

The creeping realism in fiscal policy

According to a Business Recorder exclusive, Finance Ministry sources reckon that the recently released simplified fixed tax scheme for the real estate sector would provide the necessary fuel to jump-start a sector where business had come to almost a complete standstill with negative repercussions on 30 related industries, including cement, after the Finance Bill 2019 was passed by parliament. The simplified scheme based on built-up area rather than profit is a presumptive tax that would extend to builders/developers and include: (i) a national jurisdiction; (ii) simplified return form; (iii) computation of income tax on project by project basis till project completion; (iv) dispute resolution committee; (v) no requirement for the builders/developers to operate as withholding agents; (vi) income tax at the rate of 210 rupee per square foot for all major urban centres, and a certificate from NESPAK; and (vii) reduction of rates by 90 percent for low cost housing. It is too early to maintain that these fine tunings would be sufficient to kick-start the stalled real estate activity; however, what is important is to highlight the fact that they are a reflection of an acknowledgment by the government in general and the Federal Board of Revenue (FBR) in particular that earlier decisions with respect to fiscal policy forcing an overnight change in the cultural mindset of non-filers of income tax returns were unrealistic and not doable.

The FBR must work under the assumption that there is always a cost of compliance especially as non-filers have developed a mindset spanning 72 years; and therefore it must move forward resolutely but with temperance at a pace and manner where the cost of compliance is minimized. The Finance Bill 2020 envisages a galloping pace due to the acceptance of an unrealistic FBR revenue target for the current year, 5.5 trillion rupees, while last year's total collections were 4.473 trillion rupees, or nearly one trillion rupees more than the previous year – a rise from one year to the next that has never ever been realized even with a growth rate of over 5 percent. The growth rate of the economy for the current year is projected at 2.4 percent in the budget 2019-20 and in the IMF documents uploaded on its website, though less than three months after this estimate was made, Hafeez Sheikh, Advisor to the Prime Minister on Finance, has revised the growth estimate upward to 3 percent. Even if one accepts the higher rate, it is not enough to meet an overambitious revenue target given to the FBR owing to a variety of factors regularly highlighted by this newspaper. It is important to note that sizeable increase in the number of tax return filers has not translated into increased revenue. This mismatch reflects the resistance to the cumbersome and complicated income tax regimen and the high cost of compliance associated with it that cannot be borne by a large part of the informal sector that comprises mostly of Small & Medium Enterprises (SMEs). Business Recorder suggests that the government exempt small enterprises that constitute around 90 percent of all SMEs which, in turn, constitute 30 percent of total enterprises in the country from acting as withholding agents and levy a presumptive tax rate (5 percent of turnover as final tax) as being done for the builders and developers. The definition of small enterprises, however, must be the same as used by the State Bank of Pakistan which stipulates up to 20 employees, including contract employees, and an annual turnover of 75 million rupees or less.

There is undoubtedly a compelling need to bring the large informal sector within the income tax net and make them compliant income tax return filers but at the same time it is important to recognize that this represents a sea change in their way of life and manner of doing business. This cultural change cannot be brought about overnight similarly as the culture of corruption in most government departments, including FBR cannot be done away with by a stroke of a pen. We fully support the government's effort to document the economy and also appreciate that the government has finally realized that it was proceeding too fast too soon and in the process it stalled the productive sectors of the economy and choked economic activity with consequent repercussions on employment, inflation and poverty levels.