

PAKISTAN: REVENUE MOBILIZATION MEASURES & CURRENT TAX ISSUES

By

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*IMF – JAPAN HIGH LEVEL TAX CONFERENCE FOR ASIAN
AND PACIFIC COUNTRIES*



Scheme of Presentation

- A. Over-Arching Structure of Tax Administration
 - B. Recent Reforms Introduced
 - C. Major Tax Issues
 - D. Way Forward / Proposed Reforms
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A. Over-Arching Structure of Tax Administration



Pakistan: Federal Taxes

- Income Tax except Agricultural Income Tax
- Sales Tax (VAT)
- Federal Excise Duty
- Customs Duty
- Petroleum levy

Pakistan: Provincial Taxes

- Agricultural Income Tax
- Capital Value Tax
- Motor Vehicle Tax
- Land Tax
- Property Tax
- Cesses like Cotton cess, Sugar Cane cess
- Excises on Hotels, Cinemas, Etc.




Federal Board of Revenue

- Apex Body for collection of Federal Taxes
- Collects 90% of Federal Revenue
- Formulation and administration of fiscal policies, levy and collection of taxes



Federal Board of Revenue-- Continued

- Resolving tax related disputes-ADRC
 - Conclude Double Taxation and Customs related Agreements with other Countries
 - Interaction with different Ministries and executive authorities of the State.
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Chairman/Secretary Revenue Division

Member
Inland
Revenue

Member
Customs

Member
Administ
ration

Member
Legal

Member
FATE

Member
SP&S

Member
Taxpayer
Audit

Member
E&C

Federal Taxes - Administered by FBR


- Inland Taxes
- Income Tax
- Sales Tax
- Federal Excise Duty

- Cross Border Taxes
- Customs Duty



FBR Vision


“To be a modern, progressive, effective and credible organization for optimizing revenue by providing quality service and promoting compliance with tax laws.”






FBR Mission

Enhance the capability of the tax system to collect due taxes through application of modern techniques, providing taxpayer assistance and by creating a motivated, dedicated, professional workforce





FBR Values

- Integrity
 - Teamwork
 - Fairness
 - Professionalism
 - Courtesy
 - Transparency
- 




B. Recent Tax Reforms Introduced

Need For Reforms

- Low Tax : GDP Ratio
- Narrow Tax base
- Outdated Processes
- Corruption & Administrative excesses
- Complexity of tax laws and arbitrariness in their application
- Relationship between taxpayer and tax collector largely adversarial



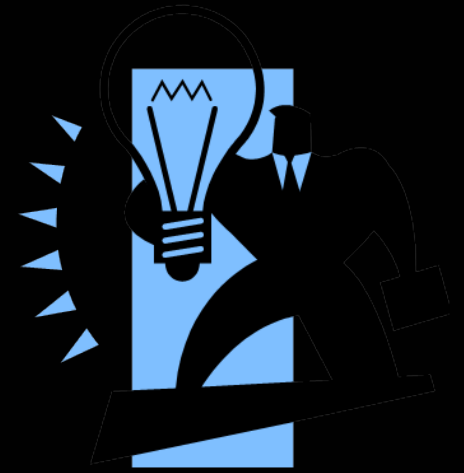
Need for Reforms--Continued

- Lack of transparency
 - Inadequate HR Skills and Capabilities
 - Management of human resources severely deficient
 - Un-documented economy
 - Lack of automation
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FBR Tax Reform Program

Objectives:

- To increase revenue
- To widen taxpayers base
- To simplify tax laws
- Taxpayer friendly environment
- To develop an honest and efficient tax administration



Strategy

■ Policy Reforms

- ✿ Simplification of Laws
- ✿ Reducing reliance on withholding taxes
- ✿ Elimination of Exemptions
- ✿ Effective Dispute Resolution Mechanism

■ Procedural Reforms

- ✿ Universal Self Assessment
- ✿ Reengineering of Processes
- ✿ Automation

■ Administrative Reforms

- ✿ Organisation of FBR on Functional Lines
- ✿ Establishment of LTUs/RTOs
- ✿ Reformed HRM Process

Policy Reform

Simple Laws & Procedures

- (i) New simplified Income Tax Law
- (ii) New Income Tax Rules
- (iii) Record Keeping Requirements
- (iv) Revised Sales Tax Refund Rules
- (v) Tax Rates and Tariff reduction and rationalization.
- (vi) Effective Dispute Resolution Mechanism

Procedural Reforms

Universal Self Assessment

- All income tax returns filed are treated as "assessment orders"
- No Returns are audited unless selected by the System or on the basis of specific information
- Contact between tax officials and Taxpayers minimized substantially.

Procedural Reforms--Continued

- Record-keeping/maintenance upgraded through massive IT injection
- Electronic Filing rendered mandatory for all corporate taxpayers, AOPs, refund claimants, salaried individuals with income exceeding Rs. 500,000, Income Tax withholding statements and sales tax returns

Administrative Reforms

New Organizational Structure

- ❑ Creation of **Inland Revenue Service** to handle all inland taxes i.e. Income Tax, General Sales Tax, & Federal Excise Duty
- ❑ Re-structuring the top hierarchical structure of FBR
- ❑ Induction of support & functional members

Administrative Reforms--Continued

- ❑ Re-organization of the entire tax administration on functional lines, consisting of 3 Large Taxpayers Units, and 18 Regional Tax Offices across the country
- ❑ Taxpayer friendly environment
- ❑ Minimizing contact between taxpayer and tax collector

Reformed Functional Structure- Field Formations

1
Taxpayer
Facilitation

2
Information
Processing

3
Audit

4
Enforcement
Collection

5
Legal

6
Information
Technology

7
HRM

8
Internal
Control

Key Elements of LTUs

- ▶ Integration of all Federal inland taxes i.e. Income Tax, Sales Tax & Federal Excise Duty
- ▶ LTUs at Karachi, Lahore, & Islamabad deal with around 1500 cases of designated large Corporate Taxpayers
- ▶ LTUs contribute an estimated revenue of around 70% of total inland revenue annually
- ▶ Open floor layout & and one-desk operation for the taxpayer in respect of all inland taxes

The Collection Effort: TAX-TO-GDP RATIO OF PAKISTAN (2000-01 To 2010-11)

(% of GDP)

Year	Direct Taxes	Indirect Taxes	Surcharge /Levy*	Total Taxes	FBR Revenue	Share of Direct Taxes
2000-01	2.99	6.89	0.73	10.61	9.42	28.18
2001-02	3.20	6.41	1.23	10.83	9.11	29.54
2002-03	3.17	6.94	1.41	11.53	9.57	27.49
2003-04	2.92	6.84	1.09	10.84	9.25	26.94
2004-05	2.72	7.01	0.41	10.14	9.05	26.82
2005-06	2.82	7.06	0.67	10.54	9.36	26.75
2006-07	3.85	6.41	0.74	11.00	9.76	35.00
2007-08	3.79	6.47	0.34	10.60	9.83	35.75
2008-09	3.46	6.00	0.99	10.44	9.08	33.14
2009-10	3.66	5.83	0.90	10.39	9.05	35.23
2010-11	3.33	5.28	0.24	8.85	8.6	38.7

* On petroleum products and natural gas

Major Tax Issues

- Low Tax/GDP Ratio
 - Role of Lobbies
 - Sectoral Imbalances
- Undocumented Economy
 - Narrow Tax base

TAX-TO-GDP RATIO! WHY LOW?

- Tax-to-GDP ratio alarmingly low at 9% of GDP
- Due to Large Tax Exemptions
 - ~ on Capital Gains on Properties
 - ~ immunity on foreign remittances
 - ~ Withdrawal of Wealth Tax
 - ~ Withdrawal of Excise Duties on Consumer Durables
- Due to Reduction in Tax Rates
 - ~ Maximum Tariffs on Imports down from 35% to 25%
 - ~ Corporate and Personal Income Tax rates brought down

TAX-TO-GDP RATIO! WHY LOW?

- Due to Slackening of Fiscal Effort
 - ~ Self-Assessment Scheme without Audits in Income Tax and Sales Tax
 - ~ Number of Income Tax returns filed at only **2.2** million (one per 75 persons)
 - ~ Provincial governments continue to slacken fiscal effort due to high dependence on transfers
- Due to high variability in revenue from Surcharges

Role of Lobbies

- There are a number of formal and informal lobbies in Pakistan, which influence policy formulation including tax reforms.
- Some of the most influential lobbies include:
 - Agriculturists (large land holders, strong presence in parliament)
 - Business Lobby (Chambers of Commerce and Industries, All Pakistan Textile Mills Association, Overseas Chamber of Commerce, Associations of wholesale and retail traders)
 - Banking sector
 - Stock Markets

Some examples of the influence on tax policy are given on next slide:

Role of Lobbies: (Continued.)

- Agricultural income continues to remain exempted from tax
 - though provinces have levied agricultural income tax but the collection is negligible and the tax is mainly based on land holding and not on agricultural income
- Several efforts from government for greater documentation of economy have failed due to strong resistance from business lobby. For example, survey for the documentation of economy launched by the government in 2000 was strongly opposed and resisted by the business sector
- Banking sector made huge profits during last decade while tax rate for banking companies were brought down from 50% in 2002 to 35% in 2007

Role of Lobbies: (Continued.)

- The Stock Exchange lobby resisted successfully to avoid taxation on capital gains until 2010-11. Capital Gains Tax could not be levied at the time when stock markets were flourishing.
- Capital Gains Tax on real estate could not be levied due to strong resistance from the concerned interest groups
- VAT could not be implemented. Introduction of VAT was delayed due to strong opposition from business community as well as from political parties
 - GST could not be extended to wholesale trade and services due to strong resistance from trading community.

IMBALANCED SECTORAL DISTRIBUTION OF THE TAX BURDEN 2009-10

	Share in GDP	Share in Tax Revenue	Ratio
Agriculture	22.5	1.2	0.053
Industry	23.5	70.4	2.995
Services (and others)	54.0	28.4	0.526
Total	100.0	100.0	1.000

Source: Ministry of Finance, Fiscal Policy Statement.



Outcome of Reforms

- Automated processes (ERS, STARR, SMART, VERITAX, RECAP etc.)
- Reduced dependence on WHT
- Increasing Revenues
- Electronic Filing
- Infrastructure improvement
- Gaining Stakeholder's respect
- Transparency and reduction in corruption



Way Forward / Proposed Reforms

RECENT REFORMS (2008-09 Onwards)

Petroleum Levy

Introduction of Fixed Levy on Petroleum Products with large revenue yield of upto 1% of GDP

Sales Tax

- Phasing out of exemptions and zero-rating of domestic sales

Rationalization of rate of sales tax

Excise Duty

- Abolition of Across-the-Board Special Excise Duty at 1% through Finance Act 2011

RECENT REFORMS (2008-09 ONWARDS)-- (Continued)

Direct Taxes

- Taxation of (Short Term) Capital Gains on Shares
- Extension of the Withholding Tax Net (Bank Cash Withdrawals, Air Travel)
- Introduction of Minimum Tax on Turnover (@ 1%)
- Random Ballot for Audit with Outsourcing to private Accounting Firms
- Detection of New Tax Payers through third party data

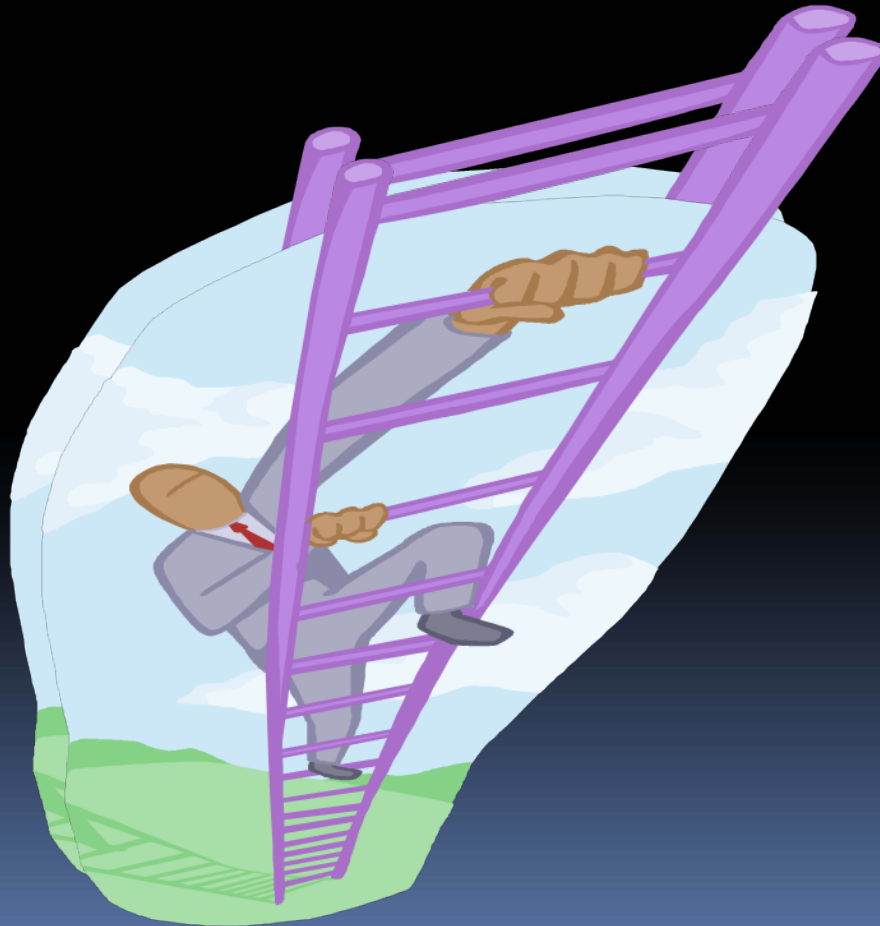
PROPOSED REFORMS

- **Introduction of Comprehensive VAT (or RGST) with the following objectives**
 1. To broaden tax base and reduce tax rate to 15%
 2. Elimination of exemptions on goods, except basic foodstuffs and life-saving drugs, could generate 0.25% of GDP
 3. Enhanced coverage of services (excluding education and health) could increase tax revenues in the medium term by 1.5 % of GDP
 4. Reduction in tax burden on industry

PROPOSED REFORMS--Continued

- Introduction delayed due to
 - ~ issue of collection by provinces of the sales tax on services
 - ~ lobbies (especially the trading community)

CURRENT STATUS





Thanks