Reforming Provincial Tax Framework in Pakistan
Challenges and Way Forward
Problem Statement

• The Tax Reform Commission report (April 2015) states:

  – Under the given scenario, federation-provinces tax tangle will continue unchecked and further taxation through local governments, when elected, would not serve any useful purpose—there will be no relief to the people. Rather tax burden accompanied with procedural complications will increase manifold.

  – Moreover, the Federal Board of Revenue through its field offices is attempting to tax the services ......in spite of the fact that sales tax is being paid at the Provincial level. This results in double taxation and consequently there are numerous appeals pending against the duplicate imposition of sales tax on services.
Methodology

- Desk review of provincial tax regime in four provinces
- Country-wide two-tier consultation on tax harmonization model, involving both government officials and business community
- In-depth interviews with tax experts including economists, accountants, tax bar associations, heads of tax committees in Chambers of Commerce
- Using a computable general equilibrium model we have quantified the revenue and welfare impact of our proposed reforms.
Issues faced by provincial revenue authorities
1. Fragmentation in Tax Collection

- Punjab: Punjab Revenue Authority, Excise Taxation & Narcotics Dept., Board of Revenue
- Balochistan: Balochistan Revenue Authority, Excise & Taxation Dept., Board of Revenue
- Khyber Pakhtunkhwa: KPRA, Excise & Taxation Dept., Board of Revenue
- Sindh: Board of Revenue, Sindh Revenue Board, Excise Taxation & Narcotics Deptt., Govt. of Sindh Levies

- Increased number of return forms, higher compliance costs and difficulties in coordination with FBR and Pakistan Revenue Automation (Pvt.) Ltd.
2. Reliance on Obsolete Tax Bases

- Provinces rely on very old tax bases and rates:
  - Property taxes, Stamp duties, Motor vehicle levies, Agriculture income tax, Duties on utilities, Professional tax, Capital value tax, Entertainment duty

- Infrastructure cess

- Non tax revenues
  - Irrigation and community services

- New additions
  - Sales tax on services.
3. Challenges to Collection of Sales Tax on Services

- Tax bases under services sector
  - Wholesale & retail trade, electricity & gas operations, agriculture & extension services, transport, storage, communications, banking, finance & insurance.

- Challenges to collection
  - Data on services establishment missing
  - Difficult to validate already available data
  - Large informal sector in services
  - Cascading in GSTS

- Scientific & welfare basis to tax often missing
  - Examples: Tax on internet and oil transporters.
4. Frictions with Federal Government

- Incidence of double taxation due to definition of output
- Some double taxation also arising due to excise duty
- Some federal SROs allow preferential rates
- Jurisdiction over certain services remains unclear
- FBR collecting the workers contributions for Workers Welfare Board
- MoU regarding input adjustment with FBR not effectively implemented
- New valuation rates for immovable properties may be higher than market rates in some cases.
Some key recommendations from SDPI-CIPE consultations
### Principles of provincial taxation

Borrowing some tenets of taxation from ACCA

<table>
<thead>
<tr>
<th>A presumption to tax neutrality</th>
<th>Efficiency</th>
<th>Tax shifting and hypothecation have a role to play</th>
<th>Tax is a matter of national sovereignty</th>
<th>Avoidance of double taxation</th>
<th>Accountability and regular review</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Provincial governments must work together to try to iron out the differences in tax bases which give rise to tax arbitrage.</td>
<td>• Governments require efficient tax systems to secure the revenue due and to prevent tax leakage. But the system should also be efficient for taxpayers in complying with its requirements.</td>
<td>• Elected governments have the right to use taxation in certain circumstances in pursuance of agreed social policies (e.g. for environmental protection).</td>
<td>• Globalisation means that each country should ensure its tax rates are competitive and its regime user-friendly. It is the quality of the underlying tax system – rather than a simple focus on comparative tax rates – which matters to companies.</td>
<td>• An essential principle of tax law must be that income should be subject to tax only once. This applies both to direct tax and consumption taxes.</td>
<td>• Tax systems should be periodically overhauled and consolidated.</td>
</tr>
</tbody>
</table>
What is Tax Harmonization?

– Tax harmonization exists when taxpayers face:
  • Similar or identical tax rates, and
  • Similar tax bases on which liability is calculated, across provinces.

– Explicit tax harmonization occurs when provinces agree to set minimum tax rates or decide to tax at the same rate.
Example: Harmonize Sales Tax on Services across Provinces

<table>
<thead>
<tr>
<th>Services from</th>
<th>GST Rate</th>
<th>Withholding of Tax on Services</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Individual</td>
<td>Company</td>
</tr>
<tr>
<td></td>
<td></td>
<td>GST Registered</td>
<td>GST Unregistered</td>
</tr>
<tr>
<td>ICT</td>
<td>16%</td>
<td>20% of GST</td>
<td>1% of Gross Service Amount</td>
</tr>
<tr>
<td>Punjab</td>
<td>16%</td>
<td>100% of GST</td>
<td>16% of Gross Service Amount</td>
</tr>
<tr>
<td>Sindh</td>
<td>13%</td>
<td>20% of GST</td>
<td>Gross Service Amount/113 * 13%</td>
</tr>
<tr>
<td>KP</td>
<td>14%</td>
<td>20% of GST</td>
<td>Gross Service Amount/114 * 14%</td>
</tr>
<tr>
<td>Balochistan</td>
<td>15%</td>
<td>20% of GST</td>
<td>Gross Service Amount/115 * 15%</td>
</tr>
</tbody>
</table>

Arbitrary classifications and levies and differential levies across provinces. Applies to other taxes too.
Tax harmonization should not hurt fair tax competition

- Should provinces be moving towards harmful tax competition? [e.g. a leading FMCG’s possible decision to move across provinces]

- For lesser developed provinces, allow tax harmonization, however threshold can be varied (e.g. in the case of Balochistan)
## Compliance Costs of Taxpayers
Via consolidation of taxes

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Punjab</th>
<th>Sindh</th>
<th>Baluchistan</th>
<th>Khyber Pakhtunkhwa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture Income Tax</td>
<td>1,550</td>
<td>350</td>
<td>6</td>
<td>80</td>
</tr>
<tr>
<td>Property Tax</td>
<td>9,224</td>
<td>3,700</td>
<td>296.5</td>
<td></td>
</tr>
<tr>
<td>Land Revenue</td>
<td>11,303</td>
<td>210</td>
<td>245</td>
<td>1,801</td>
</tr>
<tr>
<td>Tax-Profession, Trades and Callings</td>
<td>795</td>
<td>380</td>
<td>0.5</td>
<td>250</td>
</tr>
<tr>
<td>CVT on Immoveable Property</td>
<td>11,270</td>
<td>3,100</td>
<td></td>
<td>385</td>
</tr>
<tr>
<td>CVT on Moveable Property</td>
<td>361</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Direct Taxes/Capital Gain Tax-Other Collection</td>
<td>16</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provincial GST</td>
<td>62,000</td>
<td>61,000</td>
<td></td>
<td>8,000</td>
</tr>
<tr>
<td>Provincial Excise</td>
<td>2,651</td>
<td>4,000</td>
<td>436</td>
<td>38</td>
</tr>
<tr>
<td>Stamps Duty</td>
<td>25,312</td>
<td>7,532</td>
<td>450</td>
<td>814</td>
</tr>
<tr>
<td>Federal Excise Duty on Natural Gas</td>
<td></td>
<td></td>
<td></td>
<td>2,182</td>
</tr>
<tr>
<td>Royalty on Natural Gas</td>
<td></td>
<td>6,463</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Royalty on Crude Oil</td>
<td></td>
<td>0.035</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surcharges on Natural Gas</td>
<td></td>
<td>6,026</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td></td>
<td></td>
<td></td>
<td>200</td>
</tr>
</tbody>
</table>

Source: Provincial Annual Budget Statements
Compliance Costs of Taxpayers

Compliance costs can be reduced through:

- Consolidation of taxes
- Merger of provincial revenue authorities
- Introduce IT-enabled unified tax return
- Reduction in withholding mode of taxation
Introduce unified tax return and central deposit

- Allow a single unified tax return form for all forms of taxes across provinces
- Collection/deposit may be done centrally with auto-transfer of collected provincial amount to provincial revenue authorities
- Integrated database of income and wealth sources at provincial level
- Provinces should demand access to databases of income and wealth sources available with federal government
- GIS-based validation of land holdings, commercial, wholesale & retail activity.
Establishment of Intergovernmental tax committee goes well beyond the recommendation by TRC i.e. “Federal and Provincial Sales Tax Authorities should form a fully empowered commission to bring harmony in the sales tax laws dealing with services, particularly focusing on following:

- Updating list of taxable services ....
- Principle for taxation of services (origin, destination or mix);
- Avoidance of multiple taxation by Provinces and / or Federal Government;
- Mechanism for adjustment of taxes collected by Authorities
- Harmonization of Tariff headings and definition / scope of services;
- Withdrawal of FED on services where Provincial Legislation is in place”
The recent episode of revaluation in 2016-17 budget lacked provincial ownership.

TRC report also recommends that Federal Government in coordination with the Provincial Governments needs to agree a valuation mechanism for properties in various categories which need to be revised at level every year through independent credible valuers.

Further difficulties, varying rates and overlapping mandates under agriculture taxation.
Integrate audit capacities

- Enhanced capacities needed for audit, monitoring and evaluation at provincial revenue authorities.

- Address information gaps across tax bodies through joint assessments.
  - Tax potential of unorganized sector
  - Arbitrariness in assessment of provincial levies
  - Assessing genuiness of the holder of property
  - Assessment of market value of property
  - Assessment of property tax on current rental value
  - Tracking current usage-status of property.
Lessons from OECD and European Commissioner for Taxation and Customs

- Tax harmonisation is but one response to the challenges that provinces may face and other forms of cooperation or coordination of tax policies across provinces and federal government are also important.

- Tax harmonization cannot entirely address base erosion and profit shifting.
  - i.e. tax avoidance that exploits gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.
Additional tax policy cooperation or coordination measures beyond tax harmonization
Improved Inter-governmental liaison

- Remove exemptions and preferences allowed under provincial tax laws
- Coordinate with FBR in removal of exemptions allowed in provincial tax sources
- Improve tax payer’s information and make tax payer facilitation centers effective through joint FBR-provincial government efforts.
- Stronger mechanism required for resolutions of inter-governmental disputes on taxation
- Balance between rates faced by goods and services
- What measures for ‘tax simplification’? See efforts in India under Goods and Services Tax reforms.
Need for a more structured public-private tax council

- The public private dialogue allows space to the latter for informing legislation, rules and regulations.

- Present advisory councils are cosmetic in nature with irregular meeting schedule. Therefore, we propose a broad based public private tax council at the provincial level giving representation to all the major sectors generating major portion of collected taxes.
Expand mandate of Tax Reform Commission

• Interim report now available

• The commission only focused on FBR reforms

• Some pending province-federal coordination matters need attention

• Therefore the need to expand the scope of terms of reference provided to Tax Reforms Commission.
Research Units at Provincial Tax Bodies

- Need for a consistent macroeconomic framework at provincial level
- Update tax gap study for Punjab
- Tax incidence study for Punjab
- Forecasting revenues to estimate future fiscal space for development spending.
What can the government do in this budget?

• Federal Government:
  
  – Need to notify a federal-provincial working group on tax reforms to oversee implementation of MoUs between tax authorities
  – Need to move towards a single tax return (e.g. see example from India)

• Government of Punjab
  
  – Consolidating number of taxes
  – Consolidation/Merger of provincial collection bodies and move towards a single tax return
  – Expedite diagnostic assessment of PRA to suggest reforms (MoU already signed with Australian High Commission and McKinsey & Company.)
Discussion points for today’s meeting

- Comments/inputs on tax harmonization framework
- What further considerations should be part of an ideal tax harmonization framework?
- How to resolve coordination issues across federal and provincial revenue collection authorities?
Thank You