



## Citizens' Voice Project

# Citizens' Voice and Public Accountability in Tax Collection Sector

## Taxation Watch Report Nov, 2012-Jan, 2013

**Grantee: Governance Institutes Network International**

**Disclaimer:**

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## LIST OF ACRONYMS

APP	–	All Pakistan Press and Publication
CBOs	–	Community Based Organizations
CVPA	–	Citizens' Voice Project
FCCI	–	Faisalabad Chamber of Commerce and Industries
FGDs	–	Focused Group Discussions
GINI	–	Governance Institutes Network International
IEC	–	Information Education and Communication
HR	–	Human Resource
KII	–	Key Informant Interview
KPIs	–	Key Performance Indicators
MIS	–	Management Information System
MPAs	–	Member of Provincial Assembly
PMEP	–	Performance Monitoring and Evaluation Plan
RBM	–	Result Based Management
RM	–	Research Manager
RTO	–	Regional Tax Office
TDEA	–	Trust for Democratic Education and Accountability
TL	–	Team Leader
TOR	–	Terms of Reference
TPI	-	Tax Perception Index

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## A. Project Features:

<b>Reporting</b>	
<b>Name of the Sub-Grantee Organization:</b>	<b>Governance Institutes Network International</b>
<b>Project duration:</b>	<b>From <u>Nov 19, 2012</u> To <u>Nov 18, 2013</u></b>
<b>Title of the project:</b>	<b>“Citizens’ Voice and Public Accountability in Tax Collection Sector” Central Punjab</b>
<b>Project Location:</b>	<b>Country: Pakistan</b> <b>Province: Punjab</b> <b>District (s): Sargodha, Faisalabad, Gujranwala</b>
<b>Project Objectives (overall and per sector):</b>	<ul style="list-style-type: none"><li>a. Strengthened Citizen Voice through Oversight of public bodies allowing policy reforms</li><li>b. Government-civil society linkages to enhance accountability</li></ul>

## **B. Executive Summary**

Tax reform is one of the few surviving policy options left to the Pakistan government, for achieving and sustaining fiscal stability, growth and equity. Pakistan's revenue collection is historically poor and currently worsening. Poor revenue collection stems from long ignored structural problems in tax policy and administration. The involvement of citizens and civil society is essential for tax reform. This projects seeks to: a) amplify citizens voice and demands; b) establish forums where citizens and civil society can participate in and contribute to the policy making and engage with policy makers; c) facilitate oversight of relevant institutions by citizens and civil society; d) promote informed public dialogue around Federal tax policy and administration; and run campaigns and media reporting for improved delivery of taxpayer's rights. The achievement of these objectives would result in: a) enhanced awareness and knowledge among taxpayers of their rights; b) informed public debate and discourse on tax policy and administration, and the need for tax reform; c) improved taxpayer-friendliness of RTOs; d) improved satisfaction and awareness among taxpayers of grievance redress and complaint handling systems in tax collection; e) improved transparency and accountability of tax policy and administration and f) independent, evidence-based and participatory evaluation of tax policy and administration to feed into reform efforts.

The Taxation Watch Report deciphers the major trends and milestones in Tax Collection sector in general and Sales Tax in particular. GINI has established a network of stakeholders bridging the rights holders and duty bearers in Sales Tax sector. The registered sales tax paying enterprises of district Faisalabad, Gujranwala, and Sargodha espousing with Tax Bar Associations, Non-Governmental Organizations and other forums working on Taxation from the Demand-side group where as Government entities, Inland Revenue offices, RTOs and FBR form the Supply-side group. GINI keeps follows the policies, rules and procedures in the sector and convenes debates and opinion poll using social media among the panelists who are the Presidents/Secretaries of Chamber of Commerce and Industries, Commissioners/Deputy Commissioners of Revenue Departments, Members of Tax Bar Associations, Researchers, think Tanks, from the respective districts and Federal level. GINI tabulated the Taxation Perceptions Index (TPI) which is sourced from a quarterly online survey, as well as a quarterly review of Federal Sales Tax policy and administration by a panel of analysts, constituted from among the stakeholders mentioned above. The scores for this Index are based on indicators of equity and fairness of tax policy and the effectiveness and efficiency of tax administration.

## C. Background and Rationale

GST has been one of the major sources of federal tax revenues in Pakistan. Despite sales tax target revision, the sales tax collection by FBR performed poorly and remained Rs. 24.3 billion short, during the last fiscal year.

Tax Collection has been divided into Northern, Central and Southern Administrative Zones. The annual report 2009-10 by Director General Audit (Inland Revenue) depicts a grim picture of lowest revenue collection share and highest revenue loss in Central Zone (as compared to the Northern and Southern Zones) where the 3 target districts are located.<sup>1</sup> Total loss of revenue reported for the year 2009-2010 was detected at Rs. 28,191.082 (M). Additionally, the Central Region contributed 47%, Rs. 13248.928 (M) to total loss of revenue detected during the FY 2009-10.

Above all, the percentage share of total sales tax collection at RTO Faisalabad and Gujranwala are the lowest within the Central Zone and show continuous downward trends since 2004-05 as compared to other RTOs, for instance, Lahore and Multan.<sup>2</sup> Hence, while the share of sales tax in total revenue collection at the national level increased over time, the sales tax share from the Central zone, especially RTO Faisalabad and RTO Gujranwala, continue to rapidly decrease, which supports the basis of our intervention into this region. RTO Sargodha was commissioned to take effect from March 1<sup>st</sup> 2011 so the required data for this district is not readily available, but will be collected during the planned Baseline Study.

Low sales tax collection is quite surprising as Faisalabad and Gujranwala are the most highly industrialized cities in the Central Zone. In Faisalabad, there are 512 large Industrial units and **some 12,000 house-hold industries, which include some 60,000 power loom factories.**<sup>3</sup> The industry of Gujranwala mainly consists of Agriculture, Auto parts, Automobile, Cutlery, Fan Industry, Engineering Hardware Sanitary Fitting & Sanitary Wares, while the main source of income in Sargodha is based on horticulture including food, beverages and fruit processing units which gives our area of intervention diversity to include the key tax bases covered by Sales Tax. According to the World Bank's 'Doing Business' Report, 2010 Pakistan ranks poorly in the preparation and filing of tax returns. In Faisalabad and Gujranwala, the process of GST return filing accounts for 12 out of 47 payments per year, and an average tax payer has to spend 480 out of 560 total hours per year to prepare and file the return. This is inefficient in comparison to the South Asian average of 28 total payments and 281 hours per year. This results in higher tax payers compliance costs, increased administrative costs, high incidence of errors and passive process of refunds.

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<sup>1</sup> [http://www.fbr.gov.pk/Docs/2011541355610224AnnualReport\\_2009-2010\\_II.pdf](http://www.fbr.gov.pk/Docs/2011541355610224AnnualReport_2009-2010_II.pdf)

<sup>2</sup> <http://www.cbr.gov.pk/ShowDocument.aspx?Actionid=2625>

<sup>3</sup> <http://www.faisalabad.gov.pk/>

#### ***D. Taxation Watch Report Panel***

Following are the members of the Taxation Watch report Panel;

1. Mr. Ejaz Asad Rasul, Commissioner Inland Revenue Gujranwala
2. Mr. Zafar Iqbal Sandhu, Deputy Commissioners Inland Revenue Gujranwala
3. Mr. Adnan, Secretary Chamber of Commerce and Industries Gujranwala
4. Ms. Reena Mumtaz Sarwar , Members Tax Bar Association Gujranwala
5. Mr. Zahid Aslam, President Chamber of Commerce and Industries Faisalabad
6. Mr. Abdul Qayyum Ch., Member Tax Bar Association Faisalabad
7. Mr. Zulqurnain Gondal, Deputy Commissioner Inland Revenue Sargodha
8. Mr. Hassan Rao, Member Tax bar Association Sargodha
9. Ms. Mussarat, Member Tax Audit, FBR
10. Ms. Raana Seerat, Member HRM, FBR
11. Ms. Aisha Farooq, Secretary HRD, FBR
12. Mr. Majid Qureshi, Chief Tax, FBR
13. Mr. Mansoor Sadiq, Second Secretary (Legal), FBR
14. Agha Mujeeb-u-Rehman, President, Rawalpindi Islamabad Tax Bar Association (RITBA)
15. Mr. Zahid Shafiq, Secretary, Rawalpindi Islamabad Tax Bar Association (RITBA)
16. Mohammad Ahmad Tariq, Member, Rawalpindi Islamabad Tax Bar Association (RITBA)
17. Mr. Mehmood Khalid, Research Economist, Pakistan Institute Development Economics, Islamabad
18. Dr. Attiya Yasmin Javid, Professor of Economics / Section Head, Private Sector Development, Pakistan Institute Development Economics, Islamabad

## **E. Prevailing Tax Perceptions and their Impact on Economy**



Perception is a prevailing factor that defines us all. We are what we perceive. Reality is irrelevant in most of the cases and it is only perception that supersedes. Wrong or right is yet another question that is secondary to the issue, it is again the perception which rules and overtakes. Tax is an area where perceptions have had wide variations since the birth of Pakistan. Perception of whom?, well, of everyone. The Government, the tax officials, the tax payers and the middlemen involved. These changes pertaining to tax have had far reaching consequences and ramifications for all living within the bounds Pakistan.

First the Government; There was a time when many of the powers to tax were centralized and the British system of taxation was in place but then someone realized that this is wrong and process of Americanizing the structure took place. In recent past Sales tax was embedded with the operations of income tax and Pakistan Customs Service was created. The preliminary shortfalls of tax were perceived to be due to adjustments but it soon came to light that the overall collection of tax was considerably reduced due to the new system. Changes in perception had caused a negative change in tax collection. Federal Board of Revenue's name was changed from Central Board of Revenue; again this was made to enforce a change of perceptions to Government Tax structure. A change which was implemented but not achieved. Without going into further details, the World Bank and IMF consistently continue to change the perceptions of the Government of tax and as a result no solid result has been achieved yet. We can safely conclude here that changing perceptions of tax have damaged us considerably as far as the Government is concerned. Back and forth we go but the revenue keeps going down.

Perceptions of the tax officials are even more interesting. It's important to note here that perceptions of the Government are miles apart from the perceptions of the tax officials. Majority still ponder why the old system was replaced and what good have

been achieved by the changes to this day. With more regulation and more automation, the tax officials are finding more loopholes to plug and new ways to twist the system for corruption in some cases.

The main perception of the tax officials is still not to make efforts to increase the revenue and promoting a comfortable tax culture but to retain prominent posts and perks. It's a never ending race that keeps their minds occupied as the concept of tenure is subject to money or "Sifaarish", otherwise transfer/posting and OSD is the name of the game for a tax official. Anything else for tax official's perception would be superfluous.

The tax payer is of course the most impeccable part of the tax program. Split into direct and indirect taxes, these are the lifelines of the Government to keep in check economic indicators and make payments to foreign countries and organizations for goods and services. But there are grave issues with the mindset of the tax payer in Pakistan. Zakat is one of the basic principles of Islam. Pakistan is a religious country without getting into details of levels of understanding. Everyone agrees to the perception that not offering prayers is wrong and a sin, similarly, not paying Zakat is a sin and results in pain and agony in the world and in the hereafter. The issue is that why this perception is not applied to tax? This is where the complication kicks in. The majority of tax payers in Pakistan don't perceive the tax to the Government to be sacred. There is no concept of sin in evading taxes to Government whereas Zakat is taken seriously. Perception is, a penny spent into the Government's pocket goes to the bad guys, namely, lying politicians, corrupt bureaucrats and so on. This is the source of all evils and why the tax culture has not and will not be achieved in Pakistan. The economy of Pakistan is on a consistent fall and the negative perception Tax Collection System is further worsening the lean economy of the country.

## F. Tax Perception Index

Pakistan is the sixth largest country of the world with a population of approximately 174 million. (1) Despite its large human resource, Pakistan is an under developed country with GDP per capita of \$2600 which is on the rank 171 in the whole world. (1) Unemployment is widespread (*15% approximately*). According to 2006 estimates, 24% of the population was living below the poverty line. (1) A large proportion of the population is illiterate. The literacy level in age 15 and above is 50%. This is 63% for males and 36% for the female population. (*2005 estimate*)(1) Majority of the population lives in rural areas (64%). Collection of taxes is an important aspect of Government policies on Economy. The TPIs below are based on some of the surveys carried out by Gallup Pakistan over the last three decades. They represent the perception of a common man about the tax system in the country.

### IS IT FAIR OR UNFAIR TO IMPOSE TAX?

#### COMPARATIVE DATA

	<b>2002</b>	<b>2003</b>	<b>2005</b>	<b>2007</b>	<b>2009</b>	<b>2010</b>
<b>Fair</b>	<b>45%</b>	<b>42%</b>	<b>64%</b>	<b>37%</b>	<b>27%</b>	<b>32%</b>
<b>Unfair</b>	<b>54%</b>	<b>56%</b>	<b>34%</b>	<b>63%</b>	<b>72%</b>	<b>67%</b>
<b>Don't Know</b>	<b>1%</b>	<b>2%</b>	<b>2%</b>	<b>0%</b>	<b>1%</b>	<b>1%</b>

### WHO IS THE BENEFICIARY OF TAX REVENUE?

	<b>2002</b>	<b>2005</b>	<b>2007</b>	<b>2010</b>
<b>Corrupt Rulers</b>	<b>50%</b>	<b>45%</b>	<b>55%</b>	<b>60%</b>
<b>No One</b>	<b>26%</b>	<b>27%</b>	<b>25%</b>	<b>28%</b>
<b>Whole Society</b>	<b>14%</b>	<b>20%</b>	<b>15%</b>	<b>10%</b>
<b>No Response</b>	<b>10%</b>	<b>8%</b>	<b>5%</b>	<b>2%</b>

## CAN TAX REVENUE IMPROVE GOVERNMENT'S PERFORMANCE?

	<b>2002</b>	<b>2005</b>	<b>2007</b>	<b>2010</b>
<b>Not Improve</b>	<b>70%</b>	<b>65%</b>	<b>68%</b>	<b>75%</b>
<b>Improve</b>	<b>16%</b>	<b>20%</b>	<b>20%</b>	<b>15%</b>
<b>Don't Know</b>	<b>14%</b>	<b>15%</b>	<b>12%</b>	<b>10%</b>

## IEWS ON GENERAL SALES TAX (G.S.T) Does it strengthen Economy?

	<b>2002</b>	<b>2005</b>	<b>2007</b>	<b>2010</b>
<b>No</b>	<b>65%</b>	<b>63%</b>	<b>70%</b>	<b>72%</b>
<b>Yes</b>	<b>21%</b>	<b>22%</b>	<b>20%</b>	<b>18%</b>
<b>Don't Know</b>	<b>14%</b>	<b>15%</b>	<b>10%</b>	<b>10%</b>

### G. SWOT of Tax Perceptions

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>- A distant saturation points</li> <li>- Tangible Policy Reforms with Delivery can overturn the negative perceptions</li> <li>- Zakat and philanthropy trends reflect responsive attitude</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>- Long held strong negative opinion</li> <li>- Communal resistance</li> <li>- Poor administrative functions</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>- A large human resource</li> <li>- Multi-dimensional Markets</li> <li>- Tax categories</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>- Increasing poverty</li> <li>- Security Condition</li> <li>- Instable Government</li> </ul>

## **H. Policy Recommendations**

Tax policy is skewed on a number of dimensions, which undermine revenue generation, efficiency and equity. Firstly, the tax base is exceptionally narrow, drawing only 3.9% of the employed work force into the tax net. Secondly, unnecessary loopholes, contradictions and complications in the law incentivize evasion and avoidance, and penalize compliance. Income from capital gains goes largely untaxed while wage-earners bear a far greater burden. Generous exemptions, preferential rates and tax credits limit the reach of the income tax net. This weakens the redistributive function of fiscal policy. Thirdly, the industrial sector's tax share is 3 times its contribution to the GDP, while agriculture contributes over 1/5th of the GDP but provides only 1% of FBR revenue. Services account for over half of the GDP but revenue from this sector is only a quarter of total receipts. This causes sub-optimal investment and hampers growth. Fourthly, indirect taxation still constitutes 60% of overall revenues. This low hanging fruit eases collection effort but raises the cost of living for those in the vulnerable socio-economic strata, because it taxes usage of commodities rather than targeting wealth or income.

### **The involvement of citizens and civil society is essential for tax reform**

Citizens and civil society need to be informed, education, mobilized and involved in tax policymaking and administration to articulate the need for reform and create pressure for its implementation. This would improve the awareness of taxpayers concerning their rights and obligations, the equity and fairness of tax policy, and the effectiveness and efficiency of tax administration.

A good phrase that comes from the books of basic management is, "taking all onboard". This is a concept that could help us in solving the riddle of differential perceptions to tax in Pakistan. What is sinful with regards to tax and what is not? What is the value of tax? Which tax system to accept? What are the consequences of not paying tax? What are the short term and long term benefits of paying tax? All these questions and their answers need a common and solid perception of all parties involved. Only then the gap between reality and perceptions of tax will be bridged.

