TAX REFORMS

REVENUE WITH GROWTH

PIDE-PRIME Tax Reforms Commission

Pakistan Institute of Development Economics

PRIME ECONOMIC THINK TANK

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PIDE-PRIME Tax Reforms Commission

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TAX REFORMS

REVENUE WITH GROWTH

PIDE-PRIME Tax Reforms Commission

Designer: Mohsin Ali, Pakistan Institute of Development Economics, (PIDE). Islamabad.

Vision

Transforming Pakistan's
Tax System for Growth and
Ease of Tax payers

This presentation is based on the reports published by the following institutions and individuals.

- Pakistan Institute of Development Economics (PIDE)
- Policy Research Institute of Market Economy (PRIME)
- Pakistan Business Council (PBC)
- Dr. Hafiz Pasha

The Narrative and Approach Need to Change

Stable and Predictable Tax Regime

- Investment requires a stable and predictable tax regime
- Unpredictable tax regime scared away investment due to:
  - Complexities in tax code
  - Random tax measures/minibudgets
  - Annual tax dramas in the form of budgets – revised many times during a fiscal year
  - Predatory annual budget recommendations – finance bill circus is harmful to transactions and investment

Current narrative: it is the people, but the actual position is that it is the policy

- Pakistan has been struggling with its tax system since independence because expenditures have exploded to meet
  - Predatory state machinery (perks and privileges)
  - Global agendas – many of which should wait for a later stage of development
  - Poor Public Financial Management
- The assumption that Pakistanis are tax thieves needs to change
  - Poor policies, ineptitude and misgovernance are the culprits

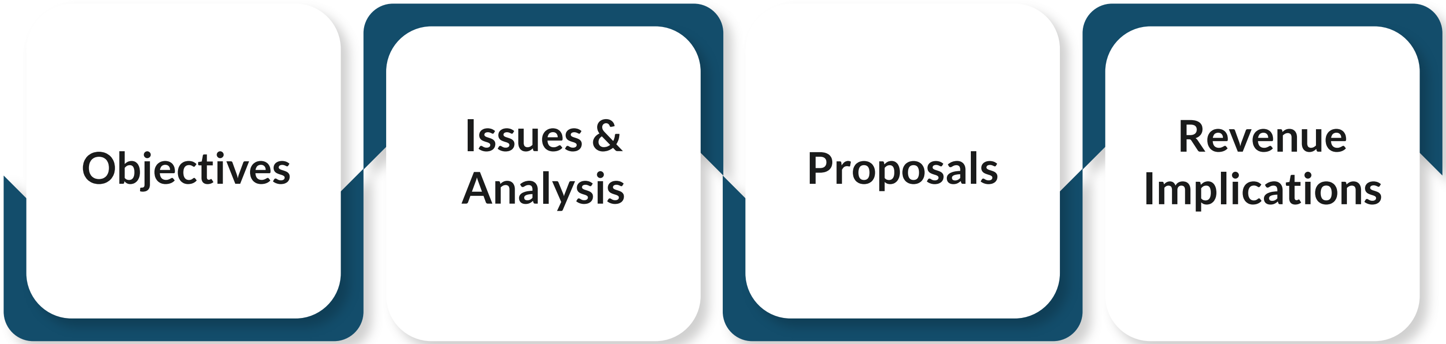
Current narrative: look at our stage of development and governance

- International comparisons of the tax/GDP ratio should not set the objective
    - At a similar stage of economic development, the US had a tax GDP ratio of 5-7 % and the UK had around 12%
- Across countries issues related to systems/institutions/structures are not similar

Current narrative: international agencies need more local engagement

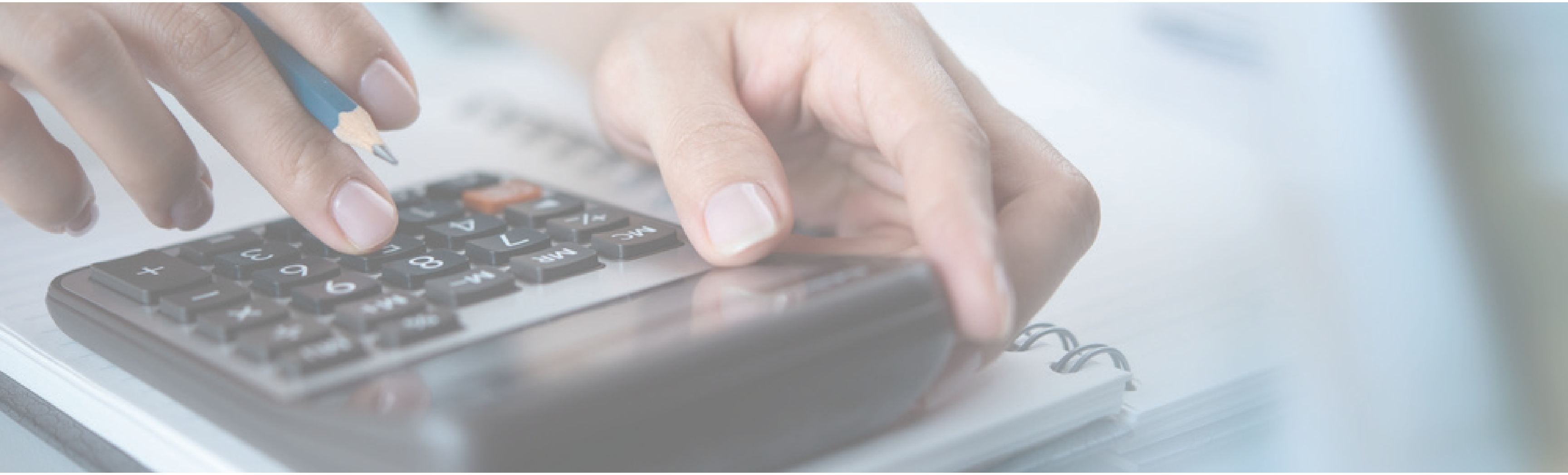
- International agencies require taxes to meet their foreign agendas rather than deal with the growing expenditure issues
    - Have a limited idea of curbing the country's expenditure needs
- Our tax policy on the advice of international agencies is raising taxes/import duties which stops global integration
- Perception of rent-seeking in tax administration, government waste, and corruption are often cited as reasons for tax avoidance
- A significant portion of legal economic activity stays informal to avoid intrusive and punitive taxes

Structure of The Report



Objectives and Parameters of A New Tax Policy

1. A citizen-friendly, transparent, stable, and predictable tax regime to stimulate growth and investment
2. Simplified & harmonized taxation to facilitate taxpayers and ease of paying taxes
3. Automated & digitized administration to eliminate the direct interface between the taxpayer and the tax authority



Summary & Key Points

Income Tax

1. Uniform tax regime for all sources of personal and non-corporate incomes
2. Decrease corporate tax rate to 25%
3. Withdrawal of deemed rental income tax, CVT, super tax, turnover tax, presumptive/final tax
4. Restore investment credits for plant and machinery

Customs Tariffs

1. Zero-rated import of plant and machinery, industrial raw materials, and intermediate goods
2. Withdraw regulatory and additional customs duties and withholding of income tax on imports

General Sales Tax

1. Harmonised GST/VAT
2. Gradual reduction of VAT to 10%

Withholding Taxes

1. Reduction in the number of Withholding Taxes and complete roll-back of WHT regime except, in the long-run, on pay-roll, interest, dividends and payments to non-residents

Tax Administration

1. Mandatory registration in GST starting in the first phase with commercial importers, wholesalers and tier-1 retailers
2. Automation and Digitization to reduce interaction between taxpayers and tax authorities
3. Abolishment of non-filer category
4. Enhancement in capacity of PRAL
5. Formation of a Pakistan Fiscal Policy Institute/Budget Office for Parliamentarians

Overall Gains From Tax Reforms (Rs. in billion)

Total Net Gain		Increase in Revenue (% of Base)
Year 1	1,194	20
Year 2	1,311	21
Year 3	1,596	26

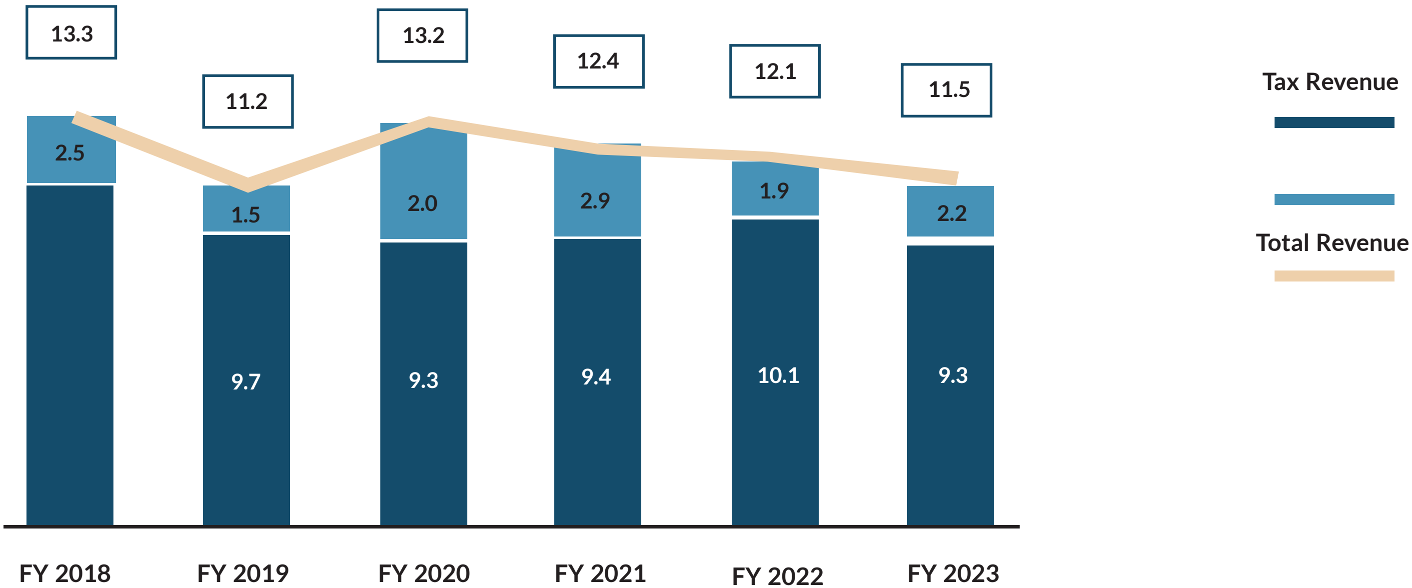
Note: Base year is FY 2021-22. All figures in Rs billion

Author's Estimations

Issues and Analysis

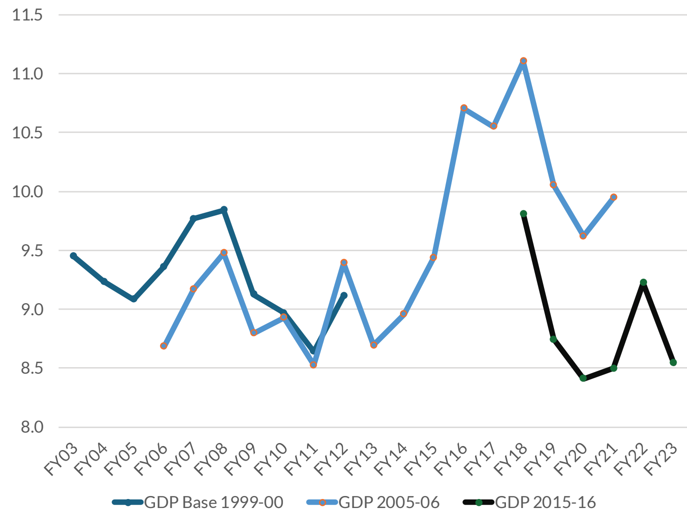
Overall revenue position is not improvingTax collection is almost stagnant in proportion to economic activities

Revenue % of GDP



- Just looking at the tax/GDP ratio as a measure to show revenue performance is misleading
  - GDP rebasing leads to a reduction in tax/GDP ratio
  - Takes time to catch up and by that time another rebasing takes place
  - Significant portion of GDP (agriculture) is not taxed by provinces

FBR Tax/GDP Ratios Across Different GDP Bases



The problem

- Pakistan has no clear tax policy – measures erratically introduced on an ad-hoc basis creating uncertainty & lack of trust
- Growth and investment are adversely affected
- Tax evasion/compliance/maladministration increases
- Revenue shortfalls because of poor policy and administration
- Tax advice influenced by lenders/consultant
    - With little domestic input

Trust Deficit Between Revenue Authority and Taxpayers

- Withholding and minimum tax regimes excessively used:
    - Approximately 68% of revenue is collected through withholding and minimum tax regimes, leading to inefficiencies and compliance challenges
- Fragmented system with many exemptions and rates:
    - creating complexity and confusion for taxpayers
- Arbitrary revision of tax rates:
    - Tax rates are frequently revised without clear rationale or economic justification, leading to uncertainty and instability for taxpayers

- Broken refund system:
    - Taxpayers face delays and hurdles in obtaining refunds, undermining trust in the tax system and hindering business operations
- High compliance costs:
    - Taxpayers incur high administrative and procedural costs to comply with tax regulations, reducing incentives for voluntary compliance and conducting economic activity
- Threat of predatory ITO:
    - Companies and investors scared of predation

Policy Gap

- Policy gap (also referred to as tax expenditures)
  - These losses result from special exemptions, permissible deductions, credits, deferrals, and preferential tax rates in federal/provincial tax laws (income tax, general sales tax, excise duty, and customs tariffs)
  - Tax expenditures reduce the tax liabilities of individuals and businesses that undertake activities specifically encouraged or assisted by the government
- For FY-22 tax expenditures as estimated by FBR are:
  - More than Rs. 400 billion in income tax
  - More than Rs. 700 billion in sales tax
  - More than Rs. 500 billion in customs

Note these expenditures could be collected with some policy changes

Compliance Gaps

- The compliance gap (tax gap) is broadly defined as the difference between what taxpayers should pay and what they are paying
- FBR estimates for FY-22 shows that:
  - Compliance gap is around RS.1.3 trillion
  - That is roughly 20% of tax revenue

The reasons for the compliance gap have not been fully analyzed but the myth has been created that we aretax cheaters

What We Propose

Proposals and Revenue Implications

Better Research, Better Technology

- Tax reforms should be
  - Changing the way taxes are collected or managed
  - Improve tax administration through digitization and technology
- Since independence, 16 tax reform initiatives undertaken
  - With little change since inelastic structure and low tax collection
  - This warrants critical analysis of the history of reforms
  - Necessitate more domestic research
- Revenues continue to lag the required expenditure needs
  - Needs more expenditure rationalization
  - Burden cannot be just on taxation

Our Position

- We need to develop a simple stable tax system relying on digitization and a digitized economy with limited human interface
- Minibudgets, erratic, and arbitrary tax increases are discouraging investment and growth
- The entire adjustment burden should not fall on tax alone
  - Undermines trust and lowers tax collection

Tax Rationalization and Potential Gains (Rs. in Billion)

Quantification of Reforms Gain

	Direct Taxes Reforms		Indirect Taxes/GST Reforms		FED Reforms		Customs Reforms		Net Impact	
	Net Gains	% of base Collection	Net Gains	% of base Collection	Net Gains	% of base Collection	Net Gains	% of base Collection	Total Net Gains	% of Base
Year 1	370	16	790	28	16	5	17	3	**1,194**	**20**
Year 2	332	14	854	30	16	5	110	21	**1,311**	**21**
Year 3	468	20	924	33						

Authors Estimation

- Tax rationalizations to yield Rs. 4 trillion in first three years

Note: The tax revenue gap attributed to the IMF according to a news item is Rs. 7 trillion, which is based on the FBR estimates of policy and enforcement gaps. In our proposal, we estimate the tax gap to be Rs. 1.1 to 1.4 trillion, assuming a 10% reduction in the policy and enforcement gaps on average. We believe that setting a higher target will put FBR under undue pressure and will damage the prospects of economic growth

Customs and Tariffs

The Need For an Open Economy

Problems in Existing Customs Tariff Regime

- Exports are dependent on imported inputs
  - Serious anti-export bias
  - Inputs are increasingly expensive because of revenue chasing
- Import substitution industries will compete and seek to export only if tariffs are low
  - Those protected now for decades have no reason to export with high tariffs
- Relying on tariff increases for revenues is keeping the economy closed, adversely affecting its compet-itiveness
  - Keeps Pakistan out of the global value chain

Anti-Export Bias: How?

- Cascading tariff as a trade policy leads to resource allocation diverted to domestic markets rather than competing in the export market
- Retaliatory cascading of tariffs can lead to lower exports
- Revenue measures through the imposition of regulatory and customs duties increase input cost

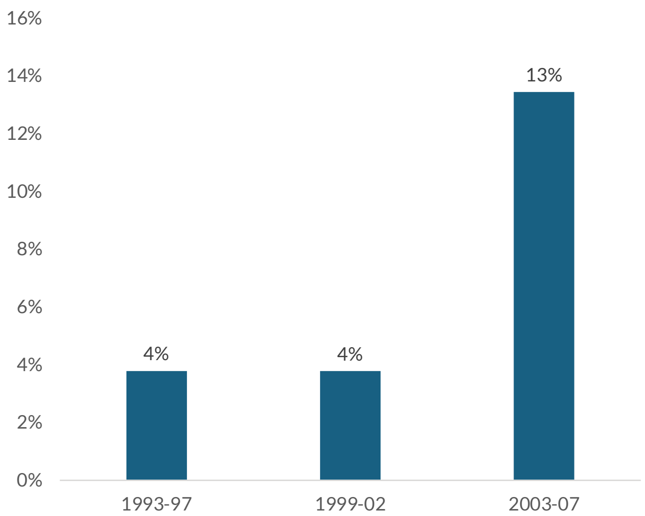
History Shows Openness Leads To a Competitive Economy

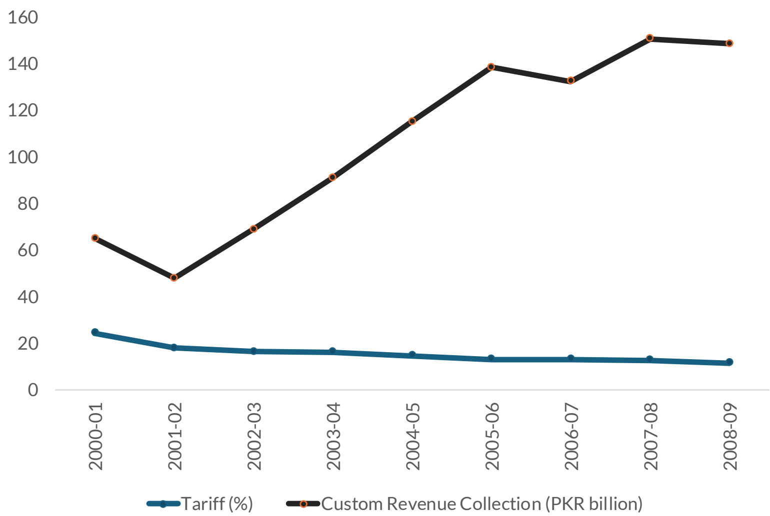
- Import taxes in Pakistan (including GST, FED, WHT, CD, and other duties) are now at 46% compared to 5% world average
- Resulting in continuously reinforcing a faulty import-substitution policy
- Lowering of tariffs has a positive impact on revenues (e.g., the case of Vietnam). Along with substantial reduction of smuggling and mis-invoicing. Other tax collection inland also increase
- History of tariff reforms in Pakistan shows that Tariff reduction has led to increase in exports as well as increased custom revenue collection.
- These reforms also increased global trade market.
    - Trade expansion as well welfare enhancing
- These facts counter the general perception that custom's revenue reduces and trade account worsen due to reduction in tariff rates.

Reforms Have Led To Significant Increase in Revenues in Past For Pakistan

- Historical Snapshot: Pakistan's Tariff and Custom Revenue: Gradual decline in custom tariff leads to exponential increase in custom revenue

Revenue Collection, CAGR (%)





An Open Economy is Essential

- Competition and growth enhanced
- Attract foreign direct investment
- Leads toward more efficient resource allocation
- Reduce smuggling and trade mis-invoicing
- Improve government revenue collection and reduce rent-seeking
- Overall, tariff reduction fosters a more dynamic and efficient economy

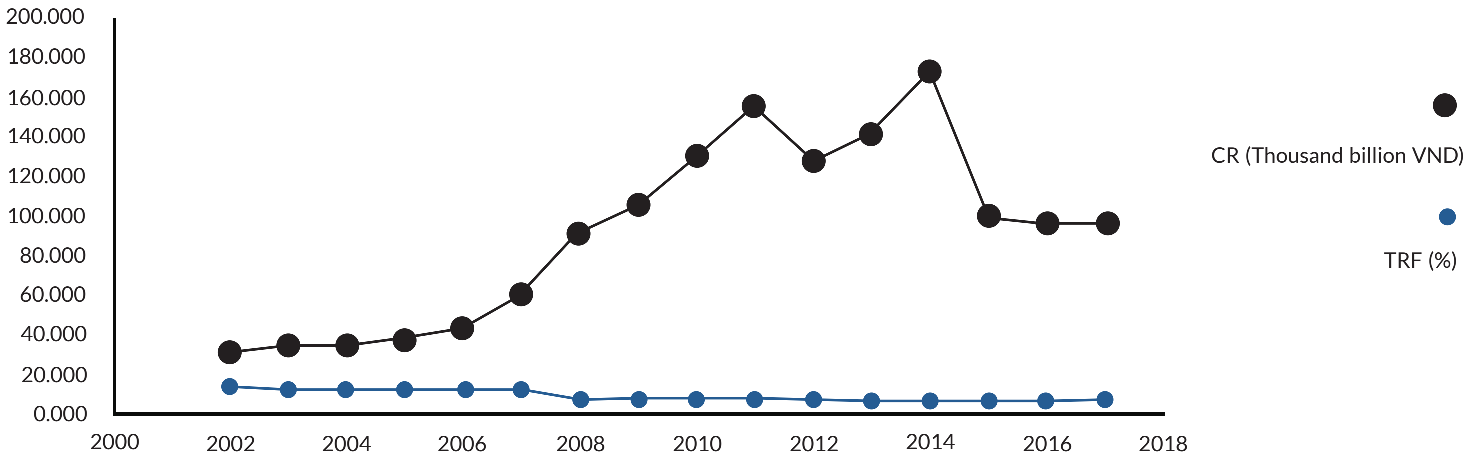
Tariff Reforms Experience in Pakistan

	Tariff (values in %)	**Custom Revenue Collection** (Rs. in Billion)	**Exports** (USD in Million)	**Imports** (USD in Million)
2000-2001	24.49	65	9,202	10,729
2001-2002	17.93	47.8	9,135	10,340
2002-2003	16.51	68.8	11,160	12,220
2003-2004	16.18	91	12,313	15,592
2004-2005	14.7	115.1	14,391	20,598
2005-2006	13.18	138.3	16,451	28,581
2006-2007	13.13	132.3	16,976	30,540
2007-2008	12.72	150.6	19,052	39,966
2008-2009	11.6	148.4	17,688	34,822

Source: World Bank Open Data (https://data.worldbank.org/)

Vietnam's Tariff Reduction Increases Revenues

Vietnam's Customs Revenue & Average Tariffs From 2002 to 2017



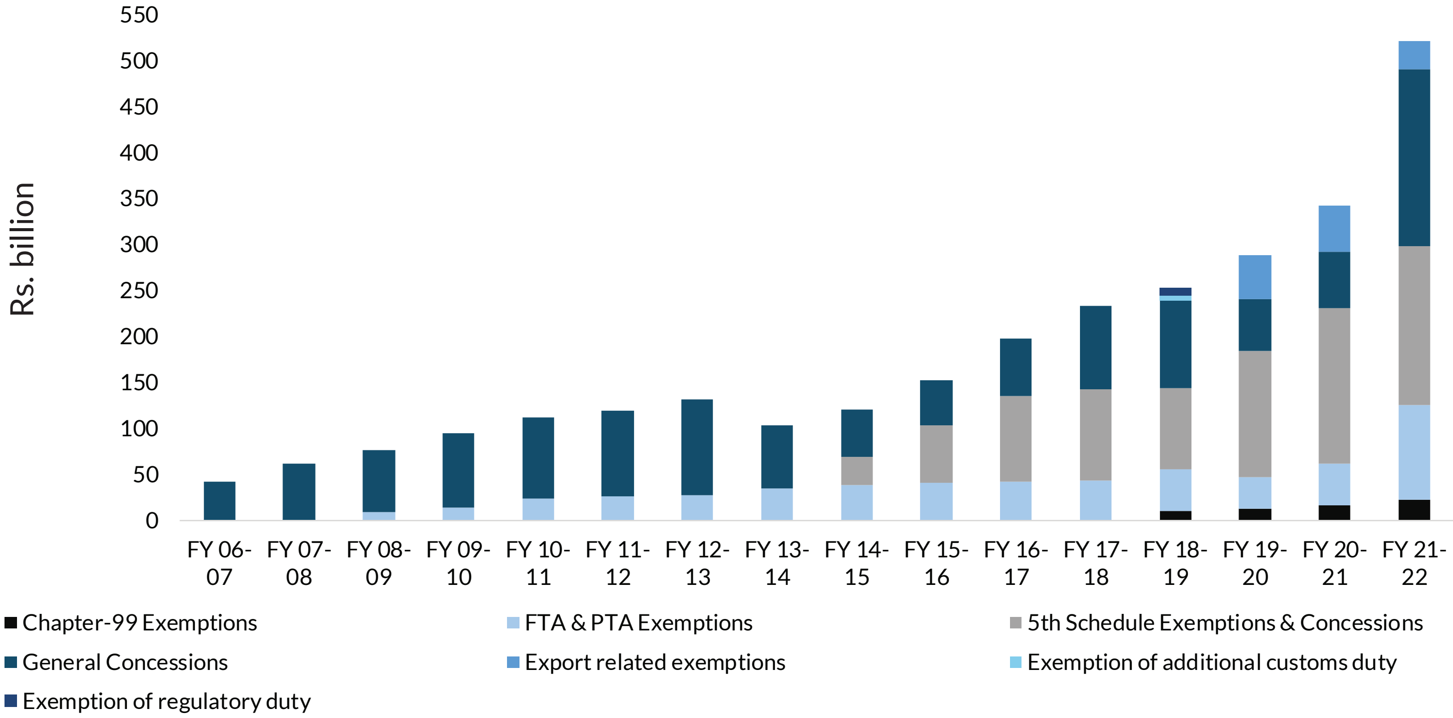
Source: CR - International publication data of Vietnam Ministry of Finance,
TRF - http://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS?page=2

- Evidence shows tariff reforms have led to growth in trade and trade-based customs revenue (CR)

Customs Duty: Tax Expenditures (Policy Gap) 2006-22

- Concessions and differential treatments lead to significant revenue losses and distortions.
- Major exemptions are provided in the 5th Schedule
- Cost of exemptions is increasing at an exponential rate

Customs Duty: Tax Expenditures (Policy Gap) 2006-22



Customs Tariff Reforms

1. Abolish regulatory duties, additional customs duties, withholding income tax, and sales tax on imports of capital goods and industrial inputs (raw materials and intermediate goods)
2. Make customs tariff transparent with 4 slabs of 0, 5,10, and 20%
3. Bring customs duty rates to par with other competing regional developing countries over time.
4. Same duty rate irrespective of the end use/user
5. Exemptions should be merged into tariffs and schedule 5 needs to be eliminated

Additional Revenue From Removing ACDS and RDS and Exemptions

- Elimination of exemptions and concessions (referred to as policy gap) will lead to an increase in the customs revenue
- Withdrawal of regulatory duties and additional customs duties on the imports will:
  - Result in the reduction in customs revenue
  - Decrease smuggling and mis-invoicing (referred to as compliance gap) as importers will be incentivized to use formal channels
- Net gains, at a very conservative level, will be Rs. 17 billion in year 1
- Reforms will result in an overall growth in tax revenue

Custom Reform Revenue Impact

	Tariff Policy	Policy Gap Reduction	Compliance Gap Reduction	Net Gains	% of Base Collection
Year 1	-258	260	15	17	3.4%
Year 2	-193	287	16	109	21.2%
Year 3	-145	315	18	188	36.5%

Source: Author's Estimation

The table summarizes our estimations on the additional revenue from adjustments in the policy gaps (assuming a 40% reduction) and compliance side (assuming a 30% reduction). Additional revenue is expected to be much higher over time

General Sales Tax

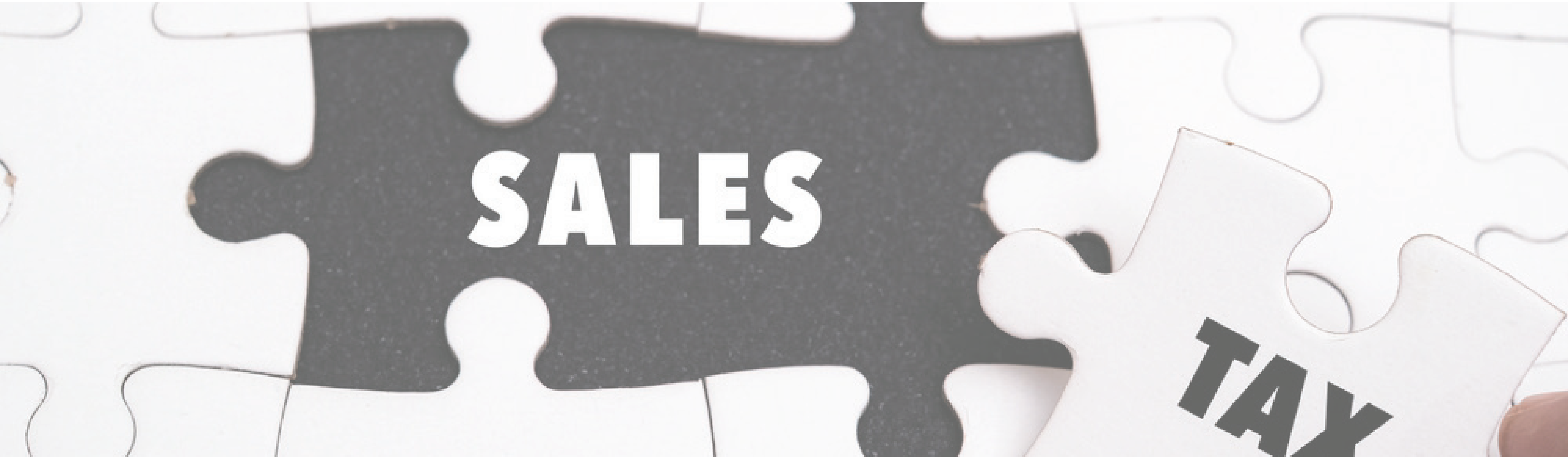
Should be the main revenue collection instrument Establish it, Evolve it Digitization and automation will improve it

Problems In Existing Gst Regime

- Broken VAT;
  - Supply chain not fully registered,
  - Preventing claims of refunds and input adjustments
- Weak enforcement by FBR
  - Number of firms registered & paying GST only 114,000 out of over 3.5 million commercial & industrial firms
- Goods and Services are taxed separately under Federal and Provincial tax authorities
- Exemptions (resulting in distortions)
- Digitization was never a priority or adequately operationalized
  - GST needs to be built around a digitized economy

General Sales Tax Reforms

- GST/VAT should be the most important revenue source
- We must first invest in developing a proper GST system
- It must be fully digital relying on an ecosystem of receipts and refunds without human intervention
- Rates must be uniform
- Follow the EU system for exemptions and zero rating
- The deadline for getting this system in order should be short and strict



Reconsider GST Rates

- An increase in GST rate brings an increase in tax revenues in the short run but leads to a decrease in tax collection in the long run
    - In the short run, a 1 percent increase in GST increases revenues by 2%, however, revenues decrease by 4% in the long run.
- We must lower the rate of the GST since:
    - Countries (like India, Georgia, Mexico, etc.) shifted from high GST (17 to 19%) to low-rate VAT system (7 to 10%) saw an immediate positive impact on the tax/GDP ratio of 3 to 4%

What is Value Added Tax (VAT)

- VAT is a common consumption-based tax imposed on the value addition of goods and services but finally borne by the consumer
- It is a major source of revenue for governments in both developed and developing countries
- VAT is collected from firms, households, and businesses in all manufacturing stages
- It is also collected from the traders and producers of intermediate goods, and it ends up with retailers

What Is VAT In Pakistan

- In Pakistan, the VAT system is broken as not all of the value chain is covered
- VAT is crucial to ensure effective revenue collection, promote economic stability, and narrow the tax gap
- It can help simplify tax administration procedures, promote efficiency, and reduce tax evasion
- Challenges such as fraudulent refund practices and unwarranted input claims exist, which diminish the efficiency of the VAT system in tax collection
- Compliance is a challenge akin to income tax compliance

Road Map For VAT*

- This should involve:
  - Removal of exemptions and special provisions because it leads to significant slippage of possible revenue from the tax base.
  - Full digitization of business both internally and externally (BTB)
  - Integration of all sizes of businesses into the VAT value chain by both policy and administrative reforms.
- Sequencing of measures for a "package of reforms" including VAT and tax administration:
  - In the short run:
    - An integrated VAT would require agreement between the Centre and the Provinces for a single administration with a board of directors representing all federating entities
    - Revenues would continue to be distributed according to the 18th Amendment
    - The proposed administration would also administer an integrated income tax and allocate revenues according to current laws
  - In the longer run:
    - A Constitutional Amendment would be needed to reassign revenue functions, taking account of the efficiency and revenue gains of digital transformations, along with new own-source provincial revenues for accountability

*(Derived from Ahmed, A. (2024). "Political Economy of Tax and Digital Transformations in Pakistan", The Pakistan Development Review).

General Sale Tax Reforms

1. Harmonized and equalized VAT mode, across goods and services and provinces, including wholesale and retail
2. VAT rate should be brought down gradually to 10% in 5 years
3. Zero-rated GST/VAT shall be applicable on the domestic supply of items as per EU standards
4. Import of plant and machinery, industrial raw materials, and intermediate goods to be zero-rated
5. By the end of 5 years GST on chapters 24-97 of the customs tariff would be gradually zero-rated on imports, with GST being applied to their domestic supply
6. No GST-related exemptions for Special Economic Zones (exports will be zero-rated) since it encourages evasions. All existing agreements/contractual obligations are to be honored

GST Reforms Will Bring More Revenue

- Strengthening the digital ecosystem, will have a positive impact on GST collection and increase the GST/GDP ratio by 1%
- Assuming a 10% reduction in GST concessions and exemptions, we estimate a revenue gain of Rs. 129 billion
- Better enforcement through POS integration and elimination of fake and flying invoices will lead to at least a 5% reduction in it, generating a revenue gain of Rs 25 billion
- We estimate net gains to be Rs. 790 billion in year 1
- Reforms will lead to growth in tax revenue

GST Reforms to result in Rs. 790 billion of additional revenue in year 1

GST Reforms Revenue Impact

	VAT Reforms	Policy Gap reduction	Compliance Gap reduction	Net Gains	% of base Collection
	1	2	3	4	5
Year 1	634	129	25	790	28.2
Year 2	698	129	25	853	30.5
Year 3	768	129	25	923	33.0

Source: Author's Estimation

- Estimations are based on FY 2021-22 data for collections, tax expenditures, and tax Gaps. The last column of percentage change can be used for current projections.

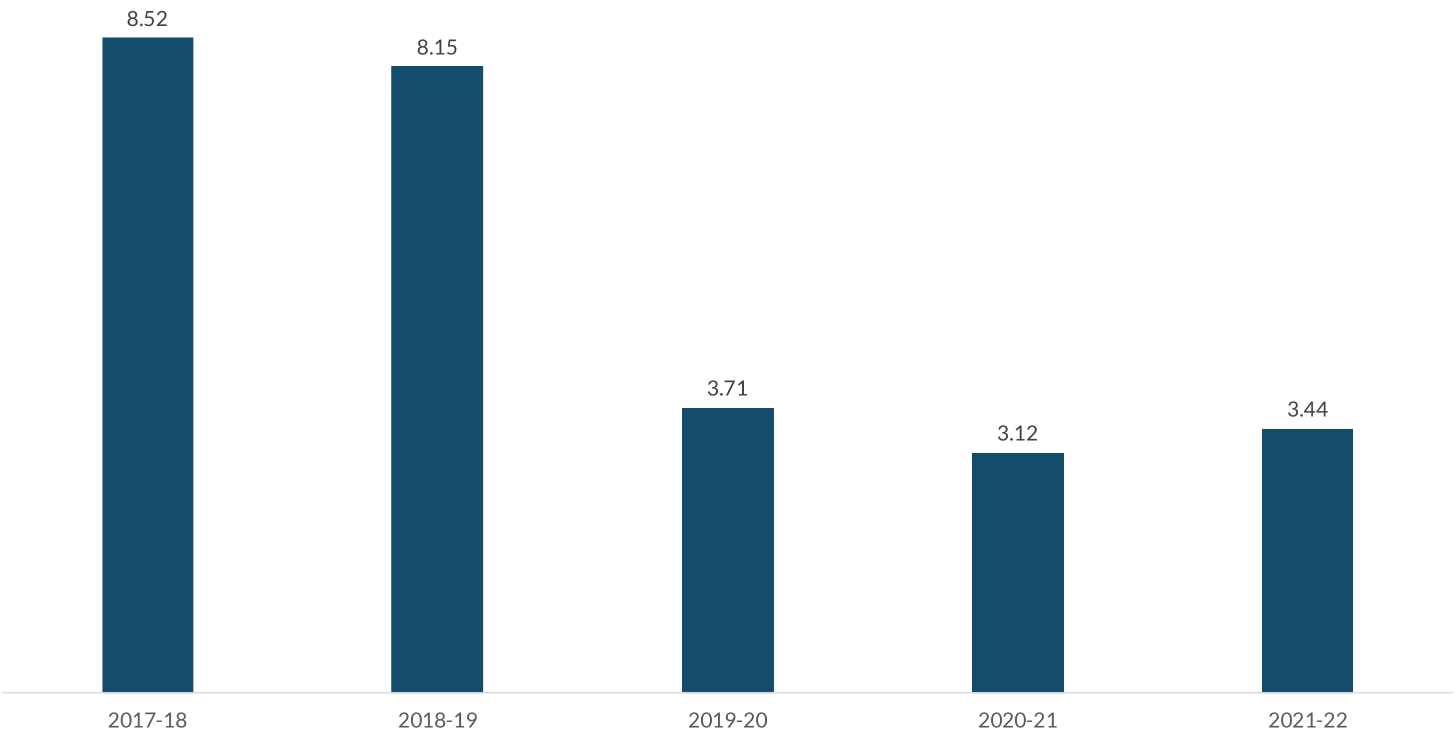
Income Tax

Simplified and low tax regime

Voluntarily Income Tax With Returns Declining

1. Heavy reliance on withholding income tax (e.g., electricity, mobile) implying that FBR has imposed its functions on the taxpayers (without any returns):
    - Adds to the cost of doing business
    - Increases complexities
2. Presumptive taxes, where the base is not income but rather its transactions, forcing businesses to hide or evade their activities
3. For the sake of predatory revenues income tax collected is not in proportion to true income and does not allow any adjustment at the time of returns

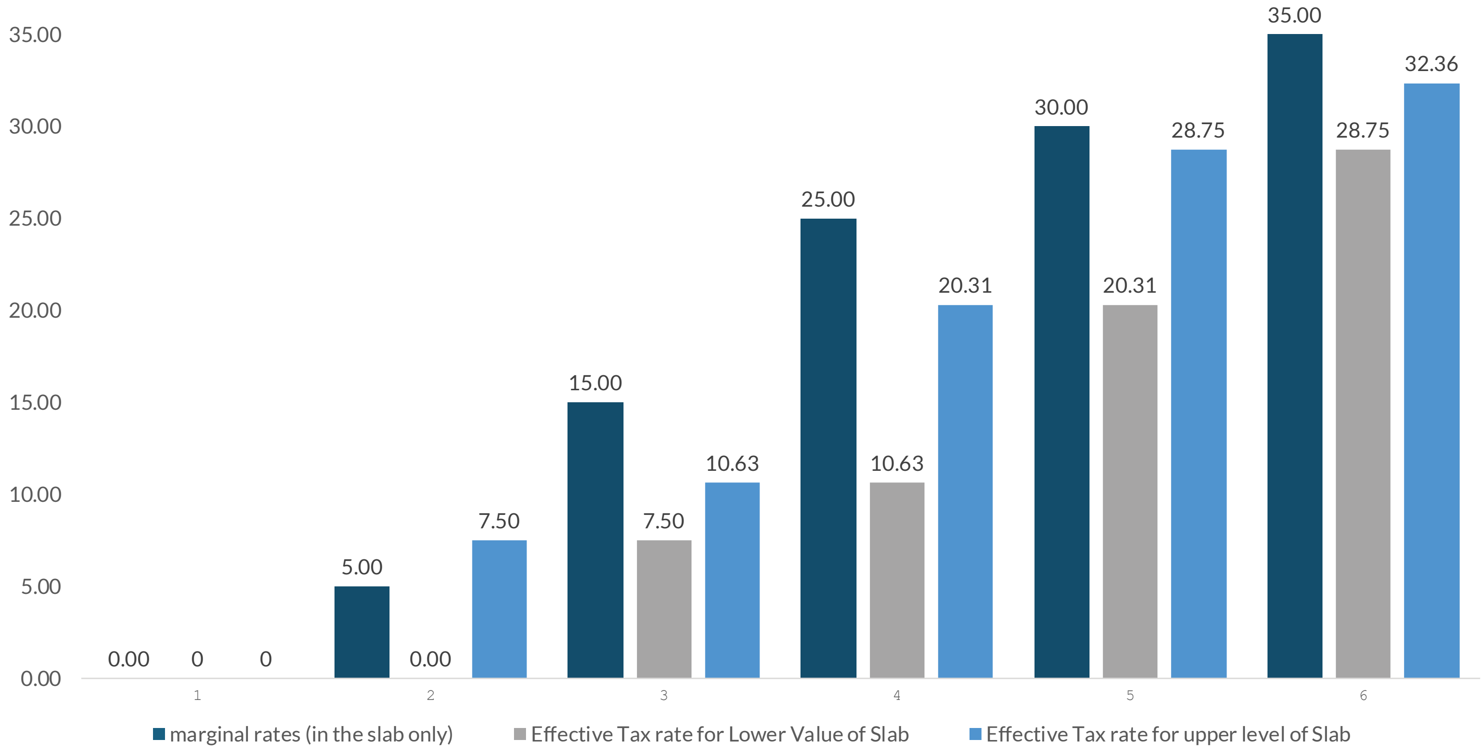
Percentage of Income Tax Voluntarily Paid With Returns



Incentives To Not Corporatize

- Income tax slabs discourage businesses from corporatizing thus remaining sole proprietors because:
  - The effective income tax rate of the higher slabs are 28.75 and 32.4 %
  - While Corporate tax is 35%+ means, people prefer to remain unincorporated
- Salaried Class overburdened and contributes a significant amount on a WHT basis
- Lacks progressivity and lower exemption threshold thus including income-vulnerable section of society in tax jaws as well

Marginal And Average Tax Rates Non Salaried/AOP



Income Tax Slab Comparison

- If we compare with regional countries our exemption threshold is on the lower side thus taxing the lower-income segment
- Marginal income tax rates in Pakistan are the highest in the region for comparable income slabs
- The same tax rate applies to six times richer people in India compared to Pakistan
- India has further reduced rates, and Pakistan has increased them for FY 2024-25

Regional Income Tax Slabs Comparison

Pakistan: Per Capita Income
$1471 Exchange Rate (278)

Taxable Income ($)	Tax Rates (%)
0 - 2158	0
>2162 - 4317	15
>4317 - 5755	20
>5755 - 11511	30
>11511 - 20144	40
>20144	45

India: Per Capita Income
$2612 Exchange Rate (83.95)

Taxable Income ($)	Tax Rates (%)
0 - 3574	0
>3574 - 8338	5
>8338 - 11912	10
>11912 - 14294	15
>14294 - 17868	20
>17868	30

Sri Lanka: Per Capita Income
$3354 Exchange Rate (300.39)

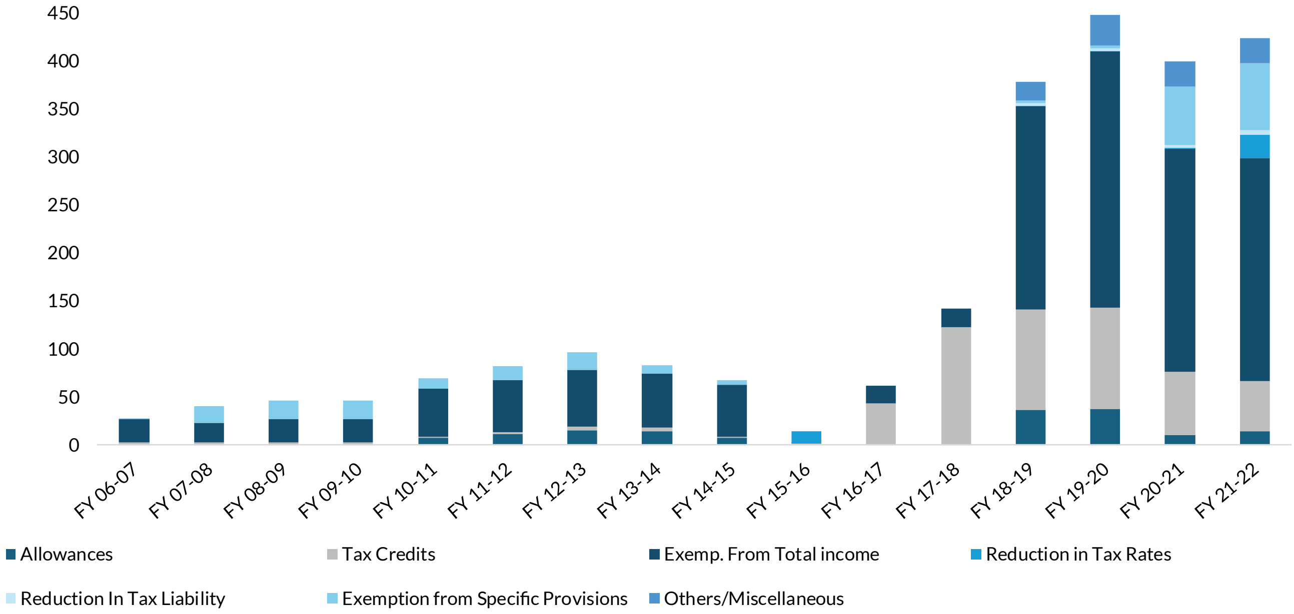
Taxable Income ($)	Tax Rates (%)
0 - 1664	6
>1664 - 3329	12
>3329 - 4993	18
>4993 - 6658	24
>6658 - 8322	30
>8322	36

Bangladesh: Per Capita Income
$2621 Exchange Rate (109.75)

Taxable Income ($)	Tax Rates (%)
0 - 3183	0
>3183 - 4093	5
>4093 - 6822	10
>6822 - 10460	15
>10460 - 15009	20
>15009	25

Income Tax Expenditures For Fy 2006-22

- Concessions and differential treatments lead to significant revenue losses and distortions
- Taxes should be uniform
- Although all concessions can not be done away with, it should be rationalized



Personal Income Tax Reforms: Simplification Pays

- Same rate of tax on same levels of income irrespective of source
- Income tax slabs rationalization for progressivity
- Increase in income tax exemption threshold to Rs. 0.8 million and review it periodically
- The effective tax rate on personal income should be 5% points higher than the corporate income tax rate
- Withdraw deemed rental income (7E) tax, capital value tax on foreign assets, super tax, turnover tax, inter-corporate dividend income, presumptive/final tax regime
- No income tax on interest income of Roshan account holders.
- Review international tax treaties for tax residency

Rationale

Simplify

Broaden

Encourage talent to stay

Corporatize

Proposed Income Tax Slabs

	Annual Taxable Income	Marginal Tax Rates
1	Up Rs. 800,000	0%
2	Rs 800,0001 – Rs 2,400,000	5%
3	Rs 2,400,001- Rs 4,800,000	12.5%
4	Rs 4,800,001- Rs 9,600,000	20%
5	Rs 9,600,001- Rs 30,000,000	27.5%
6	Amount exceeding Rs 30,000,000	35%

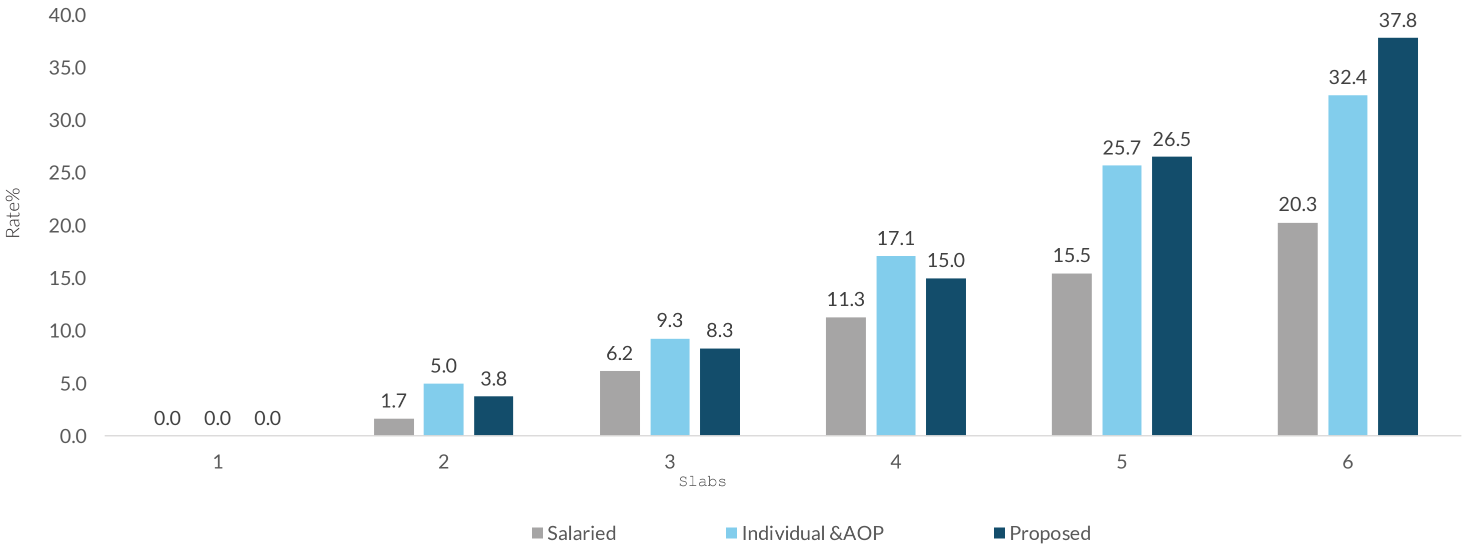
For simplicity fixed rates are dropped. Calculating tax liability for each slab and adding results in the same value

Application of New Tax Slabs

Salary (Examples) (Annual)	Current Tax on Salaried (Annual/ Monthly)	Proposed Tax on the Salaried, Business Individuals and AOPs (Annual/Monthly)	Effective Tax Rate	
			Current	**Proposed**
Rs. 700,000	Rs. 5000/417	0	0.35%	0%
Rs. 1,200,000	Rs. 30,000/2,500	Rs. 20,000/1,667	2.5%	1.6%
Rs. 2,400,000	Rs. 230,000/19,167	Rs. 80,000/6,667	9.6%	3.3%
Rs. 3,600,000	Rs. 550,000/45,833	Rs. 230,000/19,167	15.3%	6.38%
Rs. 35,000,000	Rs. 11,515,000/959,583	Rs. 8,700,000/725,000	32.9%	24.8%
Rs. 60,000,000	Rs. 20,265,000/1,688,750	Rs. 17,450,000/1,454,167	33.8%	29%

Proposed Slabs Merge Salaried With Individuals/aop And Are More Progressive

Effective Tax For Average Of Slab



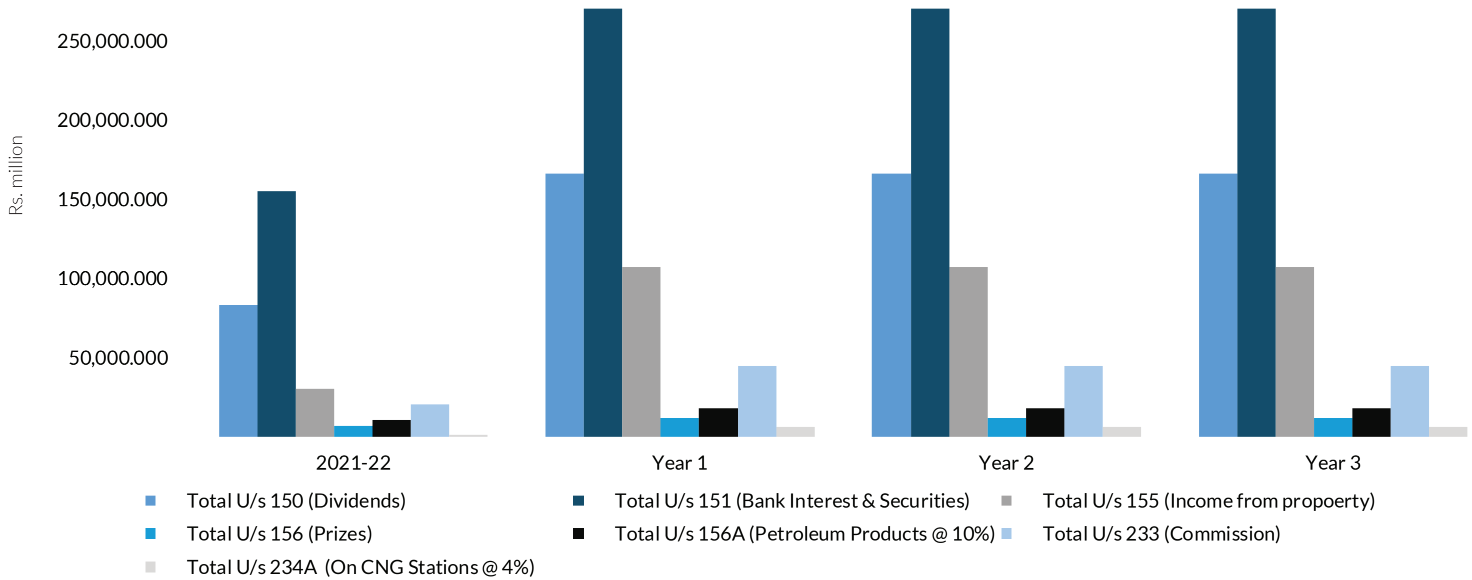
Benefits From Direct Tax Reforms

- Withholding taxes at the import/export stage, utilities, and non-income transactions gradually reduced in 1st year by 20%, 2nd by 40%, and third by 50%
- Reduction in WHT would bring economic growth of direct taxes by 0.14% in GDP (PIDE, 2020)
- Policy gap of Rs. 424 billion (FBR expenditure reports); reforms lead to a 10% reduction and focus on the exemption from the total income category
- Compliance gap (FBR tax gap reports) Rs. 730 billion; reforms lead to a 5% reduction (mandatory filing as per income tax ordinance 2001)

Same rate of tax on same levels of income irrespective of source

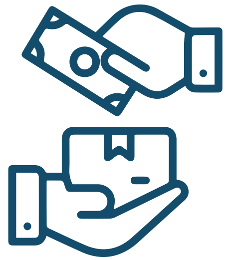
Personal Income Tax Under Different Heads To Be Merged

Uniformity Of Incomes



Dividend income, rental income, prize money, petrol pumps, commission, and profit on debt are treated as income. Tax liability estimated with an average rate of 17.5%

Increasing taxes collected with returns

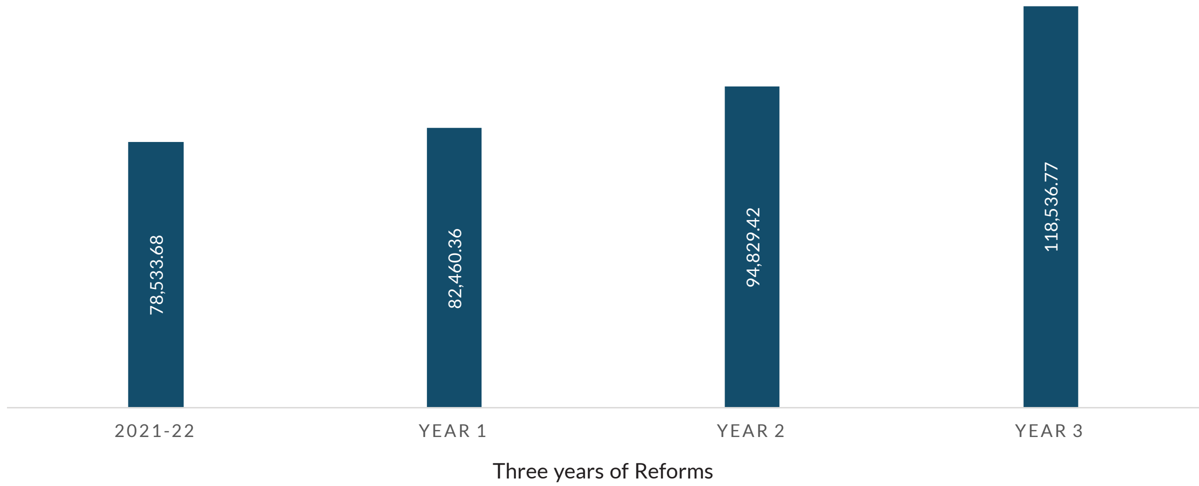


Direct Tax Reforms To Result In Higher Tax Revenue

- Individual/AOP/Companies tax collection with returns would increase because of:
  - Filer non-filer distinction abolishment

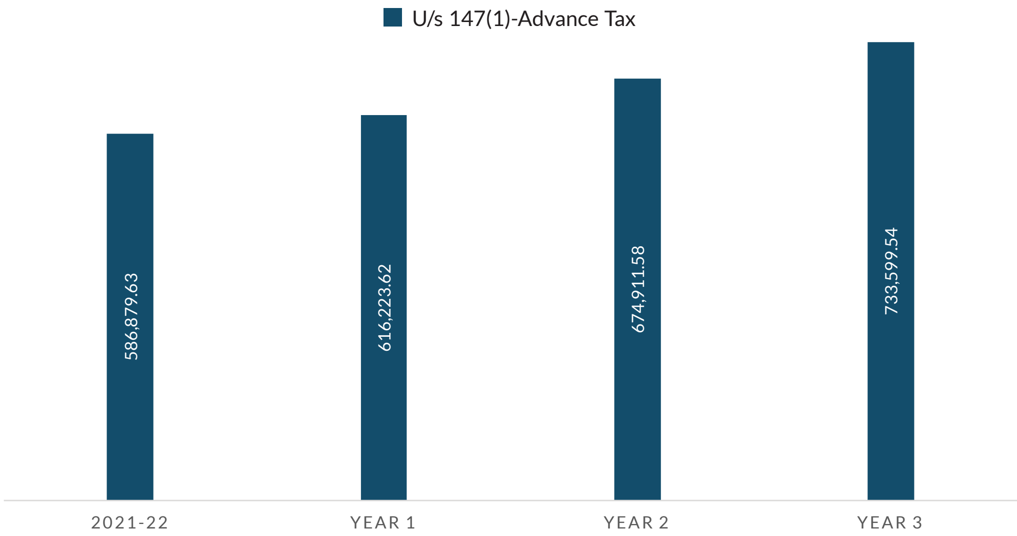
    Ease of filing of returns,

    Reduction in WHT and other reforms
- Revenue in this head would increase by 5% in the first year, 15% in the second, and 25% in the third.



Advance Tax Collection Will Increase

- Advance Tax (US-147(1)) would increase by 5% in the first year, 15% in the second, and 25% in the third owing to:
  - Withdrawal of Minimum tax and Turnover tax regime,
  - Rate rationalization on Sole Proprietorship/AOP/Corporate
  - More corporatization



Corporate Income Tax

Comparable to region allow corporate growth

Facilitate listing on the market

Corporate Income Tax Rate Comparison

Corporate income tax rates have reduced over time still, on a regional comparison basis, it is on the higher side.

Corporate Income Taxes: Regional Comparison

	Pakistan	India	Sri Lanka	Bangladesh	China	Afghanistan	Iran
2016	32	34.61	28	25	25	20	25
2017	31	34.61	28	25	25	20	25
2018	30	35	28	25	25	20	25
2019	29	30	28	25	25	20	25
2020	29	30	28	25	25	20	25
2021	29	30	24	32.5	25	20	25

World Bank Data: Accessed from https://databank.worldbank.org/

- Corporate tax rate should be reduced to 25%, or further to make it regionally competitive
- Withdraw:
    - Super tax
    - Turnover tax
    - inter-corporate dividend income
    - Presumptive/final tax regime

Rationale

Encourage

- investment,
- Corporatization
- Documentation
- Simplification

- Restore investment tax credits on plant, machinery, and industrial buildings
- Allowing 25% depreciation on new plant & equipment for the first year will incentivize businesses to modernize and upgrade current assets

Federal Excise Duty (FED)

Sin tax To discourage consumption

FED – Sin Tax

- Meant to discourage certain activities for

Health

Welfare

Social issues

Federal Excise Duty Reforms

- High rates of excise duty on tobacco and additive beverages, or any other products declared harmful to health or the environment
- PIDE has reported that increasing tax would lead to:
    - Public health improvement: Higher prices deter smoking, particularly among the youth and low-income groups, and reduce smoking-related diseases such as lung cancer, cardiovascular diseases, and respiratory illnesses
- Revenue Generation: Generate substantial government revenue
- Economic Productivity: Healthier individuals are more likely to be productive members
- For tobacco, tax at a very low rate of 500 /kg at the GLT stage increasing from Rs 10/Kg as well

FED Reforms: Revenue Implications (Rs Billion)

- Estimations are done using FY-22 data for collections (for the latest years values can be calculated using the last column of percentage increase). PIDE study (2018) shows that a change in tax rate leads to a 14.17% increase in tobacco tax collection. Assuming the same holds for beverages
- The government should also think of legalizing alcohol and collecting large FED to take the rents out of smuggling

FED Reforms Revenue Impact

	Cigarettes	Beverages	Total Gains	% of FED
Year 1	10.4	5.5	16	4.9
Year 2	10.4	5.5	16	4.9
Year 3	10.4	5.5	16	4.9

Source: Auhtor's Estimation

Withholding Income Tax

functions as an indirect tax
Simplify and withdraw

Withholding Tax

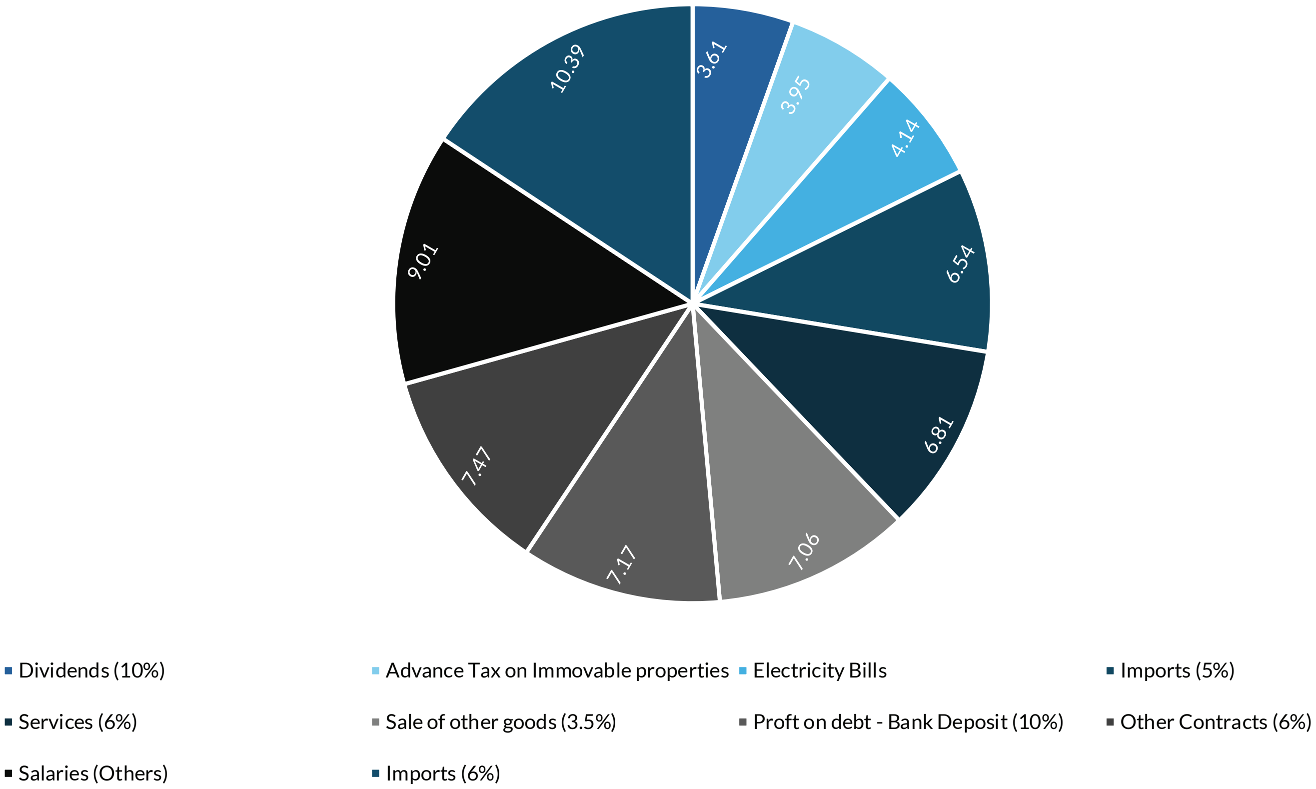
- There are more than half of WHT tax lines that are contributing less than 1% of the total withholding taxes
- Which on the other hand results in excess documentation costs for withholding agents

Withholding Tax Descriptive

No. of Goods	88
Total amount	Rs. 1,237.3 billion
No. of Goods Contributing below 1%	45
Amount Contribution below 1%	Rs. 11.2 billion
No. of Goods Contributing above 1%	43
Amount Contribution above 1%	Rs. 1225.4 billion
Top 10 (%age)	66.15%

Source: Author's Estimation

Major Spinners

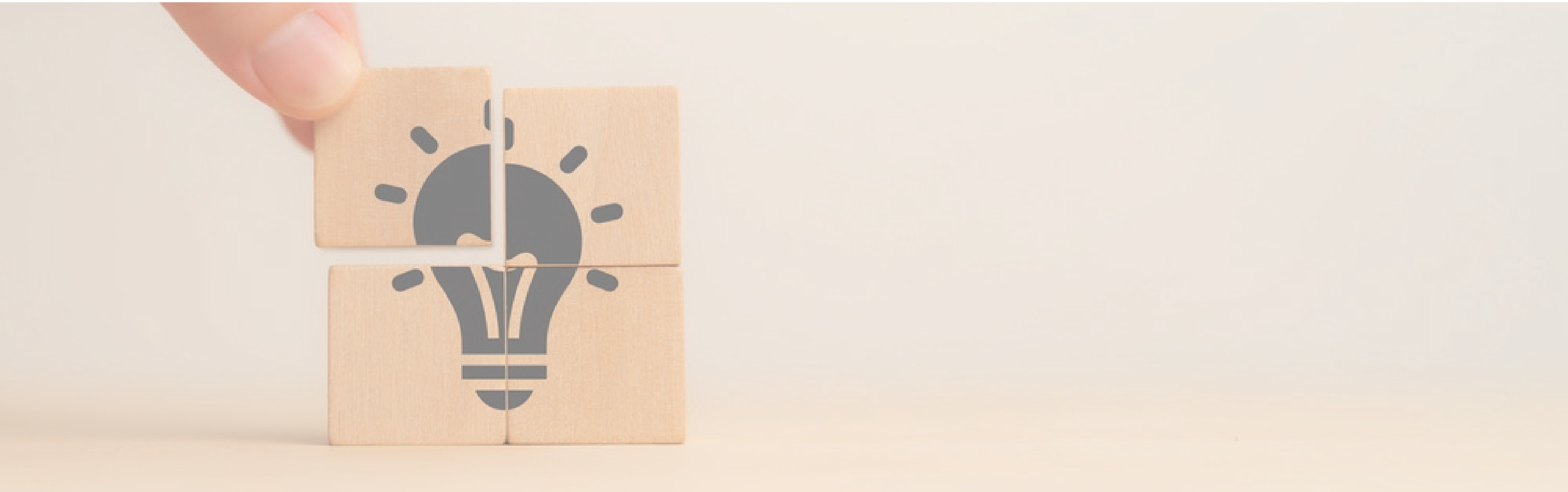


Reduce Reliance on Withholding Taxes

- While being called income taxes, they operate like indirect taxes
- Regressive in nature and non-refundable for poor people.
- Withdrawal of excessive withholding taxation will only cost less than 1% of income tax collection 0.04% of GDP.
- It will also reduce the administrative burden of the businesses involved in the collection

Reforming Withholding Taxes

1. Withholding taxation regime should be changed to an advanced income tax regime
2. All withholding taxes on transactions, which are not based on income (such as utilities, school fees, bank withdrawals, etc.) should be gradually phased out quickly
3. In the long run, withholding taxes should be discontinued except on payroll, interest, dividends, and payments to non-residents. (Almost 44 WH tax lines and 62% of the total WHT in FY-22)



Non-income/Transaction base for WHT

Sr No	Withholdings Creating distortions	Amout Million Rs	Sr No	Withholdings Creating distortions	Amout Million Rs
1	Total U/s (Surcharge)	1.074	23	Total U/s 236C (Advance Tax on Sales/Transfer of immoveable property)	16,617.136
2	Total U/s 7 (Non Residents)	14,203.207	24	Total U/s 236D (Advance Tax on Functions/Gathering)	21.197
3	Total U/s 7 (Builders & Developers)	21.719	25	Total U/s 236E (Advance Tax on Foreign Produced TV Plays & Series)	0.057
4	Total U/s 148 (Imports)	281,606.587	26	Total U/s 236F (Advance Tax on Cable Operators & Other Electronic Media)	55.130
5	Total U/s 152 (Technical Fee)	35,344.137	27	Total U/s 236G (Advance Tx on Distributors/Wholesalers)	6,919.214
6	Total U/s 153 (Contracts)	341,418.550	28	Total U/s 236H (Advance Tax on Sales to Retailers)	12,289.074
7	Total U/s 154 (Exports)	64,972.405	29	Total U/s 236I (Advance Tax on Educational Institutions)	1,506.933
8	Total U/s 156A (Petroleum Products @10%)	10,314.579	30	Total U/s 236J (Advance Tax on Dealers.Commissions Agents/Arhatis)	170.825
9	Total U/s 231A (Cash Withdrawal)	283.122	31	Total U/s 236K (Advance Tax on Purchasers or Transfer of immoveable property)	64,577.921
10	Total U/s 231AA (DD;DTC etcl)	78.737			
11	Total U/s 231B (Registration of New Cars)	18,865.036	32	Total U/s 236L (Advance Tax on Purchasers of Interantional Air Tickets)	30.018
12	Total U/s 233 (Commission)	20,432.070	33	Total U/s 236M (Bonus shares issued by companies quoted on stock exchange)	0.438
13	Total U/s 233A (Stock Exchange)	125.935	34	Total U/s 236N (Bonus shares issued by companies not quoted on stock exchange)	-
14	Total U/s 233AA (Collection of Tax by National Clearance Company Pakistan Limited)	0.344	35	Total U/s 236P (Advance Tax on banking transactions otherwise than through cash)	259.281
15	Total U/s 234 (Transport)	8,485.240	36	Total U/s 236Q (Payment to residents for use of machinery & equipment)	638.461
16	Total U/s 234A (On CNG Stations @ 4%)	1,401.952	37	Total U/s 236R (Collection of advance tax on educational related expenses remitted abroad)	1.943
17	Total U/s 235 (Electrcity Bills)	71,412.380			
18	Total U/s 235A (Advance Tax on Domestic Electricity Consumer)	1,525.543	38	Total U/s 236T (Collection of tax by Pakistan Mercantile Exchange Limited (PMEX)	0.518
	Total U/s 235B (Tax on Steel melters, re-roller etc)		39	Total U/s 236U (Advance tax on insurance premium)	27.795
19	Total U/s 236 (Telephone)	26.055	40	Total U/s 236V (Advance tax on minerals extraction)	4.367
20	Total U/s 236A (Advance Tax on Sales through Aution @ 5%	67,888.544	41	Total U/s 236W (Advance tax on purchaser or transferee)	9.612
21	Total U/s 236B (Purchased of Domestic Air Ticket @ 5%)	17,961.427	42	Total U/s 236X (Advance tax on tobacco Dealers)	0.089
			43	Total U/s 236Y (Advance tax on persons remitting amount abroad)	1,170.369
22		529.665	44	Total U/s 236HA (Advance tax on sale of certain pertroleum products)	62.924
				Total A.	**956,898.308**
				Percantage of Total WHT	**62.4**

Source: FBR Year Book. Accessed from https://www.fbr.gov.pk/

Perennial Problem of Exemptions

Tax Exemptions – Biggest Problem

- Exemptions create distortions and uncertainty that kill the market
- Incentivize businesses to seek exemptions and rent-seeking
- If all exemptions are withdrawn (including income tax), tax revenues increase by 37% and tax/GDP ratio by 3.36 %

Encourage Capital Formation

Capital Gain Tax

- The current collection is Rs. 10 billion only
- Lowering capital gains tax rates would:
  - Increase the return on investment
  - Lead to an increase in tax revenue
- Any capital gains because of inflation need to be adjusted before taxation to avoid negative impacts on the real purchasing power of an asset, which ultimately would reduce the distortionary impacts on asset holdings because of taxation

Capital Gain Tax Reforms

Listed Securities

- Sold within 12 months should be taxed as normal income
- Sold between 12 months and five years should be taxed at normal rate with indexation for inflation
- Sold after 5 years need not to be taxed

Unlisted shares

- Within five years taxable at normal rate with indexation for inflation
- After five years not taxable

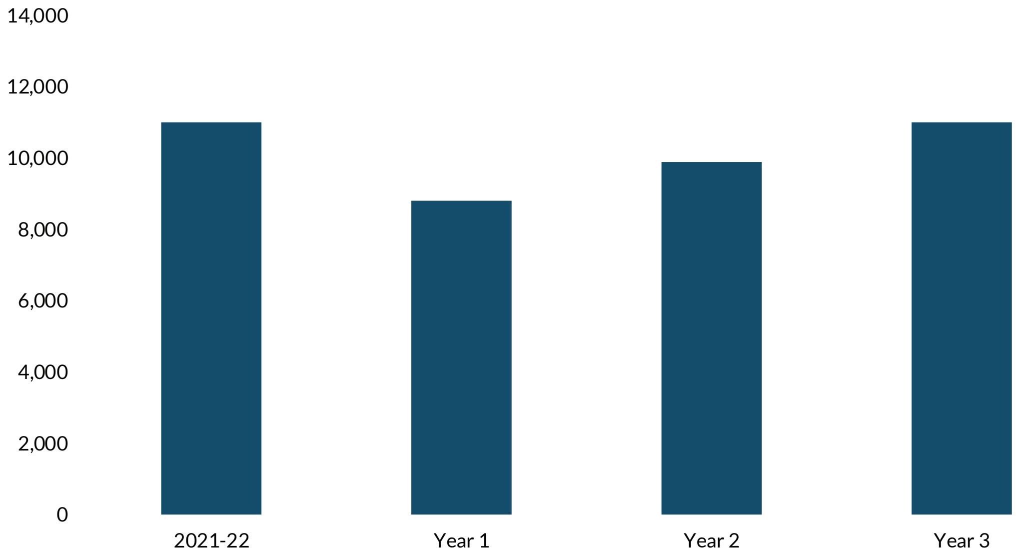
Real estates

- Open Plot: Within five years taxed at 5% with indexation for inflation. After five years not taxable
- Constructed property: 1% for 5-7 years and no tax after that

Capital Gains Tax Reforms: Revenue Implications

- Capital gains tax reforms would result in a 20% reduction in revenue for the first year
- But gradually come back to the existing level in three years

Capital Gain Tax Reforms



Agriculture Income Tax

The big issue throughout history
Needed to put all at Par

Make Agricultural Income A Federal Subject

- The exemption of agriculture income including rental income on agriculture should be removed through a constitutional amendment, thus making "income" a federal subject without any exemption.
- Corporate farming to be encouraged through a rebate of 1-5%.
- Allowing losses to be carried forward for adjustment against income tax liability.

Rationale

This would increase tax revenues of the agriculture sector by extracting maximum revenues out of potential revenue. Our estimates show potential revenue of Rs. 112 to 134 billion from this sector

Digitization Is A Must

Digitize the economy
Banks must facilitate digitization
Points of Sale must be universalized
Digital transactions must be subsidized

A Digital Tax Administration

Tax administration reforms can lead to an increase in tax revenues between 2 to 3% of GDP (experience of Jamaica, Rwanda, and Senegal

- Implement automation and digitization on fast-track basis
- Enhance the capacity and autonomy of PRAL

Develop Trust of Taxpayers

- Predictability and transparency of the system
    - Simplify and harmonization of Tax Laws and Rates
- Remove fragmentation and distortions
    - Implement Automation and Digitization FAST
    - Enhance the capacity and autonomy of PRAL.
    - Encourage Corporatization and Documentation.

Tax administration must be digital and impersonal

Tax Administration Reforms

- Abolish “non-filer”
  - “Non-filers” should be treated as tax defaulters
  - There should be only two categories, and all individuals must require to file
- Gas and electricity connection of commercial and industrial nature and other indicators can be used to identify potential taxpayers
- VAT mode will be completed starting with commercial importers and wholesalers and tier-1 retailers in the first year
  - Tier-2 and 3 retailers in the next 2-3 years
- Whole ‘Audit’ function of the Income tax, sales tax and custom to be abolished
  - In exceptional cases, audits to be undertaken using automation and digitization minimizing personal interaction between taxpayer and tax officer

- Digitization and automation to reduce interaction between taxpayers and tax authorities
- Trade facilitation reforms to bring clearance time at par with the region.
- Make customs valuation rulings more transparent using Artificial Intelligence (AI) algorithms and gradually shift to a transaction basis

Rationale

- Develop the trust of taxpayers through the predictability and transparency of the system;
- Ensure simplification and harmonization of Tax Laws and Rates;
- Implement Automation and Digitization;
- Encourage Corporatization and Documentation; and
- Remove fragmentation and distortions

Make tax policy a subject of research, learning and debate locally

- Foreign consultants shape our policy and reform
  - For the last 20 years there have been 3 tax reform donor programs costing more than 500 million dollars {TARP-Pakistan Tax Administration Reforms Project by World Bank-(2004-2010), PRRP-Pakistan Raise Revenue Project by World Bank (2019-ongoing), TAGR-Multi-Donor Trust Fund for Accelerating Growth and Reforms' (2015-19)}. And we still have neither a policy nor reform, but loans have been booked
- Pakistan Fiscal Policy Institute/Budget Office for parliamentarians to research on Pakistan's tax policy and coordinate on policy matters with lenders,Or easier option-strengthen PIDE and PIPS to perform this function. New organization might mean a more expenditures and take time
- Let our universities and think tanks into the debate.
- Budget research should be a subject that parliament should take deep interest in

Revenue Implications

The Numbers

What will our Reform mean? Ultimately the reforms should result in a significant increase in revenue, and sustainability over the coming years as well as help businesses grow. Below we have provided more details of the working on the quantitative impact of the reforms

Tax Rationalizations To Yield Rs 4 Trillion In First Three Years

Reforms Revenue Impact

	Direct Taxes Reforms		Indirect Taxes/GST Reforms		FED Reforms		Customs Reforms			
	Net Gains	% of base Collection	Net Gains	% of base Collection	Net Gains	% of base Collection	Net Gains	% of base Collection	Total Net gains	% of base
Year 1	370	16	790	28	16	5	17	3	1,194	20
Year 2	332	14	854	30	16	5	110	21	1,311	21
Year 3	468	20	924	33	16	5	188	36	1,596	26

Note: Base year is FY 2021-22

All figures in Rs Billion

Source: Author's Estimation

Note: The tax revenue gap attributed to the IMF according to a news item is Rs. 7 trillion, which is based on the FBR estimates of policy and enforcement gaps. In our proposal, we estimate the tax gap to be Rs. 1.1 to 1.4 trillion, assuming a 10% reduction in the policy and enforcement gaps on average. We believe that setting a higher target will put FBR under undue pressure and will damage the prospects of economic growth

Data Sources:

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- Tax Gap Report of FBR accessed at https://www.fbr.gov.pk/tax-gap-report/142253/173757
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