Policy Brief # 54

Tax Reforms in Sindh

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1. Background

The province of Sindh boasts a host of potential economic and geographic advantages. However, its recent growth and social development trends indicate that Sindh is not realizing its full potential. A key constraint is the low levels of resource mobilization. The province’s own revenue collection remains relatively static vis-a-vis provincial GDP, despite some success after it started collecting GST on services post-devolution.

The institutional mechanism of provincial tax collection before devolution was a carry-over from the British days. However, the formation of Sindh Revenue Board (SRB) to collect GST on services after devolution, and the recent wave of IT-based automation of tax related processes in other tax departments offer optimism, provided the challenges discussed in this paper are resolved systematically.

The provincial government has 15 taxes and other minor levies within its mandate, which are collected by three agencies: SRB, which is responsible for GST on services; Board of Revenue (BoR), which is responsible for collection of registration fee, stamp duty, capital value tax, agricultural income tax, and land revenue; and Excise, Taxation and Narcotics (ET&N) department, which is responsible for property tax, professional tax, infrastructure development cess, motor vehicle tax, excise duty, cotton fee, and entertainment duty.

This policy brief highlights a) key challenges faced by the province in generating revenues, b) inefficiencies in the provincial tax structure, and c) difficulties faced by the private sector and individuals in complying with the provincial tax rules. We also provide policy recommendations based on our interaction with law makers, private sector, government officials, civil society organizations and academia.

2. Revenue Collection: Situation Analysis

There are more than five million taxpayers in the above-mentioned taxation categories. Almost 99 per cent of Sindh’s own revenues came from 9 of the 15 taxes in 2014, which include tax on services (49 per cent), infrastructure cess (27 per cent), transfer of property taxes (12 per cent) – including stamp duty, registration fee and capital value tax, – and property tax (less than 2 per cent).

**Box 1:** Sindh Provincial Tax Revenue Collection

<table>
<thead>
<tr>
<th>Taxes</th>
<th>PKR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture Income Tax</td>
<td>600</td>
</tr>
<tr>
<td>Property Tax</td>
<td>4,500</td>
</tr>
<tr>
<td>Land Revenue</td>
<td>600</td>
</tr>
<tr>
<td>Tax-Profession, Trades &amp; Callings</td>
<td>350</td>
</tr>
<tr>
<td>CVT on Immoveable Property</td>
<td>2,500</td>
</tr>
<tr>
<td>Provincial GST</td>
<td>49,000</td>
</tr>
<tr>
<td>Provincial Excise</td>
<td>3,900</td>
</tr>
</tbody>
</table>
When the SRB began its operations, its revenues mainly came from three sectors: telecom, banking and insurance. The reliance on these sectors has come down, and according to 2016 budget documents these sectors are expected to contribute 43 per cent of the total. This diversification was seen after GST’s reach was extended to contracts, construction, port and terminal services, franchisees and stock brokers.

BOR’s contribution to Sindh’s total provincial tax collection is low. Its contribution to total own resources of Sindh is budgeted at about 14 per cent. The bulk of BOR’s revenue comes from stamp duty. The collection of direct taxes, specifically tax on agricultural income, remains poor at about 3 percent of BOR’s total collection and less than half percent of Sindh’s total provincial revenues (Box-1). About 30 percent of Sindh’s own revenues come from ET&N. The infrastructure cess accounts for about 70 percent of ET&N’s total collection. ET&N’s direct taxes – specifically, property tax and tax on profession– remain dismal at less than 10 percent of total revenue collected by ET&N.

The key issues that are preventing Sindh from achieving higher revenues include: lack of coordination between various tax collection bodies; disbursed record of provincial tax payers’ liable incomes, difficulties in automation of data, lack of documented tax bases, large informal sector in services, older laws only allowing limited jurisdiction to tax authorities.\(^1\)

There are also coordination issues with the federal government and other provincial governments. For example, Federal Board of Revenue (FBR) continues to charge excise duty on several services now falling under the provincial GST on services. An absence of inter-provincial coordination mechanism for tax authorities has been creating problems for businesses. For instance, in the case of port-related services, Sindh asserts that tax should be on the basis of where it was rendered, regardless of whether the recipient of service is in Sindh or not. In contrast, the Punjab maintains that GST on services is a consumption tax, and regardless of where the service is rendered, the tax should be paid to the province where the services are being consumed. Likewise, there are similar issues in other sectors, especially telecommunication, advertisement, and insurance.

Some definitional issues also require clarity through appropriate legislative changes. For instance, the SRB had recently imposed GST on services on ‘rent on immovable property (commercial)’. The same has been challenged in the court where the question as to whether rent is a service or not is being discussed. Risks of unnecessary litigation also stem from overlapping and omnibus clauses defining the services. For instance, the ambiguously wide.

\[^1\] For details, see ‘Sindh Tax Revenue Mobilization Plan (STRMP)’. Also see, Vaqar, A (2015b) Time for provincial tax reforms, The News on Sunday, April 5, 2015.
scope of taxation under the tariff headings ‘maintenance services’, ‘business support services’, ‘contract execution of work’, ‘management consultant’, etc. creates immense confusions, thereby opening doors of litigation, corruption and evasion.

3. Desired Reforms

3.1. Ending fragmentation in tax collection: Following the Punjab precedence, Sindh government may also think about a gradual merger of the three tax collection agencies. This will allow integration of data and information regarding various tax bases. As currently these three bodies are interacting with FBR and Pakistan Revenue Automation Limited (PRAL) Company independently, this in turn leads to the duplication of work and burden at federal level.

3.2. Better forecasting and audit capacity: A professional work force is required which is abreast with the current methods of revenue forecasting and audit. Due to the ban on fresh recruitment, it has not been possible to upgrade the human resource at these departments. For this, institutional linkages with academia may be forged and their capacity may be used until formal recruitments are allowed.

3.3. Estimation of services sector tax base: It is important to carry out a census of services sector establishments in Sindh. This applies more to this province due to the large informal sector in services. Cross-validation of incomes and turnover of services sector establishments will only be possible if SRB’s database is integrated with PRAL and National Database and Registration Authority, data warehouses.

3.4. Expediting the automation of land records: Manual land record is prone to misuse and rent-seeking. This has implications for agriculture income tax, land tax and stamp duties. The provincial government will need to allocate more resources for speedy completion of Land Administration and Revenue Management Information System (LARMIS). This should be followed by automation of stamp collection and property registration.

3.5. Updating Land Valuation Tables: The valuation of property transactions is based on tables notified by BOR. However, these have not been updated for the last 12 years and do not represent actual market values of properties. A system of indexed valuation tables should replace the current tables to prevent erosion of the tax base over time. The index may be linked to growth of provincial incomes, output or a formula based on Sindh housing index calculated using housing information in consumer price index.

3.6. Review of Legislation to Broaden Jurisdiction of Revenue Bodies: Property taxes are calculated on the basis of annual rental value that should be brought at par with fair market value. Apart from the issue of obsolete valuation tables, entry of tax collection staff in several jurisdictions is not allowed by the law. For example, Karachi has more than six cantonment areas, most of which are posh localities with high rental values. Since the cantonment areas are outside the jurisdiction of ET&N, it is deprived of significant potential revenue. Such anomalies may be resolved.

3.7. Expanding Scope of Infrastructure Cess: This cess is collected for the purpose of developing and maintaining infrastructure, specifically road and bridges. However, the cess is currently only
being collected on “goods entering into the province from outside the country through air or sea” (i.e. imports). Two potentially major revenue generating areas, namely petroleum and goods for Afghan transit trade, are outside the ambit of this cess. Considering that this cess is collected for the purpose of developing and maintaining infrastructure, these exemptions may be revisited.

3.8. Correcting Rates and Jurisdiction of Professional Tax: The upper limit fixed by parliament is dated and has not been revised in line with the growth in per capita income seen in the last 16 years. Moreover, there is a jurisdictional issue, whereby the cantonments in Sindh argue that it is they – and not the provincial government – who have the right to collect professional tax within the domain of cantonments. However, Sindh contests this view citing the decisions issued by the Ministry of Inter-provincial Coordination.

4. Way Forward

Central to the wave of provincial revenue reforms that has begun in Sindh is automation. There is an increased realization across the three revenue collecting authorities as well as in Sindh Finance Department (SFD) that the automation of processes and efficiently managed databases is the way forward. For this purpose, a Tax Reform Unit has already been established in SFD to generate data and information, design and implement specific initiatives or measures for raising tax revenue.

Currently, the balance of opinion on automation is tilted towards having three databases (one each by the three authorities), which have the ability to talk to each other. This seems to be a politically workable solution for now. But, integration towards one single database for the whole of province should be the eventual goal to reduce the cost of developing, maintaining and managing databases and gain efficiencies in tax recovery across different types of taxes.

The role and function of Council of Common Interests and the Ministry of Interprovincial Coordination need to be strengthened. An institutional mechanism also needs to be devised to ensure better and more frequent coordination on taxation affairs among provinces. A move towards having a national tax policy is also warranted to avoid duplication of taxes and overlapping jurisdictions, and to help bring efficiency and equity in the overall taxation structure across the country.

Disputes are an unavoidable feature in tax administration. However, settlement and arbitration processes need to be strengthened, and developed where need be. The provincial tax authorities also need to become consultative by engaging with the business community and ensuring that the cost of doing business in the province does not become cumbersome.

Tax authorities also need to become more transparent where the publication of quarterly and annual reports and the periodic sharing of key taxation related data on their website are imperative. A tax directory of provincial taxpayers should be published annually as part of the budget.