Federal Board of Revenue

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Government of Pakistan

Annual Report 2009-10

Directorate General of Internal Audit
(Inland Revenue)
Islamabad

With the Compliments of: -

RAANA MIRZA
Director General
Internal Audit (Inland Revenue)
Islamabad

Government of Pakistan

Annual Report

2009-2010

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(Inland Revenue)

Federal Board of Revenue
Islamabad.

December, 2010

Mr. Sohail Ahmad
Chairman
Federal Board of Revenue

Ms. Raana Mirza
Director General

C O N T E N T S

PREFACE

It gives me immense pleasure to present the Annual Report for the year 2009-10 to the honourable Chairman, Federal Board of Revenue. It reflects the performance of the Directorate General during the Fiscal Year. It also highlights the various difficulties faced by the officers and staff of this office.

Internal control is necessary to accomplish specific goals or objectives. It is a tool by which the organization's resources are monitored and measured. It plays an important role in preventing and detecting fraud, leakages and irregularities.

The Federal Board of Revenue exercises internal control through the Directorate General of Internal Audit (Inland Revenue). Internal Auditing involves measuring compliance with the entity's laws and procedures. It provides assessment of a system. It is primarily directed at improving internal control. ***The object of Internal Audit is to seek evidence that revenue is assessed and collected according to law and errors of omission and commission are avoided***. Gaps are identified and follow up is made till retrieval and recovery of lost revenues. The whole process helps the field formations in improving the quality of their responsibilities.

Unfortunately, Internal Audit has been the neglected arm of the Federal Board of Revenue. Its potentials and values have not been realized, so much so that it has not been included in Tax Administration Reform Programme. Internal Audit has certain impediments and limitations, such as:

- All field offices have been housed in renovated buildings with all the paraphernalia, whereas the offices of the Directorate General are still located in rented premises without sufficient basic amenities.
- Shortage of officers and staff coupled with frequent transfers without consulting the Directorate General cause delays in fulfillment of planned work thus hampering our efficiency. ***Despite the fact that the mandate of the Directorate General has been***

extended to the Sales Tax and Federal Excise functions, Officers and Staff having experience in these taxes have not been posted so far.

- The Audit and Inspection reports are not given due weightage vis-à-vis External Audit. Despite our best efforts regarding follow-up, timely response from the field formations is not forthcoming, as a result, potential revenue yielding cases are hit by limitation.
- ***Disciplinary proceedings against the defaulting officers are not taken in time by the field formations with the result that the officers are either retired or transferred in due course of time. Since the Internal Audit is not vested with any executive or judicial powers, therefore, the Administrative Structure does not allow the Directorate General to nip the evil in the bud.***

Upshot of these ground realities is that the Federal Board of Revenue is suffering both tangibly and intangibly. The situation necessitates that the role of Internal Audit be strengthened.

The Internal Audit has the legal responsibility to conduct periodic Inspection and Audit of the activities of the Inland Revenue Officers / Offices taking into account the essential principle of transparency while conducting the official business. ***The performance of the Directorate General has practical value only if its recommendations are implemented in letter and spirit. The mandate of the Organization, therefore, needs to be extended beyond a recommendatory body by incorporating changes in the law wherein it should be given powers to take action against the departmental officers on non-compliance of its observations contained in Inspection and Audit Repots.*** Due weightage to Internal Audit will ensure better control and accountability of the field formations by FBR in discharging its responsibility as the Prime Revenue Generating and Collecting Agency of the Government of Pakistan. “A stitch in time saves nine.”

The volume of activity under the head “Inspection” relevant to the Financial Year increased by 73%. Due to diligent follow up by the Directorate General, the number of reports where final/partial action has been completed by Taxation Officers has increased

which is commendable in view of shortage of officers and staff. The amount of Revenue Retrieved stood at Rs.8552(M) against Rs.2278(M) for the previous year ***thus registering an increase of 275% which itself is a record.***

During the year under reporting 301 functional units were audited and 118 reports were finalized which resulted in retrieval of loss of revenue amounting to Rs.16976(M) out of detected loss of Rs.28191(M) ***which is sizeable.*** In addition, the Directorate General concentrated its efforts on retrieval of earlier years' loss. A total number of 131 pending reports were finalized and loss worth Rs.6614 (M) was retrieved through the concerted efforts of audit teams.

The plan for the current year is to liquidate audit reports for past years and conduct special Audit and Inspection for Withholding Taxes and Refunds in selected sectors and synchronize the functioning of Directorate General of Internal Audit for Direct and Indirect Taxes.

The Annual Report also contains articles written by the officers of the Directorate General from which the field Officers would certainly benefit while discharging their functions.

I am grateful to the Chairman for his guidance and support for successful working of the Directorate General of Internal Audit (Inland Revenue).

I would like to appreciate the efforts of the officers and officials, of the Directorate General, specifically Mr. M. Anwar Goraya, Ex-Director Southern Region, Karachi, Mr. Jahangir Ahmad, Secretary (IA), Camp Office, Mr. Ijaz Ahmad, Second Secretary and Mr. Nawaz Ali Ansari, Inspector for their contribution in highlighting enforcement difficulties and suggestions for improvement.

The services of Mr. Muhammad Riaz, KPO and Mr. Amir Mushtaq, LDC are highly appreciated for their hard work and assistance in typing and composing work.

(Raana Mirza)
Director General

Chapter – 1

INTERNAL AUDIT – HISTORY EVOLUTION & PRESENT ORGANIZATIONAL SET UP, MANDATE

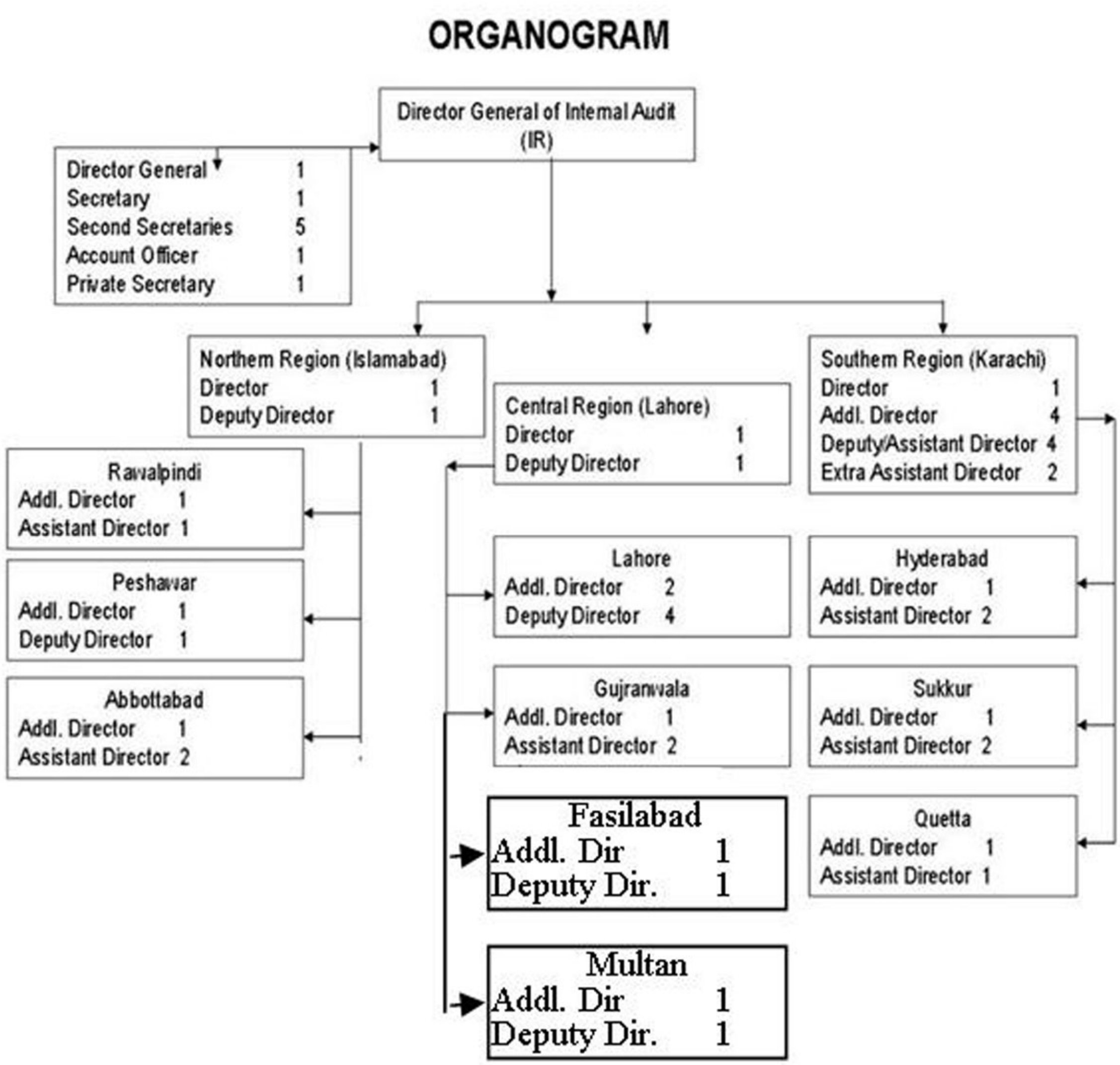
Objective and Brief History:-

1. An organization exercises internal control in order to accomplish **specific goals and objectives.** The Directorate General of Internal Audit (Inland Revenue) being Internal Control of Federal Board of Revenue safeguards revenue leakages, checks the accuracy and reliability of departmental working, promotes efficiency, and encourages adherence to prescribed law and procedures. Since its inception the Directorate General has proved to be custodian of state revenues.

2. ***The Directorate General has a significant history of detection of events of tax evasion, under-reporting, under-assessments and issuance of bogus/illegal refunds caused due to inefficiency, corrupt practices, lack of adequate skills, omissions and commissions. This inter-alia includes incorrect application of law, non-maintenance of proper records, wrong appreciation of facts, mal-practices and connivance, improper training and lack of knowledge of respective trades and procedural lapses. The core functions performed by the Directorate General are remedial, curative and preventive in nature. The Inspection and Audit authorities make recommendations for an efficient system with the objective to create a taxpayers' friendly transparent culture envisioned in Tax Administration Reform Programme.***

3. The "Directorate of Inspection & Audit" was initially created through CBR's Notification, which remained valid up to 1991. It was upgraded as "Directorate General of Inspection, Audit & Enquiries (Direct Taxes)" in 1991, and was attached to the Ministry of Finance. It was re-organized/re-designated as a statutory body through Finance Act 1995, and was re-named as Directorate General of Inspection (Direct Taxes) in 1995.

4. The administrative control was reverted to the CBR/Revenue Division in 1996. Through Finance Act (2007), this organization was renamed as “Directorate General of Internal Audit (Direct Taxes)” and it works under the administrative control of the Chairman, FBR. With the inception of the Inland Revenue Service and consequential restructuring, the mandate of the organization of Internal Audit has been redefined as is discussed in detail, in subsequent paragraphs. Organizational set up of the Directorate General of Internal Audit (IR) is as under:



Mandate:-

The Directorate General derives its mandate from Section 228 of the Income Tax Ordinance, 2001. Its functions, jurisdiction and powers have been specified vide SRO No.660 (1)/2005 dated 30-06-2005. Section 228 and the said SRO is reproduced for the sake of convenience as under:

Section 228. **The Directorate-General of Internal Audit.** (1) The Directorate General of Internal Audit shall consist of a Director-General and as many Directors, Additional Directors, Deputy Directors and Assistant Directors and such other officers as the Board, may by notification in the official Gazette, appoint.

SRO No.660 (1)/2005. The Federal Board of Revenue has specified functions, jurisdiction and powers of the Directorate-General of Internal Audit (Direct Taxes) as under:-

"In exercise of the powers conferred by sub-section (2) of section 228 of the Income Tax Ordinance, 2001 (XLIX of 2001), the Central Board of Revenue is pleased to specify functions, jurisdiction and powers of Directorate-General of Inspection (Direct Taxes) as under, namely,

Inspection authorities: - (1) The Directorate General of Inspection shall consist of the following namely: -

(a) Director General of Inspection
(b) Directors of Inspection
(c) Additional Directors
(d) Deputy Directors
(e) Assistant Directors
(f) Extra Assistant Directors

(2) The Directors, Additional Directors, Deputy Directors, Assistant Directors and Extra Assistant Directors of Inspection shall be subordinate to the Director General of Inspection.

(3) Additional Directors, Deputy Directors, Assistant Directors and Extra Assistant Directors of Inspection shall be subordinate to the Director of Inspection within whose jurisdiction they perform their functions.

(4) Deputy Directors, Assistant Directors and Extra Assistant Directors shall be subordinate to the Additional Director of Inspection within whose jurisdiction they perform their functions.

(5) Assistant Directors of Inspection shall be subordinate to the Deputy Director of Inspection within whose jurisdiction they perform their functions.

(6) Extra Assistant Directors of Inspection shall be subordinate to the Assistant Director of Inspection within whose jurisdiction they perform their functions.

Functions and powers: - (1) The functions of Directorate-General of Inspection shall be, as under, namely:

(a) to carry out inspections of income tax cases and offices;

(b) to investigate or cause investigation to be carried out in respect of cases involving leakage of revenue or evasion of taxes;

(c) to carry out internal audit of cases or offices involving income tax revenues and expenditure;

(d) to furnish an annual report about the working of income tax offices to the Central Board of Revenue (now Federal Board of Revenue) by the thirty-first day of December, following the end of the financial year to which it relates; and

(e) to carry out any other work or function that may be assigned to it by the Federal Government.

(2) In discharge of its functions under (1) above, the Directorate General of Inspection shall have the powers specified in section 176 of the Income Tax Ordinance, 2001.

Jurisdiction:- (1) The Directors of Inspection shall perform their functions in respect of such persons or classes of persons or such areas as may be assigned to them by the Director General of Inspection.

(2) The Director General or a Director of Inspection may assign any function in respect of any area, or office or offices located within an area, case, class of cases, persons or classes of persons to any inspection officer working under his control.

***Explanation*: -** "Inspection Officer" means an Additional Director, a Deputy Director, an Assistant Director and an Extra Assistant Director.

The notification shall take effect from 1st July, 2005."

2. Consequent upon the amendments made in the Income Tax Ordinance, 2001 through Finance (Amendment) Ordinance, 2009 and renaming of tax functionaries as the officers of Inland Revenue accordingly, the Board, vide order C.No.1(6) IR-Judicial/2009 dated 11th November, 2009 conferred powers under the Ordinance of 2001 to the re-designated officers. Similarly, vide notifications of even number and date, powers conferred to the authorities under the Sales Tax Act, 1990 and the Federal Excise Act, 2005 have also been conferred to the officers of Inland Revenue. Subsequently, vide notification No. 1046-02/SSM/2010 dated 28/04/2010; the Directorate General of Internal Audit (Direct Taxes) has been renamed as the Directorate General of Internal Audit (Inland Revenue). The Regional Directorates of Internal Audit (Direct Taxes) and the offices of Additional Directors of Internal Audit (Direct Taxes) have also been renamed accordingly. Vide S.R.O. 282(I)/2010 dated 29/04/2010, necessary powers under the Sales Tax Act, 1990 have been assigned to the officers of Internal Audit (Inland Revenue). Similarly, vide S.R.O. 284(I)/2010 dated 29/04/2010, necessary powers under the Federal Excise Act, 2005 have also been assigned to the officers of Internal Audit (Inland Revenue). In view of the foregoing, the mandate of the Directorate General, Internal Audit (Inland Revenue) stands extended to the Sales Tax and Federal Excise functions as well.

JURISDICTION OF THE DIRECTORATE GENERAL OF INTERNAL AUDIT (INLAND REVENUE)

1. The Directorate General of Internal Audit (IR) holds jurisdiction in respect of Internal Audit matters of the Inland Revenue wing of the Federal Board of Revenue and is headed by a BS-21 officer. He/She is assisted by three Directors (BS- 20) as under:-

(1) Director, Northern Region, Islamabad,
(2) Director, Central Region, Lahore, and
(3) Director, Southern Region, Karachi

JURISDICTION OF DIRECTORATES

(1) NORTHERN REGION, ISLAMABAD

S.No.	Name of the Office Falling Within Jurisdiction
1	LTU, Islamabad
2	RTO, Islamabad
3	RTO, Rawalpindi
4	RTO, Abbotabad
5	RTO, Peshawar

(2) CENTRAL REGION, LAHORE

S.No.	Name of the Office Falling Within Jurisdiction
1	LTU, Lahore
2	RTO-I, Lahore*
3	RTO-II, Lahore*
4	RTO, Multan
5	RTO, Gujranwala
6	RTO, Sialkot
7	RTO, Faisalabad
8	RTO, Bahawalpur*
9	RTO, Sargodha*

(3) SOUTHERN REGION, KARACHI

S.No.	Name of the Office Falling Within Jurisdiction
1	LTU, Karachi
2	RTO, Karachi
3	RTO, Sukkur
4	RTO, Hyderabad
5	RTO, Quetta

* Revived / rolled out with effect from 01/08/2010.

SANCTIONED STRENGTH VIS A VIS WORKING STRENGTH

BS	SANCTIONED	WORKING	VACANT
BS-21	1	1	-
BS-20	3	3	-
BS-19	16	11	5
BS-17/18	31	23	8
BS-16	3	2	1
Sub Total (officers)	**54**	**40**	**14 (25.93 %)**
BS-15	9	11	-2
BS-14	54	50	4
BS-12	14	12	2
BS-11	45	34	9
BS-10	5	1	4
BS-9	48	50	-2
BS-7	37	36	1
BS-5	21	14	7
BS-3	9	9	-
BS-2	87	79	10
Sub Total (Officials)	**329**	**296**	**33 (10.03 %)**

OVERALL POSITION (ALL RANKS)

Sanctioned Strength	Working Strength	Vacant Posts
383	**336**	**53 (13.84 %)**

2. ***Although the shortage of officers and staff is adversely affecting the official work both in terms of quality and quantity, nevertheless loss of revenue reported this year is Rs.28191 (M) and retrieval at Rs.23590 (M)***

3. The Directorate General through its Directorates, not only strives for retrieval of explicit loss of revenue but also ingrains internal controls, which help in promoting efficiency, encouraging adherence to law and procedures thus improving overall working of the tax machinery. These internal controls are in the form of ensuring maintenance of obligatory registers, monitoring of withholding taxes, giving timely appeal effect, issuance of un-served assessments orders, completion of pending assessments, utilization of information, disposal of rectification applications, accurate reporting of revenue figures in the MPR etc. These ensure effective control in the field formations.

Chapter-2

INSPECTION

Preamble:-

The Directorate General, Internal Audit (Inland Revenue) is responsible for Inspection and Audit of Federal Revenue Authorities in respect of their Revenue collection assignment with a view to improve performance and service delivery.

The Income Tax Ordinance, 2001 has increased the responsibilities of Internal Audit Authorities manifold. The introduction of Universal Self-Assessment Scheme as well as re-organization under Tax Administration Reform Programme on functional lines has opened new areas for improvement but not without challenges. The doctrine of voluntary compliance by the taxpayers has definitely placed the tax authorities under a lot of pressure to prove their professional worth.

Further, detection of cases of concealment, underreporting, misreporting and cases of tax evasion are now based upon records, details provided and third party information which is not easy to collect and correlate due to the fact that retrieval of information and collection of record was often found difficult after the change in organizational structure. The object of inspection is not only to keep control on the quality of work but also to ensure implementation of the FBR's policies for bringing about improvement of tax administration.

The purpose of inspection is also to create a fair, transparent and independent working environment to enhance the revenue generation capability of the FBR and to guide, educate and assist the field formations to improve overall quality of work. Inspection may also focus on the qualitative aspect of performance of the officers with reference to their respective duties and functional jurisdictions and also to evaluate their statutory duties.

Under these circumstances the job of inspection authorities is to assist the field formations in improvement of quality of work as well as to plug leakage of revenue.

Aims & Objectives:-

The basic aim of inspection is to examine, identify and report fairly and impartially tax evasion, underreporting and under assessment and loss of revenue; due to negligence, inefficiency, omissions and commissions. These, inter-alia, include misapplication of law, improper maintenance of record, inadvertent mistakes and procedural lapses etc. The inspection authorities make recommendations for improvement in the system, with the ultimate object to create a just, fair and tax friendly culture.

Types of Inspections:-

Two types of inspections are conducted namely:-

(a) Regular inspection

(b) Special Inspection

Regular Inspection:-

Regular inspection is conducted according to a schedule of inspection issued by the Director to the Additional Directors in the beginning of each financial year. This inspection may be of a division, unit of a division or any other office of RTO, LTU or a functional unit or office of Inland Revenue.

Special Inspection:-

Special inspection is conducted in respect of assessment records of a particular taxpayer or class of taxpayers or inspection of records of a division, unit of a division or any other office of the RTO, LTU or a functional unit authorized or assigned by the Director-General of Internal Audit (Inland Revenue) as a special case and is conducted by the Additional Director without prejudice to the schedule of regular inspection issued to him/her or may be conducted by the Director himself/herself if so specified by the Director General of Internal Audit (Inland Revenue).

Scope/Important Areas of Inspection:-

(i) Audit Division:-

- Selection for audit u/s 177 of the Income Tax Ordinance, 2001.
- Disposal by amendment of assessments u/s 122 of the Ordinance.
- Provisional assessments u/s 123.
- Best judgment assessment u/s 121.
- Assessments u/s 120, 120A, 143 and 144.
- Revision of assessments u/s 122A and 122B.
- Computation of taxable income, giving effect to appeal orders, rectification of orders in respect of cases selected for audit.
- Imposition of penalty in respect of cases selected for audit, finalization of complaints of existing taxpayers and any other function assigned to Audit Division.

(ii) Enforcement & Collection Division:-

- Timely compliance of filing statutory returns and statements, charge of tax on defaulting withholding agents, collection and deduction of tax at source and issuance of exemption certificates.
- Timely disposal of enforcement related revenue receipt audit (external audit) paras.
- Proper communication of assessment orders/penalty orders and demand notices to Taxpayers Facilitation and HRM Division and giving appeal effect in the cases falling under the jurisdiction of Enforcement & Collection Division, rectification of orders, imposition of penalty under Part-X of Chapter-X, not related to audit.
- Best judgment assessment u/s 121 in consequence of non-compliance of notice u/s 114, revision of assessment u/s 122A except in cases selected for audit.

- Collection and recovery of taxes under Part-IV Chapter-X and issuance of refund including refund adjustment, charge of additional tax and processing/finalization of complaints in respect of new cases and broadening of tax base.

(iii) Legal Division:-

- Defend appeals before Commissioner (Appeals), institute and defend departmental appeals and references under Part-III Chapter-X and prosecution cases u/s 203 and represent the department in the process of liquidation. Defend complaints before FTO. File/defend presentations before the President of Pakistan.
- Appoint legal advisors and assign cases, wherever required, for representation before the appellate forums.
- Recognition of provident fund, approve superannuation fund and gratuity fund under the Sixth Schedule and exercise all the powers under the said Schedule.
- Grant of approval to pension schemes for the purpose of clause 12 of Part I of Second Schedule.
- To give effect to an appeal order in all cases except those selected for audit.
- Grant of approval to gratuity schemes for the purpose of clause 13 of Part I of Second Schedule.
- Grant of approval to benevolent fund or group insurance schemes for the purpose of clause 57 of Part I of Second Schedule.
- Grant of approval to non-profit organizations under section 2(36) of the Income Tax Ordinance, 2001.

(iv) Information Processing Division:-

- Maintenance of physical and electronic records.
- Receipt of communication from Functional Divisions and other Income Tax Authorities.

- Dispatch of hard copies to different Divisions on demand and storage of information, documents, statements, returns and all other communications received from other divisions, authorities and sources.
- Cross matching of information collected from taxpayers and other sources and issuance of discrepancy reports to respective Divisions.

(v) Taxpayers' Facilitation & Human Resource Management Division:-

- Receive returns, statements, statutory notices, documents, applications from taxpayers, mail from other income tax authorities, tax payment receipts (challans) from banks, and all outside communications.
- Sort and disseminate information, documents, returns, statements and mail mentioned above, to concerned divisions or to income tax authorities, as the case may be.
- Communicate assessment orders/penalty orders and demand notices to taxpayers.
- Career planning, help line management in identifying HR needs, maintenance of employees' profiles and personal files, development of job descriptions, positive attitude building, regulation of performance related pecuniary incentives, training and development according to training needs analysis, coordination with FBR on various HRM areas.
- Initiation of disciplinary proceedings, processing and finalization thereof, and monitoring and implementation performance appraisal system.

Method of Inspection:-

The following procedure is being followed by the inspection team comprising Additional Director and his supporting staff in conducting an inspection:-

(1) The inspection authority intimates to the concerned field officer in LTUs/RTOs regarding inspection schedule and visits the said RTOs/LTUs to discuss the inspection work plan.

(2) The requisition of MPR/performance data and record of cases is made by the inspection authority followed by access to all requisite information and relevant record including computerized record, diskettes, floppies, hard discs available in the office.

(3) The inspecting authority after completion of initial scrutiny communicates draft observations on daily basis to the respective officer before finalization of inspection report.

(4) The respective taxation officer is required to respond within seven (7) days to settle the observations.

(5) Replies of the officers in charge are considered by the inspecting authorities before the draft notes are incorporated in the inspection report.

(6) Final inspection notes are serialized and incorporated in the inspection report alongwith the prescribed format on completion of the inspection work according to the method prescribed. The inspection report under the signature of inspection authority is delivered to the respective taxation officer within 15 days of the receipt of reply from the said officer, with copies to Chief Commissioner, LTUs/RTOs and Commissioner of the respective Division.

(7) The Director then forwards a copy of inspection report to the Director-General of Internal Audit (Inland Revenue) alongwith his comments and the inspection control format.

(8) Year-wise computerized inspection control record is maintained in the office of each Director.

Follow up action:-

In order to settle objections or comments made in each serialized note of the inspection report and to retrieve the loss of revenue, if any, follow up action is taken independently at each level as under:-

i. The Deputy Director/Assistant Director/Extra Assistant Director pursues the matter with the respective officer of the field formation after the delivery of inspection report and furnishes compliance report within 30 days.

ii. The Additional Director takes cognizance of the unsettled notes on the basis of follow up report of the Deputy Director/Assistant Director/Extra-Assistant Director and takes up the matter with the respective Additional Commissioner to ensure compliance within 10 days. In case the matter is not resolved, the Additional Director reports the matter to the Director, Internal Audit (Inland Revenue) under intimation to the respective Commissioner.

iii. The Director, Internal Audit (Inland Revenue) takes up the matter with the respective Commissioner to ensure resolution within 10 days. If the matter remains unresolved, the Director takes up the matter with the Chief Commissioner, RTOs/LTUs, as the case may be, and furnishes report to the Director-General of Internal Audit (Inland Revenue) under intimation to the respective Chief Commissioner, RTOs, LTUs highlighting measures adopted for follow up and disposal of the matter.

iv. The Director-General of Internal Audit (Inland Revenue) then allows 20 days for compliance to the respective Chief Commissioner, RTOs/LTUs.

v. In case the compliance is not made after the expiry of 20 days, the Director-General of Internal Audit (Inland Revenue) may take up the matter with the Chief Commissioner, RTOs/LTUs, and the respective Member or refer the matter to the Chairman, FBR as considered appropriate.

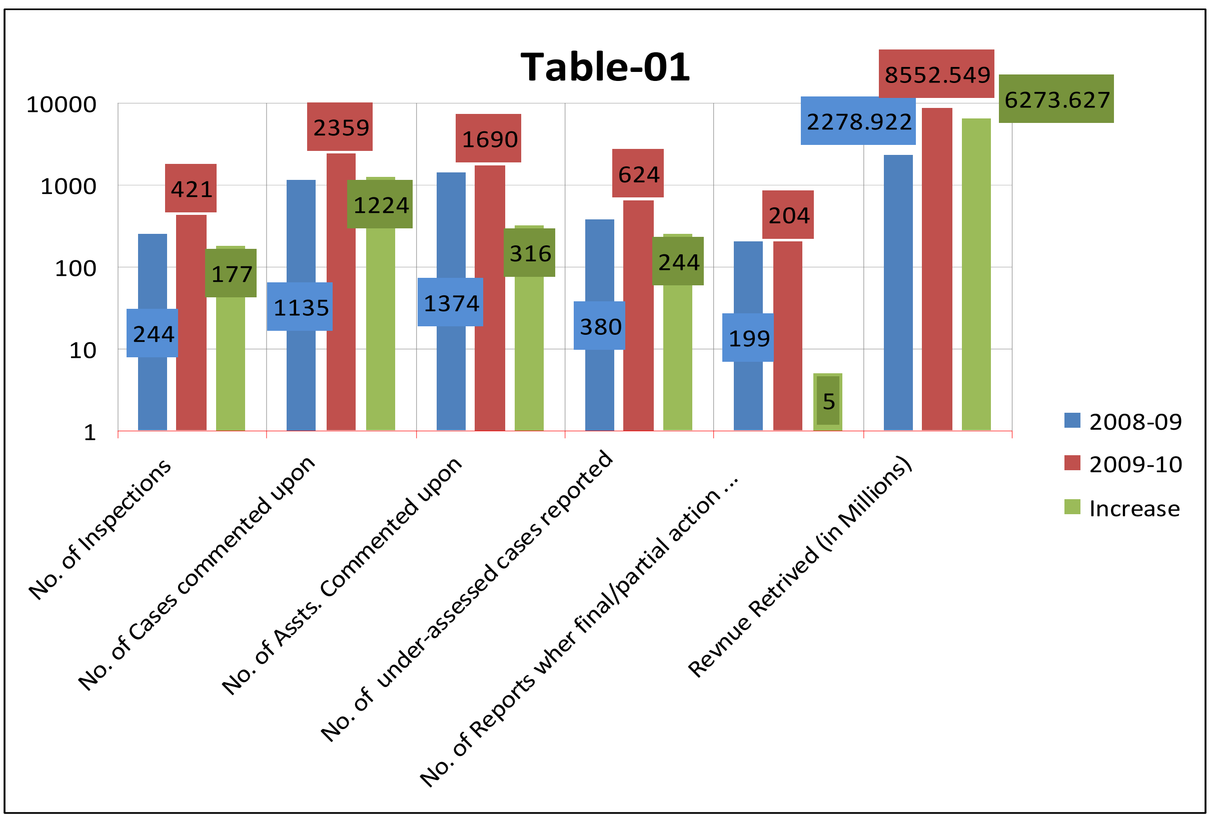
vi. The Director-General of Internal Audit (Inland Revenue) may issue necessary instructions for follow up of the matter to any of subordinate offices as considered appropriate.

vii. Final compliance in respect of each inspection report is to be reported to the Director General of Internal Audit (Inland Revenue) on prescribed format as soon as possible but in no case later than sixty (60) days from the date of delivery of inspection report to the respective field officer in LTUs/RTOs.

Facts and Figures on Performance of Inspection Function during the Year 2009-10

1. Regular Inspection Performance in Comparison with Preceding Year

Table-01				
S. #	**Description**	**2008-09**	**2009-10**	**Increase**
1.	Number of Inspections.	244	421	+ 177
2.	Number of cases commented upon	1135	2359	+ 1224
3.	Number of assessments commented upon.	1374	1690	+ 316
4.	Number of under-assessed cases.	380	624	+ 244
5	Number of reports where final/partial action completed by the taxation officer	199	204	+ 5
6	Revenue retrieved (Rs. Million)	2278.922	8552.549	+ 6273.627



The above comparison shows that the number of inspections carried out has increased from 244 inspections conducted in 2008-09 to 421 inspections completed in the year 2009-10; hence the volume of work carried out under the head 'inspection' has increased by 72.54 % during the financial year 2009-10. Similarly, the number of cases and assessments commented upon has also increased from 1135 and 1374 in the year 2008-09 to 2359 and 1690 in the year 2009-10 respectively.

It is important to mention that the number of cases of under-assessment of income and tax evasion has increased from 380 last year to 624 in the year 2009-10 which is unprecedented in the history of the organization and shows 64.21 % increase. As discussed earlier, with the advent of tax reforms undertaken by the FBR, functional based re-structuring and promulgation of the Income Tax Ordinance, 2001, the concept of **deemed assessment** calls for inspections of quality in order to detect quantified evasion of tax. In this regard, the Directorate General, Internal Audit (IR) has made land-mark progress despite frequent jurisdictional changes and administrative reshuffle which embody unsettling effect and delay in access to records for conducting inspections.

Similarly, despite all odds, 204 inspection reports have been finalized against 199 in the year 2008-09 which shows increase. As a result of above discussed performance, **loss of revenue of Rs. 8552.549 million has been retrieved** during the year 2009-10 **which is 3.75 times the revenue retrieved out of inspections in the year 2008-09.**

2. Regular Inspection Performance in Comparison with 2008-09 for Northern Region, Islamabad.

Table-02

Sr. No.		2008-09	2009-10	Difference
1	Number of inspections	92	145	+ 53
2	Number of cases commented upon	588	699	+ 111
3	Number of assessments commented upon	796	708	- 88
4	Number of under-assessed cases	588	-	-
5	Number of reports where final/partial action completed by the taxation officer	96	40	- 56
6	Revenue retrieved (Rs. Million)	563.053	846.388	+ 283.335

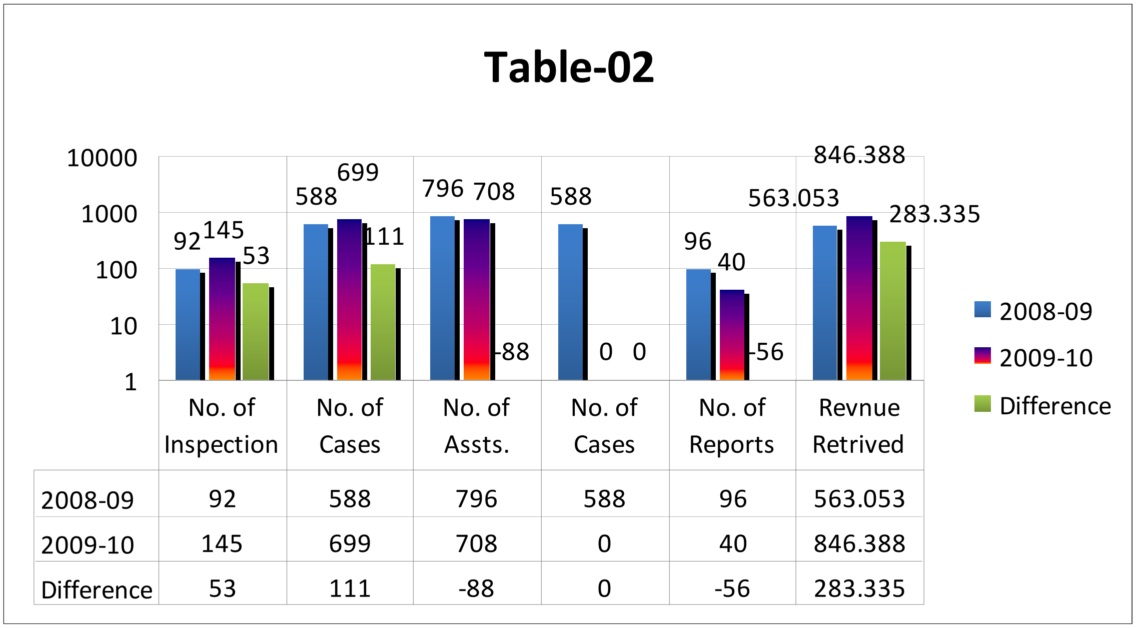
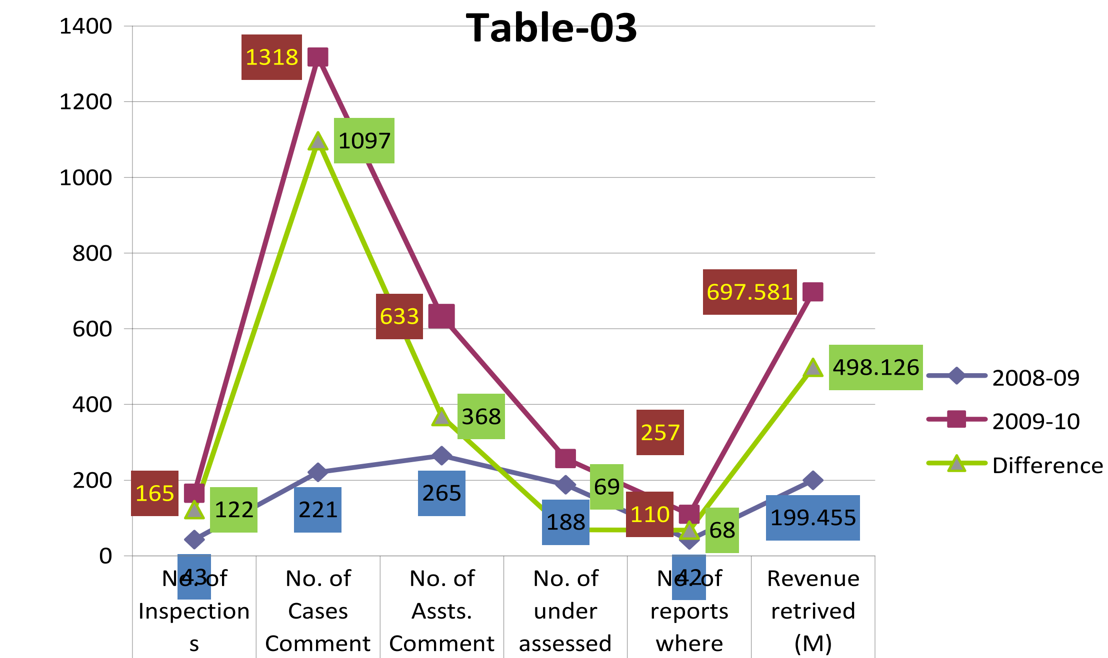


Table-02 above depicts the performance of inspection function of Northern Region during the year 2009-10 in comparison with the financial year 2008-09. During the year 2009-10, the number of inspections carried out has increased by 57.61 % compared with last year. The number of cases where discrepancies were observed have increased from 588 last year to 699 this year i.e. 2009-10. The number of cases finalized has decreased from 96 last year to 40 this year owing to shortage of officers and staff and frequent jurisdictional changes in the relevant RTOs. **Nevertheless, stringent follow up of major cases was ensured and accordingly, despite all odds, retrieval of loss of revenue increased from Rs. 563.053 million last year to Rs. 846.388 million in the year 2009-10.**

3. Regular Inspection Performance in Comparison with Preceding Year for Central Region, Lahore.

Table-03

Sr. No.		2008-09	2009-10	Difference
1	Number of inspections	43	165	+ 122
2	Number of cases commented upon	221	1318	+ 1097
3	Number of assessments commented upon	265	633	+ 368
4	Number of under-assessed cases	188	257	+ 69
5	Number of reports where final/partial action completed by the taxation officer	42	110	+ 68
6	Revenue retrieved (Rs. Million)	199.455	697.581	+ 498.126



	No. of Inspections	No. of Cases Comment	No. of Assts. Comment	No. of under assessed	No. of reports where	Revenue retrived (M)
2008-09	43	221	265	188	42	199.455
2009-10	165	1318	633	257	110	697.581
Difference	122	1097	368	69	68	498.126

Table-03 above depicts the performance of inspection function of Central Region, Lahore during the year 2009-10 in comparison with the financial year 2008-09. During the year 2009-10, 165 inspections have been conducted by the Additional Directors compared with 43 last year. ***The increase of 283.72 % is unprecedented despite shortage of officers / staff and administrative changes in the respective RTOs.*** The Central Region's contribution to the total number of inspections conducted is 39.19 %. The officers have detected record number of 1318 cases where various discrepancies were observed compared with 221 during the year 2008-09. Share of Central Region in the total number of detections made is 55.87 %. The number of cases of under-assessment and tax evasion has increased to 257 (41.19 % of the total) in the year 2009-10 compared to 188 last year.

As a result of above discussed performance, ***loss of revenue of Rs. 697.581 million has been retrieved*** during the year 2009-10 ***which is 3.5 times the revenue***

retrieved out of inspections in the year 2008-09. The performance in this field is marvellous.

4. Regular Inspection Performance in Comparison With 2008-09 for Southern Region, Karachi.

Table-04				
Sr. No.		2008-09	2009-10	Difference
1	Number of inspections	109	111	+ 2
2	Number of cases commented upon	326	342	+ 16
3	Number of assessments commented upon	313	349	+ 36
4	Number of cases under-assessed cases reported	343	367	+ 24
5	Number of reports where final/partial action completed by the taxation officer	61	54	- 07
6	Revenue retrieved (Rs. Million)	1516.414	7008.580	+ 5492.166

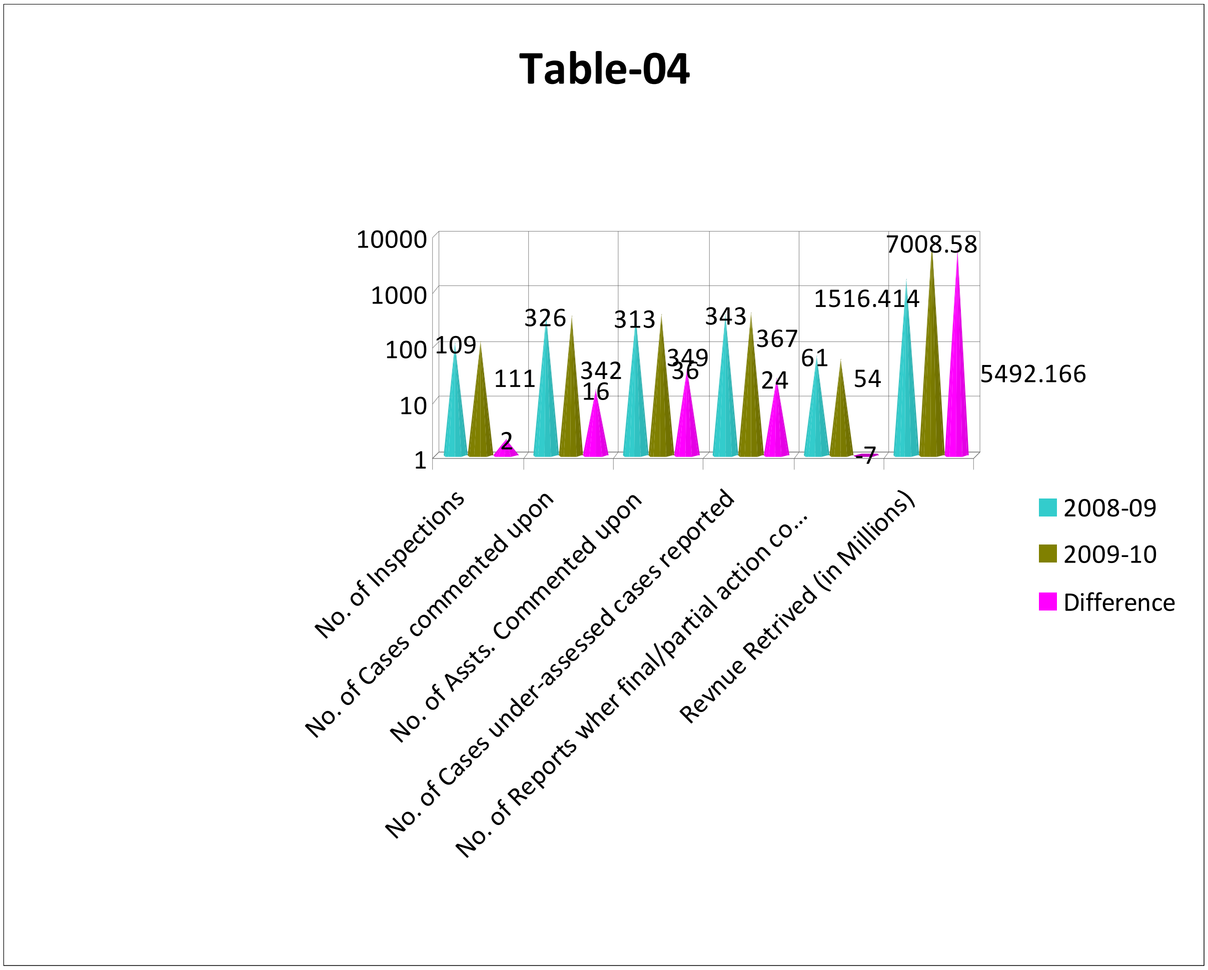


Table-04 above depicts the performance of inspection function of Southern Region, Karachi during the year 2009-10 in comparison with the financial year 2008-09. During the year 2009-10, 111 inspections have been conducted by the Additional Directors compared with 109 last year. The number of inspections where final action completed has slightly decreased due to the following reasons:

a. Shortage of Additional Directors, officers below and staff.

b. Proceeding of two (out of 7) Additional Directors on MCMC.

c. Frequent jurisdictional changes and lack of access to records.

d. Frequent transfers of Directors.

The officers have detected record number of 342 cases where various discrepancies were observed compared with 326 during the year 2008-09. The number of assessments commented upon has increased from 313 last year to 349 during the year 2009-10. The number of cases of under-assessment and tax evasion has increased to 367 during the year 2009-10 compared with 343 last year.

Despite all odds, hectic efforts were made and stringent follow up was made with special focus on major cases. As a result ***loss of revenue of Rs. 7008.580 million has been retrieved*** during the year 2009-10 compared to Rs. 1516.414 last year ***which is 4.62 times the revenue retrieved out of inspections in the year 2008-09,*** therefore, performance is unprecedented.

5. Comparative Analysis of Revenue retrieved (Region-wise)

Table-05

Sr. No	Region	Regular		Directors'		Special		Total	
		2008-09	2009-10	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10
1.	Northern	563.053	846.388	-	-	-	-	563.053	846.388
2.	Central	192.674	515.560	1.417	-	5.364	182.021	199.455	697.581
3.	Southern	1516.414	6858.605	-	-	-	149.975	1516.414	7008.580
	Total	**2272.141**	**8220.553**	**1.417**		**5.364**	**331.996**	**2278.922**	**8552.549**

The Region-wise comparison of revenue retrieved reveals that Northern Region, Islamabad has shown fairly good increase in the revenue retrieved compared with the revenue retrieved during the year 2008-09.

Central Region, Lahore and the Southern Region, Karachi have shown land mark progress as their revenue retrieved during the year 2009-10 is 3.5 and 4.62 times respectively higher than the revenue retrieved during financial year 2008-09.

6. Pending Inspection Reports as on 30-06-2010

Table-06

S. No.	Region (Including reformed Units)	Regular Inspection	Inspections by Directors	Special Inspection	Total
1	Northern Region	251	10	75	336
2	Central Region	175	-	33	208
3	Southern Region	275	-	09	284
Total		**701**	**10**	**117**	**828**

Table-06 above reflects the Region-wise breakup of pendency of inspection reports. As on 30.6.2010, 828 inspection reports are lying pending compared with 562 last year. ***The increase in pendency of the inspection reports is due to the reason that unprecedented number of regular and special inspections have been carried out during the year 2009-10 and issued to the respective field formations. Retrieval action in most of the current inspection reports has not been finalized by the respective officers within the stipulated time.*** The number of pending reports pertaining to previous years has however declined as record disposal has also been made. It has been observed that the field offices have not been able to dispose of the inspection reports within the stipulated time. In this connection, hectic follow up efforts have been made at all level. Focal persons were appointed and follow up meetings also conducted at Directors General / Chief Commissioners level.

Chapter-3

AUDIT

Internal Audit (Revenue)

Preamble:-

With the promulgation of Income Tax Ordinance, 2001 in July 2002 ("the Ordinance"), a system of Universal Self-Assessment Scheme has been introduced for all categories of taxpayers. Consequently, any return filed by a taxpayer within due date qualifies for acceptance under section 120 of the Ordinance.

This concept of Universal Self-Assessment Schemes is in vogue in many countries of the world. However, in most of the countries the scheme is backed by a strong "audit regime". The purpose of audit is to ensure compliance of tax laws and to act as deterrence to tax evasion/avoidance by taxpayers.

Audit under the Ordinance is specifically covered under section 177 which lays down a prescribed procedure for selection of cases and completion of audit. However, to err is human, therefore, element of omission and commission cannot be ruled out. Under SRO 660(I)/2005 dated 30.6.2005 the Directorate General of Internal Audit (Inland Revenue) has been entrusted to "**carry out internal audit of cases or offices involving income tax revenues and expenditure"**. Thus one of the most important tasks assigned to the Directorate General is to conduct "audit" with an aim to verify the correct application of law and rules by field officers.

Scope:-

The scope of audit conducted by the Directorate General of Internal Audit (Inland Revenue) has been provided in the Manual of Internal Audit (Revenue & Expenditure) 2009. It covers both Revenue as well as Expenditure Audit. In Revenue Audit, audit of a Division or a functional unit is conducted with a view to examine the leakages and loss of revenue due to negligence, inefficiency, tax fraud, carelessness, etc. The aim of audit is to educate and assist field formations in correct application of law, rules and regulations so as to create a fair, transparent and efficient working environment.

Methodology:-

Annual Schedule of Internal Audit (Revenue) is prepared and approved by the Director of the respective Region by 15th June of each year in respect of financial year following the said date. The approved audit schedule is circulated amongst the respective officers to conduct audit as per procedure laid down in the Manual of Internal Audit, 2009 under intimation to the Director General, Internal Audit (Inland Revenue).

The Audit teams of each Region conduct monthly audits according to the approved schedule. Each audit team is headed by a Deputy/Assistant Director /Extra Assistant Director who is assisted by a team comprising Inspectors, Upper/Lower Division Clerks etc.

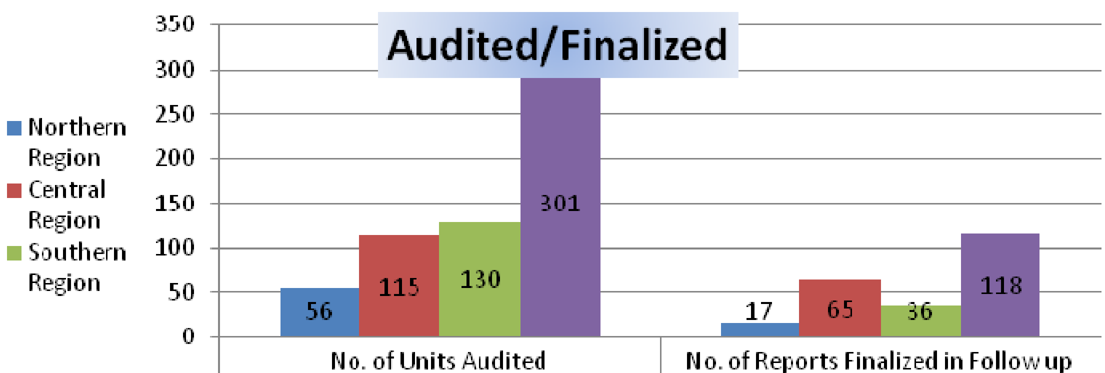
Areas of audit:-

a. Checking arithmetical accuracy of computation of income, expenditure, assets and liabilities.
b. Detection of wrong allowance of tax and improper application of tax rates.
c. Checking the accuracy of depreciation, other allowances and correctness of carry forward and adjustment of losses.
d. Pointing out mismanagement in field formations due to non-maintenance or improper maintenance of prescribed record.
e. Pointing out lapses in monitoring of withholding taxes and enforcement of statements u/s 165.
f. Detection of miscalculation of tax credits, tax rebates and refunds.
g. Checking the correctness of brought forward arrear demand, its addition and deletion.
h. Checking correct levy of additional taxes and penalties under the law.
i. Checking mis-reporting, under-reporting and over-reporting of Direct Taxes Collection.
j. Identifying improper deduction of Zakat, WWF, etc.
k. Guiding, educating and assisting the field formations on proper application of law, rules and regulations.
l. Examining fairly, independently and impartially leakages & loss of revenue.

Performance during the Financial Year 2009-10

1. Loss of revenue detected/retrieved in current audit

Table-1				
Region	**No. of Units Audited**	**No. of Reports Finalized in Follow up**	**Loss of Revenue (M)**	
			Detected during the year	**Retrieved for the Year on follow – up**
Northern Region	56	17	2231.188	965.140
Central Region	115	65	13248.928	4410.197
Southern Region	130	36	12710.966	11601.029
Total	**301**	**118**	**28191.082**	**16976.366**



	No. of Units Audited	No. of Reports Finalized in Follow up
Northern Region	56	17
Central Region	115	65
Southern Region	130	36
Total	301	118

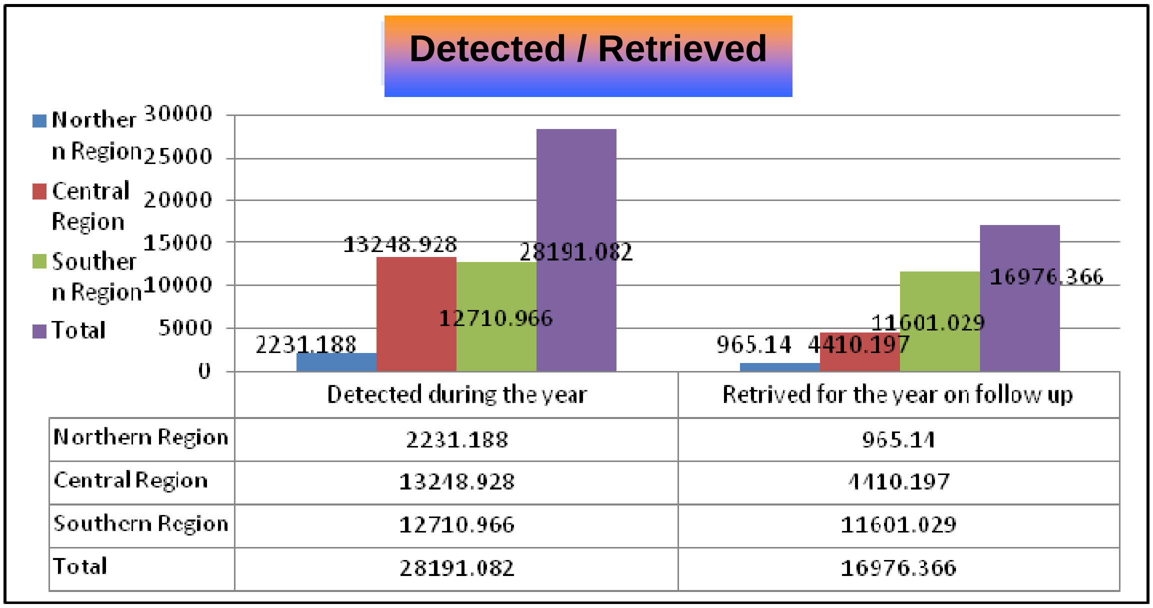


Table-1 above reflects region-wise comparison of audit conducted, audit reports finalized, loss of revenue detected and retrieved. During the financial year 2009-10 audit of 301 functioning units was conducted and 118 audit reports were finalized by the audit teams. ***Loss of revenue for the year 2009-10 was detected at Rs. 28,191.082 (M) and loss of revenue at Rs. 16,976.366 (M) was retrieved which shows a considerable increase against the retrieval of loss at Rs. 12,304.112(M) for the year 2008-09.*** The above comparison shows that Central Region, Lahore contributed 47% to total loss of revenue detected during the year 2009-10 whereas Southern Region, Karachi contributed 68% to total loss of revenue retrieved during the year under consideration.

2. Retrieval of revenue loss out of earlier years

Table-2

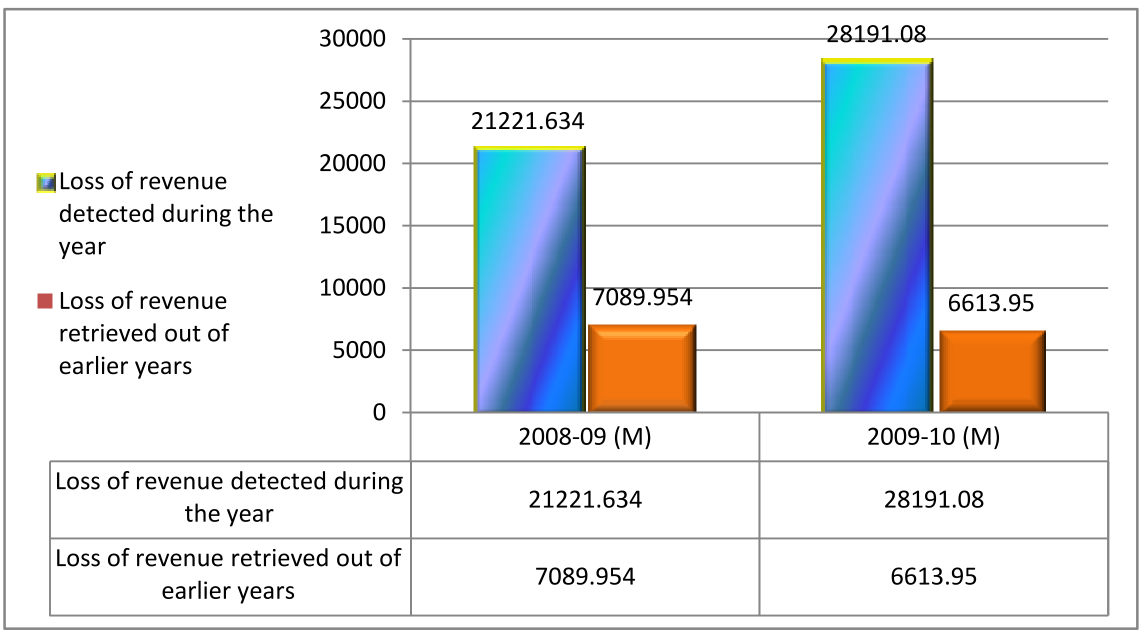
Region	No. of Units where follow-up action completed	Loss of Revenue (M) Retrieved up to 30.06.2010
Northern Region	20	695.165
Central Region	91	4615.435
Southern Region	20	1303.357
Total:	**131**	**6613.957**

Table-2 depicts the retrieval of loss of revenue pertaining to the earlier years. The Directorate General also concentrated its efforts on retrieval of loss from earlier years' in addition to the retrieval of loss of revenue from current year's detection. Total number of 131 earlier audit reports were finalized through the efforts of audit teams and loss of revenue of Rs.6, 613.957 (M) was retrieved.

3. Comparison of loss detected and retrieved

Table-3

		2008-09 (M)	2009-10 (M)
1	Loss of revenue detected during the year	21221.634	28191.082
2	Loss of revenue retrieved out of earlier years	7089.954	6613.957



Comparison of loss detected and retrieved for the financial year 2009-10 has been presented in comparison to the performance for the year 2008-09 in Table-3 above. ***The loss of revenue detected during the current year stood at Rs.28, 191.082 (M) as compared to Rs. 21, 221.634 (M) for the preceding year which shows an increase of 33%.***

4. Total revenue retrieved in 2009-10 (Including pending audit reports)

Table-4			
i) Current			
Region	**No. of Units Audited**	**Follow up/ compliance by 30.06.2010**	**Loss of Revenue retrieved(M)**
Northern Region	56	17	965.140
Central Region	115	65	4410.197
Southern Region	130	36	11601.027
Sub Total:	**301**	**118**	**16976.364**
ii)Previous Years' Reports			
Northern Region	69	20	695.165
Central Region	189	91	4615.435
Southern Region	100	20	1303.357
Sub Total:	358	131	6613.957
Grand Total	**659**	**249**	**23590.321**

Table-4 above depicts cumulative effect of retrieval out of current year's audit as well as retrieval from previous year's audit reports. ***Total number of 249 reports were finalized during the year 2009-10 resulting in retrieval of revenue of Rs. 23,590.321 (M) which shows a remarkable increase when compared with the retrieval of revenue at Rs. 19, 145.772 (M) for the year 2008-09.***

5. Comparative Analysis of Last Three years' Audits

Table-5				
S.No.	**Subject**	**2007-08**	**2008-09**	**2009-10**
1.	Number of Circles/ Units audited.	179	264	301
2.	Number of cases audited.	17294	15083	19234
3.	Number of Circles/ Units where follow up action completed.	90	194	229
4.	Number of Circles/ Units audited in previous years where follow up action completed during current year.	259	168	131
5.	Percentage compliance in current year's Audit Reports.	50.3 %	32.57 %	33%

Table-5 above provides the comparative position of units audited, number of cases audited and number of units where follow up action was completed in the last three years. The above chart reveals a considerable increase in respect of units audited and number of cases audited for year 2009-10 as compared with the previous years. However, completion of follow up action has decreased during the year 2009-10 with regard to the previous year. ***The main reason of the said decrease is due to frequent changes in Jurisdiction of cases falling in LTUs/ RTOs. Further, frequent transfers of Officers/ Officials have also caused delay in compliance of audit paras/ reports by the respective taxation officers.***

6. Loss of Revenue detected on account of non/short levy of additional taxes

Table-6

(Figures in Million)

Section of Income Tax Ordinance, 1979/2001/ Wealth Tax Act, 1963	**Loss Reported (Rupees)**		
	2008-09	**2009-10**	**Percentage Increase**
Section 86/205(3)	331.947	1207.838	264 %
Section 87/205(1)	187.061	478.746	155 %
Section 88/205(1)	29.306	58.364	99 %
Section 89/205(1)	226.652	265.204	17 %
Section 31B/31BB/31BBB	1.068	1.079	-
Total	776.034	2011.231	159 %

Table-6 above depicts the loss of revenue detected by the audit authorities on account of non/short-levy of additional taxes under various additional taxes. ***The above chart reflects a healthy increase of 159 % for the year 2009-10 over the detection of loss of revenue in the year 2008-09.***

7. Loss of Revenue on Account of Non/Short levy of additional tax u/s 205/86

Table-7				
				(Figures in Million)
S. No.	Offices	Directorate		
		Northern	Central	Southern
1.	RTO, Peshawar	160.327		
2.	RTO, Faisalabad		6.465	
3.	LTU, Lahore		60.566	
4.	RTO, Lahore.		791.224	
5.	RTO, Sialkot		7.194	
6.	RTO, Gujranwala		2.724	
7.	RTO, Multan		176.339	
8.	LTU, Karachi			-
9.	RTO, Karachi			-
10.	RTO, Sukkur			1.593
11.	RTO, Hyderabad			1.406
	Total:	**160.327**	**1044.512**	**2.999**
	Grand Total	**1207.838**		
	Region Wise Percentage	**13.28 %**	**86.48 %**	**0.24 %**

Table-7 depicts the region-wise performance on account of non/short-levy of additional tax under section 205(3) of the Income Tax Ordinance, 2001 for failure to deduct/collect withholding taxes at the rates specified in the first schedule to the Income Tax Ordinance, 2001. The Central Region, Lahore has shown better performance by detecting loss of revenue at Rs. 1,044.512 (M) which is 86.48 % of total loss detection. ***During the year 2009-10 overall loss of revenue was detected at Rs. 1207.838 (M) on account of non-levy of additional tax under section 205(3) which shows an increase of 264% against loss detected at Rs. 331.947 (M) for the year 2008-09.***

8. Loss of Revenue on Account of Non/Short levy of additional tax u/s 205/87

Table-8

(Figures in Million)

S. No.	Offices	Directorate		
		Northern	**Central**	**Southern**
1.	RTO, Rawalpindi	3.350		
2.	RTO, Peshawar	72.153		
3.	RTO, Abbotabad.	0.030		
4.	LTU, Lahore		0.353	
5.	RTO, Lahore		26.210	
6.	RTO, Multan		1.273	
7.	RTO, Gujranwala		1.134	
8.	RTO, Sialkot		2.423	
9.	RTO, Faisalabad		5.996	
10.	LTU, Karachi			189.868
11.	RTO, Karachi			175.296
12.	RTO, Hyderabad			0.475
13.	RTO, Sukkur			0.119
14.	RTO, Quetta			0.066
	Total:	**75.533**	**37.389**	**365.824**
	Grand Total	**478.746**		
	Region Wise Percentage	**15.78 %**	**7.81 %**	**76.41 %**

Table-8 above shows detection of loss of revenue on account of non/short-levy of additional tax under section 205 (1) of the Income Tax Ordinance, 2001 for failure to pay or timely deposit any installment of advance tax due under section 147 of the Ordinance. Total loss of revenue under the said head was detected at Rs. 478.746 (M). The region-wise performance vis-à-vis loss detected as presented through above chart reveals that the Southern Region, Karachi has detected loss of revenue under this head at Rs. 365.824 (M) which constitute 76.41 % of the total loss of revenue detected. ***Loss of revenue of Rs 478.746 (M) was detected on account of non-levy of additional tax under section 205 (1) which shows an increase of 155 % against loss detected under the said head for the year 2008-09 at Rs. 187.061 (M).***

Table-9

(Figures in Million)

S. No.	Offices	Directorate		
		Northern	**Central**	**Southern**
1.	RTO, Rawalpindi	1.640		
2.	RTO, Peshawar	3.711		
3.	RTO, Faisalabad		-	
4.	LTU, Lahore		34.844	
5.	RTO, Lahore		1.617	
6.	RTO, Multan		-	
7.	RTO, Gujranwala		0.055	
8.	RTO, Sialkot		2.559	
9.	RTO, Karachi			13.911
10.	RTO, Sukkur			0.027
	Total:	**5.351**	**39.075**	**13.938**
	Grand Total	**58.364**		
	Region Wise Percentage	**9.17 %**	**66.95 %**	**23.88 %**

9. Loss of revenue on account of non/short levy of additional tax u/s 205/88

Region-wise details of loss of revenue detected at Rs. 58.364 % for the year 2009-10 for short/non levy of additional tax for failure to pay admitted liability under section 137 of the Income Tax Ordinance, 2001 reveal that 66.95 % additional tax has been charged by the Central Region, followed by Southern Region and Northern Region with 23.88 % and 9.17 % respectively. ***Table-9 above also reflects that bulk of audit work has been done in LTU, Lahore.***

10. Loss of revenue on account of Non/Short Levy of Additional Tax u/s 205/89

Table-10 (Figures in Million)		
S.	**Offices**	**Directorate**

No.		Northern	Central	Southern
1.	RTO, Rawalpindi	16.639		
2.	RTO, Peshawar	1.521		
3.	RTO, Abbottabad	0.168		
4.	RTO, Faisalabad.		-	
5.	LTU, Lahore		19.207	
6.	RTO, Lahore.		3.924	
7.	RTO, Multan		175.066	
8.	RTO, Gujranwala		1.535	
9.	RTO, Sialkot		2.212	
10.	LTU, Karachi			3.178
11.	RTO, Karachi			41.263
12.	RTO, Hyderabad			0.491
13.	RTO, Sukkur			-
14.	RTO, Quetta			-
	Total:	**18.328**	**201.944**	**44.932**
	Grand Total		**265.204**	
	Region Wise Percentage	**6.91 %**	**76.15 %**	**16.94 %**

The above table provides the figures of loss of revenue detected at Rs.265.204 (M) for the year 2009-10 by the audit authorities for non / short levy of additional tax under section 205/89 of the Income Tax Ordinance, 2001 for failure to pay a part or whole of tax determined by the department. ***The major contribution of detection of loss of revenue has been made by the Central Region which constitutes 76.15 % of the total detection of loss of revenue where lot of audit work has been done in RTO, Multan.***

11. Loss of revenue on account of Non/Short levy of Additional Taxes u/s 31B, 31BB, and 31BBB of Wealth Tax Act 1963

Table-11

(Figures in Million)

S.No.	Offices Audited	Directorate

		Northern	Central	Southern
1	RTO, Multan	-	-	-
2.	RTO, Rawalpindi	1.079		-
3.	RTO, Faisalabad		-	-
	Total	1.079	-	-
Grand Total		**1.079**		

The detection of loss of revenue for non / short levy of additional Wealth Tax during the year 2009-10 amounting to Rs.1.079 (M) has been made by Northern Region only. ***Since the Wealth Tax Act, 1963 is not in operation, this area of the loss of revenue detected relates to the detection in respect of valuation dates before 30-06-2001.***

12. Loss of revenue on account of Non/Short Charge of WWF

Table-12

(Figures in Million)

Offices Audited	**Directorate**		
	Northern	**Central**	**Southern**
RTO, Rawalpindi	78.055	-	
RTO, Faisalabad	-	6.726	
RTO, Peshawar	8.450	-	
LTU, Lahore		3.287	
RTO, Lahore		6.027	
RTO, Multan		0.021	
RTO, Gujranwala		1.499	
RTO, Sialkot		1.905	
LTU, Karachi			1.249
RTO, Karachi			13.309
RTO, Hyderabad			0.002
RTO, Sukkur			5.793
RTO, Quetta			0.998
Total	**86.505**	**19.465**	**21.351**
Grand Total	**127.321**		

Audit during the year 2009-10 led to detection of number of discrepancies in the charging of WWF under section 4 of Workers Welfare Ordinance, 1971 resulting in detection of loss of revenue under this head at Rs. 127.321 (M).

13. Loss of revenue due to Miscellaneous Irregularities

i) Northern Region

Table-13

(Figures in Million)

S.No	Irregularity	Offices Audited			
		Abbott-abad	**Peshawar**	**Rawalpindi**	**Total**
1.	Wrong Calculation of Tax	-	-	21.826	21.826
2.	Arrears demand not BF (Income Tax)	-	22.592	-	22.592
3.	Arrears deleted without Incorporation certificates.	-	770.312	-	770.312
4.	Under Section 137/54	-	-	-	-
5.	Under Section 52	15.906	147.640	-	163.546
6.	Under Section 54/50	-	-	-	-
7.	Misc. (Income Tax)/ Other reasons.	28.615	926.193	0.564	955.372
	Total	**44.521**	**1866.737**	**22.390**	**1933.648**
Grand Total		**1933.648**			

ii) Central Region

Table-14

(Figures in Million)

S. No.	Irregularity	Office Audited

		LTU Lahore	RTO Lahore	RTO Multan	RTO Gujran-wala	RTO Sialkot	RTO Faisal-abad	Total
1.	Wrong Calculation of Tax	2.201	6.655	-	-	14.436	0.370	23.662
2.	Excess credit of tax.	-	-	-	-	-	128.551	128.551
3.	Arrears deleted without Incorpo-ration Certificates	-	781.011	-	45.844	8.579	55.141	890.575
4.	Arrear demand not Brought forward (I,Tax)	-	2992.178	-	0.272	-	6.404	2998.854
5.	Loss deleted u/s 161	712.128	5035.153	-	-	-	-	5747.281
6.	Wrong/excess refund adjustment.	8.666	-	-	-	-	-	8.666
7.	Wrong claim of c/f losses and incorrect figures on income declared.	-	-	-	-	-	-	-
8.	Demand notice/lack of verification.	0.267	1082.463	-	-	-	-	1082.730
9.	Irregular written off arrear.	-	-	-	7.169	4.873	-	12.042
10	Arrear recorded without incorporation certificate.	-	-	-	43.709	8.442	-	52.151

11	Difference of figures in DCR/Arrear & MPR.	-	-	-	41.172	286.680	-	327.852
12	Irregular credit of tax deducted at source.	-	-	-	0.055	-	-	0.055
13	Misc. Income Tax	0.518	32.703	0.941	7.513	10.682	532.914	585.271
	Grand Total	**723.780**	**9930.163**	**0.941**	**145.734**	**333.692**	**723.380**	**11857.690**

iii) Southern Region

Table-15

(Figures in Million)

S.No.	**Irregularities**	**Offices Audited**				
		LTU Karachi	**RTO Karachi**	**RTO Hyderabad**	**RTO Sukkur**	**RTO Quetta**
1.	Wrong Calculation of Tax	-	14.716	-	0.330	0.630
2.	Arrear deleted without incorporation certificate.	10135.694	702.705	-	-	-
3.	Misc. Income Tax (Other Reasons).	284.028	-	9.732	-	0.788
4.	Arrear demand not B/F.	-	914.636	-	-	1.198
5.	Others.	74.239	49.168	67.640	2.756	3.662
	Total	**10493.961**	**1681.225**	**77.372**	**3.086**	**6.278**
	Grand Total	**12261.922**				

Table-13, 14 and 15 show the loss of revenue detected by the Northern Region, Central Region and Southern Region respectively on account of miscellaneous irregularities in addition to detection of loss of revenue on account of non/short levy of additional taxes and WWF. ***Apart from additional taxes and WWF, major contribution of loss of revenue detected by the audit authorities comes from miscellaneous***

irregularities which include wrong calculation of taxes; arrear demand not brought forward and arrear demand deleted without obtaining incorporation certificate, etc. During the year 2009-10 total loss of revenue was detected at Rs. 26,053.260 (M) on this account as compared with the detection of loss for the year 2008-09 at Rs.19,835.643 (M). Region-wise data presented above reveals that Southern Region detected loss of revenue of Rs. 12,261.922 (M) under this head. Similarly, the Central Region also made a considerable contribution in detection of loss of revenue at Rs. 11,857.690 (M) on account of miscellaneous irregularities.

Grand total of head-wise detection of loss

Tax Revenue Loss Detected During 2009-2010		
S.No.	**Additional Taxes**	**Loss of Revenue detected**
1.	Under Section 205(3)/86	1207.838
2.	Under Section 205(1)/87	478.746
3.	Under Section 205(3)/88	58.364
4.	Under Section 205(3)/89	265.204
5.	Additional Tax under Wealth Tax Act.	1.079
6.	Surcharge	-
7.	WWF	127.321
	Other Regularities	
8.	i) Northern Region	1933.648
9.	ii) Central Region	11857.690
10.	iii) Southern Region	12261.922
	Total	**28191.812**

The above table shows a summary of total loss of revenue of Rs. 28,191.812 (M) for the year 2009-10 detected by the audit authorities under the head revenue audit as compared to immediately preceding year i.e 2008-09 where loss of revenue under all the heads of revenue audit was detected at Rs. 20,787.846 (M). ***The increase in detection of loss of revenue from audit function as indicated above clearly reflects the remarkable performance of the Directorate General.***

Chapter-4

INTERNAL AUDIT (EXPENDITURE)

In order to minimize audit objections from the AGPR, an internal control mechanism was devised at the Directorate General of Internal Audit (Inland Revenue) to conduct audit (expenditure) mandated by the SRO. 660(1)/2005 dated 30.6.2005. In Expenditure Audit, expenditure incurred by a functional Division is brought under scrutiny.

The objective of internal audit is to conduct and report an independent, impartial and fair audit of all the expenditures of Inland Revenue to enforce proper maintenance of expenditures record and check arithmetic accuracy of prescribed books of accounts and financial statements, detection and prevention of errors and mistakes by omission or commission in the accounts.

The logic behind this exercise is to impart guidance to Drawing & Disbursing Officers and sanctioning authorities to abide by General Financial Rules (GFR).

AREAS

While conducting the audit focus of Audit Team is mainly on the following areas:-

1. Log books of vehicles.
2. Consumable stores register.
3. Telephone Register.
4. Stationery Register.
5. T.A/ D.A Register.
6. History Sheet of Computers.
7. History Sheet of Photostat Machine.
8. Records whether Income Tax & Sales Tax have been properly deducted/ deposited.
9. Record of payment of overtime.
10. Monthly/ Annual Reconciliation of Expenditure with the actual of the AGPR.
11. Budget Control Register.
12. Budget allocation.

13. Cash books.
14. Stock/ Stores Register.
15. Long term/short term advances Register.
16. Photocopier Register.
17. Newspaper Register.
18. Service books of the officials.
19. Contingent Bills vouchers, T.A/D.A, Bills of advances, etc.
20. Maintenance of Bank Account in the name of DDO (if any).
21. Follow up of previous Audit Reports.
22. Scrutiny of payment vouchers and approvals accorded with reference to tendering process and quotations etc.

During the year under review, the Directorate General conducted internal audit (expenditure) of the Divisions/Offices and various irregularities were pointed out. The purpose of this exercise was to sensitize the department on various issues/irregularities which can later create problems at the time of external audit by AGPR. ***Thus, timely Expenditure Audit assists the field officers in improving internal controls and maintenance of records necessary for countering audit objections by external auditors.***

Chapter – 5

MAJOR ACHIEVEMENTS

It would be appropriate to highlight the following few cases of inspection where sizeable amount of lost revenue has been retrieved on the basis of detection of discrepancies by Inspection Authorities through various inspection reports.

SOUTHERN REGION, KARACHI

S. #	N.T. #	NAME OF TAXPAYER	TAX YEAR	ISSUE INVOLVED	LOSS OF REVENUE RETRIEVED
1	0819775	Occidental Petroleum Pakistan Inc.	2008	• Wrong claim of exemption. • Excess claim of depletion of (oil well) allowance. • Suppression of gain on disposal of fixed assets.	**4045.597 (M)**
2	1423588	Occidental Oil & Gas Pakistan Inc.	2008	• Wrong claim of exemption. • Excess claim of depletion allowance. • Suppression of gain on disposal of fixed assets.	**967.406 (M)**
3	0700009	B.P. Exploration & Petroleum Inc.	2008	• Wrong claim of amortization on account of “working interest” acquired from non-resident oil exploration companies.	**841.732 (M)**

4	0823414	ENI Pakistan Ltd.	2008	• Suppression of tax liability (on account of applying tax rate of 50 % against correct rate of 55 %). • Non-deduction of withholding tax u/s 151 from payments made as "profit on debt".	**407.925 (M)**

CENTRAL REGION, LAHORE

S. #	N.T. #	NAME OF TAXPAYER	TAX YEAR	ISSUE INVOLVED	LOSS OF REVENUE DETECTED
1	1350582	Associated Technologies (Pvt) Ltd.	2008	• Audit u/s 177 conducted but audit report not prepared. • Cost of sales not verified despite specific directions of the Commissioner Inland Revenue (Audit-I). • Suppression of sale proceeds.	**99.284 (M)**
2	1207489	Educational Excellence (Pvt) Ltd	2005 To 2008	• Income taxable under the regime of final taxation declared in addition to business income taxable at normal rates but instead of claiming	**89.062 (M)**

				proportionate expenses, entire expenses claimed against normal income (T.Y. 2005 to 2007). • Advertisement expenses not amortized as required u/s 24 which resulted in excess claim of expenses. (T.Y. 2005 to 2007). • Incorrect amortization of deferred cost resulting in excess claim of expenses. (T.Y. 2005 to 2007). • Non-declaration of business income (tax year 2008).	
3	1694540	Zarco Exchange (Pvt) Ltd	2004 2006	• Un-explained investment in fixed assets. • Un-explained creditors. • Default of withholding tax provisions.	**70.182 (M)**
4	1694540	Volvo Pakistan Ltd	2004	• Claim of time barred losses. • Excess claim of depreciation. • Incorrect proration of expenses.	**15.220 (M)**

				• Commission income not offered to tax under the regime of final taxation u/s 233.	
5	Various (As per list)	List of 128 cases of defaulter of advance tax payment u/s 147.	2010	• Non payment of Advance tax installments.	**14.678 (M)**

NORTHERN REGION, ISLAMABAD

S. #	N.T. #	NAME OF TAXPAYER	TAX YEAR/ A.Y	ISSUE INVOLVED	LOSS OF REVENUE RETRIEVED
1	0657163	S.A. Brothers (Pvt) Ltd.	2007 2008	• Un-explained investment of Rs. 183.194(M) in opening stock of raw materials and finished goods.	**247.164 (M)**
2	0700267	MCB Ltd	2000-01	• Excess claim of non-taxable perquisites.	**171.168 (M)**
3	1265896	Great Wall Drilling Company Ltd.	2003	• Claim of inadmissible depreciation allowance (Initial).	**119.294 (M)**
4	0802696	Pak Mobile Communication	2003	• Wrong claim of tax credit for investment u/s 107AA of the Income Tax Ordinance, 1979 (repealed).	**109.836 (M)**

5	0657297	Fauji Fertilizer Company	2004	• Wrong Claim of unabsorbed depreciation and carry forward of the same for setting off against the declared income.	**<u>64.175 (M)</u>**
6	NA	The Secretary, Finance, Khyber Pakhtoon-Khawa		• Default of withholding tax provisions.	**<u>25.904 (M)</u>**
7	0070012	National Highway Authority	2000-01	• Default of withholding tax provisions. .	**<u>15.721 (M)</u>**
8	0000215	Gadoon Textile Mills Ltd.		• Default of withholding tax provisions.	**<u>12.214 (M)</u>**
9		Dewan Salman Fibres Ltd.	2008	• Default of withholding tax provisions.	**<u>295.375 (M)</u>**

GLIMPSES OF EVENTS

Participants of Directors' Conference with Ms. Raana Mirza,
Director General (Lahore – 17.09.2010)

Ms. Raana Mirza, Director General presiding over Conference

Meeting continues

Mr. Shahid Zaheer, Director Lahore
presenting his performance report

Meeting with the Directors, Lahore, Islamabad and Karachi continues

Participants engrossed in the proceedings of Conference

Mr. Shahid Bashir,
Ex-Director

Mr. Muhammad Anwar Goraya,
Ex-Director

Mr. Jhangir Ahmad,
Secretary (IA)

Ms. Laila Ghafoor,
Additional Director

Ms.Amna Faiz Bhatty,
Ex-SA to Director

Mr. Ijaz Ahmad,
Second Secretary

Participants of the Conference

Mr.Ghulam Murtaza Khuhro, Additional Director explaining some issue

Elaborating on some issue during Director's conference

Ms. Laila Ghafoor, Additional Director and Mr. Talat Mehmood, Deputy Director

ROLE OF INDEPENDENT POWER PRODUCERS CRITICAL APPRAISAL

Muhammad Shahid Zaheer,
Director,
Internal Audit (Inland Revenue),
Central Region, Lahore.

Introduction:

It is universally recognized that energy is one of the most important inputs to economic growth and development. The consumption of energy is one of the critical indicators of level of development of any country. Pakistan with huge population of 160 million and a developing economy needs more energy to achieve annual growth rate of 7 – 8% per annum. In short, adequate and assured availability of energy supplies is a pre-requisite for sustained economic growth.

In early nineties, country faced acute power shortages. Due to scarcity of financial resources and non-performance by the Public Sector Entities (PSEs), government was forced to approach International Financial Institutions (IFIs), for help. IFIs advised the government to restructure PSEs and encourage the Independent Power Producers (IPPs) to invest in the energy sector to avert the looming crisis of power shortages and tide over the resource crunch being faced by the government.

The Planning Commission of Pakistan and WAPDA had envisaged that electricity demand in Pakistan will grow approximately at a rate of over 8% per annum in the Eighth Five Year Plan. As the government was unable to finance huge investments required to construct capital intensive power plants in public sector to cope with the rising power shortages, therefore, under the strait jacket of compulsions the government was forced to announce package of incentives and policy framework in 1994 to attract the foreign / private investment in the energy Sector of the country.

The paradigm shift in focus of the government in shape of 1994 energy policy was successful in bringing Foreign Direct Investment of about 3 billion dollars in power sector within a short period of three years. It also attracted world-renowned key players in power sector such as AES, EI-Paso, General Electric, Tanaga, SIEMENS, midland, etc. For the first time, Pakistan became competitive with various other countries due to the Bulk Power Tariff (BPT). Under this policy, some fourteen projects were set up in the country by IPPs adding 5,441 MW to the country's overall generation capacity.

As this significant addition to the generation capacity helped in delaying the impending power i.e. shortage crisis, this had vicissitudes attached to it too. The policy was successful in attracting only the thermal power based projects resulting in reversal of Hydel Thermal generation ratio. The IPPs electricity prices were beyond purchasing capacity of an average customer. The policy planners due to their shortsightedness failed to appreciate the crisis unfolded with 1994 policy i.e. over reliance on thermal powered generation and leaving hydropower potential untapped. The current crisis is the net result of the failure of policy planners to foresee the future needs but unfortunately, the blame is shifted to IPPs for no fault of theirs. Had the current power generating capacity of IPPs to the tune of 5,441 MW would have not been there, the country could have faced a much more devastating crisis of power outages, as against presently confronted with.

Pakistan energy needs will increase in the coming years due to:

- increase in population
- improvement in quality of life/living standards
- maintaining a consistent growth rate of 7-8 %
- Extension of public services, e.g. schools, hospitals, roads
- Village electrification
- Increasing oil reserves as planned under new Energy Security strategy

If the current growth trend in the energy supply and demand continues then it is estimated that energy consumption in Pakistan would be about 150 MTOE and the net supply from indigenous sources would be 103 MTOE by the year 2020. Thus the country would be facing a shortage of 31 percent of energy in the foreseeable future which will seriously affect the balance of payment position of the country and would make it difficult for the economy to continue moving on the present growth trajectory.

We should tap our natural resources which are available in abundance at Thar, Lakhara, Badin and Sonda Jherruk coal fields, around 45,000 MW hydropower untapped capacity and renewable energy such as wind, solar and bio-mass will have to be focused on to over come the current energy crisis.

Structure of Power in Pakistan

Power Sector Institutions

The enunciation of power sector institutions is of prime significance to develop an understanding about the system and the related trials and tribulations. The development in so far as the IPPs is concerned, has been directly dependent on the Organizational aspect of the Power sector institutions. The Ministry of Water and Power has been addressing all the issues since long with the help of:

A) Water and Power Development Authority (WAPDA);

B) Pakistan Electric Power Company (PEPCO);

C) Private Power Infrastructure Board (PPIB);

D) National Electric Power Regulatory Authority (NEPRA);

E) Alternative Energy Development Board (AEDB)

F) National Transmission & Dispatch Company (NTDC)

Factors Responsible For Energy Deficiency

Power Generation--- An Overview

Pakistan’s power generation capacity stood at 60MW at the time of independence with a per capita consumption of 4.5 units for its 31.5 million population. Power infrastructure development gained momentum in 1970 and within five years, the installed capacity rose from 636 MW in 1970 to 1,331 MW in 1975. In the year 1980, the system capacity touched 3,000 MW and thereafter it rapidly grew to over 8,000 MW in 1990-91. At present, Pakistan's total installed generation capacity from Hydroelectric, Thermal, Independent Power Producers (IPPs), and Nuclear sources stands at 19,566 MW. The existing capacity of thermal power generation in Pakistan stands at 12,630 MW, which is almost two-third (64.6 percent) of country's total generation capacity. Although, the thermal power plants are relatively quicker to set up, they are relatively most expensive due to sky-rocketing oil prices. Hydel energy is the second largest source of electricity and accounts for 33.1 percent of total power generation in the country. Hydel power is both cheap and environment-friendly. Pakistan's total identified hydel generation potential is 46,000 MW (MTDF-2005-10), out of which only 14 percent (6,474 MW) has been exploited so far. In the long run, Hydel is one of the major economic energy supply options in Pakistan for increasing the energy security of the country.

Electricity consumption in Pakistan has been growing at an elevated pace due to higher economic growth, increasing urbanization, industrialization and rural electrification over the past few years. The demand for electricity is growing at an average rate of 9.5 percent per annum over the past four years. A stagnant power supply and growing demand has created severe power shortage in the country, ranging between 4,000 to 5,000 MW. Going forward, the demand for electricity is projected to grow by 8.7 percent per annum (on the basis of average growth for the period 2003-07) while the supply of electricity, as envisaged by the Pakistan Electric Power Company (Pvt.) Limited (PEPCO), and assuming 75% utilization of installed capacity, still forecast demand surpassing the supply in the range of 2,000 MW to 3,000 MW[1]. WAPDA owns about 59.6 percent of the country's total power generation capacity and serves about 88 percent of all the electricity customers in the country, which amounts to 17.7 million customers. Out of total WAPDA capacity, the hydro power capacity accounts for 55.6 percent and thermal accounts for 44.4 percent.

[1] Economic Survey of Pakistan, 2007-08 government of Pakistan Islamabad

The electricity generated by WAPDA during July-March 2007-08 was 64,569 Gwh, as against 63,020 Gwh during the corresponding period last year, thus registering an increase of 2.5 percent due to higher generation through thermal (7 percent). The composition of electricity generation shows that hydro potential has not been fully utilized. During fiscal year 2007-08, the hydro generation accounted for 33.5 percent of the total generation.

Shortage-- A Reality

To overcome the growing shortage of electricity; gas, oil and coal-based power generation can help Pakistan to meet its requirements in the short-to medium-term. Because of escalating oil prices and shortage of gas supply, coal-based electricity generation is the best option as Pakistan possesses 185 billion tones of coal reserves. The government has signed an agreement with Iran to import 1,100 MW electricity which would help partly in bridging the gap. The government has planned for transmission of an additional 2,200 MW within a period of 12 months by April 2009. These projects comprise 81 MW of hydel and 1,427 MW of thermal power in the public sector and 1,020 MW in the private sector. The government has also launched effective conservation measures which include distribution of 10 million energy saver bulbs to consumers. These measures are expected to save about 1,000 MW at peak hours. In the medium term, small hydro dam projects can make significant contribution to the national energy supply, while in the long run; hydel power generation and alternative renewable energy can solve these problems. As a first step, Alternative Energy Development Board (AEDB) has been established to facilitate development of renewable energy i.e. solar energy, wind energy, and bio fuels.

Existing Generation Capacity

The following chart shows the existing generation capacity:-

Type of Generation	Dependable Capacity	Availability on 22 Oct. (MW)		
		Year 2008	Year 2007	Difference
WAPDA Hydro	6444	2026*	5018	-2992
GENCOs	3580	1585**	2687	-1102
IPPs (incl Nuclear)	5653	3449+	3740	-291

Rental	264	52	135	-83
Total Generation	**15941**	**7112*** **	**11580**	**-4468**
Computed demand MW		**14130**	**13143**	**987**

***Reduced generation due to less releases from three reservoirs, 115,000 cusecs last year to 78, 000 this year**

**Reduced generation due to fuel (Oil & Gas) shortage and forced outages

+Reduced generation due to scheduled (1165 MW) and forced (750 MW) outages

*** Includes 660 mw export to KESC (max 830 MW on this day) against 630 MW last year

<u>Historical Demand & Supply Position (2002-08)</u>

Year	WAPDA / PEPCO System			
	Installed Capacity	**Supply**	**Computed Peak Demand***	**Surplus / Shortfall**
2001-02	15819	10894	10459	435
2002-03	15819	10958	11044	-86
2003-04	17299	11834	11598	236
2004-05	17350	12792	12595	197
2005-06	17400	12600	13847	-1247
2006-07	17366	13292	15838	-2546
2007-08	17684	12442	17398	-4956

***Figures include load shedding and export to KESC**

<u>Factors for Electricity Shortfall</u>

Out of the numerous factors, some are discussed below which have compounded the shortage of electricity.

<u>Growth of Electricity Consumers</u>

The number of consumers has increased due to rapid extension of electricity network to villages and other areas. As of March 2008, the number of consumers has increased to 17.73 million. During the last ten years the growth has been phemenonal. The growth in number of customers has increased from 14.1 million to 18.1 million in 2008-09 as is evident from the table given below:-

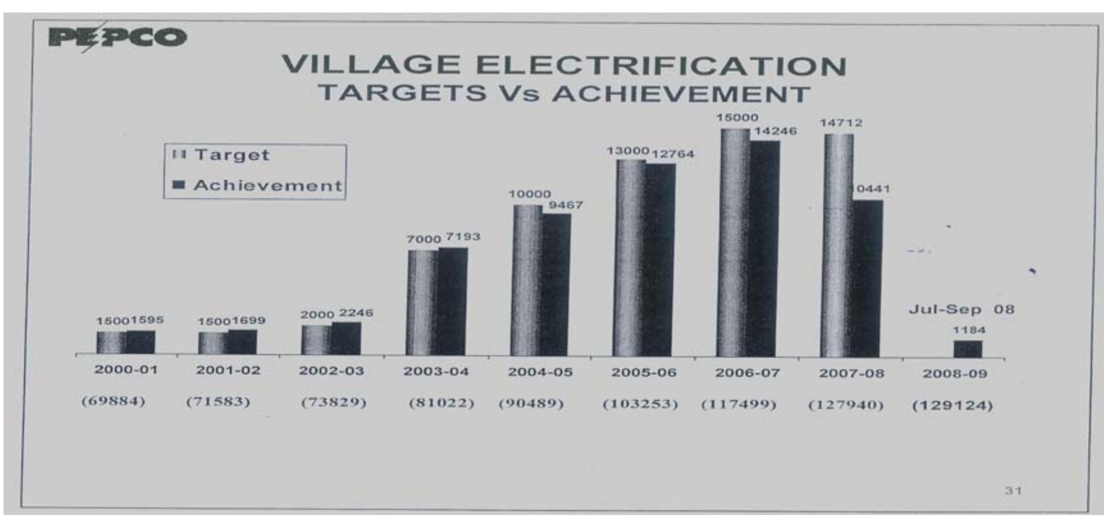
Year	No. of Customers (millions)
2003 – 04	14.1
2004-05	14.9
2005-06	15.9
2006-07	17
2007-08	18
2008 – 09 (up to Sept. 2008)	18.1

Power Transmission Dilemma

The total length of transmission lines has increased to 49,676 circuit KMs by the end of June 2007. In order to ensure uninterrupted and stable power supply to the consumers as well as integrity of the grid supply system, the augmentation of the transmission network is a continuous process. In addition to the various on-going secondary transmission lines and grid-stations Programme, new transmission lines/substations are being envisaged. But the slow growth in this sector has been a bane for the consumer.

Village Electrification

The village electrification programme is an integral part of improving the lives of the people of Pakistan, particularly in rural areas. The number of electrified villages has increased from 117,456 on 30th June 2007 to 126,296 by the end of March 2008. The electrification of the villages has also been a burden on the depleting power sector. The Gap between supply and demand has been widening due to increase in the number of consumers.



Electricity Consumption By Economic Groups

The sectoral consumption of electricity by economic groups identifies the domestic sector as the largest consumer of electricity for the past many years. Even during July- March 2007-08, the consumption pattern almost remained the same with the share of domestic consumption at 43 percent, industrial at 26.1 percent and agricultural at 12.7 percent. Domestic appliances have been a major cause of electricity consumption and misuse in this sector.

Power Losses

The National Transmission & Dispatch Company (NTDC) and DISCOs (Distribution Companies) have invoked various technical and administrative measures to improve operational and managerial efficiency to reduce power losses. These measures have given positive signs resulting in reduction of power losses and increase in revenue. However, still the power losses though decreased from 23.9% in 2003-04 to 22.6% in 2008-09 July-Sep.2008 as shown in the table remains one of the major problem. Other measures such as renovation, rehabilitation, capacitor installation and strengthening the consumer-end distribution supply network are part of a continuous process for controlling/reducing wastage power/energy.

Year	Transmission & Distribution Losses (%)
2003 – 04	23.9
2004-05	22.9
2005-06	22.4
2006-07	21.5
2007-08	21.3
2008 – 09 (July - Sept. 2008)	22.6

From the above facts we can conclude that the total power generation in Pakistan in 1947 was 60 MW; this has grown to 19,566 MW at present. Although this growth is significant, the country's population has also grown substantially along with a continuous growth in demand. Moreover, thermal generation now constitutes about two-thirds of the total generation based either on imported furnace oil or the fast depleting gas reserves in the country. The volatile global oil prices have meant that the utilities and the government is at times unable to provide the necessary fuel for the existing thermal power houses adding to the already existing electricity shortage crated mainly due to lack of power generation additions in the last ten years. The government plans to bridge the gap potential in the north, alternative energy and through an energy saving program. Another striking fact emerging from the above discussion is about present consumption pattern with share of industry and agriculture at 26.1% and 12.7% respectively. The policy makers need to look this aspect and plan for increasing its share in total consumption as it would result in increasing production and accelerating pace of economic growth.

Measures to Remove Energy Shortages

Background

Keeping in view the electricity demand patterns and lack of funds in the public sector, the Government of Pakistan decided to mobilize private sector resources by inducting it into power generation in the 1980s.

In November 1985, the GOP announced measures to encourage private sector participation in the power sector. The 1292 MW Hub Power Project (HUBCO) was initiated at the same time, which was the first private sector power project of its size and kind in the entire world. It took almost 12 years for HUBCO to reach its completion, when in March 1997 it was fully commissioned.

Policy Framework and Package of Incentives for Private Sector Power Generation Projects in Pakistan

1994 Power Policy

The initiatives to encourage private sector investment in the power sector were followed by the introduction of the 1994 Power Policy, which offered a number of attractive incentives for setting up generation projects including an attractive upfront tariff.

The Policy attracted an unprecedented response from the private sector investors and a total of 82 LOIs were issued for projects of over 18,000 MW capacity under the Policy.

1995 Hydel Policy

Since the 1994 Power Policy catered mainly to thermal projects, a separate Policy for Hydel projects was introduced in 1995. The Policy was not successful as it had major issues that proved to be hurdles in implementation of hydro projects. For instance, the policy was based on a 'take and pay' payment mechanism and did not provide coverage of hydrological risk.

1998 Power Policy

In 1998, a Power Policy for IPPs was announced, for meeting the energy demand of the country through the exploitation of indigenous resources. A lot of expectations relating to attracting new large-scale FDI were pinned on this policy. Unfortunately, it could not receive a very encouraging response. Under the 1998 Policy, just a single LOI was issued for a 450 MW coal-based project. Subsequently, the Government decided to review its power policy so as to make it more investor-friendly.

2002 Power Policy[2]

Salient features of the Policy include:

- Scope of the Policy covers private, public-private and public sector projects;
- Invitation of bids on tariff through International Competitive Bidding (ICB);
- Encourage exploitation if indigenous resources including hydel, coal, gas and renewable resources through active involvement of the local engineering, design and manufacturing capabilities

[2] Policy for power generation projects, 2002 Sectory Mirza Hamaid Hussan, Ministry of water and power Govt of Pakistan Islamabad

2006 Power Policy

Announced by the then Minister for Water & Power invited investment from the private sector for following categories of proposals:-

(i) Independent power projects, or IPPs (for sale of power to the grid only).

(ii) Captive cum grid spillover power projects (i.e., for self-use and sale to utility)

(iii) Captive power projects (i.e., for self or dedicated use)

(iv) Isolated grid power projects (i.e., small, stand-alone)

Appraisal of Policies

The selection criteria under the 1994 Policy enabled the implementation of many subprojects which were not consistent with the least-cost expansion program in terms of:

(i) capacity and location (too small given the system size and requirements and not suitably located to system requirements);

(ii) fuel selection (excessive reliance on imported fuel oil, as opposed to domestic natural gas although at the time gas allocation for power was difficult to secure and overall gas reserves were thought to be on the decline); and

(iii) Technology (too many diesel sets and steam turbines, as opposed to efficient combined cycle plants).

The implementation of the 1994 Policy been limited to about 2,000 MW – as advised by the Bank Group – WAPDA may have been better able to absorb the capacity charges under the long term power purchase agreements, despite the fact that demand for power increased at a slower pace than anticipated resulting in excess capacity for several years. However, there was no clear mechanism for GOP to prioritize projects. The basis on which projects were selected and accorded attention was not transparent and subject to political influence which led to perceptions of corruption by successive governments. Rather than proceeding through competitive bidding for private power, Pakistan instead set a tariff ceiling for investors in an effort to accelerate the private power program. This proved very successful in terms of projects being able to reach financial close in a relatively short period.

The ceiling price set in the 1994 Policy (US cents 6.1/kWh as an average for the first ten years and US cents 5.5/kWh over the life of the project on a levelized basis) was competitive with levelized prices in other developing countries at the time, including Indonesia, Philippines and India. Some people alleged that by setting a tariff ceiling, the Policy did not provide an incentive for project promoters to reduce costs. The assumed project cost under the 1994 Policy was US$1,000 per kW, but starting about 1997, capital equipment costs for combined cycle plants dropped to about US$450 to US$600 per kW. Pakistan's gas-rich neighbor, Bangladesh, was able to contract a 360 MW gas-fired, combined-cycle plant at around this time for less than 3 US cents per kWh through a competitive tender. Although not a fair or accurate comparison, this was used as an example by Pakistan authorities that they had paid too much. In fact, subsequent analysis revealed that the price in Bangladesh and Pakistan were broadly comparable after adjusting for various factors, including difference in fuel cost and technology costs available during 1994-96 when Pakistan's IPPs were contracted. Nonetheless, the public and political perception was that the cost of private power is too expensive – an important factor when it came to re-negotiation.

Another contributing factor to the implementation problems of the 1994 Policy was the slow pace of the restructuring and privatization of WAPDA and the creation of a suitable regulatory system in comparison to the speed with which the private power program was implemented. The mix of private generation and monopoly public sector transmission/ distribution, and the introduction of private power under the 1994 IPP Policy rendered the sector vulnerable to financial shocks and external events such as changes in fuel prices. While the Bank promoted measures for sector management and restructuring, as well as public sector policy reforms, including introduction of pass-through mechanisms for cost of fuel and power purchased, they were not implemented at the intended pace. The delays in sector reforms adversely impacted the efficiency of both WAPDA and the IPP program, and left the sector overly vulnerable to economic downturns.

As a result of the 1994 Independent Power Producers' Policy, some major problems were created which are as follows:

1) Between 1996 and 2001, the share of hydropower generation (with its low operating cost) declined from 47% to 29%;
2) Electricity tariffs in nominal rupee terms increased by almost 60% but fell in real terms;
3) Operating revenue increased by 13% per annum while cash operating costs and debt service increased by 20%;
4) The cost of private power reached 50% of WAPDA's operating costs.
5) Other developments which contributed to the deterioration of its financial performance included:

    a. Front-loaded IPP tariffs which are indexed to the US Dollar combined with a 45 percent devaluation of the Rupee;
    b. A decline in electricity demand due to low economic growth which led to a temporary over-capacity in generation;
    c. Poor collection rates from government customers which account for 30 percent of WAPDA's sales;
    d. Widening tariff cross subsidies that play against industrial and commercial consumers, who installed their own captive capacity.

As a result, WAPDA faced difficulties in meeting its obligations to IPPs which required a discipline of on-time cash payments. This was a new, harsh reality for WAPDA as previous cash flow problems were dealt with through the public sector debt circle where payment arrears to / from other public sector enterprises were a way of life.

From the above discussion, it is evident that due to the increasing demand of electricity and the lack of funds in the public sector, the GOP decided to attract the private sector in power generation in 1980s. HUBCO was the first project to be launched in the private sector in 1985 which took 12 years to mature. The 1994 Power Policy was much more successful and managed to add more than 5000 MW to the grid. Ironically the policy also proved to be the cause of failure of subsequent private power policies such as the 1995 Hydel Policy and the 1998 Power Policy as mostly politically motivated criticism of the tariffs offered in the 1994 Policy led to discouragement for further private investment in the Power sector. The sudden addition of more than 5000 MW expensive thermal power in the system, which resulted in surplus power for some years, also added to the financial bottom-lines of the utilities, which were hard-pressed to make prompt payments to the IPPs.

Independent Power Producers and Its Role

The following 15 IPPs were installed under the policy, including two projects (Gul Ahmad Energy and Tapal Energy) that are supplying power to KESC while the rest are supplying power to WAPDA/NTDC under power purchase agreements (PPAs) under which the utilities (i.e.,WAPDA and KESC) buy- power at pre-determined rates from the private power generating companies. A list of these IPPs is given below[3]:

No.	Project Name	Gross Capacity(MW)
1.	AES Lalpir Limited	362
2.	AES Pak Gen.(Pvt) Limited	365
3.	Altern Energy Limited	14
4.	Fauji Kabirwala Power Company	157
5.	Gul Ahmed Energy Ltd (GAEL)	136.17
6.	Habibullah Coastal Power (Pvt) Co.	140
7.	Japan Power Generation (Pvt) Limited	120
8.	Kohinoor Energy Limited	131.44
9.	Liberty Power Project.	235
10.	Rousch (Pakistan)Power Limited	412
11	Saba Power Company Limited	114
12.	Southern Electric Power Company Limited	115.2
13.	Iqbal Energy Limited	123
14.	Uch Power Limited	586
15	Hub Power Project	1292

Source: http:/www.ppib.gov.pk/commissioned ipps.html

Results of IPP Workout

The financial difficulties of WAPDA were exacerbated by too many IPPs coming on stream simultaneously at a time when demand did not grow as anticipated. This

[3] http:/www.ppib.gov.pk/commissioned IPPs. html

resulted in excess generating capacity that, in the minds of most Pakistan officials, they neither needed nor could afford. To bring some relief to the cash-strapped power utility, the Government vigorously pursued the renegotiation of tariffs with IPPs. WAPDA also delayed commissioning of several IPPs by not providing them with interconnection facilities or the approval to run their plants until lower tariffs were agreed, saving significant amounts of money in the process. (It should be mentioned that not all delays were a result of WAPDA actions and, in some cases, WAPDA was inadvertently helped by the IPPs themselves when they failed technical performance tests.) Once the Orderly Framework was accepted by the Government, the basic principles for IPP renegotiation were:

(i) contracts are a starting point for negotiation
(ii) negotiations must be by mutual agreement without coercion.

Stand-still agreements were signed for all projects which were issued Notices of Intent to terminate which prevented the companies and/or lenders from undertaking untoward legal steps to protect their rights under the agreements. Importantly, WAPDA also assumed sole responsibility for negotiations addressing the concerns by some IPPs that the parameters were forever shifting with each new IPP committee that was appointed. WAPDA was ultimately successful in securing tariff concessions from about a dozen IPPs, all of which had yet to be commissioned as these were the plants over which WAPDA had the most leverage. Significantly, no IPP (other than HUBCO) which had achieved commercial operations prior to this time, conceded to WAPDA’s desire to reduce tariffs.

Available data on roughly half of the IPPs which renegotiated their tariff reveals that the average decrease in the levelized tariff was about 10%, ranging from 7-8% to as much as 16%. In exchange for these tariff concessions, the term of their power purchase agreements was extended from around 20 years to 30 years, agreement was reached with WAPDA on the commercial operations date allowing IPPs to begin receiving revenue, and all legal disputes were resolved. There was little scope for IPPs to dramatically lower their tariffs since the investment in plant and equipment had already been made and projects were close to completion. In addition, by this stage in project implementation, sponsor groups had direct control over only a small portion of costs on which they could negotiate – essentially return on equity and the operations and maintenance cost. Since only 20% of investments were financed through equity, this left little room to maneuver in the negotiating room as project sponsors could not offer reduction in interest rates without lender consent. (In fact, the results of all negotiations were subject ultimately to lender consent.) Lender groups' contribution to the workout often resulted in capitalization of interest and/or debt payments during the early years, and in a few cases, a more extensive restructuring of the amortization profile to meet the revised anticipated cash flows.

It is interesting to note that lenders only agreed to these measures in projects where the plant was delayed in achieving commercial operations – and therefore had incurred significant cost increases (a large component of which was interest during construction costs). Lenders to Hub Power, which had been in commercial operations for a couple years, continued to receive timely debt repayments throughout the dispute period and did not agree to restructure the debt to provide further tariff concessions. It should be noted that HUBCO was able to meet their debt payment obligations throughout the workout period despite the fact that WAPDA was not paying the company the full tariff. The company had built up a rather large amount of cash in their accounts since they were prevented from distributing dividends due to a court imposed order. HUBCO was therefore able to draw on this cash to meet its debt obligations. The HUBCO case was different from the rest of the IPPs since it did not fall under the 1994 Policy.

Government officials alleged that the PPA amendments, which substantially increased the price of electricity produced during the first years of plant operation, were corruptly obtained or otherwise fraudulent. In parallel with legal proceedings related to the dispute playing out in the local courts, HUBCO, the Government and WAPDA held various meetings during 1998-2000 in an attempt to resolve their outstanding issues. At the request of both HUBCO and GOP, the Bank facilitated many of these meetings in an attempt to resolve the disputes in a neutral environment. Almost two and a half years after the first allegations of corruption were made, HUBCO, the Government and WAPDA agreed to a settlement whereby, inter-alia, the tariff level was reduced and all criminal and civil cases were disposed.

Power Generation Addition IPP Projects

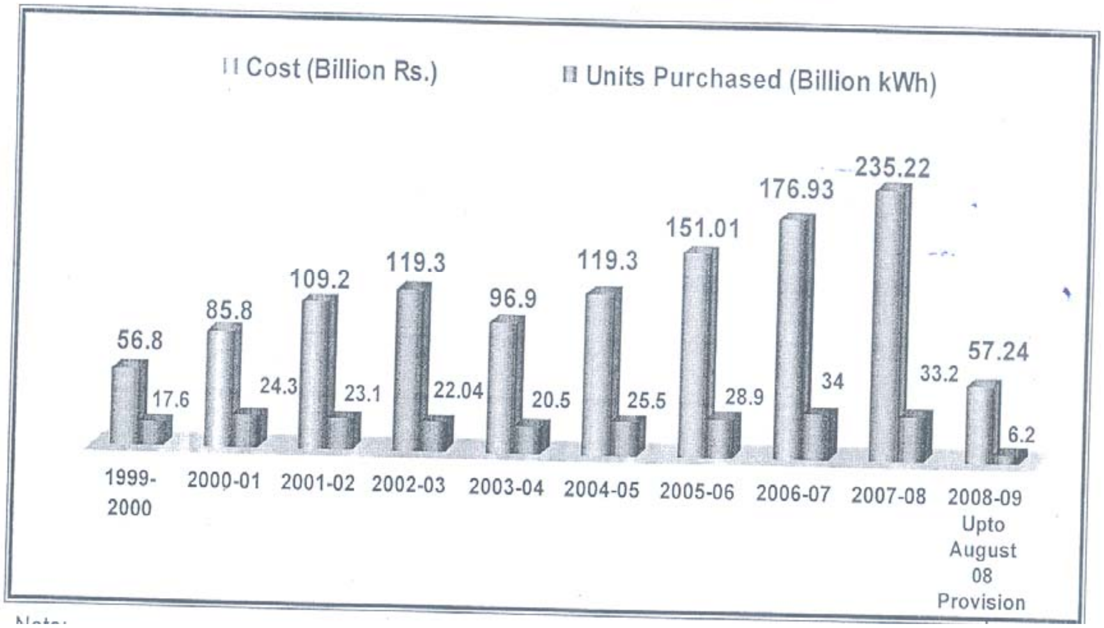
The detail of the same is given as under:-

Name of Project	Fuel	Capacity (MW)	Expected COD
1.Attock Power Project	Oil	165	Jan. 2009
2. Atlas Shirazi Project	Oil	225	Mar. 2009
3. Orient Thermal C.C. (Balloki)	Dual	225	Apr. 2009
4. Muridke Power Project	Dual	225	Jul. 2009
5. Fauji Mari Power Project	Gas	202	Sep. 2009
6. Engro Power Project	Gas	227	Dec. 2009
7. Shaiwal Power Project	Gas	225	Feb. 2010
8. HUBCO Narowal	Oil	225	Mar. 2010
9. Associated Technical Project	Oil	200	Jun. 2010
10. Nishat Chunain Project	Oil	200	Dec. 2010
11. Japan Expansion Project	Oil	101	Dec. 2010
12. Green Power Project	Gas	205	Dec. 2010
13. Bhikki Power Project	Dual	225	Dec. 2010
14. Liberty Power	Oil	200	Dec. 2010
15. PIE AmPower Project	Oil	390	Dec. 2010
16. Star Thermal Project	Gas	134	Feb. 2011
17. Bestway	Oil	200	Mar. 2011
18. Gulistan Project	Oil	200	Jun. 2011
19. New Bong Escape Project	Hydel	84	Dec. 2011
20. UCH-2 ICB Power Project	Gas	450	Dec. 2011
21. Shahkot Power Project	Oil	200	Dec. 2011
22. Kotli HPP	Hydel	100	Jun. 2012
Grand Total		**4680**	

Payments to IPPS

The payments made to IPP from 1999 - 2000 to 2008 – 09 i.e. up to August 2008 are illustrated in the form of chart is given below:-

PAYMENTS TO IPPS



1. The expenditure pertaining to FY 2007-08 is Rs.235.224 billion without GST (provisional) on accrual basis against it an amount of Rs.189.415 billion has been paid upto 30th June 2008.
2. The figure pertaining to July 2002 is Rs.57.235 billion without GST on accrual basis against it an amount of Rs.53.491 billion has been paid.

The above facts lead to the conclusion that just s most of the IPPs inducted through the 1994 Power Policy were coming on line in 1998; the GOP launched a media and legal campaign against them. A majority of the IPPs were served notices of termination on the alleged corruption during the implementation process and were pressured to lower the agreed tariffs. HUBCO agreed to the cut of their tariff by accepting a lower return on equity through an out-of-court settlement. Some of the other IPPS' tariffs were also agreed but the cut in their tariff was mostly cosmetic.

Alternate Energy -- The Pakistan Case

Pakistan Options and Efforts So far Made

The adoption of policy for the development of renewable energy is a major step by the Govt. The policy frame work aims at promoting power generation through alternate indigenous resources with the support of private sector, in the wake of anticipated power shortages at the national level as well the ever increasing cost of conventional fuels. For this purpose, the alternative energy development board (AEDB) has been allowed to deal with wind and solar energy projects of sizes even larger than 50 MW capacity each.[4] In Pakistan renewable sources of energy include; wind energy, solar energy, energy from micro hydel units, and bio-energy. The potential to exploit these forms of energy is vast but given the lack of knowledge it is difficult to sell such forms of energy to the people who are more comfortable in using gas to meet their energy requirements. To promote the use of renewable energy the Government of Pakistan has set up the Alternative Energy Development Board on 30th April 2005 by a Presidential Ordinance. This institution has outlined various short, medium and long-term plans to harness wind, solar and solar thermal sources of energy. [5]

The importance of RE was realized as far back as the early 1980s. The Sixth Pakistan Energy Plan (1983-88) allocated some 14 million euros for renewable energy projects. Earlier in 1975, the Pakistan Council of Appropriate Technology (PCAT) was set up. This was followed by the establishment of the National Institute of Silicon Technology (NIST) in 1981. The former institute's responsibilities lay in the areas of establishing small hydropower units, bio-gas plants, and solar cookers and localized wind energy units. The latter organization was more concerned with research and development as well as the commercial application of solar energy. The achievements of these two institutions in developing renewable energy was quite limited—amounting to less than 5MW by the end of the 1980s. The Pakistan National Conservation Strategy was announced in 1992 which saw the establishment of some biogas, wind power and small hydropower units for producing energy.

We discuss some of the main alternate energy resources in the following paragraphs.

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[4] Government of Pakistan, Policy for Development of Renewable Energy for Power Generation Employing Small Hydro, Wind, and Solar Technologies 2006. [Cited 23 October 2007]. Available from www.pakistan.gov.pk/ministries/water-power-ministry/media/PakistanREDevelopmentPolicy-Dec092006.pdf

[5] Mir Annice Mahmood, ed. Energy Issues In Pakistan. (Islamabad: PIDE, 2006),. Available from http://www.pide.org.pk/pdf/Books/Energy_Issues.pdf

Wind Energy

Wind energy is environment-friendly and cheaper than natural gas even. Pakistan has been blessed with an enormous potential of Wind Energy. The 1,046 Km coastline of Sindh has been identified as having wind power potential of 50,000 MW. The government has assigned AEDB to ensure installation of 700 MW wind power in coastal areas of Pakistan by the year 2010. AEDB has issued LOIs to 93 national and international investors for 50 MW wind power projects each and one LOI for 5 MW wind project. 33,976, acres of land (19,807 aces in Gharo and 14,169 acres in Jhimpir) have so far been provisionally allocated to 21 investors.

Solar Energy

Pakistan has so far not used its solar potential to save on conventional energy sources. The solar potential exists in central and southern parts of the country where it receives 2,142 kWh of solar irradiation/m2/year. The government has assigned AEDB to electrify 7,874 remote off-grid villages in Sindh and Balochistan using alternative technologies particularly solar energy under 'Roshan Pakistan Programme'. AEDB has electrified 1,762 remote off-grid homes in 31 villages in all the four provinces. Another 3,000 remote off-grid homes in District Tharparker, Sindh are in process of electrification using solar energy, out of which 700 homes have already been electrified. The entire 100 villages are expected be electrified by June 2008.

Bio-fuels

Bio-fuels (ethanol and bio diesel) are strong contenders for provision of efficient and sustainable energy. Pakistan has started work on both the bio-ethanol (sugar-ethanol) and the cellulose biomass- bacteria route. AEDB has initiated the projects for bio-fuels in Pakistan. A pilot project of using Ethanol as an alternative fuel for vehicles has been launched 1n cooperation with HDIP and PSO. Furthermore, pilot project for production of bio-diesel has been successfully implemented and using local agriculture bio-diesel has been produced and used for village electrification.

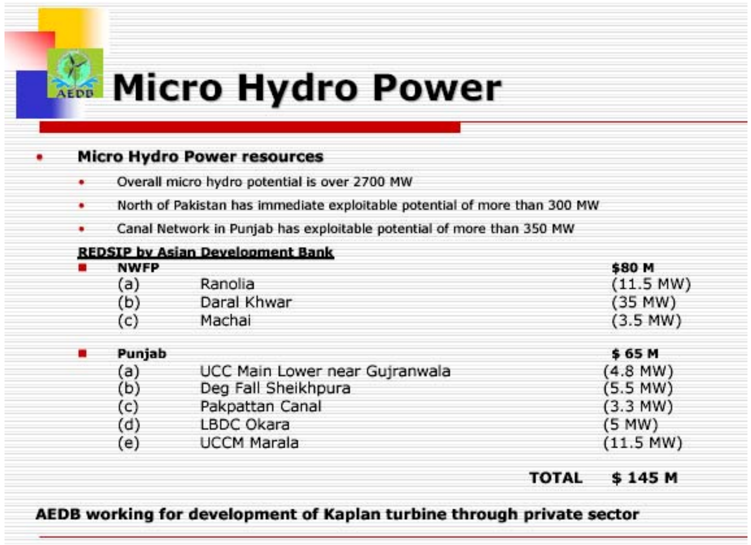
Micro Hydel Stations

In the northern areas of Pakistan including NWFP and Azad Kashmir, there are a number of streams and rivulets that are suitable for small and micro hydel stations. Some of them may be connected to their traditional water mills. They are not only cost effective but a better option for isolated areas. Similarly, in Punjab and rest of the country, where we have canal system or close-by rivers, small hydel generators can be installed to be operated on the flow of water without any obstruction to the flow or any training work or diversion of water.

According to a report published by the PPIB, there exists a total hydropower potential of additional 41,722 MW. Out of this, as many as 570 schemes and sites, with a potential of cumulative capacity of above 2,165 MW have already been identified for establishing small-size hydropower stations.

These schemes of capacity varying up to 40 MW include projects for which technical and economic feasibility studies have been finalized. Studies are being conducted on various other sites too. Punjab government has recently approved 40 schemes of small power units on various canals and barrages that would be capable to generate a cumulative total of 65 MW electricity. Efforts are thus underway by various concerned departments and agencies, at provincial level, to exploit the small hydropower potential with the strong participation of the private sector.

The governments of the NWFP and AJK have adopted simple procedures, extending fiscal and financial concessions and attractive tariffs. The NWFP government has recently revised its power policy to make it more investor-friendly, while the Punjab government has approved the hydro power policy recently. As per policy for renewable energy**,** AEDB includes the technology for small hydro of 50 MW or less capacity. Small hydro projects can make significant contribution to the national energy supply. Some 300 micro and mini hydroelectric plants, installed by the private and public sector in the northern hilly areas, are supplying electricity to areas not connected with the grid, and more have been approved recently. The potential for further development of such hydro projects would be fully utilized by 2030.

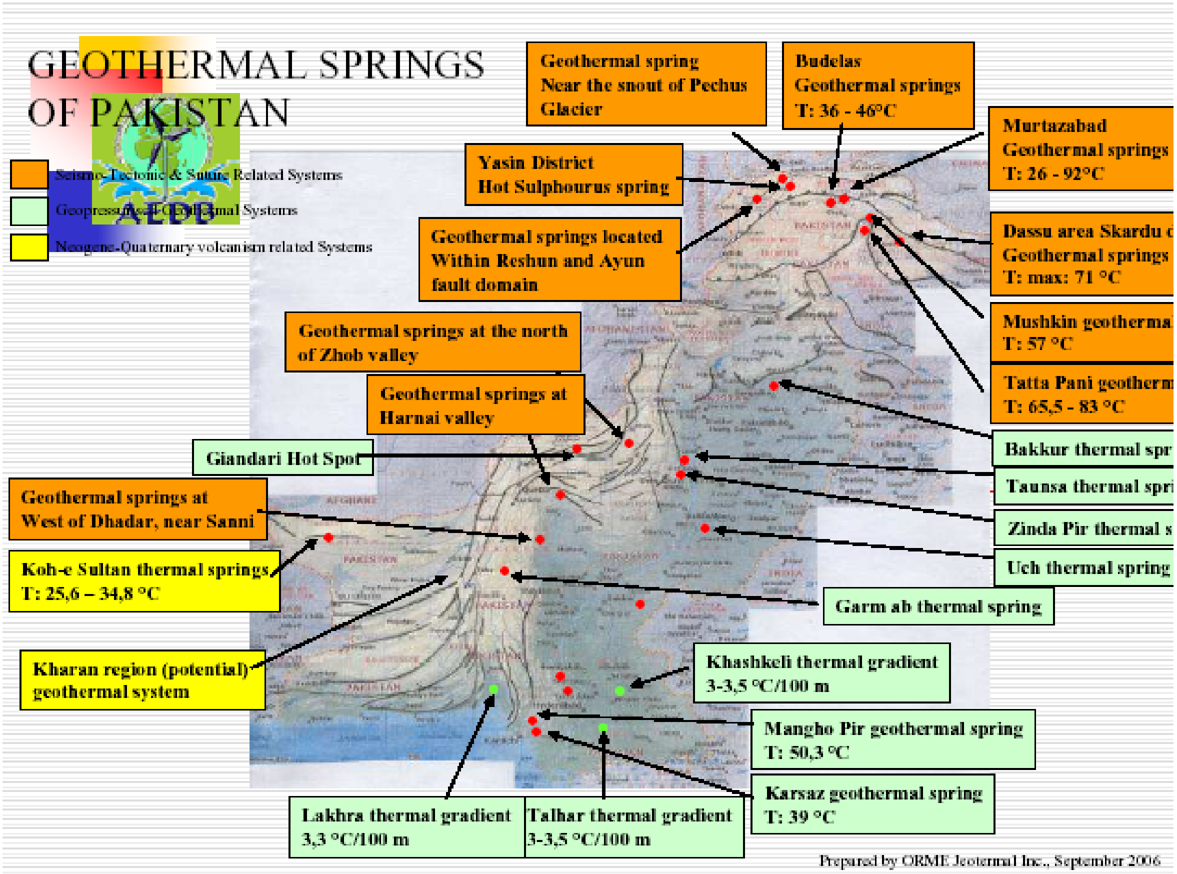


<u>Source</u> : <u>AEDB Profile 2005-2006.</u> (Islamabad: Official Printers, 2006), 92

<u>Geothermal</u>

Pakistan Scenario: Although there are numerous hot springs with temperatures ranging from 30°C to 170°C to be found in various parts of Pakistan, e.g. Karachi and in the Pakistani part of the Himalayas, there has been no physical achievement so far[6] to make use of geothermal energy in Pakistan yet. AEDB has identified the potential sites as given on the next page.

[6] Ministry of Water and Power. <u>AEDB Profile 2005-2006.</u> (Islamabad: Official Printers, 2006), 92.



Source : AEDB Profile 2005-2006. Reported by ORME September 2006.

Nuclear Fusion

Fusion power is the energy released when two atoms of hydrogen fuse into one atom of helium. This is the process that generates the energy/ power in our sun. It generates large quantities of heat by fusing the nuclei of hydrogen isotopes. The heat can theoretically be harnessed to generate electricity. The temperatures and pressures needed to sustain fusion make it a very difficult process to control and doing so is an unsolved technical challenge. The tantalizing potential of fusion is its theoretical ability to supply vast quantities of energy, with relatively little pollution. Both the United States and the European Union are supporting a moderate level of fusion-based research, along with other countries. EU has inked an agreement among its member states, known as European Fusion Development Agreement, for the development of fusion energy. Work has already started in France on the International Thermonuclear Experimental Reactor

(ITER) project in Cadarache, France, such nuclear reactor. India, though not member of the project in the beginning, has now got herself associated with it.

Wave and Tidal Power

At the end of 2005, 0.3 GW of electricity was produced by tidal power. Due to the gravitational pull of the moon (68%) and the sun (32%) there is 3 TW of tidal energy available of which approximately 1 percent is practical to exploit. The best sites could be along the sea beaches where not only it can bring light to the area but also provide electric power to water desalination projects which is the greatest problem there. The energy in waves that wash against our shores adds up to 3 TW. Pakistan, blessed with a long and accessible beach has a great potential for it.

The above discussion leads to the conclusion that in order to tap the renewable sources of power generation, including wind, solar, micro hydel and bio-energy, the GOP has set up the Alternative Energy Development Board (AEDB) in 2005. The coastal areas of Sind have a wind power potential of 50,000 MW and the AEDB plans to ensure the installation of 700 MW of wind power plants in the next 2-3 years. For this purpose LOIs for 50 wind projects have already been issued. In addition the southern areas of Pakistan receive a great amount of solar energy and the resource is viable for supplying energy to remote villages. AEDB has also initiated projects for bio-fuels (ethanol and biodiesel); the development of microhydel in the off-grid northern areas of the country where substantial hydel potential exists on small rivers and nallahs are also in hand.

Conclusion

The International Financial Institution (IFI) advised the GOP in the 1990s to re-structure the Power Sector and to introduce private sector investment in power generation. As a result, the 1994 Energy Policy was born, which introduced the concept of Independent Power Producers (IPPs) in the country. The policy was highly successful in adding 5441 MW of thermal power to the grid within a few years. However, the electricity tariffs of the IPPs were high and the rising fuel prices made them unaffordable for the average consumer and put pressure on the finances of the two public-sector utilities as well as the GOP.

Over–reliance on thermal power, which relied mainly on imported fuel, was a faulty policy direction in a country with inadequate fossil fuel resources. Tapping of indigenous resources such as hydropower, indigenous coal, and renewable sources such as wind and solar are, therefore, the obvious answer to the current energy shortage in Pakistan.

Pakistan's petroleum bill increased from about $3 billion in 2004 to nearly $8 billion in 2007. Some estimates show Pakistan's total energy requirement would increase by 48% to 80 million tons of oil in 2010 from 54 tons at present. A major shortfall is expected in the natural gas supplies current share which in energy mix 50%, as its demand would increase by 44% by 2010. In the circumstances, the options to tackle the energy crisis are limited. The government has no choice but to embark upon a phased, short term, medium & long term strategy. The government has already drawn up a 25 year plan (2005-30) for increasing energy production in the country. The proposed roadmap is detailed below:

Short Term

Energy conservation is the need of the time and concerted efforts are required to be made for conservation of energy. As per the Ministry of Petroleum & Natural Resources a large amount of electricity is wasted through inefficient and irrational use. This results in about 30% of wastage in the domestic sector and about 25% in the industrial sector. Domestic, industrial, transport and power sectors are major consumers of primary energy and squander the same as well. This wastage could be conserved through improving transmission and load management. A national awareness campaign for energy conservation and efficiency needs to be launched. It is encouraging that the government has taken cognizance of the situation besides sensitizing the public for energy conservation through media campaign.

Medium Term

Coal is our natural source of energy and power generation for our domestic and industrial sectors including re-rolling mills and other heavy industries. Pakistan has 185 billion tons of coal reserves against the world's total reserves of 909 billion tons and ranks as the 3rd in the world largest coal possessing countries. We need to tap this indigenous resource on emergency basis with the Chinese assistance to install small 200-300 MW coal fired power plants.

In Nuclear sector Pakistan has faced discriminatory treatment from the West and China has been the only country that supported us in our endeavors to acquire nuclear power generator. The 300 MW nuclear power generator installed and operating at Chashma was provided by the Chinese another 300 nuclear power plant is under installation at Chashma. According to former chairman WAPDA Mr. Tariq Hameed, China until recently did not manufacture nuclear generator higher than 300 MW capacity. However, now they have started producing higher capacity nuclear reactors which they would hopefully provide to Pakistan. He added that in the next few years the country is expected to add 3000 MW nuclear Power generation capacity with the Chinese assistance[7].

Long Term

Pakistan has an unexplored enormous hydropower potential of generating approximately 45,000 MW of electricity, however, presently we only generate 8000 MW as against an installed capacity of 11327 MW. Considering the fate of controversial Kalabagh Dam which does not seem feasible at the cost of national integrity, the way out, therefore, would be to construct several small dams to generate hydro electric power.

There is a need to carefully study the feasibility and viability of renewable energy sources such as wind, solar, bio-fuels etc., in Pakistan for long term implementation, however, due to their new technologies involving huge investments and unknown cost-

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[7] Tariq Hameed, Special report on energy crisis, Business News, The News, (March 21, 2008)

benefit matrix, it would be advisable to have pilot projects to study the pros and cons of these renewable energy sources before conscious decision is made for implementation of these resources.

Recommendations and Way Forward

- IPPs are no doubt an important but expensive alternative for producing electrical power
- They are inherently expensive due to significant 'costs' involved in getting an IPP to the take-off or financial close stage, e.g., time required in extended tariff negotiations, finalizing of "Power Purchase Agreements", hiring of expensive legal expertise (lawyers) by the sponsoring companies, insurance costs etc. Moreover, IPPs usually get 'commercial' loans, which typically are more expensive than soft loans provided by multilateral lending agencies such as the World Bank for infrastructure projects in the public sector
- The private sponsors also inflate their costs
- Moreover, IPPs which essentially offer long-term contracts with terms of 25 years or more, not match the objective of a competitive power market in which plant are set-up without guarantee of dispatch or guaranteed payment obligations
- However, in the context of Pakistan and other third world countries where public-sector utilities have limited resources for developing their own power generating plants, there may not be too many other options for power addition
- In such circumstances, IPPs still offer perhaps the most viable alternative
- Additionally, IPPs offer some significant advantages as well
- They do not require upfront investment by the utility/ government which only pays for the end-product
- Some of the project risk is shared/ transferred to other stakeholders including the sponsors and the lenders
- IPPs offer the benefits of inherent efficiencies of private sector. For example, IPPs usually have less chance of completion delays once they are finalized. They are also operated more efficiently; hence offer greater plant availability-this advantage could be exploited by installing more base load plants as IPPs

- In Pakistan, greater efforts are required to be made to install hydropower IPPs in order to exploit an indigenous source, which has remained under-exploited mainly due to indifferent attitude as well as lack of resources.

HOW TO INCREASE TAX-TO-GDP RATIO

Muhammad Feroz-ud-Din,
Ex-Director
& Mr. Abdul Sattar,
SA to Director

Federal Board of Revenue (FBR) organized an international “Conference on Tax Policy Options for Pakistan” in Lahore (Dec. 2008) to identify and generate concrete implementable tax policy options for achieving the broad micro and macro economic objectives envisaged in the Economic Stabilization Program of the government supported by the IMF. The task of the FBR is gigantic given the current macro economic environment of falling imports, negative growth in the large-scale manufacturing sector and falling commodity prices.

It is Government’s intention to undertake major tax reforms to improve the Tax-to- GDP ratio, expand the Tax-payer Base, Increase Tax Compliance and make Tax Administration more efficient. Government is moving to a tax system that is based or moderate rates and wider base through rationalization of exemptions. True is the fact that Pakistan’s Tax-to-GDP ratio remains abysmally low even in South Asia, and is at least 4 percentage point lower than other countries in the region. This 1ow Tax-to-GDP ratio is not new phenomenon but this syndrome has always contributed to deficient resource availability for development. Pakistan lackluster efforts in the past failed to increase Tax-to-GDP-ratio mainly because of pervasive corruption, distortions within the tax system, inadequate documentation and proactive resistance by the sacred cows. The collective impact of these has always undermined any significant increase in tax collection or judicial’ distribution of incidence among various sectors. The tax reforms in the FBR are going on for the last seven year without significant impact on the Tax-to-GDP ratio because the tax efforts remained modest owing to various structural problems.

The administrative reforms envisaged by the FBR, especially moving towards a functional organizational structure, has helped to enhance tax efficiency, as well as improving the tax climate and governance. However, expanding taxation gradually into the agricultural and service sectors would bring greater yields, as would efforts to reduce evasion. The government will reduce exemptions under the GST and harmonize the income and GST laws in the context of the 2009-10 budget discussions. Finally, a new draft VAT law will be submitted for public debate by end 2009. The full revenue impact of this law will materialize over the medium term.

The Seminar at Lahore highlighted the government's plan to use the ongoing review of the FBR to modernize the tax administration and bring it to high international standards. Improving the coverage and working of the GST to make it a proper value-added tax (VAT) and taxes consumption rather than the narrow sectoral focus that has resulted in erosion of the base and operation of the GST. Similarly, the income taxes need to be fully implemented with a global treatment of income. Given the rigidity of the expenditure, the fiscal adjustment will have to be achieved primarily by phasing out energy subsidies, better prioritizing development spending, and implementing tax policy and administration measures.

The track record of the reforms in the FBR is not very good because political objectivity rather than economic rationale always dominated the important taxation decisions *the* base remains punctured and the burden of taxation is skewed towards only a few segments of the society. Indirect taxation in the withholding tax regime accounts for more than 70 per cent of the revenue and the salaried class is the main victim. On the other hand, almost 83 per cent of all indirect taxes (including VAT) are contributed by 18 commodities and 53 per cent of indirect taxes are generated from five commodities, including petroleum products. Automobiles, telecom, machinery, and cigarettes. This is in sheer contrast to all tall claims of broadening of tax base during the last eight years.

The services sector, inclusive of the retail sector, transport, construction, hotels/restaurants and commission agents, is a major non-compliant sector as its contribution to the GDP does not match its tax contribution. The services sector remained the major driver of the GDP growth during the last seven years or so. One of the studies conducted by the FBR has reportedly pointed out "that 63 percent of the return filers relating to the corporate sector have declared either nil income or business losses. Even more appalling is the fact that nearly 32 percent of those declaring business incomes did so up to Rs.200 thousand. These studies are mere reflections of numerous inadequacies that beset taxation system and they range from under-reporting to evasion, to outright corruption, and to distortions within the system that incentives tax evasion. These problems have detrimental effect on the taxation system and warrants immediate remedial measures.

The government will therefore, have to make efforts to broaden the tax base i.e. to hitherto untaxed or under-taxed sectors. Broadening of tax base will enable the government to reduce marginal tax rates which will help further stimulate investment and production and will promote voluntary tax compliance.

Broadening of tax base will also ensure fair distribution of the tax burden among various sectors of the economy. The overall services sector including wholesale and retail trade as well as agriculture are potential candidates for broadening the tax base. Integrated tax administration on a functional basis to be established at the FBR that will embrace both the income and sales tax administration. This would imply that sales tax would also determine the income tax to be levied and vice versa and reduce exemptions for both taxes. Audits will be reintroduced from end of 2008 following this Seminar. The fear of an audit is expected to deter under-reporting on sales or income. The audit reintroduction should be implemented on the same pattern as that is being undertaken by the dreaded Internal Revenue Service of the US which successfully held even the wealthy and the influential accountable for tax evasion. It is now or never game and the FBR should make sure that the current wave of reforms should be result-oriented and different from reforms in the past. Fair distribution of tax burden is always the key to economic development.

DOCUMENTATION OF ECONOMY

Mr. Muhammad Ferozuddin,
EX-Director
& Ms. Ghazala Hameed Razi,
Assistant Director

Documentation of Economic activity is a pre-requisite for monitoring country's resources up to optimum level Internal Control on Economy can be exercised through documentation and registration which ultimately serves as a tool in accomplishing our goals and objectives.

In the wake of tax reforms, restructuring of FBR, certain amendments in tax laws were accordingly made. The emphasis was laid down on documentation of economy. Regional tax officers were established. The Income Tax and Sales Tax were merged and office was named as 'Inland Revenue". Henceforth Income Tax and Sales Tax record is being simultaneously maintained / monitored. The officer in Land Revenue is now in a better position to have an eye on declared sales as per return and as declared in Sales Tax thus preventing, detecting leakages and irregularities.

Needless to reiterate that documented economy plays a pivotal role in progress and prosperity. Every transaction is on record. The element of tax evasion and avoidance and leakage of revenue is plugged which ultimately contributes a lot in enhancing revenue collection.

It is pertinent to mention that 70% of our total tax collection is being contributed by corporate sector (Companies) i.e. documented sector whereas only 30% is being contributed by undocumented sector. Needless to emphasize that much potential segment of our Economy is still not paying taxes vis-à-vis economic activity, capital cash flow. We have to tap this segment and bring it in net of documentation. Our goal should be to bring undocumented sector at par with documented sector in order to boost up revenue.

ACTION TAKEN IN THIS REGARDS

1 Since a large segment of our economy is still undocumented or in process of documentation, we need to create awareness among masses especially business community to step forward and contribute towards development of country at both individual and community level. Media campaign in this regard may generate great awareness.

2. Cognizance by state for default may yield good results. In developed countries, people pay taxes regularly and honestly due to fear of excessive penalty. The government may own carrot and stick policy to enforce tax laws and collection.

3. Tax rebate may be given on maintenance of accounts and books.

4. Certain amendments in tax laws have recently been made to effectively enforce documentation of economy through Finance Acts.

a) Each transaction/expense exceeding 10000/- rupees has to be paid through cross cheque or banking channel.

b) Though recent amendment in section 231(A) of Ordinance, 2001, the tax has been imposed on all kinds of bank instruments prepared by bank. If a tax payer sends cash through bank instruments to out stations etc, tax would be deducted. This kind of **Tax information may** go a long way in unearthing all business transactions of a tax payer enlightening department on quantum of business. Thus this kind to documentation locks the way of concealment and enhances tax collection.

c) Tax is to be deducted on each cash withdrawal exceeding Rs.25000/-.

d) The provision of section 231 A, B, 233, 233A, 234A. 235, 236 of the Ordinance, 2001 being every tax payment and receipt on record.

5. It is merely though blessing of documentation of economy that we are today able to compile all sorts of information about tax payer in tax office regarding asset purchased, electricity, Sui gas bills paid, new investment made, motor vehicle purchased in a year. Thus we certainly, are in a better position to assess quantum of income more equitably and judiciously.

DOCUMENTATION OF ECONOMY

Jahangir Ahmad,
Additional Commissioner of Inland Revenue,
Additional Director, Internal Audit (IR), Lahore.

It would not be untrue to believe that economic development and esteem of socialization in developed countries owes its origin to the documentation of economy. Adequate financial resources and a strong revenue base serve pre-requisites of development; both these parameters have a direct nexus in the quality and extent of documentation. In the scenario of national revenues of a country, taxation has a cardinal role but without first evolving an efficient, effective, transparent and just taxation system, revenues cannot be optimized. The quality and extent of documentation of economy provides necessary evidence of the measure of economic transactions. Documentation not only eases out maintaining track of transactions but also provides easy access of tax machinery to the exclusion of arbitrary dispensation and uniformity of treatment having universal acceptance peculiar of promoting voluntary compliance and diminution of dispute. Unfortunately, we have not made significant progress in promoting documentation of the national economy. As a result, equal distortions are visible in our tax system. Let us analyze the question with specific reference to Pakistan.

It is important to discuss how the term “documentation” is understood in common parlance and legal perspective. Ordinarily, documentation implies maintenance of written record of a transaction having some economic value. When considered on these lines, in Pakistan, we find most of the business houses recording the transactions with as much perfection as could be elsewhere in the contemporary world. Use of computer hardware, information technology and specific software has become very common. We find the use of bar code stickers on merchandize at sales outlets, bar code readers, laser counters, cash register machines and other devices of sophistication as very common but this all, only facilitates the owner of the business to record transaction and control inventory and does not provide any help to the tax collector to cross verify the sanctity of declarations made by the taxpayer in returns of Sales Tax, Income Tax and Federal Excise or various other statements. This also signifies lack of will to offer oneself for scrutiny and accountability under tax laws.

Since ages, business community in Pakistan has been complaining lack of transparency in tax proceedings and trumpeting the right of a free hand to the elimination of departmental hand. The FBR has never been able to get spot verification of an on-going business due to obvious reason of pressures from business groups. This led to wind up of very important checks and balances. With the advent of Tax Administration Reforms and re-writing of taxing statutes, things have gone even worst. Corresponding increase in voluntary compliance has not come up. In the current decade, economies through out the world have grown sharply but unfortunately, boom in information technology has delivered very little to us in comparative terms. Secondly, our tax collection as a percentage of GDP continues to show a dismal position in the region. If we spot the crux of tax reforms, the picture it portrays has the following features:

(1) Audit of very few cases has been conducted which not only has resulted in minimal detection of loss of revenue but also has tarnished the concept of deterrence.

(2) Jurisdictional changes are frequent.

(3) Access to records became exceedingly difficult.

(4) Manual work continues.

(5) Access to data base not available to various users.

(6) Taxing statutes have become more complex and require amendments.

(7) Office procedures became complicated instead of simplification.

(8) Office accommodation is inadequate and other logistic issues not resolved.

Sub section (2) of section 114 of the Income Tax Ordinance, 2001 provides that a return (of income tax) shall be in prescribed form and shall be accompanied by such annexures, statements or documents as may be prescribed. But it is the plights of the FBR that such documents have not so far been comprehensively prescribed. At the same time, the department has not yet been able to get 100 % returns desk- audited for issuance of notices under section 120(3) to taxpayers whose returns are incomplete within prescribed time limit. A huge departmental action of statutory audit has therefore, became impossible due to absence of required information filed with the returns. On the Sales Tax side, work of remarkable significance has however, been done in terms of issuance of SROs regarding filing of Summary of Invoice Statements, Special Procedures Rules and other regulatory requirements.

Income Tax Ordinance, 2001 embodies a scheme of universal acceptance of the returns filed in terms of deemed assessment under section 120. Given so, there is need to evolve a stringent Audit base to safe guard the revenue and create a reasonable deterrence to check the tendency of under-declaration. As discussed above, in the absence of suitable details and information available on record, fool-proof parameters cannot be drawn and selection of cases for statutory audit becomes very difficult. It is important to mention that the superior courts have earlier disapproved the departmental action of selection of cases under section 177(4) due to inherent mistakes. This aspect needs special attention.

Among other flaws, a very important factor is the element of reluctance of the business community to adhere to the documentation requirement under the garb of low literacy rate. It is quite ironical that when documentation requirement is discussed, cases of small business are discussed with the view that documentation compulsion would be more of an additional burden. Such cases are like self-employed individuals and suppliers with low turnovers. Major cases are however, capable of maintaining proper records and they do so but only for exercise of internal control and as a consequence, documentation requirement whenever prescribed by the Board has remained in-effective and of little help for desk audit as the same is of general nature and without specific focus on the nature of business activity. This is how departmental authority has gradually eroded with simultaneous loss of deterrence.

If we critically analyze the extent and quality of documentation with reference to tax proceedings, astonishingly, it is only the vouchers prepared by the taxpayer himself together with books of accounts which are produced for examination. There is very narrow scope of third party verification. In case the taxpayer does not produce any records, penalty (under section 182) is quite nominal. In case the taxpayer does not produce records or the records produced are found unreliable, the department does not have means to assess the correct volume of business. The cooperation of the taxpayer in making the audit possible has become inevitable. Due to implementation problems, good tax culture remains a dream. On the other hand, a large number of private limited companies have gone under liquidation and status reduced to AOPs in order to avoid the hassle of record maintenance and the duty as a withholding agent.

The mind set has not changed. Taxpayers' confidence in the system is non-existent. It is very easy to conceal the business as unless the taxpayer himself chooses to get enrolled to tax; state does not have the means to detect. Few years ago, it was made compulsory for the banks to provide information in respect of certain cases involving major transactions but the efforts failed due to lack of proper home work before drafting the law. The upshot of discussion is that we ought to make the documentation quality compatible with the contemporary world as the economies are quite complex and gone are the days when manual monitoring was productive. The following areas of the economy embody a robust potential of tax revenue and call for attention of the policy makers at the FBR:

(1) Internet services, medical transcription, software development, advertisement and other services are being rendered in enormous quantum. In India, at Banglore, the Information Technology related services were started at individual level by various professionals a decade before. Unexpectedly, growth rate was highest in the world. Their export of IT services now surpasses our entire national exports. Experts forecast India's export sales on account of IT related services to cross 300 billion Dollars in next 5 to 10 years. In Pakistan, there is huge potential in this area of services but neither there is any documentation in this regard nor any organized control. Off channel export of IT services is being made but they are not accounted for due to lack of proper documentation and control. Unfortunately, FBR has not developed prowess to tap this source of revenue. It is proposed to arrange specific foreign training of officers and officials and benefit

from the experience of the contemporary world. This will also help identify handsome number of new taxpayers.

(2) Air travel tickets bear no identification in terms of CNIC or NTN. FBR, at some level, should have an access to the airlines' computerized ticketing records. There should be established a Repository to capture such information. The field officers may be given access to identify their respective cases and utilize the information in audit as well as broadening of tax base.

(3) In markets, sales are being made without drawing any cash memo. The FBR may consider to set up a task force who may enforce documentation at least in selected areas and markets.

(4) Liability to Sales Tax registration arises but people are not registered to sales tax. FBR has no means to detect such default. There is a need to develop legislation as without having powers to spot check; the loop holes cannot be plugged.

(5) Huge advertisements are being made at print media, electronic media and hoarding signs. Most of the input materials used (colours, flex sheets etc) are imported. There should be some level of documentation so that the information may be utilized.

(6) Investment in real estate business is a huge area which is neglected. Registration of properties at stamp duty rates has become very common, although, actual prices are manifold high. Documentation requirement in this regard may be reviewed.

Lastly, I would like to mention that the above discussed reforms require a lot of political will as prolonged quiescence of the state organ on inadequate pace of documentation has made people indifferent and reluctant to accept any increase of state's control on business.

ECONOMICS OF REVENUE COLLECTION

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Tax to GDP ratio is one of the most commonplace topics of conversation of revenue managers, businessmen, economists and media persons etc, however, it is amazing that majority of them dabble in the discussion without making a serious effort to learn about the tax or the GDP. While preparing for C.S.S, more than a decade and half ago, I heard that solution to our Tax-to-GDP ratio problem is reduction of rates and widening of tax base, and afterwards, I am continuously being confronted with phrase, widening of tax base'. Almost every year a strategy is thrashed out to widen the tax base particularly through information contained in various statements filed by taxpayers or information provided by various registration offices. Sometimes, juggadi (word 'Juggad' is used by economist and is part of English language) and crafty bosses manage to increase number of taxpayers every year and thus 'increase' the tax base which is primary object of widening the tax base.

Some 'tax intellectuals' talk about taxpayers paying taxes while purchasing mobile cards, withdrawing cash from banks, paying utility bills and paying taxes on markup on bank deposits etc without realizing that although, if such so-called taxpayers are added to the number to real taxpayers, number might swell, nevertheless, increment in the tax amount in absolute and relative terms would not be proportional and will be having a minimum addition on that account. Hence, we must delve little bit deeper to get acquainted with the reality of relevant terminology and context.

Tax base: Any asset, earning or economic activity that has potential of tax payment can be included in tax base. We normally tax incomes, consumption and international trade. Small amount of taxes is also collected as WWF and CVT etc. FBR will no more collect CVT on immovable properties; however, exemption on capital gain tax has been withdrawn rendering them taxable from 1st of July 2010.

Yet incomes out of real estate transactions and agriculture are two segments that are frequently referred as untaxed areas. Real estate transactions fall under provincial domain and particularly after 18^{th} amendment should be taxed by provinces. Although, any increase in numerator will change the outcome, but it would be unrealistic to expect from tax so generated to significantly increase the tax to GDP ratio.

However, there is gross misunderstanding regarding agriculture sector as not being taxed whereas correct position is that agriculture is being taxed on acreage basis even before the birth of Pakistan, and since 2000, after promulgation of provincial income tax ordinances in the provinces, tax is also being levied on income out of agriculture, and assessment in this regard allows tax paid on acreage basis as deduction. Further details regarding agri-income is given at the end of the article as annex-1.

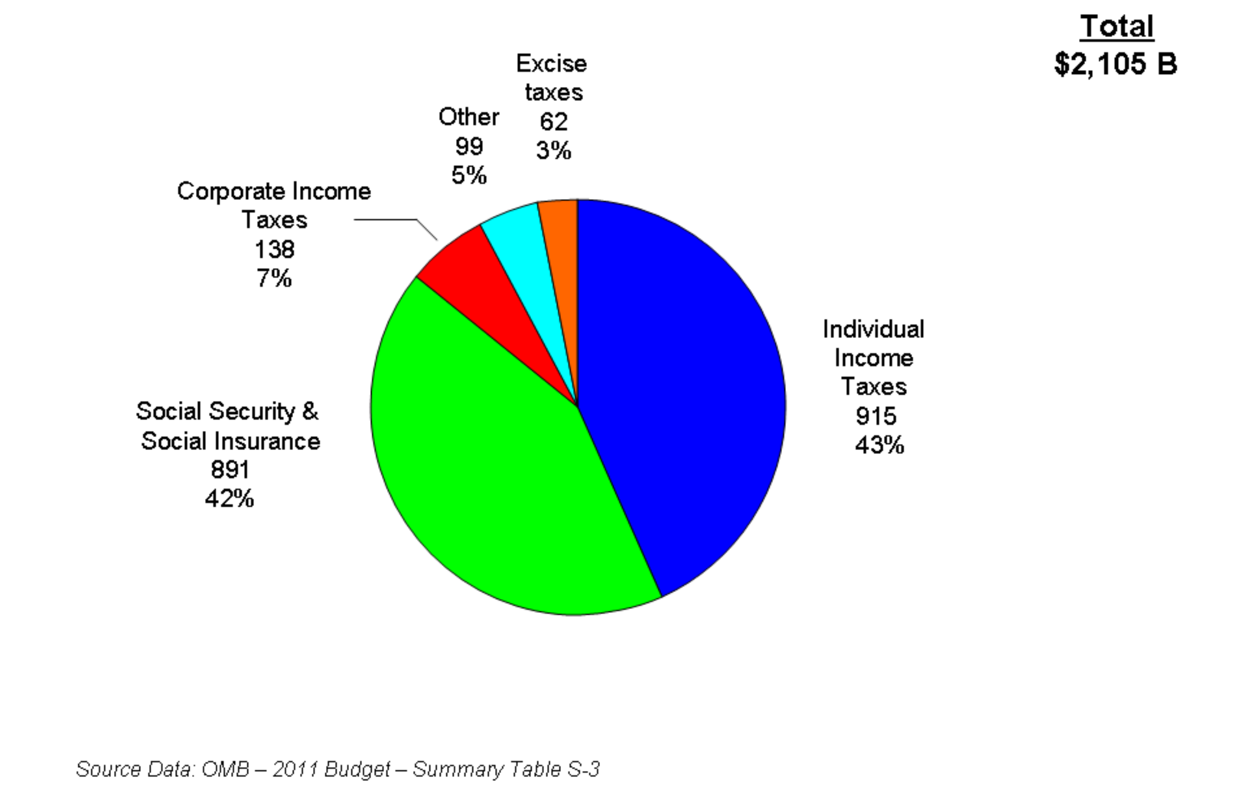
Tax: International trade taxes (custom duties on imports and income tax on exports) depend upon the structure and degree of economic activity of the country and customs duties also along with consumption taxes (sales tax and federal excise duty at import stage and on value addition by domestic production and supplies) are directly and indirectly dependent upon the number of consumers and size of the wallet of the consumer. It simply means that if more people are employed gainfully and are earning reasonable amount, more will be spent on buying of goods and services and investing in capital goods.

Interestingly, direct tax that is mainly income tax is also dependent upon the number of income earners and magnitude of their income. Income tax is charged when (net) income of a person crosses certain limit which is fixed for different persons almost every year by the law.

However, in case of corporate sector there is no such exemption limit but corporate sector in Pakistan is very small and have in general learned a lot to avoid (or evade) taxes. Salaries paid even by multi-national corporate sector are peanuts when compared to their counterparts in developed world.

Profits of non-corporate business and informal sector do contribute but even less than corporate sector. Pie chart below relating to tax structure of USA highlights the importance of non-corporate sector and payroll taxes that are significantly low in this country.

U.S. Federal Receipts – Fiscal Year 2009 ($ Billions)



Then again, tax officials are usually not trained to net the big fish or even plug multiple small leakages. Unfortunately, self assessment without adequate disclosures in accounts and along with relevant returns makes it easy for taxpayers to avoid or evade taxes and makes it very difficult or almost impossible for tax collectors to stop the major escape rather creates a conducive environment for those who collaborate indirectly in tax evasion.

But Pakistan has population of around 176 million persons. Out of which even if adjusted for working women, 50% of population are those women who neither contribute to GDP figures nor earn taxable income. To avoid any confusion or skepticism, it is clarified that value of only those goods and services is included into GDP calculation that are meant for market hence contribution of housewives etc do not make part of GDP anywhere in the world.

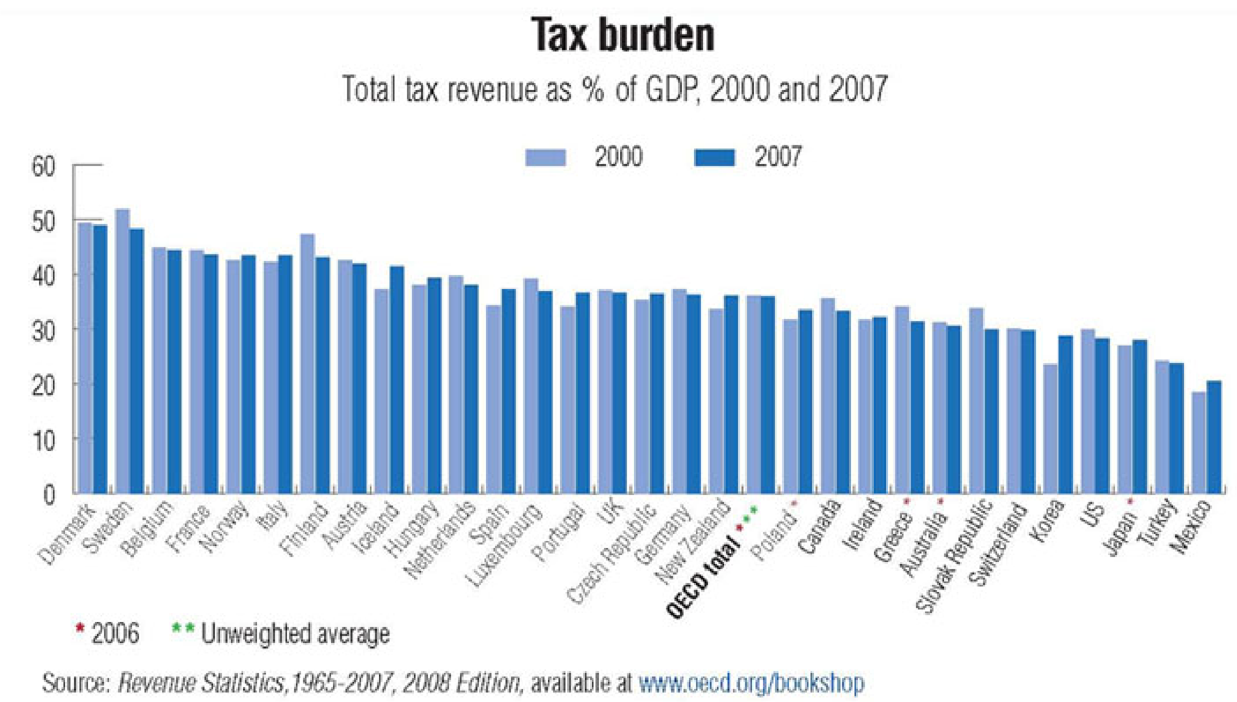
On the other hand, according to Economic Survey of Pakistan 2009-10, 62% people live in rural areas. It is not difficult to imagine how many of them i.e. mainly male population might be earning incomes going beyond exemption limit for income tax purposes and for consumption of taxable supplies for Sales Tax and FED purposes. Even in case of those who earn taxable income or have money for consumption of taxable goods and services, amount is not significant. When we compare ourselves with India, we ignore the resounding fact that middle class of India has increased tremendously in size over last many years and their purchasing power is reflected tangibly in the urban and rural mall's and markets.

Let us look the issue from different angle. Total labour force as per Economic Survey of Pakistan 2009-10 in year 2008-09 was 53.72 million that was roughly 32% of total population and out of which employed including self-employed/partly employed/underemployed were 50.79 million that formed around 30% of 169.94 million population. And according to Economic Survey of Pakistan, agriculture accommodates 45% of labour force and when remaining 55% is adjusted for informal sector employment, how many persons will be left behind to earn income that will contribute towards direct and indirect taxes. Here lies the problem that does not attract attention of our policy makers either due to their ignorance or their complacent attitude.

In fact, our tax base is not narrow only because of non-taxability of certain type of economic transactions or under-taxation of one or two sectors of economy but it is mainly limited due to underdevelopment of our economy.

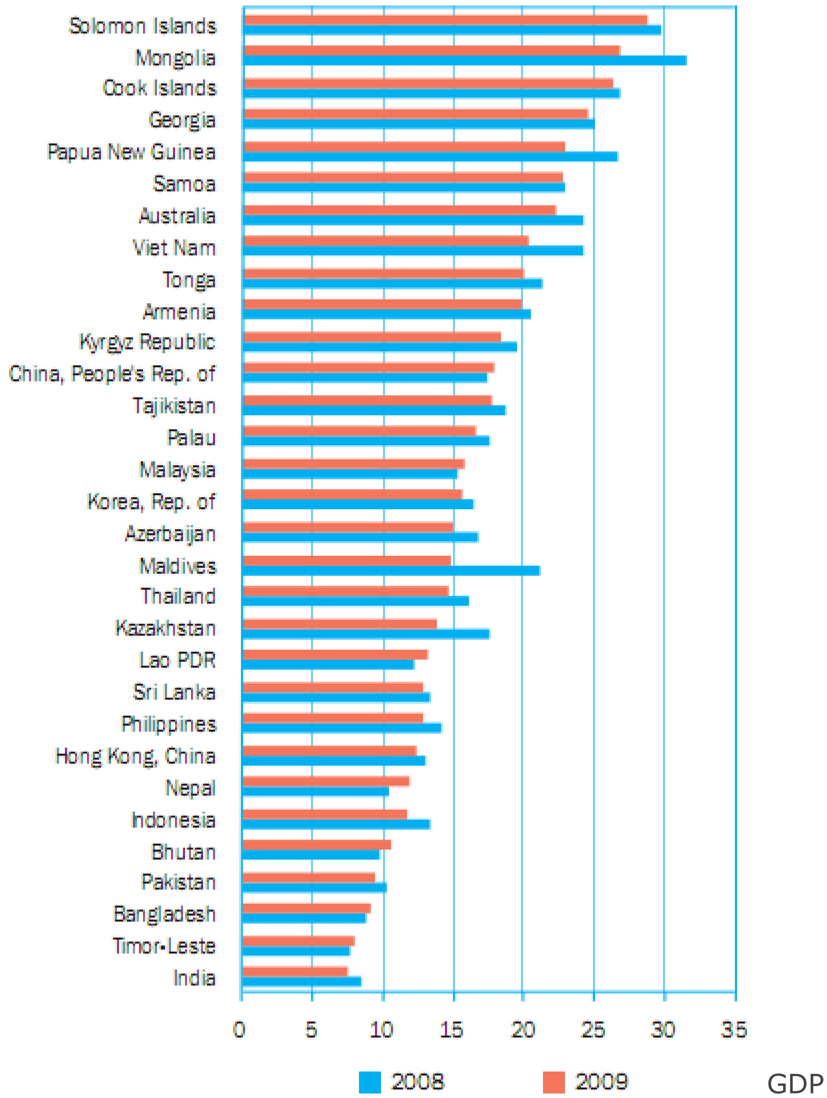
Our economic base is very narrow and is badly held back. Neither it is horizontally expanded and diversified nor is vertically developed particularly in view of opportunities being offered by science and technology- an objective force with unimaginable potential particularly its KRID (knowledge, research, innovation and development) - and globalization. World economic kaleidoscope and continuously changing standards do not find significant reflection in our economy and our increasing population do not worry us rather some policy makers and so called economists think that a large size of young population is an asset for the country. Probably they visualize to sell their flesh in world market without realizing that developed and emerging economies are increasingly placing embargo on such trade.

Tax burden of OECD (developed/ industrialized) countries testify to that elucidation.



Gone are the days when economist would recite that resources are scarce and wants are unlimited. At least after beginning of this century neither resources are scarce nor are wants unlimited. Cookie cutter economists of IMF, even after fiasco of their enhanced money supply model particularly in USA, are completely blind to these new realities.

For 176 million persons, GDP of Rs.14 trillion, even if accepted as correct, is very dismal. Following comparative graph prepared by Asian Development Bank may enlighten us in this regard. Graph shows percentage of tax revenue to GDP.



However, figure above shows Pakistan performing better than India, here lies, the catch. It is because size of India's denominator is big in proportion to GDP of Pakistan. Interestingly, percentages of taxes to GDP have decreased both in Pakistan as well as India. This also shows that debate about tax to GDP ratio is blown up out of proportion and is misleading like per capita income concept.

Historical figures of Pakistan GDP and taxes may explain it further:

		TOTAL TAXES				TOTAL TAXES
YEARS	GDP *	WITHOUT SURCHARGES				WITH SURCHARGE
	(mp)	Collection		Tax/GDP		Collection
		(Net)		Ratio (%)		(Net)
1	2	9		10		11
1996-97	2428312	282087		11.61659		309404
1997-98	2677656	293631		10.96597		336542
1998-99	2938379	308509		10.49929		370436
1999-00	3826111	347104		9.071979		386016
2000-01	4209873	392277		9.318025		422477
2001-02	4452654	404070		9.074812		458924
2002-03	4875648	460627		9.447503		528857
2003-04	5640580	520843		9.233855		582243
2004-05	6499782	590387		9.083182		617156
2005-06	7623205	713442		9.35882		764242
2006-07	8673007	847236		9.768653		865307
2007-08	10284380	1008091		9.802156		1026162
2008-09	13095039	1161150		8.867098		1179221
2009-10	14668000	1312000		8.944641	provisional figures	

In fact, imperative for policy makers is not only to widen the economic base and introduce major shifts from informal to formal economy but also to ensure inclusive growth by de-marginalization of excluded and enhancing the capacity of available human resource by invoking concept of KRID.

Prosperity and development do not solely depend upon revenue collections; they are much wider and deeper concepts. Now, when it is clear that economics text books taught at Harvard and London School of Economics etc are not that relevant particularly after nationalization of General Motors and enactments relating to health and financial institutions in USA, we also must lend our ear to concepts like inclusive growth particularly comparing Indian government with Chinese and learning from their experience.

In the end, at the cost of repetition it is again emphasized that tax collection particularly as a percentage to GDP can be enhanced in two ways:

1) By widening, deepening and modernizing economic structures and base.
2) By continuously updating and renovating tax administration with particular focus on training of human resource and by the use of latest technology.

- It would not be out of place to mention that training institutions and programs of FBR are ineffective or dysfunctional. For example, during my training at DOT, Lahore, I was told by my seniors that accounting teacher would not teach you corporate accounts and will use dilly-dallying tactics to kill the time. They were right. In fact, officers must be trained to understand and practice the use of accounting software's like JD Edwards (JDE), SAP and Oracle etc. Unless they do not know what sequence is triggered when an accounting entry is made through software, how come they would be able to examine the accounts of taxpayer? At the same time, at least one set of real-time accounts of each sector should be taught adequately to the trainees during their training and during first five years of their service.

- Sectoral training is another area that has conveniently been ignored. Officers expected to conduct audit of different sectors like a generalist. What results could be expected from such audit? At least optimum examination cannot be conducted unless an officer and staff is not trained for particular sector. One must know what is upstream of a business, processes of business and downstream of the business particularly marketing tactics and trail.

- In addition to effective training programs, training institutes should be made an attractive place for willing workers.

- Another crucially important aspect is internal audit. Unfortunately, internal audit setups have, in general, served as dumping grounds or retiring rooms. Without going into detail, it could be said that unless, inter alia, internal audit mechanism is not completely overhauled, equipped, adequately staffed and made effective with reward and risk of retribution, various functional setups will not deliver more than 50% of their working potential.

- One more area is placement of officials/ officers. If postings are not made on merit, and placement at FBR (HQ), internal audit, training setups, and legal divisions is treated and understood as punishment posting, then tax administration would never be able to transform itself into an effective and modern organization and would not be able to contribute significantly towards optimization of tax collection.

Annex-1) Some more facts: Agriculture was made provincial subject by Government of India Act, 1935 and its position remains unchanged till to date. Indeed, federation was barred by the constitution not to tax agriculture incomes. Our tax experts and policy makers failed to take cognizance of such constitutional position and did not get necessary law legislated by provinces till year 2000. Besides, confusion was created declaring agriculture income as exempt in Income Tax law. Not only that legislature unconstitutionally started taxing agriculture incomes in the form of clubbing agriculture income with income of director and business income for rate purpose since 1988, however, when brought to the notice of CBR leadership at that time and highlighted through an article published in April, 2006, relevant table in first schedule to Income Tax Ordinance was omitted. Yet agriculture income is still declared as exempt under section 41 of Income Tax Ordinance, 2001 which absolutely irrational and unconstitutional. When federation cannot tax an income, it cannot declare it exempt as well.

On the other hand, even after promulgation of agriculture income tax ordinances in 2000, they neither were adequately advertised nor are being implemented properly hence only less than 1% percent persons do file agriculture income tax returns and that also not accurately. Provinces do not have human resource and mechanism to enforce the correct payment of agri-tax.

Previously, that is before year 2000, certificates issued by Tahsildar/Mukhtiarkar certifying amount of agri-income particularly for wealth reconciliation purposes used to be accepted by assessing Officers, however, after introduction of provincial law as mentioned above, such certificates, although, still being issued and accepted carry no legal value, for only assessment order of agri-income could be produced in support of declared wealth. Unfortunately, department does not know anything about it hence erstwhile practice goes on.

There is another interesting aspect of agri-incomes. People talk about tax on agriculture while reminding that it constitutes around 21% of GDP and accounted averagely 24% to the sectoral contribution during the period years 2005 to 2010. However, a brief look to the table below will make it clear that crop agriculture that usually is taken as agriculture income as it is directly related to land is even less than 50% of total contribution of agriculture towards GDP whereas agriculture more than half is related to livestock which is around 95% in informal sector.

Even, thinking about crop agriculture one must keep in mind the pattern of land ownership in different provinces. Only a small percentage of land owners have enough land that earns taxable agri-income. On the other hand, big landownership could be fragmented into legal heirs and family members hence, it could safely be said that unless our agriculture-crop, live stock and fishery etc- is not mechanized and developed on modern lines, it would not be able to contribute even more than 2% of the total tax revenue.

Table 1.5: Sectoral Share in Gross Domestic Product(GDP)						
(At Constant Factor Cost) (In %)						
	1969-70	2004-05	2005-06	2006-07	2007-08	2008-09 P
Commodity Producing Sector	**61.6**	**48.7**	**48.3**	**48.2**	**47.0**	**46.2**
1. Agriculture	38.9	22.4	22.5	21.9	21.3	21.8
- Major Crops	23.4	8.4	7.6	7.7	6.9	7.3
- Minor Crops	4.2	2.7	2.6	2.4	2.6	2.6
- Livestock	10.6	10.6	11.6	11.1	11.1	11.3
- Fishing	0.5	0.3	0.3	0.4	0.4	0.4
- Forestry	0.1	0.4	0.4	0.3	0.3	0.2
2. Mining & Quarrying	0.5	2.7	2.6	2.5	2.6	2.5
3. Manufacturing	16.0	18.3	18.8	19.0	19.2	18.2
- Large Scale	12.5	12.9	13.2	13.4	13.4	12.1
- Small Scale	3.5	4.1	4.3	4.3	4.4	4.7
4. Construction	4.2	2.1	2.2	2.6	2.4	2.1
5. Electricity & Gas Distribution	2.0	3.2	2.2	2.2	1.6	1.5
Services Sector	**38.4**	**51.3**	**51.7**	**51.8**	**53.0**	**53.8**
6. Transport, Storage & Communication	6.3	10.4	10.2	10.0	10.2	10.3
7. Wholesale and Retail Trade	13.8	18.7	17.2	17.1	17.3	17.5
8. Finance and Insurance	1.8	4.0	5.5	5.9	6.4	6.2
9. Ownership of Dwellings	3.4	2.9	2.8	2.7	2.7	2.7
10. Public Admn. & Defence	6.4	5.9	6.1	6.1	5.9	6.1
11. Other Services	6.7	9.5	9.9	10.0	10.6	11.1
12.GDP (Constant Factor Cost)	100.0	100.0	100.0	100.0	100.0	100.0
P Provisional	*Source: Economic Adviser's Wing, Finance Division*					

But interpretation above may not satisfy some doubts regarding pomp and ostentation of big land owners.

Putting it briefly, big vehicles, houses and squads of armed and other attendants have less to do with agri-income and more to do with non-agri resources, which include illegal incomes, waived bank loans, shares out of contracts gotten awarded, bribes for Getting jobs and for transfers and postings, transaction related to illegal plots and lands and income out of permits and licenses etc. Nevertheless clout is conferred by land holding and by people linked to those lands. So solution lies somewhere else.

NEED FOR AGRICULTURE TAX IN PAKISTAN

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Additional Director

Introduction

At over one-fifth of the GDP, agriculture is the single largest segment of the economy that is almost entirely untaxed. So the desire to levy taxes, at least on the surface, seems like a good idea (Tirmizi, 2010).

In simple words agricultural income is any rent or revenue derived from land which is situated in Pakistan and is used for agricultural purposes. Successive governments have failed to effectively tax income generated by this sector. Agricultural income tax, as a result, has remained stagnant at less than Rs.1bn for more than a decade despite the prices of agricultural commodities having risen manifold over these years.

Pakistan has a history of taxing agriculture through the land revenue system. Being income and price inelastic, the replacement of the system with agricultural income tax is considered inevitable for meeting the financial needs of a growing national economy. In fact, under pressures from World Bank and International Monetary Fund (IMF), Pakistan introduced various variants of agricultural income tax in the past and in full during 1993 and 1996 respectively (World Bank, 1999). However, the introduction of agricultural income tax is a highly controversial issue in Pakistan, in government circles as well as among professional researchers and economists. (as cited in Chaudhry, 1999)

Merits of agricultural income tax.

Imposed effectively and indiscriminately, agricultural income tax has immense potential to generate billions of rupees in government revenue. But powerful landholders have always used their political clout to counter efforts to tap the potential of this tax.

The theoretical desirability of agricultural income tax follows from a number of considerations. The case for agricultural income tax follows from low contributions of agriculture to government's tax revenue. It is argued that, although agriculture's share in national income exceeds 23 percent, revenue raised from the sector is, at best, minuscule (World Bank 1999). With limited tax potential of many subsistence farmers, the land revenue system needs to be replaced by agricultural income tax for any significant increase in revenues from this sector. It is further argued that since the discrimination against agriculture in the form of low prices has ended or diminished in recent years, there exists a large untaxed potential which can be tapped by taxing this sector (Khan 1991 and World Bank 1999).

The justification for agricultural income tax is further built on criticism of land revenue system as an outmoded, regressive and price and income inelastic system of taxation. By contrast, the progressive rate structure of agricultural income tax permits heavier taxation of those with sufficient ability to pay and exemptions for the poor. Thus the system of agricultural income tax is helpful in achieving the most cherished goals of economic development such as equitable income distribution, poverty alleviation and resultant better nutrition in the rural areas. It has also been argued that the income-based tax system would be income and price elastic and would rid the economy of costly and politically sensitive periodic land assessments for increases in government’s tax revenue from agriculture (ibid).

Limitations of Agricultural Income Tax

In spite of its theoretical appeal, the imposition of agricultural income tax in Pakistan seems neither to practicable nor justified on any grounds whether economic, social or political. This can be seen from the following discussion.

Under the present situation of poor administration, rampant corruption and favoritism, the successful implementation of a graduated land tax, like the various land reform attempts, can be seriously doubted.

The operation of inheritance laws would continue to cause division of agricultural holdings to smaller size farms and consequent progressive reduction in government revenue. Between 1970 and 1990 the average farm size has already fallen from 13.0 to 9.4 acres.

Conclusion:

As the industrialists get loans from the banks and establish the industries of their choice, they not only repay the loans but also pay taxes of various kinds. The agriculturists should also get loans from the banks and develop their agriculture and should also pay the agriculture tax. The agriculturists should be treated as the industrialists and other businessmen are treated in respect of tax assessment and tax payment.

The agriculturists are being given subsidies on various items of agriculture and have also been exempted to give agriculture tax on the products of agriculture worth millions which is a preferential and discriminatory treatment much beneficial. It is a strange conduct of the Government and those related to the taxation departments that the agriculturists have been exempted from the agriculture tax but when the same product of agriculture is processed in a factory or sent to the market then various taxes are imposed on them which create frustration among the business class. If the Government is of the view that the agriculture is totally dependent on the act of God, the development of industries is dependent on the act of the Government. When for the assessment of various taxes, the Government has specific departments which properly or improperly assess the taxes; it should also open a specialized unit in the FBR for the assessment of agriculture tax and collection.

When the tax departments check the paper work of the industries, businessmen etc, the agriculture tax should be assessed on the spot from the number of sacks of wheat, bales of cotton etc. produced on a specific holding of land. The agriculturists should be rendered bound to shift the products from the lands after receiving clearance certificate from the authorized officer like the product of the industry. Each crop should be checked on the spot immediately and the report should be given to the higher authorities about the agricultural products of each land.

Pakistan is facing one of the worst natural disasters of its history; it is one thing to let them suffer out of sight and quite another to see them clearly, washed onto the shores on our newspapers and television sets, and still let them suffer. Helping them requires huge revenues and the answer to generation of more revenues is imposition of more taxes and not borrowing or foreign aid. We pay only a tenth of our collective income to our state, far less than most countries. India and Sri Lanka pay half again as much as we do. We need to pay more without foolishly bickering about whether taxes should be paid to the provinces or to the centre, by merchants or by landlords, on luxury goods or on shareholdings. The answer to these either or "or" questions is "both". Let's tax both locally and nationally, both trading and agriculture, both consumption and wealth. There is no doubt that various problems in the imposition and collection of agricultural tax will arise. But these should not deter the government from delay or dilly-dallying in the matter. It is feared that the Government may face resistance on the part of the powerful landlord lobby because nobody wants to pay taxes. In order to surmount it, the government may try to publicize and educate the farmers in respect of the advantages of the tax. For this purpose, pamphlets in local languages may be distributed free among the farmers by the provincial governments. The Government should provide inducement to the prospective tax payers in the form of concessions they would get such as supply of easy credit. (e.g. from Kissan Bank), fertilizer, seeds, water, etc. In other words, a congenial environment has to be created for the better collection of tax. The provision of tax remission should be made in view of bad crop due to recent floods. Any discontentment among the farmers will be more than offset by the pleasant impact that the tax will otherwise have on the overall situation in general and urban population in particular. The industrial and service class have long been clamouring for such tax which has so far been resisted by landlords. If the Government is afraid of the loss of its popularity among the rural people, it will be more than offset by the favourable response from the urban population particularly the industrialists and service class which, although a small segment of the total population, nonetheless, are very vocal and influential.

THE ECONOMIC COST OF FLOODS IN PAKISTAN

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Nature's fury which unleashed in the form of torrential rains in Khyber Pakhtunkhawa has inundated the huge swathes in Punjab, Sindh and Balochistan. According to the initial estimates, more than 20 million people have been displaced by the furious Indus and super floods have claimed at least 2,000 lives. Widespread deluge, which has been termed "Slow Tsunami", has undone the years of progress and development in Pakistan as it has suffered an economic loss $ 43 billion**.** And the worst is yet to come as the country will grapple with unprecedented economic crisis in the wake of floods. In this essay, I shall highlight all those facets of economy which have been buffeted by the recent floods. In the end, I will delineate the ways we can change the wrath of God into a Godsend opportunity for the reconstruction of our economy.

Ours is an agricultural country and agriculture is the mainstay of our economy as it contributes 23% to our GDP. Recent floods have wrecked havoc on the different crops in the country, converting fertile lands into marsh. As per the initial reports, damages to the crops alone have been estimated around $2bn. Given the shortage of staple crops, the country will have to spend a large amount of its foreign reserves on the food import bill. Besides this, Pakistan has also lost 15% of its cotton crop to the flooding, which will reduce the harvest to 1.9 million, estimates an international farm group and the shortage of cotton will further aggravate the crisis for Pakistan's textile industry.

Since textile sector will be amid the most hurt ones, which will inevitably lead to the banking crisis as agriculturalists will default on their debts. The loan defaults will cause an escalation in the bank's non-performing loans. According to the estimates, the non-performing loans are likely to cross Rs.500 billion by the end of the current fiscal year. Apart from coping with the bad debts, there will be a considerable slow down in the deposit mobilization over the medium term income on account of erosion in rural income.

The worst humanitarian crisis ever in the history of Pakistan has compelled the government to borrow from State Bank of Pakistan and private banks. The government has borrowed more than Rs.120 billion in the three weeks of this fiscal year, which has led to a surge in inflation. The experts warn that spiraling inflation could be as high as 25% this year. The inflationary process has already taken the shape of a storm as the prices of fruits, vegetables and other food articles are sky-rocketing not only in the flood-ravaged areas but also in those areas which have not been affected by the flood.

In order to make for the losses arising from the flood, the big-wigs of Pakistan’s finance division are planning to impose a flood tax. The proposed flood surcharge will be levied on the personal incomes exceeding 300,000 rupees per annum. Moreover, the government is all set to levy a two percent tax on all imports. Besides this, the president has also hinted at a one-time imposition of tax on the unaffected farmers and on urban property. These new taxes will be another burden on common people, who are already overwhelmed with a regressive tax regime.

Last year, people witnessed a growth in country’s economic indicators as economy grew by 4.1% and was expected to grow by 4% this year. But shortfalls in tax revenue and inevitable rise in expenses arising from the rehabilitation and rescue may cause a negative trend of GDP. The country is going to miss all of its budgetary targets and the economic experts warn that economy will contract by as much as one percent this year. In addition to this, exports could plunge by $3-4 billion, causing the balance of trade to widen, and rupee to fall. Capital flight could ensue like in 2008 when people transferred abroad about $3 billion over a period of six months.

The deluge devastation will make Pakistan’s economy dependent on foreign credit at a time when developed countries are trying to recover from a financial meltdown and therefore the calls for the aid by UN are not being heeded to. Already Pakistan is under a 25-month $11.3 billion Stand-by agreement (SBA) with IMF effective since 2008 and its total foreign debts have exceeded $55 billion. More debts and loans for the rehabilitation will push the economy further into a morass.

In order to rehabilitate the victims and to rebuild the entire infrastructure such as roads, buildings and bridges, the government will have to re-appropriate the budgetary allocations to various heads. Last year, the government envisaged a comprehensive economic policy and reserved 663 billion rupees for Public Sector Development Program (PSDP). In order to divert those funds to a mammoth task of relief and rehabilitation, the government has frozen the funds dedicated to PSDP and it plans to spend 250 billion rupees for the uplift of flood-affected people.

Apart from the colossal human loss, flood has destroyed physical infrastructure like roads, bridges, and buildings and has razed more than 1000 bridges , 400 kms of roads and 3.5 million homes and the cost of repairs has been estimated more than 8-9 billion rupees.

Epilogue

In the foregoing lines, I have traced the murky scenario of Pakistan’s economy. With so much destruction and misery around, it is difficult to pin one’s hopes on the future. But history is replete with many examples of societies having clearly turned their adversity into a window of opportunity to achieve what they never would have in their normal times. One must not forget the experiences of the first world in the wake of The Great Recession. Europe came out of the financial meltdown owing to the prudent policies devised in the wake of crisis. In the present scenario, we need to emulate the European economic apotheosis and the following lines explicate as to how we can put our country back on the path of economic recovery.

Presently, government is finding it difficult to devise any particular policy related to the rehabilitation owing to the absence of reliable statistics. In order to launch a comprehensive program, the government must launch a census of the all the flood-affected areas to get the consistent population parameters. Secondly, instead of levying new taxes, the government must broaden the tax base by bringing real estate into the tax net. This will not only improve the tax-to-GDP ratio but will provide immediate economic relief to the victims.

The present democratic dispensation has been flayed for its lavish expenditures, which can be avoided by adopting austerity measures, curtailing junkets to foreign destinations and by reducing the bloated size of parliament. The government should also withdraw the subsidies and income support programs to divert the funds for the rehabilitation and development.

Despite the economic pledges made by the international community, an aid fatigue is being noticed by all the quarters concerned and only a part of pledges has been materialized so far. An interrupted flow of aid can be ensured only by establishing a proper institution for the disbursement of aid. Moreover this entire process must be made public for achieving transparency and avoiding embezzlements.

Multinational companies can also play a pivotal role in the uplift of flood victims by introducing quota system in jobs for the natives of these areas. In order to provide a quick relief to the people, the central bank must increase the interest rates for curbing the inflation. The unemployment rate of Pakistan is feared to rise in the wake of flood which can be controlled by giving soft loans to the flood-affected people. The government must encourage the banks to provide loans to the people without the condition of collateral and mortgage. This policy will spur the economic growth as people will utilize these loans for achieving the self-sufficiency.

The recent floods have affected the people belonging from all walks of life but the peasant community has been among the worst sufferers. In order to mitigate their sufferings, we need to launch a meaningful land reform program and to discourage large land holdings. Pakistan can surface out of the present crisis as a vibrant economic power once each one of us contributes his best to the country in these trying times and believe that "crisis and opportunity always come together and one can be transformed into the other."

PROGRESSIVE TAXATION SYSTEM: A SOLUTION TO PAKISTAN'S ECONOMIC PROBLEMS

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Although there are innumerable definitions and quotes on progressive taxation system. The following quote sums up the spirit behind this system quite aptly.

"The progressive tax system is an admission to and result of the fact that our capitalist system rewards the wealthy more than its taxes hurts them. Not only is this system just, it is essential" {Gerald Cox, "Column: Obama's progressive tax plan solution to deficit"}

Adam Smith, although advocated free market capitalism, he was infact against a flat tax. He states in (The Wealth of Nation)

"When the toll upon carriages of luxury, upon coaches…… is made somewhat higher in proportion to their weight, than upon the carriages of necessary use, such as carts, wagons, the indolence and vanity of the rich is made to contribute in a very easy manner to the relief of the poor, by rendering cheaper the transportation of heavy goods to all the different parts of the country."

The argument in the aforementioned saying is basically that the richer you are the more tax you should pay.

THE PURPOSE OF TAXATION

The main purpose of taxation is to accumulate funds for the functioning of the government machinery. However, other important aims are;

i) Increasing the productivity of the nation.

ii) Rationalizing and promoting a just and equitable economic system

PAKISTAN'S ECONOMIC PROBLEMS AND PROGRESSIVE TAXATION AS WAY FORWARD

(i) Main problem is the undocumented economy;

Pakistan is facing innumerable economic challenges. The most significant however is the widespread disparity in income of various segments of the society. One of the main reasons for the aforementioned situation is that the underground economy ranges between Rs.2.91 trillion & Rs.3.34 trillion (54.6% of GDP to 62.8% of GDP respectively) in 2005. *(Estimate by M. Ali Kamal PIDE, Islamabad).*

Illegal activities like corruption, smuggling, black marketing, trafficking, hoarding, narcotics, informal legal jobs etc constitute the underground economy. These activities constitute tax evasion and produce negative impact on social welfare of the country. Almost all transactions made in the underground economy are through cash e.g. payments in illegal sales, drug trafficking etc. Non maintenance of prescribed accounts is also a major cause of revenue leakages in sales, business and trade activities.

"Rise in the underground economy decreases the state revenue which in turn reduces the quality and quantity of publicly provided goods and services" (Schneider & Enste 2000).

This shortfall of revenue is either filled through increase in tax rates or by increase in price of goods i.e. inflation.

(ii) Documentation & broadening of tax base as solution;

Documentation can help in evolution of a progressive tax system where richer segments pay taxes at higher rates and according to their ability instead of pushing the burden on poorer segments and the over burdened sections of the society. Increasing number and scope of legal documentation measures, strengthing the coordination between relevant financial and law enforcement agencies, better governance, improvement in broadening of tax base measures, and anti smuggling and anti trafficking measures will also play a very important part in curbing the mushrooming undocumented and underground economy.

"Substantial reduction of the underground economy leads to a significant increase in tax revenues and therefore to greater quantity and quality of public goods and services, which ultimately can stimulate economic growth." (Schneider & Enste 2000)

(iii) Benefits of progressive tax system

"Progressive taxes are for protecting poor, not punishing the rich"
(Robert J. Shapiro (Washington Post)

Progressive taxes are socially valuable. These encourage social cohesion. Progressive taxation can help combat-crime. There is always room for public support for progressive taxation because fairness matters. The public is concerned with the issue who pays what? This is critical for encouraging voluntary compliance. Progressive taxes help ease the blow of recession and unemployment. Successful international models of this system include USA, Australia, New Zealand.

UTILIZATION OF TAX REVENUE ON DEVELOPMENT AND WELFARE

Spending tax revenue on poverty alleviation strategies, welfare projects and health, Education, environment protection, Social Sector Development, socially beneficial programmes is the need of the hour.

In this country, there is an enormous trust deficit regarding proper utilization of tax revenue. Effective measures through using media channels and opinion leaders to inform the public regarding revenue expenditure on development, welfare & genuine betterment of country's Infrastructure and facilities would boost and encourage people to pay taxes more willingly and honestly.

Tax payer education measures should be made more broad based and interesting to attract larger attention of all stake holders in Pakistan's economy.

The tax system reform currently under way stresses on automation, setting up of data base of vital economic data, integration of relevant duties. These are very significant steps. They will be more effective if taken in conjunction with implementing compulsory maintenance of prescribed accounts and sincere efforts to make the tax system move towards distributive justice.

(iv) Generate more revenue indigenously

The various challenges being faced by Pakistan in education, health and social sector etc funnel down to the reason that poverty is wide spread and there is a shortage of funds for taking effective remedial steps. Dependence on foreign loans has added further to these problems. The solution is obvious i.e. to generate more revenue indigenously. There is a need to broaden the tax net with focus on hitherto neglected sectors like agriculture, services of professionals, real estate business etc. These are very serious issues which require tremendous political will and parliament's support. The nation needs heroes who can rise above personal interests and are willing to take pain for greater good of the country.

THE INLAND REVENUE SERVICE: RE-ORGANIZATION OF THE TAX ADMINISTRATION ON FUNCTIONAL LINES

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The CBR Act of 1924 created the Central Board of Revenue. The Board administered both the direct and indirect taxes. By 1944, CBR became a separate division under the Ministry of Finance. The Administrative Re-organization Committee in 1960 attached CBR to the Ministry of Finance. The status of CBR as a Revenue Division was restored in October, 1991. In June 2000, the Government of Pakistan appointed a Task Force on reform of tax administration. The Task force worked under the chairmanship of Syed Shahid Hussain. A reform strategy was devised and the World Bank approved the project on 12th December, 2004. Task Force Report on Tax Administration (2001) has five volumes and covers finer details of the system to offer new insight for undertaking comprehensive reforms. Briefly the report recommended that the organizational structure of CBR and its field offices need fundamental changes, especially it encouraged creating separate slots for Member (Audit) and Member (Legal).

The Federal Board of Revenue Act, 2007 was approved by the parliament thus; paving the way to the reform process. The reform project undertook three main areas of reform namely; policy reforms, administrative reforms and organization reforms. The creation of LTUs and RTOs made it possible for the tax administration dealing with domestic taxes to work under one roof yet, the functionaries of Direct Taxes and Indirect Taxes could not join hands to function as a single unit and remained at arm's length with each other. It is this premise which led to the creation of the Inland Revenue Service.

The launching of the Inland Revenue Service has a history of legal turbulence and wedging of the tax administration under the umbrella of the FBR. Since 2002, the tax reforms have witnessed a winding course, sometimes the stream seemed to be lost in the clouds of uncertainty. The launching of a new occupational group became a reality when on 12th September, 2009; the Office Memorandum declared that all the business concerning Income Tax, Sales Tax and the Federal Excise shall be transferred to the Inland Revenue Service. The Establishment Division also made it clear that the existing

Customs and Excise Group would be renamed as the Pakistan Customs Service, while the Income tax Group would be abolished. The posts currently forming part of Income Tax Group as well as the Customs and Excise Group would form part of the new "Inland Revenue Service". Further recruitment to the Income Tax Group is stopped and fresh recruitment to IRS has been initiated through the Federal Public Commission.

The OM No. f.6/2/2009-CP-II was issued by the Cabinet Division through which the invitations for options were sought. Each officer availing the IRS option was to be appointed at the same level of seniority he/she occupied in the previous cadre, in accordance with the Civil Servants (Seniority) Rules, 1993. According to the memo, if an insufficient number of officers opted for the IRS, the shortage would be met by posting officers of the Customs Group and the Income Tax Group under section 10 of the Civil Servants Act, 1973.

The initiation of the Inland Revenue Service was paved by the fact that nearly 900 to 1000 FBR officers, most of them from the Income Tax Group opted to join the Service. The Chairman FBR said in a press conference at the FBR headquarters in October, 2009 that, "system of IRS exists in 120 countries of the World and this would help us improve the tax to GDP ratio. FBR has been undergoing a reform process since 2002 and creation of IRS is a part of the reforms and is in consonance with the international best practices".

The merger unleashed a corollary of modifications in the earlier Office Orders. The powers exercised by the authorities under the Federal Excise Act 2005 and Sales Tax Act 1990, were to be shared by all the officers of the IRS. The field formations were reorganized by issuing the designation orders dated 11th, 19th and 24th November, 2009. The new Jurisdiction Orders were issued in pursuance of the Finance (Amendment) Ordinance, 2009.The powers conferred by sub-section (1) of section 209 of the Income Tax Ordinance, 2001, section 30 and section 31 of the Sales Tax Act, 1990, section 29 of the Federal Excise Act, 2005 were to be assigned to the newly created Tax administration. SRO 282(1)/2010 dated 29th April 2010 relating to Sales Tax issued by Indirect Tax Policy Wing of the FBR and SRO 284(1)/2010 relating to the Federal Excise assigned certain powers to the Directorate General of Internal Audit. Following the trail of events the Directorates of Internal Audit were renamed as the Directorate General of Internal Audit (Inland Revenue).

The sequel of legal events that led to the launching of the Inland Revenue Service was not just possible by uttering the magic spell of "Abracadabra". Wedging and un-wedging the existing tax administration has been a Herculean task. The posts of the customs and Excise officers in LTUs and RTOs have been created under the umbrella of the Inland Revenue Service.

The Direct Taxes and Indirect Taxes both generate revenue but their contribution percentage varies because of the difference in the nature of these taxes. There are three components of direct taxes i.e.; individual income tax, corporate tax and other direct taxes. The distribution of the collection is categorized into following heads: Collection on Demand (COD), Voluntary Payments (VP) in the shape of tax with returns and advance tax, withholding taxes (WHT). The other direct taxes include CVT, WWF and WPPF. The indirect taxes comprise of the Sales Tax, Federal Excise Duty and the Customs Duty.

The Sales Tax Act of 1990 has replaced the Sales Tax Act of 1951. The manufacturer, importer, distributor and wholesaler are liable to pay Sales Tax at the time of making taxable supplies. The Federal Excise Act, 2005 has repealed the Central Excises Act, 1944. The Federal Excise Duty is payable on goods produced or manufactured in Pakistan, the goods imported into Pakistan and the services provided or rendered in Pakistan.

The major significance of the merger is that the Inland Revenue Service shall function as a single unit and levy all the domestic taxes. Thus by clubbing the domestic taxes the tax record of manufacturers, distributors, wholesalers and the importers who conduct their activities in Pakistan can be located under one roof. In case of the concealment of income, an audit trail can lead to viable results. The Tax administration Report (2009) on the OECD countries, elaborates that the major OECD members have aligned the Exscise function with the Inland Tax function solely for this reason. Canada, Finland, Sweden, United Kingdom, United States of America, Australia, Spain, and Singapore etc., have established the Inland Revenue Service to levy the domestic taxes. Luxembourg, Malaysia, Malta and Cyprus have merged the administration of direct and indirect taxes within a single revenue collection body because a single purpose agency can focus on a single task and can yield better results. The same model is replicated in Pakistan in the form of the Inland Revenue Service.

The tax administration reforms initiated by TARP, have been successful in increasing the revenue generation.. The tax collection increased from Rs. 404 billion in 2001-02 to Rs.909.6 in FY 2009-10.The tax collection as revealed in the, "FBR Quarterly Review", (analysis of the third quarter of Tax year 2009-10) shows that FBR has been able to achieve double digit growth of 11.6% in the tax receipts as compared to the previous year. Moreover, sales tax and direct taxes grew by 15.6% and 11.3% respectively during July-March, 2009-10. On the other hand, federal excise exhibited only 4.2% growth in the collection.

The effects of merger will be forth coming both in the shape of more revenue generation and an effective tax administration. It is too soon to decide whether the new system of tax administration is better for Pakistan or not. The data ware house is not functional as yet therefore; the stake holders are waiting anxiously for better results to pour in. The Tax collection targets of FY 2011 will be a new challenge both for the tax administration and for the newly created Inland Revenue Service. Since 2001, the tax reforms are an on going process. It is now high time that the reform process should be brought to a close after the creation of IRS and the re-organization of the FBR on functional lines.

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