CBR Quarterly Review

A Review of Resource Mobilization Efforts of Central Board of Revenue

Central Board of Revenue
Government of Pakistan
Constitution Avenue
Islamabad - Pakistan

Volume: 1	April-June 2002	No. 4

Contact:
Dr. Ather Maqsood Ahmed
Fiscal Research and Statistics Wing
e-mail: mfrs@cbr.com
Phone: (051)-920-4436
(051)-920-1979
Fax: (051)-921-9211

Document prepared in collaborating with
Budget Wings: Direct and Indirect Taxes
Directorate of Research and Statistics
Tax Policy and Reforms Wing
Taxpayers Education & Facilitation Wing

Contents

		Page
	Foreword	*i*
I.	An Analysis of Tax Collection	1
	o The Economy	1
	o Resource Mobilization Efforts	2
	o CBR Revenue Position	3
	o Revenue Position vis-à-vis Target	4
	o Overall Collection and Refunds	6
	o A Disaggregated Analysis	7
	o Direct Taxes	7
	o Sales Tax	15
	o Customs Duties	20
	o Central Excise Duties	22
	o CBR Revenue Projections for FY 2002-03	25
II.	Income Tax Ordinance, 2001 and Maintenance of Books of Accounts, Documents and Records	28
III.	CBR Tax Reform Program: Soft Opening of the Large Taxpayers Unit at Karachi	33

FOREWORD

The reform processes are designed to have long-term benefits through efficiency gains. However, the onset of the restructuring and reform process is not without short-term costs. The experience of East European and Central Asian Countries, the leading States in transition, bears testimony to assertion that transition from a well-entrenched system to a modern setup is not always smooth. The reform process bears limited fruit if structural rigidities continue to obstruct and hinder change towards an intervention free competitive setup. Fiscal reform process is no exception to this rule.

The process of fiscal reforms started in Pakistan during the decade of the 1990s with tariff rationalization and the introduction of broad based value added tax (GST). The change envisioned pivotal roles of two major taxes, i.e., income & corporate taxes and sales tax within direct and indirect tax regimes. While tax policy initiatives alone often fail to deliver the desired results, the institutional restructuring almost always follows the initial steps. The objective of the reorganization of Central Board of Revenue is to redesign tax administration on functional lines in place of the existing cylindrical tax-by-type structure, which is regarded as inefficient and outdated. There is greater emphasis on taxpayers' facilitation and education, audit, information and management systems, human resource management, and fiscal research to ensure standardization of work processes. The soft opening of the large taxpayers unit at Karachi is an important step forward in the direction of organizational change. It serves the dual roles of leading the way to an era of modernization and to gain experience from the pilot project to replicate the forward-looking taxation system over the entire country.

The redesigning and re-engineering of work processes on the one hand and effective implementation on the other are important steps in their own respect but an extensive analytical review of the resource mobilization efforts of the revenue organization serves as a litmus test for the success of the reform process. In unison, fiscal transparency also requires improving data quality and reporting of information to the government and the public at large.

"CBR Quarterly Review" is an effort to provide an in-depth analysis of the revenue collection for the government to monitor its fiscal strength. It is designed to serve as an authentic piece of information for the end users -- the government, financial institutions, academia, fiscal researchers and the public. With an impartial and coherent analysis of the revenue potential of the CBR and the bottlenecks in effective resource mobilization, the "CBR Quarterly Review" would serve as a source of continuous dissemination, elaboration and evaluation of the on-going reform process for all stakeholders. The publication of the "CBR Quarterly Review" would also confirm the government's strong commitment to ensure that the reform process is on track. The document is being released with the hope that it will come up to the expectations of its beneficiaries and serve its intended purpose.

Riaz Ahmad Malik
Chairman

I

An Analysis of Tax Collection

The Economy

Fiscal year 2001-02 has been unique in Pakistan's economic history as the economy experienced extraordinary internal and external shocks, which resulted into lower than anticipated growth in the real sectors, stagnation in the external sector, and continuously an unfavorable investment environment. The situation was aggravated by the war-mongering sentiments and the resulting military build-up on the Eastern border. The Northwestern border also remained plagued by unusual military activity due to the war against terrorism. Consequently, the optimism expressed at the beginning of the fiscal year and the anticipatory take-off largely remained illusory, particularly until February 2002.

The economy registered a modest real GDP growth of 3.6% in 2001-02, mainly due to a near-vibrant services sector. The growth of the agriculture and the large-scale manufacturing sectors, on the other hand, remained below their respective potential levels due to wide ranging factors including persistence of drought conditions and difficult regional and global economic environment. On account of decline in production and yield, major crops, especially wheat, rice and cotton, registered negative growth.[1] Similarly, the industrial production of key industrial concerns including vegetable ghee, cigarettes, fertilizers, cement and soda ash also declined during the first ten months of fiscal year 2001-02. Failure to maintain the growth momentum is also evident from the declining share of investment, imports and exports in GDP during the year. However, on a positive note, favorable developments were experienced in the

[1] The production and yield has been influenced by a combination of factors including water scarcity, increasing costs of inputs, incentive structure especially the price support mechanism and the non-avaialability of adequate grain storage facilities. The evidence shows that the major crop sector has registered negative 'real' growth in four out of six years since 1996-97.

balance of payments account as current account balance, excluding official transfers, turned surplus, inflation remained below 3% and foreign exchange reserves registered substantial increase. Despite strong apprehensions about the law and order situation, the foreign direct investment increased by about 19%. The increase in oil and gas sectors was over 100% during the first ten months of fiscal year 2001-02. Above all, there has been an improvement in internal and external indebtedness due to debt management efforts. Thus, the prevailing optimism that the economy is poised for rebound and that the 'soft takeoff' will translate into real takeoff is not without merit. The sanguinity is based on clear signals of improvement in key macroeconomic fundamentals. But the hopefulness will turn into reality if concerted efforts continue to improve investors' confidence and there is recovery in the manufacturing sector.

Resource Mobilization Efforts

Notwithstanding various budgetary and non-budgetary measures to mobilize resources, it has not been possible to push revenue to GDP ratio beyond 13-14%. Based on the conventional wisdom, the first generation of fiscal reforms introduced under the Structural Adjustment Program in the late 1980's shifted the emphasis away from indirect taxes towards direct taxes; and within indirect taxes value added version of the general sales tax was preferred. At the same time reliance on international taxes especially customs duties was gradually reduced. This transition was consistent with efficiency and equity arguments, which perceive indirect taxes to be more regressive in nature. The motive behind tariff rationalization was also straightforward. That in view of deregulation and liberalization under WTO the domestic industrial structure will have to be competitive as hedging against protective tariff barriers would not be possible under the new trade regime.

Whereas policy advice on revenue architecture has been and continues to be a prominent part of the tax reform process, there has

been increasing realization that good policies alone are insufficient for sustained, reliable revenue generation. Evidence shows that in the medium to long term strong institutions and efficient administration are also necessary to ensure effective implementation of policies. Consequently, institutional strengthening and governance capacity building have, of late, become the integral part of the second generation of fiscal reforms being introduced in Pakistan. The most important step in this direction is redesigning and reorganizing tax administration on 'functional' rather than the 'type-of-tax' basis to reduce adversarial relationship between taxpayers and tax collectors. Major initiatives aiming at taxpayers' facilitation and education, human resource management, and simplification of audit and related procedures have already been started. This effort is supplemented by commencement of work on development of a comprehensive information system and proper dissemination of fiscal initiatives. The hind sight is that the revenue organization will be more effective if the staff is well trained, motivated and dedicated, the rules of business are transparent, the system runs on modern lines and there is a serious effort to improve the image of the organization and the morale of tax administrators and tax collectors. Through soft opening of the Large Taxpayers Unit (LTU) at Karachi, Pakistan has already entered into a new era where fiscal system has started to function on modern lines. In this changed environment motivational skills, courtesy and respect are rules of the game. It is anticipated that the combination of tax policy reforms and institutional restructuring will knock down the inherent rigidities in the system. Effective resource mobilization will make it possible for decision makers to contain both fiscal deficit and the increasing debt burden.

CBR Revenue Position

The historical evidence confirms a continuous growth in federal tax receipts. The revenue collection increased at an average annual rate of 7.4% since 1996-97. However, slower growth of the economy on

the one hand and reduced value of imports (mainly due to the appreciation of rupee vis-à-vis dollar) on the other hand an adverse impact on revenue collection in FY 2001-02. Since delay in refunds/ rebates has always invited criticism from stakeholders, promptness in refunds and clearing the backlog of refunds during the year was a deliberate policy. Consequently, the gross and net collection of CBR increased by 6.7% and 3%, respectively over the past year. [2]

Further bifurcation into major taxes indicates that the rate of increase of net collection of direct taxes and sales tax has been 14.5% and 8.3%, respectively during the year, indicating the buoyant nature of these taxes. On the other hand, net collection from customs duties and central excise declined by 26.1% and 4.4%, respectively due to tariff rationalization and decreasing emphasis on excise duties as one of the main revenue spinners. Disaggregating sales tax into its components gives further insight. While the collection from sales tax (domestic) increased by 13.1% over previous year, the collection from sales tax on imports increased by 4.8%, a pattern consistent with the overall growth of the economy. Based on provisional figures, CBR revenue to GDP ratio for FY 2001-02 has been 10.8, which is lower than the past year.[3]

Revenue Position vis-à-vis Target

It is now well recognized that revenue projection is one of the most difficult tasks in budget making. The scientific job requires thorough understanding of interplay of various sectors of the economy, tax laws, rules and procedures and the existing levels of tax compliance and tax administration. On top of these issues, one also needs to maintain a delicate balance between equity and efficiency considerations. The three commonly used methods to

---

[2] The increase in net collection goes up to 6.8% when adjustment is made for refunds. Incidentally this rate of growth matches with the nominal growth of the economy for FY 01-02.

[3] The refunds adjusted revenue to GDP ratio goes up to 11.2, which not only comes close to the last year's ratio but also remains consistent with tax to GDP elasticity coefficient of 0.96.

generate revenue projections are (a) econometric approach that requires estimation of elasticity and buoyancy estimates, (b) indirect approach that involves projections on the basis of effective rates of taxation, and (c) residual approach where future revenue needs are determined residually after taking into account expenditure needs and future sources of debt financing. The CBR revenue is projected on the basis of all these approaches.[4]

The budgetary revenue target of CBR for the fiscal year 2001-02 was set at Rs. 457 billion. The target was revised to Rs. 443 billion when actual collection of fiscal year 2000-01 was realized. During the year the target was further revised initially to Rs. 429 billion and then to Rs. 414.3 billion in view of the post September 11 and December 13 events and projection errors.[5] The revenue targets of four major taxes, i.e., direct taxes, sales tax, customs and central excise duties were revised up and downwards accordingly by +2.38%, -7.8%, -24.1% and -4.85%, respectively *(Table 1).*

Table 1: Original and Revised Targets of Revenue

(Rs. Billion)

	Original Target	Revised Target	Difference	
			Absolute	Percent
Direct Taxes	143.1	146.5	+3.4	+2.38
Sales Tax	184.5	170.1	-14.4	-7.80
Customs Duties	66.5	50.5	-16.0	-24.06
Central Excise	49.5	47.1	-2.4	-4.85
Total	443.7	414.3	-29.4	-6.63

An in-depth analysis of the revenue accounts presented below makes it clear why the initial and even the revised target of Rs. 414.3 billion was not achievable and how the resource mobilization efforts

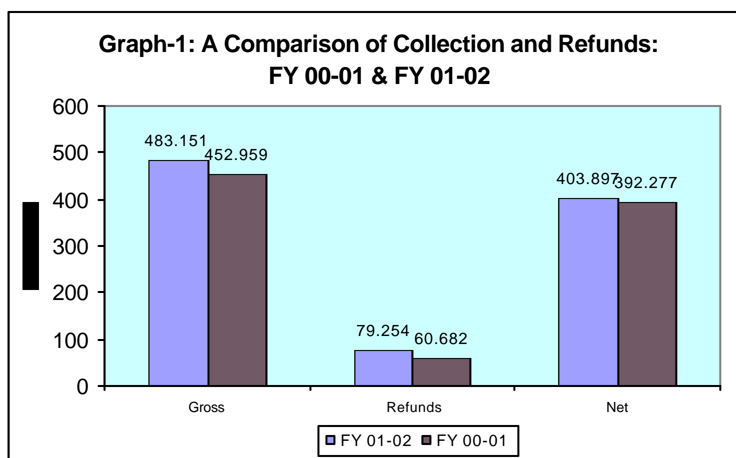
[4] Within the general equilibrium framework the outcome of all these approaches should converge. However, divergence is observed when some of the forward and backward linkages are ignored.

[5] Repeated revisions in the CBR revenue target have become a norm rather than exception. Concern on serious implications of such projection errors for actual deficit, expenditure adjustments and borrowing requirements has also been raised by the State Bank of Pakistan in its Annual Report 2000-2001.

of the revenue organization have gone a long way to realize this target. Starting with the overall collection and refunds position, the analysis is extended to individual taxes. Fluctuations in revenue collection are explained on the basis of yearly, quarterly and monthly data as has been deemed necessary.

Overall Collection and Refunds

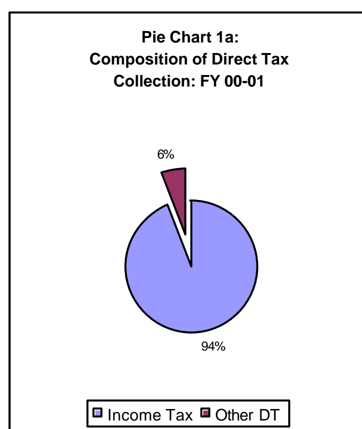
Despite various odds mentioned above, the provisional gross revenue collection shows improvement, *albeit* marginal, as compared to the past year. The tax effort has resulted in gross collection of Rs. 483.2 billion of which Rs. 79.3 billion have been paid back as refunds and rebates. Thus, the net collection has been Rs. 403.9 billion. As indicated, the average annual increase in gross collection has been 6.7% but the net collection has increased only by 3% due to hefty growth in refunds by 30.6%. The shares of direct and indirect taxes in net collection have been 35.3% and 64.7%, respectively. Compared to 1999-2000 and 2000-01, the increase in the share of direct taxes (from about 32% to 35.3%) is a positive development given the progressive nature of direct taxes and their implications for income inequality and distributive justice. The overall position of collection and refunds is displayed in *(Graph-1).*

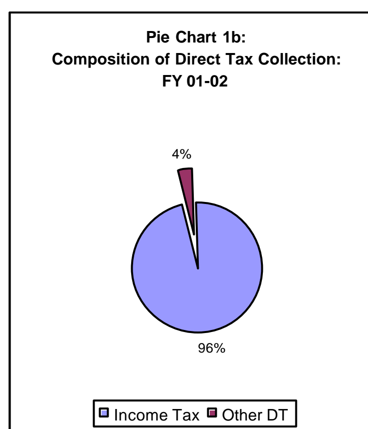


Detailed Analysis of Individual Taxes

Direct Taxes: The gross direct tax collection during FY 01-02 has registered 15.4% increase over FY 00-01. Since refund payments increased by 23.9% during the period, the growth in net direct tax collection has been 14.5%. In absolute terms the gross collection of direct taxes has been Rs. 159.1 billion, refunds Rs. 16.5 billion, and net collection Rs. 142.6 billion.

Before elaborating further, it may be useful to explain the composition of direct taxes. The two components of direct taxes are income tax and 'other' taxes. The income tax collection is based on three major components, i.e., collection on demand – representing additional tax effort on the part of tax administrators, voluntary payment – a measure of voluntary tax compliance, and deduction at source consisting of withholding taxes some of which are presumptive in nature. The components of 'other' taxes include wealth tax (now abolished though some residual tax amount still accrue), capital value tax (CVT), corporate assets tax (CAT) and workers welfare fund (WWF). Over the years the contribution of income tax and 'other' taxes in direct tax collection has generally remained constant with more than 95% of the share going to the former. *(Pie Chart 1).*



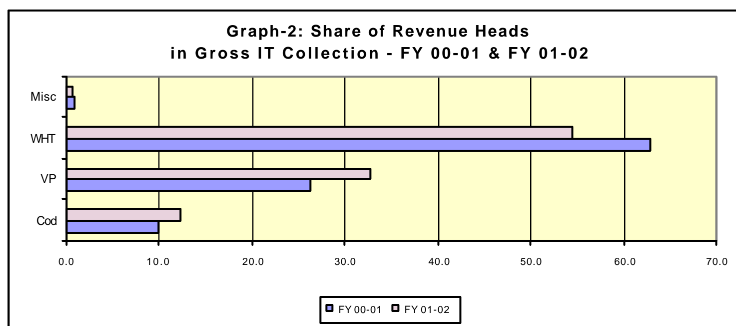


Income Tax: The analysis is started with the description of various components of income tax and the relevant clauses of income tax ordinance, 1979 under which taxes are collected. The *voluntary payments* (VP) are collections with return under SAS and collection with normal returns u/s 80-D, u/s 54 (other than 80-D), u/s 53 and tax amnesty u/s 59-D. Payments u/s 80-D are made by companies and registered firms with minimum tax of 0.5% on turnover adjustable on final liabilities; where there is no tax or final liabilities are less than this, it is the minimum. Payments u/s 54 are voluntary payments admitted with return and collections u/s 53 are advance taxes from companies and registered firms on the basis of tax-turnover ratio on assessed value of past year and from individuals whose assessed income during FY 00-01 was over Rs. 150,000. *Collection on demand* (CoD) includes arrear demand and current demand based on assessment of tax returns under normal law. Whereas current demand refers to demand created and amount collected during the on-going fiscal year, arrear demand refers to accumulated arrears on created demand of past years. Finally, *deductions at source* are withholding taxes (WHT) on various categories of economic activities. The complete listing of the WHT, rate structure including exemptions and tax deducting authorities are given in CBR document "Guide to Withholding Taxes – under section 50 of Income Tax Ordinance 1979" published in April, 1999.[6]

A comparative assessment of FY 00-01 and FY 01-02 indicates that the composition of income tax collection has changed over the two years. The share of WHT in income tax collection has reduced during FY 01-02 as compared to FY 00-01 and that of VP and CoD has increased. This is a clear indication of the tax reform process moving in the right direction by decreasing the share of WHT, some of which are considered to be more indirect in nature.

[6] An updated version of the document based on the Income Tax Ordinance 2001 is currently under preparation. It will be published in July 2002.

<u>*Voluntary Payments:*</u> The collection through voluntary payments has registered a significant increase of 42.6% during July-May of FY 01-02 as compared to FY 00-01 *(Table 2).*[7] In terms of amount, Rs. 41.5 billion have been collected during first eleven months of FY 01-02 as against Rs. 29.1 billion during corresponding period of FY 00-01. Besides natural growth in base, this increase in voluntary compliance has been the result of survey and documentation drive of the economy. This assertion is substantiated by the fact that the contribution of voluntary payments in gross income tax collection has gone up to 33% during FY 01-02 as compared to 26% during FY 00-01. Simultaneously, the number of individual and corporate income taxpayers has increased by 14.7% and 10.5%, respectively, which reflects an overall improvement in the income tax base by 14.6%. *(Graph-2).*



The quarterly data on voluntary payments indicates that the collection on account of two minor components, i.e., u/s 80-D and u/s 59-D has declined by 91% and 86%, respectively in the FY 01-02. This decline has been anticipated as minimum turnover tax, originally levied on companies and registered firms, was extended to individuals in FY 00-01 but was withdrawn during the same fiscal year. Similarly, the tax amnesty scheme is no more operative in the FY 01-02. On the other hand, collection on account of two major components of VP, i.e., payments admitted with returns (u/s 54

[7] The disaggregated figures of the components of direct tax are available only up to May, hence the comparison is based on eleven months collection.

other than 80-D) and advance tax (u/s 53) has increased by 81% and 52% respectively during FY 01-02 as compared to FY 00-01. In case of former the collection has been the highest in the second quarter, which reflects the seasonal pattern. A comparison of the second quarter figures for current and past fiscal years shows 79% increase in collection, which clearly demonstrates that effort directed towards documentation of the economy is bearing fruit. The advance tax collection has been consistently higher in the four quarters of FY 01-02 as compared to FY 00-01. However, the downside of increasing advance tax is that refunds are also increasing overtime.

Table 2: Quarterly Data on Voluntary Payments: A Comparison

(Rs. Million)

S.No.	Collection Heads	FY: 00-01	FY: 01-02	Difference Absolute	Difference Percent
1	U/s 80-D				
	Q1	16.5	74.6	58.1	352.1%
	Q2	646.6	54.4	-592.2	-91.6%
	Q3	27.2	-89.8	-117	-430.1%
	Q4	8.3	22.8	14.5	174.7%
	Total	698.6	62.0	-636.6	-91.1%
2	U/s 54 (Other than 80-D)				
	Q1	484.8	1782.2	1297.4	267.6%
	Q2	6987.4	12505.1	5517.7	79.0%
	Q3	527.1	660.4	133.3	25.3%
	Q4	39.8	-372.7	-412.5	-1036.4%
	Total	8039.1	14575.0	6535.9	81.3%
3	Tax Amnesty (U/s 59-D)				
	Q1	1889.7	132.4	-1757.3	-93.0%
	Q2	961.0	-130.6	-1091.6	-113.6%
	Q3	75.7	35.6	-40.1	-53.0%
	Q4	18.6	384.5	365.9	1967.2%
	Total	2945.0	421.9	-2523.1	-85.7%
4	Collection u/s 53(current)				
	Q1	2223.5	3280.1	1056.6	47.5%
	Q2	6254.3	8562.9	2308.6	36.9%
	Q3	4962.8	9629.8	4667	94.0%
	Q4	4001.8	5007.8	1006	25.1%
	Total	17442.4	26480.6	9038.2	51.8%
1+2+3+4	Voluntary Payments				
	Q1	4614.5	5269.3	654.8	14.2%
	Q2	14849.3	20991.8	6142.5	41.4%
	Q3	5592.8	10236.0	4643.2	83.0%
	Q4	4068.5	5042.4	973.9	23.9%
	Total	29125.1	41539.5	12414.4	42.6%

Note: *The data for Q4 is for April and May only.*

Collection on Demand: The collection on demand category assumes an important position in the overall income tax collection as it serves as an indicator of additional tax effort on the part of tax administrators. Parallel to audit activities of indirect taxes, assessment which results into creation of demand is an anti tax evasion activity. The current year collection under this head has been Rs. 15.5 billion as against Rs. 10.9 billion last year, which shows an increase of 42.4%. Since the contribution of collection on demand in gross income tax collection is nearly 12% for the current year as compared to 10% during the corresponding period of FY 00-01, an increase of two percentage points is noteworthy considering the various shocks the economy has had to absorb during the comparison period.

A further break-up of the two components of collection on demand category into current and arrears demand indicates that the collection on account of the former has been Rs. 11.7 billion during FY 01-02 (58% increase over corresponding period of FY 00-01) and of the later Rs. 3.8 billion (8% increase over FY 00-01). Thus, the proportion of current demand in the overall collection on demand has increased from 68% during first eleven months of FY 00-01 to 75% during FY 01-02.

The pace of assessment activity could be judged on the basis of quarterly data presented in *(Table 3)*. It is evident that current collection in the 4th quarter of FY 01-02 increased sharply by 226% as compared to collection in the 3rd quarter and by 82% over 4th quarter of FY 00-01. The arrear demand on the other hand increased by 29% in the 4th quarter of FY 01-02 over 4th quarter of FY 00-01. The growth in current collection has been the result of improvement in tax effort, an area that is gaining increasing importance under the on-going reform process.

Table 3: Quarterly Data on Collection on Demand: A Comparison

(Rs. Million)

S.No.	Collection Heads	FY: 00-01	FY: 01-02	Difference	
				Absolute	Percent
1	Arrears				
	Q1	850.2	819.3	-30.9	-3.6%
	Q2	885.5	1432.9	547.4	61.8%
	Q3	1214.0	828.7	-385.3	-31.7%
	Q4	537.3	692.0	154.7	28.8%
	Total	3487.0	3772.9	285.9	8.2%
2	Current				
	Q1	440.9	908.6	467.7	106.1%
	Q2	1312.0	1636.2	324.2	24.7%
	Q3	1785.3	2161.5	376.2	21.1%
	Q4	3872.8	7043.6	3,170.8	81.9%
	Total	7411.0	11749.9	4,338.9	58.5%
1 + 2	Collection on Demand				
	Q1	1,291.1	1,727.9	436.8	33.8%
	Q2	2,197.5	3,069.1	871.6	39.7%
	Q3	2,999.3	2,990.2	-9.1	-0.3%
	Q4	4,410.1	7,735.6	3,325.5	75.4%
	Total	10,898.0	15,522.8	4,624.8	42.4%

Note: *The note of Table 2 also applies here.*

Withholding Tax: Since deductions at source generate more than 50% of the gross direct tax collection, it is important to analyze the various components of the withholding tax. There are nearly 25 categories on which WHT is deducted.[8] However, 92% of total deductions come from eleven WHT heads. Within these eleven heads, nearly 82% of the contribution is made by imports [u/s 50(5)], contracts [u/s 50(4)], salaries [u/s 50(1)], securities [u/s 50(2)] and interest [u/s 50(2-A)]. The share of these five withholding taxes in eleven major categories is 27.2%, 26.0%, 11.6%, 8.7% and 8.4%, respectively.

The figures reported in *(Table 4)* show that the July-May collection has been lower by 1.9% than past year. The collection from five major WHT heads has declined by 6.1% during this period, notwithstanding an 11.4% increase in the salary category. For individual WHT heads, the decline has been the highest for securities (22.5%), followed by contracts (10.7%), imports (2.7%)

[8] Some of the WHT sub-sections were omitted through Finance Ordinance 2001. These included: (5AAA), 5(B), (7), (7A) and 7(G). Additionally, sub-sections 7(H) and 50(2B) have been omitted through Finance Ordinance 2002.

and interest (1.0%). The reasons for lower than anticipated WHT collection in FY 01-02 from these categories are: lower volume of imports, which incidentally have started to pickup in recent weeks as reflected by 4th quarter collection of FY 01-02, and appreciation of rupee vis-à-vis dollar affecting WHT on imports, decrease in interest rate on securities affecting WHT on securities, and reduction in government's development spending due to resource constraint affecting supplies and contracts. The remaining WHT heads including salary have shown an increase of 13% in FY 01-02 over FY 00-01.

Table 4: Quarterly Data on WHT: A Comparison of FY 00-01 & FY 01-02 Collection

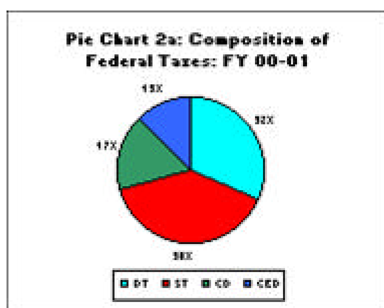
(Rs. Million)

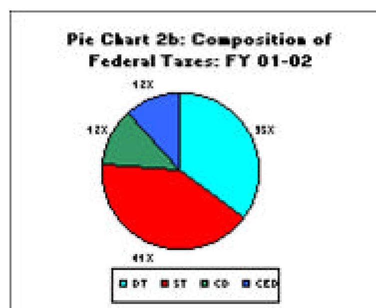
S.No.	Collection Heads	FY: 00-01	FY: 01-02	Difference	
				Absolute	Percent
1	U/s 50(4) Contracts				
	Q1	3,279.3	3538.7	259.4	7.9%
	Q2	5027.9	4145.6	-882.3	-17.5%
	Q3	6008.5	5147.3	-861.2	-14.3%
	Q4	4193.1	3688.1	-505.0	-12.0%
	Total	18508.8	16519.7	-1,989.1	-10.7%
2	U/s 50(2) Securities				
	Q1	2286.2	1025.9	-1,260.3	-55.1%
	Q2	2137.6	2357.5	219.9	10.3%
	Q3	1617.3	646.5	-970.8	-60.0%
	Q4	1169.0	1556.7	387.7	33.2%
	Total	7210.1	5586.6	-1,623.5	-22.5%
3	U/s 50(5) Imports				
	Q1	5095.3	5096.6	1.3	0.0%
	Q2	4944.9	4679.9	-265.0	-5.4%
	Q3	4970.4	4506.0	-464.4	-9.3%
	Q4	2974.9	3219.9	245.0	8.2%
	Total	17985.5	17502.4	-483.1	-2.7%
4	U/s 50(1) Salary				
	Q1	1631.7	1661.2	29.5	1.8%
	Q2	1850.2	1899.4	49.2	2.7%
	Q3	1836.9	2096.4	259.5	14.1%
	Q4	1347.2	1768.7	421.5	31.3%
	Total	6666.0	7425.7	759.7	11.4%
5	U/s 50(2-A) Interest				
	Q1	1691.0	1564.4	-126.6	-7.5%
	Q2	1415.4	1393.1	-22.3	-1.6%
	Q3	1696.8	1900.8	204.0	12.0%
	Q4	874.0	762.4	-111.6	-12.8%
	Total	5677.2	5620.7	-56.5	-1.0%
	Sub-Total (five major items)	**56047.6**	**52655.1**	**-3,392.5**	**-6.1%**
	Other withholding Taxes	14573.2	16596.3	2,023.1	13.9%
	Total Withholding Taxes	**70620.8**	**69251.4**	**-1,369.4**	**-1.9%**

Note: *The note of Table 2 applies here as well.*

'Other' Direct Taxes: The collection on the basis of these taxes increased from Rs. 4.66 billion in FY 96-97 to Rs. 7.12 billion in FY 00-01. The major component of these taxes is the workers welfare fund that is levied at the rate of 2% on the manufacturers having of Rs. 100,000 and above. The collection from this source increased significantly from Rs. 0.75 billion in 1996-97 to Rs. 4.99 billion in 2000-01. However, during July-May 2001-02 a decline of 9.2% has been registered from this source compared to the corresponding period of FY 00-01. Similarly the collection from other minor components of direct taxes including wealth tax, CVT and CAT also declined by 69%, 26%, and 4% respectively during the period. On the whole the collection from 'other' direct taxes declined by 30% during the first eleven months of FY 01-02 over FY 00-01.

Indirect Taxes: The three components of indirect taxes are sales tax, customs duties and central excise duties. Among them, the emphasis on sales tax has increased manifold over the years. Its share in total taxes has gone up from 15% in 1990-91 to over 40% in recent years. At the same time the share of customs duties has declined from 45% to 12% and that of excise duties has declined from 22% to 11% within the last decade. The increasing importance of sales tax as major revenue spinner and decreasing emphasis on the other two indirect taxes is the outcome of first generation of fiscal reforms mentioned above *(Pie Chart 2).*





For FY 01-02 the gross indirect tax collection recorded a marginal increase of 2.9% over FY 00-01. Since refund payments related to indirect taxes, especially sales tax (domestic) and customs duties, increased by 32.5%, a decline of 2.4% was registered in indirect tax collection growth. In absolute terms the gross collection on account of indirect taxes was Rs. 324.1 billion of which Rs.62.8 billion were paid back as refunds/ rebates. Thus, the net collection was Rs. 261.3 billion. The monthly and quarterly information presented in *(Table 5)* show that despite negative growth for the entire fiscal year and especially during 2nd and 3rd quarters, the net collection increased by 12.8% in the 4th quarter of FY 01-02 over FY 00-01 indicating recovery in collection due to improvement in the overall economic environment.

Table 5: Gross and Net Collection of Indirect Taxes
FY 00-01 & FY 01-02

(Rs. Million)

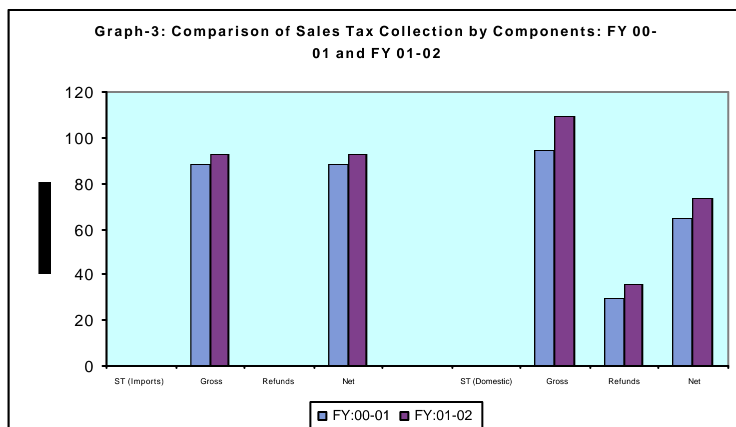
	FY-01	*FY-02*	*Growth*		*FY-01*	*FY-02*	*Growth*
Gross Collection							
January	29050.0	27075.0	-6.8	April	25393.0	29010.0	14.2
February	26636.0	24569.0	-7.8	May	27420.0	29605.0	8.0
March	25161.0	26919.0	7.0	June	34627.0	37435.0	8.1
Total – Q3	80847.0	78563.0	-2.8	Total - Q4	87440.0	96050.0	9.8
Refunds							
January	7238.0	7656.0	5.8	April	5225.0	5025.0	-3.8
February	4349.0	4492.0	3.3	May	3377.0	2477.0	-26.7
March	2791.0	4507.0	61.5	June	1140.0	901.0	-21.0
Total – Q3	14378.0	16655.0	15.8	Total - Q4	9742.0	8403.0	-13.9
Net Collection							
January	21812.0	19419.0	-11.0	April	20168.0	23985.0	18.9
February	22287.0	20077.0	-9.9	May	24043.0	27128.0	12.8
March	22370.0	22412.0	0.2	June	33487.0	36534.0	9.1
Total – Q3	66469.0	61908.0	-6.9	Total - Q4	77698.0	87647.0	12.8

Note: *Growth (in percentage) is calculated on the basis of the relevant period of PFY.*

Sales Tax: The two major sources of sales tax collection are sales tax domestic, levied on domestic economic activities, and sales tax imports, levied on imports of goods. Despite reduction in rupee value of imports and deceleration of domestic economy, gross sales

tax collection from imports and domestic activities has increased by 10.3% during FY 01-02 against FY 00-01. Due to 20.3% increase in refunds, the net collection increased by 8.3% during the period. In terms of value, the gross and net collections were Rs. 202.3 billion and Rs. 166.3 billion, respectively.

The import related net sales tax collection increased from Rs. 88.6 billion during FY 00-01 to Rs. 92.8 billion during FY 01-02, showing an increase of around 5%. On the other hand, domestic net sales tax collection increased from Rs. 65 billion to Rs. 73.1 billion, showing an increase of 13.1%. This achievement has been accomplished in spite of the fact that inflation remained at a lower than the projected level and prices of key manufacturing sector commodities remained depressed which incidentally reduced the domestic sales tax base. It may also be added that since refund claims are mostly related to domestic sales tax, the difference between gross and net collection of sales tax domestic is much higher than sales tax imports *(Graph-3)*.



Sales Tax (Imports): The slow growth of the economy and declining imports had an adverse impact on collection of sales tax from imports. Compared to FY 00-01 the collection was less in the months of January and February of FY 01-02 but improved in

March as imports started to increase. The increasing trend continued in the months of April and May but a reversal has been noticed in June. The collection in June 2002 declined by 4.4% as compared to June 2001.

One of the important policy initiatives during FY 01-02 was enhancing sales tax rate from 15% to 20% on imports of some of the raw material for finished goods. Even though the move was against the spirit of uniformity of the general sales tax rate structure, the decision was taken to arrest tax evasion and encourage registration besides providing protection to the organized sector. As anticipated, the policy measure yielded positive results. The move has largely remained neutral for the organized sector. However, the gains in terms of revenue have been accrued mostly from those operating in the murky sector. Additionally, it has also encouraged higher level of registration.[9]

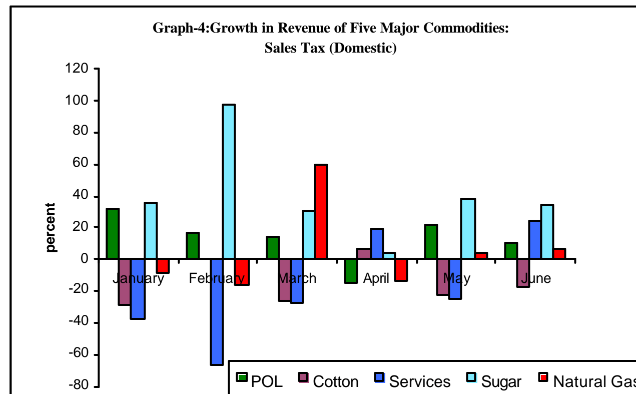
Sales Tax (Domestic): The disaggregation of domestic sales tax by major revenue spinners is reported in *(Table 6).* Notwithstanding that sales tax is levied on a wide spectrum of goods and services, the ten revenue heads contributed nearly 67% of the domestic (gross) sales tax collection in FY 01-02.[10] The quarterly data gives an indication of how domestic sales tax collection has progressed over the year. From a negative growth of 4% in the 2nd quarter, the net collection recorded a reasonable growth of 7.1% in the 3rd quarter, which jumped to 25.7% in the 4th quarter. Within ten major commodities, the share of POL products remained stable around 20% across quarters and years. The contribution of cotton (not carded or combed) was higher in the 3rd quarter as compared to the

---

[9] However, the enhanced rate has not led to an increase in the effective rate. Taking the value of total imports as base, it has been observed that the effective rate of sales t ax on imports remained constant at 14.4% in spite of the increased rate. One possible reason for this constancy of the effective rate could be the negative impact of tariff rationalization, which apparently has (partially) neutralized the impact of the enhanced sales tax rate.

[10] The share of these revenue heads varied between 63% and 67% between the 1st and the 4th quarter.

4th quarter *(Graph 4)*. The overall collection from cotton and cotton yarn remained dismal partly because of lower demand for cotton due to reduction in export orders especially after the 9-11 event and partly due to depressed prices of cotton internationally and in the local market. Furthermore, some of the cotton procured under the no duty no drawback (NDND) scheme did not attract sales tax. However, with the resumption of exports, the negative growth of 20.2% for cotton and 42.6% for cotton yarn in 3rd quarter has reduced to 10% and 33%, respectively in the 4th quarter. It is expected that the situation will improve further with the global economic recovery and increased demand for Pakistani cotton and textile products.



The contribution of cement registered a significant increase of 39% during this period due to increase in production and clearance. Similarly, there was a healthy growth in collection from sugar throughout the year. As far as the share of services is concerned, it increased from 7.3% in the 3rd quarter to 23.1% in the 4th quarter. The rate of increase in collection was much higher between 3rd to 4th quarter as compared to 2nd to 3rd quarter. The reason for low collection in the 3rd quarter was heavy adjustments made by the PTCL. The month-to-month comparison of collection shows substantial improvement in May and June.

On the whole the collection from ten major heads increased by 6.8% in the 4th quarter of FY 01-02 than the corresponding period of FY 00-01. Similarly, the collection increased significantly (by 28%) when compared to 3rd quarter collection. Surprisingly, the rate of increase has been much higher when all taxable commodities are considered -- 39.2% against 6.8% -- suggesting that the collection from comparatively less significant commodities increased at relatively higher rates than the observed rate of growth of ten major commodities.

Table 6: Comparison of Collection from Major Revenue Spinners of Sales Tax

(Rs. Million)

	FY-01	**FY-02**	**Difference**	
			Absolute	**Percent**
Ten Major Commodities				
Q1	11132.5	15645.3	4512.9	40.5
Q2	17419.7	19171.9	1752.2	10.1
Q3	17837.2	18831.9	994.7	5.6
Q4	18866.2	20141.8	1275.6	6.8
Sub Total	65255.6	73790.9	8535.4	13.1
All Commodities				
Q1	18226	23268	5042	27.7
Q2	23351	26894	3543	15.2
Q3	25477	27588	2111	8.3
Q4	27784	31546	3762	13.5
Sub Total	94838	109296	14458	15.2

Note: *Growth (in percentage) is calculated on the basis of the relevant period of PFY.*

The performance of sales tax has also been evaluated in the light of leading indicators like number of registered persons, number of audits completed and number of non-filers.

The survey and documentation drive of the government helped to increase the number of the registered persons as sales taxpayers in various categories. The number of wholesale and retail traders increased by 59.2%, turnover taxpayers by 93.6%, service providers by 27.8%, exporters 16.7% and importers 6.8%. The only exception

was that of manufacturers whose number decreased by 2.2%. The overall number of registered persons increased from 111,528 in May 2001 to 144,639 in May 2002, showing an increase of about 30%.

However, despite the increase in number, the proportionate increase in revenue was not observed. In fact revenue per registered person declined from Rs. 0.56 million during July-May 2000-01 to Rs. 0.46 million during July-May 2002.[11] The reason has been the peculiar role of the turnover taxpayers who happened to have major contribution towards number but added very little (only 0.08%) towards revenue receipts. On the positive side, the revenue from the manufacturers category, that incidentally contributes 68-72% of the revenue, increased from Rs. 38.04 billion during July-May 2000-01 to Rs. 44.55 billion in July-May 01-02 despite a decrease in registered persons.

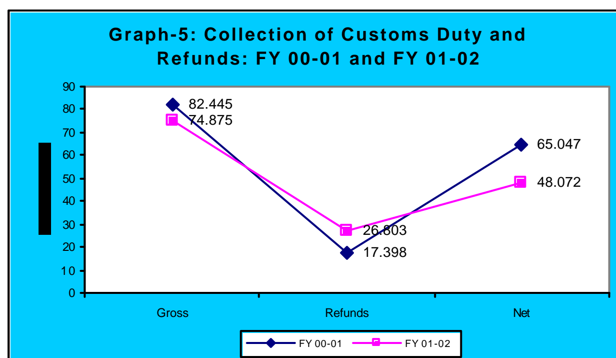
FY 01-02 also registered a record increase in the number of audits completed. The number increased from 6880 in May 2001 to 19968 in May 2002. At the same time the amount outstanding increased by 45%, i.e., from Rs. 9.98 billion to Rs. 14.5 billion.

Thus, the performance of the sales tax on the basis of collection and key indicators is that of 'strength' and 'hope'. While the ever increasing share of the sales tax receipts is in line with the overarching principles of taxation and the tax reform process, the stumbling blocks in the shape of non-filers point to the need of intensifying the enforcement efforts to enhance the compliance rate and recover the outstanding arrears. However, acknowledging taxpayers concerns about harassment, a delicate balance will have to be maintained between these two elements.

Customs Duties: Nearly 10% appreciation of rupee against dollar and a generous refund policy are mainly responsible for lower than anticipated collection on account of customs duty during FY 01-02

[11] The ratio has been calculated as sales tax revenue/registered persons excluding importers.

as compared to FY 00-01. Rationalization of duty structure as envisaged in the restructuring process is also responsible for lowering the effective rate of duty and therefore collection. Thus, there has been a steady decline in gross and net month-to-month collection in FY 01-02 as compared to FY 00-01. The gross revenue collection during FY 01-02 has been Rs. 74.9 billion as opposed to Rs. 82.45 billion of FY 00-01 (Graph-5). Similarly, the net collection declined to Rs. 48.1 billion from Rs. 65.05 billion. On the whole, the gross and net revenue collection from customs duties declined by 9.2% and 26.1%, respectively. The sharp difference in the two rates is due to 54.1% increase in refunds/ rebates in FY 01-02 over FY 00-01 *(Graph –5).*



The quarterly data on key indicators of customs duty show that total imports picked up during the 4th quarter *(Table-7)*. Similarly, the rate of growth of dutiable imports also increased from –0.8% in the 3rd quarter to 12% in the 4th quarter.[12] Thus, despite a reduction in the effective rate from nearly 20% to 17%, the rate of gross collection (excluding defense) improved from –11% to –4% between 3rd and 4th quarters as compared to the corresponding period of FY 00-01. The rates of growth of gross and net collection (inclusive of defense) nonetheless increased from –15.9% and –38.4% in the 3rd quarter to 5.6% and 4.9%, respectively in the 4th

[12] The growth rates are calculated for quarterly values in comparison with the values of the same quarter of past fiscal year.

quarter, a phenomenon consistent with an improvement in the macroeconomic environment. However, gross and net collection from major import commodities including chemicals, machinery, iron and steel, yarn and fabrics and medical and photographic equipment suffered because of rationalization of duty structure.

Table 7: Quarterly Comparison of Customs Duty Indicators: FY 2000-01 & FY 2001-02

(Rs. Million)

	FY-01	FY-02	Growth		FY-01	FY-02	Growth
Total Imports							
January	60578.0	53579.0	-11.6	April	50518.0	58706.0	16.2
February	48054.0	42146.0	-12.3	May	57241.0	59609.0	4.1
March	51401.0	52657.0	2.4	June	58775.0	58234.0	-0.9
Total - Q3	160033.0	148382.0	-7.3	Total - Q4	166534.0	176549.0	6.0
Dutiable Imports							
January	37411.0	35425.0	-5.3	April	32518.0	38308.0	17.8
February	33072.0	28120.0	-15.0	May	33754.0	38376.0	13.7
March	30267.0	36421.0	20.3	June	37740.0	39822.0	5.5
Total - Q3	100750.0	99966.0	-0.8	Total - Q4	104012.0	116506.0	12.0
Gross Duty (excluding defense)							
January	6444.0	6133.0	-4.8	April	6124.0	6306.0	3.0
February	6789.0	4787.0	-29.5	May	6737.0	6045.0	-10.3
March	6224.0	6397.0	2.8	June	8034.0	7722.0	-3.9
Total – Q3	19457.0	17317.0	-11.0	Total - Q4	20895.0	20073.0	-3.9
Effective Rate Dutiable Imports*							
January	17.2	17.3	0.5	April	18.8	16.5	-12.6
February	20.5	17.0	-17.1	May	20.0	15.8	-21.1
March	20.6	17.6	-14.6	June	21.3	19.4	-8.9
Total – Q3	19.3	17.3	-10.3	Total - Q4	20.1	17.2	-14.2

Note: *Growth (in percentage) is calculated on the basis of the relevant period of PFY.*
**** excluding defense***

Whereas tariff rationalization is often cited as reason for the reduction in collection from customs duties, there are two additional worth mentioning developments. First, the *constancy* of the share of dutiable imports in total imports at 62.5% for FY 00-01 and FY 01-02 and secondly the *tilting* of dutiable imports towards lower rate items. The Custom House data (for Karachi only) reveal that the share of goods in total assessed import value attracting 5% rate of

duty has increased from 0.39% in FY 00-01 to 15.4% in FY 01-02. At the same time the share of goods attracting 10% duty has decreased from 43.4% to 28% during the same period. It appears that both these sources are also responsible for restricting the growth of revenue from customs duties.

Central Excise: Central Excise Duty (CED) is a fading tax. With the extension of sales tax to services, CED is now levied only on a limited number of commodities and services. As a result the share of CED in total federal receipts has declined slightly from 12.5% in FY 00-01 to 11.6% in FY 01-02.[13] The (net) collection of central excise duties during FY 01-02 was Rs. 46.9 billion that shows a decline of 4.4% over last year mainly because of the sluggish activity in the large scale manufacturing sector and reduction in the base due to shifting of services to sales tax net *(Table 8).*

Table 8: Comparison of Gross and Net Collection of Central Excise Duties

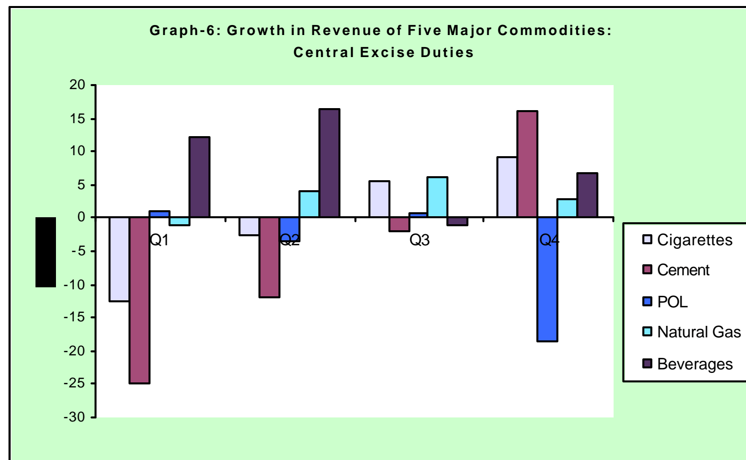
(Rs. Million)

	FY-01	FY-02	Growth		FY-01	FY-02	Growth
Gross Collection							
January	3703.0	3450.0	-6.8	April	4051.0	4660.0	15.1
February	3737.0	3702.0	-0.9	May	4670.0	4885.0	4.6
March	3586.0	3905.0	8.9	June	5376.0	6150.0	14.4
Total – Q3	11026.0	11057.0	0.3	Total - Q4	14097.0	15695.0	11.4
Refunds							
January	1.0	1.0	0.0	April	34.0	3.0	-91.2
February	0.0	2.0	0.0	May	1.0	2.0	100.0
March	1.0	3.0	200.0	June	1.0	2.0	100.0
Total – Q3	2.0	6.0	200.0	Total - Q4	36.0	7.0	-80.6
Net Collection							
January	3702.0	3449.0	-6.8	April	4017.0	4660.0	16.0
February	3737.0	3700.0	-1.0	May	4669.0	4883.0	4.6
March	3585.0	3902.0	8.8	June	5375.0	6148.0	14.4
Total – Q3	11024.0	11051.0	0.2	Total - Q4	14061.0	15691.0	11.6

Note: *Growth (in percentage) is calculated on the basis of the relevant period of PFY.*

[13] However, the share of CED within indirect taxes continues to remain around 18%.

The encouraging sign is that the negative growth in collection in the first two quarters turned positive in the last two quarters of FY 01-02. The reason being that four out of five major commodities contributing about 85% to 87% of the total CED revenue have picked up towards the end of FY 01-02. Quarterly data of the five major commodities i.e., POL products, cigarettes, cement, natural gas and beverages indicate that collection from cement, cigarette and beverages has improved gradually. It has gone up to 9.2 % in 4th quarter from 5.5 % in 3rd quarter for cigarette, 16.2 % from –2.1 % for cement and to 4.7 % from –5.8 % for beverages *(Table 9 and Graph 6).*



Whereas the increase in revenue from cement is attributed to increased production and clearance in the 4th quarter, the increased collection from cigarette and beverages is mainly due to change in duty and retail prices, respectively. POL products have, however, caused an upset by generating lower revenue in the 4th quarter, i.e., negative growth of 18.7% against 0.5% in the 3rd quarter. A number of factors have contributed towards this decline. These include exemption of CED on light diesel oil and JP-4 in the last fifteen days of the 4th quarter, as announced in the budget 2002-03. Lower

production/ clearance of diesel oil and jet fuel and shifting of consumption of diesel to other substitutes due to increase in its prices have contributed towards lower revenue collection from POL products in FY 01-02 in comparison to the FY 00-01.

Table 9: Central Excise Major Revenue Spinners

(Rs Million)

S.No.	Commodities	FY 00-01	FY 01-02	Difference	
				Absolute	Percent
Major Commodities and Services					
1st Quarter		10160.89	9088.98	-1071.91	-10.55%
2nd Quarter		9550.11	9277.31	-272.81	-2.86%
3rd Quarter		9957.11	10214.01	256.90	2.58%
4th Quarter		12863.87	13723.10	859.23	6.68%
Total		42531.98	42303.39	-228.59	-0.54%
Net Collection					
1st Quarter		12751	9945	-2806	-22.0%
2nd Quarter		11244	10233	-1011	-9.0%
3rd Quarter		11024	11051	27	0.2%
4th Quarter		14061	15691	1630	11.6%
Total		49080	46920	-2160	-4.4%

Note: *Growth (in percentage) is calculated on the basis of the relevant period of PFY.*

CBR Revenue Projections for FY 2002-03

Anticipating improvement in real and monetary sectors of the economy the budgetary revenue target for FY 2002-03 has been set at Rs. 460.6 billion – an increase of 14% over provisional collection of FY 2001-02. The distribution of the budgetary target among major taxes is as follows; direct taxes: Rs. 148.4 billion (the share being 32.3%), sales tax: Rs. 205.7 billion (44.7%), customs duties: Rs. 56.5 billion (12.3%), and central excise duties: Rs. 50 billion (10.9%). These estimates have been prepared by assuming 9.2% growth of nominal GDP at market prices, 10% growth of non-agricultural GDP, 8-10% growth of large-scale manufacturing and 12.1% growth of imports, dutiable imports and exports. A number of tax, budgetary and special measures have also been incorporated while generating these projections.

Not to mention the growing confidence reposed in the overall strength of the economy, the following two points regarding the revenue target for FY 02-03 are noteworthy. First, the share of direct taxes in the projected target has gone down to 32.2% from 35.3% observed in FY 01-02 and earlier on in FY 97-98 and FY 98-99 *(Table 10).* Notwithstanding the recent budgetary measures involving reduction and rationalization of tax rates and raising the threshold level of income tax, the implied regressivity does not augur well with the spirit of tax reforms, whereby the share of direct taxes in total tax collection has been raised gradually over the years at the expense of indirect taxes.

Table 10: Composition of Federal Tax Collection

(Rs. Billion)

Year	Collection			Share in Total Collection (%)	
	Direct Taxes	Indirect Taxes	Total Taxes	Direct Taxes	Indirect Taxes
1997-98	103.1	190.5	293.6	35.1	64.9
1998-99	110.2	198.1	308.3	35.7	64.3
1999-00	112.9	234.2	347.1	32.5	67.5
2000-01	124.6	267.7	392.3	31.8	68.2
2001-02	142.6	261.3	403.9	35.3	64.7
2002-03	148.4	312.2	460.6	32.2	67.8

Second, 14% growth in the federal tax receipts is projected for the FY 2002-03 on the basis of 19.5% growth in indirect taxes and only 4.1% growth in direct taxes. Historical evidence presented in (*Table 11)* suggests that higher growth in collection was observed in FY 94-95 and relatively moderate to high growth in 1993-94, 1995-96, 1999-2000 and 2000-01. A cursory look at this performance would indicate that except for FY 99-00, high growth has been accomplished when direct and indirect taxes have both shown promise, i.e., the collection on account of these two major sources of revenue has increased in excess of 10% per annum.

An additional aspect that has often been overlooked is the impact of tax reforms and the resulting budgetary measures introduced at the time of the budget. Besides favorable economic environment, high growth in collection especially in recent years has been the result of wide ranging tax policy measures. For example, the high growth revenues in FY 94-95 would have not been possible had budgetary measures worth Rs. 45.5 billion were not introduced. The same is true for most of the years when high growth in revenue collection has been experienced.

Within this perspective, it is now increasingly recognized that one of the outcomes of heavy taxation is stagnation of the economy and recession. The pursuance of tight fiscal policy seems to have far reaching implications not only for the revival of the industrial sector but also for the core concern of poverty and its alleviation. As far as federal tax receipts are concerned, the outcome also hinges on how the economy performs in FY 02-03. A healthy increase in revenues is expected if the assumptions of 10% growth of the economy and 12.1% growth in the value of dutiable imports come true.

Table 11: Growth of Federal Tax Collection

(Rs. Billion)

Year	Direct Taxes		Indirect Taxes		Total Taxes	
	Collection	Growth	Collection	Growth	Collection	Growth
1991-92	28.9		110.9		139.8	
1992-93	36.8	27.5	116.5	5.0	153.2	9.6
1993-94	43.5	18.2	129.1	10.9	172.6	12.6
1994-95	61.7	41.9	164.9	27.7	226.6	31.3
1995-96	78.2	26.8	189.9	15.1	268.0	18.3
1996-97	85.1	8.8	197.0	3.8	282.1	5.2
1997-98	103.2	21.3	190.5	-3.3	293.6	4.1
1998-99	110.2	6.8	198.1	4.0	308.3	5.0
1999-00	112.9	2.5	234.2	18.2	347.1	12.6
2000-01	124.6	10.4	267.7	14.3	392.3	13.0
2001-02	142.6	14.5	261.3	-2.4	403.9	3.0
2002-03	148.4	4.1	312.2	19.7	460.6	14.2

II

Income Tax Ordinance, 2001
and
The Rules for Maintenance of Books of Accounts, Documents and Records

Income Tax Ordinance, 2001 and Income Tax Rules, 2002 have been made applicable from July 01, 2002. The new law is in a simple and easy to understand language. The salient features and changes brought by the new law are:

- The new income tax law will bring a complete change in the philosophy of income tax proceedings and it will make life easier.
- Henceforth, taxpayers will themselves assess their income and determine their tax liability. The powers of the taxation officer to make the assessment and impose tax have been curtailed to a large extent.
- All income tax returns shall be accepted without any conditions of compulsory enhancement of tax liability over previous year to qualify for acceptance.
- Income tax return filed it-self will be an assessment order and taxpayer's eligibility for refund will flow from the return filed.
- A certain percentage of returns filed shall be selected for tax audit on the basis of risk assessment to verify the accuracy and correctness of income tax returns.
- Tax audit shall not necessarily mean an amendment of the assessment of income and tax liability made by the taxpayer, as per his return of income. This can only be amended on the basis of definite information acquired during tax audit or form any other source.
- As a result, the new Income Tax Ordinance, 2001 has an in-built concept of Universal Self Assessment doing away with the powers of the Central Board of Revenue to make and announce Self Assessment Scheme on year-to-year basis at its sole discretion. This in its true sense will be the "Universal Self Assessment" available to all taxpayers irrespective of quantum, status, location or size.

- The new law and its salient features, briefly explained above, are in accordance with the international practices in all developed countries around the world and a first such experience in this part of the world, which will take away the most abused discretionary powers of the taxation officers and place great responsibility and obligation on the citizen and in particular on the taxpayers.

Apart from the above philosophical changes, some of the other important changes are as under:

- Minimum threshold for taxable income of taxpayers other than companies enhanced to Rs. 80,000 from Rs. 60,000.
- Rates of tax for the banking and private companies to be gradually brought down to 35 percent in the following years to bring them in line with the maximum rate applicable to non-company taxpayers.
- Minimum tax of 20% on the income of non-residents, other than companies, has been abolished. Now the tax rates of non-residents and residents have been brought at par.
- Rate of withholding tax and final tax on export of processed meat has been brought down to 0.75 from 1.25 percent.
- Ambiguity in the provisions of mandatory payment of tax demand of 15 percent for filing of first appeal has been removed and rationalized with a capping of maximum 20 percent of the tax assessed for the immediately preceding tax year.
- Rate of additional tax for delayed payment of tax due reduced from 24 to 18 percent.
- Tax on un-distributed reserves of the companies and bonus shares withdrawn.
- Salary income now taxable on the basis of receipt instead of when due.
- All allowances, perquisites and benefits given or provided to the employees made taxable except house rent allowance given to employees with annual salary up to Rs. 600,000 and medical allowance or facilities subject to certain restrictions and conditions.
- Rules for valuation perquisites by way of accommodation or housing and motor vehicle prescribed.
- Exemption from tax on tax on salary income no longer available.

- In case of loan given to an employee after July 01, 2002 free of interest or at a concessional rate, the profit on such loans computed at the benchmark rate where loan is interest free or the difference between the profit paid by the employee and the amount of profit computed at the benchmark rate will be added to the salary of the employee.

- The limit on cost of motor vehicle for the purposes of depreciation has been enhanced to Rs. 1 million from Rs. 0.750 million.

- Initial depreciation allowance restored at an enhanced rate of 50 percent while extra shift depreciation allowance abolished.

- Cost of intangibles such as patents, inventions, copyrights etc. can now be amortized over their useful life subject to a maximum of ten years.

- Depreciation on Pre-commencement allowed. This can now be amortized in four years.

- Minimum tax of 0.50 percent now restricted to resident companies only.

- Penalty for late filing of the statements of tax collected or deducted etc., has been reduced and rationalized as under:

    - Failure to file the statement: Rs. 2,000 (Irrespective of the period of default)

    - Continuing default: Rs. 200 per day (After the imposition of first penalty of Rs. 2,000)

- Penalty for non-maintenance of records and non-compliance with notice has been reduced and rationalized as under:

    - First failure Rs. 2,000
    - Second failure Rs. 5,000
    - Third and subsequent failure Rs. 10,000

- Imposition of penalty in relation to an act or omission shall be an alternate to prosecution. If prosecution proceedings are initiated the penalty imposed earlier shall be not payable or if paid, shall be refundable.

- Higher tax withholding rates from suppliers and contractors etc. not holding NTN have been withdrawn.

- Mandatory time limit of 45 days for passing an order on a refund application.

- Refunds due will carry compensation at the rate of 15 percent from the date it is due i.e., 45 days from the application or date of receipt of order of CIT (A) or ITAT by the Commissioner.
- Status/category of taxpayers reduced from six to three i.e. Individual, AOP and Company. AOP now also includes URF, RF and HUF.
- The concept of levy of super tax on the registered firms and than income tax on the share income of the partners has been eliminated. Now AOP, URF, RF and HUF have been brought to tax under a single category.
- A single terminology "Profit on debt" has been introduced to replace interest, profit, markup, yield etc.
- "Taxpayer" has replaced "Assessee".
- Concept of "income year" and "assessment year" discontinued and replaced by "Tax Year" which means a period of twelve months commencing from 1st July and ending on 30th June. Tax Year will be denoted by calendar year in which the last day of the tax year falls, e.g., period of twelve months from 1st July 2002 to 30th June 2003 will be denoted by Tax Year 2003.
- Income from business can be computed either under Cash or Accrual method of accounting. However, Accrual Method of Accounting made compulsory on companies.
- Advances received in cash against the sale of goods or rendering of services excluded from the ambit of deemed income.
- Advance tax now payable on the basis of ratio of turnover to tax by individuals and AOP as well.
- Income from property also excluded for the purposes of payment of advance tax.
- Profit on debts i.e. interest and profit etc. now excluded from the ambit of final taxation and made chargeable to tax as part of normal income.
- Monthly statements of tax collected or deducted etc. replaced with quarterly statements.
- Agricultural income will not be included for rate purposes. Instead if such income exceeds Rs. 80,000 a separate tax rate card will be applicable, which effectively means that the exemption of Rs. 80,000 will not be available being already availed while paying Provincial Agricultural Income Tax.

- Specific provision made to the effect that certificate of tax collected or deducted attached to a return of income will be a sufficient evidence for allowing credit of the same.
- Sale/ purchase of an asset between two wholly owned companies of a group would not trigger a taxable event subject to certain conditions.
- The ambiguity of time of deduction of tax at source has been removed and it has been specifically provided that tax is to be deducted as a withholding agent at the time of making the actual payment.

The new Income Tax Ordinance, 2001 is not workable without maintenance of adequate books of account, documents and records by the taxpayers to support the assessment of income made by them and reported in the income tax return and allied statements.

The CBR has recently notified the Rules for maintenance of books of account, documents and records by all taxpayers, which are the bare minimum to support the assessment of income and determination of tax liability made by the taxpayers. These prescribed records are generally what a prudent person maintains irrespective of the fact whether he/ she is engaged in a business or profession, deriving income from salary, property, profit and dividends on investments or any other source. The change envisions that the benefits accrued to taxpayers from maintaining books of account, documents and records would outweigh the cost and effort incurred on record keeping.

In order to facilitate the taxpayers, two brochures explaining the record keeping requirements and basic information about business accounts, documents and records have already been issued by CBR, which should of great value and assistance to taxpayers in discharging their obligations.

III

CBR Tax Reform Program

Background

A number of studies over the years have been undertaken to devise a strategy for viable tax reform program, as the existing performance of the revenue departments in many developing countries, including Pakistan, is considered unsatisfactory. Depending upon the complexity of the situation in terms of both tax administration and taxpayers' compliance, guiding principles have been devised. These include: reducing complexity of the tax system, encouraging taxpayers voluntary compliance, differentiating treatment for taxpayers by their revenue potential, and ensuring the reform's effective management.[14]

In an effort to diagnose the extent of the problem and to devise an appropriate strategy for reforms, the Government of Pakistan constituted a Task Force, which submitted its report in April 2001 after extensive deliberations with stakeholders.[15] On the recommendations of the Task Force and the report of the IMF/ FAD mission of November 2001, a tax reform strategy was devised, which was approved by the President of Pakistan in November 2001. Tax Reform Wing in CBR was created to oversee implementation of the strategic objectives at the organization level.

---

[14] A comprehensive discussion on these issues is carried out in "Designing Tax Administration Reform Strategy: Experiences and Guidelines" by Carlos Silvani and Katherine Baer. Working Paper of the International Monetary Fund (March, 1997). For a review of non-conventional factors, especially the revenue administration environments, and the underlying causes of institutional and organizational dysfunction, see "A Diagnostic Framework for Revenue Administration" by Jit B. S. Gill. World Bank Technical Paper 472, (June, 2000).

[15] The report of the Task Force entitled 'Reform of Tax Administration in Pakistan' (2001) covers business processes and organizational issues concerning leading taxes, besides analyzing human resource and information management concerns. One of the chapters of the Report deals with the problems of governance.

Objectives and Strategy

The objectives of the tax reform program are to improve compliance with the tax and customs laws; development and management of an efficient revenue administration through well trained and motivated workforce; design and deliver fair, responsible and effective enforcement mechanisms in a way that directly responds to change in the environment; and to make the taxpayer service taxpayer friendly.

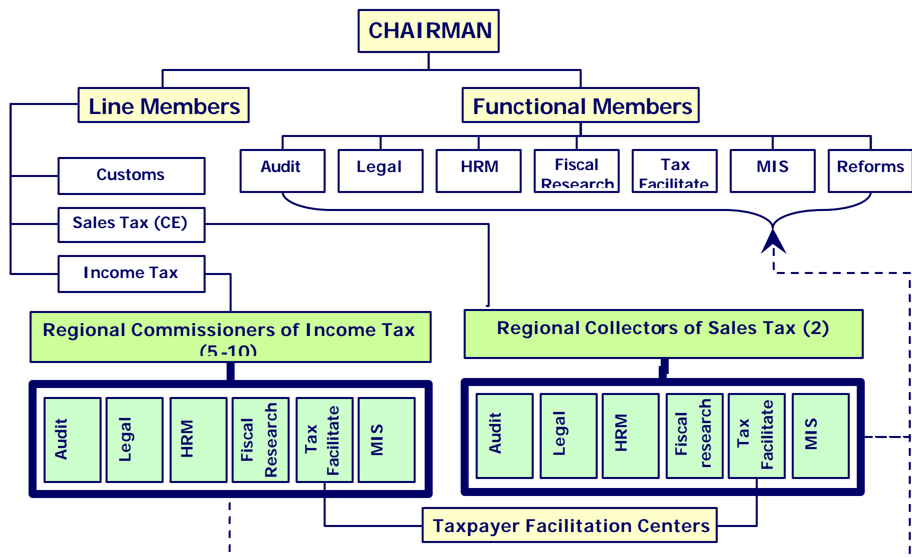
In order to achieve these objectives a well-defined strategy has been evolved in consultation with tax administrators and tax collectors at the commissionerate and the collectorate levels. The salient feature of the strategy is the introduction of universal self- assessment and that places the responsibility of determining and meeting the obligations to tax on all taxpayers. The initiative is backed by simple laws and a comprehensive and ongoing program of taxpayer education and support; automated processing of documents and accumulation of data; a selective program of audits and related strategies to improve compliance based on assessment of risk to the revenue; minimal interface between taxpayers and tax collectors; and an accountable, transparent, honest, modern and capable tax administration responsive to the ever-changing dynamics of international and local commercial realities.

From 'Cylindrical' to 'Functional' Structure of Tax Administration

At the organizational level, one of the initial steps was to redesign the managerial structure on modern lines. Presently, the organizational structure of CBR is cylindrical, evolved on traditional lines of vertical responsibility where policy and operational functions are handled together. Field departments under various taxes have different structures. This system is, however, not compatible with the concept of modern tax administration, where an individual looks after a function and develops expertise therein

rather than having a myriad of functions culminating in the same individual. The system is inefficient because of its duplication of functions and reduced flexibility in use of staff and its inconvenience for taxpayers, requiring them to deal with different organizational units.

The second generation of tax reforms, on the other hand, advocate reorganization based on the 'functional model' where staff is organized in functional groupings, i.e., registration, information processing, accounting, audit and enforcement. The new setup permits greater standardization of work processes across taxes by simplifying taxpayers' requirements and therefore regarded as being more efficient. CBR has already taken major initiatives aiming at taxpayers facilitation through education and information system, simplification of rules of business by removing irritants, streamlining audit procedures and ensuring transparency through proper dissemination of fiscal undertakings.



Large Taxpayer Unit

One of the key recommendations of the Task Force and the IMF was the establishment of Large Taxpayer Unit (LTU) at the early stages of the reform process. The argument is that differentiating tax treatment of taxpayers is required on the basis of their revenue potential. Since 80 to 90% of the revenue is contributed by 4 to 5% of taxpayers, a specialized administrative arrangement is required for systematic and efficient disposal of their cases and to minimize the risk to revenue through effective tax administration. The experience of such countries as Sri Lanka, Uruguay, and Bolivia where LTUs have already been established, show that the creation of special units to monitor, audit and enforce collection for the largest taxpayers have yielded improvement in collection.[16]

'Soft Opening' of LTU at Karachi

In Pakistan, the top 100 taxpayers contribute 28 per cent of income tax revenue, 32 per cent of sales tax revenue and 40 per cent of central excise. About 2.5% of the taxpayers thus contribute 80 to 81% of the revenue. In this respect Pakistan is no different than other countries where LTUs have been established.[17] To accrue the benefits on the one hand and to optimize organization's ability to closely supervise and control the affairs of large taxpayers the soft opening of LTU in Karachi took place on July 01, 2002. The major objectives of this endeavor are:

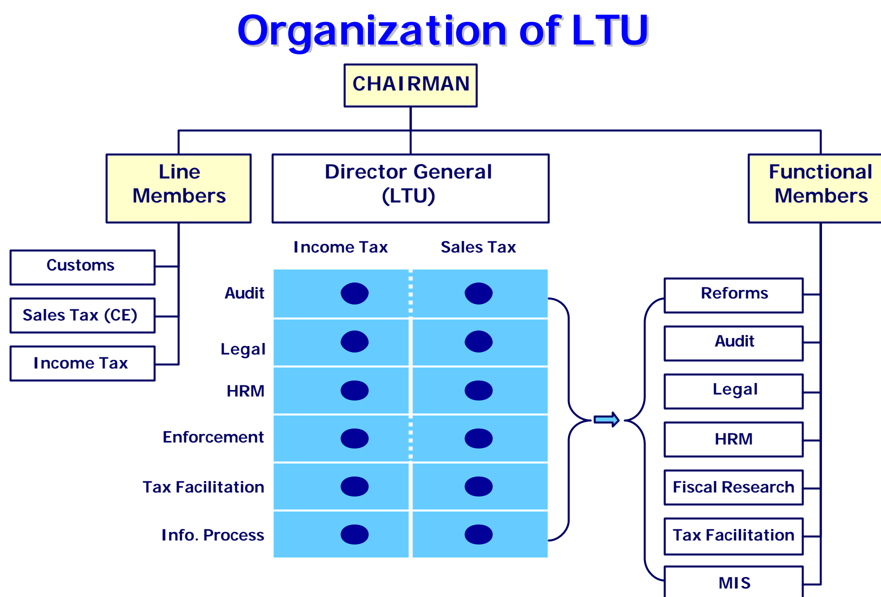
a. to provide specialized treatment to large taxpayers under one roof, and
b. to use LTU as a pilot to introduce new organizational structure, system and procedures to be replicated throughout the country.

---

[16] There are over 45 countries in the world where dedicated organizational units for large taxpayers are currently operational.

[17] The cross-county experience confirms that 92% of the revenue in Brazil is generated by 0.33% of the total taxpayers; a similar proportion in Sri Lanka is contributed by 2.02% of taxpayers, and 2% of taxpayers pay 50% of the revenue in France.

The model LTU at Karachi has the capacity to fully manage the affairs of income tax, sales tax and central excise of designated large taxpayers, which include most of the banks, insurance companies, pharmaceuticals, mining, chemical and electronics industries etc. While some of the selected taxpayers will be liable to pay all the three major taxes, the others may be required to pay any two or only one of them. Notwithstanding the number of taxes paid by a taxpayer, it will be administered as a single entity by the LTU. The CBR meanwhile has been transformed into a functional organization by adopting the new organizational structure. The new organizational structure of CBR provides that the functions of LTU will be replicated at other field formations. The following figure gives the new organizational structure of CBR.



Prominent Features of the LTU

That it will be used to introduce the new business processes based on functional arrangements. Since all the domestic taxes will be dealt within the same premise, the new re-engineered business processes will help to align the tax laws/ procedures for future integration of taxes. As regards the functions of information

technology, sharing of information between various taxes is planned. The initial architecture in this respect has been developed and made operational. While a one-step process for the filing of tax returns with minimum information and documentation will help and facilitate taxpayers, a transparent criterion for selection of cases for audit is being developed. However, since auditing of large businesses would require quality-auditing experience, special knowledge and understanding of business transactions and conditions, the Audit Division of the LTU is being organized with the objective to build the required audit capacity. At the outset auditors having necessary professional background have been selected who, in due course, will be imparted additional training in specialized audit.

Clearly defined responsibilities have been entrusted upon the officers posted at the LTU. While they will be enjoying adequate efficiency bonuses and excellent working environment, they will be held accountable for their actions. Greater stress has been laid on the improvement of their professional credentials through education and training. All this is being done to alter the *status quo* and to melt the rigidity often observed in public institutions.

The soft opening of the LTU is a leap forward. There are reasons to feel excited but there is fear as well. Nevertheless with a combination of special compliance strategies, professionally sound workforce, and efficient management skills tax compliance is expected to improve manifold.

"It takes all the running you can do, to keep in the same place.
If you want to get somewhere else, you must run at least twice as fast as that!"

Lewis Carrol, Through the Looking Glass