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A new tax model

The budget for fiscal year 2020-21, the second by the coalition government led by Pakistan Tehreek-i-Insaf (PTI), is expected on June12. The Covid-19 has already taken a toll on the economy and affected businesses and individuals on a massive scale.

The prime minister and his adviser on finance and revenue have promised a tax-free, business-friendly and pro-people budget. On the other hand, the Federal Board of Revenue (FBR) is saying meanwhile that the tax target for the next fiscal year will be Rs 5.1 trillion despite an anticipated negative growth during this and possibly the coming fiscal year.

The FBR collected Rs 3,534 billion from July 2019 to May 2020. It is going to miss the original target [Rs 5.555 billion] by a huge margin. This time they have an excuse: the disastrous impact on economy due to Covid-19 pandemic. We all know, however, that even prior to Covid-19 outbreak, the FBR had been far behind even the revised target of Rs 5,238 billion after the first review of International Monetary Fund [IMF] under its $6 billion Extended Fund Facility (EFF) programme.

Later, the target was set at Rs 4,803 billion on the eve of incomplete second review held prior to Covid-19 pandemic. After the virus outbreak, it was reduced to Rs 3,908 billion.

The collection in fiscal year (FY) 2018-19 was Rs 3,828.5 billion [the target originally assigned it was Rs 4,435 billion. It was revised downwards twice, first to Rs 4,398 billion and then to Rs 4,150 billion] which was 0.4 percent less than the collection during the previous fiscal year [source: FBR Year Book 2018-19].Thus, it missed the target by around Rs 321.5 billion.

For the fiscal year, 2017-18, the revenue target was Rs 4,013 billion, later revised downwards to Rs 3,935 billion. The FBR collected only Rs 3,751 billion. It collected Rs 1,441 billion in income tax against a target of Rs 1,562 (a deficit of Rs 121 billion).

Sales tax collection, at Rs 1,488 billion against a target of Rs 1,541 billion, witnessed a shortage of Rs 53 billion. The FBR also faced a shortfall of Rs 16 billion under the head of Federal Excise Duty as it collected Rs 216 billion whereas the target had been Rs 232 billion. Only collection under customs exceeded the target by Rs 6 billion against the assigned target of Rs 600 billion.

The overall shortfall of Rs 184 billion vis-à-vis the revised target of Rs 3,935 billion and of Rs 262 billion from the original target pushed the fiscal deficit to a record Rs 2.5 trillion as on June 30, 2018. The total revenue collection by FBR in 2016-17 had been Rs 3,368 billion. It had missed the original target by a wide margin of Rs 250 billion. In 2015-16, the FBR, despite imposing additional taxes of Rs 360 billion, and allegedly blocking over Rs 220 billion refunds and taking a Rs 30 billion advance failed to meet the third-time revised target, showing a shortfall of Rs 222 billion vis-à-vis the original target of Rs 2,810 billion, which was first revised to Rs 2.691 billion and then to Rs 2,605 billion.

This year, due to exceptional circumstances, the Finance Bill must not be a hopeless document—containing meaningless amendments in tax codes, imposing more burden on the existing taxpayers, especially through cumbersome withholding of taxes—with no policy shift to enable businesses to survive and revive. It should contain some evocative changes in our tax system that can save all businesses.

Proposals from trade and other bodies are with the FBR and the Ministry of Finance (MoF) but these are routine ones seeking patchwork here and there. These bodies lack vision to prepare and advocate for a new tax model that is simple, fair, growth-oriented and easy to comply.

Taxation in Pakistan is counterproductive— there is only 2 percent corporatisation. By heavily taxing the corporate sector, the FBR has thus been encouraging the undocumented sector. We now need a low-rate, broad-based and equitable tax system as highlighted recently by Pakistan Institute of Development Economic (PIDE) in its Policy Viewpoint [16:2020], Doing Taxes Better: Simplify, Open & Grow Economy. The model to implement this new tax policy is available in Towards Flat, Low-rate, Broad and Predictable Taxes [Policy Research Institute of Market Economy (PRIME), 2016].

Taxation should serve as a catalyst for industrial expansion and economic growth. In the past, the ill-directed, illogical, regressive and unfair tax regulations have had a dampening effect on the industrial and business growth. The stress solely on meeting revenue targets, without evaluating their 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. In the forthcoming budget, any attempt to over-tax the collapsing economy due to the devastating effects of Covid-19 outbreak, will be suicidal.

If the government wants to move from undocumented economy to a transparent corporatised sector to achieve growth, it must reduce corporate rates to 20 percent and tax non-corporate business entities at a higher rate of 30-35 percent (flat rate).

There cannot be two opinions about the complete shifting of our economic priorities. We, as a nation must concentrate on increasing our productivity, efficiency and economic growth, which alone can ensure more revenues for the State. The main cause of our economic situation is inefficient and corrupt governments/institutions, which do not think about the welfare of the common man.

Devising an efficient tax policy for the revival of economy badly hit by Covid-19 pandemic/lockdown as well as the recession and moving towards growth requires an analytical study of all the irritants in our tax policy, codes, procedures and implementation processes. The main irritants—both at federal and provincial levels—have been highlighted in PIDE's Policy Paper and Budget 2020 amid Covid-19 Crisis: Need for Paradigm Shift [PRIME Institute, 2020]. It is time that the federal and provincial governments adopt recommendations given by PIDE and the PRIME.

We need to end the anti-business, anti-growth and anti-people tax policy and safeguard businesses from closures and lay-offs. The PIDE and the PRIME have done a remarkable job. In the coming budget, the government must remove the maladies identified by them and undertake holistic reforms aimed at incentivising businesses to survive/revive and ultimately achieve growth that alone can enhance taxes. The game of fixing targets in budgets in isolation and without research-based data analysis must end now.

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