Budget 2013-14: Tax proposals

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On Jun 5, 2013, we will have a new government in action—faced with multifaceted and complicated problems on economic front. It's immediate task of framing budget for fiscal year 2013-14 is marred with monstrous fiscal deficit, unsustainable debt burden, perpetual power shortages, circular debt of billions of rupees, inflation and deteriorating rupee, fast diminishing foreign reserves and pressure on balance of payment, just to mention a few. In this bleak scenario, another bad news for Nawaz Sharif and his economic team is massive failure of Federal Board of Revenue (FBR) in achieving the revenue target that would further widen fiscal deficit and force to more borrowings.

It will be a daunting challenge for the incoming government of Pakistan Muslims League Nawaz to tackle the existing budget deficit of 7.6 percent of GDP (Rs. 1740 billion)—it is likely to hit 8.2 percent of GDP by June 30, 2013 (Rs. 1877 billion). At the time of announcing budget 2012-13, the FBR's collection target was fixed at Rs. 2381 billon—it was later reduced to Rs. 2193 billion, further slashed to Rs. 2050 billion and finally to Rs. 2018 billion. According to experts, FBR would not be able to achieve even this slashed target and final figure will be between Rs. 1980 billion to Rs. 2000 billion. The failure of FBR will have negative overall impact for the economy, especially debt servicing on domestic and external loans is going to touch the figure of Rs. 1050 billion, which was initially envisaged at Rs. 926 billion. Since external funding is also drying up and FBR is continuously failing in collecting the assigned targets, the new government like its predecessors will also have no option but to print more money and resort to further borrowing. In the past all the governments—civilian and military alike—instead of raising taxes resorted to printing money and generating funds through short-term Treasury Bills of three months having enormous roll over cost. Resultantly, debt burden has reached at the level of 62% of GDP and fiscal deficit is likely to rise to Rs, 2 trillion.

The only way out is raising of revenues, reducing unproductive expenses and stopping colossal wastages of funds by public sector enterprises. This article suggests how the new government can collect revenues of Rs. 8 trillion without levying any new taxes and causing any further harm to already ailing industry and business. These proposals, if adopted, can reduce inflation and fix the issues of deficit financing as well as give boost to new investment accelerating growth, generating more jobs and increasing productivity.

Tax potential of Pakistan is not less than Rs. 8 trillion. The simple calculation is: suppose we have 10 million individuals having annual taxable income of Rs 1.5 million (a very conservative estimate). Total income tax collection from them comes to Rs. 3750 billion. If we add income tax from corporate bodies, other non-individual taxpayers and individuals having income between Rs. 400,000 to Rs. 1,000,000, the gross figure comes to Rs. 5000 billion. FBR collected only Rs. 716 billion as income tax in 2011-12. Similarly, due to rampant corruption in sales tax, federal excise and custom duties, the total collection is not more than 30% of actual potential. In fiscal year 2011-12, FBR collected Rs. 804.8 billion under the head sales tax, Rs 122.5 billion under federal excise duty and only Rs. 216.9 billion under custom duties. The total indirect collection of just Rs 1148.2 billion was pathetically low. It should have been at least Rs 3500 billion. If prevalent tax gap is bridged, the total revenue collection would not be less than Rs. 8500 billion without imposing any new taxes or raising the tax rates. It will change the entire fiscal scene of Pakistan—instead of budget deficit we will have surplus funds to retire our debts—internal and external.

Every year before the announcement of federal budget—which has become annual ritual—plethora of tax proposals are received by FBR from trade and professional bodies, tax bars and industry's representatives. These mainly reflect vested interests and do not present anything worthwhile for overall reform of tax system. For the last many years, FBR has been soliciting budget proposals by placing detailed guidelines on its website. However, each year the Finance Bill proves to be a hopeless document—containing meaningless changes in tax codes, imposing more and more burden on the existing taxpayers—especially through cumbersome withholding of taxes—with no policy shift to bring the untaxed sectors and non-filers in the tax net.

In this article, therefore, we are not proposing cosmetic changes in the Income Tax Ordinance 2001, Sales Tax Act 1990, Federal Excise Act, 2005 or the Customs Act, 1969. We are concentrating on some key areas where paradigm shifts are needed in structural and operation level to ensure not only more tax revenue for the State but also business growth, social equity and fairness so that honest taxpayers are not disillusioned—presently FBR is extending concessions, immunities and amnesties to dishonest non-compliant people engaged in trade, business and industry. We are presenting a comprehensive tax policy matrix, operational plan for revenue mobilisation and reform agenda for FBR and tax appellate system below:

REDUCTION IN CORPORATE TAX RATE

Taxation in Pakistan is oppressive, lopsided and counterproductive—there is only 2% of corporatization of total business. By heavily taxing corporate sector vis-à-vis firms and association of persons, FBR has been encouraging undocumented sector. We have only 60,000 companies and annual addition is just 3000 or even less, whereas in countries like Malaysia and Turkey having much less population than Pakistan, the number is in millions with impressive annual growth. If Pakistan wants to move from undocumented economy to regulated and transparent corporatized sector, it will have to reduce corporate rate—restricted to 20% if not less—and will have to tax firms and other non-corporate business entities at a higher rate—between 25% to 30%.

INCENTIVES FOR INDUSTRIAL GROWTH

Taxation should serve as a catalyst for industrial expansion and economic growth. In Pakistan the ill-directed, illogical, regressive and unfair tax regulations are causing a dampening effect on the industrial and business growth. The sole stress on meeting revenue targets, without evaluating its impact on the economy, has crippled our trade and industry during the last few years, especially since we have started submitting completely before the dictates of the foreign donors. Had the successive governments concentrated on economic growth and industrial expansion, there would have been consequential substantial rise in taxes today. It is impossible to enhance revenues with stagnation in economy; and over-taxing such economy, as has been done in Pakistan, can destroy the revenue system as well.

RATIONAL REVENUE TARGETS

The priority of our tax managers is achieving revenue targets, fixed ambitiously every year in utter disregard of how economy is actually behaving. This is the main problem of tax system. By fixing revenue targets in isolation and without making necessary efforts to improve productivity and economic growth, Pakistan has been forced into a quandary, where it can neither afford to give any tax relief package to the trade and industry [due to growing fiscal deficit] nor can it achieve a satisfactory level of economic growth [due to retrogressive tax measures]. This is a vicious circle which has ensnared our policymakers. They will have to find ways and means to come out of this tangle to make Pakistan an economically viable and secure place which can attract investors. In a country where there is no security of life or property, notwithstanding the availability of a host of tax benefits and other incentives, investors would never come forward.

NEGATIVE ROLE OF FBR

FBR, apex administrative revenue authority, has been single-handedly destroying Pakistan’s trade and industry by resorting to discretionary powers [Statutory Regulator Orders (SROs)], withholding undisputed refunds payable to the taxpayers, making excessive tax demands and resorting to all kinds of negative tactics and highhandedness to meet its budgetary targets. Such actions of the tax machinery are detrimental for business and industry and resultantly, FBR not only has failed to tap the real revenue potential but has remained unsuccessful in meeting revised targets for the last many years. Besides, there is perpetual deterioration in our fiscal and budget deficits.

REPRIORITISING GOALS: EFFICIENCY & GROWTH

There cannot be two opinions about the complete shifting of our economic priorities. We, as a nation must concentrate on increasing our productivity, efficiency and economic growth, which alone can ensure more revenues for the State. The main cause of our pathetic economic situation is existence of inefficient, corrupt, repressive and criminal governments/institutions, which do not give a damn for the welfare of the common people. Successive governments' onerous tax and regulatory policies on the dictates of the foreign masters have pushed millions of people below the poverty line. We will have to move quickly and decisively to reverse this trend by restoring Pakistan's undeniable geo-strategic and business competitive position in the region. There is an urgent need to take necessary and tough decisions to make Pakistan a respectable place to live, work and invest.

COUNTERING TAX EVASION

It is a curious paradox of our situation that while money for worthwhile industrial and business growth and public benefits is scarce, there is colossal unaccounted cash supply circulating in the economy in search of further undercover gains. What is more tragic is that this social evil inherent in the tax system gets doubly compounded as it necessitates greater and greater tax burden on those who are law-abiding. The most crucial problem faced by us in fiscal reform programme is that of devising astute and stringent measures to curb tax evasion so that we can distribute the burden of taxes fairly and justly between different persons in the same or similar walks of life. Honest taxpayers have to be safeguarded as day by day they are being disillusioned by the fact that mighty tax evaders are not paying anything with the connivance of their friends and mentors in the tax machinery. The unholy alliance between tax evaders and corrupt tax officials has to be eliminated as a first and foremost step if we want to initiate any meaningful change in the tax system.

Pakistan must have 'Compulsory Public Disclosure of Assets Law' requiring the following to make their assets and liabilities public:

- High ranking civil and military officials
- All Senators, MNAs and MPAs

· Judges of the superior courts

· Any person who have availed loans exceeding Rs. 50 million from any financial institution

· Professionals like lawyers, doctors, chartered accountants, engineers, journalists, consultants etc

The above privileged classes of society shall act as an example for others. Their declarations would inspire common people to pay their taxes honestly. The State needs to wage an all-out war against burgeoning black economy, money power and corrupt politico-administrative structures. This war must start from the mighty classes as suggested above. The people of Pakistan have a right to know how these mighty sections of society amassed immense wealth without paying taxes.

CHANGE IN TAX POLICY

There is a national consensus that existing tax policy needs to be reformulated to provide an equitable, pragmatic, investment-oriented and business-friendly tax system, integrating good tax administration with simplified tax laws that are easily understood and hassle-free from the implementation perspective. Efforts of the government in the past to reform the tax system through special task forces, recruitment of new members on market wages and relying on the reports of so-called foreign experts had not yielded any positive results or acceptability from the taxpayers. It remained a closed door, bureaucratic exercise with no meaningful dialogue with the people and experts who matter in the subject. In the absence of a well-designed tax policy, the agenda of tax reforms would always remain lopsided. The government should not make any legislative and administrative changes until a transparent tax policy is announced and support of those who are affected by it, is secured.

Over the period of time our tax system has become rotten, oppressive, unjust and target-oriented. There is a dire need to discuss the philosophical framework and principles that should be the main concern of our tax policy that is above mere achieving of targets set out unreasonably by foreign donors. Our potential is much higher than these targets, which we can never attain with the present tax laws and incompetent, inefficient and corrupt tax machinery.

EQUITY PRINCIPLE

If a given amount of revenue is needed to finance public services, then each taxpayer should contribute in line with his ability-to-pay taxes. Those who possess more economic power (income and wealth) should contribute more to public exchequer and vice versa. The duty to pay taxes is seen as a collective responsibility rather than a personal one. The ability-to-pay principle views tax policy issues in isolation to incidence of public expenditure. Many regard this principle as the most equitable and just method of taxation—emphasized primarily for its redistributive role. We in Pakistan have completely deviated from this principle, which is a constitutional obligation of the government. We have to follow Quranic injunctions in this regard which unambiguously and unequivocally commands us to spend in Allah's way whatever is surplus after the fulfillment of one's legitimate needs [2:219]. There is no room for concentration of wealth in a true Islamic society.

The existing tax system is highly exploitative and unjust. It protects the rich and exploitative elements that have monopoly over economic resources. There is no political will to tax the privileged classes. The common man is paying an exorbitant sales tax of 16% (on many finished imported items the impact is as high as 25% after adding all other duties, taxes etc) on essential commodities like eatables, but the mighty sections of society such as big industrialists, landed classes, generals and bureaucrats are paying no wealth tax/income tax on their colossal assets/incomes.

The determination of a tax base capable of measuring an individual's ability-to-pay is a major problem of our tax system. This rule is incorporated in the form of progressive rate schedule for personal income tax, estate duty, and property tax worldwide. In Pakistan we have moved from this policy to unequal sacrifice rule where the mighty civil and military bureaucrats (now they are part of the landed aristocracy by getting State lands as awards and rewards), rich industrialists and greedy businessmen are paying meagre personal taxes and the poor people are compelled to pay sales tax of 16% and subjected to hardships due to ever rising costs of public utilities and POL products. This is in direct violation of Quranic injunctions and Article 3 of the Constitution of Islamic Republic. It is the duty of the government to immediately remove these dichotomies and distortions. Taxes should be for the welfare and benefit of public at large along with making the State invincible, but definitely not for the luxuries of the rulers and State functionaries.

BENEFIT PRINCIPLE

According to this principle, an equitable tax system is one under which tax payments are based on the amount of benefits received from government services. In other words, the cost of government services should be apportioned among individuals according to the relative benefits they enjoy. Clearly, implementation of the benefit principle presupposes determination of the incidence of public expenditure before deciding distribution of tax burden. Thus it encompasses issues of both tax and expenditure policies.

Our successive governments have failed to convince the people that payment of taxes is their collective responsibility. All civil and military governments alike had been engaged in wasteful expenditure, never caring to live within their means and failing to even protect the life and property of the people, not to talk of providing them basic needs of health, education and civic amenities. Are these rulers justified to ask people to tighten their belts while their own lifestyle is Shahana (like royalty)?

Tax policy must be used as a tool of distributive justice. The Government should launch programmes, financed mainly through taxes, to solve the twin problems of unemployment and poverty. These welfare-oriented schemes may also include subsidized/free medical and educational facilities, low-cost housing, and drinking water facilities in rural areas, land improvement schemes, and employment guarantee programmes. Once people see the tangible benefits of the taxes paid, there will be better response to tax compliance. Taxes cannot be collected through harsh measures and irrational policies. The rulers and tax bureaucrats would have to demonstrate a clear inspirational model by their actions, so that the taxpayers can place their trust in them and pay taxes honestly and diligently.

TAXPAYERS’ BILL OF RIGHTS

The Government, before imposing any new obligations on the taxpayers, must restore the confidence of taxpayers by immediately promulgating a Taxpayers' Bill of Rights, as was done by a number of countries including USA and UK in the 1980s.

– The provisions of the Bill must: -

(a) Safeguard and strengthen the rights of taxpayers.

(b) Ensure equality of treatment

(c) Guarantee the privacy and confidentiality of their declarations

(d) Provide right to assistance by State in tax matters

(e) Guarantee unfettered right of appeal through an independent appellate system and alternate fast-track administrative dispute resolution system.

ASSIGNMENT OF TAX

Assignment of a tax means transfer of taxation power from a higher level to a lower level government. Taxation power includes the following: right to levy tax, collect tax, and appropriate proceeds from the tax. Thus, there can be three interpretations of assignment of a tax. Firstly, higher-level government may levy and collect a tax but handover the entire proceeds to lower level governments. Secondly, the higher-level government may levy a tax but allow the lower level governments to collect it and retain fully the proceeds therefrom. Finally, the higher-level government may transfer a tax to lower level governments, a situation which defines assignment of a tax in its strictest sense.

In the Pakistani scenario the exact opposite has happened. The levy of presumptive taxation by the federal government and non-existence of local bodies to raise funds for providing education and health at grass root level have denied the fundamental rights of the people. The provinces enjoy exclusive right under the Constitution to levy taxes on services within their respective physical boundaries. The federation blatantly encroaches upon their undisputed right by levying tax on services on presumptive basis—this is in substance indirect tax—under various sections of the Income Tax

Ordinance, 2001. Such taxes are not taxes on income, which the federal government is empowered to levy under item 47 of the Federal List. Generally, the purpose of tax assignment is to augment the resources of lower level governments. The assignment of tax may be conditional. Thus, it may be obligatory on the part of a lower level government to levy the tax assigned to it. Not only this, the lower level government may not have power to alter the basic structure of the assigned tax. It may enjoy flexibility in fixing the tax rates within a minimum and maximum range prescribed by the higher-level government.

There is an urgent need in Pakistan to reconsider the equitable distribution of fiscal and taxing powers among federation, provinces and local governments. True provincial autonomy can only be guaranteed if assignment of tax principle is followed in letter and spirit. Establishment of local governments is a Constitutional obligation [Article 140A] elections and asking them to dislodge the District Management, provincial autonomy but all the four provinces and federal government have failed to fulfil this command. Let the provinces have exclusive right over their resources and finances and they must transfer taxes to local governments so that grass root democracy and funds for public services can be utilised and guaranteed.

BUOYANCY AND ELASTICITY

Tax revenue may change through automatic response of the tax yield to changes in national income and/or through the imposition of new taxes, revision of the bases and/or the rates of the existing taxes, tax amnesties, stricter tax compliance and other administrative measures backed by legal action. Changes in the tax yield resulting from modifying tax parameters (bases, rates etc.) are called discretionary changes. Variations in the tax yield flowing from the combined effects of automatic responses as well as discretionary changes constitute the buoyancy of a tax. It is computed by dividing percentage change in tax yield by percentage change in national income.

The Pakistani experience in this regard has been very disappointed as admitted by the government in almost every Economic Survey in the following manner:

“Although successive governments have made attempts to narrow the revenue-expenditure gap by taking new fiscal measures in the federal budgets, little improvement has taken place in the overall fiscal deficit. Why is it so? Pakistan tax system is still characterized by a narrow and punctured tax base, over reliance on distortionary import-related taxes, high taxes on the one hand and tax concessions and exemptions on the other, and weak tax administration. The combined effect of these structural weaknesses resulted in low and stagnant tax-to-GDP ratio on the one hand, and tax elasticity and buoyancy on the other. Such a tax system has severely hampered resource mobilization efforts in the past despite a series of discretionary measures taken in almost every federal budget to reduce the widening gap between revenue and expenditure”.

Buoyancy estimates assess the overall success of government measures to increase tax revenues while elasticity coefficients indicate the inherent responsiveness of a tax system to changes in national income. In the absence or weakness of elasticity attribute of the tax system, a government will have to revise tax rates and tax bases every year to keep the share of tax revenue in national income undiminished. Such frequent changes complicate tax laws, reduce administrative efficiency and are also politically inexpedient. This is what happened in Pakistan since 1977. It is high time that we must go for a paradigm shift in our tax policy to avoid these kinds of negative effects. Therefore, the tax structure should be redesigned so as to impart a reasonable degree of elasticity to the tax system.

Taxation is a potent instrument to shape and influence the socioeconomic polices of a country. It is therefore imperative for us to formulate a nationally acceptable tax policy keeping in view our own peculiar conditions. Our Tax policy must take into account:

* Present stage of our economic development.
* Objectives of economic policy.
* Priorities of economic policy continually change with the changing economic, social, and political milieu.

It is necessary for us to use the forthcoming budget as a tool for CHANGE and not as guardian of status quo. In taxes, we need to bring some fundamental structural and operational changes. Mere amendments here and there will serve no useful purpose. New tax strategy should entail the following three components:

RESOURCE MOBILISATION

The first and foremost objective must be to raise resources for public authorities for administration and development. Taxes are the main instrument for transferring resources from private to public use. By designing an appropriate tax structure, resources can be raised from those who are holding them idly or squandering them on luxury consumption. According to Roy Gobin, "the revenue criterion is usually the dominant consideration, since governments in developing countries have become increasingly aware of the active role which budgetary measures can play not only in initiating and promoting growth but also in maintaining political power. Not only are higher revenue levels needed, but also tax yields should be increased at a faster rate than income, if infrastructural investments and social welfare expenditures are to be financed without generating unacceptable inflationary pressures and/or increasing reliance on foreign assistance."

The revenue performance is in fact the best and optimal use of resources. Since the composition of investment is an important determinant of growth rate of the economy, public policy must discourage the flow of resources to low priority areas so that they could be diverted to vital sectors of the economy. By imposing high tax rates on luxuries and other low priority items (such as motor cars, air conditioners, and jewellery), the government can discourage the consumption and production of such items, ensuring in the process release of resources for high priority sectors.

DISTRIBUTIVE JUSTICE

Distributive justice or economic justice is an important function of tax policy. Economic justice relates largely to distribution of tax burden and benefits of public expenditure. It is a component of the broader concept of social justice, which encompasses, besides distributive justice, such questions as treatment of women and children, and racial and religious tolerance in a society. Tax policy is a democratic method to influence the distribution of income and wealth on desired lines. The main ingredients of this policy can be (a) progressive direct taxation of income, wealth, and property transactions, (b) taxation of commodities (customs duty, excise levy, and sales tax) purchased largely by high-income groups, and (c) subsidies (negative taxation) on goods purchased by low-income groups. In Pakistan we are moving from progressive taxation to regressive taxation, on the dictates of foreign donors. It is a dangerous step that is bound to force us to civil strives, as our society is already divided on economic, geographical and religious divisions.

The primary function of a tax system is to raise revenue for the government for its public expenditure as well as for local authorities and similar public bodies. So the first goal in development strategy as regards taxation policy is to ensure that this function is discharged effectively. The performance of the Pakistani tax managers is highly disappointing as fiscal deficit remained high during the last decade and the revenue targets fixed annually were revised downwards many a times and even then the same could not be achieved. The Tax-to-GDP ratio remained dismally low—it is at present about 9.2%.

The second equally important function is: To reduce inequalities through a policy of redistribution of income and wealth. Higher rates of income taxes, capital transfer taxes and wealth taxes are some means adopted for achieving these ends. In Pakistan there has been a gradual shift from equitable taxes to highly inequitable taxes. The shift from removing inequalities through taxes to presumptive and easily collectable taxes has destroyed the entire philosophy of taxes. This deviation has effectively transferred the burden of taxes from the rich to the poor.

STABILISATION

Initial developmental efforts are generally marked by inflationary tendencies in an economy. Inflation, if uncontrolled, may thwart all development plans and bring misery to the poor. A reasonable degree of price stability should be the primary concern of a government’s economic policies. The overall level of economic activity in an economy depends upon aggregate demand, relative to capacity output. At times, the level of aggregate demand may be insufficient to secure full employment of labor and other factors of production. At other times, aggregate demand may exceed available output at full employment level. Government intervention in both the cases becomes essential to correct such disequilibria in the economy.

The evaluation of our existing tax system with reference to the foregoing objectives is a difficult task because various other policies (like public expenditure policy) may be geared to achieve the same objectives. To what extent the redistributive objective has been served and the extent to which tax policy plays a relative role are difficult questions to answer. Moreover, the various objectives of tax policy may not always work harmoniously. Rather, they are often in conflict with each other if not mutually exclusive. Since the tax system of a country grows out of the interaction between political judgment and economic rationale, the process of compromises and tradeoffs is influenced by political expediency and economic logic, the former, in most cases, having the upper hand. In fact, political requirements and economic thinking change with time, giving new directions to tax policy. As Richard Bird has observed, "Tax reform is, therefore, a never-ending process, not something that can be brought about once and for all and then forgotten."

BRIDGING TAX GAP

A country's tax gap is measured by the amount of tax that remains uncollected due to non-compliance with tax laws. 'Pakistan Tax Gaps: Estimates by Tax Calculation and Methodology'a joint study of Federal Board of Revenue (FBR), Andrew Young School of Policy Studies at Georgia State University and World Bank, provides in detail, tax gaps by type of tax and describes the methodologies and data used for such estimates. The report released in December 2008 under the name of Rubina Ather Ahmad (FBR) and Mark Rider (Andrew School) warns that views expressed "are of the authors and not of the Government of Pakistan." It is shocking that FBR on the dictates of World Bank initiated this study and when final report was released it disassociated itself—this is typical of our government—always non-committal and hesitant to take any responsibility. After disowning this report, in 2013, FBR is still struggling to bridge the large tax gaps which are the direct result of its persistent inefficiency, incompetence and rampant corruption.

For fiscal year 2004-2005, according to this report, Pakistan's federal tax gap was Rs. 409.5 billion or approximately 69% of actual tax receipts of Rs. 590.4 billion. Terming this as "conservative estimate", the report claims direct tax gap at Rs. 262.8 billion (around 143% of actual collection of Rs. 183.1 billion) and indirect tax gap at 146.7 billion (36% of actual tax collection of Rs. 407 billion). In 2008, the data selected was for fiscal year

2004-2005 and tax gap was estimated at 45%. Since then tax gap has increased significantly and it can safely be concluded that it is not less that 70% of actual tax collection. This report and many others do not take into account the real tax potential of Pakistan and therefore estimates of tax gaps are under-assessed.

The real tax potential of Pakistan, by a very conservative estimate, is Rs. 8000 billion. However, the target for the current fiscal year at the time of budget announcement was fixed at Rs. 2381 billion and in is now reduced just to Rs. 2018 billion. However, FBR is finding it difficult to even meet the three time revised budget.

Who is responsible for the prevailing pathetic state of affairs? Our debt burden is increasing monstrously, fiscal deficit is getting beyond control, inflation is crushing the poor, taxes are being evaded and avoided by the rich and whatsoever little is collected, is mercilessly wasted by those who matter in the land. Domestic debt and liabilities continues to witness a rising trend and reached a new high of nearly Rs. 9 trillion as on May 30, 2013 due to a widening budget deficit and fall in tax receipts, according to the latest statistics issued by the State Bank of Pakistan. The State Bank in its report stated that financing of fiscal deficit through domestic channels has raised concerns regarding debt sustainability of the economy. A heavy reliance on expensive short-term debt has increased the debt servicing burden of the country. Pakistan has been reeling under a revenue deficit for the past six years, implying that a larger part of public borrowings, which financed the government's current expenditures, did not add to the repayment capacity of the economy.

In view of the size and magnitude of public debt, a high fiscal deficit is inevitable—our total debt and liabilities have increased to Rs.15.1 trillion, or 68.4%, of GDP, while debt alone stood at Rs 14.4 trillion, or 65.3% of GDP. Fiscal deficit reached 8.5% of GDP in 2011-12, against the original budget target of 4%, reflecting both revenue and expenditure slippages, including higher subsidies mainly to clear arrears in the power sector—the situation is worsening in the current fiscal year as FBR has miserably failed to collect even Rs. 2000 billion.

It is a great tragedy that while country is caught in debt trap, the rich and the mighty are not only refusing to pay due taxes, but are also living an emperor-like life at the taxpayers' expense and on borrowed funds. They are the de facto beneficiaries of the State's resources—generated mainly by the landless tillers, industrial workers, professionals and white-collared employees.

Pakistan is not a poor country—the State's kitty is empty because of the unwillingness of the rich to pay taxes, collossal wastage of taxpayers' money on unproductive expenses and non-exploitation of vital natural resources. Absentee landlords (they include mighty generals who have been allotted State lands under one pretext or the other during the last many decades) have been resisting proper personal taxation on their enormous income and wealth. In the wake of floods, the President promulgated an Ordinance on March 15, 2011 to levy 15% surcharge on existing taxpayers and enhance indirect taxes on poor growers and common man instead of taxing the rich. An unholy anti-people alliance of the trio of indomitable civil-military complex, corrupt and inefficient politicians and greedy businessmen—controlling and enjoying at least 90% of the State resources—contribute lower than 3% towards the national revenue collection. This tax gap has not at all been discussed in 'Pakistan Tax Gaps: Estimates by Tax Calculation and Methodology', a study which is nothing but an eye wash.

The gigantic and useless government apparatus—doing nothing for public welfare—is also busy wasting whatever taxes are collected. The army of ministers, state ministers, advisers, consultants, high-ranking government servants (sic) is not willing to cut down their perquisites and privileges. They are not ready to live like the common man by surrendering unprecedented perks and privileges they are enjoying at the cost of taxpayers' money. For their luxurious life they are burdening the poor, property-less masses with more and more taxes. Time and again we have made a case for monetizing all perks and perquisites and right-sizing of government departments and corporations, but civil-military complex and their cronies in politics are not ready for such reforms.

The existing exploitative, rotten, regressive, ill-directed and unfair tax system is widening the existing gulf between the rich and the poor—leading to gang wars, crimes, commotions and break down of the entire society. The sole emphasis on regressive indirect taxes [even under the garb of income taxation through presumptive and minimum tax regimes on goods and services] without evaluating their impact on the economy and lives of the poor masses and lack of political will to tax the rich and mighty, is the real dilemma of our State—not scarcity of resources or narrow tax base (nearly sixty million active mobile users are paying exorbitant sales tax at 19.5% and 10% income tax). Equity demands higher taxes from those who have higher income and wealth, but in Pakistan since 1991 all tax policies have been aimed at decreasing tax burden on the rich but increasing its incidence on the poor.

The realistic and correct working of tax gaps in Pakistan is not possible unless the quantum of loss of revenue of trillions of rupees caused by all governments since the first military era of Ayub Khan is not taken into account. Successive governments—civil and military alike—have extended unprecedented exemptions and concessions to the rich and mighty, some of which are mentioned below:

* Ayub Khan, Ziaul Haq and Musharraf abolished all the progressive taxes e.g. Estate Duty, Gift Tax, Capital Gain Tax on immovable property and Wealth tax etc.
* The historic decision of taxing “agricultural income”, passed by the Federal Parliament in the shape of Finance Act, 1977, was thwarted by the military regime of Ziaul Haq. Through this law, the Parliament amended the definition of “agricultural income” as contained in section 2(1) of the Income Tax Act, 1922 then in existence, to tax big absentee landlords. This was a revolutionary step to impose tax on agricultural income for the first time in Pakistan, but foiled by a military dictator, supported by Mullahs, who were funded by big landlords and businessmen. It is now well-established that pro-people economic policies of the Bhutto regime posed a great threat to neo-imperialists and their gumashtas in Pakistan.
* Zia’s rule continued for 11 long years and that of General Musharraf for nearly 9 years, but absentee land owners (including mighty generals who received state lands as gallantry awards or otherwise!) did not pay a single penny as agricultural income tax.
* Taxation of “agricultural income” is the sole prerogative of provincial governments under the 1973 Constitution of Pakistan (“the Constitution”). All the four provinces have enacted laws to this effect, but total collection in 2012 was less than Rs. 2 billion (share of agriculture in GDP in 2012 was about 22%).
* Non-taxation of long-term capital gains at stock market—exemption is meant for the rich and mighty and not for the small investors who lose more money than they make due to maneuverings of big players—caused annual loss of billions of rupees to the national exchequer [loss from 2007

to 2012 alone was more than Rs. 412 billion as admitted by the government in Economic Surveys of Pakistan]. Despite, this so-called tax incentive, market crashed many a times and billions of rupees of the small investors were gobbled up by big fish—once small brokers are now owners of many banks and investment companies and bid for vital national assets when privatization offers are made! From 2011 onwards a nominal tax is imposed on capital gains if holding is less than a year and that too as a separate block of income. Full and proper taxation of the big sharks is still a distant dream due to influence of the mighty whose benami accounts are managed by big brokerage houses. Annual tax gap under this one head alone is Rs. 125-200 billion.

* Tax losses for exempting (in fact not taxing) speculative transactions in real estate are to the extent of billions of rupees per annum. According to Economic Survey of Pakistan 2011-12, the loss for fiscal year 2011-12 was Rs. 700 billion.

* Multi National Companies (MNcs) through abusive transfer pricing mechanism deprive Pakistan of tax loss of over Rs. 200 billion every year.

* Wealth Tax Act, 1963 was abolished through the Finance Act 2003 on specific demand of Shaukat Aziz before taking charge as Finance Minister of Pakistan. He was fully aware of the fact that by virtue of his status as resident in Pakistan, his world assets would attract provisions of the Wealth Tax Act culminating into substantial tax liability annually. Repeal of this progressive law, especially suitable to Pakistan where enormous assets are created without showing income, was shown to be justified despite tremendous revenue losses, distortion in the social set-up and the resultant misery inflicted on the majority of the people of Pakistan.

* In 2002 before its abolition, wealth tax was the only progressive tax left in Pakistan with tremendous potential for growth, if exemption given to the rich absentee landlords were scrapped. This became obvious immediately after its repeal when billions of rupees (estimated at US$ 60 billion) started pouring in from all over the world, remitted by all and sundry without any fear of being investigated, courtesy amnesty given under section 111(4) of the Income Tax Ordinance, 2001. Influx of enormous wealth was directed to the stock exchanges and real estate markets where hungry sharks continued to devour the small investors through unholy maneuverings; or was used to artificially enhance prices of immovable property. With no wealth tax to pay, both these avenues helped to increase individual wealth but dreadfully stripped the entire nation of its right to live in peace and economic prosperity.

* From 2003 to date, according to a conservative estimate, we have lost Rs. 400 to 500 billion worth of wealth tax that could have been imposed on unaccounted/untaxed wealth amassed by those already enjoying the privileges of a luxurious life.
* Section 111(4) of the Income Tax Ordinance, 2001 protects tax evaders as they can whiten untaxed income through an extremely simple and easily available procedure by going to a money exchanger and getting fictitious foreign remittance in his account after paying a nominal premium of 1% to 2% of the entire proceeds! The loss caused due to this provision alone in the last five years is nearly Rs. 275 billion.
* In the last three years alone, revenue loss on account of taxing income from property at reduced rate is estimated at Rs. 480 billion.

The above are just a few areas showing how much tax loss we have been incurring perpetually. In ‘Pakistan Tax Gaps: Estimates by Tax Calculation and Methodology’, no effort was made to take into account all these factors to correctly determine total federal tax gap.

The Pakistani State does not need any borrowing at all, if the rich and the mighty are taxed according to the established norms of democratic dispensation of justice. The dire need in today’s Pakistan is to reduce inequalities through a policy of redistribution of income and wealth by taxing the rich and mighty. Higher rates of income taxes, capital transfer taxes and wealth taxes are some means adopted for achieving these ends in all democratic countries. In Pakistan, there has been a gradual shift from equitable to highly inequitable taxes. The shift from removing inequalities through taxes to presumptive and easily collectable taxes has destroyed the fundamental principle of horizontal and vertical equity. The equity principle can be held to be satisfied when the overall classification of individuals into categories is reasonable and broad enough to contain many individuals within each category and there is equality of treatment within each category.

SOCIAL DEMOCRACY

For social justice and pro-people economic development, the government, through tax policies, must discourage certain activities, which are considered undesirable, for example, excise duties on liquor and tobacco and special excise on luxury and semi-luxury goods. Such measures act as deterrents in avoiding a spill-over of these items and creating disturbance in the society as a consequence. For achieving the cherished goal of establishing an egalitarian State, we need to take the following steps through the ability of the taxation system to influence allocation of resources:

- transferring resources from the private sector to the government to finance public investment programme;

- directing private investment into desired channels (rapid industrialisation) through heavy taxation of collossal income earned by absentee landlords-cum-pirs from orchards and exploitation of labour of their murids (blind followers);

- influencing relative factor prices for enhanced use of labour and economizing the use of capital and foreign exchange;

- increase the level of savings and capital formation by enhancing investment resources for economic development. In Pakistan we find a reversal of this principle. Recent years have experienced flight of capital, closure of huge industries and recession in the trade market. Lack of consistency in the tax policies have forced the business community to move towards safer havens depriving the country of invaluable capital. Similarly, foreign investors feel shy to make use of the tremendous Pakistani talent that goes to waste for lack of proper funding.

- protect local industries from foreign competition through the use of import duties, turnover taxes/VAT and excise. This has the effect of transferring a certain amount of demand from imported goods towards domestically produced goods. Pakistan is one of those very fortunate countries of the world that has an abundance of resources and a climate that is fit for simply any activity throughout the year. But unfortunately and thanks to IMF-imposed economic wizards (sic), our dependence on imported products has been hit with an upward surge in the recent years. Due to the introduction of harsh tax measures and misadministration, our industrial sector has suffered so badly that instead of being able to export our goods we are forced to import in order to cater for the demands of the nation.

- stabilize national income by using taxation as an instrument of demand management. Taxation levels could be used to eliminate inflationary or deflationary gap in the economy. Taxation reduces the effect of the multiplier and so can be used to dampen upswings in trade cycle.

INDEPENDENT TAX JUDICIAL SYSTEM

Present 4-tier tax justice system should be reformed and there should be an independent National Tax Court [for details read ‘Need for National Tax Court’, Business Recorder, May 6-7, 2011]. There cannot be two opinions that an efficient tax judiciary ensures that demands arising out of legitimate tax assessments, which can stand scrutiny of law, are not unnecessarily locked up in litigation. As long as there is pending litigation in relation to a particular tax levy, there is a natural, and quite understandable, desire on the part of the taxpayer not to pay the pending disputed amount. An efficient tax judiciary resolves disputes quickly, quashes demands which are not legally sustainable, and thus segregates serious tax demands from frivolous tax demands, while also giving finality to legitimate tax demands. This in turn ensures that the taxpayer cannot resort to dilatory tactics for paying these genuine and legitimate tax demands which have received judicial approval. An efficient tax judiciary thus helps removing impediments from collection of tax demands by the State, which, once again, results in greater resource mobilization.

TAXES & POVERTY

There is a direct link between growing poverty in Pakistan and distortion in tax base since 1991, when a major shift was made by introducing presumptive taxes (indirect taxes in the garb of income tax). The lack of judicious balance between direct and indirect taxes has pushed an overwhelming majority of Pakistanis towards the poverty line. According to official figures, in fiscal year 2011-12, the share of indirect taxes rose to 62% and that of direct taxes dipped to 38%. It once again confirmed that the taxation system in Pakistan is highly regressive. The government statistics wrongly accounted for in direct tax collection that portion of income tax collection which in fact was indirect in nature (fixed tax on imports, supply of goods, contracts and services and rental income). In reality, after adjustment of these collections, the share of indirect tax was not less than 78% in the total collection.

PEOPLE’S ASPIRATIONS & DEMANDS

The poor and helpless masses of Pakistan desperately owe explanation from all those in power:

* Why the privileged are continuously being favoured and thriving on the money collected as “tax” (sic) from their own poorer brethren?
* Why it is that ordinary taxpayers having income of more than Rs. one million are required to submit annual wealth statements whereas rich and mighty politicians, who have exempt agricultural incomes, have not yet made public, declarations of their assets?
* Why do they hesitate from paying wealth tax but charge taxes and levies of Rs.38 per litre on petroleum products knowing very well that these are consumed by the general masses?
* Why not subsidize the poor and make good the loss by levy of wealth tax on the rich?
* Why not monetize all the perks and perquisites of government employees and those working in state-owned corporations and force them to live amongst the common people rather than in fortified (cordoned off) GORs and palatial houses?
* Why not curtail unnecessary and extravagant expenses on the civil-military establishment starting from the President House, to fill up the void?
* Why not reduce the number of ministers/advisers instead of following policy of appeasement and doling out public offices as if this nation was not burdened enough by worthless and incompetent bureaucrats?

NEW VISION FOR PAKISTAN

Based on above facts and figures, revenue target for the next fiscal year (2013-14) should not be less than Rs. 8 trillion. This is achievable provided the mighty segments, identified above, are taxed according to their capacity, number of tax filers are substantially increased, equitable and rational policies are devised with the backing of the masses, tax machinery is completely overhauled and all exemptions and concessions available to the privileged sections of society are withdrawn. If taxes are collected to this extent, Pakistan can become a self-reliant economy and easily move towards an egalitarian State. This is the only way to get out of the present quagmire of “debt prison”.

One hopes that in the new budget under the new regime, mindless changes in tax codes and procedures will be avoided as these cannot improve tax collection. These only give more leverage to tax administration and open new vistas of corruption for the unscrupulous. The real weakness of tax system is due to FBRs' incompetence and inefficiency, poor enforcement and rampant corruption. It is obvious that tax evasion is not possible without the connivance of tax collectors or due to their incompetence and apathy.

The new government must remember that amending of tax codes each year through Finance Bill and in between, by way of statutory regulation orders (SROs) is not going to serve any useful purpose—this is not a solution but part of problem. The solution lies in converting FBR into an autonomous body run by an independent Board of Directors comprising the professionals and answerable directly to the Parliament and not the headquarters of the ruling party. FBR must be insulated from all kinds of political influences. Enforcement of tax laws without any fear or favour should be the first and top most priority of the new government if it wants to bring the country out of the present economic mess. It should couple with expending taxes for the benefit of masses and stop wasting funds on white elephants—monstrous public sector enterprises sleaze with inefficiency and corruption—so that public can see that the elected government is a responsible one and cares for them. This will promote tax culture and restore the faith of people in tax system. Voluntary tax compliance can be improved only through a strong deterrent system where the compliant taxpayers are respected and rewarded, and the evaders are exposed and punished under the law.

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