Report On Biannual Monitoring of the Implementation of NFC Award

(July – December 2012)

Government of Pakistan
National Finance Commission Secretariat

LETTER OF TRANSMITTAL

MINISTRY OF FINANCE
ISLAMABAD

Dear Mr. 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 started with effect from July 1, 2010.

2. Clause 3(B) of Article 160 of the Constitution of Islamic Republic of Pakistan reads as follows:

> *"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 both Houses of the Parliament. Therefore, implementation reports for the periods covering July - December, 2010, January - June, 2011, July – December, 2011 and January – June, 2012 have already been laid accordingly.

4. The biannual monitoring report for the period from July - December, 2012 was approved by the Finance Ministers in Islamabad on 14th March, 2013. 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.

(Senator Mohammad Ishaq Dar)
Finance Minister
Government of Pakistan

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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 are required to be implemented through President's Order as provided in clause (4) of Article ibid. The 7th NFC set up in 2005 announced the Award in December 2009 and the recommendations of the NFC were enforced for implementation 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 given to the provinces in the previous Award whereas clause (3B) provides that the Federal and Provincial Finance Ministers shall monitor implementation of the Award biannually and lay a report in this regard in both Houses of the Parliament and the 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 pool taxes between the Federal and Provincial Governments vertically and amongst the four provinces horizontally.

2.3 During the period from July – December, 2012 (first half of FY 2012-13), FBR reported collection of Rs.888.98 billion including receipts of some non-divisible pool components like 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.888.98 billion, the Gross divisible pool taxes were worked out as Rs.861.76 billion as per details given below:

Rs. in Billion

	July – Dec-12
Total Collection FBR Receipts (i)	888.98
Less Non-Divisible Pool Components (ii)*	27.22
**Workers Welfare Fund (WWF)*	*7.05*
**GST on Services*	*8.44*
**Excise Duty on Natural Gas*	*5.86*
**Export Development Surcharge*	*2.56*
**1% of Income Tax on account of Income Tax paid out of the Federal Consolidated Fund*	*3.31*
Divisible Pool Gross (iii) = (i-ii)	**861.76**

2.4 The provincial share in the divisible pool has been fixed as 57.5% for FY 2012-13. Accordingly, vertical distribution of the divisible pool taxes was made as prescribed in clauses (2) and (3) of Article 3 of the President's Order ibid. In this regard, the detailed position is as follows:

Divisible Pool Gross	861.76
1% Collection Charges	8.64
Divisible Pool Net	853.12
1% set aside for Khyber Pakhtunkhwa for War on Terror	8.53
Balance Divisible Pool Taxes	844.59
Federal Share (42.5%)	358.95
Provincial Share (57.5%)	485.64

2.5 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 of President order No. 5 of 2010. 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.114.21 billion for the period under reference. In order to match this guaranteed share, Federal Government paid Rs.12.97 billion from its own resources to Government of Balochistan during the first half of financial year 2012-13. The summarized position of horizontal province-wise distribution is as follows:

Rs. in billion

Components	Total	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan
	100%	51.74%	24.55%	14.62%	9.09%
Divisible Pool Taxes	485.63	251.27	119.22	71.00	44.14
1% War on Terror	8.53	-	-	8.53	-
Additional transfer for Balochistan	12.97	-	-	-	12.97
Total	**507.13**	**251.27**	**119.22**	**79.53**	**57.11**

*The detailed working is at **Annex-II.**

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 2012-13 have been distributed amongst the provinces in accordance with the provisions of said article. Details are as follows:

Rs in billion

Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
2.536	3.266	5.047	0.002	**10.850**

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 the provinces. The net proceeds of Royalty and Surcharge on Gas for the 1st half (July – December) of FY-2012-13 as reported by M/o Petroleum and Natural Resources have been distributed precisely in accordance with said provision of the Award. Details are as follows:

Rs in billion

	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
Royalty On NG	1.391	11.607	1.724	4.312	19.034
Gas Dev. Surcharge	0.168	4.874	0.843	0.772	6.657
Total	1.559	16.481	2.567	5.084	25.691

3.2.2 In pursuance of clause (2) of Article 6 of the Award, arrears of GDS payable to Balochistan with effect from 01.07.2002 to 30.06.2010 are to be paid to the Government of Balochistan, subject to maximum of Rs.10 billion in five years. Accordingly, the Federal Government allocated Rs.2.0 billion for the purpose during FY 2012-13 out of which Rs.1.0 billion were paid to Government of Balochistan during the period under reference.

3.2.3 In addition, Rs.10 billion were also allocated as arrears of GDS prior to 1991 under Aghaz-e-Huqooq-e-Balochistan Package for the FY-2012-13 and Rs.5.0 billion have been paid to Government of Balochistan upto 31st December, 2012.

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 the province where 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-2012-13 have been distributed precisely in accordance with said provision. Details are as follows:

Rs in billion

Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
0.261	3.984	0.735	0.864	**5.844**

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

3.4.1 Under Article 7 of the Award, the province of Sindh is entitled to receive a grant-in-aid equivalent to 0.66% of the provincial share in the divisible pool as OZT. A sum of Rs.9 billion was allocated in the Federal Budget for the purpose. During the 1st half (July – December) of the financial year 2012-13, the provincial share in the divisible pool was Rs.485.63 billion. Accordingly, the grant-in-aid was worked out as Rs.3.49 billion which was 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 Punjab and Sindh provinces started collecting GST on Services at their own during period under report. For the purpose, Sindh Government has established Sindh Revenue Board whereas the Punjab Government has established Punjab Revenue Authority. However, FBR continued to collect GST on Services on behalf of Khyber Pakhtunkhwa and Balochistan for the period under report i.e. July – December, 2012.

4.1.3 The GST on Services collected during the period under report was distributed as per details given below:-

Rs in billion

Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
1527.570	-	3037.320	1188.990	**5753.880**

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 an 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 should initiate steps to tax the agriculture and real estate sectors effectively.

5.2.2 The estimated GDP (mp) for the FY-2012-13 is Rs. 23,655 billion. The total estimates for tax receipts is Rs.2691.11 billion (Rs.2503.58 Federal + Rs.187.53 billion provinces). The tax to GDP ratio is worked out to be 11.37% Summarized position of tax receipts up to December, 2012 by the Federal and Provincial Governments is as follows:

	BE 2012-13	FY-2012-13 (July – Dec., 2012)	% age over BE
Federal	2503.58	936.27	37.4%
Provinces	187.53	72.96	38.9%
Punjab	95.02	36.04	37.9%
Sindh	73.19	32.33	44.2%
Khyber Pakhtunkhwa	13.86	3.22	23.2%
Balochistan	5.46	1.37	25.1%

Note: GST on services reflected for respective provincial government being a provincial levy and corresponding adjustment has been made in the FBR receipts. Details of Provincial Own Receipt added as Annex- III.

5.2.3 Federal Government is taking various initiatives to exploit tax potential. In this regard, report received from FBR is added at **Annex-IV**. The agriculture income tax collected by the provinces is very negligible despite the fact that agriculture sector is one of the major contributors to the GDP. Therefore, the 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 provinces highlighted steps taken to increase their own revenues. The same are reproduced as follows:

Province of Punjab

Revenue Generation (clause-2 of Article-9)

- Government is striving to considerably expand the revenue base and fully tap the provincial resource potential. Moreover, special emphasis has also been placed on improving the collection efficiency of tax administering departments. Chief Secretary Punjab personally monitors the progress of revenue collection and chairs meetings of provincial own receipts on regular basis. For FY 2012-13, a target of Rs.129.839 billion of provincial own receipts has been fixed. Major revenue collecting departments were instructed to maximize their revenue collection through structural reforms; administrative measures; special campaigns etc. For effective monitoring of revenue collection, six-monthly targets were also assigned to the departments under directions of the Chief Secretary. During first 6 months of FY-2012-13, Government achieved a growth of 21% compared to corresponding period of last financial year excluding sales tax on services.
- Government has created Punjab Revenue Authority (PRA) as a major reform initiative under the Act of Assembly initially with the mandate to administer and collect Sales Tax on Services followed by collection of other important provincial taxes. It is further added that for improving the administration of Sales Tax on Services, Government has introduced a comprehensive Punjab Sales Tax on Service Act, 2012 covering imposition, collection, management and enforcement of this tax. The Authority has started collecting Sales Tax on Services w.e.f. 1st July, 2012 and a collection target of Rs.40.496 billion has been assigned to it by the Government for FY 2012-13. During first 6 months of FY 2012-13, PRA collected Rs.17.4 billion from sales tax on services.
- In order to enhance revenue collection and reduce hassle for the public, Government has levied a lump sum Token Tax of Rs.10,000/- for motorcars and jeeps upto 1000 cc at the time of registration (life-time) by amending the Punjab Motor Vehicles Taxation Act, 1958.
- To facilitate the taxpayers in deposit of Property Tax, Government has extended the period from 02 months to 03 months for payment of the Tax

with a rebate of 5%. Further amendments have been made in the Punjab Urban Immovable Property Tax Act, 1958 to encourage payment of the tax on regular yearly basis. In order to ensure timely deposit of the tax, late payment surcharge at the rate of 1% of the gross payable tax has been imposed on the first day of every month of delay if the tax is not deposited by the due date. Similarly, data of property tax in few important cities/locations having maximum revenue potential is being automated along with emphasis on improving the processes aimed at 'ease of doing business' for tax payer's facilitation. Moreover, in collaboration with London School of Economics research team, measures for improving the collection of property tax are also under implementation.

- Amendments have been made in the Stamp Act, 1899 to streamline the procedure for assessment and collection of Capital Value Tax. Further, powers of the concerned authorities have been defined in case of non-payment of the tax. These measures would improve compliance of the tax.
- Amendments have also been made in the relevant sections of Punjab Finance Act, 2011 pertaining to Farm House Tax and Education Cess on Club in order to bring more clarity in the laws and improve administration of these taxes.
- Government levied Excise Duty @ Rs.2 per litre on manufacturing of Rectified Spirit in distilleries.

Province of Sindh

- Linking receipts transactions of Government of Sindh with SAP R-3 on line system is in process.
- The Government of Sindh has framed "Sindh Financial Control Delegation of Financial Powers Rules 2012 which shall replace outmoded existing rules known as Sindh (the West Pakistan) delegation of Powers" under financial rules and "Powers of Re-appropriation of Rule 1962" which had become inadequate and called for revision in order to meet the requirement of the Sindh Government for following reasons:
  - The departments, attached departments, subordinate offices and institutions have grown and changed with passage of time necessitating thereby re-grouping of categories of officers i.e. "Authorities" for delegation of financial powers.
  - The extent of financial powers delegated to various categories of officers i.e. "Authorities" had become inadequate on account of accumulated inflationary effect and currency exchange rate effect over a period of 50 years since promulgation of the West Pakistan Delegation of Powers Rules under Financial Rules and "Powers of the Re-appropriation Rules 1962".
  - Delegation of financial powers to the authorities needed to be updated in accordance with the "New Chart of Accounts" classification.

- Requirements of departments, attached departments, subordinate offices and institutions had also undergone change.

- Government of Sindh has retired Rs.2.5 billion of Cash Development Loans during the current financial year 2012-13 bearing a high rate of interest i.e. 13.61%. Furthermore, the Government intends to retire the remaining CDL balance of Rs.2.4 billion through similar arrangement in the current financial year.
- The liabilities of electric power companies in Sindh i.e. HESCO & SEPCO is a longstanding issue which has unjustifiably given a bad name to the Sindh Government. Due to concerted efforts of Government of Sindh, an extensive reconciliation exercise has been undertaken and all the dues of HESCO & SEPCO upto June, 2012 have been cleared except the claim against unmetered connection for the period prior to June 2010 for which reconciliation exercise is underway & is expected to be completed shortly.
- Purchase of new vehicles and other physical assets are being discouraged by the Government of Sindh.
- Government of Sindh is in process to increase revenue and reducing certain exemptions through reviewing Agriculture Income Tax (AIT) in the Province.
- Government is enhancing the capacity of Sindh Revenue Board (SRB), so that Sales Tax on Services net is also broadened.
- Similarly, Government of Sindh is holding meetings with revenue generating departments periodically to increase revenue targets and broaden tax net of respective agency.

<u>Province of Balochistan</u>

- The Government of Balochistan is going to improve its tax structure to enhance its revenue. The bills regarding GST, Value Added Tax as well as the enhancement of other taxes and duties are placed before the Provincial Assembly.
- After enactment of the above bills, the Provincial Government will be able to improve its provincial own receipts. Whereas non-tax receipt is concerned, it is growing substantially.
- The issue of Agriculture Income Tax is also under consideration which will be helpful to improve the provincial own revenue.

5.3: Enforce mechanism for maintaining fiscal discipline

5.3.1 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 efforts being taken as reported by the Provincial Governments are as follows:

Government of the Punjab

- Government has been releasing development funds on biannual basis in order to match transfer of development funds with available fiscal space to Punjab Government.
- Government has been following strict austerity measures to reduce expenditure on purchase of durable goods. Purchase of all durable goods is subject to clearance of the high level austerity committee headed by Finance Minister.
- Release of development funds is being strictly monitored alongwith actual expenditure against the released amounts to avoid unnecessary parking of funds.
- The robust system developed in FY 2010-11 for management of cash balance has been continued through FY-2012-13. In this system, the liabilities of the 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;
- In order to minimize un-necessary expenditure, only 40% of non-salary budget was allocated for the first half of FY 2012-13. However, its utilization was further subjected to placing only 20% of the released budget on SAP system for the first quarter of FY 2012-13. The remaining 20% budget was transferred at the start of 2nd quarter through SAP system. For the 2nd half of the Financial Year, 30% of the remaining 60% balance is being released in the 3rd quarter of financial year. Remaining shall be released in the last quarter of current financial year.

Government of Khyber Pakhtunkhwa

- With a view to observe fiscal discipline and to streamline the management in public accounts, the Government of Khyber Pakhtunkhwa has taken certain measures such as uniform expenditure in each month, clearance of accrued liabilities in time and encashment of all cheques by 30th June, 2012.
- The Government of Khyber Pakhtunkhwa has approved certain guiding principles for all departments to curtail the current expenditure in the form of economy measures for the year 2011-12.
- The Government of Khyber Pakhtunkhwa has committed not to go in the overdraft from the State Bank of Pakistan and the cash balance position of the Provincial Government with State Bank of Pakistan is satisfactory.
- The Province's own receipts and incurrence of expenditure are monitored each month for maintenance of fiscal discipline in the province.

5.4: Specific/ Miscellaneous Grants

5.4.1 The NFC recommended that Federal Government may assist the provinces through specific grants. Therefore, Federal Government extended following grants to the provincial government during period under reference:

i. Rs.1.861 billion released to Government of Balochistan for payment to State Bank of Pakistan on account of over draft of the province.

ii. Rs.0.653 billion released to Government of Balochistan for meeting expenses of pay and allowances of 5000 posts under Aghaz-e-Huqooq-e-Balochistan Package.

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