

**Concluding remarks at the National Conference on Tax Culture
held at Karachi on February 22, 2003 under the
auspices of Income Tax Bar Association**

A Fair, equitable and efficient tax system for Pakistan

Pakistan is striving to develop a fair, efficient and equitable tax system in the country. To do so we have to start with some basic principles and agree on the essential ingredients of such a system. In my view there are at least twelve such ingredients upon which the tax system should be built.

First, tax laws, rules, regulations and administration should be made simple, user friendly and comprehensible to ordinary tax payers. With such high rates of illiteracy in the country it is essential that the tax payers do not incur additional costs in the filing of their tax returns and discharging their tax dues.

Second, maximum tax rates in Pakistan particularly on the Corporate and Individual Income should be gradually brought down from 35 to 25 percent as it will encourage greater tax compliance. Progressivity should be built in the tax structure so that those earning higher incomes beyond a certain threshold should bear a relatively higher burden.

However, these tax rates cannot be brought down unless there is a widening of the tax base. This is the third ingredient which I would like to emphasize. Survey and documentation drive has raised the number of tax payers

from 1.7 million to 2.2 million in the last three years and the CBR deserves the praise for this outcome. But according to my analysis based on the Household Income distribution and the occupational distribution of employed labor force we could reach at least 3 million tax payers in this country. Once this level is reached it should be possible to cut the tax rates in a phased manner.

Fourth, the survey and documentation should be a continuous, on-going activity carried out by the Tax authorities without any fanfare or exceptional measures. The high visibility of last survey had created fierce resistance by a segment of potential tax payers. If these surveys are conducted and tax payers are included in the net on the basis of market information and objective criteria throughout the year rather than once in a while they would not generate such political heat. Thus the survey of new businesses and tax payers should be part of the routine responsibilities of tax administrators.

Fifth, Pakistan had achieved a Tax-GDP ratio of 13.9 percent in the 1980s. Today it is down to 11.5 percent. If we could reach the same ratio as it prevailed in the 1980s our tax collection would have been Rs 560 billion – about Rs 100 billion higher than the current level. This could have relieved the consumers of petroleum products and natural gas from paying surcharge of Rs 60 billion annually and reduced the burden on our transport, energy and industrial sectors. Given the structural changes in taxes which the Chairman CBR had so ably spelled out this morning the only viable option is to increase the number of tax

payers. This is not such a difficult proposition as I would illustrate in the next point.

Sixth, what are the sectors of the economy from which these additional tax payers can be tapped. We have to reduce the ever-increasing burden of taxation on our manufacturing sector so as to make it competitive in the global market. But the services sector which has now grown to 50 percent of our GDP is at present taxed lightly. For example health care industry which accounts for Rs 90 billion of annual spending hardly contributes to the tax revenues. The same is the case for other service industries. According to my calculation, direct taxes account for only 5 percent of non-agriculture GDP of Pakistan. This originates mainly from large scale manufacturing, public enterprises, government servants and other fixed income groups. If we extend the actual coverage to other self-employed groups, enterprises and businesses we can succeed in capturing 8 percent of non-agriculture GDP in form of direct taxes. This, in essence, means an additional collection of Rs 100 billion over and above what is being collected. Thus the tax-GDP ratio will move once again to 13.9 percent as in the 1980s.

Seventh, it is my contention that the number of taxes and levies collected by the Federal, Provincial and District governments should be reduced and consolidated. At present labor levies such as EOBI, Social Security are being collected by different agencies. From the tax payer's view point 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 then 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 number of taxes and an appraisal of the total tax burden on the individual firm or business are essential to generate realistic revenue stream.

Eighth, the Government has already taken a decision to eliminate physical contact between the tax payer and tax collector. This has been a source of aggravation for most tax payers who have complained of arbitrary action by the tax collector. On the other hand, the tax collectors are always suspicious that there is deliberate understatement and concealment of income by tax payers but the tax collectors do not have appropriate tools and data at their disposal through which they can detect the true income. Thus the universal self assessment scheme introduced in the last budget is to minimize this contact and allow the tax payer to declare his income in form of final assessment. An auditor then thoroughly examines the returns of 20 percent tax payers every year on the basis of standardized criteria and takes action against only those who have misreported or concealed their income.

Ninth, the dispute resolution and adjudication process for taxes is too lengthy, cumbersome and time consuming. There are multiple tiers through which the tax payer can entangle the department in litigation and postpone the payments due. Thus the deterrence effect of non-compliance is nullified. There

is a need to streamline this process and only one appeal should be allowed to either parties after the original jurisdiction has exercised its mind.

Tenth, the recruitment, training, remuneration, progression and incentive structure of tax administration should be completely revamped to turn the CBR into a highly professional and performance based organization. At present there are too many unqualified and redundant staff occupying non-technical positions. They pre-empt a large proportion of the salaries and wages with the result that high level professionals cannot be recruited, retained and paid the remuneration which they deserve. The quality of human resources has to be upgraded and this is the main thrust of the on-going reforms of CBR for which Mr. Riaz Malik and his team deserve our full appreciation. His leadership and commitment are indeed the driving force behind the current CBR reforms.

Eleventh, it is a well known fact which is valid throughout the developing countries that even the poor segments of population are willing to pay taxes if the benefits of these taxes are proximate and visible to them. If they can see that the taxes are working for them in form of roads, schools, clinics, water supply they will be forthcoming in paying their share of taxes. But if there is no connection between the payments and tangible benefits then there is always some reluctance. In Pakistan, debt servicing burden is so high that it used to take away two-thirds of tax revenues leaving very little for social services or other amenities needed by the common man. We have to strengthen the tax raising capacity of the local

governments and gradually reduce the taxes collected by the Federal and Provincial governments commensurate with devolution of powers.

Finally, the criteria for performance assessment of tax collectors should be shifted from exclusive reliance on achievement of monthly targets of collection to a broad set of parameters in which survey, identification and inclusion of new tax payers, tax compliance and enforcement should also be given due weightage. This single parameter of tax collection generate distortions and perverse incentives and places undue pressures for excesses by tax collectors. A broad based evaluation will be compatible with the objectives of a fair, equitable and efficient tax system.