

Outlook for FBR Revenues

The revised budget for 2018-19 presented by the new government has brought down somewhat the FBR revenue target for the year from Rs 4435 billion to Rs 4398 billion. This was surprising since the new target was to scale down the fiscal deficit by about 2 percent of the GDP. Instead of more aggressive resource mobilization, reliance has been placed more on a big increase in non-tax revenues and on a sizeable cut back in the size of the Federal PSDP of 15 percent in relation to last year's level to reduce the deficit. The Punjab government has followed suit a few days ago with a reduction of 41 percent in its development program.

FBR has reported in the Revenue Division Year Book a total net collection of Rs 3842 billion in 2017-18. Therefore, the revised target for 2018-19 implies a growth rate of 14.5 percent. In 2017-18, the target growth rate was 19.4 percent and in 2016-17, 16.4 percent. As such, the Ministry of Finance has given an inherently achievable target to FBR, especially since the inflation rate is likely to be much higher in 2018-19 and some of the tax bases will be more buoyant in nominal terms this year.

Despite the not-so-ambitious target for FBR revenues, Business Recorder reports that there has already been a shortfall in the first quarter of 2018-19. Apparently, the target for the quarter was Rs 852 billion, requiring a modest growth of 11 percent in relation to the actual level of revenues in the corresponding quarter of 2017-18. Initial estimates are that the actual collection is Rs 837 billion, implying a shortfall of Rs 15 billion. The growth rate achieved is less than 10 percent. At this rate, the shortfall by the end of the year could be as large as Rs 170 billion.

There is need to study what happened in 2017-18 to get an insight into the performance of FBR in the first quarter of 2018-19. Over the four quarters of 2017-18 there was a systematic pattern of decline in the growth rate of collections. The first quarter saw an appreciably high growth rate of 22 percent. The next two quarters saw an average growth rate of close to 13 percent. Revenue growth in the last quarter plunged to a single-digit growth rate of only 8 percent.

Why did this decline in growth rate take place over the four quarters of 2017-18? The answer is to be found largely in the path followed by sales tax revenues over the year. The first quarter saw 21 percent growth; the second quarter, 18 percent; the third quarter, 15 percent and only 2 percent in the fourth quarter. This is the main reason for overall FBR revenues showing low growth in the last quarter.

This then raises the second level question: why did sales tax revenues lose their buoyancy in successive quarters of 2017-18? Here, we have finally the answer. The rise in prices of imported oil and POL products led the PML (N) Government and subsequently the caretaker Government to sharply bring down the sales tax rates on these products, so as to insulate consumers at least partly.

The average sales tax rate on motor spirit was 20.5 percent and on HSD oil, 33.5 percent, in the beginning of the first quarter of 2017-18. By the end of the fourth quarter, the rates had fallen to 12 percent and 24 percent respectively. POL products are the largest contributors to sales tax revenues with a share of over 36 percent. Therefore, a large part of the loss of revenue buoyancy of the sales tax over the year was the decline in tax rates of POL products.

The sales tax rates on POL products have continued to decline in the first quarter of 2018-19. As of end September 2018, they have been brought down further to 4.5 percent only in the case of motor spirit and to 17.5 percent on HSD oil. Despite higher import prices of these products, the sales tax per liter has fallen.

Therefore, part the shortfall in FBR revenues may be due to missing the target for sales tax in the first quarter of 2018-19. This ought to have been at least partly compensated for by a fast increase in import duty revenues with a 19 percent rise in rupee value of landed imports in this quarter.

The important question is what is the prospect for FBR revenues for the whole year of 2018-19? There are both negative and positive factors. The major worrying consideration is that if oil prices continue to go up then the sales tax rates on POL products may continue to be kept at low level. What we are seeing today is the opposite of the 'windfall' in 2014-15 and 2015-16. Exceptionally low price of oil at that time led to a big hike in sales tax rates on POL products. At one stage, the tax rate on HSD oil was as high as 51 percent, three times the standard rate. This contributed to a bonanza of revenues. Now the opposite is happening.

The other major negative development is the big tax break to personal income taxpayers. Last year, the withholding tax on salaries yielded Rs 133 billion, with a high growth rate of 20 percent. Now the exemption limit has been trebled from Rs 400,000 to Rs 1,200,000. For tax payers with higher incomes than the exemption limit the savings in tax payment range from 75 percent to 30 percent. Consequently, revenue from salaried tax payers in 2018-19 may be lower by almost half or Rs 65 billion. This is a gift to the richer segment of our society.

Other negative factors include the likelihood of lower revenue from some sources of withholding taxes. The largest source is the tax on contracts. The sharp cutback in the national PSDP could adversely affect revenues from this source. However, this may be at least partly compensated for by higher presumptive tax revenues on imports and exports, because of higher rupee value following the process of depreciation of the rupee.

The other area of concern is the income tax revenue from the corporate sector, with a share in income tax payments of over 20 percent. 2018-19 is a year which is likely to be characterized by relatively low profitability due to more modest GDP growth and high cost-push inflation in inputs of electricity, gas and imported inputs. Also, there is continuing pressure to release outstanding refunds to exporters, possibly approaching Rs 150 billion, so as to improve their liquidity and enable them to market their products internationally more aggressively.

As opposed to these negative factors, there are some developments which could raise the buoyancy of FBR revenues. These include a higher rupee value of imports due to the successive

devaluations. Already, in the first quarter of 2018-19, this value has gone up by 19 percent as highlighted earlier. Second, some additional taxation measures have been proposed on luxury goods and cigarettes. However, we will have to rely on the ingenuity and innovative capacity of FBR to generate at least an additional Rs 100 billion by broadening the tax base and catching large tax evaders, as promised in the Revised Budget.

Overall, at this stage it appears that for FBR achieving the target of Rs 4398 billion will be a challenge. The Ministry of Finance ought to anticipate pressure from the IMF during the negotiations, if they take place, for an even higher target for FBR, possibly by at least another 0.5 percent of GDP.

This may necessitate a big enhancement in the sales tax rate on motor spirit, since the price in Pakistan is comparatively low in relation to the price in other South Asian countries. Also, the exemption limit on the personal income tax may have to be brought down to say Rs 800,000. Other measures may include the postponement of other reliefs and reductions in the corporate income tax announced in the original budget for 2018-19 and retained in the Revised Budget.

The FBR has a new management team. We wish the team success in continuing the process of raising the Federal tax-to-GDP ratio like the last five years.

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