INTERNATIONAL THE NEWS

2nd June, 2019

Budget and taxation

The budget for fiscal year 2019-20, the first of government of Pakistan Tehreek-i-Insaf (PTI), is to be announced on June 11, 2019. Every year before the announcement of annual federal budget — which has become an official ritual — plethora of tax proposals are received by the Federal Board of Revenue (FBR) from trade and professional bodies, tax bars and industry's representatives.

For the last many years, FBR itself has been soliciting budget proposals by placing detailed guidelines on its website. However, each year the Finance Bill proves to be a hopeless document — containing meaningless amendments in tax codes, imposing more and more burden on the existing taxpayers, especially through cumbersome withholding of taxes — with no policy shift to promote business, facilitate existing taxpayers and bring untaxed sectors/persons in the tax net.

Taxation in Pakistan is oppressive, lopsided and counterproductive — there is only 2 percent of corporatisation of total business. By heavily taxing corporate sector vis-à-vis firms and association of persons, FBR has been encouraging undocumented sector. In 2017, we had about 95,000 companies registered with Securities & Exchange Commission of Pakistan (SECP), out of which return filers were less than 40,000 as per Tax Directory for tax year 2017. The annual addition in corporate sector is less than 10,000, whereas in countries like Malaysia and Turkey having much less population than Pakistan, the number is much higher with impressive annual growth. If we want to move from undocumented economy to transparent corporatised sector to achieve rapid growth, the government must reduce corporate rates to 20 percent and tax firms and other non-corporate business entities at a higher rate of 30 percent.

Taxation should serve as a catalyst for industrial/business expansion and economic growth. In Pakistan, the ill-directed, illogical, regressive and unfair tax regulations are causing a dampening effect on the industrial and business growth. The sole stress on meeting revenue targets, without evaluating its impact on the economy, has crippled our trade and industry. Had the successive governments concentrated on economic growth and industrial expansion, there would have been consequential substantial rise in taxes. It is impossible to enhance revenues with stagnation in economy, and over-taxing an ailing economy, as has been done in Pakistan, has destroyed our investment climate.

The Pakistani state does not need any borrowing, if all the citizens, especially the rich, are taxed according to the established norms of democratic dispensation of justice. The dire need in today's Pakistan is to reduce inequalities through a policy of redistribution of income and wealth by taxing the rich and mighty. Higher rates of income taxes, capital transfer taxes and wealth taxes are some means adopted for achieving these ends in all democratic countries. In Pakistan, there has been a gradual shift from equitable to highly inequitable taxes since 1977.

The shift from removing inequalities through taxes to presumptive and easily collectable withholding and indirect taxes has destroyed the fundamental principle of horizontal and vertical equity. The equity principle can be held to be satisfied when the overall classification of individuals into categories is reasonable and broad enough to contain many individuals within each category and there is equality of treatment within each category.

For social justice and pro-people economic development, the government, through tax policies, must discourage certain activities, which are considered undesirable — for example, excise duties on liquor and tobacco and special excise on luxury and semi-luxury goods. Such measures act as deterrents in avoiding a spill-over of these items and creating disturbance in the society as a consequence. For achieving the cherished goal of a self-reliant economy and prosperous state, we need to take the following steps through the ability of the taxation system to influence allocation of resources:

Transferring resources from the private sector to the government to finance public investment programme;

Directing private investment into desired channels (rapid industrialisation) through heavy taxation of collossal income earned by absentee landlords-cum-pirs from orchards and exploitation of labour of their mureeds (blind followers/tillers);

Influencing relative factor prices for enhanced use of labour and economising the use of capital and foreign exchange.

Increase the level of savings and capital formation by enhancing investment resources for economic development. In Pakistan, we find a reversal of this principle. Recent years have experienced flight of capital, closure of huge industries and recession in the trade market. Lack of consistency in the tax policies have forced the business community to move towards safer havens depriving the country of invaluable capital. Similarly, foreign investors feel shy to make use of the tremendous Pakistani talent that goes to waste for lack of proper funding.

Protect local industries from foreign competition through the use of import duties, turnover taxes/VAT and excise. This has the effect of transferring a certain amount of demand from imported goods to domestically produced goods. Pakistan is one of those very fortunate countries of the world that has an abundance of resources and a climate that is fit for simply any activity throughout the year. But unfortunately due to wrong policies, our dependence on imported products has been hit with an upward surge in the last two decades. Due to the introduction of harsh tax measures and higher cost of doing business, our industrial sector has suffered so badly that instead of being able to export goods, we are forced to import in order to cater for the demands of the nation.

Stabilise national income by using taxation as an instrument of demand management. Taxation levels could be used to eliminate inflationary or deflationary gap in the economy. Taxation reduces the effect of the multiplier and so can be used to dampen upswings in trade cycle.

FBR and provincial tax authorities are not collecting taxes diligently. There exists huge tax gaps at all levels. According to data prepared by National Database & Registration Authority (NADRA) there are 3.5 million individuals (ultra-rich) having income levels attracting annual income tax of at least Rs1,800 billion. If we add another 1.5 million falling under different income brackets (from Rs1.5 million to 6 million per year) the estimated collection should not be less than Rs1,200 billion from them.

In the case of corporate bodies and other non-individual taxpayers, collection should be around Rs1000 billion. This means that total income tax collection should not be less than Rs4,000 billion.

According to FBR's Year Book 2017-18, total direct tax collection in last fiscal year [2017-18] was only Rs1536.6 billion which confirms failure of FBR to tap the actual tax potential. Undoubtedly, the rich, despite having substantial undeclared, untaxed wealth, thrive on amnesties and immunities. This is our real dilemma. Elites are not paying taxes due from them.

Tax collection under indirect taxes (sales tax, customs and excise) is also low and from few items — gap of nearly 75 percent exists. In fiscal year 2017-18, total collection of sales tax (imports) was Rs814.6 billion, out of which share of petroleum products alone was Rs264 billion (32.4 percent). In sales tax (domestic) total collection was Rs676.6 billion out of which share of petroleum products was Rs283 billion (41.8 percent). It is a sad fact that only 208,243 persons were registered under Sales Tax Act, 1990 by FBR as on June 30, 2018, out of which only 43, 838 had paid some tax and rest were either NIL/NUL filers.

With the present rotten, inefficient, outdated and corrupt tax system, FBR cannot collect taxes as per its real potential — even proposed target of Rs5500 billion for next fiscal year 2019-20 would be an uphill task. We need to shift to low rate, broad-based taxation that is simple, fair and predictable with strong enforcement mechanism: 10 percent tax on individuals (with alternate minimum of 2.5 percent on net wealth exceeding Rs20 million), 20 percent on companies and other entities, and 8 percent sales tax on all goods (for exporters 0 percent tax). This will fetch more than double the tax we are presently collecting (Rs4 trillion as income tax, Rs3 trillion as sales tax and Rs1 trillion from customs by levying 5 percent duty on all items and no other tax collection at source).

For prompting exports, the exporters importing or buying raw material locally may get refund by State Bank of Pakistan once export proceeds are realised through banking channels.

<u>Dr Ikramul Haq, Huzaima Bukhari</u>