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A Review of Resource Mobilization Efforts of Central Board of Revenue

CENTRAL BOARD OF SREVENUE

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An Analysis of the 3rd Quarter Data of FY 03-04[1]

The Economy

Pakistan's economy is poised for accelerated growth in coming months. The performance of key manufacturing units serving as 'leading indicators' point out that GDP growth has already surpassed the beginning of the year projection of 5.3%. Further support to this phenomenon has been found in the foreign trade sector where sharp economic activity has been registered in plant, equipment and machinery and other raw material for capital goods. Additionally, with declining real cost of capital, partly due to recent surge in food inflation, the overall cost of borrowing has declined, thereby leaving a positive impact on the overall competitiveness of the commodity producing sectors of the economy. The broad-based recovery has been observed in other components/ sectors of the economy as well. The unambiguous manifestation to this claim can be found in the increasing level of openness, defined as the ratio of trade to GDP, the comfortable position of foreign exchange reserves, the stability of local currency vis-à-vis currencies of Pakistan's trading partners, the reduced stock of debt and flow of debt servicing, the status of foreign capital flows, and the growth in federal tax receipts. There is no doubt that the economy is gaining strength at a faster pace than envisaged earlier on.

CBR Revenue Position

CBR has achieved the revenue target of the first nine months of the fiscal year 2003-04. Besides improved voluntary compliance due to regime change in direct taxes from full assessment to universal self-

[1] The analysis is carried out by the Research Team comprising of the Fiscal Research Wing of CBR in collaboration with inputs from the staff of the Budget Wings of Direct & Indirect Taxes, and Directorate of Research & Statistics.

assessment, the sustained level of high growth of CBR revenue receipts has been possible due to over-performance of customs duties and sales tax on imports.

Overall Collection and Refunds

CBR overall net collection has surpassed the July-March target of Rs. 342 by Rs. 11.4 billion or 3.3%. The provisional *gross* and *net* collection during the first nine months of current fiscal year (CFY) stood at Rs. 414.9 billion and Rs. 353.4 billion, respectively registering growth of 11.9% and 13.9% over collection during the corresponding period of past fiscal year (PFY). The overall refund/rebate payments during first three quarters of CFY have been Rs. 61.5 billion. The broad-based growth of the leading federal taxes is consistent with the performance of the economy, especially the growth of GDP, domestic industrial production and sales, and the level of total and dutiable imports.

Table 1: Federal Gross and Net Revenue Receipts: A Comparison

(Revenue Receipts in Rs. Billion)

	FY 02-03		FY 03-04		Growth (%)	
	Gross	Net	Gross	Net	Gross	Net
July	33.1	23.6	31.0	23.4	-6.3	-1.2
August	36.5	29.6	36.1	30.1	-1.1	1.9
September	43.0	37.2	45.8	40.6	6.8	9.2
October	40.4	34.6	47.9	42.0	18.4	21.3
November	37.3	31.8	39.8	33.8	6.5	6.2
December	49.8	44.7	66.9	60.6	34.5	35.6
January	45.8	37.2	52.0	43.7	13.5	17.6
February	40.1	33.1	46.7	39.3	16.3	18.7
March	44.7	38.6	48.7	40.0	8.9	3.6
July-March	370.7	310.3	414.9	353.4	11.9	13.9

Note: (1) Figures are rounded to one decimal place

Detailed Analysis of Individual Taxes

Direct Taxes**:** The gross and net collection of direct taxes during July-March 2004 has been Rs. 116 billion and Rs. 104.4 billion, respectively, indicating that gross collection grew by 10.5% during the first nine months of CFY over the corresponding period of PFY.

Similarly, the net collection also increased by 10.3%. At the same time, Rs.11.6 billion have been paid back as refunds. It is worth mentioning that the negative growth in net receipts during February-04 was due to 154.6% growth in refund payments, which is rather high as compared to all previous months of CFY. The month-wise growth in direct tax receipts is given in Table 2.

Table 2: Gross and Net Revenue Receipts of Direct Taxes: A Comparison

(Revenue Receipts in Rs. Billion)

	FY 02-03		FY 03-04		Growth (%)	
	Gross	Net	Gross	Net	Gross	Net
July	6.3	4.8	7.1	6.2	12.8	28.1
August	7.6	7.0	7.4	6.8	-3.5	-3.3
September	13.4	11.8	12.9	12.6	-3.4	7.3
October	12.4	11.5	13.4	12.3	8.4	6.8
November	9.1	7.9	9.9	8.5	8.7	7.2
December	19.5	18.7	24.2	23.6	24.2	26.4
January	12.5	10.8	13.9	12.2	11.3	12.6
February	12.1	10.6	13.9	10.2	15.2	-4.0
March	12.2	11.5	13.3	12.0	9.3	4.7
July-March	105	94.7	116.0	104.4	10.5	10.3

Note: (1) Figures are rounded

Detailed Analysis of the Components of Direct Taxes: Based on the currently available aggregated data for July-Mar 2003-04 and using the corresponding data of PFY, the following features of direct tax receipts have been observed.

Voluntary Payments (VP)

The payments with returns have picked up by 22.5% during July-Mar 04 over the corresponding period of PFY. Similarly, the collection of advanced taxes u/s 53 has also registered a healthy growth of 15.8%. This improvement in voluntary compliance by the taxpayers should be seen as a positive development for the reason that the compliance has increased despite a reduction in returns due to increase in the basic threshold. However, since the 'salaried' individuals have benefited from increase in basic threshold, the gain in collection can be attributed to increased profitability of the corporate and non-corporate sectors, which in turn is an indication of improvement in the macroeconomic environment in the country.

Collection on Demand (CoD)

Contrary to voluntary compliance, the collection on account of demand creation has declined during the first nine months by 6.5%. Incidentally, the decline has been observed, both in arrear as well as current demand. Whereas the former decreased by 9.5%, the reduction in the latter has been 5.2%. Even though the past experience indicates that CoD usually picks up during the 4th quarter of the year when initial assessment of the returns is completed, this may not be possible during CFY, at least for the current demand component of CoD, as returns are treated as final under USAS. Under the present system, the possibility of further demand creation exists only for those cases, which will be picked for complete audit.

Withholding Taxes (WHT)

WHT continues to remain the leading component of direct tax receipts. The WHT collection during July-Mar 04 has been Rs. 62.7 billion against Rs. 59.2 billion during PFY, yielding an increase of about 5.9%. The five major withholding taxes constituting 78% of total WHT collection are: contracts, securities, imports, exports, and salary. The share of imports (27.2%) remains at the top, followed by contracts (25.7%), salary (11.3%), exports (7.6%) and securities (5.5%). The collection from imports, exports, contracts and salary have gone up by 10.4%, 14.8%, 7.5% and 19%, respectively due to substantial growth in the value of imports and exports, and improvement in economic activity. Apart from five major WHT contributors, a sizeable growth of 34.5% has also been recorded on account of telephone bills, 9.6% on electricity, and 16.4% on interest income. However, the WHT collection from bank interest has gone down by around 25.2% due to declining bank rates that have now bottomed out.

Sales Tax*:* The second major source of federal receipts is sales tax. The gross and net sales tax collection has been Rs. 195.1 billion and Rs. 155.7 billion during July-March 2003-04, respectively showing a growth of 12% and 11.9% over the corresponding period of PFY. The refund payments have increased by 12% during this period, which have been paid out almost completely from domestic ST receipts. Of the two components of sales tax, the domestic sales tax collection has increased by 7.9% in gross terms and 5.2% in net terms. On the other hand, the growth in gross and net ST collection from imports has been 17.1% and 17.2%, respectively, which is consistent with the growth in imports during the first nine months of CFY.

Domestic Sales Tax Collection and Major Revenue Spinners: The detailed analysis of domestic sales tax collection on the basis of data for July-March 2004 indicate that around 67% of gross collection (Rs. 69 billion out of Rs. 103.6 billion) has been generated by ten major revenue spinners that include POL Products, Services (Telephone and Tele fax), Electrical Energy, Cotton (not carded or combed), Natural Gas, Sugar, Cigarettes, Cement, Fertilizer, and MS Products. Of these sources of revenue, the contribution of five commodity groups and utilities has been 75.6%, indicating rather heavy reliance of sales tax on POL products, cotton (not carded or combed), telecom services, and the use of electricity and natural gas.

The highest growth of 18.7% has been recorded in the case of cotton due to higher market prices that prevailed during the harvest season. This is followed by 17% growth in collection from fertilizer due to increased demand. In the case of cement, 11.7% growth in the collection (until Feb-04) is attributable to 14.4% growth in production. However, the cumulative growth until March-04 has reduced to 10.2%. Similarly, the growth in revenue from cigarette industry has slowed down to 2.3% notwithstanding the fact that the production upto March has increased by 9.9%. Incidentally, the growth in collection during July-Feb 2003-04 was 10.7%. On a positive note, the sales tax collection from telecom sector has increased by 12% over the first nine months of preceding year mainly due to increased economic activity and the widespread use of mobile and telecom facilities (Table 3). On the other hand, even though the contribution of electrical energy in gross sales tax (domestic) collection was 4th from the top, its collection during CFY has declined by 14.2%. Finally, the domestic demand for steel products has also been compressed due to higher domestic prices that have caused substantial increase in input cost of the construction industry. In turn, the sales tax collection has also been adversely affected, the growth being -12.6%. Incidentally, the import value of iron and steel has recorded an overwhelming growth of over 48%.

Table 3: Sales Tax Collection from 10 Major Revenue Spinners (Domestic) for during 2002-2003 vis-à-vis 2003-2004

(Rs. In Million)

S. No.	Commodity	Collection Up to March 2003	Collection Up to March 2004	Growth (%)
1	POL Products (Including Petroleum, Lubricating Oils)	14788.9	14686.7	-0.7
2	Cotton not carded or combed (Ginned)	10163.5	12064.0	18.7
3	Services (Including Telephone/Fax etc)	9324.9	10441.7	12.0
4	Electrical Energy	9862.4	8460.8	-14.2
5	Natural Gas	6090.6	6510.0	6.9
6	Sugar (Including Baggage and Molasses)	6098.8	5845.1	-4.2
7	Cigarettes	3338.8	3415.0	2.3
8	Cement	2654.3	2924.0	10.2
9	Fertilizers/Urea	2410.3	2820.3	17.0
10	M.S. Products (Mild Steel Re-rolled)	2112.9	1845.8	-12.6
	Sub Total	66845.4	69013.4	3.2
	Others	28655.2	34635.3	20.9
	G. Total	95500.6	103648.7	8.5
	Refunds	34477.0	39342.9	
	Net GST Collection	61023.6	64305.8	

Customs Duties: The gross and net collection from customs duties has exhibited remarkable increase of 22.1% and 39%, respectively during July-March 2003-04 over the corresponding period of PFY.

In absolute terms, Rs. 62.8 billion have been collected during CFY against Rs. 45.2 billion during July-March 2002-03. The growth in gross collection is attributable to 23.8% growth in dutiable imports. The information presented below shows that the collection from vehicles, iron and steel, electrical machinery, paper and paperboard and edible oil has witnessed significant growth. In particular, the 56% growth in CD collection from vehicles (Chapter 87) and 53.2% growth in iron and steel (Chapter 72) is almost double the growth of 15 major commodities reported in Table 4, which is around 25%.

Table 4: Major Revenue Spinners of Customs Duties and Effective Rates

(Growth and Effective Rates in percent)

PCT Chapter	Tariff Description	July-March Growth			Effective Rates on Dutiable Imports	
		Import Value	Dutiable Imports	Customs Duties	Up to March 04	Up to March 04
15	Edible oil and Waxes	12.8	17.6	10.2	31.7	33.8
87	Vehicles	44.8	50.3	56.0	35.5	34.2
84	Machinery	10.9	32.9	32.0	9.9	10.0
39	Plastic Resins, etc.	22.9	23.7	23.1	18.5	18.6
27	POL Products	21.6	18.8	19.9	10.2	10.1
29	Chemicals	25.9	22.6	19.3	9.8	10.1
85	Electrical Machinery	33.8	32.7	32.4	13.7	13.7
72	Iron and Steel	48.2	56.9	53.2	15.6	15.9
9	Coffee and Tea etc.	12.7	8.7	-11.6	19.0	23.4
48	Paper and Paperboard	20.2	21.2	29.1	19.2	18.0
38	Misc. Chemical Prod.	23.5	24.4	8.3	12.3	14.2
32	Dyes, Paints etc.	8.2	7.2	8.0	18.0	18.2
40	Rubber Products	22.0	23.7	17.1	13.8	14.6
54	Man-made Filaments	20.0	14.9	5.2	16.1	17.6
30	Pharmaceutical Products	21.4	22.0	21.0	10.2	10.3
	Sub-total	*22.5*	*26.8*	*24.7*	*16.5*	*16.8*
	Others	1.3	13.9	8.6	11.4	12.0
	Grand Total	**13.0**	**23.8**	**21.7**	**15.4**	**15.7**

Note: The Data pertains to Custom House, Karachi and Dry ports constituting nearly 96% of total CD Collection.

Even though the duty structure has not been changed during the CFY, the effective rate on dutiable imports for 15 major commodity groups has declined from 16.8% to 16.5% during July-March 2003-04 over the corresponding period of PFY and the effective rate for all commodity groups has declined from 15.7% to 15.4%. This has been due to the changing composition of dutiable imports. Finally, it also important to observe that the effective rate of only few commodities remain higher than the maximum statutory rate implying that there has been success in reducing tariff peaks. Of 15 major revenue spinners the two commodity groups where effective rate remains higher than the maximum statutory rate of 25% are those listed in Chapter 15 (edible oil and waxes etc) and Chapter 87 (Vehicles).

Central Excise: The net collection of CED during July-March 2004 has been Rs. 30.4 billion against Rs. 31.3 billion during the corresponding period of PFY, depicting a decline of 2.8%. The overall decline in collection is mainly attributed to the shrinking base of CED. The removal of CE duty on paper and paperboard, and wires and cables, and reduction of CE duty on cement has affected the collection of CED. The revenue position for the first three quarters on the basis of five major revenue generators given in Table 5 shows that the growth of 9.6% and 12% in cigarettes and

Table 5: A Comparative Analysis of CED Collection

(Rs. Million)

Five Major Revenue Spinners	FY:03-04	FY:02-03	Difference	
	July-March		Absolute	Percent
Cigarettes	12108.8	11048.9	1059.9	9.6
Cement	6731.7	8287.3	-1555.6	-18.8
Natural Gas	3639.0	3273.9	365.1	11.2
POL Products	2534.9	2651.2	-116.3	-4.4
Beverages	1631.5	1456.7	174.8	12.0
Sub Total	26645.9	26718.0	-72.1	-0.3
All Commodities	30440.0	31122.2	-682.2	-2.2
% Share in Gross	87.5	85.8		

beverages respectively is due to higher clearances i.e., 11.8% and 21.6% during the 9 months of CFY against PFY. A growth of 11.2% in natural gas was also due to switch over of CED on heat content from volume basis and increased clearance. However, since the share of five items has increased from 85.8% in PFY 02-03 to 87.5% during CFY, a decline in collection in these five items will have adverse implications for the overall revenue target of CED.

Concluding Observations

CBR has successfully achieved the revenue target of first three quarters of CFY and the accomplishment of the year-end target is a real possibility. The performance is more commendable as original target is attained and no revision is made this year as well. This success has been possible for many reasons including the improvement in the macroeconomic environment and strengthening of the economic fundamentals. The continuation of tax policy and administrative reforms has also played an important role in the improvement of tax collection. It is anticipated that functional re-organization of CBR at the field level supported by automation will further boost tax compliance as well as tax effort. Thus, the prospects for the future are bright.