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A Review of Resource Mobilization Efforts of Federal Board of Revenue

FEDERAL BOARD OF REVENUE
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Strategic Planning and Research & Statistics Wing, FBR

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

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Abbreviations

AOPs	Association of Persons
ATT	Air Travel Tax
BPR	Business Process Reengineering
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
NTN	National Tax Number
PCT	Pakistan Customs Tariff
PFY	Previous Fiscal Year
Q1CFY	Quarter 1 Current Fiscal Year
Q1PFY	Quarter 1 Previous Fiscal Year
RTO	Regional Tax Office
STARR	Sales Tax Automated Refund Repository
STD	Sales Tax Domestic
STM	Sales Tax Import
TARP	Tax Administration Reform Project
USAS	Universal Self-Assessment Scheme
VP	Voluntary Payments
VAT	Value Added Tax
WHT	Withholding Taxes

Foreword

The FBR Quarterly Review is a regular publication and a prime source of multifaceted analysis carried out on the four taxes administered by FBR. The current issue contains detailed analysis on the resource mobilization efforts of FBR and its other important achievements during the first quarter of FY: 2009-10. FBR has made considerable progress in the areas of broadening of tax base, liquidation of refunds and enforcement, which has been highlighted in the review. The publication also includes two research articles on "How to Improve Resource Mobilization- Revisiting the Tax Policy Options" and "Efficiency of the GST in Pakistan". An update on the current FBR reforms initiative pertaining to audit activities is also part of the current issue.

Let me take this opportunity to appreciate the efforts of the research team of the Strategic Planning and Research & Statistics Wing, FBR for their research endeavors that are very helpful in policy formulation and its implementation. I hope this research will also cater to the needs of wide array of FBR stakeholders.

We look forward to receiving comments and suggestions from our valued readers for improvement of the future issues of the FBR Quarterly Reviews.

Sohail Ahmad
Chairman FBR

December, 2009

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FBR Tax Collection: An Analysis of Q1: 09-10 Outturn[1]

The Economy

Pakistan economy is slowly but surely coming out of the vicious circle, still challenges both at national and international fronts are there, the economic growth has been anemic and the imminent outlook for economic activity, especially manufacturing, remains weak. But, despite the challenges of the global downturn and an extraordinarily difficult security situation, the government has managed to stabilize the economy to some extent. The country's economy has now taken a positive turn as the economic indicators have gradually improved during first quarter of the current fiscal year. The large scale manufacturing sector has indicated a growth of 0.6% during the first quarter of CFY, as against (-) 4.7% last year, this itself is a significant improvement. Not only the country's foreign exchange reserves have now reached to $14.4 billion but the other indicators have also shown considerable positive growth during the period under review. The inflation has dropped to 10.7 per cent, after touching an all-time high of over 25 per cent in the comparable period of last year.

Despite a significant decline in imports, higher workers' remittances, and support from the International agencies, like the International Monitoring Fund, the World Bank and other friendly countries, Pakistan's external current account position has improved. The current account deficit is estimated to have declined by more than $3 billion during the first three months of the year 2009-10. With government intervention in setting 'Strategic Trade Policy framework 2009-12, to increase the export by 6 per cent during the current fiscal year, 10 per cent in the next fiscal year and 13 percent during the year 2011-12, the trade balance is expected to improve further.

[1] The Research Team of the Strategic Planning and Statistics Wing of FBR has prepared this Chapter.

On the fiscal front, considerable efforts have been made to keep the budget deficit at 4.9 percent of GDP, for which revenue generation is the key agenda item of the government. The viable tax administration reform program is actively perused by FBR, with the objectives to have a credible tax reform to ensure fiscal sustainability and to create fiscal space for increasing the social safety net, and increasing investment in human and physical capital. Moreover, in order to broaden the tax base and to correct the structural shortcomings in Pakistan's tax system and particularly to ensure horizontal equity in the taxation system, a broad-based Value Added Tax (VAT) is being implemented in the country. Besides, the Federal Board of Revenue has chalked out a feasible audit plan and withholding tax plan to check the revenue leakages. It is expected that with the implementation of these and similar other initiatives, the resource mobilization efforts will get a momentum in the coming months.

FBR Revenue Target for FY: 09-10

Keeping in view the gradual upswing of the economy, the revenue target for FY: 09-10 was budgeted at Rs. 1,380 billion that required 19.3% growth over last year's collection of Rs. 1157 billion (Table 1). Since it was natural to assume that autonomous growth in tax base will not be sufficient to generate alone the additional revenue of Rs. 223 billion, certain budgetary measures were also introduced essentially to cover those areas that had escaped tax net for various reasons. For example, tax net has been extended to services provided by import cargo handlers and stock brokers and rate of tax adjustment for banking companies and insurance companies. Similarly, minimum tax under section 113 has been revived and rate of CVT on property has also been enhanced. The combined impact of these changes would largely be on the collection of federal excise duties and direct taxes, as most of the new policy interventions relate to these two taxes. However, notwithstanding these changes, the share of sales tax in total FBR collection is expected to remain over 36% -- the level slightly below the achievement during FY: 8-09. The remaining amount is projected to be fetched through direct taxes, FED and Customs. Of this, the net collection of direct taxes would be around 41%, followed by customs duties with a share of 11.8%, and the rest will be contributed by FED.

Table 1: Baseline Collection FY: 08-09 viz-a-viz Projections for FY: 09-10

(Rs. Billion)

Tax Heads	Collection FY: 08-09	Projections FY: 09-10	Growth (%)
Direct Taxes	440.3	565.6	28.4
Sales Tax	452.3	499.6	10.5
Federal Excise	116.0	152.8	31.7
Customs Duties	148.4	162.2	9.3
All Taxes	1157.0	1380.0	19.3

FBR Revenue Position

It is highly encouraging that despite all economic odds like slow growth in GDP and substantial decline of 48% in the average price of HSD together with energy crisis etc, FBR has achieved the revenue target to the extent of 98% in the first quarter of CFY. The net collection during first quarter of FY: 2009-10 has been Rs.263.6 billion against Rs. 262.1 billion in the corresponding period of last year (Table 2). The collection grew by only 0.6% during Q1: CFY. The major reason for this low growth in the tax collection is the decline in petroleum prices; drop in imports & dutiable imports, change of advance tax regime in CFY and less than expected collection from budgetary measures announced in the Budget FY: 09-10.

Table 2: Collection during Q1: 09-10 Vs. Q1: 08-09

(Rs. Billion)

	Collection Q1: 09-10	Collection Q1: 08-09	Growth (Absolute)	Growth (Percent)
Direct Taxes	85.2	88.2	-3.0	-3.5
Sales Tax	117.1	110.2	6.9	6.2
Federal Excise	28.4	25.5	2.9	11.5
Customs Duties	33.1	38.2	-5.1	-13.4
All Taxes	**263.6**	**262.1**	**1.5**	**0.6**

Federal excise and sales tax have exhibited growths of 11.5% and 6.2% respectively during Q1:09-10 as compared to previous year. On other hand, the collections of direct taxes and customs duty have recorded negative growths of 3.5% and 13.4% during July-September, 2009-10. The decline in direct taxes is technical in nature, as an amount of Rs 22 billion of advance tax has spilled over to October on account of changes introduced in current federal budget. Had this amount been added in September 2009 as in the case of last year's the collection would have been much higher and FBR would have surpassed the quarterly target by a wide margin. As far as Customs duty is concerned, there has been considerable decline in the value of import of major items, like POL, automobiles, chemicals and edible oils etc.

Analysis of Refunds/Rebates

With focused attention on liquidating all pending refunds and timely issuance of current claims, the incidence of refund claims has increased during the current fiscal year (CFY). This is evident from the information provided in Table 3. Approaching the issue in a holistic manner it is clear that there has been 1.9% declined in these payments. The reason is that, as a policy, refund arrears related to the banking sector stuck up for many years have largely been cleared. Similarly, to clear the large backlog, the sales tax pendency is also being liquidated promptly but will take more effort to completely clear the deck. Finally, in the case of customs duty, the rebate claims are declining as compared to past years due to reduced volume of international trade transactions and introduction of the zero-rate slab.

Table 3: Comparative Position of Refunds/ Rebates Payments: Q1: 09-10 - Q1: 08-09

(Rs. Billion)

	Refunds/ Rebates		Difference	
	Q1: 09-10	Q1: 08-09	Absolute	Growth (%)
Direct Taxes	9.0	5.8	3.2	54.6
Sales Tax	6.2	8.1	-1.9	-22.6
Federal Excise	0.0	0.0	0.0	0.0
Customs	1.7	3.4	-1.7	-50.2
All Taxes	**16.9**	**17.3**	**0.4**	**-1.9**

Detailed Analysis of Individual Taxes

A detailed analysis of collection of individual taxes in relation to the economy is important for deeper understanding. This is also relevant because each year new budgetary measures are introduce to boost revenue, promote investment, and facilitate taxpayers for improved voluntary compliance and there is a need to review this position.

Direct Taxes:

The gross, refund and net collection of direct taxes during the 1st quarter of CFY has been Rs. 94.2 billion, Rs. 9 billion and Rs. 85.2 billion, against Rs. 94.1 billion, Rs. 5.8 billion and Rs. 88.2 billion respectively, in the comparable period of PFY, indicating a growth of 0.1% in gross and 3.5% decline in net term (Table 4). As indicated, there has been a positive growth of 54.6% in DT related refund payments. The reason of negative growth 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 September to of 15th of the following month. Thus, the advance tax installment due for the period September, 2009 has been paid in October. Had the Rs 22 billion advance tax of 1st quarter not been spilled over to October, the collection of direct taxes would have been Rs. 107.2 billion and growth by 21.5% over PFY. However, on the negative side the assigned target of Rs.91.3 billion fixed for 1st quarter of CFY has been missed by a margin of Rs. 6.7 billion.

Table 4: Direct Taxes Collection

(Rs. in Million)

Heads	Collection during Quarter-1		Growth (%)
	FY: 09-10	FY:08-09	
Gross	94,207	94,079	0.1
Refund	9,033	5,844	54.6
Net	85,174	88,235	-3.5

Components of Income and Corporate Taxes:

Of three major components of direct taxes namely; collection on demand (CoD), voluntary payments (VP) and withholding taxes (WHT), 67% of gross income tax is contributed by the WHT, followed by VP having 21.2% share in total; and 11.8% is contributed by CoD. In general, the performance of these sources of revenue has been almost consistent with the overall state of the economy. The WHT has registered a sizable growth of 18.9%, CoD has yielded a gain of Rs. 1.9 billion – the outturn has almost doubled the amount that was projected under this head. Similarly, other direct taxes (including WWF, CVT etc.) have also registered a substantial growth of 57%. However, the voluntary payment has registered a negative growth of 38.7% during the 1st quarter of CFY, mainly due to change introduced in advance tax payment system. Now from CFY the quarterly advance tax is now to be paid by 15th of the following month. For example the advance tax due at the end of first quarter in to be paid by 15th October. The system will continue till the third quarter. To avoid spillover in June, the advance tax of the fourth quarter is to be realized by end June. Thus one to one comparison of advance tax can not be made due to obvious reason. On the other hand the other component of voluntary compliance is payment with return, where substantial growth of 79.3 % has been recorded. A detailed analysis of three components is presented below.

Collection on Demand (CoD): The collection on account of demand creation has increased during the 1st quarter of CFY by 21.0%. Of the two components of CoD, the collection under arrear demand has significantly increased by 120.8% over the PFY. This growth is mainly due to tax drive initiatives by the income tax department against tax defaulters and partially due to the disposal of the 'Brought Forward' cases. The second component, i.e., current demand has yielded a negative growth of 28.8% over the corresponding period of PFY. It is expected to receive a boost during the 2nd quarter of the year when initial assessment of the returns will be completed and cases will be ripe for audit/ assessment through random selection criteria.

Box 1

Revival of minimum tax u/s 113

Before deletion of Section 113 through Finance Act 2008. a resident company not required to pay income tax due to loss, exemption from tax under the Second Schedule or other provisions of Income Tax Ordinance, or where tax payable was less than 0.5% of the turnover, was required to pay minimum tax @ 0.5% of its declared turnover.

This provision was deleted mainly for the reasons that revenue collection reported at Rs. 125 million was insignificant. Subsequently, it was found that the collection under section 113 was mainly reported as advance tax under section 147 and the tax paid along with return under Section 137 of the Ordinance. As per information last year's actual collection amounted to Rs. 5.3 billion.

Due to deletion of Section 113 the advance tax collection during the current year has badly been affected. Considering the substantial revenue loss the provisions of Section 113 of the Ordinance has been revived from current fiscal year.

Voluntary Payments: VP comprises of payments with returns and advance tax payments on the basis of self-assessed expected income within the PAYE regime. On the whole, Rs. 19.5 billion has been generated during the 1st quarter of CFY on account of VP as compared to Rs. 31.8 billion in the corresponding period of last year. Thus, there has been a decline in growth by 38.7%, which is mainly due to decline in advance payment. The obvious reason is the change introduced in the advance tax payment system as explained. On the other hand, the second component i.e., payment with returns has registered a healthy growth of 79.3% over PFY, reflecting confidence building of the taxpayers and the campaign drive of FBR to go against the non-filers.

Box 2

Turnover to be taken into account for working out Advance Tax in the case of a company and AOP.

Previously while working out advance tax liability under section 147 of the Income Tax Ordinance, 2001, turnover was to be taken into account for determination of advance tax liability. However, a formula was devised by the Finance Act, 2004 whereby turnover was not to be considered for the purposes of determination of the advance tax. It is felt that due to amendment made through Finance Act, 2004, the revenue collection has adversely effected. On the recommendation of the Economic Advisory Committee the old provisions of law has been restored. The original provision of sub-section (4) of section 147 of Income Tax ordinance, 2001 will give boost to the revenue collection under the head during the next tax year.

Withholding Taxes: This component has been the major contributor of the income tax gross collection. As indicated, the share of WHT in gross collection has gone up to 67% in Q1: 09-10 from 56% in Q1: 08-09 mainly due to lower collection from advance tax in CFY against PFY.

Box 3

Enhancement of Withholding Tax Rate on imports from 2% to 4%

During 2008-09 withholding tax was collected at a uniform rate of 2% from commercial as well as manufacturer importers. The rate of withholding was 5% which was final tax in respect of commercial importers and adjustable in the case of manufacturers importing goods for their own use.

It was felt that 2% rate on importers was very low because reduction in withholding tax rate from 5% to 2% had not made any significant reduction in prices for the end users. Therefore, the rate of WHT has been enhanced to 4% for all categories of importers which would be minimum tax for commercial importers and adjustable in the case of manufacturer. This measure would be helpful in discouraging imports which will substantially bring improvement in balance of payment.

Within WHT, the major share in the collection has been from major sources, namely, contracts/supplies (29.3%), imports (16.8%), salary (11.6%), telephone (8.3%), exports (6.0%) and bank interest/ securities (6.6%). Among these sources, significant growth of 111.1% in collection has been recorded in electricity bill, mainly due to increase in the electricity tariff. Similarly, more than 30% growth was recorded in WHT on imports due to upward revision of rate of WHT from 2% to 4%. Similarly, 32.6% growth in the collection was made in salaries. The reason of higher growth in the collection from salaries has been due to increase in the pay package of the government and autonomous organizations in June 2009. Growths of 44.3% and 27.2% were also recorded in case of bank interest and cash withdrawals respectively (Table 5). The bank interest rate has been increased by the government during the period under review.

Table 5: A comparative Position of Withholding Taxes

(Rs. Million)

Tax Heads	Q1: 09-10	Q1: 08-09	Difference	Growth (%)
Contracts/ Supplies	18,063	17,169	894	5.2
Imports	10,366	7,961	2,405	30.2
Salary	7,132	5,379	1753	32.6
Exports	3,675	3,606	69	1.9
Telephone use	5133	4,948	185	3.7
Electricity use	3,365	1,594	1,771	111.1
Bank Interest/Securities	4,073	2,822	1,251	44.3
Cash withdrawal	2,832	2,226	606	27.2
Dividends	1,311	1,566	-255	-16.3
Sub-Total	55,950	47,271	8,679	18.4
Other WHT	5,603	4,478	1,125	25.1
Total WHT	**61,553**	**51,749**	**9,804**	**18.9**
Share in Gross	67.0%	56.0%		

Analysis of Income Tax Returns/Statements (2009 VS 2008 Upto 20th October)

The number of returns/statements has exhibited a remarkable growth of 19.5 % while tax paid has gone up by 58.1% (Table 6). The details of the returns and statements are highlighted below:

- A total of 1,282,118 returns and statements have been received from companies, association of persons (AOPs), salaried and non-salaried individuals; importers, exporters, and contractors etc. Number of all type of returns has reflected remarkably growth and accordingly, their collection has also exhibited substantial growth.

- A further analysis confirms that 96% of income and corporate tax has been received with returns during FY 09-10 and the rest is deposited with the statements.

- It is encouraging that all the returns have exhibited robust growth not only in the number of return but also in tax payments.

- A decline of 2.1% in the submission of statements has been recorded but their tax payments have increased enormously.

Table 6: Income Tax Returns and Tax Collection during 2009 and 2008

(Tax paid in Million)

	Returns/Statements		Tax Paid		Growth (%)	
	FY:09-10	**FY:08-09**	**FY:09-10**	**FY:08-09**	**Number**	**Tax Paid**
Returns						
Corporate Cases	1048	352	2387.23	1813.60	197.7	31.6
AOPs	18923	10577	57.50	54.80	78.9	4.9
Salaried Individuals	89578	65031	142.21	60.00	37.7	137.0
Non-Salaried Individuals	433037	241294	1228.91	498.21	79.5	146.7
Sub Total Returns	**542586**	**317254**	**3815.85**	**2426.61**	**71.0**	**57.3**
Statements						
Salary certificates/statements	16694	10617	3.23	2.81	57.2	14.9
No of employees in the statement	660767	705539	-	-	-6.3	-
Importers	5096	8354	0.02	0.176	-39.0	-88.6
Exporters	6549	4317	0.24	0.04	51.7	500.0
Retailers up to 5m turnover	10578	7218	43.92	41.45	46.6	6.0
Above 5m turnover	198	125	4.86	3.05	58.4	59.3
Contractors/ Suppliers	14055	10162	7.1	1.24	38.3	472.6
Other	25595	9157	86.99	31.27	179.5	178.2
Sub Total Statements	**739532**	**755489**	**146.36**	**80.03**	**-2.1**	**82.9**
Total	**1282118**	**1072743**	**3962.21**	**2506.64**	**19.5**	**58.1**

Upto 20th October, 2009 and 2008.

Sales Tax: The sales tax (GST) is one of the leading sources of federal tax revenues by contributing 44.4% of the total taxes during first quarter of FY: 2009-10. The gross and net collection of sales tax has been Rs.123.3 billion and Rs. 117.1 billion showing a growth of 4.2% and 6.2% respectively over the corresponding period last year. The collection has missed the target of Rs. 119.1

billion fixed for the first quarter of FY: 09-10 by Rs. 2 billion. It has two components (i) sales tax imports and (ii) sales tax domestic. The share of sales tax at imports in the total sale tax collection has dropped to 44.5% during July-September, 2009-10 from 50.5% corresponding period of previous year. The main reason for this has been due to decline in imports and vibrant performance by the domestic sales tax. The component-wise sales tax collection is presented in the following (Table 7).

Table 7: Collection of Sales Tax during July-September: FY: 09-10

(Rs. Million)

Tax-Head	Collection Quarter 1			Growth (%)		
	Gross	Refund	Net	Gross	Refund	Net
Sales Tax Imports	52126	6	52120	-6.6	-88.9	-6.5
Sales Tax Domestic	71173	6236	64937	13.9	-22.2	19.2
Sales Tax (Total)	**123,300**	**6,242**	**117,058**	**4.2**	**-22.6**	**6.2**

Sales Tax (Domestic) Collection: The gross collection of sales tax (domestic) has been Rs. 71.2 billion and net at Rs. 64.9 billion respectively during July-September, 2009 showing growths of 13.9% and 19.2% respectively.

The sales tax collection from ten major commodities continued to contribute a major proportion i.e. 90.4%, in overall sales tax domestic collection. These include petroleum, telecommunication, natural gas, sugar, electrical energy, cigarettes, services, beverages, cement and motor cars.

Sectoral Analysis: The collection from petroleum products has recorded a negative growth of 0.2% as compared to collection of same period last year. The main reason for reduction in collection has been the significant decline in the prices of petroleum products in the first quarter of CFY against the corresponding period last year (Table 8).

Table 8: Sector-Wise Net Collection of Sales Tax Domestic

(Rs. Million)

PCT Ch.	Sectors	July-September FY:09-10	FY:08-09	Growth
1	POL Products	26,720	26762	-0.2
2	Telecom	10,888	10440	4.3
3	Natural Gas	5,207	2354	121.2
4	Sugar	3,788	2259	67.7
5	Electrical Energy	3,318	1733	91.5
6	Services	2,911	1511	92.6
7	Cigarettes	1,761	1877	-6.1
8	Beverages	1,757	1251	40.4
9	Cement	1,408	797	76.7
10	Motor Cars	957	381	151.4
	Sub Total	58,714	49,364	18.9
	Other	6,223	5,131	21.3
	Grand Total	64,937	54,495	19.2

The telecommunication sector which has reflected growth of only 4.3% during FY: 09-10. The tempo of higher growth in the revenues in the previous years has been in slowed down in FY: 08-09 and continued in current year. Moreover, bringing mobile phones into customs net has also affected the import of mobile phones in FY: 08-09 and onwards. Similarly, inflationary pressure has also caused shifting of consumption from telecom to the most needed heads of personal/family expenditure. As a result, the telecom share in sales tax collection has also been reduced from 19.1% last year to 16.7% during CFY.

The collection from natural gas has exhibited a robust growth of 121%. A saving of Rs. 2.2 billion in the payment of refunds has partly helped in higher growth. The collection from sugar has exhibited strong growth of 67.7% mainly due to higher prices. A decline of 6.1% in collection from cigarettes is not aligned with the expected collection within the context of increased prices of cigarettes during CFY. The collection from electrical energy has increased by 91.5% in the collection of sales tax during 2009-10. The collection from services (other than telecom) indicated a huge growth of 92.6% due to inclusion of insurance, and banking services in the fold of sales tax. The beverages industry has manifested a considerable growth of 40% in the collection. On the other hand, sizable growths of 76.7% and 151.4% in the collection of cement and motor cars respectively have covered the loss of 6% in cigarettes.

Sales Tax Collection at Import Stage

The collection from sales tax imports has dropped by 6.5% when compared with same period last year. The net collection of sales tax imports has been Rs. 52.1 billion in July-September, FY: 09-10 against 55.7 billion in the corresponding period last year. The collection from top 15 commodities groups has been presented in Table 9. Almost 88% of the sales tax collection at imports has been generated by these major commodities groups.

The sectoral analysis indicates that POL products have been the leading revenue source of sales tax during July-September 2009. It has the highest contribution of 41% of the total collection of sales tax at import stage. Its collection has dropped by 7.8% due to decline in the prices of petroleum products especially high speed diesel oil. The collection from edible oil has also registered a decline of 24.5% due to reduction in its import value of around 37%. Similarly, the collection from plastic products has decreased by 16.8% against 16.6% decline in imports. The collection realized from mechanical and electrical machinery has also declined by 11.9% and 5.8% due to decline in their imports by 5.3% and 29.2% respectively. Due to reduction in imports of automobile, the collection of sales tax has dropped by 14.6%. On the other hand, the collection of sales tax from iron and steel has grown by 14.2%.

Table 9: Chapter-Wise Collection of Sales Tax on Imports

(Rs Million)

PCT Code	Description	Collection 2009-10	Collection 2008-09	Growth (%)
27	POL Products	21,386	23,189	-7.8
15	Edible Oils & Waxes	3,568	4,724	-24.5
39	Plastic & Articles	3,866	4,645	-16.8
72	Iron & Steel	3,109	2,722	14.2
87	Vehicles	2,843	3,327	-14.6
84	Mechanical Machinery	1,625	1845	-11.9
85	Electrical Machinery	1,533	1,627	-5.8
29	Organic Chemicals	1,539	1,664	-7.5
48	Paper & Paperboards	1,143	1,280	-10.6
12	Oilseeds etc.	1,016	747	36.0
9	Coffee, Tea and Spices	1,101	967	13.9
38	Miscellaneous Chemicals	884	675	31.0
76	Aluminum Articles	769	571	34.6
17	Sugar	743	46	1506.1
40	Rubber & Articles	731	633	15.5
	Sub-total	**45,856**	**48,662**	**-5.8**
	Others	6,270	7,126	**-12.0**
	Grand Total (Gross)	**52,126**	**55,790**	**6.6**

Customs Duty:

The imports during the current fiscal year are tending to decline. In fact, the value of import and value of dutiable imports have dropped by 21.9% and 19.3% respectively during July-September, 2009. This decline has adversely impacted the collection of customs duty in particular. The gross and net collection of customs duty has fallen by 16.4% and 13.4% respectively. The difference between the two growths has been due to a saving of Rs.1.7 billion in the payment of refunds/rebates.

The collection of customs duty stood at Rs. 33.1 billion during July-September 2009, as against the target of Rs. 31.2 billion. The target has been surpassed by Rs.1.9 billion. However, the collection of customs duty has declined by 13.4% during July-September, 2009-10 as compared to the corresponding period of last year (Table 10).

Table 10: Collection of Customs Duties and Refund/Rebate during Q1: 09-10

(Rs. Million)

	FY: 09-10	FY: 08-09	Difference	
			Absolute	Percent
Gross	34,748	41,543	-6,795	-16.4
Refund/Rebate	1,684	3,380	-1,696	-50.2
Net	33,064	38,163	-5,099	-13.4

Major Sectors of Revenue Generation

It is evident from the Table 11 that around 72% of the gross customs duty has been realized from only 15 commodities grouped in PCT Chapters. These items also contribute 71.5% of total imports and 81.4% of dutiable imports. The rest of the collection of customs has emanated from remaining groups (Chapters), defense, warehouse surcharge, export development surcharge, auctions etc.

Table 11: Sector-Wise Gross Collection of Customs Duties

(Rs. Million)

PCT Ch.	Sectors	CD Collection July-September FY:09-10	FY:08-09	Growth (%)
87	Vehicles and Parts	4,366	5,729	-23.8
27	Petroleum Products	3,739	7,572	-50.6
15	Edible Oils	3,177	3,544	-10.4
84	Mechanical Machinery	2,609	3,115	-16.2
85	Electrical Machinery	2,489	4,078	-39.0
39	Plastic & Articles	1,516	1,942	-21.9
72	Iron & Steel	1,460	1,360	7.3
48	Paper & Paperboard	1,149	985	16.7
29	Organic Chemicals	939	1,037	-9.5
09	Tea/Coffee etc	654	608	7.7
73	Articles of Iron & Steel	607	785	-22.7
32	Dyes, paints etc	604	687	-12.1
38	Miscellaneous Chemicals Products	588	508	15.8
69	Ceramics	489	627	-22.1
33	Cosmetic and Perfumery	451	494	-8.8
	Sub Total	24,836	33,073	-24.9
	Other	9,912	8470	17.0
	Grand Total	34,748	41,543	-16.4

Automobile has been the top revenue generation source of customs duty during the current fiscal year. It has contributed 12.6% of the total collection of customs duty during July-September, 2009-10. However, reduction in the import of automobile has adversely affected the collection. It is further added that major contributor of CD in automobile sector has been the motor vehicles (87.03) where its dutiable imports have come down by 17.1%**.** The component-wise detail of automobile reflecting decline in customs duty has been depicted in Table 12.

Table 12: Collection of Customs Duties From Automobile during July-September, 2009-10

(Rs. Million)

Category	Growth(%) in imports	Growth(%) in dutiable imports	CD 2009	CD 2008	Diff	Growth (%)
Motor cars/Jeeps (PCT 87.03)	-14.9	-17.1	2,694	3,932	-1,238	-31.0
Motor Vehicles for Transport of goods (PCT 87.04)	-50.4	-51.3	309	753	-444	-59.0
c) Motor Cycle with Parts (PCT 87.11)	2.3	2.4	228	245	-17	-7.0

Similarly, the collection of POL has also declined by 50.6% during the period under review. The reasons of shortfall in the receipts from petroleum products are spotlighted in the followings, inter alia:

i) Substantial fall in the price of HSD by 45.2%, 49.7% and 49.4% has been recorded during July, August and September, 2009 respectively as compared to corresponding period of previous year. Since HSD is the main revenue generation source of customs duty, this price decline has badly impacted the overall collection of customs duty. Details of the prices of HSD during July-September, 2009-10 and 2008-09 have been depicted in Table 13.

Table 13: Comparison of Price of HSD during July-September, 2009-10 and 2008-09

(Rupees)

Months	2009-10	2008-09	Growth (%)
July	41.8	76.2	-45.2
August	40.7	80.9	-49.7
September	39.1	77.2	-49.4

ii) Imported High Speed Diesel (HSD) was subject to customs duty @10% in July, 2008 but was applicable 7.5% in July, 2009. Resultantly, the effective rate for petroleum products has dropped from 7.8% in July-September, 2008 to 8.5% in July-September, 2009.

The collection of customs duty from edible oil (CH: 15) has also declined by 10.4% during Q1:09-10 as its value of dutiable imports has reduced by about 37.2%. A reduction of around 34% in the imported quantity of crude palm oils has also affected the collection of customs duty by 36%.

A decline of 7.2% in the dutiable imports of mechanical machinery has resulted 16.2% reduction in CD during Q1:09-10. The reason of decline can be attributable to consumer items, textile machinery, and rubber machinery etc due to decrease in their imports.

Moreover, the import and dutiable imports of electrical machinery have dropped by around 29% and 26% respectively resulting into a decline of Rs. 1.6 billion or 39% in customs duty during July-September, 2009 as compared to July-September and 2008. The major reason behind this decrease in the collection of customs duty has been the reduction of around 56% and 50% in the imports and dutiable imports of telecommunication equipment including cellular phones (PCT 85.17), resultantly customs duty on account of cellular phone declined by around one billion rupees. One of the reasons for this decline has been slashing down of the tariff rate from Rs.500 per set in 2008-09 to Rs. 250 per set in 2009-10. Moreover, regulatory duty of Rs. 250/set on mobile phones was also abolished in the Budget 2009-10.

As far as plastic goods are concerned, the collection of CD has dropped by 21.9% due to around 17% decrease in the dutiable imports.

Federal Excise Duties: FED has performed well during the first quarter of CFY. Despite shifting of services from federal excise to sales tax net, the collection of FED has depicted a positive growth of 11.5% by collecting Rs. 28.4 billion during July-September 2009 as against Rs. 25.5 billion collected in the corresponding period of last year. The assigned target of Rs. 28.4 billion fixed for the period has also been successfully achieved.

Around 80% of FED collection is being generated by top six revenue spinners, namely; cigarettes, cement, natural gas, POL products, beverages and services. The performance of these major revenue spinners is depicted in Table 14.

Table 14: The Collection of FED from Major Revenue Spinners

(Rs. Million)

	FY: 09-10	FY: 08-09	Growth (%)
Cigarettes	7791	7,031	10.8
Services	5,383	3,529	52.5
Cement	4,165	4,302	-3.2
Beverages including Concentrates	3,630	3,237	12.1
Natural Gas	1,198	1,476	-18.8
POL Products	1,024	861	18.9
SED	3,805	3,304	15.2
Sub Total	**26,996**	**23741**	**12.4**
Other	**1,393**	**1,720**	**-19.1**
Grand Total	**28,389**	**25,461**	**11.5**

Cigarette continued to be the top FED revenue contributor with around 27% share in total collection. The collection has recorded a growth of 10.8% during the Q1 CFY. The growth is attributable mainly to upward revision FED rates on cigarettes in the Budget 2009-10.

The third major revenue generator is the cement with around 14% share in total FED collection. Its collection has come down by 3.2%. Since FED rate on cement has been revised downward from Rs. 900 PMT to Rs. 700 PMT in the budget 2009-10, the tax collection has declined.

The collection from beverages has shown a double digit growth during July-September, 2009-10. Similarly, POL products have recorded a growth of 19% in Q1 CFY as compared to corresponding period last year. However, the collection from natural gas has shown a negative growth of about 18.8%. On the other hand, the collection of SED@1% has recorded a growth of about 15.2% in the first quarter of CFY as compared to corresponding period last year.

Concluding Observations

Despite genuine issues like economic slow down including decline in imports and energy crises, and change introduced in the advance tax regime by spillover of around Rs 22 billion from September to October 2009, FBR has been able to exceed the collection of previous year by a reasonable margin. Similarly, some of the factors like decline in the petroleum prices in CFY have vastly affected the collection of customs duty during July-September, 2009-10. It is felt that difficult period in term of revenue generation seems to be over, and expected that revenue collection is likely to grow at faster rate in the rest of the period.

II
How to improve Resource Mobilization- Revisiting the Tax Policy options

By: Umar Wahid[2]

Background

Taxes are levied by the government to enhance resource mobilization to meet its diversified expenditure needs. The major areas of spending include funds for poverty alleviation, maintenance of law and order and defence, social sector expenses on health and education etc. Other motivation includes redistribution of income and wealth and promotion of special goals set for various development and non-development activities. Consequently, the resource mobilization effort is spread over the three tiers of the government. Within this effort, revenue generation through taxation has the largest share. Over the years, importance has been concentrated on voluntary tax compliance by taxpayers rather than continuing with outmoded tax structure that is open to abuse. There is a definite shift from conventional tax collection system to functional operations.

Like other countries, achievement of high level of voluntary compliance through tax policy and administrative reforms is a top priority agenda of Pakistan. A broad ranging approach incorporating both, tax policy and administrative, features is being followed to achieve this objective. It is believed that simplicity of tax rules and procedures not only provide a hassle-free environment to the taxpayers, it also lowers the processing costs of compliance. Similarly, compliance is generally high when tax rates are low. Within this perspective, the purpose of this article is to revisit, analyze various issues concerning voluntary tax compliance and provide suggestions to further improve the system.

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Voluntary Compliance

Voluntary Compliance has a direct relationship with the existing tax culture prevailing in a country. If a tax culture is developed on the basis of simplicity, equity and fair play with active public participation and collective thinking/ brainstorming, then voluntary compliance is expected to be higher. On the other hand if taxes are collected through coercive ways by adopting autocratic approach, then the voluntary compliance is generally lower. Invariably the tax culture in the developed countries is aligned with the public perception. Resultantly, compliance ratio to population ranges between 75-85%. This situation is completely opposite to most of the developing country where compliance to population ratio is low. Realizing this yawning gap, many developing economies have started initiatives to promote voluntary compliance through administrative reforms. Needless to add that the knowledge base of the society also grows with time and civilization also takes roots in the governing system. The taxpayers also feel obliged to contribute towards national exchequer.

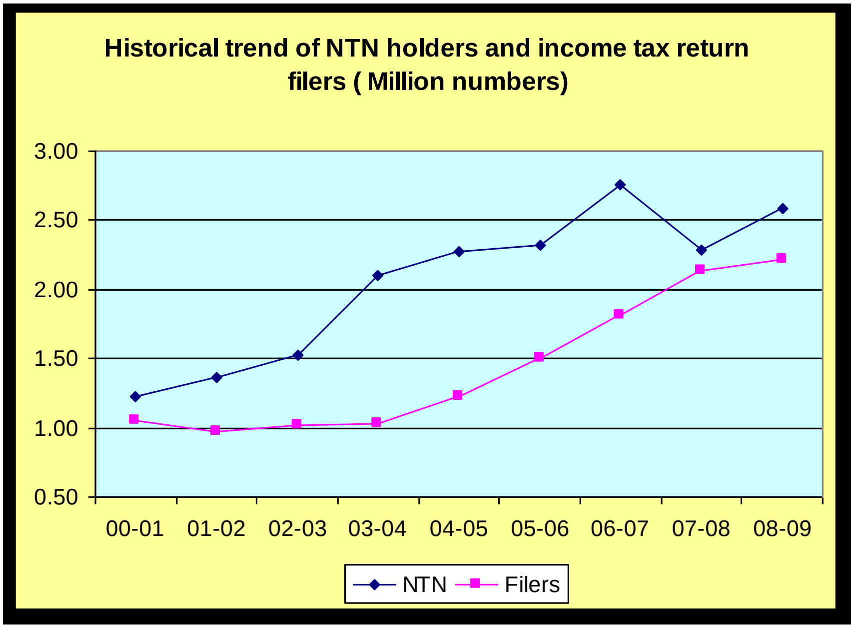
Like others, Pakistan has also made strenuous efforts in transforming the tax culture from conventional to operational functioning. The legacy taxation system in Pakistan was suffering from major weaknesses in the shape of complicated laws and procedures, high tax and tariff rates, wide array of exemptions, and many other distortions. Consequently, the taxation system was rendered inefficient and open to abuse. The concept of voluntary compliance was almost non-existent. In an effort to correct this situation, a comprehensive reform agenda focusing on wide ranging revisions in tax laws and procedures and tax and tariff structure, as well as improvement in tax administration was envisioned that has started to deliver.

Income Tax: In order to broaden the income tax base and encourage voluntary compliance a number of reforms measures have been initiated in the income tax structure with the promulgation of Income Tax Ordinance, 2001 effective from 13th September 2001. The objective was to simplify the language of the Ordinance by removing ambiguities for ensuring uniformity in treatment for various categories of taxpayers, reduce dependence on withholding taxes, and encourage voluntary compliance backed by strong audit and minimum tax exemption.

The introduction of the concept of universal self-assessment (USAS) for all categories of taxpayers, without any conditionality has been a major break through. Under this system all the taxpayers automatically qualify for self-assessment. The concept of immunity from selection of cases for audit has been done away with. The returns received are no more examined (assessed) in detail at the time of receipt. However, a limited percentage of cases are selected for audit on risk assessment basis for various classes of taxpayers. One of the important features of the USAS has been the requirement of maintenance of accounts and related documents by the taxpayers for ensuring effective audit.

On the administrative front, special tax departments have been established to cater to the needs to large and medium taxpayers. The objective of these model units has been to reduce compliance cost for the taxpayers and encourage voluntary compliance.

These changes have started to contribute positively. Both the NTN holders and return filers have increased by a considerable margin. Between 1999- 2008-09 the NTN holders have increased on an average by 12 percent. On the contrary the return filers have also gone up by more than 22 percent per year during this period.. The filers have jumped from 1 million to 1.23 million between FY 2002-03 and FY 2004-05 and further jumped to 2.14 million and 2.22 million in FY: 2007-08 and 2008-09 respectively (Graph 1).



As a result the voluntary compliance has also improved. From a negligible growth of 0.3% in FY 00-01, it has shot up to around a 13% in FY 04-05. However, during the year2007-08 and 2008-09 the collection from voluntary compliance has declined; resultantly its share in total gross income tax has also declined to 30.6% in 2008-09 from 37% during FY: 2007-08 (Table 1). It is apprehended that with the absence of audit and punitive actions under the Income Tax Ordinance 2001 the taxpayers are taking advantages of these loopholes and if the situation is not corrected in time, revenue loses may go even higher in he coming period.

Table 1: Post-Reforms Performance of the Income Tax

(Rs. in million)

Revenue Heads	FY 06-07	FY 07-08	Growth (%)	FY 08-09	Growth (%)	%Age Share	
						07-08	08-09
Voluntary Payment	165,735	145,616	-12.1	141,680	-2.7	37.0	30.6
Collection on Demand	11,173	42,779	282.9	77,167	80.4	10.9	16.7
Withholding Tax.	169,191	205,144	21.2	243,655	18.8	52.0	52.6
Miscellaneous	1286	242	-81.2	255	5.4	0.1	0.1
Gross Income Tax	**347,385**	**393,781**	**13.4**	**462,757**	**17.5**	**100.0**	**100.0**

Sales Tax: To broaden the sales tax base, and enhance voluntary compliance, a number of steps have been taken such as reduction in compliance cost, introduction of simplified schemes for small taxpayers and expanding the scope of tax by increasing the number of services liable to sales tax. Similarly, legislation to allow presumptive taxation together with improving registration procedures has also ensured more compliant response from new business.

In terms of specific numbers, tax compliance is sales tax (which is voluntary in nature, as the system operates under self-assessment) has been 58% in 2008-09, which less by standard. One of the reasons of low compliance is due to de-registration of retailers/ turnover manufacturers during FY: 2004-05, having capacity of less than five million turnovers. Many initiatives have been introduced to make the system more fair and easy. For example voluntary disclosure (before commencing of audit) does not attract penalties. To facilitate taxpayers, separate returns for different taxpayers have been designed. Electronic filing of return has also been launched in the CFY to facilitate the taxpayers and ensure transparency in the sale tax system. All these efforts seem futile.

Table 2: Sales Tax Compliance

(Numbers)

Years	Registered Taxpayers	Filers	Compliance (%)
2005-2006	124,993	86,700	69.4
2006-2007	145,107	87,949	60.6
2007-2008	130,668	89,273	74.0
2008-2009	**154,164**	**89,343**	**58.0**

It is needed to accelerate interaction with the trade and business communities, initiation of greater moves towards education and facilitation of taxpayers. A constant improvement in rules and procedures, design of forms and invoices, publication of self help leaflets on VAT provisions, media campaigns, automation of tax administration and addressing taxpayers' queries in a meaningful way would help in evolving an environment where voluntary compliance would be encouraged.

Customs: The Customs department handles all the imports/exports activities carried out in the country through various entry and exit points. Thus the department plays a significant role and generates significant revenue for the FBR. Since the system of Goods Declaration (GDs) was largely manual, therefore, complaints pertaining to delay in clearance, under-invoicing and connivance between the taxpayer and tax administrators were too frequent. To address all these issues and also to introduce self-assessment system in the customs department, a major reform initiative with the objective to ensure hassle free and speedy declaration of goods was introduced. The CARE project was inaugurated in April 2005. At the first stage the project started functioning at Karachi International Container Terminal (KICT). However, soon it has been replicated in all the customs collectorates. This project has introduced computerized Processing of Customs documents (PACCS) under which the GD can be filed by an importer on-line without physical interaction with customs officials. The processing has reduced the clearance time of goods to few hours from more than ten days. This is a major step towards customer facilitation that has reduced the up-front cost of doing business considerably. This new system has revolutionized the working of Pakistan customs, which is now at par with the modern set ups. Simultaneously, the One-Customs concept has also been introduced that allows equal treatment to all taxpayers at each entry and exit points. The evidence confirms that both these systems have been instrumental in promoting voluntary compliance in country.

Federal Excise: A major policy change by withdrawal of federal excise staff from the manufacturing units was introduced in the federal excise system. The idea was to improve the confidence of taxpayers that should promote voluntary compliance. Similarly, the federal excise Act was also transformed in conformity with the sales tax Act and the registration procedure was changed. The sales tax registration number is now sufficient for the federal excise taxpayers as well. The mode of payment has also been rationalized to provide relief to the taxpayers.

Issues and Concerns

With the introduction of tax policy reforms in FBR, the tariff rates have been rationalized, uniformity in GST rates has been ensured and also reduction in the corporate rates are the major policy shift from protection to openness. The tax administration reforms has provided relief to the taxpayers through simplification of rules and procedures, better facilitations and ensuring minimum interface between the taxpayer and the tax collector. These measures no doubt have improved revenue realization and also increased the level of voluntary compliance to certain extent, but the tax base and the level of voluntary compliance in Pakistan remaining low as compared to the emerging economies. On the part of FBR, greater efforts are needed to launch a massive campaign against tax evaders and defaulters, who have seriously hampered the revenue mobilization efforts of the Government. There is a need of fresh assessment of all those concessions and exemptions which are being enjoyed over the years. Capital gains tax should be broadened as much as constitutional restrictions allow. Until these and other distortions are not corrected, the tax base and resulting tax-GDP ratio will remain low and stagnant. Some of areas where further effort is required are discussed in the following.

- Taxpayers' perception holds key to success. Thus, the need for periodic internal and external surveys should be a priority agenda item;
- Utilization of third party information has become absolute necessity. Even though major emphasis has been laid on this in recent months, the time is now ripe to materialize this inter-

connectivity. ‘NEXUS’ is a definite way forward, that needs to be operationalized on urgent basis;

- The tax potential areas that are currently outside the tax net for one reason or the other need to be taped so that the principle of equity and fairness are established. To this end, a number of sectors have already been identified whose contribution towards taxes is far too low as compared to their share in GDP. Better strategy is needed to bring income of transporters, large formers, wholesalers and retailers, bankers and insurance agents into the tax net. Similarly, taxation of capital gains (both in capital market and real state) still remains elusive;

- Economic activities in certain areas continue to remain outside the tax net. For instance, the activities in FATA/PATA are exempted from taxation except salary received by the Government employees posted in these areas, property income if derived from a property located in settled areas. Without going into political economy of the reasons behind these exemptions, it is valid to state that serious distortions in the taxation system could not be rectified if equal treatment is not effectively implemented in all areas;

- Ironically, religious factor also plays a role in noncompliance of tax payment. The preaching for payment of Zakat and Usher being the only religious levy and its distribution on the free will of individuals has created doubts about government taxes in certain minds. To them tax evasion is not a delinquent act, as they are fulfilling their religious obligations. An open debate is needed to promote tax compliance within this specific category.

- Lack of education is one of the leading factors contributing to non-compliance. There are instances where people are found ignorant about their tax obligations while concerted effort has already been undertaken towards taxpayers’ education and facilitation, a large part still remains uncovered.

- On FBR part, besides administration reforms a monitoring approach needs to be adopted for proper record keeping of the taxpayers. In the past the record keeping of FBR taxpayers was extremely ordinary. Multiple numbers were in vogue and it was difficult to determine tax liabilities of different taxpayers. Now the effort on adoption of a unique taxpayer identification number (TIN) and its linkage with sales tax registration number has already progressed. To streamline the process and remove duplications all in-fructuous cases are being deleted. With the progress on this area, FBR would have a clean tax base to project tax liabilities and collection.

Conclusion

The world is undergoing rapid changes every day. This is an era of competition. Protective barriers are falling. The cumbersome laws and procedures are being replaced. Simplicity and automation of business processes are the taking central positions in conducting businesses. With growing needs for resources, the tax collection procedures are being modified. Pakistan has also modified its taxation system – the system of full scrutiny of tax returns has given way to a system of self-assessment. The taxpayers are now treated differently. Rather than having an adversarial relationship, they are treated as partners in growth. The hindsight is that better understanding of each other i.e., the taxpayers and the tax administrators would promote voluntary compliance. More importantly lack of audit is the major cause of low resource mobilization in Pakistan. Audit is the only tool having deterrence effect and instrument of control 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 in the government treasury and also whether input tax adjustment is correctly made to which he is legally entitled. Therefore, effective audit based on best international practice in needed.

III
Efficiency of GST in Pakistan: Need for locating a Real North Star

BY: Mir Ahmad Khan[3]

"Base erosion whether through exemptions or the zero-rating is a potential time bomb in many Developing and Transitional Countries VATs".

[Richard M.Bird and Gendron] [4]

Introduction

The Value Added Tax, as the most prolific tax with world wide success, has swept the world in span of around five decades. Fascinated by its revenue generating capacity and efficiency in the developed world, the most of the developing countries adopted it. Pakistan is no exception and had also ventured to tread on the road to VAT. A major landmark was accomplished when the Sales Tax Act 1990[5] was passed by the Parliament, which paved the way for the introduction of the value added version of sales tax, commonly known as General Sales Tax (GST), in the country in November 1990. Initially, the value added tax at each stage of business transaction was restricted to import stage and manufacturing sector. However, with the introduction of revolutionary changes in the Sales Tax Act 1990, the GST was enforced in the spirit of VAT mode in 1996. It was organized on functional lines including the functions of assessment, audit, enforcement, monitoring etc rather than the traditional administrative structure. In order to craft the

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[4] See Bird and Gendron, (2005)"VAT Revisited: A New Look at the Value Added Tax in Developing and Transitional Countries", International Tax Program, Joseph L.Rotman School of Management Toronto. pp; 96.

[5] See for details of history and evolution and performance of sales tax in Pakistan. Dr.Ather Maqsood, Robina Ather and Mir Ahmad Khan(2003) 'From ST to GST: Development of Sales Tax in Pakistan" published in CBR Quarterly Review Vol.2. No.2 Oct-Dec, 2002 ,pp:15-30

sales tax system more equitable, emphasis was shifted from production to consumption, which required phasing out of central excise and less emphasis on customs duties. The GST was developed with the element of self-assessment and it was aimed to develop an effective audit and enforcement mechanism. One of the greyest areas has been ineffective audit and enforcement system, especially, in the face of self-assessment.

The prime purpose of this paper is to review the efficiency of the GST in the light of standard performance criteria. This article will further evaluate the possible pitfalls and benefits in overhauling of current GST or embarking on implementation of comprehensive VAT in the country.

Measurement of Efficiency of GST in Pakistan

In order to evaluate efficiency of GST in Pakistan, a number of standard indicators have been used. Details of computation of efficiency and its analysis are spotlighted in the followings:

GST/VAT Productivity

It is defined as the ratio of VAT revenues to GDP divided by standard VAT rate (expressed as percentage). VAT Productivity is also called collection efficiency. Table 1 reveals that VAT Productivity in Pakistan has started to pick up from 20.3% in FY:99-2000 and peaked at 26.7% in FY:02-03 and then has fallen to 21.5% in FY:08-09. Indonesia has improved its VAT productivity from 28% in 2000 to 35.3% during 2006 (Brondolo, Silvani, Borne, and Bosch (2008)][6]. Some other countries with VAT productivity are New Zealand 72%, Japan 48% & China 39%, and Vietnam 49% (New house and Zakharova (2007))[7].

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[6] See for more details Brondolo, Silvani, Borne, and Bosch(2008)," Tax Administration Reforms and Fiscal Adjustment: The Case of Indonesia", pp40- 41, IMF Working Paper

[7] See New house and Daria Zakharova(2007)," Distributional Implications of the VAT Reform in Philippines", pp20, IMF Working Paper

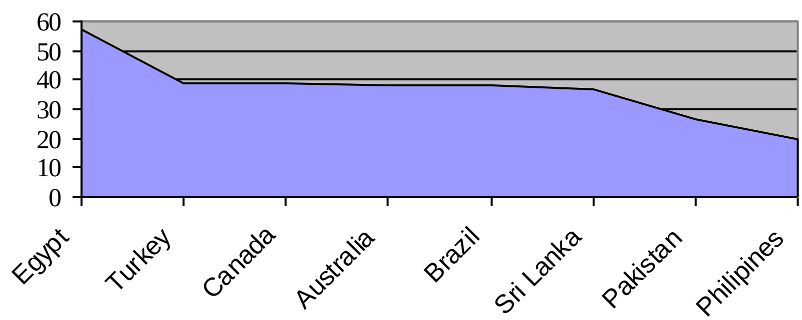
Table 1: Trends in VAT/GST Productivity in Pakistan

Fiscal Years	VAT productivity (%)
99-2000	20.3
2000-01	24.3
2001-02	24.9
2002-03	26.7
2003-04	25.9
2004-05	24.5
2005-06	25.8
2006-07	23.8
2007-08	24.5
2008-09	21.5

Source: Author's Calculations

Martinez (2006) has provided estimates of VAT Productivity for selected countries which are depicted in Graph 1

Graph 1: VAT/GST Productivity(%)



GST productivity in Pakistan is extremely low when compared with the selected countries. Currently, VAT productivity of around 22% implies that it collects even less than quarter compared to what it would collect if a uniform rate of standard GST rate is applied on all the value added of the economy. The low productivity in Pakistan reflects massive exemptions, poor administration, low compliance and exclusion of most part of the services, low threshold, and lack of audit and enforcement.

VAT-Efficiency

C-efficiency is a standard measurement of efficiency of VAT or GST in a country. This indicator uses the reference point of a uniform tax normally on all private expenditures[8] which would have an efficiency rating of 100 per cent. Higher or lower C-efficiency illustrates country's deviation from this norm either through over or under-taxation of the consumption. It is calculated by taking ratio of collection of VAT to private expenditure and dividing by standard GST/VAT rate. The C-efficiency ratio has been extremely low in Pakistan as well (Table 2). In the light of international experience, even it is lower than 40% in Sri Lanka and 48% in Indonesia. Relatively low C-efficiency rating in Pakistan reflects relatively small amount of domestic consumption that is captured in the tax base (Thirsk 2008).

Table 2: Trends in C-Efficiency of GST (%) in Pakistan

Fiscal Years	C-Efficiency (%)
99-2000	27
2000-01	32
2001-02	34
2002-03	36
2003-04	35
2004-05	32
2005-06	34
2006-07	32
2007-08	32
2008-09	27

[8] C-efficiency can be calculated for both private and total expenditures including government expenditures but normally C-efficiency is used calculated on the basis of private expenditures.

GST to GDP Ratio

The GST in Pakistan constitutes more than 1/3rd of the overall tax to GDP ratio of the country. In the last ten years, the sales tax to GDP ratio has improved from 3.1% in FY: 99-2000 to 3.5% in FY: 08-09 (Table 3). However, it remained in the range of 3.1% to 4% during the period.

Table 3: Trends in GST to GDP Ratios From 1999-2000 to 2008-09

Fiscal Years	GST to GDP Ratio (%)
1999-2000	3.1
2000-01	3.6
2001-02	3.7
2002-03	4.0
2003-04	3.9
2004-05	3.7
2005-06	3.9
2006-07	3.6
2007-08	3.7
2008-09	3.5

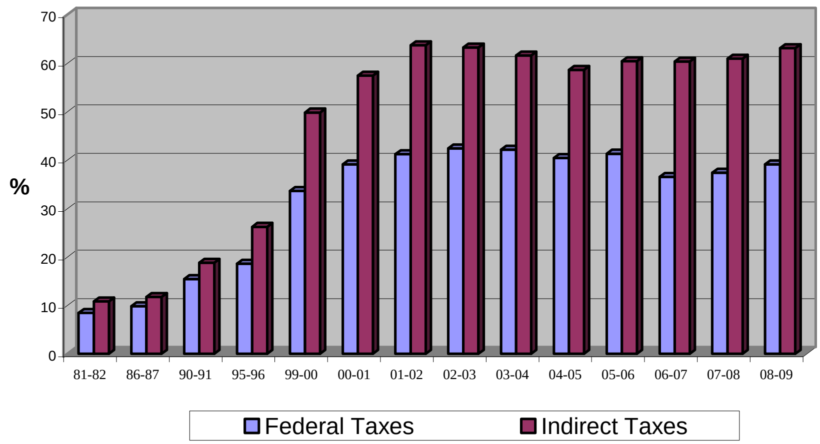
Based on experience of other countries, this ratio is quite low when viewed in cross country comparison i.e. New Zealand (9.1%), China 6.6%, Australia 4.4%, Korea 4.4% (New house and Zakharova (2007))[9], Turkey 8.2 %(Bird and Gendron).

Average Compound Growth Rate (ACGR) and Tax Mix

The GST has vastly improved its share of 33.6% in total taxes from FY: 99-2000 to 39.1% in FY: 08-09. Similarly, its contribution in indirect taxes has also gone up from 49.8% in FY: 99-2000 to 63.1% in FY: 08-09(Graph 2).

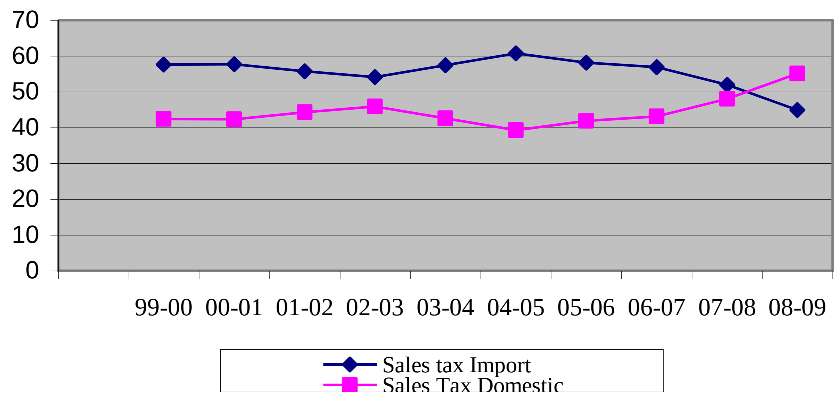
[9] See New house and Daria Zakharova(2007)," Distributional Implications of the VAT Reform in Philippines", pp20, IMF Working Paper

Graph 2: Contribution of GST in Pakistan



Since GST has two components i.e. sales tax import and domestic. Historically, tax revenues from sales tax on imports were normally higher than the domestic sector sales tax. The situation has started to change and Graph 3 illustrates that sales tax domestic has improved its contribution and sales tax imports has plummeted to second position in FY: 08-09 mainly due to better performance of sales tax from domestic sector.

Graph 3 : Trends in Tax Mix of Sales Tax



Barring three years, double digit growth has been recorded from FY: 99-2000 to FY: 08-09(Table 4). This performance is good but not robust as ACGR of 16.2% reflects some improvement in the sales tax revenues.

Table 4: Trends in Growth in GST Revenues

Fiscal Years	Growth in GST (%)
99-2000	-
2000-01	31.6
2001-02	8.5
2002-03	17.2
2003-04	12.3
2004-05	8.8
2005-06	23.6
2006-07	5.0
2007-08	22.0
2008-09	19.8
Average Compound Growth Rate (ACGR)	**16.6**

It is well established from the above analysis that efficiency of GST is below the world standard despite its significant contributions as the leading tax in term of revenue generation in the country. Now it is imperative to tackle the crucial factors which have largely hampered the efficiency of GST in the country. Some of the factors responsible for low efficiency have been illustrated in the following; *inter alia*:

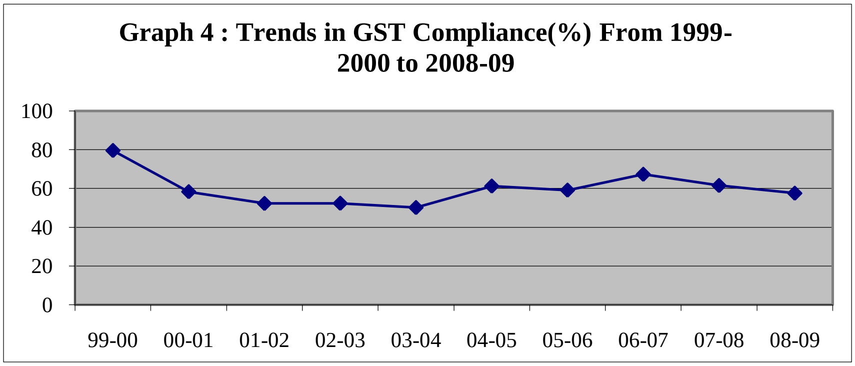
Major Factors Responsible for Low Efficiency

Wide Tax Gap and low Compliance

Tax gap of a tax is the difference between the potential and actual tax collected. In other words, it is the uncollected tax due to lack of compliance to the tax laws. The tax gap illustrates the extent of tax evasion in a country. The tax gap emanates from non-compliance and only from tax evasion but not from tax avoidance. So the tax gap is directly related to the tax evasion. Robina and Mark Rider

(2008) provided conservative estimates for sales tax gap of around Rs.73 billion during FY: 04-05. Their compilation further reveals that actual collection for FY: 04-05 constitutes only 30% of the potential collection of GST.

GST compliance is the number of GST returns divided by total registrants. The GST compliance has declined from 79.6% from FY: 99-2000 to 57.5% during FY: 08-09(Graph 4).

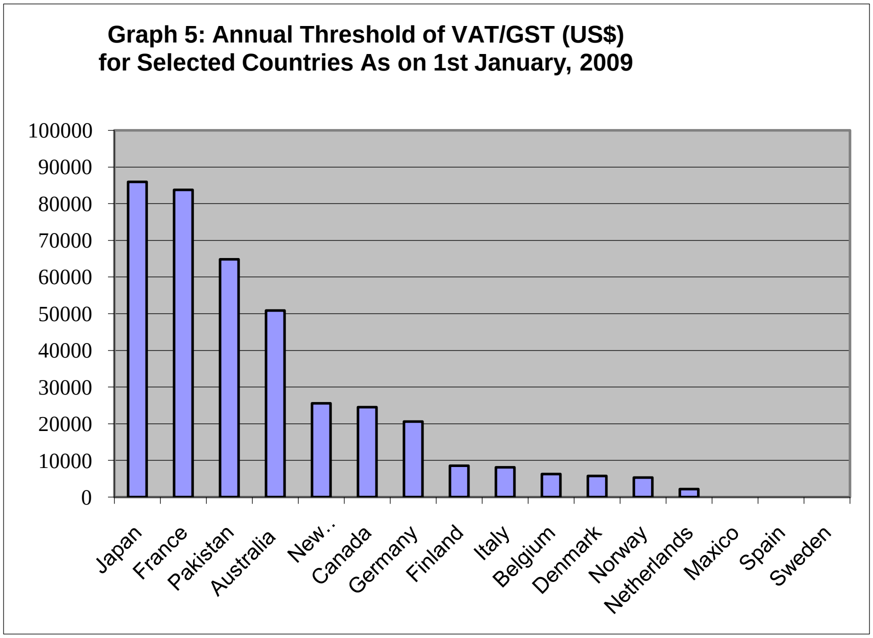


Prima facie, this is point which justifies attraction of large scales audit operations, effective enforcement and strong system of penalties.

Higher Threshold of GST

Higher threshold of GST i.e.Rs.5 million for small retailers and manufacturers since FY: 04-05 has also allowed a major chunk out of the tax net. The Graph 5 provides evidence that threshold of Pakistan is far greater than most of the selected countries[10].

[10] See www.oecd.org for thresholds of selected countries excluding Pakistan.



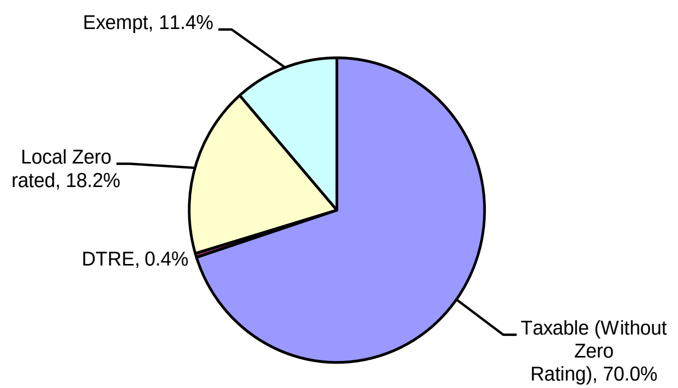
Shahid Ahmad (2005) pointed out that despite 26% shrinking base due to higher threshold, there has been substantial gains in terms of reduced cost of tax administration, as the department has to deal with smaller and more compliant tax base. Although, impact of the higher threshold on revenues was quite small but still it has shrunk the base. There is an understanding of some of the writers that there should be comparatively high threshold where compliance cost is high. However, threshold can be lowered keeping the ground realities in view. Audit and enforcement will play a decisive role when threshold is revised downwards. This will also reduce distortion in the system.

Narrowness of Base

The number of GST registrants were 0.075 million during FY: 99-2000 but peaked at 0.163 million in 2003-04 but introduction of higher threshold has brought it down to 0.12 million during FY: 04-05. After that gradual improvement has been recorded and reached 0.1567 million during FY: 08-09. A number of exemptions of GST are allowed to taxpayers and even some of the sectors are out of the net or lightly taxed. Details of exemptions can be seen from sixth schedule to the Sales Tax Act, 1990. On the other hand, some of the services have also brought into GST net through FED in VAT mode. Major chunk of the services are still outside the net. Although there are a number of constitutional and legal issues in the taxation of services in Pakistan, but still, it warrants expansion of sales tax to remaining services[11].

On the other hand, inability of FBR to cope with the monster of refunds payment, the whole of the export oriented industries were made zero rated in the budget FY: 05-06. It is evident from Graph 6 that a major chunk of around 30% of the sales declared by the taxpayers during FY: 08-09 has either been zero rated or exempt. Interestingly, the share of zero-rated sales is considerably higher than the exempted sales. In order to deal the refund issue, information technology based tested system would be helpful in talking the refund issue but this system should not be like the previous ones already failed.

Graph 5: Distribution of Sales During 2008-09



[11] See more elaborations and comprehensive account of issues in sales tax on services, Mir Ahmad Khan(2009)"Vying for Raising Tax–GDP Ratio: Taxation of services in Pakistan " published in FBR Quarterly ReviewVol.8, No.3 January-March, 2009, PP:54-74". The article covers legal and constitutional issues, some tax related issues and prospects of revenue generation especially in the light of Indian experience.

In order to raise revenues, the exemption and zero rating will have to be curtailed. This measure along with extension of GST to all services will bring neutrality in the system which is the essence of VAT. The untaxed sectors, if brought into net, would generate bulk of revenues and will definitely improve the efficiency of the GST in the country.

Audit and Enforcement

Audit plays an important role in safeguarding government revenues and audit brings discipline in the tax system. The GST can also be evaded or avoided like other taxes. Some of sources of evasion in GST are non-registration, under-reporting of gross receipts, undue claim of inputs and non-remittances of taxes collected from customers to tax authorities.

The main feature of value added version of the GST in Pakistan is self assessment. Pre-conditions for an effective self assessment have been highlighted in Box 1.

Box 1 : Pre-Conditions for Effective Self-Assessment

i)	*Simple, clear, Stable tax laws*
ii)	*Adequate Service and support to the taxpayers in complying with tax obligations*
iii)	*Simple procedures for registration, filing, payment, and refund*
iv)	*Effective collection enforcement*
v)	*Reasonable audit coverage*
vi)	*Strict application of penalties*
vii)	*Provision for independent review*

Source: Ebrill et.al.(2001).”The Modern VAT”

The sales tax audit has not been properly operative for many years. The low tax compliance and wide tax gap are the manifestation of lack of audit and enforcement activities in the country adding to low efficiency.

Box 2 :Keeping an Eye on the Ball: Continued Efforts to Improve audits in Canada [12]

Canada is generally considered to have a good administration. Indeed, a comparative study of administrations in a number of developed countries, for example, concluded that in many ways Canada's administration was a north star' on which other countries might benchmark. It is interesting, however, to note that over a decade after Canada adopted VAT, the country's Auditor General, in a review of the VAT system, still found it necessary to stress the need for the revenue agency to do more and better VAT(GST) audits. Achieving a satisfactory level of tax administration is not a "once and for all task". Hence, every country must continually strive to maintain its performance at a satisfactory level in the face of the constantly strive to maintain its performance at the satisfactory level in the face of the constantly changing real world in which the tax system operates.

Source: Auditor-General of Canada, Revenue Canada-----Goods and Services Tax: Returns Processing and Audit, Ottowa, 1999; Vazquez-Caro, "Benchmarking Complex Tax Systems: In the Search for a North Star," March 2005.

Lack of Documentation

The One of the reason behind low compliance in GST has been lack of documentation in the economy. Some efforts were made by the government in the past in the form of country wide survey but could not achieve the desired goals.

Implementation of Comprehensive VAT in Pakistan

In the face of low efficiency and hindrances warrant GST large scale overhauling of the present GST. The most ideal situation will be the implementation of comprehensive VAT in the country for greater revenue yield, efficiency, neutrality and increased compliance.

[12] Adopted from Strengthening of the VAT in Ukraine (2005), The World Bank, paper prepared for the Public Expenditure Review of Ukraine 2005-06.

Box 3: External and Internal Neutrality of VAT

The design of a modern VAT is guided by the principles of external and internal neutrality. External neutrality ensures that the tax burden on domestic consumption is the same irrespective of the origin of the goods or services consumed. It also ensures that the government receives tax revenue from domestic consumption. External neutrality is achieved by applying the destination principle, which is currently the preferred jurisdictional principal for value added taxes. This involves taxing imports at the same rate as domestically produced goods or services; and zero rating exports.

Internal neutrality ensures that consumers bear the same tax burden on all consumption and that taxpayers are taxed in the same way irrespective of the business structure adopted or the way in which supplies are made. It is best achieved by a broad based tax applied to all goods and services, all types of taxpayers, and all types of transactions at a single rate. In particular, internal neutrality in the legal design of VAT requires:

- *minimal use of multiple rates;*
- *minimal use of exemptions and zero-rating;*
- *broad coverage of taxpayers by using broad concepts of 'taxable person'*
- *application to each and every stage in production and distribution chain, including the retail stage;*
- *a broad input credit mechanism designed to ensure that each taxpayer pays taxes only on its value added; and*
- *a broad and inclusive concept of 'taxable value' so that the tax burden as a percentage of consumption closely approximates the rate of tax.*

Source: Pakistan Tax Policy Report(2009), The World Bank

Undoubtedly, VAT has swayed over the world for its revenue raising demonstration but it is imperative to understand the basic ingredient in its implementation. In order to make transformation more fruitful, proper homework would be crucial as some of the countries like Vietnam has introduced VAT first and then cancelled and subsequently, re-introduced. In a country like Pakistan where education level is quite low and there is a lack of documentation in the economy and the tax culture is not encouraging, a lot of effort will have to be made in making VAT a success.

The VAT will have to be extended to all the consumption and services with a low threshold and minimum exemption for essential items. It implies that entire zero rating, especially, five export oriented industries will be brought into normal GST regime, the base of sales tax will be extended to more retailers and manufacturers, services, dismantling of the special rules and single GST rate will be the best option.

In the process, political will of the government and good understanding with the stakeholders would prove crucial in VAT implementation as well. On the top of all, a great deal of effort in overhauling of audit, enforcement and system of penalties will be needed for successful implementation of VAT in the country.

Conclusion

Although GST has exhibited some buoyancy in its revenue generation in the country yet its standard performance indicators reveals its extremely low efficiency when compared to most of the countries including Sri Lanka. A number of factors are responsible for low GST efficiency. Some of them are conspicuous like large volume of exemptions and zero rating, higher GST threshold, poor compliance rate and abysmally wider tax gap pointing towards gross evasion, lack of documentation, absence of strong audit, ineffective enforcement. It will be exceedingly difficult to trudge along such an inefficient tax without its comprehensive overhauling for long. There is a vast scope of revenue generation from GST in the country. The expedient of GST rate as the easy revenue generation source has to be stopped. Due to financial constraints of the government, it is imperative to step up the generation of the tax revenues led by GST as similar tax has demonstrated miraculous improvement in revenues of many countries. Implementation of comprehensive VAT covering almost all the consumptions and services with uniform procedures would be a milestone towards a better fiscal landscape of the country.

The success in implementation of VAT would depend on the home work of FBR, political resolve of the government, prior understanding and tackling of legal & constitutional complications, well tested audit and enforcement system, education of general public and tax personnel.

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IV

Reform Program: Taxpayer's Audit – Annual Plan 2009-10[13]

Introduction

The taxpayer audit function plays a critical role in the administration of tax laws. An audit for tax purposes in many countries is mainly conducted to ensure that income or turnover, as the case may be, has been properly ascertained and to ensure that the taxpayers have correctly assessed/ reported their tax liability and fulfilled other legal obligations. Nevertheless, audit remains a major tool for tackling non-compliance. In practice, the scope and nature of any audit activity undertaken for a particular taxpayer will depend on the available evidence pointing to the likely risks of non-compliance and a taxpayer's prior history.

The tax system in Pakistan is operating mainly on self assessment basis. There is no physical control on the persons (including industrial concerns) registered under different taxes, except under special circumstances. The system promotes voluntary – compliance, self-documentation, self-assessment, and self-policing. Audit is the only tool having deterrence effect and instrument of control through which compliance level of registered persons is monitored i.e. whereby the government checks whether a registered person/taxpayer has correctly determined his tax liability, deposited due amount of tax to the government and is making adjustments of those input tax etc to which he is legally entitled.

[13] This update has been prepared by Mr. Nawab Khan Chief Taxpayers' Audit, FBR.

During the initial phase of the Federal Board of Revenue Reform process, it adopted a system of universal self-assessment (similar to that already operating in most of the developed countries) for determining income and sales tax liabilities. However, it was realized that no universal self-assessment system will be effective without an effective National Audit Plan. For this purpose the services of an International Audit Consultant (Ms.Yassie Hodges) were hired who prepared a National Audit Plan / Manual for FBR, which outlines the broad based guidelines for the audit of taxpayers.

Transparent Selection

In the light of National Audit Plan, the FBR in the second phase of its reform efforts is expanding its activities to focus on structured approach of audit of Large and Medium size taxpayers during 2009-10, by utilizing departmental and out- sourced audit resources.

In pursuance to the decision made in the second meeting of the Business Persons Council held on October 15, 2009, computer based random balloting was held in the presence of representatives of trade, industry, Tax Bar Associations and media on December 11, 2009 to select units/persons for audit of domestic taxes for the year 2008. The purpose of this automated selection of taxpayers was to ensure complete transparency and to avoid possibility of any discrimination.

Out- Sourcing

A Memorandum of Understanding (MOU) dated 19.06.2009 has also been signed between the Federal Board of Revenue (FBR), Government of Pakistan and the Institute of Chartered Accountants of Pakistan (ICAP) to outsource tax audit in respect of corporate cases. In accordance with the said MOU, a Tax Audit Framework (TAF) has been prepared and approved by the competent authority. The TAF contains scope of audit, engagement letter, form of audit report and other parameters to complete the audit proceedings.

Objectives

In addition to the objectives mentioned in the National Audit Plan, the main objectives of the Taxpayer's Audit will be to:

- Educate taxpayers regarding their rights and obligations
- Promoting voluntary compliance
- Detect non-compliance on the part of medium and large taxpayers
- Evaluate usefulness of internal FBR data and available third party data associated with the relevant taxpayer's returns
- Provide FBR and its field formations with data to aid in future strategic Planning
- To ensure collection of that additional revenue which has not been declared / paid

In the first phase, the audit coverage of about 900 corporate and AOPs taxpayers, located in the jurisdiction of our various field formations in Pakistan, shall be ensured.

Ensuring quality of Audits

- Audit reports shall be checked by a committee of authorized & competent officers.
- Adjustments / amended adjustments to be approved by audit managers

- The system & procedures in the audit manual may be ensured to be followed
- It may also be ensured that the audit teams / auditors are performing as per guidelines provided in National Audit Manual

The audits shall be conducted in light of relevant statutes/Rules, National Audit Manual and its templates/forms (which are required to be completed at various stages of audits by the audit Managers/officers) and in accordance with expertise and resources available with the relevant field formations.

Taxpayer feed back

Periodic surveys of a sample of audited taxpayers will be conducted to:

- Gauge perception of the audit process
- Help in improvement of the overall audit functions
- Evaluate the behaviors, professionalism and competence of audit staff

Computerization

The Taxpayer's Audit Monitoring System (TPAS) for automation of Taxpayers Audit and monitoring Auditors transactions/activities during the audits of Income Tax & Sales Tax has been developed with the help of M/s PRAL and is being installed at fielded formations. The system will not only ensure the quality of audit reports but will also minimize the time taken in completion of audits.

Review of Audit Report

The Chief Commissioners of all LTUs / RTOs shall play a key role by assigning responsibility to the relevant audit managers and their staff for smooth functioning of audit. They shall ensure the quality of audits being conducted in their respective jurisdiction through formations of quality review Committee in their unit / office. The Committee will review audit reports on test basis and report its findings to the commissioners concerned for his further instructions.