FAIR TAX MONITOR 2018, PAKISTAN

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Contents

ACRONYMS

ADR	Alternate Dispute Resolution
BEPS	Base erosion and profit shifting
BISP	Benazir Income Support Programme
BHU	Basic Health Unit
CPEC	China Pakistan Economic Corridor
DFID	Department for International Development
E&P	Exploration and Production
FBR	Federal Board of Revenue
FTA	Free Trade Agreement
KPK	Khyber Pakhtunkhwa
GDP	Gross Domestic Product
GST	General Sales Tax
NTN	National Tax Number
OECD	Organisation for Economic Co-operation and Development
PRSP	Pakistan Rural Support Program
PTA	Preferential Trade Agreement
RHC	Rural Health Centre
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SECP	Security Exchange Commission of Pakistan (SECP)
SRO	Statutory Regulatory Order
TRC	Tax Reforms Commission

FOREWORD

In Pakistan, as in many other developing countries, the tax system is far from fair. It has many features that exacerbate inequality and hold back poverty reduction. This has not gone unnoticed. In 2016, a highly critical report was published by the Tax Reforms Commission, an advisory body to the Pakistani government. The following quote from the report hit the media: "In Pakistan, it seems the poor are subjected to heavy and harsh indirect taxation and the elite are enjoying free perquisites and benefits (...)". Out of context, this may sound like a superficial manifesto of a protest movement. It wasn't. This was the verdict of a commission of prominent legal experts that had taken over a year to produce their report.

At the same time, Oxfam Pakistan conducted its first round of research for the Fair Tax Monitor. This enabled them to make an active contribution to the Tax Reforms Commission. Moreover, they worked actively with chambers of commerce to build a joint agenda for tax reforms. The Rawalpindi Chamber of Commerce & Industries even awarded Oxfam Pakistan for its constructive and high-quality contributions to enhance the country's tax regime. It is this kind of coalition building and well-informed advocacy that often makes the difference between a problem getting ignored or addressed by policy makers.

Three years later, as Oxfam Pakistan is publishing its second round of research for the Fair Tax Monitor, it seems that the problem is getting addressed. Some tax exemptions mainly benefitting the rich have been reversed. Moreover, the Islamabad Capital Territory recently announced to reduce the sales tax on prepared food from 17% to 7.5%. This means that over 2 million people will see their cost of living reduced, due to lower prices for household products like breads and cheese (paneer). Progress may be slow and patchy, but these are meaningful changes.

The current Fair Tax Monitor report shows that Pakistan's tax system is still far from fair. That has a positive side too: it means that there is a lot of room for improvement. This won't happen by itself, and positive changes initiated by one government may be discontinued by a next one. Yet with sustained advocacy efforts, further progress may become a reality, and as the country's tax system becomes fairer, millions of poor people could see their lives improved.

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EXECUTIVE SUMARY

Pakistan has for many years been an underperforming economy; it has recorded only three episodes of growth acceleration since 1960, when GDP per capita exceeded 3% per annum (1963-66, 1980-83 and 2004-07). Pakistan's economy is characterized by the following:

- A decline in structural growth from 6-7% in 1960 to less than 3% in 2000.
- A marked deterioration in many structural areas such as revenue collection, health, social protection, etc.
- Constraints on fiscal space.
- Increasing debt burden.
- Rising levels of poverty and inequality of income distribution across regions.

Like other developing countries, Pakistan faces the daunting challenge of mobilizing domestic revenues for creating the fiscal space to support much-needed human development of millions of its population.

Successive governments have initiated tax reform programs in order achieve this goal, but have somehow failed to realize the true revenue potential of the country. Consequently, the tax machinery opts for short-term revenue measures, which help achieve the short-term targets but further distort the tax system in the long term, as fundamental anomalies like undocumented transactions, tax exemptions, weak enforcement, evasion and massive under-declaration are not addressed.

Until now, no one has calculated how much tax loss Pakistan has suffered since 1977 on account of non-taxation of agriculture income alone, as suggested under the Finance Act 1977. Through Statutory Regulation Orders (SROs) issued during the last four decades, the figure comes to over Rs. 100 trillion. This demonstrates how unprecedented concessions to the rich have made the state poorer, rendering every citizen of this country severely indebted.

One of the key factors which has perennially distorted the tax culture and tax structure in Pakistan is the presumptive tax regime, whereby transactions/ payments are taxed through a withholding mechanism at the time of payment. This mode essentially indicates two weakness in the system: poor enforcement capacity of the tax machinery, which always finds it easy to collect at the point of payment; and a weak tax culture, where taxpayers are less compliant.

For Pakistan to be able to meet its development challenges under the global framework of the Sustainable Development Goals, it is critical to focus on domestic revenue mobilization. This can only be optimally achieved if the fundamental anomalies and distortions in the tax system are removed and the tax administration is realigned according to the needs and aspirations of the people of Pakistan.

This study builds on the Fair Tax Index Research 2015-16 and reassesses Pakistan's performance under the six categories of the Fair Tax Monitor (FTM).

TABLE 1: PAKISTAN'S PERFORMANCE ON THE FTM – PREVIOUS AND REVISED SCORES (OUT OF 10)

Category	2015-16 score	Revised score (2018)
Progressive tax systems	6	4
Sufficient revenues	7	6
Well-governed tax exemptions	6	3
Effective tax administration	9	6
Pro-poor government spending	6	6
Accountable public finances	5	4

The changes in scores are in part due to the addition of new question in the methodology of the FTM. In the first phase of monitoring, it was observed that Pakistan has a law in place that addresses all six elements of the methodology and is therefore capable of implementing the methodology in full.

However, in this second round of FTM monitoring, it was found that Pakistan lacks the political will through which the law can be implemented. It was concluded that due to lack of political will, the system is rendered ineffective: exemptions and evasion lead to huge losses of taxes paid that could fund public spending, while equity and principles of fairness are compromised in the name of meeting revenue targets.

The Progressive tax systems score (4) is lower than the previous score mainly because additional withholding taxes were introduced, and the equity principle was ignored completely.

Under the Sufficient revenues category score (6), revenues targets were rarely met and tended more towards indirect taxes. This resulted in not broadening the tax base as committed in the Finance Act 2016-2017.

CHAPTER 1 INTRODUCTION

Tax structure in Pakistan

Pakistan's tax system is a highly regressive and enormously presumptive regime which is designed and practised in a regressive way; approximately 91% of taxes are either collected through indirect taxes or through taxation at source.[1] The reliance on indirect taxation is increasing, as evidenced by the fact that from 2013-14 to 2016-17, federal government revenue from indirect taxes increased by 48%.[2] The incidence of tax on the poor has increased substantively (35%)[3] during the last 20 years, while for the rich, the tax burden decreased by 18% over the same period.

The International Monetary Fund (IMF) estimates that the Pakistan economy could generate enough tax revenues to double the current tax-to-GDP ratio of 11%.[4] Of the estimated total population of 180 million, 60% are in the age group 20-24 years and 60 million are below the age of 15 (dependants). As many as 30 million are classed as 'chronic poor', earning less than two dollars a day. Our labour force, the tenth largest in the world, is around 65 million, of which 56.5 million are employed. The rural labour force of 55.5 million is earning below the taxable income or agricultural income, falling outside the ambit of the Income Tax Ordinance, 2001. Reading all these facts together, the total number of persons liable to income tax could not be more than 6 million, yet the Federal Board of Revenue (FBR) is extorting income tax at source from over 95 million mobile phone users alone.

Meanwhile, only 1.2 million income earners file income tax returns. Because of the highly unjust tax system, the burden of a number of withholding, minimum, and indirect taxes levied under the guise of income and sales tax law has been shifted from income earners to consumers. This violates the central tenet of an equitable taxation system: that the 'burden of the taxes should fall on those with the broadest shoulders'. These presumptive taxes have not only distorted the whole tax system, destroyed economic growth and made the consumer carry the biggest burden; these short-term, figures-oriented measures have also failed to bridge the burgeoning fiscal deficit,[5] as tax collection is declining due to the failure of the system to tax the rich.

General sales tax (GST) on various products and services is the main source of indirect tax revenue (which accounted for 61% of the total tax revenue collected in 2016-17). The GST rate varies; 17% is charged at federal level, while Sindh province charges the lowest rate, at 13%.[6] Similarly, huge amounts are collected indirectly by ignoring the principle of equity: for example, in the case of petroleum products (for light diesel, the tax rate is 40%) and in telecommunications (mobile call rates include 32 to 35% charged in the form of advance income tax and sales taxes). There is no wealth tax, and only limited basic foodstuff exemptions. According to the Economic Survey of Pakistan, tax expenditure is around 1% of GDP, whereas the Tax Reforms Commission (TRC) states that it is around 5% of GDP.[7]

The difference between the statutory rate of GST (17%) and the effective rate (3.9%) actually collected by the government is enormous.[8] Reasons for the huge difference include tax exemptions, concessions, tax fraud, and less-than-satisfactory tax administration (including corruption). This means that not only are the poor forced to pay tax on essential goods and services, but much of the revenue that *could* be raised from GST is not actually collected by the government, and therefore inequality increases as budget allocation on public services such as education and healthcare remain inadequate.

CHAPTER 2 PROGRESSIVITY OF THE TAX SYSTEM

An optimal and just taxation system aims to mobilize resources from a broad base of taxpayer population through direct taxation – and to redistribute these resources in a fair manner towards the segments of population with lesser means. In the case of Pakistan, the taxation structure evolved in an imbalanced manner, which has undermined the fairness of the system in two ways. First, a large segment of the population that could pay tax is left out of the tax net; and second, injustice is done by those who are registered to pay tax but do not declare their income accurately. The federal government collects direct and indirect taxes, which are analysed in detail below.

2.1 Indirect taxation

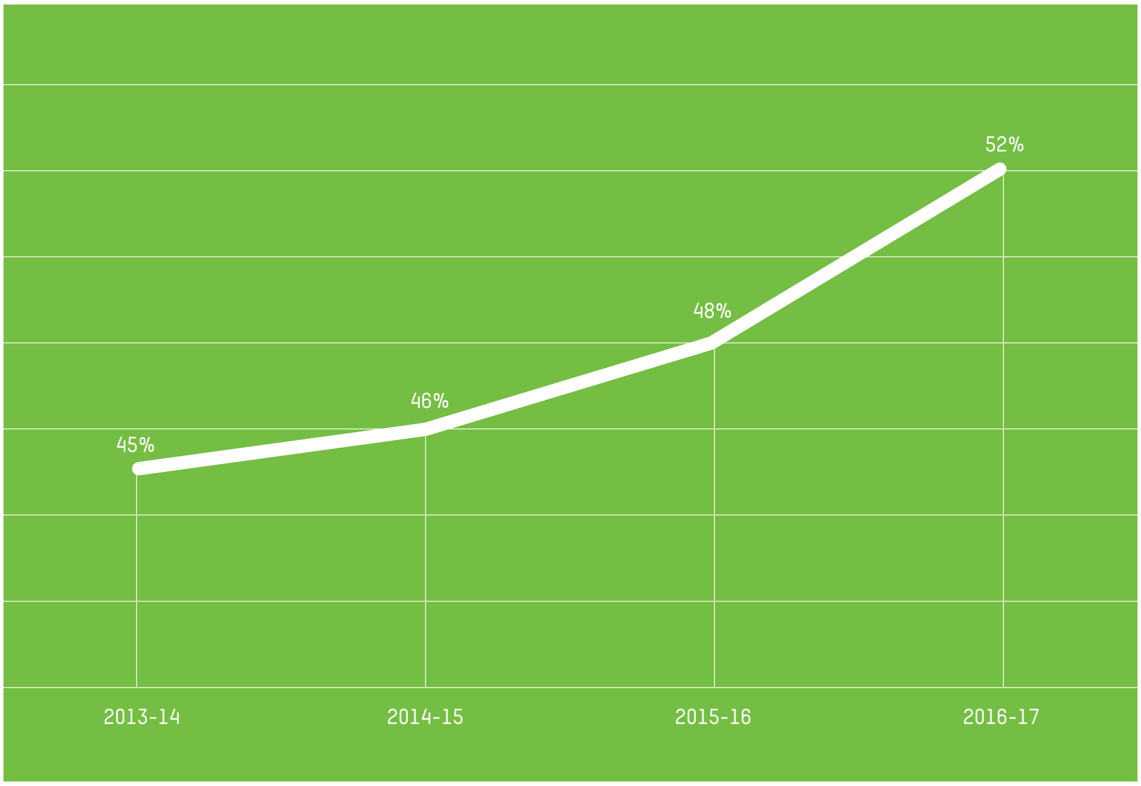
Indirect taxation comprises of customs duty, GST, federal excise duty, petroleum levy, taxes collected by the Islamabad Capital Territory (ICT) administration, and airport tax. Indirect taxation is the main source of revenue, and there is increased government reliance on it, as is evident from the figure below.

The susceptibility of GST to unethical practices is considered a daunting challenge for the FBR. In 2014, the FBR detected 40 fictitious companies in Karachi alone, that were claming illegal sales tax refunds. These companies had been registered without physcial verification by FBR staff. On average, each company had claimed Rs. 30 million in fraudulent claims by issuing fake/flying invoices.

Salient facts and figures on indirect taxes in recent years are as follows:

- In 2016-17, Rs. 2,446 billion was collected through indirect taxes, as compared to the budgeted estimate of Rs. 2,398 billion.
- The FBR was able to surpass the budgeted target of indirect taxes by 2% in 2016-17.
- Indirect tax collected in 2016-17 comprised 52% of the total resources, which is 4% higher than in the year 2015-16 and 6% higher than in 2014-15.
- As a ratio of GDP, indirect taxation accounted for 7.67% in 2016-17.
- Sales tax on various products is the main source of indirect revenue, accounting for 67.4% of total indirect taxes.

FIGURE 1: INDIRECT TAXES AS A PERCENTAGE OF TOTAL REVENUE, 2013-14 TO 2016-17



2.2 Direct taxation

Direct taxes comprise:

- Income tax (corporate income tax and personal income tax)
- Worker Welfare Fund
- Worker Participation Fund
- Capital value tax

Ninety-one percent of direct taxes in Pakistan are collected through the presumptive tax regime and include many indirect tax levies, such as minimum taxation and presumptive taxes on services, under the Income Tax Ordinance, 2001.

Salient facts and figures on direct taxation in recent years are as follows:

- In 2016-17, the government collected Rs. 1,558 billion from direct taxes, 11.5% less than the budget estimate of Rs. 1,558 billion. During the previous three years, average actual collection was at around 95% of the target.
- 21.59% of the total resources came from direct taxation in 2016-17. This represents an increase on the last three-year average (18.46%).
- Direct taxes as a ratio of GDP increased to 4.65% in 2016-17, as compared to an average ratio of 4.04% for the previous three years.
- There is a nominal increase on a year-to-year basis of 17.67%.

FIGURE 2: DIRECT TAXES AS % OF TOTAL RESOURCES (FOR 2016-2017 AND PREVIOUS THREE-YEAR AVERAGE

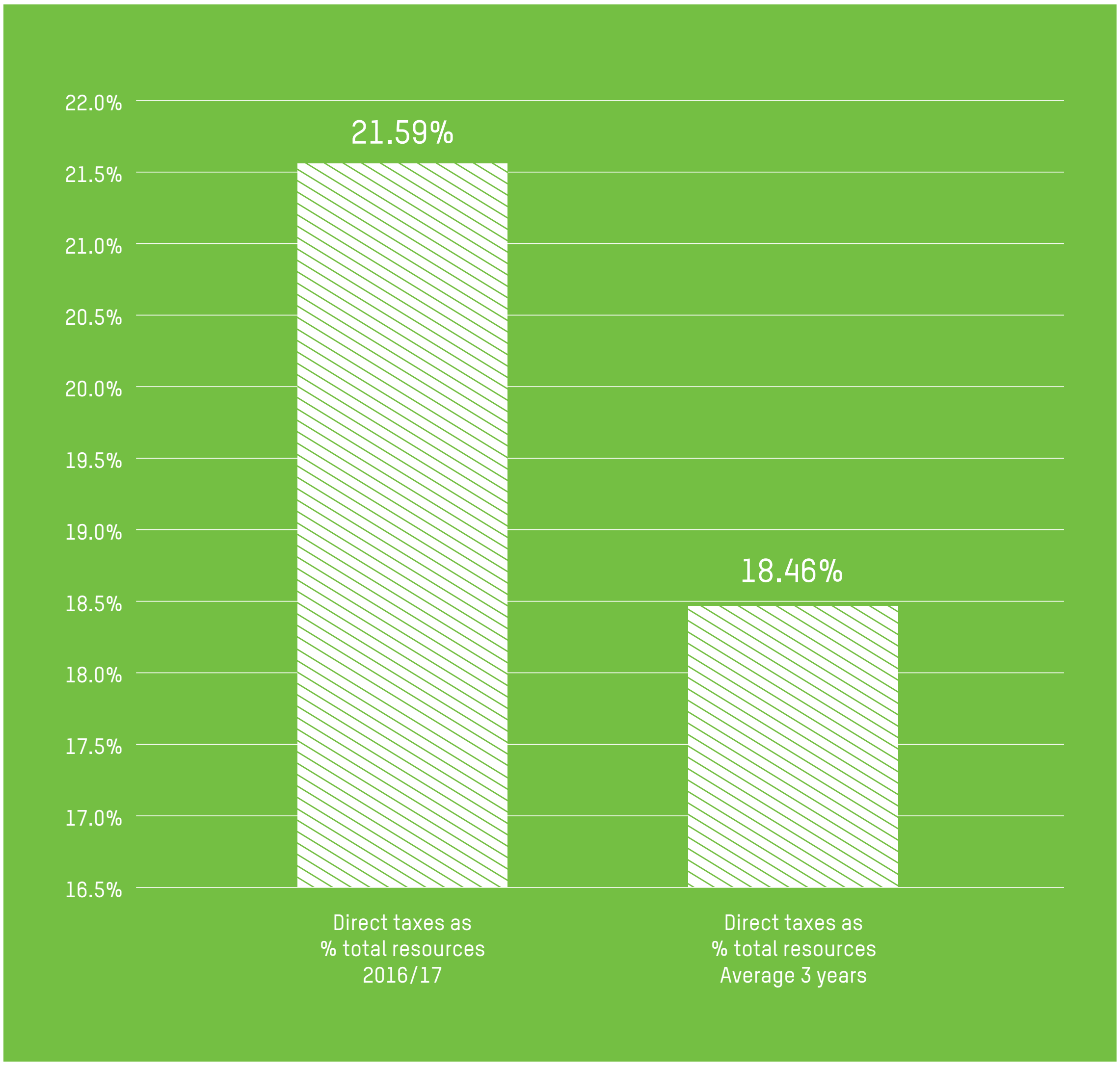


FIGURE 3: DIRECT TAXES AS A PERCENTAGE OF TOTAL REVENUE, 2013-14 TO 2016-17

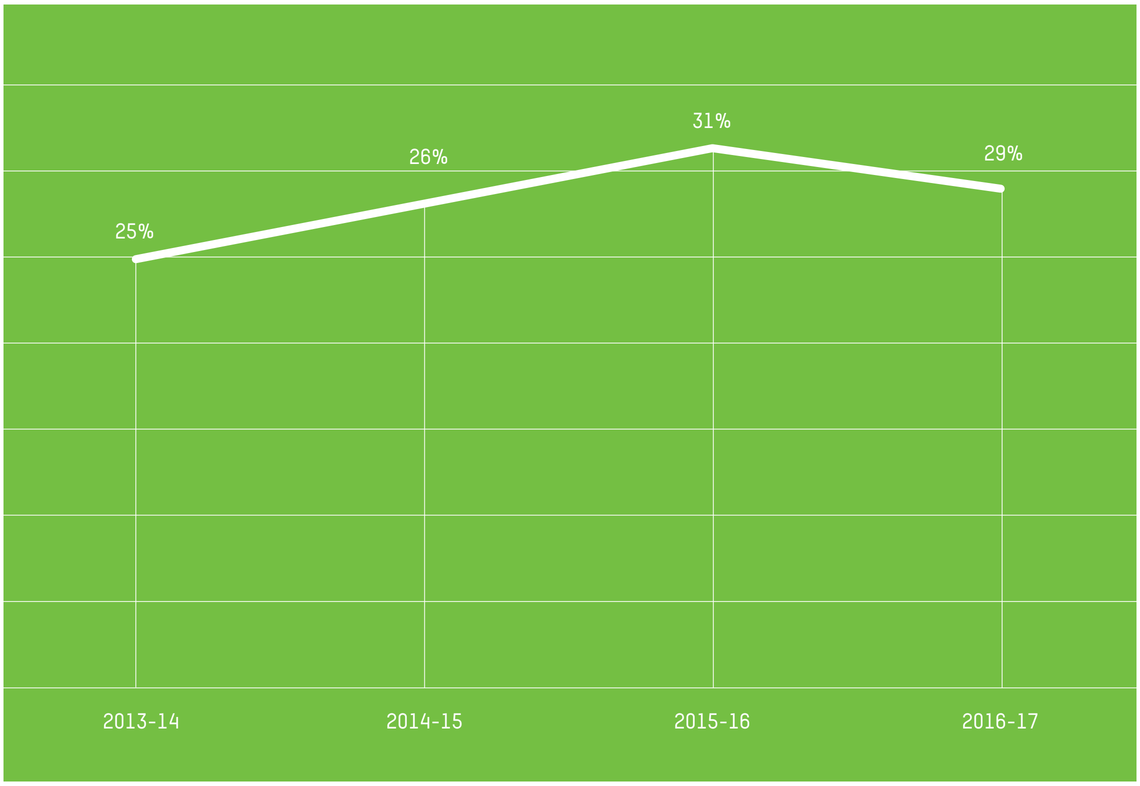
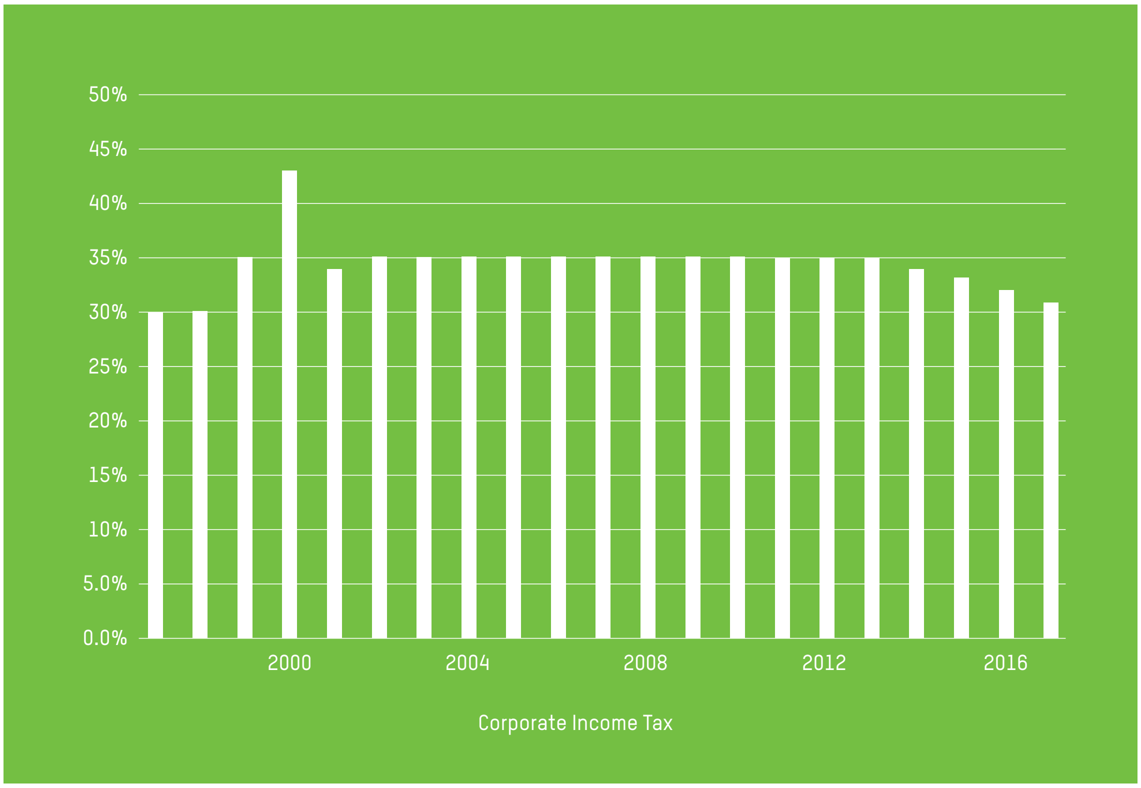


FIGURE 4: CORPORATE INCOME TAX RATE 1997 TO 2017



Corporate income tax (CIT): In Pakistan, the government is applying the international phenomena of a 'race to the bottom' to cut corporate tax rates in order to attract new business and retain economic activity. The corporate tax rate in Pakistan currently stands at 31%, having averaged 34% from 1997 until 2017, reaching a record low of 30% in 1998 and an all-time high of 43% in 2000.[9]

There has been a decrease in the corporate tax rate by 1% each year from 2014 to 2017, and it dropped from 35% to 31% in 2017. However, along with CIT, companies are liable to pay into the Worker Welfare Fund at a rate of 2% and the Worker Participation Fund, also at 2%.

Through the 2015 Finance Bill, a 'Super tax' was introduced on the super-rich, Associations of Persons (AOPs) and companies earning above Rs. 500 million. This aimed to generate Rs. 24 billion extra revenue to fund the rehabilitation of temporally displaced persons.

Personal income tax is paid by wage earners, i.e. the salaried class, self-employed workers and non-incorporated firms. Personal income tax is one of the most important sources through which a government finances its activities. Tax slabs (or thresholds) for personal income tax for 2017 are shown in the table below.

TABLE 1: PERSONAL INCOME TAX RATE SLABS FOR 2016-17

Serial No	Taxable income	Rate of tax
1	Up to Rs.400,000	0%
2	Exceeds Rs.400,000 but does not exceed Rs.500,000	2% of the amount exceeding Rs.400,000
3	Exceeds Rs.500,000 but does not exceed Rs.750,000	Rs.2,000+5% of the amount exceeding Rs.500,000
4	Exceeds Rs.750,000 but does not exceed Rs.1,400,000	Rs.14,500+10% of the amount exceeding Rs.750,000
5	exceeds Rs.1,400,000 but does not exceed Rs.1,500,000	Rs.79,500+12.5% of the amount exceeding Rs.1,400,000
6	Exceeds Rs.1,500,000 but does not exceed Rs.1,800,000	Rs.92,000+15% of the amount exceeding Rs.1,500,000
7	Exceeds Rs.1,800,000 but does not exceed Rs.2,500,000	Rs.137,000+17.5% of the amount exceeding Rs.1,800,000
8	exceeds Rs.2,500,000 but does not exceed Rs.3,000,000	Rs.259,500+20% of the amount exceeding Rs.2,500,000
9	Exceeds Rs.3,000,000 but does not exceed Rs.3,500,000	Rs.359,500+22.5% of the amount exceeding Rs.3,000,000
10	Exceeds Rs.3,500,000 but does not exceed Rs.4,000,000	Rs.472,000+25% of the amount exceeding Rs.3,500,000
11	Exceeds Rs.4,000,000 but does not exceed Rs.7,000,000	Rs.597,000+27.5% of the amount exceeding Rs.4,000,000
12	Exceeds Rs.7,000,000	Rs.1,422,000+30% of the amount exceeding Rs.7,000,000

The Wealth Tax Act 1963 was abolished through the Finance Act 2003, at the specific demand of Shaukat Aziz before he took charge as Finance Minister of Pakistan. This progressive law was especially suitable to Pakistan, where enormous assets are created without the declaration of income. Despite this, repeal of the wealth tax was somehow shown to be justified despite causing tremendous revenue losses and distortion in the social set-up, inflicting misery on the majority of the people of Pakistan. Before its abolition, the wealth tax was the only progressive tax left in Pakistan, with tremendous potential for growth (particularly if exemptions given to rich absentee landlords were scrapped). According to a conservative estimate, since 2003 we have lost Rs. 400–500 billion worth of wealth tax that could have been imposed on unaccounted/untaxed wealth.

Similarly, the Finance Act 2013, which requires the banks to share transactions and deposits exceeding one million rupees, was suspended by SRO 115(1)/2014 of 19-2-2014 for existing taxpayers, allowing them to keep on evading taxes by paying only small amounts.[10]

2.3 Taxation of agriculture income

Taxation of agricultural income is the sole prerogative of provincial governments under the 1973 Constitution of Pakistan. All four provinces have enacted laws[11] to this effect, but total collection in 2013-2014 was less than Rs. 2 billion against potential of Rs. 200 billion (the share of agriculture in GDP that year was 22%).[12] Agriculture income tax is not being collected because agriculture landlords have powerful representation in provincial and federal assemblies, who have thwarted every attempt to levy and implement an effective agriculture tax.

2.4 Impact of taxation system on women

Women have traditionally been marginalized in the patriarchal societies of Pakistan. Their access to basic assets like proper food, education and cash for basic needs, as well as their awareness of the outside world, are restricted by social and gender norms. Women's low level of individual autonomy results in unequal access to resources and facilities, while poverty further increases their vulnerability. Pakistan's low female literacy and high maternal mortality rates clearly demonstrate the urgent need for the government to prioritize budget allocations for women's health, education and empowerment. However, the many weaknesses of the tax system limit tax collection and reduce the government's allocations to the development budget to overcome these challenges. It is vital for the government to formulate measures to overcome these flaws in the tax system.

Lack of skills and low literacy rates coupled with discriminatory social norms confine women in rural areas to a very limited range of waged employment opportunities. This makes women's economic empowerment very challenging. The nature of their work is such that it goes unrecorded, e.g. sewing at home, and the unpaid domestic work looking after children and elderly persons. This leaves women outside the formal job sector, thus increasing their vulnerability to additional exclusion on the basis of religion, ethnicity, age and location. A significant portion of what women do earn is taken from them in the form of indirect taxes which they are not even aware of. The application of 17% GST on most food/household items and 33% GST on petroleum products has a profound impact on women's lives.

The existing inequalities between different sectors of society widen further as the poor pay a disproportionate amount of their income as indirect taxes, with adverse effects on limited household budgets, while the rich opt for tax evasion. In order to narrow the wealth gap, efforts need to be made in both formal and informal spheres, with gender at the centre of all policy making, planning and budgeting. Political representatives, especially women legislators, need to be more influential to ensure gender-responsive allocation of government funds and tax money/public revenue. Parallel efforts need to be made by civil society groups to develop a transparency mechanism for monitoring budget allocations and expenditures.

2.5 Public perceptions of the tax system

The majority of ordinary people in Pakistan believe that their country's taxation system is based on indirect taxation, whereby the general public is overtaxed by the tax administration authorities due to unfair and unjustified policies. A survey conducted by Gallup, Pakistan in March 2015, with a sample size of 1,574 men and women from all four provinces, showed that many respondents believe it is the low-income classes of society who are paying a great chunk of different taxes, while around 49% of respondents were of the opinion that comparatively high-income classes are paying too little in taxes.[13]

2.6 'Progressive tax system' revised score

As we can see from the above, Pakistan's reliance on indirect taxes is growing, and there has not been any progress on taxation laws incorporating a pro-poor and gender perspective. Pakistan's previous progressive tax system score of 6 has now been revised downward to 4, due to the following answers being revised.

- **Is property, land and financial assets or income derived from these assets taxed?**

The previous answer to this question was in the affirmative; it has now been changed to reflect a more 50-50 scenario, as the government has been trying to bring the Rs. seven trillion real-estate sector under the tax net for the last couple of years. Through the Finance Bill 2016, the government attempted to double the tax burden on buyers and sellers of property by taking the following steps:

- Increasing immovable property valuation. The existing rates, called the DC rates, were to be revised and increased to reflect fair market value.[14] First State Bank and then the FBR were assigned the task of valuation.
- Introducing capital gains tax at the rate of 10%, 7.5% and 5% (depending on the period of the holding).
- Introducing different tax rates for tax filers and non-filers.

This amendment offered the government a chance not only to document one of the largest sectors of its economy, but also to raise significant tax revenues. However, the real-estate sector – faced with increased taxation and having to answer for trillions of Rupees worth of black money – naturally resisted. After prolonged negotiation, the government as usual backtracked, announcing an amnesty scheme which allows the following:

- Individuals who have not paid any tax in recent years are allowed to document their income and wealth without specifying any sources, by paying a mere 3%.
- Provincial property taxes, which include capital value tax,[15] registration and stamp duty, are collected based on the revised DC rates (20% of fair market value); and federal property taxes, including capital gains tax and advance tax (withholding tax), are collected based on FBR rates (around 30% of fair market value).

The amnesty scheme is being termed[16] by some commentators as a legal licence to whiten black money. It is a classic example of the political capture of the country's institutions, whereby the elite are able to manipulate laws in their favour. It is open-ended, and will allow anyone with ill-gotten money to whiten it by paying a mere 3% as advance income tax.

- **Are there no policies or laws that have a negative effect on gender equality?**

The previous answer has now been changed to a 'no', as there are many laws and taxes which negatively affect gender inequality. Examples include the withholding tax on communications, particularly on mobile phones; these are subject to sales tax ranging from 17 to 19.5% depending on the province, and advance tax of 12.5%. This tax has to be paid by all segments of the society, including the poorest of poor women, hindering their economic mobility. Moreover, analysing the impact of indirect tax on Pakistani women is challenging due to a number of factors, such as the lack of gender-segregated data in relevant government documents including Finance Bills, budget documents and the Household Integrated Economic Surveys (HIES) regarding household consumption and gender-based spending patterns. As noted above, the majority of women work either in the informal sector or are providing unpaid services, which also makes income sources and spending patterns difficult to document.

- **Is there a lower/zero rate for essential food products?**

The answer has also been changed to reflect a 50-50 scenario, because although certain exemptions on basic foodstuffs of the Consumer Price Index (CPI) basket are in place, including for wheat, fresh milk and certain vegetables, some are taxed at varying rates. For example, 8% excise duty is imposed on sugar, and there is a 10% GST on yogurt, cheese, butter, cream, desi ghee, whey and cream. Cooking oil and vegetable ghee are among items which are taxed at 17%.

The tax incidence is difficult to estimate because of the high indirect taxes on fuel (for example, GST on light diesel is 40%). This affects food prices, as most food items are transported to urban centers by trucks. Even the rural poor who have managed to grow or obtain wheat (which is exempted from GST) have to pay these indirect taxes in the form of higher processing costs due to taxation on fuel and electricity.

The Commitment to Reducing Inequality index has estimated that only 53.3% of food expenditure in Pakistan is excluded from GST tax.[17]

CHAPTER 3 SUFFICIENCY OF TAX REVENUES

Pakistan's tax-to-GDP ratio has hovered at around 10% for the last decade.[18] Considering the size of Pakistan's economy, the IMF has estimated that the country's tax-to-GDP ratio should be at least 22%.[19] This low tax-to-GDP ratio means that the government is unable to raise sufficient revenues even for essential services like health, education and social protection. If we look at the tax incidence,[20] some sectors of the economy are contributing far less than their fair share. Agriculture, which accounts for nearly 21% of GDP, has a share of less than 2% of total tax collected, while traders account for 18% of GDP but only 1% of tax revenue.[21] The tax contribution of the services sector is less than half its share of GDP.

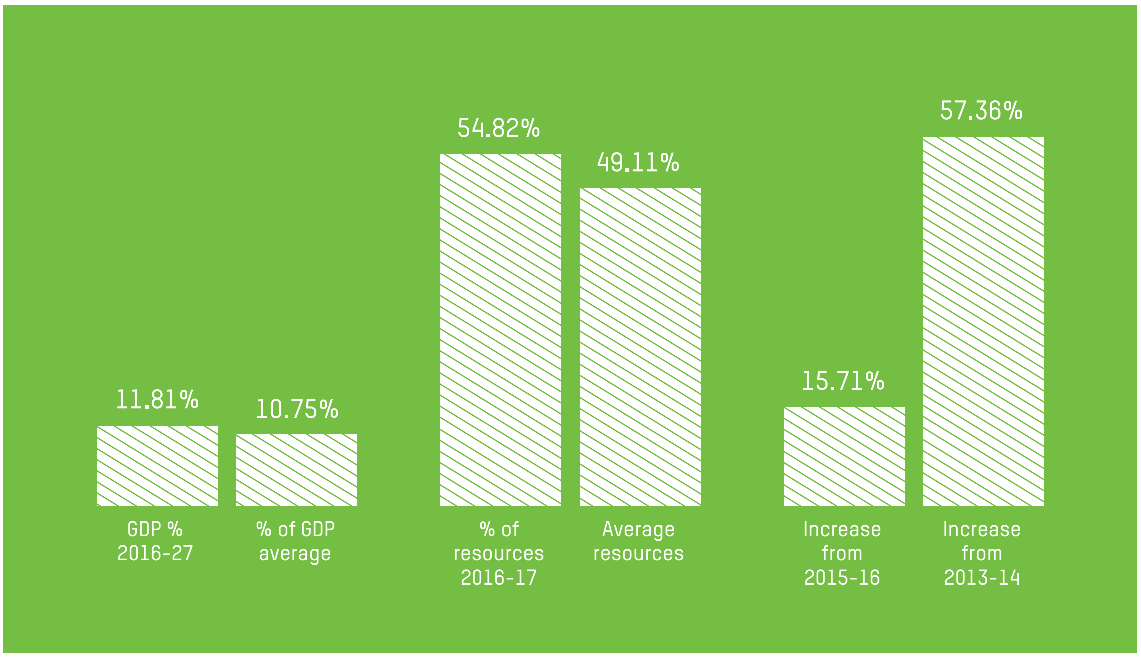
Before the last election, PML (N) in its pre-election manifesto committed to a progressive tax system with the pledge to 'tax all income and to achieve greater equity in the tax system by increasing dependence on direct taxes',[22] reform the tax system and increase tax-to-GDP ratio from 9% to 15% by the end of 2018.

Although the tax-to-GDP ratio has marginally risen[23] and the government has been consistent in publishing the tax directory, which is a positive step towards transparency and accountability, most of the party's pledges remain unfulfilled. Revenue from indirect taxes has increased by 48%,[24] casting doubt on the government's commitment to achieving greater equity in the tax system. With regard to the promised reforms, while some progress has been made with the establishment of provincial revenue authorities, again these are focused on raising revenue through indirect taxation on citizens. No one is willing to collect due amount from rich and powerful landlords, agriculturalists, traders, and professionals such as doctors, lawyers and industrialists.

Ruling party politicians and FBR officials claim that less than 1% of Pakistan's citizens pay tax, presenting this as an excuse for the dismal state of revenue generation in Pakistan. In fact, the narrow tax base is one of the biggest myths prevailing in Pakistan. In reality, the tax base is *not* narrow but is highly unjust because at least 50% of citizens pay one tax or another in the form of indirect taxes, namely GST on foodstuffs, the petroleum levy, taxes in utilities bill, taxes on mobile phone use,[26] and taxes on transport. Ordinary citizens who do not have a taxable income are still paying taxes, while the rich enjoy tax waivers and exemptions and are not contributing their due share.

The current system has failed to adequately tax the richest 15 million citizens of the country.[27] This is evident in the fact that in 2014 only about 15,000 individuals in Pakistan filed tax returns, showing taxable liability exceeding one million Rupees.[28]

FIGURE 5: ANALYSIS OF TAXES 2016-17 (AS % OF GDP AND % INCREASE ON PREVIOUS 2 YEARS)



Around the same time, the National Database and Registration Authority (NADRA) pointed out the almost 3.2 million Pakistanis who were frequently travelling abroad but were not registered with the FBR. Instead of trying to bring these individuals and others under the tax net to increase the tax base, the government has been busy protecting the rich by issuing unprecedented amnesty schemes,[29] with the flawed logic that these amnesties will help broaden the tax base. Needless to say, all of these schemes have failed, and Pakistan's rich continue to enjoy their lives without paying their fair and due share of taxes.

An estimated 55% of the total resources came from indirect and direct taxes in 2016-17. This represents an increase on the average over the previous three years (49.11%).

Revenue from tax collection in 2016-17 increased on a nominal basis by 15.71% as compared to the previous financial year, and by 57.36% when compared with revised taxation revenues for the year 2013-14. If the tax revenue target had been achieved, Pakistan's tax-to-GDP ratio would be 11.81% – higher than the average tax-to-GDP ratio for the last three budgets of 10.75%, but still far below the 15% target set by the PML (N) government. The comparison of the last three years' average estimated figures vs. average revised figures reflects under-collection by 4.07%. This means that while actual tax collection may be less than the estimate made at the start of the year, there was still steady growth in tax revenue over the four years. However, the increased revenue is mainly coming from indirect taxation (61% of total tax revenue for the year 2016-17).

3.2 Non-tax revenues

The non-tax revenue of the federal government is administered by various ministries/divisions/ departments and comprises of the following:

i. Income from property and enterprise
ii. Receipts from civil administration and other functions
iii. Miscellaneous receipts.

TABLE 2: INDIRECT TAXES AS A PERCENTAGE OF TOTAL OUTLAY IN 2016-17 AND 2017/18

	Indirect taxes				Rupees (millions)
	Particulars	Estimate 2017-18	% of total outlay	Estimate 2016-17	Revised 2016-17
1	Sales tax (excluding services)	1,602,262	34%	1,434,552	1,443,285
2	Services	2,448	0%	1,677	2,938
3	Federal excise duty	231,519	5%	213,000	206,144
4	Customs duty	581,371	12%	425,167	504,249
	Total	**2,417,600**	**51%**	**2,074,396**	**2,156,616**

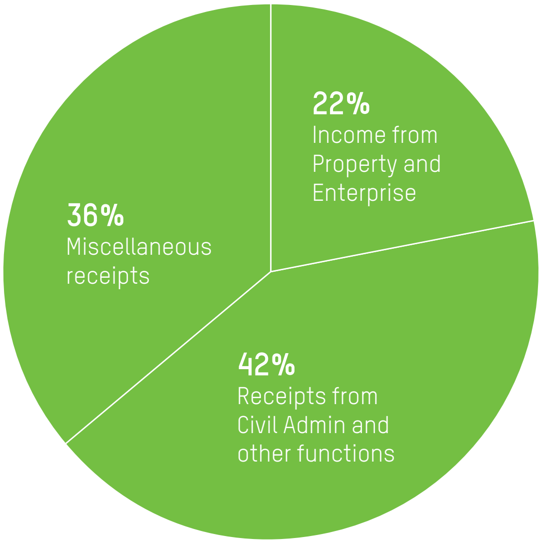
TABLE 3: NON-TAX REVENUES IN 2017-18 AND 2016-2017 (RS. MILLIONS)

	Non-tax revenues				Rupees (millions)
	Particulars	Estimate 2017-18[30]	% of total outlay	Estimate 2016-17[31]	Revised 2016-17[32]
1	Income from property and enterprise	214,688	5%	261,217	243,814
2	Receipts from civil admin and other functions	413,172	9%	459,811	314,138
3	Miscellaneous receipts	351,992	7%	238,424	354,165
	Total	979,852	21%	959,452	912,117

The non-tax revenues also include State Bank of Pakistan (SBP) profit, which is the consolidated net profits of the SBP from its operations after the bank's adjustment for administrative and operational costs.

Defense Services Receipts are realized mainly through service charges in accordance with the protocol, dues from civil agencies, sale and auction of obsolete stores, charges for use of army aviation facilities, etc.

FIGURE 6: SOURCES OF NON-TAX REVENUES IN 2016-17



3.3 Tax payers

Unfortunately, the limited number of people and/or organizations actually paying taxes points to a country with a high rate of tax avoidance. The following table indicates tax compliance,[33] using statistics relating to 2015-16.

TABLE: 4: FILE RETURNS PER POPULATION IN 2015-16

Population	Registered National Tax Number (NTN) holders	File return (population)
190 million	4.2 million	1.2 million

The same situation was highlighted by the World Bank's *Doing Business Report 2015*,[34] in which Pakistan's ranking fell to 172 in the 'paying taxes' index for the fiscal year 2015, down from 168 in 2014. The average time taken to comply with tax also increased, from 560 hours per year in 2014 to around 595 hours per year in 2015. Likewise, the country's tax-to-GDP ratio fell from 13% in 2006-07 to 9% in 2013-14. There are a number of reasons that could explain why such a declining trend persists in the overall tax-to-GDP ratio of an emerging economy with the world's sixth biggest population. These include the high cost of tax compliance, the cumbersome and difficult process of filing a tax return, inefficient tax administration, and a poor taxation policy which reflects the state's failure to extract taxes from tax evaders and corruption mafia.

3.4 Informal sector

Factors leading to the emergence of the informal economy are described below.

Tax evasion

Tax evasion means intentionally attempting to evade or otherwise defeat state or federal taxes. It is one of the fundamental aspects of any informal economy, resulting in a reduction in revenue resources. Reasons behind tax evasion could include high tax rates, cumbersome compliance mechanisms, low audit probabilities, discriminatory tax laws and the irresponsible attitudes of taxpayers. Various studies have calculated the amount foregone due to tax evasion in Pakistan. The tax evasion to GDP ratio (GDP loss due to tax evasion) remains at around 2 to 4%.[35] For instance, Kemal and Qasim (2012), using a consumption approach, estimated that the total amount lost due to tax evasion was about $5,346 million, with a ratio of 2.5% of tax evasion to GDP. Studies using a monetary approach estimated tax evasion to GDP ratio at 3.5%, with the amount forgone due to tax evasion estimated at $7,486 million.[36]

Barriers to entry into the formal sector

Strict government regulatory measures, excessive costs and cumbersome registration processes for new business firms/entities and corruption in the process of starting up a new business, granting work permits or licences and land titles have forced people to remain in the informal sector, causing major revenue loss to the state.

Another major reason for non-participation in the formal sector is the over-regulatory measures of market operations, not only through the number of taxes with higher rates but also poor labour market legislation, quality regulation and production limits. Transaction costs for participating in the formal sector have increased due to such over-regulation; thus it becomes more appealing for businesses and individuals to stay in the informal sector.

3.5 'Sufficient revenues' revised score

The existing score of 7 has now been revised down to 6, due to the following question being reassessed:

- **Is the ratio of personal income tax payers to total population higher than the average of previous 3 years?**

The personal income tax payers base has decreased during the last 10 years; in 2007, 2.1 million people filed returns, whereas in 2015, only 1.24 million people filed income tax returns, and the number of tax returns filed fell by 17% in 2016.[37]

CHAPTER 4 TAX EXEMPTIONS

Exemptions from income tax, sales tax and customs duty are a serious issue for Pakistan, as they not only cause a major loss in revenue[38] but also create loopholes and anomalies in the economy. A large majority of these exemptions are issued by the FBR through Statutory Regulation Orders (SROs),[39] and are not routed through the national assembly as required by law. By definition, the use of SROs should be restricted to framing rules and procedures for implementing a tax law or laws. Or they can be used to remove 'hardships' and ambiguities that taxpayers may encounter during the enforcement of a tax law or laws passed by the legislature – without involving new levies, exemptions, concessions, waivers, etc.

In Pakistan's context, however, the FBR has been given statutory powers to give unlimited tax concessions, waivers and exemptions without parliamentary approval. That is why experts find excessive misuse of delegated legislative powers – which favour powerful interest groups at the expense of honest taxpayers – to be at the root of our tax woes.[40]

4.1 The high price of tax exemptions

Most of the tax exemptions are enjoyed by the rich and the powerful.[41] Powerful companies and businesses also manipulate or misuse exemptions to make unreasonably high profits. Estimating the cost of tax exemptions technically known as 'Tax expenditure' is difficult, as government figures are simply unreliable,[42] with considerable differences[43] between FBR strategy paper estimations and Economic Survey figures. The latest Economic Survey estimates the cost of tax exemptions at Rs. 394.5 billion for the fiscal year 2015-16, while experts who include the disruptive effects[44] of the exemptions on the economy put the actual cost at a minimum of Rs. 700 to 800 billion[45] per year. To put this in perspective, the federal Public Sector Development budget was Rs. 800 billion for the year 2016-17. Monitoring showed a drastic reduction in tax expenditure due to eliminations of SROs in 2016-2017, which was a very positive measure towards the improvement of the revenue collection system. The table below gives consolidated tax expenditure or revenue foregone summary for Pakistan for 2010-11 to 2016-17.

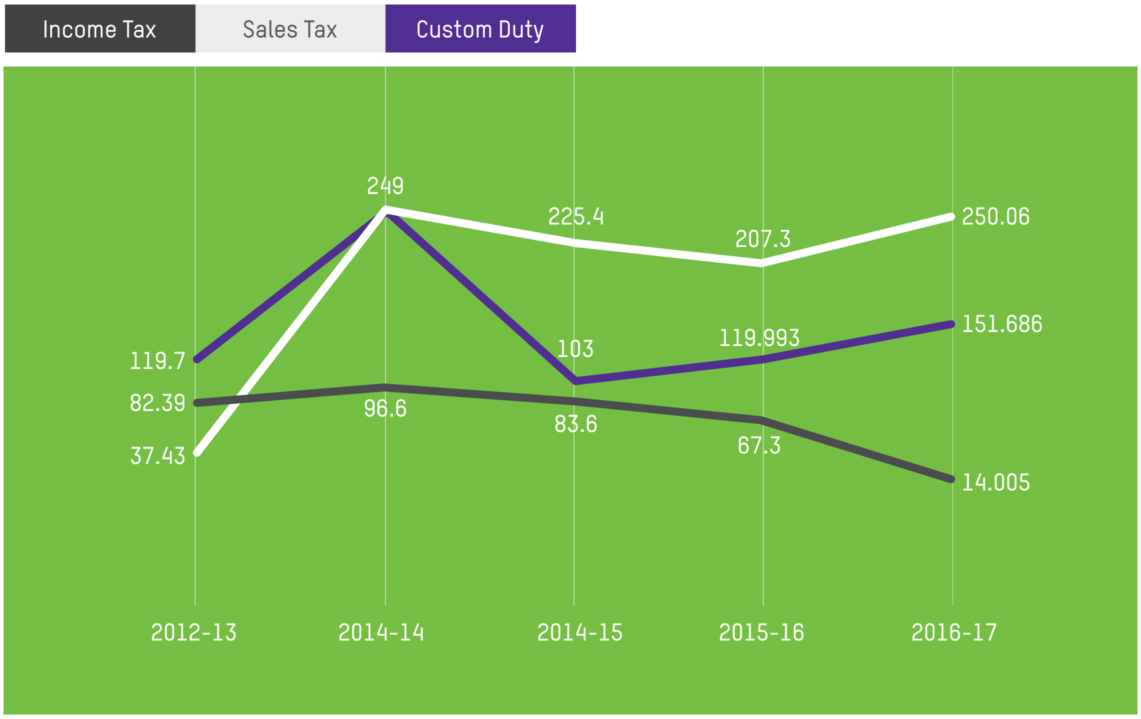
The table clearly indicates a significant amount of money (about Rs. 2,298 billion) as a potential revenue forgone from 2010-11 to 2016-17 due to a high level of tax exemptions/concessions. In percentage terms, tax expenditure was 1.6% of GDP on average during the same period.

TABLE 5: REVENUE FOREGONE DUE TO EXEMPTIONS IN FEDERAL FAXES FOR 2010-11 TO 2016-17 (RS. BILLIONS)

Serial no.	Type of tax	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
1.	Income tax	46.51	69.61	82.39	96.6	83.6	67.3	14.005
2.	Sales tax	33.76	24.3	37.43	249.0	225.4	207.3	250.06
3.	Customs duty	94.4	91.6	119.7	131.5	103.0	119.993	151.686
Total	Total	175.2	185.45	239.52	477.1	412.0	394.593	415.751

Source: Economic Survey of Pakistan 2011-12 to 2016-17

FIGURE 7: NON-TAX REVENUE 2012-13 TO 2016-17 (RS. BILLIONS)



4.2 Income tax exemptions

Tax expenditure in terms of direct taxes during 2016-17 is shown in the table below. In order to overcome the energy crisis, the government introduced power policies which provided tax incentives in order to attract private investment in the power sector. This is the major tax exemption of income tax, which benefits the private power producers rather than the poor consumers.

TABLE 6: REVENUE LOSS DUE TO EXEMPTIONS AND CONCESSIONS ON DIRECT TAXES IN 2016-17

Tax expenditure on various exemptions and concessions	Estimated revenue loss 2016-17 (Rs. billions)
Enhanced tax credit on employment generation under section 64B of the Ordinance	150
Enhanced tax credit for making sales to registered persons under section 65A of the Ordinance	200
Extension in time limit for availing tax credit for balancing, modernization and replacement of plant and machinery under section 65B of the Ordinance up to 30.6.2019	500
Extension in time limit for availing tax credit for enlistment in stock exchange under section 65C of the Ordinance	5
Tax credit for establishing new industry under section 65D of the Ordinance	300
Tax credit for expansion of existing plant or new project under section 65E of the Ordinance	200
Extending exemption to export of IT services under clause (133) of Part-I of the Second Schedule	100
Enhancing limit of interest on house building loan under section 64A of the Income Tax Ordinance, 2001.	50
Rationalization of corporate tax rates	12,000
Relief on education expenses	500
Total	14,005

Source: Economic Survey of Pakistan 2011-12 to 2016-17

4.3 Sales tax exemptions

Major sales tax exemptions and their estimated cost is reflected in the table below.

TABLE 7: LOSS OF SALES TAX DUE TO EXEMPTIONS FOR 2016-17

SRO	Loss of sales tax due to exemptions (Rs. billions)
SRO 1125(I)/2011, dated 31.12.2011 (leather, textile, carpets, surgical goods etc.)	50.4
Imports under 5th Schedule	0.56
Local supply under 5th Schedule	25.8
Imports under 6th Schedule	67.6
Local supply under 6th Schedule	89.3
Imports under 8th Schedule	16.4
Total	250.06

The 'Sixth Schedule' covers food items, livestock, cotton seeds, vegetable oil, agriculture produce and equipment, poultry-related equipment, medical equipment, scientific equipment, solar technology related equipment, etc.

4.4 Customs duty exemptions

Major customs duty exemptions and their estimated cost is shown in the table below.

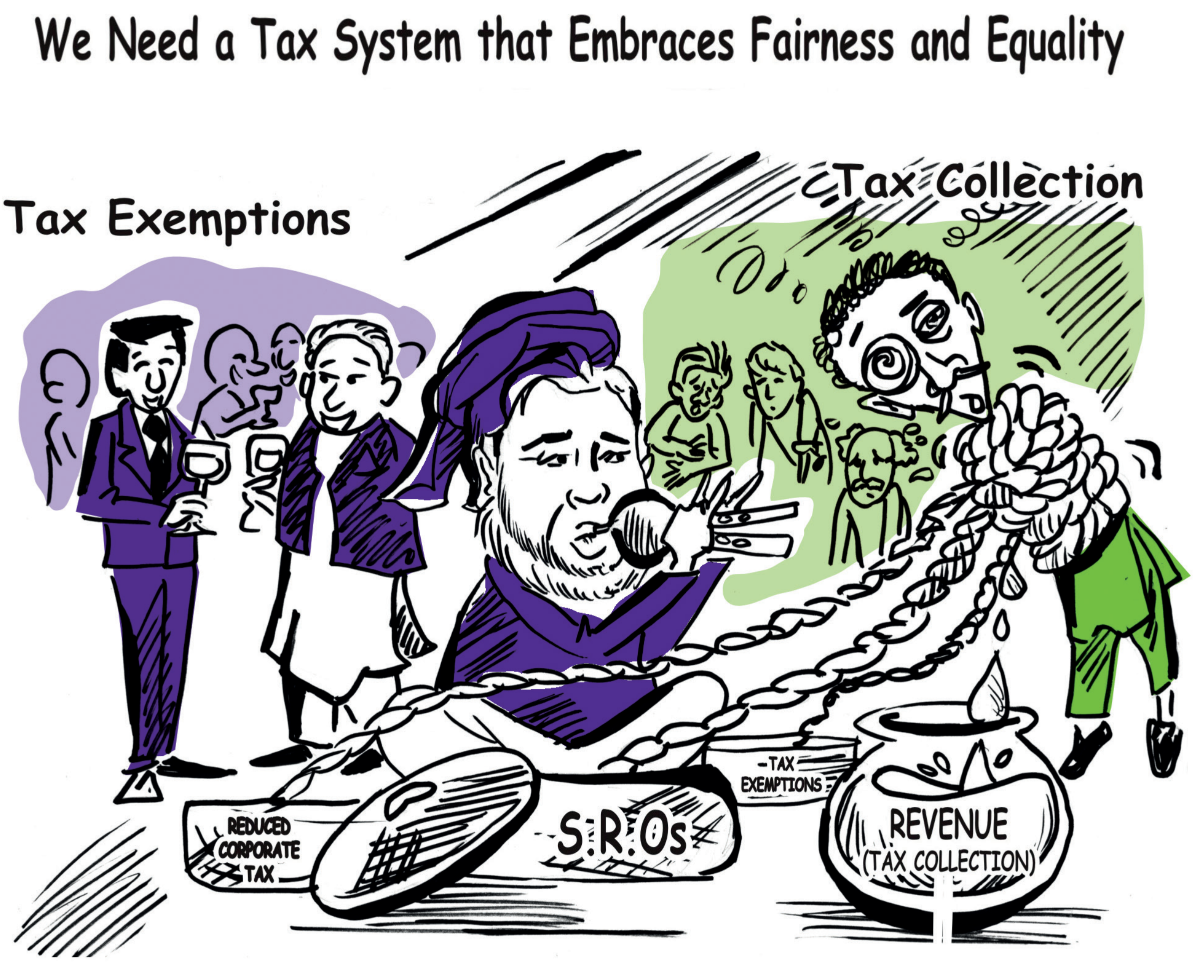


TABLE 8: ESTIMATED COST OF CUSTOMS DUTY EXEMPTIONS FOR 2016-17

Serial no.	SRO no. and date FTA As/ PTA	Description	Cost of exemption (Rs. millions, estimated) FY2017
1	558(I)/2004 01.07.2004	Concession of customs duty on goods imported from SAARC and ECO countries	73
2	894(I)/2006 31.08.2006	Exemption from customs duty on imports into Pakistan from Iran under Pak-Iran PTA.	-
3	1274(I)/2006 29.12.2006	Exemption from customs duty on imports into Pakistan from under SAFTA Agreement	1,184
4	659(I)/2007 30.06.2007	Exemption from customs duty on imports into Pakistan from China	31,618
5	1151(I)/2007 26.11.2007	Exemption from customs duty on goods imported from Mauritius	27
6	741(I)/2013 28.08.2013	Exemption from customs duty on imports into Pakistan from Indonesia under Pak-Indonesia PTA	3,309
7	280(I)/2014 08.04.2014	Exemption from customs duty on imports from Sri Lanka	2,538
8	1261(I)/2007 31.12.2007	Exemption from customs duty on imports into Pakistan from Malaysia	1,983
	General concessions: automobile sector, exploration and production (E&P), textile, energy and others		
9	565(I)/2006 05.06.2006	Conditional exemption of customs duty on imports of raw materials and components etc. for manufacture of certain goods (Survey based)	2,276
10	678(I)/2004 12.6.2004	Exemption of customs duty and sales tax to E&P companies on imports of machinery, equipment and vehicles, etc.	6,282
11	655(I)/2006 22.06.2006	Exemption from customs duty for vendors of automotive sector	17,668
12	656(I)/2006 22.06.2006	Exemption from customs duty for original equipment manufacturers (OEMs) of the automotive sector	21,827
13	*809(I)/2009 19.09.2009	Exemption of machinery and equipment, if imported by textile industrial units	
14	5th Schedule	Concessions under 5th Schedule	62,901
		Total	15,686

Source: Economic Survey of Pakistan 2016-17; and PRAL + WeBOC*: SRO.809(I)/2006 was rescinded in the Budget 2016-17. However, remaining concessions have been shifted to Part-IVI of 5th Schedule to the Customs Act.

Customs duty exemptions are granted as an incentive to promote investment in the exploration and production (E&P) and automotive sector to revive economic growth. However, the automotive sector and E&P companies have a huge influence in shaping the tax structure, which ultimately costs the poor segments of society.

4.5 'Well-governed tax exemptions' revised score

The score has been revised from 6 down to 3, due to the fact that tax exemptions are now routinely being issued without any clear rules.

The government has committed to phase out tax exemptions under the recently adopted IMF program, and in 2015, nearly Rs. 124 billion worth of exemptions were withdrawn; however, at the same time many new exemptions were granted, which meant that net reduction in tax expenditure was only Rs. 17.5 billion. It is expected that tax expenditure will increase due to China Pakistan Economic Corridor[46] (CPEC) related projects. To date, approximately Rs. 160 billion in exemptions have already been given to CPEC-related projects, with tax exemptions on mass transport projects costing around Rs. 76-80 billion, and tax exemptions on hydropower projects costing Rs. 50 billion.

Parliamentary oversight of the taxation laws received a serious blow due to the substitution of the term 'federal government' with 'Board' in the Finance Bill 2017, by virtue of which all powers and functions of the federal government provided in the taxing statutes have been shifted and delegated to the FBR and the Finance Minister.[47] The bill was strongly opposed by opposition in Parliament and the Senate: 32 senators challenged the bill in the Islamabad High Court.[48]

CHAPTER 5 EFFECTIVENESS OF TAX ADMINISTRATION

This chapter provides an overview of historical context, tax administration, tax reform initiatives and the impact of these initiatives vis-à-vis tax justice in Pakistan.

5.1 Historical context of Pakistan's tax system

The Central Board of Revenue (CBR) was created through the enactment of the Central Board of Revenue Act, 1924. In 1944, a full-fledged Revenue Division was created under the Ministry of Finance. After independence, this arrangement continued up to 1960, when on the recommendations of the Administrative Re-Organization Committee, the Federal Board of Revenue (FBR) was made an attached department of the Ministry of Finance. In 1974, further changes were made to streamline the organization and its functions. Consequently, the post of FBR Chairman was created with the status of ex-officio Additional Secretary. The Secretary of Finance was relieved of his duties as ex-officio and became the Chairman of the FBR.

In order to remove impediments to the exercise of administrative powers by a Secretary to the Government, and to facilitate effective formulation and implementation of fiscal policy measures, the status of the FBR as a Revenue Division was restored under the Ministry of Finance in October 1991. However, the Revenue Division was abolished in January 1995, and the FBR reverted back to the pre-1991 position. The current Revenue Division has existed since 1 December 1998, and in the wake of the restructuring of its functions, a new Act was promulgated under which it was renamed the Federal Board of Revenue (FBR) in July 2007.

5.2 Functions of the FBR

In the existing set-up, the Chairman of the FBR, being the executive head of the FBR, has the following responsibilities:

- Formulation and administration of taxation policy.
- Levy and collection of federal taxes.
- Quasi-judicial function of hearing of appeals.
- Entering into double-taxation treaties with other countries, as per recommendations of aligned ministries and institutions.
- Liaison with all ministries, chambers of trade and industry, as well as international organizations.
- Providing updates on FBR activities to the President and the Prime Minister of Pakistan.

5.3 Organizational set-up of the FBR

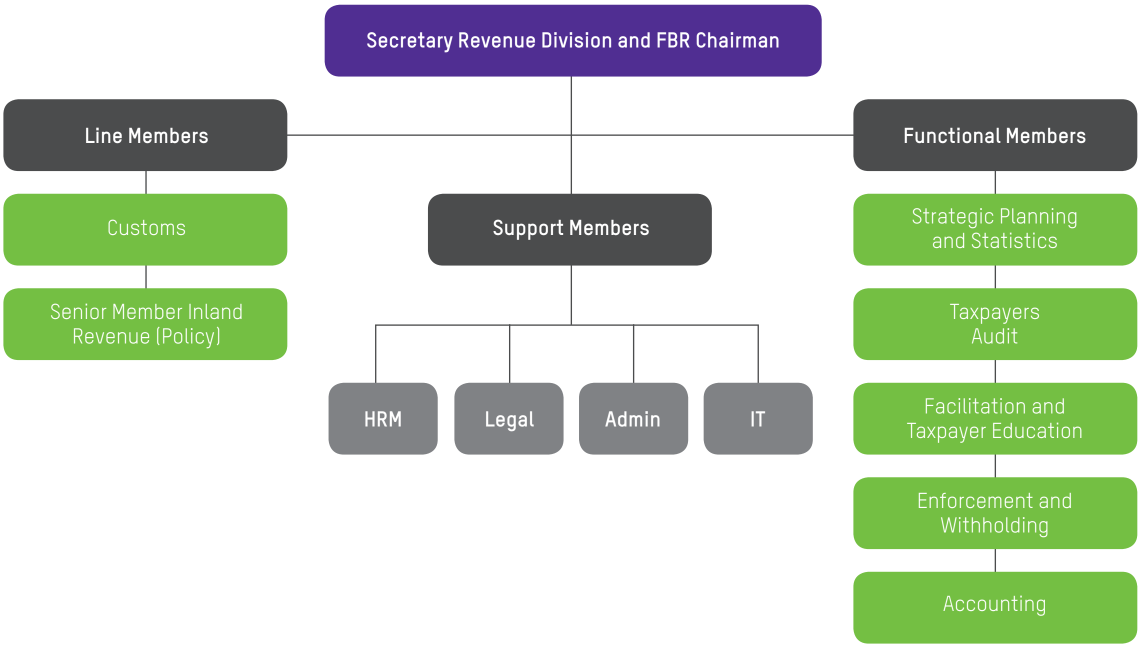
The Chairman of the FBR is assisted by the following members and the Additional Secretary in the Revenue Division, distributed along three broad functional categories, as shown below. Senior management also includes various director generals and chief collectors.

A. Operations/policy
   i. Customs
   ii. Senior Member Inland Revenue (IR) (Policy)
   iii. Member IR (Operations)

B. Functional
   i. Strategic Planning and Statistics
   ii. Taxpayers Audit
   iii. Facilitation and Taxpayers Education
   iv. Enforcement and Withholding
   v. Accounting
   vi. Information Technology

C. Support
   i. Legal
   ii. Administration
   iii. Human Resource Management (HRM)

FIGURE 8: ORGANIZATIONAL STRUCTURE OF THE FEDERAL BOARD OF REVENUE



5.4 Key challenges facing the FBR

The key challenges faced by the FBR are the need to:

i. Broaden the tax base.
ii. Rationalize the concessionary regime.
iii. Facilitate taxpayers to improve quantity and quality of tax returns filed.
iv. Strengthen the audit and ensure enforcement.

The following table shows that as far as annual target achievements are concerned, the FBR has consistently improved over the years; however, it has failed to adopt a long-term approach towards making the revenue streams sustainable and people-centric.

For instance, it has not meaningfully simplified the tax laws and procedures so that ordinary citizens can easily manage their tax affairs without the help of a tax lawyer. The FBR also failed to enforce tax laws across the board, particularly among influential segments of society. It has also failed to engage civil society or the media in creating the space for a just and equitable tax system in the country. And it has failed to optimally utilize technological platforms to bring accountability and efficiency into the tax system, despite heavy investments under the tax reform program funded by the World Bank.

TABLE 9: COMPARISON OF FBR COLLECTION (ESTIMATED VS. REVISED) 2012-13 TO 2017-18 (RS. BILLIONS)

Year	Estimated	Revised	Outturn (-,+)
2012-13	2,381	2,007	84%
2013-14	2,475	2,275	92%
2014-15	2,810	2,605	93%
2015-16	3,103	3,103	100%
2016-17	3,621	3,521	97%
2017-18	4,013	0	0%

Source: 'Explanatory Memorandum on Federal Receipts', Federal Budget

The regressive tax system shifts almost all of the tax burden to the middle and lower classes of society by relying more on indirect taxation, resulting in increased income inequalities and disparities. This is shown by the peak value of the share of indirect modes of taxation, of around 69%, in two consecutive years, 2005 and 2006. The slight increase in the share of direct tax is mainly due to an increase in presumptive taxes, which according to studies (as well as the Income Tax Ordinance 2001) reduces the tax burden of the rich and increases the burden on the poor.[49] Presumptive taxes are collected through withholding and are treated as the final tax liability, as discussed in Chapter 2. This also indicates an inefficient approach of the tax administration.

5.5 Alternate dispute resolution (ADR) mechanism

The FBR established an alternate dispute resolution mechanism (ADR), a system that operates side by side with the existing conventional appellate system, but with simpler procedures and fewer technicalities. In other words, the ADR is a system where a taxpayer can easily refer contentious issues for the consideration and recommendations of independent experts, and make an out-of-court settlement with the tax collector in light of such recommendations. The ADR does not involve any fees, charges or costs.

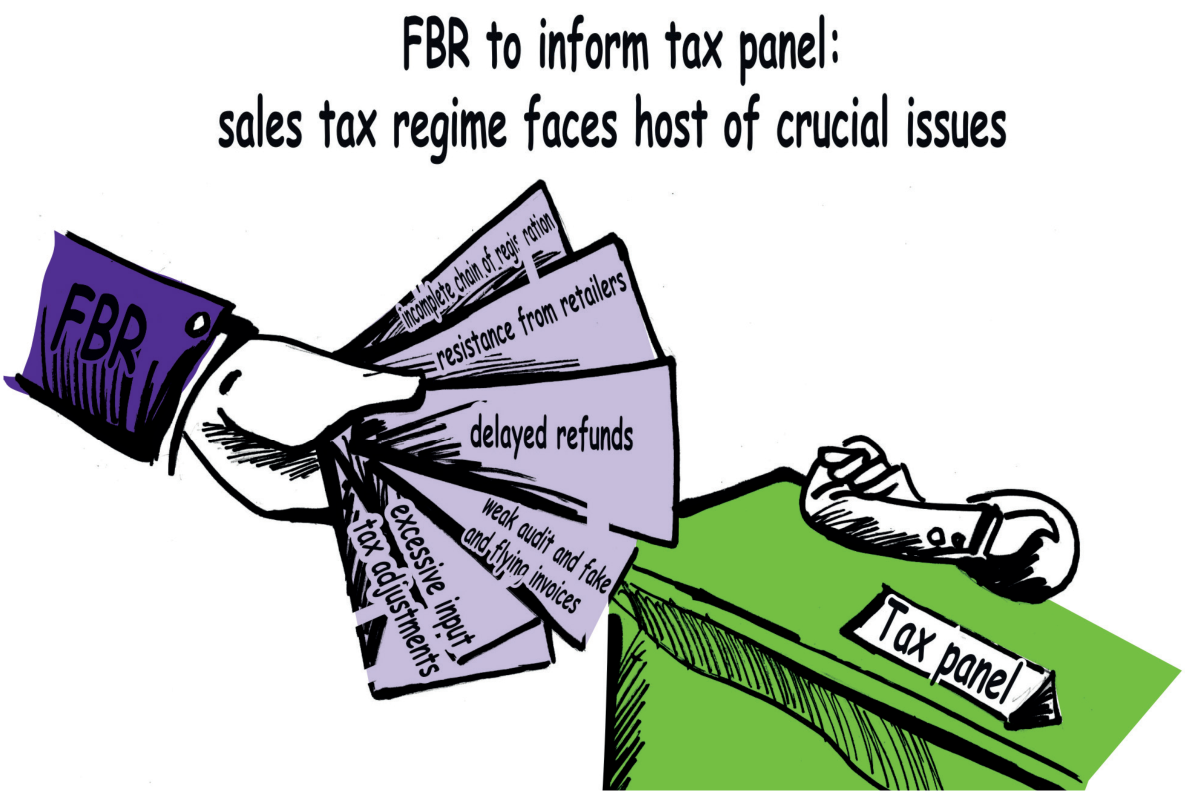
There is no time limit for applying for ADR. The application can be submitted any time during the pendency of the matter before any appellate authority, tribunal or court. Any aggrieved person or group can request ADR, for example:

- An individual
- An Association of Persons – any partner or member of the association
- A company – the principal officer of the company
- A trust – any trustee of the trust
- In the case of a deceased individual – the legal representatives of the deceased
- An individual under legal disability or a non-resident person – his/her 'representative', as defined in the respective laws.

5.6 'Effective tax administration' revised score

The score has been revised from 9 down to 6, due to the fact that although it is possible to file tax returns online, it is a complicated and not a user-friendly process.

The cost of tax collection per (100) unit(s) of net tax revenue in Pakistan is difficult to calculate, but as approximately 91% of taxes are either being collected through indirect taxes or taxation at source,[50] and FBR staff only collect around 9% of taxes, we can safely say that the cost of collection is above the OECD average.



CHAPTER 6 PRO-POOR GOVERNMENT SPENDING

In Pakistan, the year before the election year is always crucial for the ruling party. In 2017, a year before the election year, the government showed less interest in the development of public services. The health, education and social welfare sectors need proper funding without any gaps; leaving them with less funding means putting the people who use them at risk. This particularly affects poor and marginalized people living below the poverty line, who are the most reliant on these services.

Currently in Pakistan, major spending on health and education comes from out-of-pocket (OOP) payments. For nearly 20 years, average OOP payments have remained at around 78% of total spending on health by the private and public sectors, whereas the remaining 22% comes from the public sector through government spending. In recent years, OOP payments have significantly increased for both poor and non-poor households. While non-poor households account for the greatest share of OOP payments, it is poor families who suffer their effects the most, as unavoidable OOP payments can make a huge dent in their limited household budgets.

The Economic Survey 2015-16[51] estimates that in 2014-15 the Pakistan Federal and Provincial Government spent Rs. 923 billion, amounting to 3.43% of the GDP, on education, health[52] and social protection. Although no verified figures are available, we can safely assume that current figures will be nearly double this as all provinces have substantially increased their spending on education and health, with Punjab province spending Rs. 312 billion on education in 2016-17. The Economic Survey estimates the pro-poor spending figure for the first half of 2016-17 at Rs. 1,017 billion. The following table shows a breakdown of figures for the 17 sectors which the Government of Pakistan declared as pro-poor sectors in the Pakistan Economic Survey 2016-17.

TABLE 10: PAKISTAN RURAL SUPPORT PROGRAM (PRSP) BUDGETARY EXPENDITURES BY SECTORS (RS. MILLIONS)

Sector	2012-13	2013-14	2014-15	2015-16	2016-17 (July-Dec)
Roads, highways and bridges	94,750	96,504	190,984	397,506	149,765
Environment/water supply and sanitation	34,055	32,000	54,093	63,554	22,913
Education	479,853	537,598	599,047	663,356	310,155
Health	161,202	201,986	231,172	267,953	111,867
Population planning	7,142	12,609	13,943	10,894	3,038
Social security and welfare*	72,898	93,481	155,725	173,532	76,466
Natural calamities and other disasters	32,699	18,404	40,525	59,204	6,998
Agriculture	148,554	157,894	199,903	239,019	88,481
Land Reclamation	4,805	4,796	5,184	4,601	877
Rural Development	31,926	14,727	29,122	37,419	6,545
Subsidies	556,113	502,098	459,325	437,087	76,897
People's Works Programme-I	3,346	-	-	-	-
People's Works Programme-II	42,486	-	-	-	-
Low Cost Housing	603	676	581	460	165
Justice Administration	22,512	24,378	26,041	33,255	18,449
Law and Order	220,343	237,027	268,983	306,738	144,863
Total	1,913,287	1,934,178	2,274,628	2,694,578	1,017,479
Total as percentage of GDP (2005-06 base)	8.5	7.7	8.3	9.3	-

Source: Ministry of Finance, External Finance Policy Wing *Social Security & Welfare also includes the expenditure of BISP, MGDs and PBM

The highlighted rows of the table show that in the first two quarters of 2016-17, the Pakistan federal government and provinces were only able to spend Rs. 496 billion on education, health, and social security and welfare.

While a recent increase in allocations to pro-poor sectors is heartening, this alone will not be enough to overcome the significant challenges faced by the government in terms of providing quality education, healthcare and social protection to its citizens, for to the following reasons:

- The budgetary allocations are simply not enough to education the 25 million children who are out of school. Pakistan needs to spend 4% on education alone to expect some progress on fighting illiteracy. Developed countries on average spend 5% of their GDP on education, with most developing countries allocating more resources than Pakistan.[53]
- Budgetary allocations are decided and disbursed through a process which is political, non-participatory, centralized, time-consuming and obsolete, resulting in delays and lapses of funds. As a result, according to a World Bank review, development projects typically cost double the original estimate and take twice as long to complete.
- The focus of the allocations is on enhancing service delivery, which – although an essential requirement – means that most of the expenditure in health and education is in the form of current expenditure (80% of the Rs. 312 billion being spent by Punjab province), i.e. payment of salaries, administration costs etc., while development expenditures for new schools – to fund missing facilities, new staff etc. – are not receiving the required allocations.
- Nearly 50% of the development budget is being financed through loans and grants from external sources. The UK Department for International Development (DFID) is funding Punjab in the education sector, while the Benazir Income Support Programme (BISP) is being financed by a number of external funding agencies. This reflects Pakistan's inability to finance its essential needs and also places a question mark over the sustainability of the funding.

6.1 Spending on education

Article 25-A of the Constitution of Pakistan makes free and compulsory education the fundamental right of every child in Pakistan. The country is also a signatory to various treaties and international commitments related to universal education, but progress towards meeting this goal has been painfully slow. Currently there are 25 million out-of-school children (aged 5-16 years) in Pakistan, 13.7 million of whom are girls. Due to unavailability of the required funds and infrastructure, these children suffer – and the government has no proper plan to overcome the situation.

As per Article 25-A, it is the duty of the government, both federal and provincial, to ensure that every child has an education. The governments are failing to meet their constitutional obligation by not investing enough resources in education: currently Pakistan is spending only 2.1% of GDP on education, which is not enough to meet the legal obligation. Government spending on education as percentage of GDP is lower in Pakistan than in any other country in the South Asia region. As a signatory of various universal commitments, Pakistan is bound to spend a minimum 4% of GDP on education, which will require a massive increase in spending. If Pakistan succeeds in meeting this target, public sector schools and education departments across the country will experience an unprecedented flow of financing that has the potential to produce a range of opportunities.

TABLE 11: EXPENDITURE ON EDUCATION (RS. MILLIONS)

Year	Current	Development	Total expenditure	As % of GDP
2006-07	130,313	31,771	162,084	1.75
2007-08	155,622	32,034	187,656	1.76
2008-09	197,723	42,655	240,378	1.82
2009-10	219,933	39,592	259,525	1.75
2010-11	276,239	46,572	322,811	1.77
2011-12	330,228	63,295	393,523	1.96
2012-13	428,944	50,909	479,853	2.14
2013-14	453,735	83,863	537,598	2.14
2014-15	500,390	98,657	599,047	2.2
2015-16	561,386	101,970	663,356	2.3
2016-17 July-December (provisional)	278,434	31,721	310,155	

Source: PRSP Budgetary Expenditures, External Finance Policy Wing, Finance Division

Following the 18th Amendment, education in Pakistan has been devolved to the four provinces; as such, the onus is now on provinces to make it possible to bring out-of-school children into the classroom and provide sufficient resources to educate all. Currently, more than 50% of Pakistan's out-of-school children reside in Punjab, even though the Punjab province allocations to education are significantly higher than in other provinces.

Unavailability of resources and lack of government interest in the education sector give the private sector a chance to fill the vacuum, resulting in the mushrooming growth of private schools. This is a very alarming situation for the public and policy makers alike, as concerns have been raised about quality of education, lack of accountability, and the impact of private schools on inequality.[54]

6.2 Spending on healthcare

Currently the World Health Organization (WHO) has set a benchmark of 6%[55] GDP spending on providing basic health facilities and lifesaving services. However, developed countries are spending 4% of GDP on health services, and Pakistan only spent 0.91%[56] of its GDP on health facilities in 2017-18. Rs. 20.48 billion was provided to the health sector in the federal Public Sector Development Program (PSDP) 2014-15, with utilization of approximately Rs. 22.4 billion by the end of March 2015 (this includes Rs. 10.8 billion as foreign aid for a program for elimination of polio). Currently, Pakistan is spending 0.42% of its GDP on healthcare services.

TABLE 12: HEALTH AND NUTRITION EXPENDITURES 2000-01 TO 2016-17 (RS. BILLIONS)

Fiscal year	Public sector expenditure (Federal and provincial)		% Change	Health expenditure as % of GDP	
Total health expenditures		Development	Current		
2000-01	24.28	5.94	18.34	9.98	0.58
2001-02	25.41	6.69	18.72	4.63	0.57
2002-03	28.81	6.61	22.21	13.42	0.59
2003-04	32.81	8.50	24.31	13.85	0.58
2004-05	38.00	11.00	27.00	15.84	0.58
2005-06	40.00	16.00	24.00	5.26	0.49
2006-07	50.00	20.00	30.00	25.00	0.54
2007-08	59.90	27.23	32.67	19.80	0.56
2008-09	73.80	32.70	41.10	23.21	0.56
2009-10	78.86	37.86	41.00	6.86	0.53
2010-11	42.09	18.71	23.38	-46.63	0.23
2011-12	55.12	26.25	28.87	30.96	0.27
2012-13	125.96	33.47	92.49	128.51	0.56
2013-14	173.42	58.74	114.68	37.68	0.69
2014-15	199.32	69.13	130.19	14.94	0.72
2015-16 July-March	225.33	78.07	147.26	13.05	0.76
2016-17	145.97	37.47	108.50	8.99	0.46

Source: Finance Division (PF Wing)

The number of dispensaries and Basic Health Units (BHUs) have significantly increased since 1980, but the reach of their services is restricted to below 1,000 people. Rural Health Centres (RHCs) cover healthcare needs of 25,000 to 50,000 people, but their number has remained unchanged since 1980. Hence, the coverage and outreach of the health establishment has remained low, despite the increase in BHUs and dispensaries. Moreover, no major general hospitals have been set up in the public or the private sector since 1985, despite the fact that the population has more than doubled in this time. The ratio of population per hospital bed has increased from 1,450 in 2000 to 1,700 in 2010, before declining to 1,600 in 2016.

CHAPTER 7: ACCOUNTABLE AND PUBLIC FINANCES

7.1 Transparency and tax administration

The tax administration in Pakistan is not enjoying a good reputation among the general public. Some commentators argue that people evade taxes primarily because of an absence of trust towards the administration and lack of transparency.[57] Often taxpayer records are managed in a very poor manner, which causes difficulties for taxpayers. Frequent complaints of maladministration are filed with the federal tax ombudsman. Similarly, policy formulation is less than transparent in terms of stakeholder engagement.

7.2 Availability of information on companies

In Pakistan, a company is a separate legal entity incorporated under the law and registered with the Security Exchange Commission of Pakistan (SECP) under the Companies Act 2017. Before this act, all companies were registered under the Companies Ordinance 1984. The latest act comes with significantly enhanced SECP[58] authority in relation to: investigation and related matters, disqualification of directors, the power to call for information, mediation, compromises, arbitration, arrangement and reconstruction. This will give a boost to corporatization in the country. It will also provide a simpler and softer regulatory regime for small companies, enable e-governance, boost standards of transparency and quality of information, and ensure better corporate governance. However, there is still a lack of transparency regarding the real owner or 'Ultimate Beneficial Owner' of companies. This means companies are still able to hide the ultimate beneficiary, and the system is still generating loopholes to benefit the elite.

7.3 Lack of a transparent method for tax auditing

A tax audit is an examination to determine whether a taxpayer has correctly reported and assessed their tax obligations. The role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detecting discrepancies between a taxpayer's declaration and supporting documentation. A well-managed audit program plays a major role in managing compliance. In developed countries, a selection of audit cases for review is made on the basis of a benchmark provided each year before the filing of returns, and a special audit is done in cases where any definite information about companies and individuals is generated by a computerized tax intelligence system.

However, the FBR does not provide any transparent method for the selection of cases for audit under any tax law. This has created distrust, and taxpayers invariably contest the audit selection in the High Courts, invoking Article 199 of the Constitution of Pakistan.[59] In Pakistan, a computer ballot for 2017 FBR selected 2.3% of cases for audit out of the total filers following income tax submission, after exclusions. For sales tax and federal excise duty, the FBR selects 2.5% and 7.7% cases for audit respectively out of the total filers, after exclusions under the Income Tax Ordinance 2001.[60]

7.4 Limited role of Parliament in budget-making process

A budget is a government document presenting the government's proposed revenues and spending for a financial year. It is often passed by legislatures, approved by the Chief Executive or President and presented by the Finance Minister to the nation. In the Constitution of Pakistan, there are various provisions relating to budget. The budget, when proposed, is a bill before the Parliament, and once accepted is an Act of Parliament. The procedure for general bills establishes that a bill can originate either in the National Assembly or in the Senate; however, the Finance Bill can only be originated in the National Assembly. The Constitution of Pakistan gives power to Parliament and its members to constitute the annual budget. The different articles of constitution permitting government to prepare the budget are articles 73,[61] 77,[62] 80,[63] 81,[64] 82,[65] 83[66] and 84.[67]

Parliament has a very limited role in the budget-making process, even though it is a parliamentary process. In particular, the opposition is not part of the process at all; the Ministry of Finance prepares the whole budget and presents it in Parliament. The budget-making process can be enhanced and become more participatory through the standing committees. There are currently 41 National Assembly standing committees and 28 standing committees of Senate, which can play an effective role in the constitution of the budget and make it participatory to an extent. Civil society is not consulted at all during the budget-making process (see below). The process could be more efficient and effective if the views of all stakeholders were taken on board before the finalization of budget proposals. The executive budget proposal includes information on all tax and non-tax receipts. However, these are not thoroughly debated in Parliament, particularly the tax measures and annual subsides provided to large public sector enterprises.

7.5 Lack of citizen engagement in budget-making process

It is the common perception that Pakistan follows an incremental budget-making process and that budget estimates are based on minor percentages changes from the previous year's budget rather than on the basis of needs and assessment. Budgets are heavily driven by technocrats, and there are at least three obstacles to improving transparency in the budget-making process – weak citizen involvement, limited Parliamentary debate, and unavailable or opaque information.

Citizen participation is critical to the budget-making process because it addresses inequalities and enhances the impact of the budget. Despite this, the concept of participatory budgeting does not exist in Pakistan. Due to non-participation of public representatives in budget-making, financial managers and tax collectors have persistently failed to overcome the fiscal deficit and remove fiscal imbalances, as their tax policies are narrowly based on collecting taxes at source, without bringing powerful sections of society within the tax net or collecting what is actually due from them. Only the Chamber of Business and Industry is allowed to submit its proposal with the Ministry of Finance and FBR; however, this segment of society belongs to the elite and richest class, which is only 1% of the population.

There is no formal institutional mechanism in place that ensures the regular engagement of citizens during the budget-making process. There are several best practices available that would ensure citizen participation in budgetary processes, including gender-aware beneficiary assessment surveys, citizen scorecards, opinion polls and citizen comments/feedback through internet surveys.

7.6 'Accountable public finances' score revised

The score has been revised from 5 down to 4, mainly due to the fact that although there is a grievance mechanism in place, it is not very effective and suffers due to a lack of political will and resources.

7.7 Tax Reforms Commission

The Tax Reforms Commission (TRC) of Pakistan was formed in 2014 to raise awareness among the general public regarding taxation issues and to update the current taxation system. The TRC was set up to: undertake a review and rationalization of direct and indirect taxes and customs tariffs; review the autonomy and administrative structure of the FBR; and to work on the creation of a border force to deal with illegal movement of people and goods across the international borders.[68] While the establishment of the Commission is welcome, as yet many of the recommendations it put forward in 2015 have yet to be implemented.

CHAPTER 8: CONCLUSION AND RECOMMENDATIONS

In order to mobilize citizens for voluntary compliance, the government has to ensure transparency and accountability in the fiscal regime both at the policy-formulation stage and in tax administration. The following recommendations can stimulate growth and build a broader consensus for promoting a culture of tax compliance, while at the same time fixing the anomalies in the tax system.

1. IMPLEMENT THE TAX REFORM COMMISSION'S RECOMMENDATIONS 2015

A significant number of the TRC's 2015 recommendations have yet to be carried out. We demand that these recommendations, particularly regarding structural changes in the tax system, are implemented in letter and spirit.

2. ENSURE THAT TRANSNATIONAL AND MULTINATIONAL COMPANIES PAY THEIR DUE SHARE OF TAX SHARE

We demand implementation of the principals of delineation of standards for the assessment of fair share of tax by trans/multinational companies, with the government clamping down on any tax avoidance and evasion by trans/multinationals and implementing the base erosion and profit shifting (BEPS) inclusive framework and Multilateral Convention on Mutual Administrative Assistance in Tax Matters of the OECD.[69]

3. IMPLEMENT PROGRESSIVE INCOME AND CORPORATION TAX

The government should embark upon progressive income and corporation taxes for subsequent enforcement – a system in which the burden of taxes falls on those with the broadest shoulders, with the rich liable to pay higher rates of taxes while everyone else pay taxes as per their means. Indeed, there is a need to overhaul the whole taxation system and revert to progressive lines. The personal income tax minimum threshold should be Rs. one million.

4. INCREASE NATIONAL WEALTH TAX

Capital gains tax on national stock exchange dividends and rates of wealth taxes should be increased nationally.

5. REDUCE GENERAL SALES TAX

The government should introduce a phased approach for reducing GST – a discriminatory indirect tax – from 17% to 8%, shifting the tax burden from those who can least afford it by ending tax havens and imposing progressive taxation measures on the richest 15 million people in the country.

6. EXPAND AND EXEMPT THE CONSUMER PRICE INDEX BASKET OF ITEMS

The consumer price basket containing 487 items should be expanded to include more essential items, based on in-depth exploratory survey results. Items in the basket should remain exempt from import duties and surcharges.

7. INCREASE SPENDING ALLOCATIONS FOR EDUCATION, HEALTH AND SOCIAL DEVELOPMENT

Increasing tax revenues through progressive tax measures must be used to raise public spending on education, health and social safety nets to the tune of a 5% and 3% of GDP on education and health, respectively, and a two-fold increase in expenditure for the safety net.

Conclusion

Domestic revenue mobilization is the only answer if Pakistan is to achieve the Sustainable Development Goals. Like other developing countries, Pakistan has to make a concerted national effort involving government, tax administration, civil society, media and the general public. The challenge is too big to be overcome by any one stakeholder in the tax system, as past reform initiatives have shown.

All the current distortions and anomalies born out of the short-sighted approach by the tax administration need to be drastically overhauled. Reforms must be holistic and pro-poor, and must cover policy, legal, administrative and tax culture aspects of the tax system.

A strong and persistent communications strategy is critical for mobilizing national demand from the people for a fair and transparent tax system which will lift the burden from the poorest citizens and guarantee the achievement of the Sustainable Development Goals.

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