Taxation without tears

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By Sultan Ahmed

FEDERAL tax revenues have been largely static in Pakistan, both in terms of tax:GDP ratio and overall revenues for a country with a population of 140 millions.

The chairman of the Central Board of Revenue, Riaz Ahmad Malik, told the National Tax conference in Karachi last week the tax:GDP ratio was moving between 12 and 14 per cent of the GDP for long. And if the ratio had come down lately that was because of the reduction of the average import duty from 35 per cent to 25 per cent and the rate of economic growth had been low in the second half of the 1990s. And much of that growth has been in the largely non-tax paying agricultural sector and less tax-paying service sector.

Hence the rise in the overall revenues has not been as large as expected despite the several tax surveys and vigorous other efforts to boost the revenues. And this is a drawback which Pakistan suffers along with India, where the tax: GDP ratio has been between 11 and 12 per cent.

When about 40 per cent of the people are living below the poverty line of a dollar a day, and the number of the employed, including partial employment, is below 30 per cent of the population, the tax revenues are bound to be low, while the public expenditure is very high.

It has taken many years for the tax revenues to break out of the Rs 300 billion and above bracket, and after the over Rs 400 billion bracket was reached last year, it remains to be seen when the budget will break out of the Rs 400 billion bracket. An ambitious Rs 460 billion tax revenue target was set for the current year, and unlike in the past a 15.5 per cent revenue increase has been recorded in the first seven months of this financial year ending January, which is also 0.26 per cent above the target and that is to be welcomed.

In the days of Nawaz Sharif as prime minister with Ishaq Dar as his finance minister he was keen on setting a target of Rs 600 billion as revenue collection. But that remained more of a dream than become a reality. He could not touch even the Rs 400 billion mark as the businessmen were not cooperating with him. He told his fellow textile mill owners at a meeting that the 300 textile mills could pay Rs 200 to Rs 300 billion as taxes, but they paid less tax than a multinational company — ICI as it was then. The mill owners shrugged their shoulders and continued paying as little tax as possible.

The country has also large tax-exempt areas, like the vast Tribal Areas and Azad Kashmir, which the CBR chief now wants to be brought under the tax net. And there are many tax exempt goods and services or incomes. Fiftyfive exemptions are to be withdrawn in June when the new budget is presented after 55 others had been withdrawn or allowed to expire, as scheduled.

There are heavy duty drawbacks on exports and large abuse of the system by the exporters in collusion with the taxation officials. There has been a demand for abolition of import duties and other taxes on items meant for use in the manufacture of items for export to eliminate such abuses; but that has yet to come to pass.

The CBR now says duty drawback on 11 textile items are to be halved and there are also reports of more duty drawbacks on other export items. What we have is a mixed picture in this regard.

The service sectoı as a whole pays very little of taxes though officially it has a 50 per cent share in the GST. The governor of the State Bank, Dr Ishrat Husain has called for proper taxation of the service sector if the tax revenues are to go up. That can be a tough task as the service sector is not standardised. But quite often the people pay, particularly the sales tax of 15 per cent; but the government does not seem to get it, certainly not the full amount. Such abuses must come to an end.

Dr Ishrat wants a fair, just and efficient system of taxation. He suggests the number of taxes be reduced and the rate of taxation also cut. He wants the peak rate of taxation to be reduced from 35 per cent to 25 per cent, a radical suggestion which no other official has publicly put forward. Above all, he wants real return for taxation in terms of public services and utilities.

The CBR chief talks of new measures to boost the tax revenues without specifying what they may be. These will probably include utility bills, trade documents, property transactions, mobile phones and new cars for further taxation. At the same time, prime minister Zafarullah Jamali has initiated moves to give smuggled cars in Balochistan tax exemption. Once that is done in one province other provinces will come up with similar demands.

Three years ago we were told the number of federal taxes in the country was as high as 102. Mr Shaukat Aziz as finance minister wanted a sharp reduction in that with income tax, sales tax and customs duties as principal federal revenues. Wealth tax has gone also the heavily-abused Octroi's way which is now returning through the new local body system.

How many taxes do we have now after many of the exemptions are gone? We ought to be told year after year how many federal, provincial and local taxes we have and how heavy is the tax burden on the people and how small is the real return to the government at all three levels?

Some of the heavy taxes are not called taxes at all formally. While the finance ministry officials admit they are taxes. The heavy surcharge on petroleum and natural gas is to get Rs 60 billion this year in revenues inclusive of Rs 45 billion from petroleum. But that is not called a tax and included in the tax revenues!

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The CBR is happy it has been able to raise the number of income tax payers on the tax register to 2.2 million from 1.7 million — an increase of 5000,000 — though its tax surveys. But the overall revenue collection has not increased correspondingly as many of the new comers are small tax payers. Nevertheless it is a welcome development.

But the number of persons on the taxation rolls has become less significant as the total income tax revenues this year is to be only Rs 143 billion, while the sales tax revenue is to be Rs 206 billion — a rise of Rs 36 billion from last year. Almost everyone is paying the hefty sales tax of 6 to 15 per cent so Shaukat Aziz calls sales tax the tax of the future. If only the sales tax was not as high as 15 per cent there would have been less evasion and more honesty in this area.

Dr Ishrat wants the number of tax payers to be raised to 3 million from 2.2 million. He says that could be achieved if the number of taxes is reduced and the higher rate of taxes cut. But I think the focus should be less on increasing the number of tax-payers and more on making the big tax payers pay full taxes. The Large Tax Payers Unit set up in Karachi is a right move and that should be replicated in other major industrial centres in the country, beginning with Lahore.

The CBR chief says the tax culture is taking root and slowly getting popular. People will begin paying taxes gladly when they see real returns for that in the form of quality schools, hospitals, roads, water supply etc. They would not pay taxes to see senior officials in plush cars and ministers moving in a fleet of limousines or house in posh homes at public expense. Such returns are long in coming. They are promised, not delivered. When the people do not pay enough of taxes the government borrows the money from within the country or form abroad in the name of aid which is loans that add to the national debt. And that adds to the burden of the people, and more and more of the taxes they pay go to service the loans of not repay them.

The people pay the taxes when they buy the goods or use the services. The businessmen and industrialists often do not pay those taxes in full to the government, and so they get very little in return for the taxes they pay in terms of public services. So the people are the losers at both ends. And the poor becomes poorer.

The government at the top needs a radical new approach to taxation. What matters is not only how much to collect, and from whom to collect but also how well that is used and how does the tax-payer gains for the taxes he pays and more demanded of him. He can't be paying all that to meet the inexorable demands of a fat bureaucracy of diverse stripes.