**Expanding the Tax Ambit (Part II)**

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There is also an imperative to review and restructure Free Trade Agreements (FTAs), particularly the Pak-China FTA. The latter was signed in 2006 and came into effect in 2007, marking a critical juncture in the trajectory of economic development in Pakistan. Currently, it is based on the 6,786 tariff lines mutually agreed upon between the two countries. Concessionary tariff lines consist of finished as well as raw materials. To achieve optimality, there is a need for a part country like Pakistan to reduce the tariff structure on industrial inputs and raw materials and increase the tariff on finished goods.

Moreover, there is a need to redo it to enhance exports from Pakistan and balance imports of Chinese goods against the protection of local industry. Both countries can work together to identify sectors with export potential in Pakistan and facilitate their growth through capacity building, access to finance, and technical assistance. This will contribute to a more balanced trade relationship. Infrastructure development projects, such as the China-Pakistan Economic Corridor (CPEC) can be further strengthened and expanded. Investing in transportation networks, energy projects, and industrial zones, will enhance connectivity, promote economic integration, and create employment opportunities. Continued efforts ought to be made to enhance trade facilitation measures, such as simplifying customs procedures, reducing non-tariff barriers, and promoting the use of digital technologies for seamless trade transactions.

Afghan Trade: Pakistan has been facilitating Afghanistan for a long for transit trade. The port operators at Karachi, customs administration and computerized systems are facilitating it without any reciprocity. International obligations don’t permit levies of taxes on transit but the transit trade is heavily impacting roads, port congestion and human resources of our state. Many countries in the world have levied such service charges. According to a conservative estimate, the volume of trade of Afghan transit ranges between 3 to 5 billion US dollars per year. A levy of service fees on all transit consignments can be one of the unexplored measures that can generate substantial revenue for Pakistan. It will increase the cost of reverse transit which is a major source of smuggling in Pakistan.

There is a need to redo the tariff structure to enhance exports from Pakistan and balance imports of Chinese goods against the protection of local industry.

Value Added Tax (VAT): Pakistan has levied sales tax either at the standard rate of 18% or reduced rates of sales tax varying from 1% to 15% through the enactment of the Sales Tax Act, of 1990. Sales tax in Pakistan has similar characteristics to VAT as sales tax has been charged and levied at each stage of the supply chain from manufacturer to retailer with the similar concept of input tax and output tax used under VAT. In VAT mode, the whole supply chain would pay sales tax at each stage of value addition as collected by manufacturers to distributors/wholesalers to retailers to end consumers through shifting the burden of sales tax from one person to another.

This simple mechanism of VAT is adopted by all persons in the supply chain leaving very little room for tax leakage under the real VAT regime. Contrary to this, Pakistan, despite adopting VAT in the name of Sales Tax, has been facing multiple distortions/deviations from VAT which has resulted in the presence of a fragile tax collection system in Pakistan causing low sales tax collection against its actual potential. Thus, introducing VAT in its true sense would fetch huge revenue for the country in these dire circumstances.

Tax Expenditure (Exemptions): FBR extends tax exemptions to diverse sectors of the economy in four fiscal domains under its jurisdiction. These tax exemptions constitute tax expenditure and aggregate to PKR 2.24 trillion in 2022-23. There has been a growth trend in this tax expenditure from its share of 1.6% of GDP in 2019-20 to 3.6% in 2022-23; it was PKR 1,150 billion in 2019-20 but rose to PKR 2,236 in 2021-22. In terms of different taxes, such exemptions constituted a sum of PKR 521 billion in customs, PKR 1,294 billion in sales tax and Rs 423 billion in income tax.

It is observed that such exemptions have both structural issues as well as issues of misuse and malpractice. Misuse by organizations can easily be noticed as hospitals and educational institutions that took benefit of charities even though they were commercial and profitable entities. Structural issues were found in the case of exemptions to sectors such as auto, power, textile, and others. Though exemptions are driven by principles of welfare or development, however, sectors benefiting from the exemptions have emerged as interest groups entrenched into the fiscal state. Such sectors and the exemptions granted were also found to be lacking any sun-set regime required to be built in the exemption structures, and where they were provided as in the case of the auto sector through its depletion programme, they had been made ineffective by the influence of the concerned elite groups concerned.

(To be continued).

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