REPORT ON BIANNUAL MONITORING ON THE IMPLEMENTATION OF NFC AWARD

(July – December 2010)

Government of Pakistan
National Finance Commission Secretariat

LETTER OF TRANSMITTAL

MINISTRY OF FINANCE
ISLAMABAD

Dear Mr. Chairman,

As required by Article 160 3(B) of the Constitution of Islamic Republic of Pakistan, I am pleased to submit herewith the **First Report on Biannual Monitoring on the Implementation of 7th National Finance Commission Award for the period July – December, 2010** of the Ministry of Finance, Government of Pakistan.

Yours Sincerely,

(Abdul Hafiz Shaikh)
Finance Minister
Government of Pakistan

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Dear Madam Speaker,

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MINISTRY OF FINANCE
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Dear Madam Speaker,

The 7th National Finance Commission signed the Award on 30th December, 2009 and its recommendations were given legal cover with effect from 1st July 2010 through President's Order No.5 of 2010 (Distribution of Revenues and Grants-in-Aid Order, 2010). The implementation of 7th NFC Award has been started w.e.f. 1st July, 2010. Clause 3(B) of Article 160 of the Constitution of Islamic Republic of Pakistan, it has been stated that:

> *"Federal Finance Minister and Provincial Finance Ministers shall monitor the implementation of the Award biannually and lay their report before both Houses of Majlis-e-Shoora (Parliament) and the Provincial Assemblies."*

2. In pursuance of the above provision in the Constitution, it is now imperative upon the Finance Ministers of the Federal and Provincial Governments to monitor implementation of the Award biannually and lay a report in this regard before the both Houses of the Parliament. The implementation status during the period July to December, 2010 was monitored by the Finance Ministers in Islamabad on 7th March 2011. The implementation status on each of the articles of the President's Order was deliberated upon and a report was finalized/approved for laying before both the Houses of the Parliament.

(Abdul Hafiz Shaikh)
Finance Minister
Government of Pakistan

INTRODUCTION

1.1: National Finance Commission (NFC)

1.1.1 Article 160 of the Constitution of Islamic Republic of Pakistan governs the National Finance Commission (NFC). The NFC is required to be set up at intervals not exceeding five years as required under clause (1) of the Article ibid. The NFC shall consists of the Federal Finance Minister, the Finance Ministers of the Provinces and such other members (historically one from each province) as appointed by the President in consultation with the Governors of the provinces. The mandate of the NFC as provided in clauses (2) and (3) of Article ibid is to make recommendations to the President on the following:

(I) The distribution between the Federation and the Provinces of the net proceeds of the following taxes:

(i) Taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;

(ii) Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed;

(iii) Export duties on cotton, and such other export duties as may be specified by the President;

(iv) Such duties of excise as may be specified by the President; and

(v) Such other taxes as may be specified by the President.

(II) The making of grants-in-aid by the federation to provinces.

(III) The borrowing powers exercised by the federal and provincial governments.

(IV) Any other financial matter referred to the Commission by the President of Pakistan.

1.1.2 The recommendations of the Commission is required to be given legal cover by promulgating President's Order called as Distribution of Revenues and Grants-in-Aid, Order as provided under Clauses (4) and (7) of Article 160. The recommendations of the NFC together with an explanatory memorandum as to the actions taken are required to be laid before the Parliament and Provincial Assemblies as provided in clause (5) of the Article ibid. Through the 18th Amendment in the Constitution, two new sub clauses i.e. clauses (3A) and (3B) have also been inserted under this Article. Through clause (3A), it has been made binding for the NFC not to reduce the share of the provinces as compared to previous Award. Through clause (3B), the Federal and

Provincial Finance Ministers have to monitor implementation of the Award biannually and lay a report in this regard in the both Houses of the Parliament.

1.2: NFC Award 2009

1.2.1 The 7th NFC was set up on 21st July, 2005. An informal meeting was held in 2005 but could not reach a consensus on the mechanism for resource distribution. In order to provide a larger share to the provinces, the Distribution of Revenues and Grants-in-Aid Order, 1997 was amended by the President vide President's Order No.1 of 2006. The revised sharing arrangements were implemented with effect from 1st July, 2006. The Commission did not convene any meeting till formation of the present government.

1.2.2 The present government reconstituted the seventh NFC on 24th July, 2009. After its reconstitution, the NFC held six meetings, two at Islamabad and one each at the provincial headquarters. Threadbare discussions on all contentious issues were held during the meetings. The 6th meeting held at Lahore lasted for four days. Chief Ministers of the provinces were also associated in the discussions. At the end of the meeting consensus on all issues were achieved and a Record Note was signed by the members duly endorsed by the Chief Ministers. The 7th NFC signed the Award on 30th December, 2009 at Gawadar.

1.3: Implementation of NFC Award

1.3.1 The Summary of Recommendations of the NFC is at Annex-I. The recommendations are of three natures. These are:

(i) Recommendations relating to the Distribution of Revenues between the Federal Government and Provinces and amongst the Provinces. These recommendations are required to be given legal cover through President's Order as provided under clause (4) and (7) of Article-160 of the Constitution;

(ii) Recommendations requiring its implementation through legislation i.e. enhancing rate of excise duty on Natural Gas, bringing agriculture and real estate sectors into provincial tax net etc.; and

(iii) Recommendations requiring its implementation through administrative steps such as measures to be adopted for fiscal discipline at federal and provincial governments' level.

The recommendations of the NFC (Award) were given legal cover with effect from 1st July 2010 through President's Order No.5 of 2010 (Distribution of Revenues and Grants-in-Aid Order, 2010) (Annex-II). The President's Order also covers the other two natures of the recommendations i.e. those to be implemented through legislation and also to be implemented by adopting administrative steps.

1.3.2. Through 18th amendment in the Constitution, clause 3(B) has been added under Article 160 of the Constitution of Islamic Republic of Pakistan, which states:

> "Federal Finance Minister and Provincial Finance Ministers shall monitor the implementation of the Award biannually and lay their report before both Houses of Majlis-e-Shoora (Parliament) and the Provincial Assemblies."

1.3.3 In pursuance of the above provision in the Constitution, it is now imperative upon the Finance Ministers of the Federal and Provincial Governments to monitor implementation of the Award biannually and lay a report in this regard before the both Houses of the Parliament.

DIVISION OF DIVISIBLE POOL TAXES

Article 3 & 4 of President's Order No.5 of 2010

2.1: Distribution of Divisible Pool Taxes

2.1.1 Articles 3 and 4 of the President's Order i.e. Distribution of Revenues and Grants-in-Aid Order, 2010 (Award) regulates the distribution of divisible taxes between the Federal and Provincial Governments vertically and amongst the four provinces horizontally.

2.1.2 During the first half of the financial year, Federal Board of Revenues (FBR) has reported tax receipts of Rs.621.015 billion. This includes receipts of some non-divisible pool components including income tax paid out of the Federal Consolidated Fund. The components of divisible pool taxes have been laid down in clause (1) of Article 3 of the Order. As against FBR tax receipts of Rs.621.015 billion, the Gross divisible pool taxes worked out to be Rs.594.67 billion as per details given below:

Rs. in Billion

Total Collection FBR Receipts up to 31st December 2010 (i)	621.02
Less Non-Divisible Pool Components (ii)	26.35
WWF	*2.42*
GST on Services	*16.39*
Excise Duty on Natural Gas	*4.56*
Export Development Surcharge	*0.84*
1% of Income Tax on account of Income Tax paid out of the Federal Consolidated Fund	*2.14*
Divisible Pool Gross (iii) = (i-ii)	594.67

2.2: Vertical Distribution

2.2.1 After subtracting the non-divisible pool components, the net divisible pool would be determined by deducting cost of collection (1% as recommended by the NFC). It may further be added that additional 1% of Income tax is also deducted as Income Tax paid out of the Federal Consolidated Fund, which is not part of the Divisible Pool taxes as laid down in the Constitution of Islamic Republic of Pakistan and the President's Order (Award). The entire proceeds have been distributed between the federation and provinces amongst the provinces exactly in accordance with the provisions of these two articles of the Order ibid. The details of vertical tax-wise distribution are as follows:

Rs. in billion

	FBR Receipts	Collection Charges (1%)	Net Div. Pool Taxes	1% for WoT for KPK	Balance Net Div. Pool	Prov. Share (56%)	Prov. Share with 1% WoT
Divisible Pool Taxes	**594.67**	**8.10**	**588.70**	**5.89**	**582.83**	**326.38**	**332.27**
Income Tax	211.11	2.12	208.99	2.09	206.90	115.86	117.95
Wealth Tax	-	-	-	-	-	-	
Capital Value Tax	0.05	-	0.05	-	0.05	0.03	0.03
Sales Tax (Excl.GST on Services)	258.41	2.58	255.82	2.56	253.27	141.83	144.39
Federal Excise (Excl. ED on NG)	48.08	0.48	47.59	0.48	47.12	26.39	26.87
Customs (Excl. Export Dev. Surcharge)	77.02	0.77	76.25	0.76	75.49	42.27	43.03
Total provincial share after adding the additionality (Rs.11.83 billion) being provided by Federal Government to match the share of the province at Rs.83 billion							**344.10**

2.3: Horizontal Distribution

2.3.1 The percentage share of each province in the provincial share of the Divisible Pool Taxes has been laid down in Clause (2) of Article 4. Further, Clause (3) of Article 4 of the Order ibid guarantees that the share of Balochistan province would not be less than Rs.83.0 billion in the first financial year of the Award period. In order to match this guaranteed share, Federal Government has picked up the additional burden of Rs.11.83 billion from its own resources. The details of horizontal tax-wise distribution are as follows:

Rs. in billion

	Total	Punjab	Sindh	Khyber Pakhtunkhwa			Balochistan		
	100%	51.74%	24.55%	14.62%	1%WoT	Total	9.09%	Additionality	Total
Divisible Pool Taxes	**344.10**	**168.86**	**80.13**	**47.72**	**5.89**	**53.61**	**29.67**	**11.83**	**41.50**
Income Tax	124.32	59.95	28.44	16.94	2.09	19.03	10.53	6.37	16.90
Wealth Tax	-	-	-	-	-	-	-	-	-
Capital Value Tax	0.15	0.01	0.01	-	-	-	-	0.12	0.13
Sales Tax (Excl.GST on Services)	147.24	73.38	34.82	20.74	2.56	23.29	12.89	2.86	15.75
Federal Excise (Excl. ED on NG)	28.41	13.65	6.48	3.86	0.48	4.33	2.40	1.55	3.95
Customs (Excl. Export Dev. Surcharge)	43.96	21.87	10.38	6.18	0.76	6.94	3.84	0.93	4.77

STRAIGHT TRANSFERS/GRANTS-IN-AID

Article 5, 6 & 7 of President's Order No.5 of 2010

3.1: Distribution of Royalty on Crude Oil

3.1.1 Article 5 of the Order (Award) relates to the distribution of Net Proceeds of Royalty on Crude Oil. M/o Petroleum and Natural Resources is responsible for collection of this levy who reports to Finance Division on a monthly basis the province-wise collection of royalty on crude oil for onward transfer to provinces. The entire net proceeds reported by M/o Petroleum and Natural Resources up to 31st December 2010 have been distributed amongst the provinces in accordance with the provisions of the above article. Details are as follows:

Rs in billion

	Punjab	Sindh	Khyber P'Khwa	Balochistan	Total
Royalty on Crude Oil	2.187	2.915	3.068	0.002	**8.172**

3.2: Distribution of Gas Development Surcharge and Royalty on Natural Gas

3.2.1 Article 6 of the Order (Award) governs the distribution of Surcharge on Gas (GDS) and Royalty on Natural Gas. M/o Petroleum and Natural Resources is the collecting agency of these two levies. The proceeds so collected are reported to Finance Division on monthly basis for onward transfer to provinces. The entire net proceeds of Royalty and Surcharge on Gas reported by M/o Petroleum and Natural Resources have been distributed exactly in accordance with the above provisions of the Award. Details are as follows:

Rs in billion

	Punjab	Sindh	Khyber P'Khwa	Balochistan	Total
Royalty On NG	0.793	11.962	1.805	3.331	**17.891**
Gas Dev. Surcharge	1.059	14.315	1.843	3.278	**20.495**
Total	**1.852**	**26.277**	**3.648**	**6.609**	**38.386**

3.2.2 As per clause (2) of Article 6, GDS payable to Balochistan with effect from 01.07.2002 to 30.06.2010 based on the new formula was to be worked out and the arrears, subject to maximum of Rs.10 billion, were to be paid to

Balochistan in five years. Federal Government has accordingly allocated Rs.2.0 billion for the purpose. Out of which Rs.1.0 billion have been paid to Government of Balochistan during the first half of the financial year.

3.2.3 In addition to this, Rs.10 billion have been allocated as arrears prior to 1991 under Aghaz-e-Huqooq-e-Balochistan Package. Out of which Rs.5 billion have also been paid to Government of Balochistan during the first half of the financial year.

3.3: Distribution of Excise Duty on Natural Gas

3.3.1 As per Article 161 (1) of the Constitution of Islamic Republic of Pakistan, the excise duty on Natural Gas are required to be paid to the province in which the well head of Natural Gas is situated. FBR is the collecting agency of this levy. The proceeds so collected are reported to Finance Division on monthly basis for onward transfer to provinces. The entire net proceeds of have been distributed exactly in accordance with the constitutional provision. Details are as follows:

Rs in billion

	Punjab	Sindh	Khyber P'Khwa	Balochistan	Total
Excise Duty on Gas	0.21	3.04	0.41	0.81	**4.47**

3.4 Grants-in-Aid to Sindh Province

3.4.1 Under Articles 7 of the Order ibid (Award), the province of Sindh is entitled to receive a grants-in-aid equivalent to 0.66% of the provincial share in the divisible pool. A sum of Rs.6 billion has been allocated in the Federal Budget for the purpose. In the first half of the financial year, the provincial share in the divisible pool was Rs.326.364 billion. Accordingly, the grant-in-aid was worked out to be Rs.2.154 billion. The same amount has been paid to Government of Sindh.

GENERAL SALES TAX ON SERVICES

Article 8 of President's Order No.5 of 2010

4.1 Collection and Distribution of GST on Services

4.1.1 Through Article 8 of the Order ibid (Award), NFC accepted that Sales Tax on Services is a provincial subject under the Constitution and may be collected by the respective provinces, if they so desire.

4.1.2 Since this issue was linked with the implementation of Reformed GST, therefore, status-quo for its collection has been maintained for the time being by taking the provincial governments on board. Presently, the GST on Services is being collected by the Federal Government. The provincial Finance Secretaries in a meeting held at Islamabad while discussing the draft law on Reformed GST agreed to distribute the net proceeds of GST on Services provisionally based on the following ratio:

- GST (CE Mode) on the ratios provided by the telecom operators regarding revenue generation based on calls generated in view of the fact that bulk of the generation of CE mode comes from Telecom Sector. The ratios are:

Punjab	Sindh	Khyber PK	Balochistan	Total
53.9%	23.6%	13.5%	4.3%	95.3%

  4.7% collection comes from ICT/FATA and as such would be retained by the Federal Government

- GST(Provincial) based on the formula devised for distribution of Group-III Services (Services requiring input/output adjustments) and given in the Record Note on Implementation of Reformed GST.

Punjab	Sindh	Khyber PK	Balochistan	Total
60.39%	50.00%	15.62%	10%	136.01%

4.1.3 The above arrangements of distribution of GST on Services are purely provisional and subject to adjustment based on final decision in the matter. Based on the above formula, the following distribution has been made so far:

Rs in billion

	Punjab	Sindh	Khyber P'Khwa	Balochistan	Total
GST (CE Mode)	7.955	3.483	1.992	0.635	**14.065**
GST (Provincial)	0.888	0.735	0.230	0.147	**2.000**
Total	**8.843**	**4.218**	**2.222**	**0.782**	**16.065**

MISCELLANEOUS PROVISIONS OF THE AWARD

Article 9 of President's Order No.5 of 2010

5.1: Increase in Rate of Excise Duty on Natural Gas

5.1.1 NFC recommended increase in the rate of excise duty on natural gas to Rs.10.0 per MMBTU. The rate of excise duty on natural gas has accordingly been enhanced to Rs. 10/- per MMBTU through Finance Bill, 2010.

5.2: Increase in Tax to GDP Ratio

5.2.1 The NFC recommended that the Federal Government and Provincial Government should streamline their tax collection systems to reduce leakages and increase their revenues through efforts to improve taxation in order to achieve a 15% tax to GDP ratio by the terminal year i.e. 2014-15. NFC also recommended that provinces to initiate steps to effectively tax the agriculture and real estate sectors.

5.3: Performance in the First Half

5.3.1 It may further be pointed out that FBR tax receipt for the first year of the Award was fixed as Rs.1,667.0 billion against the NFC projection of Rs.1,710.0 billion. The budget estimates of the provinces are according to projections of NFC. The realization of tax receipts during the first half of the financial year vis-à-vis budget estimates are tabulated as follows:

	BE 2010-11	Progressive Dec. 2010	% age
FBR Receipts	1,667.0	621.02	37.3%
Provinces (combined)	161.55	36.99	22.9%
Punjab	90.08	23.14	25.7%
Sindh	50.15	11.72	23.4%
KPK	15.53	1.70	10.9%
Balochistan	5.79	0.43	7.4%

5.3.2 As evident from the above, the tax collection both at Federal and Provincial level is not encouraging and if this state of affairs continues it may not be possible to achieve 15% tax to GDP ratio by the terminal year i.e. 2014-15.

5.4: Steps being taken by Federal/Provincial Governments

5.4.1 A report in the matter received from FBR is at Annex-III. The efforts being taken by the Provincial Governments are as follows:

Province of Punjab

- Revision of valuation list on the basis of revised valuation tables for property tax
- Reduction of tax differential between self and rented properties from 10:1 to 5:1
- Rationalization of exemptions
- Incentive based scheme for rewarding best performance introduced on pilot basis in collaboration with International Growth Center, Oxford University, UK and Howard Business School, USA.
- Reformed property tax is expected to be implemented w.e.f. 01.07.2011
- Valuation tables in rural areas introduced through the Punjab Finance Act 2010
- Through amendments in Stamp Act 1899 and Land Revenue Act 1967, Government has plugged an important area of tax evasion that was exploited in cases of property transfer in rural areas.
- Provincial tax collection up to the month of December 2010 from Land Revenue and Stamp Duty has shown a growth of 43.5% and 21.3% respectively compared to corresponding period of last financial year.
- Some part of this growth is definitely attributable to this reform initiative
- Capital Value Tax (CVT) on property transactions @2% of the value of property introduced w.e.f. 01.07.2010 instead of 4% levied earlier by the Federal Government.
- Healthier collection on this account has been witnessed in first 06 months of FY 2010-11
- Against a target of Rs. 1.5 billion for FY 2010-11, an amount of approximately Rs. 1.0 billion has been collected in first 06 months.

Province of Khyber Pakhtunkhwa

- Entry 47 of the Federal Legislative List entitles the “Provinces” to legislate on Agricultural Income Tax (Definition of Agricultural Income in I.T.Ord)
- Khyber Pakhtunkhwa was first in introducing Agricultural Income Tax in 1993 (Tax on land basis model)
- In 2000 a new legislation came introducing tax on “taxable income” + land basis
- In 2005, by an amendment holdings upto 5 acres got exempted

- Khyber Pakhtunkhwa has smaller holdings, which are being divided further because of inheritance etc
- Conflict, IDPs and later natural calamities (flood etc) affected targets and recoveries

Province of Balochistan

- Numerous efforts are underway by Government of Balochistan to control non-Development Expenditures

5.5: Developing/enforcement of Fiscal Discipline

5.5.1 The NFC recommended that Federal and provincial governments would develop and enforce mechanism for maintaining fiscal discipline at the federal and provincial levels through legislative and administrative measures. The measures being adopted by Federal/ Provincial Governments are summarized as follows:-

Federal Government.

- *In view of the flood situation, the budget deficit for 2010-11 has been upwardly revised from 4% to 4.7%. It may go up.*
- *Non-salary current expenditure frozen at last year level.*
- *For supplementary grant beyond 10% approval of Cabinet will be required.*
- *Reduction in PSDP spending.*
- *Monitoring of revenue receipts on fortnightly basis.*
- *Restructuring of PSEs to reduce subsidies.*
- *Introduce additional tax measures in the Parliament to mobilize domestic resources.*

Province of Punjab

- Size of ADP rationalized from Rs. 193.5 billion to Rs. 128.0 billion
- Development funds being released on quarterly basis
- 10% economy cut imposed on non-salary / non-obligatory expenditure under current budget
- Review of provincial government departments / district governments, autonomous bodies undertaken to identify overlaps / redundancies etc.
- As a result, number of departments has been rationalized along with abolition of large number of posts.

- It is expected that a total saving of approximately Rs.6.1 billion would be mobilized in the current financial year.
- Constitution of Austerity Committee headed by Finance Minister which acts as a clearing house for all purchase proposals (development + non development) with reference to purchase of durable goods including transport, machinery and equipment, furniture and fixtures.
- Ban on furnishing / refurbishing of offices.
- Hiring of contingent paid staff restricted.
- Continuous monitoring of cash balance, liabilities, authorizations, payments etc.

Province of Sindh

- Complete ban on purchase of Luxury Vehicles
- Purchase of other vehicles allowed in exceptional cases
- New expenditure (SNE) is being allowed only in cases of strong need
- Lump sum provisions are withheld and released only in cases of urgent demand
- ADs have been instructed not to create any liability beyond budgetary authorization
- Foreign visits/trainings on Government expenses have been curtailed.

Province of Khyber Pakhtunkhwa

- Nil Fiscal Deficit in future years
- Provincial Government will become self reliant
  - Increase provincial receipts
  - Invest in revenue generating activities such as Hydel Projects and Gas & Petroleum explorations
- Current expenditure will focus on service delivery
  - Rationalize establishment charges
  - Invest in Operations and Maintenance
- Development expenditure will be result oriented
  - Throw forward will be curtailed by slashing down unfunded projects
  - Bulk of development expenditure to be allocated for completion of existing projects
  - Rationalization and review of existing Development Proposals

Province of Balochistan

- Reforms in Urban Immovable Property Tax (UIPT): amendment in UIPT Act 1958 for valuation table; tackling issue of self-occupied VS rented properties
- Stamp duty rates
- Considering Infrastructure Cess in Balochistan.

5.6: Grants in times of unforeseen calamities

5.6.1 The NFC recommended that Federal Government may assist the provinces through specific grants in times of unforeseen calamities. Federal Government extended following grants to the provincial government during the period under report:

i. Rs.3.900 billion has been released to Govt. of KPK on account of expenditures incurred on Law and Order in the province.

ii. Rs.1.961 billion has been released to Govt. of Balochistan for further payment to SBP on account of over draft of the province.

iii. Rs.0.370 billion has been released to Govt. of Balochistan for meeting the pay and allowances of 5000 posts under Aghaz-e-Huqooq-e-Balochistan Package.

5.7: Holding of NFC Meetings to Monitor Implementation of the Award

5.7.1 The NFC recommended that meetings of the NFC may be convened regularly on a quarterly basis to monitor implementation of the award in letter and spirit. However, The 8th NFC was constituted on 21st July, 2010, pending notification of non-statutory members. The non-statutory members could not be notified yet for want of certain clarifications from Provinces. Due to incomplete composition of NFC, the quarterly meeting of NFC could not be convened so far.

5.8: General Observations

5.8.1 It was observed that:

a) FBR will provide tax-wise details to Finance Division for each reporting period with copies to Finance Departments. Finance Division to share working of the divisible pool with the Provincial Finance Departments.

b) Ministry of Petroleum & Natural Resources will provide wellhead-wise/field-wise production of oil and gas, calculation of Royalty on Oil and

Gas and Gas Development Surcharge to the provinces along with the collection figure of each month. This wellhead-wise/field-wise detailed information may also be to Finance Division so as to make it a part of funds release order.

c) FBR may also provide the detailed collection from each province for Sales Tax on Services all the provinces as will as to Finance Division so to make part of the funds release/sanction order.

Annex-III

Federal Board of Revenue
-:-

Subject: **STEPS BEING TAKEN BY FEDERAL GOVERNMENT IN IMPLEMENTATION OF NFC RECOMMENDATIONS.**

(a) **Sales Tax & Federal Excise Duty.** In order broaden the tax base, the General Sales Tax Bill, 2010 was introduced in the National Assembly of Pakistan in 2ndweek of November, 2010. Most of the political parties represented have opposed the RGST Bill, 2010 and Government is holding talks with all major political parties to reach a consensus on RGST. Similarly, the Federal Government 'is taking Provincial Governments into confidence with the objective to reach a consensus regarding services to be taxed via necessary amendments in the Provincial GST laws. The last such meeting was held in Finance Division on 19.01.2011 and the decision was taken that a separate meeting on the issue of RGST will be convened in Finance Division after two weeks, to finalize the remaining issues. The World Bank consultant who has drafted .the RGST law will be invited to clarify some of the provisions of the draft law. The FBR is currently working on reorganizing its workforce as well as restructuring its functions in line with global best practices to achieve efficiency, plug leakages and increase revenue.

(b)Income Tax.

(i) Streamlining of Tax Collection System:
Income Tax is collected through the designated branches of National Bank of Pakistan and through State Bank of Pakistan. Now the Income Tax payments are processed electronically and a computerized payment receipt is issued on each tax payment. Computerized data of Income Tax payments has facilitated tax payments verifications. Also, automated payments (movement of funds from the bank electronically for effecting tax payments) has also been launched. This module is being expanded gradually for the facility of the taxpayers which enables them make tax payments with least amount of hassle minimizing leakages in the collection system.

(ii) Increase in Revenue to Improve Taxation:

Through an elaborate and extensive exercise each year, proposals for streamlining the tax system, for facilitating taxpayers in payments of due taxes and for increasing tax revenues, are invited and after thorough sifting of each proposals suitable measures are adopted through the legislative process with the approval of the Legislature.

(iii) Broadening of Tax Base:

A. Assessing 700,896 potential taxpayers identified by NADRA.
B. Process for acquiring data from NADRA underway and the process to be completed in 4 months including:

- Notices to potential taxpayers to file a tax return within 30 days.
- Inc case of non-filing, Provisional assessment under Section 122-C of the Income Tax Ordinance, 2001 to be completed.

(iv) Improvement of Enforcement:

A. Focus on tax avoiders, short filers and non-filers. In this regard notices have been issued.

B. Audit of withholding agents. This task would be completed by 30 April,2011.

(v) Introducing Risk Based Audit:

Audit to be conducted on risk based criteria for FY 2009. Risk based audits would be completed by 30th April, 2011 and the demand raised would be collected by 30thJune, 2011

(vi) Collection of Stuck up Arrears:

Federal Board of Revenue would be requesting honorable Chief Justices of High Courts to constitute special benches for speedy hearing of tax cases.

(C) Customs Duty.-

(i) The tax base for the purposes of Customs Duty (CD) is primarily based upon dutiable imports of the country which in turn depends upon the overall national and international economic conditions. Any increase or decrease in the volume of dutiable imports is subsequently reflected in revenue collected under the "HEAD" of Customs. In recent past, factors like nationwide floods, law & order situation, (particularly the strikes in Karachi) resulting in repeated closures of economic activity, and severe energy crises, have greatly affected customs revenue collection. For example, the Non-clearance of HSD due to floods caused a revenue shortfall of approximately Rs.900 million in the months of September & October, 2010 alone. Such heavy reliance on dutiable imports leaves a very narrow opportunity to the Customs to increase revenues through administrative measures. More so, as the revival and growth in the industry and promotion of exports warrant exemptions and concessions which further erode the CD base already narrowed by gradual/regular customs tariff rationalization which effectively means reduction in duty rates.

It is further pointed out that in pursuance of the government's policy and also to provide relief to the common man, no major revenue generating measures were taken in the budgets for FY2009-1 0 and FY 2010-11. There was, in fact, net negative impact of Rs.173 million and Rs.705 million in the respective years.

(ii) Special Administrative Measures:

Despite the above mentioned handicaps, the field formations of Customs wing have generated customs duty of Rs.4.8 billion during the first six months of current fiscal year which is in addition to the revenue collected through normal imports. The additional revenue during this period has been collected through special administrative measures like improved valuation, checking mis-declaration and realizing revenues stuck up as arrears and through aggressive pursuance of cases under litigation. This duty is also 22% higher than that collected under same head of special initiative during July-Dec, 2009-10.

Future Plans:

- In order to further improve these measures, special teams have been constituted in field formations for recovery through perusal of arrears and court cases. Increased monitoring of assessments and examinations by senior customs officers has also been directed to check any connivance at lower levels.
- As a result of these improved measures, additional CD of Rs. 5 billion is expected to be realized during the remaining 6 months of this FY.

(iii) Tariff Rationalization:

Pakistan Customs has been following a policy of tariff rationalization since long and has reduced its tariff rates from 125% in 1988-89 to 25% in 2007-08 keeping in view its national requirements and international commitment. However, in 2008-09 when the international commodity prices were at their peak and the government was facing sever shortage of forex reserves, duties on approximately 397 items were increased which again raised our normal tariff peak to 35%. As mentioned above, tariff rationalization is a continuous process which evolves with requirements of changing times.

Future Plan:

- Process of tariff rationalization will continue in the light of inputs from all stakeholders;
Depending upon the prevailing economic conditions at the time, particularly the position of foreign exchange reserves, proposal for downward revision of tariff rates of 30% & 35%, increased in 2008-09 from 20% & 25% respectively, will be considered at the time of next budget. This measure will divert the smuggled goods to legal regime which will, in turn, increase the revenue;

(iv) Improvement in Valuation:

In order to plug revenue leakage through under invoicing of imported goods, following major measures have been initiated to improve valuation aspect of assessment process:..,

~ Pakistan Customs Valuation Gateway (PCVG), a customs valuation website has been launched and is operational since March, 2010. International reliable data on prices of goods is available in Pakistan. Customs Valuation Gateway as a reference tool to check under invoicing. The Valuation database is compiled. from international journals and websites like LMB, Public Ledger, ICIS, Polymer scans, etc.

~ In order to curb under invoicing, cooperation agreements in customs matters have been executed with several countries like China, UAE, Iran, Kyrgyzstan, Turkey, Azerbaijan, Mauritius, Uzbekistan, USA, SAARC and D-8 countries.

~ After proper field investigations by the Directorate General, 113 Valuations Rulings have been issued during the financial year 2009-10 to curb under invoicing in some of the major revenue spinning sectors like iron & steel, paper & paper board, cosmetics and electronic appliances.

Future Plan:

~ Deliberations are underway for information sharing with regulatory authorities to check under invoicing. Negotiations have already been initiated with the State Bank of Pakistan for developing Electronic Data Interchange (EDI) between Banks and Customs department for online verification of import documents like LCs and sales contracts to check under invoicing.

~ Negotiations for cooperation agreements in customs matters, including valuation, are also underway with Japan and ECO countries.

(v) Post Clearance Audit:

The introduction of Self Assessment System (SAS) in customs required the creation of Post Clearance Audit department to check declarations, particularly those cleared by the system under 'green' flag. The Directorate of Post Clearance Audit became operational in 2008 and is in its formative phase. Despite being a new organization, it has shown a very impressive performance. Total detections made since July 2009 are worth Rs.6,384 million as against Rs.2,339 million in corresponding period of previous FY, showing an increase of 174%.

Future Plan:

Development of Post Clearance Assistance System (PCAS) is underway for profiling of importers and selection of audits on automated basis.

(vi) Enforcement Measures:

The facility of transit trade extended to Afghanistan under the Afghan Transit Trade Agreement, 1965, is being misused since long. Part of the goods that go to Afghanistan are smuggled into Pakistan through the long and porous border. In order to address this serious problem and to reduce smuggling of these goods, following steps have been taken:-

- All transit trade cargo under the Afghan Transit Trade Agreement moves from the point of entry (Karachi Port or Port Qasim) to the point of exit (Amangarh/ Torkham and Chaman) in containers under customs seals only.
- The cargo is inspected at Karachi on selectivity basis. If, on inspection, any discrepancy is found in the cargo with respect to the documents submitted, legal action shall be initiated. If any suspicious consignment is found, it shall be screened out for detailed examination at Karachi. Loose container load (LCL) cargo shall not be allowed to be carried in ordinary trucks and shall be imported in FCL or it shall be containerized at Karachi before departure.
- The. movement of each cargo container en route to Afghanistan will be monitored at the designated check posts on route from Karachi to Peshawar/Quetta.

- The cargo shall be examined at Torkham/Amangarh and Chaman.

- Each .collectorate at point of entry of ATT cargo and at point of exit furnishes cross border certificate on weekly basis besides coordinating with one another for acknowledging receipt of ATT containers at Torkham or Chaman.

- The goods brought under Afghan transit and smuggled in Pakistan are included in the list of items of section 2(s) notified under SRO 566(1)/2005 dated 06.06.2005 so that in case such goods are seized, these shall not be released on payment of redemption fine along with duty and taxes but shall be out rightly confiscated and prosecution can also be initiated against persons smuggling such transit goods.

- Penalty account of violation of transit trade provisions has also been increased from Rs.25,OOO/- to twice the value of the seized goods in the Finance Act, 2010. It is further intimated that considering the above facts, the Federal Board of Revenue has recently vide Notification NO.SRO.1090(1)/2010, dated 01.12.2010 entrusted anti-smuggling powers to other enforcement agencies like Pakistan Rangers and Frontier Corps. Due to increased focus on anti-smuggling activities and revival of check posts in September, 2009, anti-smuggling goods worth Rs.4,928 millions have been seized during the period July-June -2009-10 as against Rs.1,858 millions in 2008-09 which reflects an increase of 165%.

Future Plan:

A new Afghanistan Pakistan Transit Trade Agreement (APTTA) has recently been signed to control the smuggling of goods. The following provisions are aimed at reducing the phenomenon of smuggling:-

- Movement of goods on providing customs security which means encashable financial guarantee acceptable to Customs, submitted by the traders or by their authorized brokers, on transit goods, for an amount equivalent to the import levies of contracting parties.

- Afghanistan Pakistan Transit Trade Coordination Authority (APTTCA) shall be established which shall look into all matters related to the unauthorized trade.

- Tracking of vehicles involved in transportation of Afghan Transit Trade goods shall be introduced.
- The customs administration of Contracting Parties shall ensure customs to customs cooperation by information sharing through setting up the facility of electronic interface.

- Another initiative for effective and efficient control of smuggling is under way for online interconnectivity of customs check posts to improve real time exchange of information between them as well as with their field headquarters.

(vii) **Re-organization of Customs Department:**

During the last few years, while Pakistan's international trade and population has increased manifold focus primarily remained on the Sales Tax and the Income Tax. After creation of Inland Revenue Service recently as a part of restructuring plan of FBR, Customs service is also being re-organized on modern lines with a motivated workforce by creating the appropriate support departments as well as restructuring the existing operational departments by taking into account the international best practices. It is expected that the above measures would enable Customs Department to effectively contribute in the overall efforts of the Board to achieve the desired Tax-to-GDP ratio by the deadline of 2014 in terms of the recommendation of the NFC award.