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FBR estimates tax gap of ST, IT at 65pc, 57pc respectively

ISLAMABAD: Federal Board of Revenue (FBR) has preliminary estimated tax gap of sales tax and income tax at 65 percent and 57 percent respectively, according to the latest data compiled by FBR.

Sources told Business Recorder that the tax gap of sales tax and income tax is different in terms of percentage. The FBR has initially worked out the tax gap of 65 percent in sales tax on national level. The estimated tax gap of income tax has been calculated at 57 percent. The estimated figures of tax gap have been worked out by the FBR on the basis of sectoral analysis of different sectors including sugar, cement and steel, they added.

The FBR is also in the process on conducting tax-gap analysis in Pakistan, officials added.

A leading tax expert said that most of the retail sector, wholesalers, manufactures and small industries are operating out of the sales tax net which is one of the main reasons of gap between the actual potential and collection of sales tax in Pakistan. On the income tax side, wide range of exemptions under Second Schedule of the Income Tax Ordinance 2001 is one of the reasons of gap between the potential of income tax as compared to actual direct taxes collection, he added.

The total tax exemptions and concessions to various sectors, lobbies/groups, and investors had cost the government Rs 540.98 billion during the fiscal year 2017-18 against Rs 415.751 billion in 2016-17, reflecting an increase of Rs 125.229 billion.

Tax expenditure for 2017-18 was worked out at Rs 540.98 billion. The cost of tax exemptions of sales tax, income tax and customs duty increased by Rs 124.249 billion in 2017-18 when compared with 2016-17.

The cost of sales tax exemptions totalled at Rs 281.05 billion in 2017-18 against Rs 250.06 billion in 2016-17; income tax, Rs 61.78 billion against Rs 14.005 billion and cost of customs duty exemptions was Rs 198.15 billion against Rs 151.686 billion in 2016-17.

It is important to mention that the Tax Reform Commission (TRC) in its last report said that the excess of tax revenue potential over actual tax revenue is called the tax gap.

It said that the potential tax revenue is the theoretical tax liability as per the tax law(s), the tax rate structure, and at full compliance. Tax gaps can be broken up as policy gap, compliance gap, and administrative efficiency gap.

In Pakistan, in spite of the existence of huge compliance and administrative gaps, hardly any official attempt has been made to measure the tax gap either at the federal government level or at the level of provinces for any of the major direct or indirect taxes. Revenue targets are what the governments fix based on changes in tax law and assuming better compliance and administrative efficiencies. Revenue targets are often fixed above revenue forecasts to reduce the compliance gap and meet the requirements in some cases of donors and aid partners. Linking administrative efficiency to meeting or missing revenue targets has in Pakistan led to highly distorted decisions regarding penalising or rewarding tax payers and the tax officials.

Sectorial analysis is one of the best methods to determine the collectable tax from each sector and then looking into the gaps and reasons of the short collections, the TRC said.

The revenue forecast is the forecasting of tax revenue for a given tax policy structure. Revenue target in theory can be equal to or more than the revenue forecast as it may attempt to cover part of the tax gap, which could be due a number of factors via compliance, policy, and administrative efficiency gaps.

Revenue potential is in theory higher than both the revenue forecast and the revenue target as it projects and estimates potential tax revenue after fully bridging the tax gap, and assuming 100 per cent compliance, policy benchmarked to the best in similarly placed environment, and administrative efficiency at highest attainable level, the TRC report added.

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