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Case for 'National Tax Authority' – I

In the wake of dismal results on the fiscal front for the first quarter of the current financial year, serious debates and action plans are needed for tapping the real tax potential of the country which is not less than Rs 12 trillion. Unfortunately, the present tax collection by federal and provincial governments is highly unsatisfactory. The real potential at federal level alone is not less than Rs 8 trillion, whereas FBR is not collecting even half of it. The same is the position of provincial tax authorities that have failed to realise the tax potential of Rs 4 trillion. At present, all broad-based and buoyant sources of revenue are with the federal government while contribution of provinces in total tax revenues is only seven percent-in overall national revenue base (tax and non-tax revenue) it is around eight percent. This has made them totally dependent on the federal government for transfers from divisible pool and/or direct grants.

During July-September 2018 quarter, fiscal deficit was Rs 541.7 billion (1.4% of GDP), mainly due to "inflexible" and "compulsive" expenditure under the head debt servicing and defence. The colossal deficit was despite a massive cut in development spending and securing Rs 246.6 billion in terms of provincial surpluses. Startlingly, the current expenditure increased by nearly 20%, whereas tax revenues grew only by 7%. The federal government showed a deficit of Rs 733.3 billion or 2.5% of GDP. The rise of fiscal deficit of 1.4% should be a cause for concern vis-à-vis revised annual target of 5.1% of GDP or Rs 1.9 trillion sent for fiscal year 2018-19.

The debt servicing in the first quarter stood at Rs 507 billion, higher by Rs 90 billion or 20.2% and defence spending amounted to Rs 219.4 billion, up Rs 37 billion or 20.3%. Together, these two consumed Rs 726 billion or 67.7% of the total expenditure incurred by the federal government. Domestic debt servicing increased to Rs 461.7 billion, a surge of Rs 44.2 billion or one-tenth over the same quarter of previous year. Foreign debt servicing of Rs 45.4 billion was higher by 63%. The government of Pakistan Tehreek-e-Insaf (PTI) is still optimistic that it would contain the deficit to 5.1% of GDP announced in the supplementary budget presented in September after assumption of power.

In the Supplementary Budget, the PTI Government reduced the target of Federal Board of Revenue (FBR) from Rs 4435 billion to Rs 4398 billion. However, the collection in the first quarter was only of Rs 886.5 billion or 18.8% of the annual target. The government also revised upwards the total expenditure estimate to Rs 5.3 trillion. The results of first quarter show total federal expenditures at Rs 1.07 trillion or 20.2% despite a slowdown in development spending. In terms of the size of national economy, total revenues remained stagnant at the level of last quarter (2.9% of GDP). On the other hand, current expenditures that stood at 3.5% in the first quarter of previous fiscal year shot up to 3.9% of GDP. Provincial governments recorded a cash surplus of Rs 246.6 billion out of the Rs 662.6 billion that the federal government transferred as their share under the 7th National Finance Commission (NFC) Award.

The performance of the provinces in collecting revenue is more pathetic than that of the Federal Government. The share of provincial taxes in total revenues has slipped to only 11%. All the federating units, except for Sindh, could not enhance revenues, thus, their reliance on NFC Award would continue unabated.

In the first quarter, cumulatively, all the four provinces collected merely Rs 88.6 billion in taxes, higher by only Rs 1.7 billion or 2% over the same quarter of previous year (FBR showed growth of 8%). The declining figures of provincial taxes for the July-September quarter have underlined the need for revamping of the provincial tax regimes. The provincial tax collection was 0.22% of gross domestic product (GDP), which was far lower than the potential.

According to a report, "the provincial share in federal revenues has jumped to Rs 663 billion or 84% of their total revenues in the first quarter, partly due to delayed transfers by the federal government. In July-September 2017, the provincial share in federal revenues was equal to 74.4% of their total revenues. In June this year, the finance ministry blocked the release of the last tranche under the NFC Award to the provinces aimed at restricting the budget deficit to 6.6% of GDP. Had the money been timely transferred to the provinces, the budget deficit could have gone up to 7.1% at the end of last fiscal year. Like the federal government, the provincial current expenditures also registered a double-digit growth. The provincial governments cut their development spending to Rs 55.7 billion-41.7% less than first quarter of the previous year. The steep decline in the federal and provincial development spending is likely to adversely affect economic growth in the current fiscal year, which is now projected to remain at around 4%".

In the first quarter, Punjab collected only Rs 42.6 billion in taxes, which was lower by Rs 2.4 billion or 5.3%. Due to this, the share of tax collection in total revenues dropped from 16% to only 10.8%. Punjab received Rs 326 billion from the federal government under the NFC Award, higher by 63%. The provincial government saved Rs 126.4 billion from its budget. The provincial government's collection on account of sales tax on services dropped 8.7% in the first quarter. However, the total expenditures increased to Rs 264.4 billion in spite of the fact that development budget was slashed by 54% to only Rs 30.3 billion during July-September 2018.

Sindh emerged as the only province that registered a 10.8% growth in provincial taxes in the first quarter. The provincial government collected Rs 40 billion, constituting nearly one-fifth of the total revenues. It collected Rs 20.6 billion in sales tax on services alone showing growth of 10%. Sindh received Rs 163.7 billion as its share under the NFC Award, higher by 53.7%. Out of Rs 163.7 billion received from Federal Government, Sindh gave a surplus of Rs 64 billion.

The government of Khyber Pakhtunkhwa generated a mere Rs 4.1 billion in taxes through its own efforts which was equal to 3.6% of the total revenues. The Khyber Pakhtunkhwa government received Rs 107.7 billion from the centre under the NFC Award, higher by 62.6% and gave back cash surplus of Rs 29.4 billion. The provincial expenditures stood at Rs 86.6 billion, showing an increase of 30%.

The government of Balochistan generated a meagre sum of Rs 2 billion in taxes which constituted just 2.8% of the total provincial revenues. The largest province in terms of area received just Rs 65.6 billion under the NFC Award, which was higher by 18.5%.

The overall picture that emerges from the results of first quarter of the current year, it is clear that the country is confronted with daunting fiscal challenges requiring immediate action and prompt solutions based on rational and bold decision-making. The fiscal crisis faced by Pakistan, in terms of abysmally low tax to GDP ratio and lower revenue collection vis-à-vis the tax potential of the country. These taxes are, therefore, insufficient for the needs of the country such as debt servicing and defense expenditures, poverty alleviation and pro-poor economic growth.

Pakistan, as mentioned in PTI and tax reforms, Business Recorder, August 17, 2018, needs to increase collection at all levels of governments to bridge monstrous fiscal deficit that reached the level of 6.8% of GDP (Rs 2.3 trillion) for the fiscal year 2017-18. It was suggested in the article that the federal and provincial governments must immediately prepare finance bills to tax the rich and mighty through alternate minimum tax of 2.5% of net worth and property tax according to the size of the house/office. However, no heed was paid to this proposal. It was also suggested that along with these two measures, bridging tax gap of nearly 70% in collection of income tax, sales tax, customs and agricultural income tax can wipe out the entire fiscal deficit in 2018-19. As mentioned in the article, for achieving this goal, the federal government, after consultations with provinces, should introduce harmonised sales tax (HST) on goods and services.

It was stressed in 'Overcoming fragmented tax system', Business Recorder, October 19, 2018 that all the tax collection agencies in Pakistan should be dismantled and merged into single National Tax Authority (NTA), which should effectively enforce tax laws at federal, provincial and local levels, besides providing single window facility to taxpayers. A timeframe was also suggested but unfortunately, the PTI government did not bother to consider it. Now, the recommendations of sub-committee on tax of Economic Advisory Council (EAC), approved by Prime Minister on November 25, 2018, show complete apathy on this issue. The report prepared by EAC's sub-committee is so superficial that it even does not take into account the most vital issue of fragmentation of taxation in Pakistan. One wonders how easily the Prime Minister and his financial team are being hoodwinked by the same officials of FBR who earned notoriety as cronies of Nawaz and Dar.

(To be continued)

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