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Foreign-funded tax reforms

Fiscal consolidation should be as growth-friendly as possible. In general, tax base-broadening reforms are identified as growth-oriented reforms. To the extent that they reduce distortions to economic decisions on work, saving, investment and consumption, they should increase output and improve social welfare—Choosing a Broad Base–Low Rate Approach to Taxation, OECD Tax Policy Studies No. 19.

The Prime Minister of Pakistan on October 3, 2019, in a meeting, approved some important foreign-funded tax reforms—US$ 400 million World Bank's 'Pakistan Raises Revenue Project'. Now, the Federal Government, in order to expedite the process for restructuring the entire tax machinery and introduce centralised collection of general sales tax (GST) on services and goods, has constituted a seven-member Steering Committee under the supervision of Chairman of Federal Board of Revenue (FBR) Syed Muhammad Shabbar Zaidi. In addition to it, four sub-committees have also been constituted. The committees are asked to examine the future status of the tax authority under the Federal Government as attached department or semi-autonomous body or completely autonomous. Other issues which the committees will look into relate to recruitment, retention, capacity, remuneration, financial autonomy, organisational structure and work process.

The salient features of the three-year-long World Bank's 'Pakistan Raises Revenue Project as reported in the Press are:

* "Nation-wide tax assessment and documentation drive from November 30, 2019. The drive has been planned to be completed within two years and detailed proposals will be submitted later on. It will aim at ascertaining untapped segments including businesses, real estate and industries.

* Tax reforms must not create a choking effect for economy and correct taxation measures be taken with prompt implementation instead of entanglement in extended impasses.

* Launching a nation-wide survey of immovable property, starting from Islamabad industrial area this month. The nation-wide survey of immovable properties should be undertaken and completed over the next two years. It has been decided to involve Ministry of Interior and Ministry of Defence for completing the immovable property survey.

* Considering a proposal from a Chinese company for a digital land survey. In order to assess the wealth parked in the real estate sector a nationwide survey along with geo-tagging was imperative. A Chinese firm has offered to conduct the digital land survey but its proposal remains pending for the last two years.

* FBR's broadening of tax base (BTB) zones have completed mapping of major shopping malls and plazas in the main cities but it was not clear whether the authorities used this information to enhance revenue collection.

* The Prime Minister asked to fully implement the value-added tax (VAT) regime for all business segments over the next three years. The deadline for the full VAT implementation is June 2022 for

the FBR. The VAT will be progressively implemented across various segments commencing with Third Schedule products and gradually absorbing the complex value chain products. During the last stint of Dr Abdul Hafeez Shaikh as Finance Minister (2010-2012), the then government had tried to implement a VAT system under an IMF programme. But the Pakistan People's Party (PPP) government had to retreat after opposition from the business community.

* The PM approved to enact the VAT-related legislation and formulate rules on need basis. FBR will undertake surveys to assess particular business and industrial sectors to find out the revenue potential of VAT of particular industrial sectors.

* Adopting the computerized national Identity card (CNIC) as common identifier by June 2020 –a thing that FBR is trying to implement for the last many years without any success.

* Formulation of comprehensive proposal for establishing the Pakistan Revenue Authority (PRA) by June next year.

* The Ministry was also directed to make plans for centralised collection of General Sales Tax (GST) on goods and services by the PRA—that cannot be implemented without the support of the provinces.

* Restructuring of the FBR including appointing a Deputy Chairman for Inland Revenue and Deputy Chairman Customs. The restructuring and new appointments will be made before end of November, 2019. In the interim period, the FBR headquarters will be restructured on functional lines by segregating Inland Revenue and Custom Operations into North and South Zones.

* On the customs side, there will be two members for customs North and South operations, member transit trade and export and member legal and accounting.

* There will be four directors general in grade-21 looking after exports and transit trade, strategic planning, investigation and prosecution, valuations, input-output coefficients.

* On the Inland Revenue side, there will be member IR operations north and south, member taxpayers' audit and member legal and accounting.

* There will be six directors general looking after investigations, strategic business analysis, international tax compliance, reforms & automation, VAT and broadening of the tax base and amnesty regime.

* The approved restructuring includes a Tax Policy Board that will be assisted by member human resource management and administration, member strategic planning, chief management information system, and member facilitation and taxpayers' education.

* There will be six director generals in addition to four members. The PM approved the post of chief management officer and also to initiate the process of total automation of the income tax architecture of the FBR.

* In the Revenue Division, there will be secretary revenue, additional secretary customs policy, additional secretary income tax policy, additional secretary sales tax and federal excise and additional secretary international conventions.

* The prime minister also approved to restructure the existing regional tax offices, large taxpayers units, customs collectorates and district tax facilitation centres on fast track basis.

* It was also conditionally approved to enhance the FBR's collection charges from 0.65% of the total collection to 1% over a period of three to five years subject to increase in collection. The first review of collection charges will be undertaken after June next year".

The important question is: Will the above actions, if implemented successfully, bring fiscal consolidation that is one of the daunting challenges faced by Pakistan? In fiscal year 2018-19, total payment, as budget documents, on account of debt servicing was Rs 1,987 billion against the budgeted figure of Rs 1,620 billion. Allocation for the current fiscal year is Rs 2,891 billion, 78 percent higher than last year! If FBR achieves reduced target of Rs 5,503 billion (original fixed in budget was Rs 5,555 billion and after request from government, IMF agreed for reduction to the tune of Rs 233 billion against the demand of Rs 300 billion), after transfer to provinces under 7th National Finance Commission (NFC) Award of Rs 3,200 billion, net tax collection available to the federal government will be Rs billion 2,300 billion, which is short by Rs 591 billion of debt servicing of Rs 2,891 billion!! This shows the gravity of the fiscal crisis faced by Pakistan as aptly highlighted by Prime Minister during his meeting with Grade 22 and 21 officers of the FBR.

Though the Prime Minister admitted in his speech that FBR lacks people's confidence as well as there is huge lack of trust between the State and citizens regarding prudent spending of taxes collected, he failed to mention the massive revenue loss caused by his own and earlier regimes through money whitening schemes. The man he selected for reforming FBR was the most zealous proponent of the asset whitening scheme that was opposed by many in the federal cabinet. Now the Prime Minister wants a new tax agency to be established by the same person who wants to hold back the idea after angry protest by FBR's top notches. Imran Khan conceded to their pressure and asked them to suggest reforms! For such occasions, great Urdu poet Mir Taqi Mir very correctly said: Mir kya sada hain, beemar huay jis ke subub; Usi attar kay londay say dawa laity hain (What a simple soul is Mir that he seeks medication from the healer's boy, who is the cause of his ailment).

Successive governments have failed to end harmful tax policies and reduce wasteful expenses. No serious effort has been made by any government, military and civilian alike, to broaden the tax base through lowering of rates and effective enforcement. The decision of Government of Pakistan Tehreek-e-Insaf (PTI) to take $400 million or Rs. 56 billion loan from the World Bank was criticised in 'Tax reforms with borrowed refunds', Business Recorder, February 8, 2019. It was highlighted in the article that the foreign-funded reforms package in the past to fix the country's ailing tax system miserably failed to yield the desired results.

The World Bank estimates Pakistan's tax gap at 10% of the GDP or Rs. 3.8 trillion. Our current tax-to-GDP ratio is 12.6% that according to the World Bank should be 23%. Among the 13 federal countries, Pakistan is second to last in the performance of provincial governments on tax collection. While the services sector accounts for 56% of GDP, it contributes only 0.5% of the GDP in taxes and about 11% in sales tax collection. The World Bank analysis is that Pakistan has a complex tax system of over 70 unique taxes and at least 37 government agencies administering these taxes. Through a $400 million lending, the World Bank is keen to help Pakistan develop a long-term tax policy. But there are concerns that the money may be spent on building new offices and procuring furniture as was done in the last programme. The World Bank is also pushing for decisively moving towards a functional organisational structure to overcome current fragmentation and inefficiencies in the FBR. It is of the view that the functional system permits standardisation of similar processes across all taxes and facilitates simplification of procedures.

It may be recalled that the World Bank in 2004 extended to Pakistan $125.9 million, including IDA credit of $102.9 million and a UK DFID grant of $23 million, for Tax Administration Reform Project (TARP). The objective of TARP was to improve "the integrity and fairness of tax administration by improving organizational efficiency and effectiveness of the revenue administration". It was a national shame that for improving the integrity and fairness of tax administration we agreed to such heavy external borrowing/grant.

Tragically, tax-to-GDP ratio in 2012, the last year of extended World Bank funded TARP, dipped to 8.2% from 10.6% in 2005 when the programme started! The World Bank in its report, "Implementation, Completion and Result Report" on TARP observed that "the current narrow-base of general sales tax (GST) in Pakistan remained almost entirely unchanged throughout 2005-2012, despite efforts to overhaul the indirect taxation structure by introducing a reformed GST featuring few exemptions and wide coverage of goods and services".

The report while highlighting the poor performance of FBR noted that "different from other sources of tax revenue in Pakistan, administration of GST entails a full-fledged operation of major FBR functionalities, including: registration, monthly tax return processing, collection, refunds, audit and enforcement. GST operation also integrates joint effort from both internal revenue administration and customs since GST import tax is collected at the borders and zero-rating is targeted for export operations, besides other activities".

For evaluating FBR's overall performance during the 5-year-long TARP, the World Bank used GST administration as an indicator. The result compiled is highly disappointing—GST productivity turned out to be only 23 percent, compared to an average ratio of 34 percent worldwide. According to the World Bank, "the estimation covering the project life reflected an overall decreasing trend during 2005-06 to 2010-11 suggesting feeble tax administration efforts throughout the reform period". Shockingly, during the reform implementation period, there was "a declining performance in both tax policy and administration". Even during the economic boom (2005-08) GST productivity index "showed a rather declining trend despite modest buoyancy gains in FBR revenue collection, signaling relatively poor tax administration performance amidst relatively favorable overall economic conditions", says World Bank.

The World Bank concluded that "during the economic crisis period and subsequent years (2008-11), GST productivity index declined at a higher rate compared to FBR tax-GDP despite a swift turnaround in project implementation and concomitant positive trends in some outputs by the last two years of project life". The report while pointing out weak compliance levels, lackluster results in reform implementation, especially those related to short term actions aimed at curbing evasion through more effective enforcement actions by the final year of project implementation, noted "performance from 2008 onwards, far from the project's objectives envisioned at the outset". This is the sordid story of tax reforms in Pakistan even when enormous funds—over 100 million US$—and best professional advice was available.

FBR ruthlessly wasted borrowed funds of millions of dollars—Pakistan with tax-to-GDP ratio of 8.5% was at 155th among 179 nations at the end of TARP in 2011. According to reports, tax-to-GDP ratio further deteriorated to 8.2% during the financial year 2011-12. Not only did FBR fail to implement tax reforms, there were unprecedented increase in tax frauds that were not taken into account by the World Bank in its report (Acts of deceit and frauds, Business Recorder, July 31, 2011). The World Bank in its report did not mention certain 'mafia-like' operations of FBR.

Pakistan is facing multiple challenges on the economic front: reckless borrowing by successive governments for meeting its day-to-day expenses, lack of resources for rapid infra-structure improvements, trade deficits, fiscal deficit, inflation, balance of payments, and what not. In these challenging times, we want more loans, even from World Bank to reform our tax system! Faced with grave challenges to combat terrorism, money laundering operations funding the militants and criminals, and the problem of ever-growing black money, which according to independent experts is about three times of the documented economy, our political leadership and tax officials opted for yet another foreign-funded tax reforms.

In the name of tax reforms since 2004, FBR has been imposing more and more obligations on the citizens of Pakistan. The nation has been burdened with a number of cumbersome tax terms and over 70 withholding taxes without any compensation. Now even the PTI Government, contrary to its claims of finding indigenous solutions, wants World Bank-funded reforms (sic) which is highly lamentable. What will happen—the same old modus operandi of hiring hand-picked foreign and local consultants to further destroy tax policy and administration?

The problem of Pakistan is that its tax system is not equitable. The burden of taxes is already less on the rich and more on the poor. In the face of this reality, the Government of PTI, like its predecessors, is resorting to more regressive taxation. Our potential is much higher than targets achieved by FBR.

In all democratic countries special house committees are formed by elected parliaments for conducting tax reform exercises. Here in Pakistan we are doing it through bureaucratic structures, which are outdated, inefficient, incompetent and corrupt. This is like asking the troublemakers to do trouble-shooting.

Pakistan's tragedy is that things are always being done by people who are not eligible for that job. Military governments make constitutional changes and tax reforms are undertaken by tax bureaucrats, who have a proven track record of inefficiency, incompetence and corrupt practices.

Our present tax revenue potential, if monstrous black economy is dealt with an iron hand, is not less than US $ 60 billion (Indonesia collected US$ 38 billion in 2018) provided that the existing tax base is made wider and equitable, black economy is discouraged, tax machinery is completely overhauled and exemptions and concessions available to some privileged sections of society are withdrawn. We wrote in 'Tax reforms with borrowed refunds', Business Recorder, February 8, 2019 but no heed is paid by Prime Minister and his team, rather he has opted for complete subjugation:

To achieve these goals we do not need any loan from the World Bank or other donors. If we take money from them then we are bound to follow their conditions, as beggars cannot be choosers. Many local experts can do the reform work either voluntarily or at much less cost than what we intend to waste on foreign consultants at the commands of World Bank and others.

It is an undisputed fact that FBR has perpetually and miserably failed to tap the real tax potential despite imposing all kinds of oppressive taxes, including many introduced by the present government through the Finance Act, 2019 [Taxes, prosperity and welfare, Business Recorder, August 9, 2019, Rationalising tax system, Business Recorder, July 19, 2019 and The Money Bill, Business Recorder, July 5, 2019].

It is strange that in the three-year plan approved by Prime Minister nothing is available about simplification of taxes. Whenever there is a demand or debate about simplification of tax codes, ease of compliance, facilitation of taxpayers and improvement in tax administration, the worst resistance comes from top notches of FBR, who think they are the ultimate wizards and nobody else has a right to talk about tax base-broadening reforms aimed at accelerating economic growth, promoting investment, boosting up savings to ensure fiscal consolidation. FBR now headed by a renowned chartered accountant must go for these and tell the self-acclaimed wizards to read 'OECD Tax Policy Studies No. 19', crux of which is quoted above.

As explained in 'Overcoming fragmented tax system', Business Recorder, October 19, 2018], Pakistan needs a paradigm shift in tax policy and revamping of entire tax administration—establishment of a tax authority that is capable of generating sufficient resources for the federal and provincial governments, It should be the top priority of the government. Through democratic process vide Article 144/147 of the Constitution of Islamic Republic of Pakistan all the provincial parliaments can jointly establish an autonomous tax agency, comprising specialists in the required areas. Taxpayers should be facilitated rather than forced to comply at multiple levels and that too at very heavy costs.

For effective running of FBR and other tax agencies at various levels, major information technology and human resource improvements in tax collection methods as well as effective audit techniques should be developed along with a rational tax policy. Tax reforms or three-year-plan approved by Prime Minister are meaningless without an efficient tax administration and investment-conducive tax policy—see details in 'PTI and tax reforms', Business Recorder, August 17, 2018.

The main emphasis of the PTI government is still not on low-rate taxes on the broadest possible tax base, taxing the rich and mighty through alternate minimum tax and property tax according to the size of the house/office. Along with these measures, it is vital to bridge the monstrous tax gap which according to official claims is not less than 70%, the collection of which is essential as it can wipe out the entire fiscal deficit. This is, however, not possible unless federal government, after consultations with provinces, introduces harmonised sales tax on goods and services and establishes a single agency to monitor all inflows and outflows and document all the transactions relating to acquiring of assets. We have been advocating for it since long but nobody has seriously considered it, not even the PTI Government until recently.

The main challenge before the PTI government is to optimize tax collection without hampering business growth and investment clime. It requires massive structural reforms, abolition of the existing complicated tax laws and procedures. New simple tax codes/procedures should be enacted in English and with versions in Urdu and local languages—details in 'Need for National Tax Authority', Business Recorder, October 20, 2017.

Tax agencies, before their merger into a single tax agency (a process that may take a few years), should be equipped with modern Tax Intelligence System sending quarterly information to potential taxpayers about their economic activities so that they can be informed in advance as to how their incomes and expenditure should finally look like in their tax declarations. For promoting tax culture, it is equally important that there should be prudent spending of public money on welfare of masses through a transparent process. This perspective is still missing, not even made a part of the long-term planning approved by the Prime Minister.

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