THE NEWS **Fixing the taxation system - Part IV**

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Among many compelling reasons for further devolution to the third tier is that citizens in a local jurisdiction are found to pay more taxes as they see that these are being used for their access to basic public services.

Under a centralized system they consider it disappearing into a black box and they don't see any perceptible benefits for themselves or the areas they live in. The quantum of revenues can rise significantly if taxes such as agriculture income tax and urban property tax are devolved to local governments. The metropolitan corporations of Karachi, Islamabad, Lahore and many others would be able to manage their current and development expenditures by revamping property tax, collecting water and conservancy charges by eliminating water tanker mafias and providing piped water and sewerage channels, other cesses, fees, and user charges.

It is possible to raise additional tax revenues of up to two per cent of GDP through a combination of reforms in the FBR and the provincial tax machinery–- one per cent each by the FBR and the provincial tax authorities. The specific measures for achieving this are summarized: one, withdrawal of Statutory Regulatory Orders(SROs) that are providing exemptions, concessions, waivers and rebates to specific firms or sub-sectors. Some progress was made under the IMF programme but these are now gaining currency.

Two, end-to-end automation, computerization and digitization through cloud computing, blockchain, machine learning, expanding functionality of websites and efiling and epayment systems should be accelerated. IRS and Customs databases and IT systems should be integrated and a central data centre established.

Three, out of 6.7 million potential taxpayers only 2.7 million are actually filing tax returns. New taxpayers should be brought in the net through the use of third party databases, information exchange, data analytics and digitalization , reducing the interaction between the taxpayer and the tax collector, enforcement and audit. .Wholesale and Retail trade and real estate sector are thriving due to the development of infrastructure facilities provided by the Government but paying a puny sum as taxes.

Four, to curb underreporting and non-reporting a risk-based computerized audit system and Compliance Improvement Programme should identify those found understating or concealing their incomes. They should be penalized, creating a deterrent effect for others. Third party data collected for the broadening of the tax base should be made available to audit.

Five, the provincial tax collection remains abysmally low at one per cent of GDP. Urban property tax, GST on services and agriculture income tax have high potential that is not being tapped.

Six, presumptive and withholding taxes which are then taken as full and final settlement of tax liability should be phased out and replaced by mandatory filing of tax returns along with payments on all sources of income.

Seven, the system of tax refunds has to be fully automated for all taxes on the line of FASTERR and eventually replaced by a single stage non-refundable tax at a reasonable rate.

Eight, the tax code that has become too complex and convoluted, giving rise to discretionary powers to tax collectors with a lot of loopholes. It needs to be revised and simplified through Business Process Reengineering and change management. The ongoing efforts regarding Pakistan Single Window (PSW) should be expedited.

Nine, the powers of the federal tax ombudsman (FTO) have to be expanded to detect, investigate and take action against those found indulging in malpractices, misuse of office for personal gains and causing revenue leakages.

Ten, the multiplicity of taxes and levies and rates should be reduced, streamlined, harmonized and consolidated to increase compliance , minimize administrative costs. From the taxpayer's point of view, it is the total burden of all taxes, fees, levies and contributions which is relevant. If this burden is excessive, then there will be a natural temptation for them to evade taxes and collusion will take place between them and the tax collectors to minimize this burden. The state exchequer is the ultimate loser in that case. Thus the reduction in the number of taxes and an appraisal of the total tax burden on the individual firm or business is essential to generate a realistic revenue stream.

Eleven, the dispute resolution and adjudication process for taxes is too lengthy, cumbersome and time consuming with multiple tiers nullifying the deterrence effect of non-compliance. Only one appeal should be allowed to either party after the original jurisdiction has exercised its mind.

Twelve, the recruitment, training, remuneration, progression and incentive structure of tax administration should be completely revamped, HR skills aligned with end-to-end automation needs, and performance evaluation systems with KPIs introduced to turn the FBR into a highly professional and performance-based organization. At present, there are too many unqualified and redundant staff occupying non-technical positions. They preempt a large proportion of salaries and wages with the result that high level professionals cannot be recruited, retained and paid the remuneration they deserve.

Thirteen, tax policy and tax administration functions should be separated. The FBR should be responsible for administration under the guidance of an autonomous Policy Board with full control on its own budget, procurement of goods and services, the authority to hire and dismiss staff and the levels and mix of staff, enter into agreements with third parties without prior clearance from the Ministry of Finance. The FBR would enter into a performance agreement with the Ministry of Finance with targets and KPIs.

The analysis here shows that the present taxation regime is highly complex, narrow, mostly skewed towards the urban, industry and formal sectors, inequitable, regressive and distortive. It has low compliance and enforcement and inefficient administrative structure. The most thriving sector of the economy – real estate – is benefiting enormously from concessional land prices, infrastructure development provided out of the government's development expenditures but is paying almost nothing in form of taxes.

Speculation is diverting resources from the productive sectors of the economy such as industry and hence aggregate supply of goods and services is lagging behind the aggregate demand which is increasingly met by imports causing current account crisis and exchange rate instability and volatility. A structural transformation that regulates and taxes the real-estate market, expands the formal sector, makes the rural sector and agriculture more efficient, and makes taxes more progressive and less patronage-ridden will produce impressive results.

A number of commissions and committees have been formed in the past which have produced sensible recommendations aimed at making the tax system more efficient, buoyant and equitable. What has been missing is the political courage to take the plunge. Since 1998-1999, at least eight attempts have been made to bring the wholesale and retail trade sector into the tax net. Despite agreements, these reforms had to be rolled back. Attempts to raise valuation of real-estate transactions on FBR valuation rather than low DC rates have also proved futile so far. As a result, housing societies in peri urban areas encroaching upon fertile agricultural land are mushrooming everywhere.

Urban informal settlements are being set up by land and water mafias in collusion with politicians and bureaucrats. Constituency politics as well as political parties are beholden to them for campaign finance. How can they commit political suicide by alienating their supporters and voters?

The proposed reforms have clearly positive repercussions for the health of the economy but they are still unacceptable to the large landholders, real-estate developers and trade associations backed by their political patrons. The most recent example of their influence on the power corridors is when the FY23 budget levied a fixed tax upon commercial electricity consumers but this measure had to be withdrawn soon as the traders threatened to launch a nationwide agitation.

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