gap. They claimed that as intergovernmental transfers increase, states' tax efforts deteriorate; Nonetheless, states' tax effort improves when law and order improve, political competition intensifies, and the proportion of public expenditure in GSDP rises.
Mukherjee (2017) [4]	Researchers attempted to assess VAT effectiveness and the causes of difference among Indian states between 2001 and 2014. Increased grants and a bigger share of central revenues, on the other hand, tended to reduce the VAT effort. State tax efficiency did not demonstrate any convergence during our analysis. He called for a thorough examination of tax administration in order to assist governments in improving their tax efficiency.
Naidu (2019) [5]	Argues that with the implementation of GST, states' only substantial sources of tax revenue are stamp duty and registration fees. He used SFA to assess the tax effort stated taxes of 16 major states from 2001 to 2014.

Objective

The goal of this research is to comprehend and examine the importance of tax revenue in various Indian states.

Research Methodology and Data Source

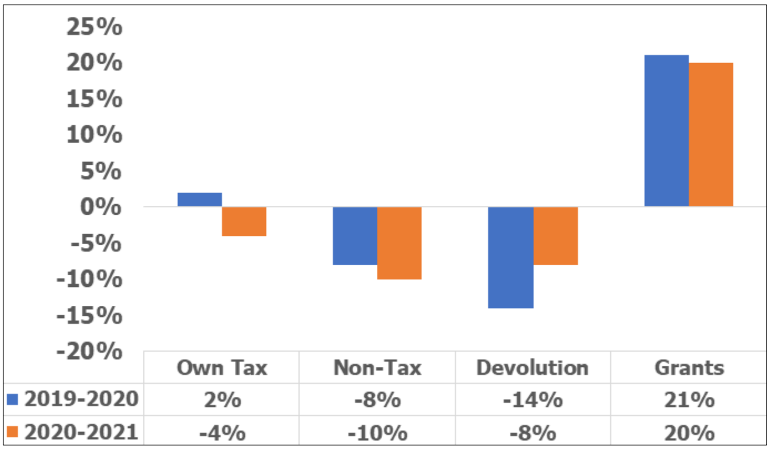
In the years 2020-21, state revenue receipts fell by 0.6%. Due to the slowing in the economy, a similar drop was expected in 2019-20. States were allowed to borrow more in 2020-21 to avoid making dramatic cuts in spending. While total spending increased by roughly 5% in both years, capital spending fell by 5% in 2019-20. It grew by 1.4 percent in 2020-21, but was still 4% lower than in 2018-19.

Table 3: 2018-2021 State Budget (Rs lakh crore)

	2018-19	2019-20	2020-21
Revenue receipt	25.47	25.38	25.22
Change%	-	-0.4%	-0.6%
Revenue expenditure	25.75	27.3	28.88
Change%	-	6%	5.8%
Capital Outlay	4.32	4.08	4.14
Change%	-	-5.4%	1.4%
Fiscal deficit	4.65	5.85	8.1
Change%	-	26%	38.4%
% Of GDP	2.5%	2.9%	4.1%

Sources: CAG; State Budget Documents; PRS.

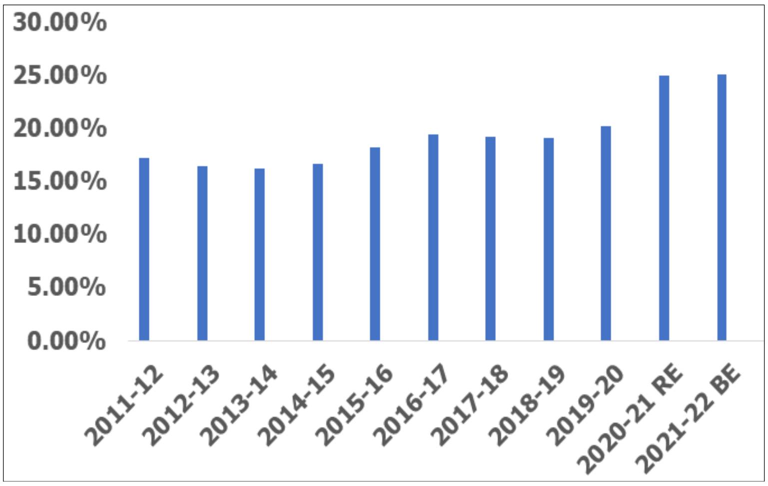
Illustrates the source-by-source change in state revenue receipts from 2019 to 2021. The sole source of funding that increased in 2019-20 and 2020-21 was grants from the Centre (largely due to Finance Commission grants).



***Sources*:** CAG; State Budget Documents; PRS.

Fig 2: Change in revenue receipt during 2019-2021

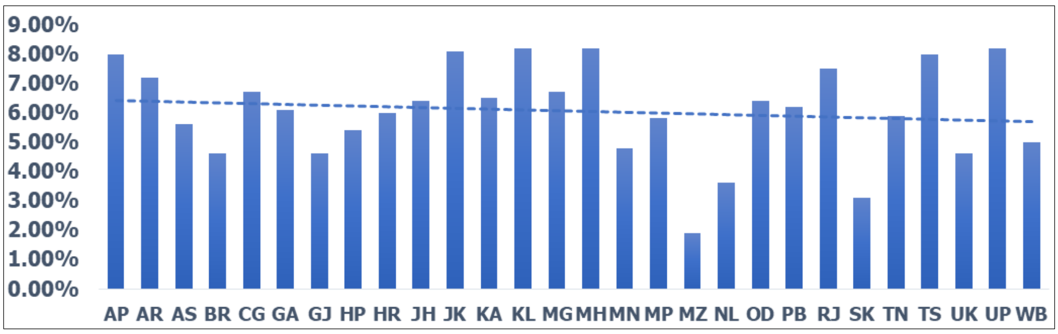
The outstanding public debt of a state is made up of liabilities contracted against the state's consolidated fund and indicates the total amount borrowed to cover the budget deficit. Borrowings from markets and financial institutions, as well as central government loans, are included. State public debt is expected to reach 25.1 percent of GDP by the end of 2021-22, up from 17.2 percent in 2011-12. In the future, states will be forced to set aside a higher amount of their budget for interest and debt payments, reducing other development spending.



***Sources*:** State Finances: A Study of Budgets 2020-21, RBI; State Budget Documents; Union Budget; PRS.

Fig 3: States' Public Debt estimated to rise to 25.1% of GDP by 2021-22

The most important source of revenue in 2021-22 is likely to be state-level taxation (45 percent of total revenue receipts). The tax-to-GDP ratio is a measure of a state's ability to produce revenue from its own economy. The higher the proportion, the stronger the state's ability to collect taxes from its economic operations. In 2021-22, state tax income is estimated to account for 6.7 percent of GDP.



***Sources*:** State Budget Documents; PRS.

Fig 4: Own tax as a % of GSDP (2021-2022)

After a 12% increase in GST income over December 2019, monthly GST revenues for the month of December 2020 totaled'1.15 lakh crore. Since the implementation of GST, this has been the biggest monthly GST collection. The swift economic rebound following the epidemic, coupled with a nationwide crackdown on GST evaders and false invoices, as well as a slew of recent institutional modifications that have enhanced compliance, has resulted in a resurgence in GST collection.

Table 4: The GST collection in 2019-2021 is depicted in the table and graph below

Month	2019-202C	2020-2021
Apr	1.14	0.32
May	1	0.62
Jun	1	0.91
Jul	1.02	0.87
Aug	0.98	0.86
Sep	0.92	0.95
Oct	0.95	1.05
Nov	1.03	1.05
Dec	1.03	1.15

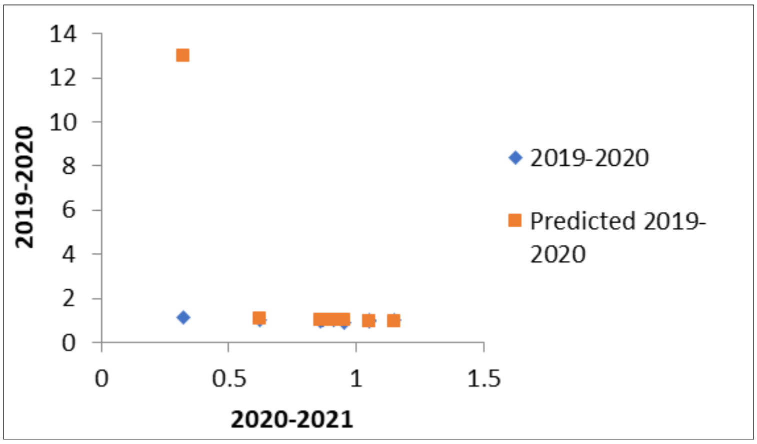


Fig 5: 2020-2021 Line Fit Plot

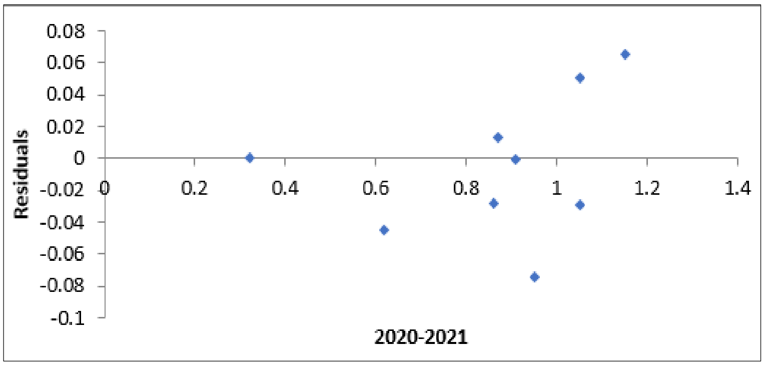


Fig 6: 2020-2021 Residual Plot

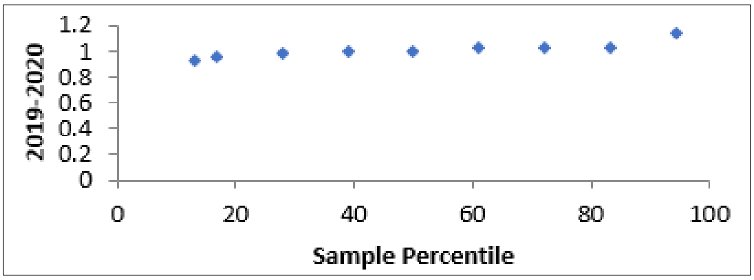


Fig 7: Normal Probability Plot

Table 5: Show the summary output

Summary output		**Summary output**		**Summary output**				
Regression Statistics		Regression Statistics		Regression Statistics				
Multiple R	0.621265	Multiple R	0.621265	Multiple R	0.621265			
R Square	0.385971	R Square	0.385971	R Square	0.385971			
Adjusted R Square	0.298252	Adjusted R Square	0.298252	Adjusted R Square	0.298252			
Standard Error	0.051771	Standard Error	0.051771	Standard Error	0.051771			
Observations	9	Observations	9	Observations	9			
ANOVA		**ANOVA**		**ANOVA**				
	df		df		df			
Regression	1	Regression	1	Regression	1			
Residual	7	Residual	7	Residual	7			
Summary output		**Summary output**		**Summary output**				
Regression Statistics		Regression Statistics		Regression Statistics		Upper 95%	Lower 95.0%	Upper 95.0%
Multiple R	6.998433	Multiple R	6.998433	Multiple R	6.998433	1.291328	0.985597	1.291328
R Square	8.64076	R Square	8.64076	R Square	8.64076	0.019241	-0.3216	0.019241
Adjusted R Square	10.28309	Adjusted R Square	10.28309	Adjusted R Square	10.28309			
Standard Error	11.92541	Standard Error	11.92541	Standard Error	11.92541			
Observations	13.56774	Observations	13.56774	Observations	13.56774			
ANOVA		**ANOVA**		**ANOVA**				
	df		df		df	2019-2020		
Regression	13	Regression	13	Regression	13	0.92		
2	1.044732	-0.04473	-0.92369		16.66667	0.95		
3	1.000891	-0.00089	-0.01839		27.77778	0.98		
4	1.006938	0.013062	0.269723		38.88889	1		
5	1.00845	-0.02845	-0.58747		50	1		
6	0.994844	-0.07484	-1.54547		61.11111	1.02		
7	0.979726	-0.02973	-0.61382		72.22222	1.03		
8	0.979726	0.050274	1.038125		83.33333	1.03		
9	0.964608	0.065392	1.350297		94.44444	1.14		

Conclusion and Suggestion

The variety of ways that tax regulation influences the ebb and flow of economic activity demonstrates the relevance of taxes. The tax structure of India's states was examined in this research. This research compares tax revenue growth and state revenues by taxes across states. The purpose of the study is to examine local tax collections, GST revenue, and growth in Indian states up to the present time.

The adoption of the GST will result in a single tax structure that will consolidate the majority of current indirect taxes, resulting in higher output, more job opportunities, and a 1-1.5 percent growth in GDP over time. The GST has limited the states' ability to enact tax legislation. The number of CSSs (Centre Sponsored Scheme) has decreased dramatically, while state government participation in the programmes has increased from 50% to 60%. State governments must achieve budgetary consolidation when their autonomy is eroded and their responsibilities are increased. As a result, it is classified as subnational. States have little room to increase non-GST/legislative tax revenue because they have already achieved more than 90% of their tax goals. However, in order to collect taxes from their restricted legislative taxes, the government's tax base should be expanded, and its administration should be improved. Non-tax revenue streams should be considered by state governments in order to generate fiscal flexibility.

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