



EXPLANATORY MEMORANDUM
AS TO THE ACTION TAKEN ON THE
RECOMMENDATIONS
MADE BY THE
SIXTH STATE FINANCE COMMISSION
IN ITS REPORT SUBMITTED
TO THE STATE GOVERNMENT

AUGUST 2024

FINANCE DEPARTMENT
GOVERNMENT OF SIKKIM

EXPLANATORY MEMORANDUM AS TO THE ACTION TAKEN ON THE RECOMMENDATIONS MADE BY THE SIXTH STATE FINANCE COMMISSION IN ITS REPORT SUBMITTED TO THE STATE GOVERNMENT

The Sixth State Finance Commission was constituted by the Governor vide Notification No. GoS/Fin/FCD/2021-22/01/273 dated 20th June 2022 to review the financial position of the Panchayat & Municipalities, consisting of a Chairperson and other three members. The Terms of Reference of the Commission was to recommend distribution of fund between the State and the local bodies, the net proceeds of the taxes, duties, tolls and fees leviable by the State; determination of taxes, duties, tolls and fees which may be assigned to or appropriated by local bodies; and the Grants-in-Aid to the local bodies from the Consolidated fund of the State.

The Commission submitted its report to the Government on 20th February 2024 covering all aspects of its mandate. The report of the Commission covers a period of five financial years commencing from April 1st, 2025 to 31st March, 2030.

The summary of the main recommendations of the Commission is in Chapter 8 of the Report and is categorized under Devolution and Grant of Funds to PRIs and ULBs, Strengthening the Capacities and Functioning of the Local Bodies, Incentivizing the Own Source Revenue Mobilization, Corporate Social Responsibility Fund (CSR), Devolution of Functions and Functionaries, and Transparency and Accountability in Functioning of the Local Bodies at Para 1 to 29 of the Report of the Commission.

The Government has carefully examined the main recommendations of the Commission. The action to be taken on these recommendations is detailed below:

Overall Devolution

1. We recommend that 6% of the Net Own Tax Revenue should be devolved every year for the Local Bodies in Sikkim (Para 7.20)

Grants to PRIs and ULBs

2. Grants to the Local Bodies are as follows:

(a) Grants to the Local Bodies: Out of the recommended devolution of 6% of the NOTR, 5% should be devolved directly to the PRIs and the ULBs as Grants.

(b) Grants to Nodal Departments to enable the Local bodies: The remaining 1% of the NOTR should be allocated to different State Level Initiatives to strengthen the functioning of Local Bodies in Sikkim. Out of this 1% of NOTR,

(i) 0.5% should be devolved to the State Capacity Building Fund for providing appropriate capacity building support to the PRIs and ULBs and

(ii) 0.5% should be devolved as the Enabling Grant. The Enabling grant has two components: (i) Office Infrastructure Grant to enable appropriate functioning of the Local bodies, and (ii) the Lumpsum yearly grant (₹60 Lakhs per annum) for establishment and functioning of a permanent SFC cell. The SFC cell will enable effective implementation of the SFC recommendations.

The Government accepts the recommendation. The devolution of grants would be on absolute figures as recommended by the 6th State Finance Commission as in Table 7.3 of the Report.

3. We recommend that every Gram Panchayat and every ULB in Sikkim should receive the Minimum Assured Grant (MAG) every year during 2025-30.

(i) Each Gram Panchayat of Sikkim should receive ₹6 Lakhs per annum as Minimum Assured Grant and

(ii) Each ULB should receive Minimum Assured Grants at the rate of ₹50 Lakhs per ULB per annum.

The Government accepts the recommendation. The Nodal Department for PRIs and ULBs shall prepare detailed guidelines for making expenditure out of the Minimum Assured Grant (MAG). The Local Bodies may also explore and provide fiscal space out of the MAG and share portion of their committed expenditure wherever feasible.

4. The Minimum Assured Grant should be secured first. The divisible pool for devolution to PRIs and the ULBs will be derived after subtracting the Total of MAGs from the recommended Total Devolution to the PRIs and the ULBs.

The Government accepts the recommendation.

5. We recommend that the Divisible Pool should be distributed between the PRIs and the ULBs in ratio of 75% to 25%. The proportion of suggested distribution approximately conforms to the proportion of rural and urban population in Sikkim.

The Government accepts the recommendation.

6. We recommend that out of the total devolution, as obtained in Table 7.4, 70% should be allocated to the Gram Panchayats and 30% to the Zilla Panchayats.

The Government accepts the recommendation.

7. To determine the quantum of devolution to individual local bodies, we recommend 90% weightage for population (2011 Census) and 10% weightage to the geographical area of the Local Body (Gram Panchayat or Zilla Panchayat or Urban Local body).

The Government accepts the recommendation.

8. We recommend that the amount devolved to the individual GPs, the ZPs, and the ULBs after deduction of MAG shall be divided into 80% as Basic Grants and 20% as Performance Grant.

The Government accepts the recommendation.

9. We recommend that Basic Grant to the PRIs and the ULBs should be released in the following manner:

(i) **Number of Instalments:** The Basic Grant should be released to all local bodies in a maximum of two instalments: the first instalment by 30th May and the second instalment by 30th November of each financial year.

(ii) **Criteria for the Release of Basic Grant:**

(a) The Basic Grant for the year 2025-26 should be released to all GPs, ZPs and ULBs without any condition.

(b) From the year 2026-27 to 2029-30, the Basic Grants should be released to only those local bodies who have submitted the utilization certificate for the expenses related to the preceding financial year.

(c) If a local body is not able to submit the said utilization certificate (for the preceding year) during the year, it will lose its basic grant for that year.

(d) The State Government or the nodal departments should not stipulate any additional condition for the release of Basic Grant.

The Government accepts the recommendation. The release of basic grant however is to be made on quarterly basis.

10. Release of the performance grant to the local bodies will depend on their performances in terms of regular audit, improvement in Own Source Revenue (OSR) mobilization and prioritizing expenses for achieving the SDGs in their geographical jurisdictions.

(i) **Number of Instalments:** The performance grant should be released in 3 instalments: (a) The first installment (30% of Performance Grant) by 30th May of the year after showcasing improvement in OSR mobilization, (b) The second installment (50% of the Performance Grant) by 30th September of the year after submitting the statutory audit report and (c) the third and final instalment (20% of the Performance Grant) by 30th January after the nodal department certifies improvements in efforts to achieve the SDG.

(ii) **Criteria for the Release of the Performance Grant:** There are 3 conditions for the release of the performance grant.

(a) Regular Statutory Audit of the Expenses: The Local Body should submit statutory audit report to receive 50% of its allocation for Performance Grant of the preceding year,

(b) The nodal department should assess and provide a certificate of improvement to show that the Local Body is making serious effort to improve its OSR mobilization. Once certified by the nodal department (or a local officer designated by the nodal officer for this purpose), the Local Body will receive 30% of Performance Grant. In order to examine OSR efforts of LBs, the receipt figures of the preceding year shall be compared with the receipt figures of year earlier to the preceding year. For example, in order to release PG for 2025-26, the revenue collection of 2024-25 and 2023-24 shall be compared and examined.

(c) A Local Body (GP/ZP/ULB) should plan and spend resources to achieve one or more of the targeted SDGs. The Nodal Department (or its designated local official) should assess and certify such efforts and expenses to facilitate release of 20% of the Performance Grant to the Local Body. The nodal departments in consultation with SFC Cell shall devise a format for ascertaining improvement in SDGs.

(d) The State Government or the Nodal department should not add any other condition for release of the Performance Grant.

The Government accepts the recommendation.

Strengthening the Capacities and Functioning of the Local Bodies

11. We recommend that 0.5% of the NOTR should be allocated every year for the State Capacity Building Fund. 60% of this fund should be allocated for the Rural Local Bodies and 40% for the Urban Local Bodies. This Fund should be managed by the Rural Development Department for the PRIs and Urban Development for the ULBs.

The Government accepts the recommendation.

12. We recommend allocation (0.5% of NOTR per year minus Operational cost of the SFC Cell per year) for creation and management of the Infrastructure Grant at the State Level.

The Government accepts the recommendation.

13. The Infrastructure Grant should be managed at the State level. It should be distributed between Rural and Urban Local Bodies in a ratio of 75% to 25%. The Rural component should be managed by the Rural Development Department (Directorate of Panchayat) and Urban component by the Urban Development Department (Directorate of Municipalities).

The Government accepts the recommendation.

14. The respective departments must ensure that 75% of the Infrastructure Grant should be allocated as the 'Digitization Grant' for IT infrastructure (hardware and software) and 25% for other office infrastructure, including the office furniture.

The Government accepts the recommendation.

15. We recommend the establishment of a permanent State Finance Commission Cell in the Finance Department, Government of Sikkim to monitor and support the implementation of Recommended for Government Approval recommendations of the SFCs. The SFC Cell should provide required support to the future SFCs. The Commission recommends allocation of a lump-sum amount of ₹60 Lakhs per year for salaries of contractual manpower (if required) and operational/administrative cost of the SFC Cell.

The Government accepts the recommendation. The Finance Commission Division shall continue to function as the State Finance Commission Cell.

16. We recommend continuity of the existing provision of Grants-in-Aid from the Government of Sikkim to the PRIs and the ULBs.

The Government accepts the recommendation. The release of grants would be based on availability of adequate funds.

17. We recommend that honorarium of elected representatives should be raised appropriately to compensate them for their ever-increasing responsibilities.

The Government accepts the recommendation.

Incentivizing the Own Source Revenue Mobilization

18. We recommend revision of the rates of taxes, fees, and levies assigned to the GPs, the ZPs and the ULBs. These rates must be revised by the nodal departments before 30th June 2025. The Secretaries of Rural Development and Urban Development department should ensure compliance.

The Government accepts the recommendation.

19. We recommend that the Rural Development and Urban Development Departments should facilitate contractual relations between the willing SHGs and the willing Local Bodies for collection of Taxes, Fees, ad Levies. In lieu of tax collection, the SHGs should be paid appropriate collection charge as per mutual agreement between the SHGs and the Local Bodies. The nodal departments should prepare a Standard Operating Procedure (SOP) for tax collections ad handover the SOP to the Local Bodies and the SHGs.

The recommendation is not accepted as there are adequate manpower under the Local Bodies.

20. We recommend that the Commissioner, Commercial tax should coordinate with the Secretaries of Rural and Urban Development Departments to evolve an institutional relationship between Commercial Tax Department and the Local Bodies to develop updated data bank for commercial enterprises (in Panchayats and in ULBs). The Commercial Tax department should take the lead in developing an appropriate data format and orient the Local Bodies to collect and update the data on commercial enterprises in their areas.

The Government accepts the recommendation.

21. The Commission agrees with 15th Finance Commission recommendation for increasing the profession tax limit from ₹2500, which has been in force for almost 35 years, to ₹18000 per annum.

The Government accepts the recommendation. The State Government shall take up the matter with Government of India for constitutional amendment as recommended by the 14th and 15th Central Finance Commissions.

22. We recommend that 15% of Net Profession Tax, currently collected by the State, should be shared with the Local Governments. To give a boost to infrastructure development activities in the Local Bodies that would augment their OSR, the Commission recommends the creation of a Capital Investment Fund (CIF) at the State Level. The CIF will be funded at the rate of 15% of Net Professional Tax collection per year. The CIF will be managed by the Finance Department.

The recommendation is not accepted. Most of the requirements of the Local Bodies shall be taken up out of the State Sectoral Allocations.

23. The Commission recommends that RDD should prepare a set of Building Bye Laws to regulate the construction activities in rural areas in consultation with UDD. A defined processes and frame work should be put in place which will also augment the OSR of PRIs through collection of various fees related to the construction activities. For this purpose, the fund under SCBF could be utilized subject to a maximum of ₹7.50 lakhs per year.

The Government accepts the recommendation.

Corporate Social Responsibly Fund (CSR):

24. The Commission recommends that the Commerce and Industries Department should act as the Nodal Department for CSR activities. It should prepare CSR Policy and should formulate the guidelines for mobilizing the CSR Fund.

The Government accepts the recommendation. The Commerce and Industries Department shall take up the matter with the constituted CSR authority.

Devolution of Functions and Functionaries:

25. The 6th SFC recommends that the Secretaries of the Rural Development Department and the Urban Development Department should complete the Activity Mapping based devolution of functions to the PRIs and the ULBs. For this purpose, funds from the State Capacity Building Fund can be used. The Activity Mapping based devolution of functions must be completed before 31st March 2026.

The Government accepts the recommendation.

26. The Commission recommends comprehensive mapping of staffing at every GP, ZP and ULB level. The nodal departments should prepare a standard format to delineate the personal profiles, exclusive roles and responsibilities and salaries of all employees working with the GPSs, ZPs and ULBs. Once this data is generated, nodal departments should review the staffing arrangements and if needed be, some of the staff should be re-located. The Local Body wise list about the above details of each employee should be uploaded on the website of the nodal department.

The Government accepts the recommendation.

27. The 6th SFC urges the Rural Development Department and the Urban Development Department to provide a lump-sum one time IEC- grant for printing and dissemination of the copies of ATR among all GPUs, ZPs, ULBs, SIRD and NGOs. People should be made aware after these issues immediately after the presentation of the ATR in the State Legislature. That may be much before the 6th SFC recommendation period starts. The Commission recommends using the already existing fund under the State Capacity Building Fund under 5th SFC Grant for this purpose. The ATR booklets in Nepali and English should be disseminated within 3 months of acceptance of the ATR in the State Legislature. The Finance Department

shall be responsible to pool the resources from RDD and UDD in the ratio of 75:25% for printing and dissemination of the booklets.

The Government accepts the recommendation.

Transparency and Accountability in Functioning of the Local Bodies:

The Statutory Audit:

28. The Commission recommends that the Directorate of Local Fund Audit should further strengthen the statutory audit process by ensuring the audit of all Local Bodies in Sikkim. The DLFA should take lead for each of the following recommendations.

(i) The Local Governments should put their accounts online. If needed be, they could seek from the Digitization Grant, proposed by this Commission.

(ii) The Audits conducted by CAG on department works in a Local Body area and audits conducted by the DLFA on accounts of the same Local Body should be integrated and made available in public domain.

The Government accepts the recommendation.

Social Audit:

29. All local bodies should voluntarily undertake the social audit of expenses incurred by them during a financial year. The social audit strengthens the participation of people and catalyzes the enhanced support to efforts of local bodies in delivering the required services.

The Government accepts the recommendation.

P. S. Tamang (Golay)

Chief Minister -cum- Minister-In-Charge

Finance Department