Reformed GST: Challenges and Opportunities

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Firstly I would like to appreciate the views and compliments. I was mentioning to Mr Idrees Khawaja that perhaps they could have chosen a much better representative for the private sector because my view is distinctly in the minority in case of RGST. I will just share with you where the private sector stands on the issue of RGST, what their opinion is and then I will give you my own stance on the subject as well as justification on the same. As you would know from newspapers and other media, the private sector is strongly against the imposition of RGST. The vast majority of chambers, which represent the bulk of Pakistan’s private sector, have been vociferous in the opposition of RGST. I must mention here that in addition to my responsibilities at Engro, I also serve in the role of Chairman of Pakistan Business Council, which was created a few years ago. Pakistan Business Council comprises of largest business groups of Pakistan. Every single large business group of Pakistan is its member, including some of the key multinationals operating in Pakistan. Pakistan Business Council formally supported the RGST, even during its hearing in the National Assembly Finance Committee. Part of the difference that you see here can be explained in terms which would be flattering to us. We have been part of the industry since a very long time but we realise where the world is headed, and understand that a modern country cannot progress and cannot be run effectively with a tax-to-GDP ratio which is in single digit. But since the private sector is not significantly represented here, I think it is only fair that I try to bring forth where some of their apprehensions come from. We at large businesses have management systems and teams who are sophisticated enough to deal with complex systems. We have the necessary resources which enable us to engage the most expensive lawyers in Pakistan, and fight with the FBR when we see corruption or unfair practices being carried out. We can also raise issues that we face in front of the highest authority in the country. The vast majority of the Pakistani businessmen are small traders or small manufacturers. They do not have the systems and resources like large companies. Moreover, fact of the matter is that the tax machinery in Pakistan is both incompetent and corrupt. Therefore, it is a very legitimate concern on part of the business community that the RGST will make their lives difficult, more than the way economic theory portrays it to be. This is because there are certain realities that have to be looked at.

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Having given you our position that we support RGST implementation let me share with you some of the concerns that we have. The first is the threshold level of Rs 7.5 million that has been taxed. Any threshold will have this problem but the more you raise the threshold the bigger the problem becomes. I am surprised that this question was not raised in the hearing which took place (and by coincidence, it is the same question which my driver asked me). He asked how RGST would be any different from the current system. Upon explaining the concept to him, he surprised me by asking how would one determine who has a turn-over of Rs 7.5 Million. I have yet to get an answer on this question from someone. If this sector is totally undocumented, then who is going to make the call that this shop is above that threshold and this shop is not. Are we not opening the door to a massive rent seeking opportunity? I think this is an aspect that we have not paid any attention to, and demands serious consideration. One of the biggest oppositions against the RGST is the issue of inflation. Most people do not realise that today the GST is imposed on the vast majority of products except for those which are zero-rated or exempted. The manufacturer collecting the GST does so at the retail price. So even though the intermediary participants of the chain are not documented but tax is being collected effectively on the entire value added. When you go through a different system where you are now trying to recover at each stage, it is quite expected that collection from manufacturers is going to fall. Now you are moving into a much more difficult terrain. You are trying to collect from the undocumented sector. So the chain will break and indeed is going to break in many instances. As a result collection is going to be far below the set target. The third element, which is a big issue under any circumstance in the current macroeconomic environment, is that of liquidity. Liquidity problems will be created when you take away the zero rating. That is the reality and once again I am very surprised that very little has been done to address the apprehensions of the business community in this particular aspect. Even the most successful businesses are expecting problems because it is a given reality. If you look at our balance sheets right now you will see that the government of Pakistan is using refunds as a float to finance its funding requirements. The numbers have continued to float over the last few years and it has become bigger and bigger with time. Whether it is being done deliberately or is just due to absence of a sophisticated mechanism or perhaps due to weak systems, in any case it is a reality. Moreover as a result of monetisation of fiscal deficit and resultant crowding out effect, inflation has gone up, discount rates have had to follow the same direction with interest rates rising more and more. It has become quite a significant issue for businesses and it is not just the interest rates but also liquidity which is an issue for the small trader/businessman. If you look at the State Bank data on the amounts outstanding as credit to the private sector, you will see a continuous decline in numbers for the last three years. Therefore, they do not have ample liquidity, or the capacity to pay for the very expensive credit even if they can get their hands on it. Therefore, I truly believe we are setting ourselves for a difficult transition and by this I am not in any way implying that we shouldn’t do it. We have to do it –that road has to be travelled, and we have to start the movement in that direction but I truly believe that we could have done much better homework in preparing for this transition and its implementation as well as in dealing with both the perceptual and the real issues which are going to be faced as a result of this.
The last thing I will say is that even those of us who support the RGST have a very strong feeling that the tax structure in Pakistan is completely and totally inequitable. The low tax-to-GDP ratio is just one issue—the inequity of that tax system is another major issue. When I used to be a director at Karachi Stock Market I ran at crusade literally arguing for capital gains tax on stock market at that time. I used to give the example of my accounts clerk who resided in Orangi, and changed two mini buses to get to office, paid tax on his income and there were many days in a year when in a single day had more capital gains—I, Asad Umar, had more capital gains than that poor clerk had in his entire year’s earning, and I paid no tax on capital gains. That is just criminal.

I am glad to see we have moved in that direction but there are many other taboos which have been left outstanding. I will just mention two of them. One of them is Agriculture Tax. Everybody talks about it but again the question is of fairness. There is an incorrect impression which has been created that while agricultural tax must be imposed because it is the right thing to do, even those who support imposition of agricultural tax say that the actual collection is going to be a very insignificant amount. That is just patently wrong, and people who make that assertion have not seen what has happened to the commodity markets in the recent years. The earnings of the agricultural sector have gone up. Doing my calculations I have not finalised it, I will not take a number but it is many manifold more than the estimates that I had before. The other thing which I have to mention mainly because I come from three generations of Army Family (Fauji Khandan) is about a particular tax that was passed, specifying that if an employer gives an asset to an employee at a price below the market value the differential has to be taxed. I would want to hear from the FBR as to how much tax has been collected from all the land which have been distributed to many generals in previous years.

Once again I must say that I am not implying in any way that the RGST should not be implemented; it should be implemented but one must know that it is only an essential but insufficient condition for tax reforms in Pakistan.