

Finance commissions-VII

Inclusion of federal taxes in divisible pool

*Part 2
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THE 1990 finance commission projected the revenue receipts of federal divisible pool taxes, after deducting 5 per cent collection charges, but for royalties on crude oil and natural gas, and excise duty and surcharge on natural gas, the collection charges have been worked out at 2 per cent. No explanation has been put forward for different rates of collection charges, which, in fact, are one of the lowest in the world — hardly touching 2 per cent!

Another recommendation was that the ratio between excise duty and development surcharge on natural gas should be substantially improved in favour of excise duty. As far as the award of the commission is concerned, this was a superfluous recommendation because the full amount of development surcharge was recommended to be paid to the provinces concerned. However, the recommendation indicates the direction in which the next finance commission and the federal government have to move in regard to the development surcharge on natural gas.

In the history of finance commissions in Pakistan, no finance commission was so controversial as the one constituted on December 10, 1996, with revised terms of reference, which were, among others, to recommend the distribution between the federation and the provinces of the net proceeds of (i) taxes on income, including

redundant, because (if the intention is the same) they are already mentioned with earlier part of the terms of reference, in conjunction with "taxes on income". Customs duties and federal excises are not taxes on income!

Under the Constitution, the president has to specify "such duties of excise", and "such other taxes". No "such duties of excise" have been specified by the president in the terms of reference. The commission's charter is limited. The wholesale inclusion of federal excise is not visualized in the Constitution. Similarly, all taxes and duties cannot be included in the divisible pool. If 'customs duties' are to be included, the president has to specify which 'customs duties' would be divisible.

If the intention of the framers of the Constitution was such,

ered by "such other taxes as may be specified by the president", because "services" have not been specified.

The idea of including all federal taxes in the divisible pool appears to have been borrowed, in a quarter-baked manner, from the recommendations of the tenth Indian finance commission, which had suggested an alternate scheme of devolution, in its report, submitted in December 1994, for the years 1995-2000. Under this scheme, proceeds of all shareable taxes would constitute a common shareable pool from which a share was to be devolved to the states.

The Commission observed, "In the framework of cooperative federalism, the Constitution currently provided for sharing of two taxes, income tax and union excise duties, with the states

Recent economic reforms, including tax reforms, have underlined this fact. The progress of reforms will be greatly facilitated if the ambit of tax-sharing arrangement is enlarged so as to give greater certainty of resource flows to, and increased flexibility in tax reforms for the two layers of government".

The tenth commission recommended 29.5 per cent of the proceeds to be devolved to the states under this scheme. This excludes grants-in-aid. The commission suggested that this scheme of resource sharing be brought into force after necessary amendments to the Constitution.

And when the eleventh commission was at the end of its task, the Constitution (Eightieth Amendment) Act, 2000 received the assent of Indian president. This "altered the pattern

Is it fortuitous that the terms of reference of the national finance commission, established in 2000, are almost the same as for the 1996-97 commission? There is a continuing constitutional violation, which is further compounded by the inclusion of a new item "GST on services". The idea of including all federal taxes in the divisible pool appears to have been borrowed from the recommendations of the tenth Indian finance commission.

the net proceeds or (1) 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 sales and purchases of good imported, exported, produced, manufactured or consumed; (iii) export duties on cotton; and (iv) to consider the inclusion of other federal taxes, including customs duties and federal excises, but not including tax on income paid out of the federal consolidated fund.

The very establishment of a national finance commission by a caretaker government violated one of the basic principles of good governance — an interim or caretaker government fills the gaps between the dissolution of the National Assembly and fresh elections within ninety days of the dissolution. Its main duty is to look after day-to-day administration, and not to take any decision that may have long-term financial, political, administrative, economic and commercial implications. The other principle, which was ignored, was *festina-lente*: 'hurry up slowly'. There was no question of 'hurry up quickly' in a matter of such importance as the establishment of national finance commission. This should have been left to the elected government, as was done in 1990. And within a short period of two months, the commission submitted its report, and the Distribution of Revenues and Grants-in-Aid Order 1997 was issued on February 12, 1997!

Even the terms of reference were not in accordance with the Constitution. In so far as only a few "specified" taxes are included in Article 160, the commission has a restrictive constitutional jurisdiction. The incorporation of "Consider the inclusion of other Federal Taxes including Customs Duties and Federal Excises, but not including tax on income paid out of the Federal Consolidated Fund" in the terms of reference, is ultra-constitutional, and, there is a mixing of direct and indirect taxes, as well. The words, "but not including tax on income paid out of the Federal Consolidated Fund" are

they would have said "all or such duties of excise" and "all or such other taxes" in Article 160. Except 'income tax' and 'sales tax' (as defined in Article 160), there is no provision for inclusion of the whole of the net proceeds of federal excises or customs duties or any other federal tax. Their wholesale inclusion is unconstitutional.

The Distribution of Revenues and Grants-in-Aid Order 1997 has included taxes not mentioned in the Constitution and in the terms of reference, like "wealth tax", "capital value tax", and "any other tax which may be levied by the federal government"! This was beyond the constitutional limit.

The constitution is very clear. It does not include "any other tax which may be levied by the federal government". The duty of the national finance commission is to recommend to the president the distribution of the net proceeds of the taxes, raised under the authority of the parliament, and as listed in Article 160. It does not cover any tax to be levied in future. And how could the finance commission recommend, and the president / government agree to include for distribution "any other tax which may be levied by the federal government"?

The commission, like other commissions, recommended that distribution of all taxes would be on population basis. Since the divisible pool was enlarged, the commission recommended that the centre should retain 62.5 per cent and the provinces be assigned 37.5 per cent of net proceeds of the taxes. As such, Punjab was to receive 57.88 per cent, Sindh 23.28 per cent, NWFP 13.54 per cent, and Balochistan 5.30 per cent.

Is it fortuitous that the terms of reference of the national finance commission, established in 2000 is almost the same as for 1996-97 commission? There is a continuing constitutional violation, which is further compounded by inclusion of a new item "GST on services", which is not mentioned in clause (3) of Article 160; it is not even cov-

This "altered the pattern of sharing of central taxes between the centre and the states in a fundamental way", under which all central taxes and duties are to be shared between the centre and the states. The terms of reference of the eleventh commission had to be modified by the president to include all central taxes and duties for distribution; this required the commission to re-determine the share of the net proceeds of all Union taxes and duties, which might be assigned to the states, and the respective share of each state.

The commission recommended that the share of the states be fixed at 29.5 per cent of the net proceeds of all taxes and duties, referred to in the union list. The criteria and relative weights for determining inter-se share of the states are population (10 per cent); distance (62.5 per cent); area (7.5 per cent); index of infrastructure (7.5 per cent); tax efforts (5 per cent); and fiscal discipline (7.5 per cent). The commission recommended that the ceiling of overall transfer of resources (tax devolution, grants-in-aid, and grants in other forms like Plan Grants) should be 37.5 per cent of the gross revenue receipts of the centre.

What we, in Pakistan, have done is that we have included all federal taxes and duties in the divisible pool without any constitutional amendment to give a proper legal and constitutional cover to our borrowed idea.

Finally, a word about "net proceeds", which, under the Constitution, "means, in relation to any tax or duty, the proceeds thereof, reduced by the cost of collection, as ascertained and certified by the Auditor-General". Normally, every Finance Commission has assumed the cost of collection as five per cent, when it is actually two per cent or so. Has the auditor-general ascertained and certified the cost of collection as 5 per cent or less than that? If it is less, has the federal government distributed the enhanced portion of the net proceeds among the provinces. Most probably, not.

Concluded