

Policy Brief # **53**

Tax Reforms in Punjab

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1. Background

Provinces are gearing up for an active resource mobilization after the additional powers allowed to them under the 18th Constitutional Amendment. The Punjab has three revenue authorities namely: Punjab Revenue Authority (PRA), the Board of Revenue (BoR), and the Excise and Taxation Department (E&TD). The provincial government has suggested in the medium term the merger of all revenue collecting bodies.

Currently, E&TD is responsible for collecting Urban Taxes, e.g. Property Tax and Motor Vehicle Tax. The BoR operates in rural areas and collect land revenue, agricultural income tax, and stamp-duties. Following the 18th Amendment, the Punjab has created its own authority to collect General Sales Tax on Services (GSTS). The PRA started with the collection and enforcement of sales tax on services. Currently, this body is collecting sales tax on 14 services.¹

In 2015, International Finance Corporation (IFC) launched tax reforms project in the Punjab to reduce the compliance cost burden for the private sector and increase the GSTS net in the province. IFC will conduct mapping of the GSTS system in Lahore to identify serious cost constraints and bottlenecks, which private sector faces while complying with the regulations. That will also include a legal and policy review, capacity and training needs assessment, and organizational structure review. It was expected that the project would also develop a taxpayer charter of rights and code of conduct.

The Punjab government has also decided to establish a dedicated Tax Reform Unit (TRU) within the finance department for tax policy analysis. To conduct research in the field of collections and highlight weaknesses in the system and suggest reforms to increase revenue of the province.

This policy brief makes an effort to highlight: a) key challenges faced by the province in generating revenues, b) inefficiencies in the provincial tax administration and policy, and c) difficulties faced by the private sector and individuals in complying with the provincial tax rules. We also provide policy recommendations based on our interaction with law makers, private sector, government officials, civil society organizations, and academia.

2. Revenue Collection: Situation Analysis

The provincial government missed its tax collection target of Rs164.5 billion for the year, 2014-15, with a 39 per cent shortfall. This shortfall has been attributed to weak forecasting capacity, obsolete methods of taxing incomes from agriculture and property, and a collection mechanism that suffers from rent-seeking (Ahmed 2015, Ahmed 2015b).

The White Paper on Budget 2015-16 makes the confession that “currently, the Punjab government has an incomplete picture of its tax system... while the main hindrance is a lack of

¹ In the Budget 2012-13, the Punjab government had made a new legislation for sales tax on services titled the Punjab Sales Tax on Services Act, 2012. The Punjab Sales Tax Ordinance, 2000 was repealed. Services on which tax is collected, include: Hotels, Clubs, Caterers, Advertisements on T.V & Radio Including Cable T.V, Customs Agents, Ship Chandlers, Stevedores, Telecommunication, Insurance and Re-Insurance, Banking Companies, Non-Banking Financial Institutions, Stock Brokers, Shipping Agents and Courier Services.

capacity, there is also a lack of reliable data — economic and sectoral data as well as taxpayer data, which is used as the basis for assessing different taxes that need to be updated.” The provincial income accounts are also not available in regular frequency at the Pakistan Bureau of Statistics or the Punjab Bureau of Statistics.

Box 1: Punjab Provincial Tax Revenue Collection

	PKR Million
Taxes	2014-15*
Agriculture Income Tax	1,000
Property Tax	8,742
Land Revenue	12,290
Tax-Profession, Trades & Callings	720
CVT on Immoveable Property	4,649
CVT on Moveable Property	240
Other Direct Taxes	11
Provincial GST	46,369
Provincial Excise	1,783
Stamps Duty	21,073
Motor Vehicles	10,284
Others Indirect Taxes	7,089

Source: Annual Budget Statement, Government of Punjab, *Revised Estimates.

Recent literature has also pinpointed potential issues with existing tax bases available with the provincial government. For example, the Punjab Urban Immoveable Property Tax (UIPT) - a local government tax but collected by the provincial government, and then shared with local administration, brings low levels of revenue (Box-1). Key reasons include old valuation tables, lack of incentive for tax officials to improve their performance, exemptions and preferences allowed in the tax schedule particularly for owner occupied properties (Nabi & Sheikh 2013).

Similarly under the Punjab Agriculture Income Tax Act 1997, the taxpayer is supposed to pay the larger of, a) charge on cultivated land, or b) tax on agriculture income. Such a system is leading to tax evasion as it is not compulsory for the farmers to file a return. They can get away by only paying the acreage tax (PILDAT 2011).

3. Desired Reforms

As part of this research exercise, SDPI team interviewed government officials, business community, law makers, civil society and academia in order to prioritize the key reforms that can fetch greater revenues with an additional objective of ensuring basic equity principles.

3.1. Boosting collections from services sector:

The legal status of PRA needs to be approved and strengthened by the provincial parliament and appropriate cover given to its activities. The issue to double taxation, where Federal Board of Revenue (FBR) is found to be charging excise on services-activities already paying GST to the province, may be resolved. There are assessment problems which can be resolved through a one-time census of services units in the province.

The Finance Act 2013-14 had introduced withholding tax (WHT) on builders, retailers, and educational institutions. In addition, rates of WHT and advance tax have been enhanced in case of professional services. Some of these income activities also fall under the preview of provincial GSTS and such steps are likely to increase cost of doing business, reduce consumer surplus and also increase the cost of compliance for taxpayers. There is a need to conduct a detailed study on the incidence of provincial taxes.

3.2. Revisiting tax on agriculture incomes:

The current system of taxing through agricultural activity and land-based taxes is not efficient. The land revenue rates are between PKR 100-300 per acre and need to be updated on scientific lines. The land tax should be formulated in a manner that reflects potential income from land. It was estimated, at 2010 prices, that potential tax revenue from agriculture could range between PKR 55-75 billion annually (Nasim 2014). The penalties for non-compliance are not effective. Appropriate legislative changes may be required to strengthen and increase the capacity of collection department. A revenue-neutral reform can be introduced where incomes from agriculture are taxed in tandem with a tax-cut or otherwise reduction in the prices of inputs.

3.3. Realizing the potential of UIPT:

Regular survey of urban properties is required to ensure that rates under UIPT correctly represent changes in property and rental values. The exemptions and preferences allowed to various types of owners and users of property need to be revisited. The rating areas need to be notified and revised regularly so that coverage of tax net can be expanded. The key reasons of corruption and tax evasion are higher tax rates, differential between owner and lessee-occupied rates, and differential between rates for same type and size of properties in various cities across the country. Such anomalies may be corrected through appropriate legislative and policy changes.

3.4. Need to strengthen progressivity of taxes:

After the 18th Constitutional Amendment, progressive taxes, e.g. wealth tax, capital gain tax on immovable property, estate duty and gift tax are within the powers of provinces. The Punjab Assembly may introduce these progressive taxes through appropriate legislation. Such taxes can augment the growth in provincial spending needed for health, education, low-cost housing and public transport. The FBR may also be asked to remove any federal exemptions or concessions allowed to provincial taxpayers.

3.5. Strengthen Grievance Redressal Mechanism (GRM):

A key issue faced by the business community in the Punjab is lack of appropriate and effective GRM. The private sector wants that their ideas on increasing the efficiency of taxes should be heard. A key recommendation from them is the desired reduction in the frequency of tax payments. However, there are four different departments for which this recommendation applies.² None of them has a documented and publically communicated GRM, which can guide the business community.

4. Way Forward

In the coming days, provincial revenue authorities are likely to establish a baseline of tax bases for each of the taxes. They should be able to introduce IT-based business processes for tax compliance to reduce human contact between taxpayers and payee. The GIS-based validation of land holdings, commercial wholesale and retail activity may be pursued. A serious effort may be made to improve the taxpayers' information regarding provincial taxes, ideally through one-window operation. The low yielding taxes such as cotton fee, entertainment tax and tax on property transfers may be abolished.

The above-mentioned will require a reform of the tax collection administration. The merger of E&TD, BoR and PRA may be expedited to ensure low administrative costs and better rapport with the taxpayers. The provincial tax ombudsman may be appointed and strengthened with judicial powers. Finally in order to ensure some level of social accountability a tax directory of agricultural income tax and urban immoveable property tax payments should be annually published and disseminated as part of the provincial budget.

² Three revenue collection bodies and Punjab Employees Social Security Institution

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