REPORT ON
BIANNUAL MONITORING ON THE IMPLEMENTATION OF NFC AWARD

(July – December 2011)

Government of Pakistan
National Finance Commission Secretariat

LETTER OF TRANSMITTAL

MINISTRY OF FINANCE
ISLAMABAD

Dear Madam Speaker, National Assembly
Dear Mr. Chairman, Senate
Dear M/S Speakers, Provincial Assemblies

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 with effect from July 1, 2010.

2. In 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."*

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. The reports for the period from July 1, 2010 to December 31, 2010 and January 1, 2011 to June 30, 2011 have already been laid before the Parliament and Provincial Assemblies.

4. The biannual monitoring report for the period from July 1 to December 31, 2011 was monitored by the Finance Ministers in Islamabad on May 14, 2012. The implementation status on each of the articles of the President's Order was deliberated upon and the report was finalized/ approved for laying before both the Houses of the Parliament and Provincial Assemblies.

(Dr. Abdul Hafeez Shaikh)
Finance Minister
Government of Pakistan

INTRODUCTION

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. The NFC shall consist 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 has been given in clauses (2) and (3) of Article ibid and the recommendations of the NFC is required to be implemented through President's Order as provided in clause (4) of Article ibid. The 7th NFC set up in 2005 has announced the Award in December 2009 and the recommendations of the NFC have been implemented with effect from July 1, 2010 through *"Distribution of Revenues and Grants-in-Aid Order 2010 (President's Order No.5 of 2010)" (Annex-I)*.

1.2 Through the 18th Amendment in the Constitution, two new clauses i.e. clauses (3A) and (3B) have been inserted in the Article 160. 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.

1.3 The reports for the period from July 1, to December 31, 2010 and January 1, 2011 to June 30, 2011 have already been laid before the both houses of the Parliament and Provincial Assemblies.

DIVISION OF DIVISIBLE POOL TAXES

Article 1,2, 3 & 4 of President's Order No.5 of 2010

2.1 Articles 1 & 2 consist of title and definition of the Order and therefore no action warrants on these articles.

2.2 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.

2.3 The first and second bi-annual reports of the financial year 2010-11 was laid before the both Houses of the Parliament and the Provincial Assemblies. The distribution of divisible pool taxes given in the reports was based on the provisional figures conveyed by the FBR on fortnightly basis. FBR, however, vide letter dated October 5, 2011, has conveyed the final reconciled tax receipts for the financial year 2010-11. Based on this information, the provincial shares in the divisible pool taxes were reassessed/calculated **(Annex-II).** The summarized position is as follows:

Rs. in Billion

	Final figure 2010-11
Total Collection FBR Receipts (i)	**1558.01**
Less Non-Divisible Pool Components (ii)	113.49
Workers Welfare Fund (WWF)	*19.89*
GST on Services	*70.97*
Excise Duty on Natural Gas	*11.65*
Export Development Surcharge	*5.15*
1% of Income Tax on account of Income Tax paid out of the Federal Consolidated Fund (FCF)	*5.83*
Divisible Pool Gross (iii) = (i-ii)	**1444.52**
1% Collection Charges	**14.50**
Divisible Pool Net	**1430.02**
1% set aside for Khyber Pakhtunkhwa for War on Terror	**14.30**
Balance Divisible Pool Taxes	**1415.72**
Federal Share (44%)	**622.92**
Provincial Share (56%)	**792.80**

Province-wise Distribution Rs. In Billion

	Punjab	Sindh	Khyber P'Khwa	Balochistan	Total
Divisible Pool Taxes	410.19	194.63	115.91	72.07	**792.80**
1% War on Terror			14.30		**14.30**
*Additional transfer for Balochistan				10.93	**10.93**
Total	**410.19**	**194.63**	**130.21**	**83.00**	**818.03**

**Clause (3) of Article 4 of the Order ibid guarantees that the share of Balochistan province would be Rs.83 billion in FY 2010-11 and any shortfall would be made up by the Federal Government from its own resources. Accordingly, Federal Government transferred Rs.10.93 billion to Balochistan Government from its own share.*

2.4 The excess/ less transfers made provisionally during the financial year 2010-11 have been adjusted on 30th December 2011. Details of adjustments are at Annex-III. Summarized position is as follows:

Rs. in Billion

	Punjab	Sindh	Khyber P'khwa	Balochistan
Total Adjustments	**(3.39)**	**(0.57)**	**(1.32)**	**0.58**
Divisible Pool Taxes	(7.39)	(3.51)	(2.35)	-
GST on Services	4.00	2.94	1.03	0.58

The figures in parenthesis are negative and have been deducted/adjusted from the provincial share for the month of December, 2011.

2.5 During the period from July – December, 2011 (first half of FY 2011-12), FBR reported Rs.751.70 billion. This includes receipts of some non-divisible pool components including income tax paid out of the Federal Consolidated Fund (FCF). 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.751.70 billion, the Gross divisible pool taxes worked out to be Rs.730.63 billion as per details given below:

Rs. in Billion

	July - Dec-2011-12
Total Collection FBR Receipts (i)	751.70
Less Non-Divisible Pool Components (ii)	21.07
Workers Welfare Fund (WWF)	*10.42*
GST on Services	*0*
Excise Duty on Natural Gas	*3.97*
Export Development Surcharge	*4.16*
1% of Income Tax on account of Income Tax paid out of the Federal Consolidated Fund	*2.52*
Divisible Pool Gross (iii) = (i-ii)	**730.63**

2.6 Vertical distribution of the divisible pool taxes have been made as prescribed in clauses (2) and (3) of Article 3 of the President's Order ibid. The provincial share in the divisible pool has been fixed as 57.5% from FY 2011-12 onwards against 56% fixed for FY 2010-11.The position of vertical distribution emerges as follows:

Rs. In Billion

Divisible Pool Gross	730.63
1% Collection Charges	**7.32**
Divisible Pool Net	**723.31**
1% set aside for Khyber Pakhtunkhwa for War on Terror	**7.23**
Balance Divisible Pool Taxes	**716.08**
Federal Share (42.5%)	**304.34**
Provincial Share (57.5%)	**411.74**

2.7 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 Balochistan province shall receive the share from the divisible pool taxes based on annual budgetary projections and any shortfall as a result of less tax collections shall be made up by the Federal Government from its own share. The budgeted divisible pool share of Balochistan province is Rs.93.26 billion. In order to match this budgeted share, Federal Government has paid Rs.9.20 billion from its own resource to Government of Balochistan during the first half of financial year 2011-12. The summarized position of horizontal province-wise distribution is as follows:

Rs. in billion

Province Components	**Total**	**Punjab**	**Sindh**	**Khyber Pakhtunkhwa**	**Balochistan**
	100%	51.74%	24.55%	14.62%	9.09%
Divisible Pool Taxes	411.74	213.04	101.08	60.20	37.43
1% War on Terror	7.23			7.23	
Additional transfer for Balochistan	9.20				9.20
Total	**428.18**	**213.04**	**101.08**	**67.43**	**46.63**

The detailed working is at Annex-IV

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. That ministry reports to Finance Division on a monthly basis about the province-wise collection of royalty on crude oil for onward transfer to provinces. The net proceeds reported by M/o Petroleum and Natural Resources for the 1st half (July – December) of FY 2011-12 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 Pakhtunkhwa	Balochistan	Total
2.959	2.517	4.777	0.000	**10.253**

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 net proceeds of Royalty and Surcharge on Gas for the 1st half of FY-2011-12 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 Pakhtunkhwa	Balochistan	Total
Royalty On NG	1.024	10.533	1.969	3.822	17.348
Gas Dev. Surcharge	0.698	7.361	1.176	0.799	10.034
Total	**1.722**	**17.894**	**3.145**	**4.621**	**27.382**

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 uniform 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.

Rs.1.0 billion have been paid to Government of Balochistan during the first half of financial year 2011-12.

3.2.3 In addition to this, Rs.10 billion were allocated as arrears prior to 1991 under Aghaz-e-Huqooq-e-Balochistan Package and Rs.5.3 billion have been paid to Government of Balochistan upto 31st December, 2011 for the financial year 2011-12.

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 federal excise duty on natural gas is required to be paid to that 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 net proceeds for the 1st half of FY-2011-12 have been distributed exactly in accordance with the constitutional provision. Details are as follows:

Rs in billion

Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
0.24	3.27	0.53	0.85	**4.89**

3.4 Grants-in-Aid to Sindh Province in lieu of abolition of Zila Tax

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 as OZT. A sum of Rs.7 billion has been allocated in the Federal Budget for the purpose. During the 1st half of the financial year 2011-12, the provincial share in the divisible pool was Rs.411.74 billion. Accordingly, the grant-in-aid was worked out Rs.2.720 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.

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4.1.3 Since this issue was linked with the implementation of Reformed GST, therefore, status-quo for its collection has been maintained for the time by the three provinces i.e. Punjab, Khyber Pakhtunkhwa and Balochistan. Sindh, however, promulgated its own law and established Sindh Revenue Board. In order to resolve the issue, number of meetings took place but no consensus could be arrived particularly on seven contentious services. However the four provinces have shown agreement to deliberate upon the same at Finance Ministers' level.

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 Governments 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.

5.2.2 The estimated GDP (mp) for the FY is Rs.20,815 billion. The total estimated tax receipts is Rs.2,187.81 billion (Rs.2074.20 billion Federal + Rs.113.61 billion provinces). The tax to GDP ratio is worked out to be 10.5%. Summarized position of tax receipts up to December, 2011 by the Federal and Provincial Governments is as follows:

	BE 2011-12	FY-2011-12 (July - Dec., 2011)	% age over BE
Federal	2,074.20	867.36	41.8%
Provinces	113.61	47.20	41.6%
Punjab	48.61	17.15	35.3%
Sindh	60.04	27.82	46.3%
KPK	3.61	1.77	49.0%
Balochistan	1.35	0.46	34.1%

Detail statement giving both tax and non-tax receipts are at Annexes-V-VI.

5.2.3 Federal Government is initiating certain measures to properly exploit tax receipts. A report in the matter received from FBR is at **Annex-VII**. The agriculture income taxes collected by the provinces are very negligible despite the fact agriculture sector is one of the major contributors of the GDP. As such Federal Government is facilitating provinces to harmonize taxation on agriculture income. The main objective of this exercise is to properly explore potential of tax collection from this sector and bring it at par with other sectors.

5.2.4 The steps being taken by the provinces to increase own revenues are as follows:

Province of Punjab

Revenue Generation (clause-2 of Article-9)

- Government of the Punjab, through Punjab Finance Act, 2011, has introduced following new taxes:
    - Tax on Farm Houses;
    - Tax on swimming pools; and
    - Tax on Education Cess on Clubs.

  The above taxes are expected to yield significant amount of revenue for the government of the Punjab.

- Government of the Punjab has increase the rate of token tax for private cars/vehicles exceeding engine strength of 1000 CC. The detail of these changes in taxation structure may be seen in Finance Act, 2011 of Government of the Punjab.
- Government of the Punjab has also levied toll on 04 newly constructed highways in the province which is expected to yield revenue in excess of 500.00 million per annum.
- Finance Department has been regularly holding monthly meetings at the level of Chief Secretary to review progress of tax/non-tax collection.

Province of Sindh

- In order to streamline the tax collection systems to reduce leakages, the Finance Department Government of Sindh has already undertaken steps to automate collections of tax and non-tax receipts of collection agencies and administrative departments through introduction of SAP R-3 system. This will ensure the following:

- Receipts transactions of Government of Sindh will be linked with SAP R-3 on line system on the level of Revenue Collecting Office (RCO);
- Each and every receipt will be collected and deposited with code of RCOs w.e.f. 1st July, 2012 with detailed objects;
- All SBP/NBP Branches in Sindh will receive challans with code of RCOs.

- In order to effectively tax the agriculture sector, the Government of Sindh has held several meetings with stakeholders including representatives from the Sindh Chamber of Agriculture Department. In this regard, efforts are underway.
- In addition, the information regarding data on income tax on agriculture declared by the tax payers in their returns has been provided by FBR to Government of Sindh. In this regard, the information has been shared with Board of Revenue and the Divisional Commissioners and is being examined to develop options to harmonize and strengthen the assessment/collection mechanism of agriculture income tax as decided in the meeting of the Provincial Finance Secretaries under the Chairmanship of Federal finance Secretary dated 20th February, 2012.
- As regards the taxation of real estate sector, the Board of Revenue has been entrusted the task of formulating effective proposals for the same.

Province of Khyber Pakhtunkhwa

The Provincial Government of Khyber Pakhtunkhwa has taken various measures to increase Revenue generation in line with (clause-2 of Article-9) of the 7th National Finance Commission Award. The details are as under:-

A.Tax Receipt

- Increase in the tax rates in respect of Urban Immovable Property Tax (UIPT) both residential and commercial property.
- Reforms to categorize the property situated at different localities.
- Property let out on rent, lease etc. will pay tax double to the property self occupied.
- Guest houses, hostels etc. are included in the tax net.

- Registration fee for default registration has been enhanced. Route permit fee and motor vehicle fitness certificate fee has also been revised.
- Fee under Motor Vehicle Rules for change in the address in registration certificate, change of body type, transfer fee and new registration mark has been enhanced.
- The rates of professional tax have been enhanced besides expansion of the schedule of the tax by including more categories therein.
- Rates of Tobacco Development Cess charged on tobacco have been increased.
- The rates of Capital Value Tax (CVT) have been rationalized.
- Court fee has been enhanced to bring at par with other provinces.
- Sugarcane Development Cess has been revised.

B. Non Tax Receipt

- Various type of fee being charged under Electricity Rules have been revised.
- Timber Duty rates have been revised.
- Water charges both for domestic and commercial consumers have been enhanced.
- Contractor Registration fee and Tender form fee have been enhanced.

C. Other Reforms

- In order to streamline the tax collection system, to reduce leakages, the provincial government linked receipt transactions with SAP on line system on the level of Revenue Collecting Office (RCO). Each and every receipt will be deposited with RCO code with detail object.
- Agriculture Income Tax is being harmonized in consultation with Federal Government and other stakeholders.
- Review meeting are being held to review the progress of tax/non-tax collection. The tax collecting departments have been motivated to hold monthly meeting with their line offices to improve the collection of receipt.

The above measures are expected to yield significant amount of revenue for the government of the Khyber Pakhtunkhwa.

Province of Balochistan

The Provincial Government constituted the Provincial Advisory Committee on Provincial Own Revenues under the chairmanship of Senior Member Board of Revenue to review the exiting provincial direct and indirect taxes, charges etc. and would advise the provincial government the measures for improvement of provincial own revenues in Balochistan.

5.4: Enforce mechanism for maintaining fiscal discipline

5.4.1 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.

Federal Government

Federal Government is taking austerity measures to curtail its expenditures. The salient features of the austerity measures of the Federal Government are as follows:

- Allocated resources for current expenditure and Dev. expenditure are being released as per mechanism/procedure as laid down in revised system of financial control and budgeting.
- Revenue collection & expenditure are monitored on monthly basis.
- Provincial revenues/expenditure are also being monitored on monthly basis.
- Efforts are being made to avoid un-budgeted expenditure.
- There is ban on new recruitment.
- There is ban on purchase of physical assets including all types of vehicles. Ban on purchase of vehicles will also be applicable to development expenditure.
- Cut has been imposed at 20% of budget estimates on account of expenditure on traveling allowance, stationery, entertainment, advertisement, repair/maintenance and utilities.
- Entitlement of periodical, magazines etc. of all officers has been withdrawn. Only one copy of periodical/magazine will be available in the library of each Ministry/Division/Department/ Organization for reference purposes. Only one daily newspaper will be allowed to the entitled officers.
- Officers will not be allowed to use air-conditioner before 11.00 a.m. and below 26 degrees.
- Principal Accounting Officers will ensure rationalization of utility bills.
- Both sides of paper should be used.
- Serving of official lunches/dinners should be restricted.

- Ministries/Divisions will not be authorized to re-appropriate funds from the above mentioned heads of expenditure.

The efforts being taken by the Provincial Governments are as follows:

Government of the Punjab

- During FY-2011-12, government of the Punjab has been releasing development funds on biannual basis in order to match transfer of development funds with that the fiscal space available to Government of the Punjab.
- Government of the Punjab continued to implement strict austerity measures to reduce it expenditure on purchase of durable goods during FY 2011-12. Through these measures, purchase of all durable goods was subjected to clearance of the high level austerity committee headed by Finance Minister.
- The government of the Punjab developed a robust system for cash balance management during FY 2011-12. In this system, the liabilities of the Punjab government, accruing against budgeted/authorized amounts, are monitored at three stages i.e. bill generation, receipt of cheques in treasury office and authorization of payment and withdrawal of cash from the government account.
- Expenditure in development projects is being continuously monitored against the released amounts to avoid unnecessary parking of funds;

Province of Khyber Pakhtunkhwa

- Government of Khyber Pakhtunkhwa in light of the NFC recommendations regarding fiscal discipline at the provincial level has approved the economy measures to curtail the recurring expenditure for current financial year 2011-12.
- Expenditure incurred by Government of Khyber Pakhtunkhwa is within the budgetary limits and the cash balance of the provincial government is also satisfactory.

Province of Balochistan

The Government of Balochistan has taken the following measures/steps to control over the expenditure:-

- The Provincial Government has constituted the Provincial Fiscal monitoring Committee under the chairmanship of Finance Minister whose terms and conditions are as under:-
    - To ensure timely reconciliation of Receipts and Expenditure for each Administrative Department;
    - To ensure timely compilation of Civil Accounts;
    - To ensure reconciliation between Civil Accounts and Cash Accounts maintained by State Bank of Pakistan;
    - To review performance of Departmental Accounts Committee;
    - To review audit observations and follow-up;
    - To review accounts of Local Councils;
    - Any other matter that may be deemed necessary.

5.5: Grants in times of unforeseen calamities

5.5.1 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 up to 31-12-2011:

i. Rs.1.952 billion has been released to Government of Balochistan for further payment to State Bank of Pakistan on account of over draft of the province.

ii. Rs.0.404 billion has been released to Government of Balochistan for meeting the pay and allowances of 5000 posts under Aghaz-e-Huqooq-e-Balochistan Package.

5.6: Holding of Quarterly NFC Meetings to Monitor Implementation of the Award

5.6.1 This meeting is being arranged on quarterly basis as per decision.