FBR Quarterly Review

Vol. 10, No. 2, October – December 2009

A Review of Resource Mobilization Efforts of Federal Board of Revenue

FEDERAL BOARD OF REVENUE
Government of Pakistan
Constitution Avenue
Islamabad - Pakistan

Editor:
Zafar ul Majeed
Member, Strategic Planning and Research & Statistics
e-mail: membersps@fbr.gov.pk
Phone: (051)-9219665
Fax: (051)-9206802
March: 2010

Strategic Planning and Research & Statistics Wing, FBR

The FBR Quarterly Review October – December, 2009 has been prepared by the Research Team of Strategic Planning and Research & Statistics wing.

Research Team

1. Zafar ul Majeed
   Member, Strategic Planning and Research & Statistics

2. Umar Wahid
   Secretary, *Strategic Planning and Research & Statistics*

3. Mir Ahmad Khan
   Second Secretary, *Strategic Planning and Research & Statistics*

Contents

Abbreviations

BPR	Business Process Reengineering
ATT	Air Travel Tax
AoPs	Association of Persons
CD	Customs Duties
CFY	Current Fiscal Year
CoD	Collection on Demand
DT	Direct Taxes
FBR	Federal Board of Revenue
FED	Federal Excise Duties
FY	Fiscal Year
GST	General Sales Tax
LTU	Large Tax Payers' Unit
MCC	Model Customs Collectorate
NFS	Non-Fund Services
NTN	National Tax Number
PCT	Pakistan Customs Tariff
PFY	Previous Fiscal Year
Q2CFY	Quarter 2 Current Fiscal Year
Q2PFY	Quarter 2 Previous Fiscal Year
RTO	Regional Tax Office
ST(D)	Sales Tax Domestic
ST(M)	Sales Tax Import
STARR	Sales Tax Automated Refund Repository
TARP	Tax Administration Reform Project
USAS	Universal Self-Assessment Scheme
VP	Voluntary Payments
VAT	Value Added Tax
WHT	Withholding Taxes

Foreword

The current issue of the FBR Quarterly Review provides in-depth analysis of federal taxes during first half of the FY: 2009-10. The discussion is comprehensive in the sense that it also highlights the adverse impacts of various shocks that have rocked the economy during past six months. The report also provides an overview of various segments of the economy, especially the contribution of the corporate sector in revenue receipts. The issue also includes an article on "Addressing Structural Weaknesses of the Taxation System- A Strategic Approach". This study draws readers' attention to the weaknesses of the taxation system of Pakistan and its remedial measures in the light of FBR's recent efforts towards broadening of tax base and withdrawal of unnecessary exemptions. It further highlights the need for a broad based Value Added Tax (VAT) which is proposed to be introduced in the country. The VAT is expected to raise substantial additional revenue in the coming 2-3 years which will amount to increase the Tax to GDP ratio by 2-3%.

I appreciate the efforts made by the research team of Strategic Planning and Statistics Wing, FBR for bringing out this valuable publication and firmly believe that the multifaceted information, analysis, and its lucid presentation will be useful for wide spectrum of readers including business community, policy planners, partners in development, and researchers.

Comments and suggestions from our valued readers will be highly appreciated for forthcoming publications of the FBR Quarterly Reviews.

Sohail Ahmad
Secretary Revenue Division/
Chairman, FBR

March, 2010

I

FBR Tax Collection:
An Analysis of 2nd Quarter Revenue Outturn[1]

The Economy

Pakistan's economy has now started showing some signs of improvement after having long confrontation with continuous external shocks and internal challenges during the past couple of years. The major breakthrough is the significant decline in inflationary pressure. Inflation has declined to single digit in October 2009, after constant double digit rate during the last two years. However, in November and December the inflation rate is stabilized at 11.7%, though high but substantially below as compared with last year. Similarly, better economic management has also resulted in significant improvement in the current account balance.

The global financial and economic meltdown combined with crippling power crisis and the security environment exacerbated Pakistan's miseries as economic growth slowed down sharply, foreign exchange reserves dwindled, and foreign capital inflows dried up. The surging fiscal and current account deficits and unavailability of other external financing options forced the government to sign a stand-by agreement with the IMF in November 2008 to achieve macroeconomic stability through fiscal consolidation and monetary measures. For the first time, IMF has accepted Pakistan's homegrown proposals/programs which have two main objectives: (i) to restore the confidence of domestic and external investors by addressing macroeconomic imbalances through a tightening of fiscal and monetary policies until visible signs of demand curtailment; and (ii) to protect the poor and preserve social stability through well-targeted and adequately funded social safety nets. The government's new broad-based program for economic stabilization was mainly focused on rationalization of expenditures, removal of unproductive

[1] The Research Team of Strategic Planning and Statistics Wing of FBR has carried out the analysis.

subsidies to reduce the burden on the budget; significant cuts in expenditures to reduce budgetary deficit and a tight monetary policy to fight inflation.

The Government of Pakistan has signed Stand By Arrangement (SBA) with the International Monitory Fund on 25th November, 2008. The SBA was initially fixed for 23 months (7 Quartets) but later on the period was extended to 25 months. Similarly, the initial agreement with the IMF was for an amount of US$ 7.236 billion, but the amount was later on enhanced to US$ 10.854 billion. One of the reasons for going to the IMF was the low interest rate as compared to other international organizations. The interest rate ranges "between" 3.51% to 4.51% adjustable for market changes. The Government has been meeting successfully the quarterly targets as agreed with the Fund, therefore, the quarterly installment are regularly released. So far Pakistan has received US$ 7.6 billion.

With the help of prudent expenditure management the fiscal deficit has narrowed down to 4.9 percent of GDP, a decline of about 35% in 2008-09. The current account deficit has also declined to 3.7% from the peak of 8.5% last year. More importantly the manufacturing sector posted positive growth during the first half of the year, whereas there was a negative growth of 6.5% in the comparable period of PFY. Foreign exchange reserve has increased to US$ 15.5 billion form mere US$ 6.7 billion last year.

On the tax revenue front, despite all economic odds, the resource mobilization effort by FBR has been encouraging. The tax collection has started picking up and Tax to GDP ratio is planned to increase to 9.3% in FY: 2009-10 from the lowest ratio of 8.8% in FY: 2008-09. Mid-to-long term planning is to increase the ratio 13-15% in the next five years. To achieve the planned Tax to DGP ratio, a comprehensive strategy has been evolved. A broad based Value Added Tax is proposed to be introduced in the country to broaden the tax base, where all unnecessary exemptions/ zero rating will be withdrawn. The measure is likely to raise additional revenue in the coming 2-3 years which will amount to increase the Tax to GDP ratio by 2-3%. Strengthening of Customs controls at import stage and international borders, checking of under invoicing, reactivation of audit functions and implementation of wide-ranging enforcement plan to identify and bring it to tax net the non compliant taxpayers are the other important measures of the FBR strategy.

FBR Revenue Collection vis-à-vis Target

FBR revenue target for the FY: 2009-10 was fixed at Rs. 1,380 billion at the time of announcement of Federal Budget. The target was linked with the economy on the assumptions that growth in revenue collection will correspond with growth in the economy. It was anticipated that nominal GDP will grew by 13.5% during the year. Large scale manufacturing sector will improved by 12% in nominal term and import will grow by 2.6% in dollars term. Thus, the tax bases both at import and domestic taxes were assumed to increase accordingly. Keeping in view the high growth scenario, the revenue target of Rs. 1,380 was highly pitched by 19.3% over the actual collection of Rs. 1,157 billion during past fiscal year 2008-2009. The target appears to be ambitious as, there has been general economic slowdown since beginning of the year, against the anticipated high growth scenario.

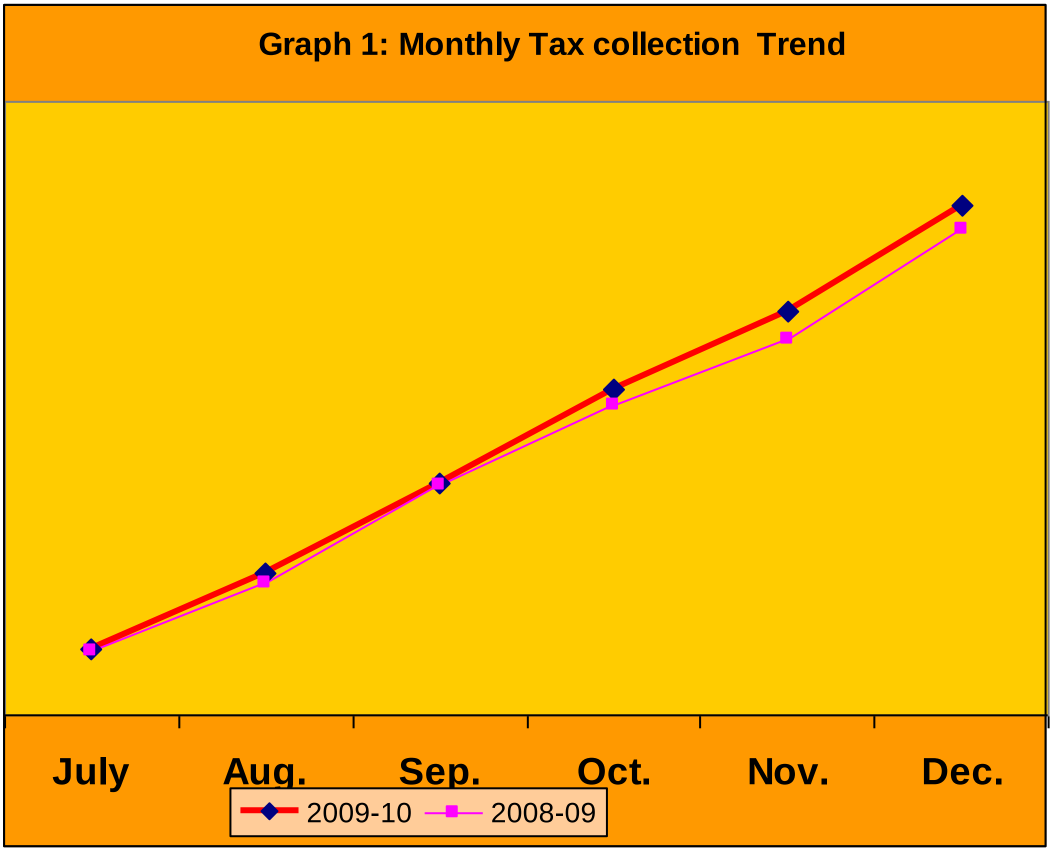
FBR is striving hard and taking extraordinary efforts to achieve the huge revenue target. In response to the revenue target, FBR has collected Rs. 615.1 billion and Rs. 582.1 billion in gross and net terms, respectively during first half of FY: 09-10. The growth in gross and net collection has been 4.4% and 5.1% respectively. One of the major reason of low growth in the collection is due to change introduced in the advance tax system i.e shifting payment of due advance tax from end of the quarter to 15th of the following month. Thus, the advance tax installment due for the December, 2009 has been paid in January 2010. Had the Rs 25 billion advance tax of 2nd quarter not been spilled over to January, the net collection would have been Rs. 607.1 billion and growth by 10% over PFY. During the same period Rs 33 billion refund/rebate has been paid back to the taxpayers. The six monthly target of Rs. 582.3 billion has been achieved. Keeping in view the deteriorating national and international economic conditions this performance is satisfactory. However, there will be more pressure in the second half of current fiscal year to collect the remaining balance of Rs.797.9 billion which is about 58% of total revenue target. Month-wise details of collection have been depicted in Table-1.

Table 1: Month-wise Comparative Net Revenue Collection

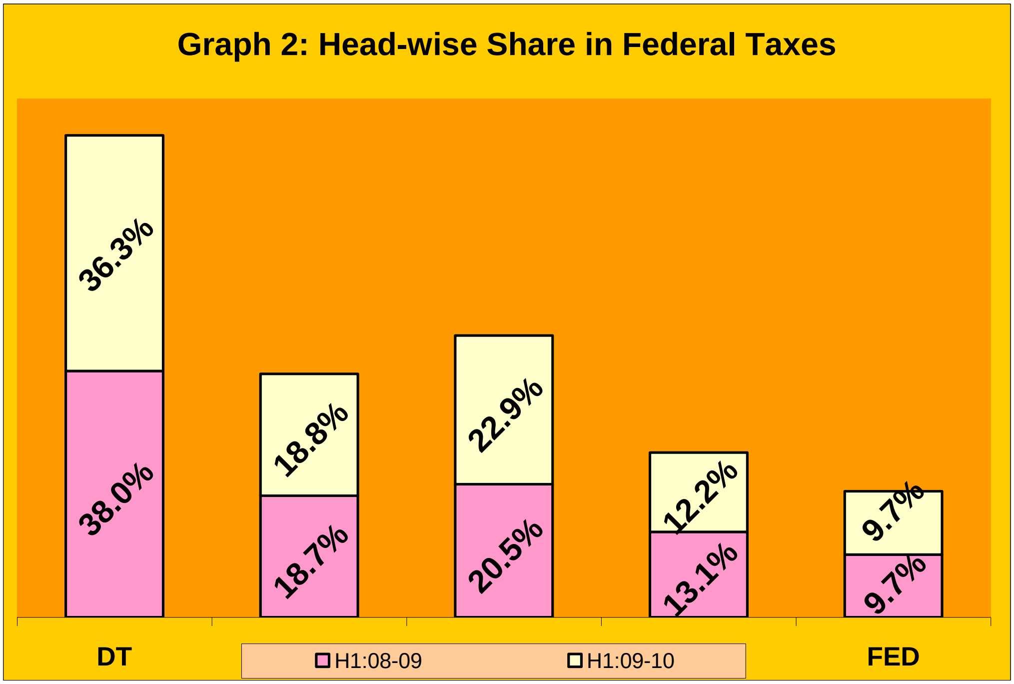
(Rs. Million)

Months	FY 09-10	FY 08-09	Difference	
			Absolute	Percentage
July	74,680	72,462	2,216	3.1
August	86,189	78,815	7,374	9.4
September	102,816	110,813	-7,997	-7.2
October	108,128	92,182	15,947	17.3
November	87,859	74,809	13,051	17.4
December	122,477	124,752	-2,275	-1.8
July-December	**582,150**	**553,833**	**28,316**	**5.1**

The monthly collection trend during first half of the year has been inconsistent. From July to September 2009 FBR has been able to maintain equity in collection viz-viz last year. However, from October onward the collection has started picking up. The reason is that last year the first three months were highly productive on account of higher oil prices in the international market, whereas the first three months of current year were facing low oil prices in international market. A visible positive change in revenue collection can be seen from October onward. The tax collection has indicated high growth since then. It is expected that high growth momentum in revenue realization is likely to develop in the second half of the year (Graph 1).



The tax-wise details reveal that the direct and indirect taxes grew by 0.5% and 7.9% respectively during H1:09-10. Among indirect taxes, sales tax (import), sales tax domestic, Customs and FED grew by 5.3%, 17.7%, -2.1% and 5.8% respectively. The contribution of direct taxes during H1: 09-10 has been reduced for 38% in PFY to 36.3% CFY (Graph-2). This notable change is witnessed in direct taxes as the share of DT in federal taxes has declined by 1.7%. This is due to change in the advance tax regime where the advance tax payable in December has been paid in January 2010. On the contrary the share of ST (D) has increased by 2.4%. The reason for this shift is change in policy of zero rating of POL products (major source of revenue) at import stage and levy of sales tax at domestic level.



Though the target for first half of CFY has almost been achieved, but to achieve the overall target for the second half of CFY as depicted in the table 2 appears to be an uphill task, particularly, for direct taxes at Rs.329.3 billion and sales tax at 297.4 billion. However, to reach the target of Rs 1380 billion, FBR has chalked out a comprehensive strategy to tap those sectors that are not paying due taxes, recovery of outstanding arrears of income tax, curbing smuggling and tightening of Afghan Transit Trade (ATT).

Table 2: Net Collection vis-à-vis Targets for H1: 2009-10

(Rs. Billion)

Tax Heads	Target	Collection	Difference	Balance Amount to be collected in H2:09-10	Remaining Balance as % of total Target
Direct Taxes	211.5	211.4	-0.1	329.0	60.9
Sales Tax	242.7	242.9	0.2	297.4	55.0
FED	56.7	56.7	0.0	77.7	57.8
Customs	71.4	71.2	-0.2	93.7	56.8
Half Year	**582.3**	**582.2**	**-0.1**	**797.8**	**57.8**

Analysis of Refund/ Rebate Payments

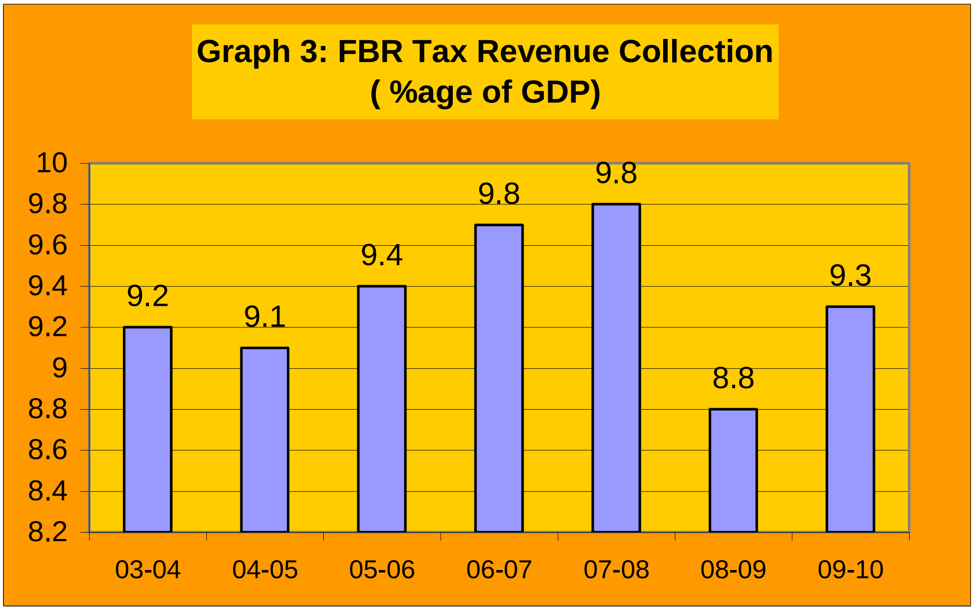
An overall refund payment has registered a negative growth of 6.4% during H1:09-10. A substantial decline has been witnessed in ST (D) refund payments, which has been the major source of refund payments. In absolute terms, Rs. 4,525 million lesser amounts has been paid in ST (D), which is around 33% lower than the previous year refund payments. Similarly, in the customs side more than 40% decline has been registered in refund/rebate payments during the same period. However, in direct taxes Rs.20.7 billion refunds have been paid during H1:09-10 against Rs.16.3 billion in the corresponding period last year showing a growth of 27%.

Tax/GDP Ratio

Like other developing countries, Pakistan is also confronted with low Tax /GDP ratio scenario during the past few years. Tax to GDP ratio is one of the major indicators of a tax administration's efficiency and overall state of economy in a country. Pakistan is amongst the countries having one of the lowest tax to GDP ratio in the world as well as the region. Although FBR's revenue collection during the last 5 years has considerably increased in absolute terms, but the tax to GDP ratio has been on decline. (Graph 3)

Main reasons for the low tax to GDP ratio have been identified as follows:

- The tax base is narrow
- Agriculture, large number of services, Capital gains are outsider tax net
- Low tax compliance
- Wide spread exemptions
- Large undocumented informal sector
- Weak Audit and Enforcement



FBR is striving hard to generate sufficient resources to increase the Tax to GDP ratio to a respectable level. FBR aims to increase Tax to GDP ratio from existing 8.8% to 13-15% during the next five years. A number of additional Tax Policy and Administrative Reforms initiatives have been undertaken in this regard which include;

- Phasing out duty/tax exemptions and concessions to help broadening the tax-base and making the system equitable for taxpayers;
- Conversion of GST into full VAT-mode and bringing such sectors as “Services” and “Retail trade” under the tax net. These measures are expected to broaden the tax base significantly.
- Integration of the management of domestic taxes together with strengthening of enforcement and audit functions has helpful in increasing compliance of domestic taxes. Restructuring of FBR administration on functional-lines will further help in improving the efficiency of the tax machinery as well as taxpayers’ facilitation.
- Prevention of revenue leakages through automation and re- engineering of existing business processes (BPR) is expected to bring new tax-culture in the country.

Detailed Analysis of Individual Taxes

***Direct Taxes*:** The gross and net collection of direct taxes during H1: 09-10 has been Rs. 232.1 billion and Rs. 211.4 billion, indicating a growth of 2.4% and 0.5% respectively. The low growth scenario in the net collection of direct taxes has been the change introduced in the payment of quarterly advance tax system i.e shifting payment of due advance tax from end quarter to 15th of the following month. Thus, the advance tax installment due for the December, 2009 has been paid in January 2010. Had the Rs 25 billion advance tax of 2nd quarter not been spilled over to January 2010, the collection of direct taxes would have been Rs. 236.4 billion and growth of 12.5% over PFY. The performance when viewed in the given a circumstances has shown better results, and since the economy is picking up and number of enforcement measures has also been undertaken, it can be argued that the direct taxes might achieve the envisaged target for 2009-10. Within various components of direct taxes, major growth has been encountered in withholding tax.

Components of Income & Corporate Taxes

Collection on Demand (COD): Although COD has become a minor component over the years after the shift towards self assessment system but it will remain of paramount importance as it is the only component which reflects the departmental efforts to recover arrear payments and raise current demand by analyzing the documents (returns and annexes) filed by the taxpayers. The share of COD, in total income tax collection has almost the same around 13.2% during H1: 09-10 and H1: 08-09. Within the COD, the share of current demand and arrear demand was 50.3% and 49.7%, as against 74.3% and 24.8% respectively in the previous year. The collection from current demand reached Rs. 14.9 billion in H1:09-10 against Rs. 22 billion in H1:08-09, whereas under the head of arrear demand Rs. 14.7 billion against 7.4 billion have been accrued . The decline in collection from current demand is indicative of low departmental efforts towards targeted audit of the submitted declarations. Similarly, more than hundred percent increases in the collection on account of arrear demands are reflective of clearance of arrear backlog and also indicative of a renewed strategy and more efforts in this regard.

Voluntary Payments (VP): This component includes payments with return and advances. In net terms, Rs. 61.1 billion have been generated during H1: 09-10 as compared to Rs. 80 billion in the corresponding period last year. Thus, negative growth of 23.7% has been witnessed. Had the amount of Rs 25 billion pertaining to advance tax due in December 2009 not been spilled over to January 2010 as per policy shift, the collection of VP would have been Rs 86.1 billion, higher by Rs 6 billion as compared to PFY.

It may be recalled that after the introduction of USAS, the share of VP in gross collection has kept on rising and during H1: 06-07 it reached 55.5%, but in the last two years there has been a reverse trend whereby during H1: 08-09 it has declined to only 39.5% and presently in H1:09-10, it has further dipped to 27.2%. A detailed analysis of this component reveals some development and the payments with return have registered a negative growth of 38.2%. In nominal terms, an amount of Rs.7.9 billion against Rs12.8 billion has been collected in H1: 09-10, and consequently its share in total VP has also declined to 12.9% from 15.9% in the previous year. The second component of VP, i.e., advance payments has also shown negative result with a growth of 20.9 % during H1: 09-10. In value term an amount of Rs.53.2 billion were collected during H1 2009-10 against Rs. 67.3 billion in H1: 09-10. The reason of decline in advance tax is due to change introduced in the advance tax regime from 1st July 2009 by liking it with turnover tax. Due advance tax of Rs 25 billion, of December 2009 as explained above, has been paid in January 2010.(Table 3).

In a system of USAS, this component should have an increasing trend as has been witnessed up till 06-07, but on the contrary it is constantly decreasing as observed during the last two years. As VP is the primary indicator reflecting the success and failure of the prevalent system of USAS, the department need to review this aspect comprehensively so as to evolve an appropriate strategy to make the USAS successful.

Table 3: Voluntary Payments (VP): A Comparison

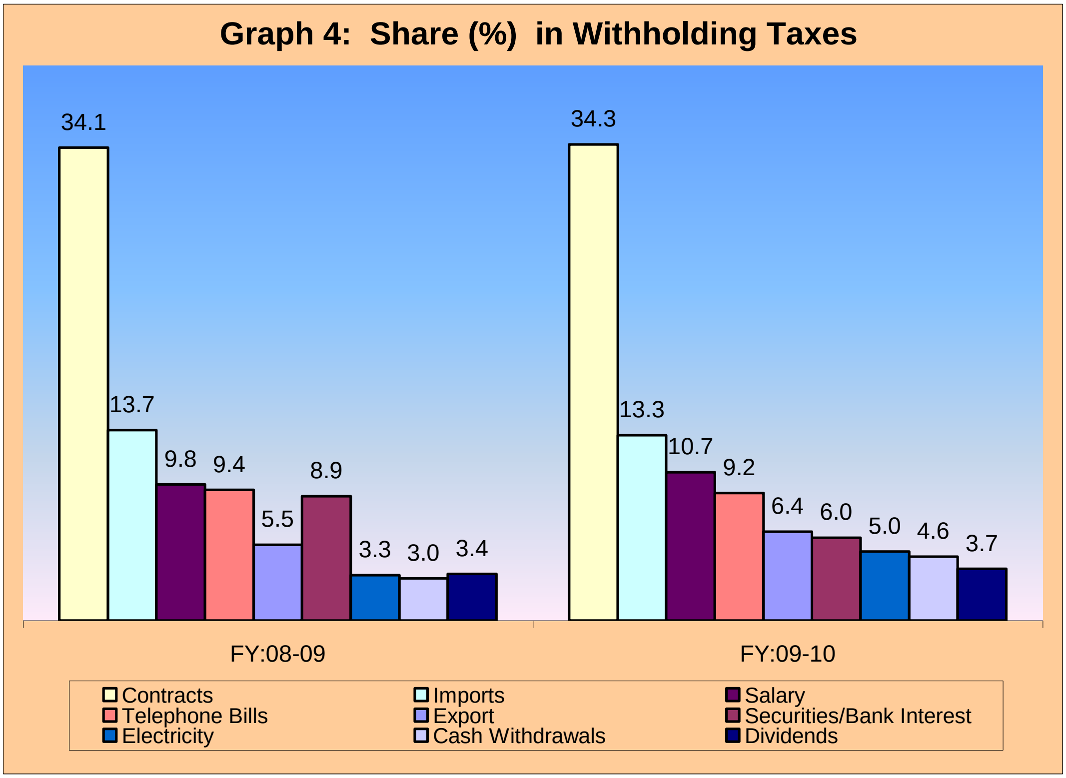
(Rs. Million)

Heads	H2: 09-10	H2: 08-09	Growth (%)	Share (%) in Total VP	
				H2: 09-10	H1: 08-09
With Return	7,886.1	12,769.1	-38.2	12.9	15.9
Advance Tax	53,202.6	67,261.5	-20.9	87.1	84.1
Total VP	**61,088.7**	**80.30.6**	**-23.7**	**100**	**100**

Withholding Taxes (WHT): Withholding tax is the third important component of income tax. During H1: 09-10 tax receipts worth Rs. 133.9 billion have been collected against Rs. 112.8 billion in the corresponding period of last year entailing a significant growth of 18.7%. The share of WHT in gross income tax collection has increased during the current period and stands at 65.5% against 54.6% in H1: 08-09.

The major revenue spinners as far as WHT is concerned are: contracts and supplies, imports, salary, telephone, exports, bank interest, electricity, cash withdrawals and dividends.

The major heads, mentioned in Table 4, contribute 94.5% of total the WHT collection. Their respective shares are shown in Graph 4. The major share of WHT comes from contracts and supplies (31.4%), which are followed by trade related deductions 23.3% [imports (17.4%) and exports (5.9%)], salaries (10.7%) and Telephone bills (8.0%) and so on.



A healthy performance in receipts on account of contracts, telephone use, salary payments, electricity bills, cash withdrawals and dividend has been witnessed during H1: 08-09. On the other hand, there has been a decline in WHT on imports and exports which appears to be inconsistent with 14.1% and 3.8% growth in imports and exports respectively during H1: 08-09. Finally, 86% increase in deductions on cash withdrawal vindicates the assertion that the undocumented economy requires special tax treatment.

Table 4 Half-Yearly Collection from Major Revenue Spinners Related to Withholding Taxes

(Rs. Million)

Collection Heads	H1: 09-10	H1: 08-09	Difference (Absolute)	Growth	Share in WHT H1: 09-10
Contracts	42080.2	38,711.2	3,369.0	8.7	34.3
Imports	23,307.6	15,046.6	8,261.0	54.9	13.3
Salary	14,274.2	12,042.0	2232.2	18.5	10.7
Telephone Bills	10,760.8	10,355.6	405.2	3.9	9.2
Export	7,896.6	7,209.5	486.1	9.5	6.4
Bank Interest	7,871.8	5,865.2	2,006.6	34.2	6.0
Electricity	6,919.8	5,597.4	1,322.4	23.6	5.0
Cash Withdrawals	6,197.4	5,196.6	1,000.8	19.3	4.6
Dividends	3,188.9	4,195.6	-1,006.7	-24.0	3.7
Sub-Total (9 major items)	122,495.6	10,4219.4	18,276.2	17.5	91.5
Share in Total WHT	91.5%	92.4%			
Other WHT	11,419.5	8,555.7	2,863.7	33.5	6.8
Total WHT	**133,915.1**	**112,775.2**	**21,139.9**	18.7	100
Share in Gross I. Tax	65.6	54.6%			

Analysis of Income Tax Returns: The number of Income Tax Returns and statements received during H1:09-10 as compared to the corresponding period last year are lower by 24,637 indicating a decline of about 1.3%. However, there has been positive growth of 9.3% in the number of returns received during this period has been observed. On the contrary statements have declined by 7.4% (Table 5). Total tax received with returns/ statements has also declined by 38.2%. It is quite clear that there has been gross mis-use of the USAS, which is alarming for the income tax department.

Table 5: Comparison of Income Tax Returns during H1: 2009-10 and 2008-09

Rs in Million

	No. of Returns Received H1: 09-10	**No. of Returns Received H1:08-09**	**Growth (%)**
Returns			
Corporate Cases	19,910	14,976	32.9
AOPs	41,897	26,195	59.9
Salaried Individuals	114,513	132,689	-13.7
Non-Salaried Individuals	583,637	518,130	-12.6
Sub Total Returns	759,957	691,990	9.3
Statements			
Salary certificates	18,829	21,443	-12.8
No of employees in the statement	1,052,880	1,145,574	-8.1
Importers	12,262	11,771	4.2
Exporters	8,473	8,096	4.7
Retailers up to 5m turnover	13,332	18,937	-29.6
Above 5m turnover	581	832	-30.2
Contractors/ Suppliers	24378	26,438	-7.8
Others	29,110	19,358	50.4
Sub Total Statements	1,159,845	1,252,449	-7.4
Total	**1,919,802**	**1,944,439**	**-1.5**

Return Analysis of corporate entities

Corporate sector plays an important role in the economy and tax contribution. Around 70% income tax is originated form this sector. The return filers are 19,910 during FY: 2009-10. To ascertain the potential growth vis-à-vis the department efforts with regard to the 'Returns' a gap analysis of corporate returns received up to December 09-10 has been done.

Table 6: Number of Corporate Returns and Payment with returns

	2009-10	**2008-09**	**Change (%)**
Returns filed	19,910	14,976	32.9
Payments With Returns (Rs Million)	7,886.1	12,769.1	-38.2

The above table clearly shows that the number of corporate returns filed during the period H1 09-10 has registered a growth of 32.9 %, but there has been massive negative growth (38.2%) in payment with return. The growth in returns filing has been driven away by negative growth in collection. It indicates that large number of returns has been filed showing losses or nil income which is again warrant for scrutiny of the filed returns and effective audit. Now to analyze the potential of increasing the compliance of corporate sector, it is better to review the SECP data, which is depicted below in Table 7. The given data not only reveals poor compliance of only 39% on part of the corporate taxpayers, but also leave a viable room for the department to broaden the tax base and improve collection by nabbing 31,00 corporate non- filers as registered with SECP.

Table 7: Comparison with the SECP data of registered corporate entities

	Nos
Corporate entities registered with SECP as on 30-06-2008	50,952
Corporate returns received as on 31-12-2009	19,910
% age of compliance	39.1%
Deficiency in compliance	31,042 60.9%

Source: PRAL and SECP (2008), Islamabad

By analyzing the returns received from the corporate sector during H1: 09-10, the data (Table -8) give us another gloomy picture. Out of the total returns filed only 24% have declared income and 76% are without any contribution to the federal revenue.

Table 8- Analysis of Corporate return data w.r.t Income, Loss or Nil

	2009-10	**2008-09**	**Growth %**
No of cases declared income	4,865 (24.4%)	4,201 (24.1%)	15.8
No of cases declared Loss	3232 (16.2%)	2,480 (14.2%)	30.3
No of cases declared NIL	11,813 (59.3%)	10,749 (61.7%)	10.0

Source PRAL

A further in depth analysis of the corporate sector would provide a comprehensive picture to ascertain and pinpoint the non compliant sectors so as to devise a strategy accordingly. From the given table it is well evident that of the top 20 corporate entities except for five sectors, the compliance level in submitting the returns is less than 50%.

The sector wise analysis of corporate case with respect to the declaration of income and loss (Table 9) is also quite dismal as the percentage of cases declaring income in all the listed major 20 corporate entities is 24% and majority of the companies are either declaring loss or nil income. The question here is how a company is surviving over the years by continuously declaring losses? This aspect must be probed in by conducting a detailed field audit.

Table 9 – Income / Loss Analysis – Top 20 Corporate entities

	Sector	Total No	Cases with Income		Loss Declared	NIL Income
			No	%		
1	Tobacco & Products	23	8	34.8	5	10
2	Autos	288	106	36.8	70	112
3	Hotel	107	35	32.7	25	47
4	Iron & Steel	266	103	38.7	58	105
5	Chemical	298	114	38.3	62	122
6	Pesticides	54	27	50.0	6	21
7	Pharmaceuticals	431	159	36.9	70	202
8	Banks	77	27	35.1	23	27
9	Electronics	249	87	34.9	45	117
10	POL	46	12	26.1	16	18
11	Food Products	809	246	30.4	169	394
12	Paper	237	90	37.9	53	94
13	Fertilizers	24	9	37.5	3	12
14	Beverages	41	10	24.4	13	18
15	Services	7,922	2,189	27.6	1,147	4,586
16	Sugar	77	17	22.1	46	14
17	Power	175	29	16.6	40	106
18	Telecom	158	33	20.9	33	92
19	Textile	1,742	298	17.1	380	1064
20	Cement	37	8	21.6	17	12
	Others	6849	1,264	17.5	951	4640
	Total	19,910	4,865	24.4	3,232	11,813

Source PRAL

As far as the contribution of revenue is concerned (Table10), top five sectors contribute 80 % of the total revenue received with the corporate returns. Owing to this uneven composition and reliance on few entities of corporate sector is not at all promising for the overall health of the economy, thus a detailed analysis and probe is reiterated to get the maximum revenue from the rest of the non compliant entities of corporate sector. As far as the growth is concerned the traditional sectors like telecom, chemical and POL sectors have either shown negative growth or marginally improvement. The non traditional sectors like sugar, paper and cement etc have exhibited higher growth during H1FY: 09-10.

Table 10 – Contribution towards revenue - top 20 corporate entities

	Sector	Total Tax Paid (Rs. in Million)		% age Share in 09-10	Growth (%)
		2009-10	2008-09		
1	POL	73,249	81,115	32.6	-9.7
2	Banking	40,863	38,063	18.2	7.4
3	Services	27,088	25,583	12.1	5.9
4	Autos	5,022	6,414	2.2	-21.4
5	Telecom	8,701	7,572	3.9	14.9
6	Food Products	8,782	6,854	3.9	28.1
7	Fertilizers	7,056	3,968	3.1	77.8
8	Power	4,711	3,963	2.1	18.9
9	Pharmaceuticals	5,077	4,603	2.3	10.3
10	Textile	9,206	8,122	4.1	13.5
11	Chemical	3,338	2,495	1.5	33.8
12	Tobacco	2,199	1,671	1.0	31.6
13	Iron and Steel	2,720	2,208	1.2	23.1
14	Electronic	2,741	2,231	1.2	22.9
15	Beverages	1,528	1,151	0.7	32.8
16	Paper	1,861	1,242	0.8	49.8
17	Sugar	1,167	877	0.5	33.1
18	Cement	2,214	9,28	1.0	138.5
19	Hotel	457	454	0.2	0.8
20	Other	16,676	24,116	7.4	30.9
	Total	**224,656**	**222,702**	**100.0**	**0.9**

Source PRAL

Sales Tax:

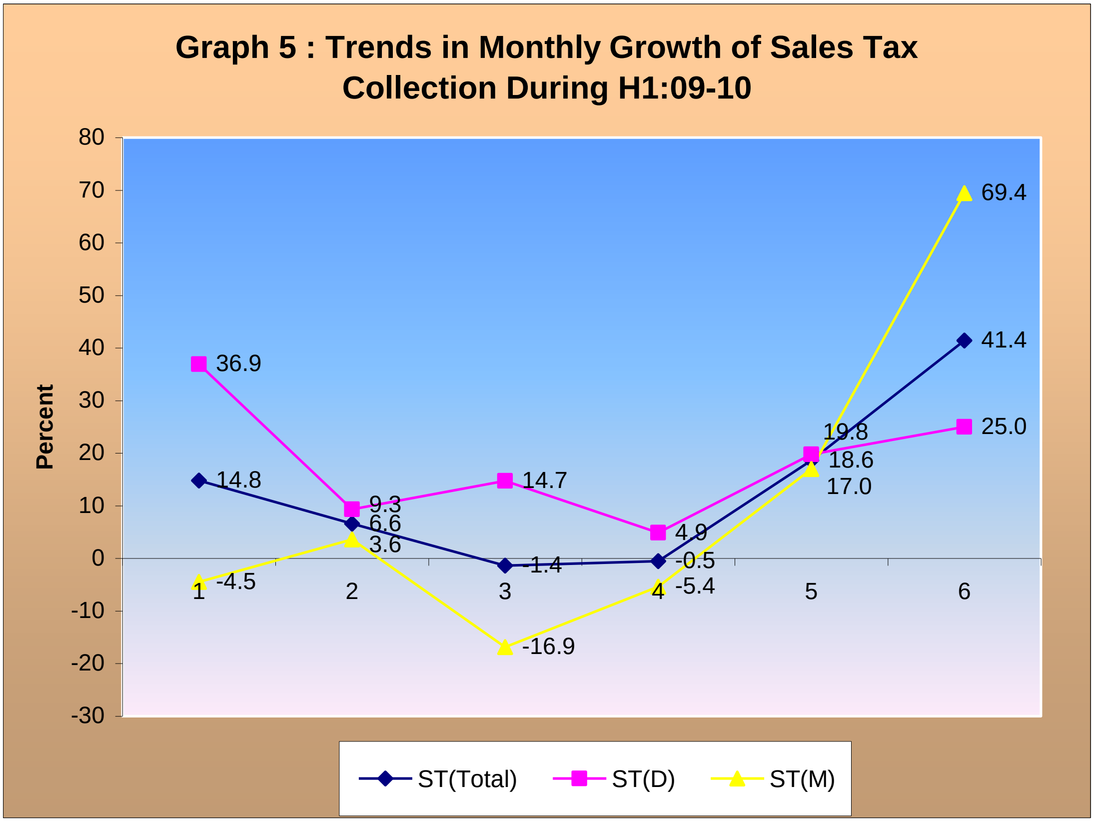
The total gross and net collection stood at Rs.252.1 billion and 242.9 billion respectively during July-December 2009-10. The gross and net tax revenues grew by 9.2% and 11.8% respectively. The refund payments declined by around 33.1% during the same period as Rs. 9.2 billion were paid as refunds during H1:2009-10 against Rs.13.8 billion in the corresponding period last year. Thus, lesser payments of refunds have boosted the growth of the net collection of sales tax domestic. Overall monthly collection has grown by around of 12% during first half of CFY. In respect of ST (D) and ST (M), the growths have been 17.8% and 5.3% during the same period. Table 11 presents details of collection of two components of sales tax imports and sales tax domestic.

Table 11 : Collection of Sales Tax during H1:2009-10

(Rs. Million)

Tax-Head	Net Collection		Growth	
	H1:09-10	H1:08-09	Absolute	%
Sales Tax Imports	109,277	103,732	5,545	5.3
Sales Tax Domestic	133,595	113,448	20,147	17.8
Sales Tax (Total)	**242872**	**217,180**	**25,692**	**11.8**

The low international prices of petroleum products during first 4 months in CFY as compared to high prices during corresponding period PFY, have vastly affected collection of sales tax on imports. The monthly growths trend has been presented in the Graph 5.



***Sales Tax (Domestic) Collection and Major Revenue Spinners*:**

The share of major ten commodities has come down to 89.3% in H1: CFY from 93.8% in the corresponding period last year mainly due to decline in the shares of top 2 revenues spinners i.e. petroleum products and telecommunication (Table 12). Contrary to this, the share of remaining major items except cigarettes has improved during the same period.

Table 12: Net Collection of GST (Domestic) from Major Revenue Spinners

(Rs. Million)

Commodities/Items	Net Collection			Share (%)	
	H1:09-10	H1:08-09	Growth (%)	H1:09-10	H1:08-09
POL Products	56,018	55,391	1.1	41.9	48.8
Telecom Services	21,701	24,412	-11.1	16.2	21.5
Natural Gas	10,196	7,232	41.0	7.6	6.4
Sugar	5,497	4,533	21.3	4.1	4.0
Cigarettes	4,444	4,012	10.8	3.3	3.5
Services	7,357	3,028	143.0	5.5	2.7
Electrical Energy	6,480	2,812	130.4	4.9	2.5
Beverages	3,505	2,212	58.5	2.6	1.9
Tea	1,958	1,318	48.6	1.5	1.2
Cement	2,161	1,492	44.8	1.6	1.3
Major Ten Commodities	**119,317**	**106,442**	**12.1**	**89.3**	**93.8**
Other	14,278	7,006	103.8	10.7	6.2
All Commodities	**133,595**	**113,448**	**17.8**	**100.0**	**100.0**

The petroleum is the top revenue generator of sales tax domestic. The overall collection of sales tax depends on the collection of petroleum products as it contributes more than 40%. The collection of petroleum products has reflected a low growth of only 1.1% during H1:09-10 mainly due to reduced prices of petroleum products in the first half year as compared to the corresponding period last year. The collection from telecom, second major source of sales tax domestic, has declined by 11.1%. A robust growth of 41% has been recorded in the collection of natural gas and its contribution in the overall sales tax domestic has increased from 6.4% in H1:08-09 to 7.6% in H1:09-10. This vibrant performance by natural gas is attributable to saving in payments of refunds of Rs.2.6 billion. Another important source of ST (D) revenue is the cigarettes, but collection increased only by 10.8%. Despite increase in the retail price of cigarettes, this growth seems quite low. A huge growth of around 130% was evinced by services mainly due to shifting of banking and insurance services from FED to sales tax coupled with increased rates from 10% to 16%. A significant growth in the collection from electrical energy is visible, which is due to increased rates of electricity during the current July-December 2009 as compared to corresponding period last year. The collection from sugar exhibited growth of 21.3% mainly due to increased prices. It is encouraging that the ST (D) collection from tea grew by 48.6% over the collection of previous year. On the other hand, the collection of cement has also improved by 41.8%.

Sales Tax Collection on Imports

The share of sales tax on imports in total sales tax has come down from 48% in the first half of 2008-09 to 45% in July-December, 2008. The collection of sales tax on imports grew by only 5.3% against decline of growth in the value of imports by 9.4%. The major reason behind this mismatch has been robust growth in the collection of motor spirit, furnace oil, oilseeds and sugar which has resulted in positive growth in the overall collection of sales tax imports despite decline in the overall imports.

Major Revenue Spinners of Sales Tax on Imports

Ten major revenue spinners contributed around 81% of the sales tax import collection during July-December 2009-10 (Table 13). Petroleum sector is the top revenue generation source of sales tax imports by contributing $2/5^{th}$ of the collection of sales tax on imports. Due to comparatively low prices of petroleum during H1 FY 2009-10: the growth in the collection of sales tax on import was hampered. As far as the collection of plastic, second major source is concerned; the collection grew by 6.5% mainly due to 4.4% growth in the value of imports.

Edible oil is (Ch:15) the third top source of sales tax imports with around 8% share in total (STM). The collection of sales tax on imports from edible oils recorded a negative growth of 5.1% in the collection due to 18.6% decline in the value of imports. Iron and steel sector (Ch: 72) has exhibited significant growth of 23% in the collection due to 4.1% growth in its imports. The auto sector(Ch: 87) has also exhibited 12.3% growth in the collection of sales tax imports due to increased imports by 19.9%. Despite decline of 17.2% in the imports of electrical machinery, the collection of sales tax has marginally improved. The collection of mechanical machinery (Ch: 84) has dropped by 6.3% mainly attributable to lesser imports by 20%. On the other hand, a sizable growth of 83.7% in the sales tax collection from oilseeds (Ch: 12) has been mainly due to 78.3% growth in its import.

Table 13: Sales Tax (M) from Ten Major Chapters during July-December: 09-10

(Rs. Million)

PCT Head	Commodity	H1: 09-10	H1: 08-09	Growth (%)	Share (%)
27	POL Products	43,526	43,028	1.2	39.8
39	Plastic	8,517	7,997	6.5	7.8
15	Edible oil	8,343	8,792	-5.1	7.6
72	Iron and Steel	7,208	5,835	23.5	6.6
87	Automobile	6,551	5,834	12.3	6.0
84	Mechanical Machinery	3,245	3,465	-6.3	3.0
85	Electrical Machinery	3,040	3,028	0.4	2.8
48	Paper and Paperboard	2,394	2,773	-13.6	2.2
29	Organic Chemicals	3,054	2,860	6.8	2.8
12	Oilseeds	2,212	1,204	83.7	2.0
	Sub Total	88,090	84,816	3.9	80.6
	Others	21,207	18,972	11.8	19.4
	Gross	109,297	103,788	5.3	100.0
	Refund	20	56	-64.3	
	Net	109,277	103,732	5.3	

Customs Duties: Customs duty is still one of the significant sources of collection of federal taxes. It constitutes 19.2% and 12.1% of the indirect taxes and all taxes respectively. The gross and net collection from CD during H1:09-10 has been Rs. 74.3 billion and Rs. 71.2 billion; respectively reflecting declines of 4.6% and 2.1% respectively. The decline in the collection is attributable to significant drop in the dutiable import by 10.8%. The refunds/rebates payments have exhibited a reduction of Rs. 2.1 billion.

Customs Duty from Major Revenue Spinners July-December 2009-10

It is evident from Table 14 below that 64.1% of the customs duty has been emanated from only 10 major commodities grouped in PCT Chapters. Out of ten major spinners of customs duty, only half of them reflected positive growth and only iron and steel products (CH: 72) has exhibited double digit positive growth in the collection of customs duty.

Automobile, the top revenue generator, has contributed 13.6% of the total customs duty during H1:09-10 and exhibited only 3% growth in the collection despite 13.3% growth in the dutiable imports. The major reason for this mismatch between growth of dutiable imports and customs has been 46% decline in the collection from vehicles for transport of goods (87.04) and almost no growth from motor cars (87.03) achieved despite its13.4% growths in dutiable imports.

Due to decline in the international prices of petroleum products in the first half of 2009-10 as compared to previous year has vastly affected the collection of customs during July-December, 2008-09. In fact, the collection of customs from petroleum has dropped significantly by 32.3% during H1:09-10 due to 29.2% decline in the dutiable imports. Moreover, the share of POL products has come down from 16.2% in H1:08-09 to only 11.5% in H1:09-10.

The collection of customs from the imports of edible oil (Ch: 15) has recorded only 3.3% growth. The major reason behind this low growth has been lesser imported quantity of crude palm oil by 22.6% during H1:2009-10 as compared to corresponding period last year. As far as mechanical machinery (Ch: 84 and electrical machinery (Ch: 85) is concerned, a significant reduction in the collection of customs duty by 29.5% and 37% respectively was observed. This was due to decline in the dutiable imports of 28.8% and 26.9% respectively during first half of CFY against PFY. A considerable growth of 17.2% was manifested by customs duty in Iron & Steel (Ch; 72) due to robust growth of 31% in the dutiable imports in the first half of CFY. On the other hand, the import of articles of iron and steel (Ch; 73) has dropped by 23.6%, resultantly; the collection of customs duty has also reduced by 12.6%. On the other hand, the collection from plastic (Ch; 39) has come down 5.8% against low growth of 4.6% in the dutiable imports.

Table 14 : Major Revenue Spinners of Customs Duties July-December

(Rs. Million)

PCT Chapter	Tariff Description	Collection of Customs Duties			Contribution in Customs Duties (%)	
		H1:09-10	H1:08-09	Growth (%)	H1:09-10	H1:08-09
87	Automobile	10,114	9,821	3.0	13.6	12.6
27	POL Products	8,524	12,590	-32.3	11.5	16.2
15	Edible oil	7,452	7,212	3.3	10.0	9.3
84	Mechanical Machinery	4,882	6,929	-29.5	6.6	8.9
85	Electrical Machinery	4,581	7,269	-37.0	6.2	9.3
72	Iron and Steel	3,378	2,882	17.2	4.5	3.7
39	Plastic	3,199	3,396	-5.8	4.3	4.4
48	Paper and Paperboard	2,377	2,339	17	3.2	3.0
29	Organic Chemicals	1,898	1,782	6.5	2.6	2.3
73	Articles of Iron & Steel	1,280	1,465	-12.6	1.7	1.9
Sub-total		**47,685**	**55,685**	**-14.4**	**64.1**	**71.5**
Others		26,657	22,250	19.8	35.9	28.5
Gross		**74,342**	**77,935**	**-4.6**	**100.0**	**100.0**
Refund/Rebate		**3,094**	**5,175**	**-40.2**		
Net		**71,248**	**72,760**	**-2.1**		

Federal Excise: The collection from federal excise duties has registered a growth of 5.8% during H1: 08-09. The net revenue stood at Rs. 56.7 billion against Rs. 53.6 billion during the corresponding period last year. This growth is significant as the banking services and insurance services have been shifted from FED to sales tax domestic in the Budget 2009-10. The collection of these two services has been included for July, 2009 in FED collection while the collection for remaining months of the first half of CFY has been included in the sales tax. Moreover, motor cars were also exempted from FED in the Budget has also affected the collection of FED.

The commodity-wise collection of major revenue spinners provides a comparison between H1: 09-10 against H1: 08-09 (Table 15). The share of six major items excluding SED has been around 82% during this period. A detailed analysis confirms that except cement all other major items have recorded a double-digit positive growth. The collection from cigarettes exhibited a growth of 18.6% mainly due to increased retail prices by upward adjustment in FED rates. Moreover, in spite of 16.3% growth in the production of cement and increased FED rates, the collection of cement has dropped by 9.4%. In case of beverages, the collection of FED from beverage has improved by 5.6% despite decline in its production by around 12%.

Table 15 : FED Collection from Major Commodities H1:09-10

(Rs. Million)

Commodities	Collection		Difference	
	H1: 09-10	H1: 08-09	Absolute	Percent
Cigarettes	18,346	15,471	2,876	18.6
Services	8,964	8,314	650	7.8
Cement	7,907	8,706	-1,898	-9.2
Natural Gas	3,028	2,993	34	1.2
POL Products	2,157	1,704	453	26.6
Beverages	5,900	5,588	312	5.6
1% SED	7,590	6,543	1,047	16.0
Sub Total	**53,892**	**49,319**	**4,573**	**9.3**
Others	2,763	4,239	-1,476	-34.8
Grand Total	**56,655**	**53,558**	**3,097**	**5.8**

As far as SED is concerned, it grew by 16% by collecting Rs. 7.6 billion as compared to Rs. 6.5 billion in the corresponding period last year.

Concluding Remarks

Despite economic slow down featuring low GDP growth, contraction in imports and load shedding, FBR has managed to achieve the target and marching towards annual target of Rs. 1380 billion. Since petroleum is the top contributor of the tax collection, the lower international prices in the current fiscal year especially in the first 4 months as compared to corresponding period of last year have vastly affected the collection of customs duty. Moreover, the change in the regime of advance tax payments on 15th of following month of the quarter instead of 15th of the last month of quarter has also affected the collection of direct taxes upto second quarter.

FBR has chalked out a comprehensive plan to collect additional revenue from the stuck up income tax arrears and enforcement measure to check leakages in Afghan Transit Trade (ATT). Similarly, Increased electricity prices, expected increase in the petroleum products and good prospects for imports of the automobile is expected to boost revenue in the second half of the year. Apart from these measures, effective audit and enforcement will be instrumental in raising revenue and increasing compliance.

II

Addressing Structural Weakness of the Taxation System- A Strategic Approach

By Umar Wahid[2]

The primary function of a tax system is to generate revenues for the government without hindering economic growth to meet its public expenditure. To achieve this objective the pre-requisite for a good taxation system is to follow the principles of equity, simplicity, progressivity and fairness. Pakistan taxation system is lacking these principles to a greater extent. Pakistan's tax collection has failed to improve since the late 1990s. Structural problems, such as a narrow tax base, tax evasion, distrust by the taxpayer of public institutions and administrative weaknesses, have all taken a toll on tax collection. The tax-to GDP ratio is stagnant rather declining for the last so many years. However, in FY: 2000-10 it expected to increase to 9.3 percent from 8.8 percent during FY: 2008-09 (Graph 1). In order to ensure adequate public funding for development priorities while safeguarding macroeconomic stability, the government has endorsed the objective to increase tax collection to 13-15 percent of GDP in the next five years. This commitment is linked with implementation of broad based Value Added Tax from the fiscal year 2010-11.

International experience shows that tax reform can deliver large increases in the tax-to-GDP ratio. While there are other developing countries at Pakistan's income level with similarly low tax-to-GDP ratios, countries in the region set a different example (Table 1). The simple average of the tax-to-GDP ratio in Bangladesh, India, and Sri Lanka – countries with similar tax policies and administration – is systematically higher than in Pakistan, and the gap increased during the present decade. Furthermore, countries like Malaysia, India Thailand, Turkey, and Sweden experienced rapid growth and rising tax ratios, while Pakistan saw tax collection rising just in line with economic growth while central government tax collection increased from 13.8 percent in 2000 to 16.5 percent in 2004 in Asian and Pacific countries, it remained roughly constant as a percent of GDP in Pakistan since the early 2000s[3].

[2] The author is Secretary (Strategic Planning and Statistics) FBR. The views/comments expressed in the article are the author's own point of view.

[3] Pakistan Tax Policy Report: Tapping Tax Base for Development. World Bank report No 50078-PK

Pakistan taxation system is having structural weakness like narrow tax base, low compliance, widespread exemptions, low coverage, and lack of audit and low tax efforts by the federation and provinces. Brief overview of these challenges is highlighted below:

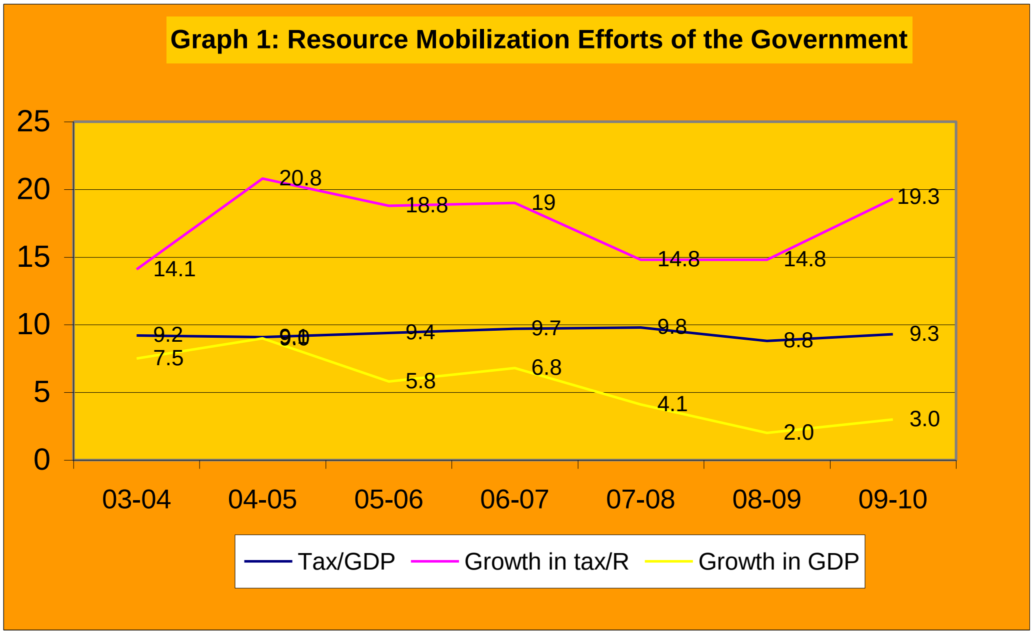
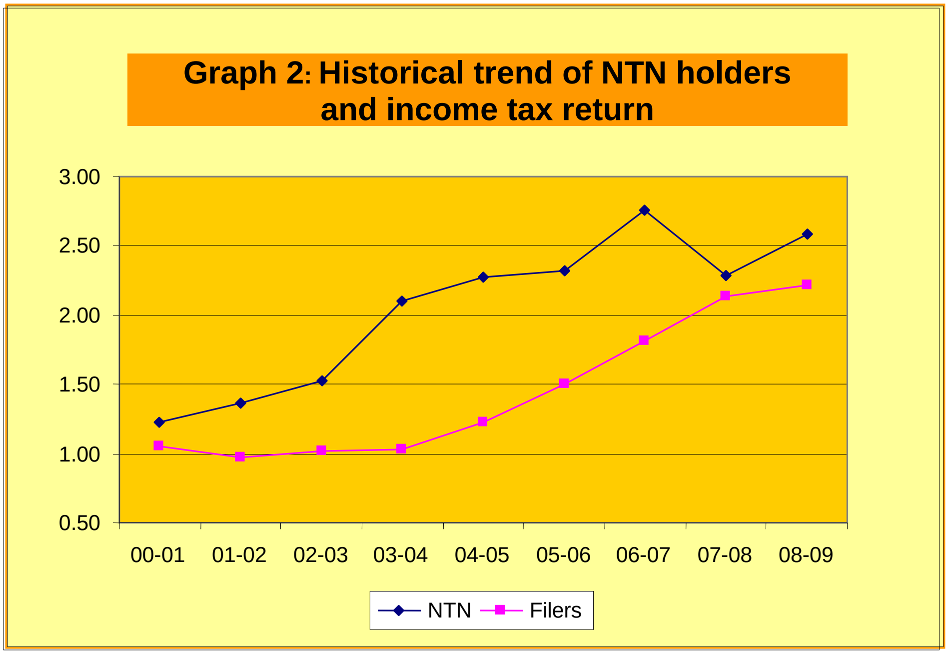


Table 1 Cross Country Comparison of TAX/GDP Ratio

Country	Ratio (%)
Bangladesh	8.1
Pakistan	**8.8**
India	11.7
Indonesia	12.3
Sri Lanka	14.0
Malaysia	17.6
Turkey	29.3
Australia	31.2
United Kingdom	36.0
Sweden	50.4

Narrow Base: There are, 2.75 million National Tax Number (NTN) holders in the country of 160 million people, which is only 1.6 percent of the population. Out of the NTN holders, the return filers are only 2 million (Graph 2). The compliance ratio has always been below. The share of taxpayers to population is low when compared with few selected developing and developed countries, where the share ranges between 4.7percent and 86.4percent[4]. For example, in India the share of taxpayers to population is 4.7percent, in Argentina 16.5 percent, France is around 58 percent and the same is over 80 percent in Canada. Despite this low share in comparison to population in Pakistan, the share of taxpayers belonging to non-corporate sector is close to 99% in the total returns filers. On the other hand, the corporate sector that contributes around 66% in the total income tax collection has a share of only 1% in income tax base.



Low Compliance: At present, there are over 50,000 companies registered with the Securities Exchange Commission of Pakistan (SECP), while NTN holders are with FBR around 24,000. The returns received were around 20,000. With such a low

[4] Umar Wahid article on Structure of direct taxes in Pakistan: FBR quarterly review 3:1 PP 21-31

compliance rate, the obvious outcome is the unsatisfactory level of the revenue realization. The tax-to-GDP ratio of income tax (including corporate income tax has remained hovering between 3% and 3.5%, which is in no way aligned with the resource mobilization efforts of the government. In fact, the ratio has started to decline in recent years, which is even worse. The gravity of the situation becomes even more pronounced, when an international comparison is drawn. Pakistan is far behind from the emerging economies[5] of East Asia like Malaysia, Indonesia, Thailand and Philippines where the ratio of income tax to GDP is 7 percent, 6.8 percent, 6.3 percent and 5.7 percent respectively. Therefore, there is serious need to expand the income tax base to bring currently untaxed corporate entities to the tax net.

On the other hand, under the sales tax regime with a wide legal domain of taxation, there are only 0.161 million number of Sales tax registrants. Out of these, 0.157 million are the domestic GST Payers and 0.043 million are importers. In the domestic GST category, wholesalers & retailers are 52,882, manufacturers 39,574, exporters 13,230, and service provider 12,689. The sales tax collection by volume of turnover indicates that over 88% of the Sales tax collection has been contributed by the businesses of more than 300 million rupees turnover. However, the rate of realization i.e., ratio of collection to turnover is maximum in case of businesses with less than one million rupees. The substantially large size of Null/Non filers constitute about 43% of the sales tax base and needs special examination to ascertain their potentiality. With the narrow sales tax base, the revenue collection in relative term is also low. The tax GDP ratio of GST is 3.5 percent at present, whereas in countries like Turkey, Indonesia, New Zealand and Thailand, the ratio is over 7 percent of GDP.

Low Coverage: An analysis on the relative strength of different components of GDP and their contribution to revenue is quite revealing. It is patently clear that growth in a number of sub-sectors does not correspond on one-to-one basis with growth in FBR revenue. For instance, the contribution of bumper crop of cotton is immense as far as value added in agriculture is concerned, but the revenue

[5] Article written by Umar Wahid on "The income tax regime in Pakistan" FBR quarterly review 4:4.pp 44-54

contribution of this source of GDP has been insignificant. The same has been true of transport, wholesale and retail trade, and many other sub-components of GDP.

Structural weaknesses of Pakistan's tax system heighten its vulnerability to the economic crisis. The revenue is raised in an inefficient way by favoring certain sectors and economic activities over others. This creates excess burden of taxation and can deter people from investing in the most productive sectors and earning more from the resources available. This ultimately gets in the way of economic growth. Some sectors are more heavily taxed compared to their contribution in terms of GDP than others. Agriculture contributes about one fifth of GDP, yet gives no more than 1 percent in FBR tax revenue. Services sector make up almost half of economic value added, but contribute only one quarter of central taxes due to the low tax receipts from wholesale, retail and transport sub-sectors. Given the shortfall in agriculture and services, industry carries the brunt of the tax burden – its tax share is three-times as high as its GDP share. In addition, there are question marks to what extent the tax system, through the way it treats different income classes of people differently, is sufficiently equitable. While some progress has been made, Pakistan's tax system remains complicated and mot taxpayers have little knowledge of their obligations.

Thus, to have any meaningful increase in revenues, there is a need for widening of tax base to sectors that are either outside the tax net or they are lightly taxed. Probably, it is about time to have a fresh review of the situation to have an even-handed treatment for every sector according to its tax paying capacity. It is important that equity and efficiency considerations continue to be the driving forces behind modernization of taxation system. For instance, the revenue productivity of sales tax is extremely low in Pakistan mainly due to low coverage and huge exemption.

Exemptions: Exemptions are made part of the tax system for a variety of reasons. Some (like the income tax threshold and GST exemption on basic foodstuffs) are granted to protect the most vulnerable groups of society from "onerous" taxes. Some (the GST threshold) are done for administrative reasons. Exemptions are also introduced to protect certain industries or provide for the development of infant industries. There are also political exemptions for segments of the economy like diplomats, top echelon of civil and military bureaucracy, and employees of international organizations. Specific temporary exemptions are also granted to address issues that arise from time to time. The exemptions granted for import of essential commodities to counter inflationary expectations are a good example of these temporary exemptions.

The estimated total cost of all of the exemptions that could be around Rs 200 billion, which comes to 3 percent of the GDP.

Threshold exemptions: Thresholds are another form of exemption allowed under various taxes. Below the income tax and GST threshold, a person or company is not liable for tax. A high GST threshold could lead to very low GST yields. A secondary market may develop for GST invoices available in the hands of small taxpayers who could not utilize the invoices for claiming GST input tax credit since they were below the threshold. The regular GST payers would have incentives to work out ways to avoid, or even evade the GST taxes by buying invoices in the market that do not relate to their own business activities, and taking input tax credit on their taxable output.

In case of Pakistan, the threshold is Rs. 200,000 ($2,410) for the individual income tax and Rs. 5,000,000 ($60,240) in turnover for the sales tax. The income tax threshold is about three times that of per capita income in Pakistan, so the threshold protects a large segment of the population from the income tax. The GST threshold is high. It is among the highest within Middle Eastern countries, for example Algeria, 45,000 euro, Egypt 25000 euro and Morocco 18,000 euro, and almost equivalent to that in OECD and other countries (ranges between 65,000 euro and 70,000 euro)[6]. If low income households in Pakistan largely purchase goods from retailers below the GST threshold, they may bear a smaller portion of the GST as well.

Table: 2 Thresholds for VAT in Middle Eastern Countries

Countries	Threshold (in Euros)
Algeria	43,000
Egypt	25,000
Jordan	90,000
Lebanon	90,000
Mauritania	45,000
Morocco	18,000
Pakistan	80,000
Sudan	21,000
Tunisia	70,000

Decision on the appropriate threshold needs to take into consideration the small business development strategy of the country and the actual capacity of its tax administration. It also means that the threshold must not necessarily be constant in the long run. With improving clarity and quality of tax policy and increasing capacity of tax administration the threshold should eventually be lowered and more taxpayers brought into the standard taxation system.

[6] Wahid Umar and Sally Wallace: Incidence of Taxes in Pakistan: Premier and Estimates

Table: 3 Thresholds for VAT in OECD Countries

Countries	Threshold (in Euros)
Austria	22,000
Finland	8,500
France	76,300
Germany	16,620
Greece	9,000
Ireland	51,000
Luxembourg	10,000
Poland	10,000

Provincial Taxes: Contribution of provincial taxes in the overall taxes collected is very low. While vesting the power to tax incomes on the Centre, presumably as a legacy of history, the Constitution excluded income from agriculture from the purview of the income tax, violating the canon of horizontal equity and opening up scope for evasion and litigation. Total collection of agriculture income tax is hardly Rs. 1 billion that is mostly from Punjab. Sindh makes an insignificant contribution, while Baluchistan and NWFP have no contribution at all. There is a probable estimate that in Punjab there is a potential of Rs. 6 billion a year. Provincial taxes yield no more than 0.4 percent of GDP, so that district and provincial governments depend on large fiscal transfers from the centre to meet their expenditure responsibilities.

Taxation on Services: Services sector has been growing at a faster rate as compared to other sectors of the economy. The share of services sector is increasing every year. Currently, services contribute 53 percent to the GDP. An increasing share in economy should mean that that the sector's share in revenue collection should also increase. However, the corresponding increase in revenue from services is around 33%, which is not taking place. One reason for this lopsidedness is that the issue of taxing the services has remained a controversial item between the

Federation and the Provinces; nevertheless, there is no dispute that a comprehensive attempt to tax this sector will have significant implications for the economy and federation-federating unit relation.

Bringing services into sales tax base may reduce the year to year volatility of sales tax collection. Expanding the taxation of services will make the sales tax fairer also. Sales tax is generally considered to be regressive; that is they absorb a large proportion of the income of lower income taxpayers than of higher income taxpayers. Thus, regressivity of sales tax can be reduced by expanding the sales tax to services purchased primarily by the affluent. Taxing services can also improve the allocation of economic resources. Moreover, the small tax base raises the effective rate, thereby intensifying administrative problems and inequities among the taxpayers. The efficiency of the tax system would therefore be compromised if services are not brought within the scope of tax base.

Audit: Lack of audit is the major cause of low resource mobilization in Pakistan. The tax system in Pakistan is operating mainly on self assessment basis. The system promotes voluntary – compliance, self-documentation, self-assessment, and self-policing Audit is the only tool having deterrence effect and instrument of control with the FBR through which compliance level of registered persons is monitored, whereby the government checks whether a registered person/ taxpayer has correctly determined his tax liability, deposited due tax to the government and is making adjustments of input tax etc to which he is legally entitled. Therefore, effective audit based on best international practice in needed.

Recommendations:

Pakistan’s need to look thoroughly at the available reform options, pursuing the twin track reforms of tax policy and tax administration would put the government in good stead to meet its medium-term revenue collection targets. Different studies conducted on Pakistan taxation system highlights that Pakistan has the potential to achieve the objective of increasing the tax to GDP ratio by 13-15 percent over the next five years. At the same time, in order to ensure healthy long-run economic development, Pakistan needs to embrace substantial changes in its tax policy. These should be aimed at increasing the buoyancy of the tax system, broadening the tax base, reducing distortion and phasing out exemptions. From the perspective efficiency, the primary role of taxation is in ensuring a level playing field for economic activities. From the equity side, it is in raising resources fairly to fund equitable public spending. Similarly, from the compliance side, it is in ensuring low costs of compliance (and large costs of non-compliance). It might meets the desired multiple objectives and follow the countries where prosperity flourish and the taxation system is based on best international practice like make the tax base as broad as possible; keep tax rates as low as possible; and Make compliance simple and non-compliance expensive.

Pakistan had made considerable progress in this direction. To broaden the tax base and ensure equity in the taxation system, a broad based Value Added Tax is proposed to be implemented in the country from FY: 2010-11. Value Added Tax could be considered as an efficient tool for documentation of the economy, widening of tax base and affective taxation mechanism leading to substantial increase in government revenue.

APPENDECES

III
Glossary of Fiscal Decentralization Terms

By Umar Wahid[7]

The purpose of compilation of glossary of fiscal de-centralization is to abreast the policy makers and general readers about the terms uses internationally in the reports and discussions. The glossary may not be new one for many readers, but to refresh their minds attempts has been made to retrieve the glossary terms from the valuable literature provided by the Andrew Young School of Policy Studies (AYSPS) Georgia State University Atlanta USA during a Workshop organized at AYSPS Atlanta on "Fiscal Decentralization Concept and Applications in DPR Lao, 3-7 March, 2008. The author was one of the participants in the said Workshop. The cooperation and support extended by the faculty of AYSPS is highly appreciated
*A comprehensive research paper on fiscal decentralization with special reference to Pakistan will be included in the next publication of FBR quarterly review***.**

Allocation Formula
A formula used in a formula-based grant system to distribute or allocate grant resources among different sub-national government jurisdictions. Also referred to as a horizontal allocation formula

Allocation factor
A measurable variable used as part of an allocation formula. *Sound allocation factors have a number of desirable statistical characteristics.*

Ability to pay principle
The principle that is order for a tax system to be considered fair, taxpayers should pay taxes in accordance with their ability to pay: those with greater ability should pay more. *Contrast with benefits principle.*

Ad valorem tax
A tax that is specified as a percentage of the value of the tax base. *For instance, a sales tax of 16% of the value of sales is an ad valorem tax. Contrasts with a nominal (specific) tax.*

Allocative efficiency
Resources are used in such a manner that firms produce the goods that are most desired by society. *See Efficiency.*

---
[7] Umar Wahid is Secretary (Strategic Planning & Statistics) FBR.

Area-based programs
Donor-funded development programs which target a specific regions or area. *Area-based programs often provide (sectoral or non-sectoral) capital development funding to local governments or communities in a region, along with providing capacity building support to local governments and/or community organizations.*

Avoidance
Tax avoidance encompasses legal actions that taxpayers take in order to reduce their tax burden. *Moving to a different local government in order to avoid high local property taxes is an example of tax avoidance. Contrast with evasion.*

Benefit principle
The principle that in order for a tax system to be considered fair, taxpayers who benefit from a publicly provided service should pay taxes roughly in proportion to the benefits received. *(See Benefits tax) Contrast with the ability to pay principle.*

Benefit Tax
A tax that adheres to the benefit principle in taxation. Common examples of sub-national benefits taxes include user fees, road tolls and property taxes. (See the benefits Principle)

Block grant
A block grant is an intergovernmental fiscal transfer that is non-matching in nature. *Lock grants may be unconditional, sectoral or earmarked grants. Contrast to Matching grant.*

Buoyancy
An indication of how revenue collections from a revenue source respond to changes in the economic base or tax base. *Buoyancy is typically measured as the percentage change in revenue that occurs as the result of a percentage change in the tax base.*

Cess
An Assessment, tax or levy collected by local authorities for local purposes. Also use to refer to a tax levied on a specific object (with a prefix to define the object of taxation). *Superseded in British English by the term "Rate"*

Club Good
Private (i.e., rival and excludable) goods and services that are provided by local governments because they can be provided more cost-effectively when produced for a group of residents instead of a single household. *For instance, a swimming pool is both excludable and (to some degree) rival, yet most households do not have*

a swimming pool of their own due to significant scale economies involved in building a private swimming pool. Buchanan (1965) argues that in many cases local governments simply function as clubs to provide certain desired local goods or services, and then collects user fees from households, are proxy user-fees in the form of local taxes.

Closed list (restrictive) approach to sub-national taxes.
All approach to sub-national taxation by which the central government enumerates an exclusive list of sub-national taxes that sub-national governments are allowed to collect. *Contrast with permissive (open list) approach.*

Compliance
The degree to which taxpayers comply with tax laws and regulations. *Often measured as a ratio of tax receipts to assessed tax liabilities.*

Compliance costs
The cost incurred by taxpayers in order to comply with tax regulations. Compliance costs include actual costs (i.e., the cost of a tax preparer) as well as the time costs for preparing a tax return.

Conditional grant
An intergovernmental fiscal transfer to which certain conditions are attached by the central government. *(Conditional grants range from highly conditional earmarked grant to much more permissive sectoral grants. Contrasts with Unconditional Grant*

Consumption taxes
Taxes imposed on the consumption of goods and services. *Examples of consumption taxes include general sales and use taxes, VAT, and excise taxes.*

Correspondence principle
The principle that a sound local tax should establish a link between the jurisdiction in which a tax is levied and the area in which the benefits are received from the local services funded with that revenue source. *Adherence to the correspondence principle gives local governments the right incentives to fund an optimal amount of locally provided goods (where marginal costs equal marginal benefits). Tax exporting is a practice that violates the correspondence principle.*

Deadweight loss
The value of the economic loss incurred as a result of the imposition of tax and the subsequent reductions in production and consumption. *Deadweight loss equals the sum of the reduction of consumer surplus and the reduction of producer surplus in excess of the amount of revenue generated with this tax.*

Decentralization
Decentralization is the empowerment of local communities by the empowerment of local governments. *De-concentration, delegation, and devolution provide progressively decentralized approaches to organizing the public sector. Decentralization can be divided into political decentralization; fiscal decentralization and administrative decentralization.*

Delegation
The process of shifting the responsibility of providing certain services from the central government to local government bodies that are not wholly controlled by the central government, but that are ultimately fully accountable to it. *Delegation requires local governments to be semi-autonomous (i.e. elected), but it does not give local governments substantive decision-making authority over how the service should be provided/produced. Local governments are used as agents to produce the government service, but in the end the central government is actually responsible for all facets of the provision of the service.*

De-concentration
The process of shifting decision-making power within the central government structure from central government officials in the capital to central government officials that is located outside the capital, at the local (or regional) level. *Although government services are produced by a (de-concentrated) local entity, all decision-making authority remains with the central government. There is no need to have elected local government authorities Compare with delegation and devolution.*

Derivation basis
Refers to the basis of where revenues are derived or collected. *For instance, if a revenue source is shared on a derivation basis, then the collections from this revenue are shared with sub-national jurisdictions in proportion to where these revenues were collected.*

Devolution
The process of assigning substantive responsibility for the delivery of a public good or service to a sub-national government level. *Either the central government could devolve the responsibility to provide a central government service to the local government level, or the central government could devolve responsibility over all aspects of a functional responsibility. (Also see expenditure assignment).*

Direct taxes
Originally denoted taxes whose burden is intended to be borne by the very subject who pays these taxes. In practice is used to denote taxes which are levied on permanent and recurring occasions (e.g., on income or property) regardless of the ultimate incidence of the burden. *Compare to indirect taxes.*

Distributive Efficiency
Goods are consumed by people who value them relatively the most. *See Efficiency.*

Double taxation
The instance in which two or more taxes are imposed on a common tax base. *For instance, the imposition if a federal income tax and a state-level income tax on the some tax base (household income) could be considered double-taxation.*

Earmarked grant
Am earmarked grant is a conditional intergovernmental fiscal transfer that is required to be spent on a specific program or for a specific purpose. (At times, earmarked grants are used to fund specific items such as a particular capital project)

Economic burden (economic incidence)
Economic incidence represents how the burden of a tax is ultimate distributed among tax payers (based on the change in the distribution of private real incomes). *Compare to legal (or statutory) burden.*

Earmarked grant
Am earmarked grant is a conditional intergovernmental fiscal transfer that is required to be spent on a specific program or for a specific purpose. (At times, earmarked grants are used to fund specific items such as a particular capital project)

Effective tax rate
Expresses the total tax liability as a percentage of actual tax base. Can be lower than the nominal tax rate due to exclusions, exemptions, and underassessment of the tax base. *Compare Tax Rate.*

Efficiency
Economic efficiency is achieved when a society produces the combination of outputs with the highest attainable total value to society, given its limited resources. For economic efficiency to be achieved, three separate notions of efficiency need to be satisfied; allocative efficiency, productive efficiency, and distributive efficiency.

Effort (Revenue Effort or Fiscal Effort)
The degree of effort with which a sub-national government pursues revenue collections, given the revenue instruments and tax bases that are available to it. *Typically measured as the ratio of collections to be underlying tax base. Also referred to as Revenue Performance.*

Equalization
Policy of the higher-level government aimed at equalizing capacities of sub-national governments to discharge functions assigned to them.

Equity
The principle that a tax system should be designed so as to be fair. Also see ability to pay *Principle; benefits principle; vertical equity, horizontal equity.*

Evasion
Tax evasion encompasses illegal actions that taxpayers take in order to reduce their tax burden. *Failure to register as a tax payer or the underreporting of income on tax declaration in order to avoid higher income taxes are examples of tax evasion. Contrast with avoidance.*

Excess burden
See Deadweight loss.

Excises
An excise tax is a duty levied on specific goods and services – usually luxuries and “sin” goods, such as alcohol, tobacco, gasoline, etcetera.

Expenditure assignment
The delineation of roles and functional responsibility among levels of government for regulating, financing, administering, and producing public goods and services

Expenditure incidence
The analysis of how benefits from a government expenditure program are distributed across different groups of the population, typically by income group.

Externalities
A situation in which a benefit or a cost results from a market transaction that affects a person or persons who are not part to the transaction. *Externalities can be either positive or negative; externalities can occur either in production (production externality) or in consumption (consumption externalities). Also see Inter-jurisdictional spillover.*

Fiscal capacity
Fiscal capacity reflects the ability of a jurisdiction to raise revenue for public spending. This capacity is determined both by the level of economic activity within the boundaries of the jurisdiction and the government's ability to translate this economic activity into public revenues. *The ability to transform the economic base into public revenues is determined with legally available taxing powers (such as authority to tap particular taxable bases or to set tax rates) and tax administration capacity.*

Fiscal decentralization
The empowerment of local communities by the fiscal empowerment of their local governments. *See Decentralization.*

Free rider
A situation in which someone benefits from a good or service without contributing to cost of providing of that good or service. *Free-riding can become a problem when a good or service is non-excludable.*

General-purpose local governments
A local government unit or jurisdiction that has a general mandate to provide numerous local government services; for instance, a county or municipality. *Contrast special-purpose local governments.*

Grant
See intergovernmental fiscal transfer.

Holding Harmless
A transitional measure sometimes put in place when introducing a new transfer scheme to assure that local governments who would receive fewer resources under the new transfer mechanism are (fully or partially) compensated for that loss.

Horizontal
Within the context of intergovernmental fiscal relations, referring to relations of interactions between different government units at the same level of government. *Contrast with vertical.*

Horizontal Equity
The principle that taxpayers in essentially equal positions should be treated equally by the tax system.

Horizontal fiscal balance
Horizontal fiscal balance refers to the existence of balance in fiscal needs and resources between different government units at the same level of government. Also referred to as regional or local fiscal inequity. *If the revenue assignment causes horizontal fiscal imbalance, this can be addressed through the transfer system.*

Income Taxes
Taxes imposed on the income of households and business firms. *Examples of income taxes include the personal income tax, the corporate income tax and may include local income taxes.*

Indirect taxes
Originally denoted taxes whose burden is expected or intended to be ultimately shifted to someone other than the subject who statutorily pays these taxes. In practice, this term is used to denote charges on occasional and particular events (e.g., consumption purchases, the import of goods, etc.) regardless of the ultimate incidence of the burden. *Compare to direct taxes.*

Intergovernmental fiscal relations
Intergovernmental fiscal relations relates to how different levels of government interact with each other on fiscal issues. *Intergovernmental fiscal relations comprise four broad dimensions, including expenditure assignments, revenue assignments, intergovernmental fiscal transfers and the framework for local government borrowing and debt.*

Intergovernmental fiscal transfer
A non-compulsory, non-repayable financial payments between government units; typically (although no always) from a higher-level government to a lower-level government unit. Usually intergovernmental fiscal transfers are aimed at achieving vertical fiscal balance, horizontal equalization, or other specific objectives of the payer.

Inter-jurisdictional spillover
A case in which costs or benefits from the provision of a sub-national good in one jurisdiction spill over onto neighboring jurisdictions, or onto the nation as a whole. *For instance, primary education causes inter-jurisdictional spillover, since the nation as a whole benefits from a more educated, productive workforce. Also see Externalities.*

Large Taxpayer Unit
Subdivision of tax administration dedicated to registration, taxpayer service provision, collections, tax accounting, and auditing of major contributors of government tax revenue.

Legal tax burden (legal incidence)
Indicates who is legally liable to pay a tax. *Compare to economic burden/incidence.*

Levy
The imposition or collection of an assessment. The term levy is frequently used to refer to a tax levied on a specific object, or to a revenue source collected for a specific purpose.

Local expenditure needs
Denotes the amount a locality must spend to obtain a standardized service quality for a standardized package of uniform service responsibilities.

Marginal tax rate
The rate at which the marginal increment (e.g., the last and the next dollar) of the taxable base is taxed. *Under a proportional tax, the marginal tax rate is constant. Under a progressive tax, the marginal tax rate increases as the tax base increases.*

Market fees
A type of user fee, typically paid by a seller of goods in order to sell his or her wares at a public market.

Matching grant
Intergovernmental transfer that matches at a predetermined rate every dollar of the recipient government's own funds allocated for a specific purpose.

Minimum access Conditions
Conditions that a sub-national government must fulfill in order to become eligible or to gain access to an intergovernmental transfer scheme.

Moral hazard
Moral hazard is a situation in which one of the parties to an agreement has an incentive after the agreement is made to act in a manner that brings additional benefits to himself of herself at the expense of the other party.

National Minimum Standards (for service delivery)
The minim level of service that the national government wishes to secure for all citizens regardless of where they reside. *Sometimes this National Minimum Standards are imposed on local governments, irrespective of whether they are affordable.*

Net Fiscal incidence
Analysis of the combined distributional effect of government expenditure programs and public revenue sources on the well-being of different groups of population, particularly difference income groups. *See Expenditure incidence and Revenue Incidence.*

Nominal (specific) tax
A tax or charge that is determined as a nominal or specific amount. *As opposed to an ad valorem tax.*

Non tax revenue
Government receipts that generally involves a quid pro quo (Latin; “this for that”) provided to the payer in exchange for the payment, such as a benefit, goods, or service. Non tax revenues include licenses, fees, charges, as well as other revenues, such as rent, sales of property, and interest, *In addition to these revenue sources, this category also includes fines that are compulsory and do no involve any benefits in exchange.*

Nuisance tax
A low-yielding tax for which the collection costs exceed the revenue yield of a tax. *Examples of typical nuisance taxes include taxes of fountain drinks, bowling, haircuts, movie tickets, dry cleaning, parking, and shoe repairs. A broader definition of the term defines a nuisance tax as a small excise tax levied on separate purchases and collected directly from the purchaser.*

Own source revenues
Indicates a revenue source over which a sub-national government has substantive control. Economists consider this to mean a tax a tax for which (a) the collections flow to the local level and (b) over which local government jurisdictions have

control over the marginal tax rate, either through policy discretion or through direction over its collection. *See Revenue assignment.*

Permissive (open list) approach to sub-national taxes.
Allows sub-national government to utilize any tax base which is not specifically barred or exclusively assigned to another level of government. *Contrast to the closed list approach.*

Phasing-in

A transitional measure sometimes put in place when introducing a new transfer scheme to assure that local governments that would receive a large increase in their resource allocation under the new transfer mechanism are gradually brought up to the new, higher level. *A common reason for phasing-in is to prevent absorption problems associated with sudden, large resource increases.*

Poll tax
A tax imposed on households at an identical rate or on the basis of the number of people or adults in the households. *Examples of poll taxes are "head taxes" or "hut taxes." Poll taxes are relatively simple to administer but tend to be highly regressive.*

Piggy-back tax
A tax that is legislated and collected by the central (or other higher-level) government as a surtax on a central government tax, while local governments are allowed to set the rate for the surtax and receive the proceeds from the sub-national surtax on a derivation basis. *Common forms of piggy-back taxes include piggy-back sales taxes and income taxes. As a result of the local control over the tax rate, a piggy-back tax is considered a local government revenue source.*

Presumptive taxes
A Presumptive tax (sometimes referred to as an "alternative minimum tax ") involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on taxpayer accounts. *The term "presumptive" is used to indicate that there is a legal presumption that the taxpayers 'income is no less than the amount resulting from application of the indirect method. This presumption may or may not be rebuttable. The concept covers a wide variety of alternative means for determining the tax base, ranging from methods of reconstructing income based on administrative practice, which can be rebutted by the taxpayer, to true minimum taxes with tax based specified in legislation.*

Private good
A good that is rival and excludable in nature, “Rival” means that a person cannot enjoy the benefits of a good without reducing the benefit received by others; “excludable’ means that a person can easily be excluded from enjoying the benefits of the goods. *Most regular consumption goods are private goods; for instance, consider food. The market mechanism is typically the most efficient mechanism to provide private goods. However, sometimes central or local governments provide private goods. See public goods; Club goods; publicly provided goods.*

Productive Efficiency
Goods are produced in the least costly way; opportunity costs in production are minimized. *See Efficiency.*

Property taxes
A type of tax for which the liability of the tax stems from ownership of assets. Usually the taxable assets are limited to “real Property” which included land, buildings, structures, and other improvements that are constructed on or in the land, attached to the land, or placed upon a foundation. However, in some countries taxable property extends to boats, vehicles, aircraft and even business inventories.

Proportional taxes
A tax that has the same liability as a percentage of taxpayer’s income or wealth regardless of the level of income or wealth. *Compare to progressive taxes and regressive taxes.*

Public good
A good that is non-rival and non-excludable. Non-rival means that a person can enjoy the benefits of a good without reducing the benefit received by others; excludable means that a person cannot be excluded (or prohibitively expensive to expensive to exclude him/her) from enjoying the benefits of the good. *Good examples of pure public goods are national defense and radio transmissions.*

Publicly Provided good
A good that is provided by the public sector (i.e. central government or sub-national government). *Publicly provided goods may either be public goods or private goods.*

Rate
British English: a local tax Not *used in American English; term causes potential confusion with the tax rate.*

Regressive taxes
A tax which requires lower-income taxpayers to pay a greater percentage of their income in tax than upper-income taxpayers. *Compare to progressive and proportional taxes.*

Residence basis
Refers to the jurisdiction in which the taxpayer resides. *For instance, if a revenue source is assigned on a residence basis, then the revenues from this source are collected by (or assigned to) the sub-national jurisdiction in which the taxpayer resides.*

Restrictive (closed list) approach to sub-national taxes.
An approach to revenue assignment that allows local governments to utilize only those revenue sources that are explicitly authorized by the national government

Revenue adequacy
The principle that a good revenue source should generate an adequate amount of revenue. *A number of different approaches can be used to consider what is relatively "adequate."*

Revenue assignment
A comprehensive definition of a revenue assignment considers which government level (1) legislates each tax; (2) defines the tax base (and exemptions); (3) determines the tax rate; (4) collects/administers the tax; (5) receives the revenues from the tax. *See Own source revenue*

Revenue autonomy
The extent of control that sub-national governments are able to exercise over the sources of their revenue. Revenue autonomy is determined by the local governments' discretion to determine taxable bases, determine rates, introduce the tax, or any combination of these three.

Revenue decentralization
The degree to which control over revenues is decentralization to sub-national governments. Typically measured as the ratio of sub-national revenues and total national revenues.

Revenue incidence
The analysis of how economic burden from a tax or another government revenue source is distributed across different groups of the populations, typically by income group.

Revenue neutrality
The concept that – in order to maintain the overall tax burden and fiscal balance-any reduction in one revenue sources should be offset by a proportional increase in another revenue source.

Revenue performance (or Fiscal performance)
See Effort.

Revenue sharing
Transfer of revenues generated at one level of governments to finance a portion of expenditures carried out by another level of government. Revenue sharing can be done on a derivation-basis based on a predetermined, uniform sharing rate; or on a formula basis. *Usually revenue sharing aims at rectifying the mismatch in the vertical division of expenditure responsibilities and revenue sources. When shared revenue sources are collected by the higher-level government, revenue sharing should be considered a type of intergovernmental transfer, since the sub-national government has no control over the tax rate, base or collection.*

Revenue yield
The amount of money generated by the application of a tax rate of set of rates to a tax base.

Scale economies
A situation in which the cost of producing a unit of a good or service declines as the scale of production (the number of units produced) is increased.

Scope economies
A situation in which the cost savings can be achieved in the production (or provision) of a good or service by combining the production (provision) of good with the production (provision) of another good. *Scope economies could make it more cost-effective for one general-purpose local government to provide several local government services, as opposed to having several separate special-purpose local governments.*

Sectoral grant
Intergovernmental transfer targeted toward funding activities in a particular sector of public services, such education, healthcare, etcetera.

Special-purpose local governments
A local government unit or jurisdiction that has a single or special purpose; for instance, local school districts or local water districts. *Contrast general-purpose local governments*.

Spillover effect
See Externali9ties.

Subsidiary principle
The principle holding that nothing should be done by a larger and more complex organization which can be done equally efficiently by a smaller and simpler organization. Recognized as a driving principle in the assignment of expenditure responsibilities. The principle is restated in the EU treaty to allow the Union to undertake an action "only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States".

Subvention
See Intergovernmental fiscal transfer.

Surtax / Sub-national Surtax
See Piggy-back tax.

Tax
An involuntary payment to a government (by households and business firms) that does not involve a *quid pro quo (*Latin; "this for that") benefit. *Common categories of taxes include income taxes, consumption taxes, property taxes and transaction taxes. Tax instruments can be regressive, proportional or progressive.*

Tax base
Collective value of assets and activities that are subject to a tax,

Tax exporting
Shifting of a tax burden to non-residents of a given jurisdiction. *For instance, a local sales tax allows a locality to export the burden of the tax to the extent the tax is borne by residents from other localities who do not necessarily benefit from the public services in the locality.*

Tax coverage
The share of the potential taxpayers in a universe that are covered by a tax instrument. *For instance, x% of households in the United States are subject to the personal income Tax.*

Tax rate
The ratio, scale, or standard at which a tax liability is determined in relation to the tax base. *Compare with Effective Tax Rate.*

Tie bout by hypothesis
A hypothesis set forth by Charles. Tie bout that, under a number of assumptions about household mobility and local government structure, local governments

provide a mechanism for households to reveal their demand for local government services and for local government to provide these services in an efficient manner, just as competition leads to efficiency in the private sector.

Transaction taxes
A type of tax for which the liability of the tax stems from a specific transaction, such as the sale of property assets, or the import or export of a good or service.

Transfer
See Intergovernmental fiscal transfers.

Turnover taxes
A tax imposed on business firms on the basis of the firm's turnover (sales revenue). *Turnover taxes are often considered to be inefficient-particularly in developed economies – because they can have a cascading or "snowballing" effect as each stage of production is fully taxed.*

Unconditional Grant
An intergovernmental transfer provided without any specific conditions attached. *Contrast with conditional grant.*

Value-Added Tax (VAT)
A tax imposed on business firms on the basis of the value added by the firm. *Value-added taxes avoid the cascading effect of turnover taxes.*

Vertical
Within the context of intergovernmental fiscal relations, referring to relations or interactions between different levels of government. *Contrast with horizontal.*

Vertical allocation rule (vertical allocation formula)
A formula or budget rule or practice that determines how a transfer pool or a shared revenue source is shared vertically between different government levels.

Vertical equity
Vertical equity means that those with limited ability to pay should be treated more favorably by the tax system relative to those with a greater ability to pay. *Note that this does not necessarily mean that a tax should be progressive in order to be vertically equitable.*

Vertical fiscal balance
Balance that exists when there is a broad correspondence between the aggregate revenue sources assigned to *each level of government* and relative expenditure responsibilities of each government level. Vertical fiscal imbalance results when

one government level receives a disproportionate amount of revenue sources compared to its expenditure responsibilities and this imbalance is not corrected through the transfer system.

Withholding tax

A tax which is deducted or withheld at source (for instance, from wages, pension, dividends, or other sources of income) before it is paid to the person entitled to receive the payment. *Introduction of a withholding tax can be justified by administrative convenience (for instance, there are fewer employers than employees), political considerations (it makes a tax less visible and therefore more politically palatable) or compliance considerations (e.g., facilitates reaching foreign beneficiaries)*

Yield

See Revenue yield.

IV

The concept of Tax Buoyancy and Tax Elasticity[8]

As GDP increases, do the tax revenue rise at the same pace? To answer this question it is useful to measure the buoyancy and elasticity.

Tax Buoyancy:

TB= %▲in Revenue / %▲in base

Tax Elasticity:

TE= %▲in Revenue / %▲in base

If we look at the formula it is the same, but calculating methodology is different. In Tax buoyancy additional factors are not taken into account like, change in tax rate, tax base, tax administration, where as in elasticity calculation there is a crucial difference, revenue, is calculated as it would have been if there had not been any change in the tax rates, tax administration and tax base.

The main use of tax elasticity is to identify which tax is naturally elastic-i.e. which tax will yield more revenue as GDP rises, even if the rates are not changed from year on year basis. Elastic taxes are generally considered to be desirable, because they reduce the need to tinker with the tax system.

Calculation example:

Suppose in 2007-08 excise duty on beverages was Rs 1 per bottle and total 1.3 million bottles were sold. The revenue collection was Rs 1.3 Million. (1*1.3)

In 2008-09 the rate of excise was increased to Rs1.2 per bottle and sales also increased to 1.4 million bottles. Revenue realization was Rs 1.7 million (1.2*1.4). The real GDP stabilize at **2.5%** and inflation at 15%. Calculate TB and TE.

Tax buoyancy:

Revenue in 2007-08 was Rs 1.3 Million. Revenue in 2008-09 (After adjustment of inflation) was Rs 1.47million (1.7/1.15). So real increase was **13.1%** (1.47/1.3)

---

[8] This note has been prepared by Umar Wahid for understanding the concept and calculation of tax elasticity and tax buoyancy. A comprehensive paper on the subject will be presented in the coming issues of FBR quarterly reviews.

Buoyancy = %▲in Revenue / %▲in base (13.1% change in tax revenue and 2.5% in GDP) TB= **5.2**

Tax Elasticity:

In this case the increase in tax revenue is due to both factors, higher sales of bottles and change in tax rate. If the rate would have not been changed the revenue would have been Rs 1.4 million instead of Rs 1.7 million (rate per bottle= Rs1*1.4 million sales). Revenue reduction by **17.6%** (1.4/1.7)

Elasticity = %▲in Revenue / %▲in base (**-**17.6% change in tax revenue and 2.5% in GDP)**TE= -7.04**

This indicates that if the rate had not been changed, then real revenue would have fallen between 2007-08 and 2008-09 despite the increase in GDP. Negative tax elasticity is not unusual where taxes are specific (rather than ad val) and also where there is a significant level of inflation.

Moreover, it is not wise to pay too much attention to the tax elasticity between two years. One needs to consider the measures over a longer period of time- at least 10 years.