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A Review of Resource Mobilization Efforts of Central Board of Revenue

CENTRAL BOARD OF REVENUE

Government of Pakistan

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An Analysis of Revenue of Q1: 05-06[1]

Pakistan's economy continued its broad-based strong growth during the first quarter of FY: 05-06. The macroeconomic indicators moved in the right direction and the major sectors also achieved their assigned targets. However, weaknesses in certain areas have started to create ripples in recent months. Firstly, there has been a slow down in the manufacturing sector that appears to be inconsistent with the overall policy framework. Secondly, the unprecedented growth in imports relative to exports has widened the trade gap necessitating a careful analysis of composition of imports. There is no doubt that the import of plant, machinery, and equipment as well as industrial raw material is essential for boosting investment activity and growth, nonetheless, the rush for consumer items and automobiles if continues for a prolonged period may create balance of payment difficulties in future. Furthermore, the inflationary pressure that was a constant source of instability during much of the FY: 05-06 has not pacified completely. While part of the surge in prices has been controlled through a combination of monetary and fiscal policies, the volatility of oil prices and the large monetary overhang have been the constraining factors to bring back the rate to the target level. As a consequence of tightening of money, there has been the steady increase in interest rates. Can this factor be held responsible for further slowing down of economic activity? At this moment, it is probably a premature thought. However, there should be no denying that a careful monetary approach is desired to address some of the re-emerging macroeconomic imbalances.

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[1] The Research Team of the Fiscal Research Wing of CBR has prepared this Chapter. Valuable support has been received from the Budget Wings of Direct & Indirect Taxes and the Directorate of Research & Statistics.

Apart from the factors just mentioned, the country has also experienced the most unfortunate and devastating earthquake on 8th October 2005, which brought massive destruction of life and property in the NWFP province and Azad Kashmir. While, it is too difficult to project the socio-economic and psychological aftereffects of this disaster, the immediate reaction by the entire nation has been extremely encouraging. It is anticipated that the strong will and determination of the people of Pakistan and proper planning, zeal and commitment of the government would prevail ultimately in overcoming this tragedy. We hope that the population in the affected areas would start benefiting when the reconstruction activities start soon after the winter season.

CBR Revenue Target for FY 05-06

Anticipating continuity in growth momentum, the budgetary target for FY 05-06 has been set at Rs. 690 billion, showing an increase of 19% on the start of the year target of Rs. 580 billion for FY 04-05 and 16.9% over the enhanced revised target of Rs. 590 billion. In comparison to provisional collection of Rs. 591.1 billion during FY: 04-05, the target for FY 05-06 requires an increase of 16.7% (Table 1). These projections for the CFY are based on the baseline collection of FY 04-05, assumed growth for various components of GDP, elasticity/ buoyancy estimates, and the expected impact of wide-ranging budgetary (tax and relief) measures announced at the time of Federal Budget 2005-06. Specifically, the nominal GDP is expected to grow by 14.5% during FY 05-06, the large scale manufacturing to maintain its buoyant posture is expected to grow by 19.1%, and dutiable imports to increase by 19.5%. The buoyancy of three major revenue spinners, i.e., direct taxes, sales tax, and customs duties is expected to remain close to unity. Thus, provided the outturn of individual taxes and growth trajectories are materialized, it is anticipated that the share of direct taxes in total CBR collection would be around 31% and the remaining amount will be generated by indirect taxes.

Table 1: Provisional Baseline Collection for FY 04-05 and Projections for FY 05-06

(Collection in Rs. Billion)

	Provisional Collection FY 04-05	Projections FY 05-06	Growth (Percent)
Direct Taxes	183.1	214.0	16.9
Sales Tax	240.0	276.5	15.2
Customs Duties	115.1	140.0	21.6
Federal Excise	52.9	59.5	12.5
All Taxes	591.1	690.0	16.7

Monitoring CBR Revenue Collection

In an effort to regularly monitor CBR revenue collection, the monthly and the quarterly targets of the four federal taxes have been projected on the basis of historical trends in collection, i.e., average collection during FY 01-02 through FY 04-05 and the existing state of the economy. Further adjustments have been made to these guiding posts in the light of the most recent outturn and the policy initiatives undertaken during the year *(Table 2)*. For example, with the zero-rating of entire chain of five export industries, the sales tax (domestic) collection is expected to be lower in gross terms. However, since fewer refunds will be accrued, the net collection is expected to exceed last year's collection by a fair margin. Needless to add that the first quarter will have to absorb some adjustment for stock of inputs accumulated over the last months of PFY. Thus, the monthly and the quarterly targets have been fine-tuned in the light of such measures related to the four federal taxes.

Table 2: Monthly Targets of Federal Taxes: FY 05-06

(Rs. Billion)

	DT	ST	FED	CD	ALL
July	6.9	16.0	2.6	8.4	33.9
August	8.2	19.6	4.9	8.8	41.5
September	33.7	21.5	5.2	9.7	70.1
First Quarter	**48.8**	**57.1**	**12.7**	**26.9**	**145.5**

Accordingly, the revenue target for the July-September 2005 has been fixed at Rs. 145.5 billion, which constitutes 21.1% of the yearly target of Rs. 690 billion. Perceived as taxes of the future, more emphasis has been placed on sales tax, and income and corporate taxes. Resultantly, nearly 73% of the total collection during July-September 2005 was realized from these two sources and the share of direct taxes and sales tax has been 32% and 41% respectively.

CBR Revenue Position

The net collection of CBR has surpassed the 1st quarter target by Rs. 6.6 billion. The net collection of Rs. 152.1 billion during July-September 2005 shows a remarkable growth of 21% over the corresponding period of PFY. A double-digit growth has been recorded in direct taxes, sales tax, and customs duty receipts. Also there has been a significant increase in FED receipts *(Table 3)*. Due to broad-based growth in revenue, the collection of three leading sources of federal receipts, i.e., sales tax and customs duties has exceeded their respective targets. This indicates that not only the momentum in revenue collection has been preserved, but also it has been further reinforced through wide-ranging incentives and taxpayer-friendly measures. At the same time, the continuous strong performance of the economy, especially in the area of international trade, continues to provide the required impetus to CBR collection efforts.

Table 3: Comparison of Collection: Q1: 05-06 and Q1: 04-05

	Collection	Collection	Difference	
	Q1: 05-06	Q1: 04-05	Absolute	Percent
Direct Taxes	48.2	41.7	6.5	15.5
Sales Tax	63.0	50.4	12.6	25.1
Federal Excise	12.2	11.2	1.0	9.0
Customs	28.6	22.4	6.2	27.9
All Taxes	**152.1**	**125.7**	**26.4**	**21.0**

Note: Collection and Target in Rs. Billion.

Analysis of Refunds/Rebates

Contrary to popular perception, the collection of domestic sales tax has recorded a healthy increase of 39.5% over Q1: 04-05 as there has been a substantial saving on account of zero-rating of five export-oriented industries. Table 4 shows that, notwithstanding 58.9% increase in income tax refunds and 27.2% increase in rebates, the overall refund/ rebate payments have declined by 19.4% during the first quarter of CFY over PFY. It is interesting to observe that there has been over 50% decrease of refunds in total sales tax.

Table 4: Comparative Position of Refunds/ Rebates: Q1: 05-06 - Q1: 04-05

*(Collection in **Rs. Million**)*

	Refunds/ Rebates		Difference	
	Q1: 05-06	Q1: 04-05	Absolute	Growth (%)
Direct Taxes	5,202	3,273	1,929	58.9
Sales Tax	7,574	15,163	-7,589	-50.1
Imports	*37*	*5*	*32*	*640.0*
Domestic	*7,537*	*15,158*	*-7,621*	*-50.3*
FED	150	10	140	1,400.0
Customs	5,282	4,151	1,131	27.2
All Taxes	**18,208**	**22,597**	**-4,389**	**-19.4**

This confirms that there is no harm in introducing certain country-specific measures within the globally accepted procedures to tackle soaring problems that are difficult to address due to less than fool proof systems and procedures currently in vogue. The criticism from certain quarters regarding ‘breaking of VAT chain’ due to zero-rating appears to be misplaced. There is no denying the fact that the existing refund/rebate procedure needs to be strengthened by automation of the process and strict vigilance against shady practices. The leakages through flying and fake invoices and lack of transparency in the issuance of refunds need to be urgently plugged so that the taxation system operates within the internationally accepted norms and procedures. However, till such time that these loopholes are plugged, a custom-made compromising solution should be allowed to prevail when the benefits are also far too apparent.

Detailed Analysis of Individual Taxes

The in-depth analysis of individual taxes provides further insight on specific sources of growth. It also helps in understanding the linkages between tax receipts from various components and the sectoral composition of the economy. A number of fiscal policy initiatives have been undertaken during the current and past fiscal years in the realm of broadening of tax base, reduction and rationalization of tax and tariff rates, automation, and improvement in tax administration. It is, therefore, relevant to know the impact of these policy changes on tax collection and the overall equity and efficiency gains in the taxation system.

***Direct Taxes*:** Direct Tax gross and net collection during the 1st quarter of CFY was Rs. 53.4 billion and Rs. 48.2 billion, respectively with refund payments of Rs. 5.2 billion. This outcome compares with gross and net collection of Rs. 45 billion and Rs. 41.7 billion, respectively and payments of refunds amounting to Rs. 3.3 billion during Q1: 04-05. Thus, the growth registered by the direct taxes during Q1 of CFY has been 18.6% in gross term and 15.5% in net revenue collection, besides payment of higher refund by 58.9%. This notable growth in the collection of direct taxes is attributed to the following factors:

(a) Increase of 35% in Collection on Demand, by clearing the Brought Forward cases as indicated by a growth of 81% attained in the collection of arrear demand, while current demand has declined by 31.8%; and

(b) The growth of around 27% in the withholding taxes indicates stability in the economy. as imports are growing to meet the domestic demand.

An Analysis of Income Tax Returns: The preliminary analysis of income and corporate tax returns filed during the first quarter of CFY highlights the following interesting points.

- There has been a modest growth in the number of returns and statements as well as voluntary tax compliance as compared to last year (Table 5);

Table 5: An Analysis of Returns and Tax Collection during 2005 and 2004

	Up to October 15th 2005		Up to October 15th 2004		Difference (Absolute)		Growth (%)	
	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid
Returns								
Corporate Cases	1742	4951.0	1353	5299.7	389	-348.7	28.8	-6.6
AOPs	21826	91.2	24612	95.9	-2786	-4.7	-11.3	-4.9
Salaried Individuals	62896	175.8	129069	186.2	-66173	-10.4	-51.3	-5.6
Non-Salaried Individuals	510189	1009.2	496334	1076.9	13855	-67.7	2..8	-6.3
Sub Total Individuals	573085	1185.0	625403	1263.1	-52318	-78.1	-8.4	-6.2
Sub Total Returns	***596653***	***6227.2***	***651368***	***6658.7***	***-54715***	***-431.5***	***-8.4***	***-6.5***
Statements								
Salary certificates/statements	485215	123.7	372713	131.8	112502	-8.1	30.2	-6.1
Importers	9826	8.4	8375	3.4	1451	5.0	17.3	147.1
Exporters	8967	1.9	9078	1.9	-111	0.0	-1.2	0.0
Contractors/ Suppliers	33993	45.6	36249	50.4	-2256	-4.8	-6.2	-9.5
Other(including Retailers)	36378	104.2	25017	93.3	11361	10.9	45.4	11.7
Sub Total Statements	574379	283.8	451432	280.9	122947	3.0	2.9	1.1
Total	**1171032**	**6511.0**	**1102800**	**6939.6**	**68232**	**-428.6**	**6.2**	**-6.2**

Note: Tax paid in Million Rupees.

- As of October 15, 2005 a total of 1,171,032 returns and statements have been received from Companies, Association of Persons (AOPs), Salaried and Non-salaried individuals; and Importers, Exporters, and Contractors etc. At the aggregate level, the number of returns/ statements shows a growth of 6.2% over the preceding year;

- The voluntary tax compliance has recorded a negligible growth over PFY;

- Even though the number of returns filed by the taxpayers has registered a positive growth, but tax paid with returns has shown negative growth of 6.2%. The amount of tax paid by the corporate cases has declined by a modest amount of Rs. 348.7 million, followed by non-salaried individuals of Rs. 67.7 million and salaried individual by Rs. 10.4 million.

- The regional comparison reveals a mixed performance. For instance, the growth in the number of returns and statements in the Northern Region was 1.2%; Eastern Region 18.4% and southern Region Karachi 12.6%. Surprisingly, rest of the regions including LTUs have indicated a decline in the number of returns received during the period under review. Similarly, the growth in tax payment with returns has also been negative in all the regions and LTUs except the Southern Region Karachi, where 14.4% growth has been recorded.

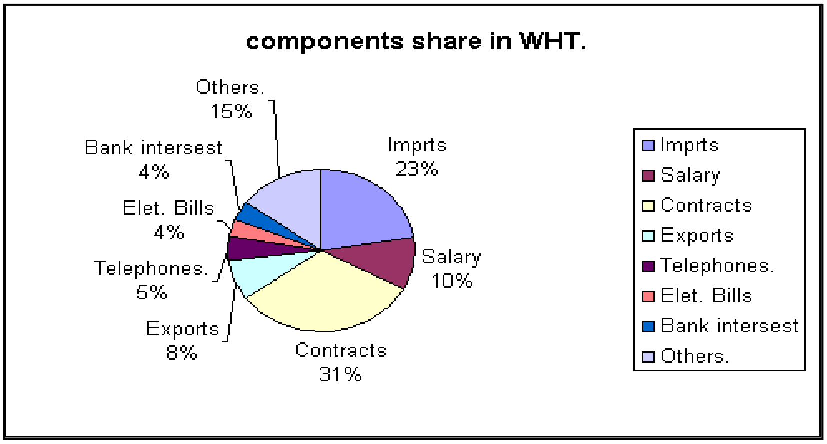
A further analysis confirms that during FY 05-06 nearly 96% of income and corporate tax has been paid with returns and the rest is submitted with the statements. This outcome is aligned with last year performance. However, the noted feature of the corporate sector is that the share of returns and tax paid with returns are static. *(Table 6)*. Specifically stating, the amount of tax paid by the corporate sector has decreased from Rs. 5299.7 million during FY 04-05 to Rs. 4951.0 million during FY 05-06. No significant change has been observed in the statements group except for the 'other' category, which indicates the significance of the emerging share.

Table 6: A Further Analysis of Returns and Voluntary Compliance

	Up to October 15, 05		Up to October 15, 04	
	No. of Returns Received (Share %)	Tax Paid (Share %)	No. of Returns Received (Share %)	Tax Paid (Share %)
Returns				
Corporate Cases	0.3	79.5	0.2	79.6
AOPs	3.7	1.4	3.8	1.4
Salaried Individuals	10.5	2.8	19.8	2.8
Non-Salaried Individuals	85.4	16.2	76.2	16.2
Sub Total Individuals	96.0	19.1	96.0	19.0
Sub Total Returns	100.0	100.0	100.0	100.0
Statements				
Salary	84.5	43.6	82.6	46.9
Importers	1.7	3.0	1.9	1.2
Exporters	1.6	0.7	2.0	0.7
Contractors/ Suppliers	5.9	16.0	8.0	18.0
Other	6.3	36.7	5.5	33.2
Sub Total Statements	100.0	100.0	100.0	100.0

Components of Income and Corporate Taxes:

Compared to 1st quarter of last year, a notable growth in COD and withholding taxes i.e. 35% and around 27% have been recorded. As indicated above, the significant increase in COD is mainly due to clearance of backlog by the regions, resultantly the collection under arrear demand substantially increased over PFY. The collection on account of withholding taxes has also increased due to 44.9% growth in WHT on contract, 37.7% on bank interest, 28.6% on phones and 14.6% on account of transport. This growth pattern is consistent with the overall economic progress in the country. The major share in the collection of withholding taxes has been contracts (31%), followed by Imports (23%) and salary (10%), see (Graph 1).



Sales Tax: Sales tax has exhibited growth of 7.7% and 25.1% in gross and net receipts, respectively during the first three months of CFY. Total gross and net collection realized during Q1:05-06 was Rs. 70.6 billion and Rs. 63.0 billion, respectively while Rs. 7.6 billion were paid back as refunds. As indicated, with zero-rating of the entire chain of five major export oriented industries during budget FY: 05-06 i.e., textile, carpets, surgical goods, sports goods and leather, refunds of sales tax have been reduced by 50%. Thus, net collection has improved significantly. Lower growth in the gross collection of sales tax is also attributed to zero-rating of export-oriented industries.

Domestic Sales Tax Collection: Ten major revenue spinners have realized around 69% of the total collection of sales tax domestic during 1st quarter of CFY. These include POL products, services including telephone, natural gas, sugar, electrical energy, cement, cigarettes, aerated waters, motorcars and auto parts. The gross collection from these major items has increased by 2.4% (Table 7). This low growth in collection from 10 major revenue items can mainly be attributed to more than 50% lesser contribution by electrical energy during first quarter of the CFY. Apart from electrical energy, tax realized from cigarettes and POL products has also decreased during the Q1: 05-06 by 24.4% and 4.5%

respectively. In case of cigarettes, the collection has dropped during July-August 2005 due to less production by 3.4%. However, an increase in demand for cigarettes during September has helped in increased collection by 15.3%.

Table 7: Gross Collection of GST (Domestic) from Major Revenue Spinners

	FY: 05-06	FY: 04-05	Growth (%)		FY: 05-06	FY: 04-05	Growth (%)
POL Products				*Cement*			
July	1560.7	1631.1	-4.3	July	362.9	312.6	16.1
August	2183.5	2154.1	1.4	August	357.8	298.3	19.9
September	1676.2	1891.4	-11.4	September	434.3	323.6	34.2
Q1	5420.4	5676.6	-4.5	Q1	1155.0	934.5	23.6
Total Services including Telephone/Fax				*Cigarettes*			
July	1633.4	1432.3	14.0	July	109.5	309.7	-64.6
August	2194.8	1545.7	42.0	August	220.2	346.8	-36.5
September	2403.4	2100.0	14.4	September	483.4	419.4	15.3
Q1	6,231.1	5,078.0	22.7	Q1	813.1	1075.9	-24.4
Natural Gas				*Beverages*			
July	488.0	835.5	-41.6	July	209.6	211.4	-0.9
August	1173.7	833.5	40.8	August	279.3	237.8	17.4
September	1270.3	966.4	31.4	September	261.8	216.2	21.1
Q1	2,932.0	2,635.5	11.3	Q1	750.6	665.4	12.8
Sugar				Motor Cars			
July	798.5	520.0	53.6	July	105.6	10.4	915.4
August	699.1	683.4	2.3	August	262.7	155.6	68.8
September	518.6	530.9	-2.3	September	316.6	367.5	-13.9
Q1	2,016.2	1,734.4	16.3	Q1	684.9	533.5	28.4
Electrical Energy				*Auto Parts*			
July	25.1	52.8	-52.5	July	201.8	126.2	59.9
August	79.8	47.6	67.6	August	171.2	114.6	49.4
September	1,142.20	2,489.1	-54.1	September	205.2	158.7	29.3
Q1	1,247.1	2,589.4	-51.8	Q1	578.2	399.5	44.7
Major Ten Commodities				*All Commodities*			
July	5495.1	5152.6	6.6	July	8883.0	9644.0	7.9
August	7621.6	6114.5	24.6	August	10744.0	9724.0	10.5
September	8712.1	9115.6	-4.4	September	11870.0	12697.0	-8.5
Q1	21828.8	21322.7	2.4	Q1	31497.0	32335.0	-2.6

The remaining seven major revenue spinners have registered a double-digit growth during first quarter. In particular, the growth in services including telecommunication was 22.7%, natural gas

11.3%, sugar 16.3%, cement 23.6%, aerated waters 12.8%, motorcars 28.4% and auto parts 44.7%. While the growth in collection from services is attributable to the increased competition in the telecom sector spurred by growing use of mobile phones, the healthy increase in the remaining six commodity groups has mainly been due to strong demand, resulting into manifold increase in taxable sales.

Regarding decline in the POL, although taxable sale has increased significantly from Rs. 17.5 billion during July-Sep, FY 04-05 to Rs. 25.2 billion during Jul-Sep, 2005-06, but substantial input adjustment from Rs. 21.4 billion to Rs. 32.4 billion has been responsible for shrinking revenue. Thus, despite strong demand, the effective rate has reduced from 3.2% in Q1: 04-05 to 2.1 % in CFY. The reduction in revenue from POL has been mainly noticed in LTU, Karachi. Apart from Price Differential Claim (PDC) swallowing Rs. 876.1 million, change over to hydropower and gas by the industrial units has been cited as the reason for reduced collection.

Customs Duties: Despite emergence of sales tax and income tax as the two leading sources of tax collection in the last few years, the Customs Duties (CD) are still generating significant quantum of collection. Large-scale tariff reduction has spurred imports especially capital goods. As a result of continuous tariff reduction in the recent years, around 53% of the tariff lines are now subjected to 10% customs duty. It is encouraging that tariff reduction has not affected the collection due to substantial growth in the imports that has neutralized its negative impact.

Tariff reduction during FY: 05-06 has brought down effective rates of total import and dutiable imports from 9.7% and 15.7% in the Q1:04-05 to 8.7% and 13.9% during 1st quarter of CFY. The gross and net receipts from customs duties stood at Rs. 33.9 billion and

Rs. 28.6 billion, respectively entailing an increase of more than 27%. It is relevant to mention that this vibrant performance is despite massive growth of 27.2% in the rebate payments during Q1: 05-06. In absolute terms, rebates paid during the period were Rs. 5.3 billion against Rs. 4.2 billion in the corresponding period of last year. The month-to-month growth presented in Table 8 depicts that net CD collection has improved substantially during all the first three months of the 1st quarter FY: 05-06. The growth is recorded 28.1% in July, 19.7% in August and 35.3% in September during FY: 05-06

Table 8: Comparison of Gross and Net collection of Customs Duties and Refund/ Rebate Payments

(Rs. Million)

	FY: 05-06	FY: 04-05	Difference	
			Absolute	Percent
Gross Collection				
July	9,717	8,001	1,716	21.4
August	11,568	8,958	2,610	29.1
September	12,643	9,587	3,056	31.9
Q1	33,928	26,546	7382	27.8
Refund/ Rebate				
July	1,334	1,456	-122	-8.4
August	2499	1,382	1,117	80.8
September	1449	1,313	136	10.4
Q1	5282	4,151	1,131	27.2
Net Collection				
July	8,383	6,545	1838	28.1
August	9,069	7,576	1493	19.7
September	11,194	8,274	2920	35.3
Q1	28,646	22,395	6251	27.9

Table 9 presents the data related to fifteen leading revenue spinners of CD during Q1: 05-06. These commodity groups categorized within Pakistan Customs Tariff (PCT) headings have contributed 80% of customs receipts, 62.9% of total imports and 84.4% of the dutiable imports. As in previous year, the leading contributor has been vehicles (chapter 87). In the budget FY:05-06, tariff has been reduced on certain categories of vehicles and parts. Since elasticity of demand is higher for vehicles, the import of automobile has increased by 55.3% in the first quarter of FY:05-06. Dutiable imports of vehicles constitute 94.3% of the total imports of vehicles indicating that no exemptions are available on luxury items. Chapter 15 pertaining essentially to edible oil has been the second significant source of CD collection during the first quarter of CFY. The collection under this chapter grew by 16.3%.

Table: 9 Chapter-Wise Growth of Major Revenue Spinners and Effective Rates

PCT Ch.	Tariff Description	July-September Growth (%)			Effective Rates (%) With Dutiable Imports	
		Import Value	Dutiable Imports	Customs Duties	Jul-Sep 05-06	Jul-Sep 04-05
87	Vehicles	55.3	60.9	56.9	35.4	36.3
15	Animal or vegetable fats	5.2	5.2	16.3	33.1	29.9
84	Mechanical Machinery	36.4	66.3	39.0	6.8	8.1
85	Electrical Machinery	106.4	130.4	42.5	7.6	12.3
72	Iron & Steel	73.6	25.5	9.6	10.8	12.3
27	POL Products	66.7	87.5	91.5	10.2	10.0
39	Plastic & Articles Thereof	39.9	41.6	0.1	8.7	12.2
29	Organic Chemicals	3.3	-13.3	-20.8	8.4	9.2
48	Paper & Paperboard	25.9	26.9	27.9	18.8	18.6
73	Articles of Iron & Steel	70.6	85.8	119.3	15.0	12.8
38	Misc. Chemical Products	-1.3	-2.9	-15.1	8.0	9.1
32	Dyes, paints etc	15.3	6.6	-3.2	13.1	14.5
40	Rubber & Articles thereof	39.0	12.3	8.8	11.5	11.9
69	Ceramics	77.2	69.0	73.4	22.8	22.2
54	Man made filaments	143.7	146.5	36.1	8.8	15.9
	Sub-total	46.5	49.8	33.0	13.2	14.8
	Others	35.6	-0.2	10.5	17.9	16.1
	Grand total	42.2	39.0	27.8	13.9	15.1

As part of the government policy to increase the inflow of investment, in the case of electrical and mechanical machinery (Chapter 84 & 85), the tariff rates were reduced substantially. As a result, the import of mechanical machinery has increased by 36.4% and electrical machinery by 106.4% during Q1:05-06, while the CD receipts have also improved from these two sources by 39% and

42.5%, respectively. It is again evident that the higher demand for import of machinery has compensated for the anticipated negative impact of reduction in CD rates. Within the same context, with the expansion of economy, the demand for iron and steel has also increased. The imports of iron & steel (Chapter 72) and articles of iron & Steel (Chapter 73) increased by 73.6% and 70.6%, respectively during the first quarter of FY: 05-06. The growth in CD collection from these two items has been 9.6% and 119% respectively. Finally, POL products (Chapter 27) also recorded an increase of 91.5% in CD due to higher dutiable imports by 87.5%.

Out of fifteen commodity groups items, three have registered negative growth in the CD collection. These items were plastics, organic chemicals, miscellaneous chemical products and tanning or dyeing extracts. In all these cases, the rates of customs duty were slashed in the federal budget FY: 05-06 to boost the industrial production.

Federal Excise: The collection of FED exhibited a moderate growth of 9% in the first three months of CFY. The receipts increased from Rs. 11.2 billion in Q1: FY:04-05 to Rs. 12.2 billion during Q1: FY: 05-06. Starting with negative growth of 29.6% & 2.7% mainly due to considerable decline in the collection of cigarettes in July and August, the collection has shown improvement by 50.6% in the month of September of the first quarter FY: 05-06. It may be recalled that the FED is being withdrawn gradually in the recent years according to tax policy of the government. The FED from soap and detergents was withdrawn in the federal budget 2005-06.

The major chunk of FED collection i.e., around 91% comes from five major revenue spinners for revenue. These include: POL products, cigarettes, cement, natural gas and beverages & concentrates. The month-wise performance of these major revenue spinners is depicted in Table 10.

Table 10: Central Excise Major Revenue Spinners

(Rs Million)

	FY 05-06	FY 04-05	Difference	
			Absolute	Percent
Cigarettes				
July	536.9	762.9	-226.0	-29.6
August	1474.2	1515.6	-41.4	-2.7
September	2526.7	1677.3	849.4	50.6
Q 1	4537.8	3955.8	582.0	14.7
Cement				
July	924.6	867.4	57.2	7.7
August	996.1	825.9	170.2	20.6
September	1030.0	949.4	80.6	8.5
Q 1	2950.7	2642.6	308.1	11.7
Natural Gas				
July	366.7	441.1	-74.4	-16.9
August	466.3	454.4	11.9	2.6
September	508.5	443.6	64.9	14.6
Q 1	1341.5	1339.1	2.4	0.2
POL Products				
July	279.7	350.4	-70.7	-20.2
August	364.1	375.5	-11.4	-3.0
September	377.6	409.2	-31.6	-7.7
Q 1	1021.4	1135.1	-113.7	-10.0
Beverages & Concentrates				
July	399.4	373.2	26.2	7.0
August	514.1	381.8	132.3	34.7
September	484.2.	374.5	109.7	29.3
Q 1	1397.7	1129.5	268.2	23.7
Total (Major Commodities)				
July	***2507.3***	***2794.9***	***-287.6***	***-10.3***
August	***3814.8***	***3553.2***	***261.5***	***7.4***
September	***4927.0***	***3853.0***	***1073.0***	***27.8***
Q 1	***11249.1***	***10202.2***	***1046.9***	***10.3***
Share in Gross CED (%)	***90.8***	***90.9***		

The cigarette is the leading revenue source. It has yielded Rs. 4.5 billion during July-September, 2005 as compared to Rs. 4.0 billion in the corresponding period of last year. The receipts from the cigarettes have declined in the first two months partly due to negative growth of 3.4% in the production of cigarettes. However, the collection has improved by 50.6% in September 2005, which has helped in the overall improvement in the tax receipts of cigarettes during Q1:05-06. Cement is the second major contributor of FED during Q1:05-06. It posted positive growth in all the three months of CFY. This growth is backed by around 14% growth in the production of cement as compared to previous year while the collection from natural gas has shown a slight increase of 0.2% in the first quarter of CFY, it declined for POL products.

The decline mainly noticed in the collection of LTU was attributed to certain constraints faced by one of the refineries. Finally, the collection improved for aerated waters including concentrates by around 24% due to increased sales around by 32% in July-September, 2004-05 as compared to corresponding period last year.

Concluding Observations

The CBR revenue performance during 1st quarter of CFY has been as per *a priori* expectations. The overall revenue collection has exceeded the revenue target, which is a major development in view of the wide-ranging tax policy (relief) initiatives introduced at the beginning of the current fiscal year. The broad-based growth not only reflects an expansion of economic activities in the country, it is also indicative of enhanced taxpayers' confidence on the taxation machinery. The government policy of providing favorable environment for investment has been rewarding so far. The manifold increase in the import of plant, machinery and equipment on the one hand and raw materials on the other confirms that domestic demand remains strong. The expected impact of the reduction in the rates of customs duties have been compensated by a significant increase in the dutiable imports which has led to an impressive growth in the taxes as well as customs duties. Similarly, the growth in the collection of income and corporate tax and sales tax is attributable to growth in diversified industries including cement, sugar, telecom, banking and insurance and oil and gas exploration. We anticipate that this positive trend will continue in the subsequent quarters of CFY, albeit at a slower rate, and as a consequence CBR is able to generate adequate resources for the government to fulfill its fiscal needs. This will also be helpful in raising tax/GDP ratio to a respectable level in the coming years.

II

Impact Evaluation:

An *Ex Post* Analysis of Budgetary Measures During 1st Quarter of FY: 2005-06[2]

Background

The taxation policy evolves constantly to promote economic growth and minimize distortions. Wide-ranging budgetary measures are undertaken for creating conducive environment for investment and trade. These are also needed for expansion of tax base and improvement in tax compliance. A range of tax measures was announced at the time of Federal budget FY: 05-06. These measures included reduction and realization of tax and tariff rates and introduction of the concept of zero-rating of sales tax on the entire chain of five major export-oriented industries to tackle the refund/rebate problem and to enable these industries to compete in the world. We start with a brief review of the recently announced budgetary measures.

Budgetary Measures: A Brief Review

A summery of tax and facilitation measures related to federal taxes, and initiatives introduced at the time of Budget FY: 05-06 is provided in the following. Starting with direct taxes, the presentation continues for measures related to sales tax and customs duties.

Direct Taxes:

a) Levy of WHT @ 0.1% on Cash Withdrawal exceeding Rs. 25,000/- per transaction;

b) Brining uniformity in WHT on execution of Contracts at 6% in 2005-06 from 4-8% in 2004-05;

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[2] Prepared by the Research Team of the Fiscal Research and Statistics Wing in association with the computer Wing of DRS.

c) Reduced rates of withholding tax @ 1% on import of export oriented industries;

d) The rates of salaried taxpayers rationalized between 3.5% and 30% in 2005-06 as compared to 7.5% to 35% during FY: 04-05;

e) The five export oriented industries have been zero-rated for sales tax purposes and subjected to pay enhanced WHT @ 0.25%.

f) Corporate tax rates have been reduced by 3% and 2% for banking and private companies.

Sales Tax and Federal Excise:

a) Zero-rating of the entire chain of Export oriented Industries i.e., textile, leather, carpets, sports and surgical goods, including their raw materials;

b) Zero-rating of machinery, plant and equipment and parts of capital goods;

c) Activation charges of Cellular Phones have been reduced from Rs.1,000 to Rs. 500;

d) Payments of sales tax by manufacturers on retail stage on some items like toothpaste, biscuits, toilet soap, tea, footwear, perfumery & cosmetics, shaving cream, shampoo, powder drinks, milky drinks and detergents;

e) Withdrawal of FED from Soap & Detergents;

f) Rationalization of FED on payphone/prepaid callig cards and wireless local loop (WLL) services;

g) Upward adjustment of excise tariff on middle and lower slabs of cigarettes;

h) Levy of single stage sales tax @ 3% on retail sale of five export oriented industries. The 3% is inclusive of 1% of income tax.

Customs Duties:

The budgetary measures were essentially related to rationalization and reduction of tariff rates for different commodities to obtain raw material and machinery at competitive rates to accelerate economic activity. The specific details are as follows:

Textile: In order to boost the textile sector, the CD rates have been reduced on textile items i.e., MEG from 10% to 0%, PTA from 20% to 15% (refundable U/S 21(1)(b) of Customs Act, 1969 read with SRO 450(I)/2001 dated 18.06.2001), chip from 20% to 3%. Reduction of CD 6.5% on fibers, 7% on yarns, and on fabrics CD rates has been reduced from 25% to 14%.

Agriculture: To achieve sustainability in the agricultural production the following relief measures have been initiated for this sector.

a) Exemption of Duty on Urea Fertilizer from its present rate of 5%;

b) Reduction of CD on the import of Agri-Tractors in CBU Condition from 20% to 15%;

c) Reduction in CD on import of agriculture equipment; and

d) Decrease in CD on import of 319 edible items.

Raw Materials: The customs duty has been reduced on the following raw materials during budget FY: 05-06.

a) Primary Raw Materials from 25% to 15%;

b) Organic and inorganic chemicals from 25% to 20% to 15% and 10% to 5%;

c) Dyes and Chemicals reduced to 5%, 10%, 15% and 20%;

d) Plastic Raw Materials from 10-25 to 5-20%;

e) Hepatitis-B Vaccine from 20% to 10% and 10% to 5%;

f) CD on Wood has been exempted for HS headings 44.03 and 44.07 while for some other items it has been reduced from 25% to 20%.

g) Raw materials for Confectionary Industry from 25%, 20%, 10% to 15%, 10% and 5%;

h) Essential Oils, Cosmetics/Toilet Preparations from 20% to 15% and 10%;

i) Photographic and Cinematographic Goods from 10% to 5%; and

j) Petroleum Additives from 20% and 10% to 5%.

Machinery: The CD on machinery, plants, equipment and parts has been reduced to promote the manufacturing sector activities.

Vehicles: Cars in CBU (Completely Built-in Units) condition were subjected to customs duty ranging from 50% to 100% in FY: 04-05. In order to provide further relief to the consumers in the shape of reduced premium by vested groups and fair competition to the local assemblers, the following three duty slabs have been introduced in the budget 2005-06.

a) CBU Cars up to 1500 CC: @ 50%

b) CBU Cars up to 1501 CC to 1800 CC: @ 65%

c) CBU Cars above 1800 CC: @ 75%

d) Duty and Taxes in US$ (or equivalent amount in Pak Rupees) for Old and Used Automotive Vehicles to the range between US$ 4000 and US$ 21,000.

***Ex Post* Assessment of Policy Measures**

Tax-wise *ex post* impact of major taxation policy changes during July-September FY:05-06 has been presented below.

Direct Taxes

Introducing Uniformity in the WHT Rate for Contracts i.e. 6%: WHT different rates were in vogue until FY: 2004-05 that resulted into complexity of the system. For example, payments made to a resident person or a non-resident person or permanent establishment of a resident person on account of execution of a contract (other than a contract for sale of goods or rendering of services) were subjected to WHT at the following rates.

In the case of a contract with a value exceeding thirty million rupees	6% of the gross amount payable
In any other case	5% of the gross amount payable

On the other hand, rates of WHT for other categories of projects during 2004-05 were as under:

a. In the case of turnkey contract	8% of the gross amount payable
b. In the case of hydel power project or a transmission line project.	5% of the gross amount payable
c. In any other power project.	4% of the gross amount payable

Partly due to the introduction of uniformity in the rate of contracts at 6%, the collection from contractors has increased from Rs. 6.1 billion in Q1: 04-05 to Rs. 8.9 billion in the Q1: 05-06, entailing an increase of Rs. 2.8 billion (Table 1). It is important to add that enhanced government spending has been mainly responsible for more revenues from this source. Thus, if natural growth is assumed to be around 18%, the impact of the policy on contracts is estimated to be Rs.1.6 billion. With the introduction of uniformity in the rate of contracts i.e. 6%, the collection from contractors has increased from Rs. 6.1 billion in Q1: 04-05 to Rs. 8.9 billion in the Q1: 05-06, entailing an increase of Rs. 2.8 billion (Table 1).

Table 1: Impact of Uniformity of Withholding Tax Rates on Contracts

Months	2005-06	2004-05	Diff	Growth (%)
July	2206.8	1317.9	888.9	67.4
August	2075.3	1684.4	390.9	23.2
September	4589.3	3119.6	1469.7	47.1
Without Growth Adjustment	8871.4	6121.9	2749.5	44.9
With Growth Adjustment	8871.4	7223.8	1647.6	22.8

Figures are in million

Rationalization of Tax Rates of Salaried individuals: In the previous regime, standard personal rates for salaries ranging between 7.5% and 35% were applied during FY:04-05. These rates have been revised between 3.5% and 30% during FY:05-06. The basic threshold remains at Rs.100,000. The overall increase in revenue has not been substantial – only Rs. 125.1 million, which may be entirely due to natural growth in the base (Table 2).

Table 2 : Impact of rationalization of Income Tax Rates for Salaries

Months	2005-06	2004-05	Diff	Growth (%)
July	727.6	641.7	85.9	13.4
August	999.2	897.5	101.7	11.3
September	1238.6	1301.1	-62.5	-4.8
Total	2965.4	2840.3	125.1	4.4

Figures are in million

*Discouraging Cash Economy**:*** A new section has been introduced in the budget FY 2005-06 making every bank to deduct tax @ 0.1% at the time of cash withdrawal exceeding Rs. 25,000. This measure is intended to discourage cash economy. It is relevant to add that the

WHT on cash withdrawal is adjustable in tax assessment, therefore, the taxpayers belonging to the formal sector will face no additional burden of this tax. Furthermore, tax shall not be deducted in the case of withdrawal made by the federal and provincial governments, foreign diplomats or diplomatic missions in Pakistan or a producer having exemption certificate from the commissioner of income tax. The collection due to this measure has been only Rs. 425.7 million during the first quarter of CFY. (Table 3).

Table 3: Impact of @ 0.1% WHT Tax On Cash Withdrawal

Months	2005-06
July	45.2
August	126.3
September	254.2
Total	425.7

Figures are in million

Sales Tax and Federal Excise

Zero Rating of Export Oriented Industries: Delay in refunds payments of sales tax has been a source of anxiety for the taxpayers. Textile sector undoubtedly, has been one of the biggest refund claimer in the economy. As a first step, in the PFY budget, the ginned cotton was zero-rated mainly to improve the cash flow situation of taxpayers. This measure was also necessary due to rampant use of fake and flying invoices by unscrupulous agents to claim illegitimate refunds. This situation was indeed disturbing for the CBR and the genuine taxpayers. The overall improvement in the system has encouraged the authorities to take additional steps in this direction. Thus, in the federal budget 05-06, the entire chain of export oriented industries and their inputs have been zero-rated. This bold decision was expected to have two benefits. Firstly, the refund payments would be reduced considerably, and secondly, there would be an improvement in the liquidity position of textile sector leading to investment and boosting export and growth further.[3]

It is evident from Table 4 that zero rating has paid dividend during first quarter FY: 05-06 in the form of 62.3% decline in the payments of refund. The refund payment has come down from Rs 12.6 billion in Q1: 04-05 to only Rs.4.8 billion in Q1: 05-06. The overall improvement in the net collection stood at Rs. 1.6 billion. It may be noted that while making these computations, tax receipts at domestic as well as import stages of sales tax have been taken into account. This was necessary because while tax receipts are generated at the two sources of sales tax, refunds are paid out of domestic collection only. Two further aspects need mentioning. Firstly, the refund claims during the first quarter are higher due to claims for 'stock adjustment' and secondly, further clarity is possible in this result when all four taxes are considered.

Table 4: Impact of Zero Rating of Five Major Industries in July-Sep, 05-06 (Imports and Domestic)

Months	Gross	Refund	Net	Gross	Refund	Net
	Impact in Absolute			Impact in %		
Textile	-3640.75	-7768.03	4127.27	-91.26	-65.05	-51.90
Carpets	-26.26	-17.03	-9.24	-84.15	-59.52	-354.59
Leather	-83.29	-146.7	63.41	-73.65	-27.04	14.77
Sports	-8.74	10.96	-19.71	-66.81	12.12	-25.46
Surgical goods	4.66	43.38	-38.72	8.73	230.86	-112.14
Raw Materials	-2463.59	2.98	-2466.57	-88.82	15.76	-89.54
Total	-6217.98	-7874.42	1656.44	-89.16	-62.29	-29.23

Figures are in million

[3] The criticism that this move has broken the VAT chain is even though valid; but the evidence generated so far confirms that the benefits of zero-rating have exceeded the cost not only in monetary terms but also in terms of improved governance and transparency of the system.

3% Sales Tax on Retail Sales of Textile Fabrics/Garments, Leather, Carpets and Sports Goods: A single stage retail sales tax @ 3% (including 1% income tax) was levied during budget FY:05-06 on textiles fabrics/garments, leathers, carpets and sports goods so that the domestic sales of the products are taxed while exports remain zero-rated. Unfortunately, due to ineffective enforcement mechanism and strong lobbying by the trades communities, only around Rs.4.3 million of sales tax and Rs.4.6 million of income tax have been realized during Q1:05-06.

Levying Sales Tax on Printed Retail Price on Consumer Items: According to the present VAT system, tax is paid on value addition attributed to each stage – i.e., from manufacturing to retail sale to end consumer. It was felt that distributors/wholesalers etc. were not paying due sales tax. In order to ensure proper payment of sales tax, was levied on printed retail price for consumer items in the budget FY:05-06. Due to this measure, the collection of these items has exhibited Rs. 168.4 million higher collection during Q1: 05-06 as compared to corresponding period last year (Table 5).

Table 5 : Impact of Levying of Sales Tax on printed retail price during July-Sep.

Raw Materials	2005-06	2004-05	Diff	% Growth
Toilet Soap	149.2	90.4	58.8	65.0
Detergents	114.3	57.2	57.1	99.8
Shampoo	0.0	.007	.043	614.3
Toothpaste	5.9	1.2	4.7	391.7
Perfumery & Cosmetics	27.6	21.2	6.37	30.0
Biscuits	121.5	84.3	37.2	44.0
Confectionary Including Bakery	33.8	36.1	-2.3	-6.4
Tea	102.1	94.5	7.6	8.0
Footwear	21.5	22.6	-1.1	-5.0
Total	575.9	407.5	168.4	41.3

Figures are in million

Zero Rating of Sales Tax on Specific Machinery, plant and Equipment and Parts whether locally manufactured or imported: In order to boost the import of plant, machinery and equipment including parts has been made zero-rated. The value of imports of these items has gone up by 47% and total loss due to this measure was around Rs. –256.0 million during first quarter of CFY.

Withdrawal of FED from Soap & Detergents: The scope of the federal excises is being reduced constantly during the past several years. Since soap and detergents were subjected to both sales tax and FED in the past, resultantly, the prices of soap and detergents were rather high. In the budget FY: 05-06, FED has been withdrawn. It was envisaged that the relief through withdrawal of FED on soap and detergents would boost local production and reduce illegal trading. The production of soap & detergents has improved by 12.2% during July-September of CFY against the corresponding period last year. Similarly, the import of soaps (PCT 3401) has declined by 41% causing a loss of Rs. 12.6 million in CD and Rs. 12.5 million in sales tax. However, unlike soaps, the imports of detergents (3402.2000), has increased by 30%. Table 6 shows that a loss of Rs. 351.6 million due to withdrawal of FED from soap & detergents.

Table 6: Loss Due to Withdrawal of FED From Soap & Detergents

Months	2005-06	2004-05	Diff	Growth (%)
July	0.2	115.3	-115.1	-99.8
August	0.1	111.9	-111.8	-99.9
September	0.3	125.0	-124.7	-99.8
Total	0.6	352.2	-351.6	-99.8

Figures are in million

Revision in Prices of Middle & Lower slabs of Cigarettes: Since excise tariff has direct relationship with retail prices of cigarette, an upward adjustment in excise duty and retail price was required to compensate the market loss of manufacturers due to illegal trade. The upward adjustment in retail prices is described in the Table 7.

Table 7: Adjustment of FED and Retail Price of Cigarettes

Slabs	Threshold FY: 04-05	Threshold FY: 05-06
Upper	63% of the Retail Price	63% of the Retail Price
Medium	Rs. 2.27 per 10 cigarettes plus 69% incremental rupee or part thereof	Rs. 2.45 per 10 cigarettes plus 69% incremental rupee or part thereof
Lower	Rs. 2.27 per ten cigarettes	Rs.2.45 per ten cigarettes

During July-September, FY:05-06, an additional collection of Rs. 582 million was recorded. The overall collection has exhibited 14.7% growth in the July-September FY: 05-06 as compared to corresponding period last year (Table 8). If natural growth is estimated at 14%, the total impact of this measure would be around 28 million higher collection in first quarter, 2005-06 as compared to corresponding period last year.

Table 8: Comparison of the Collection of FED From Cigarettes

Months	2005-06	2004-05	Diff	Growth (%)
July	536.9	762.9	-226.0	-29.6
August	1474.2	1515.6	-41.4	-2.7
September	2526.7	1677.3	849.4	50.6
Total Without Growth Adjustment	4537.8	3955.8	582.0	14.7
Total With Growth Adjustment	4537.8	4509.6	28.2	0.6

Figures are in million

Customs

i) *Reduction in Tariff for Textile Sector:* The textile sector is the backbone of the Pakistan economy. Export of the country mainly depends on the textile. Reduction in tariff has been announced in the budget FY: 05-06 to boost the polyester, MMF and blended textile sectors. New rate of the duty are: PTA 15%, chips 3%, fibre 6.5%, yarn 7% while fabrics of all man-made yarns, blended yarns etc at 14%. This will also apply to silk and woolen sectors.

This tariff reduction in textile sector has resulted a growth of 82.4% in the value of imports of textile while customs duties have also gone up by 22.2% during Q1: FY: 05-06. In absolute terms, the collection has increased from Rs. 777 million in July-September, FY: 04-05 to Rs. 951.2 million in the same period of FY: 05-06. A gain of Rs. 174.2 million has been noticed during first three months of CFY.

Decrease in CD on Edible Items: In order to provide relief to the common man and control prices, the customs duty on 319 edible items has been reduced. Due to this measure, the imports of these edible items have increased by 17.5% while customs duties have declined by nearly 30.2%. Total loss due to this measure stood at Rs. 53.3 million during July-September, 2005 as compared to the PFY.

Tariff Reduction for Agricultural Equipment: The tariff has been reduced on agricultural machinery and equipment during budget FY: 05-06. Due to this measure, the value of imports of these items has increased by 64.7% and an additional collection of Rs. 61.9 million has been registered in Q1: 05-06.

Tariff Reduction from 20% to 15% on Agricultural Tractors: The tariff has been reduced on agricultural tractors during budget FY: 05-06. Due to this measure, the value of imports of these items has increased by 290.1% and an additional collection of Rs. 132.7 million has been registered in Q1: 05-06.

Exemption of Customs Duties from Urea @5%: Fertilizer plays vital role in increasing the crops output. The import of fertilizers except urea were exempted from CD before the budget 2005-06. The import of urea has been exempted during budget FY: 05-06. The urea has been imported during July-Sep i.e. Rs. 2853.7 million against nothing during FY: 04-05. No loss in CD was occurred as no import of Urea during the first quarter of PFY was made.

Tariff reduction on Machinery, Parts and Equipment: Capital inflow is important for increasing the pace of development of the industry. CD on locally made machinery was reduced to 10% and duty on parts equated with the duty on machinery parts to which they form part. Moreover, the local manufacturing machinery parts subjected to 10% duty were allowed to import raw material @ 5% ad valorum.

The imports of machinery, plants and equipments have largely increased by 117.2% while dutiable imports has also gone up by 212.0% during first quarter of FY: 05-06. The growth in imports has not only compensated the drastic effects of duty reduction on collection but also increased the collection from Rs. 691.5 million to Rs. 1373.5 million. An additional amount of Rs. 682 million has resulted due to this measure during Q1 of CFY.

Decrease in CD for Raw Materials: The customs duty on a large number of raw materials has been reduced during FY: 05-06 to lower the cost of business, expand industrial production, and accelerate the economic activities. Due to reduce rates of CD on Raw materials, the imports of these items have gone up by around 33.2% while the collection of CD has declined from Rs. 2217.5 million in July-September FY: 04-05 to Rs. 1621.8 million in the same period of CFY entailing a decrease of Rs. 595.7 million or 23.8%. The detail of impact of tariff rationalization on the collection of raw materials is depicted in Table 9.

Table 9: Impact of tariff rationalization of Raw material on Collection of CD during July-September

Raw Materials	2005-06	2004-05	Diff	% Growth in CD	% Growth in Total imports
Primary Raw Materials like lac, natural gums, resins, gum resin and oleo resins	11.3	12.8	-1.5	-11.5	50.6
Organic & Inorganic Chemicals	201.1	535.7	334.6	-62.5	19.7
Dyes & Chemicals	466.7	590.1	-123.4	-20.9	19.6
Plastic	771.8	827.7	-55.9	-6.8	51.9
Wood	90.7	97.4	-6.7	-6.9	41.3
Hepatitis Vaccines	7.5	3.8	3.7	97.4	123.4
Confectionary items	11.9	15.2	-3.3	-21.7	139.5
Cosmetic & Toilet preparation	4.1	5.1	-1.0	-19.6	7.6
Soap & Detergents	27.8	32.3	-4.5	-13.9	10.2
Photography & Cinematography	7.4	20.4	-13.0	-63.7	-25.5
Petroleum Additives	21.5	77.0	-55.4	-72.0	1.1
Total	1621.8	2217.5	-595.7	-26.9	33.0

Figures are in million

Tariff Reduction for CBU Cars: Auto sector is one of the largest contributors in CD collection. Like previous year, the reduction of customs duty on CBU motorcars has boosted not only the imports by about 237% but also improved the CD collection by 145.5%. Thus, total impact was around Rs. 2.1 billion during Q1: FY: 05-06. The CD collection from CBU cars has been reflected in Table 10.

Table 10: Impact of tariff rationalization on CBU Cars (First Quarter)

Vehicles	CD Collection 2005-06	2004-05	Diff	% Growth in CD	% Growth in Total imports
Motor Cars (CBU)	2939.4	873.2	2066.2	145.5	236.6

Figures are in million

Protection to the Domestic Industries: The government has given protection to the local industry on 16 items including worn cloths by increasing tariff during the budget 2005-06. Despite upward revision of tariff rates the total imports have increased by around 36% in Q1: 05-06. On the other hand, the higher tariff rates have increased the collection from Rs.57 million to Rs.140.6 million during July-Sep FY: 05-06. Thus, the collection has shown an increase of Rs. 83.9 million during this period.

Concluding Remarks

A comprehensive package of incentives has been announced in the federal budget FY: 05-06. Zero Rating of export-oriented industries for sales tax purposes has been one of the important and bold decisions. Relief has also been granted in income tax and customs duties to export oriented industries. This liberalization and facilitation is expected to further boost exports. Besides benefits to exporters, a significant amount has also been saved in the shape of reduction in refunds. The policy of tax and tariff cut has improved inflow of machinery and parts and as a consequence the industrial sector has also expanded. Moreover, tariff reduction on a number of raw materials will further reduce the cost of doing business in the country.

III

CBR Reform Program:
The Establishment of Regional Tax Offices (RTOs)[4]

Introduction

In the first phase of Tax Administration Reforms CBR embarked on an enclave approach to governance by providing different facilitation treatment to large taxpayers in LTUs at Karachi and then at Lahore. It has now gone beyond this to reorganize administration for small to medium size taxpayers by introducing Regional Tax Offices (RTOs). The rationale for this approach is that each size group of taxpayers has its own set of characteristics and compliance behavior, which poses a different kind of risks to the revenue base. A recent study by NIPA has indicated that element of non-compliance is high in small to medium taxpayers.[5] Thus, maximizing voluntary compliance for each taxpayer segment requires different strategies to cater for the unique characteristic and compliance issue presented by each group of taxpayers.

The Objectives

The foremost objective for setting up of the RTOs is to bring the activities of all the domestic taxes under one roof so that the ultimate objectives of tax reform are met and the taxpayer is provided better facilities through one window operation. The initial vision in the reform strategy for RTOs was that they would be dealing with direct taxes only on functional lines. Later the concept of co-location of all federal domestic taxes was developed and LTUs were established for large taxpayers on these lines. RTOs are to be replicated on the lines of LTUs. Thus The creation of RTOs will not only lead to co-location of the offices of Income and Sales Taxes

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[4] Prepared by the Research Team of the FR&S Wing of CBR. Initial input by Mr. Abdus Sattar Aura, Secretary (TP&R) is gratefully acknowledged.

[5] See Improvement in the Tax Base of Pakistan conducted by participants of 88th ACPSM Sept-December 2005.

(including excise duties), but the strengthening of hard- and soft-wares will also ensure that information sharing between all taxes also takes place instantaneously.

Operations

Self-assessment will be the standard of the RTOs where there will be minimum contact between taxpayers and tax officials. This will be ensured through the introduction of modern administrative practices. Responsibilities of the RTOs will be to carry out the full range of domestic tax administration tasks that are currently being undertaken in Collectorates/Commissionarates. The operations will be organized differently and will be conducted in a more streamlined, professional managed manner. Moreover, these RTOs will be organized along functional lines, to correspond with counterpart functional officials located in the central CBR office. The functional program areas to be carried out includes (1) taxpayer registration (2) taxpayer education and facilitation (3) information processing and accounting (4) enforcement and collection (5) taxpayer audit (6) investigation (7) legal (8) human resource (8) administrative infrastructure and (10) information technology.

It is also important to make note that full implementation of these functions will take three or more years. A special emphasis is laid to strengthen human resource function to ensure effective and efficient functioning of RTOs. Effort will be made to match the skills and experience of current employees into the new requirements. A detailed plan is being developed well in advance of implementation so that all employees are aware of what is happening and how it impacts them. Appeals and adjudication, internal audit and other field operations associated with the direct and sales tax administration, but having a separate organization from it, will be reviewed as is required in order to provide the most practical ongoing relationships for future corresponding tax organizations. The organization structure for these related activities will remain separated from the line structure of direct tax and sales tax to ensure impartiality of decisions and actions and ensure that available resources are applied in the most effective manner. Details will, once again, be developed in accordance with further planning and transition. To compliment the self-assessment approach, a selective audit program based on risk management analysis will be employed to improve compliance.

Proposed Administrative Set Up

RTOs will be headed by a Director General to carry out the assigned functions of the organization. He will be assisted by commissioners and collectors for direct and indirect taxes in the field of registration, audit, enforcement and tax facilitation etc. Detailed organization chart is annexed as A.

Time Lines

The current phase of reform initiatives revolves around the establishment of 12 RTOs, at Peshawar, Abbottabad, Rawalpindi, Lahore, Gunjranwala, Sialkot, Faisalabad, Multan, Sukkur, Hyderabad, Karachi and Quetta. Physical work has been completed on these sites and refurbishment of the buildings for these offices has started. It has been planned that the first six RTOs will be functional by the end of FY 2005-06. The remaining six RTOs will be operational in the next financial year 2006-07. The task ahead is the smooth transition from the current ‘territorial based’ tax collection to a new system of taxation based on ‘functional lines’.

Conclusion

Apparently the organizational structure as well as the functional structure of LTU has been replicated in RTOs. However small to medium taxpayers have peculiar problem because of their size and understanding of tax laws and procedures. A large informal economy which is not paying taxes partially due to complexity of tax laws and partially because of lack of deterrence needs to be looked into by the RTOs. This definitely requires a different set of strategies that are appropriate for small to medium taxpayers. Such as targeted audit action, law clarification by public rulings and specific taxpayer education initiatives.

Annex A: Organization Chart of RTO