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Determinants of Income Tax Base in Pakistan: A Policy Review

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INTRODUCTION

This paper is divided into six parts. Following this introduction a reivew of the fiscal policies pursued by the Government of Pakistan is presented in the second section. The third section contains an assessment of the performance of different taxes while the fourth presents the reasons for low revenue performance. The key issues in tax policy reform are discussed in the fifth section. The final section presents the recommendations for future policy directions. The taxation structure of Pakistan is both Federal and Provincial in nature. This structure was derived from the revenue-sharing provisions of the Government of India Act, 1935 and has been incorporated into successive constitutions delineating the respective revenue powers of the Federal and Provincial Governments. Under the present constitution, the Federal Government has the constitutional right to levy a wide range of direct and indirect taxes [Government of Pakistan (1973)].

Federal direct taxes comprise of personal and corporate income tax (excluding tax on agriculture income), and capital taxes (excluding tax on immovable property). Since the abolition of estate duties and gift taxes, the latter include wealth tax and Capital Value Tax. One time Capital Assets Tax on companies was levied in 1991. Income of small businesses is subject to fixed tax. Minimum tax at the rate of 0.5 percent of turnover applies to Corporate and Registered Firm taxpayers. Presumptive tax regime applies to dividends and interest, prizes on prize bonds, lotteries and raffles, payments for contract execution and supply of goods, and value of imported and exported goods [Government of Pakistan (1991)].

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Author's Note: This paper is essentially based on my extensive association with tax policy and administration and reflect my views on the revenue performance over the years. The paper is meant to be a purely descriptive analysis and as such discussion of the theoretical aspects is deliberately minimal. The data presented here are taken from the unpublished reports prepared by me as Commissioner of Income Tax, Computer Wing, Income Tax Department. Interested persons should contact me for the original data.

II. REVIEW OF PAST FISCAL POLICY

Over the years, the taxation system has undergone major changes both in policy and procedures. The resource mobilisation aspect of the system was substantially diluted through the pursuit of secondary objectives of promoting industrialisation, savings, exports, welfare and charities, and other key economic activities. Various tax measures including tax exemptions, investment and tax credits, tax rebates, accelerated depreciation of capital assets, lower tax rates and higher exemption limits were used as the medium for achieving the desired objectives. Exemption of agriculture income was extended to the agro-based industries and agricultural services. Operation of tax on capital gains was suspended to promote the capital market. Tax rates for public limited companies were reduced as an incentive for private companies going public [Khan (1990)].

In June 1979, the Income Tax Act of 1922, was repealed by the Income Tax Ordinance, 1979. It made no fundamental changes in the system of income taxation. Instead, as announced by the Government, the reasons for enforcing the new enactment were to arrange the provisions in more systematic and logical form, simplify the law, plug the loopholes, remove lacunae and ambiguities, and to evolve a tax system which is fair, equitable and capable of voluntary compliance leading to effective administration [Government of Pakistan (1979)]. Thus, the fundamental concepts of fiscal policy as well as the basic features of the tax laws remained unchanged.

During the 1980's, certain clear departures were made from the concepts followed during the previous decades. In the area of personal taxes, the income threshold for tax purposes was substantially raised. Income computation provisions, particularly those relating to technical service fees, carry forward of losses, investment allowances and donations to charities were liberalised. Agriculture income was also included in the tax base for rate purposes. Investment income such as dividends, interest, capital gains, etc. attracted a mixed approach, i.e. extension in certain exemptions and withdrawal of others.

Tax rates were gradually reduced over the period of the 1980s. The policy on depreciation of fixed assets was liberalised. Industrial investment incentives in the form of tax and investment credits and tax holidays were expanded along with the extension of existing concessions. The withholding tax net was extended as a measure of resource mobilisation as well as for expanding the tax base. The self-assessment scheme, as started in 1979, was continuously liberalised and the scope of tax audit minimised. Anti-tax evasion and avoidance provisions were introduced to promote better compliance [Government of Pakistan (1979)].

In November 1990, the Government constituted a Committee on Tax Reforms "to review the existing taxation structure and recommend a system that will substantially increase government revenues". While making its recommendations in February 1991, the Committee observed that "there is a need to take up and attempt the task of restructuring the entire taxation system .... (taking) into account the revenue generation aspects, economic growth potential, removal of anomalies ....". A wide range of recommendations on policy, procedures and administrative aspects of taxation were made [Committee on Tax Reform (1991)]. Some of these were implemented through the 1991 Budget. Others have been involved through the 1992 Budget [Government of Pakistan (1992)].

The new policy direction implemented through the 1991 and 1992 Budgets particularly includes the extension of the wihholding mechanism, introduction of fixed tax on small businesses, presumptive tax on various incomes, minimum tax on companies and registered firms, one-time Capital Assets Tax on Companies with minimum paid-up capital of Rs 50 million, etc. These revenue raising measures, adopted in the context of reforms of tax policy and administration, can be questioned as to their effectiveness in terms of widening the tax base, improving tax administration and providing long-term solutions. Generally, the perception is that these measures are ad hoc and inconsistent with the Government's stated industrialisation policy. Further, they run counter to the established principles of equity, progressivity and ability to pay [FIAS (1991)]. It is feared that it may further erode the confidence of the taxpaying community and may not help in achieving the desired objectives of broadening the revenue base and mobilisation additional resources. This is quite evident from the taxpayers' disappointing response towards fixed tax on small business and less than expected revenue yield from Capital Assets Tax and minimum tax on companies.

III. PERFORMANCE OF TAXES

The primary objective assigned to the taxation system in Pakistan remains to be resource mobilisation. However, as stated above, over the years, the taxation system has also been used as a vehicle for achieving several secondary objectives [Government of Pakistan (1990)]. As a consequence, the present tax system is characterised by the presence of multiple exemptions and incentives, which have riddled the tax system, thus constraining its revenue-generating capacity. Further, the pursuit of so many objectives has greatly complicated the tax system and most of the above objectives may not be achieved in a cost-effective way by these fiscal methods. It has also been observed that fiscal concessions generally had a marginal effect on investment decisions [Khan (1980)]. These concessions, on the contrary, facilitated the tax-evasion process through the transfer of taxable profits to nontaxable activities. Revenue performance was adversely effected and the share of direct taxes in federal revenues gradualy went down from 21 percent in 1979 to around 18 percent in 1992 [Government of Pakistan (1991)]. Hence, Government's heavy reliance on customs duties and domestic inputs.

Whereas Pakistan's GNP experienced a sustained real growth at the rate of approximately 6 percent in real terms, direct tax revenues did not match this figure. The ratio of direct taxes to GNP has in fact declined from 3.07 percent in 1979-80 to 1.9 percent in 1990-91 percent. The direct tax system has reflected low built-in elasticity between 0.4 percent and 0.7 percent primarily due to the exclusion of major sectors of economy from the tax base [Coopers and Lybrand (1990)].

Over the period 1979-80 to 1991-92, net direct tax receipts (other than wealth tax) increased from Rs 5,225 million to Rs 27500 million. The tax base, however, continues to be composed of a small number of corporate taxpayers. Contribution by various categories of taxpayers to the total assessed tax has generally been around 84 percent by corporations, 5 percent by Registered Firms, and 11 percent by individuals, etc. The major contributing sectors were the manufacturing sector (27 percent), wholesale and retail trade (16 percent each), financial institutions (14 percent), and business services (9 percent). Within the manufacturing sector, major contributors included chemicals and paints (4.34 percent), pharmaceuticals (4.06 percent) and textiles (2.7 percent). Sectors such as sugar, cigarettes, crude petroleum and natural products, non-metallic products, cement, equipment and machinery manufacture, and transport equipment manufacture contributed between 1.2 percent to 1.4 percent each. The construction sector contributed only 4.4 percent of the total tax assessed. Compared with the general level of business activity, contribution by various sectors appears to be relatively low [Government of Pakistan (1991)].

A comprehensive analysis of the fiscal results of the corporate sector for FY 1986-87 to 1990-91 revealed that over this period, the number of taxpayers paying tax declined from 4300 to 3982 i.e. of the registered companies. There was, however, no consistent relationship in growth of paid-up capital, turnover, gross profits, assessed income, and tax, etc. Generally, the growth in tax revenues was disproportionately lower compared with the increase in paid-up capital and declared turnover. This is reflective of administrative inefficiency in tax assessment and collection and the ad hoc changes in policy framework.

The over all number of 'revenue yielding taxpayers' is around 750,000 as against 1.5 million taxpayers registered with the Income Tax Department. This includes 6,000 Corporate and 24,000-30,000 Registered Firms taxpayers. The individual taxpayers are around 720,000. Out of the later, 350,000 taxpayers

Table 1

Fiscal Results for Corporate Taxpayers for Assessment Year 1987-88 to 1990-91

	Assessment Year			
	1990-91	1989-90	1988-89	1987-88
Companies Analysed	10,755	10,755	10,755	10,755
Companies Paying Taxes	3,982	4,304	4,300	4,206
Paid-up Capital	77.49	48.72	47.48	41.90
Gross Profit/Sales	13.42%	1.58%	10.19%	9.25%
Declared Income/Sales	4.24%	4.12%	4.04%	3.81%
Assessed Income/Sales	5.01%	5.45%	6.02%	5.54%
Gross Tax/Sales	2.20%	2.21%	2.03%	1.945
Gross Tax/Assessed Income	44.0%	40.6%	33.8%	34.6%

Source: Resource Mobilisation and Tax Reforms Commission, Karachi.

derive income from business. Others are salaried persons, rent-seekers, and partners/directors of firms/companies. Income pattern of taxpayers shows that around 24,000 taxpayers are assessed at income above Rs 100,000, and 8,000 to 10,000 at income exceeding Rs 200,000. Amongst the corporate taxpayers, 25 percent taxpayers are assessed at income upto Rs 100,000; 35 percent between Rs 100,000 to Rs 500,000; and 12–15 percent between Rs 500,000 to Rs 1000,000. About 25 percent of the corporate taxpayers are assessed at income exceeding Rs 1 million. Public Limited Companies constitute around 65 percent of the corporate taxpayers assessed at Rs 1 million and above. Over 35 percent of the foreign companies declare taxable profits exceeding Rs 10 million.

The tax collection pattern shows that, over the past several years, withholding taxes have constituted a major share of tax revenues. Withholding taxes which were initially imposed on salaries, and in the late Sixties extended to payments for execution of contracts, were primarily introduced to ensure tax compliance by non-reporting income earners. During the Eightees, the emphasis was changed and withholding taxes were employed both for income tax compliance as well as augmenting revenue receipts. Whereas the revenue yield through the withholding tax system has greatly increased, the desired goal of expanding the taxpayer base was, however, not adequately served inspite of the manifold expansion in economic activities encompassed through withholding net [Government of Pakistan (1991)].

It was also observed that as a consequence of liberal tax regimes and in the absence of objective income computation norms, a large component of withholding taxes was refunded to the taxpayers. This necessitated a change in emphasis through the Budget for 1991-92 and 1992-93 in so far as withholding taxes paid on several incomes are deemed as discharge of full and final tax liability, i.e. presumptive tax regime applies.

Table 2

Breakdown of withholding Taxes on Various Economic Activities

(Rs in Million)

Economic Activity	Fiscal Year				
	1990-91	1989-90	1988-89	1987-88	1986-87
Salaries	1395.483	929.761	929.761	705.14	621.46
Interest on Securities	1386.983	1850.117	1836.19	1073.03	756.59
Payments to Non-Residents	494.490	232.097	263.60	351.47	295.94
Execution of Contracts, Supply of Goods and Services	4119.973	2813.996	2239.37	1743.83	1693.47
Import of Goods	2093.268	1950.341	930.46	1349.92	1190.42
Motor Vehicles	124.505	109.238	59.30	57.39	59.84
Bonus Shares	72.733	26.596	16.18	1.31	1.34
Auctioned Property	149.143	84.131	64.69	65.85	66.54
Total 10136.528	7996.277	6114.93	5264.29	4572.05	4685.60

Source: Central Board of Revenue, Islamabad.

The forgoing revenue performance analysis could be summed up as under:

(i) Share of direct taxes to the overall revenues is very low;

(ii) Percentage share of direct and indirect taxes in the overall revenues has more or less remained constant over the decade of eightees;

Table 3

Breakdown of Gross Tax Collections under Provisions of Law

(Rs in Million)

Charging Section	Fiscal Year 1990-91	1989-90	1988-89	1987-88	1986-87	% Age of Various Payments to Total Revenues 1986-87	1990-91	1991-92 Ist threa Quarters
Withholding Taxes	10186.528	7996.277	6114.093	5264.029	4572.005	338.4%	46.6%	54.7%
Advance Tax Payments	3801.591	3494.144	2362.937	1733.803	2476.958	20.8%	17.4%	17.8%
Tax Payments with Returns Departmenaly Efforts	3026.425	2870.344	2839.602	2757.843	1869.507	15.7%	13.9%	21.6%
Current Demand	3832.141	2540.694	2780.623	2651.956	2232.097	25.1%	22.1%	5.9%
Arrear Demand	992.064	876.578	709.432	590.397	746.312	19.7%	17.5%	
Miscellaneous	25.061	25.840	20.422	7.609	12.80	6.4%	4.6%	
Total:	21813.810	17803.877	14827.109	12921.637	11909.686	100%	100%	100%

Source: All Pakistan Statement, Central Board of Revenue, Islamabad.

(iii) Share of personal taxes to the overall direct taxes is very low and has remained constant;
(iv) Tax base is extremely narrow compared with the income distribution in the country;
(v) The tax system is a 'system of tax exemptions' rather than 'tax collection';
(vi) Tax compliance in terms of non-reporting/under-reporting of income is extremely high;
(vii) 'Average effective rate of taxation' compared with the statutory rates is very low, viz: 5.26 percent, 17.25 percent, 36.42 percent in respect of Individuals, Registered Firms and Companies respectively during FY 1989-90;
(viii) Withholding taxes contribute to the major portion of total income taxes as compared to collections through the direct efforts of the Income Tax Department. The latter has touched an all time minimum of 6 percent for the first three quarters of FY 1991-92;
(ix) Basis of income computation continues to be the traditional, ad hoc gross profit/net profit rate criteria which has no relevance to the on-ground realities; and
(x) The administrative efficiency is very low.

IV. REASONS FOR LOW REVENUE PERFORMANCE

The performance analysis provided above reflects poor revenue yield as against reasonably high level of growth in the national economy. Further, fiscal measures also do not appear to have adequately served the secondary goals of promoting industrial investment (both sectoral and area-wise), rate of savings, capital markets, welfare activities and exports. The identifiable factors adversely affecting performance of the direct tax system as regards revenue yield generally relate to policy and implementation, administrative and budgetary constraints. Briefly, these include:

(a) Pursuit of multiple objectives which has clearly complicated the tax system;
(b) Exemption of agricultural incomes;
(c) Exclusion of various other types of incomes and capital gains such as pensions and annuities allowances, house rent, investment incentives, interest, dividends, and capital gains;
(d) Exemption of employer – provided perquisites such as rent – free accommodation and allowance upto 45 percent of basic salary, life insurance and annuity, payments by employers, etc.;

(e) Tax holidays, investment and tax credits to industrial companies, etc.;
(f) Defacto exemption of capital gains;
(g) Tax exemption to welfare trusts and foundations;
(h) Tax shelters under immunity provisions of self- assessment scheme, and significantly high level of income under-reporting under the Simplified Assessment Procedure;
(i) Reduction in tax rates and increase in personal allowances;
(j) Non-reporting and under-reporting of income;
(k) Collusion between assessing authorities and taxpaying public; and
(i) Administrative handicaps such as insufficient manpower at all levels, inadequate geographical spread of offices at national level, lack of training facilities, non-existence of formal legal set-up, lack of infrastructural facilities, and inadequate automation in tax assessment and collection functions.

Some of these factors are briefly discussed below:

(a) Small Number of Assessees

The present non-corporate income tax roll comprises wage and salary earners in the formal sector and individual traders and self-employed professionals in the informal sector. The total number of reported individual taxpayers is small compared to the total size of urban employed labour force and the estimated income distribution thereof. On the basis of rough estimates derived from the 1989 Economic Survey and the Household Expenditure Survey 1986-87, the employed labour force stands at 31.78 million out of which 8.45 percent falls in the taxable slab. Further, 20.88 percent of GNP during FY 1988-89 falls in the taxable bracket as against only Rs 58.00 billion assessed to tax during the relevant period. A significant part of the higher income groups appear to be outside the tax net.

(b) Sectoral Exemption of Agricultural Income

While the vast majority of the agriculturists would be exempt from tax because of earning less than the exemption level, the remaining minority could generate as much as 60 percent of the present assessed revenue from the corporate and personal income tax. It has been observed that misuse of the agricultural exemption to shelter from tax other incomes has increased over recent years. Specifically, the exemption of agricultural income has given rise to various methods of tax evasion which *inter alia* include purchase of agricultural land by industrialists, who claim it as the source of other income, operation of non-agricultural businesses by agriculturists who claim income generated from such businesses as agricultural income, and fictitious loans made by agriculturists to industrialists and other traders help this class of taxpayers to evade tax on their commercial incomes [Government of Pakistan (1991b)].

(c) Exclusion of Other Incomes and Capital Gains

A wide range of exclusion has reduced the scope of personal income tax and contributes to the low yield of the system. These include, *inter alia*, pensions and annuities, house rents, investment incentives: interest and dividend income: and capital gains.

(d) Reduction in Tax Rates and Increase in Allowances

Effective assessment year 1986-87, personal tax rate at the margin was reduced to 45 percent (or 49.5 percent, taking account of surcharge) and to a maximum of 35 percent w.e.f. assessment year 1992-93. Effective from the assessment year 1992-93, the personal income exemption has increased from Rs 24,000 to Rs 30,000. For taxpayers whose total income is less than Rs 100,000 and where more than 50 percent of the total income consists of salary income the exemption is increased to Rs 40,000. Exemption limits have risen faster than inflation, thus narrowing the tax base. Corporate tax rates have consistently declined to 35 percent for public limited companies and 45 percent for private limited companies.

No official estimates are available regarding the reduction in revenue resulting from the changes in rates and personal allowances. But if it is assumed that the same average tax rate had applied to personal incomes in 1986-87 and 1987-88 as had applied in 1985-86, the revenue in those years would have been respectively Rs 410 million (5.6 percent of 1986-87 total assessed direct taxes) and Rs 570 million (6.5 percent of 1987-88 total assessed direct taxes) higher. The revenue lost in respect of the corporate sector is much higher. The revenue lost has been significantly made up in consequent to the legislative steps taken to broaden the tax base to compensate for the revenue foregone i.e. expanding the tax withholding to economic activities otherwise escaping tax, and the application of the presumptive tax regime to several incomes.

(e) Evasion of Tax

Tax evasion is a principal cause of the low yield of income tax. The size of tax evasion in Pakistan, measured by under or non-reporting of income, has been estimated by several studies to be between 10 and 30 percent of non-agricultural GDP. These estimates are not, however, robust calculations as they have either been based on simple methodologies and/or informed opinions about the Pakistan economy. Using sectoral exemptions e.g. (agriculture, poultry, cattle, fish farming and processing etc.) to disguise other sources of income, fragmenting income-earning assets among family member, creating fictitious fee arrangements with affiliates and deducting such fees from income, and claiming deductions for fictitious salaries to dependents [Government of Pakistan (1987)] are some of the methods used for tax evasion.

(f) Welfare Trust

Welfare trusts and foundations established exclusively for the benefit of armed forces personnel and their dependents or for Federal and Provincial employees and their dependents, have been wholly exempt from tax. It is estimated that during the recent year tax revenue foregone because of this exemption was of the order of Rs 300–400 million per year.

(g) Capital Gains Tax

Capital gains are *de facto* exempt from tax. Historically, capital gains tax has not been a significant source of direct tax revenue. The principal cause of the low yield of tax is that in practice it applies only to gains on shares in private companies; and that gains on shares in public companies and in particular, on land and buildings, are not charged.

V. KEY ISSUES IN TAX POLICY REFORM

The foregoing discussion on broad features of direct tax policy and administration, recent policy directions, and revenue performance reflects that the taxation system which conceptually had all the ingredients of equity and progressivity has, over the years, become extremely inequitable and regressive. Revenue receipts have been in elastic and have grown at a pace slower than the growth in national income. This has, in turn, contributed towards large fiscal deficits, major inequities and inefficiencies leading to large-scale macroeconomic disequilibria characterised by inflation, and balance of payments difficulties. Tax reforms are, therefore, necessary firstly, as part of stabilisation efforts to increase public revenues in a reasonably non-distorting, equitable and sustainable manner; secondly, to reduce severe distortions in fiscal incentives and the resulting inefficiencies and inequities in resource allocation.

The types of issues that arise as a result of the foregoing and which must be appropriately considered to remedy the adverse effects of ad hoc measures adopted over the years are as under:

1. Fiscal Imbalance and Insufficient Tax Revenues

The primary function of the tax system is to generate sufficient revenues to meet legitimate public needs to finance goods and services. This is particularly important where public expenditure needs are too pressing for fiscal balance to be achieved by expenditure cuts alone. It is, therefore, imperative to analyse the country's potential "ability to tax" in the light of its characteristics, and identify the "tax handles" to activate the un-utilised part of this potential to determine the size of the policy reform packages. The ratio of taxes to GDP is in itself not an adequate measure of revenue performance (either potential or actual) as large areas of income are otherwise excluded out of the tax-net as part of public policy. Some of the vital questions to be addressed as a part of the broader assessment of fiscal policy include: "Can public expenditure (both capital and recurrent) be cut back? Will public savings be increased through increases in public revenue? Will the additional public savings add to or substitute for private savings? Can public revenue increases be met without activating tax instruments? and finally, will additional taxation create disincentives to private economic behaviour that might further undermine the efficient allocation of resources and growth or worsen the distributional features built into the tax system? [Government of Pakistan (1990)]. The answer to these questions will determine the size of the reform measures.

For the purpose of generating additional tax revenue, several options are available. Short-term pressures to reduce the fiscal deficits can be met by higher rates on existing bases of tax instruments. However, as the prevailing tax system is deficient in many respects e.g. exclusion of several classes of income and high degree of tax evasion and avoidance, etc. increasing rates on existing bases will result in a highly complex and internally inconsistent tax structure that will be difficult to administer and costly in terms of efficiency, growth and equity. The alternative could be expanding the withholding tax net and/or introducing presumptive/fixed taxes. These will raise serious issues of tax equity and progressivity. It will, therefore, be preferable to follow a long-term policy of expanding the existing tax base along with rate adjustment which should be based on the revenue requirements against concerns of efficiency, equity and ease of administration.

2. Distortions in Resource Allocation that can Reduce Economic Welfare and Growth

Taxpayers' attempt to reduce their tax burdens or spending resources in evading taxes could reduce their real income by more than the amount of revenue transferred to the Government. The production and consumption decisions based more on tax implications than on their inherent economic virtues are socially inefficient. The difference between the resources that the Government gains and the sacrifice that is made by taxpayers represent the "efficiency cost" of taxation. Tax reform must, therefore, reduce the size of this cost of taxation for a given level of revenues as the attempt must be made to raise revenues not only at a minimum administrative cost but also at a minimum economic cost. The latter will be reduced only where the tax system interferes as little as possible in production, trade and investment decisions of the firms and consumption and savings decisions of household. A reduction in the "efficiency cost" will improve both the static and dynamic efficiency.

3. Inadequate Equity Features

The tax system in Pakistan is generally not progressive and the poor often bear significant tax burdens. This happens through the taxation of inputs in production, lower threshold income level in the personal income tax and exclusion of several classes of income rendering the tax system extremely inequitable and regressive. Tax reform should, therefore, lift the tax burden off the poorest households and ensure that actual tax structures become more equitable, both horizontally and vertically. This can be achieved by implementing appropriately targeted exclusions and re-designing tax, fixed and presumptive taxes, bases. The implementation of concept of 'ability to pay' in real manifestation by doing away with all exclusions except the welfare and charities – directed provisions will be a step in the right direction.

4. Administrative Constraints

Weak administrative establishments generally result in opportunities for tax evasion and corruption, and constrain virtually all tax reform proposals. The ability of taxpayers to thwart registration, assessment and collection procedures, and thus successfully evade and avoid taxation, determines the size and nature of the economy's actual effective tax base. Excessive complexity of tax laws and procedures to accommodate exclusions, preferences, and special interests further constrains the limited enforcement capabilities of tax administration. Inadequate facilities/skills and lack of political will also undermine the fair enforcement of tax laws and procedures. As tax administration and structure are interdependent, therefore, they need to be dealt with simultaneously in tax reform.

VI. FUTURE POLICY DIRECTION

The tax policy reform package for implementation, as stated above, must aim at fundamental and comprehensive changes in emphasis and concepts. The policy reform package should cover fiscal structure and administration and implemented in totality. The tax reform policy may be tailored around the key principles of (i) primary objective to be raising of revenues, secondary objectives dropped; (ii) taxes are fair, progressive and equitable; (iii) income to be taxed is documented. While tailoring the tax policy directions, broadening of the tax base must be given high priority so as to reduce reliance on relatively high tax rates to generate revenues. Within base broadening, the use of 'tax expenditures' (tax preferences and exemptions to promote specific economic and social objectives) should in general be reduced. While devising tax expenditures, the potential gains need to be weighed explicitly against the potential losses in revenues and efficiency that must be associated with these measures. The rate structure should be rationalised. Also tax reform should aim at lowering the burden on the poor.

Further, since tax reform typically involves the balancing of multiple objectives and evaluation of the interactions between different tax instruments and bases, a systematic approach to tax reform can yield major gains. The policy reform package must be accompanied by suitable improvements in tax administration. Excessive complexity of tax laws and procedures which places burden on the limited enforcement capabilities of tax administration must be reduced through simplification of tax laws and procedures.

As all objectives of tax reform cannot be satisfied simultaneously, trade-offs are unavoidable. However, multiple objectives may be addressed by altering specific features of each tax instrument or using a different instrument for each objective. For example, a general consumption tax for revenue purposes, selected luxury taxes for equity purposes, and tariff structure with very few rates for protection purposes. Where it may not be possible to perfectly match objectives with instruments, this approach can result in a simple tax structure while still addressing all major objectives.

Broad outlines of the proposed policy direction are as under:

Widening the Tax Base

- Phasing out all exclusions, exemptions, investment and tax credits, etc., except for the donations to selective charities.
- Bringing into the tax base all incomes irrespective of their source and origin.

- Replacing the present concept of 'basic exemption' for personal taxes with the principle of universal taxation of all incomes with appropriate rate adjustments.
- Penalties and prosecutions in income concealment cases.
- Documentation of economy, anti-corruption units and 'lifestyle' audits to discourage corruption.

Simplification of the Tax System

- Combination of corporate tax rates and rebates into a single charge and uniform tax rates for all corporate taxpayers.
- Single tax rate structure for all income groups and abolition of surcharges in personal taxes.
- Suitable adjustments in tax rates to ensure that the tax burden on existing taxpayers remains almost the same, and is not a disincentive for persons presently not reporting their incomes for tax purposes. The rate structure may be simple and progressive.
- Developing comprehensive income and profitability norms for each trade and industry based on systematic analysis of relevant economic data. The tax-payer in such a system should be allowed to present himself for investigation where he differs with these norms.

Taxation of Capital

- Taxation of gains on quoted stocks, on depreciable assets, and compulsory acquisition as a tax point.
- Reintroducing estate duty and gift taxes for income redistributive purposes.

Tax Procedures and Administration

- Institutional changes in the administrative set-up by removing the territorial jurisdiction on taxpayers and reintroducing concept of panel assessments. Business/professionals representatives may be associated both in developing the assessment norms as well as while carrying out tax audit and tax investigation.
- Extensive automation of tax department for processing of cases not selected for test audit, and for tax collection purposes.
- Developing a comprehensive data base for matching of information for tax assessment and MIS purposes. Existing concept of 'National Tax Number' may be replaced by 'National I.D. Card Number' as the ref-

erence point for tax purposes. Recording of this number on all economic transactions except the retail sale of goods may be made mandatory. The information collected from various agencies controlling/executing economic transactions through surveys will be part of the comprehensive Data Base.

- Comprehensive taxpayer assistance programme may be introduced. This may include setting up of information centres at key stations, publication of information booklets, and brochures and advertisements.
- To ensure appropriate coordination between survey and data processing functions of the Income Tax Department, both in terms of policy and administrative controls, these departments may be placed under a single control. This set-up may be responsible for automation, MIS and collection and disseminations of economic data for policy and assessment purposes on a national basis.
- Introduction of effective and comprehensive control and accountability arrangements for the auditing of tax assessment.
- Infrastructure facilities such as provision for adequate office space, furniture, typewriters and wordprocessors, communication vehicles, residential accommodation, etc., may be substantially improved.
- The existing training facilities being inadequate may be improved by creating regional training institutes for officers and staff.
- Career prospects for revenue officers may be substantially improved. This may also include more lucrative pay-packages for revenue officials to reduce the temptation for misusing their wide authority in tax matters.

While embarking upon a broad-based fiscal policy direction, it is important to note that there is no optimal tax structure. Whereas some broad principles of tax reform can be developed that apply across the board, the details of tax design and implementation being a complex matter, requires detailed assessment and careful tailoring. A conscious decision in respect of the fiscal policy and administration package backed by political will and administrative commitment could definitely increase the revenue yield many times. The extent of revenue increased, nevertheless will depend upon the size and extent of the fiscal policy reform package.

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Comments on
"Determinants of Income Tax Base
in Pakistan: A Policy Review"

The tax structure and its incidence have remained one of the neglected areas of research in Pakistan. The study of changes in direct and indirect taxes is important for many reasons like efficiency, impact on allocation of resources and equity, etc. The paper by Mr Ahmed is very interesting which highlights several changes which have taken place in the last decade or so. It points out the share of different taxes towards government revenue, its pattern, and incidence of taxes in Pakistan. The most important issue discussed is the failure of government to mobilise revenue through direct taxes and the heavy reliance on indirect taxes; like customs duties and sales taxes, etc. Moreover, it provides a good evaluation of some aspects of fiscal policy followed in Pakistan.

2. The author has rightly pointed out that direct taxes did not grow much and heavy dependents was laid on indirect taxes. It would have been appropriate if a rationale is provided why both kind of taxes may grow equitably or why the pattern observed was not desirable. It appears that the author seems to support equitable growth of direct and indirect taxes without providing any justification for the same. Moreover, the growth of taxes has been compared with the growth of GNP and claimed that direct taxes do not grow when compared to the growth of GNP. As already pointed out, the rationale for such equitable growth has not been indicated. Similarly, the author claims that inefficiency has been created due to changes in the taxes, whereas hardly inefficiencies are proved to support such claims. The author has freely expressed his personal views without providing adequate support for his arguments. Therefore, the reader is hardly convinced with the claims made in the paper.

3. The author derived his support based on: (i) review of taxation policy (ii) empirical findings. The review and empirical findings lacks in theoretical support. Therefore, empirical findings and claims made therein need to be co-related and linked with some logical and theoretical rationale which has been ignored by the author. The author has mentioned in the footnote that the paper deliberately keeps the discussion on theoretical aspects to a minimum. Providing such a footnote neither relieves the author from the responsibility to provide such a rationale nor convinces the reader regarding his claims. Besides, empirical relationship are developed without considering such aspects; for example, the provincial revenues

have been compared with GNP which may not be appropriate and it may provide misleading results. Such estimates may be done in relation to GNP since growth of taxes are linked with well-being and development of the area.

4. The discussion based on empirical findings does not seem consistent; for example, discussion of Table 1 is based on the FY 1986-87 to 1990-91 whereas the data in the table pertains to FY 1987-88 to 1990-91. Furthermore, it is difficult for the reader to understand the figures provided therein. The unit of measure etc. has not been provided in the table; for example, there is no indication for paid up capital which is in million rupees or dollars. Similarly, it has been stated that number of taxpayers, registered companies, declined from 4300 to 3982. Whereas the table indicates that tax-paying companies continue to increase since 1987-88 to 1989-90 i.e. from 4206 companies to 4304 companies. However, it declined from 4304 to 3982 companies since 1989-90 to 1990-91, respectively. Such a shift in the pattern should have been rationalised for example, based on industrialisation policy, concessions provided therein, industrial development and unrest etc., rather than just making a statement that the taxpaying companies decreased. The author also makes general statements without providing any base in the paper; for example, a summary for the analysis of Table 3 provides that the tax base is extremely narrow compared with income distribution and tax base. It has been stated that basis of income computation is traditional and has no relevance to the on-ground realities. It appears that faulty techniques were used for the base of income computation. The author criticised such techniques at one place and used figures based on the same methodology in his own analysis and draws results for future policy implications. It might have been more convincing if such inconsistencies are improved and then claims are made based on adequate empirical and theoretical bases.

5. The author provides policy recommendations at the end of his paper which is a significant contribution. However, it appears that these recommendations have not been derived from the analysis of discussion of the paper. The author proposes a single tax-rate structure for all income groups which does not seem to be supported in the paper. Such a tax rate might not be desirable in an environment when a country is in a developing stage. There is a need to encourage some groups by providing financial incentives. Notwithstanding the above, the paper does highlight the relative share of different taxes, changes in their shares, the tax base and its empirical growth which is an important contribution and may be very useful for future research in this area. The author has very rightly pinpointed that under the present structure of taxation, who bears the burden of tax. It appears that the tax structure is biased towards indirect taxes which puts a burden

on the common man which is not justified under the principles of equity and ability to pay. Moreover, the long experience of the author, dealing with practical aspects of taxes led him to point out the deficiencies of the present structure which could be very important for future policy formation in Pakistan.

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