National and Sub-National Tax Reforms: An Iterative Public-Private Dialogue Approach from Pakistan

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Abstract

The provincial administrations in Pakistan have been entrusted with greater revenue mobilization responsibilities in a post-18th Constitutional Amendment milieu. Apart from the traditional taxes under provincial jurisdiction (e.g. taxes on property, transport and agriculture), the sales tax on services is also under the provincial domain. Some provinces have also demanded to devolve the control over federal excise collections. As provinces gear up to achieve greater control over resource mobilization, there are issues related to double taxation (at federal and provincial stages), lack of census of agricultural and property incomes, missing data on services sector establishments and their turnover. Key reasons for these issues are: a) fragmented structure of revenue mobilization at provincial level and b) weak capacity to plan, forecast and audit the incomes and wealth base under provincial jurisdiction.

The provincial governments in Punjab and Sindh have undertaken a medium-term exercise towards provincial revenue mobilization reforms. However, there are several features of tax policies that require harmonization across provinces. An inability to do so will imply that a business or individual operating in at least two or more provinces is prone to face double taxation, cascading and other implications that impact cost of doing business. Currently Punjab, Sindh and Khyber Pakhtunkhwa provinces have different tax rates and tax bases (on services, property, agriculture and transportation). There are also definition issues across legislation dealing with provincial taxes. The Federal Board of Revenue (FBR) has been trying to advocate the idea of National Tax Authority to coordinate the tax reform efforts across various provinces. The provinces however see this as a violation of devolution under 18th Constitutional Amendment.

Literature suggests that a relatively better way to resolve the above mentioned issues is a reform process driven by structured public-private dialogue (PPD) which in turn can take place at more regular intervals (e.g. before and after the federal and provincial budget announcements and review). Several PPD models have recently been tested in the region as well. This study explains the experience of Sustainable Development Policy Institute (SDPI) in using an iterative PPD approach to create a consensus around some key tax reforms among economy-wide stakeholders. This PPD forum which now meets on a quarterly basis has allowed greater confidence to both public and private sector to share their perspectives and formulate policies which carry a shared ownership. Finally the paper suggests how the PPD approach initially led by local policy think tanks can now be owned and institutionalised at federal and provincial finance departments.

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1. Background

Pakistan’s tax reforms program has been taking shape in a sporadic manner during the last two decades. The tax to GDP ratio is low compared to several peer economies (see Figure 1). The provincial government did not have in the past much incentive to raise their own taxes – something which has changed after the devolution through 18th Constitutional Amendment in 2011. The provincial administrations now have control overall at least a dozen taxes under their jurisdictions. Besides the sales tax on services sector - which has a dominant share in the national income now also rests with the sub-national finance departments.

As the provinces geared up for local level resource mobilisation, all sub-national parlaments passed their own provincial tax laws to give way for provincial tax authorities (e.g. Punjab Revenue Authority and Sindh Revenue Board). Since 2014 all provinces now have their own revenue collection bodies to collect sales tax on services. These provinces also continue to run the tax bodies which historically were collecting taxes on property, agriculture, land and transport.

While it is welcoming to see the recent increase in provincial revenues (Figure 1), there are certain problems attached to the devolution of taxation system. Initially, the focus of all provincial governments is on indirect mode of taxation which harshly affects the lower income groups. The whole burden of these indirect taxes throughout the supply chain falls on the end-user in turn also creating an inflationary impact in the economy and increase in cost of doing business. The overall number of indirect taxes in Pakistan has also gone up however this has not resulted in a substantial increase in share of indirect taxes in overall revenues (see figure-2)
As a result of multiple taxation on same tax bases, the Federal Tax Ombudsmen (FTO) report in 2014-15 highlighted the set of issues that are being faced by the tax payer post-18th Amendment. Later there also was a Tax Reforms Commission constituted by the Ministry of Finance as a result of this report but the government was not able to implement most of the recommendations offered by the commission including double taxation, lack of coordination amongst tax authorities, audit capacity enhancement, research and development, increasing the tax base and several other issues that are being faced by individuals and businesses in Pakistan (FTO, 2014).

There were demand-side reform programs run by several development partners in order to persuade the current and potential tax payers to pay their liabilities and to explain how much a developing country such as Pakistan was dependent upon continuous increased in tax collection. However such efforts lacked the ownership of FBR. The advocacy and outreach for improving tax collection primarily involved civil society and private sector association. Such an outreach effort was not institutionalised at FBR or provincial tax authorities.2

This paper explains how using an iterative PPD approach has recently led to some success in improving coordination between the various tax authorities across the country. A key objective of the study is to see how PPD approach led by policy think tanks can now be owned and institutionalised at federal and provincial finance and revenue departments.

2. Literature Review

The study and SDPI’s work takes both its motivation and structure from the model presented by Centre for International Enterprise (CIPE) in their article titled, “Public-Private Dialogue: The Key to Good Governance and Development” (Kim Eric Bettcher, 2015). The paper defines role of effective stakeholder engagement in policy, governance and development issues. It provides a comparison for policies that were developed with and without engagement of the private sector. The main factors provided for the effective PPD are:

a) prepare champions from both public and private sector;

2 For example Ahmed, V. et al. 2015. Agenda for Tax Reforms, RAFTAAR 2015.
b) have an inclusive approach not missing out on any public or private stakeholder;
c) open access and transparency through inclusion of media;
d) evidence preparation prior to the PPD;
and e) integrating the PPD into the system by using a network of local organization for sustainability of the initiative.

Several other countries have also experimented with structured PPDs which has motivated the use of this tool over time. An impact assessment was conducted by the International Finance Corporation (IFC) for Cambodia, People’s Democratic Republic of Lao, and Vietnam to assess how effective the PPD experience has been over time (IFC, 2007). The paper presents a PPD lifecycle. In the first phase, evidence based results have to be drawn out and these findings need to be advocated through outreach activity. There is a need to develop areas of consensus and a level of trust on both public and private side.

During the second phase, the practitioners usually start observing results which may include increase in production, productivity or revenue. However during the PPD activity differences of opinion are likely which can be bridged through more regular interactions. The third phase has three options:
a) If there is ownership without capacity, the PPD results will get worse;
b) If there is a permanent agreement on the issue, the PPD results will decline with time since the debate will be stopped;
and c) If local organizations are kept actively involved in this process, the process will continue to produce better results and the reform process will be sustainable.

Similarly, a report was published by the IFC for impact assessment of Mediterranean Region and has very similar findings as provided above but with a sectoral focus. The report also provides a detailed account of principles that are involved in all the phases of the PPD including the champions, facilitators (change agents), sector scope, international references, outputs, outreach and communication, structure & participation, mandate and institutional alignment, sub-national & local, conflict resolution, role of development partners and monitoring and evaluation team (IFC, 2011). Taking lead from the above mentioned work, SDPI structured the following methodology for implementation across three years.

### 3. Methodology

This effort to put in place a structured PPD started three years back with a detailed review of the practices adopted in other countries for interaction between public and private sectors on fiscal issues. Taking into account the key features of an effective PPD, a framework was developed to take the PPD forward at both federal and provincial levels. There was a mechanism developed to measure the short-term, medium-term and long-term successes. A detailed study identified the key stakeholders from both the public and private sectors and also from consumer associations.

The first year was spent in collecting evidence on priority tax administration difficulties and presenting the same to the public sector stakeholders in the presence of private sector to ensure mutual understanding of issues. The second year was spent on mass awareness generation through print, electronic and social media, individual meeting sessions and public symposiums. The third year was spent on targeted interventions (e.g. arranging dialogues between the private sector and parliamentarians from federal and provincial levels) and now SDPI is currently working towards developing a network of organizations in all provinces to ensure that PPD becomes a locally led exercise. This hopefully will bring greater

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sustainability and ownership for our work. In all our meetings presence of public sector representatives particularly the revenue departments was ensured.

4. Findings

Unfortunately the private sector in Pakistan has mostly seen tax reforms as a donor-led agenda. It is usually associated with International Monetary Fund’s conditionalities which is not always true. The manifestos of all political parties in Pakistan do own the tax reform agenda, however practicing the interventions mentioned in the manifesto has been difficult. This also became the starting point for our work where we wanted to investigate why the political parties once in power are not willing to complete their promise vis-à-vis tax administration.

Year-1: Producing Evidence on Tax Reforms

Through detailed literature review and consultative process involving meetings with the federal and sub-national tax authorities, two detailed policy briefs were prepared for Sindh. (Suhaib Jamali, 2016) and Punjab provinces (Vaqar Ahmed, 2016). Policy recommendations from both briefs were discussed with the provincial administrations to solicit both their ownership and inputs. The findings from these papers were well taken and appreciated by both governmental and private sector stakeholders with more than 1590 downloads till date for both. The senior officials of Sindh and Province tax authorities acknowledged the role and support of civil society in tax reforms program.

Year-2: Generating Mass Awareness

The next year was spent in meeting up the relevant stakeholders and provide them the awareness regarding the need for a progressive tax system at both federal and provincial levels. Additionally, there was an electronic, print and social media campaign run to facilitate the mass awareness of the general public on the issue. It was a targeted campaign focusing on one TV program, one article, and five social media messages per week. There was also a youtube campaign launched along-side named RAFTAAR. This also provided mass awareness to our subject. Along-side, five public symposiums were held in the federal capital and all the provincial capitals of Pakistan. The symposiums were attended by large audiences and the message of the need for tax reforms was made viral. This ensured that the revenue authorities treated SDPI team as their partners and started using the evidence produced by the team for their own work as well (e.g. during the budget preparation sessions). This approach was later endorsed by several senior level officials especially the Governor of Sindh Province and Minister for Finance, Government of Punjab.

Year-3: Targeted Interventions

In year 3, after raising the awareness and complete mapping of national and sub-national stakeholders, we started a set of focused roundtables with select stakeholders. The prime focus of this year was to the parliamentarians in order to ensure that the acts of parliament relevant to the tax administration are amended in order to ensure that the issues facing the tax payers are gradually addressed. We are now training local organisations to take forward this approach with local tax administrations.
5. Outcomes and Impact

As a result of iterative PPD (also acknowledged by the Federal Finance Minister) the government of Pakistan amended the tax system in it budget 2018-19 with the aim to reduce overall number of indirect taxes, decrease in corporate tax rates, reduction in customs duties, and some reduction in the double taxation faced across provinces. The main points that we advocated and were incorporated were simplification in tax code, reduction of taxes on salaries, reduction in number of taxes, reduction in corporate tax rate. During one of our meetings, we set ground for signing of Memorandum of Understanding between Sindh Revenue Board and the Federal Board of Revenue. Some short and medium term impacts of our study and work for year-2 are provided below:

1. In line with SDPI’s evidence, the government has announced in budget 2017-18: zero-rating on imported agriculture machinery; lowering of corporate tax rate; government promises to work on people’s oversight of budget through fiscal transparency measures under the proposed open government partnership; lowering of customs duty on clean energy equipment; targeted subsidy for small farmers; lowering of indirect taxes on farm inputs; increased budget allocation to promote value addition in agriculture and food processing sector; indirect taxes and withholding taxes on ICT and technology sub-sectors lowered; FBR asked to clear refunds of exporters by September 2017.

2. In the Khyber Pakhtunkwaz budget 2017-18, a key recommendation during SDPI consultations and official meetings in Peshawar, in which KPRA had also participated, was to enhance KP government's outreach towards potential tax payers. This was to be carried out in public-private dialogue mode. Furthermore, we had noted that Tax Facilitation Centres across the province were weak and too few in number. The KP government has announced increase in tax facilitation centres across the province. Also, the Finance Minister Mr. Muzzafar Said accepted that the province was slow in increasing tax collection through a ‘progressive’ tax bases, and that the provincial government was committed to increasing its revenue base in the aftermath of the provincial autonomy.

3. As a result of the framework that was discussed in the Punjab events, the Government of Punjab's Planning & Development Department has sent a letter to Federal Ministry of Finance in Islamabad to move towards streamlining / harmonization of federal and provincial tax regime in the interest of improving cost of doing business. They are also proposing federal government to notify inter-governmental tax working group - in line with SDPI presentation to Finance Minister, Punjab.

4. Due to SDPI outreach at least two provincial revenue authorities have now signed MoUs for sharing resources and proceeds under input adjustment tax.

5. In April 2017, the Overseas Investors Chamber of Commerce and Industry submitted their taxation proposals which included the SDPI proposal for tax harmonization across provinces.

Some short and medium term impacts of our study and work for year-3 are provided below:

1. The greatest outcome of the SDPI efforts in relation to the PPD is that there is a developed trust between the government officials and the private sector. There is an increased frequency of visits of high government officials to the chambers of commerce and industry. During our visit to Lahore Chamber of Commerce and Industry (LCCI), the officials told us that the former finance minister, Dr. Ayesha Ghous Pasha, regularly visited the chamber. Similarly, we have seen several visits from FBR officials to the chambers; including the visit by Chairman FBR before and after the budget.

2. Another outcome of the SDPI efforts in the last two years is the focus on economic consensus with the benchmark being the evidence based reports that were presented. All political parties and private sector representatives are comfortable to sit and discuss the economic agenda
putting aside the political differences. Several business associations have made efforts towards advocating the idea of “Charter of Economy” initially floated during initial SDPI roundtables.

3. SDPI team was asked to present their research findings especially focusing on the tax and trade policy framework recommendations to the high officials of the Ministry of Commerce at the Institute of Trade and Commerce, Islamabad.

4. Discussing economics is usually the least priority of the electronic and print media but due to the media engagement and advocacy of the program run by SDPI, we have managed to get several big media groups to talk on economy.

5. Several renowned economists, policy-makers and columnists have also started writing in favour of the political consensus on economic reforms.

6. Punjab government has initiated and reported progress towards implementation of several of the proposals put forth by SDPI research collaboration during the last 3 years including:
   a. They have started working towards broadening of the tax base rather than increasing the tax rate.
   b. Sent request to the federal government to reduce FEDs on farm inputs

7. The government of Pakistan presented the federal budget for the year 2018-19 on 27th April 2018. The recommendations put forth by SDPI during the last two years were taken up by the government. Some of the worth mentioning achievements are:
   a. Some of the accepted proposals from last year have been continued by the federal government which include custom duty exemption on harvesters and removal of GST on imported sunflower and canola seeds
   b. We recommended reduction of the indirect tax burden on agriculture sector. The government has reduced the GST on fertilizers to 2% and GST on machinery from 7% to 5%.
   c. Government has introduced zero-rating regime in 5 sectors namely textile, leather, sports goods, surgical goods and carpets.
   d. The government has promised to refund pending refund claims of exporters over the next 12 months and afterwards all claims will be paid back on monthly basis as stipulated by law.
   e. Government has accepted our proposal of risk-based audits and in this regard, the grant of stay by the Commissioner (Appeals) was subject to payment of 25% of tax liability. The condition has now been relaxed to 10% of the tax liability. The authority of commissioners and chief commissioners to appoint staff at premises of the tax payer to monitor sales and production has been withdrawn due to complaints of misuse.
   f. Regarding the real estate sector, the FBR rates have been abolished and the transaction will be recorded on basis of value declared by the buyer and seller.
   g. The government has decided to reduce the corporate tax rate standing at 30% now to 25% in the next 5 years.
   h. Several measures on reduction of customs duty and indirect taxes have been taken.

8. Some of the recommendations were made part of the political manifestoes of the political parties for elections 2018
   a. Pak Sarzameen Party proposes a tax reforms program that will enable Pakistan to reduce the debt, increase its own revenue, increase the tax base, and formalize the informal sector of economy through automation.
   b. Pakistan People’s Party-Parliamentarians has put enhanced focus on tax reforms and resource mobilization which includes directing vision towards a single window operation and enhancement of trust deficit between tax payer and the tax authority. Other Tax reforms, especially administrative re-structuring of FBR, is one of the most important component of economic manifesto presented by PPP-P.
9. The amnesty scheme announced in the recent budget is also as per the recommendations sent forth by SDPI. As on 12th June 2018, FBR has already received 1000 returns under this amnesty scheme estimated to receive around USD 4 Billion. This will not only increase the tax revenue collection of the tax authorities but also widen the tax base, and in return reducing the tax burden on individual. (https://www.thenews.com.pk/print/328584-fbr-receives-1-000-returns-under-tax-amnesty-scheme)

10. Recently, we received information that the LCCI and Faisalabad Chamber of Commerce and Industry (FCCI) has established a special help desk to facilitate the tax payers especially with regards to the recently announced tax amnesty scheme. This was part of our recommendations to improve the public-private environment and reduce the trust deficit.

11. The current government gave some agenda points during its election campaigns which included tax reforms as priority with tax administration reforms as one of the top agenda items.

6. Conclusion

This paper makes a case for addressing the welfare loss that is accruing due to overlaps in tax administration across federal and provincial administrations. We also make a case of strengthening coordination among over a dozen tax authorities across the country to avoid issues related to double taxation. This paper proposes the iterative PPD method which helps to correct and refine the approach to dialogue over time. It also strengthens the social capital much needed for public and private sector to interact and share perspectives on a regular basis and ultimately make Pakistan's taxation structure more progressive.

References


