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## Tax Policy Design And Reform Options

Taxes are involuntary charges levied on individuals or corporations and enforced by a government entity—whether local, subnational or national—in order to finance for government activities. The level and nature would vary depending on the structure of the economy and other goals mandated with taxation system. These other goals are but not limited to redistribution, economic efficiency, intergenerational transfers, pricing, equality, development and others. In Pakistan resource mobilization takes place at federal and provincial government level. Main taxes are broadly differentiated in direct and indirect taxes (with surcharges included in the indirect taxes).

Federal Board of Revenue is the federal entity responsible for collecting major part of tax revenue. A substantial increase in the tax collections has been witnessed during last two decades. FBR tax collection was just around Rs.392 billion in 2000-01 which has jumped to around Rs.4 trillion in 2019-20. Pakistan is under a IMF program and as per news reports Four pending reviews (2nd to 5th) are completed and \$500 million for budgetary support will be released very soon. The domestic authorities have adopted some tax policy recommendations proposed by the Fund and it is expected that more changes will be made in the coming days. Some favor these tough steps whereas some have vehemently opposed them.

Government tend to set illusive tax-to-GDP targets based on over optimistic projections for tax bases growth and then try to chase these targets through arbitrary measures. These numbers are projected under the pressure of either the IMF program or for the sake of putting up an all good position as well. Once these numbers, which have been floated at budget time, shows sign of plummeting then fiscal policy making gets compromised both for the federal government and federating units who have set up higher expenditure portfolios based on expected increased

flow. On the other hand a good tax system need to be least distortionary, has ease of collection, doesn't discriminate and is politically acceptable. Most experts are of the view that Pakistan tax policy is not based on these well-known and clear principles.

These revenue pursuits have faltered the Tax Policy structure. Growth and employment creation is left primarily to some PSDP funded projects and overall tax Policy does not follow principles of fairness, certainty, efficiency and convenience. In general, the current Tax policy is killing transactions which are required for economic growth while pursuing tax targets. This also results in mini budgets and off-budget revenue measures for revenue boasts while chocking the already suffocated business environment and creates uncertainty for new investments.

Therefore we need Tax reforms; where we change the way taxes are collected or managed by the government and is usually undertaken to improve tax administration or to provide economic or social benefits. There have been 16 Tax Reforms efforts since independence. The unmet need for more reforms considering inelastic structure and low tax collection from the economy warrants a critical analysis of history of reforms and there outcome. Revenues thus generated are not upto the mark, required for expenditure needs thus forcing government to borrow perpetually. Which in turn reduces the resource envelop required for development and other critical economic and social needs of the society owing to higher debt servicing costs and debt hangovers. In a more recent work of Nasir et.al. (2020) notes that long term growth and productivity have declined while tax policy has become more contentious and fragmented. Measures multiply as unrealistic targets are chased with mini budgets every quarter. The study further identifies that the policy priority has been to increase tax-to-GDP ratio thus leaving growth and employment to an outcome mainly produced from Public Sector Development Programs (PSDP). Arbitrary and frequent tax changes have created an environment of uncertainty<sup>1</sup>.

Considering the importance and strategic nature of the theme Pakistan Institute of Development Economics (PIDE) have been actively engaged in research and provision of evidence based policy recommendations. A recent report titled "Growth Inclusive Tax Policy: A Reform Proposal" by Macroeconomics Section PIDE estimates that there are about 35 out of a total of 82 Withholding taxes, 596 out of total 821 domestic sales tax lines; 42 out of 97 for Sales tax on imports, 37 out of 95 in case of customs and 09 out of 37 in case of Federal Excise Duties, contribute less than 1% in their respective revenue heads. The report further estimates that about 11.14 Billion rupees of compliance cost of these taxes and 0.24 Billion FBR cost of collection is saved if these taxes are not levied. Further if these taxes are not levied, businesses would reinvest them to expand, then the overall impact would be more economic activity resulting in more tax collections. But unfortunately, no one notices the loss to economic growth and job creation due to these adverse tax measures.

Finally, the False Narrative of Tax Cheating nation has to change. Pakistan has served to paint the country as totally immoral as well as with a state that is bordering on failure. This is despite the fact that many of our comparator countries like Bangladesh, Indonesia, Malaysia and others are not doing much better than us. There is a need for Simplicity of Taxes and Better Administration- Not Killing Transactions.

### TAX EXEMPTION v/s TAX CREDIT

**Tax Exemption:** Refers to a complete exemption and/or waiving off of the tax liability on your income. As a result, your income is considered as non-taxable.

**Tax Credit:** Unlike tax exemption, in case of tax credit, liability is levied on the earner and as a result, the income is considered as taxable. Relief to the earner, however, upon fulfillment of criteria is provided by waiving off payment of the tax liable on the income earner.

Summing up, Tax Exemption reduces the earner's taxable income while Tax Credit reduces the tax payable.

<sup>3</sup> Nasir Muhammad, Naseem Faraz and Saba Anwar (2020), Doing Taxes Better: Simplify, Open and Grow Economy, PIDE Policy Viewpoint 17:2020.