

Death, taxes and FBR shortfall

There is a reason why serious questions are being raised over the federal tax target set for fiscal year 2021: magic and shamanism have no role to play in public finances. This very concern was expressed in BR Research's coverage of budget 2020, and this year is only different to the degree that the growth in targeted collection is less ambitious than last year.

The budgeted growth in FY20 was 45 percent – a never-before in FBR's history, at least recent history (see table). In comparison, actual growth in FY20 tax collection is provisionally estimated to be at 2 percent. Net off nominal GDP growth in FY20, FBR's tax revenues have decreased 8.8 percent, the worst since FY13, where growth in sales tax collection was worse: negative 12.8 percent (net off FY20's provisional nominal GDP growth) compared to the targeted growth of 29.6 percent (net off FY20's then-targeted nominal GDP growth).

The government obviously blames Covid-19 for its inability to meet FY20's tax target, but the fact is that its credibility was questioned as soon as it was released in June 2019. Speaking at the post-budget press conference on Saturday, Advisor on Finance, Dr Hafeez Shaikh, boasted that tax performance before Covid-19 was phenomenal, citing 17 percent growth in total FBR taxes and 27 percent growth in domestic sales tax in 9MFY20. Hafeez said if Covid-19 had not struck the economy, FBR's full year tax collection would have been Rs4500 billion. Given historical trends and FBR's performance in 9MFY20, that assumption seems farfetched. But that too would have been 18 percent short of the original tax target of Rs5500 billion. (See BR Research's 'Does Shabbar have a magic spell', Jun 12, 2019)

For FY21, the targets are a little less lofty. Budgeted growth in total sales tax collection is 25.4 percent over and above the nominal GDP growth, where that for direct tax collection is 17.4 percent (net off nominal GDP growth). Both growth numbers are less ambitious than last year, yet very ambitious at a time when no new major taxes have been levied across the three major tax categories: income, sales, customs.

Until some years ago, the government used to share item-wise details of budgeted tax collection under major tax categories. This practice was shelved a few years before the PTI came to power. At Saturday's post-budget presser, Hafeez and the rest of his team was asked at least twice about the sources of the additional Rs 1 trillion tax target. But all anyone got was wishy-washy answers; the specifics (even if indicative in nature given pandemic) were not shared – neither of tax collection, nor of the size of tax net.

In the absence of these details, the fact that the list of relief measures appears longer than the list of revenue measures doesn't inspire confidence in FBR's ability to grow revenues by 18 percent over and above nominal GDP in FY21. That said, kudos to the government for reducing customs duties, WHT on a wide range of tariffs lines and other items of domestic consumption aimed to spurring economic growth.

All bets, therefore, seem to be placed on FBR's ability to increase documentation and rope in a greater number of individuals and businesses into the tax net – both by active pursuit and by incentives. The former includes targets to more-than-double the list of retailers with POS terminals to 15000 by December 2020, and plans to triangulate various datasets (bank accounts, property, vehicles, travel, etc) to expand the tax net. The latter includes a host of tax incentives and a much-needed direction towards ease of doing business. But the pace of these measures is questionable, so is the timeline of their impact.

About this time last year, all drums were beating to the tune of tax reforms, as Shabbar Zaidi, the famed tax expert, was brought in with much fanfare, amid removal of zero rating, stringent audit, promises of data triangulation, separation of tax policy and administration and a host of other measures. Gradually, the hype washed away, as did Shabbar. Data triangulation, track and trace for tobacco, mapping of shopping plazas in major cities, and host of other promises are still unkept are 'in process' where progress report and milestones with timelines are not periodically shared. That it has taken one whole year for the FBR to establish the first of its kind 'Tax Information Processing Unit' for data triangulation purposes speaks volumes about the FBR speed. And the fact that a member FBR will be heading it, as against an outside professional, doesn't inspire confidence.

These days, tax is not the hottest agenda. Covid-19, and the ensuing plight is. In such an environment when the economy is taking a hit across the board, hard measures by the FBR (which in itself is a tall assumption) will erode political capital – something which the PTI can ill afford at the moment. Ergo, compared to FY20, the bet on the expansion of tax net is rather riskier. Expect serious tax shortfalls in FY21, especially if Covid-19 hits the economy harder than currently envisaged.

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GROWTH IN FBR'S TAX COLLECTION

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	FY21-B**	FY20-B**	FY20-P*	FY19	FY18	FY17	FY16	FY15	FY14	FY13	FY12	FY11	FY10	FY09	FY08
Total FBR taxes	27%	45%	2%	0%	4%	8%	20%	15%	16%	3%	21%	17%	14%	15%	19%
Direct taxes	26%	44%	12%	-6%	14%	10%	18%	18%	18%	1%	23%	15%	19%	14%	16%
Customs	17%	16%	-20%	13%	22%	23%	32%	26%	1%	10%	17%	15%	8%	-2%	14%
Sales tax	34%	44%	-2%	-2%	12%	2%	20%	9%	18%	5%	27%	23%	14%	20%	22%
Real GDP growth	2.10%	2.4%	-0.4%	1.9%	5.5%	5.2%	4.6%	4.1%	4.1%	3.7%	3.8%	3.6%	2.6%	0.4%	5.0%
Inflation	6.50%	12.0%	11.2%	6.8%	4.7%	4.8%	2.9%	4.5%	8.6%	7.4%	11.0%	13.7%	10.1%	17.0%	12.0%

Nominal GDP growth	8.6%	14.4%	10.8%	8.7%	10.2%	10.0%	7.4%	8.6%	12.7%	11.0%	14.9%	17.3%	12.7%	17.4%	17.0%
Growth in direct tax collection	17.4%	29.6%	1.2%	-14.7%	3.8%	0.0%	10.6%	9.4%	5.3%	-10.0%	8.2%	-2.3%	6.3%	-3.4%	-1.0%
(net of nominal GDP growth)															
Growth in sales tax collection	25.4%	29.6%	-12.8%	-10.7%	1.8%	-8.0%	12.6%	0.4%	5.3%	-6.0%	12.2%	5.7%	1.3%	2.6%	5.0%
(net of nominal GDP growth)															

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** FY21-B and FY20-B numbers are targets/budgeted numbers at the time of budget announcement in June 2020 and June 2019 respectively

* FY20-P numbers are official provisional estimates for ongoing fiscal year. FY08-FY19 are actual revised numbers

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Source: BR Research based on Economic Surveys: Budget in Brief: FBR Yearbooks