**The tax challenge**

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Taxation is the lifeblood of any country's economic system – as the primary source of government revenue for public services, infrastructure, and social welfare.

Taxation in Pakistan dates back to the days of the British Raj. In 1860, the British government implemented the first income tax law in India, which was subsequently expanded to include Pakistan following its independence in 1947.

The tax system in Pakistan is currently based on the Income Tax Ordinance of 2001, and the government of Pakistan has been actively engaged in implementing various tax reforms in recent years. However, these reforms have heavily impacted the middle and poor classes, benefiting the elite, including industrialists, agriculturalists, retailers, and jewellers. Let's examine Pakistan's various challenges in expanding its tax base and explore how the government can enhance revenue generation by developing a modern tax system while ensuring minimal impact on economic growth.

Unfortunately, Pakistan has one of the lowest tax-to-GDP ratios in the world. The tax-to-GDP ratio indicates a country's fiscal health since it shows how much of its economic production is taxed. This suggests room for improvement in the country's tax collection efforts, potentially enhancing the government's capacity to fund crucial public services and infrastructure investments.

Pakistan's tax-to-GDP ratio dropped to 6.7 per cent in the first nine months of 2022-2023 from 7.2 per cent at the same time the previous year. Pakistan has faced several challenges in enhancing its tax-to-GDP ratio. One of the key factors contributing to this situation is the existence of a substantial informal sector, which plays a significant role in the country's economic activity but operates with limited regulation and taxation.

Several businesses in the informal sector have been observed to operate without being fully integrated into the tax system, which can pose challenges for the government regarding tax collection. Former FBR chairman Shabbar Zaidi recently shared significant insights during the Geo’s Aaj Shahzeb Khanzada Kay Sath, shedding light on aspects that were not previously highlighted, even during his tenure under the leadership of former prime minister Imran Khan. He revealed that approximately 4 to 4.5 tonnes of gold are smuggled into Pakistan yearly. He also mentioned that he faced pressure from politicians to withdraw cases against influential individuals who were closely associated with them or held political significance.

Another critical factor is that provincial governments are not keen on taxing property and agricultural revenue. This could be ascribed to implementation of the National Finance Commission (NFC) Award, which has granted significant funding to provincial governments. For instance, the federal government is expected to allocate Rs5.27 trillion to provinces through the NFC Award in the forthcoming fiscal year 2023-24. However, there is a possibility that, like previous years, the provinces may not fully utilise these funds, posing further challenges for the federal government.

It is time for the provincial and federal governments and other key stakeholders to carefully consider the current circumstances, explore the potential benefits of acknowledging and discussing the matter of legalising gold imports, and re-examine Pakistan’s NFC award. We must strengthen Pakistan Metal Exchange (PME), the country's largest online platform for traders to buy and sell ferrous, nonferrous, and precious metals.

By organising various awareness events for Pakistani gold market players, we hope to provide them with the skills and knowledge they need to contribute to long-term development and help Pakistan's local gold market. Exploring the possibility of offering returning Pakistanis a golden opportunity to import a specified amount of gold per passenger while paying a reasonable import duty could have certain advantages. Our neighbouring country, India, has tried and tested this approach, and it's been a game-changer for their economy since 1991.

As it is well known, Pakistan has implemented a national policy to increase exports to address the Balance of Payments. Consequently, the export sector has been granted favourable tax treatment through reduced tax rates or exemptions to enhance the competitiveness of Pakistani products in global markets. It is observed that the government frequently imposes additional taxes on the salaried class, which are deducted at the source and the responsibility of employers to deduct and remit to the government. This process is meticulously tracked and well-documented, facilitating seamless deduction at the source.

However, the current tax system has been criticized for its regressive nature and perceived flaws in its policies, resulting in a situation where the federal government has become reliant on these taxes over the years. A significant portion, approximately 66 per cent, of tax collection is facilitated through withholding tax, which includes salary tax. There is a strong argument for considering a policy shift in taxation that could enhance its effectiveness, fairness, and progressivity.

It is essential to acknowledge our current challenging financial circumstances and explore the potential benefits of implementing a progressive tax system to reduce the burden on the middle and lower classes while increasing taxes on the wealthiest individuals and corporations.

As a result, potential tax changes should be approached cautiously. The FBR should increase transparency and accountability in the current tax system to reduce the influence of corruption and political pressure on tax collection efforts. It would be beneficial to consider fostering a sense of responsibility and compliance among the public regarding tax payment, drawing inspiration from the practices observed in developed economies such as the US and UK.

Finally, if the current, caretaker, and subsequent elected governments do not prioritize broadening the tax base and enacting critical structural reforms the IMF may set stringent conditions, making it difficult for Pakistan to get a new IMF arrangement once the existing nine-month $3 billion stand-by agreement ends.

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